MISCELLANEOUS TAX BILLS I

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 2872

TO AMEND THE INTERNAL REVENUE CODE OF 1954, AS AMENDED, SO AS TO EXEMPT SUBSISTENCE ALLOWANCES OF LAW ENFORCEMENT OFFICERS OF THE UNITED STATES FROM FEDERAL INCOME TAXES

H.R. 810

TO AMEND SECTION 4941(D)(2)(G) OF THE INTERNAL REVENUE CODE 1954

H.R. 1337

TO AMEND THE INTERNAL REVENUE CODE OF 1954 WITH RESPECT TO EXCISE TAX ON CERTAIN TRUCKS, BUSES, TRACTORS, ET CETERA

H.R. 1920

TO AMEND SECTION 5064 OF THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE FOR REFUND OF TAX ON DISTILLED SPIRITS, WINES, RECTIFIED PRODUCTS, AND BEER LOST OR RENDERED UNMARKETABLE DUE TO FIRE, FLOOD, CASUALTY, OR OTHER DISASTER, OR BREAKAGE, DESTRUCTION, OR OTHER DAMAGE (EXCLUDING THEFT) RESULTING FROM VANDALISM OR MALICIOUS MISCHIEF WHILE HELD FOR SALE

H.R. 2028

TO AUTHORIZE THE HOME PRODUCTION OF BEER AND WINE

H.R. 2852

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE THAT REFUNDS OF THE TAXES ON GASOLINE AND SPECIAL FUELS SHALL BE MADE TO AERIAL APPLICATORS IN CERTAIN CASES

H.R. 2984

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO EXEMPT FROM THE EXCISE TAX IMPOSED ON TRAILERS ANY TRAILER DESIGNED TO BE USED WITH A LIGHT-DUTY VEHICLE FOR FARMING PURPOSES OR FOR TRANSPORTING HORSES OR LIVESTOCK

H.R. 3050

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE AN EXCLUSION FROM GROSS INCOME WITH RESPECT TO MAGAZINES, PAPERBACKS, AND RECORDS RETURNED AFTER THE CLOSE OF THE TAXABLE YEAR

H.R. 5103

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE FOR EXCISE TAX REFUNDS IN THE CASE OF CERTAIN WARRANTY ADJUSTMENTS ON TIRES, AND FOR OTHER PURPOSES

H.R. 6635

TO AMEND THE SECOND LIBERTY BOND ACT TO ALLOW THE INTEREST RATES PAID ON UNITED STATES RETIREMENT PLAN AND INDIVIDUAL RETIREMENT BONDS TO BE INCREASED TO THE RATE PAID ON UNITED STATES SERIES E SAVINGS BONDS

H.R. 8535

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H.R. 8811

TO AMEND SECTION 7447 OF THE INTERNAL REVENUE CODE OF 1954 WITH RESPECT TO THE REVOCATION OF AN ELECTION TO RECEIVE RETIRED PAY AS A JUDGE OF THE TAX COURT

JUNE 19, 1978

Printed for the use of the Committee on Finance

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MISCELLANEOUS TAX BILLS I

MONDAY, JUNE 19, 1978

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT GENERALLY OF THE
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m. in room 2221, Dirksen Senate Office Building, Hon. Harry F. Byrd, Jr. (chairman of the subcommittee) presiding.

Present: Senators Byrd, Jr., of Virginia, Long, Curtis, Hansen, Dole, and Packwood.

[The committee press release announcing this hearing and the miscellaneous tax bills follow:]

[Press Release]

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT ANNOUNCES HEARINGS ON MISCELLANEOUS TAX BILLS

Senator Harry F. Byrd, Jr., (I.-Va.), Chairman of the Senate Finance Committee Subcommittee on Taxation and Debt Management, announced that a hearing will be held on June 19, 1978, on various miscellaneous tax bills.

The hearing will be held on Monday. June 19. 1978. at 9:00 a.m. in room 2221 Dirksen Senate Office Building.

The following pieces of legislation will be considered:

S. 2872, sponsored by Senator Allen, a bill to exclude from gross income statutory subsistence allowances paid to law enforcement officers. It is estimated that this measure will benefit approximately 12 States which have established a cash meal allowance system for law enforcement officers and will cause a loss of revenues of less than $5 million.

H.R. 810, sponsored by Representative Conable, a bill amending Section 4941 of the Code to permit private foundations to pay or reimburse government officials for expenditures (up to certain limits) incurred for travel outside the United States. It is estimated that this bill will not have any direct revenue effect.

H.R. 1337, sponsored by Representative Steiger, a bill amending Section 4216 of the Code to modify certain rules used in determining the manufacturer's excise tax on sales of trucks, buses, highway tractors, trailers, and semi-trailers. The provisions contained in this bill are estimated to reduce revenues by $500,000 per year, beginning with fiscal year 1978.

H.R. 1920, sponsored by Representative Waggonner, a bill to amend Section 5064 of the Code to expand the list of circumstances under which distributors or retailers of alcoholic beverages receive payments from Treasury for prepaid excise taxes and customs duties on such products if destroyed by diasters, etc. The provisions contained in this bill, as amended, are estimated to result in a revenue loss of less than $100,000 in fiscal year 1978 and approximately $500,000 each year thereafter.

H.R. 2028, sponsored by Representative Conable, a bill to amend certain alcohol tax provisions of the Code to permit adults (after registration) to produce beer in limited quantities for personnel or family use, and modifies present law relating to tax-free production (without registration) of wine for home use.

The provisions contained in the bill, as amended, are estimated to reduce revenues by less than $1 million in fiscal year 1978 and by less than $1.5 million a year thereafter. S. 2930, an identical measure sponsored by Senator Moynihan, will also be considered.

H.R. 2852, sponsored by Representative Pickle, a bill modifying the procedures pursuant to which excise tax refunds or credits are allowed for farming-purpose use of aviation fuels, so that the cropduster (rather than the farmer) claims the refund or credit. The provisions contained in this bill, as amended, are estimated to reduce revenues by less than $100,000 in fiscal year 1978 and by less than $1.5 million a year thereafter. (These amounts would otherwise go to the Airport and Airway Trust Fund—through June 30, 1980.)

H.R. 2984, sponsored by Representatives Duncan and Pickle, a bill to amend Section 4063 of the Code to modify an exemption provided in present law from the 10 percent manufacturers excise tax imposed on sales of certain trailers or semi-trailers, in the case of trailers or semi-trailers designed for farming purposes or for transporting horses or livestock. The provisions contained in the bill are estimated to reduce revenues by $2 million per year, beginning with fiscal year 1978.

H.R. 3050, sponsored by Representative Corman, a bill providing a new tax accounting method applicable to returns of unsold magazines, paperback books, and records. This bill, as amended, is estimated to reduce budget receipts $22 million in fiscal year 1980, $11 million in fiscal year 1981, $12 million in fiscal year 1982, and $12 million in fiscal year 1983.

H.R. 5103, sponsored by Representatives Conable and Rostenkowski, a bill clarifying and modifying excise tax provisions relating to warranty adjustments on tires and tread rubber. The provisions contained in the bill, as amended, are estimated to reduce revenues by less than $100,000 in fiscal year 1978 and by less than $200,000 a year thereafter.

H.R. 6635, sponsored by Representative Pickle, a bill authorizing the Treasury to increase the interest rate payable on previously issued U.S. retirement bonds, so that those bonds will earn interest at rates consistent with rates currently established for Series E U.S. savings bonds. The provisions contained in the bill, as amended, are estimated to have no effect on budget receipts but will result in increased budget outlays of $1 million per year.

H.R. 8535, sponsored by Representative Conable, a bill amending Section 44A of the Internal Revenue Code to extend the child care credit to otherwise qualifying payments for child care services performed by grand parents or other adult relatives, regardless of whether the relatives' services constitute "employment" as defined for Social Security tax purposes. The provisions contained in the bill, as amended, are estimated to result in a decrease in budget receipts of $3 million in fiscal year 1978, $36 million in fiscal year 1979, $35 million in fiscal year 1980, $37 million in fiscal year 1981, $37 million in fiscal year 1982, and $38 million in fiscal year 1983.

H.R. 8811, sponsored by Representatives Ullman and Conable, a bill amending Section 7447 of the Internal Revenue Code to allow present or former U.S. Tax Court judges to revoke a prior election to come under the Tax Court retirement pay system, and qualify for Civil Service Retirement benefits (but not for benefits under both systems). The bill would benefit any Tax Court judge who has elected the Tax Court retirement system and has not yet retired and former Tax Court Judge Russell E. Train, who is not eligile for Tax Court retirement and is currently ineligible for Civil Service Retirement benefits because of his Tax Court election. The provisions contained in the bill are estimated not to have any significant revenue or expenditure effect in the current fiscal year or in any of the five following fiscal years.

Requests to Testify.—Persons who desire to testify at the hearing should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510 by no later than the close of business on Wednesday, June 14, 1978.

Legislative Reorganization Act.—Senator Byrd stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify must comply with the following rules:

(1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 75 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their five-minute oral presentations to a summary of the points included in the statement.

(5) Not more than five minutes will be allowed for oral presentation.

Written Testimony.—Senator Byrd stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by June 23, 1978, to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510.

95TH CONGRESS
2D SESSION

S. 2872

IN THE SENATE OF THE UNITED STATES

APRIL 11 (legislative day, FEBRUARY 6), 1978

Mr. ALLEN introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954, as amended, so as to exempt subsistence allowances of law enforcement officers of the United States from Federal income taxes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That chapter 1 of title 26 of the United States Code is
4 amended by adding after section 119 (2) a new section 119
5 (3) to read as follows:
6 "(3) (a) Gross income does not include any amount
7 received as a statutory subsistence allowance by an individual
8 who is employed as a law enforcement officer in the United
9 States.
10 "(b) The term 'law enforcement officer' means a full-

II

1 time, certified, law enforcement officer with power of arrest
2 employed by a State, a political subdivision of a State, any
3 municipal corporation in a State, a territory, a possession
4 of the United States, or by the District of Columbia, who is
5 required by the terms of his employment, whether such
6 employment exists by virtue of election or appointment, to
7 give his full time to the preservation of public order and the
8 protection of life or property, or the detection of crime, and
9 shall include enforcement officers for conservation laws,
10 wardens, guards of penal institutions, and full-time coroners,
11 but shall not include any district attorney, assistant district
12 attorney, commissioner, deputy commissioner, any municipal
13 inspector, county inspector, or State inspector, or any like
14 employee of a State, a political subdivision of a State, any
15 municipal corporation in a State, a territory, a possession of
16 the United States, or the District of Columbia.
17 "(c) The provisions of this bill shall be retroactive to
18 January 1, 1970.".

95TH CONGRESS
2D SESSION

H. R. 810

IN THE SENATE OF THE UNITED STATES

MARCH 15 (legislative day, FEBRUARY 6), 1978

Read twice and referred to the Committee on Finance

AN ACT

To amend section 4941 (d) (2) (G) of the Internal Revenue Code of 1954.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That section 4941 (d) (2) (G) of the Internal Revenue Code
4 of 1954 (relating to payment or reimbursement of certain
5 traveling expenses) is amended by striking out "or" at the
6 end of clause (vi), by striking out the period at the end of
7 clause (vii) and inserting in lieu thereof ", or", and by add-
8 ing at the end thereof the following.
9 "(viii) any payment or reimbursement of
10 traveling expenses for travel between a point
11 in the United States and a point outside the

1 United States, but only if such payment or
2 reimbursement with respect to any one trip by
3 an official does not exceed the lesser of the
4 actual cost of the transportation involved or
5 $2,500, plus an amount for all other traveling
6 expenses not in excess of 125 percent of the
7 maximum amount payable under section 5702
8 (a) of title 5, United States Code, for like
9 travel by employees of the United States for a
10 maximum of 4 days.
11 Clause (viii) shall not apply to any payment or
12 reimbursement made by a private foundation if more
13 than one-half of the foundation's support (as defined
14 in section 509(d)) is normally derived from any
15 business enterprise, trade association, or labor
16 organization.".
17 SEC. 2. The amendments made by the first section of
18 this Act shall apply to travel beginning after the date of the
19 enactment of this Act.

Passed the House of Representatives March 14, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

95TH CONGRESS
2D SESSION

H. R. 1337

IN THE SENATE OF THE UNITED STATES

MAY 19 (legislative day, MAY 17), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 with respect to excise tax on certain trucks, buses, tractors, et cetera.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) paragraph (1) of section 4216(b) of the Internal
4 Revenue Code of 1954 (relating to constructive sale price)
5 is amended by inserting after the second sentence thereof the
6 following new sentence: "In the case of an article the sale of
7 which is taxable under section 4061 (a) and which is sold at
8 retail, the computation under the first sentence of this para-
9 graph shall be a percentage (not greater than 100 percent)
10 of the actual selling price based on the highest price for
11 which such articles are sold by manufacturers and producers
12 in the ordinary course of trade (determined without regard
13 to any individual manufacturer's or producer's cost".

II

1 (b) The second sentence of paragraph (1) of such sec-
2 tion 4216(b) is amended by inserting "(other than an ar-
3 ticle the sale of which is taxable under section 4061(a))"
4 after "sold at retail".
5 SEC. 2. The amendments made by this Act shall apply
6 to articles sold by the manufacturer or producer after Sep-
7 tember 30, 1977.

Passed the House of Representatives May 16, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

95TH CONGRESS
2D SESSION

H. R. 1920

IN THE SENATE OF THE UNITED STATES

MAY 9 (legislative day, APRIL 24), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend section 5064 of the Internal Revenue Code of 1954 to provide for refund of tax on distilled spirits, wines, rectified products, and beer lost or rendered unmarketable due to fire, flood, casualty, or other disaster, or to breakage, destruction, or other damage (excluding theft) resulting from vandalism or malicious mischief while held for sale.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) so much of section 5064 of the Internal Revenue
4 Code of 1954 (relating to losses caused by disaster) as pre-
5 cedes subsection (c) is amended to read as follows:

II

1 "SEC. 5064. LOSSES RESULTING FROM DISASTER, VANDAL-
2 ISM, OR MALICIOUS MISCHIEF.
3 "(a) PAYMENTS.—The Secretary, under such regula-
4 tions as he may prescribe, shall pay (without interest) an
5 amount equal to the amount of the internal revenue taxes
6 paid or determined and customs duties paid on distilled
7 spirits, wines, rectified products, and beer previously with-
8 drawn, which were lost, rendered unmarketable, or con-
9 demned by a duly authorized official by reason of—
10 "(1) fire, flood, casualty, or other disaster, or
11 "(2) breakage, destruction, or other damage (but
12 not including theft) resulting from vandalism or mali-
13 cious mischief,
14 if such disaster or damage occurred in the United States
15 and if such distilled spirits, wines, rectified products, or beer
16 were held and intended for sale at the time of such disaster
17 or other damage. The payments provided for in this section
18 shall be made to the person holding such distilled spirits,
19 wines, rectified products, or beer for sale at the time of such
20 disaster or other damage.
21 "(b) CLAIMS.—
22 "(1) PERIOD FOR MAKING CLAIM; PROOF.—No
23 claim shall be allowed under this section unless—
24 "(A) filed within 6 months after the date on
25 which such distilled spirits, wines, rectified products,

1 or beer were lost, rendered unmarketable, or con-
2 demned by a duly authorized official, and
3 "(B) the claimant furnishes proof satisfactory
4 to the Secretary that the claimant—
5 "(i) was not indemnified by any valid
6 claim of insurance or otherwise in respect of
7 the tax, or tax and duty, on the distilled spirits,
8 wines, rectified products, or beer covered by
9 the claim; and
10 "(ii) is entitled to payment under this
11 section.
12 "(2) MINIMUM CLAIM.—Except as provided in
13 paragraph (3) (A), no claim of less than $250 shall be
14 allowed under this section with respect to any disaster
15 or other damage (as the case may be).
16 "(3) SPECIAL RULES FOR MAJOR DISASTERS.—If
17 the President has determined under the Disaster Relief
18 Act of 1974 that a 'major disaster' (as defined in such
19 Act) has occurred in any part of the United States,
20 and if the disaster referred to in subsection (a) (1)
21 occurs in such part of the United States by reason of
22 such major disaster, then—
23 "(A) paragraph (2) shall not apply, and
24 "(B) the filing period set forth in paragraph
25 (1) (A) shall not expire before the day which is 6

1 months after the date on which the President makes
2 the determination that such major disaster has
3 occurred.

4 "(4) REGULATIONS.—Claims under this section
5 shall be filed under such regulations as the Secretary
6 shall prescribe."

7 (b) The table of sections for subpart E of part I of sub-
8 chapter A of chapter 51 of such Code is amended by striking
9 out the item relating to section 5064 and inserting in lieu
10 thereof the following:

"Sec. 5064. Losses resulting from disaster, vandalism, or malicious mischief."

11 (c) The amendments made by this section shall apply
12 to disasters (or other damage) occurring on or after the first
13 day of the first calendar month which begins more than 90
14 days after the date of the enactment of this Act.

Passed the House of Representatives May 8, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

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95TH CONGRESS
2D SESSION

H. R. 2028

IN THE SENATE OF THE UNITED STATES

MARCH 15 (legislative day, FEBRUARY 6), 1978
Read twice and referred to the Committee on Finance

AN ACT

To authorize the home production of beer and wine.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) EXEMPTION FROM TAX ON WINE.—Section
4 5042(a)(2) of the Internal Revenue Code of 1954 (relat-
5 ing to production of wine for personal consumption) is
6 amended to read as follows:
7 "(2) WINE FOR PERSONAL OR FAMILY USE.—
8 Subject to regulations prescribed by the Secretary—
9 "(A) EXEMPTION.—Any adult may, without
10 payment of tax, produce wine for personal or family
11 use and not for sale.

II

1 "(B) LIMITATION.—The aggregate amount of
2 wine exempt from tax under this paragraph with
3 respect to any household shall not exceed—
4 "(i) 200 gallons per calendar year if there
5 are 2 or more adults in such household, or
6 "(ii) 100 gallons per calendar year if there
7 is only 1 adult in such household.
8 "(C) ADULTS.—For purposes of this para-
9 graph, the term 'adult' means an individual who has
10 attained 18 years of age."
11 (b) EXEMPTION FROM TAX ON BEER.—
12 (1) IN GENERAL.—Section 5053 of such Code (re-
13 lating to exemptions from excise tax on beer) is
14 amended by redesignating subsection (e) as subsection
15 (f) and by inserting after subsection (d) the following
16 new section:
17 "(e) BEER FOR PERSONAL OR FAMILY USE.—Subject
18 to regulations prescribed by the Secretary, any duly regis-
19 tered adult may, without payment of tax, produce beer for
20 personal or family use and not for sale if the amount of such
21 beer on hand at any time (including beer in process) does
22 not exceed 30 gallons. The aggregate amount of beer exempt
23 from tax under this subsection with respect to any household
24 shall not exceed—

1 "(1) 200 gallons per calendar year if there are
2 2 or more adults in such household, or
3 "(2) 100 gallons per calendar year if there is only
4 1 adult in such household.
5 For purposes of this subsection, the term 'adult' means an
6 individual who has attained 18 years of age."
7 (2) ILLEGALLY PRODUCED BEER.—
8 (A) Section 5051 of such Code (relating to
9 imposition and rate of tax) is amended by adding
10 at the end thereof the following new subsection:
11 "(c) ILLEGALLY PRODUCED BEER.—The production
12 of any beer at any place in the United States shall be sub-
13 ject to tax at the rate prescribed in subsection (a) and such
14 tax shall be due and payable as provided in section 5054
15 (a)(3) unless—
16 "(1) such beer is produced in a brewery qualified
17 under the provisions of subchapter G, or
18 "(2) such production is exempt from tax under
19 section 5053(e) (relating to beer for personal or family
20 use)."
21 (B) Section 5054(a)(3) of such Code (re-
22 lating to illegally produced beer) is amended to
23 read as follows:
24 "(3) ILLEGALLY PRODUCED BEER.—The tax on

1 any beer produced in the United States shall be due and
2 payable immediately upon production unless—
3 "(A) such beer is produced in a brewery
4 qualified under the provisions of subchapter G, or
5 "(B) such production is exempt from tax un-
6 der section 5053 (e) (relating to beer for personal
7 or family use)."
8 (3) DEFINITION OF BREWER.—Section 5092 of such
9 Code (defining brewer) is amended to read as follows:
10 "**SEC. 5092. DEFINITION OF BREWER.**
11 "Every person who brews beer (except a person who
12 produces only beer exempt from tax under section 5053
13 (e)) and every person who produces beer for sale shall be
14 deemed to be a brewer."
15 (4) EXEMPTION FROM CERTAIN PROVISIONS RE-
16 LATING TO DISTILLING MATERIALS.—Section 5222 (a)
17 (2) (C) of such Code (relating to certain exemptions)
18 is amended by striking out "; or" and inserting in lieu
19 thereof "or 5053 (e) ; or",
20 (5) PENALTY FOR UNLAWFUL PRODUCTION OF
21 BEER.—
22 (A) Section 5674 of such Code (relating to

1 penalty for unlawful removal of beer) is amended to
2 read as follows:
3 "SEC. 5674. PENALTY FOR UNLAWFUL PRODUCTION OR
4 REMOVAL OF BEER.
5 "(a) UNLAWFUL PRODUCTION.—Any person who
6 brews beer or produces beer shall be fined not more than
7 $1,000, or imprisoned not more than 1 year, or both, unless
8 such beer is brewed or produced in a brewery qualified un-
9 der subchapter G or such production is exempt from tax un-
10 der section 5053 (e) (relating to beer for personal or family
11 use).
12 "(b) UNLAWFUL REMOVAL.—Any brewer or other
13 person who removes or in any way aids in the removal
14 from any brewery of beer without complying with the
15 provisions of this chapter or regulations issued pursuant
16 thereto shall be fined not more than $1,000, or imprisoned
17 not more than 1 year, or both."
18 (B) The item relating to section 5674 in the
19 table of sections for part III of subchapter J of
20 chapter 51 of such Code is amended to read as
21 follows:

"Sec. 5674. Penalty for unlawful production or removal of beer."

1 (c) EFFECTIVE DATE.—The amendments made by this
2 section shall take effect on the first day of the first calendar
3 month which begins more than 90 days after the date of the
4 enactment of this Act.

Passed the House of Representatives March 14, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

95TH CONGRESS
2D SESSION

H. R. 2852

IN THE SENATE OF THE UNITED STATES

MAY 9 (legislative day, APRIL 24), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 to provide that refunds of the taxes on gasoline and special fuels shall be made to aerial applicators in certain cases.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. REFUNDS TO BE MADE TO AERIAL APPLI-**
4 **CATORS IN CERTAIN CASES.**
5 (a) ENTITLEMENT OF AERIAL APPLICATORS TO RE-
6 FUND OF GASOLINE TAX IN CERTAIN CASES.—Subsec-
7 tion (c) of section 6420 of the Internal Revenue Code of
8 1954 (defining use on a farm for farming purposes) is
9 amended by redesignating paragraph (4) as paragraph (5)

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1 and by inserting after paragraph (3) the following new
2 paragraph:
3 "(4) CERTAIN FARMING USE OTHER THAN BY
4 OWNER, ETC.—In applying paragraph (3)(A) to a
5 use on a farm for any purpose described in paragraph
6 (3)(A) by any person other than the owner, tenant, or
7 operator of such farm—
8 "(A) the owner, tenant, or operator of such
9 farm shall be treated as the user and ultimate pur-
10 chaser of the gasoline, except that
11 "(B) if the person so using the gasoline is an
12 aerial applicator who is the ultimate purchaser of
13 the gasoline, subparagraph (A) of this paragraph
14 shall not apply and the aerial applicator shall be
15 treated as having used such gasoline on a farm for
16 farming purposes."
17 (b) ENTITLEMENT OF AERIAL APPLICATORS TO RE-
18 FUND OF SPECIAL FUELS TAX IN CERTAIN CASES.—The
19 second sentence of subsection (c) of section 6427 of such
20 Code (relating to use for farming purposes) is amended to
21 read as follows: "For purposes of this subsection, if fuel is
22 used on a farm by any person other than the owner, tenant,
23 or operator of such farm, the rules of paragraph (4) of
24 section 6420(c) shall be applied (except that 'liquid taxable

1 under section 4041' shall be substituted for 'gasoline' each
2 place it appears in such paragraph (4))."
3 (c) CONFORMING AMENDMENT.—Subparagraph (A)
4 of section 6420 (c) (3) of such Code is amended by striking
5 out "except that" and all that follows down through the
6 semicolon at the end of such subparagraph (A).
7 **SEC. 2. EFFECTIVE DATE.**
8 The amendments made by the first section of this Act
9 shall take effect on the first day of the first calendar quarter
10 which begins more than 90 days after the date of the enact-
11 ment of this Act.

Passed the House of Representatives May 8, 1978.

Attest: EDMUND L. HENSHAW, JR.,
Clerk.

95TH CONGRESS
2D SESSION

H. R. 2984

IN THE SENATE OF THE UNITED STATES

MAY 9 (legislative day, APRIL 24), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 to exempt from the excise tax imposed on trailers any trailer designed to be used with a light-duty vehicle for farming purposes or for transporting horses or livestock.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 SECTION 1. EXCISE TAX EXEMPTION FOR CERTAIN
4 TRAILERS DESIGNED TO BE USED WITH
5 LIGHT-DUTY VEHICLES.
6 (a) IN GENERAL.—Section 4063(a) of the Internal
7 Revenue Code of 1954 (relating to exemptions from motor
8 vehicle excise taxes) is amended by adding at the end thereof
9 the following new paragraph:

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1 "(8) CERTAIN TRAILERS USED FOR FARMING OR
2 FOR TRANSPORTING HORSES OR LIVESTOCK.—The tax
3 imposed under section 4061 (a) shall not apply in the
4 case of any trailer or semitrailer, or any chassis or body
5 for any trailer or semitrailer, which is—
6 "(A) suitable for use with a vehicle having a
7 gross vehicle weight of 10,000 pounds or less (as
8 determined under regulations prescribed under sec-
9 tion 4061 (a) (2)), and
10 "(B) designed to be used for farming purposes
11 (determined in accordance with section 6420 (c))
12 or for transporting horses or livestock.".
13 (b) FLOOR STOCKS REFUNDS.—
14 (1) IN GENERAL.—Where, before the day after the
15 date of the enactment of this Act, any article made
16 exempt from taxation by reason of the amendment made
17 by subsection (a) has been sold by the manufacturer,
18 producer, or importer and on such day is held by a
19 dealer and has not been used and is intended for sale,
20 there shall be credited or refunded (without interest) to
21 the manufacturer, producer, or importer an amount
22 equal to the tax paid by such manufacturer, producer, or
23 importer on his sale of the article, if—
24 (A) claim for such credit or refund is filed
25 with the Secretary of the Treasury or his delegate

1 before the first day of the tenth calendar month be-
2 ginning after the day after the date of the enact-
3 ment of this Act based upon a request submitted to
4 the manufacturer, producer, or importer before the
5 first day of the seventh calendar month beginning
6 after the day after the date of the enactment of this
7 Act by the dealer who held the article in respect
8 of which the credit or refund is claimed; and
9 (B) on or before the first day of such tenth
10 calendar month reimbursement has been made to
11 the dealer by the manufacturer, producer, or im-
12 porter in an amount equal to the tax paid on the
13 article or written consent has been obtained from
14 the dealer to allowance of the credit or refund.
15 (2) LIMITATION ON ELIGIBILITY FOR CREDIT OR
16 REFUND.—No manufacturer, producer, or importer shall
17 be entitled to credit or refund under paragraph (1)
18 unless he has in his possession such evidence of the in-
19 ventories with respect to which the credit or refund is
20 claimed as may be required by regulations prescribed
21 by the Secretary of the Treasury or his delegate under
22 this subsection.
23 (3) OTHER LAWS APPLICABLE.—All provisions of
24 law, including penalties, applicable with respect to the
25 taxes imposed by section 4061 of the Internal Revenue

1 Code of 1954 shall, insofar as applicable and not incon-
2 sistent with paragraphs (1) and (2) of this subsection,
3 apply in respect of the credits and refunds provided for
4 in paragraph (1) to the same extent as if the credits
5 or refunds constituted overpayments of the tax.
6 (c) DEFINITIONS.—For purposes of subsection (b)—
7 (1) The term "dealer" includes a wholesaler, job-
8 ber, distributor, or retailer.
9 (2) An article shall be considered as "held by a
10 dealer" if the title thereto has passed to such dealer
11 (whether or not delivery to him has been made) and if
12 for purposes of consumption title to such article or
13 possession thereof has not at any time been transferred
14 to any person other than a dealer.
15 **SEC. 2. EFFECTIVE DATE.**
16 The amendment made by subsection (a) of section 1
17 shall apply with respect to articles sold on or after the day
18 after the date of the enactment of this Act.

Passed the House of Representatives May 8, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

95TH CONGRESS
2D SESSION

H. R. 3050

IN THE SENATE OF THE UNITED STATES

MAY 25 (legislative day, MAY 17), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 to provide an exclusion from gross income with respect to magazines, paperbacks, and records returned after the close of the taxable year.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) subpart B of part II of subchapter E of chapter 1
4 of the Internal Revenue Code of 1954 (relating to taxable

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1 year for which items of gross income included) is amended
2 by adding at the end thereof the following new section:
3 "SEC. 457. MAGAZINES, PAPERBACKS, AND RECORDS
4 RETURNED AFTER THE CLOSE OF THE
5 TAXABLE YEAR.

6 "(a) EXCLUSION FROM GROSS INCOME.—A taxpayer
7 who is on an accrual method of accounting may elect not to
8 include in gross income for the taxable year the income at-
9 tributable to the qualified sale of any magazine, paperback, or
10 record which is returned to the taxpayer before the close of
11 the merchandise return period.

12 "(b) DEFINITIONS AND SPECIAL RULES.—For pur-
13 poses of this section—

14 "(1) MAGAZINE.—The term 'magazine' includes
15 any other periodical.

16 "(2) PAPERBACK.—The term 'paperback' means
17 any book which has a flexible outer cover and the pages
18 of which are affixed directly to such outer cover. Such
19 term does not include a magazine.

20 "(3) RECORD.—The term 'record' means a disc,
21 tape, or similar object on which musical, spoken, or
22 other sounds are recorded.

23 "(4) SEPARATE APPLICATION WITH RESPECT TO
24 MAGAZINES, PAPERBACKS, AND RECORDS.—If a tax-
25 payer makes qualified sales of more than one category of

1 merchandise in connection with the same trade or busi-
2 ness, this section shall be applied as if the qualified sales
3 of each such category were made in connection with a
4 separate trade or business. For purposes of the preceding
5 sentence, magazines, paperbacks, and records shall each
6 be treated as a separate category of merchandise.
7 "(5) QUALIFIED SALE.—A sale of a magazine,
8 paperback, or record is a qualified sale if—
9 "(A) at the time of sale, the taxpayer has a
10 legal obligation to adjust the sales price of such
11 magazine, paperback, or record if it is not resold,
12 and
13 "(B) the sales price of such magazine, paper-
14 back, or record is adjusted by the taxpayer because
15 of a failure to resell it.
16 "(6) AMOUNT EXCLUDED.—The amount excluded
17 under this section with respect to any qualified sale shall
18 be the lesser of—
19 "(A) the amount covered by the legal obliga-
20 tion described in paragraph (5) (A), or
21 "(B) the amount of the adjustment agreed to
22 by the taxpayer before the close of the merchandise
23 return period.
24 "(7) MERCHANDISE RETURN PERIOD.—
25 "(A) Except as provided in subparagraph (B),

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1 the term 'merchandise return period' means, with
2 respect to any taxable year—
3 "(i) in the case of magazines, the period
4 of 2 months and 15 days first occurring after
5 the close of taxable year, or
6 "(ii) in the case of paperbacks and records,
7 the period of 4 months and 15 days first occur-
8 ring after the close of the taxable year.
9 "(B) Under regulations prescribed by the Sec-
10 retary, the taxpayer may select a shorter period than
11 the applicable period set forth in subparagraph (A).
12 "(C) Any change in the merchandise return
13 period shall be treated as a change in the method
14 of accounting.
15 "(8) CERTAIN EVIDENCE MAY BE SUBSTITUTED
16 FOR PHYSICAL RETURN OF MERCHANDISE.—Under
17 regulations prescribed by the Secretary, the taxpayer
18 may substitute, for the physical return of magazines,
19 paperbacks, or records required by subsection (a), cer-
20 tification or other evidence that the magazine, paper-
21 back, or record has not been resold and will not be
22 resold if such evidence—
23 "(A) is in the possession of the taxpayer at
24 the close of the merchandise return period, and
25 "(B) is satisfactory to the Secretary.

1 "(9) REPURCHASE BY THE TAXPAYER NOT
2 TREATED AS RESALE.—A repurchase by the taxpayer
3 shall be treated as an adjustment of the sales price rather
4 than as a resale.
5 "(c) QUALIFIED SALES TO WHICH SECTION
6 APPLIES.—
7 "(1) ELECTION OF BENEFITS.—This section shall
8 apply to qualified sales of magazines, paperbacks, or
9 records, as the case may be, if and only if the taxpayer
10 makes an election under this section with respect to the
11 trade or business in connection with which such sales
12 are made. An election under this section may be made
13 without the consent of the Secretary. The election shall
14 be made in such manner as the Secretary may by regu-
15 lations prescribe and shall be made for any taxable year
16 not later than the time prescribed by law for filing the
17 return for such taxable year (including extensions
18 thereof).
19 "(2) SCOPE OF ELECTION.—An election made
20 under this section shall apply to all qualified sales of
21 magazines, paperbacks, or records, as the case may be,
22 made in connection with the trade or business with re-
23 spect to which the taxpayer has made the election.
24 "(3) PERIOD TO WHICH ELECTION APPLIES.—An
25 election under this section shall be effective for the tax-

1 able year for which it is made and for all subsequent
2 taxable years, unless the taxpayer secures the consent
3 of the Secretary to the revocation of such election.
4 "(4) TREATMENT AS METHOD OF ACCOUNTING.—
5 Except to the extent inconsistent with the provisions of
6 this section, for purposes of this subtitle, the computation
7 of taxable income under an election made under this sec-
8 tion shall be treated as a method of accounting.
9 "(d) 5-YEAR SPREAD OF TRANSITIONAL ADJUST-
10 MENTS FOR MAGAZINES.—In applying section 481 (c) with
11 respect to any election under this section which applies to
12 magazines, the period for taking into account any decrease
13 in taxable income resulting from the application of section
14 481 (a) (2) shall be the taxable year for which the election
15 is made and the 4 succeeding taxable years.
16 "(e) SUSPENSE ACCOUNT FOR PAPERBACKS AND
17 RECORDS.—
18 "(1) IN GENERAL.—In the case of any election
19 under this section which applies to paperbacks or records,
20 in lieu of applying section 481, the taxpayer shall es-
21 tablish a suspense account for the trade or business for
22 the taxable year for which the election is made.
23 "(2) INITIAL OPENING BALANCE.—The opening
24 balance of the account described in paragraph (1) for
25 the first taxable year to which the election applies shall

1 be the largest dollar amount of returned merchandise
2 which would have been taken into account under this
3 section for any of the 3 immediately preceding taxable
4 years if this section had applied to such preceding 3
5 taxable years. This paragraph and paragraph (3)
6 shall be applied by taking into account only amounts
7 attributable to the trade or business for which such ac-
8 count is established.

9 "(3) ADJUSTMENTS IN SUSPENSE ACCOUNT.—At
10 the close of each taxable year the suspense account shall
11 be—

12 "(A) reduced by the excess (if any) of—

13 "(i) the opening balance of the suspense
14 account for the taxable year, over

15 "(ii) the amount excluded from gross in-
16 come for the taxable year under subsection (a),
17 or

18 "(B) increased (but not in excess of the initial
19 opening balance) by the excess (if any) of—

20 "(i) the amount excluded from gross in-
21 come for the taxable year under subsection (a),
22 over

23 "(ii) the opening balance of the account
24 for the taxable year.

25 "(4) GROSS INCOME ADJUSTMENTS.—

1 "(A) REDUCTIONS EXCLUDED FROM GROSS
2 INCOME.—In the case of any reduction under para-
3 graph (3) (A) in the account for the taxable year,
4 an amount equal to such reduction shall be excluded
5 from gross income for such taxable year.
6 "(B) INCREASES ADDED TO GROSS INCOME.—
7 In the case of any increase under paragraph (3)
8 (B) in the account for the taxable year, an amount
9 equal to such increase shall be included in gross
10 income for such taxable year.
11 If the initial opening balance exceeds the dollar amount
12 of returned merchandise which would have been taken
13 into account under subsection (a) for the taxable year
14 preceding the first taxable year for which the election
15 is effective if this section had applied to such preceding
16 taxable year, then an amount equal to the amount of
17 such excess shall be included in gross income for such
18 first taxable year.
19 "(5) SUBCHAPTER C TRANSACTIONS.—The appli-
20 cation of this subsection with respect to a taxpayer which
21 is a party to any transaction with respect to which
22 there is nonrecognition of gain or loss to any party to
23 the transaction by reason of subchapter C shall be deter-
24 mined under regulations prescribed by the Secretary."

1 (b) The table of sections for such subpart B is amended
2 by adding at the end thereof the following:

"Sec. 457. Magazines, paperbacks, and records returned after the close of the taxable year."

3 SEC. 2. The amendments made by the first section of
4 this Act shall apply to taxable years beginning after Decem-
5 ber 31, 1976. The time for making an election under section
6 457 of the Internal Revenue Code of 1954 (as added by the
7 first section of this Act) for any taxable year beginning
8 before the date of the enactment of this Act shall not expire
9 before the date which is one year after such date of
10 enactment.

Passed the House of Representatives May 23, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

95TH CONGRESS
2D SESSION

H. R. 5103

IN THE SENATE OF THE UNITED STATES

MARCH 15 (legislative day, FEBRUARY 6), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 to provide for excise tax refunds in the case of certain warranty adjustments on tires, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) subparagraph (G) of section 6416(b)(2) of the
4 Internal Revenue Code of 1954 is amended to read as
5 follows:
6 "(G) in the case of tread rubber in respect of
7 which tax was paid under section 4071(a)(4)—
8 "(i) used or sold for use otherwise than in
9 the recapping or retreading of tires of the type

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1 used on highway vehicles (as defined in section
2 4072 (c)),
3 "(ii) destroyed, scrapped, wasted, or ren-
4 dered useless in the recapping or retreading
5 process,
6 "(iii) used in the recapping or retreading
7 of a tire the sale of which is later adjusted pur-
8 suant to a warranty or guarantee, in which case
9 the overpayment shall be in proportion to the
10 adjustment in the sales price of such tire, or
11 "(iv) used in the recapping or retreading
12 of a tire, if such tire is by any person exported,
13 used or sold for use as supplies for vessels or
14 aircraft, sold to a State or local government for
15 the exclusive use of a State or local government,
16 or sold to a nonprofit educational organization
17 for its exclusive use,
18 unless credit or refund of such tax is allowable
19 under paragraph (3);".
20 (b) Section 6416 (b) (3) of such Code is amended by
21 inserting after subparagraph (C) the following new sub-
22 paragraph:
23 "(D) in the case of tread rubber in respect of
24 which tax was paid under section 4071 (a) (4) used
25 in the recapping or retreading of a tire, such tire is

1 sold by the subsequent manufacturer or producer on
2 or in connection with, or with the sale of, any other
3 article manufactured or produced by him and such
4 other article is by any person exported, sold to a
5 State or local government for the exclusive use of a
6 State or local government, sold to a nonprofit educa-
7 tional organization for its exclusive use, or used or
8 sold for use as supplies for vessels or aircraft, unless
9 credit or refund of such tax is allowable under sub-
10 paragraph (C);".

11 (c) (1) Section 6416(b)(2)(E) of such Code is
12 amended by inserting after "paragraph 3" the following:
13 "(or in the case of the tread rubber on a recapped or re-
14 treaded tire, resold for use as provided in subparagraph
15 (D) of paragraph (3)),".

16 (2) Section 6416(a)(1)(C) of such Code is amended
17 by striking out "(b)(3)(C)" and inserting "(b)(3)(C)
18 or (D)".

19 (3) Section 6416(b)(3)(A) of such Code is amended
20 by inserting "(D)," after "(C),".

21 (4) Section 6416(b)(4)(A) of such Code is amended
22 by striking out "section 4071" and inserting in lieu thereof
23 "section 4071 or a recapped or retreaded tire in respect of
24 which tax under section 4071(a)(4) was paid on the tread
25 rubber used in the recapping or retreading".

1 (d) Section 6416(b)(2) of such Code is amended by
2 striking out "or" at the end of subparagraph (J), by strik-
3 ing out the period at the end of subparagraph (K) and
4 inserting in lieu thereof "; or" and by adding at the end
5 thereof the following:

6 "(L) in the case of a tire in respect of which
7 tax was paid under section 4071(a) (1) or (2) or
8 under section 4071(b), adjusted pursuant to a war-
9 ranty or a guarantee in connection with the sale of
10 a replacement tire or otherwise, in which case the
11 overpayment shall be in proportion to—

12 "(i) the adjustment (whether the adjust-
13 ment method is by tread wear or otherwise) in
14 the sales price to the ultimate consumer of the
15 replacement tire, or

16 "(ii) in the case of a contract providing
17 an overall adjustment for reimbursement with
18 respect to tire warranties or guarantees, an
19 average amount per tire based on the adjust-
20 ment method (whether the method is tread
21 wear or otherwise) which is in accordance
22 with regulations prescribed by the Secretary
23 and which is used by the ultimate vendor in
24 making the adjustment to the ultimate con-
25 sumer of the replacement tire,

1 unless credit or refund of such tax is allowable
2 under paragraph (3).
3 For purposes of subparagraph (L), in the case of a con-
4 tract providing an express warranty or guarantee only
5 between the manufacturer, producer, or importer and an
6 immediate vendee other than the ultimate consumer, (i)
7 subparagraph (L) (i) shall be applied by substituting
8 such immediate vendee for the ultimate consumer, (ii)
9 subparagraph (L) (ii) shall be applied by substituting
10 the manufacturer, producer, or importer for the ultimate
11 vendor and by substituting such immediate vendee for
12 the ultimate consumer, and (iii) no adjustment shall be
13 made under subparagraph (L) before the adjustment to
14 the ultimate consumer is made (or, in the case of sub-
15 paragraph (h) (ii), deemed made)."
16 (e) Section 6511 of such Code is amended by redesig-
17 nating subsection (g) as subsection (h) and by inserting
18 after subsection (f) the following new subsection:
19 "(g) SPECIAL RULE FOR CERTAIN TREAD RUBBER
20 OR TIRE EXCISE TAX CREDITS OR REFUNDS.—The period
21 for allowing a credit or making a refund of any overpay-
22 ment of tax arising by reason of subparagraph (G) (iii) or
23 subparagraph (L) of section 6416(b) (2) with respect to
24 any adjustment of sales price of a tire pursuant to a war-
25 ranty or guarantee shall not expire if claim therefor is

1 filed before the date which is 1 year after the day on which
2 such adjustment is made (or, in the case of section 6416 (b)
3 (2) (L) (ii), deemed made)."
4 (f) Section 4071 of such Code is amended by adding at
5 the end thereof the following new subsection:
6 "(f) IMPORTED RECAPPED OR RETREADED UNITED
7 STATES TIRES.—
8 "(1) IN GENERAL.—For purposes of subsection
9 (a) (4), in the case of a tire which has been exported
10 from the United States, recapped or retreaded (other
11 than from bead to bead) outside the United States, and
12 imported into the United States—
13 "(A) the person importing such tire shall be
14 treated as importing the tread rubber used in such
15 recapping or retreading (determined as of the com-
16 pletion of the recapping or retreading), and
17 "(B) the sale of such tire by the importer
18 thereof shall be treated as the sale of such tread
19 rubber.
20 "(2) EXCEPTION FOR CERTAIN TAXABLE SALES.—
21 Paragraph (1) shall not apply with respect to the sale
22 of any tire if such tire is sold on or in connection with
23 the sale of an article on which tax is imposed under
24 section 4061."

1 (g) The amendments made by this section shall take
2 effect on the earlier of—
3 (1) the first day of the first calendar month which
4 begins more than 10 days after the date of the enact-
5 ment of this Act, or
6 (2) April 1, 1978.

Passed the House of Representatives March 14, 1978.

Attest: EDMUND L. HENSHAW, JR.,
Clerk.

95TH CONGRESS
2D SESSION

H. R. 6635

IN THE SENATE OF THE UNITED STATES

MARCH 15 (legislative day, FEBRUARY 6), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend the Second Liberty Bond Act to allow the interest rates paid on United States retirement plan and individual retirement bonds to be increased to the rate paid on United States series E savings bonds.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the first section of the Second Liberty Bond Act (31
4 U.S.C. 752) is amended by adding at the end thereof the
5 following new paragraph:
6 "The Secretary of the Treasury, with the approval of
7 the President, may provide by regulations that the invest-
8 ment yield on any offerings of bonds issued under this Act
9 which are described in section 405(b) or 409(a) of the

1 Internal Revenue Code of 1954 (relating to retirement
2 plan bonds and individual retirement bonds, respectively) be
3 increased for the interest accrual periods specified in such
4 regulations so that the investment yield on such bonds for
5 such periods is consistent with the investment yield on series
6 E savings bonds for such periods."

7 SEC. 2. The amendment made by the first section of this
8 Act shall apply with respect to the investment yield on bonds
9 issued before, on, or after the date of the enactment of this
10 Act, but only for purposes of increasing the investment
11 yield on such bonds for interest accrual periods beginning
12 after September 30, 1977.

Passed the House of Representatives March 13, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

95TH CONGRESS
2D SESSION

H. R. 8535

IN THE SENATE OF THE UNITED STATES

MAY 24 (legislative day, MAY 17), 1978

Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 with respect to the treatment of amounts paid to relatives for purposes of the credit for expenses for household and dependent care services necessary for gainful employment.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) paragraph (6) of section 44A (f) of the Internal
4 Revenue Code of 1954 (relating to payments to related
5 individuals) is amended to read as follows:
6 "(6) PAYMENTS TO RELATED INDIVIDUALS.—No
7 credit shall be allowed under subsection (a) for any
8 amount paid by the taxpayer to an individual—
9 "(A) with respect to whom, for the taxable

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32-978 O - 78 - 4

1 year, a deduction under section 151 (e) (relating to
2 deduction for personal exemptions for dependents)
3 is allowable either to the taxpayer or his spouse, or
4 "(B) who is a child of the taxpayer (within
5 the meaning of section 151 (e) (3)) who has not
6 attained the age of 19 at the close of the taxable
7 year.
8 For purposes of this paragraph, the term 'taxable
9 year' means the taxable year of the taxpayer in which
10 the service is performed."
11 (b) The amendment made by subsection (a) shall ap-
12 ply to taxable years beginning after December 31, 1977.

Passed the House of Representatives May 23, 1978.

Attest: EDMUND L. HENSHAW, JR.,
Clerk.

95TH CONGRESS
2D SESSION

H. R. 8811

IN THE SENATE OF THE UNITED STATES

JANUARY 25 (legislative day, JANUARY 24), 1978
Read twice and referred to the Committee on Finance

AN ACT

To amend section 7447 of the Internal Revenue Code of 1954 with respect to the revocation of an election to receive retired pay as a judge of the Tax Court.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That section 7447 of the Internal Revenue Code of 1954
4 (relating to retirement of Tax Court judges) is amended by
5 adding at the end thereof the following new subsection:
6 "(i) REVOCATION OF ELECTION TO RECEIVE RETIRED
7 PAY.—
8 "(1) IN GENERAL.—Notwithstanding subsection
9 (e) (2), an individual who has filed an election to
10 receive retired pay under subsection (d) may revoke

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1 such election at any time before the first day on which
2 retired pay (or compensation under subsection (c) in
3 lieu of retired pay) would (but for such revocation)
4 begin to accrue with respect to such individual.
5 "(2) MANNER OF REVOKING.—Any revocation
6 under this subsection shall be made by filing a notice
7 thereof in writing with the Civil Service Commission.
8 The Civil Service Commission shall transmit to the chief
9 judge a copy of each notice filed under this subsection.
10 "(3) EFFECT OF REVOCATION.—In the case of any
11 revocation under this subsection—
12 "(A) for purposes of this section, the individual
13 shall be treated as not having filed an election to
14 receive retired pay under subsection (d),
15 "(B) for purposes of section 7448—
16 "(i) the individual shall be treated as not
17 having filed an election under section 7448 (b),
18 and
19 "(ii) section 7448 (g) shall not apply,
20 and the amount credited to such individual's
21 account (together with interest at 4 percent per
22 annum to December 31, 1947, and 3 percent
23 per annum thereafter, compounded on Decem-
24 ber 31 of each year to the date on which the

1 revocation is filed) shall be returned to such
2 individual,
3 "(C) no credit shall be allowed for any service
4 as a judge of the Tax Court unless with respect to
5 such service either there has been deducted and
6 withheld the amount required by the civil service
7 retirement laws or there has been deposited in the
8 Civil Service Retirement and Disability Fund an
9 amount equal to the amount so required, with
10 interest,
11 "(D) the Tax Court shall deposit in the Civil
12 Service Retirement and Disability Fund an amount
13 equal to the additional amount it would have con-
14 tributed to such Fund but for the election under sub-
15 section (e), and
16 "(E) if subparagraph (D) is complied with,
17 service on the Tax Court shall be treated as service
18 with respect to which deductions and contributions
19 had been made during the period of service."
20 SEC. 2. (a) The amendment made by the first section
21 of this Act shall apply with respect to revocations made after
22 the date of the enactment of this Act.
23 (b) Any individual who elects to revoke under section
24 7447(i) of the Internal Revenue Code of 1954 within one

1 year after the date of enactment of this Act shall be
2 treated as having the requisite current service for purposes
3 of redepositing funds in the Civil Service Retirement and
4 Disability Fund and for purposes of reviving creditable serv-
5 ice under subchapter III of chapter 83 of title 5 of the
6 United States Code.

Passed the House of Representatives January 24, 1978.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

Senator BYRD. The subcommittee will come to order.

Today we will consider a group of bills which, except for S. 2872, sponsored by the distinguished late Senator James B. Allen of Alabama, have been passed by the House of Representatives.

Because there are so many bills to consider today, each witness on each bill is limited to 5 minutes of oral testimony. I urge the witnesses to summarize their main points. The full text of their written testimony will be printed in the record.

The Department of the Treasury will testify after the other witnesses. However, I understand that representatives from the Department of Treasury are to be present throughout the hearing and are prepared to offer comments as the witnesses appear.

For the record, it should be noticed that the distinguished Senator from Kansas, Senator Dole, has introduced S. 2153, which is identical to H.R. 8535. S. 2153 will be considered in connection with the House bill today.

I would suggest that the committee begin with testimony from the distinguished Members of the House of Representatives who are here today.

Congressman HUGHES. Congressman Duncan, we would be glad to take up the bill that you are interested in now, if you would like. What is that number?

Representative DUNCAN. H.R. 2984, Mr. Chairman.

Senator BYRD. You may preceed as you wish, Congressman. We are glad to have you.

STATEMENT OF HON. JOHN J. DUNCAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Representative DUNCAN. Mr. Chairman, I appreciate the opportunity to appear before you on behalf of this bill, H.R. 2984. May I say that Mr. Pickle and I are cosponsors of the bill and he thought there might be some chance that he would not get back in time to testify but——

Senator BYRD. So you are testifying, in effect, both for Congressman Pickle and yourself?

Representative DUNCAN. Yes. I am sure that he can do a much better job than I, and if he gets here, then he can add his part to it.

Senator BYRD. I think that both of you do a great job.

Representative DUNCAN. In 1971, we acted to amend the section 4061 of the Internal Revenue Code to exclude from the manufacturers' excise tax certain bodies and chassis of trucks and buses, truck trailers and semitrailers. Our intent at that time was to exempt from the tax the majority of farm and ranch trailers. Actually all but the three-axle trailers of the so-called gooseneck configuration.

In the case of these truck trailer and semitrailer chassis and bodies, the exclusion applies to the chassis and bodies that are suitable for use with the the trailer or semitrailer having a gross vehicle weight of 10,000 pounds or less. However, because of very technical regulations, revenue rulings, and revenue procedures which the IRS has promulgated for the administration of this law, unrealistically low limits are

imposed upon trailers intended to be used for farming or for horses or for livestock transport purposes.

These restrictive administrative practices have limited the availability of the exclusion in the case of farm and ranch trailers. The trailers in question are manufactured by a relatively small number of producers, many of whom are currently involved with disputes in IRS in some 38 States. Approximately 15,000 people are employed by this industry.

Because the industry is so small and does not have precise engineering standards or specifications, it is all but impossible for the industry to respond to the strained and technical limitations which the IRS is seeking to impose. A further hardship is imposed on the industry because the IRS, lacking sufficient personnel to enforce payment of the tax by all producers, often "misses" some marginal producers, primarily welding shops which may only build two or three trailers a year, thus putting legitimate producers at a competitive disadvantage.

H.R. 2984 would change current administrative practices and provide an exemption from the 10-percent manufacturers excise tax in the case of sales of trailers or semitrailers or the chassis or body for any trailer or semitrailer which is suitable for use with a vehicle having a gross vehicle weight of 10,000 pounds or less and which is designed for use for farming purposes or transporting horses or livestock.

Mr. Chairman, may I say that we passed this legislation in our Ways and Means Committee in the last Congress. It was late in coming to the floor and when it passed the House of Representatives and it was too late for consideration over here. It again passed in the Ways and Means Committee and the House in this Congress by almost unanimous vote, and I hope you will certainly consider a favorable report on this legislation.

It is certainly badly needed. I am glad Mr. Pickle has arrived now. As I say, he can do a much better job than I.

Senator BYRD. Thank you very much, Congressman Duncan. The committee is glad that Congressman Pickle is present, and you may proceed as you wish, Congressman.

Representative PICKLE. Well, Senator, may I file a statement with the committee and consent to revise and extend my remarks in addition to that?

Senator BYRD. Yes. That will be published in the record.

STATEMENT OF HON. J. J. PICKLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Representative PICKLE. This bill is an attempt to clear up an amount of confusion that is brought on by the Internal Revenue Service to try and give interpretation to what they mean by gross axles and the weights involved. We are simply saying that these trailers, these gooseneck type trailers, that would be exempt if they are hauling commodities to and from the farm and if they are using it for vehicles that are suitable for farming purposes.

It does not invade the big vehicles. It is not in competition with that. It is an attempt to clarify what has been brought about because of the interpretation of the IRS.

This simply would exempt them from this excise tax. I think this has been intended all along. The manufacturers have been very surprised that they have had this added legal interpretation about gross weight. This just simply would say that if it is suitable for the light duty truck under the 10,000 pounds, then you would be exempt.

We have an anomaly, Senator, where if you haul feed to the farm that would be exempt, this type of vehicle. But if you hauled cattle from the farm to the market, that would not be exempt. And, of course, that was an oddity that should not be allowed.

This bill would clear up that type of thing and simply say, if they have the vehicles under 10,000 pounds and it is for light duty purposes, not intended for commercial uses and is for farming purposes, then it would be exempt. That is basically all the bill does.

Senator BYRD. Is one of the rationales behind the bill that the trailers in question do not make sufficient use of the Federal highways to warrant the payment of excise taxes?

Representative PICKLE. Senator, that is correct. They are going a distance of maybe 5 or 10 miles to and from the farms and that is not out on the highway. It is a very small revenue loss and it is not in the big tractor purposes at all.

Senator BYRD. What was the attitude of the Treasury Department when you appeared before Ways and Means?

Representative PICKLE. Well, I do not remember that the Internal Revenue offered any testimony on it. I am not certain of that one way or the other. I think they would welcome a clarification of the law.

Senator BYRD. The revenue loss, as I understand it, would be very little.

Representative PICKLE. Yes, $1 million a year, or less.

Senator BYRD. Thank you very much. The committee is glad to have both of you here this morning.

Representative PICKLE. Senator, I have two other bills, and I presume before this same committee.

Senator BYRD. Well, the committee would be glad to take up those two bills.

Representative PICKLE. I do not know what order you have for witnesses——

Senator BYRD. Your two bills would be H.R. 2852 and H.R. 6635?

Representative PICKLE. I believe that is correct.

Senator BYRD. Why do you not proceed with H.R. 2852, then?

Representative PICKLE. Well, thank you, Senator. And I have a very short statement. Let me just present the statement here.

More and more of our farm operations are now handled by air. Planting, as well as spraying, are increasingly done by air. It is more efficient, faster, uses less fuel as well as less manpower.

This bill merely puts the aerial aircraft operators in the place of the farmer to obtain gasoline tax refunds for use on the farmlands.

Under the present law, gasoline and special fuel used in noncommercial aviation are subject to excise tax totalling 7 cents per gallon. The present law provides exemptions from these taxes in certain cases including farming. These refunds also apply to gasoline or other fuel as used on the farm by someone other than the owner, tenant or operator, such as crop dusting.

However, in order to get this refund, the owner, the tenant or the operator must know exactly how many gallons of fuel were consumed over his particular farm, so that he can then claim the excise tax credit. The cost of making individual determinations and of supplying each farmer with information adequate to obtain the credit or repayment of taxes paid by the aircraft operator frequently exceed the applicable result.

All that this bill does is to make the applicable excise tax repayment or credit directly to the agricultural aircraft operator in place of the farmer.

This cuts out a lot of complicated bookkeeping. The amount that an individual farmer would have collected is not that large.

For example, the refund per acre would be 1.4 cents, or $1.40 for a 100-acre farm. This is hardly worth the necessary paperwork.

However, for the crop duster who is spraying many farms, it is worthwhile and easily calculated, since he knows exactly how many gallons of fuel he uses.

Fuel used in going to and from the farm is not included in the refund.

All this bill is doing is giving to the crop sprayer the refund that the farmer is already entitled to on the gasoline used in crop dusting the farm. This is a necessary service to the farmer, and the person who buys the gasoline, it seems to me, should be entitled to the exemption.

Senator BYRD. May I say, at this point, that the committee has received a letter from Senator Burdick of North Dakota expressing keen interest in this legislation and urging that it be approved. Senator Burdick feels that it would be very beneficial to the farmers, at little, if any, cost to the Treasury, and I assume that that is your view also.

[The letter referred to follows:]

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C., June 15, 1978.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: It is my understanding that the Senate Finance Committee will hold a hearing Monday, June 19, 1978, on H.R. 2852, a bill providing for the refund or credit of the gasoline excise tax to operators of agricultural aircraft. As a long-time sponsor of similar Senate legislation, I am writing to express my support for H.R. 2852 and to urge you and your Committee colleagues to give this bill favorable consideration.

As you may know, present law exempts gasoline excise taxes for farming purposes but restricts the claim and issuance of the tax refund or credit to the farmer. This situation has resulted in an administrative situation whereby the aircraft operator pays the tax outright and passes this cost along to the farmer who, in turn, files a claim with the Internal Revenue Service for a credit or refund. The cost of providing the documentation to the farmer frequently exceeds the refund or credit, and very often no claim is made at all.

The legislation before the Committee simply changes the procedure to permit the plane operator, and not the farmer, to claim the refund or credit. This bill is noteworthy also in that it will not have an inflationary impact on the national economy and that it will reduce the amount of paperwork required under the present system.

I am pleased that the Senate Finance Committee has provided the forum in which the proposal contained in H.R. 2852 can be studied and reviewed. Once again, I ask your favorable consideration of this measure and I appreciate this opportunity to share with you my views.

With kind personal regards, I am

Sincerely,

QUENTIN N. BURDICK.

Representative PICKLE. Senator, it is. Senator Burdick had submitted testimony to the House which we made known to our committee when it was considered over there. Really all this is is a bookkeeping change that says instead of the farmer making an application to the crop duster and return back, he just goes directly to the crop duster. And that does not hurt the farmer. He does not bother with it, and does not want to bother with it. It is a bookkeeping correction that would save time and be helpful to the duster.

Senator BYRD. Then I assume that the farmer and the crop duster could not both apply?

Representative PICKLE. No, no. Not at all. It would go to one, the direct applicator, and that would be it.

Senator BYRD. Thank you, Congressman Pickle. And now, do you want to go to H.R. 6635?

Representative PICKLE. Yes, Senator. I do not want to impose on anybody else's time, but it will not take but a minute, I think, and I would appreciate it if I could go right ahead.

Senator BYRD. Yes; go right ahead.

Representative PICKLE. The next bill, Senator, is H.R. 6635 and it amends the second Liberty Bond act. It is a rather small bill, but nevertheless an important effort to provide an equitable investment for persons setting up retirement plans.

The measure allows the interest rate paid on U.S. retirement plans, individual retirement bonds, to be increased to the rate paid on U.S. Series E Savings Bonds. Under present law, money set aside in the individual retirement accounts, or Keogh plans, may be invested in individual retirement bonds, or retirement plan bonds offered by the Treasury.

But these bonds are an extremely long good investment, but they have a very low interest rate. And we ought to remember that any bonds sold helps relieve the pressure on the short-term market and thereby also helps to slow down pressures on the interest rate.

But the share of the market affected by these bonds has historically been very small. Currently they offer serious drawbacks to the investor, drawbacks which this legislation seeks to remedy.

The IRA, or the individual retirement bonds, and the retirement plan bonds bear an interest rate fixed as of the date of purchase. They cannot be sold or exchanged until age 59½ or until death or disability.

Thus, in most instances, the purchaser is locked into an investment of these bonds at a fixed rate of interest until retirement. Some retirement bonds still outstanding were issued at 3¾-percent rate of interest. They have been like that for 5 or 6 years or longer.

This legislation before you would provide simple equity to these investors by increasing the rate of return to the current rate of return on Series E bonds. It would maintain that equity in the future.

It would also make these bonds a more attractive investment by insuring that the future rate of return kept pace with the general market conditions, as does the Series E Savings Bonds.

At the same time, since the Series E rate is carefully set so as not to interfere with the needs of the private market, these bonds would have no deleterious effects.

