Calendar No. 737

82D CONGRESS *1st Session*	SENATE	REPORT No. 781

THE REVENUE ACT OF 1951

REPORT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

TO ACCOMPANY

H. R. 4473

A BILL TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

SEPTEMBER 18 (legislative day, SEPTEMBER 13), 1951.—Ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
89079 WASHINGTON : 1951

TABLE OF CONTENTS

	Page
I. General statement	1
II. Revenue estimates	2
III. Changes in the individual income tax	3
A. Rate changes	3
1. Description	3
2. Reasons for the rate changes	6
B. Head-of-household provision	8
1. Description	8
2. Reasons for adopting the head-of-household provision	10
C. Distribution of tax burden	11
IV. General corporate tax changes	12
A. Normal tax and surtax rate changes	13
B. Ceiling rate or maximum rate limitation	15
C. Capital-gains tax rate	17
D. Percentage of the average base period net income taken into account in computing the excess-profits credit	18
E. Effective date	18
F. Distribution of the burden	19
V. Tax-exempt organizations	20
A. Cooperatives	20
B. Mutual financial institutions	22
1. Mutual savings banks	22
2. Savings and loan associations	26
C. Unrelated business income of government colleges and universities	29
D. Educational "feeder" corporations	29
VI. Structural changes in the income taxes	30
A. Provisions in the House bill also in your committee's bill	30
1. Life-insurance companies	30
2. Offset of short- and long-term capital gains and losses	32
3. Collapsible corporations	33
4. Dealers in securities	34
5. Gain from sale or exchange of the taxpayer's residence	34
6. Percentage depletion	37
7. Family partnerships	38
8. Gains from sales of livestock	41
9. Coal royalties	42
10. Expenditures in the development of mines	43
11. Venture capital companies	45
12. Additional withholding upon agreement by employer and employee	46
B. Provisions added by your committee	47
1. Additional allowance for certain members of the Armed Forces	47
2. Sales of land with unharvested crops	47
3. Elections to file joint or separate returns and to use the standard reduction	48
4. Pensions	48
5. Stock distributions of profit-sharing plans	49
6. Death benefits to employees	50
7. Termination payments to employees	50
8. Restricted stock options	50
9. Medical expenses	51

VI. Structural changes in the income taxes—Continued
B. Provisions added by your committee—Continued Page
10. Redemption of stock to pay death taxes 51
11. Basis of joint and survivor annuities included in the gross estate 52
12. Abatement of income taxes for certain members of the Armed Forces dying in combat zones or as a result of injuries received in such zones 52
13. Individuals earning income abroad 52
14. War losses 53
15. Foreign tax credit for taxes paid by a foreign subsidiary 54
16. Postponement of due date for returns of China Trade Act corporations 55
17. Application of the intercorporate dividends-received credit in the case of resident foreign corporations 56
18. Net operating loss deductions 56
19. Corporate reorganizations (spin-offs) 57
20. Back mail pay of railroads 58
21. Income from discharge of indebtedness 59
22. Liquidation of corporations 60
23. Capital gains of corporations improperly accumulating surplus (sec. 102) 61
24. LIFO method of accounting 61
25. Exchanges and distributions under SEC orders 62
26. Preferred stock of public utilities 62
27. Earnings of dependents 62
28. Mine exploration expenditures 63
29. Corporate liquidations accompanied by reorganizations 63
C. Provisions of the House bill not accepted by your committee 65
1. Withholding on dividends, interest, and royalties 65
2. Surtax exemptions and minimum excess profits tax credits of related corporations 67
3. Sale of property to controlled corporations 69
VII. Structural changes in the excess profits tax 70
1. Extension of growth alternative to new corporations 70
2. Special ceiling rate for new corporations 72
3. Special relief provision for companies engaged in television broadcasting during the base period 74
4. Taxable exchanges 75
5. Base period abnormalities 76
6. Change in products committed to prior to close of base period 77
7. Lessor railroad corporations 78
8. Exempt excess output of sulfur, potash, metallurgical grade limestone and chemical grade limestone 78
9. Reductions in inadmissible assets subsequent to the base period 79
10. Inadmissible assets of banks 80
11. Dealers in municipal bonds 80
12. Regulated public utility credit for intrastate pipelines 81
13. Management and technical service fees 81
14. Technical amendment relating to new corporations 82
15. Technical amendment of growth alternative 82
16. Base period of fiscal-year corporations 83
17. Consolidated returns 83
18. Capital reduction for loans made by parent corporations to subsidiaries 84
19. Transitions from World War II production and increases in peacetime capacity 84
20. Special relief provision for corporations suffering catastrophes 85
21. Consolidation of newspapers 85

Page
VIII. Structural changes in estate and gift taxes 86
A. Provision in the House bill also in your committee's bill 86
1. United States bonds held by nonresident aliens 86
B. Provisions added by your committee 87
1. Estate taxes of servicemen killed in Korea 87
2. Pre-1916 transfers with reversionary interests retained 87
3. Reversionary interest of decedents dying prior to February 10, 1939 88
4. Decedents dying in 1950 with pre-1931 life estates retained 88
5. Reversionary interests in life insurance—Decedents dying after October 21, 1942 88
6. Foreign estate tax credit 89
7. Works of art loaned by nonresident aliens 90
IX. Excise tax changes 90
A. Alcoholic beverages 91
1. Distilled spirits 91
2. Beer 92
3. Wines 93
4. Occupational taxes on dealers in liquor 94
B. Tobacco products 95
1. Small cigarettes 95
2. Snuff and fine-cut, scrap, plug, and twist chewing tobacco 95
C. Manufacturers' excises 96
1. Gasoline and Diesel fuel 96
2. Passenger cars and motorcycles 97
3. Automobile trucks, busses, and truck trailers 98
4. Automotive parts and accessories 99
5. Tires on toys, etc 100
6. Electric, gas, and oil appliances 100
7. Navigation receivers sold to the United States Government 102
8. Refrigeration equipment 102
9. Sporting goods 103
10. Photographic apparatus and film 103
11. Electrical energy 105
12. Fountain pens, ball-point pens, and mechanical pencils 105
13. Cigarettes, cigars, and pipe lighters 106
D. Retail excises 106
1. Cigarettes, cigars, and pipe lighters 106
2. Toilet preparations 106
E. Transportation and communication excises 107
1. Domestic telegraph, cable, and radio messages 107
2. Long-distance telephone calls to or from members of the Armed Forces in combat areas 108
3. Transportation of persons 108
4. Transportation of property 109
F. Excises on amusements or recreation 110
1. General admissions 110
2. Cabarets 112
3. Bowling alleys and billard and pool tables 112
G. Excises on gambling 112
1. Tax on wagers 113
2. Occupational tax 118
3. Coin-operated gaming devices 118
H. Floor stock taxes and refunds 119
X. Tax treatment of illegal activities 120

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REVENUE ACT OF 1951

SEPTEMBER 18 (legislative day, SEPTEMBER 13), 1951.—Ordered to be printed

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

REPORT

[To accompany H. R. 4473]

I. GENERAL STATEMENT

This is the third time your committee has been called upon to consider revenue increases since the outbreak of hostilities in Korea a little over a year ago. The Revenue Act of 1950, which became law on September 23, 1950, increased revenues by $6.1 billion; the Excess Profits Tax Act of 1950, which became law on January 3, 1951, raised revenues by $3.9 billion; and it is estimated your committee's bill will increase revenues by $5.5 billion. In the fiscal year 1952 the bill is expected to increase revenues by $2.7 billions, raising collections this year to $64.7 billion.

The revenue raised by these two acts, plus that provided by your committee's bill, will add to Federal revenue $15½ billion at calendar year 1951 levels of income and in a full year of operation. These three revenue-raising measures on the average will increase the taxes of individuals by 29.0 percent of the amount which would have been due under the prior law, and will raise corporate taxes by 52.9 percent.

Never before has so much additional revenue been raised in so short a period of time. Moreover, these three revenue measures have brought the income tax burdens of most corporate and individual taxpayers near the World War II peak and for many such taxpayers the rates imposed under your committee's bill are above the maximum rates imposed during World War II. As a result your committee has serious doubts as to the feasibility of raising any substantial additional amounts of revenue from income tax sources. This is said although it is recognized that present expenditure estimates made by the executive departments indicate very substantial additions to Federal expenditures next year. In view of this, your committee believes that every effort must be made to reduce expenditures.

Your committee's bill provides tax increases in all of the major tax areas. Individual income taxes for most taxpayers are raised by 11 percent effective November 1, 1951. The top income tax rate of corporations is raised to 52 percent. The ceiling rate on excess profits taxes is raised to provide a maximum effective income and excess profits tax rate of about 69 percent. Excise taxes also are raised, primarily those on alcoholic beverages, tobacco, gasoline, automobiles, and electric, gas, and oil appliances, and a new tax is imposed on wagering. The bill also provides taxes for certain types of presently exempt income of cooperatives, mutual savings banks, and building and loan associations.

II. REVENUE ESTIMATES

Table I shows the estimated increase in tax liabilities under your committee's bill and under the House bill in a full year of operation, and also the effect of these bills on collections in the fiscal year 1952. Both the increases in liabilities in a full year and the increases in collections in the fiscal year 1952 are shown by major revenue sources.

It is estimated that your committee's bill will increase tax liabilities in a full year of operation by approximately $5,500 million, and that it will increase collections in the fiscal year 1952 by about $2,700 million. The increases in collections in the fiscal year 1952 are considerably smaller than the increase in tax liabilities provided by your committee's bill in a full year of operation, both because the changes are not fully effective in the fiscal year 1952, and because collections tend to lag behind the incurring of liabilities. The House bill would increase tax liabilities in a full year of operation by approximately $7,200 million and would increase collections in the fiscal year 1952 by about $4,900 million.[1] The major differences from the standpoint of revenue between the House bill and your committee's bill can be accounted for by the fact that your committee did not impose as large increases in individual and corporate taxes as the House, and did not subject corporate dividends to withholding.

The increase in excise tax collections in the fiscal year 1952 assumes that the changes in these taxes become effective as of November 1, 1951, the same date as is provided in your committee's bill for the increases in the individual income tax.

TABLE 1.—*Estimated effect of the House bill and committee bill on tax liabilities in a full year of operation and on collections in the fiscal year 1952*

[In millions]

	House bill		Committee bill	
	Full year effect	Fiscal year 1952 effect	Full year effect	Fiscal year 1952 effect
Individual income tax	$2,847	[1] $1,652	$2,367	$1,379
General corporate tax changes	[2] 2,855	[2] 1,740	[2] 2,060	(2)
Tax-exempt organizations	0	0	150	0
Structural changes in the income taxes	245	705	−224	−219
Structural changes in the excess profits tax	0	0	−120	−120
Structural changes in the estate and gift taxes	(*)	(*)	−2	0
Excise tax changes	1,252	[3] 811	1,275	[4] 823
Total	7,199	4,908	5,506	2,733

*Negligible.
[1] Estimate based on the assumption House provision is effective Nov. 1, 1951, instead of Sept. 1 as provided by the House bill.
[2] Net increase after allowing for reduction in individual income taxes due to lower dividends.
[3] This larger amount is due primarily to the acceleration of collections on withholding.
[4] Assumes excise tax changes effective Nov. 1, 1951.

[1] This assumes excise and individual income tax increases provided by the House bill are effective November 1, 1951.

III. CHANGES IN THE INDIVIDUAL INCOME TAX

Your committee's bill, in a new rate schedule, provides the lower of the following two increases: An 11-percent increase in present tax rates, or an 8-percent additional tax based on the surtax net income [2] remaining after the deduction of present taxes. The House bill provided an additional tax equal to 12½ percent of the existing tax for all income brackets except the very highest.

The increase provided by your committee applies only to the tax on ordinary income. The increase under the House bill also applies to the alternative tax on capital gains.

The rate increases under your committee's bill, in effect, are made as of November 1, 1951, the date when increased withholding becomes effective, and are to terminate as of December 31, 1953. Under the House bill the rate increases, in effect, are made as of September 1, 1951, the date when increased withholding was to become effective under that bill, but no termination date was set.

Both your committee's bill and the House bill grant to heads of households some of the benefits of income splitting now enjoyed by married persons. Under your committee's bill they obtain one-quarter of the benefits of income splitting, and under the House bill, one-half. For calendar year taxpayers this head-of-household provision under both bills is to be effective beginning in 1952.

It is estimated that in a full year of operation the individual income tax rate changes provided by your committee's bill will increase liabilities by $2,394 million and that on the same basis the head-of-household provision provided by your committee's bill will decrease revenues by $27 million. Thus, it is estimated that the combined effect of these provisions will be to increase liabilities in a full year of operation by $2,367 million.

Since, in effect, the rate changes made by your committee's bill do not become operative until November 1, and the head-of-household provision for practically all taxpayers will not be effective until January 1, 1952, collections in the fiscal year 1952, ending June 30, 1952, will not fully reflect the increases provided. Therefore, fiscal year 1952 collections under your committee's bill are expected to be increased by only about 58 percent of the $2,367 million, or by $1,379 million. Since the rate changes made by the House bill were to be effective as of September 1, 1951, the report by the Committee on Ways and Means of the House estimated collections in fiscal year 1952 would be increased by $1,947 million. However, had the effective date been November 1, as under your committee's bill, fiscal year 1952 collections under the House bill would have been increased by $1,652 million.

A. Rate Changes

1. Description

For taxable years beginning after October 31, 1951, your committee's bill increases the present individual income taxes by the lower of either about 11 percent of the present combined normal tax and surtax, or approximately 8 percent of the surtax net income [3] after present taxes. These increases are to terminate as of December 31, 1953. The House bill increases the present normal tax and surtax

[2] Surtax net income is income after deductions and exemptions.
[3] Surtax net income is income after deductions and exemptions.

in most cases by 12½ percent for taxable years beginning after August 31, 1951. No termination date for this increase is provided. The 11- or 8-percent increase provided by your committee's bill is incorporated in the surtax rate schedule. Under the House bill the 12½-percent increase is to be a separate tax computation, although it is incorporated in the tax table used by those with adjusted gross incomes of $5,000 or less.

The new surtax table in your committee's bill provides surtax bracket rates ranging from 19.2 percent on the first $2,000 of surtax net income to 88.7 percent on surtax net income in excess of $200,000. This, when combined with the flat 3-percent normal tax, gives total rates which range from 22.2 percent on the first $2,000 of taxable income to 91.7 percent on taxable income in excess of $200,000. The combined normal tax and surtax rates (including the 12½ percent increase) under the House bill range from 22.5 percent on the first $2,000 of surtax net income to 94.5 percent on surtax net incomes in excess of $80,000. Under present law these combined rates range from 20 percent on the first $2,000 of taxable income to 91 percent on incomes in excess of $200,000.

