

RELATING TO THE ALLOWANCE OF THE CREDITS FOR DIVIDENDS RECEIVED, FOR DIVIDENDS PAID, AND FOR A WESTERN HEMISPHERE TRADE CORPORATION IN COMPUTING THE ALTERNATIVE TAX OF A CORPORATION WITH RESPECT TO ITS CAPITAL GAINS

JANUARY 12, 1956.—Ordered to be printed

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

REPORT

[To accompany H. R. 7282]

The Committee on Finance, to whom was referred the bill (H. R. 7282) relating to the allowance of the credits for dividends received, for dividends paid, and for a Western Hemisphere trade corporation in computing the alternative tax of a corporation with respect to its capital gains, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this action, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

PURPOSE OF BILL

This bill provides that in the computation of the credits for intercorporate dividends received, for dividends paid on certain preferred stock, and for Western Hemisphere trade corporations, a corporation's net income under the 1939 Code is to be determined without reduction for the excess of the net long-term capital gain over the net short-term capital loss.

REASONS FOR BILL

The credit for intercorporate dividends received under the 1939 code was 85 percent of the dividends but not to exceed 85 percent of the adjusted net income computed without regard to the deduction allowed for a net operating loss. Similarly, the credit allowed for dividends paid on certain preferred stock of public utilities was limited to a percentage of the amount of dividends paid, or to the percentage applied to the adjusted net income less the credits for dividends received. In the case of a Western Hemisphere trade corporation the credit was limited to a percentage of the normal tax net income. In all of these cases the question has arisen as to whether net income for purposes of computing the limitation with respect to the intercorporate dividends-received credit or the basis on which the other credits are computed, is to include capital gains. Capital gains under section 117 of the 1939 code may (and under existing rates practically always are) subject to an alternative tax of 25 percent in lieu of inclusion in the base on which the regular corporate income tax is computed.

Apparently prior to 1952 the Internal Revenue Service accepted the computation of these credits based upon net income including capital gains and even the recent rulings do not attempt to upset these computations. In the instructions accompanying the 1952 return from (and in 1953 a footnote was also added on the return) the Service indicated that it did not consider that net income for the purposes of computing these credits should properly include capital gains. It was not until 1954 in Revenue Ruling 54-28 that the position of the Internal Revenue Service on this matter was dealt with in a definitive ruling. Then this ruling was made applicable to 1952 and subsequent years. Your committee believes that the position in the ruling should be reversed for years prior to 1954 in order to provide a consistent policy for the period of the 1939 code. Under these circumstances and because your committee believes that since capital gains may be included in the ordinary corporate tax base and are excluded only in arriving at an alternative, as distinct from a separate, tax the inclusion of such capital gains in income for purposes of computing these credits under the 1939 code appears entirely reasonable.

EXPLANATION OF BILL

Under this bill corporations, for taxable years beginning after December 31, 1951, and before January 1, 1954, may compute the intercorporate dividends-received credit (sec. 26 (b) of the 1939 code), the credit for dividends paid on certain preferred stock (sec. 26 (h) of the 1939 code), and the credit for Western Hemisphere trade corporations (sec. 26 (i) of the 1939 code) on the basis of the net income of the corporation without reduction for the excess of the net long-term capital gain over the net short-term capital loss.

Under an amendment made by your committee interest will not be allowed on any refunds resulting from the enactment of this bill.

CHANGES IN EXISTING LAW

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

SECTION 117 (c) (1) OF THE INTERNAL REVENUE CODE OF 1939

(c) ALTERNATIVE TAXES.—

(1) CORPORATIONS.—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 13, 14, 15, 204, 207 (a) (1) or (3), 421, and 500, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

(A) A partial tax shall first be computed upon the net income reduced (*except for the purposes of determining the credits allowable under subsections (b), (h), and (i) of section 26*) by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted.

(B) There shall then be ascertained an amount equal to 25 per centum of such excess, except that in the case of any taxable year beginning after March 31, 1951, and before April 1, 1954, there shall be ascertained an amount equal to 26 per centum of such excess.

(C) The total tax shall be the partial tax computed under subparagraph (A) plus the amount computed under subparagraph (B).