As of April 30, 1978, approximately $152 million in retirement plan bonds and approximately $36 million in individual retirement bonds

were outstanding from the U.S. Treasury. The revenue impact of improving the investment yields on these bonds is negligible, amounting to less than $5 million in 1981. But, again, while this is a small bill it is important.

Improved yield would allow these bonds to serve as a competitive yardstick to private investors. A citizen would always have the option to go into a nontrustee plan using these bonds. This will make it harder for someone to be victimized by unscrupulous retirement plan sellers offering programs which have a lower yield than is available on the open market.

At the same time, it would provide a good investment for the U.S. Government with beneficial effects on the overall interest rate.

I urge the approval of this bill, Mr. Chairman. The Treasury endorses this bill. It was passed unanimously in the Ways and Means Committee and passed out by unanimous consent on the calendar.

It just simply says that IRA bonds and Keogh bonds would have the same rate of return as regular Series E bonds.

Senator BYRD. That seems reasonable.

Are retirement bonds widely used?

Representative PICKLE. Well, Senator, they are not so widely used, really. When I read you the figures, that is a relatively small amount and they do not anywhere near capture the portion of the market that I think they are entitled to. I think the lower rate of return is one reason for it. I would think and hope that they would grow, but I think that has been one phase of the Government program that has not been tried to sell the public.

But we are not talking about a high sum. now. It does not take a lot of revenue out of the Treasury. but it does give equity to them. If they want to invest in it, at least they would not be locked in in this 3¾-percent interest.

Senator BYRD. 3¾ percent?

Representative PICKLE. That is mighty small.

Senator BYRD. Thank you very much, Congressman Pickle.

Representative PICKLE. Thank you. Senator. and I appreciate the courtesy you have extended to me by allowing me to present my testimony on all three bills.

Senator BYRD. It is an honor to have you here today, sir.

Representative PICKLE. Well. sir, I spent the weekend in your lovely State tending to my garden and I can report to you that we beat the birds out of two big cherry trees, and that is a good accomplishment for the weekend.

Senator BYRD. I thought you had a good Virginia suntan.

Thank you, sir.

[The prepared statement and attachments of Mr. Pickle follow:]

STATEMENT OF HONORABLE J. J. PICKLE, TO THE SENATE FINANCE COMMITTEE

Mr. Chairman, in support of H.R. 2985 that would amend the Internal Revenue Code to exempt from the excise tax imposed on trailers a trailer designed to be used for farming purposes or for transporting horses or livestock that is suitable for use with a vehicle having a gross vehicle weight of 10,000 pounds or less. The types of trailers involved that would now be tax exempt include cattle trailers, general livestock trailers, flatbed farm and ranch equipment trailers, and other agricultural trailers. However, since they must be suitable to be used with a vehicle having a gross vehicle weight of 10,000 pounds or less we are still not talking about the really heavy trailers. This bill is designed to help the

farmer and rancher who carries produce or cattle in a trailer hooked up to his pickup.

The reason for this bill that passed the Ways and Means Committee last session, and the House on August 24, 1976, and again on May 8, 1978 is to correct an IRS revenue ruling saying these trailers, which can be pulled by a light vehicle, were subject to the trailer excise tax. The ruling came as quite a surprise to the people who make the trailers because they naturally assumed the tax code exempted all agricultural vehicles. The present requirement for exemption, that the trailer itself have a gross vehicle weight of less than 10,000 pounds, is administered by the IRS in a manner which imposes unrealistically low limits in the case of trailers designed to be used for farming purposes or for transporting horses or livestock.

As I drive around my district, I see these small trailers hooked to the back of pick ups all the time. I am sure you do too. It seems unjust to me to make the manufacturer, and in turn, the farmer and rancher pay an excise tax on these small trailers used for local, not long distance hauling. With the farmers having to pay more for everything this year, this is one way we can help. I urge you to support this bill. The revenue loss is estimated at $2 million.

Mr. Chairman, more and more of our farm operations are now handled by air. Planting as well as spraying are increasingly done by air. It is more efficient, faster, uses less fuel as well as less manpower. This bill merely puts the aerial aircraft operators in place of the farmers to obtain gasoline tax refund for use on farmland. Under present law, gasoline and special fuels used in noncommercial aviation are subject to excise taxes totaling 7¢ per gallon. Present law provides exemptions from these taxes in certain cases including farming. These refunds also apply where the gasoline or other fuel is used on the farm by someone other than the owner, tenant, or operator such as a crop duster. However in order to get this refund, the owner, tenant, or operator must know exactly how many gallons of fuel were consumed over his particular farm so that he can then claim the excise tax credit. The cost of making individual determinations and of supplying each farmer with information adequate to obtain a credit or repayment of taxes paid by the aircraft operator frequently exceeds the applicable result.

All this bill does, is make the applicable excise tax repayment or credit directly to the agricultural aircraft operators in place of the farmers. This cuts out a lot of complicated bookkeeping. The amount that an individual farmer would have collected is not that large—for example the refund per acre would be 1.4¢ or $1.40 for a 100 acre farm. This is hardly worth the necessary paper work. However, for the crop duster who is spraying many farms it is worthwhile and easily calculated since he knows exactly how many gallons of fuel he used. Fuel used in going to and from the farm is not included in the refund.

All this bill is doing is giving to the crop sprayer the refund that the farmer is already entitled to on the gasoline used in crop dusting the farms. This is a necessary service to the farmer and the person who buys the gasoline it seems to me should be entitled to the exemption.

H.R. 6635, AMENDING THE SECOND LIBERTY BOND ACT

Mr. Chairman, distinguished members of this Committee, I am pleased to have this opportunity to review with you a bill which has received strong support in the House of Representatives.

H.R. 6635, to amend the Second Liberty Bond Act, is a small bill, but it nevertheless is an important effort to provide an equitable investment for persons setting up retirement plans.

The measure allows the interest rates paid on United States retirement plan and individual retirement bonds to be increased to the rate paid on United States series E savings bonds.

Under present law, money set aside under individual retirement accounts or Keogh plans may be invested in individual retirement bonds or retirement plan bonds offered by the U.S. Treasury.

These bonds are an extremely good long-term investment for the U.S. Treasury, and any bonds sold help to relieve the pressure on the short term market and thereby also help to hold down pressures on interest rates.

But the share of the market affected by these bonds has historically been very small. Currently they offer serious drawbacks to the investor—drawbacks this legislation seeks to remedy.

The individual retirement and retirement plan bonds bear an interest rate fixed as of the date of purchase. They cannot be sold or exchanged until age 59½ or until death or disability. Thus, in most instances, the purchaser is locked into an investment in these bonds at a fixed rate of interest until retirement. Some retirement bonds still outstanding were issued at a 3¾ percent rate of return.

The legislation before you would provide simple equity to these investors by increasing that rate of return to the current rate of return on the series E savings bond. It would maintain that equity in the future—and also make these bonds a more attractive investment—by ensuring that the future rate of return kept pace with the general market conditions, as does the series E savings bond. At the same time, since the series E rate is carefully set not to interfere with the needs of the private market, these bonds would have no deleterious effect there.

As of April 30, 1978, approximately $152 million in retirement plan (Keogh) bonds and approximately $36 million in individual retirement bonds were outstanding from the U.S. Treasury. The revenue effect of improving the investment yield on these bonds is negligible, amounting to less than $5 million by 1981.

But, again, while this is a small bill, it is an important one. An improved yield will allow these bonds to serve as a competitive yardstick with private investment. The citizen will always have the option to go to a non-trustee plan using these bonds, and this will make it harder for someone to be victimized by unscrupulous retirement plan sellers offering programs which have a lower actual yield than is available on the open market. At the same time, we provide a good investment for the U.S. government with beneficial effects on the overall interest rate picture.

I urge approval by this Committee of this measure and thank you for your consideration.

Union Calendar No. 470

95TH CONGRESS
2D SESSION

H. R. 6635

[Report No. 95-921]

IN THE HOUSE OF REPRESENTATIVES

APRIL 26, 1977

Mr. PICKLE introduced the following bill; which was referred to the Committee on Ways and Means

MARCH 3, 1978

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Omit the part struck through and insert the part printed in italic]

A BILL

To amend the Second Liberty Bond Act to allow the interest rates paid on United States retirement plan and individual retirement bonds to be increased to the rate paid on United States series E savings bonds.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the first section of the Second Liberty Bond Act (31
4 U.S.C. 752) is amended by adding at the end thereof the
5 following new paragraph:
6 "The Secretary of the Treasury, with the approval of
7 the President, may provide by regulations that the invest-
8 ment yield on any offerings of bonds issued under this Act
9 which are described in section 405(b) or 409(a) of the

I

Internal Revenue Code of 1954 (relating to retirement plan bonds and individual retirement bonds, respectively) be ~~increased for each interest accrual period which begins after September 30, 1976, so that the investment yield on such bonds is consistent with the investment yield on series E savings bonds.".~~ *increased for the interest accrual periods specified in such regulations so that the investment yield on such bonds for such periods is consistent with the investment yield on series E savings bonds for such periods."*

SEC. 2. The amendment made by the first section of this Act shall apply with respect to the investment yield on bonds issued before, on, or after the date of the enactment of this Act, but only for purposes of increasing the investment yield on such bonds for interest accrual periods beginning after September 30, 1977.

Rate of Interest on Individual Retirement Bonds

Mr. Ullman. Mr. Speaker, I move to suspend the rules and pass the bill H.R. 6635 to amend the Second Liberty Bond Act to allow the interest rates paid on U.S. retirement plan and individual retirement bonds to be increased to the rate paid on U.S. series E savings bonds, as amended.

The Clerk read as follows:

H.R. 6635

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the first section of the Second Liberty Bond Act (31 U.S.C. 752) is amended by adding at the end thereof the following new paragraph:

"The Secretary of the Treasury, with the approval of the President, may provide by regulations that the investment yield on any offerings of bonds issued under this Act which are described in section 405(b) or 409(a) of the Internal Revenue Code of 1954 (relating to retirement plan bonds and individual retirement bonds, respectively) be increased for the interest accrual periods specified in such regulations so that the investment yield on such bonds for such periods is consistent with the investment yield on series E savings bonds for such periods."

Sec. 2. The amendment made by the first section of this Act shall apply with respect to the investment yield on bonds issued before, on, or after the date of the enactment of this Act, but only for purposes of increasing the investment yield on such bonds for interest accrual periods beginning after September 30, 1977.

The Speaker pro tempore. Is a second demanded?

Mr. Conable. Mr. Speaker, I demand a second.

The Speaker pro tempore. Without objection, a second will be considered as ordered.

Mr. Symms. Mr. Speaker, I object. And on that I demand tellers.

Tellers were ordered, and the Speaker pro tempore appointed as tellers Mr. Ullman and Mr. Symms.

The House divided, and the tellers reported that there were—yeas 13, nays 1.

Mr. Symms. Mr. Speaker, I object to the vote on the ground that a quorum is not present and make the point of order that a quorum is not present.

The Speaker pro tempore. Evidently a quorum is not present.

The Sergeant at Arms will notify absent Members.

The vote was taken by electronic device, and there were—yeas 372, nays 1, not voting 61, as follows:

[Roll No. 131]

YEAS—372

Abdnor
Addabbo
Akaka
Alexander
Allen
Ambro
Ammerman
Anderson, Calif.
Andrews, N. Dak.
Annunzio
Applegate
Archer
Armstrong
Ashbrook
Aspin
Badham
Bafalis
Baldus
Barnard
Baucus
Bauman
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Brown, Ohio
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Burton, John
Burton, Phillip
Butler
Byron
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Carter
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Clausen, Don H.
Clawson, Del.
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Collins, Tex.
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D'Amours
Daniel, Dan
Daniel, R. W.
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Miller, Ohio
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Mitchell, Md.
Mitchell, N.Y.
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Moffett
Mollohan
Montgomery
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Moorhead, Calif.
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Murphy, Ill.
Murphy, Pa.
Murtha
Myers, Gary
Myers, John
Myers, Michael
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Skelton
Skubitz
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Smith, Nebr.
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NAYS—1

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NOT VOTING—61

Anderson, Ill.
Andrews, N.C.
Ashley
AuCoin
Beard, Tenn.
Bedell
Boggs
Bonker
Breaux
Broomfield
Collins, Ill.
Conyers
Crane
Dent
Diggs
Eckhardt
Erlenborn
Flippo
Florio
Ford, Mich.
Fowler
Fraser
Gammage
Garcia
Hansen
Heckler
Ireland
Jeffords
Jenkins
Kasten
Krueger
Lehman
Long, La.
Lujan
McClory
McDade
McKinney
Madigan
Martin
Miller, Calif.
Moorhead, Pa.
Murphy, N.Y.
Nix
Nolan
Pepper
Quie
Quillen
Risenhoover
Ruppe
Ryan
Santini
Satterfield
Shipley
Teague
Traxler
Tucker
Vander Jagt
Watkins
Weaver
Wiggins
Wilson, C. H.

Mr. SCHULZE changed his vote from "nay" to "yea."
So a second was ordered.
The result of the vote was announced as above recorded.

The SPEAKER pro tempore. The gentleman from Oregon (Mr. Ullman) and the gentleman from New York (Mr. Conable) will be recognized for 20 minutes each.

The Chair recognizes the gentleman from Oregon (Mr. Ullman).

Mr. ULLMAN. Mr. Speaker, I yield myself such time as I may consume.

Mr. Speaker, H.R. 6635 authorizes the Treasury Department to increase the interest rate payable on previously issued U.S. retirement bonds, so that those bonds will earn interest at rates consistent with rates currently established for series E U.S. savings bonds.

Under present law, a person eligible to establish an individual retirement account may purchase retirement bonds issued for this purpose by the Treasury. Also, self-employed persons with "H.R. 10 plans" and companies with certain qualified retirement plans may purchase retirement plan bonds from the Treasury.

The interest rate on these retirement bonds remains the same, under present law, from the date of issuance until the bond is redeemed when the owner retires, becomes disabled, or dies. For example, retirement plan bonds issued in 1963 to self-employed persons with "H.R. 10 plans" bear interest today at only 3.75 percent.

By contrast, present law authorizes the Treasury Department to increase the interest rate payable on previously issued series E U.S. savings bonds so that those bonds earn higher interest rates when the rate goes up for newly issued series E bonds. For example, the owner of a series E bond issued in 1963 at 3.75 percent today receives interest at 6 percent.

H.R. 6635 eliminates this unfair treatment of holders of different types of U.S. bonds, and makes Treasury retirement bonds more attractive to potential buyers. The bill permits the Treasury Department to adjust upward the interest rate paid on outstanding retirement bonds, so that such rates are consistent with the rates on series E bonds. The bill requires that any interest rate increase proposed by the Treasury must be submitted to the President for approval.

Mr. Speaker, H.R. 6635 eliminates an inequity in present law and encourages investment in Treasury bonds. The Treasury Department supports this bill. I urge its adoption.

Mr. Speaker, I yield such time as he may consume to the gentleman from Texas (Mr. Pickle), the author of the bill.

(Mr. Pickle asked and was given permission to revise and extend his remarks.)

Mr. PICKLE. Mr. Speaker, I thank the chairman for yielding.

As the chairman said, this bill provides equity for those who want to buy the individual retirement bonds or retirement plan bonds.

H.R. 6635—LIBERTY BOND AMENDMENTS

Mr. Speaker, the bill before us is a small bill. It is recommended by the Treasury. It will effect revenues by less than $5 million between now and 1982, about $1 million per year. At the same time, it is an important effort to provide equity for persons setting up retirement plans.

Under present law, money set aside under individual retirement accounts or Keogh plans may be invested in individual retirement bonds or retirement plan bonds offered by the U.S. Treasury.

These bonds are an extremely good long-term investment for the U.S. Treasury, and any bonds sold help to relieve the pressure on the short-term market and thereby also help to hold down pressures on interest rates.

But the share of the market affected by these bonds has historically been very small. Currently they offer serious drawbacks to the investor—drawbacks this legislation seeks to remedy.

The individual retirement and retirement plan bonds bear an interest rate fixed as of the date of purchase. They cannot be sold or exchanged until age 59½ or until death or disability. Thus, in most instances, the purchaser is locked into an investment in those bonds at a fixed rate of interest until retirement. Some retirement bonds still outstanding were issued at a 3¾-percent rate of return.

The legislation before you would provide simple equity to these investors by increasing that rate of return to the current rate of return on the series E savings bond. It would maintain that equity in the future—and also make these bonds a more attractive investment—by insuring that the future rate of return kept pace with the general market conditions, as does the series E bond. At the same time, since the series E rate is already carefully set not to interfere with the needs of the private market, these bonds would have no deleterious effects there.

As of February 28, 1978, approximately $183 million in retirement plan bonds and approximately $37 million in individual retirement bonds have been issued

by the Treasury. Most are still outstanding. The revenue effect of improving the investment yield on these bonds is negligible, amounting to less than $5 million by 1982.

But, again, while this is a small bill, it is an important one. An improved yield will allow these bonds to serve as a competitive yardstick with private investment. The citizen will always have the option to go to a nontrustee plan using these bonds, and this will make it harder for someone to be victimized by unscrupulous retirement plan sellers offering programs which have a lower actual yield than is available on the open market.

At the same time we provide a good investment for the U.S. Government with beneficial effects on the overall interest rate picture.

Mr. CONABLE. Mr. Speaker, I yield myself such time as I may consume.

(Mr. CONABLE asked and was given permission to revise and extend his remarks.)

Mr. CONABLE. At the outset, let me express my deep and abiding gratitude to Members of this House for having supported my demand for a second. I regret that the gentleman from Idaho (Mr. Symms) could not see fit to go along with this perfectly reasonable request, but I shall be brave.

Mr. Speaker, I rise in support of H.R. 6635, which would amend the Second Liberty Bond Act, to allow the interest rates on U.S. retirement plan and individual retirement bonds to be raised to the rate paid on series E savings bonds.

Under present law, U.S. retirement plan savings bonds yield, until redemption, the interest rate which was applicable when the bond was issued. H.R. 6635 would enable investors in such bonds to earn interest at the same rate as is paid currently on series E bonds by allowing the Treasury Department to make adjustments in the interest rate.

Currently individuals receive a tax deduction for amounts paid to purchase individual retirement bonds which are issued by the Treasury Department. The bonds are not transferable and are subject to a number of the same restrictions which apply to individual retirement accounts. Similar bonds are issued for annuity and retirement plans which have been established by employers for their employees. H.R. 6635 will enable investors in retirement plan bonds to receive the same interest rate as do series E bonds investors.

It should be noted that H.R. 6635 will increase the interest paid in interest accrual periods beginning after September 30, 1977, on retirement bonds issued on, before, or after the date the bill is enacted.

The bill would correct an inequity in treatment of investors in the two types of U.S. savings bonds. Absent this correction, it is feared that investors will turn increasingly to retirement plan schemes offered in the private sector, thereby reducing Treasury receipts from the sale of these bonds and increasing the amounts of money which will have to be raised in the money markets generally.

The Treasury Department supports H.R. 6635, believing that this bill will help maintain the competitiveness of retirement plan bonds and individual retirement bonds with other investment vehicles, thereby assisting the Treasury in its debt management functions. I urge its enactment.

Mr. Speaker, I reserve the balance of my time.

GENERAL LEAVE

Mr. ULLMAN. Mr. Speaker, I ask unanimous consent that I may revise and extend my remarks that all Members may have 5 legislative days in which to revise and extend their remarks on the bill H.R. 6635.

The SPEAKER pro tempore. Is there objection to the request of the gentleman from Oregon?

There was no objection.

The SPEAKER pro tempore. The question is on the motion offered by the gentleman from Oregon (Mr. ULLMAN) that the House suspend the rules and pass the bill H.R. 6635, as amended.

The question was taken; and (two-thirds having voted in favor thereof) the rules were suspended and the bill, as amended, was passed.

A motion to reconsider was laid on the table.

Senator BYRD. I note that Senator Allen of Alabama is present and she is interested, as I understand it, in S. 2872.

Senator Allen, will you come forward, please?

I understand also that Congressman Hughes is interested in this legislation. Congressman, we are glad to have you.

Senator Allen, I believe this is your first time to appear before this committee, and I want to say that we are tremendously pleased to have you here today. I know this is a very important bill to you, just as it was to Senator James B. Allen, and you may proceed as you wish. Then, following that, I will ask Congressman Hughes if he will speak.

STATEMENT OF HON. MARYON ALLEN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator ALLEN. Thank you. I am proud to be here.

Mr. Chairman, I take great pleasure in introducing to you this morning a panel of witnesses from Alabama who will testify in support of S. 2872, a bill introduced on April 11, 1978, by my late husband, Senator James B. Allen. The bill is designed to exclude the taxable income the statutory subsistence allowances paid to state law enforcement officers.

Mr. Chairman, prior to the recent decision of the Supreme Court in *Kowalski*, State statutory subsistence allowances were considered nontaxable since they are paid principally for the convenience of the State or local governments rather than for the income benefit of the law enforcement officers. S. 2872 would allow the States to continue to provide nontaxable subsistence allowances through legislative enactment and would recognize that State troopers are paid subsistence not as an income benefit, but rather for the convenience of the State in providing meals to officers while they are on duty.

But, Mr. Chairman, the gentlemen with me can provide the subcommittee with detailed information on this subject. Col. M. L. Hilyer is the director of the Alabama Department of Public Safety and has had a long and distinguished career in public service in Alabama.

Maj. Harold Hammonds is a career State trooper who has risen through the ranks to his present position as head of the Drivers License Division of the Alabama Department of Public Safety, and he served previously as director of administrative affairs for the department.

Capt. Jerry Shoemaker has worked in the Alabama Department of Public Safety since the age of 18, and he now heads the Intelligence Division.

Lt. Roy McLellan will next year complete 25 years of outstanding service as an Alabama State trooper, and he is, at present, president of the Alabama State Policemen's Association, an organization of 900 law enforcement officers throughout the State of Alabama, all of whom have been adversely affected by the *Kowalski* decision.

The panel is also accompanied by Edward L. Hardin of Birmingham, Ala., who provided legal counsel to the Alabama State Policeman's Association during the litigation of *Kowalski* and related lawsuits.

Maj. Harold Hammonds will be the principal witness and will present testimony for the entire panel. However, each gentleman is available to the subcommittee for questions.

Mr. Chairman, please accept my sincere thanks for your consideration in scheduling this hearing and allowing this opportunity for discussion of S. 2872.

Thank you very much.

Senator BYRD. Thank you very much, Senator Allen.

Before going to the panel, I would like to call on Mr. Hughes so that we will not hold him up any longer. Then I do have a few questions to ask the panel, Senator Allen.

Congressman Hughes? Welcome, Congressman Hughes.

Representative HUGHES. Thank you, Senator, and good morning.

STATEMENT OF HON. WILLIAM J. HUGHES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Representative HUGHES. Mr. Chairman, I wish to thank you for providing me this opportunity to testify this morning on S. 3134. That legislation, sponsored by the late Senator Allen of Alabama, would alleviate the severe financial hardship upon State police officers that is resulting from the Supreme Court's recent decision in *Commissioner* v. *Kowalski.*

The case, as you know, ended almost 25 years of relatively consistent judicial opinion that meal allowances paid to State police officers were not taxable. As a result of that decision, State police officers are now liable for taxes on their meal allowances back through 1971.

There can be little question but that the retroactive enforcement of that decision back through 1971 will result in a very serious hardship. In my home State of New Jersey. I am personally aware of several State troopers who have already been audited and assessed for as much as $4,000 in back taxes as a result of the *Kowalski* decision. Assessments could go as high as $7,000 in the case of some individuals.

Needless to say. for troopers who have an average take-hope pay of between $10,000 and $12,500 per year, the burden of such high assessments will be crushing. It will inevitably force many troopers deeply into debt. I understand that similar hardships will occur in other States as well.

I believe it is our responsibility under the circumstances to take action to relieve this heavy burden. It is one thing to say that State police must pay taxes on their meal allowances from now on, but it is quite another thing to say that they must pay taxes for a 6-year period in which the prevailing law was different from that found by the Supreme Court in 1977.

The Third Circuit Court of Appeals, for example, followed a consistent policy of excluding meal money from taxation from 1954, when the tax code was adopted, through 1977 when it was reversed by the Supreme Court. A similar policy of excluding meal money from taxation was followed in the Fifth, the Eighth, and Tenth Circuit Courts of Appeals as well.

The Supreme Court itself commented on this issue in a case that was decided a few weeks after *Kowalski*, in the case of *Central Illinois Public Service Company* v. *the United States*, wherein the Court stated that: "The income tax character of lunch reimbursements * * * were not entirely clarified until the *Kowalski* decision a few weeks ago."

Under the circumstances, it would be fair for us to conclude that the *Kowalski* decision represents a substantial shift in the law on the tax treatment of meal money. In not paying taxes on their meal al-

lowances prior to *Kowalski*, I feel that State police officers were acting in good faith in reliance on the law as it existed at that time.

It is a very simple principle of equity that persons should be allowed to act upon reliance on the law until it is changed. I believe that in applying the *Kowalski* decision back to 1971, we are violating that principle, and working a great injustice.

The House Ways and Means Committee has already acted to remedy this injustice by approving an amendment to H.R. 12841 which is identical to S. 3134. It is possible that H.R. 12841 will be considered by the full House today and I am very hopeful that in the interests of justice and equity you will take similar favorable action on S. 3134.

Senator, the amount of money we are talking about to the Treasury is very small, but I can attest personally to the hardship it will cause. I worked for about 10 years with State troopers in my home State as a prosecutor and I know that these men and women of the State police have been seriously affected by the decision. The morale is extremely low. In some instances, troopers are seriously considering bankruptcy because they just do not have the funds. And I just hope that this distinguished subcommittee will move the legislation ahead so that we can provide the relief that I think they are justly entitled to.

Senator BYRD. Congressman, you say the Internal Revenue plans to go back to 1971?

Representative HUGHES. Yes; Mr. Chairman, they already have, in fact, audited many returns and there are dozens and dozens of audits being conducted now. Many assessments have already been made by the Internal Revenue Service and, in some cases, the assessment, as I indicated, could go as high as $7,000.

But when you are only talking about a trooper making $12,500, with three or four kids, as in many instances, they just do not know where to turn.

Senator BYRD. Regardless of what might be done in the future, it does not seem to me to be very reasonable to go back 6 or 7 years on a matter where the individuals acted in good faith and apparently acted in accordance to the law at that particular time.

Representative HUGHES. I agree, Mr. Chairman, and I would say that Colonel Pagano, who is our superintendent of State police, will be testifying subsequently, and I am sure that he can corroborate what I have indicated.

I am aware that there are State troopers in my own particular district, which is a very rural district in south Jersey, comprising about one-third of the land area of the State, who travel long distances and must eat away from home. I do not think a week goes by that I do not have telephone calls from State troopers whom I have worked with over the years who are just besides themselves trying to figure out how to try to come up with the assessment.

Senator BYRD. That is the reason for the retroactive date to January 1, 1970, I take it?

Representative HUGHES. That is correct.

Senator BYRD. What States are affected by the taxation as gross income of meal allowances? How many States, do you know?

Representative HUGHES. Fifteen States are.

Senator BYRD. Fifteen States are affected by it.

And what is the amount of additional tax liability which the taxation of meal allowances places on the average State trooper? You mentioned the possibility of $7,000. Also, $4,000 was referred to? Is $4,000 the average figure, would you say?

Representative HUGHES. Of course, it is averaging around $3,000 but it is a little premature, because we are just in the auditing process now. But we are aware, in some instances, where assessments as high as $7,000 will be imposed and there have been a number of assessments as high as $4,000. To date, it averages about $3,000 per trooper.

And of course, in some instances, these troopers sometimes travel as far away as 80 miles from their home, and it is unreasonable and unrealistic that they could get home for meals. Of course, that was a major reason for the meal allowance to begin with.

Senator BYRD. Thank you very much, Congressman.

Representative HUGHES. Thank you, Senator.

Major Hammond, I understand you will be speaking for the panel from Alabama?

Mr. HAMMOND. That is correct, sir.

Senator BYRD. We are delighted to have you, and you may proceed as you wish.

Mr. HAMMOND. Thank you very much, Senator.

STATEMENT OF HAROLD HAMMOND, HEAD, DRIVERS LICENSE DIVISION, ALABAMA DEPARTMENT OF PUBLIC SAFETY

Mr. HAMMOND. Thank you, Senator Byrd, for this opportunity. I do represent State police officers in the State of Alabama. I am grateful to this committee's willingness to hear us today on this question.

I am here to speak in support of S. 2872, introduced by Senator James Allen. The bill, of course would exclude from gross income statutory subsistence allowances received by State law enforcement officers. My comments will be brief, but we would like to submit to this committee later this week fuller written detail.

I would also like to submit for the record a letter from Colonel Dennis Eisnach who is superintendent of the South Dakota Department of Public Safety who sends his regrets that he could not be here, but he also writes in support of S. 2872.

Senator BYRD. Could you, at this point, list the 15 States which are involved?

Mr. HAMMOND. Senator, I could call some of them. I could not call them all. I do not think.

The history of subsistence payments of State police officers in Alabama is rather brief, since it was proposed and passed in 1973 to become effective on October 1 of that year. It was first proposed by the organization representing the State police of Alabama. It had the support of Governor Wallace and the leadership of agencies of the State.

In 1973, the State Police officers in Alabama were among the lowest paid State police officers in the Nation. They averaged about $8,000 a year. At that time, our attrition rate was very high and many officers worked at second jobs to provide adequately for their families.

During the legislative hearings at the State capitol while a subsistence bill was being considered, it was established that many State police officers were forced to spend out of pocket money for work-

related expenses. Most of it went to provide meals on duty, since our officers are assigned over the entire county and, in many cases, could not return to their homes for meals because of their responsibilities as law enforcement officers.

Under the State law, no per diem could be paid them so long as they remained in their assigned county. It was not unusual for an officer to find himself 20 or 25 miles away from his home at mealtime.

At that time, he was performing duties which would not permit him to return home for his meal.

Our department director at that time and the department staff felt that it was unfair to expect a trooper or a State police officer to have to dip into his own pocket to pay expenses incurred as the direct result of his employment as a State police officer.

The legislature of Alabama agreed and passed the bill providing a modest $5 a day daily subsistence allowance for each working day to defray the cost of meals while these officers were on duty.

In the face of limited resources on the State level, the State was able to relieve a growing burden by enacting this statute.

I should mention, and I am sure you realize, that Alabama is primarily a rural State. A large number of our 67 counties have only two or three troopers assigned to provide rural law enforcement. Several of them have only one.

This means that there is never more than one trooper on duty at any given time in many of the counties of Alabama. An officer cannot call for relief at mealtime if his duties demand his presence. He cannot block off one hour of his daily shift and say that is reserved for his mealtime.

In fact, it is not uncommon for a trooper to order a meal and then be called away for an emergency before the meal is even set before him and sometimes before he finishes eating it.

He cannot call for relief to take a lunch hour, but must remain at accident scenes, at scenes of disorders, at traffic congestion, at crime scenes, oftentimes eating on the run by grabbing a sandwich and eating as he runs to an emergency call.

It is advantageous—the Department realizes it and I believe that State Police officers in Alabama realize—that it is advantageous to both and to the citizens we serve by taking our meals in our assigned areas.

After the subsistence law passed in 1973, the Director of our Department issued instructions to all State police officers regarding the tax status of such payments. Based on conversations with attorneys and accountants dealing with tax matters and relying on several courts of appeals decisions, including our own Fifth Circuit in New Orleans, our officers were instructed not to report subsistence payments as income.

The State Comptroller concluded that the payments were not subject to State and Federal taxes, and none was withheld. In 1976 when our State revenue department announced that they were considering taxing this income, the leadership of both the State House and Senate and Governor Wallace informed the revenue department to delay any attempt to collect the State tax until the legislative intent could be further clarified.

This was done in 1977, when the legislature of Alabama amended the act to read: "It is the legislative intent of this legislature that the subsistence allowance provided by this section is to be solely a subsistence

expense allowance for the purpose of providing meals while said officers are on duty and is not to be considered as compensation under the laws of this State."

Senator BYRD. What is the subsistence allowance in Alabama?

Mr. HARDIN. It is $5 a day, Senator, and it amounts, for the average officer, to $1,100 a year.

Senator BYRD. It is how much a day?

Mr. HARDIN. Five dollars. Senator, we have a list of the affected States, if you would like them.

Senator BYRD. Yes, would you read those off?

Mr. HARDIN. Alabama, Arkansas, Colorado, Connecticut, Idaho, Iowa, Texas, Louisiana, Mississippi, Missouri, New Jersey, New Mexico, North Dakota, South Dakota, and West Virginia.

Senator BYRD. Thank you. I thought it would be well to have that as a part of the record.

The subsistence allowance became effective in your State, you say, in 1973?

Mr. HARDIN. Yes, sir.

Senator BYRD. So the effect would vary from State to State as to the number of years that would be affected, I assume?

Mr. HARDIN. Yes, sir.

I think the average would be—it would be approximately $300 on an average per officer per year, for a total of around $1,200.

Senator BYRD. Yes.

Well, thank you, thank you gentlemen very much, and we are glad to have you.

I cannot speak very much about the State police in Alabama, or any other States except Virginia, and I have been very much impressed with the consistently high quality of State police personnel that we have in the State of Virginia. I do not remember the exact total, but I believe we have somewhere in round figures of a thousand. How does that compare with Alabama?

Mr. HAMMOND. 1,200.

Senator BYRD. You have 1,200?

Maybe Virginia is a little higher than a thousand.

Anyway, I have been much impressed with the State troopers in my State and judging from you gentlemen, it must be the same caliber in Alabama. We are glad to have you.

Mr. HAMMOND. Thank you, sir.

[The prepared statements of the preceding panel follow:]

TESTIMONY OF MAJOR HAROLD J. HAMMOND, ALABAMA DEPARTMENT OF PUBLIC SAFETY, SPEAKING IN BEHALF OF THE ALABAMA STATE POLICEMEN'S ASSOCIATION

Thank you, Senator Byrd. I represent State Police Officers of Alabama and am grateful for this Committee's willingness to allow us to appear and offer testimony in support of Senate Bill 2872 introduced by Senator James Allen. This bill excludes from gross income statutory subsistence allowances received by law enforcement officers.

My comments will be brief this morning, but we would like to submit more detailed, written comments outlining my Department's position for the Committee's consideration later this week. I would also like to submit for the record, a letter of support for S. 2872 from Colonel Dennis Eisnach, Superintendent, South Dakota Department of Public Safety, who sends regrets he could not be present for this hearing today.

The history of subsistence payments to State Police Officers in Alabama is brief since it was proposed and passed by the State Legislature in 1973 to become

effective October 1, 1973. It was proposed by the organization representing State Police Officers in Alabama and had the support of the Governor and the leadership of State Law Enforcement Agencies.

In 1973, State Police Officers in Alabama were among the lowest paid in the nation, averaging $8,000 annually. Our attrition rate was high and many officers worked at a second job to provide adequately for their families.

During hearings while the subsistence bill was being considered, it was established that State Police Officers were forced to spend out-of-pocket money for work related expenses. Much of it went to provide meals on duty since our officers are assigned to an entire county and in many cases could not return to their homes for meals because of their responsibility as law enforcement officers. No per diem could be paid them under state law so long as they remained in their assigned county. It is not unusual for an officer to find himself 20–25 miles from his home performing duties which did not permit him to take his meal at home.

Our Department Director and Staff felt it unfair for a Trooper to dip into his own pocket to pay expenses incurred as a direct result of the performance of his duties. The Legislature of Alabama agreed and passed the bill providing a modest $5.00 daily subsistence allowance for each working day to defray the cost of meals and other work related expenses for State Police Officers. In the face of limited resources, the state was able to relieve a growing burden on state officers by enacting this statute.

I should mention, Alabama is primarily a rural state and a large number of our 67 counties have only 2–3 Troopers assigned, in fact several have only one (1). This means that there is never more than one Trooper on duty at any given time. He can't call for relief at meal times if his duties demand his presence. He cannot block off one hour of his day and treat it as reserved for his meal time. In fact, it is not uncommon for a Trooper to order a meal and then be called away for an emergency before the meal can be eaten. He cannot call for relief to take his meal hour, but must remain at accidents, on manhunts, at crime scenes, or at scenes of traffic congestion oftentimes eating on the "run" by grabbing a sandwich and eating while responding to an emergency call. It is advantageous to the Department and to the public he serves for an officer to take his meal in his assigned territory.

After the subsistence law passed in 1973, the Director of our Department issued instructions regarding the tax status of such payments. Based on conversations with attorneys and accountants dealing with tax matters and relying on several Court of Appeal decisions, including our own Fifth Circuit at New Orleans, our officers were instructed not to report subsistence payments as income or claim deductions. The State Comptroller concluded the payments were not subject to state or federal income taxes and none was withheld.

In 1976, our State Revenue Department, Income Tax Division, announced they were considering taxing the payments for state tax purposes. Based on statements from the leadership of both the State House and Senate and upon instructions from Governor Wallace, the Revenue Department delayed any attempt to collect state tax on subsistence payments until the State Legislature further clarified their intent. This was done in 1977 when the Legislature amended act to read—

"It is the legislative intent of the Legislature that the subsistence allowance provided by this section is to be solely a subsistence expense allowance for the purpose of providing meals while said officers are on duty and is not to be considered an compensation under the laws of this state. It is the legislative intent that this subsistence allowance shall not be subject to any income or other taxes levied by the State of Alabama or the federal government". Codified as amendment to 1973 subsistence law, Code of Alabama, Title 36, Chapter 21, Section 2(b).

In late 1977, taxes were assessed for subsistence payments received in 1974 and 1975 against all 1200 Alabama State Police Officers. In addition, interest was added to tax bills received by the officers.

State Police Officers faced tax bills amounting to $600–$700, even though they had followed instructions and did not claim legitimate work related deductions. No provision had been made to pay federal taxes because our officers relied upon the Circuit Court of Appeals for the Fifth Circuit and instructions from the Department Director that such payments were non-taxable.

We are concerned, as are other states, because of the financial burden this retroactive levy is having on the average officer who must already budget an in-

adequate salary wisely. We expect our men to meet their financial commitments, but this tax levy may mean some must seek other employment to properly provide for their families.

I would urge you to give S. 2872 a favorable report and support its passage among your colleagues. The amount of funds we speak about today may seem small and insignificant to many people, but a levy of $700 for back taxes is a burden on any taxpayer who is paid the salary of a Trooper in Alabama.

A reasonable subsistence allowance of $5.00 for duty days permits the officer to protect a modest salary by providing tax free funds for duty related and deductible expenses incurred in this unique occupation.

I trust you will send this bill to the full Senate at the earliest possible time. If this committee cannot in good conscience support S. 2872, we urge your support for S. 3134. If you have questions, I shall be happy to respond.

DEPARTMENT OF PUBLIC SAFETY,
DIVISION OF HIGHWAY PATROL,
Pierre, S. Dak., June 7, 1978.

DEAR SENATOR ALLEN: I am writing to you as author of Senate Bill 2872 which exempts subsistence allowances of law enforcement officers from Federal Income Tax. South Dakota will not be able to have anyone present to offer testimony on behalf of this legislation but we would like to take this means to go on record in support of Senate Bill 2872.

The South Dakota Highway Patrol has for the past several years paid our officers a flat rate per diem which has been considerably less than what other state employees are entitled to. We have chosen to do this because of the unusual schedules and assignments that our troopers are called on to work, that make it next to impossible to meet the requirements of the regular state subsistence allowance. The criteria for the regular subsistence spells out specifics such as being away from your home station at certain specified times of the day in order to qualify for payment of meals. One can readily see that this type of criteria is not compatible with police duties and scheduling.

Our present flat rate per diem of $4.50 per working day, does not cover the actual meal expenses and with Federal Income Tax now being withheld, it further reduces the actual take-home pay by approximately $1.00 per day.

Sincerely,

COLONEL DENNIS EISNACH,
Superintendent.

STATEMENT OF EDWARD L. HARDIN, JR., GENERAL COUNSEL, ALABAMA STATE POLICEMEN'S ASSOCIATION

Mr. Chairman and Members of the Subcommittee: On behalf of the 1,200 law enforcement officers of the State of Alabama adversely affected by the *Kowalski* decision, I thank you for an opportunity to supplement the oral testimony given on June 19, 1978, in support of Senate Bills 2872 and 3134.

As you well know, S. 2872, introduced by Senator Allen, would amend Section 119 of the Internal Revenue Code to exclude from gross income subsistence payments received by law enforcement officers. The bill would provide retroactive relief as well as prospective relief. S. 3134, also introduced by Senator Allen, only provides retroactive relief from Federal income taxes from 1970–1977 for statutory subsistence allowances received by certain state law enforcement officers. The Department of The Treasury, as expected, appeared and spoke in opposition to S. 3134. No mention was made by Mr. Halperin of S. 2872, but, we must assume The Department of The Treasury is opposed to S. 2872 for the same reasons advanced in opposition to S. 3134 plus some others.

The Department of The Treasury has advanced three arguments in support of their position:

(a) The exclusion of subsistence pay for law enforcement officers is inequitable and that was decided by Congress in 1958 when Section 120 of the 1954 Internal Revenue Code was repealed.

(b) The Internal Revenue Service has consistently taken the position that subsistence allowances were taxable. Therefore, the risk of financial hardship has been voluntarily assumed by law enforcement officers because they were aware of the position of the Internal Revenue Service.

(c) Enactment of this legislation would encourage other taxpayers to protest Internal Revenue Service positions because, if the taxpayers lose in Court, they may be liable for taxes only in the year following the Court decision.

We respectfully request careful consideration of the Internal Revenue Service position in light of all the facts and circumstances.

In 1954 (the same year Section 120[1] of the Internal Revenue Code was enacted), the Third Circuit Court of Appeals in *Saunders* v. *Commissioner*, 215 F.2d 768, determined that cash payments under the New Jersey meal-allowance program were not taxable. The law governing the taxability of subsistence payments for law enforcement officers in New Jersey and all other law enforcement officers in the states comprising the Third Circuit remained the same until the Supreme Court of the United issued its opinion in *Commissioner* v. *Kowalski* on December 29, 1977. The law of the Fifth Circuit has been that subsistence payments were non-taxable from 1963 (*United States* v. *Barrett*, 321 F.2d 740) until the *Kowalski* decision in December, 1977. The same is true for the Eighth Circuit from 1966 to December of 1977. Consequently, subsistence payments have been held to be non-taxable by case law governing some 15 states for many years even though Congress repealed Section 120 in 1958. The payments were considered to be non-taxable under Section 119 of the Internal Revenue Code.

So, as to the Internal Revenue Service position that it is unfair or inequitable to apply the *Kowalski* decision retroactively because Congress repealed § 120 and the Internal Revenue Service has always taken the position that subsistence allowances were taxable, it is important to keep in mind that the courts continued to hold subsistence payments non-taxable, and these decisions were the law, upon which the Troopers had to rely. The Internal Revenue Service is contending that the affected state law enforcement officers should have relied upon the position of the Internal Revenue Service and disregard the law as determined by the Federal Courts. The law, as interpreted by the Federal Courts, said the payments were not taxable and the law enforcement officers relied thereon. It is well settled law in this country that one who reasonably relies upon a fact which he in good faith believes to be true will prevail against one who misrepresented the fact and induced one to act in reliance upon that fact to his detriment. The equity in the proposed legislation overwhelmingly favors the affected law enforcement officers.

On page 3 of the Internal Revenue Service statement filed with the Chairman of this committee, it is stated that the Internal Revenue Service has required states to withhold income tax from state troopers' meal allowances since 1970 and "such taxes have been withheld." While this may be true for the State of New Jersey, the State of Alabama did not withhold income tax from the trooper's subsistence pay until 1977.

In connection with the issue of fairness, Mr. Justice Blackmun with whom the Chief Justice joined, stated in his dissenting opinion in the *Kowalski* case:

"The Court in its opinion makes only passing comment, with a general reference to fairness, on the ironical difference in tax treatment it now accords to the paramilitary New Jersey state trooper structure and the federal military. The distinction must be embarrassing to the Government in its position here, for the Internal Revenue Code draws no such distinction. The Commissioner is forced to find support for it—support which the Court in its opinion in this case does not stretch to find—only from a regulation. Treas. Reg. § 1.61-2(b), excluding subsistence allowance granted the military, and the general references in 37 U.S.C., § 101(25) (1970 ed., Supp. V), added by Pub. L. 93-419, § 1, 88 Stat. 1152 (1974), to "regular military compensation" and "Federal tax advantage accruing to the aforementioned allowances because they are not subject to Federal income tax." This, for me, is thin and weak support for recognizing a substantial benefit for the military and denying it for the New Jersey state trooper counterpart.

"I feel that state troopers the country over, not handsomely paid to begin with, will never understand today's decision. And I doubt that their reading of the

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[1] "SEC. 120. STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE

(a) GENERAL RULE.—Gross income does not include any amount received as a statutory subsistence allowance by an individual who is employed as a police official * * *

"(b) LIMITATIONS.—

"(1) Amounts to which subsection (a) applies shall not exceed $5 per day.

"(2) If any individual receives a subsistence allowance to which subsection (a) applies, no deduction shall be allowed under any other provision of this chapter for expenses in respect to which he has received such allowance, except to the extent that such expenses exceed the amount excludable under subsection (a) and the excess, if otherwise allowable as a deduction under this chapter." Pub. L. No. 83-591, § 120, 68A Stat. 39."

Court's opinion—if, indeed, a layman can be expected to understand its technical wording—will convince them that the situation is as clear as the Court purports to find it."

As to the position of the Internal Revenue Service that the tax system cannot be administered properly, if unsuccessful contestants are only liable for taxes for years after a Court decision, we think it is important to remember that no one is compelled to avail himself of an exemption or deduction. If the proper legislation is unfair to those persons who did avail themselves of the exemption, it is equally unfair to penalize those who availed themselves of what the Courts said was a legitimate exemption. The fact that some persons chose not to avail themselves of the exemption is not material.

We respectfully submit there is substantial justification for treating law enforcement officers subsistence payments as non-taxable—not only because they relied upon the law as determined by the Federal Courts, but because the terms of their employment required that they be on duty continually without time off for meals. This requirement coupled with the fact that there is no way to furnish troopers actual meals which would not be taxable to the troopers as income, means that the trooper situation is unique in that they are required to be on duty at all times for the convenience of their employer, but are denied the exemption for meals offered under the "Convenience of Employer Rule" because the employer cannot supply additional meals.

Additionally, the current practices of the Internal Revenue Service vary from state to state as well as from individual to individual within the states. Some District Directors have chosen not to assess back taxes while other District Directors are aggressively assessing and instituting collection procedures. The situation is completely unfair to these taxpayers.

As Mr. Halperin stated, the Internal Revenue Service realizes that the life savings of many state policemen will be wiped out if this proposed legislation fails.

We respectfully request favorable action to avoid this deplorable situation.

Senator BYRD. I understand there is another panel, which is interested in this same piece of legislation so we would be glad to have testimony from this panel at this time. I would suggest that one individual be the spokesman for the panel. We would be glad to put in the record any written testimony that any panel members may have.

Would you identify yourself, each of you?

Mr. PAGANO. Senator Byrd, I am Col. Clinton Pagano, superintendent of the New Jersey State Police.

Mr. MURPHY. I am Glen Murphy, legal counsel for the International Association of Chiefs of Police, of which the State provincial division is a division of our association.

Mr. LUHKER. I am Col. Al Luhker, a superintendent of the Missouri Highway Association.

Mr. CHAMBERS. I am Sgt. John Chambers of the Arkansas Highway Department.

Senator BYRD. We are very glad to have you.

Mr. PAGANO. If you please. Senator, I would appreciate it if Mr. Murphy would lead off, and we will be quick.

STATEMENT OF GLEN R. MURPHY, DIRECTOR, BUREAU OF GOVERNMENTAL REGULATIONS AND LEGAL COUNSEL, INTERNATIONAL ASSOCIATION OF CHIEFS OF POLICE

Mr. MURPHY. Senator, we are here to support bill S. 2872 and bill S. 3134. I have filed a written statement with the subcommittee and I will not read that. I would just like to comment that there are 49 State police agencies in the United States all of whom are members of the International Association of Chiefs of Police which represent 95 per-

cent of the law enforcement agencies of the United States, and all of the 49 State police agencies.

We will file with the subcommittee this week a supportive resolution from all 49 States, although, as has already been testified to, there are only 15 States which are affected directly by this at this time. However, over the period of time that this has been under litigation, all States have been adversely affected by this piece of legislation.

We certainly are in support of Senator Allen's bill, S. 2872, which has retroactive as well as prospective legislation but because of the vital nature of this bill, we certainly think the least that we would like to see reported from the subcommittee, Senator, is S. 3134 which eliminates the abhorrent retroactive aspects applied by the Internal Revenue Service.

We have unsuccessfully used administrative and judicial procedures to work this problem out and so legislation is our final alternative. And, at this time, I would like to have Colonel Pagano——

Senator BYRD. I would like to say, at this point, Colonel, that the committee has a letter addressed to me as chairman from Senator Williams from New Jersey who had hoped to be here this morning to introduce you to the committee and I want to make his letter a part of the record.

[The letter referred to follows:]

U.S. SENATE,
COMMITTEE ON HUMAN RESOURCES,
Washington, D.C., June 16, 1978.

Hon. HARRY F. BYRD, Jr.,
Chairman, Senate Subcommittee on Taxation and Debt Management, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I had hoped to appear before your Subcommittee today to introduce Colonel Clinton Pagano, Superintendent of the New Jersey State Police, and to indicate my full support for legislation to remove the retroactive tax on state troopers' meal allowances. Unfortunately, previous commitments have prevented my attendance at your hearings, and so I would be most appreciative if you would read into the hearing record the following statement:

The back taxes resulting from the Supreme Court's recent Kowalski decision have greatly concerned me. Troopers in fifteen states are affected by the decision, and a number of them face additional tax obligations stretching back seven years and reaching as high as $6,000. Such crushing tax burdens threaten to drive these individuals and their families into financial ruin, and undermine the morale and effectiveness of state police organizations. To provide the necessary relief, I recently joined with the late Senator from Alabama, James Allen, in introducing legislation that would exclude from taxation meal allowances provided to state troopers between 1970 and 1977.

Appearing before your Subcommittee today to testify on this legislation will be Colonel Clinton Pagano of the New Jersey State Police. For many years, Colonel Pagano has dedicated himself to the safety and security of the people of New Jersey, and as a result has earned the highest reputation for excellence in public service. Recently, he has assumed a leadership role in the efforts of state troopers to receive the fair tax treatment they deserve. He has proven himself to be an articulate and effective spokesman for state troopers all across the nation and has played an important role in focusing the attention of Congress on their plight. I am sure that his views will be most helpful to the Subcommittee's deliberations.

In closing, let me commend you for the concern you have shown for our state troopers through your scheduling of these hearings.

With best wishes,

Sincerely,

HARRISON A. WILLIAMS, Jr.

Mr. MURPHY. This is Colonel Pagano of New Jersey.

Senator BYRD. Colonel Pagano you may proceed.

STATEMENT OF COLONEL CLINTON L. PAGANO, SUPERINTENDENT, NEW JERSEY STATE POLICE

Mr. PAGANO. Mr. Chairman, I am Colonel Pagano, the superintendent of the New Jersey State Police and what I may say briefly will echo the presentation of Congressman Hughes and essentially the same presentation by the Alabama group. We all find ourselves in a little bit different circumstances through the 15 States, but nonetheless, the heavy burden that we face today is the retroactive burden.

In New Jersey, we say there is an average of $3,000 but it is not unusual to find a $6,000 levy. With the meager income—and the Supreme Court itself addressed the fact that State troopers in general are not well paid, but with that kind of an assessment we find ourselves with a situation where the morale of the organization and the manner in which our people are responding to this heavy burden creates a real problem as far as the administration of the organization is concerned.

We have consistently, since 1949, been in accord with the Internal Revenue Service over the taxability of the food and maintenance allowance and until *Kowalski* in 1977, with the exception of one rule or one tax court ruling, New Jersey won the case.

In the tax court ruling in 1976, the court itself said that, as far as *Kowalski* was concerned, that he was entitled to approximately three-quarters of that meal allowance as a deduction.

Our biggest problem right now is the manner in which the assessments are being granted. Even though the tax court said that three-quarters of Kowalski's maintenance was not taxable, we find other troopers right today going through assessments, audits and assessments, where they are not being granted that amount.

This is a heavy burden on a State trooper. Without question, I can represent to you that our people cannot bear this burden.

I know, as a matter of my own conversation—not from my own experience, because I have not been in for assessment yet—but I do know that in many of the cases the troopers are being assessed and they are not in a position to pay and this creates a great deal of difficulty.

I think the one point that I want to make is that across the spectrum of those 15 States there is no specific equality being shown. In some States they have only gone back 1 year. In other States they have really not taken any action at all.

In New Jersey, because we were the original test State, we find ourselves being assessed back to 1970. It is an unfair burden. We can argue for prospective relief, but what we really need the relief from, today, is for that retroactive burden which we cannot shoulder.

Senator BYRD. What is the subsistence allowance in New Jersey?

Mr. PAGANO. In New Jersey, it is $3,000. And I would say without question, that regardless of what the State may be, it is all relative. Living costs are different from State to State, and I am sure you are well aware of that, Senator.

Senator BYRD. What is the allowance in Missouri?

Mr. LUHKER. It is up to $3.25 a day, but we do not get subsistence; we just have an expense account.

Senator BYRD. $3.25 a day.

Mr. LUHKER. Up to, yes, sir.

32-978—78——6

Senator BYRD. Up to $3.25 a day.

How about Arkansas?

Mr. CHAMBERS. $4.

Senator BYRD. $3.25 in Missouri, $4 in Arkansas and $5, I believe they said, in Alabama. And then yours is on an annual basis?

Mr. PAGANO. Ours is on an annual basis, and I guess McDonald's must charge more in New Jersey.

Senator BYRD. Thank you gentlemen very much. We are glad to have you.

Do you have additional comments?

Mr. LUHKER. Yes, sir, if I may speak.

We have a system in our home State and I know you can argue one way or another, but I do not feel like we can let our troopers brown-bag their lunch or let them have a picnic lunch alongside of the road.

They are on duty 9 hours a day. They make $12,000 a year and, as they said in Alabama, they are called out many times, or anytime they sit down for lunch, it seems like the citizen has a question.

And we are requiring these people to eat away from their homes and, again, we allow up to $3.25 a day.

Our troopers receive no overtime and last year they put in 77,000 hours of overtime without any compensation. We have had no trouble with IRS. They have been very cooperative since this case.

But certainly we would be in favor, in the future, if we could go to a system like we have had where you swear that this was on-the-road expense, produce your tab, if necessary. I just really feel like these people have it coming. It is a business expense.

And I would appreciate it, on behalf of our 800 troopers, if anything could be done to give them some relief in this situation.

As has been pointed out, morale is very bad. It seems like the State troopers are being the ones that are being picked out, that industry and everyone else are reimbursed for their expenses away from their home station.

Again, I do not want to say that we have not found IRS cooperative; because they certainly have been, but we do need some relief, sir.

Senator BYRD. Do you have a comment from Arkansas?

Mr. CHAMBERS. What has been said, sir—the troopers from Arkansas are grateful to be represented here and what has been said, we just go along with.

A beginning salary for a State trooper in Arkansas is just $9,900 a year. We work 10 hours a day. This would be a great morale booster if we could just possibly have some tax relief.

We are just like every other State represented here, sir. We are trying to do a job and anything that can be done, we would greatly appreciate it.

Senator BYRD. The starting salary is $9,000?

Mr. CHAMBERS. Yes, sir.

Senator BYRD. And it goes up to what figure?

Mr. CHAMBERS. $14,000.

Senator BYRD. $14,000?

Mr. CHAMBERS. Yes, sir.

Senator BYRD. What is New Jersey?

Mr. PAGANO. New Jersey starts at about $12,500. We go, after a 15-year period, about $18,000. But again, Senator, I think we find the liv-

ing conditions and the salaries are relative when you speak in terms of an expense like this, because living costs are higher in the Northeast. Not that I do not think that Arkansas and Missouri should not have a pay raise, but as a matter of fact, it is a relative situation.

Senator BYRD. I do not believe that this committee ought to get into that question.

Mr. PAGANO. Do not get into the pay raise area, Senator. Just take care of that tax for us, if you will.

Senator BYRD. Thank you, gentlemen.

Mr. PAGANO. Thank you, Senator.

[The prepared statements of the preceding panel follow:]

STATEMENT OF GLEN R. MURPHY, DIRECTOR, BUREAU OF GOVERNMENTAL RELATIONS AND LEGAL COUNSEL

Thank you, Mr. Chairman. I appreciate this opportunity to appear before the Senate Subcommittee on Taxation and Debt Management to express the beliefs of the International Association of Chiefs of Police (IACP) regarding S. 2872, a bill to exclude from gross income statutory subsistence allowances paid to law enforcement officers.

The IACP is a professional membership organization with more than 11,000 members in 64 nations. The Association was established in 1893 to further the science of police administration. It is comprised of chiefs of police and other law enforcement officials, although command personnel make up over 70 percent of its membership.

As you know, there have been many bills introduced by various Congressmen and Senators dealing with this very real problem of the taxing of statutory subsistence allowances given to law enforcement officers. One difference found among these bills is that some of them apply to all law enforcement officials, whereas others refer only to police officers and highway patrolmen employed by a state (including the District of Columbia) on a full-time basis with the power of arrest. You may be assured that the IACP fully supports either of these versions. However, since the Association largely represents command personnel and police officers I will limit my testimony to discussing the legislation which adversely affects that segment of the law enforcement community.

The primary difference found in the various bills is that some of them apply only retroactively whereas others apply both retroactively and prospectively. Again, the Association would support passage of either of these versions. However, we realize the problems which may be presented by the bills which apply prospectively and therefore we will focus our support on those bills that apply only retroactively because they have a more realistic possibility of passage. The IACP is completely willing to accept as law the decision handed down by the Supreme Court concerning the taxability of subsistence allowances as gross income. We believe, however, that it is a gross misapplication of justice to penalize state police officers and patrolmen for exclusions which were permissible when they were taken.

I would now like to relay to the Subcommittee a concise history of the problem as it relates to law enforcement officers.

On November 29, 1977, the U.S. Supreme Court rendered a decision in the *Commissioner of Internal Revenue* v. *Robert J. Kowalski*.[1] The Court held that cash payments to state police troopers, designated as meal allowances, are included in gross income according to § 61(a) of the Internal Revnue Code of 1954, as amended, (26 U.S.C. § 61(a)), and are not excludable under § 119 of the Code.[2]

The Court concluded that in the absence of a specific exemption, meal allowance payments are income within the meaning of § 61 since the payments are undeniably accessions to wealth, clearly realized, and over which the respondent (Kowalski) had complete dominion.[3] The Court further concluded that § 119

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[1] —— U.S. ——, 98 S. Ct. 315, 54 L.Ed. 2d 252, 46 L.W. 4015.

[2] Section 119. Meals or lodging furnished for the convenience of the employer. "There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer but only if * * * (1) in the case of meals, the meals are furnished on the business premises of the employer * * *."

[3] —— U.S. ——, 46 L.W. at 4017.

does not cover cash payments of any kind but rather § 119 covers *meals* furnished by the employer and not *cash* reimbursements for meals.[4]

The problem we are faced with is not the Supreme Court's decision, per se, but rather, the opinion of the Commissioner of the IRS that this decision applies retroactively to law enforcement officers thereby creating a severe financial hardship for thousands of state police officers across the nation.

As New Jersey (where Kowalski is employed), represents, the payment of a cash meal allowance has been a tradition and even an ingredient of employment in many states. Prior to 1949, the State of New Jersey provided an official meal station where on-duty troopers could stop (in the meal station) for his or her mid-shift meal. The station system proved unsatisfactory to the State because it required troopers to leave their assigned areas unpatrolled for extended periods of time. As a result, the State closed its meal stations and instituted a cash-allowance system which permitted troopers to remain on call in their assigned patrol areas during their mid-shift break.

As previously stated, the issue as we perceive it is the IRS Commission's ruling that troopers are retroactively liable for taxes, penalties, and interest as far back as 1971. The relief we are seeking is to minimize any liability for retroactive payments that may be demanded by the IRS from state and local law enforcement officers. To hold law enforcement officials accountable for past taxes, interest, and penalties on meal allowances is not only unfair, but could result in the financial ruin of many.

Furthermore, the rule announced in *Kowalski* reverses the approved income tax practice existing for 50 years. Until the decision was handed down in *Kowalski*, the New Jersey police officers assumed (and it was affirmed by the United States Court of Appeals for the Third Circuit) that the State Trooper's allowance was nontaxable.[5] Throughout this period, troopers have acted in good faith in deducting meal allowances pursuant to case law within the Third Circuit.

Throughout the country, there have been many differing opinions regarding this issue. The following is a list of a few Circuit Court of Appeals cases and their holdings: *Wilson* v. *United States*, 412 F.2d 694 (CA1 1969) (troopers subsistence allowance taxable); *United States* v. *Keeton*, 383 F.2d 429 (CA10 1967) (*per curiam*) (troopers subsistence allowance nontaxable); *United States* v. *Morelan*, 356 F.2d 199 (CA8 1966) (same); *United States* v. *Barrett*, 321 F.2d 911 (CA5 1963) (same): *Magness* v. *Commissioner*, 247 F.2d 740 (CA5 1957) (troopers subsistence allowance taxable), *cert. denied*, 355 U.S. 931 (1958); *Ghastin* v. *Commissioner*, 60 T.C. 264 (1973) (troopers subsistence allowance taxable); *Hyslope* v. *Commissioner*, 21 T.C. 131 (1953) (troopers meal allowance taxable).

For many troopers, of whom there are approximately 2,000 in New Jersey and approximately 9,000 in the 14 other states that have had subsistence allowance programs similar to that of New Jersey, the Internal Revenue Service will be able to apply the rule in *Kowalski* retroactively as far back as 1970 or 1971. IRS is now in the process of auditing the past tax returns of the New Jersey state troopers for all open years for this very purpose.