Your committee's bill raises the effective rate limitation, or maximum combined normal tax and surtax on total net income, from the 87 percent provided by present law to 88 percent. This effective rate limitation prevents an individual's total net income from being taxed at a rate higher than 88 percent, although the bracket rate on income in excess of $200,000 permits a portion of an individual's income to be taxed at as high a rate as 91.7 percent. Under the House bill the effective rate limitation is raised to 90 percent.

Your committee's bill also provides a new surtax rate schedule for the calendar year 1951, adding to the present tax burden about one-sixth of the increase provided for 1952 and 1953. Thus, for 1951 the present tax is increased by the lower of either nearly 2 percent of the existing law tax, or by slightly over 1 percent of surtax net income after deducting the present tax. This is roughly the equivalent of making the full 11-percent or 8-percent increase effective November 1, 1951. The House bill which would have been effective as of September 1, 1951, provided a 4-percent increase in the present law tax for calendar year 1951 taxpayers. This would have been roughly the equivalent of making the tax increase effective for the last third of the year. The combined normal tax and surtax bracket rates under your committee's bill for the calendar year 1951 range from 20.4 percent on the first $2,000 of taxable income to 91.1 percent on taxable income over $200,000. Under the House bill these rates range from 20.8 percent on the first $2,000 of taxable income, to 92.56 percent on taxable incomes in excess of $200,000. Under your committee's bill the effective rate limitation for calendar year 1951 taxpayers is 87.2 percent, and under the House bill, 88 percent.

Your committee's bill also adds a provision which makes inapplicable, for 1951, the penalties and additions to tax for willful failure to make declarations or pay estimated tax with respect to the additional tax imposed on individuals by this bill.

For 1952 and subsequent years and for the last third of 1951 the House bill provides an increase in the alternative tax on capital gains of individuals. For 1952 and subsequent years this increase is 12½ percent, the same increase as provided for the normal tax and surtax. Applying this to the present 25-percent capital gains tax gives a new rate of 28.125 percent. For the calendar year 1951 the House bill provides a 4-percent increase in the alternative tax on capital gains resulting in a total capital gains tax rate of 26 percent. Under your committee's bill no change is made in the alternative tax on capital gains. Thus, the rate remains at 25 percent both for 1951 and 1952 and subsequent years.

Under both your committee's bill and the House bill new withholding tables are provided to reflect the increased taxes. The withholding in both of these tables is at approximately 20 percent as contrasted to 18 percent in the table in present law. Similar adjustments are made in the percentage method of withholding. A withholding tax rate of approximately 20 percent collects the full amount ordinarily due on the beginning rates provided by your committee's bill and the House bill after allowance for the standard deduction.

Table 2 shows the amount of tax paid at selected net income levels under present law, under the House bill for the calendar year 1952 and subsequent years, and under your committee's bill for the calendar years 1952 and 1953. The tax burden is shown separately for single persons with no dependents, for married couples with no dependents, and for married couples with two dependents. The tax of single persons, of married couples with no dependents and of married couples with two dependents shown in this table differ because the amount of tax paid is shown by net income [4] classes. Net income for these classes of taxpayers differs from the income on which the tax is based because a single person receives one $600 exemption, a married couple two $600 exemptions and a married couple with two dependents four $600 exemptions. In addition, married couples receive the benefits of income-splitting.

[4] Net income is income after deductions but before exemptions.

TABLE 2.—*Comparison of individual income-tax burdens under present law with those under the House bill and Finance Committee bill for 1952 and 1953*

SINGLE PERSON, NO DEPENDENTS

Net income (after deductions but before exemptions)	Amount of tax		
	Present law	House bill	Finance Committee bill
$800	$40	$45	$44
$1,000	80	90	89
$2,000	280	315	311
$3,000	488	549	542
$4,000	708	797	786
$5,000	944	1,062	1,048
$8,000	1,780	2,003	1,974
$10,000	2,436	2,741	2,704
$15,000	4,448	5,004	4,940
$20,000	6,942	7,810	7,718
$25,000	9,796	11,021	10,872
$50,000	26,388	29,687	28,234
$100,000	66,798	74,831	69,344
$300,000	247,274	263,831	251,522
$500,000	429,274	[2] 450,000	434,922
$1,000,000	[1] 870,000	[2] 900,000	[3] 880,000

MARRIED COUPLE, NO DEPENDENTS

Net income (after deductions but before exemptions)	Present law	House bill	Finance Committee bill
$1,500	$60	$68	$67
$2,000	160	180	178
$3,000	360	405	400
$4,000	560	630	622
$5,000	760	855	844
$8,000	1,416	1,593	1,571
$10,000	1,888	2,124	2,096
$15,000	3,260	3,668	3,618
$20,000	4,872	5,481	5,408
$25,000	6,724	7,565	7,460
$50,000	19,592	22,041	21,744
$100,000	52,776	59,373	56,468
$300,000	222,572	244,161	228,664
$500,000	403,548	433,161	411,344
$1,000,000	858,548	[2] 900,000	869,844

MARRIED COUPLE, 2 DEPENDENTS

Net income (after deductions but before exemptions)	Present law	House bill	Finance Committee bill
$3,000	$120	$135	$133
$4,000	320	360	355
$5,000	520	585	577
$8,000	1,152	1,296	1,278
$10,000	1,592	1,791	1,766
$15,000	2,900	3,263	3,222
$20,000	4,464	5,022	4,952
$25,000	6,268	7,052	6,956
$50,000	18,884	21,245	20,964
$100,000	51,912	58,401	55,592
$300,000	221,504	243,027	227,584
$500,000	402,456	432,027	410,243
$1,000,000	857,456	[2] 900,000	868,743

[1] Maximum effective rate limitation of 87 percent.
[2] Maximum effective rate limitation of 90 percent.
[3] Maximum effective rate limitation of 88 percent.

2. *Reasons for the rate changes*

Your committee believes that in view of revenue requirements resulting from the present national defense emergency it is necessary to make substantial increases in the individual income taxes. Only by such increases will it be possible to come close to balancing the budget and alleviating the impact of increased inflationary pressures arising from additional defense expenditures. It is believed, however, that the 12½-percent increase in present taxes provided by the House bill is too severe in view of the fact that an average increase of 17 percent in individual income taxes has been made quite recently by the Revenue Act of 1950. For that reason your committee has reduced this percentage increase for the bulk of the taxpayers to 11 percent of their present taxes. Even with this increase many taxpayers will find themselves with tax rates in excess of the peak rates imposed during World War II.

Your committee modified this 11-percent increase by providing that in no case is the increase to be more than about 8 percent on the income remaining after taxes. Your committee believes that a provision of this type is fairer to all income groups than the type of provision adopted by the House. For most taxpayers their present tax is much smaller than their income remaining after the payment of taxes. However, because of the present highly progressive income tax rates for some taxpayers, their income remaining after the payment of all taxes is smaller than their present tax burden. In the case of both of these groups of taxpayers, your committee's bill imposes an increase on the smaller amount; in the case of the former group, on the present tax burden, and in the case of the latter group, on the income remaining after payment of the present tax burden. The percentage increase in income after taxes is effective with respect to taxable incomes of about $27,000 and over. It was believed necessary to provide a limitation of this type, in view of the fact that in the upper income brackets the marginal rates, or the rates applying to the next dollar of income, are already very high. The present law marginal tax rate at $28,000 of surtax net income, for example, is 62 percent; at $44,000 is 72 percent; at $70,000 is 81 percent; and at $200,000 is 91 percent. Your committee's bill raises these marginal rates very substantially, although not as much as the 12½-percent increase provided by the House. In the view of your committee, the marginal rate of about 70 percent provided on surtax net income of $28,000 under the House bill will seriously impair the incentives of the taxpayers in this bracket to work and to invest. Still more drastic is the marginal rate of nearly 85 percent provided by the House bill on incomes of $50,000, and the rate of 94.5 percent provided for incomes of $80,000. The rates provided by your committee's bill in these brackets also are drastic but less so than those of the House bill. Under your committee's bill the marginal rate at $28,000 is 67 percent; at $44,000 is 73 percent; at $70,000 is 82 percent; and at $200,000 is 91.7 percent.

A similar limitation on the tax increase was previously provided in the Victory tax imposed by the Revenue Act of 1942. That tax was limited to the excess of 90 percent of net income after the regular income tax liability. The 1940 defense tax also used this type of formula. Your committee believes that in bracket areas where the progression is already quite steep the formula used in imposing additional taxes should measure ability to pay by taking into consideration taxes already paid. It is only the funds remaining after the payment of the present tax burden which such individuals will have available to meet additional tax burdens.

Although the House bill increases the alternative tax on capital gains to a little over 28 percent, your committee's bill retains the ceiling rate in this tax at 25 percent. Your committee recognizes that capital gains are different from ordinary income in that the time of realizing a capital gain, to a substantial degree, is subject to the control of the taxpayer. Therefore, in this case, particularly, high rates tend to discourage the realization of gains. Congress has recognized this as far back as the Revenue Act of 1942 by placing an effective ceiling rate of 25 percent on capital gains income. Since that time, although individual income tax rates have been both substantially increased and decreased, this ceiling rate has remained the same. In view of this your committee does not believe that it is appropriate to consider a change in this ceiling rate at this time.

A termination date, namely, December 31, 1953, has been provided by your committee for the individual income tax rate increases because it is recognized that these rates are exceedingly high, and your committee hopes that it will be unnecessary to continue rates at this high level after December 31, 1953. In any case, it appears desirable to review the levels of the individual income tax rates at that time.

November 1, 1951 was selected as the effective date for the individual income tax increases because so much of the individual income tax is collected through the withholding system that it is not feasible to make changes in this tax applicable prior to the time the withholding rate increases can be made. Because some time will be required for the preparation of the new withholding tax tables and their distribution to employers, November 1 appears to be the earliest possible date at which withholding can be made effective. The September 1 date contained in the House bill was selected before it was known how much time would be required for the proper consideration for this tax measure.

Your committee has included the increase provided by its bill in the regular surtax rate schedule because it is believed that this will be easier for both the taxpayers and the administrators. The report of the Committee on Ways and Means of the House indicates that the rate increase provided by the House bill was not included in the rate schedule because it was believed that a separate schedule would be more generally recognized as representing a temporary tax increase. Your committee agrees with this objective, but believes that it is better accomplished by the termination date for the individual income tax increases as provided in its bill. Therefore, it was believed unnecessary to retain the increase made by your committee as a separate computation.

B. Head-of-Household Provision

1. Description

For persons qualifying as a "head of a household" your committee's bill provides a new surtax table applicable for taxable years beginning after October 31, 1951 and the House bill, for taxable years beginning after August 31, 1951. Thus, in both cases, for a calendar year taxpayer, the provision will not become effective until 1952. In your committee's bill the new surtax table is constructed to give heads of households approximately one-quarter of the benefits of income-splitting, while the surtax table in the House bill provides them approximately one-half of these benefits.

Your committee's bill defines a head of a household, for purposes of obtaining the benefits of this special provision, as an individual who is not married and who maintains a household in which lives—

(1) One of his children (including an adopted child), one of their descendants or a stepchild (but the child, descendant, or stepchild if married must still be a dependent of the taxpayer and not file a joint return); or

(2) Any person (not filing a joint return with a spouse), who has a gross income of less than $600,[5] more than half of whose support is supplied by the taxpayer and who bears one of the following relationships to the taxpayer:

(a) A brother or sister or stepbrother or stepsister,
(b) A parent or one of their ancestors,
(c) A stepparent,
(d) A nephew or niece,
(e) An uncle or aunt, or
(f) A son-in-law, daughter-in-law, mother-in-law, father-in-law, sister-in-law, or brother-in-law.

The House bill differs only in one minor respect in the tests outlined above. In the House bill the descendants of stepchildren are included among the relatives who if living in the household of a taxpayer may make him eligible for the head-of-household status.

Under both bills, a taxpayer is considered as maintaining a household only if during the year he furnishes more than half the maintenance costs of such household. Moreover, the individual who makes it possible for the taxpayer to gain the benefits of the head-of-household status must actually live in the taxpayer's household during the entire taxable year unless he is temporarily absent, for example, attending school or for reasons of health. Under this definition it is immaterial how much gross income an unmarried child or grandchild living with the taxpayer may have.

Table 3 shows for both the House bill and your committee's bill the amount of tax paid at selected net income levels for heads of households with one dependent, for single individuals with one dependent, and for married couples with no dependents. It also shows how much less the tax of the head of household and the tax of the married couple are than that of the single person at the same income level. This represents the benefits of income splitting which present law grants in full to married couples and which both the House and your committee's bill grant in part to heads of households. The last column of the table expresses the income-splitting benefits granted heads of households as percentages of the income-splitting benefits available to married couples. This shows that your committee's bill grants about 25 percent, and the House bill about 50 percent, of the benefits of income splitting to heads of households.

[5] Under present law the taxpayer is allowed a dependency credit provided the dependent has a gross income of less than $500. Sec. 310 of your committee's bill, discussed elsewhere in this report, raises the allowable gross income of a dependent to $600.

TABLE 3.—*Comparison of individual income tax burdens for heads of households under the House bill and your committee's bill with those for single persons with 1 dependent and for married couples under both bills, for 1952*

A. HOUSE BILL

Selected net income levels [1]	Amount of tax			Amount of tax difference between single person with 1 dependent and—		Percent tax difference of head of household is of that of married couple
	Head of household with 1 dependent	Single individual with 1 exemption	Married couple filing a joint return	Head of household	Married couple	
$1,500	$68	$68	$68			
$2,000	180	180	180			
$3,000	405	405	405			
$5,000	875	896	855	$21	$41	51.2
$8,000	1,697	1,800	1,593	103	207	49.8
$10,000	2,318	2,511	2,124	193	387	49.9
$15,000	4,172	4,696	3,668	524	1,028	51.0
$20,000	6,462	7,452	5,481	990	1,971	50.2
$25,000	9,092	10,622	7,565	1,530	3,057	50.0
$50,000	25,605	29,201	22,041	3,596	7,160	50.2
$100,000	66,830	74,264	59,373	7,434	14,891	49.9
$500,000	442,724	[2] 450,000	433,161	7,276	16,839	43.2
$1,000,000	[2] 900,000	[2] 900,000	[2] 900,000			
B. COMMITTEE BILL						
$1,500	$67	$67	$67			
$2,000	178	178	178			
$3,000	400	400	400			
$5,000	872	883	844	$11	$39	28.2
$8,000	1,728	1,776	1,571	48	205	23.4
$10,000	2,388	2,476	2,096	88	380	23.2
$15,000	4,372	4,636	3,618	264	1,018	25.9
$20,000	6,872	7,364	5,408	492	1,956	25.2
$25,000	9,722	10,482	7,460	760	3,022	25.1
$50,000	26,288	27,796	21,744	1,508	6,052	24.9
$100,000	65,732	68,816	56,468	3,084	12,318	25.0
$500,000	428,890	434,372	411,344	5,482	23,028	23.8
$1,000,000	[3] 880,000	[3] 880,000	869,844		10,156	

[1] Income after deductions but before exemptions.
[2] Maximum effective rate limitation of 90 percent.
[3] Maximum effective rate limitation of 88 percent.

2. Reasons for adopting the head-of-household provision

Your committee agrees with the House that taxpayers, not having spouses but nevertheless required to maintain a household for the benefit of other individuals, are in a somewhat similar position to married couples who, because they may share their income, are treated under present law substantially as if they were two single individuals each with half of the total income of the couple. The income of a head of household who must maintain a home for a child, for example, is likely to be shared with the child to the extent necessary to maintain the home and raise and educate the child. This, it is believed, justifies the extension of some of the benefits of income splitting. The hardship appears particularly severe in the case of the individual with children to raise who, upon the death of his spouse, finds himself in the position not only of being denied the spouse's aid in raising the children, but under present law also may find his tax load much heavier.

As indicated by the report of the Committee on Ways and Means of the House it does not appear appropriate to give a head of household the full benefits of income splitting because it is unlikely that there is as much sharing of income in these cases as between spouses. Moreover, it is your committee's opinion that in view of the fact that under the head-of-household provision taxpayers are not required to include the income of the dependent (spouses must file a joint return in order to enjoy the benefits of income splitting) an allowance of 25 percent of the benefits of income splitting for such taxpayers should be adequate.

In defining the relationship to the taxpayer of an individual who enables the taxpayer to claim the head-of-household status, the relationships provided in section 25 (b) (3) of the code for claiming a dependency credit have been followed. In all cases except those in which unmarried children, their descendants or stepchildren live in the home of the taxpayer he must supply over half of the support of the relative and the relative must have gross income of less than $600.[6] These limitations are believed to be unnecessary in the case of children, grandchildren, or stepchildren because such relatives are ordinarily a part of the close family unit and the relationship is more nearly similar to that existing between spouses than is true in the other cases. However, even such individuals must live in the same household as the taxpayer, except for the temporary absences previously described, and the taxpayer must supply over half the cost of maintaining the household. However, the limitations described in section 25 (b) (3) are applied where the children or grandchildren are married. This will prevent extending the benefits of a head of household to a parent while the child is himself obtaining the benefits of income splitting with his spouse.

C. Distribution of Tax Burden

Table 4 shows the distribution of the individual income tax burden under present law, the House bill and your committee's bill by adjusted gross income classes.[7] It also distributes by the same classes the number of taxable returns, the adjusted gross income, the value of the exemptions and the normal tax and surtax net income.[8]

The table indicates that of $25,823 million in total individual income tax liability under your committee's bill, $9,637 million will come from those with adjusted gross incomes of $5,000 or less and $16,186 million from those with adjusted gross incomes of over $5,000.

[6] See footnote 4 above.
[7] Income after business but before personal deductions and exemptions.
[8] Income after business and personal deductions and exemptions.

TABLE 4.—*Estimated distribution of individual income-tax returns, income, exemptions, and tax liability under present law, House bill, and Finance Committee bill when fully effective*

[Money amounts in millions of dollars]

Adjusted gross income classes	Total number of returns	Adjusted gross income	Value of exemptions	Surtax net income	Total tax, present law [1]	Total tax under House bill [1]	Total tax under Finance Committee bill [1]
Under $1,000	1,868,095	$1,556	$1,121	$272	$54	$61	360
$1,000 to $2,000	6,991,074	10,875	5,436	4,209	842	947	934
$2,000 to $3,000	10,908,014	27,275	12,918	11,226	2,245	2,526	2,492
$3,000 to $4,000	9,830,797	33,462	15,496	14,315	2,871	3,229	3,186
$4,000 to $5,000	6,262,777	27,905	11,259	13,247	2,672	3,002	2,964
Total under $5,000	35,860,757	101,073	46,230	43,268	8,684	9,765	9,637
$5,000 to $10,000	6,645,679	42,850	12,524	24,916	5,080	5,707	5,635
$10,000 to $25,000	1,342,865	19,470	2,637	14,742	3,488	3,908	3,864
$25,000 to $50,000	247,141	8,200	495	6,970	2,289	2,560	2,529
$50,000 to $100,000	70,115	4,675	138	3,966	1,862	2,086	2,026
$100,000 to $250,000	18,276	2,559	35	1,966	1,276	1,429	1,341
$250,000 to $500,000	1,967	647	3	438	378	418	388
$500,000 to $1,000,000	479	316	1	185	192	209	195
$1,000,000 and over	189	310	(2)	178	206	219	208
Total over $5,000	8,326,711	79,027	15,833	53,363	14,771	16,537	16,186
Total	44,187,468	180,100	62,063	96,631	23,455	26,302	25,823

[1] Includes normal tax, surtax, and alternative tax on net long-term capital gains.
[2] Less than $500,000.

NOTE.—Figures are rounded and may not add to totals.

IV. GENERAL CORPORATE TAX CHANGES

Both your committee's bill and the House bill provide a top corporate rate of 52 percent as contrasted to 47 percent under existing law. Your committee's bill provides a corporate income tax rate of 27 percent on the first $25,000 of each corporation's income, and a 52-percent rate on all income in excess of $25,000. This can be compared with House bill rates of 30 percent on the first $25,000 of income, and 52 percent on all income in excess of $25,000. Under existing law the first $25,000 of each corporation's income is taxed at 25 percent and all income in excess of this amount is taxed at 47 percent. Under both your committee's bill and the House bill the top corporate income tax rate, taken together with the 30 percent excess profits tax rate, gives a combined rate of 82 percent applying to adjusted excess profits net income, as compared with a combined rate of 77 percent under existing law. Your committee's bill provides a ceiling rate of 17 percent for excess profits tax and consolidated return purposes, which when taken together with the maximum effective rate of about 52 percent under the corporate income tax, means that in no case will more than about 69 percent of a corporation's income be taken in income, consolidated return and excess profits taxes. The House bill provides a ceiling rate on income taxes and excess profits taxes, taken together, of 70 percent, and present law provides a 62 percent ceiling of this type. The normal tax and surtax rate changes provided by your committee's bill are effective as of April 1, 1951, and are to terminate as of December 31, 1953. The House bill sets January 1, 1951, as the effective date but has no termination provision.

It is estimated that in a full year of operation these changes in corporate rates will increase liabilities by $2,220 million before consideration is given to the effect on individual income taxes of the smaller amounts which will be available for corporation dividend payments. Of this amount, $2,100 million is attributable to the increases in the regular corporate income taxes. The additional $120 million is attributable to increases in excess profits tax liabilities. It is estimated that after the decrease in individual income tax collections resulting from smaller dividend payments is taken into account, the net increase provided by the actions of your committee with respect to corporate rates will be $2,060 million. The House bill provided a gross increase in corporate tax liabilities of $3,078 million and a net increase of $2,855 million.

In the fiscal year 1952, ending June 30, 1952, it is estimated that the increases in corporate rates provided by your committee's bill will increase revenues in this year by $870 million as compared with $1,740 million under the House bill.

A. Normal Tax and Surtax Rate Changes

Your committee's bill provides a corporate normal tax rate of 27 percent as compared to 25 percent under existing law, and 30 percent under the House bill. The corporate surtax rate under your committee's bill is 25 percent as compared to 22 percent under both existing law and the House bill. Changes are also provided in both your committee's and the House bills in the credits allowed Western Hemisphere trade corporations and the credits for dividends paid and received on preferred stock of public utilities, in order to retain the tax differential provided in these cases under existing law.

Since corporations with incomes of $25,000 or less are subject only to the normal tax, their rate of tax is increased from 25 percent to 27 percent under your committee's bill, or by 3 percentage points less than is provided by the House bill. The combined normal tax and surtax on incomes in excess of $25,000 is increased from 47 percent to 52 percent by your committee's action, the same increase as is provided by the House bill. Table 5 compares for corporations with selected net incomes the combined corporate normal tax and surtax effective rates under your committee's bill with those under the House bill, under existing law and under the law in effect prior to the enactment of the Revenue Act of 1950. The table indicates that under your committee's provisions the effective rate, or average rate on the entire taxable income, for corporations with incomes of $25,000 or less, is always 2 percentage points above existing law and 3 percentage points below the House bill. For corporations with incomes above $25,000 the percentage point increase provided by your committee as the income grows larger gradually approaches, but never quite reaches, a 5-percentage-point increase over existing law. Or, expressing it another way, the increase provided by your committee's bill never quite reaches the increase provided by the House bill. This is attributable to the fact that your committee did not place the full 5-percentage-point increase on the normal tax with respect to which corporations are fully taxable, but rather added 3 of the additional 5 percentage points to the surtax with respect to which corporations have a $25,000 exemption.

Table 6 shows for corporations with selected net incomes the combined corporate normal tax and surtax liabilities under your committee's bill, under the House bill, under existing law, and under the law in effect prior to the enactment of the Revenue Act of 1950. The increase in tax liabilities of your committee's bill over existing law ranges in the cases shown from 8 percent on incomes under $25,000, to 10.64 percent on incomes of $100,000,000. Under the House bill the increase in tax liabilities ranges in the cases shown from 20 percent of the tax due under present law on incomes under $25,000, to 10.64 percent on incomes of $100,000,000. Thus under your committee's bill the percentage increase in tax grows larger as the income increases, while under the House bill exactly the reverse is true.

The rate increases provided by your committee's bill are much larger than it would ordinarily be desirable to provide, and it is realized that if corporate rates are continued at this high level indefinitely the expansion of productive facilities may be seriously impaired. For this reason your committee has set December 31, 1953, as the termination date for these increases. In the interval before 1953, your committee believes that corporations will be able to stand these high rates in view of the high corporate profits stemming in a large part from the national defense program and the high level of demand generally for products and services. In the first quarter of 1951 corporate profits before taxes were running at the annual rate of nearly $52 billion, and in the second quarter of 1951 it is estimated that corporate profits were running at the annual rate of $48½ billion. Thus, corporate profits in the first half of 1951 are above the very high rates reached in the last half of 1950 and one-half again as large as the profits in the calendar year 1948, which were the largest prior to 1950. It is expected that corporate profits after all taxes, even including the taxes imposed by your committee's bill, will be within about $2.5 billion of the level of corporate profits after taxes in 1950 and above the profits after taxes in any prior year except 1948. During World War II, for example, corporate profits after taxes ranged from $8.5 billion to $10.8 billion as compared to anticipated corporate profits of about $20 billion after the taxes imposed under your committee's bill.

TABLE 5.—*Comparison of corporate combined normal tax and surtax effective rates under present law, House bill and Senate Finance Committee bill*

Net income subject to normal tax and surtax	Effective rates of combined normal tax and surtax (percent)				Percentage point increase over present law	
	Pre-1950	Present law	House bill	Finance Committee bill	House bill	Finance Committee bill
$1,000	21.00	25.00	30.00	27.00	5.00	2.00
$5,000	21.00	25.00	30.00	27.00	5.00	2.00
$10,000	22.00	25.00	30.00	27.00	5.00	2.00
$25,000	23.00	25.00	30.00	27.00	5.00	2.00
$30,000	28.00	28.67	33.67	31.17	5.00	2.50
$40,000	34.25	33.25	38.25	36.38	5.00	3.13
$50,000	38.00	36.00	41.00	39.50	5.00	3.50
$60,000	38.00	37.83	42.83	41.58	5.00	3.75
$75,000	38.00	39.67	44.67	43.67	5.00	4.00
$100,000	38.00	41.50	46.50	45.75	5.00	4.25
$200,000	38.00	44.25	49.25	48.88	5.00	4.63
$500,000	38.00	45.90	50.90	50.75	5.00	4.85
$1,000,000	38.00	46.45	51.45	51.38	5.00	4.93
$10,000,000	38.00	46.95	51.95	51.94	5.00	4.99
$100,000,000	38.00	46.99	51.99	51.99	5.00	[1] 5.00

[1] This percentage is rounded. It actually is just under 5 percent.

TABLE 6.—*Comparison of corporate normal tax and surtax liabilities under pre-1950 law, present law, House bill, and Finance Committee bill*

Net income subject to normal tax and surtax	Combined normal tax and surtax				Increase in tax liability over present law			
					Amount		Percent	
	Pre-1950	Present law	House bill	Finance Committee bill	House bill	Finance Committee bill	House bill	Finance Committee bill
$1,000	$210	$250	$300	$270	$50	$20	20.00	8.00
$5,000	1,050	1,250	1,500	1,350	250	100	20.00	8.00
$10,000	2,200	2,500	3,000	2,700	500	200	20.00	8.00
$25,000	5,750	6,250	7,500	6,750	1,250	500	20.00	8.00
$30,000	8,400	8,600	10,100	9,350	1,500	750	17.44	8.72
$40,000	13,700	13,300	15,300	14,550	2,000	1,250	15.04	9.40
$50,000	19,000	18,000	20,500	19,750	2,500	1,750	13.89	9.72
$60,000	22,800	22,700	25,700	24,950	3,000	2,250	13.22	9.91
$75,000	28,500	29,750	33,500	32,750	3,750	3,000	12.61	10.08
$100,000	38,000	41,500	46,500	45,750	5,000	4,250	12.05	10.24
$200,000	76,000	88,500	98,500	97,750	10,000	9,250	11.30	10.45
$500,000	190,000	229,500	254,500	253,750	25,000	24,250	10.89	10.57
$1,000,000	330,000	464,500	514,500	513,750	50,000	49,250	10.76	10.60
$10,000,000	3,800,000	4,694,500	5,194,500	5,193,750	500,000	499,250	10.65	10.63
$100,000,000	38,000,000	46,994,500	51,994,500	51,993,750	5,000,000	4,999,250	10.64	10.64

Moreover, these larger tax collections during the immediate period ahead will occur during a period of large defense orders and a high level of consumer income. The assurance of these large and predictable markets for producers during the immediate period ahead must be offset against the adverse effect on incentives of the high corporate taxes provided by this bill.