The retroactive application of the rule handed down in *Kowalski* will place a severe burden on all state troopers. The average salary of a trooper is low: between 1970 and 1977, it ranged from a minimum of $7,737 per year in 1970 to a maximum of $14,616 per year in 1977. A trooper's subsistence allowance for the same period ranged from approximately $1,074 in 1970 to $3,000 in 1977. If held accountable for the retroactive payment, many troopers will be forced to seek outside employment to meet this tax liability.

We are proposing that the rule handed down by the Supreme Court in *Kowalski* apply to future tax years only, and that troopers should not be held accountable for taxes applied retroactively, pursuant to *Kowalski*, by the Internal Revenue Service. Although we support S. 2872, we now urge the immediate passage of the late Senator Allen's second bill (S. 3134) because of the urgent need to prevent taxation of past subsistence allowances.

S. 3134 would apply the Supreme Court's decision to State police officers on a prospective basis only. It would allow an exclusion from gross income for statutory subsistence allowances received by an officer during the years 1970 through 1976, to the extent that the allowances were not included in income on the officer's income tax return. The exclusion would also apply to allowances an officer re-

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[4] *Id.* at 4017.

[5] *Saunders* v. *Commissioner*, 215 F.2d 768, 1954. IRS did not seek review by the Supreme Court.

ported in gross income to the extent that he claimed an offsetting deduction. In addition, the bill would exclude from gross income all statutory subsistence allowances received by State police officers during 1977. However, the bill generally does not authorize the refund of taxes paid where statutory subsistence allowances were included in income on the officer's tax return.

I cannot emphasize enough the gravity of this legislation. The IACP wholeheartedly urges passage of one of these bills. However, we do want to encourage that any tax refunds to officers should be permissive and not compulsory. Many state police officers included these subsistence allowance payments in their income tax forms, and it has been added to their income for retirement benefits. If rebates were forced upon them, these officers would face a reduction in retirement benefits.

At this time I would be happy to entertain any questions.

Thank you.

STATEMENT OF COLONEL C. L. PAGANO

I appear today to support the passage of S-3134 a bill to provide that certain statutory subsistence allowances received by state police officers will not retroactively be included in gross income. The purpose of this proposed legislation is to lift an unbearable retroactive tax burden that has been imposed upon thousands of state police officers across the nation. This severe hardship that will befall state police troopers comes as a result of the Internal Revenue Service application of the rule recently announced by the Supreme Court of the United States in *Commissioner of Internal Revenue* v. *Robert J. Kowalski* (Argued October 12, 1977, decided November 29, 1977).

In *Kowalski*, the Supreme Court held in a split decision that the State of New Jersey's cash subsistence allowances to its state troopers to reimburse them for the cost of meals consumed while on active policy duty constituted income and that the allowance could not be excluded from income under the special provisions of Internal Revenue Code. Section 119 (relating to the value of meals furnished for the convenience of the employer) because the allowance was provided in cash. The *Kowalski* rule would apply prospectively only under the proposed legislation.

Since the establishment of the New Jersey State Police in 1921 and until the Supreme Court's announcement of the *Kowalski* rule, meals and meal allowances furnished to New Jersey Troopers had never constituted income. Thus, this rule reverses a statutory result in New Jersey that has stood for over 50 years.

From 1921 to 1949, the State of New Jersey provided meals to the troopers of the state police at the state operated barracks. The Bureau of Internal Revenue never challenged the exclusion of these meals from income. In 1949, the State of New Jersey eliminated the meals served at the various barracks and instituted a cash meal allowance for administrative reasons. The Bureau of Internal Revenue immediately challenged the exclusion of the allowance from income, but the exclusion was upheld by the U.S. Court of Appeals for the Third Circuit in *Saunders* v. *Commissioner of Internal Revenue*, (1954), reversing the U.S. Tax Court. The Bureau of Internal Revenue did not seek review by the Supreme Court of the U.S.

The State of New Jersey continued to provide the meal allowance, and the Internal Revenue Service on audit of Kowalski's federal income tax return for 1970—20 years after the Saunders audit—disallowed any exclusion of the meal allowance and any deduction for meal expenses. Kowalski filed a petition in the United States Tax Court disputing the determination of the IRS. In October, 1975 the Tax Court decided that the meal allowance was not excludable under either Section 61 or Section 119 of the Internal Revenue Code, but that two-thirds of the meal expenses was deductible, since Kowalski had spent two-thirds of his time on overnight active duty. The Tax Court's opinion was joined in by nine judges. Six other judges (including Judge Sterrett, the trial judge) dissented on the ground that the meal allowance was fully excludable under Section 61 of the Code and one other judge dissented on the ground that the meal allowance was fully deductible. Kowalski appealed, and in November, 1976 the Third Circuit reversed the decision of the tax court on the basis of its prior decision in the Saunders case in 1954 and on the basis of Judge Sterrett's dissenting opinion in the tax court. Thus, the IRS lost, once again, in the U.S. Court of Appeals for the Third Circuit in a unanimous per curiam opinion.

In February, 1977, the IRS petitioned to the Supreme Court of the United States for review of the decision of the Third Circuit. The Supreme Court granted

the petition for review in March, 1977. The case was argued on October 12, 1977 and decided November 29, 1977. At this time the IRS decision was sustained by a divided court, in spite of the fact that cash subsistence allowances paid to personnel of the armed forces and certain other federal employees are excluded by the Internal Revenue Service from their income without statutory authority. This is weak support for recognizing a substantial benefit for the Military and denying it for the paramilitary New Jersey State Trooper counterpart.

Thus, as I previously stated, the *Kowalski* rule has reversed an income tax result of over 50 years standing with the New Jeresey State Police. Until the U.S. Supreme Court's announcement of the *Kowalski* rule, the New Jersey Troopers assumed, and it was affirmed on two occasions by the U.S. Court of Appeals for the Third Circuit, that the trooper's meal allowance was non-taxable. As a result of the Supreme Court Decision, the Internal Revenue Service has begun to audit individual returns of state troopers in order to claim back taxes on meal allowances. These audits are expected to reach eventually as many as 9,000 troopers in 15 states across the nation. I understand that in some states the IRS has decided that it will apply *Kowalski* only for the future. In other states, troopers face retroactive tax obligations dating back only three years, the maximum period of tax liability ordinarily open under the statute of limitations. However, the troopers in New Jersey are being forced to pay taxes on meal allowances retroactive as far as 1970 because, at the request of the IRS and in order to forestall tax assessments, these troopers agreed to extend the statute of limitations pending the outcome of the *Kowalski* case.

The Supreme Court's *Kowalski* decision and the determination of the Newark District of Internal Revenue Service to collect taxes on meal allowances paid over the past 7 years place thousands of state troopers and their families on the brink of financial ruin. In spite of the fact that the Tax Court allowed Trooper Kowalski a deduction equal to two-thirds of his meal allowance, the Newark District is limiting the deduction for many other troopers to a much smaller amount. Such assessments will surely in many cases spell the difference between fiscal solvency or personal bankruptcy of the individual troopers whom the Supreme Court admitted in its decision "are not handsomely paid to begin with." Many of these troopers will have to seek outside employment to meet this tax liability, and such outside employment may affect their primary occupation. Since the Kowalski decision and the Internal Revenue Service's action, the requests for outside employment to my office from sworn members of the Division have shown a marked increase. As the Superintendent, I am very concerned for the morale and well-being of the men of my command. The crushing tax assessments they face under the current rule will surely place added mental and physical strains on our troopers and their families that can only destroy their morale and jeopardize their effectiveness. Unless action is taken upon this proposal, I feel a great many people across this nation will needlessly suffer severe financial harm. I am also very concerned with the inequity of placing upon my men a vastly disproportionate share of the retroactive application of the Kowalski rule, owing to the zealous tenacity with which the Internal Revenue Service has concentrated its efforts in New Jersey. This legislation would insure that the state police troopers and their families receive the fair tax treatment they deserve, and I strongly urge its endorsement by this committee.

Senator BYRD. Our next witness is Dr. Robert Hill, director of research, National Urban League.

Dr. Hill? Welcome, Dr. Hill.

Mr. HILL. Thank you very much, Senator Byrd.

Senator BYRD. About which bill will you be testifying?

Mr. HILL. It is H.R. 8535, introduced by Senator Conable.

Senator BYRD. You may proceed as you wish.

STATEMENT OF ROBERT B. HILL, DIRECTOR OF RESEARCH, NATIONAL URBAN LEAGUE

Mr. HILL. My name is Robert B. Hill, and I am director of research for the National Urban League, which is headed by Vernon E. Jordan, president. I am grateful to this committee for giving me the oppor-

tunity to make these remarks concerning bill H.R. 8535 relating to tax credits for child care services provided by relatives.

It is the intent of this bill to permit working parents who pay relatives for day care services to receive the same 20-percent tax credit as working parents who place their children in the care of nonrelatives or in formal day care facilities.

Unfortunately, even the liberalized day care provisions in the Tax Reform Act of 1976 exclude care by grandparents, if the child's parents are married, or were never married, and/or if the child care takes place in the grandparent's home.

In other words, in order for a working parent to qualify for the 20-percent tax credit for day care services provided by a grandparent under current law, that parent must be either widowed or divorced, and the day care services must be provided in the child's home and not in the grandparent's.

It seems highly unlikely that it was the intent of Congress to suggest that married couples who depend on relatives for child care services would have to dispose of their spouses through divorce or death in order to take advantage of the tax credit for day care expenses paid to the child's grandparents. This anomaly has resulted from the unfortunate cross-reference in the Tax Reform Act of 1976 to the Social Security definition of employment services in section 3121(b) of the Internal Revenue Code.

This section defines domestic services provided by a parent of the taxpayer as qualifiable employment only when: They are rendered to taxpayers who are divorced, widowed, or have a mentally or physically incapacitated spouse and those services are provided solely in the home of the taxpayer.

Bill H.R. 8535, introduced by Representative Conable, eliminates this inequitable cross-reference and thus removes the taxpayer's marital status and the place where the care was provided as conditions to qualify for tax credits for day care services by grandparents, when no such conditions hold for child care services provided by nonrelatives.

Of course, understandably, this tax credit would not be allowed for day care services rendered by grandparents who are also the dependents of their taxpaying children.

Senator BYRD. Who are also what? I did not catch the relationship to which you refer.

Mr. HILL. Who are also dependents of their children.

Passage of this legislation would constitute a major step forward in the development of Federal policies that reinforced the strengths of American families, instead of weakening them as so many current policies do. Any governmental policy that encourages grandparents, aunts, and uncles to care for their grandchildren, nieces, and nephews to enable the children's parents to work, not only removes a barrier that now prevents many moderate-income families from seeking employment, but also serves to strengthen the bonds among kin in extended families.

Many research studies have shown that day care provided by relatives and especially by grandparents, is not only preferred by the majority of working parents, but is also the best care and is vital to the economic viability of many American families. This is particularly

the predominant mode of child care in the black community where extended family ties are still stronger than in the larger society.

For example, research by Dr. Andrew Billingsley, who is currently the president of Morgan State University, which emanated from his study, "Black Families in White America," strongly documents the close relationship between governmental policies and black family stability.

Moreover, two of my own studies, "The Strengths of Black Families" and "Informal Adoption Among Black Families," have shown that the extended family is still a major source of strength in the black community today, although many governmental policies have the effect of weakening these self-help and coping efforts among kin.

But it should also be clearly understood that, while day care by relatives is the predominant mode of child care among black families, it is also the most frequent pattern among all other American families.

Today, 2.5 million children, or 39 percent of all children 3 to 13 years old with mothers in the labor force who are not able to care for themselves are being cared for by relatives. At the same time, while one-fourth of these children are cared for by nonrelatives, only 4 percent are being left in day care centers.

These day care studies by the U.S. Census Bureau also reveal that over half of all black children with mothers in the labor force leave their children with relatives, while 14 percent and 3 percent, respectively, leave their children in the care of nonrelatives and day care centers.

Thus, it is clearly evident that day care by relatives, most of whom are grandmothers and aunts, is the most common form of child care among most working parents who are unable to provide such care themselves.

Consequently, I strongly urge the passage of this legislation in order to strengthen the bonds in American families—at a time when it is so sorely needed.

Thank you.

Senator BYRD. The Chair Notes that H.R. 8535 is identical with legislation introduced by Senator Dole, S. 2153. Senator Dole has another commitment this morning. I know that, because I had the same commitment and had to leave to come here, but I want the record to show Senator Dole's interest in this legislation.

Let me ask you a couple of questions. You make a good presentation, Dr. Hill.

Does this proposal provide a great opportunity for abuse?

Mr. HILL. I do not think so. I think there was a concern, particularly in the cases of taxpayers who also had their grandparents as dependents to also try to get credit for child care services, but that would not be permitted in this legislation. In other words, they would not be allowed to taxpayers who have their parents as dependents.

Senator BYRD. If the grandparents live in the same home, whether it is the grandparents home or whether it is the home of the child, would tax credits be permitted under those conditions?

Mr. HILL. Yes: either one of those conditions. It should be.

Senator BYRD. Provided that the grandparents are not dependents?

Mr. HILL. That is right. Dependents of the taxpayer, the children. That is right.

Senator BYRD. This bill, I assume, would reverse the decisions which were made by the Congress in connection with the 1976 Tax Reform Act?

Mr. HILL. Yes; well, I do not know whether you would say it would reverse it. It really just eliminates—it maintains, I think, the essential intent of that act, but it does eliminate the cross-reference to the Social Security definition of employment in which the marital status of taxpayers are involved.

Senator BYRD. From your study of this matter, what income levels utilize child care credit?

Mr. HILL. It is pretty much across-the-board, but I would say it is mostly moderate income. In other words, I would say families who are between—well, first of all, many low-income families use relatives and a number of them do not, the lowest of them are not even able to pay their relatives for it. But in terms of paid child care by relatives, I would say that it ranges quite a bit from about—I guess the bulk of them would be between about $7,000 to about $20,000.

Senator BYRD. Thank you, sir.

Senator Hansen, this is Dr. Hill, director of research for the National Urban League. He is testifying on H.R. 8535 which is a bill identical with Senator Dole's S. 2153.

Senator HANSEN. Thank you, Mr. Chairman.

Let me observe that I am sorry I was at another meeting earlier this morning and I will not be able to stay here, despite my keen interest in the panels who are yet to appear. I know my good friend and former colleague, Senator Kuchel is here, and I just wish I could hear him.

I am on the conference on the Outer Continental Shelf and, if you will forgive me, I have to run to that. But I did want to come by and pay my respects and express my deep disappointment in being unable to hear the witnesses who will appear.

I will read the testimony. Thank you, Mr. Chairman.

Senator BYRD. Thank you, Senator Hansen. The Outer Continental Shelf is a very important conference.

Senator HANSEN. Well, unless we want to run completely out of energy, we had better start drilling.

Senator BYRD. We had better start now. Thank you, Senator Hansen. Thank you, Dr. Hill.

Mr. HILL. Thank you, Mr. Chairman.

[The prepared statement of Senator Dole follows:]

STATEMENT BY SENATOR BOB DOLE

I would like to commend the chairman for calling these hearings to address a number of miscellaneous tax bills. I am particularly interested H.R. 8535, a bill to address the question of child care.

Last fall, I introduced S. 2153, which would alter the present law requirements regarding amounts paid for child care services performed by relatives. The bill before the committee, H.R. 8535, is a result of the House passing a bill similar to S. 2153.

The bill before the committee eliminates the present law requirement that child care services performed by certain relatives must constitute "employment" as defined by the social security tax rules in order to quality for the child care tax credit. By eliminating the present law reference to the social security tax defini-

tion, the bill makes the credit available for payments to grandparents to care for their grandchildren while the parents are working. The bill does not change the present rule which denies the child care credit for amounts paid to a relative who is a dependent of the taxpayer or the taxpayer's spouses'.

When the Congress enacted the tax credit for daycare expenses in 1976, I believed that it would be good for families and for the children to allow the credit for amounts paid to relatives. I thought that the 1976 provision accomplished this, however, that was not the case when individuals who tried to claim the credit were denied the credit by the IRS. The bill before the committee simply makes clear that the day care credit accomplishes what the Congress thought it had done two years ago.

This bill had overwhelming support in both the Ways and Means Committee and in the House. I would hope that the Senate could act favorably on this issue.

Senator BYRD. Senator Dole is on his way to the committee room. Until he gets here, we will go to the next panel, which will consist of Mr. William J. Lehrfeld, representing Fruehauf Corp.; Mr. John A. Hazlewood, representing Brenner Tank, Inc., accompanied by David H. Brenner, president and each witness had better identify themselves.

Mr. LEHRFELD. Mr. Chairman, my name is William Lehrfeld and I am counsel for the Fruehauf Corp. On my left is Mr. T. Neal Combs who is the vice president of Fruehauf Corp. and who will deliver the oral remarks in support of H.R. 1337.

Mr. HAZELWOOD. My name is John Hazelwood. I am a lawyer with Carlton Brady in Milwaukee and I am the counsel for Brenner Tank, of Fond-du-Lac, Wis.

Mr. BRENNER. I am David Brenner, president of Brenner Tank, Inc., of Fond-du-Lac, Wis.

Senator BYRD. All of you are most welcome. We are glad to have you today, and you may proceed as you wish.

STATEMENT OF T. NEAL COMBS, VICE PRESIDENT AND GENERAL COUNSEL, FRUEHAUF CORP.

Mr. COMBS. Thank you, Mr. Chairman. This statement is submitted for the Fruehauf Corp. of Detroit, Mich. My name is Neal Combs and I am vice president and general counsel of the Fruehauf Corp. We are a major manufacturer of chassis and bodies for semitrailers and trailers, truck bodies, and related parts and accessories for such products.

We are appearing in support of H.R. 1337 and we are informed that the truck trailer industry, in general, supports H.R. 1337.

Also, on September 7, 1977, Daniel Halperin, Tax Legislative Counsel of the Treasury Department testified before a subcommittee of the House Ways and Means in support of H.R. 1337. We support its enactment, and wish to make the following comments.

If a manufacturer does not customarily sell an article in substantial quantities to wholesale distributors, his constructive sales price must be determined by the Secretary of the Treasury. As early as 1947, the Internal Revenue Service determined that, in the automotive and truck trailer industry, the constructive sales price represents 75 percent of the established retail price of the article. In 1954, the Internal Revenue published this determination in Revenue Ruling 54-61.

This discount off the established retail price represented, in the judgement of the Internal Revenue Service, the approximately price

of the manufacturer when it sold to the first level of distribution outside of its own corporate family.

As early as 1958, the Internal Revenue Service held that a manufacturer is not required to use a single method of determining constructive sales price where it sells taxable articles at different levels of distibutions.

For example, if a manufacturer customarily sells milk tank trailers to a wholesale distributor, then, with respect to retail sales of that type or model milk tank trailer, the constructive sales price is the lower of the actual price to the consumer or the highest wholesale price of the manufacturer.

If that same manufacturer sold a standard van trailer through dealers and not through wholesale distributors, then the constructive sales price on retail sales of that van trailer would be 75 percent of the manufacturer's established retail sales price for the van.

Over the years, the Service, in private letter rulings to taxpayers, has modified its position with respect to when a manufacturer may use the 75 percent rule of Rev. Rul. 54–61 and what the term "established retail price" means. By its terms, Rev. Rul. 54–61 literally applies only where the manufacturer sells at retail, and does not sell both to dealers and at retail.

At least as early as 1964, in private rulings, the Internal Revenue Service recognized that when a manufacturer sells articles to dealers and also sells that article at retail, then the manufacturer may use, for its constructive sales price of the retail sales, 75 percent of the established retail price of the particular article.

There are two major problems which H.R. 1337 will alleviate. First. the Internal Revenue Service has for some time imposed a "cost floor" in connection with the constructive sales price for retail sales. According to the Service, a manufacturer using the retail method cannot go below its apparent cost of manufacturing the taxable article.

One purpose of this bill is to abolish the cost floor to avoid the uncertainty which occurs at the time when the excise tax liability accrues. Because excise tax is paid on a quarterly basis, meaning there are four taxable periods within the fiscal year of the manufacturer, there is almost a certainty that the manufacturer will not know the "cost" with respect to the taxable article sold until well after the close of the taxable period.

Many manufacturers simply cannot state, with any degree of certainty, what their costs will be with respect to the articles even after the close of the period in light of different costing factors, attribution of selling expenses, reimbursement of freight and other transportation charges, et cetera.

The cost floor is an administrative creature and not part of section 4216(b)(1). It was adopted as a revenue ruling and not through notice hearing and related provisions of the Administrative Procedures Act. Thus, manufacturers affected by the 75 percent rule on their retail sales were not able to comment on the "legitimacy" of the new rule.

For those reasons and several others, at least one Federal Court disregarded the cost floor. *Quaker City Iron Works* v. *United States*, 256 F. Supp. 450 (D.C. Pa. 1966).

In addition, determining the cost of a trailer is not a simple computation. It is often rather sophisticated, especially since the cost, like the

"established retail price," must be determined on a type-by-type and model-by-model basis. Even if cost can be generally determined, there are questions on whether a particular cost is a cost of manufacturing—includable in the tax base—or a cost of retail selling—excludable from the tax base. As early as 1954, the Service took the position that all costs, including selling expenses, administrative overhead, et cetera, had to be used in these computations. Some time later, the Internal Revenue Service changed its position, permitting a manufacturer to exclude retail selling and administrative expenses. It wasn't until 3 years later, in 1976, that IRS published its private letter ruling allowing the manufacturer to take advantage of the more liberal interpretation of cost for manufacturers using the retail method.

Second, the bill substitutes "actual selling price" for "established retail price" as the amount to which the percentage is applied. The Federal excise tax on retail sales will hereafter approximate a retail sales tax. Simplicity and ease of administration, not simply for taxpayers, but also for the Internal Revenue Service, will result. The problem with "established retail price," now found in Rev. Rul. 54–61, is that it requires detailed price records for each model for each quarter. A major manufacturer of trucks of trailers with numerous models of trucks or trailers must now maintain an "established retail price" as to each such model, adding significantly to his recordkeeping requirements.

To avoid this complication, the bill wisely substitutes the actual retail selling price of the taxable article on a transaction-by-transaction basis, and that actual retail selling price will be multiplied by the percentage determined by the Internal Revenue Service.

Suppose that, in a retail sale, the actual selling price is $5,000 with an additional $300 added for freight and delivery charges and $240 for State sales tax. Further suppose that the Service publishes a 75-percent rule for section 4216(b)(1) upon its amendment by this bill. To compute tax under the bill, the manufacturer would multiply $5.000 by 75 percent by $\frac{1}{11}$ to determine the tax due.

The example points out that the actual selling price of the article is not the invoice price for the article. Inevitably, there are charges made to the customer which are not part of the selling price of the article, such as, for example, any retail sales tax or use tax imposed by a State, charges rendered to the customer to register or license the trailer, freight or delivery or "make ready" charges for the unit where the article is sold f.o.b. plant, et cetera. See, for example, Rev. Rul. 56–335, C.B. 1956–2, 1006.

Moreover, there may be instances where, in the sale of a taxable article, another article is an integral part of such taxable article, but is specifically exempt from tax by law. For example, cold storage trailers, known as reefers are often sold with built-in refrigeration units. In that situation, the Internal Revenue Service is called upon to recognize that there are basically two articles being sold, one taxable and one nontaxable, and the "actual selling price" must be the actual selling price only of the taxable article itself and not any part of a tax-exempt component. See, for example, *Thermo King Corp.* v. *United States*, 354 F. 2d 242 (Ct. Cl. 1966).

Presently, the Service has determined that the proper discount for our industry is 25 percent off the established retail price. The Internal

Revenue Service is currently reviewing this percentage and may promulgate a new percentage, if this bill is enacted. Once it promulgates a percentage, the industry will be able to determine, as to each and every retail sale that it makes, exactly what excise tax should be charged to the customer when selling a truck or trailer body or chassis at the time of sale.

We would like to make two points to close our written presentation. First, the sponsor of H.R. 1337, Mr. Steiger, said in his floor statement, when the bill was brought before the House:

> In addition, special rules are provided where articles are not sold to wholesale distributors. Thus, for example, where a manufacturer sells a taxable article only at retail, the excise tax is based upon a constructive sale price which is equal to the lower of, the price at which the article was sold, or the highest price at which such article is sold to wholesale distributors by other manufacturers. The Treasury Department is authorized to determine the price at which articles are sold by other manufacturers.
>
> The Internal Revenue Service has ruled that in cases where a manufacturer sells only at retail, the price at which articles are sold by other manufacturers is considered to be 75 percent of the price at which the manufacturer in question sold at retail. (See Cong. Rec., May 16, 1978, H. 3978 and H. 3979.)

We believe he intended to say the bill applied only to retail sales, not to manufacturers who sold only at retail. At least since 1964, in private letter rulings, the Internal Revenue Service has held that a manufacturer may use the retail method for computing his constructive sales price where he sells the same article at retail and to retailers. Thus, we wish to underscore the fact that, a company such as Fruehauf, selling both to retailers and at retail, is entitled to use the retail method.

Finally, it will be some time before the Internal Revenue Service promulgates a regulation dealing with what the new percentage, if any, will be for 4216(b)(1), as amended. During that interim period, we assume that the 75-percent rule of Revenue Ruling 54-61 will apply. If the Service decides to raise the percentage, current law would require that the higher percentage be made prospective in effect.

Section 1108(b) of the Revenue Act of 1926 provides, in pertinent part:

> "No tax shall be levied, assessed, or collected on any article sold or leased by the manufacturer if at the time of the sale or lease there was an existing ruling, regulation or Treasury decision holding that the sale or lease of such article was not taxable, and the manufacturer, parted with possession or ownership of such article, relying upon the ruling, regulation or Treasury decision. (See, *Cory* v. *Sauber*, 363 U.S. 709 (1960) at 717 (note 2).)

This limitation prevents the retroactive imposition of tax if a manufacturer relied on a ruling and did not pay tax on an article. It has been recognized to apply continuously to all excise taxes imposed upon manufacturers under the 1954 Internal Revenue Code. (See Rev. Proc. 72-3, C.B. 1972-2, 698.)

The Supreme Court recognized its continuing efficacy as recently as 1960 in *Cory* v. *Sauber*, supra, as did the U.S. Court of Claims, in *International Business Machines Corporation* v. *United States*, 343, F. 2d 914 (Ct. Cl. 1965). Because manufacturers will part with possession of their goods in reliance upon the 75-percent test of Revenue Ruling 54-61 and Revenue Ruling 68-519, a change of the percentage which increases tax liability will have to be prospective in effect, because we assume that a higher percentage will increase the excise tax burden.

Thank you for the opportunity to submit this statement.

Senator BYRD. At this point in the current proceedings, I will ask the official reporter to put Senator Dole's statement at the appropriate place in the record. At the completion of testimony on H.R. 8535, the Chair announced, at that time, that the committee would also consider simultaneously an identical bill by Senator Dole, S. 2153. The Chair noted at the time that Senator Dole was detained at another meeting. Senator Dole is here now and, Senator Dole, if you have any comments you would like to make on that legislation, this would be the appropriate time at which to do it.

Senator DOLE. I will not take the time of the committee. I know there are a number of witnesses who have come long distances. I was detained in a visit with Howard Jarvis, the originator of Proposition 13.

I do have a statement I would like to have made a part of the record following the statement of Dr. John Hill. I think the bill is self-explanatory. It has wide support in the House, and I will not detain the committee further.

Senator BYRD. Thank you, Senator Dole.

Mr. Hazelwood?

STATEMENT OF JOHN A. HAZELWOOD, ESQ., ON BEHALF OF BRENNER TANK, INC., ACCOMPANIED BY DAVID H. BRENNER, PRESIDENT

Mr. HAZELWOOD. I am John Hazelwood and am a lawyer from Milwaukee. We represent Brenner Tank. Brenner Tank is a small company in Fond-du-Lac, Wis., with about 190 employees and $10 million in sales.

We represent the other end of the spectrum in this industry, the small manufacturers, compared to Fruehauf, who is a large manufacturer.

We are here in support of 1337. It is very important to us. We have given the committee a brochure [1] which shows the type of product we are in: Tanks, truck-mounted tanks, tank trailers. Historically, most of them have been used for hauling milk.

Under the existing law, section 4216(b)(1)(A) of the excise tax code, the Internal Revenue Service has the authority to set up a constructive wholesale selling price for manufacturers selling at retail in order to create substantial equality between them and those who sell at wholesale. This is the so-called percentage rule, and in the 1950's, the service adopted a 75 percent rule under which a manufacturer selling at retail computes his constructive wholesale selling price supply by multiplying 75 percent times his normal retail price.

This assumes more or less a 25-percent markup.

We have no objection to the 75 percent rule or even a higher percentage. It is simple to apply and fair within the group. However, the Internal Revenue Service did not leave well enough alone back in those 1950 rulings and added some "but if" type language which denies to manufacturers in the group the right to the 75 percent rule if their costs exceed 75 percent of the retail price.

This is the so-called cost-floor doctrine and the proposed legislation would eliminate it and further simplify the computation.

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[1] The brochure was made a part of the committee file.

Now, in our industry, virtually everybody's costs exceed 75 percent, so what has happened over the years is that the cost-floor doctrine ceased to become the exception to the rule and become the rule itself.

Now, at first blush, computing excise taxes based on costs would appear fair and simple, but there are several reasons why this is not the case.

First of all, cost is not an easy term to define and the IRS's definitions have only made it worse. All in all, it is an administrative nightmare for both the Service and the taxpayer.

Second, the excise tax is a transactional tax whereby each separate sale is separate and distinct. Now, our costs vary from item to item, even making the same product. Under the cost-floor doctrine, it is impossible to compute the exact tax payable at the time of the sales contract.

If the manufacturer undercharges the excise taxes, he pays the deficiency when the Internal Revenue Service audits. If he overcharges it, he cannot get the money back without the customer's consent, and then the customer gets the money back.

It's a heads, the IRS wins; tails, the customer wins situation. In either event, the manufacturer is harmed.

Finally, in a competitive industry like we are in, the cost floor doctrine becomes a regressive income tax. The higher cost, lower profit manufacturer pays excise taxes that are higher than does the lower cost, higher profit company. It is a classic regressive income tax.

Now, we should not be complaining because we are reasonably cost-efficient here, but the administrative headaches are far worse to us than the few advantages.

Gentlemen, we urge the passage of H.R. 1337 under the new statute by adjusting the percentage level. The Treasury should not incur a revenue loss. The unfair and regressive cost-floor rule imposed by the ruling would be eliminated, and finally, manufacturers who sell at retail would have certainty as to amount of tax in advance of sale.

Now Mr. Brenner would like to make a couple of remarks, if that is okay.

Senator BYRD. Did you say that there would be no cost to the Treasury under this proposal?

Mr. HAZELWOOD. There is absolutely no reason why this should cost the Treasury a dime. As a matter of fact, they should make money on this proposition.

Senator BYRD. Mr. Brenner?

Mr. BRENNER. Mr. Chairman, thank you for letting us appear. In light of all of the previous testimony, I will make my remarks as brief as possible.

A small business has an extreme difficulty in coping with the various IRS men and the individual IRS rulings put forth on Federal excise tax. Because our profits are relatively small, it is very difficult for us to do extensive planning for the future with the fear that the IRS men can come in and completely refigure our Federal excise tax payments retroactively perhaps three years or more, based on the cost floor doctrine.

When the IRS audits our excise tax payments, if there are additional payments to be made, we have to pay them. If we have overpaid

our excise tax, we cannot get the money back from the IRS without the consent of the customer and then he gets the money.

We try to live by the excise tax rules, but they are so complicated and inconsistent that we live in a constant fear of an IRS audit whereby the IRS wins and, tails, we lose.

A case in point. Last Friday we were just going over some cost figures on some special tanks we just finished building for Coca-Cola. Now, this is a very competitive account.

On two of these tanks we actually lost money due to variance in labor hours. You can see in the back of our brochure we are in manufacturing and our labor hours will vary in a plant considerably, based upon whether it is Monday morning or Friday afternoon, whether it is 95° in the shade, or whether we have to rework for quality control.

Now, on the two tanks that we actually lost money, under the cost floor doctrine our company would be penalized another $400 in excise tax. The Federal excise tax would increase from $1,400 normally paid to $1,800 per tank on the cost floor doctrine.

Now, what kind of a deal is it when you kick a man when he is down and charge him more tax because he lost money than you would have charged him had he made a profit?

We are aware that it takes taxes to run the Government, the same way it takes money to run a business. We do not propose that the Government reduce the total amount of excise taxes paid, including excise taxes paid by us. We do not even argue with the percentage base at which the Commissioner sets the wholesale rate.

We ask two things. We want certainty in advance as to the total amount of the Federal excise tax due and uniformity and nondiscrimination—meaning, we do not want a regressive tax situation resulting from the application of the cost floor doctrine in which the less profit we make, the more tax we pay.

Thank you very much.

Senator BYRD. Is my understanding correct that the elimination of the cost floor method for computing the excise tax would in effect follow the current legal interpretation of section 4216(b) of the Internal Revenue Code?

Mr. HAZELWOOD. I believe that is the case. There are some cases that uphold that. There is a case in the Federal district court, I think, in Pennsylvania called Quaker City which supports that. There is a case that I think is distinguishable in the eighth circuit—it escapes my mind what it is called—that might go the other way.

But I had some litigation involving this matter for Brenner Tank that subsequently has been settled some time ago and I was convinced we were going to win that case on the merits, and I think the Justice Department was convinced as well, and that is the reason why they basically gave up on the case.

I think it is the current law.

Senator BYRD. How many companies would be affected by this legislation?

Mr. HAZELWOOD. I think probably the representatives from Fruehauf can say, probably as well as anybody.

Mr. COMBS. Well, this affects the entire truck-trailer industry and I hate to hazard a guess in terms of the total number of companies in the industry because it ranges in size from a small company that

manufacturers one trailer in the back of a garage to a company of our size. Let me just use a figure of 200 to 250 companies.

In addition, this will have an impact on a number of small companies in the truck body and truck equipment industry who are also subject to the same cost floor. And just to go forward with the discussion of cost floor, there is no support in 4216(b)(1) for a cost floor. It is entirely a creation of the Internal Revenue Service, and I agree with Mr. Hazelwood entirely in terms of its lack of legal basis.

Senator BYRD. Thank you very much.

Senator Curtis?

Senator CURTIS. I have no questions, because we have a long list of witnesses, but I think you established your points and I am glad you were here. Thank you for your time.

Mr. HAZELWOOD. Thank you very much.

[The prepared statement of Mr. Hazelwood follows:]

STATEMENT OF JOHN A. HAZELWOOD

Mr. Chairman: I am a lawyer with the Malwaukee law firm of Quarles & Brady, and I am here representing Brenner Tank, a Wisconsin corporation, with approximately 190 employees.

David Brenner, the president of the company, is here with me, and he would like to give the committee some brochures to show the type of business we are in.

Mr. Brenner and I appeared both on August 26, 1976, and September 7, 1977, before the House Subcommittee in support of this legislation. We believe it is important to our company and industry.

In each case, the Truck Body and Equipment Association asked me to announce its concurrence in my statement.

Brenner Tank is a manufacturer of truck mounted tanks and tank trailers. Most of Brenner's tanks are purchased for milk hauling; some are for chemical or other food product hauling. Typical buyers of its products include dairies, farm co-ops and individual milk haulers. Annually Brenner sells between 300 and 400 units.

Most of Brenner's sales are directly to the user of the tank. This is what is called a retail sale. 95 percent of the time Brenner uses no middlemen, but it occasionally does sell at wholesale, to a dealer. This legislation is concerned only with direct retail sales.

A sale of a tank is subject to the 10-percent Federal manufacturer's excise tax. The code section 4216(b) is entitled "Constructive sale price." Subsection (b)(1)(A) relates to sales at retail.

Under the existing statute the Internal Revenue Service has authority to set a constructive wholesale selling price for manufacturers selling at retail in order to create substantial equality between manufacturers selling at retail and those who sell to wholesale distributors. That is the purpose of the basic law. However, in attempting to create this equality, the Internal Revenue Service created an inequality among members of the retail selling group itself, vis-a-vis one another, and also created substantial administrative problems for these taxpayers and the Internal Revenue Service.

Pursuant to various revenue rulings under section 4216(b)(1)(A) the Service adopted the so-called 75-percent rule.[1] Under this rule a manufacturer selling truck bodies at retail computes his constructive wholesale price by multiplying 75% times his normal retail price. For example, if the normal price of a tank is $10,000, the computed wholesale base is $7,500 and the excise tax would simply be computed by multiplying 10% times $7,500 or $750.

Now we have no objection to the 75-percent rule or even to a higher percentage. It is simple to apply and fair to all within the group. The problem here is that the Internal Revenue Service could not leave well enough alone and added some "but if" type language in the ruling which denies to manufacturers in the group the right to use the 75-percent rule if their "costs" exceed 75% of the retail price. This is the so-called "cost floor doctrine," and the proposed legislation

[1] For example, Rev. Rul. 54-61, 1954-ICB 259 and Rev. Rul. 68-519, 1968-2CB 513.

would eliminate it and further simplify the computation of the excise tax payable on each sale.

Most tank and truck body manufacturers' costs exceed 75% of the ultimate retail price. Accordingly, the cost of each item they sell under the revenue ruling then becomes the tax base of the item. Ironically here the higher the cost and, therefore, the lower the profit margin, the higher the excise tax payable. For example, in a competitive industry a given size tank might sell for $10,000 without the tax. Manufacturer A's cost is $7,500 to make and sell it. His gross profit is $2,500, and he pays an excise tax of $750. B's costs are $9,000, his gross profit is only $1,000 and yet his tax is $150 higher than A's or $900 for a sale of exactly the same tank.

On a tax included basis, A's price would be $10,750 and B's would be $10,900. This is a very competitive industry. One loses orders for a $25 differential. Since B has a higher excise tax, he is forced to cut his margins even further, and the regressive nature of this tax becomes doubly vicious as it cuts further into his already narrow profit margin.

Our study of the legislative history of section 4216(b)(1)(A) indicates that Congress never intended the Treasury to have the power to tax one competitor on a percentage of selling price basis and the other one on cost. One court has agreed with us. We believe that the proposed legislation confirms the correct interpretation of the current law.

Gentlemen, there is another equally serious problem involved here, both for the maunfacturers and the Internal Revenue Service. The cost floor doctrine is a giant administrative headache. The term cost is extremely difficult to define and determine.

The excise tax is a transactional tax; each sale is separate and taxable. At the time of the sale and collection of the tax from the buyer, a manufacturer often does not know what his precise cost is. He especially does not know his exact costs when he bids the job. Two years later when the Internal Revenue Service audits his excise tax return, long and expensive disputes can arise between the manufacturer and the agent as to what constitutes cost. In fact, the Internal Revenue Service itself is not sure what constitutes "cost" and has issued conflicting and confusing opinions here. Costs not only vary from manufacturer to manufacturer, they vary from item to item especially when the items are built on individual order.

You should be aware that the manufacturer is caught in a heads the customer wins, tails the Internal Revenue Service wins situation if he is wrong about his excise tax computation. If he overcharges excise taxes to a customer, he can only get the refund back with the customer's consent—and usually the customer gets the refund. If he undercharges, the Internal Revenue Service collects the added amount due directly from the manufacturer. In either even the manufacturer loses.

Gentlemen, please believe our objective here is not to pay less excise taxes. Of course we would like to have the excise taxe repealed entirely because it increases the cost of our product, but we are realistic. What we do want, however, is a simple, fair rule applicable to all within the industry.

Under the proposed legislation the Internal Revenue Service would study each industry, as it is required to do under existing legislation, and would set a fixed percentage which all manufacturers selling at retail within that industry would use to compute their excise tax base regardless of their individual costs. For example, the Internal Revenue Service might determine that the constructive price at which manufacturers would sell tanks to wholesale distributors would be, say, 85% of the actual retail selling price. Maybe in some cases 85% would be too high and in other cases it would be too low. Nevertheless 85% would then become applicable for the entire industry. Each time a manufacturer sold his product at retail, he would simply multiply the actual selling price times 85% and then multiply the result times the excise tax rate. This is a simple calculation.

It is important that the Committee Reports reflect that this calculation be made based on the *actual* retail selling price of the article involved as opposed to any average or computed selling price. The bill uses the words "actual selling price." The intention is simplicity. For example, if a manufacturer sells at retail a tank for $10,000 and the percentage rate is 85%, the tax would by $850. If the manufacturer cuts his price by $100 to get that order, the resulting tax would similarly decrease by $8.50. Similarly, if he raises his price by $100, the resulting tax would increase by $8.50.

Gentlemen, we urge the passage of H.R. 1337. Under this statute by adjusting the percentage levels, the Treasury should not incur a revenue loss. The unfair

and regressive cost floor rule imposed by the Internal Revenue Service would be eliminated and finally manufacturers who sell at retail would have certainty as to the amount of tax to be collected in advance of the time of sale. Thank you very much.

Senator BYRD. The next witness will be Mr. Abraham Tunick, representing Wine and Spirits Wholesalers of America, Inc., and Mr. John F. White, executive vice president, National Beer Wholesalers Association of America.

STATEMENT OF ABRAHAM TUNICK, WINE AND SPIRITS WHOLESALERS OF AMERICA, INC.

Mr. TUNICK. Mr. Chairman and members of the committee. My name is Abraham Tunick and I am Washington counsel for Wine and Spirits Wholesalers of America, the national trade association representing more than 816 independent distributors of alcoholic beverages doing business in 37 States, the District of Columbia, and the Virgin Islands.

My testimony this morning is not only on behalf of WSWA but also on behalf of every major national trade association representing every segment of the alcoholic beverage industry including the National Alcoholic Beverage Control Association which represents the 18 control States—that is to say those States in which the State itself is actually engaged in the sale and distribution of alcoholic beverages at either or both wholesale and retail. Such States as your own State, Mr. Chairman, Virginia; Ohio, Pennsylvania, Michigan, Oregon, and Wyoming.

We support the enactment of H.R. 1920 and respectfully urge that your subcommittee report it favorably and that the bill be speedily enacted.

H.R. 1920 provides, in substance, for a refund of tax and duty on liquors held for resale which are destroyed as a result of fire, flood, casualty or damage resulting from vandalism or malicious mischief if the claimant is not otherwise indemnified. Theft is excluded.

In order to minimize the impact on revenue, the bill provides that before a claim is eligible for refund, the amount of the tax loss must be at least $250 and in order to avoid any undue administrative burden—the loss must be as a consequence of a single occurrence, thereby eliminating cumulative losses.

I think the committee would be interested in a translation of what $250 in tax means in terms of quantity. For example, for distilled spirits, it would mean 12.4 cases of fifths at 80 proof. Fortified wines—that is wines over 14-percent alcohol—155.5 cases of fifths. For table wines—wines under 14 percent of alcohol—612.7 cases of fifths. And for beer, 382.8 cases of 24 12-ounce cans.

So we are not talking about a de minimus situation. We are not talking about a casual or insignificant loss.

At present, the only circumstances under which wholesalers control States and retailers receive a refund as a consequence of losses such as those described in this bill, would be losses sustained as a result of a Presidentially declared major disaster.

The Ways and Means Committee in its report recognizes that a void exists in this area and that corrective action is needed. Implicit in their report is a recognition of the fact that where a loss occurs to a

holder of tax-paid liquor under the circumstances mentioned, that loss is as great as though the loss had occurred as the result of a Presidentially declared disaster.

Congress, over the years, has recognized this equitable concept. Special enactments were passed to cover losses resulting from the floods of 1936, 1937, and 1951 and the hurricane of 1954. Finally, in 1958, the Congress enacted the major disaster provision which requires a Presidential declaration.

It was never intended that the burden of the tax should be borne by anyone other than the ultimate consumer.

The equity of the concept of this bill is further supported by the fact that when a Federal excise tax is increased, a floor stock tax is levied on every gallon of tax-paid alcoholic beverage held for resale at every level. Thus Treasury recognizes that while liquors are held for resale, they remain within the competence of its taxing authority. Conversely, where those tax-paid liquors are destroyed fairness and equity require that there should be a refund of the tax and duty.

If I may take just 1 more minute, Mr. Chairman, the impact on revenue would be minimal. The Ways and Means Committee in its report recognizes this fact and the Treasury concurs in the estimate of the Ways and Means Committee.

Senator BYRD. Thank you, Mr. Tunick.

Mr. TUNICK. One further sentence, Mr. Chairman.

I just want to disspell any notion that the relief afforded by this bill extends only to the industry members in the private sector. On the contrary, every one of the 18 control States are direct recipients of the exact same type of relief as is afforded to every other holder of tax-paid liquor.

I thank you, Mr. Chairman.

Senator BYRD. Thank you, Mr. Tunick.

This proposal has been criticized by some as creating an insurance policy for liquor distributors and as being unfair for sellers of other types of merchandise on which an advance tax is paid.

How do you respond to that criticism?

Mr. TUNICK. If the provisions of this bill are characterized as insurance, then I must submit that every other refund provision which is presently in the Code is likewise an insurance provision, including the major disaster provision.

At the present time, the Code specifically provides for refunds of tax and duty in limited and varied degree for losses resulting from some of the perils described in this bill to distillers, importers, and brewers and proprietors of bonded wineries.

As a matter of fact, the Code with respect to losses sustained by brewers as a result of fire, theft, casualty or act of God provides specifically that those tax losses are refundable—provided that the brewer has not transferred title.

As 1970, the code was amended to include theft as one of the perils covered, and the Treasury Department supported the enactment of that change. Losses resulting from theft are excluded under H.R. 1920.

Senator BYRD. How often do events that are covered by this bill occur?

Mr. TUNICK. Very infrenquently, sir. If the estimate of the Ways and Means Committee—and I say that was concurred in by the Treasury—is any indication, the date of the committee report was April 5 and they estimated that for the balance of fiscal 1978, the loss would be less than $100,000. For the remaining years, the estimate was $500,000 per year.

May I say at this point that the revenue generated by the excise tax and other related imposts on alcoholic beverages for fiscal year 1977 was over $5,193,000,000. At this point, if I may, Mr. Chairman, inadvertently in my prepared statement at page 6, I refer to calendar year when I show the estimated revenue. It should be fiscal year, and I trust that will be corrected.

Senator BYRD. That will be corrected, as you request.

Mr. White, do you have any additional information to give to the committee?

Mr. WHITE. Yes, sir, I do.

STATEMENT OF JOHN F. WHITE, EXECUTIVE VICE PRESIDENT, NATIONAL BEER WHOLESALERS' ASSOCIATION OF AMERICA

Mr. WHITE. Mr. Chairman and members of the subcommittee, I am John F. White, executive vice president of the National Beer Wholesalers of America, NBWA. I would like to thank you for giving NBWA an opportunity to appear before you today in support of H.R. 1920.

I would like to introduce our Washington counsel, Mrs. Cathleen Douglas.

NBWA is a national trade association comprised of approximately 2,000 independent distributors of beer products doing business in all States of the United States, the District of Columbia, and the Virgin Islands. These small often family owned and operated enterprises, are responsible for marketing the various brands of beer sold in this country.

Most of our members do business in an area embracing one or more counties. Few do business in more than one State. Most serve their retail customers from a single warehouse facility utilizing a fleet of delivery vehicles sometimes driven by the owner themselves.

If adopted, H.R. 1920 would amend the Internal Revenue Code to provide the tax refund on the excise tax paid on beer, wine, and liquors lost or rendered unmarketable as a result of fire, flood, casualty, or other disaster or breakage, destruction or damage, excluding theft resulting from vandalism or malicious mischief while such products are held for resale by the wholesaler.

Currently, the Internal Revenue Code provides such a rebate only in the event of a Presidentially declared disaster, IRS Code 50-64.

H.R. 1920 merely seeks to apply the same relief to victims of disasters which do not constitute major disasters. After all, it matters little to the individual wholesaler who happens to suffer the loss whether it is caused by a major or minor disaster.

There are a number of reasons H.R. 1920 should be passed, but I shall concentrate on only four of them.

First, it should be passed because it addresses a real problem faced by beer wholesalers.

Second, H.R. 1920 will assist the small businessman and not significantly reduce Federal tax revenues.

Third, the terms of H.R. 1920 are consistent with the intent of Congress to impose an excise tax on alcohol products that are consumed or sold.

Finally, H.R. 1920 will not impose a significant administrative burden on the Treasury Department.

Disasters such as those covered by H.R. 1920 do occur. For instance, on March 25, 1975, a tornado hit the Atlanta area. Its path traveled directly through the All State Beer Co. of Atlanta, Ga. It destroyed All State's entire warehouse except for a portion of its small office area.

While the tornado effectively destroyed All State Beer Co. warehouse, it did not cause enough damage in the region surrounding the warehouse to constitute a Presidentially declared disaster.

No relief was available through the Federal Government on the excise tax paid by All State's president Robert Randolph on the over 2,000 cases of product that he would never be able to sell. In addition, no relief was then available to All State under State law.

I am delighted to report that the Georgia Legislature subsequently passed a bill that granted Georgia beer wholesalers a refund of State excise taxes in this type of situation.

Because the problem is real, most, if not all, beer wholesalers insure their inventories against loss including the loss of sums expended for the excise tax. In the ordinary case, then, the savings of the beer wholesaler would be gained by the passage of H.R. 1920 is the amount paid by him annually for the purchase of inventory insurance. In the case of the very small beer wholesaler, the savings would amount to $1,000 to $1,200 annually.

Although that might appear on the surface to be a small savings, it is a considerable savings to the small beer wholesaler. His cost of doing business has increased 8 to 10 percent while the price of his product has increased at a far smaller rate.

I have, of course, referred to the plight of our members during the course of this testimony but, as the committee is aware, added and nonessential costs are passed, of necessity, by the businessman to the consumer in the form of higher prices. The passage of 1920, then, will ultimately benefit the consumer.

NBWA respectfully urges that H.R. 1920 be reported favorably by this committee and that it be speedily enacted.

Senator BYRD. Thank you, Mr. White.

Senator Packwood?

Senator PACKWOOD. No questions.

Senator BYRD. Senator Dole?

Senator DOLE. What is the total revenue loss?

Mr. TUNICK. The total revenue loss estimated by the Ways and Means Committee for the balance of fiscal 1978 was less than $100,000—less than $100,000. For each succeeding year, $500,000.

Senator DOLE. This bill seems to be reasonable, which means you may have difficulty.

Mr. WHITE. I thank you, Senator Dole.

Senator BYRD. Thank you, gentlemen. Thank you Mrs. Douglas.

[The prepared statements of the preceding panel follow:]

STATEMENT OF ABRAHAM TUNICK ON BEHALF OF WINE & SPIRITS WHOLESALERS OF AMERICA, INC., NATIONAL ALCOHOLIC BEVERAGE CONTROL ASSOCIATION, INC., DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC., NATIONAL ASSOCIATION OF ALCOHOLIC BEVERAGE IMPORTER, INC., WINE INSTITUTE, NATIONAL LICENSED BEVERAGE ASSOCIATION, NATIONAL LIQUOR STORES ASSOCIATION, INC., UNITED STATES BREWERS ASSOCIATION, INC., NATIONAL BEER WHOLESALERS ASSOCIATION OF AMERICA, INC., AND STATE BEER ASSOCIATION EXECUTIVES OF AMERICA

Mr. Chairman and Members of the Subcommittee: I thank you for giving us the opportunity to appear before you today to express our views on H.R. 1920.

My name is Abraham Tunick and I am Washington Counsel for Wine and Spirits Wholesalers of America (WSWA), a national trade association comprised of 816 independent distributors of alcoholic beverages doing business in 37 states, The District of Columbia and the Virgin Islands.

This statement is presented on behalf of WSWA and the following national trade associations representing virtually every segment of the alcoholic beverage industry:

National Alcoholic Beverage Control Association, Inc.; Distilled Spirits Council of the United States, Inc.; National Association of Alcoholic Beverage Importers, Inc.; Wine Institute; National Licensed Beverage Association; National Liquor Stores Association, Inc.; United States Brewers Association, Inc.; National Beer Wholesalers Association of America, Inc.; and State Beer Association Executive of America.

We support the enactment of H.R. 1920 and respectfully urge your Subcommittee to report the bill favorably.

H.R. 1920 would amend the Internal Revenue Code to provide for a refund of tax and duty on liquors lost or rendered unmarketable as a result of fire, flood, casualty or other disaster, or breakage, destruction or other damage (excluding theft) resulting from vandalism or malicious mischief while such liquors are held for sale, provided the claimant is not otherwise indemnified.

At present, the Internal Revenue Code limits the refund of tax and duty on alcoholic beverages lost or rendered unmarketable to losses sustained by wholesalers, control states and retailers as a result of a major disaster declared by the President.

The reasons for the enactment of H.R. 1920 are cogently expressed in the Ways and Means Committee report as follows:

"Prepaid excise taxes constitute a high proportion of the cost of alcoholic products, as compared with excise taxes on other products. The tax on the production of distilled spirits is $10.50 per gallon; the beer tax generally is $9 per barrel (equivalent to about 29 cents per gallon); and the wine tax ranges from 17 cents to $3.40 per wine gallon (depending upon the type or alcholic content of the wine).

"Accordingly, if alcoholic products held for sale are destroyed after taxes and duties have been paid, a large portion of the loss will be attributable to prepaid taxes which cannot be passed on to consumers.

"Under present law, the Treasury can make payments for such taxes and duties only if the cause of loss is a Presidentially declared major disaster. The committee believes that there are certain circumstances which, while not constituting such a major disaster, can likewise result in substantial losses of distilled spirits, wines, rectified products, or beer. The committee has concluded that losses of such products caused by fire, flood, casualty, or other disasters, or by vandalism or malicious mischief (not including theft), should be given the same treatment with respect to tax and duty repayments as is now accorded to losses of such products caused by Presidentially declared major disasters."

Implicit in the Committee's report is the recognition that a void exists in this area and that the corrective action provided by this bill is fair and equitable.

If it is suggested that the enactment of this bill would place those holding alcoholic beverages for sale in a preferred position insofar as their risks from casualty losses are concerned, we respectfully submit that this contention is wholly without merit. The Congress had determined many years ago and has consistently recognized that when taxpaid liquors are destroyed or lost while being held for resale, equity and fairness require that the seller sustaining the loss should have the tax and duty refunded if he is not otherwise indemnified. It was never intended that the burden of the tax and duty on liquor should be borne by anyone other than the ultimate consumer.

More specifically, this equitable concept finds expression in the separate enactments to cover such losses resulting from the floods of 1936, 1937, 1951 and the

hurricane of 1954. To eliminate the necessity of special enactments to cover such situations, the Internal Revenue Code was amended in 1958 to provide for tax refunds on a continuing basis on liquors lost or rendered unmarketable as a result of a major disaster declared by the President.

The principle of tax refunds for losses other than those covered by a Presidentially declared major disaster resulting from most of the same causes as those covered in H.R. 1920 has been extended in varying and limited degree to distillers, brewers, proprietors of bonded wineries, tobacco manufacturers, importers and export warehouse proprietors. However, as previously indicated, control states, wholesalers and retailers receive no tax relief whatever on liquors lost or destroyed while being held for resale unless such losses occur as a consequence of a Presidentially declared major disaster. If enacted, the amendment will not only grant long overdue relief to control states, wholesalers and retailers, but every other segment of the industry will also benefit from the extension of the circumstances under which tax refunds may be made for liquor losses.

At the risk of repetition, I would like to dispel any notion that the only beneficiaries under this bill are industry members in the private sector. On the contrary, the 18 control states in which the state is actually engaged in the sale and distribution of alcoholic beverages at wholesale and/or retail are also direct recipients of the relief afforded under the bill.

If it is contended that the government should not act as an insurer of the internal revenue tax and customs duties on alcoholic beverages since they form part of the value of the dealer's inventory, and to do so would be to grant an exception to those holding alcoholic beverages for resale, we submit that that contention likewise is wholly without merit. In its report on H.R. 1920, the Committee on Ways and Means acknowledges that a high portion of the cost of alcoholic products is attributed to prepaid taxes and duties. As we have previously stated, the rationale for legislation granting tax refunds on taxpaid liquors lost or destroyed while being held for resale is based on the principle of equity and fairness, and is intended to prevent unjust enrichment on the part of the government. The Congress has consistently adhered to this policy. If there were any merit in characterizing this type of legislation as "insurance" of tax and duty, then each of the Congressional enactments referred to above, including Section 5064, which provides for refund of taxes and duty on losses sustained as a consequence of Presidentially declared major disasters, are by their very nature an insurance of the tax and duty, provided the holder is not otherwise indemnified. Far from granting a special exception to those holding liquors for resale, H.R. 1920 is a reasonable and logical extension of the equitable concept which Congress has adopted and implemented for many years.

In our judgment, the administration of H.R. 1920 would pose no problem. The Bureau of Alcohol, Tobacco and Firearms has promulgated regulations regarding proof of loss under existing refund provisions and those regulations have fully protected the revenue and the government's interests. We respectfully submit that if H.R. 1920 is enacted, appropriate regulations will be issued by BATF which will accomplish both purposes.

We would also point out that in all cases the burden of establishing proof of loss must be sustained by the claimant.

The equity of the proposed amendment is further supported by the fact that whenever the federal excise tax has been increased, a floor stocks tax has been levied on every gallon of taxpaid liquor held for resale at every level. Thus, the government recognizes that while liquors are held for resale, they remain within the competence of its taxing authority. Conversely, when such taxpaid liquors held for resale are destroyed, fairness and equity require that there should be a corresponding obligation on the part of the government to refund the tax and duty paid on such liquors.

If the amendment is enacted it will save for the 18 control states and the entire industry in excess of 50 percent of the insurance premiums paid on distilled spirits for this type of coverage since tax and duty represent that percentage of value on which the premiums are based. The insurance savings on the other types of alcoholic beverages will be proportionately less, but substantial in total, nevertheless.

For the calendar year 1977 the alcoholic beverage industry generated federal revenue from excise and other taxes directly related to alcoholic beverages estimated in the sum of $5.193.770,232. It is anticipated that the amendment would have an insignificant effect on the revenue, because of the rigid limitations im-

posed on the filing of such claims. It is proposed that no claim would be eligible unless the tax and duty of such liquors lost amounts to $250 or more. Additionally, such loss must have resulted from a single disaster, thus avoiding claims for cumulative losses. These limitations will also avoid any undue administrative burden on the government.

The Ways and Means Committee in its report on H.R. 1920 recognizes the minimal impact on federal revenue resulting from its enactment and the Committee's estimate is concurred in by the Treasury Department.

Finally, every dollar saved by the industry (other than the control states) in insurance premiums covering these losses will be eliminated as a deductible business expense. This income tax offset would further lessen the impact on the revenue expected to result from the enactment of this amendment.

We respectfully urge that H.R. 1920 be reported favorably and that it be speedily enacted.

Statement of John F. White, Executive Vice President, National Beer Wholesalers' Association of America

Mr. Chairman and members of the Subcommittee, I am John F. White, Executive Vice President of the National Beer Wholesalers' Association of America (NBWA). I would like to thank you for giving NBWA an opportunity to appear before you today in support of H.R. 1920. NBWA is a national trade association comprised of approximately two thousand independent distributors of beer products doing business in all states of the United States, the District of Columbia and the Virgin Islands. These small, often family-owned and operated enterprises are responsible for marketing the various brands of beers sold in this country. Most of our members do business in an area embracing one or more counties. Few do business in more than one state. Most serve their retail customers from a single warehouse facility utilizing a fleet of delivery vehicles sometimes driven by the owner himself.

I. What H.R. 1920 would accomplish

If adopted, H.R. 1920 would amend the Internal Revenue Code to provide a tax refund on the excise tax paid on beer, wine, and liquors lost or rendered unmarketable as a result of fire, flood, casualty, or other disaster, or breakage, destruction, or other damage (excluding theft), resulting from vandalism or malicious mischief while such products are held for resale by the wholesaler.

Currently, the Internal Revenue Code provides such a rebate only in the event of a Presidentially declared disaster (IRS Code, § 5064). H.R. 1920 merely seeks to apply the same relief to victims of disasters which do not constitute major disasters. After all, it matters little to the individual wholesaler who happens to suffer the loss whether it is caused by a major or minor disaster.

II. Why H.R. 1920 should be passed

There are a number of reasons H.R. 1920 should be passed, but I shall concentrate today on only four of them. First, H.R. 1920 should be passed because it addresses a real problem faced by beer wholesalers. Second, H.R. 1920 will assist the small businessman and not significantly reduce federal tax revenues. Third, the terms of H.R. 1920 are consistent with the intent of the Congress to impose an excise tax on alcohol products that are consumed or sold. Finally, H.R. 1920 will not impose a significant administrative burden on the Treasury Department.

A. H.R. 1920 addresses a real industry problem

Disasters such as those covered by H.R. 1920 do occur. For instance, on March 25, 1975, a tornado hit the Atlanta area. Its path traveled directly through the All-State Beer Company of Atlanta, Georgia. It destroyed All-State's entire warehouse except for a portion of its small office area. While the tornado effectively destroyed All-State Beer Company's warehouse, it did not cause enough damage in the region surrounding the warehouse to constitute a Presidentially declared disaster. No relief was available through the Federal Government of the excise tax paid by All State's President, Robert Randolph, on the over two thousand cases of product that he would never be able to sell. In addition, no relief was then available to All-State under state law. (I am delighted to report the Georgia legislature subsequently passed a bill that granted Georgia beer wholesalers a refund of state excise taxes in this type of situation.)

B. H.R. 1920 will save the hard-pressed small businessman money

Because the problem is real, most, if not all, beer wholesalers, insure their inventory against loss, including the loss of the sums expended toward the excise tax. In the ordinary case, then, the savings to the beer wholesaler that would be gained by the passage of H.R. 1920 is in the amount paid by him annually toward the purchase of inventory insurance. In the case of the small beer wholesaler, the savings would amount to $1,000 to $1,200 annually. That might appear like a small savings to you. It is a considerable savings to the small beer wholesaler. Recently, his cost of doing business has increased eight to ten percent, while the price of his product has increased at a far smaller rate. With the larger beer wholesaler, the savings on insurance costs is, of course, very substantial.