Your committee deems it desirable to add only two out of the five percentage points by which corporate taxes are increased to the normal tax because this is the only rate under which some small corporations are taxed and the rate under which most of the income of other relatively small corporations is taxed. Your committee believes that the continuance of a free competitive market demands the creation of new, and the growth of existing, small businesses and that this necessitates preferential tax treatment with today's corporate tax burden.

B. CEILING RATE OR MAXIMUM RATE LIMITATION

Under existing law the normal-tax, surtax, 2-percent tax on consolidated returns, and excess profits tax together may not exceed 62 percent of a corporation's excess profits net income (income before deducting the excess profits credit and unused excess profits credit carry-over.[9] Thus, for corporations with effective income tax rates of about 47 percent, this means that the excess profits tax may not exceed about 15 percent of their excess profits net income.

Under the House bill this ceiling rate, or maximum rate limitation, is raised to 70 percent, or by 8 percentage points. Five of these percentage points merely offset the 5-percentage-point increase in the income tax rates in the case of the corporation with most of

[9] For this purpose the excess profits net income is substituted for the normal tax net income and surtax net income in computing the various taxes involved. Excess profits net income is income before the deduction of the excess profits tax credit and the excess profits credit carry-over. The 30 percent excess profits tax rate is applied to adjusted excess profits net income—that is, excess profits net income after deduction of the excess profits credit and the unused excess profits credit carry-over.

its income taxed at the 52-percent rate. The additional 3-percentage-point increase in the ceiling rate provided by the House bill, however, has the effect of increasing the excess profits tax liabilities of many corporations. The 70-percent ceiling rate for a corporation with an effective income tax rate of about 52 percent means that its excess profits tax may not exceed about 18 percent of its excess profits net income under the House bill as contrasted to 15 percent under existing law.

Your committee's bill adopts a new type of ceiling rate. The ceiling rate in this bill is 17 percent of excess profits net income but applies only with respect to excess profits tax liability and the tax liability on consolidated returns. For corporations with income tax effective rates of about 52 percent this is the equivalent of about a 69-percent ceiling rate on liabilities under the income taxes, consolidated return tax and excess profits tax, taken together, and this is the rate which is comparable in these cases to the 70-percent ceiling rate under the House bill and the 62-percent ceiling rate under existing law. However, because of the $25,000 surtax exemption, the effective income tax rates of corporations with taxable incomes of less than $300,000 is less than 50 percent. As a result a ceiling rate of 69 percent on their combined income and excess profits liabilities is quite different from a 17-percent ceiling on their excess profits tax liabilities. Table 7 shows for selected income levels, the effective income tax rates under your committee's bill, and the maximum effective rates with the 69-percent ceiling formula and the 17-percent ceiling formula. The table indicates that for corporations with incomes over $58,000 [10] the 17-percent formula is the more generous, resulting in a maximum tax saving of nearly 6 percent of total income for corporations with incomes of about $106,000.

[10] For corporations with incomes under $57,692.31 the $25,000 minimum excess profits tax credit prevents a higher effective rate than 17 percent under both formulas.

TABLE 7.—*Corporation normal tax and surtax effective rates under the Finance Committee bill, and a comparison of the maximum effective rates of income and excess-profits taxes under a 69-percent ceiling rate on income and excess-profits taxes with the ceiling rate under the Senate Finance Committee bill (a 17-percent ceiling rate on excess-profits taxes alone)*

Current income	Effective rate of normal tax and surtax under Finance Committee bill	Maximum effective rate of income and excess-profits taxes		
		69 percent income and excess-profits ceiling	17 percent excess-profits tax ceiling (provided by bill)	Percentage point difference
	Percent	*Percent*	*Percent*	*Percent*
$10,000	27.00	[1] 27.00	[2] 27.00	
$25,000	27.00	[1] 27.00	[2] 27.00	
$30,000	31.17	[1] 36.17	[2] 36.17	
$40,000	36.38	[1] 47.63	[2] 47.63	
$50,000	39.50	[1] 54.50	[2] 54.50	
$57,692	41.17	[1] 58.17	[2] 58.17	
$60,000	41.58	[1] 59.08	58.58	0.50
$70,000	43.07	[1] 62.36	60.07	2.29
$80,000	44.19	[1] 64.81	61.19	3.62
$90,000	45.06	[1] 66.72	62.06	4.66
$100,000	45.75	[1] 68.25	62.75	5.50
$105,769	46.09	69.00	63.09	5.91
$150,000	47.83	69.00	64.83	4.17
$200,000	48.88	69.00	65.88	3.12
$250,000	49.50	69.00	66.50	2.50
$300,000	49.92	69.00	66.92	2.08
$400,000	50.44	69.00	67.44	1.56
$500,000	50.75	69.00	67.75	1.25
$1,000,000	51.38	69.00	68.38	.62
$10,000,000	51.94	69.00	68.94	.06
$100,000,000	51.99	69.00	68.99	.01

[1] As a result of the $25,000 surtax exemption and the $25,000 minimum credit, the maximum effective rate on income and excess-profits tax liabilities is always less than 69 percent for corporations with incomes below $105,769.23.

[2] As a result of the $25,000 minimum excess-profits-tax credit, the maximum effective excess-profits tax rate for corporations with incomes below $57,692.31 is always less than 17 percent.

Your committee prefers this ceiling on excess-profits-tax liabilities over the type of ceiling rate in present law and the House bill because this type of ceiling rate is more advantageous to small corporations. Moreover, even for large corporations this 17-percent ceiling rate provides a maximum effective rate on total liabilities which is never quite 69 percent as compared to the flat 70-percent ceiling provided under the House bill. Although the large corporations subject to this maximum rate necessarily have substantially larger earnings than their excess-profits-tax credit would suggest is "normal," this lower maximum rate is deemed desirable because imperfections in the present allowable methods of computing the excess-profits credit may substantially understate "normal" earnings.

C. Capital-Gains Tax Rate

The House bill increased the capital-gains tax rate for corporations from 25 to 28.125 percent. This is an increase of 12½ percent, which corresponds with the 12½-percent increase made by the House bill in the capital-gains tax rate of individuals. Since your committee's bill provides no increase in the maximum capital-gains tax rate of individuals, no increase is made in the capital-gains tax rate of corporations. Under the House bill it was estimated that the rate increase in capital gains would increase corporate tax liabilities by $38 million before taking into account the reduction in corporate dividend payments.

D. Percentage of the Average Base Period Net Income Taken Into Account in Computing the Excess-Profits Credit

Under present law a corporation in computing its excess-profits credit on the basis of average earnings may take into account only 85 percent of its average earnings in its three best years in the period 1946–49. The House bill reduces this percentage to 75 percent, but your committee's bill keeps it at 85 percent.

After studying this point last year in its consideration of excess profits tax legislation, your committee concluded that a 15-percent discount was an adequate adjustment in order to place 1946–49 earnings on a normal basis and your committee believes a greater discount cannot be sustained. To further reduce this 85 percent in the case of the average-earnings base is to penalize those using this type of credit instead of the invested capital credit. It should not be forgotten that in the World War II excess-profits tax the average earnings in the base period was only reduced by 5 percent.

E. Effective Date

Under your committee's bill the corporate rate increases are effective as of April 1, 1951. Under the House bill they are effective as of January 1, 1951. Your committee generally is opposed to making retroactive rate increases and for this reason did not accept the House effective date of January 1. However, the need for revenue in the fiscal year 1952 made it necessary for your committee to apply these rate increases as far back as April 1 of this year. By making these corporate rate increases effective at that time it is anticipated that collections in the fiscal year 1952 (before taking into account the effect of smaller dividends on individual income tax collections) will be increased by $975 million as contrasted to only $615 million if, for example, the corporate rate changes were not made effective until July 1, or $295 million if the rate changes were made effective as of October 1. Moreover, by making the rate increase effective as of January 1, the House bill increases the tax of most corporations even before they have paid any of the additional taxes resulting from the increases made by the Revenue Act of 1950. Thus, for a calendar year corporation, for example, the top corporate rate would jump from 42 percent in 1950 to 52 percent in 1951. This is an increase of about 24 percent, and your committee considers it too steep an increase to be made with respect to a single year. By making the increase effective as of April 1, your committee's bill spreads the full 24 percent increase over 2 years instead of 1. It should also be noted that for the bulk of the corporations, which are on a calendar-year basis, the Government will not begin collecting this additional 1951 tax liability until March 1952 and will not complete its collection until December 1952. Thus, corporations will have adequate time in which to prepare for these additional tax payments.

The corporate income tax and ceiling rate changes provided by your committee's bill are to be effective with respect to taxable years beginning after March 31, 1951. For corporations with taxable years beginning prior to July 1, 1950, and ending after March 31, 1951, your committee's bill provides a formula for prorating the taxes due under the law in effect prior to the Revenue Act of 1950, under existing law and under your committee's bill. For corporations with taxable years beginning after June 30, 1950, and ending after March 31, 1951, your committee's bill prorates the taxes due under existing law and under your committee's bill. In general these proration formulas provide that the tax on the entire income is to be computed at the two or three different rates applicable. Then these taxes are multiplied by a fraction of which the numerator is the number of days in the corporation's taxable year in which the rate in question is effective, and the denominator is the total number of days in its taxable year. The sum of these fractional taxes is the corporation's final obligation.

F. Distribution of the Burden

Table 8 shows the combined corporate income and excess profits tax liabilities of corporations in various income classes under existing law, under the House bill and under your committee's bill. The table indicates that of the 415,182 corporations with taxable net income, 292,491, or about 70 percent of the total, have incomes of less than $25,000. These corporations which have 4.8 percent of the total taxable income, bear 3.55 percent of the increase in tax liabilities provided by the House bill, but only 1.94 percent of the increase in tax liabilities under your committee's bill. The 45,022 corporations with incomes of $100,000 and over, which constitute about 11 percent of the total number of corporations with taxable net income, have 87.25 percent of the total taxable income, and would bear 89.34 percent of the increase provided by the House bill, or 92.37 percent of the increase provided by your committee's bill.

Table 8.—*Estimated corporate income and excess profits tax liabilities under presen law, the House bill and the Finance Committee bill, calendar year 1951* [1]

Taxable net income classes	Number of taxable returns	Taxable net income	Income and excess profits tax liabilities			Increase over present law	
			Present rates	House bill	Finance Committee bill	House bill	Finance Committee bill
		Millions	*Millions*	*Millions*	*Millions*	*Millions*	*Millions*
Up to $25,000	292,491	$2,161	$540	$648	$583	$108	$43
$25,000 to $50,000	47,192	1,566	520	608	563	88	43
$50,000 to $100,000	30,477	2,018	899	1,027	982	128	83
$100,000 and over	45,022	39,311	21,426	24,142	23,473	2,716	2,047
Total	415,182	45,056	23,385	26,425	25,601	3,040	2,216
	Percent distribution						
Up to $25,000	70.45	4.80	2.31	2.45	2.28	3.55	1.94
$25,000 to $50,000	11.37	3.47	2.22	2.30	2.20	2.90	1.94
$50,000 to $100,000	7.34	4.48	3.85	3.89	3.84	4.21	3.75
$100,000 and over	10.84	87.25	91.62	91.36	91.68	89.34	92.37
	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[1] Based upon a level of profits before tax (Commerce basis) of $48 billion.

V. TAX-EXEMPT ORGANIZATIONS

Your committee's bill imposes the regular corporate income tax on certain undistributed profits of the following organizations fully exempt from income tax under section 101 of the present law: farmers' purchasing and marketing cooperatives, mutual savings banks, and State chartered savings and loan associations, as well as Federal savings and loan associations. A minor amendment is also provided in the case of educational bodies with respect to their "feeder" organizations. This provision is in the House bill. With respect to mutual casualty and fire insurance companies, presently subject to limited taxation, the staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation have been requested to prepare a report on their tax treatment, and your committee will give consideration to this matter as soon as is feasible after the completion of that report.

The House bill does not go into the subject of tax treatment of cooperatives or mutual financial institutions. As a result the $150 million which it is anticipated will be derived from the tax treatment provided in your committee's bill for these organizations represents an increase not only in the amount collected under present law but in the amount which would be collected under the House bill.

A. Cooperatives

Section 101 (12) of the code exempts from income tax all farm cooperatives which meet certain specified requirements. This exemption includes not only cooperatives marketing the products of farmers but also cooperatives purchasing products and reselling them to farmers. The chief requirements which must be met by cooperatives in order to be exempt from income tax under section 101 (12) are as follows:

1. They must be farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of marketing products or purchasing supplies for their members.
2. Substantially all of their stock (other than preferred nonvoting stock) must be owned by producers marketing products or purchasing supplies through the cooperatives.
3. The marketing of products of nonmembers may not exceed 50 percent in value of the cooperative's total marketing.
4. The purchasing for nonmembers may not exceed 50 percent of the cooperative's total purchasing, and the purchasing for persons who are neither members nor producers may not exceed 15 percent of the cooperative's total purchasing.
5. Nonmembers must not be discrimated against in the allocation of patronage dividends or refunds to the accounts of patrons.

At the present time, the advantages which are derived from exemption can be summarized as follows: First, the earnings of a cooperative which are paid out to shareholders in the form of dividends on capital stock are not taxable to an exempt cooperative but are taxable to other cooperatives. Second, any part of the net margins or profits which are retained as reserves and not allocated to the accounts of patrons are not taxable to an exempt cooperative but are taxable in the case of other cooperatives. Third, nonoperating income such as interest, dividends, rents, and capital gains and also the income from certain business done with the United States Government or its agencies, is taxable to the ordinary cooperative even when allocated to the accounts of patrons, but are tax-free to the exempt cooperative whether or not allocated.

Section 314 of your committee's bill continues the exemption provided by section 101 (12) of the code but removes from its application earnings which are placed in reserves or surplus and not allocated or credited to the accounts of patrons. In addition to being tax-free with respect to patronage dividends paid or allocated to patrons, as is generally also true in the case of other cooperatives, the cooperatives coming under section 101 (12) are also to remain exempt with respect to amounts paid as dividends on capital stock, and with respect to amounts allocated to patrons where the income involved was not derived from patronage, as for example in the case of interest or rental income, and income derived from business done with the Federal Government. Moreover, they will not be taxed in any way with respect to reserves set aside for any necessary purpose, or reserves required by State law, if such reserves are allocated to patrons.