Compare now the substantial savings that the beer wholesaler will experience with the passage of H.R. 1920 against the income the Federal Government receives each year from the imposition of the excise tax on the beer industry. In 1977, 156,500,000 barrels of beer were sold in the United States, an increase of 6,100,000 barrels from 1976.[1] Excise tax on beer is $9.00 per barrel (IRS Code § 5051(1)), thereby providing the United States Treasury with some $1,408,500,000 in income. The House Ways and Means Committee staff estimated in 1977 that the total expected reduction of revenues resulting from the enactment of H.R. 1920 would be $500,000 per annum. Remember, this is the expected reduction caused by the wine, liquor and beer industry combined. It is an insignificant sum to the Federal Government, especially when you realize that the tax is on products that the beer wholesaler was never able to sell to the retailer for public consumption.

Where then do the equities lie? With the beer wholesaler who objects to paying tax on beer that is destroyed or with the legitimate need of government to collect revenues. An analysis of the Internal Revenue Code sections imposing the tax on beer makes it clear the equities lie with the beer wholesaler.

C. H.R. 1920 is consistent with Congress' intent to impose an excise tax only on alcohol consumption and sale

Section 5051 of the Internal Revenue Code imposes an excise tax "on all beer brewed or produced and removed for consumption or sale, within the United States . . ." A careful reading of this section of the Code and those sections which impose a similar tax on liquor and wine makes clear that Congress intended that the excise tax on alcohol be ultimately borne by the consumer of alcoholic beverages. This reading of section 5051 is supported by other provisions of the Internal Revenue Code concerning destroyed products. If beer is destroyed at the brewery, Congress has provided a rebate of the Federal tax to brewers. Any tax paid by a brewer may be refunded or credited to the brewer if the beer is lost or destroyed or otherwise rendered unmarketable "by fire casualty, or act of God" prior to sale (IRS Code § 5056(b)). In addition, any tax paid by a brewer on beer which is returned to any brewery or voluntarily destroyed pursuant to IRS regulation, is also rebated (IRS Code § 5056(a)).

When H.R. 1920 is read with these existing sections, it is seen for what it is—merely another amendment in a chain passed by Congress to insure the excise tax is paid only on products that are sold for consumption.

D. H.R. 1920 will not impose administrative burdens on the Treasury Department

In addition, H.R. 1920 will not impose an administrative burden on the Treasury Department. Rigid limitations are imposed on the filing of claims under H.R. 1920. It is proposed that no claim would be eligible for refund unless the tax and duty on the product with respect to which refund is sought amounted to $250 or more. Such loss must be filed within six months of the occurrence which must result from a single disaster, thus avoiding claims for cumulative losses. The burden of proof is on the wholesaler to prove his loss. Since the Treasury Department already successfully imposes stringent recordkeeping requirements on the beer wholesalers in order to determine the amount of the tax owed by the wholesaler to the government, it would appear they will be able to rely on this same documentation to prove loss.

III. CONCLUSION

During the course of this testimony, I have, of course, referred to the plight of our members. But as the committee is aware, added and nonessential costs are passed of necessity by the businessman to the consumer in the form of higher prices. Passage of H.R. 1920, then will ultimately benefit the consumer.

[1] Beer Marketers Insights, January 30, 1978, p. 1.

NBWA respectfully urges that H.R. 1920 be reported favorably by this committee and that it be speedily enacted.

Has Senator Cranston come in yet?

Senator DOLE. I think he is with Mr. Jarvis.

Senator BYRD. The next panel will consist of Fran Reibman, Lee Coe, and Albert Copp.

You seem to be by yourself.

Mr. COPP. It looks like that. I believe we represent different interests.

Senator BYRD. We now have several witnesses. Each of you had better identify yourself.

Mr. COPP. While they are getting arranged, my name is Albert M. Copp, I live in Baltimore and I represent the American Wine Society.

Ms. REIBMAN. My name is Fran Reibman, I am here representing Vynox Industries of Rochester, N.Y.

Mr. COE. My name is Lee Coe. I am speaking on behalf of a national trade organization and five California home brewers' clubs.

Senator BYRD. I might say that Senator Cranston is interested in this legislation. He is on his way to the committee now. He also has a statement to make, but we will not hold up the hearing until he gets here. You may proceed.

Who is the spokesman for this panel?

Mr. COPP. I believe you will find that there are three different spokesmen. In fact, I did not know we were a panel until we got here in the committee room and saw our names listed as a panel.

STATEMENT OF ALBERT M. COPP, AMERICAN WINE SOCIETY

Mr. COPP. The American Wine Society is a consumer organization working for the improvement of American wines and winemaking. It is a small organization of some 2,000 persons, but it is growing.

It was organized in 1967 in southern New York State. Approximately 70 percent of the membership make wine.

I have been an amateur winemaker for the past 10 years and in each of these years I have dutifully registered my intent to make wine with the Federal Government. At no time in the past 10 years has the Federal Government found it necessary or desirable to visit me or to ask me any questions about my winemaking.

In addition, each year I have entered wine in at least one wine evaluation contest and in several of those years I have been responsible for organizing and conducting various amateur wine contests in the Baltimore area.

It is with humbleness that I appear before you today, for the subject legislation hardly compares with many of the issues before you. However, to people engaged in amateur winemaking, the passage of this legislation is important.

On June 10, 1978, the board of directors of the American Wine Society adopted a position in favor of H.R. 2028 and Senate bill 2930. To the organization, and to amateur winemakers everywhere, it has several benefits.

One, it removes a minor—although important to us—inconvenience to a delightful and growing hobby of amateur winemaking.

Two, it will contribute to an effort to streamline our Government by eliminating Federal regulations that, we believe, have outlived their need.

Three, it will tend to encourage the development of an expanding domestic wine culture and industry in this country.

Amateur winemaking is an important market for the small fruit farmer and businessman. Several people in the Baltimore area, as well as in other parts of the country, have grown from amateur winemakers into small growers and commercial winemakers.

In summary, the American Wine Society feels that the elimination of the registration requirements on amateur winemaking will be beneficial with no adverse effects, and we urge favorable consideration of this legislation by the subcommittee and by the Senate.

Senator PACKWOOD. I have no questions, either. Which of the others are going to go next?

Mr. COPP. Fran, do you want to be next?

STATEMENT OF FRAN REIBMAN, VYNOX INDUSTRIES, INC., ROCHESTER, N.Y.

Ms. REIBMAN. Mr. Chairman and members of the committee, I would like to thank you for the opportunity to testify today. I appear here on behalf of H.R. 2028, which Senator Moynihan has introduced before your committee to amend section 505(3) of Title XXVI of the United States Tax Code to allow for the home production of beer.

I will dispense with a reading of most of my statement and tell you that I understand that Senator Cranston has introduced a similar bill. Now, we have no objection to the bill that he has similarly introduced, providing that the BATF is willing to go along with it.

H.R. 2028 recently passed the House and we understood from the Treasury Department that they did have a problem with the Cranston bill because it lifted all restrictions.

So that, if they have no problem with it, fine with us. Otherwise, we tend to support H.R. 2028.

Senator PACKWOOD. What is Vynox Industries?

Ms. REIBMAN. Vynox Industries manufactures home beermaking and winemaking equipment.

Senator PACKWOOD. Equipment?

Ms. REIBMAN. Yes, sir.

Senator PACKWOOD. I have no other questions.

Go ahead, sir.

STATEMENT OF LEE COE, ON BEHALF OF HOME WINE MERCHANTS ASSOCIATION

Mr. COE. I told you whom I represent. I am, myself, a home brewer and have been one for more than 25 years, so I am speaking from experience.

I want to present, first, the—well, let me put it this way. The subcommittee has had by mail copies of petitions bearing 991 signatures.[1] I have another petition that brings the total to 1,017 and I want to put that in the record with the others that have been mailed to you.

Senator BYRD. Without objection.

[The material referred to follows:]

[1] The remaining petitions were made a part of the committee file.

On March 14, 1978, the House of Representatives passed a bill, HR 2028, that would abolish two present restrictions on home wine-making. But it would also establish three restrictions on home brewing of beer. That is, the bill does not treat beer and wine alike.

Petition

to our U. S. Senators

We ask the U. S. Senate to adopt three amendments to provide equality for home-made beer and wine:

1. The bill would abolish registration for wine-makers, which the sponsor of HR 2028 says "has proven to be of little use to the Federal Government and is burdensome to the public." We ask that registration for beer-makers be eliminated from the bill.

2. We ask elimination from the bill of the limit of 30 gallons of beer in a household at any one time. It provides no such limit for wine. Both beer and wine must be aged for months, so several batches can be around the house even though little is being consumed.

3. We ask annual limits based on the amount of alcohol in beer and wine, not on the amount of water. The present bill would limit both beer-making and wine-making to 100 gallons a year for single-individual households, 200 gallons for larger households. Because beer contains less than half as much alcohol as wine does, we ask limits for beer of 200 gallons and 400 gallons.

With these amendments, the bill would be a good one, establishing controls without unfair restrictions "burdensome to the public."

Name	Address	City	State	Zip
Michael R. Van Dyke	37 Huntington Rd.	Hadley	MA.	01035
Christopher M. Chastain	Randall Rd	Northfield	Mass.	01360
Stefan Meyer	Ox Bow Road	Northampton	Mass.	01060
Russell Bearcroft	RFD#1 Box 99	Ware	Mass	01082
[illegible]	P.O. Box 222	[illegible]	[illegible]	0126[illegible]
Mary S. Lucas	Creamery Rd	Ashfield	Mass	01330
Eleanor Potter	Pleasant St	Plainfield	Ma.	01070
[illegible] Potter	Pleasant St	Plainfield	Mass.	01070
[illegible]	Box 199	Turners Falls	Mass.	
[illegible]	11 Hendrick St	Easthampton	MA	01027
[illegible]	RFD	Conway	MA	01341
[illegible]	251 Pleasant St	Northampton	Mass	01060
[illegible]	522 Coldspring Ave #3B	W. Springfield	MA.	
Matthew Cancelliere	31 Federal St.	Agawam	Mass	
D. Gordon MacLeod	P.O. Box 94	Deerfield	Mass	01342
[illegible]	23 [illegible]	Granby	Mass	01033
[illegible]	22 Lyman Ave	Easthampton	Ma.	01027
[illegible] Lucas	125 Millers Fls. Rd.	Turners Falls	Ma	
Joseph P. Lucas	125 Millers Falls Rd	Turners Falls	Ma	
John W. Woodward Jr.	PO Box 137	Goshen	Mass	
Margaret [illegible]	[illegible] Rd	Amherst		
[illegible]	[illegible]	Hadley	MA	
[illegible]	Sugarloaf St	So. Deerfield	Mass.	
[illegible]	83 [illegible] St	E. [illegible]	Mass.	01027
[illegible]	Corashire Road	Monterey	Mass	01245
Joan H. Brown	Corashire Road	Monterey	Mass	01245

When signed, return to Jim Weathers, vice-president
Home Wine Merchants Assn., 2761 Teagarden St., San Leandro CA 94577

BEST AVAILABLE COPY

Mr. Coe. I have also been asked to put into the record an article on home-brewed beer that appeared in the Los Angeles Times of June 13.

Senator Byrd. Without objection, it will be incorporated in the record.

[The material referred to follows:]

[From the Los Angeles Times, Tues. June 13, 1978]

HOME-BREWED BEER COMES OUT OF THE CLOSET

(By Mark Jones, Times Staff Writer)

Every few months, Ray Sandoval cooks up 25 gallons of home-brewed beer, and though his wife prefers Budweiser they've worked out a satisfactory arrangement. He brews it, she bottles it, he drinks it. She drinks Bud.

The other day Sandoval confessed that, although Prohibition ended 45 years ago, he fantasizes that a pair of gray-suited federal agents will knock at his front door one day, interrogate him about his home brew, then whisk him off.

"Sure, I know the government doesn't give a damn about a guy making a few gallons of beer on the kitchen stove," the San Fernando Valley man said, "but just the same it is *still* illegal to do it in this country."

True enough, the Prohibition-era state and federal laws are still on the books prohibiting beer brewing without a manufacturer's license, but things are changing. Congress and the California Legislature are expected to legalize home brew by the end of summer, thus putting such phrases as "bathtub beer" and "basement booze" back into the language for the first time in a half-century.

And Sandoval can finally put an end to his private fantasy.

Amateur beer makers, of which there may be as many as 3,000 in Southern California—an estimated 100,000 nationwide—are a cautious lot who until the proposed legislation becomes law are naturally reserved about what they do and what they say to strangers.

As one of them said recently, "The crazy thing about the law is that it's so contradictory you can legally buy beer-making books, kits, supplies and equipment, but the law says you can't use them! My conscience is clear, though," he said stiffly, "because at least I don't sell the stuff.

"But please do me a favor and leave my name out of the story. The last thing I want is the Treasury Department snooping around my house."

One day last week the Maltose Falcons, a small and little-known organization of Los Angeles-area beer-making hobbyists, gathered for an unpublicized, members-only meeting in Woodland Hills where they spend the day paying their profound respects to what is believed to be man's oldest fermented beverage.

The men and women members were a mixture of ages and occupations. They share a disdain for domestic beer ("tastes like it's been processed through a horse" complained one of them), a creative desire to concoct beer to their personal taste and a consumer's need to cook a tasty brew for the equivalent of 15 to 25 cents a quart.

The cast of characters that afternoon included:

Orville Byrd, 63, the church deacon's son who as a child drove a bootlegger's truck for date money and who in 1934 tried his hand, he says, at a little basement booze while his father studied the Bible upstairs.

Merlin Elhardt, 55, a utility company lineman who cultivated a taste for German beers during the years the Army stationed him in Europe and who's been brewing quality pilsners for the last four years.

Tracy Grade, 33, a Glendale teacher who said last year she prepared 300 gallons of home-brewed beer and Zinfandel wine and explained that her "sign" (she's a Cancer) dictated that she spend a lot of time working at domestic activities.

Sylvester Tomm, 28, a UCLA doctoral candidate from Britain who says he's been drinking 7% ale since age 14. He's been making beer since he came to this country six years ago.

"Your American beer is all right if you're spending a hot day at the beach and you want something cold, light and refreshing," Tomm said, "but the domestic stuff is really the white bread of world beers and it just doesn't have the rich, malty taste that the best beers have."

Throughout the day the Maltose Falcons (maltose, as in beer malt) huddled around sycamore-shaded picnic tables, sampling chilled home brew in everything from stemmed wine glasses to German steins, nibbling sesame crackers between beers and observing, with a chemist's sobriety, "Hmmmmm, good aroma here * * * yes, yes, a delicate taste, very bitey, too * * * uh-huh, this one has a nice upfront hop flavor and a good malty character * * * excellent, what sort of yeast did you use?" And so on, until the sun disappeared behind the hills.

AN AESTHETIC EXPERIENCE

It was a serious, genteel affair and it was not surprising that everyone was still on his feet at the end of the afternoon. As Jim Brenneman, a Santa Monica College student, explained, "Most of us are into the taste of beer, not the 'buzz.'"

The sponsor of the small beerfest was John Daume, a bearded, accomplished beer- and winemaker in his early 30s and owner of the Valley's Home Winemaking Shop, one of a growing number of such outlets throughout California and the Pacific Northwest (where more home brew is made than anywhere else in the country).

Daume said that in the past—and to some extent now—the image of home brew has been of the "strong, cidery, vile-tasting" beer that often was cooked under unsanitary conditions. "Nowadays," he said, "with a little practice and no more than a $30 investment in equipment and supplies, almost anyone can turn out a batch of ale, lager or stout that in some cases I'd even stack against some of the commercial stuff."

Daume speculated that in the next few years the homebrew hobby (which in 1977 accounted for $4 million in national gross supply sales) will grow far more popular than it is today.

"For one thing," he speculated, "I think more and more beer drinkers will start making their own brew because of the trend by commercial breweries to producing lighter, less alcoholic beer with less of a malt and hop taste."

Legalization of home brew, too, will have a dramatic effect, he said.

"The British finally legalized home brew in 1968, and now you should see all the people cooking up ale, bitters and stout at home. People in this country love drinking beer, too (they consume almost 14 million gallons a night, according to an industry publication) and I think what happened in England can happen here."

A VINTAGE NECTAR

At the height of the Maltose Falcons' tasting session Merlin Elhardt, whose T-shirt was inscribed, "Beermakers make better lovers," ambled among his fellow club members pouring an inch of his latest batch of amber pilsner into their glasses. His beer is acknowledged to be the club's best and it usually evokes the same response all around: a sip, a smile and a hearty compliment.

Elhardt is modest but realistic. "Yes, it is good isn't it? Well, it only took me four years to get the recipe down."

The utility company lineman makes beer from scratch rather than using commercial malt extracts (he even grinds his own barley and uses a yeast culture reportedly smuggled out of Denmark's Tuborg Brewery by a friend). He says he tried dozens of beer recipes but always returns to the beer tasting most like the brew he knew as a GI in Germany.

After all these years and thousands of gallons of home-brewed beer, though, does Elhardt ever turn out a bad batch? "Yes," he said with a laugh.

"The other day I finished making five gallons of a new recipe that tasted so bad I was tempted to pour it out on my lawn. I think the problem was a contaminated yeast culture. Anyway," Elhardt said, "the beer was terrible.

"But then I thought, 'Who am I to judge?' So I let my neighbor sample the beer and he loved it, and he gave it to his friend who swore the stuff tasted better than a bottle of commercial beer. Heck, I let them both have the whole batch, and I probably saved my lawn in the bargain."

The idea behind fermenting barley to produce alcohol (and hangovers, too) hasn't changed much since the Babylonians wrote the book on beer 8,000 years ago; nor do the mechanics of beer making differ greatly from the Prohibition era. The equipment is still essentially a pair of 5-gallon bottles or crocks and a quantity of malt, hops and distilled water (and a bit of sugar to increase the alcoholic content from two to three times higher than the 3.2% permitted in commercial beer).

SIMPLE, ANCIENT RECIPE

Orville Byrd, an Antelope Valley retiree and senior member of the Maltose Falcons, has been brewing beer since one hot summer night in Wichita, Kan., in 1934. Byrd was 15 then and driving a bootlegger's truck after school to supplement his weekly allowance.

"That night in '34 my buddy and I finished aging our first batch of beer. Oh, yeah, that tasted good. Made it from a can of drugstore malt, sugar, raisins and five gallons of sweet Kansas water.

"Man, that beer was so thick you could have eaten it with a fork . . . but what a taste," Byrd recalled at the Woodland Hills beerfest. He said, though, he almost didn't get to enjoy it, because most of the bottles exploded in the summer heat, one bottle setting off another.

"The funny thing was," said Byrd, "is that my daddy was studying the Bible upstairs all the time and must have known what I was up to, but he never let on."

Just as beer maker Ray Sandoval fantasizes that one day federal agents will discover his home-brew operation and cart him off to prison, so, too, do other home-brew hobbyists wonder what will happen if they have a brush with the law.

A couple of months ago Brent Wilson, 25, a West Los Angeles artist and president of the Maltose Falcons, was driving to the club meeting with a partially filled bottle of home-brew on the front seat when suddenly a California Highway Patrolman waved him to the side of the San Diego Freeway. "I was petrified," Wilson recalled, "and I didn't know how I was going to explain about the beer."

Wilson said he got an unexpected reprieve when the patrolman couldn't decide if the capped, half-filled bottle represented a violation. "I really thought the CHP guy was going to take me in until he asked me if I could tell *him* how to make home-brew. What a relief that was.

The Maltose Falcons said that each home-brewer prepares from 5 to 25 gallons of beer every few months (the new law would permit up to 200 gallons to be brewed a year and eliminate certain fees) and that in most cases they drink some and give the rest away to friends. Sometimes as gifts.

"Most of the people I know who make beer are not heavy drinkers," said teacher Tracy Grade, who has gallons of beer and wine aging in bottles and barrels in the dining room of her San Fernando Valley home ("You never know when company is going to drop over"). Had she ever consumed too much of her own home-brew?

"Well, just put it this way," she said, "my husband and I don't drink the stuff in the morning."

Mr. Coe. I am speaking on behalf of Senator Cranston's bill, S. 3191. We want just one thing. We want equality of treatment for home brewers and for home winemakers.

Senator Cranston's bill provides that equality; the other bills before this subcommittee do not. We think that the restrictions in the other bills are grossly unfair.

I have submitted a written statement that explains this in detail, and I think that is all I need to say. I will, of course, answer any questions you may have.

Senator Byrd. Thank you.

Senator Cranston has a statement which I will insert on his behalf at this point at which he starts out by stating that he is pleased to testify today on the Home Brew Beer Equality Act and this statement will be inserted in the record at this point.

If Senator Cranston is able to be here before the committee adjourns today, we will be glad to hear Senator Cranston.

[The prepared statement of Senator Alan Cranston follows:]

STATEMENT OF SENATOR ALAN CRANSTON

Mr. Chairman, I'm pleased to testify today on behalf of the Home Brew Beer Equality Act.

As you know, under current law, only heads of households, after registering with Treasury, can produce up to 200 gallons of wine per year for family use

without payment of tax. This means that a single individual who is not the head of a family cannot produce wine without being subject to tax and penalties.

The House-passed bill, H.R. 2028, eliminates this absurdity and allows any individual 18 years of age or older to produce up to 100 gallons of wine or beer for personal and family use. The maximum amount is 200 gallons per year in a household where there are two or more individuals age 18 or older.

The House bill also eliminates the registration requirement for home winemakers who produce less than the maximum amount. But it imposes a registration requirement for homebrewers. In other words under the House bill, home winemakers need not register but homebrewers must register with the Bureau of Alcohol, Tobacco and Firearms or be subject to a $1,000 fine and one year in jail.

The House bill also limits the amount of beer a household may have on hand at any one time to 30 gallons.

My bill, the Home Brew Beer Equality Act, would eliminate these discrepancies and provide equal treatment for homebrewers.

My bill, like H.R. 2028, will permit the production of up to 200 gallons of homebrew beer annually, but it will also drop the registration requirement for homebrewers and lift the 30-gallon restriction on beer permitted to be on hand at any one time.

Treasury has indicated that the registration requirement for winemakers has been of little use to the Federal Government, and indeed, has proven burdensome to the public.

But Treasury expresses concern that removing the registration requirement for homebrewers would open the door to widespread moonshine distilling operations. Homebrewers, on the other hand, point out that a whisky mash is significantly different from homebrew fermentation. To make beer, you use brewer's yeast; to make whisky, you use distiller's yeast. Brewer's yeast and distiller's yeast are quite different. Brewer's yeast will not produce the high alcoholic content necessary to make whisky.

And, as far as I've been able to learn, the present widespread practice of making beer at home has not led to increased moonshine operations.

It's unfortunate that BATF is convinced that hordes of "Phantom Moonshiners" are lurking in the basements and closets of ordinary citizens who make beer in their own homes. The bureau has stated, on the other hand, that it has not the slightest interest in small scale homebrewers and has not made any arrests of small scale homebrewers since prohibition was repealed 44 years ago. To go ahead with legislation requiring homebrewers to register is a foolish waste of everybody's time, energy, and money. BATF took a common sense position with respect to home winemakers. The bureau ought to accord equal treatment to homebrewers. My bill assures that the bureau will.

My bill also eliminates the 30-gallon restriction. Beer must be aged to acquire an acceptable taste. Homebrew should be aged at least two months—meaning it should not even be tasted until two months from the day the yeast was pitched. And three months is better. Many homebrewers have multiple batches going and with the standard three-months aging period, the 30-gallon limit would penalize them by reducing the amount of beer they would be allowed to make in a calendar year. The effect of such a limit would be to discourage homebrewing and encourage the purchase of store beer.

Homebrewers brew home beer because domestic beer lacks the rich, malty taste they like. Homebrewers share a creative desire to concoct beer to their own personal taste. They also share a consumer's need to cook a tasty brew for the equivalent of 15 to 25 cents a quart.

My bill would permit them to enjoy these privileges, just as home winemakers do.

Senator BYRD. Senator Packwood?

Senator PACKWOOD. I have no questions.

Senator BYRD. Senator Dole?

Senator DOLE. Well, as I understand it, you are all seeking about the same relief, but you want to make certain that the Cranston bill is not going to be opposed by BATF. Is that correct?

You do not have any quarrel among yourselves. You are all seeking pretty much the same action by the Congress.

32-978--78----8

Mr. COE. We have common ground, but there are some differences. We think the restrictions written into the bill by the BATF are unduly severe. Our written statement explains why.

Senator DOLE. All right. Is that bill passed the House, the one——

Mr. COE. H.R. 2028 has passed the House. A companion bill, identical to 2028, has been filed in the Senate by Senator Moynihan of New York.

Senator Cranston's bill differs in only a few words in that it removes the restrictions in the other two bills—the restrictions that we regard as grossly unfair.

Senator DOLE. As I understand, the Cranston bill is acceptable to the other two witnesses. Is that right?

Mr. COPP. Yes. If the BATF approves.

Senator BYRD. Well, there are three bills, H.R. 2028, S. 2930, and the Cranston bill. Now, all three of you approve the Cranston bill?

Mr. COPP. We will accept the Cranston bill, yes.

Senator BYRD. You accept the Cranston bill.

Do all three of you support or oppose H.R. 2028 and Senator Moynihan's duplicate bill?

Mr. COPP. Yes.

Senator BYRD. You favor both of those bills?

Mr. COPP. Yes, sir.

Mr. COE. I most emphatically oppose Senator Moynihan's bill and Representative Conable's bill. They are the objectionable ones.

Senator BYRD. Senator Curtis, do you have any questions?

Senator CURTIS. Yes. In reference to the age limit to which your bill would apply, it is age 18, is it not?

Mr. COPP. I believe it is.

Mr. COE. I think the bills say "adult."

Senator CURTIS. And it defines an adult as 18 years of age, as I understand it.

Would you have any objection to an amendment which left the minimum age up to State law?

Mr. COPP. No, I would think that would be a good amendment, because many States have varying minimum age limits for the purchase of alcoholic beverages.

Senator CURTIS. Yes, and as a matter of public practice, the United States Government has not fixed the minimum age for dispensing liquor in the various States, and we might have a problem if we defined adult as an 18-year-old while some States defined adult as a 19-, 20-, or 21-year-old. It would seem to me that we should leave that particular decision to the individual State.

Thank you.

Mr. COE. Senator, as I understand it, all three bills simply say "adult." There is a bill before the California legislature now which makes the age 21, and it is exactly the same in its effects as the Cranston bill. It has passed the lower house in California; it has passed unanimously a Senate committee and is now before the State Senate.

Senator CURTIS. I am reading from the description of tax bills prepared for this hearing by the Committee on Finance and the staff of the Joint Committee on Taxation in reference to H.R. 2028.

It says that the bill allows "any individual 18 years of age or older," and then later on it says: "* * * in a household in which there are two or more individuals 18 years or older."

But at any rate, you have no objection to having it conform to State law?

Mr. COE. None whatever. None whatever.

Senator CURTIS. All right.

Senator BYRD. I would think that the point raised by Senator Curtis is important. You mentioned that the State of California is already considering legislation to set the age at 21. So you—I think Senator Curtis' proposal would be logical for the committee to accept.

Mr. COE. We would definitely support that.

Senator BYRD. Just to clarify things a bit, as I understand it, two members of the panel support H.R. 2028 along with the Moynihan bill, those two being identical; and would accept the Cranston bill. One member of the panel opposes the H.R. 2028 and its companion, the Moynihan bill, and favors the Cranston bill.

Mr. COPP. That is correct.

Senator BYRD. Thank you. No further questions.

[The prepared statements of the preceding panel follow:]

STATEMENT OF FRAN REIBMAN, REPRESENTING VYNOX INDUSTRIES, INC., ROCHESTER, N.Y.

Mr. Chairman, members of the committee, I would like to thank you for the opportunity to testify here today. I appear on behalf of H.R. 2028, which Senator Moynihan has introduced before your committee, to ammend section 5053 of title 26 of the United States Tax Code to allow for the home production of beer. I will dispense with reading our full statement and ask that you enter it into the record. I would, however, like to call your attention to the following letters. The first dated April 4, 1977 from the Department of Justice reiterates its support for this legislation. The second dated April 11, 1977 from the General Council of Treasury also indicates the administration support for this legislation. I would be happy to answer any questions you have pertaining to this issue and strongly urge you to favorably report H.R. 2028 out of committee.

Thank you again for this opportunity.

DEPARTMENT OF JUSTICE,
Washington, D.C., April 4, 1977.

Hon. AL ULLMAN,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. ULLMAN: This is in response to your request for the views of the Department of Justice on H.R. 2028, a bill to authorize the home production of beer and wine.

The portions of H.R. 2028 which would amend the Internal Revenue Code provisions relative to the production of beer are virtually identical to the provisions of H.R. 8643, 94th Congress, 1st Session. That bill was the subject of our letter to you dated January 14, 1976. H.R. 2028 reflects the one minor suggestion which we made in that letter.

The home production of wine, limited to 200 gallons per year, is currently exempt from the tax under Section 5042(a) (2) of the Code. H.R. 2028 proposes to amend that exemption to limit the production to 100 gallons per year when there is only one adult in the household. The same annual gallonage limitations would apply in connection with the proposed exemption for the home production of beer.

The Department of Justice has no objection to enactment of H.R. 2028. The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

PATRICIA M. WALD,
Assistant Attorney General.

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., April 11, 1977.

Hon. AL ULLMAN,
Chairman, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This report is in response to your request for the views of the Treasury Department on H.R. 2028, "To authorize the home production of beer and wine." The bill would revise section 5042(a)(2) of the Internal Revenue Code of 1954 relating to home production of wine, and would authorize the home production of beer.

Under existing law (26 U.S.C. § 5042), the head of any family may, after registering, produce up to 200 gallons of wine a year for family use without payment of tax. An individual or married woman who is not the head of any family is not covered under this exemption.

Existing law has no provision which authorizes the home production of beer. However, the Treasury Department recognizes that since the brewing of beer entails the production of a mash fit for distillation, and in order to protect the revenue in the distilled spirits area, specific controls are necessary.

H.R. 2028 would permit any duly registered individual 18 years of age or older to produce wine and beer without payment of tax for personal and family use and not for sale. The aggregate amounts which may be produced free of tax could not exceed 200 gallons of wine and 200 gallons of beer per year in a household in which there are two or more individuals 18 years of age or older. If there is only one individual 18 years of age or older in the household, the annual limit is 100 gallons of wine and 100 gallons of beer. However, a 30-gallon per household limitation has been placed on the amount of beer that can be on hand at any one time (including beer in process). The exemption under Federal law would not serve to authorize the home production of beer contrary to State law.

In addition, the proposed bill would amend section 5051 by adding a new subsection (c) to provide that any beer produced in the United States at any place other than a qualified brewery or as authorized by section 5053(e) would be subject to tax at the rate prescribed in subsection (a), and such tax would be due and payable as provided in section 5054(a)(3) relating to the tax on illegally produced beer. This amendment is in no way intended to affect the imposition of the tax pursuant to section 5051(a) on beer produced in the United States in a qualified brewery.

Section 5092 would be amended to redefine the term "brewer" as every person who brews beer, except a person who brews beer pursuant to the home brew exemption, or every person who produces beer for sale. Thus, except for a person who brews beer for home consumption pursuant to section 5053(e), any person who brews beer or produces beer for sale would be subject to the special (occupational) tax as a brewer and all the provisions of title 26 of the United States Code relating to beer.

Since the brewing of beer entails the production of a mash fit for distillation, section 5222(a)(2) (relating to exemptions for production, removal, etc., of distilling materials) would be amended to provide an additional exemption for the home production of beer. Section 5054(a)(3) which imposes the tax on illegally produced beer would be amended to include unauthorized production of home brew.

Finally, existing section 5674 imposes a criminal penalty on the unauthorized removal of beer from a brewery. The bill would add a new criminal penalty for the production of beer at any place other than a brewery or for the unauthorized production of home brew. This offense would be a misdemeanor.

Enactment of H.R. 2028 would affect the revenue only to the extent that those newly granted the right to produce tax-free beer and wine for personal or family consumption carried out such production in lieu of purchases of taxpaid beer or wine. We believe any such revenue effect would be quite small.

The Department has no objection to the enactment of H.R. 2028. We recommend that "duly registered" be deleted from proposed section 5042(a)(2). Registration of producers of wine for personal or family use has proven of little use to the Bureau of Alcohol, Tobacco and Firearms and is burdensome to the public. As you know, elimination of unnecessary Federal paperwork is one of President Carter's goals. However, for enforcement and revenue protection purposes, registration is necessary in the case of home brew since the process entails the production of a mash fit for distillation.

The Department has been advised by the Office of Management and Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

HENRY C. STOCKWELL, Jr.,
Acting General Counsel.

TESTIMONY OF VYNOX INDUSTRIES, ROCHESTER, N.Y.

Mr. Chairman, members of the committee, we would like to thank you for the opportunity to testify here today. We speak on behalf of H.R. 2028, which would amend section 5053 of title 26 of the United States Tax Code to allow for the home production of beer. Specifically, this redesignation of subsections 'e' would permit "Any duly registered individual 18 years of age or older without payment of tax to produce beer for personal use and not for sale." [1]

Under the present law it is neither legal or tax exempt to produce beer at home. Yet it is specifically permissable to produce wine for personal use without payment of tax.[2] Ironically, wine has a higher alcohol content (up to 16% by volume) than does beer. Article XXIX section 178.195 of the United States Treasury Department regulations states the following with regard to home wine production:

"A duly registered producer may produce not in excess of 200 gallons of still wine per year for the use of his own family without payment of tax. Wine thus produced must not be sold or otherwise removed from the place of manufacture." [3]

H.R. 8643 reflects the aforestated regulation. This legislation would limit the amount of beer to be produced to 200 gallions per annum for a household of two or more and 100 gallons per annum for a single individual.

It is our contention that the present code governing the production of beer at home is anachronistic and should be amended. In a Cleveland Plain Dealer article, dated August 5, 1973, the author noted that "Test cases in Ohio courts have protected stores that sell home brew equipment, a Government spokesman explained, because the statute governing beer is a poorly written law." [4]

On January 30, 1973, Heinz L. Herz, District Director, Treasury Department Bureau of Customs, Chicago, issued a memorandum concerning restrictions and prohibitions on kits for the home manufacture of beer. This memorandum stated that "Kits for the home manufacture of beer will be admissible to entry without specific authorization by the Bureau of Alcohol, Tobacco, and Firearms." [5] The memo did not concern itself with the legality of home brewing, therefore, the kits are permissible but, the practice of home brewing is not. This is rather contradictory.

We are convinced that the passage of H.R. 2028 would not have a negative impact on the beer producers of America. Home brew kits, are in general, purchased by hobbyists. These persons tend to be connoisseurs of beer and wish to brew to personal taste. In addition, the legislation provides that "The amount of beer on hand at any one time (including beer in process) shall not exceed 20 gallons per household." Thus the overall market for home production of beer will remain relatively small and non-competitive with the retail market. Our major concern is that purchasers of these kits not be in violation of the law and subject to penalties.

Due to specialization of the market, we do not feel that the Government will lose significant revenues by permitting home production to be tax-exempt. It is our understanding that the Treasury Department supports enactment of this legislation and agrees that "any such revenue effect would be quite small." [6] As

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[1] H.R. 2028.
[2] H.R. 2096.
[3] United States Treasury Department Regulations No. 7, Wine, 1945, pp. 99 and 100 (see appendix I).
[4] The Cleveland Plain Dealer, Sunday, August 5th, 1973 (see appendix II).
[5] See appendix III.
[6] See appendix IV.

over the counter sales of beer will continue to predominate the market, we cannot foresee any negative effects on either the market or Government with enactment of this legislation. Sales tax of the kits and supplies should offset revenue loss to the States. Finally, small enconomies may be effectuated when need for prosecution of home brewers is eliminated.

In conclusion, we request your support of H.R. 2028, and would be happy to answer any questions you may have regarding this issue.

Title and description

Action—All Congressional Record page numbers refer to daily Congressional Record

CONFERENCE ACTION

Agreed to Senate Amendments

Increasing interest paid with respect to tax deficiencies and interest charged with respect to tax overpayments;

Relating to interest on certain deposits, etc., in the United States;

Excluding interest on certain obligations issued prior to 1971;

Extending existing credit and deduction provisions for political contributions to contributions for newletters;

Increasing political contributions credit and deductions;

Relating to transfer of appreciated property to political organizations; and

Providing that gift taxes are not to apply to contributions to political parties or committees.

Rejected Senate Amendments:

Dealing with tax treatment of student loan funding programs; and

Exempting from Federal taxation the interest on obligations issued by the American Falls Reservoir District.

Modified Senate Amendment:

Relating to tax on certain income of political organizations was modified to clarify the provision regarding separate segregated campaign funds established by exempt organizations to conform to State laws.

Dec. 20, 1974.—Senate agreed to the conference report by voice vote (Congressional Record S22529).

Dec. 20, 1974.—House agreed to the conference report by rollcall vote (No. 723) of 257 yeas, 71 nays (Congressional Record S12598).

BILL SIGNED

Jan. 3, 1975.—Signed by the President.

(Public Law 93-625)

R. 2096 Sept. 12, 1973

To prohibit the imposition by the States of discrimination burdens upon interstate commerce in wines, and for other purposes.

Prohibits any State from imposing any tax, regulation, prohibition, or requirement on wine produced out of the State that is not imposed on wine produced in the State.

AMENDMENTS

Sept. 19, 1973 (Packwood) Enables individiuals to produce for private use and not for sale up to 100 gallons of wine per year.

Oct. 11, 1973.—Referred to Office of Management and Budget and Department of the Treasury.

Jan. 11, 1974.—Report from the Department of the Treasury (no objection).

Jan. 11, 1974.—Favorable report from the Office of Management and Budget.

Jan. 17, 1974.—Referred to Departments of Agriculture and Commerce.

Jan. 17, 1974.—Report from Department of Justice (no position).

Jan. 21, 1974.—Public hearing.—Printed.

Jan. 25, 1974.—Report from the Department of Commerce (favors, but defers to the Department of Justice).

Feb. 7, 1974.—Report from Department of Agriculture. (Defers to Justice Department.)

Apr. 19, 1974.—Adverse report from the Department of the Treasury.

SEC. 178.194 APPROVAL OR DISAPPROVAL OF PROCESS.—The district supervisor will forward all three copies of the statement of process to the Commissioner with his comment. Upon examination of the process, the Commissioner will note his approval or disapproval on all copies of the statement, retain one copy and return two copies to the district supervisor, who will keep one copy for his files and send the other copy to the winemaker. If the process is approved, the winemaker shall file his copy at the winery available for reference by Government officers.

(a) *Extent of Commissioner's approval or disapproval.*—The Commissioner's approval or disapproval of the statement of process shall pertain only to the manufacture of the product on bonded winery premises and the labeling of the same as to kind, and shall not constitute in any way an approval or disapproval of the product as to quality.

ARTICLE XXIX.—PRODUCTION OF WINE FOR FAMILY USE

SEC. 178.195 REGISTERED PRODUCER.—A duly registered producer may produce not in excess of 200 gallons of still wine per year for the use of his own family without payment of tax. Wine thus produced must not be sold or otherwise removed from the place of manufacture. Such exemption does not authorize the production of wine for such use contrary to State law. (Sec. 3030(a)(1), I.R.C.)

SEC. 178.196 LIMITATIONS OF EXEMPTION.—The statutory exemption does not apply to (*a*) wine made by one person for the use of another, whether consumed on the premises or removed therefrom for the family use of the owner; (*b*) wine produced by a single person, unless he is the head of a family; (*c*) wine produced by a married man living apart from his family; (*d*) wine made by a partnership or produced at a winery operated by two or more heads of families jointly; (*e*) wine produced by a corporation or association; or (*f*) wine furnished to persons not members of the producer's family. (Sec. 3030(a)(1), I.R.C.)

SEC. 178.197 REGISTRATION: FORM 1541.—Every person (other than the operator of a bonded winery) coming within such exemption and desiring to produce still wine for the exclusive use of his family must prepare Form 1541, registration for production of wine for family use without payment of tax, in duplicate and send both copies to the district supervisor, Alcohol Tax Unit, of the district in which he resides. The form must be sent to the district supervisor at least five days before commencing to produce the wine. A new form must be submitted each succeeding year during which it is desired to produce wine for family use, the year to be reckoned as commencing on July 1 and ending on June 30. (3030(a)(1), I.R.C.)

SEC. 178.198 RETENTION OF FORM 1541.—When Form 1541 is received by the district supervisor, he will stamp both copies with his receiving date stamp. If the form is properly prepared and the supervisor has no information indicating that the registrant is not entitled to the exemption, he will retain one copy for his files and return one copy to the registrant, who shall keep the same at his premises and upon production of the wine shall enter thereon the quantity produced and the date of production. (Sec. 3030(a)(1), I.R.C.)

ARTICLE XXX.—WINE TO BE DEPOSITED WITHIN BONDED PREMISES

SEC. 178.199 STORAGE.—Upon removal from the fermenters wine must be conveyed immediately into storage containers within the storage portion of the winery or fortifying tanks in the fortifying room. When the manufacture of vermouth is completed, it must be transferred from the processing tanks to storage or shipping containers. Wine received in bond from other bonded premises must be deposited immediately in the storage portion of the winery or bonded storeroom. Wine may not be stored in outbuildings or containers outside the storage portion of the bonded premises.

(a) *Exception: sun-baking of sherry wine.*—The district supervisor may, in his descretion, permit the sun-baking of sherry wine in an open area on the bonded winery premises, in cases where the wine will be protected against theft by a

secure and substantial fence or wall of appropriate height and construction, with locked gates, surrounding the winery or the area in which the wine will be baked, or where the wine will be otherwise equally safeguarded during the baking process. Application for such permission should be made in writing to the district supervisor, setting forth the approximate quantity of wine to be baked, the period during which the wine will be stored in the open, and the means by which the wine will be safeguarded.

APPENDIX II

[From the Plain Dealer, Sunday, Aug. 5, 1973]

HOME BREW CAN LAND MAKER IN PRISON

(By D. Vivian Aplin)

Home brew, the bubbly beverage that has made some good times even better, can take a heavier toll on its maker than just a bad morning after. It can also cost him $5,000 and five years in prison.

Home brew kits are available from some Cleveland retailers. Selling the equipment and materials is not illegal, but its manufacture in a private home constitutes an offense.

Rex D. Davis, director of the U.S. Bureau of Alcohol, Tobacco & Firearms, issued a recent warning to those who might brew up a few bottles in the family cellar, using their own makings or a store-bought kit. It is a federal offense.

"Home beer kits have been advertised extensively in newspapers and magazines, and some of the ads have stated than an individual can make up to 200 bottles of beer for personal use," Davis noted.

"Since it is unlawful to make beer in any amount other than on brewery premises, we want to insure that a person doesn't unwittingly break the law as a result of such false and misleading statements."

On the other hand, the home production of up to 200 gallons of wine yearly for personal use is permitted, provided the family head registers with the Bureau of Alcohol, Tobacco and Firearms before beginning production.

A statement on the side of the American Home Brew, Inc., kit declares: "Technically, beer is wine made from hop-flavored, malted barley." The notice continues: "The federal law implies that beer made at home cannot be sold or removed from the premises."

This description of wine is taken from a very loose dictionary definition, which says wine is the fermented juice of fruits and plants.

Using that approach, whiskey would also be wine, since it is made from the fermented mash of grain.

But the federal definition differs. One section of the Code of Federal Regulations clearly distinguishes wine from beer.

"Molasses, malts, cereals and grains may not be used in the production of wine," it states.

Another section explains that "wine" means the various products of grapes, berries or other fruits.

Test cases in Ohio courts have protected stores that sell home brew equipment, a government spokesman explained, because the statute governing beer is a "poorly written law."

It is also one that is only loosely enforced. Probably the worst a home brewer can expect is a visit from a government inspector bearing bad tidings, but no arrest warrant.

"It amounts to this," a spokesman said, "it's the kind of thing that doesn't have much prosecutable appeal. If someone makes a little home brew we just advise them to cease.'"

APPENDIX III

TREASURY DEPARTMENT,
BUREAU OF CUSTOMS,
Chicago, Ill., January 30, 1973.

To: Customhouse brokers, importers and others concerned.
Subject: Restrictions and prohibitions; kits for the home manufacture of beer.
References: Internal Revenue Code of 1954 (26 U.S.C. 5054(a)(3), 5222(a)); sections 18.25 and 15.5, Customs regulations.

The Director, Bureau of Alcohol, Tobacco and Firearms, Department of the Treasury, has ruled that the restriction on the importation of kits for the home manufacture of beer, and kits which may be used for that purpose is to be discontinued.

Kits for the home manufacture of beer will be admissible to entry without specific authorization by the Bureau of Alcohol, Tobacco and Firearms, Department of the Treasury.

Pipeline No. 84 dated February 14, 1972 is hereby superseded.

HEINZ L. HERZ,
District Director.

DEPARTMENT OF THE TREASURY,
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS,
Washington, D.C., December 21, 1972.

Mr. BERNARD POSSER,
Turnbridge Wells Products, Ltd.,
New York, N.Y.

DEAR MR. POSSER: This is in reply to your letter of November 30, 1972, concerning our position on selling homebrew kits.

We agree with the position taken by our regional office that the production of beer in the home is illegal. This position is based on Sections 5054 and 5222 of the Internal Revenue Code 1954. Notwithstanding our position in this regard, we do not oppose the commercial sale of homebrew kits.

Sincerely yours,

REX D. DAVIS.

APPENDIX IV

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., December 24, 1975.

Hon. AL ULLMAN,
Chairman, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Treasury Department on H.R. 8643, 94th Congress, 1st Session. H.R. 8643 would amend section 5053 of title 26 of the United States Code by adding a new subsection (e) which would authorize the home production of beer. Under existing law, there are no provisions which would authorize this production.

The Treasury Department recognizes that since the brewing of beer entails the production of a mash fit for distillation, and in order to protect the revenue in the distilled spirits area, specific controls are necessary.

New section 5053(e) would require that before an individual produces beer for home consumption, he be 18 years of age or older and registered with the Secretary or his delegate and that the beer must be produced for personal use and not for sale. The bill would limit the amount of beer that can be produced in any household to 100 gallons per annum where there is only one individual 18

years of age or older in such household or 200 gallons of beer per annum if there are two or more individuals 18 years of age or older in such household. Further, due to the nature of the product and for reasons of effective law enforcement, a 20-gallon per household limitation has been placed on the amount of beer that can be on hand at any one time (including beer in process). Of course, the exemption under Federal law would not serve to authorize the home production of beer contrary to State law.

In addition, the proposed bill would amend section 5051 by adding a new subsection (c) to provide that any beer produced in the United States at any place other than a qualified brewery or as authorized by section 5053(e) would be subject to tax at the rate prescribed in subsection (a), and such tax would be due and payable as provided in section 5054(a)(3) relating to the tax on illegally produced beer. This amendment is in no way intended to affect the imposition of the tax pursuant to section 5051(a) on beer produced in the United States in a qualified brewery.

Section 5092 would be amended to redefine the term "brewer" as every person who brews beer, except a person who brews beer pursuant to the home brew exemption, or every person who produces beer for sale. Thus, except for a person who brews beer for home consumption pursuant to section 5053(e), any person who brews beer or produces beer for sale would be subject to the special (occupational) tax as a brewer and all the provisions of title 26 of the United States Code relating to beer.

Since the brewing of beer entails the production of a mash fit for distillation, section 5222(a)(2) (relating to exemptions for production, removal, etc., of distilling materials) would be amended to provide an additional exemption for the home production of beer. Section 5054(a)(3) which imposes the tax on illegally produced beer would be amended to include unauthorized production of home brew.

Finally, existing section 5674 imposes a criminal penalty on the unauthorized removal of beer from a brewery. The bill would add a new criminal penalty for the production of beer at any place other than a brewery or for the unauthorized production of home brew. This offense would be a misdemeanor.

Enactment of H.R. 8643 would affect the revenues only to the extent that those newly granted the right to produce tax-free beer for personal consumption carried out such production in lieu of purchases of tax-paid beer. We believe any such revenue effect would be quite small.

Accordingly, the Treasury Department favors enactment of H.R. 8643.

The Department has been advised by the Office of Management and Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

DONALD B. E. RITGER,
Acting General Counsel.

STATEMENT OF LEE COE, ON BEHALF OF HOME WINE MERCHANTS ASSOCIATION, A NATIONAL ORGANIZATION; SANTA CLARA VALLEY BREWERS, MOST OF WHOSE MEMBERS LIVE IN SAN JOSE; MALTOSE FALCONS, OF WOODLAND HILLS, A LOS ANGELES SUBURB; SAN ANDREAS MALTS, OF SAN FRANCISCO; REDWOOD LAGERS, OF MARIN COUNTY; YEAST BAY BREWERS, OF BERKELEY AND ADJACENT CITIES.

SUMMARY

You are considering three bills, S 3191, HR 2028, and S 2930. The latter two are identical. We urge passage of S 3191.

Registration of home winemakers and beermakers—HR 2028 and S 2930 would abolish registration for winemakers, but would institute it for beermakers * * * S 3191 would not require it for either group; we urge passage of S 3191 because registration "has proven to be of little use to the Federal Government and is burdensome to the public."

Beer and wine should be aged—HR 2028 and S 2930 would allow home-made wine to be aged properly. But they would allow home-brewed beer to be aged properly only if home brewers were to make less than the bills purportedly allow. That is, HR 2028 and S 2930 contradict themselves * * * S 3191 would allow both wine and beer to be aged properly; we urge its passage because beer, like wine, must be aged to be at its best.

DISCUSSION

Registration.—All three bills would abolish the present requirement that home winemakers must register. The sponsor of HR 2028 has said: "* * * that requirement has proven to be of little use to the Federal Government and is burdensome to the public." We agree.

But HR 2028 and S 2930 would also *institute* registration for home brewers of beer—while abolishing it for home winemakers.

S 3191, on the other hand, would not require registration for either group. We favor it.

Like Wine, Beer Should be Aged.—Our principal objection to HR 2028 and S 2930 is that they would penalize home brewers who age their beer to improve its quality. S 3191, on the other hand, would allow proper aging for both wine and beer.

HR 2028 and S 2930, identical twin bills, would forbid beermakers to have on hand at any one time any more than 30 gallons of beer, including fermenting beer, beer being aged, and beer being consumed. But these twin bills would have no such limitation for wine. S 3191 would have no such limitation for either wine or beer.

How the twin bills would work in practice is shown in the table on Page 4 of this statement.

The twin bills say in one place that a single individual would be allowed to make 100 gallons of beer in a calendar year. But the table shows that if a single individual were to make 1 batch a month, age it for 3 months, and take 3 months to drink it, he or she would be allowed to make only 72 gallons a year, 6 gallons a month.

Surely it would be improper for a law to say in one place, "You can make 100 gallons a year," but then add in another place, "It is illegal for you to make more than 72 gallons a year if you age your beer properly."

Things would be even worse for a household with more than 1 individual in it. The twin bills say such a household would be allowed to make 200 gallons a year, but the actual limit would be 72 gallons a year if the beer were to be aged 3 months and if the householders were to spend 3 months drinking it.

Moreover, 3 months' aging for beer is a minimum. Home brewers who desire the utmost in quality age their brew for 4, 5, 6 months, even more in some cases. If the twin bills were to become law, such dedicated hobbyists would be restricted to an absurd degree.

Thus, the effect of HR 2028 and S 2930 would be: the worse your beer, the more you could make—the better your beer, the less you could make. The faster you were to drink it, the more you could make—the slower you would drink it, the less you could make. You *could* make the limit of 200 gallons a year the twin bills promise, but only if you were to drink green beer, bad beer, "aged" only 24–25 days—and you would have to drink all of each in 1 month if you were to have beer on hand at all times.

Nothing of the sort would happen under Senator Cranston's bill, S 3191. The limits of 100 and 200 gallons a month would be genuine.

We support the Cranston bill with enthusiasm.

If you want home brew on hand at all times,
and if you make 1 batch a month,
HR 2028 would allow you to make only this much:

Age your beer 3 months		
take 1 month to drink a batch	take 2 months to drink a batch	take 3 months to drink a batch
maximums: batch, 7 1/2 gallons 1 year, 90 gallons	maximums: batch, 6 2/3 gallons 1 year, 80 gallons	maximums: batch, 6 gallons 1 year, 72 gallons

Age your beer 2 months		
take 1 month to drink a batch	take 2 months to drink a batch	take 3 months to drink a batch
maximums: batch, 10 gallons 1 year, 120 gallons	maximums: batch, 8 4/7 gallons 1 year, 102 6/7 gal.	maximums: batch, 7 1/2 gallons 1 year, 90 gallons

Age your beer 1 month		
take 1 month to drink a batch	take 2 months to drink a batch	take 3 months to drink a batch
maximums: batch, 15 gallons 1 year, 180 gallons	maximums: batch, 12 gallons 1 year, 144 gallons	maximums: batch, 10 gallons 1 year, 120 gallons

Senator BYRD. The next panel consists of Senator Thomas Kuchel representing the Petersen Publishing Co.; James Pratt, vice president and director of taxes, General Mills, Inc., accompanied by Roger Sherman, manager of taxation, Pillsbury Co.; and Mr. Townsend Hoppes, president, American Association of Publishers.

Welcome, gentlemen. Senator Kuchel, we are glad to see you back at this committee again.

Mr. KUCHEL. Thank you very much, Mr. Chairman.

STATEMENT OF THOMAS H. KUCHEL, ESQ. ON BEHALF OF PETERSEN PUBLISHING CO.

Mr. KUCHEL. Mr. Chairman, I am Thomas Kuchel. I am a partner in the law firm of Wyman, Bautzer, Rothman, & Kuchel, whose principal offices are in Los Angeles.

We represent Petersen Publishing Co., also of Los Angeles, a publisher of sundry magazines. Accompanying me here today is Mr.

Chapin Carpenter, the executive vice president of the Magazine Publishers Association and I think I may say on this occasion I speak on behalf of the Magazine Publishers Association as well as, particularly, our own client.

Mr. Robert McDavid, a certified public accountant with Petersen Publishing Co. over the years, came with me here from California but was compelled to return home suddenly over the weekend because of an emergency in his family.

Petersen sells its magazines through a national distributor to retail outlets, and it sells not only the number of copies which the parties to the contract of sale anticipate will be sold to the general public, but it also sells an additional number of copies which will be used for display purposes only and which the parties do not anticipate will be sold.

Petersen agrees, again by contract, to accept the return of the unsold copies which are used for display purposes, or for advertising purposes. And when the next issue of the magazine is published and shipped to the retailers, the unsold copies of the prior issue, now for all intents and purposes dead and perished, are returned to Petersen. In actual practice, the cover pages of the prior issue are torn off and returned.

Petersen is an accrual basis taxpayer. Under IRS rules, Petersen is required to include in its income the sale of magazines based on the total number of copies which are shipped to the retail distributors, including those copies shipped for display purposes only. When the new issue arrives, and copies of the prior issue are returned to Petersen, Petersen reduces its income accordingly. But if the sale occurs in one taxable year, and the return occurs in the following year, Petersen is not permitted to reduce its income in the year of sale, but, instead, in the year of return.

In other words, if the taxable year concludes on the last day of December and copies for display purposes are returned to Petersen in January representing the December issue of the magazine, perhaps the November issue of the magazine—quite conceivably the September issue of the magazine—Petersen is not allowed, by the IRS, to reduce its income accordingly for its taxable year, but must reduce its income in the next year in which the actual return of the copies takes place.

This, Mr. Chairman, is unfair. Petersen is deprived, by this method of accounting, to reflect accurately its income subject to tax.

The bill before you corrects this distortion by providing a new accounting procedure. Under the bill, an accural basis publisher of magazines may elect to exclude from its gross income for the taxable year the income attributable to those copies of magazines used for display purposes which are returned to him within 2 months and 15 days after the close of the taxable year. That is to say, up to the date upon which the corporation would normally file its return.

The bill requires that, at the time of sale, the publishers have a legal obligation to accept return of the unsold copies. It provides further that in the first year that the election is made by the accrual basis publishers, the reduction in taxable income for that year be taken into account over a 5-year period, to diminish the impact on the Treasury.

This bill was introduced in the beginning of the last Congress after Petersen appeared before the late, able Chief of Staff of the Joint Committee, Laurence Woodworth, who agreed with the complaint of Peter-

sen and who proceeded, through his staff, to draft the bill affecting magazines only.

It passed the House in that form but came here too late in the last Congress to be acted upon by this committee.

This year, practically the same bill was introduced and the spokesman for the publishers of paperback books and records, representing both of those industries, came before the House committee and asked that the bill be amended by giving somewhat similar relief to paperback books and records and he said then, "The revenue impact can be minimized by including a suspense account provision in the bill to defer the transition year adjustment until such time as there is a decline or termination of the taxpayer's business."

He also asks that the return period for the paperback books and for the magazines be 4½ months after the taxable year instead of 2½ months.

The magazine publishers took no part in those deliberations. The House committee approved an amendment to provide for an election by paperback books and records to utilize a 4½-month period after the end of their taxable year in order to receive returns and to account for the value of those returns in the suspense account.

The House approved the bill as the House committee amended it and widened its coverage, and it is before you for action.

Mr. Chairman, my words are spoken on behalf of magazines. They are periodicals. They are somewhat like newspapers, except that they exist for more than a 24-hour period. They are either weekly magazines or monthly magazines, and they are all dated.

Books are not dated. Records are not dated, but magazines are. And when the new issue comes on the newsstand, the old issue is dead.

Nevertheless, we do not take a position objecting to the amendment of the House. We respectfully urge the members of this committee to approve the adoption of the bill in the wording which is before you now.

Senator BYRD. Thank you, Senator Kuchel.

Do other members of the panel have a statement?

Mr. PRATT. Yes, please.

STATEMENT OF JAMES PRATT, VICE PRESIDENT AND DIRECTOR, TAXES, GENERAL MILLS, INC., ACCOMPANIED BY ROGER SHERMAN, MANAGER OF TAXATION, PILLSBURY CO.

Mr. PRATT. Mr. Chairman and members of the subcommittee, my name is James Pratt. I am vice president and director of taxes of General Mills in Minneapolis. I am accompanied today by Roger Sherman, manager of taxation of Pillsbury Co. and by Ernest Christian and James O'Hara, our Washington lawyers.

We support H.R. 3050 which provides the special tax accounting rule for sales and returns of magazines, books and records. We believe it gives a much more accurate tax basis for that industry.

I would like to call the committee's attention to a situation which, in terms of accounting principles, is substantially identical to the problem addressed by H.R. 3050. I refer to the discount coupons that are issued by manufacturers. You are probably familiar with them. They are "cents-off" coupons that are published in newspapers and maga-

zines or sent out with the product. They allow the discount on the subsequent purchase of the same product or of a different product.

"Cents-off" coupons are very popular with consumers. Over 60 billion were issued last year and about 3 billion were redeemed. They are issued by more than 1,000 companies in the consumer products industry.

Most give significant discounts on sales of the products to which they relate and they are used by over 70 percent of the households in the United States. These coupons are perceived by homemakers to be a very useful way to reduce grocery prices, particularly in periods of inflation, and they do give families of moderate income an opportunity to make substantial savings on grocery bills.

Senator BYRD. Let me interrupt you for a minute for clarification. Is that a part of H.R. 3050?

Mr. PRATT. It is not now a part of H.R. 3050. I am calling the committee's attention to a situation that is very similar in principle to that addressed in H.R. 3050.

Senator BYRD. So your testimony, then, is on behalf of extending H.R. 3050 to cover this?

Mr. PRATT. Yes, sir.

These coupons have been used for over 50 years under a Treasury regulation which allows taxpayers to set up liabilities at the end of the year for estimated redemptions of trading stamps and coupons. It has been possible to make such estimates with great accuracy by using statistical data built up over many years, and this accounting procedure is very widely used in the consumer products industry.

The Internal Revenue Service has recently, through a series of rulings, attempted to greatly narrow the regulations governing the tax treatment of such coupons by excluding coupons issued through newspapers and magazines from the provisions of the regulations and also, very recently, they have now tried to reinterpret the regulation to exclude the so-called "in-pack/on-pack" discount coupons.

The IRS's position would almost eliminate the possibility of using this 60-year-old regulation for consumer products companies except in very narrow cases, such as the familiar Raleigh cigarette coupon. We do not believe that such narrowing has any economic justification. It creates an artificial distinction, very arbitrary, between trading stamps and coupons on the one hand and the types of coupons that I am talking about, the "cents-off" discount coupons, on the other hand.

We believe that such a distinction is inequitable and should be corrected.

We urge that H.R. 3050 be expanded to include a new section, section 3458, which would codify 50 years of industry practice and make clear that the regulation applies to "cents-off" coupons, as well as to trading stamps and to merchandise coupons.

A form of such amendment is contained in the House bill, H.R. 13047 recently introduced in the House by Mr. Frenzel of Minnesota. We have, with our statement, included a complete and comprehensive description of the coupon system and the reason that we believe that the present attitude of the IRS is unreasonable.

We urge the committee to take this into account in their deliberations on H.R. 3050.

I thank you very much for your attention.

Senator BYRD. Thank you.

To get my mind clear on this matter, the bill as originally introduced, H.R. 3050, applied only to magazines; is that correct, Senator Kuchel?

Mr. KUCHEL. Yes, sir.

Senator BYRD. And then that was expanded in the House to include books and records?

Mr. KUCHEL. In a little different treatment, Mr. Chairman.

Senator BYRD. And then your proposal is to expand it again to take care of the coupons that you mentioned?

Mr. PRATT. Yes, sir.

Senator BYRD. Thank you.

Mr. Hoopes?

STATEMENT OF TOWNSEND HOOPES, PRESIDENT, AMERICAN ASSOCIATION OF PUBLISHERS

Mr. HOOPES. Mr. Chairman, my name is Townsend Hoopes and I am the president of the American Association of Publishers. Accompanying me are Robert Klayman of the Washington law firm of Caplin and Drysdale; Cary Sherman of the Washington law firm of Arnold and Porter; and Charles Ruttenberg of the Washington law firm of Arent, Fox, Kintner, Plotkin and Kahn.

Mr. Klayman represents the Association of American Publishers in connection with the consideration of H.R. 3050. Mr. Sherman and Mr. Ruttenberg represent, respectively, the Recording Industry Association of America and the National Association of Recording Merchandisers.

Because we share common interest, and in order to conserve the time of the subcommittee, I am testifying on behalf of all three of these associations.

Members of the Association of American Publishers publish more than 90 percent of the paperback books produced in the United States. The member companies of the two recording associations create and market about 90 percent of the sound recordings sold in the United States.

We are here to urge the enactment of H.R. 3050 and, in this regard, I wish to emphasize just two brief points. They are covered in greater depth in our joint statement which has been submitted for the record.

The first point is that, in the case of producers and distributors of magazines, paperback books and records, H.R. 3050 provides a significant improvement in the tax accounting rules for reporting income on merchandise which is sold subject to a right of return.

All three of these industries experience a high percentage of returns, ranging from 20 to as much as 60 percent of the initial distributions. This is because the companies intentionally distribute more products than they actually expect to sell so that the product will be available at the retail level during its short demand time.

The companies are under a legal obligation to give full refund or credit for copies not sold. Existing tax accounting rules require all distributions to be included in income, but fail to give credit for returns which come in after the close of the tax year. This results in a mismatching of income and related business expenses.

H.R. 3050 resolves this discrepancy by providing that distributions made in one taxable year and returned within a specified period after that year are not includible in taxable income. The bill thus achieves a more accurate statement of actual sales, and thus of current income, one closer to the requirements of generally accepted principles of accounting.

The second point I wish to emphasize, Mr. Chairman, is that under H.R. 3050 as it passed the House, a deduction will be denied for actual returns of paperback books and records that are received during the first $4\frac{1}{2}$ months of the year in which the new accounting method is first used. As a general rule, changes in method of accounting result in a duplication or omission of items of income or deductions in the change year.

Recognizing the need to prevent such duplications or omissions, the Congress, in 1954, enacted section 481 of the Code which corrects this situation by spreading the adjustment amount over a period of years.

Under H.R. 3050, the change in the method results in the loss of deductions for certain actual returns. In the case of magazines, as Senator Kuchel has said, the bill provides that these lost deductions will be recovered over a 5-year period.

In the case of paperback books and records, however, H.R. 3050 provides that section 481 will not apply at all. Instead, the lost deductions will be placed in a suspense account. This has the effect of denying the taxpayer the benefit of these deductions until the taxpayer goes out of business.

We believe that the treatment of the transition year adjustment provided for the magazine industry in this bill is fair and equitable and that the spreading technique provided by section 481 should be extended to the paperback book and sound recording industries as well.

There is no equity in a provision that places deductions to which taxpayers are entitled in suspense for an indefinite period of time.

With this one change, Mr. Chairman, we strongly urge that the Finance Committee approve H.R. 3050 as passed by the House.

Thank you, sir, for the opportunity to appear here today.

Senator BYRD. Thank you.

Senator Packwood?

Senator PACKWOOD. No questions.

Senator BYRD. Senator Curtis?

Senator CURTIS. Senator Kuchel, I want to make sure I understand. Under present law, if, in November, 100 copies of a particular magazine are delivered to a retailer, another 100 in December, and after the first of the year, they return 7 of the November issue and 7 they could not sell of the December issue, then, under existing law, he could not take a deduction for those returns in the year of the sale, is that right? Simply because the taxpayer was on a calendar year basis and the returns were made after the year ended?

Mr. KUCHEL. That is correct.

Senator CURTIS. And what you propose is that if the returns are made within $2\frac{1}{2}$ months after the close of the taxable year, then a deduction in the year of the sale would be available?

Mr. KUCHEL. Yes, sir.

Senator CURTIS. Now, in reference to the coupon issue, is this the problem you are trying to solve? You run an ad in a publication that

says send in a box-top and a dollar and get something that is worth $3. You do not have a complete return, but you know approximately what the anticipated response will be.

Someone sends that coupon in a taxable year different from the date of publication, or the date the magazine was offered for sale. Under existing law, the cost of subsidizing that sale cannot be charged in the year that the offer was made, is that right?

Mr. PRATT. That is basically right, Senator Curtis. What we——

Senator CURTIS. And then what is it you are seeking?

Mr. PRATT. I am sorry?

Senator CURTIS. What are you asking?

Mr. PRATT. We are asking for a clarification of the present regulations that make it clear that we can set up a liability at the end of the year in which the coupon is issued based on statistical data, for estimated redemptions of those coupons.

It covers not only the kind you described, but also the "cents-off" coupons, where they——

Senator CURTIS. What kind?

Mr. PRATT. What they call "cents-off" coupons, or discount coupons, where the consumer can take a coupon into the store and get, say, 10 cents off on a box of cereal, something similar to that.

Senator CURTIS. Is the present law burdensome to business?

Mr. PRATT. Yes, it is.

I might say that we have been using the accounting method prescribed by the regulation for many years under what we thought was a clear mandate to do so. The fact is that the IRS has changed their position recently and has retroactively said that we can no longer use this accounting method and that is what we are trying to correct.

The present law, really, is in a state of limbo now until this is straightened out.

Senator CURTIS. In the overall, is there any loss of revenue?

Mr. PRATT. I believe, Senator Curtis, that the loss of revenue would be quite small. The Service has not yet really applied its new position to very many taxpayers. A few taxpayers have been issued assessments, but I doubt there would be any large loss of revenue because the practice that we want to have confirmed is still being used by most taxpayers, in my opinion.

Senator CURTIS. Well, if there is a coupon in a magazine published in 1977 that says it will give 6 cents off on a pound of coffee, you have a thousand of those redeemed in 1978. You want to charge the expense of that redemption in 1977?

Mr. PRATT. That is right.

Senator CURTIS. Within that same 2½-month period?

Mr. PRATT. We would like a little different rule on that because, in the publishing business, of course, the returns do come in very quickly. In our business, it takes a matter of more months than that. We would rather use a statistical estimate than to base it on the actual returns over a short period of months.

Senator CURTIS. Is this practice limited to rather large companies where the statistics and figures are available?

Mr. PRATT. I think that most of it is. I am sure there are some smaller organizations that do this, but it is mostly large consumer products companies.

Senator CURTIS. Now, to the gentleman who testified with reference to the books, what is it that you are seeking? The paperbacks?

Mr. HOOPES. We are seeking, Senator, the right to deduct in the taxable year revenues attributable to returns that come in within 4½ months in the next taxable year.

Senator CURTIS. For paperback books, and what else?

Mr. HOOPES. For paperback books and records, yes, sir.

Senator CURTIS. What kind of records?

Mr. HOOPES. Popular records. All kinds of phonograph records.

Senator CURTIS. The issue is just a little different, is it not? In one, nobody wants them because they do not like them, or it does not appeal, right?

In reference to the magazine, they do not want to read the October issue when the January issue is available, is that right? Is that the difference?

Mr. HOOPES. I think that is a difference, but I think there are considerable similarities in that we are dealing with consumer products of high topicality in each case. Mass paperback books are sold en masse in airports and other places.

Senator CURTIS. Are these sold on consignment?

Mr. HOOPES. It is as if they are sold on consignment, yes, sir. The publishers, both of books and records, have the obligation to take back returns.

Senator CURTIS. Would what you are advocating here have an application to all merchandise sold on consignment?

Mr. HOOPES. It would not, in our case, no, sir.

Senator CURTIS. That is all.

Senator BYRD. Thank you, Senator Curtis.

On the coupons, over a period of time, will that not be a wash, whether you use the present system or whether you go to the system that you are recommending?

Mr. PRATT. It is basically a timing difference, Senator, but the problem is that if you are forced to switch methods and continue to issue coupons over a period of years, of course, you have a permanent cash loss because you are not allowed to accrue a liability that exists at the end of each year. In other words, you never catch up with what you lost the year of the changeover.

Coupons have grown over the years and, of course, any time that you are required to change accounting methods you have to pay a big tax to the Internal Revenue Service and you do not really get that back, on a cumulative basis, until you either go out of business or you drop your coupon business entirely.

Senator BYRD. Well, in regard to Senator Kuchel and Mr. Hoopes' situation, what will be done with the funds due to be refunded under the old rule if a company elects to be covered under the new methods?

Mr. HOOPES. I think the bill provides, if I may say so, in the case of magazines for a recovery by the taxpayer over a 5-year period. The impact of the transitional adjustment will be spread over 5 years, in the case of magazines.

As the bill is now written, the transitional adjustment will go into a suspense account in the case of paperback books and records, and we are recommending that a comparable spreading technique be applied, as in the case of magazines.

Mr. KUCHEL. Mr. Chairman, may I comment on that?
Senator BYRD. Yes.
Mr. KUCHEL. Mr. Chairman, I think your question concerns the transitional year when the taxpayer elects, as he is given the right to do here.
Senator BYRD. Right.
Mr. KUCHEL. The magazine publishers must spread out the money represented by the transitional year over a 5-year period, whereas, as my friend has suggested, the book publisher or record manufacturer must establish for that one transitional year a suspense account.
That was written into the bill in the House to lessen the impact on the Treasury and the Treasury Department's position pretty generally approves the bill before you, with one caveat directed at our people.
The Treasury Department, according to your staff, believes that the relief provided by the bill should be allowed only to those taxpayers who, in the year they elect the new method of accounting, establish a suspense account to delay the reduction for goods returned during the year the election is made or the due date, without extension of time, for filing the income tax for the prior year.
Requiring a suspense account, says the Treasury, would prevent a substantial revenue loss in the year of enactment.
However, it says, Mr. Chairman, in the case of an election to account for magazine returns under the bill, if it is determined, and it means by this committee and by the Congress, that amortization of the transitional adjustment is preferable to the establishment of a suspense account—and it is confining this comment to magazines—the Treasury Department recommends that the normal 10-year amortization period for such adjustments be used instead of the 5 years which the bill does.
I would like to point out, too, Mr. Chairman—just one more sentence—we are given the 2½-month period in which to accept returns after the close of the taxable year. The way the bill reads before you the paperback and record people are given 4½ months.
I just want to say that the magazine people do not quarrel with what the House did, and I again urge your favorable consideration .
Senator BYRD. Well, in regard to the 2½ months and the 4½ months, does the corporate report not have to be filed within 2½ months following the close of the fiscal year?
And, if so, how would the 2½-month proposal be handled?
Mr. HOOPES. Mr. Chairman, I would like to refer to my counsel to answer that question. I can tell you that the 4½ months was developed because it is consistent with the pattern of distribution and return in the paperback and record industries, but in technical response to your question, let me refer to counsel.
Mr. KLAYMAN. Mr. Chairman, my name is Robert A. Klayman and I will respond to your question.
We are dealing here with corporations in these various industries, and corporations are permitted an automatic extension of a 3-month period for filing their returns. And, even without regard to this legislation, almost all corporations avail themselves of that, so their returns are actually filed 5½ months after the close of the preceding year.
The reason for the 4½-month period would be that it would permit the recognition of the returns that come in after the year in keeping

with the practices of these industries and still not require any additional extensions of time, because you would have from 4½ months to 5½ months to get the returns prepared.

Senator BYRD. You say the 3 months extension is automatic? Three months extension beyond the 2½?

Mr. KLAYMAN. If it is requested.

Senator BYRD. Thank you.

Senator Packwood?

Senator PACKWOOD. I have no questions.

Senator BYRD. Thank you, gentlemen.

[The prepared statements of the preceding panel follow:]

STATEMENT OF ROBERT E. McDAVID

SUMMARY OF PRINCIPAL POINTS

The statement explains the reasons why magazine publishers are erroneously taxed on their newsstand sales and how H.R. 3050 will provide relief.

STATEMENT

My name is Robert E. McDavid. I am a Certified Public Accountant representing Petersen Publishing Company, Los Angeles, California.

My statement relates *only* to the portion of H.R. 3050 pertaining to publishers who sell magazines on newsstands. It explains why those publishers need H.R. 3050, a Bill titled "Tax Treatment of Magazines, Paperbacks and Records".

Publishers distribute more copies of magazines to newsdealers than will be sold in order to obtain effective newsstand display. A reserve for return of unsold copies, having a dollar total equal of the sales value of the estimated overshipment, is established concurrent with the date of shipment.

Magazines are sold to newsdealers on a fully returnable basis. Newsstand magazines have a predetermined on-sale period and upon expiration of that period, the next subsequent issues are delivered to newsdealers and the unsold copies of the off-sale issues are returned to the publishers for credit.

It is not unusual for publishers to show a reserve balance applicable to three separate issues. Normally two of the three issues are off-sale and the unsold copies are in the process of being returned. Open reserve balances have little or no effect in the determination of actual final sales. The sales results were predetermined when the reserve for returns was established.

The Internal Revenue Service, in its interpretation of the Code, maintains that unsold magazines must be *received* by publishers before they can be used to reduce the sale dollar value of the original gross shipments to newsdealers. This means that, at tax year-end, all reserve balances, including reserves applicable to off-sale magazines, must be added to the *true* sales to determine taxable income.

This inequity in the Internal Revenue Code requires publishers to pay income tax on non-existing income. It is a prepayment of tax that is *not* owed. It deprives the publishers of the use of their funds that may be needed to operate and expand their businesses.

H.R. 3050 will permit publishers to take into account unsold magazines *received* from newsdealers within two months and fifteen days after the close of their tax year. This extra time of 75 days, to receive and process returned magazines that were sold in the prior year, will alleviate to a large extent, the present tax inequity. It will also reflect taxable income in the year earned.

I urge your approval of H.R. 3050.

STATEMENT OF JAMES PRATT, VICE PRESIDENT AND DIRECTOR OF TAXES, GENERAL MILLS, INC.

SUMMARY

1. We support the principle in H.R. 3050, which provides a special method of accounting for publishers and distributors of magazines, books, and records.

2. Since 1918, Treasury regulations have provided a similar method of accounting for manufacturers of food and other products who issue redeemable coupons and for trading stamp companies.

3. H.R. 3050 should be expanded to codify in statutory form this long-standing method of accounting for coupons and trading stamps.
4. Over one thousand companies issue coupons, and coupons are used by two out of every three families as an integral part of their shopping for food and other basic essentials.
5. After 60 years, the Internal Revenue Service has "reinterpreted" the regulations, and in Revenue Ruling 78-212 held that this method of accounting does not apply to "media" coupons and "cents-off" coupons.
6. In order not to disrupt the coupon system or to create arbitrary distinctions, H.R. 3050 should reaffirm the application of the method of accounting to "media" and "cents-off" coupons.

STATEMENT

Mr. Chairman and members of the Committee. My name is James Pratt, Vice President and Director of Taxes, of General Mills, Inc., in Minneapolis, Minnesota. I am accompanied by Mr. Roger Sherman, Manager of Taxation, of Pillsbury Company, who supports my statement. We are also accompanied by Mr. Ernest S. Christian, Jr., of the Washington, D.C. law firm of Patton, Boggs & Blow.

H.R. 3050 provides a special tax accounting rule in the case of sales and returns of magazines books, and records. When, for example, a publisher or distributor of a magazine sells a quantity of magazines to a dealer, he is obligated to repurchase so-called "returns" which the dealer does not sell to customers. However, many such "returns" do not come back to the publisher or distributor for repurchase until several months after the end of the taxable year in which the magazines were sold. Accordingly, in order accurately to reflect income, H.R. 3050 permits an accrual method publisher to accrue for the taxable year in which the magazines were sold, the expense of repurchasing magazines which are returned within 2½ months after the end of the taxable year. Absent the special method of accounting that would be added by proposed new Code section 457, an accrual method publisher or distributor would be required to prepay taxes he does not owe.

We support the principle of H.R. 3050. However, we believe that H.R. 3050 is too narrow in scope. H.R. 3050 should be expanded to apply the same tax accounting principle to redeemable coupons and to trading stamps which present an exactly similar situation.

Indeed, since 1918, the Treasury regulations, § 1.451-4, have provided a comparable method of accounting for redeemable coupons and trading stamps. When, for example, an accrual basis manufacturer of food products such as General Mills, Inc., sells products during the taxable year, and also issues redeemable coupons to consumers of such products, its income is the price for which the products were sold minus its liability to redeem the coupons. But, like returns of magazines, many coupons do not come in for redemption until after the end of the taxable year. Unlike returns of magazines, however, coupons do not all come in for redemption within a period of 2½ months after the end of the year.

Nevertheless, by using statistical data built up over many years, and methods prescribed by the Treasury, the number of coupons that will be presented for redemption can, as of the end of the taxable year, be predicted with a high degree of accuracy. Thus, Treasury Reg. § 1.451-4 has for 60 years provided that the amount of such liability is to be estimated and accrued as of the end of the taxable year. Any slight inaccuracies are taken into account in subsequent accruals for estimated future redemptions.

This method of accounting for coupons and trading stamps has worked well for many years and insofar as is known, no problems of inaccuracy or misuse have ever been associated with it. Absent this method of accounting, thousands of manufacturers and all trading stamp companies would have to prepay taxes they do not owe.

Redeemable coupons, as well as trading stamps, play a large and vital role in the efficient retail distribution of goods at the lowest price to consumers. Redeemable coupons are most prevalent in the sale of dry packaged food products, but are also used to a substantial extent in the sale of household products, toiletries, drugstore items and the like. Over one thousand manufacturers all over the country now issue coupons. The issuance and use of coupons is increasing. The annual volume of coupons issued is now approximately 60 billion; compared to about 45 billion coupons issued in 1976 and 35 billion coupons issued in 1974. This greater importance of coupons is significantly attributable to increasing inflationary pressures on the price of food and other

basic consumer purchases. It is obvious that the discounts offered by coupons assume greater importance when family budgets for food and other essentials are squeezed tighter by inflated price levels.

The average redemption value of a coupon is 15 cents—often as much as 25 percent of the cost of the merchandise. Coupon discounts are especially important to large families. Coupon usage is particularly high in large urban areas where there are concentrations of low income families. However, coupon usage is widespread throughout the nation. Two out of every three families use coupons as in integral part of their shopping. Coupons are a means by which manufacturers selectively provide discounts to those families to whom discounts are the most important, and are the only effective way of assuring that these discounts are actually passed on, beyond the retailer, to the consumer.

Thus, as it is important to provide in H.R. 3050 the special method of accounting for magazines, books, and records, it is also important to perpetuate in statutory form the long-standing, and similar, tax accounting rule for coupons and trading stamps which has been contained in the regulations.

The greater certainty and more uniform application provided by a statutory rule will facilitate the increasingly vital role of redeemable coupons and trading stamps in ameliorating to some extent the spiraling inflationary pressures on the prices of food and other basic consumer products.

The need to reaffirm this method of accounting is made particularly timely by recent actions by the Treasury and the Internal Revenue Service.

Although the language of the regulations has not been changed, after over a half century, the Internal Revenue Service has arbitrarily reinterpreted Reg. § 1.451–4. On June 5, 1978, Revenue Ruling 78–212 announced that this method of accounting does not apply to so-called "media" coupons which are issued by manufacturers in newspapers and other publications. Revenue Ruling 78–212 also held that this method of accounting does not apply to so-called "cents-off" coupons which entitle the consumer to a discount on a subsequent purchase. "Cents-off" coupons have been in use, and subject to this accounting method, at least since 1927. Such a reinterpretation, after 60 years, is as a basic proposition unjustified. The grounds stated in Revenue Ruling 78–212 are also erroneous.

The result is to disqualify nearly all coupons, to require substantial prepayments of tax by some issuers of coupons but not by others, and to disrupt the efficient distribution and discount system represented by coupons. Hundreds of manufacturers all over the country are directly affected, and many millions of consumers are indirectly affected.

Revenue Ruling 78–212 not only creates inconsistent and random distinctions between different forms of coupons where no differences in substance exist, it would also create unjustified differences between coupon on the one hand and trading stamps on the other. For example, all trading stamps, as well as a few coupons, presumably would remain under the method of accounting prescribed by the regulation and have the competitive advantage of not being required to prepay tax. Ultimately, the Internal Revenue Service may also deny the application of this method of accounting to trading stamps. Otherwise, it may maintain a totally arbitrary position in which one taxpayer is required to prepay tax and another not.

Accordingly, we would urge that H.R. 3050 be expanded to add proposed new section 458 to the Internal Revenue Code which would codify the historical method of accounting in the regulations and reaffirm its application to "media" coupons and "cents-off" coupons, as well as to trading stamps and the other redeemable coupons to which the regulation has applied. A form of such amendment is contained in H.R. 13047, which was recently introduced in the House by Mr. Frenzel of Minnesota.

A complete description of the coupon system, and the types of coupons in use, is set forth in an appendix to my prepared written statement.

I thank the Committee for its attention.

June 19, 1978.

Appendix to Prepared Written Statement of James Pratt

Brief Discription of Trading Stamp and Coupon Systems

A. Trading stamps

Every shopper is familiar with trading stamps. Although there are many trading stamp companies and stamps, perhaps the most well-known are S&H "green" stamps. A trading stamp company issues the stamps by selling them for a

specific price to a retailer. The retailer then distributes them to his customers in proportion to their purchases from him. Any particular dollar amount of purchases entitles the customer to a specific number of stamps. Typically, when the purchaser has accumulated a sufficient number of stamps, he can redeem them for merchandise at a redemption center maintained by the trading stamp company. The redemption center stocks a wide variety of consumer merchandise—each item of which has a price expressed as a number of trading stamps.

Thus, in essence, the trading stamp system is a method by which each retailer promotes his own sales, at his own expense, by allowing a discount to his customers in the form of redeemable stamps which he has purchased from the issuer—the trading stamp company.

B. Redeemable coupons

Although equally familiar to every shopper, the redeemable coupon system is somewhat more complex and varied. In this case, the manufacturer of a product issues the coupons in connection with a sale of that product by a retailer. The most typical case is where the manufacturer of a product issues a coupon entitling a consumer to a specified discount on the retail purchase of one of the manufacturer's products. The consumer takes the coupon to one of the retail stores which sell that product. The retailer allows the discount on the retail sale by him, collects the coupon, and then sends the coupon to the manufacturer who issued it. The manufacturer then redeems the coupon by cash payment to the retailer.

Coupons are issued in several ways. So-called "media" coupons are issued gratuitously in newspapers, magazines and the like. A potential customer may clip out the coupon, take it to any store which sells the product, and apply it against the price. Sometimes such coupons are distributed to potential customers by direct mail or by circulars. Similar to "media" coupons are "in-ad" coupons, inserted by the manufacturer in the retailer's weekly advertisements. Coupons may also be issued by attaching them to a product. This is the familiar "in-pak/on-pak" coupon. In this case, a consumer who purchases the manufacturer's product at a retail store obtains not only that product, but a redeemable coupon also. In relative amounts, about 92 percent of all coupons issued are "media" coupons, and about 8 percent are "in-pak/on-pak" coupons. However, the redemption rate on "in-pak/on-pak" coupons is three times greater.

Coupons may also be used or redeemed in several ways. A "cents-off" coupon, whether issued in the media or attached to a product, entitles that user to a discount of a specified amount on the purchase of merchandise. If such a coupon is an "in-pak/on-pak" coupon, the merchandise for which it can be exchanged may be the same product as the item to which the coupon was attached, or may be some other product.[1]

Other coupons widely in use are much like trading stamps: once the consumer has accumulated the required minimum number of coupons, he may exchange them for an item of merchandise or, occasionally, for cash. It is relatively rare that a single coupon will entitle the user to obtain cash or to obtain a whole item of merchandise without the payment of at least part of its price.

The result of all coupons, however issued and however redeemable, is to create a *liability* on the part of the issuer to redeem them and to *reduce* the effective price of a wide variety of consumer products in connection with which coupons are issued.

ROLE AND SIGNIFICANCE OF COUPONS

Coupons play a large and vital role in the efficient retail distribution of goods at the lowest price to consumers. Redeemable coupons are most prevalent in the sale of dry packaged foods, but are also used to a substantial extent in the sale of household products, toiletries, drugstore items and the like. Today, approximately one thousand different manufacturers issue coupons in connection with the retail sale of their products and two out of every three households use coupons as an integral part of their regular shopping.

The issuance and use of coupons is increasing. The annual volume of coupons issued is now approximately 60 billion; compared to about 45 billion coupons

[1] When a coupon on one product may be applied against the purchase of a different product, it is called "cross-couponing". That type of coupon arrangement is, however, relatively minor in amount.

issued in 1976 and 35 billion coupons issued in 1974. This greater importance of coupons is significantly attributable to increasing inflationary pressures on the prices of food and other basic consumer purchases. During periods of high inflation, manufacturers tend to switch part of their budgets out of advertising and into coupons.[2] Advertising is primarily designed to increase sales above existing levels. But in a period of high inflation, when the price elasticity of demand becomes critical, the discounts offered by coupons may better serve to *maintain* sales. From the standpoint of the consumer, it is obvious that the discounts offered by coupons assume greater importance when family budgets for food and other essentials are squeezed tighter by inflated price levels.

The discounts offered by redeemable coupons are substantial in amount. The average face value of redeemable coupons is about 15 cents each and the average price of food products purchased with coupons is about 60 cents—a discount of roughly 25 percent. In the aggregate, the total sales price of food products purchased with coupons is about $1 billion annually, ultimately reduced by about $250 million in coupons redeemed. If all available coupons on all products were in fact used by consumers, the savings would be about $8 billion annually, or about $112 per household.

The potential savings to consumers who maximize the use of coupons, as well as the high degree of interest among shoppers, is illustrated by an article at page 107 of the May 22, 1978 issue of *People* magazine. By assiduous, systematic use of all available coupons, a young housewife was able to feed her family of three on $10 per week. After appearing on a local television program, she received 80,000 letters inquiring about her coupon techniques. Since then, she has begun the publication of a newsletter to keep other consumers informed.

The importance of coupons is, however, not limited to the absolute amount of the discounts and indirect price reductions involved. Perhaps more important is the way the coupon system works in selectively providing the discounts, at the least cost, to those consumers to whom the reducton in price is most significant. In effect, coupons provide a discount at the option of the consumer. Those consumers who are not motivated to save the coupons and use them will receive a discount. Those consumers to whom the reduction in price is less important will not save the coupons, and will thus pay the full price for their purchases. Accordingly, a manufacturer, through the mechanism of the coupon system, is able to offer a larger price reduction to those who desire it, than he could by merely reducing the basic price of his product across-the-board. Moreover, coupons are the only mechanism by which a manufacturer can assure that discounts and indirect price reductions are actually received by consumers. If the manufacturer merely reduced the wholesale price of products, the redudction might be taken up by the retailer and not passed on to the consumer.

Efficient shoppers in all parts of the country use coupons, without regard to income level, family size or age. Nevertheless, there are variations. Coupon usage is greatest among large families. The data indicate that 78 percent of large families use coupons, and only 60 percent of small families use coupons. Coupons are, in fact, the only practical way of allowing what amount to volume discounts, where numerous small items are bought intermittently, as needed, at many different retail stores.

In addition, the greatest potential beneficiaries of coupons are low and middle income families. Some data indicate that middle and upper income families use the most coupons; but those famlies also purchase the most merchandise. On the other hand, when expressed as a percentage of family income or as a percentage of the family budget for food, coupon discounts loom largest for lower income families. Some indication of this relative importance is the unusually high incidence of coupon usage by consumers in New York City, in Chicago, and in other areas where there are large concentrations of urban families, many of whom have lower incomes. Typically, a family in the income bracket of $5,000 to $10,000 would spend $29.72 per week for food. On the average, coupons provide such a family about 1½ days of "free" food per year. Many low income families who maximize the use of coupons achieve a much greater savings on the food costs.

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[2] *Wall Street Journal*, June 6, 1978, p. 20.

A. *Historical application of method of accounting* [3]

The income of an accrual basis manufacturer who issues coupons in connection with sales of his product is the amount for which he sold the product *minus* the amount he has paid to redeem coupons during the taxable year, and *minus* his liability for future redemption of coupons which, as of the end of the year, have not yet been presented for redemption.

Since 1918, Treasury regulation § 1.451–4 and its predecessors [4] have provided that the liability for future redemption is to be accrued at the end of the taxable year. The amount of such accrued liability is to be determined by estimating the number of coupons outstanding that will be presented for redemption, and by multiplying that number by the average cost of redeeming each such coupon. The Internal Revenue Service has prescribed detailed procedures for making these estimates. Over many years, the industry as a whole, and each manufacturer individually, has built up a substantial statistical base. As a result, the number of coupons which will be presented for redemption can be estimated with great accuracy. Although there are variations among different companies and types of coupons, on an industry-wide average, about 5 percent of the coupons issued are ultimately presented for redemption. The average rate of redemption on 'in-pak/on-pak" coupons is, however, about 11 percent.

Insofar as is known, there have never been any significant problems of misuse or inaccuracy associated with this method of accounting for stamps and coupons prescribed by Treasury regulation § 1.451–4. Without this method of accounting, issuers of trading stamps or coupons would be required to prepay substantial amounts of taxes which, in fact, they do not owe. It is clear at the time of issuance that a certain amount of the coupons will be presented for redemption. The only question is with respect to a very small margin of variance around that base amount; and even that variation can be predicted with sufficient accuracy to permit accrual of the liability—especially in view of the procedure in Treasury regulation § 1.451–4 for adjusting any small inaccuracies that may occur.

Over the period of years since 1918, this method of accounting for coupons has in various respects been broadly interpreted in order to give effect to its intended meaning. See *Gunn Bros. Stamps, Inc.* v. *United States*, 75–2 USTC § 9740 (N.D. Tex. 1975); *Brown & Williamson Tobacco Corp.*, 16 T.C. 432 (1951); *United States* v. *Morrison Stores of Fairmont*, 99 F. 2d, 77 (4th Cir. 1938); and *Creamette Company*, 37 B.T.A. 216 (1938). Historically, the method of accounting prescribed in Reg. § 1.451–4 has applied to "cents-off" coupons, "media" coupons, and the other types of cash and merchandise coupons previously described. "Cents-off" coupons, for example, have been in use by one major manufacturer of household products at least since 1927, and the Raleigh coupons have been in use at least since 1932.

B. *Recent reinterpretation by Internal Revenue Service*

After more than a half century, the Internal Revenue Service has now undertaken to reinterpret Treasury regulation § 1.451–4 in a manner contrary to its historical application and intended meaning.

Although the language of the regulation has not been changed, on June 5, 1978, the Internal Revenue Service published Revenue Ruling 78–212 which held that the method of accounting prescribed in Reg. § 1.451–4 does not apply to "media" coupons or "in-ad" coupons, and does not apply to "cents-off" coupons, however issued.

The result is to disqualify nearly all [5] coupons, to require substantial prepayments of tax by some issuers of coupons but not by others, and to disrupt the efficient distribution and discount system represented by coupons. Revenue Ruling 78-212 also creates inconsistent and random distinctions between different forms of coupons where no differences in substance exist, and would create further unjustified differences between coupons on the one hand and trading stamps on the other. For example, all trading stamps, as well as a few coupons, would remain under the method of accounting prescribed by the regulation and have the competitive advantage of not being required to prepay income taxes.

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[3] This discussion is equally applicable to trading stamps. It is, however, concentrated on redeemable coupons because it is coupons, not stamps, that would be affected by Revenue Ruling 78–212.

[4] Reg. 45, Art. 88 (Revenue Act of 1918).

[5] Widely used and accepted data indicates that the overwhelming majority of all coupons historically covered by Reg. § 1.451–4 would be disqualified.

A reinterpretation of the historical meaning of Reg. § 1.451–4, after many decades and countless audits of taxpayers, is unwarranted as a basic proposition. A sudden[6] and drastic change of such magnitude and consequences, based on such tenuous grounds is, in the opinion of many, sufficiently arbitrary to be unauthorized. See *Fribourgh Navigation Company* v. *Commissioner*, 383 U.S. 272 (1966).

At best, this recent action by the Internal Revenue Service is an example of the type of tax administration that ought not occur.

Wholly apart from the broader considerations of sound tax policy and administration, the new interpretation of Reg. § 1.451–4 utterly departs from logic and the plain meaning of the language in the regulation. The narrow technical grounds stated in Revenue Ruling 78–212 simply do not support its conclusion that "media", "in-ad", and "cents-off" coupons suddenly are outside the scope of Reg. § 1.451–4. To understand this most clearly, it is necessary to go back to the basic purpose of Reg. §1.451–4.

The method of accounting in the regulation is designed to achieve, in the special circumstances of coupons, essentially the same result as would occur if the amount of coupons issued were exactly equal to the amount of coupons the manufacturer ultimately would have to redeem. If all coupons issued during the year were certain to be redeemed, there would be no need for Reg. § 1.451–4. Under the basic accrual accounting rules in the Code, the manufacturer's accrued income from total sales of all products during the year properly would be *matched* with his total accrued liability to redeem in the future any coupons issued during the year. Such tortured distinctions as Revenue Ruling 78–212 seeks to make between different coupons would be irrelevant; as would the Internal Revenue Service's new insistence on trying to match particular coupons with particular items of merchandise. Reg. § 1.451–4 serves only closely to approximate the same result by means of *estimating* the number of coupons that will be redeemed. Therefore, distinctions between different coupons and attempts at item-by-item matching are equally irrelevant to Reg. § 1.451–4.

Nevertheless, Revenue Ruling 78–212 concludes that "media" and "in-ad" coupons are disqualified because, it is said, they are not issued "with sales". The purportedly critical phrase in Reg. § 1.451–4(a)(1) is as follows: "an accrual basis taxpayer issues trading stamps or premium coupons with sales". But the term "with sales" is only descriptive, not limiting in any technical sense. In view of the purpose of Reg. § 1.451–4, the meaning of "with sales" is obvious. The term "with sales" means no more than "associated with sales" or "in connection with sales". The whole point of the regulation is to determine the amount of the manufacturer's actual income from the sale of products, taking into account his liability for coupons which are related to sales of products. Where, as part of a single sales promotion and pricing structure, a manufacturer is *selling* products wholesale to a retailer and the products are sitting on the store shelf for resale to the consumer, and the manufacturer is also *issuing* to potential retail consumers coupons which they can apply to the purchase price of the manufacturer's products, it is inconceivable that those coupons are not issued "with sales" within the meaning of the regulation.

It is not apparent why a coupon is any more or less issued "with sales", depending upon whether the coupon is delivered to a consumer by being attached to the product or by inclusion in the customer's morning paper. Yet, Revenue Ruling 78–212 concludes that an "in-pak/on-pak" coupon is issued "with sales", but that a "media" coupon is not issued "with sales". Even if the literal language of the regulation were after 50 years subject to such an interpretation, what conceivable reason could there be for straining to read it that way. Certainly, such a distinction between coupons is unrelated to the purpose of the regulation, which is accurately to reflect income on an accrual basis.

Revenue Ruling 78–212 also concludes that a "cents-off" coupon, even though issued "in-pak/on-pak", is disqualified because it is not, as the regulation requires, "redeemable in merchandise, cash or other property." Here Revenue Ruling 78–212 undertakes to distinguish between coupons redeemable in cash or redeemable for the full value of an item of merchandise, and coupons which represent only part of the value of an item of merchandise; i.e., discount or "cents-off" coupons. Obviously, however, the right to purchase an item of merchandise at a reduced price has value. When such coupon is used to satisfy part of the purchase

[6] It was not until 1973, in Revenue Ruling 73–415, which dealt with "media" coupons, that the Internal Revenue Service began the process of dismantling Reg. § 1.451–4; which process has now culminated in Revenue Ruling 78–212.

price or merchandise, the user has exchanged it either for the equivalent of cash, or, in the words of the regulation, "other property." Certainly, for other purposes of the Code, and in other regulations of the Internal Revenue Service, the right to purchase at a discount is treated as the equivalent of cash or as "other property".[7] Thus if the redemption of a "cents-off" coupon occurs when the consumer uses it to obtain a discount, then such coupons fall squarely *within* the literal language of the regulation.

Revenue Ruling 78-212 advances further justification for its conclusion that "cents-off" coupons are excluded from the regulation. The basic concept of Reg. § 1.451-4 is stated by Revenue Ruling 78-212 to be as follows:

"Implicit to the matching concept is that the issuance of a coupon with the sale of a product creates an incidental obligation in an accrual method taxpayer that requires the taxpayer to incur additional expenses at some future time. *Mooney Aircraft Inc.* v. *United States*, 420 F. 2d 400 (5th Cir. 1970). This additional expense of coupon redemption is properly matched with the revenue derived from the sale of the product with which the coupon was issued."

Except for the Internal Revenue Service's new erroneous interpretation of "with sales", the quoted statement would be reasonably accurate had Revenue Ruling 78-212 stopped there and said no more. But this would not support the conclusion reached and Revenue Ruling 78-212 went on to say:

"Such right of redemption must be unconditional, that is, the coupons must be redeemable without additional consideration from the consumer * * *.

"The purpose of section 1.451-4 is to match, in the same taxable year, revenues with expenses incurred in producing those revenues * * *.

"When the right of redemption of the *in pak* and *on pack* coupon is conditioned on an additional purchase of the retailer's product by the consumer, the purpose of section 1.451-4 of the regulation is not fulfilled * * *.

"The amount of the discount is an expense properly attributable to the revenue derived from the second purchase and not the first because the retailer has no obligation to redeem until the second purchase of its product."

In this statement of its penultimate conclusion Revenue Ruling 78-212 seems to be saying a number of things, all of which are erroneous. First, by citing the *Mooney* case, the ruling seems to be saying that, in order for Reg. § 1.451-4 to apply, the redemption of each coupon must be *certain* to occur. But that obviously could not be correct. The whole purpose of Reg. § 1.451-4 is to provide a method of accounting based on *estimating* the number of stamps and coupons that will be presented for redemption, in circumstances where it is clear that the vast majority of stamps and coupons issued will not be redeemed. No stamp or coupon is certain to be redeemed, and if such certainty were to be required, the entire regulation would be pointless.

Next, Revenue Ruling 78-212 seems to be saying that the consumer's ability to use the coupon cannot be conditioned upon the consumer making an additional purchase. But that obviously cannot be the case either. It is not only the "cents-off" coupons in Revenue Ruling 78-212 that involve an additional purchase. Almost all "in-pak/on-pak" coupons in use, both presently and in the past, involve additional purchases. Certainly the coupons in use in the early days, when the regulation was taking shape and around which it was built, involved additional purchases. So do trading stamps which were as recently as 1972 included in Reg. § 1.451-4 by a special amendment to the regulation.

A good example is the familiar Raleigh coupons in use at least as early as 1932, and still in use today. As described by the Tax Court in *Brown & Williamson Tobacco Corp.*, supra, a coupon attached to the package of cigarettes had a cash redemption value of ¾ of a cent. Quite clearly, the consumer had to purchase at least one additional package of cigarettes in order to be able to get even one cent of redemption value—which would not have paid the cost of first-class postage to mail the coupon into Raleigh for redemption. As a practical matter, only if the consumer continued to make additional purchases over a period of time could he accumulate coupons in a useable monetary amount. Only then could he have them redeemed for either cash or merchandise.

Other similar coupons to which Reg. § 1.451-4 has traditionally applied are as follows: (i) merchandise or cash may be obtained for some specified number of labels or box tops, but rarely for only one such top; (ii) book clubs and record clubs issue "dividend" coupons which can only be used after the consumer has made enough additional purchases to accumulate the number of "dividends" required to obtain a "free" book or record.

[7] See sections 356(a), 1001(b) and 1031(b) of the Internal Revenue Code.

Trading stamps also involve additional purchases by the consumer. There is nothing so worthless as one trading stamp or even ten trading stamps. The consumer must accumulate a significant number of stamps in order to redeem any of them. Moreover, there are very few individual items in a food store, for example, which alone carry with them a sufficient number of trading stamps to reach the minimum redeemable amount. In fact, the whole structure and concept of the trading stamp system is based on the accumulation of stamps from a large number of purchases over a period of time.

In view of these facts, how can Revenue Ruling 78–212 conclude that "cents-off" coupons are outside the scope of Reg. § 1.451–4? "Cents-off" coupons are no more and no less "conditioned on an additional purchase" than are all stamps and nearly all "in-pak/on-pak" coupons. The logical dilemma is apparent. If the Internal Revenue Service applies Revenue Ruling 78–212 only to "cents-off" coupons, then the regulation, as so interpreted, is sufficiently arbitrary and unreasonable to be unlawful. If, on the other hand, Revenue Ruling 78–212 is extended to the other coupons and to trading stamps as its stated rationale would compel, the regulations would apply only to a few fairly isolated coupon transactions. A regulation so narrowly confined, for no rational reason related to accrual accounting, would be sufficiently arbitrary and unreasonable to be unlawful.

Two other errors in the above-quoted language of Revenue Ruling 78–212 must be mentioned. It is not correct, as Revenue Ruling 78–212 subtly implies, that the purpose of accrual accounting in general, or the purpose of the method of accounting in Reg. § 1.451–4, is to match revenues and expenses "in the taxable year" *on an item-by-item basis.* Moreover, even if that were the case, it would not justify the conclusion that a "cents-off" coupon is outside the regulation because it is an expense attributable to the revenue from the second purchase instead of the first purchase to which the "in-pak/on-pak" coupon was attached.

This last assertion in Revenue Ruling 78–212 is indicative of a fundamental misunderstanding of Reg. § 1.451–4. The necessary comparison is between the *issuance* of a coupon, the *use* by the consumer and the *redemption* by the issuer. In the case of an "in-pak/on-pak" coupon, the manufacturer *issues* the coupon when he attaches it to the product and sells the product to the retailer. It is the manufacturer's liability to redeem this coupon which Reg. § 1.451–4 requires to be estimated and accrued as of the end of the year in which the coupon was *issued.* The *use* of the coupon by the consumer in obtaining cash or merchandise is either the redemption or a stage in the redemption process, depending on which type coupon is involved. If, for example, the consumer sends in four box tops to the manufacturer in exchange for cash or merchandise, the *use* by the consumer is the *redemption* by the manufacturer who is the *issuer.* If, on the other hand, the manufacturer issues a "cents-off" coupon which the consumer turns in to the retailer for a discount on a purchase, the *use* by the consumer is only a step in the redemption process. The actual redemption by the *issuer*—to which Reg. § 1.451–4 clearly is referring—takes place when the retailer presents the coupon to the manufacturer who *redeems* it for cash.

This point alone is sufficient to invalidate Revenue Ruling 78–212 as an interpretation of Reg. § 1.451–4, both in the case of "media" coupons and in the case of "in-pak/on-pak" coupons. One need only read the regulation as follows:

"If an accrual method taxpayer issues * * * coupons with sales * * * and such * * * coupons are redeemable by such taxpayer in merchandise, cash, or other property, the taxpayer should, in computing the income from such sales, subtract from gross receipts * * *."

It is perfectly clear that the manufacturer is both the *issuer* and the *taxpayer* and that, in the case of the "cents-off" coupon described, the taxpayer has redeemed the coupon for *cash.* The fact that Reg. § 1.451–4 also refers to a redemption by the *taxpayer* in "merchandise * * * or other property" does not mean that a "cents-off" coupon is redeemed by the taxpayer when the coupon is used at the retail store. The reason the regulation refers to redemptions by all three means is because the regulation also covers other types of coupon transactions, as described, in which the consumer sends the coupon to the manufacturer in exchange for merchandise or other property. The foregoing is thought to be a correct interpretation of Reg. § 1.451–4; but even if the retailer is considered to be the manufacturer's agent and the redemption by the *taxpayer* occurs when the consumer is allowed a discount on a purchase in exchange for the "cents-off" coupon, the *taxpayer* (the manufacturer) still has redeemed the coupon for the equivalent of cash, merchandise or other property. See discussion at page 15.

Finally, in an overall assessment of Revenue Ruling 78–212, it must be kept in mind that the Internal Revenue Service is, in that ruling, reinterpreting *its own*

regulation. Thus, the tortured new interpretation of Reg. § 1.451–4 is not the result of being constrained by narrow, mandatory statutory language. If, after many decades, the precise language of the regulation were somehow thought to compel the illogical result in Revenue Ruling 78–212, the Internal Revenue Service could readily change the language to continue to give effect to its long-standing and intended meaning.

On the other hand, if, as is obviously the case, the Internal Revenue Service no longer agrees with the method of accounting in Reg. § 1.451–4, it could, under established procedures, revoke the regulation. Such a revocation would, under section 7805 of the Code, be prospective only. However, instead of revoking the regulation, the Internal Revenue Service has chosen *to interpret it out of existence* for all taxpayers other than trading stamp companies and a few issuers of coupons. Such *de facto* revocation is retroactive for 60 years and is contrary to section 7805 of the Code.

H.R. 3050 WOULD CODIFY REG. § 1.451–4 AS IT HAS HISTORICALLY BEEN APPLIED

In order to avoid the disruption of the coupon system, and to reflect accurately the income of accrual basis taxpayers, H.R. 3050 should be amended to add new section 458 to the Internal Revenue Code.

Section 458 would codify Reg. § 1.451–4 as it has been historically interpreted prior to Revenue Ruling 73–415 and Revenue Ruling 78–212. Thus, the accounting method prescribed by section 458 would apply to "media" coupons, "in-ad" coupons, and "cents-off" coupons, as well as to trading stamps and to other types of coupons described in this memorandum. New section 458 would, however, be elective by the taxpayer; whereas Reg. § 1.451–4 is mandatory. In all other respects, the new statutory rule would be the same as the regulations.

Proposed new Code section 458 reflects the same Congressional policy given effect in H.R. 3050, introduced by Mr. Corman of California, reported out by the Committee on Ways and Means, and recently passed by the House. H.R. 3050 would by statute apply a substantially similar accounting method of publishers and distributors of books, magazines, and records. In the case of magazines, etc., an accrual basis distributor must take into income the magazines, etc., "sold" to newstands and other retailers; but typically he has a liability to repurchase "returns" of unsold copies—a liability exactly similar to a manufacturer's liability to redeem coupons. However, many of these "returns" do not come in to the distributor until months after the close of the taxable year in which the magazines, etc., were sold by the distributor to the retailer.

In order not to require an accrual basis distributor to prepay a tax that he does not owe, H.R. 3050 permits the distributor to take into account "returns" made within 2½ months (in the case of magazines) or 4½ months (in the case of paperbacks and records) after the close of the taxable year in which the sale was made. That particular remedy was chosen because, in the case of magazines, etc., all permitted returns are made within the specified periods. In contrast, coupon redemptions are not confined to a specified period. Coupons continue to come in for redemption in significant amounts for many months after the year in which the coupons were issued. *However,* the number of coupons that will be presented for redemption *can,* as of the end of the taxable year, be estimated with a high degree of accuracy.

Hence, proposed new Code section 458 is in form slightly different from proposed new Code section 457 as contained in H.R. 3050; but in substance, the two amendments are the same and both reflect the same policy decision already recently adopted by the House.

STATEMENT OF THE ASSOCIATION OF AMERICAN PUBLISHERS, THE RECORDING INDUSTRY ASSOCIATION OF AMERICA, AND THE NATIONAL ASSOCIATION OF RECORDING MERCHANDISERS

SUMMARY OF PRINCIPAL POINTS

I. H.R. 3050 will prevent distortion of income by correcting present tax treatment of returns of magazines, paperback books, and sound recordings

H.R. 3050 will ameliorate a hardship faced by producers and distributors of magazines, paperback books, and sound recordings by adopting a tax accounting rule for returns of these products which is more consistent with the generally accepted accounting principle of matching income and expenses. In recognition of

the facts that (1) these taxpayers distribute more products than they expect to sell, (2) the products have a short shelf life at the retail level, (3) the taxpayers are under a legal obligation to accept all returns for full refund or credit, (4) there is a high rate of return (in excess of 20 percent in all three industries), and (5) a failure to match these returns with related sales results in a distortion of income. H.R. 3050 provides that distributions made in one taxable year and returned within a specified period after that taxable year are not includible in taxable income. The bill would thus bring tax accounting for returns into closer alignment with financial accounting.

II. H.R. 3050 would be improved by inclusion of an amendment to permit producers and distributors of paperback books and records to recover over a period of years the deduction for certain returns that will otherwise be lost because o fthe change in method of accounting

Because a change in method of accounting generally results in a duplication or omission of items of income or deductions, section 481 of the Code provides for an adjustment to income, spread over a period of years, to eliminate the duplication or omission. Under the change in method of accounting for returns provided by H.R. 3050, the deduction for certain actual returns would be lost. In the case of magazines, the bill provides that these lost deductions are to be recaptured over a 5-year period under section 481. In the case of paperback books and records, however, H.R. 3050 provides that section 481 is not to apply at all; rather the lost deductions are to be placed in "suspense." In effect, the lost deductions are deferred until the taxpayer goes out of business.

We urge that H.R. 3050 be amended so that the spreading technique of section 481 is extended to the paperback book and record industries.

STATEMENT

This Statement is submitted on behalf of the Association of American Publishers, the Recording Industry Association of America, and the National Association of Recording Merchandisers to urge passage of H.R. 3050.

I. Problem addressed by H.R. 3050

H.R. 3050 would go a long way toward eliminating a disparity which exists between the financial and income tax accounting of accrual basis taxpayers in the magazine, paperback book and sound recording industries. Under generally accepted accounting principles, producers and distributors of magazines, paperback books, and sound recordings are required to maintain a reserve to provide for refunds payable with respect to products returned after the close of the taxable year in which they were sold. Under current tax law, however, such reserves are considered nondeductible, even though the producer or distributor intentionally overdistributes its products to assure that adequate copies are available at the retail level to meet demand during the short shelf-life of these products, and even though the taxpayer is legally obligated to accept for refund all returns of the excess distributions. This results in significant distortions of taxable income because, in the three industries covered by the bill, the ratio of returns to sales is very high, ranging from about 20 percent up to as much as 60 percent.[1]

H.R. 3050 would ameliorate the income-distorting effect of the present tax law on producers and distributors of magazines, paperback books, and sound recordings. The bill would accord those taxpayers an elective right not to include in income for a taxable year products returned within a specified period after the close of that year (2½ months in the case of magazines and 4½ months in the case of paperback books and sound recordings), provided the taxpayer has a legal obligation to accept the returns.

In effect, H.R. 3050 would authorize a tax treatment for excess distributions of magazines, paperback books and sound recordings which is more consistent with economic realities than is the present treatment. Producers and distributors of these products would no longer be required to report artificially inflated income attributable to excess shipments of products—which will never really be sold.

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[1] A study of the American Institute of Certified Public Accountants singled out paperback publications, magazines and sound recordings as items that are so often returned that it is inappropriate to treat all distributions as completed sales. See Accounting Standards Division of AICPA, "Statement of Position on Revenue Recognition When Right of Return Exists." p. 16 (January 17, 1975).

II. Treatment of one-time revenue cost of permitting change in method of accounting for returns

Whenever a method of accounting is changed, an adjustment is necessary to prevent the omission or duplication of items of income or deductions. In general, section 481 of the Code prevents such duplications or omissions by spreading an adjustment over a period of years.

In the case of returns, the change to the more accurate method of accounting envisaged by H.R. 3050 would result in the loss of deductions for actual returns in the early part of the first year in which the new method is employed. For magazines, H.R. 3050 provides that the adjustment covered by section 481, that is, the lost deductions for returns in the first year of the new method, is to be spread equally over a 5-year period beginning with the year of change. However, in the case of paperback books and sound recordings, H.R. 3050 provides that section 481 is not to apply at all, but rather that the taxpayer is to place the deductions for those returns in "suspense." A complex suspense account procedure is provided under which the taxpayer can never take the deductions to which it is entitled so long as its business is stable or growing. In effect, the deductions are locked up until the taxpayer goes out of business.

The Association of American Publishers, the Recording Industry Association of America and the National Association of Recording Merchandisers believe that the treatment of the transition year adjustment as provided for the magazine industry in H.R. 3050 is fair and equitable. Indeed, we believe that the spreading technique provided by section 481, which is applied generally to changes in method of accounting, should be extended to the paperback book and sound recording industries as well. There is no sound reason to place the adjustments to which these taxpayers are entitled in suspense for an indefinite period of time. With this one change, we strongly urge that the Finance Committee approve H.R. 3050 as passed by the House of Representatives.

Senator BYRD. We have only one additional witness before calling on the Treasury for its comments on the various proposals. Our next witness will be Mr. Donald G. Brotzman, vice president, Rubber Manufacturers Association.

Mr. BROTZMAN. Thank you, Mr. Chairman.

I am accompanied at the table by Mr. Morgan of the law firm of Alexander and Green.

STATEMENT OF DONALD G. BROTZMAN, VICE PRESIDENT, RUBBER MANUFACTURERS ASSOCIATION

Mr. BROTZMAN. Very quickly, Mr. Chairman, the bill that I am speaking about here today is one that is probably familiar to this committee in that it, like others I have heard mentioned today, has been before this committee before. In fact, it was within about 1 inch of passage last session.

It passed the House of Representatives and then was reported out of this committee. It got caught in the rush to adjournment.

So we are back here today with a little bit more time. This measure, very briefly, codifies our existing practice of dealing with the adjustment and the credit on the excise tax when a tire is returned on a warranty.

I know the chairman is aware of the fact that there is an excise tax on tires and that particular tax is passed on down to the dealer and then down to the consumer.

We have a system working now that would appear to be infallible in that anyone that has a deficiency in a tire that is covered by a warranty can take it back to anyplace in this country where there is a dealer selling that particular tire and he will receive credit for the unused portion of the tire, not only as to the value of the tire, but also

will receive a credit on the unused portion of the tax, if I might put it that way.

This, then, redounds to the benefit of the manufacturer and the dealer. So that, as the system is currently working, it is fair and equitable to everyone.

By that, I mean first of all, the manufacturer is covered. He receives his credit. The customer is certainly taken care of, because he receives exactly the amount of the credit to which he is entitled, predicated upon measurement of the portion of the unused tread. And the Government also is paid its tax in a constitutional and legal manner in that it is uniformly applied.

The reason we are here is because the service has chosen another approach which does not have all of these laudatory features. The service, in its push for consistency, or at least theoretical consistency, is trying to apply a so-called ad valorem taxation system here and while technically it might sound good, it simply does not work, and actually is inequitable in its application.

So we have been able to receive two extensions on the application of that new system so that we might seek relief in the Congress of the United States in this regard.

Now, as the chairman notices, there was supposed to be another member or two on this particular panel today and may I comment on that very quickly, to mention the issue that they are interested in?

Under H.R. 5103, as originally drafted, we had also provided for other methods called "overall methods" of permitting excise tax adjustments which would have broadened the scope of how we could proceed in that it would have moved away from the strictly tire by tire arrangement to "warranty reserves" and "discounts in lieu of warranty."

However, as this particular measure was presented in the House of Representatives, first before Congressman Waggonner's Committee on Miscellaneous Taxation and then to the full Ways and Means Committee, the Treasury raised, and interposed, objections to the "discount in lieu of warranty" approach that I mentioned before.

Accordingly, we, in the interests of passage of this bill, struck that particular method out of the bill and this is what those individuals that were going to testify would have spoken in behalf of, because they believe, and certainly we, also, believe that it is a fair system of doing business.

However, I want to make it clear to the committee that we did make this agreement with the Treasury and that we are staying hitched with that particular agreement. However, we do feel that it is a fair system, and this is what they would have testified to.

Senator BYRD. Thank you, sir.

Senator Packwood?

Senator PACKWOOD. No questions.

Senator BYRD. Under this proposal, H.R. 5103, are there other industries, other than the tire manufacturing industry, which would benefit from it?

Mr. BROTZMAN. It basically would benefit the tire manufacturing industry but, of course, as I have said in my testimony in chief, really, I think that those who benefit the most are the customer, the consumer, because they will still be able to maintain this opportunity to go get their tire adjusted any place in this country.

32-978—78——10

Senator BYRD. Thank you, sir.
Mr. BROTZMAN. Thank you, Senator.
[The prepared statement of Mr. Brotzman follows:]

STATEMENT BY DONALD G. BROTZMAN, VICE PRESIDENT, RUBBER MANUFACTURERS ASSOCIATION

I am Donald G. Brotzman, Vice President of the Rubber Manufacturers Association. In this hearing today, the Association is representing the United States tire manufacturing industry. Our members have tire manufacturing facilities in 24 states, and when office and sales facilities are considered, are in active business in all 50 states. I am very pleased to have this opportunity to appear before the Subcommittee, in connection with H.R. 5103.

Initially, I would point out that the subject matter of H.R. 5103 should be familiar to the Committee. A bill introduced for the same objective was passed by the House in the last Congress, and after some adjustments to more precisely carry out the bill's purpose, was reported on favorably by the Senate Finance Committee. The version reported out by the Finance Committee was approved by the Joint Committee on Internal Revenue Taxation and was not objected to by the Treasury Department. It appears the bill would have been passed in the last Congress had it not been reported out so near to adjournment. H.R. 5103 unanimously passed the House of Representatives on March 14, 1978. Because of the implementation deadline in *Rev. Rul. 76-423* (presently April 1, 1978, with a request for extension pending at the date this statement is submitted), prompt action on H.R. 5103 is urgently needed. The Rubber Manufacturers Association strongly recommends adoption now of H.R. 5103 as the best solution to the problem of excise tax adjustments in connection with tire warranty adjustments.

If we take the subject to its barest essentials, the purpose of H.R. 5103 is to establish workable excise tax adjustment procedures for cases where new (or retreaded) tires fail before normal service and are adjusted under warranty or guaranty. The tire industry proposes to codify existing administrative procedures which have been proven to be workable for more than 40 years. The Internal Revenue Service has (through Rev. Rul. 76-423, 1976-2 C.B. 345) proposed drastically different procedures, involving substantial administrative costs for all concerned without any improvement in either tax equity or tax revenues. The long-standing administrative practices on excise tax adjustments have also been questioned during a number of IRS field audits in recent years. Notwithstanding, the Treasury Department is not opposed to the legislative changes of H.R. 5103 which will make it perfectly clear that the long-standing administrative procedures are in conformance with the law.

Present law imposes an excise tax of 10 cents per pound on new highway tires (5 cents per pound for off highway tires and tread rubber). A credit or refund of the tax is available to the manufacturer where an adjustment or refund has, after the original tire sale, been made to the tire purchaser, or the tire dealer and then ultimately the tire purchaser, because of a guarantee or warranty. For the ultimate consumer, the existing administrative procedures are not only workable; they are simple and uniform in their application. Regardless of where the consumer bought his tire, he can now present it for warranty adjustment anywhere in the United States where the same brand is sold, and get the identical excise tax adjustment. His proportionate product adjustment and excise tax adjustment are measured by unexpended service use (generally by tread wear) and are not affected by whether he is doing business with a large or smaller, company store, gas station, or private brand merchant. If the excise tax for the consumer's type of tire is $2.50, and the old tire rendered only 40% of the service warranted, the excise tax adjustment to the consumer will be 60% of $2.50, or $1.50.

From the example, it is apparent that price is not a necessary element to correct computation of the tax adjustment. The tire tax is based upon weight, and all that is needed for proper tax adjustment is the tire type and the measure of unexpended service use (i.e., 60% in the example). With that measurement accurately made, the adjustment to the consumer also has reality, because the same percentages are used for both the product and the tax adjustment. The IRS would change all of this and substitute a system, premised on theoretical consistency with the more common ad valorem taxes, which would distort the economic effects of the present direct warranty relationship between the manufacturer and the consumer, and produce inconsistent excise tax results for

identical warranty adjustments at the consumer level. In effect, the Service would require manufacturers to revise their warranty adjustment policies, accounting procedures, computer programs, dealer contracts, schedules and forms, directives and training materials for dealers and others handling warranty procedures, and informational materials to educate the general public—and neither the Treasury nor the consumer would be the better for the changes made.

In every case where a tire manufacturer's warranty runs to the consumer, excise tax adjustments have always been computed without regard to the variations in manufacturers' distribution procedures, product pricing between the manufacturer and dealer, or other manufacturer-dealer arrangements concerning the adjustment in tire price between the manufacturer and dealer net of excise tax considerations. (Such arrangements may be made, for example, to share the cost of tire price adjustments between the manufacturer and the dealer, or to insure that a dealer does not make unjustifiable tire adjustments.) In contrast with the Service's new proposal, this insures that the excise tax will be uniformly imposed and that consumers will be uniformly treated. The computation of the excise tax refund or adjustment independent of other manufacturer-dealer arrangements does not unjustly enrich the manufacturer (or dealer), because the manufacturer receives a tax credit from the government only for the precise amount of tax credit already passed on to the consumer. The consumer appropriately benefits from the full excise tax adjustments or refund computed by the manufacturer, since the consumer bears the economic burden of the excise tax on tires.

H.R. 5103 will therefore continue the existing administrative procedures in the most common tire warranty situation which has been discussed. The bill will also continue the existing administrative practice, accepted by the Internal Revenue Service, in certain private brand situations. Manufacturers' warranties commonly run to the ultimate consumer (with the dealer handling warranty transactions with the consumer as an agent for the manufacturer), but some major private brand distributors handle their own warranty adjustment procedures. In such cases, the manufacturer's express warranty is extended only to its immediate vendee, and a tire adjustment is made at that level.

H.R. 5103 will also permit the use (under regulations to be prescribed by the Secretary of the Treasury) of overall methods of excise tax adjustment in cases where the manufacturer utilizes an overall method of product warranty adjustment. The provision allowing overall methods was originally added to H.R. 2474 last year when it was suggested that the law should permit manufacturers to shift from traditional tire-by-tire bookkeeping to more modern statistical sampling or averaging techniques. At the request of the Treasury Department, the provision was amended by the House in the current bill in order to exclude discounts in lieu of warranty, pursuant to *Rev. Rul. 68-400*, 1968-2 C.B. 502. (H.R. 5103, as passed by the House, also includes at Treasury suggestion the tread rubber provisions of the bill from the prior Congress. This would essentially give tread rubber treatment more equivalent to new tires than in the past and we therefore support the tread rubber provisions also.)