As a result of this action, all earnings or net margins of cooperatives will be taxable either to the cooperative, its patrons or its stockholders with the exception of amounts which are paid or allocated to patrons on the basis of purchases of personal, rather than business, expense items. With this exception, funds which are allocated to the accounts of patrons, or paid in cash or merchandise, are taxable to them. This is true in the case of either taxable or tax-exempt cooperatives. In the case of either a tax-exempt or a taxable cooperative funds which are paid or allocated to patrons on the basis of personal expense items have no income-tax consequences to the patrons, since they represent a return with respect to expenditures by the patron of a personal nature, for which no income tax deduction has been taken by him. Funds which are not paid or allocated to patrons but are retained as reserves by the cooperatives will be taxable to the cooperative. This also will be true of both types of cooperatives. Funds paid out as dividends on ordinary capital stock in the case of the exempt cooperative will be taxable to the stockholder, while in the case of the taxable cooperative a tax is imposed at both the stockholder and the cooperative levels.

While the tax treatment provided by your committee for cooperatives does not impose the double taxes payable in the case of ordinary corporate income, your committee believes that the securing of a single tax with respect to substantially all of the income of cooperatives should be sufficient in view of the unique characteristics of a cooperative.

Your committee disapproves of withholding on dividends. However, should withholding on corporate dividends be provided your committee believes it should also be provided for patronage dividends paid by cooperatives. For that reason your committee has added a provision to the bill which subjects patronage dividends of cooperatives to a withholding tax if at any time one should be imposed upon corporate dividends.

It has been contended that, although patronage dividends are generally taxable to the patron, the patronage dividends paid in scrip or some other noncash form have not been included in the patron's income. It has been suggested that this is true because the patron who reports his other income on a cash basis is not accustomed to considering noncash payments as income. Also, it has been suggested that the patron is reluctant to include noncash patronage dividends in his income in many cases because he does not have sufficient other cash income available to pay the tax involved. To ascertain the degree to which both cash and noncash patronage dividends are included in returns at the present time your committee's bill provides that the Commissioner of Internal Revenue is to require reporting by all cooperatives of patronage dividends which are paid to or allocated to the accounts of patrons in amounts of $100 or more, and is to have the discretion to require reporting on smaller amounts. Also, the committee has instructed the staffs of the Treasury Department and Joint Committee on Internal Revenue Taxation to study and report by April 1, 1952, the possibility of withholding against reserves allocated, and on the various methods used in allocating reserves and the form and character of the certificates issued.

It is estimated that the action provided by your committee with respect to exempt cooperatives will increase collections from this source in a full year of operation by $10 million.

B. Mutual Financial Institutions

1. *Mutual savings banks*

Mutual savings banks were established to encourage thrift and to provide safe and convenient facilities to care for savings. They also have the responsibility of investing the funds left with them so as to be able to give their depositors a return on their savings. Mutual savings banks were originally organized for the principal purpose of serving factory workers and other wage earners of moderate means who, at the time these banks were started, had no other place where they could deposit their savings.

Most mutual savings banks were started by groups of individuals who put up guaranty funds which were repaid out of subsequent earnings. The organizers appointed boards of trustees to manage the affairs of the banks. The boards of trustees, which are generally self-perpetuating, direct the policies of the banks, subject to the limitations imposed upon them by the laws of the several States in which they operate. The depositors themselves have no voice either in the choice of trustees or in the management of the bank's affairs. However, since a mutual savings bank has no capital stock, everything that the bank earns is, in theory, held for the benefit of the depositors.

With respect to outlets for their funds, mutual savings banks are subject to limitations similar to those which apply to other banking institutions. They are not required to make loans only to depositors or members. Table 9 shows the types of assets held by mutual savings banks as of December 30, 1950, and in the case of federally insured mutual savings banks, the types of real estate loans as of June 30, 1950, and their earnings, expenses, and dividends for the year ending December 30, 1950. The table indicates that United States Government obligations represent nearly 51 percent, and loans 38 percent of the total loans and investments of these banks. In the case of commercial banks nearly 49 percent of their total loans and investments represent United States Government obligations, and

41 percent represent loans.[11] This indicates that if there is any important difference between the use of funds by mutual savings banks and commercial banks, it is that the investments of the former are somewhat safer. Mutual savings banks, of course, have a larger portion of their loans in real estate than do commercial banks, but this can be attributed to the fact that since the deposits of mutual savings banks are almost exclusively time deposits, it is possible for them to invest a substantial portion of their funds in nonliquid assets. On the other hand, the majority of the deposits of commercial banks are demand deposits requiring greater liquidity in their investments. In any case, the investment of funds in real estate today is not a sign of insecurity in view of the fact that an important segment of such loans are backed by the Federal Government. Table 9 indicates in the case of federally insured mutual savings banks, for which statistics are available, that, as of June 30, 1950, about 33 percent of the real-estate loans held by these banks were either insured by the Federal Housing Administration, or guaranteed by the Veterans' Administration. Moreover, even the other real-estate loans are more secure than formerly was the case because of the present general use of "declining-balance" loans in lieu of the older "fixed-amount" loans.

The total deposits of mutual savings banks as of June 27, 1951, were $20,400 million and their capital accounts, $2,290,[12] indicating that they have about $1 of capital for every $9 of deposits. As of the same date the total deposits of all commercial banks were $150,280 million, and their capital accounts $11,860 million, indicating that they only have about $1 of capital for every $13 of deposits. Thus, despite the absence of capital stock the mutual savings banks today on this ground also appear to have considerably more protection than commercial banks.

[11] As of December 30, 1950. Computed from data available in the Federal Reserve Bulletin.
[12] These statistics are published regularly in the Federal Reserve Bulletin.

TABLE 9.—*Types of assets held by mutual savings banks as of Dec. 30, 1950, and for federally insured mutual savings banks, types of real estate loans held as of June 30, 1950, and earnings, expenses, and dividends in the calendar year 1950*

I. ASSETS OF ALL MUTUAL SAVINGS BANKS IN THE UNITED STATES, AS OF DEC. 30, 1950

Item	*Dollar amounts in millions*
Total assets	$22, 385
Cash and funds due from banks	797
United States Government obligations	10, 868
Obligations of States and subdivisions	88
Other securities	2, 253
Real estate and other loans	8, 137
Miscellaneous assets	242
Number of banks, 529.	

II. FEDERALLY INSURED AND CONVENTIONAL REAL ESTATE LOANS HELD BY INSURED MUTUAL SAVINGS BANKS, JUNE 30, 1950

Total real estate loans		$5, 447
Federally insured:		
Insured FHA and guaranteed VA mortgage loans on 1- to 4-family properties	$1, 364	
Insured FHA and guaranteed VA loans on 5 or more family properties	415	
Total		1, 779
Conventional loans		3, 668
Number of insured mutual savings banks, 192.		

III. EARNINGS, EXPENSES AND DIVIDENDS OF INSURED MUTUAL SAVINGS BANKS FOR THE YEAR ENDING DECEMBER 30, 1950

	Dollar amounts in thousands
Current operating earnings, total	$478, 695
Interest, discount and other income on real estate loans	231, 730
Interest on U. S. Government obligations, direct and guaranteed	182, 457
Other current earnings	64, 508
Current operating expenses	115, 470
Net current operating earnings	363, 225
Dividends (interest) paid on deposits	257, 770
Net profits after interest and dividends	91, 175
Number of insured mutual savings banks, Dec. 30, 1950, 194.	

Source: Annual Report of the Federal Deposit Insurance Corporation for the year ended Dec. 31, 1950, pp. 55 and 272, and Operating Insured Commercial and Mutual Savings Banks, Assets and Liabilities, June 30, 1950, Rept. No. 33, Federal Deposit Insurance Corporation.

Section 102 (2) of the code exempts mutual savings banks from the payment of any income tax. The effect of the exemption has been to relieve mutual savings banks of income tax on the amounts retained as undivided profits and additions to surplus. Since they have increased their surplus and undivided profits by over $800 million since 1940, and by more than $500 million since 1945, it would appear that they have enjoyed substantial tax savings as a result of the exemption.

Section 313 of your committee's bill removes the exemption of mutual savings banks and permits them to deduct amounts paid, credited or allocated to the accounts of depositors and, as in the case of other banks, permits them to deduct amounts credited to a reasonable reserve for bad debts. The addition to the reserve for losses on loans is to be determined with due regard to the taxpayer's surplus or loss reserves at the close of December 31, 1951. In addition, mutual savings banks are to be allowed as a deduction from gross income any amount currently paid to the United States, or to any Federal Government instrumentality exempt from Federal income taxes, in repayment of indebtedness incurred prior to September 1, 1951. On the remaining income, mutual savings banks are to be taxed in the same manner as ordinary corporations. This provision is effective with respect to taxable years beginning after December 31, 1951.

The size of the bad-debt allowance provided in the case of commercial banks is determined under administrative rulings by the Commissioner of Internal Revenue. At present it is provided in the case of commercial banks that the amount which can be deducted from taxable income in any one year shall be determined by applying the ratio of losses to outstanding loans during the past 20 years, to the loans outstanding in the current year. These reserves are limited to three times the current 20-year loss ratio. In the case of mutual savings banks also, the formula permitted may be quite different from that now provided for commercial banks if the Commissioner after investigation finds that the historical loss experience of these institutions differs substantially from that of commercial banks. In fact, your committee believes that the loss experience of these banks should be based upon a period of at least 25 years if this, in the aggregate, would result in greater loss deductions for these banks than the 20-year period now provided in the case of commercial banks. Basing loss reserve deductions on the loss experience of the past 20 or 25 years will include a period in which the losses of the mutual savings banks were quite large, with the result that the loss reserve deductions permitted in the next several years will be relatively large.

At the present time, mutual savings banks are in active competition with commercial banks and life insurance companies for the public savings, and they compete with many types of taxable institutions in the security and real estate markets. As a result your committee believes that the continuance of the tax-free treatment now accorded mutual savings banks would be discriminatory. So long as they are exempt from income tax, mutual savings banks enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves. The tax treatment provided by your committee would place mutual savings banks on a parity with their competitors.

Moreover, earnings of a mutual savings bank which are allocated to the accounts of depositors are subject to individual income tax. Since it is contended that the income which is retained by the mutual savings banks is the income of depositors, there seems to be no reason why this also should not be subject to tax. However, it is impossible to tax the depositors on these unallocated funds, since they have no legal right to the funds unless they are depositors at the time of liquidation of the bank. Therefore, if these earnings are to be recognized as income, there is no alternative but to tax them in the hands of the mutual savings banks which have the power over their management and disposition.

It has been suggested that mutual savings banks might be taxed only on their net income in excess of some specified reserve. However, if the funds going into this reserve represent income there would appear to be no reason for not taxing them. If they are funds which are necessary to offset future losses, allowance will already have been made for them through a loss-reserve deduction which will afford these institutions at least as generous treatment as is accorded their chief competitors, namely, commercial banks.

2. Savings and loan associations

Savings and loan associations were established to encourage thrift and to promote home ownership. These organizations, which also go under the name of building and loan associations, are typically nonstock corporations which in reality secure their funds through deposits, which are known as "shares." Savings and loan associations may be chartered by the States or by the Home Loan Bank Board. Of the 5,980 associations which were doing business at the end of 1949, 1,505 were Federal associations and the remainder were State-chartered institutions. The former group accounted for $7.1 billion, or nearly 50 percent, of the $14.7 billion of total assets of all the associations.

TABLE 10.—*Types of assets held by savings and loan associations as of Dec. 30, 1950, and for federally insured associations, types of real-estate loans held as of Dec. 30, 1950, and income dividends and undivided reserves and profits in 1950*

I. ASSETS OF ALL SAVINGS AND LOAN ASSOCIATIONS AND INSURED SAVINGS AND LOAN ASSOCIATIONS AS OF DEC. 30, 1950

[Dollar amounts in millions]

Item	All savings and loan associations	Insured savings and loan associations
Total assets	[1] $16,925	$13,641
First-mortgage loans	$13,810	$11,153
Cash	$913	$800
U. S. Government obligations	$1,491	$1,202
Number of associations	5,980	2,860

II. FEDERALLY INSURED AND CONVENTIONAL FIRST-MORTGAGE LOANS HELD BY INSURED SAVINGS AND LOAN ASSOCIATIONS, DEC. 30, 1950

[Dollar amounts in millions]

Total first-mortgage loans		[2] $11,188
Federally insured:		
VA-guaranteed loans	$733	
FHA-insured loans	2,507	
Total		3,241
Conventional loans		7,947

III. INCOME, DIVIDENDS, AND UNDIVIDED PROFITS OF INSURED SAVINGS AND LOAN ASSOCIATIONS, FOR THE YEAR ENDED DEC. 30, 1950

[Dollar amounts in thousands]

Net income	$411,347
Dividends	262,781
Undivided profits and reserves	148,566

[1] Preliminary.

[2] The difference between this figure and the comparable category shown in pt. I is due to differences in accounting methodology.

Sources: Statistical Summary, 1951, Home Loan Bank Board, pp. 8 and 14; Operational Analysis Section, Home Loan Bank Board.

Not all of the earnings of savings and loan associations are distributed in the form of cash or credited to the shareholders' accounts. Some earnings are set aside in various reserve accounts, and some are retained as undivided profits. At the end of 1949, the general reserves and undivided profits of all savings and loan associations in the United States amounted to $1.1 billion. This was over 7.5 percent of the $14.7 billion of private savings invested in these institutions.

Most of the assets of savings and loan associations take the form of mortgage loans, usually on residential properties. Thirty years ago, this type of loan accounted for over 90 percent of the assets of these institutions; today, the percentage is somewhat lower, although mortgage loans represented 80 percent of all assets held at the end of 1950. Table 10 shows for 1950 the types of assets held by savings and loan associations at the end of the year 1950, and in the case of federally insured associations, the types of mortgage loans held at the end of the year and the net income, dividends, and additions to undivided profits during the year. The table indicates that these associations have a much larger portion of their assets invested in real-estate mortgages than is true in the case of commercial banks. However, this can be attributed to the fact that since the deposits of savings and loan associations are almost exclusively time deposits, it is possible for them to invest most of their funds in nonliquid assets. The majority of the deposits of commercial banks, on the other hand, are demand deposits requiring greater liquidity in their investments. It should also be noted that, as in the case of the mutual savings banks, nearly one-third of the mortgage loans of the building and loan associations, in terms of value, are insured or guaranteed by the Veterans' Administration or the Federal Housing Administration.