In connection with the foregoing, the bill will preclude the application to warranty adjustments of the ad valorem concepts proposed by *Rev. Rul. 76-423*. While an ad valorem theory might have been adopted for the tire tax forty years ago, the fact is that it was not. Complex systems of tire distribution have since evolved, in reliance upon existing weight-oriented procedures. Given the lack of revenue impact of the Service's proposed changes, no good reason has been suggested why the tire industry, tire dealers and ultimate consumers should be forced to change now. Only an expensive and useless administrative exercise for the tire industry and others would be involved, and it is totally unnecessary to equitable administration of the excise tax on tires and tread rubber. Such a change, fundamentally, should not be made, because it would tend to introduce the very inconsistencies in excise tax administration which Congress said should be avoided when the manufacturers' excise taxes were originally enacted in 1932:

"It is of utmost importance that the tax be imposed and administered uniformly and without discrimination. Each member of a competitive group must pay upon substantially the same basis as all his competitors, even though his sales methods may differ." H.R. Rep. No. 708, 72 Cong., 1st Sess. (1932), reprinted in 1939-1 (Part 2) C.B. 457, 480.

Senator BYRD. The next bill is H.R. 8811, which permits a Tax Court judge to elect civil service retirement. As I understand it, there

are no witnesses in regard to this legislation, but a statement has been submitted for the record, and then I assume that Treasury will comment on it at the appropriate time.

At this point in the record, I will submit a statement of C. Moxley Featherston, Chief Judge, U.S. Tax Court, and, without objection, ask that it be published at this point in the record.

[The material referred to follows:]

STATEMENT OF C. MOXLEY FEATHERSTON, CHIEF JUDGE, U.S. TAX COURT

In Re. H.R. 8811—a Bill to amend section 7447 of the Internal Revenue Code of 1954 with respect to the revocation of an election to receive retired pay as a judge of the tax court.

Mr. Chairman and members of the committee, I appreciate your invitation to present the views of the U.S. Tax Court with respect to H.R. 8811. As you know this bill was introduced jointly by Mr. Ullman and Mr. Conable, reported unanimously by the House Ways and Means Committee, and passed by the House of Representatives on January 24, 1978. The Tax Court did not initiate this legislation, but we heartily endorse and support it. In our opinion its enactment would be in the public interest and would provide more equitable treatment for judges of the Tax Court.

This bill would allow a Tax Court judge who has filed an election to receive retired pay as a judge to revoke that election at any time before retired pay would begin to accrue, thereby enabling the judge to seek to qualify for benefits under the civil service retirement system.

Section 7447, Internal Revenue Code of 1954, establishes a retirement plan for judges of the United States Tax Court. When a judge is appointed and takes office, he becomes an employee of the United States, and as such, he is covered by the civil service retirement system. However, section 7447 allows any judge to elect not to be covered by the civil service system but instead to participate in the Tax Court judicial retirement system. Subsection (e) of that section provides in part "[s]uch an election * * * once made, shall be irrevocable." Section 7447(g)(2)(A) further provides:

(2) EFFECT OF ELECTING RETIRED PAY.—In the case of any individual who has filed an election to receive retired pay under subsection (d)—

(A) no annuity or other payment shall be payable to any person under the civil service retirement laws with respect to any service performed by such individual (whether performed before or after such election is filed and whether performed as judge or otherwise);

These provisions have been interpreted to mean that a Tax Court judge who has elected the Tax Court retirement system can never qualify for civil service retirement even though he has not served on the Court long enough to qualify under the Court's plan. H.R. 8811 would permit a judge to revoke his election of the Tax Court system, make the required payments to the civil service fund, and receive a civil service annuity on the same terms as other employees.

The Treasury Department supports H.R. 8811. We have been advised by the staff of the Committee on Ways and Means that the Civil Service Commission also supports this bill.

We believe that making the election of the Tax Court retirement system irrevocable frustrates the public interest. From time to time judges are asked to serve in other public positions. Recently, Court of Appeals Judge Wade H. McCree, Jr., was appointed Solicitor General of the United States, and Court of Appeals Judge William H. Webster was appointed the Director of the Federal Bureau of Investigtaion. Judge Russell E. Train, who served on the Tax Court from 1957 to 1965, later became Undersecretary of the Department of the Interior, Chairman of the Council on Environmental Quality, and Administrator of the Environmental Protection Agency.

When one of our judges elects to participate in the Tax Court judicial retirement plan instead of the civil service retirement system, he does so on the basis of the circumstances known to him at that time. However, none of us can foresee the future with accuracy. Judges McCree, Webster, and Train had no way of knowing that they would be asked to assume those positions of great public responsibility. Judges McCree and Webster were not faced with a forfeiture of eligibility for civil service retirement benefits because the judicial retirement provisions applicable to them do not contain the restrictions embodied in section

7447(e) and (g)(2)(A). A United States Court of Appeals or District Court judge may receive retirement benefits both as a judge and under civil service. See 45 Comp. Gen. 383. A Tax Court judge may not receive both and H.R. 8811 would not allow a Tax Court judge to receive both. But the irrevocability of the election to participate in the Tax Court judicial retirement system, applicable to Judge Train, may create economic conditions which are such as to stand in the way of a judge accepting such a responsible nonjudicial position when requested to do so. In that event, the public would be the loser. Indeed, in Judge Train's case, the effect of these provisions has been to forbid him to receive civil service retirement benefits, even though he is not eligible to receive Tax Court retirement benefits. In other words, he has been shut out of both systems.

Moreover, it is very unfair to deprive Judge Train of any civil service retirement benefits for any of his almost 30 years of service on Congressional staffs, in the Executive departments, and on the Tax Court because of the election which he made while serving on the Court. When he was appointed to the Tax Court, he had no reason to anticipate that at some later date he would be asked to serve in another position covered by the civil service retirement system. Yet, he did not serve on the Court long enough to receive retired pay as a judge, and if he is not allowed to revoke his election, he will receive no credit under the civil service retirement system for any of the years he spent serving this Government. To us, it seems eminently fair to allow Judge Train to revoke his election and allow him, after making the required contributions, to receive whatever benefits he is eligible for under the civil service retirement system. Furthermore, in the future, some of the judges of the Tax Court may be asked to take other key positions in the government or private sector and it would be equitable to allow them to revoke their elections under such circumstances.

Allowing a judge to revoke the election made under section 7447(e) will not defeat the purpose of that provision. In connection with the amendments of section 7447 made in 1969, the Senate Finance Committee report indicates that the Congress did not intend to deny all retirement benefits to a judge making this election. The purpose of the election was to allow a judge to choose between the judicial retirement system and the civil service retirement system, but not to allow him to receive benefits under both systems. S. Rept. No. 91-552 (1969) pp. 302-305, (1969-3 C.B. 423, 614-616). That purpose will still be accomplished if H.R. 8811 is enacted, because a judge will still be required to make a choice between the two systems. He will not be allowed to participate in both.

To be sure that the committee is aware of all relevant facts, we feel compelled to point out that H.R. 8811 does involve some costs. If the bill is enacted, the Court would be required to contribute to the civil service system the amount which would have been contributed for the judge if he had been participating in that system while serving on the Court.

We will be happy to furnish any additional information regarding this matter and to cooperate with you and your staff in any manner you desire.

Senator BYRD. Now, the Treasury is represented by Daniel Halperin, tax legislative counsel of the Treasury Department.

Mr. Halperin, in what order do you wish to take up your comments on these various bills?

STATEMENT OF DANIEL I. HALPERIN, TAX LEGISLATIVE COUNSEL, OFFICE OF TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. HALPERIN. Thank you, Mr. Chairman.

I have a written statement in which, basically, I commented on S. 3134, the one involving the subsistence payments to police officers, and we have attached an appendix to that which has our positions on the other 11 bills. I guess we can do it in any way that seems fit, if you want to get into some of the comments that have been raised by the various witnesses.

Senator BYRD. Well, now, No. 1, suppose that your statement be inserted into the record at this point. Is that what you would prefer to be done?

Mr. HALPERIN. That is correct.
[The prepared statement of Daniel I. Halperin follows:]

STATEMENT OF DANIEL I. HALPERIN, TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY, OFFICE OF TAX POLICY

Mr. Chairman and Members of the Subcommittee: We welcome the opportunity to present the Treasury Department's views on the 12 miscellaneous bills to be considered by your Subcommittee. The most far-reaching and important of these bills is S. 3134 (the only one of the 12 which has not been passed by the House) and I want to devote the bulk of my statement to a discussion of the Departmental position on that bill. The Treasury's views on the other 11 bills are summarized at the end of my statement and fully described in the appendix.

However, before turning to S. 3134, I would like to comment briefly on what we see as the purpose to be served by consideration of these miscellaneous bills. It is extremely important to have a forum for the examination of legislative proposals that might bear on only one of the many sectors of our society; proposals that might otherwise not receive adequate attention from Congress. The existence of such a forum encourages continuous review of the law by both the Internal Revenue Service and groups in the private sector such as the American Bar Association and the American Institute of Certified Public Accountants. This continuous review promotes an atmosphere in which necessary corrective changes may be identified and enacted expeditiously.

On the other hand, we urge extreme caution in the use of the miscellaneous bill procedure to create special exceptions to generally applicable rules for particular taxpayers. Opinions may differ as to whether such relief is equitable in the particular case involved. However, we should all recognize that special exceptions inevitably increase the complexity of the Code, invite other taxpayers to seek similar relief and, unless scrupulously drafted, may create new potential for abuse. As noted in the Appendix, the Treasury opposes H.R. 1920 and H.R. 2984 on their merits; but even if you disagree with us we urge the Subcommittee to consider these other factors—complexity and potential for abuse—before approving these proposals.

The guiding principle for the Treasury in our review of these miscellaneous bills is the continuing effort to further simplicity, as well as equity, in the tax law. Thus, while we continue not to raise any objections to H.R. 5103, we are disappointed in the industry reaction to our alternative suggestion that warranty adjustments for taxes be eliminated in favor of a reduction in the original tax on tires. I have read H.R. 5103 and the background material a number of times, and I will readily admit that I do not fully understand all its ramifications. If it is at all possible to eliminate a substantial administrative burden for both the IRS and the industry without an overall increase in tax, we should push as hard as we can to see if it is feasible.

Let me now turn to S. 3134. This bill would provide an exemption from Federal income taxes for years 1970–77 for statutory subsistence allowances received by certain State police officers. The bill is intended to reverse as to prior years, the result of the November 1977 Supreme Court decision in *Kowalski* holding that meal allowance paid by New Jersey to its State troopers are includible in income.

On the merits there is no justification for treating a portion of compensation as tax-free merely because it is designated as a subsistence allowance. Such a special tax exemption would be unfair to the overwhelming majority of American workers who must pay tax on the compensation out of which they buy their meals and meet their other subsistence needs.

S. 3134 would recognize this by not allowing tax exemption for the future. Further, it allows tax exemption for 1970–76 [1] only to those police officers who claimed the exclusion in a tax return filed prior to the *Kowalski* decision. The case for the bill must then rest on the supposed unfairness of applying the *Kowalski* decision for prior years to those who acted as if the subsistence allowance was tax exempt. In our opinionn there is no support for this position.

First, it must be understood that the idea that State troopers' meal allowances are includible in income is not new. In 1954 Congress enacted an exemption for State and local police subsistence allowances of up to $5 a day. Within a few years, Congress found that amounts which constituted ordinary police salaries

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[1] For 1977, the relief would be available to all State police who received subsistence allowances.

had been designated as subsistence allowances to obtain the benefits of the exemption. The Senate Finance Committee reported that a number of States and localities had altered, or were in the process of altering, the form of payment of compensation to their police officials in order to maximize utilization of the exemption.

In 1958 the Finance Committee concluded that there was "no reason to provide what in effect is likely eventually to amount to a $5 a day exclusion for police officials." The Committee believed that the exclusion was "inequitable because there are many other individual taxpayers whose duties also require them to incur subsistence expenditures regardless of the tax effect." Therefore, to "bring the tax treatment of subsistence allowances for police officials in line with the treatment of such allowances in the case of other taxpayers," the Committee recommended that the exclusion be repealed. Congress promptly followed this advice.

Second, the IRS has consistently taken the position that subsistence allowances were taxable. While it was not successful in several courts of appeal, the U.S. Court of Appeals for the First Circuit upheld the IRS position as long ago as 1969. Ever since 1970, the Internal Revenue Service has required States to withhold income taxes from State troopers' meal allowances and such taxes have been withheld.

State troopers who owe taxes based on the *Kowalski* decision owe such taxes only because they claimed *refunds* of taxes withheld on meal allowances. Those refunds were claimed in disregard of the Internal Revenue Service's long-standing position. Most of the refunds were claimed by State troopers in New Jersey even though New Jersey troopers were aware that the IRS was contesting their position and were advised by their own association in 1974 to set aside additional money to pay income taxes that might be due. If the Supreme Court decision in *Kowalski* imposes hardship by requiring, in effect, that the refunds be repaid to the Federal Treasury, the risk of such hardship was voluntarily chosen.

Third and most important, S. 3134, if enacted, would set a precedent which has very serious implications for administration of the tax law. Providing a tax exemption for only those allowances received in 1970 through 1976 for which tax refunds were claimed would provide about $6 million, all of which would go to State troopers who chose not to follow the Internal Revenue Service's interpretation of the law and most of which would go to State troopers in New Jersey.[2] We cannot administer the tax system if taxpayers who unsuccessfully contest an IRS position are liable for taxes only for years following the court decision. This is unfair to those who do not contest the position and it encourages everyone to take aggressive positions on their returns since they have nothing to lose and everything to gain by doing so.

It should go without saying that we have sympathy for the plight of the New Jersey trooper but it is inequitable to expect taxpayers in the other 49 Sates to bail them out. As suggested in a *New York Times* editorial of May 18, 1978, "A fairer solution would be for New Jersey to grant the troopers bonuses or retroactive pay raises in the amount of their tax debts."

SUMMARY OF TREASURY DEPARTMENT POSITIONS

1. *S. 3134* (police officer—subsistence allowances)—Opposed.
2. *H.R. 810* (foreign travel—government officials)—Not opposed in principle. Suggests limit to coach air fare.
3. *H.R. 1337* (constructive sales prices—trucks)—Supports. Suggests delay in effective date.
4. *H.R. 1920* (repayment of liquor excise taxes)—Opposed.
5. *H.R. 2028* (home production of beer and wine)—Not opposed.
6. *H.R. 2852* (crop dusters)—Supports refund to crop sprayer if farmer waives rights in writing.
7. *H.R. 2984* (trailers for farm use)—Opposed.
8. *H.R. 3050* (accounting for sale of magazines)—Supports in principle but recommends modification in treatment of prior year's adjustment for magazines.
9. *H.R. 5103* (tire warranty adjustments)—Does not oppose.
10. *H.R. 6635* (retirement bonds)—No objection if certain modifications are made.
11. *H.R. 8535* (child care payments to relatives)—Not opposed.
12. *H.R. 8811* (Tax Court judge)—Supports.

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[2] Providing a tax exemption for all allowances received in 1977, as S. 3134 would also do, would provide an additional $2 million to State troopers in about 16 States.

Treasury Department Recommendations on 11 Bills To Be Considered by Subcommittee on Taxation and Debt Management

2. H.R. 810

The Tax Reform Act of 1969 added a provision to the Code (section 4941) which in general prohibits certain transactions between private foundations and certain "disqualified persons," by imposing a graduated series of excise taxes on the disqualified person (and in certain circumstances on the foundation manager). Government officials are "disqualified persons" for this purpose except for certain specifically set forth transactions including the payment of expenses of domestic travel. The bill would provide an additional exception for payment or reimbursement of foreign travel expenses of a government official by a private foundation.

The Treasury Department recommends that H.R. 810 be amended to limit the permitted amount of reimbursable transportation expenses to the cost of the lowest coach or economy air fare charged by a commercial airline.

The recommended change would make the reimbursable amounts under the bill consistent with the limitation on deductions for attending foreign conventions under the Administration's 1978 tax program. Treasury would not oppose H.R. 810 if this change were made.

3. H.R. 1337

Present law provides that for purposes of computing a manufacturer's excise tax on sales at retail of trucks, buses, and trailers the taxable price is the lower of (1) the price for which the article is sold or (2) the highest price at which competing articles are sold to wholesale distributors in the ordinary course of trade. If a manufacturer has an established practice of selling taxable articles in substantial quantities to wholesale distributors, the tax on his sale at retail ordinarily will be computed upon the highest price for which similar articles are sold by him to wholesale distributors. Where the manufacturer does not ordinarily sell trucks and trailers to wholesale distributors (and few do), the constructive price for sales at retail is 75% of the manufacturer's retail selling price. However, this constructive price cannot be less than the manufacturer's cost where the manufacturer has an established retail price, and cost plus 10% where (as in the case of custom work) he does not have an established retail price.

H.R. 1337 would eliminate the use of an individual manufacturer's costs (or cost plus 10%) in determining a constructive price in the situation where the 75% rule is now applied, *i.e.*, sales at retail where the manufacturer does not sell such articles to wholesale distributors. In addition, even if the manufacturer does sell such article to wholesale distributors, he would be required to adjust the price of his retail sales by the ratio generally prescribed for manufacturers who do not sell to wholesalers.

The Treasury Department supports H.R. 1337. The not less than cost rule produces uncertainty at the time of sale as to the amount of the manufacturer's excise tax liability. Computing "costs" is always complicated, especially the problem of allocating overhead costs. A straight percentage of retail price would greatly simplify matters for the trade and the Internal Revenue Service.

The Treasury Department recommends that the effective date of the bill be September 30, 1978 to eliminate the possible need to adjust taxes on sales made before enactment of the bill.

Even though the not less than cost rule is deleted, we recommend repetition of the explanation in the report on H.R. 1337 by the House Committee on Ways and Means (H.R. No. 95-976) that the rule may continue to be prescribed for constructing a taxable price where a person makes and uses a taxable item (sec. 4218 of the Internal Revenue Code). Such item may be a specialized unit which is never sold, so that no market price is available from which to construct a manufacturer's price. In this case, cost of production is the only realistic tax base.

4. H.R. 1920

The proposed bill would require the Treasury Department to repay the amount of internal revenue tax paid (or determined) and customs duty paid on distilled spirits, wine, rectified products, and beer, which, while being held for sale, are lost, rendered unmarketable, or condemned by duly authorized officials, by reason of fire, flood, casualty, or other disaster, or breakage, destruction, or other damage (excluding theft) resulting from vandalism or malicious mischief. No

reimbursement would be made for tax losses of less than $250 per occurrence, or for losses covered by insurance.

Present law provides for similar payments for both alcoholic beverages and tobacco products (without the $250 minimum requirement) only in the case of a "major disaster" as declared by the President.

The Treasury Department is opposed to H.R. 1920. The dollar a business invests in inventory is a dollar of cost irrespective of the factors going to make up the cost, whether such factors be raw materials, wages, transportation, or taxes. Past Congressional policy as to casualty losses has recognized this fact and, as a consequence, losses by handlers of alcoholic beverages, except in the case of disasters of extraordinary severity, have been treated as ordinary business hazards to be borne by the holder of the beverages or his insurance company. H.R. 1920 would provide an exception to this general policy by, in effect, having the Federal government provide free insurance to dealers in alcoholic beverages for the portion of their inventory reflecting internal revenue tax and customs duty. By so doing, the Federal government would be treating those holding alcoholic beverages for sale on a more favorable basis than other merchants selling products subject to excise taxes and all merchants selling products not subject to excise taxes.

H.R. 1920 would be difficult to administer. It would be quite difficult, often impossible, to make a factual determination as to the amount of loss by vandalism or malicious mischief as distinguished from theft or mishandling. And in the case of civil disorders, the circumstances often would make it virtually impossible to segregate the cause of losses.

The present "major disaster" provision also provides dealers in alcoholic beverages and tobacco with free insurance that is not given to dealers in other products, both products subject to excise taxes and those not taxed. Since there is no reason why dealer's losses of alcoholic beverages and tobacco products should be treated differently than losses of other products, repeal of the "major disaster" provision is indicated.

5. H.R. 2028

Under present law, the head of any family may, after registering, produce up to 200 gallons of wine a year for family use without payment of tax. An individual who is not the head of any family is not covered under this exemption. Existing law has no provision which authorizes the home production of beer.

H.R. 2028 would permit any adult (an individual 18 years of age or older) to produce specified amounts of wine and beer for personal or family use and not for sale without payment of tax. Individuals would have to register before producing tax free beer and could not have more than 30 gallons of beer on hand at any time. The exemption under Federal law would not serve to authorize the home production of beer contrary to State law.

The Treasury Department has no objection to the enactment of H.R. 2028. The deletion of the present law requirement for registration by producers of wine for personal or family use reflects the fact that registration has proven of little use to the Bureau of Alcohol, Tobacco and Firearms and is burdensome to the public. However, for enforcement and revenue protection purposes, registration and the inventory limitation are necessary in the case of home brew, since the process entails the production of a mash fit for distillation.

6. H.R. 2852

Under present law, when gasoline or special fuels are used on a farm for farming purposes by a custom operator, credit or refund of the tax on the fuel so used can be claimed only by the owner, tenant or operator of the farm. The bill would revise the law to provide that an aerial applicator (crop duster, etc.) would be entitled to the credit or refund of gasoline and special fuels excise taxes used in aerial applications on a farm.

The restriction of the farm fuel tax refund to the owner, tenant or operator of a farm was intended by the Congress to assure that the farmer received the benefit of the refund. It was felt that if the refund were given directly to the custom operator, the farmer would not benefit through a lower price for the custom work. Over the years since the enactment of the credit or refund provision, it has been argued that the farmer hasn't gotten the benefit of the refund for custom work because the custom operator doesn't give him the information as to gallons used so that he (the farmer) can claim the refund. The instant bill

would meet this argument by permitting an aerial applicator doing custom work to apply for the farm fuel refund without any consent from or notification to the farmer. This would not be consistent with the original intent of the Congress of making sure that the farmer received the benefit of the credit or refund of the tax on fuel used by the custom operator.

The Treasury Department would support H.R. 2852 if it were amended so that the farmer would have to waive in writing to the aerial applicator his right to a refund. This would put the farmer on notice as to the existence of the credit or refund provision and permit him to obtain the benefit of the credit or refund indirectly through a reduction in the fee paid to the aerial applicator or to apply himself for the credit or refund. The waiver provision was in a bill ordered reported out by the Ways and Means Committee in the mid-1960's. That bill, although supported by Treasury and the Department of Agriculture, was never enacted.

The Treasury Department also suggests that H.R. 2852 be extended to cover all custom work, not just aerial application, since plowing and harvesting is done by custom operators.

7. H.R. 2984

The bill would exempt from the 10 percent manufacturer's excise tax on trucks, truck trailers, and buses, whose trailers or semitrailers which are suitable for use with a towing vehicle having a gross vehicle weight of 10,000 pounds or less and which are designed to be used for farming purposes or for transporting horses or livestock. Provision also is made for refund of the tax to dealers holding tax-paid trailers exempted by the bill which they hold for sale on the day after the date of enactment of the bill.

The Revenue Act of 1971 (Public Law 92–178) exempted from the manufacturer's excise tax trucks with a gross vehicle weight of 10,000 pounds or less and trailers and semitrailers with a gross vehicle weight of 10,000 pounds or less if suitable for use with a vehicle having a gross vehicle weight of 10,000 pounds or less. The proposed bill would remove the present 10,000 pound limit for the exemption of trailers and semitrailers provided they were designed to be used for farming purposes or for transporting horses and other animals.

Because the trailers proposed to be exempted would have a gross vehicle weight in excess of 10,000 pounds, the exemption would be accorded to trailers with a gross vehicle weight at which single unit trucks are taxable. The proposed exemption for trailers thus would constitute an obvious discrimination against single unit trucks in the 10,000 and 20,000 pound class.

The bill also would create a dual standard for trailers over 10,000 pounds gross vehicle weight which are suitable for use with pickup trucks. Those designed for farming purposes or the hauling of animals would be exempt, while trailers of the same capacity designed for hauling general merchandise, or supplies and equipment for mechanics, would continue to be taxable.

The Treasury opposes H.R. 2984 because the bill would discriminate against single unit trucks and non-farm trailers and semitrailers of the same carrying capacity. It could also be expected that there would be problems in differentiating trailers and semitrailers "designed to be used for farming purposes" from similar vehicles designed for the carriage of general cargo.

8. H.R. 3050

To ensure that retail outlets have an adequate number of copies of magazines, paperback books and records, publishers and distributors often distribute more copies of a magazine, book or record than it is anticipated the retailer can sell. When the retailer has sold as many of the particular items as will be likely, he returns the unsold merchandise to the publisher or distributor. The Internal Revenue Service has taken the position that accrual basis publishers and distributors must include the sale of the magazines, paperback books, and records in income when they are shipped to the retailers and may exclude from income the returns only when the merchandise is actually returned by the retailer during the taxable year.

The bill would allow accrual basis publishers and distributors of magazines, paperbacks and records to elect to exclude from income amounts attributable to merchandise returned within a specified period of time after the close of the taxable year in which the publisher or distributor shipped the merchandise to retailers.

The bill requires publishers and distributors of paperbacks and records who elect the new method to establish a suspense account to avoid a double deduction for the initial year under the new method. In the case of returns of magazines, the bill permits taxpayers to amortize the deduction attributable to actual returns from prior years sales in the year the new method is elected over a five-year period.

The Treasury Department believes that the special relief provided by the bill should be allowed only to those taxpayers who, in the year they elect the new method of accounting, establish a suspense account. The suspense account procedure essentially allows the new method of accounting for the future while delaying the deduction for the additional amount the taxpayer would have deducted for all past years under the new method as opposed to the old until there is a termination or decline in business. If this approach is not taken there would be an additional revenue loss ($86 million for books and records if the entire deduction were allowed in the year of change) which could prevent the adoption of what we believe are sound accounting procedures for those industries and others which may have similar problems. Current allowance of deductions denied in prior years may well provide a windfall gain to current owners since the tax burden may well have been borne by customers or prior owners. However, in the case of an election to account for magazine returns under the bill, if the Subcommittee believes amortization of the transitional adjustment is preferable to the establishment of a suspense account, the Treasury Department recommends that the normal ten-year amortization period for such an adjustment be used instead of the special five-year amortization period provided by H.R. 3050. The Treasury Department would oppose amortization of the transitional adjustment for publishers and distribtuors of paperback books and records who elect the new method of accounting.

9. H.R. 5103

The bill would provide credit or refund to the manufacturer or importer of the excise tax on tread rubber destroyed or scrapped in the retreading of recapping process or used in retreading or recapping a tire which is used or sold for purposes for which new tires may be used or sold tax free. Provision is made for credit or refund to the manufacturer or importer of the taxes on tread rubber or on new tires where the sales price of the recapped or new tire is later adjusted pursuant to a warranty or guarantee. In addition, the bill modifies the statute of limitations so that claim for a credit or refund of the tread rubber or new tire taxes can be filed for a period of one year after the warranty or guarantee adjustment is made. Finally, the bill imposes the tax on tread rubber used in a foreign country to recap or retread tires which have been exported from the United States and then reimported into the United States.

The Treasury Department has no objection to the enactment of H.R. 5301.

The credit or refund provisions for tread rubber are intended to make the tax treatment of this product equivalent to the tax treatment of new tires. Because the tread rubber loses its identity when attached to a tire, it has not been possible under present law to grant credit or refund of tread rubber tax when the retreaded tire has been exported, sold to a State or local government, or sold in any other transaction for which a new tire may be sold tax free.

A tire which has been taxed in the United States can be exported and reimported into the United States without payment of the tire tax. If the tire has been retreaded, the tread rubber tax is not due because the tread rubber is considered to have lost its identity when attached to the retreaded tire. United States retreaders located near Canada or Mexico have complained that some United States dealers are shipping domestically used tires to Canada or Mexico for retreading to take advantage of this tax treatment. The bill would rectify this competitive inequity.

The section granting a credit or refund of tax when the price of a new tire is readjusted pursuant to a warranty or guaranty is intended to codify procedures which have been permitted for a number of years even though present law limits the credit or refund of tax for warranty adjustments of products subject to manufacturers excise taxes to cases where the tax is an ad valorem tax. The bill would grant a credit or refund of tax proportionate to the price adjustment made with the ultimate consumer; and proportionate to the price adjustment made with the immediate vendee where the manufacturer's guarantee runs only to his immediate vendee. In addition, a new approach is included in the bill whereby provision is made for the granting of a credit or refund for warranty

adjustments of an average amount per tire based on some overall method (e.g., a sampling method) rather than computation on a tire-by-tire basis. The Ways and Means Committee report (H. Rep. No. 95–916) notes that this procedure would not permit an adjustment in the excise tax prior to the time the warranty or guarantee adjustment is made (or deemed to have been made) to the ultimate consumer.

The extension of a credit or refund of the tread rubber tax to cases where the retreaded tires are adjusted pursuant to a warranty is consistent with the treatment of new tires.

Since the guarantee on a tire may last for the life of the tire, a manufacturer could be prevented from obtaining refund or credit of tax for a warranty adjustment by the fact that section 6511 of the Code requires claims for overpayment of tax to be filed within 3-years from the time the returns were filed or 2-years from the time the tax was paid, whichever expires the later. Accordingly, the bill proposes to modify the statute of limitations as indicated above as to allowance for claims for refund or credit or overpayment of tire or tread rubber taxes in the case of warranties.

Some private brand dealers have requested that where the manufacturer's warranty or guarantee is extended only to his immediate vendee there be deleted the requirement in the bill that the prior granting of an adjustment to the ultimate consumer is a prerequisite to the allowance of a credit or refund of tax to the manufacturer or importer. Rulings under present law have held that where the tire warranty runs only from the manufacturer to his immediate vendee, the adjustment by the manufacturer need only be made with his immediate vendee. This interpretation is based on the general rule for price readjustments in section 6416(b)(1) of the Code which requires the manufacturer, or importer, to make an adjustment with his immediate vendee to obtain a proportionate credit or refund of tax.

One way of retaining the general principle set forth in the bill of requiring adjustment of tax to the ultimate consumer before the manufacturer can claim credit or refund would be to state in your committee report that where the private dealer's warranty to the ultimate purchaser is as good or better than the manufacturer's warranty to the dealer, it then will be assumed that the required adjustment has been made to the ultimate consumer when the immediate vendee makes his request for credit or refund from the manufacturer.

The effective date specified in the bill is April 1, 1978. This is the effective date of Part 1 of Revenue Ruling 76-423. Part 1 of this ruling specifies that the credit or refund of tax to the tire manufacturer for a warranty adjustment is to be proportional to the reduction in the price of the replacement tire that the manufacturer sells to his immediate vendee. The tire industry's practice where the tire warranty runs from the manufacturer to the ultimate consumer has been to take credit or refund of tax based on the proportionate reduction by the dealer in the price of the replacement tire to the ultimate consumer even though the manufacturer may reduce the price (exclusive of tax) of the replacement tire to the dealer by less than the proportionate reduction to the consumer, or perhaps not even reduce the price to the dealer at all. The bill would give statutory sanction to this practice and the April 1, 1978 effective date would insure that Part 1 of Rev. Rul. 76–423 would not be effective for the period of time between April 1, 1978 and the enactment of the bill.

10. H.R. 6635

The bill would amend the Second Liberty Bond Act to allow the Secretary of the Treasury, with the approval of the President, to increase the investment yield on outstanding United States retirement plan bonds and individual retirement bonds for each interest accrual period beginning after September 30, 1977, so that the investment yield on such bonds is consistent with the investment yield on Series E savings bonds.

Treasury would support H.R. 6635 if it is amended (1) to permit the interest rate on already issued retirement bonds to be changed to match the interest rate on new retirement bonds rather than to match the interest rate on Series E savings bonds and (2) to change the effective date to permit an increase in the investment yield for interest accrual periods beginning after the date of enactment rather than for periods beginning after September 30, 1977. The bill will help to assure that the rate of return to holders of retirement plan bonds and individual retirement bonds is maintained at a level commensurate with the rate

of return on new retirement bonds. It will help maintain the competitiveness of retirement plan bonds and individual retirement bonds with other investment vehicles and, therefore, will assist the Treasury in the exercise of its borrowing authority.

11. H.R. 8535

Under present law, the child care credit is not allowed for amounts paid to a relative unless (a) neither the taxpayer nor the taxpayer's spouse is entitled to a dependency personal exemption deduction with respect to that relative, and (b) the services provided by the relative constitute "employment" within the meaning of the Social Security taxes definition.

The bill would allow the child care credit for amounts paid for child care services performed by relatives of the taxpayer whether or not such services constitute "employment" within the meaning of the Social Security taxes definition of that term, provided neither the taxpayer nor the taxpayer's spouse is entitled to a dependency personal exemption deduction with respect to that relative. The child care credit will not be allowed for amounts paid to a child (or stepchild) of the taxpayer under age 19.

The Treasury Department does not oppose H.R. 8535.

12. H.R. 8811

Under present law if a United States Tax Court judge elects to come under the Tax Court retirement system, he is required to make an irrevocable election which bars him from ever receiving any benefits under the Civil Service retirement system for any nonjudicial Federal service performed before or after his election is made, even though he served as a Tax Court judge for less than the minimum 10-year period required to qualify for retired pay under the Tax Court retirement system.

The bill would amend section 7447 to allow a Tax Court judge to revoke an election to receive retired pay under the Tax Court retirement system at any time before the first day on which retired pay would begin to accrue with respect to that individual. The bill would also provide that no Civil Service retirement credit would be allowed for any service as a Tax Court judge, unless with respect to such service the amount required by the Civil Service retirement laws has been deposited, with interest, in the Civil Service Retirement and Disability Fund.

The Treasury Department supports H.R. 8811.

Now, in the interests of time, go through these bills and let me ask the Treasury's position on each one. That might save us a little time, to do it that way, and if there is no controversy, we can proceed rather rapidly.

Now, S. 2872, dealing with the State troopers, what is the Treasury's position on that?

Mr. HALPERIN. The Treasury is opposed to that, Mr. Chairman, and my statement does concentrate on that bill because we do feel that it is the most important of the bills that are before you today.

Senator BYRD. Do you oppose leaving out what might be done in the future, prospectively; do you oppose making adjustments retroactively?

Mr. HALPERIN. Yes. We oppose S. 2872 which would affect the treatment for the future, and we also oppose S. 3134, which affects only 1970 to 1977.

Let me see if I can explain briefly why.

First of all, the idea that State troopers' meal allowances are includable in income is not a new idea with the Supreme Court in the *Kowalski* decision of last November. In 1954, Congress enacted a $5-a-day exemption for subsistence allowances for police officers; 4 years later, that exemption was repealed, and the Finance Committee stated in its report that the exclusion was "inequitable because there are

many other individual taxpayers whose duties also require them to incur subsistence expenditures regardless of the tax effect."

Therefore, to "bring the tax treatment of subsistence allowances for police officials in line with the treatment of such allowances in the case of other taxpayers," the committee recommended that the exclusion be repealed.

That quote is on page 3 of my statement.

Senator BYRD. What date was that?

Mr. HALPERIN. That was done in 1958.

The IRS has consistently taken the position that subsistence allowances are taxable. Now, it is true that it was not successful in all the courts. It was successful in the Tax Court, but several of the courts of appeals reversed the Tax Court, and some others supported the IRS.

Senator BYRD. Is it not correct that IRS has not levied on State troopers up until just recently?

Mr. HALPERIN. The IRS has consistently levied on State troopers. It has not always been successful in the courts, but it did win in the First Circuit in 1969, and it asked that States withhold: and ever since 1970, State troopers have been withheld on—at least, we are sure of that in New Jersey, and we assume that that is true in most States.

Kowalski itself, the case, involved the tax year 1970. The State troopers in New Jersey knew that the IRS was contesting their position. Let me point out that these amounts were withheld. It is not a question of somebody getting a paycheck in which there is no withholding on a subsistence allowance, and you come around to April 15 and you are required to make a big payment.

Senator BYRD. The amounts——

Mr. HALPERIN. The States treated these amounts as income for purposes of withholding, beginning——

Senator BYRD. Federal withholding?

Mr. HALPERIN. Federal withholding, beginning in 1970.

Senator BYRD. And that was the State of New Jersey?

Mr. HALPERIN. The State of New Jersey did that.

Senator BYRD. Now, what about the 14 other States?

Mr. HALPERIN. We are not sure of that, but most of the money from 1970 through 1976 does involve the State of New Jersey. By far the largest percentage of the $6 million involved for those years, and probably closer to half of the $2 million involved for 1977 is New Jersey.

Senator BYRD. That is already withheld from the troopers?

Mr. HALPERIN. It was withheld. Of course, they filed tax returns on April 15 and asked for refunds, and did get the amount back on the end of each year.

Senator BYRD. IRS returned——

Mr. HALPERIN. The Government does not have it at the moment. It repaid it.

It does not audit tax returns when people ask for refunds. In the normal course, when the troopers filed for refunds and excluded these subsistence allowances, they received their checks.

The point that we would make here is that they knew of the problem. They did get a check in April which they conceivably could have put aside, assuming the possibility that they would lose the case.

They were advised, at least in New Jersey, by their own association in 1974, to do just that, to set aside additional money to pay income taxes that might be due.

We think that this bill could set a very unfortunate precedent because it basically, at least from 1970 through 1976, does not give every police officer a refund based on subsistence allowances. It only gives it to those who filed tax returns prior to the *Kowalski* decision in which they took this position.

So if you filed the tax returns and you read the IRS rulings and you believed that they were correct, or you just did not want to go through the hassle of contesting it, and you included the subsistence allowance as income, the bill does not help you, except for 1977. It only helps those people who took the position that the subsistence allowances were tax free and it really puts a premium on contesting Service positions.

If people know that if they file tax returns and contest an IRS position, even if they lose, we will say, "Well, it is unfair because you do not have the money now; you will therefore only be liable for future years."

If we do this it is unfair for people who do not contest the IRS' position. It encourages everyone to take aggressive positions on their returns since they have nothing to lose, and everything to gain, by doing so, since their only liability would be for future years, if we followed this precedent.

Now, it is a very sympathetic situation and I do not want to be put in the position of feeling no sympathy for these State troopers, many of whom owe, as they say, $3,000 or $4,000 and that is a significant part of their life savings. But we do not think it is fair for the taxpayers in the other 49 States to bail out the New Jersey State troopers.

Senator BYRD. You have been dealing mostly with New Jersey. Can you cite other States that have withheld from the State troopers?

Mr. HALPERIN. Let me point out that the New Jersey allowance, which is $15 a day right now, is almost twice as big as the allowance of any other State. It is also true that they have far more people involved than in any other State.

So the real revenue cost is there.

In terms of whether or not other States have withheld or not, the IRS issued a ruling in 1970 which required the States to withhold on this and we have no reason to believe that that was not generally followed.

Senator BYRD. Well, you have records in your department. You could easily ascertain that.

Mr. HALPERIN. Yes; we could, and we could submit for the record what information we have.

Senator BYRD. Why do you not submit for the record what other States, if any, have withheld?

Mr. HALPERIN. We will do that, Mr. Chairman.

Senator BYRD. Thank you.

[The following material was subsequently supplied for the record:]

The following states have withheld taxes from troopers' meal allowances: Alabama (from 1977); Connecticut (from 1970); Mississippi (from 1974); New Jersey (from 1970); and West Virginia (from 1975). (The year in parentheses is the year in which withholding was begun.)

Senator BYRD. The next on my list is 810, but we have not had a hearing on that, so we will pass that by temporarily.

The next on my list is H.R. 1337, the 10-percent excise tax on manufacturers wholesale, placed on trucks, buses, and so forth.

Mr. HALPERIN. We have no objection to that bill as it passed the House. Some people have asked that they be allowed to use the price that they sell to retailers since they do sell to retailers in addition to selling directly to the ultimate consumer.

They want to use the price to which they sell to retailers rather than 75 percent of the price that they sell to ultimate consumers.

I think that one of the things that we have tried to keep in mind when we have commented on these miscellaneous bills is the need to try to get as much simplicity as possible. I suppose that one can look at the situation of 200 different truck manufacturers and say that this particular method is good for 150 of them and we should have this other method for 75. But I do not think any serious objections have been raised to the equity of applying a percentage of the ultimate retail price to everyone, and we would think that a case really cannot be made for special treatment in one case as opposed to others, so we think that the House bill ought to go through as it was originally enacted.

Senator BYRD. You have no objection to the House proposal?

Mr. HALPERIN. That is correct.

Senator BYRD. And your opinion of the additional suggestions?

Mr. HALPERIN. We do have objection to the additional suggestion that has been made.

Senator BYRD. You would prefer not to expand it beyond the House proposal?

Mr. HALPERIN. Right. We think there is a lot to be said for treating everybody alike and having one method of collecting it.

The objection to the present treatment is the administrative difficulties in trying to measure costs, and we think that is correct. There is no reason to get into that problem. But we would like to keep it simple and have one method across the board.

Senator BYRD. Now, H.R. 1920, the beer and wine bill?

Mr. HALPERIN. The Treasury has consistently opposed that bill and we are staying with that position. We believe that, on the merits, there is no reason to, in effect, provide free insurance for this particular cost and for these particular people.

We also think that there will be administrative difficulties in trying to deal with this bill. You have to decide whether there has been vandalism, which is covered by the bill, as distinguished from theft or mishandling which is not. If liquor is destroyed through mishandling, or if liquor is stolen, this bill does not apply. It applies only to losses through fire, et cetera, and also through malicious mischief. And we think that that is a line drawing problem that may be difficult.

So on administrative grounds, we are opposed to it. We also believe that there is no policy that would require the Federal Government to provide this kind of insurance for these costs.

Senator BYRD. Do you have any quarrel with the revenue estimate?

Mr. HALPERIN. No; we do not.

Senator BYRD. Now, there is another wine and beer bill, H.R. 2028, and a companion bill, S. 2930. And then another bill on the same subject, but slightly different, Senator Cranston's proposal.

Mr. HALPERIN. That is correct, Mr. Chairman. We have no objection to H.R. 2028 as it has passed the House and the companion bill. The Bureau of Alcohol, Tobacco, and Firearms has objected to Senator

Cranston's proposal which would delete the registration requirements for the home brew of beer.

I might point out that the suggestion that the registration requirement for home producers of wine be deleted came from the Bureau, the ATF. They believed that they did not need it, and there was no reason to put people through that particular burden.

On the other hand, when it comes to beer, the Bureau is convinced that there is greater potential for harm because the beer process produces a mash which is fit for the production of whisky which they think creates greater potential, and they would, therefore, like to see the registration requirements in that area.

I think that they have shown that they are reasonable and they are not insisting on registration just for the sake of having a lot of people keep records, but are really conscious of their enforcement problems. And if it turns out that they really do not need it in the case of beer as well, I think we can rely on the Bureau to come forward with that position, in view of what they have done in the wine area.

Senator BYRD. Well, let me see if I can understand Treasury's position.

Treasury, as I understand it, then, does not oppose H.R. 2028 and it does not oppose Senator Moynihan's bill, which is a companion to that?

Mr. HALPERIN. That is correct.

The major difference in Senator Cranston's bill—there are two provisions, I think, in there. One, it removes the registration requirement. Now, I guess, the witnesses who have testified here believe that one interpretation of present law is that there is no registration requirement at all today so that H.R. 2028 actually imposes the registration requirement on home brew of beer for the first time.

Now, the Bureau of Alcohol, Tobacco, and Firearms have opposed removing it because they think there is a greater danger of abuse going into the production of whiskey from the beer process, but that is the issue and Senator Cranston's bill would not have a registration requirement for either wine or beer.

Senator BYRD. The objection, really, is to the registration requirement for beer rather than for wine?

Mr. HALPERIN. Right. The Bureau had recommended the deletion of the registration requirement for wine by itself.

Senator BYRD. H.R. 2852?

Mr. HALPERIN. We have no objection, in principle, to that bill. We have suggested, in our comment, that the farmer be required to waive his right in writing.

The farmer now has the right to refund himself. The bill would give the right to the refund to the crop duster, the argument being that since the amount is so small the farmer never applies for the refund particularly because the crop duster never figures out for him how much the farmer is entitled to.

If the theory of the bill is that the farmer ought to get the benefit of it, we think that the crop duster ought to, in effect, make disclosure to the farmer what is going on here and the farmer could waive his right. We did make that suggestion on the House side; they did not accept it over there.

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Senator BYRD. Well, my recollection of the testimony of the sponsors is that at least one sponsor and maybe both said that it was not contemplated that both the farmer and the crop duster would get the refund.

Mr. HALPERIN. Right. The farmer has no right to get the refund under this bill as it passed the House. Our suggestion would be that the farmer would retain the right unless he waives it. But the bill does take it away from the farmer and give it to the crop duster. Their argument would be they are not taking anything away since nobody uses it at the present point.

Senator BYRD. I cannot see that the Treasury would care one way or the other, would it, so long as both do not get the refund?

Mr. HALPERIN. Well, the purpose of the bill is to give the benefit to the farmer and not to the crop duster. Now, they may, in effect, pass it on in terms of the price but if, right now, nobody is getting the refund and under this bill, the crop duster gets the refund, one would expect, perhaps, a reduction in price to the farmer.

If that, in effect, does not happen, then we are giving the refund to the crop duster and the farmer does not really have any notice as to what is happening.

Senator BYRD. But, under the bill, the farmer and the crop duster both cannot get a refund?

Mr. HALPERIN. No; only the crop duster can under the bill.

Senator BYRD. What about H.R. 2984?

Mr. HALPERIN. We have opposed that bill for several reasons. This bill gives an excise tax exemption for trailers which are suitable for use with trucks which have a gross vehicle weight of 10,000 pounds or less. That, in effect, gives an exemption for trailers when single-unit trucks of equal size would be subject to the excise tax.

Second, the bill gives an exemption to these trailers which are designed to be used for farming purposes.

That creates, we think, two problems, one is discrimination in favor of trailers which are designed to be used for farming purposes compared to trailers which are used for retail businesses for delivery, for example.

Second, there is going to be a problem in trying to distinguish trailers. In order to be able to tell whether a particular trailer is taxable or not, one would have to decide whether it is designed to be used for farming purposes or not, and we think that that can create difficulties in administering the law.

Congressman Pickle, this morning, I think raised two points in favor of the bill. One that these vehicles are not used on the highway very much. That may be true on certain of these trailers, but certainly trailers for transporting horses are used on the highway a good deal.

The gasoline tax is the tax that imposes differential costs on users of the highway based on how many miles they drive. We believe that the tax on the truck and the trailer body itself is not intended to draw that kind of line and, if it were, we would be in an impossible area. There are a lot of other trucks and trailers which do not get driven very much and yet are subject to the excise tax and it is hard to distinguish the farm vehicles on that basis.

Mr. Pickle also pointed out that there was already an exemption for vehicles used for hauling feed, seed, and fertilizer and this just extends it to other farm trailers. That exemption in the present law is limited to the body itself and does not include the chassis of the truck or the trailer, so that there is a further extension of the exemption here, not only to new kinds of trailers, but also to the full trailer itself.

Senator BYRD. It only applies to those that can carry loads of less than 10,000 pounds.

Mr. HALPERIN. No, that is what present law does. Present law provides an exemption for trailers which can carry loads of less than 10,000 pounds. This extends it to a trailer that can carry a greater load than that, provided it is designed for use with a towing vehicle that can only carry 10,000 pounds or less.

It is hard to understand that, since a truck, which itself can carry more than 10,000 pounds, is subject to tax. The exemption for the towing vehicle, or the main truck, only applies if it carries 10,000 pounds or less, and we are now suggesting here an exemption for trailers which can carry more than 10,000 pounds. We understand it is perhaps as high as 18,000 pounds which could be carried by these trailers.

Senator BYRD. Well, it really extends the use of the farm equipment to carry the livestock whereas it now exempts it if it carries feeds or fertilizer or whatnot?

Mr. HALPERIN. That is true. It extends it to livestock and it also expands the exemption because the exemption for feed and fertilizer only applies to the body of the trailer and not to the chassis. Exactly what that means in terms of what percentage of the tax is excused, I do not know, but it is not a full exemption for carrying the feed and the fertilizer.

Senator BYRD. Anyway, Treasury opposes it?

Mr. HALPERIN. Treasury is opposed.

I might note, Mr. Chairman, that of the 11 bills that have passed the House, we have essentially raised no objections to 9 of them. We are objecting only to 2984 and 1920 and we do have some minor suggestions as to some of the others.

Senator BYRD. 1920, yes.

Now, what about H.R. 3050?

Mr. HALPERIN. Well, we have—let me say first that we have no argument with the principle that is involved in that case as it applies to the magazines, book publishers, and record dealers. We believe that the accounting treatment that they are asking for the future is both correct and administratively feasible.

The issue is what to do about prior years and really what is involved here is under the present methods of accounting that is required by present law, they have paid more total taxes up to this point than they would pay under the new method. They paid a little bit more each year. If they have been in business for 50 years, they have paid a little bit more each of those 50 years than they would under the new method, and in cumulative total, they have this excess tax payment, not that it was not proper under prior law, but it is more than they would have paid if this new provision had always been effective.

The question is, when should they get that back?

The Treasury has recommended a suspense account procedure which essentially says you do not get it back until your business declines or

you go out of business completely. What the taxpayer has asked for is that they get it back over a 10-year period or, in the House bill, in the case of magazines, over a 5-year period.

Now, we think that it would be better if we could adopt a general principle that we always look to suspense accounts. When this particular bill came up before this committee 2 years ago, there was a long colloquy about whether the committee could afford the revenue that would be involved in giving relief to the magazines without a suspense account procedure. And generally, Larry Woodworth, at that time, recommended to the committee that a suspense account procedure be followed. It is my understanding from reading the transcript that the committee generally seemed to feel that that was a good idea, but there was not enough time to try to do it before the end of the session.

As you know, this problem has been around for 25 years. In the 1954 code, a provision was enacted which allowed income to be deferred, in many cases, and which also allowed the setting up of reserves, which people with the food coupons have asked for.

Congress retroactively repealed those 1954 code provisions right away because of the fear of the large amount of the one-item revenue loss.

Senator BYRD. When were they repealed?

Mr. HALPERIN. They were repealed, I think, a year or so later. I think it was 1955 and it was retroactively repealed, primarily because of the one-time revenue loss.

Since that time, people have sat down and figured out a way out of that problem and come up with the suspense account procedure which eliminates the one-time revenue loss and enables us to contemplate on the merits and decide whether this accounting treatment that these industries seek is correct and whether it raises administrative problems for the IRS. And if it is determined that it is correct and that the IRS can handle the auditing problems involved then we ought to be able to say, OK, let's give it to them, without getting into these arguments year after year about whether we can afford it or not.

Now, it may be true that magazines are different from everything else and therefore, since we can afford the revenue loss from magazines, which is $22 million, without breaking the bank, we do not need a suspense account procedure. They argue that they have a special case.

The records say no, they are very close to magazines and they are different from everybody else and we now have the coupon people come in and say no, they are quite the same as everybody else.

There have got to be lots of other industries out there waiting in line and we hope that we could deal with these other industries on the merits without the revenue implications getting in the way, and that is why we prefer a suspense account procedure across the board.

Now, as we said in our statement, that if the committee wants to adopt the House bill as it is, which gives the magazine special treatment, we would urge two things—one, that it not be extended to anybody else, and second, that the normal 10-year amortization period be applied rather than the special 5-year period that is provided by H.R. 3050.

Senator BYRD. The revenue loss, if it applied to magazines, you said was $22 million, but would not that be the loss when applied to magazines, paperbacks, and records? Are you giving the loss only for magazines?

Mr. HALPERIN. Magazines is $22 million. There is a 2-year revenue loss in the first year since this bill does go back to 1976, and that is $22 million in fiscal year 1979 and then $11 million for the next 3 years.

For paperback books and records, it is $86 million altogether; and if they had the same treatment as magazines, there would be a $42 million revenue loss in 1979.

Senator BYRD. How serious is the problem for the magazines under the present law?

Mr. HALPERIN. Well, I do not know whether it is a serious problem. The question is whether their income has been properly measured if they are required to pay taxes on the amount of money that they received, for example, for a November or December issue when they know that a substantial part of that will not be sold and they will have to, in effect, give credit for that accrued income in the following year.

I think it is correct, as they say, that that results in an overpayment of taxes. Of course, as you pointed out, Mr. Chairman, once you have a going concern, provided that there is no growth, in future years their income tends to be measured correctly.

But the primary effect of the bill, as to companies presently in business, if the suspense account procedure is adopted, would be to take care of that growth and to avoid having to pay the taxes to the extent that the returns for this year are more than the returns for last year.

And we think that their income is more correctly measured under the system that is put in by the bill, and we have no objection to that particular change.

Obviously, they have been existing for a number of years under the old system, so I do not know whether one can claim it is a serious problem, but I do not think there is any reason to overtax people if you can avoid it.

Senator BYRD. What about adding the coupons to it?

Mr. HALPERIN. Well, we have not considered it on the merits. I think that there we are clearly switching away from the question of how much income should be reported in current years and talking about a reserve for future expenses.

They are asking to set aside as an expense the amount of money that it will cost them to redeem coupons which have been put into a magazine.

It seems to me that there is very little difference between that and an announcement that says, "I am going to reduce my prices next year, and therefore I would like to set up an expense this year."

Now, maybe I am wrong about that, but at least on first blush it seems to me that they are not saying that they have collected too much on this year's sales or that this year's income is overstated. They are really saying that they are going to be selling next year's goods cheaper and therefore they ought to have a reserve against that cost.

But we would be glad to look at it and see if they were correct in asking for this tax treatment, and second, whether there are administrative problems for the Service. And if they make the case that they fit in with the other issues here, then we would have no objections to extending it, but at least on first hearing about it which was on late Friday afternoon when I got a copy of their testimony, it seems to me that there are distinguishing features here.

Senator BYRD. In other words, you feel that you need a little additional time and information?

Mr. HALPERIN. Yes, sir.

Senator BYRD. How about H.R. 5103?

Mr. HALPERIN. We have not objected to H.R. 5103. As I said in my prepared statement, I am not sure I really understand it completely, but to the extent that I can figure it out, we have not objected to it.

We have—let me just say one thing about that. Mr. Brotzman mentioned the fact that the bill does not help those wholesalers who do not get warranties from the manufacturers.

Apparently, the major retailers, under private brands like Sears, do receive a warranty from the manufacturer, but other retailers who use private brands do not, and the bill as proposed, does not help those people, with all of its complexity. It does not help those people.

What the Treasury suggested to the tire manufacturers and asked them to try to think about very seriously is that this bill creates an immense administrative problem, not only for the IRS but also for the industry, to have to keep track of all returns in order to determine how much tax they are entitled to get refunded. And we suggested to them that they give serious consideration to the possibility of eliminating the refund on warranty adjustments. In return, we thought we could support a reduction in the tax rate so that the total tax collections would not go up and we could ignore warranty adjustments completely.

I recognize that any new system creates problems and readjustments among people, but from what I have heard from the private brand manufacturers, we have not heard the last word on this problem and the IRS assures me that there will be many administrative problems in administering H.R. 5103 and that they expect to hear from the industry again.

I would hope that if we were going to get into this again that Congress would urge the industry to see if they can work with the Treasury and the congressional staffs to come up with a system where we just get rid of warranty adjustments and reduce the tax in the first place. It just seems to me that that is a better way to do things.

Senator BYRD. You started off by indicating that you had no objection.

Mr. HALPERIN. We do not object to the bill as it now stands.

Senator BYRD. What is your position on H.R. 6635?

Mr. HALPERIN. We have no objection to the bill in principle. We have suggested two minor modifications.

The bill as passed the House, was effective back in 1977. We would ask that the effective date be moved up to a current period. And second, the bill ties the interest rate on these retirement bonds to the interest rate on series E bonds. We think it would, on reconsideration of this matter, be more logical to tie it to the interest rate on the new issues of retirement bonds. They are now consistent with series E bonds, but if, in fact, there are differential interest rates in the future between these retirement bonds and series E bonds, it would be more logical to change the interest rate on old issues to the rate on the new retirement bonds rather than the interest rate of the series E bonds.

Senator BYRD. What is your position on H.R. 8535 and the companion bill, Senator Dole's S. 2153?

Mr. HALPERIN. We do not oppose H.R. 8535. And I guess the last bill was H.R. 8811 and the Treasury supports H.R. 8811.

Senator BYRD. Treasury approves H.R. 8811?

Mr. HALPERIN. Right.

Senator BYRD. Well, that takes care of everything except H.R. 810. I have not had a chance to look at that. I would like to carry that over until next time.

Mr. HALPERIN. I could describe it if you would like, Mr. Chairman. Essentially, present law prohibits private foundations from making certain grants to Government officials. One of it is for foreign travel. They are allowed to pay for domestic travel of Government officials, but not for foreign travel.

The bill would allow certain private foundations to pay for foreign travel.

We have not objected to it. We suggested, in accordance with proposals we have made earlier this year for tax changes generally, that the reimbursement be limited to commercial airfare as the bill, as it passed the House, would permit the payment of first class fare.

Senator BYRD. I would like to carry that bill over to the next meeting of the committee.

With regard to H.R. 8811, which Treasury approves, Treasury has had correspondence with Judge Queely of the Tax Court in regard to a possible amendment. I do not know whether you are prepared to go into that at this point, or whether——

Mr. HALPERIN. Mr. Chairman, we have not gotten clearance from OMB as to whether they will agree with the position we have taken in our letters with Judge Queely.

Senator BYRD. Very good.

Thank you very much, gentlemen.

[Thereupon, at 12:10 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman, the following communications were made a part of the record:]

UNITED STATES SENATE,
Washington, D.C., June 20, 1978.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I understand that the Senate Finance Committee has under consideration H.R. 2852, a bill providing for the refund or credit of the gasoline excise tax to operators of agricultural aircraft.

As a long-time sponsor of similar legislation in the House and as co-sponsor of a Senate companion bill, S. 196, I am writing to express my support for H.R. 2852 and to urge you and your Committee colleagues to give this bill favorable consideration.

As you know, the legislation before the Committee changes the procedure to permit the agricultural aircraft operator to claim a gasoline excise tax refund or credit, rather than the farmer claiming tax credit as in the past after the cost is passed on to him by the aircraft operator. With the present system, the cost to the farmer and the administrative burden of providing documents often exceeds the value of the tax refund or credit.

We are all opposed to red tape and it is noteworthy that this bill will have an anti-inflationary impact in that it will reduce the amount of paperwork required under the present law exempting gasoline excise taxes for farming purposes.

I again ask your favorable consideration of this bill and appreciate the opportunity to share my views with you.

Best personal regards.

Sincerely,

JOHN MELCHER.

STATEMENT IN SUPPORT OF H.R. 8535 BY REPS. BARBER B. CONABLE, JR., RAYMOND F. LEDERER, JOSEPH L. FISHER, WILLIAM M. KETCHUM, BILL FRENZEL AND MARTHA KEYS

We strongly favor enactment of H.R. 8535 into law, and urge the Finance Committee to act favorably on it. This bill would eliminate the existing "anti-grandmother clause" and "marriage penalty" from the Section 44A daycare credit.

Existing law requires that in order for a taxpayer to claim the daycare credit for amounts paid to his/her parent, the taxpayer's parent must be "employed" under the definition of employment contained in Section 3121(b) of the Social Security Act. This cross reference to Section 3121(b) has had capricious and absurd results. Married taxpayers are denied the tax credit when "grandma" babysits, but widowed or divorced parents are allowed the credit in identical circumstances. The tax credit may be allowed if the grandmother lives in or comes to the parent's home to babysit, but it is not allowed if the child is taken to the grandmother's home for babysitting. The credit is allowed when the babysitters are the taxpayer's sisters, aunts, cousins or nieces but usually not when the babysitter is the taxpayer's parent.

When Congress voted to extend coverage of the daycare tax credit to relatives in the Tax Reform Act of 1976, it did not anticipate that the cross reference to the Social Security Act would work out this way. The cross reference was described simply as a way to avoid possible abuse by making sure relatives were bona fide employees and that social security taxes were not evaded. It is doubtful that Congress realized it was creating a new marriage penalty in the tax code and an anti-grandmother clause to boot.

The bill we have cosponsored would remove this cross reference, and replace it with new safeguards which better and more accurately address the situations which arise when relatives are paid for babysitting services.

Our main concern in this bill is the elimination of anti-family provisions in our laws. We recognize that when economic dealings take place between close family members—in this case between taxpayers and their parents—there is indeed a potential for possible abuse. However, we believe it is possible to structure the bill in a way that encourages family ties while discouraging tax abuse.

For example, some critics of this measure fear that some taxpayers would try to minimize their tax burden by transferring income to lower-bracket relatives in return for babysitting services instead of supporting those relatives as dependents. However, under both existing law and under the changes proposed by H.R. 8535, the tax credit is not allowed for payments made to an individual with respect to whom the taxpayer or his spouse is *entitled* to claim a dependency deduction. This means that a taxpayer could not choose to trade a $750 dependency exemption for a $400 or $800 daycare tax credit depending on whether he treated his parent as a dependent or a babysitter. So long as he is entitled to the dependency exemption, even though he does not claim this exemption, he must forego the daycare tax credit.

It has been suggested that some people would claim the daycare tax credit for amounts that they did not actually pay their relatives. This sort of fraud would show up in IRS audits of taxpayer returns and any taxpayer who claimed a credit against amounts which were not paid or for which proof of payment could not be produced—whether to a relative, a neighbor, daycare center or hired babysitter—would be subject to the appropriate penalties.

The language of H.R. 8535 addresses another potential area of abuse by prohibiting the tax credit for amounts paid to one's own child younger than age 19. The idea here is that we did not want to permit parents to claim a tax credit for paying an older child to care for a younger one, particularly during the years when the older child was still of school attendance age.

Language in the House report on the bill also made it clear that Congress and the IRS do not believe either the present law or proposed changes allow the credit to be claimed for amounts paid to one's own spouse.

The final area of abuse sometimes cited is a practice that we do not believe is an abuse at all. Some critics have charged that the credit should not be allowed for amounts paid to a grandmother who babysits for her grandchildren because the grandmother would probably have provided this care in any event, even in the absence of the credit or pay. We believe, however, that simply because the parents have hired a babysitter who loves the children enough to provide the services even if pay had not been offered, they should not have to forego the tax credit. If all the requirements have been met—both parents working,

young children in need of care, a paid relative who actually provides the care—then we believe the credit constitutes good public policy, not tax abuse.