In the early days of these institutions, the transactions of the associations were confined to members, and no one could participate in the benefits they afforded without becoming a shareholder. Individuals became investing members of these organizations in the expectation of ultimately becoming borrowing members as well. Membership implied not only regular payments to the association for a considerable period of time, but also risk of losses. Members could not cancel their memberships or withdraw their shares before maturity without incurring heavy penalties. The fact that the members were both the borrowers and the lenders was the essence of the "mutuality" of these organizations.

Although many of the old forms have been preserved to the present day, few of the associations have retained the substance of their earlier mutuality. The steady decline in the proportion of share-accumulation loans is evidence that the character of these organizations has changed. More and more, investing members are becoming simply depositors, while borrowing members find dealing with a savings and loan association only technically different from dealing with other mortgage lending institutions in which the lending group is distinct from the borrowing group. In fact, borrowers ordinarily have very little voice in the affairs of most savings and loan associations.

One characteristic of the earlier mutuality which remains is the absence of capital stock. However, the character of the organization has been modified by the practice of paying more or less fixed rates of return on shares, and of building up substantial surplus accounts to protect shareholders against the risk of losses.

Savings and loan associations at present are exempt from income tax under section 101 (4) of the code. In addition, Federal savings and loan associations which are chartered by the Federal Government are exempt from income tax under the Home Owners' Loan Act of 1933 and are covered by subsection (15) of section 101 of the code providing for the exemption of United States instrumentalities.

Section 313 of your committee's bill removes the exemption of savings and loan associations, including Massachusetts cooperative banks, and those chartered by the Federal Government and taxes them as ordinary corporations. However, it specifically allows the deduction for dividends paid to depositors and the amounts placed in bad-debt reserves on basis similar to that provided for mutual savings banks. This provision is effective with respect to taxable years beginning after December 31, 1951.

The grounds on which your committee's bill taxes savings and loan associations on their retained earnings, after making a reasonable allowance for additions to reserves for bad debts, are the same as those on which mutual savings banks are taxed under the bill. Moreover, since savings and loan associations are no longer self-contained cooperative institutions as they were when originally organized there is relatively little difference between their operations and those of other financial institutions which accept deposits and make real-estate loans.

The principal argument that a savings and loan association does not really have income which could be taxed is based on the theory that both the borrowers and the investors are members of the association and that the interest paid by the borrowers on their loans is really only paid to themselves as members of the association. In other words, it is argued that the mutuality of the borrowing and the investing members is such that no income exists.

The mutuality argument assumes that in the long run, the investments of each member are equal to the debts he has owed the organization. It also assumes that the membership in each organization is fixed and that eventually each member will receive a proportionate share of the accumulated earnings of the organization. These assumptions might have been valid for the original savings and loan associations which terminated after they had fulfilled their purposes for the original membership groups. They are not generally valid, however, for the present-day associations, where investing members may never contemplate becoming borrowers and where the organizations are permanent and a member has no right to a share in the undistributed earnings upon withdrawal.

Another basis on which it is argued that the savings and loan associations do not have income is that all their receipts are either paid out as expenses or as dividends to members or accumulated for the mutual benefit of the members. However, an individual member or depositor has no claim to a share of the accumulated earnings unless he remains in the organization until its dissolution. The idea that income of a savings and loan association belongs to a member even though it is not paid to him or allocated to his account is a more extreme concept of cooperative ownership than that used by cooperatives.

The income which is added to reserves and undivided profits by the savings and loan associations cannot be treated as income to a member or depositor for income-tax purposes under the doctrine of constructive receipt because the member cannot obtain it unless he remains a member of the association until it is dissolved. It is income of the associations. The fact that it is retained for the benefit of the members makes it analogous to the income retained by an ordinary taxable corporation for the benefit of its stockholders.

C. Unrelated Business Income of Government Colleges and Universities

The Revenue Act of 1950 imposed the regular corporate income tax on certain tax-exempt organizations which are in the nature of corporations with respect to so much of their income as arises from active business enterprises which are unrelated to the exempt purposes of the organization (including certain "lease-back" income). However, the present provision does not apply to such income of State universities and other schools of governmental units. It has been called to the attention of your committee that some State schools are engaging in unrelated activities and "lease-backs" which would be taxable if they were not a State or its instrumentality. It is clear that the same opportunities for unfair competitive advantage exist in connection with these activities of State universities as with respect to similar activities of other educational institutions. Therefore, section 338 of your committee's bill extends the present tax to the unrelated business income of universities and colleges of States and of other governmental units. As a result governmental universities and colleges will be taxable on income derived from any unrelated business activities carried on by the schools themselves (including the income derived from leases for over 5 years of property purchased with borrowed funds), and also their "feeder" corporations carrying on a trade or business will be fully taxable.

This amendment is effective with respect to taxable years beginning after December 31, 1951.

The House bill contained no similar provision.

The revenue gain from this provision is expected to be small.

D. Educational "Feeder" Corporations

The Revenue Act of 1950 included a series of provisions which, under specified conditions, resulted in the imposition of taxes on educational, charitable, and certain other tax-exempt organizations, foundations, and trusts. Among these provisions was one which for 1951 and subsequent years specifically denied exemption to "feeder" corporations, that is, corporations carrying on a trade or business for profit whose profits inure exclusively to organizations exempt under section 101 of the code. With respect to prior years the tax status of such corporations was then in litigation. With respect to these years the Revenue Act of 1950 provided that no tax would be asserted for years prior to 1947 unless a deficiency had already been asserted, or taxes had already been assessed or paid. Your committee believes undue hardship would arise if any of these educational feeder corporations were required to pay taxes on income which had already been spent to carry on educational programs.

Therefore, both section 601 of your committee's bill and section 501 of the House bill amend section 302 of the Revenue Act of 1950 to provide that for years prior to 1951 exemption is not to be denied feeder corporations if their profits inure to a regularly established school, college, or university.

This provision is expected to have no permanent effect on revenues.

VI. STRUCTURAL CHANGES IN THE INCOME TAXES

A. Provisions in the House Bill Also in Your Committee's Bill

1. Life-insurance companies

In section 401 of the Revenue Act of 1950 the formula used for computing the net income of life-insurance companies was amended, the action being effective only for 1949 and 1950. This action was necessitated by the fact that the formula set up in the Revenue Act of 1942 resulted in no tax being due from any company on its life-insurance-investment income for the years 1947 and 1948. The substitute formula provided for 1949 and 1950 was intended to be a stopgap which would terminate the tax-exempt status of this type of income and permit the completion of the study needed for the development of a permanent solution to the problem of the taxation of life-insurance companies.

Section 311 of the House bill applies the stopgap formula to life-insurance-investment income for 1951. This was deemed necessary because, although considerable progress has been made in the study of the problems of the proper taxation of life-insurance companies, a reasonable and acceptable solution to many of the problems has not yet been developed, and it is generally recognized that the formula set up in the Revenue Act of 1942 is defective. Although that formula would no longer have resulted in a tax-free status for life-insurance companies in 1951, because the yield on life-insurance investments has somewhat increased and the average rate of interest required to maintain the life-insurance reserves has decreased, the revenue which would have been obtained under that formula is, because of its defective nature, only about half that which would be obtained for 1951 by a continuation of the use of the stopgap formula.

During the hearings conducted by your committee, representatives of almost all the life-insurance companies presented a proposal which in their view is a reasonable and adequate method of taxing the income of those companies. In your committee's bill that plan is substituted for the stopgap formula as provided in the House bill, as the method for determining the income-tax liability of life-insurance companies for 1951.

Under the stopgap formula, as used for 1949 and 1950 and as provided for 1951 in the House bill, the taxable income of each life-insurance company relating to its life-insurance business is determined by deducting from its net investment income a percentage of that income. To that amount is added an amount—3¾ percent of the unearned premiums and unpaid losses—reflecting the taxable income of its accident and health business, if any. Appropriate adjustments are made with respect to exempt interest and the credit for dividends received. The normal tax is obtained by applying the ordinary corporation normal tax rate to that entire amount, and the surtax is obtained by applying the ordinary surtax rate to that portion in excess of $25,000. The percentage to be deducted in arriving at the taxable income is the same for all life-insurance companies, and is determined and proclaimed for each year by the Secretary of the Treasury, by comparing the aggregate amount needed in the previous year by all life-insurance companies to meet their life insurance policy obligations and any other interest on indebtedness with the aggregate net investment income of all life-insurance companies less 3¼ percent of the unearned premiums and unpaid losses of those companies which had health and accident insurance. For 1950 this percentage, based on 1949 data, was slightly more than 90 percent; for 1951, based on 1950 data, it would probably be between 87 and 88 percent.

Section 335 of your committee's bill substitutes a different formula for the taxation of life insurance companies in 1951. Under it the income tax is in general to be 3¾ percent of so much of the net investment income of each company as is not in excess of $200,000, and 6½ percent of the amount over $200,000. It will be noted that 3¾ percent of $200,000 is approximately the same as 27 percent of $25,000; and that 6½ percent of net investment income is approximately the same as 52 percent of 12 to 13 percent (100 percent less 88 or 87 percent) of the entire net income. For those companies with accident and health insurance an appropriate adjustment is made so that the tax computed at the 3¾- and 6½-percent rates is approximately the same as a tax at the ordinary 27- and 52-percent rates on the income (determined as before) from that part of their business. As under the present stopgap formula, appropriate adjustments are made for exempt interest and the credit for dividends received.

Since the new formula, under the circumstances of 1951, is substantially equivalent to the stopgap formula, it is clear that, for most life-insurance companies, the income-tax liability under your committee's bill will be substantially the same for 1951 as it would be under the provisions of the House bill.

It is expected that a number of companies, mostly small, will not in 1951 earn their interest requirements, or will earn an amount only slightly in excess of their requirements. Under the stopgap formula these companies would have paid ordinary corporation normal taxes and surtaxes on the same percentage of their net investment incomes as the other companies whose net investment income materially exceeded their policy requirements. Under your committee's bill a measure of relief is accorded such companies: those with net investment income less than their policy requirements will, in general, pay a tax at 3¾ or 6½ percent on only 50 percent of their net investment incomes, while those with net investment incomes of from 100 to 105 percent of their policy requirements will pay a tax at the rate of 3¾ or 6½ percent on amounts varying from 50 to 100 percent of their net investment incomes. With respect to companies which also do an accident and health insurance business, in determining whether or not their net investment income is less than that required to meet their life-insurance-policy requirements, or not more than 105 percent of that amount, the total net investment income is reduced by one-half of 3¼ percent of their unearned premiums and unpaid losses on the accident and health policies. The limitation of this reduction to one-half of the adjustment for such business appears to be reasonable since, as was stated in the report on the 1942 provisions by the Committee on Finance,[13] "there is very little investment income derived from the investment of premiums on such (accident and health) contracts."

[13] 77th Cong., 2d sess., S. Rept. No. 1631, p. 148.

It is believed that the method of taxation provided by your committee's bill is not only more equitable with respect to certain of the smaller companies which do not earn a margin of investment income over their requirements but also that it is simpler in structure and involves fewer compliance and administrative difficulties than the stopgap formula provided in the House bill.

It has been suggested that this new method of taxing life-insurance companies should be used permanently, or for an indefinite period in the future. It is the opinion of your committee, however, that the question whether this new method is the best practicable method should only be answered after the results of the present continuing study are available, and after this method is carefully compared with other possible methods of taxing life-insurance companies which may be suggested as the results of that study. Therefore, in your committee's bill, the application of this method is limited to taxable years beginning in 1951.

It is estimated that for 1951 the revenue under your committee's bill will be about $111 million, an amount about $58 million more than would be obtained under the 1942 formula.

2. Offset of short- and long-term capital gains and losses

Section 322 of this bill amends the treatment of the gains and losses of individuals so as to eliminate a defect in existing law. This section is identical to section 305 of the House bill. Present law excludes 50 percent of a long-term capital gain or loss from the computation of net capital gain, net capital loss and net income, but includes 100 percent of a short-term capital loss in such computations. As a result a $1 short-term loss can wipe out a $2 long-term gain.

Under the bill long-term gains are included in gross income at 100 percent and a deduction from gross income is allowed equal to 50 percent of the amount by which the taxpayer's net long-term gain exceeds his net short-term loss. Thus, if a taxpayer has a net long-term gain of $1,000 and a net short-term loss of like amount, no deduction is to be allowable. If the net long-term gain is $2,000 and the net short-term loss is $1,000, the deduction against gross income will be 50 percent of the excess of $2,000 over $1,000, or $500. Hence the amount actually taxed as a long-term capital gain will be $500. Under existing law the $1,000 of short-term loss offsets the portion of the long-term gain included in the calculation of net income, and no tax liability exists.

Long-term losses, like long-term gains, are to be taken into account in full. Long-term losses will therefore offset short-term gains on a dollar-for-dollar basis, just as short-term losses will offset long-term gains. If long-term losses exceed short-term gains, the unreduced excess will be offset against other income up to $1,000. The net loss which is not absorbed in this manner will be carried forward as a short-term capital loss, whether arising out of short- or long-term operations.

Under both your committee's bill and the House bill, the amendment applies only to taxable years beginning on or after the date of enactment of this act.

It is estimated that when fully effective this amendment will increase the revenues by $28 million annually.

3. Collapsible corporations

Section 326 of this bill, which is identical to section 308 of the House bill, amends section 117 (m) of the Code, which denies capital-gains treatment to the sale, exchange, or retirement of stock in a "collapsible corporation," so as to extend the application of this section to cases where the corporation is used as a device for converting inventory profits into capital gains. Section 117 (m) was added to the code by the Revenue Act of 1950 to forestall the use of the collapsible corporation as a device for converting ordinary income into long-term capital gain. At that time it was believed that the collapsible corporation was used principally in the motion-picture and building-construction industries. The reports on the bill which became the Revenue Act of 1950 illustrated the device by the case of a corporation organized for the production of a single motion picture. Upon the completion of the film, but prior to the realization by the corporation of any income therefrom, the corporation would be liquidated and its asset distributed. No tax would be paid by the corporation because it had realized no income. Each former shareholder would pay a tax upon the difference between the cost of his stock and the fair market value of his portion of the fair market value of the motion picture and any other assets so distributed. Prior to the Revenue Act of 1950 this gain might have been taxed as a long-term capital gain with a maximum effective rate of 25 percent; under the law as amended by that act the gain is now taxed as ordinary income.