For many children, particularly infants, organized daycare centers are not a desirable alternative. As the House Report on the Tax Reform Act of 1976 stated, "Relatives generally provide superior attention." We agree with this principle, and believe further that in times when family life is under visible stress, our laws ought to encourage reliance on family and kin relationships wherever possible rather than acting as a deterrent to such ties. This bill is designed to accomplish this goal by carrying out what many of us believe was the intent of the 1976 Act. We therefore urge the Senate Finance Committee and the Subcommittee on Taxation and Debt Management to consider H.R. 8535 favorably and order it reported.

FREEMAN CROP SERVICE, INC.,
Melfa, Va., June 1, 1978.

Senator HARRY F. BYRD, JR.,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: We seldom write you unless it is deemed necessary to keep you posted on your constituent's attitudes.

On May 8, the House of Representatives passed HR 2852 which is an amendment to the Internal Revenue Code 54 exempting certain agricultural aircraft from aircraft use tax, and provides for refund of the gasoline tax to the agricultural aircraft operator. To clarify that, up until this time the ag-aviation operator (crop dusters) have been paying gas taxes which the farmer can recover and which is an inequity in itself and in the law. By obtaining the refund directly, it will hold down costs or perhaps reduce costs to the farmer, thus lowering their farm input. With the complexities as they now exist, nobody really got the benefit of the tax and the paper work more than out-weighed the benefits. Your cooperation in helping in this important project for our industry would certainly be appreciated.

I know all the other ag-aviation operators in Virginia as well as in the nation feel the same way. I would be grateful for anything you could do concerning this matter.

Sincerely,

BRUCE FREEMAN.

WINE AND SPIRITS WHOLESALERS OF AMERICA, INC.,
Washington, D.C., June 23, 1978.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. STERN: This is to comment on the Treasury Department's statement in opposition to HR 1920 presented to the Subcommittee on Taxation and Debt Management at the hearing held on June 19, 1978.

As you will recall, I testified before the subcommittee on June 19 on behalf of a coalition representing virtually every segment and level of the alcoholic beverage industry including the eighteen control states which are actually engaged in the sale and distribution of alcoholic beverages at wholesale and/or retail. Although most of the objections raised by Treasury were addressed in my testimony, I feel it important to further amplify my comments because of the erroneous interpretation of previous congressional policy which underlies Treasury's reasoning for opposing HR 1920.

At the outset, it would appear that Treasury views the concept of tax refunds on alcoholic beverages lost as a result of the perils covered by HR 1920 as innovative and requiring a policy determination for the first time. On the contrary, the Congress made this determination many years ago and has consistently recognized that when taxpaid alcoholic beverages are destroyed or lost while being held for resale, equity and fairness require that the seller sustaining the loss should have the tax and duty refunded if he is not otherwise indemnified.

In stating the policy of the Congress with respect to such casualty losses, Treasury alleges that ". . . losses by handlers of alcoholic beverages, except in case of disasters of extraordinary severity, have been treated as ordinary business hazards to be borne by the holder of the beverages or his insurance company." This statement is at substantial variance with the facts.

For example, in addition to the separate enactments to cover such losses resulting from the floods of 1936, 1937, 1951 and the hurricane of 1954, I would call the Subcommittee's attention to the specific relief granted to distillers in Section 5008(c)(A) (ii) and (iii) of the Internal Revenue Code.

That section in substance provides for a refund of tax for losses sustained prior to removal from the distilled spirits plant premises by reason of flood, fire or other disaster or by reason of accident while on the distilled spirit's plant premises if the loss amounts to 10 proof gallons or more in respect of any one accident. Taxes are also refundable to distillers under Section 5008(a)(1)(A) for losses resulting from theft.

HR 1920 provides that no claim would be eligible unless the tax and duty on such liquors lost amounts to $250 or more. Translated in terms of proof gallons this would mean almost 24 proof gallons.

As a further illustration of congressional policy on tax refunds on liquors lost or destroyed while being held for sale. Section 5056(e) of the IRC provides for a tax refund to brewers on beer lost by fire, theft, casualty or act of God before transfer of title to another person.

It should be noted that losses by theft are covered for both distillers and brewers provided there was no connivance, collusion, fraud, etc., where as HR 1920 expressly excludes theft from the perils covered.

It is difficult to reconcile Treasury's opposition to HR 1920 with their approval of the foregoing enactments including Section 5064 of the IRC which provides for tax refunds on liquors lost as a result of a presidentially declared major disaster. As further evidence of Treasury's inconsistency, on April 21, 1970, Treasury filed a report with the Senate Committee on Finance approving an amendment to Section 5056 of the IRC to include theft among the perils covered for losses sustained by brewers.

In our filed statement we have responded fully to Treasury's assertion that the enactment of HR 1920 would in effect provide free insurance to dealers in alcoholic beverages covering tax and duty. I would only emphasize that legislative history and congressional policy over the years makes it abundantly clear that it was never intended that anyone other than the ultimate consumer should bear the burden of the tax. If there were any merit to Treasury's contention, then carried to a logical conclusion virtually every provision under Section 5008 of the IRC covering abatement, remission, refund and allowance for loss or destruction is by its very nature some form of insurance.

We have also responded to the contention that HR 1920 would be difficult to administer. Again we point out that in all cases the burden of establishing proof of loss must be sustained by the claimant. If he cannot sustain that burden, there would be no refund.

Finally, after initial approval as well as twenty years of acquiescence, Treasury now contradictorily suggests the repeal of the major disaster provision since that precedent is not compatible with the position it now takes on HR 1920. We submit that any consideration of that proposal would be a giant step backward and would frustrate the concept of fairness and equity which the Congress has consistently applied to tax refunds on liquors lost or destroyed while being held for resale.

We request that this communication be made part of the hearing record and urge that HR 1920 be reported favorably and speedily enacted.

Respectfully yours,

ABRAHAM TUNICK,
On Behalf of the Coalition.

NATIONAL WOMEN'S CHRISTIAN TEMPERANCE UNION,
Washington, D.C., June 12, 1978.

Re. H.R. 2028—an act referred for deliberation to the U.S. Senate.

U.S. Senate Committee on Finance,
2227 Dirksen Senate Office Building,
Washington, D.C.

HONORABLE GENTLEMEN: As this legislation has all the earmarks of bootlegging which the nation rejected by Repeal of the Eighteenth Amendment, we urge you not to put this "stumbling-block" (Romans 14:13–KJV) in the way of our youthful citizens.

The act defines adult as any individual who has attained 18 years of age. A multitude of citizens this age both male and female, are still in high school un-

prepared for adult responsibilities. Giving them the authority to produce alcoholic beverages within the home, would only cause problems for parents and teachers.

The health hazard of imbibing alcohol has now reached the ultimate victim, in the current medical concern for prevention of the Fetal Alcohol Syndrome during pregnancy. Voting to suspend their own rules to facilitate human debilitation is unworthy of constituent trust in elected capability.

The Space Age has made possible intelligent cognizance of causal health factors. The oft-repeated excuse "we cannot legislate morality" has now been sensibly adjudged, "we can only legislate against the consequences of immorality."

This, gentlemen, gives you the opportunity to exercise ethical statesmanship by renouncing the excess availability of alcoholic beverages this legal loophole would produce, and furtherance of governmental rehabilitation expense to remedy the inevitable consequences!

Sincerely,

MARION B. S. CRYMES,
Washington Correspondent.

HUDSON, WILF & KRONFELD,
Philadelphia, Pa., June 21, 1978.

Re. H.R. 1337.

MR. MICHAEL STERN,
Staff Director, Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR MR. STERN: This statement is being submitted by me as counsel for Strick Corporation, of Fort Washington, Pa. Strick Corporation's primary business is the manufacture and sale of truck trailers.

Strick Corporation urges the enactment of H.R. 1337. The elimination of the so-called "cost floor", as an alternative method for determining a constructive sales price under Section 4061(a), is highly desirable for all segments of the truck trailer manufacturing industry. The report of the Committee on Ways and Means, dated March 16, 1978, with respect to H.R. 1337 (Report No. 95-976) very ably sets forth the essential considerations warranting the adoption of H.R. 1337. We would like to amplify some of the comments mentioned in that Report.

First, we wish to point out that the enactment of H.R. 1337 will eliminate the uncertainty and controversy under present law as to whether the "cost floor" method adopted by the Internal Revenue Service is, in fact, a permissible method of determining a constructive sales price. In the one case on point, *Quaker City Iron Works* v. *United States*, 66-1 U.S.T.C. ¶15,684 (E.D. Pa. 1966), the court held that the "cost floor" is not a permissible method. A second relevant case, *Whattoff* v. *United States*, 355 F. 2d 473, 66-1 U.S.T.C. ¶15,670 (8th Cir. 1966) upheld the application of the "cost floor" method, but under circumstances which the Circuit Court believed to be the most favorable method available to the taxpayer. Strick Corporation is presently involved in litigation in which the validity of the "cost floor" method is at issue. Irrespective of the outcome of Strick Corporation's present litigation, H.R. 1337 has the highly salutory effect of eliminating, for all periods after its enactment, the continuing uncertainty as to whether the "cost floor" method is valid to affect the tax consequences prior to its effective date, by stating (page 4):

"It is also intended that no inference be drawn from this legislative action with regard to controversies between taxpayers and the Service concerning either the validity of the cost floor rule or determinations of cost for taxable transactions which occurred before the effective date of this legislation."

Second, the "cost floor" method discriminates against Strick Corporation, a high unit product cost maufacture. This discrimination, as stated in the House Committee Report, is contrary to the purpose and intent of the excise tax. All competing maufacturers should be treated fairly by the excise tax. And, fair treatment can only be attained by a tax based upon a uniform percentage of selling price.

Third, the "cost floor" method necessarily involves the determination of what is "cost" for such purposes. The Committee Report correctly points out (page 3) that a manufacturer may be assessed a deficiency at a date "long after the sale has occurred" by reason of the Service's concept of cost. Strick Corportaion is, also, presently litigating the assertion by the Service that a substantial excise tax deficiency arose in 1971 (and in subsequent years), because, in the Service's view, another item should be added to Strick Corporation's cost of manufacture.

H.R. 1337, by eliminating the "cost floor", eliminates all problems involved in determining cost for all manufacturers, a highly desirable result.

In summary, we support the views expressed in the House Committee Report that the elimination of the "cost floor" concept will provide the competitive fairness and certainty of taxation so essential to the proper administration of the excise tax. HR. 1337 will also greatly simplify the tax laws in a narrow but important area. There will be no need for sophisticated methods of allocation and determination of costs or for the audits and litigation relating to such determinations, with the concurrent savings of time and money both to taxpayers and the Government. H.R. 1337 will promote both certainty and fairness in the application of the excise tax, two highly important results in an era of increasingly complicated and ambiguous taxing measures.

We have one suggestion for your consideration. The purpose of the legislation is to provide a uniform rule for determining the excise tax base for all sales at retail of items under Section 4061(a). There is language in the Internal Revenue Service rulings which, if read in a narrow way, could be used by the Service in an attempt to defeat this Congressional intent. Accordingly, we respectfully suggest that the Report of the Senate Finance Committee explicitly eliminate any possible inconsistent interpretation by the Service. We further respectfully suggest that this could be accomplished with a statement along the following lines (to be inserted immediately preceding the penultimate sentence of the first paragraph under the hearing "Explanation of the bill", page 3 of the House Committee Report):

"It is intended that all sales at retail by manufacturers of items taxable under Section 4061 shall be governed by this rule, whether or not a manufacturer sells the same or similar items at other levels of distribution."

We appreciate the opportunity of presenting our views to you.

Very truly yours,

MERVIN M. WILF.

STATEMENT OF INTERNATIONAL HARVESTER CO.

International Harvester Company ("IH") submits this statement for the record to the Subcommittee on Taxation and Debt Management of the Senate Finance Committee in connection with the Subcommittee's consideration of H.R. 1337, a Bill to amend the "constructive sale price" provisions of section 4216(b)(1) of the Internal Revenue Code (the "Code").

I. INTRODUCTION

IH is a major manufacturer in the truck, bus and highway tractor industry. The sale of these items by IH is subject to the manufacturers excise tax imposed by section 4061(a) of the Code. While the normal practice for manufacturers in the industry is to sell these items to independent retail dealers, some manufacturers (including IH) sell both to independent retail dealers and directly at retail to ultimate consumers through retail outlets. It is not the practice of any major manufacturer in this industry to sell to wholesale distributors.

IH currently sells approximately 85,000 taxable vehicles of various sizes and prices per year. Identical models have the same "suggested retail price", without regard to whether the vehicles are destined for sale to an independent retail dealer or directly at retail to a consumer by an IH retail outlet.

IH supports H.R. 1337 insofar as the Bill is directed towards the elimination of the "cost floor" as a possible constructive sale price for purposes of computing the excise tax on retail sales of trucks, buses and trailers. IH agrees that using the "cost floor" can lead to uncertainty at the time of the retail sale as to the amount of excise tax that may be due.

However, in IH's view, H.R. 1337 goes too far by providing a mechanical rule (based on percentage of the actual retail sales price) which is to apply to all retail sales of all manufacturers in the industry. IH believes that the rule contemplated by H.R. 1337 makes good sense for manufacturers who sell only or primarily at retail and, as a consequence, have no other available constructive sale price for use in computing the excise tax due on their retail sales. However, that rule should not automatically be imposed by the statute with respect to the retail sales of manufacturers who, like IH, also sell a substantial portion of their taxable items to independent retail dealers. Such manufacturers should be permitted to use their lowest price to such dealers as the constructive sale price for retail sales.

II. IH'S POSITION

In support of its position, IH submits the following points:

1. *Certainty as to the amount of tax.*—One of the primary arguments advanced on behalf of H.R. 1337, as currently drafted and under consideration, is that it will simplify the excise tax computation for retail sales by providing a constructive sale price that will permit the tax to be computed simply and with certainty at the time of each retail sale. See H. Rep. No. 95–976, 95th Cong., 2d Sess., which accompanied H.R. 1337 and the Statement (pp. 2–3) of Mr. Daniel I. Halperin, Tax Legislative Counsel, submitted to this Subcommittee. This argument is valid with respect to manufacturers who sell only or primarily at retail. However, where, as is the case with IH, a manufacturer has substantial sales to independent retail dealers, utilization of the manufacturer's lowest price to such dealers as the constructive sale price for a vehicle being sold at retail also affords the manufacturer certainty in computing the tax on the retail sale. The IH method of paying tax on a retail sale produces the same tax on each retail sale of the same item— without regard to the specifically negotiated retail price.

2. *Uniformity and fairness.*—Another argument advanced on behalf of H.R. 1337 is that it will provide uniformity and fairness by causing the same amount of excise tax to be generated if different manufacturers sell the same article at retail at the same price. H. Rep. 95–976, *supra.* In this way, it has been suggested the excise tax itself will become a neutral factor insofar as price competition among competitors is concerned.

Again, this argument is valid only where manufacturers sell only or primarily at retail. However, where, as is the case with IH, a manufacturer has substantial sales to independent retail dealers, H.R. 1337 has the opposite effect and results in a lack of uniformity among competitors. In IH's case, H.R. 1337 will operate in a discriminatory manner by providing for different amounts of excise tax where two competitors (namely, IH and the IH independent retail dealer) sell exactly the same item at exactly the same price.

H.R. 1337 would cause IH to pay a different amount of excise tax on the same items depending on whether IH sold the item to an independent retail dealer (in which event the tax would be based on the actual dealer price) or at retail through IH's own retail outlet (in which event the tax would be based on a percentage of the actual sales price to the customer). This difference in the computation of the tax obviously would produce a competitive disadvantage for either IH or the independent dealer depending on which tax base was higher. Thus, H.R. 1337, as drafted, will produce a result which is contrary to its intended goal of uniformity and fairness within a competitive group.

In effect, H.R. 1337 would be undermining the provisions of the Excise Tax Technical Changes Act of 1958 (the "1958 Act") dealing with the constructive sale price in just this type of situation. See sections 4216(b)(1) and (b)(2) of the Code as added or amended by the 1958 Act. The whole thrust of these provisions was to provide a rule whereby a manufacturer selling at different levels in the market place—*i.e.*, to wholesale distributors, retail dealers, and at retail—would compute the excise tax on all items on the same tax base or constructive sale price, without regard to whether the particular item actually was sold at retail or to a dealer. See S. Rep. No. 2090, 85th Cong., 2d Sess. 21–26.

3. *IH's position is in accord with current statutory provision as evidenced by Proposed Regulations.*—Prior to the 1958 Act, the constructive sale price rule contended for herein by IH (based on the sales price to independent retail dealers) unquestionably represented the position of the Internal Revenue Service where a manufacturer sold both to independent retail dealers and to consumers at retail. See *Rev. Rul. 54–61*, 1954–1 C.B. 259; see also, H. Rep. No. 481, 85th Cong., 1st Sess. 21, 24, and S. Rep. No. 2090, 85th Cong., 2d Sess. 22, 25, which accompanied the 1958 Act. In addition, IH received letter rulings from the Internal Revenue Service to that effect going back to 1934.

IH believes that this constructive sale price rule was not changed by the 1958 Act. However, some confusion has apparently developed in this regard in view of the sentence added by the 1958 Act to section 4216(b)(1) of the Code to the effect that the constructive sale price should be the lower of "(i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary." This provision created doubt as to the manufacturer's ability to continue to use its dealer prices as its constructive sale prices. *Rev. Rul. 68–519*, 1968–2 C.B. 513.

However, this confusion has been resolved by Prop. Reg. § 48.4216(b)-2(b) which provides, in part:

"* * * However, in the case of an article that in the ordinary course of trade is not sold by manufacturers to wholesale distributors, the constructive sale price shall be the lowest price for which the article is sold by manufacturers to retail dealers in the ordinary course of trade, as determined by the Secretary or his delegate. If the constructive sale price so determined is less than the actual sale price, the constructive sale price shall be used as the tax base. If the constructive sale price is not less than the actual sale price, the actual sale price shall be considered as not less than fair market, and shall be used as the tax base. * * *"

This rule makes perfect sense since the "lowest price for which the article is sold by manufacturers to retail dealers" is likely to be very close to the "highest price for which such articles are sold to wholesale distributors". Certainly, it is more appropriate to use the lowest sales price to independent retail dealers under these circumstances than to pick an arbitrary percentage of the actual retail sales price. IH endorses Prop. Reg. § 48.4216(b)-2(b).

4. *H.R. 1337 is contrary to the settled practice in the truck industry.*—As indicated by the foregoing, IH has consistently used its sales price to independent retail dealers as its constructive sale price for its retail sales since 1934. This practice has been confirmed by letter rulings from the Internal Revenue Service and upon audit. It is the understanding of IH that other manufacturers in the truck industry who sell both to independent retail dealers and at retail also follow the same practice. Thus, H.R. 1337, as currently drafted, will disrupt the established practice in the industry and will have an adverse effect on those manufacturers who sell at retail and their relationship with their independent retail dealers.

III. IH'S PROPOSAL

To avoid the problems described above, IH proposes that H.R. 1337 be modified so that the third sentence of section 4216(b)(1) of the Code will read as follows:

"In the case of an article the sale of which is taxable under section 4061(a) and which is sold at retail, the computation under the first sentence of this paragraph *may be either (i)* a percentage (not greater than 100 percent) of the actual selling price based upon the highest price for which such articles are sold, *or (ii) the lowest price for which such articles are sold to retail dealers,* by manufacturers and producers in the ordinary course of trade (determined without regard to any individual manufacturer's or producer's costs)." [Proposed language in italic.]

IH believes that this provision would go far towards establishing certainty and uniformity of tax imposed by section 4061(a) in the case of all manufacturers, whether they sell (a) only at retail, (b) primarily at retail, (c) primarily to independent retail dealers, and (d) only to independent retail dealers.

STATEMENT OF THE NATIONAL CATTLEMEN'S ASSOCIATION

(Submitted By B. H. (Bill) Jones, Vice President Policy Development, National Cattlemen's Association)

The National Cattlemen's Association is the national spokesman for all segments of the nation's beef cattle industry—including cattle breeders, producers, and feeders. The NCA represents approximately 280,000 professional cattlemen throughout the country. Membership includes individual members as well as 51 affiliated state cattle associations and 13 affiliated national breed organizations.

H.R. 2852—AGRICULTURAL AIRCRAFT

The proposed legislation would amend the Internal Revenue Code to exempt certain agricultural aircraft from the aircraft use tax and to provide for the refund of this tax when aircraft are used in Agriculture.

The excise tax currently levied on fuel use by aircraft engaged in agricultural operations constitutes an unjustified added production cost to farmers and ranchers. The aircraft designated in the bill makes very little or no use of commercial airport facilities financed by the use tax; therefore, it is unjust to levy the tax on fuel used for agricultural purposes.

H.R. 2984—LIVESTOCK AND FARM TRAILERS

The bill provides an exemption from the 10 percent manufacturers excise tax for certain trailers or semitrailers which are designed to be used for farming purposes or for transporting livestock or horses.

Current law provides an exclusion from the tax in the case of chassis and bodies of light-duty trucks, buses, truck trailers, and semitrailers. To be eligible for the exclusion, the chassis or body truck trailer or semitrailer must be suitable for use with a trailer or semitrailer having a gross vehicle weight of 10.000 pounds or less. Furthermore, in order to be exempt, the truck or semitrailer itself must be suitable for use with a towing vehicle having a gross vehicle weight of 10,000 pounds or less.

The manner in which present law is administered by the Internal Revenue Service has aborted the actual Congressional intent with respect to exempting trailers or semitrailers used for farming purposes or for transporting livestock or horses. The Revenue Act of 1971 repealed the excise tax on automobiles and their trailers and semitrailers. The IRS subsequently ruled that one-horse and two-horse trailers were considered to be suitable for use with passenger automobiles. Three-horse and four-horse trailers, however, were concluded to be designed for highway use in combination with taxable trucks.

Also, under the present regulations, the primary determinant of gross vehicle weight is frequently the maximum load carrying capacity of the axles used. Manufacturers of farming trailers and trailers designed for transporting livestock or horses often use axles produced primarily for recreational mobile homes and these vehicles are frequently rated at more than 10,000 pounds.

In view of these developments, the Subcommittee is urged to act favorably on H.R. 2984 in the interest of re-establishing the original intent of the Congress to exempt trailers and semitrailers designed for farming purposes or for transporting livestock or horses from the 10 percent manufacturers excise tax.

STATEMENT OF JAMES F. MARSHALL, EXECUTIVE DIRECTOR, ASSEMBLY OF GOVERNMENTAL EMPLOYEES

Subject: Support of legislation to exempt subsistence allowance of law enforcement officers from Federal income tax (S. 2872, S. 3134 and similar legislation).

Mr. Chairman and Members: I appreciate an opportunity to present a statement on behalf of state and local public employees on the matter of subsistence allowances to police officers. For over 25 years the Assembly of Governmental Employees has been a federation of independent public employee organizations representing state and local employees throughout the United States. Some of our affiliate organizations have been representing public employees for more than 50 years. We have 46 affiliate organizations located in 35 states, including 34 state employee associations. Most of our affiliates include state police and other law enforcement officers in their memberships.

Your late colleague, Mr. Allen of Alabama, earlier this year introduced S. 2872, and subsequently for himself and other members, S 3134. Public employees in Alabama and throughout the United States appreciated his efforts and deeply regret his untimely passing.

These bills and similar legislation introduced in the House of Representatives are intended to deal with the serious financial problems created for thousands of law enforcement officers throughout the United States when the United states in serious financial jeopardy, facing retroactive tax assessments averaging cash meal allowances paid to a New Jersey state trooper could not be excluded from income for federal income tax purposes.

This decision places thousands of law enforcement officers in at least 16 states in serious financial jeopardy, facing retroactive tax assessments averaging $3000.00 apiece. We feel this is a very unfair assessment. Relief for these law enforcement officers from serious tax liability incurred over past years when they were following long-established practices and precedents is urgently needed. We urge quick congressional action on the retroactivity clause of this legislation.

S 2872 covers all law enforcement officers and applies both retroactively and prospectively. S 3134 covers only state police and applies retractively. Both refer to "statutory subsistence allowances."

We urge the committee to consider an amendment. The phrase "statutory subsistence allowances" that appears in both S 2872 and S 3134 assumes that all such subsistence allowances have been provided by statute. We know of at least one exception to that assumption in a collective bargaining agreement between the State of Montana and the Montana Public Employees Association. The subsistence allowance is authorized through a contract agreement rather than through statutory provision. We can only assume that there might be other, similar contractual arrangements. If relief from a retroactive tax assessment is valid for those law enforcement officers who receive such an allowance by statute, then the same should be valid for contractual arrangements.

We respectfully request that the language be amended, either by deleting the word "statutory" or by rewording the phrase to read, "statutory or contractual subsistence allowance."

Although we are not personally aware of other law enforcement jurisdictions that have such subsistence allowances, it is feasible that there are similar subsistence allowances for law enforcement officers in other jurisdictions. We therefore suggest that the committee consider use of the language "law enforcement officer in the United States" that appears in S 2872 instead of "state police officers" that appears in S 3134.

With regard to the prospective tax relief proposed in some of the legislation pending before Congress, we agree with Mr. Justice Blackmun, who pointed out the difficulty of reconciling a statutory interpretation which allows tax exemption for meals and housing allowances for the entire military establishment and denies exception for a state trooper's lunch money.

We believe that the meal allowance granted to on-duty law enforcement officers by state and local government to meet the service needs of the law enforcement agency involved should be tax exempt in the future as it has been in the past.

We thank you for your consideration of our requests. We stand ready to assist the committee in any way possible to ensure a responsible conclusion to this issue.

Statement of Raymond P. Bilger, Vice President-Taxes on Behalf of Sears, Roebuck and Co.

Summary of Statement on H.R. 5103

1. H.R. 5103 codifies long-standing administrative practice by allowing tire manufacturers an excise tax credit or refund with respect to warranty adjustments of tires. The bill provides that where the manufacturer's warranty runs only to its immediate vendee (and not to the ultimate consumer) no adjustment shall be made by the manufacturer nor excise tax credit taken before an adjustment has been made with the ultimate consumer.

2. The Ways and Means Report on H.R. 5103, but not the bill, places the burden on the "immediate vendee" to maintain records to prove that the adjustment has been made to the ultimate consumer. Sears is a private brand retailer of tires. The manufacturer's warranty on Sears brand tires runs only to Sears, and Sears provides its own broader warranty on the tires to its customers, the ultimate consumers. Sears takes exception to the record keeping requirement which would be placed on it and similar tire retailers.

3. Sears recommends elimination of the record keeping requirement (1) by deleting the provision in the bill coupling the manufacturer's warranty adjustment with the immediate vendee to the independent adjustment of the immediate vendee with the ultimate consumer, or (2) by having the Senate Finance Committee Report accompanying the bill make it clear that the immediate vendee, i.e., the private brand tire retailer, is not required to maintain records of its warranty adjustment with its customer, the ultimate consumer, in order to support the excise tax credit taken by the tire manufacturer on its warranty adjustment with the immediate vendee.

Mr. Chairman: I am Raymond Bilger of Sears, Roebuck and Co., and am pleased to submit comments regarding H.R. 5103 as passed by the House and presently pending before the Subcommittee.

By way of background, Sears is the world's largest retailer of general merchandise. The company and its consolidated subsidiaries distribute broad lines of goods through some 3,800 selling locations, (including 1,400 independent catalogue merchants) in fifty states, Puerto Rico and Central America. As a retailer of general merchandise, Sears sells a variety of products, among which are automobile and truck tires.

H.R. 5103 as passed by the House deals with this sales area by providing for excise tax refunds in the case of certain warranty adjustments on tires and for other purposes. Principally, the Act clarifies the treatment of credits or refunds of the manufacturer's excise tax on new (or retreaded) tires where the sales are later adjusted as a result of a warranty or guarantee. It also deals with retread rubber, modifies the statute of limitations, and affects imported retreaded tires. H.R. 5103 as passed is essentially designed as it pertains to new tires to clarify long-standing administrative practice under which a manufacturer is allowed an excise tax credit or refund with respect to sales of tires for which a warranty adjustment is made on a tire-by-tire basis and to apply this same principle to cases where warranty adjustments are made on an overall basis.

The Report of the Committee on Ways and Means (No. 95-916) contains a requirement in reliance on subparagraph (L)(iii), p. 5, lines 12-15 of H.R. 5103 as passed which would have an adverse effect on Sears and similar retailers and which we believe is not entirely consistent with the stated intent of the bill to codify long-standing administrative practice relative to the excise tax aspects of tire warranty adjustments.

In dealing with the situation where a tire manufacturer's warranty runs only to its immediate vendee (and not to the ultimate consumer), the Act provides that no adjustment shall be made by the manufacturer on which an excise tax credit is taken before an adjustment is made with the ultimate consumer. The Ways and Means Report, (page 5), directs the Treasury Department to issue Regulations on acceptable methods to prove that the adjustment has been made to the ultimate consumer and places a burden on the immediate vendee, in this case Sears, to maintain records to prove that the adjustment has been made with the ultimate consumer. It is this recordkeeping requirement and provision to which Sears takes exception.

As a "private brand" retailer of general merchandise, Sears gears it's operating, merchandising, and accounting policies and procedures regarding Sears brand tires to reflect this "private brand" approach to retailing. The manufacturer's warranty on Sears' brand tires runs *only* to Sears—*not* to the Sears customer, the "ultimate consumer," for purposes of this legislation. Sears provides its own broader tire warranty to its customers. Any adjustment made under the Sears warranty is based on the Sears retail price of the tire. After Sears makes an adjustment with its customer, an adjustment may also be made under the manufacturer's warranty to Sears. Then the tire is physically returned by Sears to the manufacturer for such an adjustment and the adjustment would be based on the manufacturer's price of the tire to Sears. An excise tax credit taken by the manufacturer would be in proportion to the sales price adjustment paid by it to Sears. As with any item of Sears "private brand" merchandise, the tire manufacturer's warranty to Sears is not contingent on Sears warranty to its customer (the ultimate consumer), nor is the Sears warranty to its customer contingent on the manufacturer's warranty to Sears. Sears warranty adjustments with its customers are completely independent from adjustments made by the manufacturer pursuant to its warranty with Sears. Sears does not, nor is required to, maintain any records which would connect its warranty adjustment to the Sears customer (the ultimate consumer) on an individual tire to any subsequent warranty adjustment with Sears by the manufacturer which would be applicable to any individual tire.

Thus, to comply with the provisions of H.R. 5103 as passed, Sears would be required to initiate and maintain special records supporting the fact that it made an adjustment with the ultimate consumer on each individual tire in order for the manufacturer to make an excise tax credit incident to its warranty adjustment with Sears on that tire.

While the consumer ultimately bears the expense of the tire tax (as well as with any other excise tax on a product or service), it is not an excise tax imposed on the ultimate consumer. The tire tax is imposed directly on the manufacturer, the same as all other manufacturer's excise taxes covered by Chapter 32 of the

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Internal Revenue Code. The factor which distinguishes the tire tax from other manufacturer's excise taxes is that it is not based on selling price, but in weight. (Even in this respect the tire tax is not unique: the manufacturer's excise tax on gasoline and on lubricating oil are based on volume rather than selling price. For a manufacturer to take an excise tax credit on a price adjustment to Sears under its warranty it is not required that Sears maintain a record of its independent adjustment with its customer in the case of a shotgun, of a truck part, of a fishing rod, or in the case of any other item subject to a manufacturer's excise tax which is sold by Sears. It make little sense that this should not be a requirement in the case of tires.

Requiring a "private brand" tire dealer to maintain records to prove that an adjustment was made with the ultimate consumer has never been a part of the long-standing administrative practice under which a manufacturer is allowed an excise tax credit with respect to a tire warranty adjustment. This long-standing administrative practice began in 1932 (at about the time the tire tax became effective). In a letter to an association of tire manufacturers, the Commissioner of the (then) Bureau of Internal Revenue ruled on the tire adjustment question by simply paraphrasing a paragraph in the then existing Regulations applicable to *ad valorem* excise taxes. The paraphrased passage read:

"Where a taxpaid article is returned to the manufacturer thereof for adjustment. replacement or exchange, under a guaranty as to quality or service, and a new article given pursuant to guaranty, free or at a reduced price, the tax on the article given in exchange or replacement shall be computed on that portion of the total weight which is proportionate to that portion of the actual price, if any, to be paid to the manufacturer of the new article."

Thus, from the very outset, the long-standing practice was simply an attempt to extend to warranty adjustments of tires those manufacturer's price adjustment provisions in effect for other articles subject to a manufacturer's excise tax. There was no intent or suggestion that the tire manufacturer should go beyond its own price adjustment transaction in order to support its excise tax reduction. This administrative position was later contained in a Revenue Ruling S.T. 644, XII-1 C.B. 381, published in 1933, and reiterated in Revenue Ruling 59-394. 1959-2 C.B. 280.

In Revenue Ruling 59-394 the administrative position was stated as follows:

" * * * it is held that where the manufacturer sells a customer a new replacement tire at a reduced price pursuant to the guaranty contract, the manufacturer's excise tax on the replacement tire is computed upon that proportion of the total weight of the second tire which the actual sale price bears to the regular sales price of the second tire."

In 1960 several tire manufacturers decided to require "private brand" tire dealers such as Sears to provide them with documentation of the dealer's adjustment of a tire with the ultimate consumer to "protect" the excise tax credits taken by the manufacturers on their subsequent adjustments with the dealers. Sears refused to do this on the basis that it was an unreasonable burden and unnecessary, and requested a ruling from the National Office of the Internal Revenue Service as to whether such documentation was required. In July, 1961, Sears received a ruling on the question which supported its position. In the ruling the Internal Revenue Service held:

"Under the situation present here where the manufacturer's guarantee runs only to Sears, we consider that Sears is the 'customer' involved in the transaction within the meaning and intent of Revenue Ruling 59-394. This conclusion applies without regard to the guarantee which Sears may independently extend to its customers. Thus, a tire manufacturer claiming a tax credit with respect to replacement tires sold to Sears under this arrangement at a reduced price pursuant to guarantee is not required to show that such credit is passed on to the ultimate consumer. The tax due from the tire manufacturer with respect to the sale of the replacement tire under its guarantee is to be computed upon the basis of the ratio outlined in Revenue Ruling 59-394."

Clearly, the provision in the bill as passed coupling the warranty adjustment made by the tire manufacturer to the warranty adjustment made independently by the tire dealer to the ultimate consumer is contrary to long-standing administrative excise tax practice relative to tire adjustments.

Also the maintenance of records to support this warranty adjustment would be unnecessary and superfluous. Where a "private brand" tire has been used on the road and appears to have failed because of a factory defect and is physically returned to its manufacturer for a price adjustment under the manufacturer's warranty, then it would be self-evident that a price adjustment on that tire

has been made by the retailer to the customer. By the wildest stretch of imagination, it would be ludicrous to assume that the retailer could come into possession of many thousand of such tires each year, if it had not obtained them through warranty adjustments with its customers.

We recommend deletion of the provisions in the bill to the effect that "no adjustments shall be made under subparagraph (L) before the adjustments to the ultimate consumer is made (or, in the case of subparagraph (L)(ii), deemed made)." Alternatively, we think it should be made clear in the Senate Finance Committee Report accompanying the bill explaining this provision that the tire manufacturer would not have to go beyond its warranty adjustment transaction on which the proportionate excise tax credit is based in order to support the excise tax credit. In other words, it should be clear that the immediate vendee, i.e., the retailer, is not required to maintain records of its warranty adjustment with its customer, the ultimate consumer. This could be accomplished by language designed to insure retention of the procedures permitted private brand dealers in the 1961 ruling, namely "that where the private brand dealer's warranty to the ultimate purchaser is as good or better than the manufacturer's warranty to the dealer, it then will be assumed that the required adjustment has been made to the ultimate consumer when the immediate vendee makes his request for credit or refund from the manufacturer."

With the foregoing clarification, Sears would not have objection to the House-passed bill.

COMMENTS OF THE PRIVATE BRAND TIRE GROUP

The Private Brand Tire Group, an organization of some fifty independent companies who market tires with private brand labels. submits these comments on H.R. 5103. We sincerely appreciate the opportunity the subcommittee has afforded us to present our views on a matter which is of great importance to the industry we represent.

Before I discuss our interest in this Bill, it would be useful to describe for the Subcommittee the role and operations of a private brand marketer in the tire industry. Generally speaking, private brand marketers market, distribute, or sell tires under their own brand name. These tires are produced to the specifications of the private brand marketer by tire manufacturers who have no financial involvement in the marketing function. In some cases, these tires are marketed in competition with brand labeled tires manufactured by the same tire manufacturers. In many cases private brand tires are marketed in competition with the so-called "Big 5" tire manufacturers. It should be noted at this point that while large retailing organizations such as Sears and Montgomery Ward, as well as national oil companies who market tires, may fit within the purview of this definition, the Private Brand Tire Group does not purport here to represent their views. Our companies market brands which are relatively small, on an individual basis, and which, even though sold nationally in most cases, have not achieved the national recognition afforded those brands of the major retailers. This is not to say, however, that our combined marketing strength is insignificant. More importantly, we believe private brands are a viable part of the replacement tire industry and contribute significantly to maintaining an open and competitive marketplace which, of course, ultimately redounds to the benefit of the tire consumer.

Let us turn now to H.R. 5103. We are concerned only with subparagraph (L) which H.R. 5103 would add to Section 6416(b)(2) of the Internal Revenue Code. Our concern with subsection (L) may be briefly stated. As interpreted by the Ways and Means Committee Report[1] section (L) would only benefit that segment of the tire retail industry which includes tire manufacturers. It would deny the relatively small independent tire marketer the vehicle for excise tax recovery that it grants tire manufacturers who are vertically integrated into marketing or, as in the case of the Big 5 manufacturers, who are further integrated into retailing. Consequently, our companies are placed at a significant competitive disadvantage. Because the law would hamper our ability to compete and therefore to stimulate competition in the tire retail industry, the tire consumer ultimately will bear the resulting burden of higher tire prices.

In order to better understand H.R. 5103, it is necessary to examine briefly how excise tax refunds are made in the tire retail industry. Federal excise taxes are

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[1] H.R. Rep. No. 95-916, 95th Cong., 2d Sess. 6 (1978).

taxes generally imposed on the manufacture of the product to be taxed. Under such a tax, generally it is the manufacturer who is liable to pay the tax. This is also true for the tire manufacturing industry. Under long standing administrative practice, however, when a purchaser of tires receives an adjustment on the price of a tire incident to a claim made under a tire warranty, he also receives a corresponding adjustment to the federal excise tax. The manufacturer is entitled to receive a credit or refund from the government if he can show that he repaid the tax to the ultimate consumer.[2] For warranty purposes then, the customer is deemed to have paid the tax. In pertinent part H.R. 5103 codifies this historic practice. Thus, when the consumer returns a tire to his retail dealer and receives an adjustment pursuant to a warranty, H.R. 5103 allows the dealer to allocate a portion of this adjustment to the excise tax paid on the tire and to collect this "credit" through the distribution chain from the government. Clearly, then, the recovery of that portion of a warranty adjustment attributable to the excise tax depends upon the existence of a warranty. Accordingly, three basic situations arise in which the question of excise tax refund is raised.

First, a warranty may run directly from the manufacturer to the consumer. This is the most common situation with which we are all probably familiar. In this case H.R. 5103 allows a direct pass through of the tax credit from the consumer to the government.

The second situation involves two warranties. The first extends from the manufacturer to his distributor. The second extends from the distributor to the consumer. If the scope of each warranty is the same we presume H.R. 5103 allows the manufacturer to receive a tax credit from the government. Thus, in this situation, even though there is no warranty relationship between the manufacturer and the consumer the continuous warranty chain apparently would provide the basis for tax relief.[3]

There is a third basic situation. But in this situation H.R. 5103 would be deemed to preclude the retailer from obtaining a credit from the government when a warranty adjustment is made. It arises as follows. Where the manufacturer does not extend a warranty or guarantee to the dealer—in our case a private brand marketer—but merely reduces the price to the dealer to reflect the anticipated warranty or guarantee expenses which the dealer may incur when the dealer provides the consumer his own warranty, no refund or credit of excise tax is allowed to the fanufacturer when a warranty claim is later made. We refer the committee specifically to page 6 of the Ways and Means Committee Report, No. 95-916 and to the language of the new subparagraph (L).

Apparently, the law would apply the term "adjusted pursuant to a warranty or guarantee" in subparagraph (L) only when warranties or guarantees are issued by the manufacturer. If this is indeed the meaning of this language then no refund would be allowed for the third situation outlined above. We believe this result places private brand marketers at a substantial competitive disadvantage by depriving them of the opportunity to issue their own warranties on an equal basis and at equal cost with that of the manufacturer. Proper tax policy should allow private brand marketers the opportunity to compete fully with tire manufacturers who, with their own brand name products, compete directly with us.

Let us attempt to illustrate how this unfairness comes about. H.R. 5103 does not allow tax credit pass through to the government when the net result of a sale by a manufacturer to a distributor is that the manufacturer bears no warranty risk. Accordingly, the manufacturer reduces his price to the distributor. In order to remain competitive with the brand name products produced by that same manufacturer, or produced by competing manufacturers, the private brand marketer creates his own warranty program and thereby warrants his privately labeled product. Of course, he is able to stay competitive in the sale of privately labeled tires by taking advantage of his reduced price. If the private brand marketer cannot pass through to the government the tax credit he must provide his customer, the cost of his warranty program per tire goes up by the amount of that tax credit.

On the other hand, consider the result when there is no break in the warranty chain from the manufacturer to the consumer. In that case, the manufacturer includes in his price to his wholesale marketer the cost of administering the manufacturer's warranty. Thus, the price to the manufacturer's wholesaler or distributor is increased by that amount—an amount which was absent in the price to the

[2] I.R.C. § 6416.

[3] However, if the distributor's warranty is greater in scope than the manufacturer's, it is not clear to us how H.R. 5103 would apply.

private brand marketer who receives no warranty from the manufacturer. When the consumer in this situation receives an adjustment on a warranty claim, he also, of course, receives a tax credit. Since H.R. 5103 would unquestionably allow the dealer, through his wholesaler and through the manufacturer, to recover the amount of that tax credit from the government, the government is, in effect, subsidizing the manufacturer's warranty program.

The following demonstrates the effect of H.R. 5103. Let us assume that the excise tax on a particular tire is $3.00 and that this tire is sold through the manufacturer to a consumer. The manufacturer's price to the consumer includes both the excise tax and the cost of his warranty program. If a defect occurs after 50% of the tread life, the government will refund to the manufacturer $1.50 and the manufacturer will, in turn, pass this refund down through the chain of distribution to the ultimate consumer. The price adjusted to the consumer, of course, is independent of the excise tax adjustment. The net effect is that the manufacturer need not consider the $1.50 in planning his warranty program. Now consider the situation where an independent private brand marketer buys the equavalent tire (perhaps even made by the same manufacturer) from a manufacturer at a discount in lieu of the manufacturer's warranty. The manufacturer's price to the private brand marketer in this case includes only the excise tax of $3.00. In order to remain competitive the independent marketer then issues an equavalent warranty to the consumer. After 50% use, the consumer makes a claim. As in our first situation, he receives an adjustment on price and receives $1.50 as a tax credit from the private brand marketer. But in this case under H.R. 5103 the private brand marketer cannot recover this $1.50 from the government. Unlike the manufacturer, then, the independent private brand dealer must absorb this $1.50 and must consider it when planning his warranty program. In this example in each case the consumer is benefited by equivalent warranties. Yet in the first case the manufacturer receives a subsidy from the government to the extent of the tax adjustment—$1.50 per tire. The private brand marketer enjoys no such help.

As is apparent from the example above, it has become a traditional marketing practice in the industry to return to the customer a portion of the "tax" he originally paid. This law would prevent the private brand marketer from complying with this customer requirement or, more likely, would force him to increase his original price to make up for the tax credit he must ultimately give the consumer. Thus, not only would this law increase the private brand marketer's warranty costs as compared to the manufacturer, thereby making it less likely that he could offer such warranties, the law would create an automatic retail level marketing bias in favor of tire manufacturers.

It is obvious that such a result would place the private brand marketer who chooses to issue his own warranty to the consumer at a serious competitive disadvantage. We do not believe this result is fair. Nor do we believe it is proper tax policy. Tax policy should encourage competition, not hinder it. The exclusion of pass throughs on adjustments resulting from private brand warranties seems to us to be completely arbitrary.

The Internal Revenue Service has taken the lead in opposing our view on this matter. In 1976 it published Revenue Ruling 76-423,[4] which disallows the tax credit with respect to tires sold to distributors at a discount in lieu of warranty. (Exhibits 1 and 2 to this testimony are copies of a letter to Congressman Long by one of our members concerning this problem and the IRS response.) Apparently the Service believes that since the tax is imposed upon the manufacturer there must be some adjustment of the manufacturers price *after a sale is made* to the distributor before the Service will allow a tax refund to pass through to the government. With all due respect to the Service's position, we believe its view clearly elevates form over substance.

The availability of a tax credit is the result of an administrative practice which is based upon the economic reality that the ultimate tire consumer pays the excise tax. It is assumed that by allowing the refund the Service wishes to encourage the industry to offer consumers tire warranties. Again, we see that it is the existence of the warranty which is crucial, not the point in the distribution chain at which the warranty originates. Yet it is only when the manufacturer, in effect, agrees to assume the costs of administering a warranty program that the Service would allow, and apparently the law would formalize, a tax refund from the government. Keep in mind that payment of the excise tax, which is based on tire weight, does not depend upon the terms of sale or the

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[4] 1976 Int. Rev. Bull. No. 44, at 13 (November 1, 1976).

manner in which the manufacturer sells his tires. It is only when a warrantly adjustment is made that the law will deem the tax paid by the consumer and therefore allow a tax credit.

When the manufacturer transfers the cost of a warranty program to some one else—in this case case the private brand marketer—and thereby excludes completely the warranty factor from his price, the manufacturer nevertheless still allows for a warranty. But, in this case he does so in his price *at the time the sale is made.* Competitive pressures will force the private brand marketer to offer a competitive warranty. Yet under H.R. 5103, as presently interpreted, tire marketer is not afforded the flexibility of the tax credit pass through that his manufacturing competitor enjoys. In short, the Service would, artificially in our view, limit to manufacturers a tax incentive to offer consumer warranties and, at the same time, increase the relative cost of warranty programs for private brand marketers. We can find no sound tax policy basis or other reason for this result.

CONCLUSION

We urge the subcommittee reject the Ways and Means Committee view that there should be no refund as a consequence of a consumer warranty adjustment when the manufacturer does not extend a warranty to his immediate vendee. We find nothing in the language of the bill that is inconsistent with our views. The reason for the refund is the existence of a consumer warranty. We respectfully submit that the source of the warranty is irrelevant to the proper determination of whether the refund should be allowed.

The subject matter of H.R. 5103 has been pending before Congress for some time. Its predecessor, H.R. 2474, was reported on favorably by the Senate Finance Committee during the 94th Congress but failed to achieve passage because it was reported out too near to adjournment. Because of the overall importance to the entire tire industry of the need to resolve the general problems of tax credit in connection with warranty adjustments, the Private Brand Tire Group does not now oppose passage of H.R. 5103. But we note that subparagraph (L) need not be interpreted to exclude refunds in the case of discounts in lieu of warranties. Nevertheless, even if the subcommittee feels constrained to accept the interpretation given subparagraph (L) by the Ways and Means Committee, we strongly urge that the Senate Finance Committee in its report recognize the inequity that results from such an interpretation and leave the way open for future amendments of the language of subparagraph (L), if that proves necessary. In this context, we note that refunds for discounts in lieu of warranties were not prohibited under H.R. 2474 and that, except for the IRS there appears to be no opposition to the relief we are seeking.

The Private Brand Tire Group is vitally interested in insuring that excise tax recovery is not arbitrarily limited to a particular group. We believe that even handed tax policy is particularly crucial in the case of independent tire distributors and marketers who, as small businesses, simply cannot afford the unnecessary competitive barriers that the House Committee Report would impose.

EXHIBIT 1

SCHENUIT TIRE & RUBBER CO.
Timonium, Md., March 18, 1977.

HON. CLARENCE D. LONG,
Chesapeake and Washington Avenues,
Towson, Md.

DEAR CONGRESSMAN LONG: In further reviewing Revenue Rulings #74–558 and #76–423 which pertain to Section 4071 of the Internal Revenue Code, one cannot help but question the logic employed.

First, the rulings fail completely in understanding the role and competitive position of a relatively small independent tire marketing company such as Schenuit by denying any reasonable route to Excise Tax recovery. At the same time, they allow those manufacturers who are vertically integrated into marketing and, in the case of the Big 5, further integrated into retailing full access to this recovery. Also protected are large retailers such as Sears, Penneys, and Wards as well as the oil companies such as Exxon and American Oil. Both of these methods of private labeling are based on tremendous power on the buying end and controlled distribution on the selling end, thereby permitting them a correspondingly larger margin and permitting them the luxury, if desired, of purchasing tires from manufacture with warranty. In Schenuit's case, we have

elected to assume the risk of buying without the manufacturer's warranty in order to help maintain a competitive position based on our experience that, as a marketing tire company, we can support a warranty program comparable to our larger competitors at a cost less than our principal manufacturer would charge us if warranty were included in our buying price.

Secondly, while it is true that we buy without warranty and maintain a reserve, it would appear that confusion exists at the Internal Revenue Service as to the competitive need for warranty coverage regardless of the channel of distribution through which a tire reaches the consumer. In order to be competitive, a marketing company is required to take a position similar to the manufacturers with regard to defective workmanship and other warranties extended by manufacturers. In view of this, the rulings ignore the basic premise that in selling a tire brand to consumers thru any channel of distribution, warranties are necessary and that independent marketing companies, such as Schenuit, have substantially the same obligations to the public to refund pro-rated excise tax on adjustments as does a Goodyear or a Sears.

Thirdly, warranty reserves, whether maintained by the manufacturer and included in the selling price, or whether maintained independently as in our case, pertain to the cost of merchandise only and not to Excise Tax. Excise Tax is a pass thru cost from the manufacturer to the marketer and then to the dealer and finally to the consumer. We are aware that excise tax is based on weight and not on selling price, and we are also aware that the excise tax is paid by the manufacturer and we feel that both of these are reasonable, in that, by basing the excise tax on weight, there is consistency of application of the law and the fact that the tax is paid by the manufacturer appears to provide consistency of collecting excise tax on all tires manufactured, rather than some other tax collection vehicle that would be most difficult to administer and possibly not have the consistency that currently exists. However, regardless of the formulation or interpretation of the current revenue rulings, it makes a very substantial difference in collection of excise tax as to whether tires are sold by manufacturer's outlets and other large retailers, or a small independent marketing company, such as Scheniut.

Example

If a tire is sold through a manufacturer and excise tax is calculated to be $3.00, this amount is then remitted to the government. If a defect occurs after 50% of the tread life, a new tire is sold to the consumer and the price, as well as the excise tax, is adjusted. The net effect of this excise transaction is that the government will only receive $1.50 on the replacement tire after the adjustment offset. The total of money collected by the government on the above transaction is $4.50. ($3.00 on original plus $1.50 on replacement.) A tire sold through an independent would remit to the manufacturer the same $3.00 and pass thru to the consumer. With regard to the adjustment tire, the independent would then provide the replacement tire to the consumer at the same adjusted price as above, however, with the purchase of the replacement tire for the customer the independent again pays $3.00 excise tax to the manufacturer who will remit same to the government. The total tax collected by the government under the second situation is $6.00. ($3.00 on the original purchase and $3.00 on replacement.)

This example cites the inconsistency since tires marketed through independent marketers are taxed at rates equivalent to 100% of their tread life regardless of whether the tire is in service for 100% or 10%. This is not merely a hypothetical situation since enclosed is a letter from our supplier stating that $8,771.76 of our excise tax credits from prior years are being disallowed and the inconsistency that exists is that these same credits would be allowed if they were adjusted by the manufacturer. The true impact of this $8,771.76 charge measured in sales dollars is approximately $350,000 since a 2½% profit margin is an average achievement in today's competitive climate.

Fourthly, reference is made in these Revenue Rulings to the marketer repurchasing the adjusted tires from the manufacturer. While this is technically true, these were paper transactions only made for the purpose of recovering Excise Tax previously passed by us to our dealers and by them to the consumer. Actually, the tires re-purchased are failed tires having only scrap value.

In light of the above and as these aforementioned rulings now stand, Schenuit and other independent marketing companies are being subjected to tax discrimination by the Internal Revenue Service by being denied any reasonable route to Excise Tax Recovery on adjustment tires. Because substantial dollar amounts are

involved, our competitive position will be noticeably weakened if these rulings continue to prevail.

To remedy this, we recommend that Section 3 of Revenue Ruling 76-423 be revised to read as follows:

Situation 3. The facts are the same as those in Situations 1 or 2 except that instead of the manufacturer giving its usual warranty to the marketer, it sells tires to the marketer under a price reduction arrangement in lieu of a warranty (a standard price without warranty). However, the marketer also pays an amount, in addition to the price, to the manufacturer who places it in the tire adjustment reserve for the marketer for a specific period of time. Charges are made to the reserve when the manufacturer makes adjustments for defective tires sold to the marketer. At the end of the specified period, if the charges exceed the reserve, the marketer reimburses the manufacturer for the excess, or if the charges are less than the reserve, the balance is refunded to the marketer. This arrangement effectively removes the future liability of the manufacturers of the tires that prove defective, however, the excise tax adjustment liability remains with the marketer.

Section 4071(a) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, importer, or marketer of tires made wholly or in part of rubber.

Rev. Rul. 59-394, 1959-2 C.B. 280 should be amended to hold that when a tire manufacturer or marketer sells a customer a new replacement tire at a reduced price pursuant to a guaranty contract, the manufacturers or marketers excise tax on the replacement tire is computed upon that proportion of the total weight of the second time that the actual sale price bears to the regular sale price of the second time.

The rationale of Rev. Rul. 59-394 should also be amended or modified as follows: A Tire Manufacturer or Marketer would be allowed a proportionate credit or refund of the excise tax imposed by section 4071(a) of the Code when it makes an actual, after-the-fact price adjustment pursuant to a warranty on a tire that proves defective. The credit or refund shall be computed in proportion to the extent of the manufacturer's or marketer's warranty, and his obligations thereunder.

In Situation 3 the pre-determined reduction in sales price is made by the manufacturer in lieu of selling its tires under a warranty. The marketer's payment in excess of this tire pric› to the manufacturer is repaid to the marketer in the form of tire adjusments and cash if there is a balance. The net effect of this system is that the marketer bears the risk and burden of the tire adjustments and the manufacturer's future liability on its defective tire is therefore eliminated.

Accordingly, while in Situation 3, the manufacturer sells tires to the marketer at a price reduction and makes no warranty under which adjustments in price will actually be made by him if the tire proves defective.

The marketer, under his own warranty to his dealers, may still be liable for an adjustment in Excise Tax. If this be the case as a matter of consistent policy, then an adjustment in Excise Tax is allowable. Since Excise Tax accounts are maintained by the manufacturers, Excise Tax adjustments on a pro-rated weight basis should be passed by the manufacturer to marketer at the time merchandise adjustments are charged against the marketer's warranty reserve. The manufacturer, in turn, would then apply these Excise Tax adjustments as credits to his Excise Tax account.

Conclusion: The intent of this revision or rewording of Section 3 of Revenue Ruling 76-423 is to properly recognize the role of an independent marketer as a viable and desirable force in the distribution of replacement tires to the consumer, by allowing parity with the manufacturers when it comes to recovery of Federal Excise Tax on adjustment tires.

This is consistent with our valued concept of fairness and is also consistent with the intent of the Anti-Trust laws and with more recent consumer legislation such as the Magnuson-Moss Act.

We ask that serious consideration be given to our recommendation and will be very happy to meet with the proper people at IRS or elsewhere to substantiate what we feel is a fair position.

Sincerely,

W. T. CONKLIN, *President.*

EXHIBIT 2

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, D.C., April 20, 1977.

Hon. CLARENCE D. LONG,
200 Post Office Building,
Towson, Md.

DEAR MR. LONG: This is in reply to your March 21, 1977, letter transmitting an inquiry from your constituent, Mr. William T. Conklin, President, Scheniut Tire and Rubber Company (Scheniut), relating to the availability of a credit or refund of manufacturers excise tax where defective tires are adjusted pursuant to a private brand distributor's warranty.

Mr. Conklin states that Scheniut purchases tires from the manufacturer at a price discount in lieu of the manufacturer's warranty, and, maintains a reserve account for purposes of making defective tire adjustments. Scheniut and other independent distributors, like the tire manufacturers, bear the risk and burden of the adjustments and play an important role in the distribution of replacement tires to the consumer.

Mr. Conklin indicates, further, that Revenue Ruling 59-394, published in Internal Revenue Cumulative Bulletin 1959-2, at page 280, Revenue Ruling 74-558, 1974-1 C.B. 354, and Revenue Ruling 76-423, 1976-44 I.R.B. 13, discriminate against independent marketing companies like Scheniut because the Rulings do not allow the private brand distributors to obtain excise tax credits for replacement tires sold pursuant to a distributor's warranty. Mr. Conklin recommends that the Rulings be modified to correct what he perceives to be an inequitable situation.

Section 4071 of the Internal Revenue Code of 1954 imposes a tax on the sale by a manufacturer (including a producer or importer) of tires made wholly or in part of rubber. This tax is based on the weight of the tire, not on its sales price.

The general practice in the industry is for the manufacturer to add an amount equal to the tax in its price to its distributor or dealer-customer. The manufacturer, however, is liable for the tax on the tires and is responsible for paying it.

Revenue Ruling 59-394 concludes that, when a tire manufacturer sells its customer (a distributor or dealer) a new replacement tire at a reduced price pursuant to a guaranty contract, the manufacturers excise tax is computed upon the proportion of the total weight of the second tire that the actual sales price bears to the regular sales price of the second tire. Under section 6416(b)(1) of the Code a credit or refund of tax is available only to the manufacturer since the manufacturer paid the tax in the first case. A further requirement is that an actual after-the-fact adjustment in price be made to the customer (the distributor or dealer). The customer benefits from the price adjustment. The manufacturer benefits from the credit or refund. Whether the manufacturer produces and sells private brand tires to a private brand distributor is not material. The credit or refund would be available whenever a price adjustment is made by the *manufacturer.*

Rev. Rul. 74-558 discusses a situation where the net result of transactions between a tire manufacturer and its customer is that no adjustment has been made by the manufacturer and no tax credit or refund is allowable.

Rev. Rul. 76-423, (situation No. 3), concludes that the net effect of a predetermined reduction in sales price by the manufacturer in lieu of selling its tires under its warranty is that the manufacturer's future liability on its defective tires is eliminated and, therefore, no adjustment in excise tax is allowable.

There is no provision of excise tax law that would permit any tire distributor to obtain a credit or refund on the basis of a distributor's warranty. Credits and refunds are based on the tax paid. The manufacturer, not the distributor, pays the excise tax on the manufacturer's sale of tires.

We fully appreciate Mr. Conklin's concern in this matter; however, our decision must be made in light of the existing law and regulations.

With kind regards,

Sincerely,

JOHN L. WITHERS,
Assistant Commissioner.

STATEMENT OF ALFRED DAHL, PRESIDENT, NATIONAL AGRICULTURAL AVIATION ASSOCIATION

My name is Alfred Dahl. I own and operate Dahl Air Spray, Inc. in Cogswell, N. Dak. I am also President of the National Agricultural Aviation Association (NAAA), an organization which represents over 3,300 aerial applicators whose businesses involve aircraft application of seed, fertilizer and pesticides throughout the United States.

I offer this document to the Senate Finance Committee as an aid to their deliberations on H.R. 2852, a bill to amend the Internal Revenue Code of 1954 to provide that refunds of the taxes on gasoline and special fuels shall be made to aerial applicators in certain cases.

In the House of Representatives the rules were suspended and the bill, as amended, was passed. NAAA believes that positive House action occurred because H.R. 2852 is a bill free of controversy; resolves an inequity in the tax law; reduces the paperwork burden on government and taxpayers alike and helps continue utilization of an energy efficient food and fiber production tool—agricultural aviation.

At the present time, Sections 4041(c)(2) and 4081(a) of the Internal Revenue Code of 1954 provide that gasoline and special fuels used in non-commercial aviation are subject to excise taxes totaling seven cents per gallon. The revenues from these taxes on fuel used by noncommercial aviation go to the Airport and Airways Trust Fund.

Section 4081(a) imposes a manufacturer's excise tax of four cents a gallon and is included in the invoice cost of gasoline to the consumer. Under the amendments proposed in H.R. 2852, the consumer will be able to claim a rebate on tax form 1040 for the four cent tax paid on fuel used by the aerial applicator for farming purposes.

Section 4041(c)(2) imposes a retailer's excise tax of three cents a gallon. This tax is not necessarily included on the buyer's invoice and the tax must be paid quarterly on reporting form 720 by the purchaser or his agent. While some aerial applicators have entered into agreements with their fuel suppliers whereby the supplier collects from and pays the tax for the buyer, the responsibility for payment of this tax rests solely with the buyer. Under the amendments proposed in H.R. 2852 this tax will no longer be paid thereby eliminating the need for a rebate.

Our nation's farmers now have the right to claim a refund on the total seven cents tax when the fuel is consumed for farming purposes. The current law also permits the farmer to claim a refund on fuels used by the aerial applicator, however, the refund is so small the cost of recordkeeping frequently exceeds the tax rebate. Tax refunds directly to the aerial applicator, as provided in H.R. 2852, would be worth claiming and be of benefit in holding down agricultural production costs.

Since 1970 many members of the Congress and the ag-aviation industry have worked hard at substantial cost to all involved to bring H.R. 2852 this far. We believe H.R. 2852 is an excellent example of needed legislation developed as a result of outstanding cooperation between government and a segment of the agricultural community. We urge the Committee to bring this effort to a long sought for and positive conclusion.

Please accept our sincere thanks for inviting us to be heard today.

LAW OFFICES OF CAPLIN & DRYSDALE,
Washington, D.C., June 26, 1978.

Re. H.R. 3050—tax treatment of returns of magazines, paperback books and sound recordings.