The collapsible corporation was also illustrated with cases in which a corporation set up to construct a building was liquidated and the rights in the building were sold by the former stockholders acting as individuals.

Because the device of the collapsible corporation was believed to be used largely in these two cases, section 117 (m) was drafted so as to apply when the corporation was "formed or availed of principally for the manufacture, construction, or production of property."

It is now understood that the collapsible-corporation device has also been used in an attempt to convert into capital gains the profits on inventory and stock in trade. The procedure used is to transfer a commodity to a new or dormant corporation, the stock of which is then sold to the prospective purchaser of the commodity who thereupon liquidates the corporation. In this manner the accretion in the value of the commodity, which in most of the actual cases has been whisky, is converted into a gain realized on the sale of stock of a corporation, thus creating the possibility that it might be taxed as a long-term capital gain.

To prevent the use of the collapsible corporation in cases of this type, section 117 (m) is extended by both bills to corporations formed or availed of principally for the purchase of property which is inventory or stock in trade in the hands of the corporation.

This amendment applies with respect to taxable years ending after August 31, 1951, but will only apply to gains realized after that date. The House provision applies to taxable years beginning after December 31, 1950. The determination of the tax treatment of gains realized in taxable years beginning prior to September 1, 1951 (January 1, 1951, under the House bill), will be made as if this section had not been enacted and without inferences drawn from the fact that the amendment made in this bill is not specifically retroactive and without inferences drawn from the limitations contained in section 117 (m) as amended by section 326 of this bill.

It is estimated that in a full year's operations this provision will increase the revenues by $5 million.

4. Dealers in securities

Under existing law, dealers in securities are permitted to hold some securities as a personal investment. Gains or losses on those securities which are held by the taxpayer in his capacity as a dealer are treated as ordinary income. Capital gain or loss treatment is accorded the results of the transfer of securities which the taxpayer holds as an investor. Existing law also permits the transfer of securities from such a taxpayer's investment account to his inventory account and vice versa with corresponding changes in tax liabilities. These transfers increase the difficulty of determining in which portfolio specific securities are actually held, and facilitate the manipulation of the taxpayer's accounts so as to obtain ordinary loss treatment on securities sold at a loss and capital-gains treatment on those sold at a gain.

To forestall this practice, section 327 of this bill, which is substantially the same as section 309 of the House bill, provides that in the case of a dealer in securities capital-gains treatment be available only under certain specific conditions. The security in question must have been clearly identified in the dealer's records as "a security held for investment" within a period of 30 days after the date of its acquisition or after the date of enactment of the Revenue Act of 1951, whichever is later, and must not at any time thereafter have been held by the taxpayer "primarily for sale to customers in the ordinary course of his trade or business." Unless these terms are complied with, the gain on the sale of the security is to be taxed as ordinary income.

Ordinary loss treatment is not to apply where the security sold was, at any time after this section becomes applicable, clearly identified in the dealer's records as "a security held for investment."

Your committee has changed the House provision to insure that this amendment will not affect the application of section 117 (i) of the Code which provides, in the case of banks, that, if losses from the sale of all securities during a year exceed the gains, then the net loss shall be treated as an ordinary loss.

The amendment applies to sales or exchanges made more than 30 days after the date of enactment of this act.

The revenue loss resulting from this amendment is expected to be negligible.

5. Gain from sale or exchange of the taxpayer's residence

Section 318 of your committee's bill and section 305 of the House bill are the same except in one respect. Both sections amend the present provisions relating to a gain on the sale of a taxpayer's principal residence so as to eliminate a hardship under existing law which provides that when a personal residence is sold at a gain the difference between its adjusted basis and the sale price is taxed as a capital gain. The hardship is accentuated when the transactions are necessitated by such facts as an increase in the size of the family or a change in the place of the taxpayer's employment. In these situations the transaction partakes of the nature of an involuntary conversion. Cases of this type are particularly numerous in periods of rapid change such as mobilization or reconversion. For this reason the need for remedial action at the present time is urgent.

Both bills provide that when the sale of the taxpayer's principal residence is followed within a period of 1 year by the purchase of a substitute, or when the substitute is purchased within a year prior to the sale of the taxpayer's principal residence, gain is to be recognized only to the extent that the selling price of the old residence exceeds the cost of the new one. Thus, if a dwelling purchased in 1940 for $10,000 is sold in 1951 for $15,000, there would ordinarily be a taxable gain of $5,000 under existing law. Under both bills no portion of the gain is to be taxpable provided a substitute "principal residence" is purchased by the taxpayer within the stated period of time for a price of $15,000 or more. If the replacement cost is less than $15,000, say $14,000, the amount taxable as gain is to be $1,000.

The provision of both your committee's bill and the House bill applies to cases where one residence is exchanged for another, where a replacement residence is constructed by the taxpayer rather than purchased, and where the replacement is a residence which had to be reconstructed in order to permit its occupancy by the taxpayer. However, under the House bill, where a replacement residence is constructed by the taxpayer, he must occupy the new residence within 1 year after sale of his old residence. This is the same rule which both your committee's bill and the House bill apply in the case of the purchase of a new residence. However, in the case of new construction the requirement of occupancy within 1 year appears to your committee not to be realistic, particularly during the present period of material and labor shortages. Therefore, your committee's bill provides that in the case of the construction of a new house, if the construction of the house begins within a year before or after the sale of the first house, and the new house is used as the taxpayer's principal residence within 18 months after the sale of the first house, then all expenditures on the new residence within this 18-month period are to be considered as a reinvestment of the selling price of the first residence.

In cases where the replacement is built or reconstructed, only so much of the cost is to be counted as an offset against the selling price of the old residence as is properly chargeable against capital account within a period beginning 1 year prior to the date of the sale of the old residence and ending 18 months (1 year under the House bill) after such date in the case of construction of a new house, and 12 months after such date in the case of reconstruction of an existing house.

This special treatment is not limited to the "involuntary conversion" type of case, where the taxpayer is forced to sell his home because the place of his employment is changed. While the need for relief is especially clear in such cases, an attempt to confine the provision to them would increase the task of administration very much.

The adjusted basis of the new residence is to be reduced by the amount of gain not recognized upon the sale of the old residence. Thus, if the replacement is purchased for $19,000, the old residence cost $10,000 and was sold for $15,000, the adjusted basis of the new residence is to be $19,000 minus $5,000, or $14,000. This is equal to the cost of the old residence plus the additional funds invested at the time the new residence is purchased. If the second residence had been purchased for $14,000, so that $1,000 of gain on the sale of the old residence would be recognized, its basis would be $14,000 minus $4,000, or $10,000.

For the purpose of qualifying a gain as a long-term capital gain the holding period of the residence acquired as a replacement in a set of transactions which qualify under the terms of the amendment is to be the combined period of ownership of the successive principal residences of the taxpayer.

The new provision extends to cases in which similar treatment is available under existing law under the involuntary-conversion provisions of section 112 (f). Such cases arise when a home is destroyed by fire or is lost by seizure or by the exercise of the powers of requisition or condemnation and the proceeds are invested in a replacement. In such cases the new provision, and not section 112 (f), is to apply. Generally this will result in more favorable treatment for the taxpayer than that available under the involuntary-conversion provisions. The latter require the tracing of the expenditure of the funds obtained as a result of the loss of the previous residence, and substantial tax consequences result from such technicalities as a decision to use the money so received to repay a mortgage on the previous residence and to use other funds for the purchase of a replacement. Moreover, no relief is available under the involuntary-conversion sections in cases where the replacement is acquired before the actual condemnation or requisition of the previous residence.

The taxpayer is not required to have actually been occupying his old residence on the date of its sale. Relief is to be available even though the taxpayer moved into his new residence and rented the old one temporarily before its sale. Similarly, he may obtain relief even though he rents out his new residence temporarily before occupying it.

The special treatment is to be available only with respect to one sale or exchange per year, except when the taxpayer's new residence is involuntarily converted, in which case he is to be treated as though a year had elapsed since the time of the previous sale of an old residence.

The ownership of stock in a cooperative apartment corporation is to be treated as the equivalent of ownership of a residence, provided the purchaser or seller of such stock uses the apartment which it entitles him to occupy as his principal residence.

Regulations are to be issued under which the taxpayer and his spouse acting singly or jointly may obtain the benefits of the bill even though the spouse who sold the old residence was not the same as the one who purchased the new one, or the rights of the spouses in the new residence are not distributed in the same manner as their rights in the old residence. These regulations are to apply only if the spouses consent to their application and both old and new residence are used by the taxpayer and his spouse as their principal residence.

Where the taxpayer's residence is part of a property also used for business purposes, as in the case of an apartment over a store building or a home on a farm, and the entire property is sold, the provisions of both bills apply only to that part of the property used as a residence, including the environs and outbuildings relating to the dwelling but not to those relating to the business operations.

These provisions apply to a trailer or houseboat if it is actually used as the taxpayer's principal residence.

In order to protect the Government in cases where there is an unreported taxable gain on the sale of the taxpayer's residence, either because he did not carry out his intention to buy a new residence or because some of the technical requirements were not met, the period for the assessment of a deficiency is extended to 3 years after the taxpayer has notified the Commissioner either that he has purchased a new residence, or that he has not acquired or does not intend to acquire a new residence within the prescribed period of time.

The benefits of both your committee's bill and the House bill will apply to the sale of a taxpayer's principal residence made after December 31, 1950.

The revenue loss will be about $112 million annually.

6. Percentage depletion

Under existing law depletion based on cost is available to all mining industries and in addition percentage depletion is available to oil, gas, sulfur, metal mines, and certain nonmetallic minerals. The allowable rate of percentage depletion is 5 percent in the case of coal, and 15 percent in the case of the other nonmetallic minerals except sulfur which is allowed 23 percent.

The testimony received by this committee both in connection with this bill and the bill which became the Revenue Act of 1950 revealed that in a number of cases nonmetallic minerals which are not in the enumerated group under existing law are competitive with those receiving percentage depletion, or have just as good a claim for such treatment as the enumerated minerals. The testimony also indicated that the 5-percent rate allowed coal is of little practical value, and that the coal mining industry is peculiarly in need of more favorable tax treatment because of the inroads which alternative sources of energy, particularly oil and gas, have made on the potential markets of coal.

Both section 319 of your committee's bill and section 304 of the House bill set up a new group of minerals to which percentage depletion is available at the rate of 5 percent. Both bills extend this rate to sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, and marble. In addition, your committee has added to this category entitled to the 5-percent rate sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, potassium chloride, and bromine. In the allowance of percentage depletion for these items, your committee does not intend to reduce allowances now granted. For example, potash is allowed percentage depletion at 15 percent under present law, and your committee does not intend to reduce this allowance with respect to potash or any of its salt derivatives which are presently receiving percentage depletion at 15 percent. The bill also makes a technical change in this portion of the House provision by including slate as a separate item rather than including it as a type of stone as in the House bill.

The House bill also included asbestos at the new 5-percent rate. Because of the importance of this product and the smallness of its supply in this country, your committee has allowed asbestos a 10-percent rate. Both bills increase coal from its present 5-percent rate to 10 percent.

The House bill added to the list of nonmetallic minerals, to which percentage depletion is available at a 15-percent rate, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, and metallurgical and chemical grade limestones. Your committee's bill, on the other hand, provides that these items added by the House are to receive percentage depletion at the same 10-percent rate accorded coal and asbestos. In addition to these items, your committee has added a 10-percent rate for wollastonite, which is important as an insulating and fireproofing material and thus competitive with other items presently accorded similar treatment, and the magnesium compounds magnesite, dolomite, and brucite.

Your committee's bill adds to the nonmetallic minerals presently receiving 15-percent depletion, aplite. This material, which is found in only small quantities in this country, is closely related to feldspar, which already receives 15-percent depletion.

Your committee has also made two technical revisions in the 15-percent depletion section of the House bill. The latter includes at the 15-percent rate "thenardite (including thenardite from brines or mixtures of brine)." Your committee has eliminated the parenthetical limitation as unnecessary and because it might give rise to doubt as to certain other of the enumerated products. For example potash, trona, and borax are also frequently recovered from brines or mixtures of brine. The phrase "mines and other natural deposits" is clearly broad enough to include brines as well as all other natural sources. The particular type of source is immaterial.

The names of all the various enumerated minerals are of course intended to have their commonly understood commercial meaning. For example, the term "thenardite" applies to sodium sulphate, also known as salt cake; the term "trona" to sodium carbonate and sodium bicarbonate, also known as soda ash; and the term "borax" to boron minerals generally.

Your committee has also amended the House provision which reads "ball and sagger clay" to read "ball clay, sagger clay" in order to remove the implication of the House bill that these are not separate types of clay.

Many of the above changes were provided in the House version of the bill which became the Revenue Act of 1950 but they were eliminated by your committee and from the final legislation largely because of the revenue loss involved. It is apparent, however, that the need for equalization is substantially greater now because of the additional taxes imposed under the legislation of 1950 and under this bill. Therefore, the committee believes that the proposed extension of the percentage depletion system is necessary in spite of the revenue loss involved. The latter is estimated to be about $76 million in a full year's operation.

The amendments made by this section of the bill apply to taxable years beginning after December 31, 1950.

7. Family partnerships

Section 339 of your committee's bill is intended to harmonize the rules governing interests in the so-called family partnership with those generally applicable to other forms of property or business. Two principles governing attribution of income have long been accepted as basic: (1) income from property is attributable to the owner of the property; (2) income from personal services is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee. Your committee's amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.

Although there is no basis under existing statutes for any different treatment of partnership interests, some decisions in this field have ignored the principle that income from property is to be taxed to the owner of the property. Many court decisions since the decision of the Supreme Court in *Commissioner* v. *Culbertson* (337 U. S. 733) have held invalid for tax purposes family partnerships which arose by virtue of a gift of a partnership interest from one member of a family to another, where the donee performed no vital services for the partnership. Some of these cases apparently proceed upon the theory that a partnership cannot be valid for tax purposes unless the intrafamily gift of capital is motivated by a desire to benefit the partnership business. Others seem to assume that a gift of a partnership interest is not complete because the donor contemplates the continued participation in the business of the donated capital. However, the frequency with which the Tax Court, since the *Culbertson* decision, has held invalid family partnerships based upon donations of capital, would seem to indicate that, although the opinions often refer to "intention," "business purpose," "reality," and "control," they have in practical effect reached results which suggest that an intrafamily gift of a partnership interest, where the donee performs no substantial services, will not usually be the basis of a valid partnership for tax purposes. We are informed that the settlement of many cases in the field is being held up by the reliance of the field offices of the Bureau of Internal Revenue upon some such theory. Whether or not the opinion of the Supreme Court in *Commissioner* v. *Tower* (327 U. S. 280) and the opinion of the Supreme Court in *Commissioner* v. *Culbertson* (337 U. S. 733), which attempted to explain the *Tower* decision, afford any justification for the confusion is not material—the confusion exists.