Hon. HARRY F. BYRD, JR.,
Chairman, Subcommittee on Taxation and Debt Management, U.S. Senate, 417 Russell Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I am writing on behalf of the Association of American Publishers, the Recording Industry Association of America, and the National Association of Recording Merchandisers to clarify several points discussed with respect to H.R. 3050 at the hearing held by the Subcommittee on Taxation and Debt Management on June 19, 1978.

REVENUE IMPACT

During his testimony, Daniel I. Halperin, Tax Legislative Counsel, Department of the Treasury, indicated that the revenue cost estimates for H.R. 3050 ($22 million in fiscal 1979, $11 million in fiscal 1980, $11 million in fiscal 1981, $12 million in fiscal 1982, and $12 million in fiscal 1983) related only to magazines. In fact these revenue estimates relate to the entire cost of H.R. 3050 if it is enacted in its present form. Thus, the estimates include (1) the loss of revenue to the Treasury resulting from the use of the better accounting method in the magazine, paperback book, and sound recording industries; and (2) the loss of revenue resulting from magazine publishers and distributors spreading their transition year adjustments over a five-year period commencing in 1977. Since the transition year adjustments for the paperback book and record industries are to be placed in "suspense," no further revenue losses are incurred under the bill.

Townsend Hoopes, testifying on behalf of the three Associations listed above, urged that the spreading technique provided for magazines be extended to paperback books and records as well. According to Mr. Halperin's prepared statement (page 12), Mr. Hoopes' recommendation would have a total revenue impact of $86 million. If the normal rule of section 481 of the Code were applied, this revenue impact would be spread over a ten-year period, producing a revenue cost of only $8.6 million per year.

Mr. Halperin in his testimony indicated that adopting the spreading technique for paperback books and records would increase the revenue cost of H.R. 3050 in fiscal 1979 by $20 million. This is because the bill as written is effective as of the beginning of 1977. If a ten-year spread for paperback books and records were added to the bill and no further changes were made, the revenue cost of the spread applicable to 1977, 1978, and a portion of 1979 would all fall in fiscal 1979. This exaggerated impact can readily be avoided, however, if the commencement of the spreading period for paperback books and records is deferred until 1980. Under this approach, the spreading technique of section 481 can be extended to paperback books and records without affecting the fiscal 1979 revenue cost of H.R. 3050 at all. In 1980 and subsequent years, the revenue cost of the bill would increase by only $8.6 million.

In sum, the traditional rule for spreading transitional adjustments resulting from changes in methods of accounting can be applied to the paperback book and record industries in H.R. 3050 without incurring a substantial increase in the annual revenue cost of the bill. Most important, such a change would mean that taxpayers in these industries are not, by means of the suspense account procedure, denied the benefit of deductions to which they are clearly entitled.

INCONSISTENCY OF TREASURY POSITION

The Treasury argument in favor of the suspense account approach, as expressed by Mr. Halperin at the hearing, is that it will be easier for Congress to adopt sound accounting procedures for future years, if it avoids the cost of transition year adjustments.

This argument is contrary to the policy adopted by the Congress in 1954 when it enacted section 481 of the Code. That section provides that, if there is a change in method of accounting, "there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted * * *." These adjustments are generally spread over a ten-year period.

Moreover, the Treasury position is inconsistent with Treasury practice. When a change in method of accounting results in an omission of *income*, the Internal Revenue Service, as a condition to the change, requires the omitted items to be included in income over a ten-year or even shorter period. Certainly, the Treasury Department has never suggested the use of a suspense account to freeze lost items of income rather than lost deductions. The Treasury should not have it both ways.

QUESTIONS REGARDING CONSIGNMENT

During the hearing, Senator Curtis asked several questions which suggested that magazines, paperback books and records are distributed on a consignment basis. In fact, these items are not consigned, but are *sold* subject to a right of return.

When goods are consigned, title passes only when the goods are sold to the consumer. There is no income recognition until the ultimate sale. Thus, items that are consigned are not sold at the time of consignment, and do not give rise to the problem addressed by H.R. 3050.

In the three industries covered by the bill, for business reasons, the goods are sold—i.e. title passes—when the goods are shipped, but there is a legal obligation to accept returns. The business effect is the same as consignment, but because a sale has taken place, the Internal Revenue Service requires the income to be recognized upon shipment and gives credit for returns only when they are received.

H.R. 3050 has no effect on consignment arrangements. Rather, it brings the tax treatment of the three affected industries closer to that which would apply in a consignment situation.

Thank you for the opportunity to supplement our testimony on H.R. 3050.

I respectfully request that this letter be included in the record of the Subcommittee's June 19 hearings.

Very truly yours,

ROBERT A. KLAYMAN.

Senator HARRY F. BYRD,
Chairman, Subcommittee on Taxation and Debt Management of the Senate Committe on Finance, Dirksen Senate Office Building, Washington, D.C.

SIR: There is a bill currently before you known as the Home Brew Equality Act of 1978 (S. 3191) which the undersigned would like to comment upon. Please admit the following as testimony regarding the above mentioned bill.

Beginning early in 1975, an unaffiliated group of home wine and beer making supply merchants circulated a petition requesting changes on four points of the regulations concerning home-made beer and wine, specifically:

1. Allowing home brewers the same privileges extended home winemakers.
2. Removing the Head of Household requirement in favor of any interested adult concept permitting women and single persons to participate.
3. Removing the federal transprotation restrictions in favor of existing state regulations.
4. Permitting untaxed beverages to be shared with friends or relatives as long as there was no monetary transaction involved.

The result of the petitioning was the Conable Bill (H.R. 2028), passed recently by the House and sent to your Committee. Unfortunately, this bill was modified to such a degree as to make it unfair and unenforceable to the nation's home brewers.

Subsequently, Senator Cranston introduced his Home Brew Equality Act of 1978 to return the original intent to the Conable Bill. We would like to urge passage of the Cranston Bill as introduced for the reasons documented below.

For the record, we would like to point out that it is estimated that less than ten percent of the nation's home winemakers comply with the registration requirements of the current regulations. The Treasury's Bureau of Alcohol, Tobacco, and Firearms (ATF) has recommended that these regulations be discontinued. However, they have reversed themselves and recommended regulations creating a similar problem for home brewers. They have also admitted that they have not arrested anyone for violations since the Repeal of Prohibition. This makes the undersigned wonder why Congress should enact legislation that is either unenforceable or that the appropriate agency is unwilling to enforce. Aren't there enough of these kinds of regulations already?

Further, it is the opinion of the ATF that it is necessary to restrict the amount of home brew on hand to thirty gallons. They have stated that this is necessary to prevent the possibility of moonshiners distilling legal beer into illegal whiskey. We can not believe that the Enforcement Section of ATF can not tell the difference between mash and malt. Any informed amateur can. We suggest that these regulations are also unenforceable and should be removed in deference to the limits established for home winemakers.

Two of Virginia's greatest statesmen made their own beverages. Washington was a brewer and Jefferson spent years trying to raise wine grapes in Virginia. We can't help but wonder how they would feel about the restrictions in the Conable Bill as it stands. In our opinion, it was the intent of an earlier Congress to continue the right of Americans to produce beer and wine for their own consumption without being subject to federal taxation or regulation other then those

minimal safeguards necessary to protect the federal tax revenues. We are of the opinion that The Home Brew Equality Act of 1978 best meets these guidelines. In the absence of any evidence to the contrary, we urge prompt passage of that document.

EDWARD R. BRUECK.

ABOUT THE PETITIONER

Edward R. Brueck, who resides at 341 Woodland Avenue, Lynchburg, Virginia 24503 is the American Wine Society's Regional Vice President for the Commonwealth of Virginia. He was a founding member of the Home Wine Merchants Association, The Blue Ridge and Lynchburg Chapters of the American Wine Society, and the Central Virginia Winemakers. He is an active member of the American Society of Enologists, the Vinifera Wine Growers Association, the Society of Wine Educators, and a number of local wine oriented wine organizations. He has taught winemaking and wine appreciation at Central Virginia Community College. He frequently is the guest speaker at a variety of civic and social organizations throughout Virginia. He is the sole proporietor of the Wine Cellar, a small wholesaler of wine and beer making supplies. He is primarily an amateur home winemaker and brewer who has won a number of prizes in both local and regional competitions. He is a strong believer in the philosophy that the government that governs least governs best.

[Western Union Telegram]

KRAFT, INC.,
Glenview, Ill., August 9, 1978.

Hon. RUSSELL LONG,
Chairman, Senate Committee on Finance,
Dirksen Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: We want to express our strong support for adding an amendment to H.R. 3050 which would permit manufacturers who issue redeemable coupons to continue to account for them under the regulations which have been in effect since 1918. At a minimum, the Internal Revenue Service should not be permitted to withdraw application of these regulations retroactively and increase the taxes of our company and others for prior years.

The amendment to H.R. 3050 should at least perpetuate application of these regulations for all years prior to 1980.

I request that my letter be entered in the record of the hearings on H.R. 3050.

Very truly yours,

THOMAS MCHUGH,
Vice President-Taxes.

APPENDIX

[COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON JUNE 19, 1978

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JUNE 16, 1978

U.S. GOVERNMENT PRINTING OFFICE
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I. INTRODUCTION

The bills described in this pamphlet have been scheduled for a hearing on June 19, 1978, by the Subcommittee on Taxation and Debt Management of the Committee on Finance. The bills include 11 bills which have passed the House of Representatives.

The pamphlet first briefly summarizes the bills, in the order in which the bills were listed in the press release announcing the hearings. This is followed by a discussion of each bill, setting forth present law, the issue involved, an explanation of what the bill would do, the bill's effective date, the revenue effect of the bill, any prior Congressional consideration of the bill, and the position of the Treasury Department with respect to the bill.

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II. SUMMARY

1. S. 3134

Subsistence Allowance for Law Enforcement Officers

In 1977, the U.S. Supreme Court held that cash meal allowances paid to New Jersey highway patrol officers constitute gross income to the recipients and are not excludable under section 119 of the Code, relating to meals furnished for the convenience of the employer. The bill (S. 3134) provides an exclusion from gross income for statutory subsistence allowances received after 1969 and before 1978 by State police officers (including highway patrol officers).

2. H.R. 810

Treatment of Payment or Reimbursement by Private Foundations for Expenses of Foreign Travel by Government Officials

Present law in effect prohibits any "self-dealing" between private foundations and "disqualified persons." Under these rules, any payment or reimbursement by a private foundation of expenses of government officials generally is classified as an act of self-dealing. However, a limited exception in existing law permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States.

The bill (H.R. 810) broadens this existing exception to permit a private foundation (other than a foundation supported by any one business enterprise, trade association, or labor organization) to pay or reimburse government officials for certain expenses of foreign travel under similar types of limitations as apply under current law in the case of expenses for domestic travel.

3. H.R. 1337

Constructive Sale Price for Excise Tax on Certain Articles

Present law imposes a manufacturers excise tax on trucks, buses, highway tractors, and trailers at a rate of 10 percent of the price at which the manufacturer or importer sells a taxable product. Statutory rules provide for constructive sale prices in certain cases, including sales at retail by the manufacturer. In the case of a manufacturer selling at retail, the Internal Revenue Service has developed constructive prices as a percentage of the manufacturer's retail selling price.

The Service also has ruled, however, that in cases of such retail sales, if the manufacturer's actual costs in making and selling the article exceed the percentage constructive price, the costs instead will be used as the base for computing the manufacturer's excise tax.

The bill (H.R. 1337) provides that percentage constructive prices are to be used in cases where a manufacturer sells trucks, buses, highway tractors, or trailers at retail, and prohibits the use of manufacturer's costs as an alternative tax base in such situations.

4. H.R. 1920

Repayment of Alcohol Taxes and Duties After Loss Due to Disaster or Damage

The bill (H.R. 1920) expands the definition of the circumstances under which a loss of distilled spirits, wines, rectified products, or beer held for sale gives rise to payments by the Treasury, to those holding the products for sale, of amounts equal to the excise taxes and customs duties earlier paid on these products. At present, the only recognized circumstance which can give rise to such payments is a Presidentially declared "major disaster." The bill provides for payments on account of losses resulting from fire, flood, casualty, or other disaster, or from damage (not including theft) resulting from vandalism or malicious mischief.

5. H.R. 2028

Excise Tax Treatment of Home Producers of Beer or Wine

The bill (H.R. 2028) allows any individual 18 years of age or older to produce wine and (if the individual registers with the Treasury Department) to produce beer for personal and family use up to certain quantities without incurring the wine or beer excise taxes or any penalties. The maximum amounts which may be produced free of tax are 200 gallons of wine and 200 gallons of beer per year in a household in which there are two or more individuals 18 years or older. If there is only one individual 18 years or older in the household, the annual limit is 100 gallons of wine and 100 gallons of beer. In addition, the bill provides that the amount of such home-brewed beer on hand in any household at any one time (including beer in process) may not exceed 30 gallons.

6. H.R. 2852

Credit or Refund of Fuel Excise Taxes for Aerial Applicators

Present law provides an exemption from the excise taxes imposed on gasoline and special fuels if such fuels are used for farming purposes. Under the bill (H.R. 2852), an aerial applicator, such as a cropduster, who uses fuel (on which taxes have been paid) for farming purposes is authorized to claim the applicable excise tax repayment or income tax credit directly, in place of the farmer.

7. H.R. 2984

Exemption From Excise Tax for Farm, Horse, or Livestock Trailers and Semitrailers

The bill (H.R. 2984) provides an exemption from the 10-percent manufacturers excise tax on sales of trailers and semitrailers which are (1) suitable for use with "light-duty" towing vehicles and (2) de-

signed to be used for farming purposes or for transporting horses or livestock. The exemption also applies to sales of separate bodies and chassis for these trailers and semitrailers.

8. H.R. 3050

Tax Treatment of Returns of Magazines, Paperbacks, and Records

Under present law, sellers of merchandise who use an accrual method of accounting generally must include sales proceeds in income for the taxable year when all events have occurred which fix the right to receive the income and the amount can be determined with reasonable accuracy. The Internal Revenue Service has taken the position that accrual-basis publishers and distributors of magazines, paperbacks, or records must include the sales proceeds of these items in income when they are shipped to purchasers, and may reduce income for returns only in the year the items actually are returned unsold by the purchaser.

The bill (H.R. 3050) permits an accrual-basis publisher or distributor of magazines, paperbacks, or records to elect to exclude from income amounts attributable to items returned within 2 months and 15 days (in the case of magazines) or 4 months and 15 days (in the case of paperbacks and records) after the close of the taxable year in which the sales of the items were made.

9. H.R. 5103

Excise Taxes on Tires and Tread Rubber

The bill (H.R. 5103) clarifies the treatment of credits or refunds of the manufacturers excise tax on new (or retreaded) tires where sales are later adjusted as the result of a warranty or guarantee.

The bill also provides for credits or refunds of the manufacturers excise tax on tread rubber where tax-paid tread rubber is (1) wasted in the recapping or retreading process, (2) used in the recapping or retreading of tires the sales of which are later adjusted under a warranty or guarantee, or (3) used in the recapping or retreading of tires which are exported, sold to State or local governments, sold to nonprofit educational institutions, or sold as supplies for vessels or aircraft.

In addition, the bill modifies the statute of limitations so that a credit or refund of the tread rubber or new tire tax can be obtained for a period of one year after the warranty or guarantee adjustment is made. Also, the bill imposes a tax on tread rubber used in recapping or retreading certain tires abroad, if those tires then are imported into the United States.

10. H.R. 6635

Interest Rate Adjustments on Retirement Savings Bonds

Under present law, the interest rate on an individual retirement bond issued by the Treasury Department or a retirement plan bond issued by the Treasury Department remains the same from the date

of issuance until the bond is redeemed (generally when the owner retires, becomes disabled, or dies). The bill (H.R. 6635) authorizes the Treasury Department to make upward adjustments in the interest rate on outstanding retirement bonds, so that such a bond will earn interest at a rate consistent with the rate then established for Series E U.S. savings bonds.

11. H.R. 8535

Child Care Credit for Amounts Paid to Certain Relatives

Under present law, payments by a taxpayer to certain relatives for child care services qualify for the child care credit only if the relatives' services constitute "employment" as defined for purposes of social security taxes. Because of the operation of that definition, payments to grandparents to care for their grandchildren generally are not treated as qualifying for the credit.

The bill (H.R. 8535) repeals the requirement that qualifying child care services of relatives must constitute "employment" under the social security tax rules. Thus, otherwise qualifying payments to grandparents to care for their grandchildren will be eligible for the child care credit. Also, the bill disallows the credit for amounts for child care services paid by the taxpayer to his or her child if the child performing such services is under age 19.

12. H.R. 8811

Revocability of Election to Receive Tax Court Judge Retired Pay

The bill (H.R. 8811) allows an individual who has filed an election to receive retired pay as a Tax Court judge to revoke that election at any time before retired pay would begin to accrue, thereby enabling that individual to seek to qualify for benefits under the civil service retirement system (but not under both retirement systems).

III. DESCRIPTION OF BILLS

1. S. 3134

Subsistence Allowance for Law Enforcement Officers

Present law

Section 61 of the Code defines gross income as including "all income from whatever source derived," and further specifies that it includes "compensation for services." Treasury regulations provide that gross income generally includes compensation for services paid other than in money, including the value of meals which an employee receives in addition to salary (secs. 1.61-1(a), 1.61-2(d)(3)).

The Congress has provided a number of express statutory exceptions to the broad definition of gross income. One exception provides that an employee's gross income does not include the value of employer-furnished meals if they are supplied for the employer's convenience and on its business premises (sec. 119).

In *Commissioner* v. *Kowalski*, 98 S. Ct. 315 (1977), the United States Supreme Court held that New Jersey's cash payments to its police troopers for meals consumed while on highway patrol duty constitute gross income to the troopers.[1] In arriving at its decision, the Court pointed out that in 1954 the Congress had enacted a companion provision to section 119 which allowed an exclusion of up to $5 per day of statutory subsistence allowances received by police officials. This provision was repealed in 1958[2] in order "to bring the tax treatment of subsistence allowances for police officials into line with the treatment of such allowances in the case of other taxpayers. . . ."[3] Thus, if cash meal allowances were excludable from an employee's gross income under section 119, the Court reasoned, the repeal of the former $5-per-day exclusion would be rendered ineffective.

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[1] In *Central Illinois Public Service Co.* v. *U.S.*, — U.S. —, 41 AFTR2d 718 720 (1978), the Supreme Court noted that "it is fair to say that until this Court's' very recent decision in *Kowalski*, the Courts of Appeals have been in disarray on the issue whether, under §§61 and 119 of the 1954 Code or under the respective predecessor sections of the 1939 Code, [cash meal] reimbursements were income at all to the recipients * * *."

In *Central Illinois*, the Court held that cash reimbursements for employees' lunch expenses did not constitute "wages" subject to withholding under the law applicable at the time the reimbursements were made, even though the reimbursements constituted gross income. The Court's decision did not alter the treatment of meal reimbursements for FICA (Treas. regs. sec. 31.3121(a)-1(f)) or FUTA (sec. 3306(b)) purposes.

[2] Technical Amendments Act of 1958, sec. 3, 72 Stat. 1606, 1607.

[3] H.R. Rep. No. 775, 85th Cong., 1st Sess. 7 (1957).

Issue

The issue is whether certain subsistence allowances received by law enforcement officers should be excluded from gross income.

Explanation of the bill

The bill in effect applies the Supreme Court's *Kowalski* decision to State police officers on a prospective basis only.

The bill provides an exclusion from gross income for statutory subsistence allowances received by an officer during the years 1970 through 1976 to the extent that the allowances were not included in income on the officer's income tax return (including an amended return filed before December 1, 1977). In addition, the bill excludes from gross income statutory subsistence allowances received by an officer during 1977. The bill applies to police officers (including highway patrolmen) employed by a State or the District of Columbia on a full-time basis with the power to arrest.[1]

Effective date

The bill applies to statutory subsistence allowances received after December 31, 1969, and before January 1, 1978.

Revenue effect

It is estimated that the bill would result in a decrease in budget receipts of $8 million for fiscal year 1979.

Departmental position

The Treasury Department opposes the bill on the ground that it would provide an unjustified tax refund to individuals who chose not to follow the clear and long-standing interpretation of the law by the Internal Revenue Service. The Department believes that any tax exclusion for subsistence allowances received by State police officers would be unfair to the overwhelming majority of workers who had to pay tax on the compensation out of which they bought their lunches and met their other subsistence needs.

[1] The press release issued by the Subcommittee on Taxation and Debt Management of the Committee on Finance to announce the June 19 hearing stated that the issue of the tax treatment of statutory subsistence allowances paid to law enforcement officers would be considered at the hearing, and referred to S. 2872. The latter bill would amend section 119 of the Code, retroactively to January 1, 1970, to provide that certain amounts paid to full-time law enforcement officers (including conservation officers, wardens, prison guards, and coroners) as statutory subsistence allowances are excludable from gross income. Subsequent to issuance of the press release, the House Committee on Ways and Means reported H.R. 12841 (H.R. Rep. No. 95-1232), section 3 of which is substantially identical to S. 3134 described in the text above.

2. H.R. 810

Treatment of Payment or Reimbursement by Private Foundations for Expenses of Foreign Travel by Government Officials

Present law

The Tax Reform Act of 1969 added a provision to the Code (sec 4941) which in effect prohibits "self-dealing" acts between private foundations and certain designated classes of persons (referred to as "disqualified persons") by imposing a graduated series of excise taxes on the self-dealer (and also on any foundation manager who willfully and knowingly engages in self-dealing acts). Under this provision, the payment or reimbursement by a private foundation of expenses of a government official generally is classified as an act of self-dealing (sec. 4941(d)(1)(F)).

A limited exception to this provision permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States (sec. 4941(d)(2)(G)(vii)). Under this exception, it is not an act of self-dealing for a private foundation to pay or reimburse a government official for actual transportation expenses, plus an amount for other traveling expenses not to exceed 1¼ times the maximum *per diem* allowed for like travel by Federal employees. However, no such private foundation payment or reimbursement to government officials is permitted for travel to or from a point outside the United States.

Issue

The issue is whether private foundations should be permitted to pay or reimburse government officials for expenses for foreign travel and, if so, under what circumstances.

Explanation of the bill

The bill provides that a private foundation does not engage in an act of self-dealing in paying or reimbursing certain expenses of government officials paid or incurred for travel between a point in the United States and a point outside the United States. The maximum amount thich can be paid or reimbursed by a private foundation for any one wrip by a government official is the sum of (1) the lesser of the actual cost of the transportation in⁻⁻olved or $2,500, plus (2) an amount for all other traveling expenses not in excess of 1¼ times the maximum amount payable under section 5702(a) of title 5, United States Code (relating to like travel by a U.S. Government employee) for a maximum of 4 days.[1]

[1] Under 5 U.S.C. 5702(a), in the case of travel outside the continental United States, the President or his designee has the authority to establish the maximum *per diem* allowance for the locality where the travel is performed. Currently, for example, 1¼ times the daily amount so established for travel expenses in London is $102.50, for travel in Paris, $100.00, and for travel in Tokyo, $110.00.

The exception added by this bill is not available to a private foundation if more than one-half of the foundation's support (as defined in sec. 509(d)) is normally derived from any one business enterprise, any one trade association, or any one labor organization, whether such support takes the form of interest, dividends, other income, grants, or contributions.

Effective date

The bill would apply with respect to travel beginning after the date of enactment.

Revenue effect

It is estimated that this bill would not have any direct revenue effect.

Prior Congressional action

An identical bill (H.R. 2984, 94th Cong.) was passed by the House of Representatives by voice vote on May 18, 1976, but was not acted upon by the Senate Finance Committee or considered by the Senate.

Departmental position

The Treasury Department recommends that the bill should be amended to limit the permitted amount of reimbursable transportation expenses to the cost of the lowest coach or economy air fare charged by a commercial airline.

The recommended change would make the reimbursable amounts under the bill consistent with the limitation on deductions for attending foreign conventions under the Administration's 1978 tax program. The Treasury Department would not oppose the bill if this change were made.

3. H.R. 1337

Constructive Sale Price for Excise Tax on Certain Articles

Present law

Under present law, a manufacturers excise tax of 10 percent is imposed on the sale by a manufacturer or importer of trucks, buses, highway tractors, and their related chassis, bodies, and trailers (sec. 4061(a)).[1] Generally, the tax is based on the price at which a taxable item is sold by the manufacturer.

However, present law also provides for a constructive sale price if taxable articles are sold by a manufacturer or importer to other than a wholesale distributor (sec. 4216). If a manufacturer or importer sells a taxable article at retail—i.e., directly to ultimate consumers—the constructive sale price is the lower of (1) the price for which the article was sold, or (2) the highest price at which competing articles are sold by wholesale distributors, as determined by the Treasury Department (sec. 4216(b)(1)).

The Internal Revenue Service has ruled that if a manufacturer sells taxable items at retail, the price at which competing items are sold to wholesale distributors is considered to be 75 percent of the established retail price (Rev. Rul. 54-61, 1954-1 CB 259). The "established retail price" is the highest price for which a manufacturer sells, or offers to sell, an item for use by an independent purchaser who ordinarily would not be expected to buy more than one item. If a taxable item actually is never sold at its list price, because of discounts or other price modifications, the "established retail price" is the price resulting from the minimum discount off the list price (Rev. Rul. 68-519, 1968-2 CB 513).

The Service also has ruled that if a manufacturer's actual cost of making and selling a taxable item is greater than the percentage constructive price referred to above, then its actual cost is used in lieu of the percentage constructive price for purposes of computing the applicable excise tax (Rev. Ruls. 54-61 and 68-519, as noted above). This method of calculating the tax base has been referred to as the "cost floor" rule.

Issue

The issue is whether the "cost floor" rule should be applied for purposes of determing a constructive sale price if a manufacturer sells trucks, buses, and similar articles at retail.

Explanation of the bill

The bill amends the constructive sale price rule to eliminate the use of a constructive sale price based upon the manufacturer's costs in cases where trucks, buses, highway tractors, and related articles tax-

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[1] The tax is scheduled to be reduced to 5 percent on October 1, 1979. Revenues from this tax go to the Highway Trust Fund (through September 30, 1979).

able under section 4061(a) are sold at retail by a manufacturer. The excise tax in these situations is to be determined by using a percentage constructive sale price based on the price for which such articles are sold, in the ordinary course of trade, by manufacturers, as determined pursuant to Treasury regulations. As under present law, the Internal Revenue Service may establish percentages to be used for determining the excise tax base. However, under the bill, the percentage constructive price is not to exceed 100 percent of the actual sale price.

Effective date

This bill would apply to articles which are sold by the manufacturer or producer after September 30, 1977.

Revenue effect

The bill is estimated to reduce budget receipts by $1 million in fiscal year 1979 and by $500,000 annually thereafter. These revenues would otherwise go into the Highway Trust Fund (through September 30, 1979).

Departmental position

The Treasury Department supports the bill. However, the Department recommends that the effective date of the bill be changed to September 30, 1978, in order to eliminate the need to adjust excise taxes on sales made before enactment of the bill.

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4. H.R. 1920

Repayment of Alcohol Taxes and Duties After Loss Due to Disaster or Damage

Present law

The excise taxes and customs duties on distilled spirits, wines, rectified products, and beer are paid or determined before these products leave the site of their production and enter marketing channels. If the products subsequently are lost, made unmarketable, or officially condemned while held for sale, amounts equal to the taxes and duties can be paid by the Treasury to wholesalers or retailers holding the products for sale only if the cause is a "major disaster" so declared by the President (sec. 5064 of the Code). Similar repayment rules apply to tobacco products lost in major disasters so declared by the President (sec. 5708).

Issue

The issue is whether payment by the Treasury of alcohol excise taxes and duties should be authorized for losses resulting from vandalism or malicious mischief or from disasters of a lesser magnitude than those which are declared by the President to be "major disasters."

Explanation of the bill

The bill provides for payment (without interest) by the Treasury of amounts equal to the alcohol excise taxes and duties paid or determined on distilled spirits, wines, rectified products, or beer held for sale but lost or ruined because of certain events if these events occurred in the United States. These events are: (1) fire, flood, casualty, or other disaster or (2) breakage, destruction, or other damage (not including theft) resulting from vandalism or malicious mischief.

As under present law with respect to Presidentially declared major disasters, payment is not to be available for taxes, or taxes and duties, the loss of which was indemnified by insurance or otherwise.

Present law does not impose any "floor" or minimum amount for which a claim for repayment of taxes, or taxes and duties, may be filed under the Presidentially declared major disaster provision. The bill imposes a $250 floor on any claim arising from any single disaster or damage, other than one for which a claim would have been allowable under present law. The bill makes no change on this point with respect to claims that would have been allowable under present law.

The bill provides that no claim under this section is allowable unless it is filed within 6 months after the date of the loss, except that in the case of a Presidentially declared major disaster, the claim period is not to expire before the day which is 6 months after the date on which the President determined the disaster occurred.

Effective date

The bill would apply to disasters (or other specified causes of loss) occurring on or after the first day of the first calendar month which begins more than 90 days after the date of the bill's enactment.

Revenue effect

It is estimated that the bill would reduce revenues by about $500,000 annually, beginning with fiscal year 1979.

Departmental position

The Treasury Department opposes the bill on the following grounds. The bill would, in effect, provide free fire, casualty, and flood insurance for merchants for the portion of their alcoholic beverage inventories attributable to excise taxes and customs duties. Merchants holding other types of products do not receive similar protection against losses, and there is no reason to provide such protection on a general basis. The Treasury Department also recommends repeal of the "major disaster" provisions of present law for both alcoholic beverages and tobacco products, since these provisions also grant holders of alcoholic beverages and tobacco products free insurance that is not given merchants who lose other merchandise in a "major disaster."

5. H.R. 2028

Excise Tax Treatment of Home Producers of Beer or Wine

Present law

Present law (sec. 5042 of the Code) permits the "head of any family," after registering with the Treasury Department, to produce up to 200 gallons of wine a year for family use without payment of tax. However, a single individual who is not the head of a family is not covered by this exemption. (See Treas. Regs. 27 CFR §§ 240.540 *et seq.*)

The Bureau of Alcohol, Tobacco, and Firearms interprets present law (sec. 5054(a)(3)) as providing that it is illegal to brew beer in one's home for home consumption. As a result, the tax of $9 per barrel (31 gallons or less), which is imposed on the production of beer (sec. 5051(a), is due and payable immediately upon production. In addition, the Bureau takes the position that home brewers are subject to the criminal penalties imposed by the Code (sec. 5687) for liquor tax offenses that are not otherwise specifically covered.

Issues

One issue is whether the present exemption from the wine tax for a head of a family who produces up to 200 gallons of wine a year for family use should be expanded to include other adult individuals.

Another issue is whether there should be an exemption (similar to the exemption for home-produced wine) for beer which is produced by an individual in his or her home for personal use, rather than for commercial sale; and if so, under what limitations or conditions the exemption should be provided.

Explanation of the bill

Wine

The bill modifies the provisions of existing law that permit heads of families to produce wine tax-free for family use. Under the bill, the present limitation of 200 gallons of tax-free production in a calendar year is to apply if there are two or more adults (age 18 or older) in the household. The present law's requirement that any producer of wine under the family-use exemption must be a "head of any family" is repealed; however, the producer must be an adult.

The bill provides that, if there is only one adult in the household, then 100 gallons of wine may be produced by that adult tax-free in a calendar year.

In addition, the bill would eliminate the present-law requirement that the person producing the wine must have registered with the Treasury Department.

Beer

The bill provides essentially the same rule in the case of household production of beer, with the added requirement that, in order not to be subject to the beer tax, the amount of beer on hand at any one time (including beer in process) is not to exceed 30 gallons. Also, the bill requires that producers of beer register with the Treasury Department in order to qualify under the home brewing exception.

The bill also makes it clear that criminal penalties imposed under Federal law in connection with illegally produced beer do not apply to home production which qualifies for the exemption provided in this bill. The provisions dealing with illegally produced beer are amended to make it clear that home production of beer that does not qualify for the new exemption is illegal.

Identical bill

S. 2930 is identical to H.R. 2028.

Effective date

The bill would take effect on the first day of the first calendar month which begins more than 90 days after the date of the bill's enactment.

Revenue effect

The bill is estimated to reduce budget receipts by less than $1.5 million annually, beginning with fiscal year 1979.

Departmental position

The Treasury Department supports the bill.

6. H.R. 2852

Credit or Refund of Fuel Excise Taxes for Aerial Applicators

Present law

Under present law, gasoline and special fuels used by noncommercial aviation are subject to excise taxes totalling 7 cents per gallon (secs. 4041(c) and 4081 of the Internal Revenue Code).[1] Present law provides an exemption from these taxes if the fuel is used for farming purposes (sec. 4041(f)).

The farming-use exemption applies if gasoline or special fuel is sold for use, or used, on a farm in the United States for farming purposes by the owner, tenant, or operator of the farm (secs. 4041(f), 6420(c), and 6427(c)). If the taxes have been paid, the owner, tenant, or operator may obtain a "refund" of the excise taxes, either by a payment under the excise tax system (secs. 6420 and 6427) or by a refundable income tax credit (sec. 39). The repayment and credit provisions also apply if the gasoline or other fuel is used on the farm by someone other than the owner, tenant, or operator (such as a cropduster). In the latter situations, the owner, tenant, or operator reports the number of gallons of fuel consumed on or over the farm and claims the repayment or credit (see Treas. Regs. sec. 48.6420(a)-1(c)).

Issue

The issue is whether aerial applicators, such as cropdusters, should be allowed to claim the credit or refund of aircraft fuel taxes for fuel used on or over farms for farming purposes.

Explanation of the bill

The bill permits aerial applicators, such as cropdusters, to claim the credit or refund of aircraft fuel taxes for fuel used on farms for farming purposes. Under the bill, the farmer is no longer permitted to claim the credit or refund for these taxes. The bill does not change the uses which qualify a taxpayer to claim the credit or payment.

The exemption applies only to the extent that gasoline or special fuels are used for farming purposes by the aerial applicator as determined in accordance with Treasury regulations (secs. 4041(f)(1), 6420(f), and 6427(h)).[2]

Effective date

The bill would apply to fuels used on or after the first calendar quarter which begins more than 90 days after the date of enactment, even if the tax was paid before the effective date.

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[1] The excise tax on gasoline imposed by section 4081 is scheduled to be reduced to 1½ cents per gallon on October 1, 1979 (sec. 4081(b)). At that time, the excise taxes imposed by section 4041(c) are scheduled to be 5½ cents per gallon (to total 7 cents per gallon on aviation fuel; the section 4041(c) taxes are then scheduled to expire on July 1, 1980 (sec. 4041(c)(5)). The revenues from these taxes on fuel used by noncommercial aviation go to the Airport and Airway Trust Fund (through June 30, 1980).

[2] S. 196, which also has been referred to the Committee on Finance, would permit aerial applicators, effective July 1, 1977, to claim the credit or refund of aircraft fuel taxes for fuel used on or over a farm for farming purposes (sec. 2 of the bill).

Revenue effect

The bill is estimated to reduce budget receipts by less than $1 million annually, beginning with fiscal year 1979. These revenues would otherwise go into the Airport and Airway Trust Fund (through June 30, 1980).

Departmental position

The Treasury Department recommends that the bill should be amended to provide that aerial crop sprayers will be entitled to receive credits or refunds of the fuel excise taxes only if the farmers otherwise eligible for the credits or refunds have waived in writing their rights in favor of the aerial crop sprayers. The Department would support the bill if this change were made.

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7. H.R. 2984

Exemption From Excise Tax for Farm, Horse, or Livestock Trailers and Semitrailers

Present law

Under present law, a manufacturers excise tax of 10 percent is imposed on sales of chassis and bodies of trucks, buses, highway tractors, or their related trailers and semitrailers by a manufacturer, producer, or importer of such an article (sec. 4061 (a) of the Internal Revenue Code).[1]

Present law provides an exemption from the tax in the case of sales of chassis and bodies of light-duty trucks, buses, truck trailers, and semitrailers (sec. 4061(a)(2)). To be eligible for this exemption, the chassis or body of the truck trailer or semitrailer must be "suitable for use" with a trailer or semitrailer having a gross vehicle weight of 10,000 pounds or less, determined in accordance with Treasury Department regulations (sec. 4061 (a)(2)).[2] Furthermore, in order to be exempt, the truck trailer or semitrailer itself must be suitable for use with a towing vehicle having a gross vehicle weight of 10,000 pounds or less (sec. 4061(a)(2)).

Issue

Present law excludes from the manufacturers excise tax "light-duty" trailers and semitrailers suitable for use with "light-duty" trucks. The issue is whether the "light-duty" limitation on the trailer or semitrailer exclusion should be removed in the case of trailers or semitrailers designed to be used for farming purposes or for transporting horses or livestock.

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[1] The tax is scheduled to be reduced to 5 percent on October 1, 1979. Revenues from this tax go to the Highway Trust Fund (through September 30, 1979).

[2] "Gross vehicle weight" is defined as the maximum total weight of a loaded vehicle (Treas. Regs. § 48.4061(a)-1(f)(3)(i)). The maximum total weight of a loaded vehicle is the gross vehicle weight rating of the manufactured article as specified or established by the manufacturer, unless such a rating is unreasonable in light of the particular facts and circumstances. Generally, a manufacturer must specify or establish a weight rating for each chassis, body, or vehicle sold by it if the item requires no significant post-manufacture modifications (Treas. Regs. § 48.4061(a)-1(f)(3)(ii)).

The manufacturer's gross vehicle weight rating must take into account the strength of the chassis frame, the axle capability (capacity and placement), and the spring, brake, rim, and tire capacities. The lowest weight rating component ordinarily is determinative of the gross vehicle weight (Treas. Regs. § 48.4061 (a)-1(f)(3)(v)). The total of the axle ratings is the sum of the maximum load-carrying capability of the axles and, in the case of a trailer or semitrailer, the weight that is to be borne by the vehicle used in combination with the trailer or semitrailer for which gross vehicle weight is determined (Treas. Regs. § 48.4061 (a)-1(f)(3)(vi)).

Explanation of the bill

Under the bill, an exemption is provided from the 10-percent manufacturers excise tax for certain trailers or semitrailers which are designed to be used for farming purposes or for transporting horses or livestock. The bill, in effect, eliminates the present-law requirement for exemption that a trailer or semitrailer designed for such purposes have a gross vehicle weight of 10,000 pounds or less. However, the bill retains the present law limitations on the size of such a trailer or semitrailer—that it be suitable for use with a light-duty vehicle having a gross vehicle weight of 10,000 pounds or less. If a body or chassis is sold separately, then it must be suitable for use with such a trailer or semitrailer in order to qualify under the exemption.

The bill does not affect the separate 8-percent manufacturers excise tax on truck parts and accessories (sec. 4061(b)).

To avoid creating competitive disadvantages which might arise because of the relative sizes of dealers' inventories, and in conformity with prior practice in excise tax legislation, the bill provides for floor stocks refunds or credits (without interest) with respect to all articles exempted by the bill that are in dealers' inventories on the day after the date of enactment.

Effective date

The exemptions made by the bill would apply with respect to articles sold on or after the day after the bill's enactment.

Revenue effect

The bill is estimated to reduce budget receipts by less than $2 million per year, beginning with fiscal year 1979. These revenues would otherwise go into the Highway Trust Fund (through September 30, 1979). If the bill becomes public law within the next three months, it could also reduce 1978 budget receipts by a negligible amount.

Prior Congressional action

An identical bill (H.R. 6521, 94th Cong.) was passed by the House of Representatives by voice vote on August 24, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate.

Departmental position

The Treasury Department opposes the bill because the bill would discriminate against single unit trucks (i.e., without trailers or semitrailers) and non-farm trailers and semi-trailers of the same carrying capacity. In addition, determination of whether a trailer was designed for farming purposes could be difficult and add to the complexity of the law.

8. H.R. 3050

Tax Treatment of Returns of Magazines, Paperbacks, and Records

Present law

Generally, sellers of merchandise who use an accrual method of accounting must report sales proceeds as income for the taxable year when all events have occurred which fix the right to receive the income and the amount can be determined with reasonable accuracy (Treas. Regs. sec. 1.451-1(a)).

In some cases, the seller expects that accrued sales income will be reduced on account of events subsequent to the date of sale, such as returns of unsold merchandise for credit or refund pursuant to a preexisting agreement or understanding between the seller and the purchaser. In these instances, the reduction in sales income generally must be recognized in the taxable year during which the subsequent event, such as the return of unsold merchandise, occurs. Deductions or exclusions based on estimates of future losses, expenses, or reductions in income ordinarily are not allowed for Federal income tax purposes.

Under these general tax accounting rules, the Internal Revenue Service has taken the position that accrual-basis publishers and distributors of magazines, paperbacks, or records must include the sales proceeds of these items in income when they are shipped to the purchaser, and may reduce income for returned items only in the taxable year the items actually are returned unsold by the purchaser.

Issue

The issue is whether an accrual-basis publisher or distributor of magazines, paperbacks, or records should be permitted to elect to exclude from income amounts attributable to items returned within a specified period of time after the close of the taxable year in which the publisher or distributor shipped the items to purchasers.

Explanation of the bill

For taxpayers who account for sales of magazines, paperbacks, or records on an accrual method, the bill provides an election to exclude from gross income for a taxable year the income attributable to unsold merchandise returned within a certain time (the "merchandise return period") after the close of the taxable year (new sec. 457 of the Internal Revenue Code). In the case of magazines, the merchandise return period extends for 2 months and 15 days after the close of the taxable year. In the case of paperbacks and records, the merchandise return period extends for 4 months and 15 days after the close of the taxable year.

The bill establishes several requirements to define those returned items which may be used to reduce gross income if a timely election is made: (1) the taxpayer must be under a legal obligation, at the time

of sale, to adjust the sales price of the magazine, paperback, or record on account of the purchaser's failure to resell it; (2) the adjustment to the sales price must be on account of the purchaser's failure to resell the magazine, paperback, or record in its trade or business; and (3) the merchandise must be returned to the taxpayer by the close of the merchandise return period.

The amount to be excluded from gross income on account of otherwise qualifying returns is limited to the lesser of (1) the amount covered by the acknowledged legal obligation with respect to such returns or (2) the amount of adjustment to the sales price agreed to by the taxpayer before the close of the merchandise return period.

The computation of income under the merchandise-return election constitutes a method of accounting. In the absence of a specific statutory rule to the contrary, an adjustment to income attributable to a change in method of accounting (called the "transitional adjustment") is amortized over a period of time prescribed by the Internal Revenue Service, usually 10 years (sec. 481(c)). However, the bill provides specific rules for the transitional adjustments arising out of merchandise-return elections.

In the case of an election to account for magazine returns under this bill, a special 5-year amortization of the transitional adjustment is provided in place of the normal 10-year period. In the case of an election to account for paperback or record returns, the bill establishes a "suspense account" to hold the transitional adjustment. The operative effect of the suspense account is to defer deduction of the transitional adjustment until the taxpayer is no longer engaged in the trade or business of selling the items which were the subject of an election.

In the case of a suspense account established with respect to paperback or record returns, as long as merchandise returns during the merchandise return period remain at or below the level of the initial opening balance in the account, taxable income under the merchandise-return method is the same as it would have been absent an election. However, an increase in returns over the initial opening balance is recognized one year earlier under the elected method.

Effective date

The election provided by the bill could be made with respect to taxable years beginning after December 31, 1976. The time for making the election for any taxable year beginning before the date of enactment of this bill would not expire before the date which is one year after the enactment date.

Revenue effect

The bill is estimated to reduce revenues by $22 million in fiscal year 1979, $11 million in fiscal year 1980, $11 million in fiscal year 1981, $12 million in fiscal year 1982, and $12 million in fiscal year 1983.

Prior Congressional action

A bill relating to accounting for magazine returns (but not paperback or record returns), somewhat similar to this bill, was passed by the House of Representatives by voice vote on August 2, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate (H.R. 5161, 94th Cong.).

Departmental position

The Treasury Department believes that the special relief provided by the bill should be allowed only to those taxpayers who, in the year they elect the new method of accounting, establish a suspense account to delay the deduction for goods returned during the year the election is made before the due date (without extensions of time) for filing the income tax return for the prior year. Requiring a suspense account would prevent a substantial revenue loss in the year of enactment. However, in the case of an election to account for magazine returns under the bill, if it is determined that amortization of the transitional adjustment is preferable to the establishment of a suspense account, the Treasury Department recommends that the normal ten-year amortization period for such adjustments be used instead of the special five-year amortization provided by the bill.

9. H.R. 5103

Excise Taxes on Tires and Tread Rubber

A. New Tires—Credit or Refund If Tire Sale Is Adjusted Pursuant to Warranty or Guarantee (Subsec. (d) of the bill)

Present law

Present law (sec. 4071(a) of the Code) imposes a manufacturers excise tax of 10 cents per pound on new tires of the type used on highway vehicles, and 5 cents per pound on new nonhighway tires.[1]

Since these taxes are imposed on the basis of weight, rather than on the basis of the price for which the tire is sold, changes in the sale price of the tire generally do not affect the amount of tax due on a manufacturer's sale. However, under present practice (Rev. Rul. 59-394, 1959-2 CB 280), if a tire manufacturer sells a customer a new replacement tire pursuant to a warranty or guarantee on the tire that is being replaced, the manufacturers excise tax on the replacement tire is reduced in proportion to the reduction in price of the replacement tire.

The tire industry's practice has been to apply this rule based on the proportionate reduction in the price to the ultimate consumer where the manufacturer's warranty or guarantee runs to the ultimate consumer. The Internal Revenue Service did not dispute this industry practice before the publication of Rev. Rul. 76-423, 1976-2 CB 345. In that ruling, the Service has taken the position that the tax should be reduced in proportion to the reduction in price from the manufacturer to its immediate vendee—usually, a wholesaler or a dealer. Since this price reduction often is proportionately less than the reduction given by the retail dealer to the ultimate consumer, the Service's position generally produces a smaller tax reduction (hence, a larger net tax) than that produced by the rule that focuses upon the adjustment in sale price to the ultimate consumer.

As originally announced, the 1976 ruling was to take effect with respect to this issue on April 1, 1977. This effective date has been twice postponed by the Service, most recently to April 1, 1978, in order to give the Congress an opportunity to consider whether legislative change is appropriate.

Issues

The issues relate to the proper method of computing the manufacturers excise tax where tire warranty or guarantee adjustments have been made.

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[1] The revenues from these taxes go into the Highway Trust Fund (through September 30, 1979). The tax on new highway tires is to be reduced to 5 cents per pound as of October 1, 1979.

Explanation of the provision

The bill codifies the long-standing administrative practice under which a manufacturer is allowed an excise tax credit or a refund with respect to sales of tires for which a warranty or guarantee adjustment is made on a tire-by-tire basis. The bill also applies the same general principles to cases where warranty or guarantee adjustments are made on an overall basis. In addition, the bill provides corresponding rules for situations where the manufacturer's warranty or guarantee runs only to its purchaser and not to the ultimate consumer.

B. Tread Rubber—Credit or Refund Under Certain Circumstances (Subsecs. (a), (b), and (c) of the bill)

Present law

Present law imposes a tax of 5 cents per pound on tread rubber used for recapping or retreading tires (secs. 4071(a)(4) and 4072(b)).[2]

Tread rubber may be sold tax-free for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles (sec. 4073(c)). Also, a credit or refund (without interest) of the tread rubber tax may be obtained if the tax-paid tread rubber is used or sold for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles (sec. 6416(b)(2)(G)).

In the case of new tires, sales may be made tax-free (or a credit or refund obtained if tax has been paid) if the tires are exported, sold for use as supplies for vessels or aircraft engaged in foreign trade, or sold to a State or local government for exclusive use by such an entity or to a nonprofit educational organization for its exclusive use (secs. 4221(a) and 6416(b)). A credit or refund also is available if the sale of a new tire is adjusted later under a guarantee or warranty. However, if a retreaded tire is exported, etc., or the price is adjusted pursuant to a warranty or guarantee, no credit or refund is available as to the tread rubber tax.

No credit or refund of the tread rubber tax currently is available if the rubber is destroyed, scrapped, wasted, or rendered useless in the recapping or retreading process.

Issue

The issue is whether a credit or refund of the tread rubber tax should be made available in various situations if a credit or refund would be available for new tires in comparable situations.

Explanation of the provision

The bill makes a credit or refund of the tread rubber tax available (1) if rubber is destroyed, scrapped, wasted, or rendered useless in the recapping or retreading process; (2) if the tread rubber is used in the recapping or retreading of a tire and the sales price of the tire is later adjusted because of a warranty or guarantee; (3) if a recapped or retreaded tire is exported, sold to a State or local government for the government's exclusive use, sold to a nonprofit educational organization for its exclusive use, or used or sold for use as supplies for a

[2] Revenues from this tax go into the Highway Trust Fund. This tax is scheduled to expire as of October 1, 1979.

vessel or aircraft; and (4) in certain cases if a retreaded tire is sold by a second manufacturer on or in connection with another article manufactured by the second manufacturer.

C. Statute of Limitations (Subsec. (e) of the bill)

Present law

Under present law, the general time by which a claim for credit or refund of a tax must be filed is 3 years from the time the tax return was filed or, if later, 2 years from the time the tax was paid (sec. 6511).

Issue

The issue is whether the statute of limitations for filing refund claims should be extended with respect to credits or refunds of the excise taxes on tires and tread rubber.

Explanation of the provision

The bill modifies the statute of limitations in cases where a claim for credit or refund of tire tax or tread rubber tax is filed as a result of a warranty or guarantee adjustment. The bill provides that in such a case a claim for credit or refund may be filed at any time before the date which is one year after the date on which the adjustment is made, if otherwise the period for filing the claim would expire before that later date.

D. Imported Recapped or Retreaded U.S. Tires (Subsec. (f) of the bill)

Present law

The excise taxes on tires and tread rubber apply to imported articles as well as those produced or manufactured in the United States. However, if a used tire which has been taxed in the United States is exported, is retreaded (other than from bead to bead) abroad, and is then shipped back into the United States, then there is neither a tax on the imported retreaded tire nor on the tread rubber used in the retreading, because the tire already has been taxed and the tread rubber is considered to have lost its identity.

Issue

The issue is whether used tires which are exported, recapped or retreaded abroad, and then returned to this country, should be subject to the excise tax on tread rubber.

Explanation of the provision

The bill provides that used tires which are exported from the United States, recapped or retreaded abroad (other than from bead to bead), and then reimported into the United States are to be subject to the tax on tread rubber to the extent that tread rubber is incorporated into the tire. For this purpose, the amount of tread rubber to be taken into account is to be determined as of the completion of the recapping or retreading of the tire.

E. General

Effective date

The amendments made by this bill would take effect on the earlier of (1) April 1, 1978, or (2) the first day of the first calendar month which begins more than 10 days after the date of the bill's enactment,

The statute of limitations amendment would apply on and after the effective date. In effect, it would apply to adjustments made (or deemed made) on or after the date one year before the effective date.

Revenue effect

The bill is estimated to reduce budget receipts by less than $300,000 in fiscal year 1979 and by less than $200,000 per year thereafter. (If the bill becomes public law within the next three months, 1978 budget receipts could be reduced by as much as $100,000 and 1979 revenue loss would be reduced by a corresponding amount.) These revenues would otherwise go into the Highway Trust Fund (through September 30, 1979).

Prior Congressional action

A bill with somewhat similar provisions (H.R. 2474, 94th Cong.) was passed by the House of Representatives by voice vote on August 24, 1976. The bill was reported by the Senate Finance Committee (S. Rept. 94-1348) on September 29, 1976, but was not acted upon by the Senate because of lack of time before adjournment.

Departmental position

The Treasury Department does not oppose the bill.

10. H.R. 6635

Interest Rate Adjustments on Retirement Savings Bonds

Present law

Under present law, a person eligible to establish an individual retirement account may purchase retirement bonds issued for this purpose by the Treasury Department. These bonds are not transferable and are subject to many of the restrictions that apply to individual retirement accounts. Retirement plan bonds are issued for H.R. 10 plans established by self-employed persons and for retirement and annuity plans established by employers for their employees. The interest rate on any such retirement bond remains unchanged throughout its life.

By contrast, the interest rates on issued Series E savings bonds are increased whenever there is an increase in the interest rates on new issues of Series E bonds. This adjustment is made in recognition of the holder's ability to redeem the outstanding bond before maturity for the principal and accrued interest and to reinvest the proceeds in new Series E bonds issued with the higher interest rate.

Issue

The issue is whether the Treasury Department should be authorized to increase the interest rate on U.S. retirement plan bonds and U.S. individual retirement bonds so that the investment yield on the bonds is consistent with the yield on Series E savings bonds.

Explanation of the bill

The bill permits the interest rate on U.S. retirement plan bonds (sec. 405(b)) and U.S. individual retirement bonds (sec. 409(a)) to be increased for any interest accrual period so that the investment yield for that accrual period on the bonds is consistent with the investment yield for that accrual period on Series E savings bonds.

Any increased interest rates, and the accrual periods to which these rates apply, are to be specified in regulations to be issued by the Treasury Department. The bill provides that these regulations, to be effective, must be approved by the President.

Effective date

The bill would apply to interest accrual periods that begin after September 30, 1977, with respect to bonds issued before, on, or after the date of the bill's enactment.

Revenue effect

It is estimated that this bill would have no effect on budget receipts, but would result in increased budget outlays of $1 million per year.

Departmental position

The Treasury Department would not object to the bill if it is amended (1) to permit the interest rate on already issued retirement bonds to be changed to match the interest rate on new retirement bonds rather than to match the interest rate on Series E savings bonds and (2) to change the effective date so that the bill applies to interest accrual periods that begin after the date of enactment of the bill, with respect to bonds issued before, on, or after the date of the bill's enactment.

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11. H.R. 8535

Child Care Credit for Amounts Paid to Certain Relatives

Present law

Present law provides a nonrefundable income tax credit equal to 20 percent of household and dependent care expenses incurred to care for a dependent child under the age of 15 or for an incapacitated dependent or spouse. The maximum tax credit for one year's qualifying expenses is $400 for one dependent and $800 for two or more dependents (sec. 44A of the Code).

The credit is allowed for amounts paid to a relative only if (1) neither the taxpayer nor the taxpayer's spouse is entitled to treat the relative as a dependent for whom a personal exemption deduction could be claimed, and (2) the services provided by the relative constitute "employment" as that term is defined for purposes of social security taxes (sec. 44A(f)(6)).

For social security tax purposes, child care or other domestic services performed in the taxpayer's home by the taxpayer's parent generally do not constitute "employment" (sec. 3121(b)(3)(B)). Also, services by the taxpayer's parent which are not performed in the course of the taxpayer's trade or business generally do not constitute employment, whether or not performed in the taxpayer's home. The Internal Revenue Service apparently takes the position that child care services performed in a grandparent's home are not performed in the course of the taxpayer's trade or business. Under this view, both child care services performed by a grandparent in the taxpayer's home and child care services performed by a grandparent in the grandparent's home generally would not constitute "employment," and hence payments for such services would not qualify as expenses eligible for the child care credit.

However, services performed by a grandparent in caring for a child (living in the taxpayer's home) who is either under 18 or is mentally or physically incapacitated may constitute "employment" if the taxpayer is a surviving spouse or is divorced and not remarried, or if the taxpayer has a mentally or physically incapacitated spouse who is unable to care for the child (sec. 3121(b)(3)(B)). In these circumstances, payments for child care services performed by the child's grandparent may be eligible with respect to the child care credit.

Services performed for the taxpayer by other relatives (other than by the taxpayer's child if under age 21) may constitute "employment" under the social security tax definition if a bona fide employer-employee relationship exists. Therefore, payments to these relatives may qualify with respect to the child care credit if neither the taxpayer nor the taxpayer's spouse can claim a personal exemption deduction for the relative. Services performed by the taxpayer's child, if under age 21, do not constitute such "employment" (sec. 3121(b)(3)(A)) and hence cannot qualify with respect to the credit.

Issue

The issue is whether the child care credit should be allowed for payments to adult relatives in cases where the services rendered by the relatives do not constitute "employment" as that term is defined for purposes of social security taxes.

Explanation of the bill

The bill eliminates the requirement of present law that child care services performed by relatives must constitute "employment" within the meaning of the social security tax definition in order to qualify under the child care credit provisions. As a result, otherwise qualifying amounts paid by a taxpayer for care of his or her child by a grandparent of the child would be eligible for the credit to the same extent as if paid to a person who is not related to the taxpayer.

The bill does not affect the rule of present law that disallows the child care credit for amounts paid to a relative (including amounts paid to a child or to a parent of the taxpayer) for whom the taxpayer or the taxpayer's spouse could claim the deduction for personal exemptions for dependents. Thus no credit would be allowed for otherwise qualifying amounts paid by a taxpayer for child care services performed by a grandparent of the child if either the taxpayer or the taxpayer's spouse could, for the year in which such services are performed, claim a personal exemption deduction for the grandparent.[1]

The bill provides that the credit is not to be allowed for amounts paid by the taxpayer to his or her child (including a stepchild) for child care services if the child being paid is under the age of 19 as of the close of the year in which the services are performed. The credit would not be allowed for any such payments to the child under 19 whether or not either the taxpayer or the taxpayer's spouse could claim a personal exemption deduction for the child being paid for child care services. If the taxpayer's child is 19 or over by the end of the year, payments for child care services performed by the child would qualify for the credit only if neither the taxpayer nor the taxpayer's spouse could claim a personal exemption deduction for the child performing the services.

Amounts paid by a taxpayer to his or her spouse to care for the taxpayer's child (including a stepchild) would not qualify for the child care credit.

Effective date

The bill would apply to taxable years beginning after December 31, 1977.

Revenue effect

The bill is estimated to reduce budget receipts by $3 million in fiscal year 1978, $36 million in fiscal year 1979, $35 million in fiscal year 1980, $37 million in fiscal year 1981, $37 million in fiscal year 1982, and $38 million in fiscal year 1983.

Departmental position

The Treasury Department does not oppose the bill.

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[1] S. 2153, which also has been referred to the Senate Finance Committee, would delete, effective for taxable years beginning after December 31, 1976, the present-law requirement that amounts paid for child care services performed by relatives must be for services which constitute "employment" within the meaning of the social security tax definition in order to qualify for the credit.

12. H.R. 8811

Revocability of Election to Receive Tax Court Judge Retired Pay

Present law

If a United States Tax Court judge elects to come under the Tax Court retirement system, all civil service retirement benefits are waived. Thus, any Tax Court judge who elects to be covered by the Tax Court retirement system may not receive any benefits under the civil service retirement system for any service performed before or after the election is made, for services performed as a judge or otherwise.

The Tax Court retirement system is noncontributory. The survivors' benefit provisions, however, require that the judges make contributions (3 percent of salary) if they want coverage for their families. The civil service retirement system is contributory (generally, 7 percent of salary). The civil service system includes survivor benefits with no additional contributions required for those benefits. If a judge elects to come under the Tax Court retirement system, then not only is that judge excluded from civil service retirement benefits, but also the judge's survivors are excluded from the civil service survivors' program, whether or not the judge also elects to come under the Tax Court survivors' program.

Present law has been interpreted as barring an individual who elects to be covered by the Tax Court judges retirement system from ever receiving any civil service benefits, even though the minimum requirement of 10 years of Tax Court service necessary to qualify for Tax Court judge retired pay never may be met, and notwithstanding the fact that the individual otherwise might qualify for civil service retirement benefits. Thus, an individual who has creditable civil service time before and after Tax Court service, and who elected Tax Court retirement pay while a judge, but served in that capacity for less than 10 years, will be precluded from receiving benefits under either system.

Issue

The issue is whether an election to come under the Tax Court retirement system should be allowed to be revoked before retired pay begins to accrue, thereby allowing the individual to qualify to receive civil service retirement benefits.

Explanation of the bill

The bill allows an individual who has filed an election to receive retired pay as a Tax Court judge to revoke that election at any time before the first day on which retired pay would begin to accrue with respect to that individual.

Under the bill, no civil service retirement credit is to be allowed for any service as a Tax Court judge, unless with respect to that

service the amount required by the civil service retirement laws has been deposited, with interest, in the Civil Service Retirement and Disability Fund. The bill also provides that if an individual revokes an election to receive retired pay and thereafter deposits the required amount with the Civil Service Retirement and Disability Fund, service on the Tax Court is to be treated as service with respect to which deductions and contributions had been made during the period of service. Therefore, such a revocation will allow service on the Tax Court to satisfy the civil service rule that an individual must have current covered employment in order to be permitted to revive his or her credits for prior covered employment.

Under the bill, a revocation of an election to come under the Tax Court retirement system also constitutes a revocation of any election to come under the Tax Court survivors' benefit system. In addition, the bill provides that upon a revocation of an election, the individual's account is to be credited with any amounts paid by the individual, together with interest thereon, to the Tax Court judges survivors' annuity fund. This amendment is necessary to prevent the individual from having to contribute to two survivors' annuity systems (U.S. Tax Court and Civil Service) even though his or her survivors would be entitled to benefits under only one system.

This bill applies to any Tax Court judge who has elected the Tax Court retirement system and has not yet retired. It also applies to a former Tax Court judge, Russell E. Train, who did not serve on the Tax Court long enough to qualify for Tax Court retirement, but has been ruled by the Civil Service Commission to be ineligible for civil service retirement benefits because of his Tax Court election, and to any other former Tax Court judge who may be in a similar position.

Effective date

The bill would apply to revocations made after the date of enactment.

Also, if anyone revokes his or her Tax Court retirement system election within one year after the date of this bill's enactment, that individual is automatically treated as satisfying the civil service rule that an individual must have current covered employment in order to be permitted to revive his or her credits for prior covered employment. This provision is expected to apply to Mr. Train's situation, discussed above. After leaving the Tax Court, Mr. Train served in covered employment under the civil service retirement system from 1969 until early in 1977. If this bill had been enacted before the end of that 8-year period, Mr. Train could have complied with the regular civil service rules regarding current covered employment. This effective date provision gives Mr. Train, and anyone else similarly situated, one year to "catch up" to the change in the law.

Revenue effect

It is estimated that the bill will not have any significant revenue effect.

Departmental position

The Treasury Department supports the bill.

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