The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of *Helvering* v. *Clifford* (309 U. S. 351). The same standards apply in determining the bona fides of alleged family partnerships as in determining the bona fides of other transactions between family members. Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny. All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.

Not every restriction upon the complete and unfettered control by the donee of the property donated will be indicative of sham in the transaction. Contractual restrictions may be of the character incident to the normal relationships among partners. Substantial powers may be retained by the transferor as a managing partner or in any other fiduciary capacity which, when considered in the light of all the circumstances, will not indicate any lack of true ownership in the transferee. In weighing the effect of a retention of any power upon the bona fides of a purported gift or sale, a power exercisable for the benefit of others must be distinguished from a power vested in the transferor for his own benefit.

Since legislation is now necessary to make clear the fundamental principle that, where there is a real transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which actuated the transfer, it is considered appropriate at the same time to provide specific safeguards—whether or not such safeguards may be inherent in the general rule—against the use of the partnership device to accomplish the deflection of income from the real owner.

Therefore, the bill provides that in the case of any partnership interest created by gift the allocation of income, according to the terms of the partnership agreement, shall be controlling for income-tax purposes except when the shares are allocated without proper allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the allocation to the donated capital is proportionately greater than that attributable to the donor's capital. In such cases a reasonable allowance will be made for the services rendered by the partners, and the balance of the income will be allocated according to the amount of capital which the several partners have invested. However, the distributive share of a partner in the earnings of the partnership will not be diminished because of absence due to military service.

When more than one member of a family is a member of a partnership, all interests purchased by one member of the family from another will be treated as though the transfer were made by gift. For this purpose the family of an individual includes his spouse, ancestors, lineal descendants, and any trust for the primary benefit of such persons.

The amendment made by the House bill was made applicable only to taxable years beginning after December 31, 1950, with the express intention that no inferences were to be drawn from the enactment of the amendment with respect to taxable years beginning prior to January 1, 1951. Apparently with respect to prior taxable years the House amendment would have left the status of family partnerships to be determined under existing law. As the above discussion clearly indicates, the application of existing law has been extremely uncertain. Your committee believes that it is equally important to establish a rule which can be used with respect to those prior years, thus minimizing the necessity for litigation in this area. Therefore, your committee has provided that the amendment shall, at the election of any member of such a partnership, be effective with respect to any open taxable year since December 31, 1938, that date being just prior to the enactment of the Code. Such an election will be valid only if any other members of the partnership whose taxable income would be increased consents to the assessment and collection of such deficiency, or if the taxpayer who would be entitled to a refund or reduction of his tax liability consents to the reduction of such refund or tax decrease by the amount of the related taxpayer's additional tax.

8. Gains from sales of livestock

Section 117 (j) of the code provides, in effect, that a net gain from sales of "property used in the trade or business" of a taxpayer and held for more than 6 months is to be treated as a capital gain. In the case of a loss, it is to be treated as an ordinary loss. However, section 117 (j) states that this treatment is not to apply to "property of a kind which would be properly includible in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." In the case of farmers there has been considerable confusion and dispute for several years as to whether all livestock held for draft, dairy, or breeding purposes is "property used in the trade or business," or whether in some cases the livestock should be deemed held "primarily for sale to customers in the ordinary course of his trade or business."

Rulings of the Treasury Department issued in 1944 and 1945 held that the capital gains treatment was applicable only in the case of unusual sales such as those which would reduce the normal size of the herd or those resulting from a change of breed or other special circumstances, and that the capital gains treatment would not apply to the customary sale by a farmer of old or disabled animals culled from the breeding herd and replaced by young animals produced by the breeding herd. Early in 1949 the United States Court of Appeals, Eighth Circuit, held in the *Albright* case (173 F. 2d 399) that animals used for breeding purposes, whether or not sold as culls in the ordinary course of business, constituted "property used in the trade or business" within the meaning of section 117 (j). That decision specifically applied to dairy cattle and hogs but was applicable by implication to other types of livestock.

Notwithstanding the *Albright* decision, the Treasury Department continued to adhere to its position initiated in the 1944 and 1945 rulings, pending possible contrary decisions in other courts which might result in a conclusive decision by the Supreme Court. The Revenue Act of 1950 as passed by the Senate contained a provision intended to clarify this situation, but this was rejected in conference, principally because it referred to "cattle" and thus did not clear up the situation with respect to other forms of livestock such as sheep and hogs. However, the conference committee expressed the hope that the Treasury would follow the *Albright* decision.

In January 1951 the United States Court of Appeals, Fifth Circuit, decided the *Bennett* case (186 F. (2d) 407) in a manner similar to the *Albright* decision. Subsequently the Bureau of Internal Revenue issued a ruling, Mim. 6660, stating that the capital gains treatment provided by section 117 (j) would be applied to sales of culls. However, this ruling contained a statement that this treatment might not be applied in the case of animals "not used for substantially their full period of usefulness." This exception appears to have resulted in new uncertainties, and it has been stated that Bureau agents are interpreting this ruling to mean that only animals which have completely outlived their usefulness can qualify for the capital gains treatment.

The House bill added a new sentence to section 117 (j) (1) providing that the term "property used in the trade or business" includes "livestock held by the taxpayer for draft, breeding, or dairy purposes for 12 months or more." In view of the uncertainties resulting from the recent ruling (Mim. 6660), section 324 of your committee's bill restates the sentence contained in the House bill as follows:

Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition.

Under your committee's bill, the term "livestock" does not include poultry except that it does include turkeys, regardless of age, held by the taxpayer for breeding purposes and held for 12 months or more from the date of acquisition. Thus section 117 (j) will apply to livestock used for draft, breeding, or dairy purposes, and to turkeys used for breeding purposes, whether old or young; and the holding period will start with the date of acquisition, not with the date the animal or fowl is put to such use.

The provision of the House bill is effective with respect to taxable years beginning after December 31, 1950. Your committee's bill makes the amendment applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months and the amendment with respect to poultry and turkeys both apply only in the case of taxable years beginning after December 31, 1950.

Your committee believes that the gains from sales of livestock should be computed in accordance with the method of livestock accounting used by the taxpayer and presently recognized by the Bureau of Internal Revenue.

The revenue loss under this provision is expected to be $15 million in a full year of operation.

9. Coal royalties

Section 325 of your committee's bill, which is similar to section 307 of the House bill, provides tax relief for the recipients of coal royalties. Most leases on coal properties are long-term and call for royalty payments expressed in cents per ton. Therefore, the lessor does not receive the automatic adjustment for price changes which occurs when a royalty is expressed as a percentage of the value of the mineral extracted from the property. Many of the existing coal leases are old and their royalty payments are small.

It is reported also that as a practical matter the lessor of a coal property is not likely to benefit from percentage depletion even under the new 10-percent rate provided in this bill, although it is anticipated that this rate will be of material benefit to the coal operators.

This section extends to the recipients of coal royalties the capital gains treatment now available to timber under section 117 (k) (2) of the code. It is intended by this provision of your committee's bill that coal royalties receive the same treatment as timber royalties. In the case of timber coming under this section, percentage depletion is not allowed, and it also is not to be available in the case of these coal royalties.

Considerable uncertainty now exists as to the proper interpretation of the clause "held for more than 6 months prior to such disposal" in section 117 (k) (2) of the present law, because of a recent decision of the Tax Court (*Springfield Plywood Corp.*, 15 T. C. No. 91) which held, under the particular facts in that case, that disposal of the timber occurred when the lease was made and not when the timber was cut. Your committee believes that, whatever the legal technicalities may be, the lessor's holding period should run to the time the coal is mined or the timber is cut, as the case may be, and the provisions of the House bill are amended to so provide.

In order to differentiate a lessor entitled to receive royalties from a person participating in the operation of a mine, the provisions of the House bill are inapplicable if the owner of the coal is "personally obligated to pay a share of the cost of mining operations." Since lessors who have no interest in the operating profits of a mine may nevertheless pay real estate taxes, exploration expenses, or other expenses, your committee's bill provides, instead, that those provisions shall be inapplicable to "income realized by the owner as a coadventurer, partner, or principal in the cutting of such timber or the mining of such coal."

It is also made clear that these provisions do not apply to a lessee, and that the term "coal" includes lignite.

Because treatment of coal royalties as capital gains will automatically exclude such income from income subject to excess-profits tax, your committee's bill provides conforming amendments to the excess profits tax law. Where the taxpayer computes his excess profits credit by the income method, these royalties are to be excluded from the taxpayer's base period income. Similarly, for the purposes of computing the invested capital credit and computing capital changes, the lessor's interest in the coal property from which the royalties are derived is to be treated as an inadmissible asset.

Section 325 applies to taxable years ending after December 31, 1950, but only with respect to amounts received or accrued after that date.

The revenue loss involved is estimated to be about $10 million annually.

10. Expenditures in the development of mines

Under existing law and regulations all expenditures made with respect to a mine prior to the time it has reached the production stage must be capitalized, except that incidental income from the production of ore while the mine is being developed is offset by development expenditures, only the excess of such expenditures over such receipts being capitalized. Amounts so capitalized are deductible for income-tax purposes only through depletion allowances.

Included in the expenditures which must be so capitalized are the costs of shafts, tunnels, galleries, etc., which are necessary to make the ore or other mineral accessible. Such expenditures are required to be capitalized only until the mine reaches the production stage, which occurs when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

After a mine reaches this production stage continued expenditures must be made to extend tunnels, galleries, etc., as the working face of the ore or other mineral recedes. Such expenditures are deductible currently, unless extraordinary in scope, in which case they are treated as prepaid expenses to be deducted ratably as the ore benefited by the expenditure is produced and sold.

It is believed that the expenditures for the development of a mine—those incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed—are essentially similar to those incurred after the production stage has been reached, and, like those, should be treated as expenses relating to the production of the ore or minerals.

This is particularly important where the depletion allowance is a percentage of the gross income from the property. This allowance is the same whether a large expenditure or a relatively small one is necessary to develop the mine in order to enable the ore or mineral to be extracted, with the result that mines with relatively large development costs are subjected to unfair discrimination. Moreover, where percentage depletion is used, the development costs are never specifically deductible for tax purposes, except in years when the deduction available under cost depletion exceeds that which may be taken under percentage depletion.

The requirement that development expenditures must be capitalized presents a serious obstacle to expansion in the mining industry. This is especially serious at the present time because of the shortage of many essential minerals and the desirability of major developments in the case of certain minerals such as iron which are necessary to the defense effort.

The House bill provides that expenditures paid or incurred after December 31, 1950, in the development of a mine or other natural deposit are to be deductible ratably over the period during which the ores or minerals benefited by such expenditures are sold. This provision applies even though the ore or minerals were produced in a year other than the year of the sale. However, this rule applies only when the expenditures are made after the existence of ores or minerals in commercially marketable quantities has been determined and the development stage has begun. It is not applied to oil or gas wells, where the problem at issue has been dealt with through the optional deduction of intangible drilling and development costs in the year they are incurred.

Expenditures made for the purchase of depreciable property are not to be counted as development expenditures for this purpose but the depreciation charges which appear as the result of the use of such property for development purposes may qualify for such treatment as development costs.

Expenditures made for development will continue to increase the adjusted basis of the mine for computing gain or loss as under existing law; however, this basis will then be reduced as the deductions allowable under this provision of the House bill occur. Although thus included in the adjusted basis for the purpose of computing a gain or loss from a sale, in order to prevent duplication of tax benefits, such development expenditures are not to be taken into account in determining the adjusted basis of the property for the purpose of computing depletion based upon costs.

Your committee's bill retains the principle of the House bill. However, section 309 of your committee's bill provides that the taxpayer may elect either to deduct development expenditures, whether incurred before or after the production stage has been reached, in the year when they are incurred, or to treat development expenditures incurred before the production stage has been reached as deferred expenses, to be deducted ratably as the ore or mineral is sold. This second alternative is the same as under the House bill. Such an election may be made for each year, but must be for the total amount of net development expenditure made in that year with respect to the mine. As under the House bill, if the taxpayer elects to defer development expenditures the amount so deferred will be included in the basis of the mine for the purpose of determining a gain or loss on its sale, and the basis will be reduced as the deductions, allowable when ore or mineral is sold, are made.

Your committee's bill also provides that if the taxpayer elects to defer the deduction of development expenditures incurred during the development stage, the amount to be so deferred in any year will be the excess of the development expenditures in that year over the net receipts during that year from the ores or minerals produced.

This provision of your committee's bill is effective with respect to taxable years beginning after December 31, 1950.

It is estimated that in a full year's operation this provision will involve a revenue loss of about $20 million annually.

11. Venture capital companies

Section 336 of this bill will permit certain so-called venture capital companies to qualify as regulated investment companies. Under Supplement Q of the code, regulated investment companies which distribute currently at least 90 percent of their income, and meet certain other tests set out in section 361 (b) of the code, are not taxed upon amounts distributed to shareholders. One of these tests is that the company must not invest more than 50 percent of its assets in companies in which it holds more than 10 percent of the value of the voting securities. This rule has the effect of denying special treatment to companies which undertake to control the enterprises in which the bulk of their funds are placed. It clearly excludes a holding company in the ordinary sense of the word.

It has been brought to the attention of this committee that the 10 percent stock-ownership limitation constitutes a serious impediment to the development of so-called venture capital companies. These are investment companies which are used principally to provide capital for other companies engaged in the development or exploitation of inventions, technological improvements, new processes and products which were not previously generally available. In such cases the investment company must provide most of the capital needed to finance the venture and will frequently hold more than 50 percent of its assets in stock representing more than 10 percent of the voting stock of the operating companies. As a result, it cannot qualify under Supplement Q if it invests more than 50 percent of its assets in such companies. Unless this rule is amended, it will not be possible for an investment company to devote itself principally to the development of such ventures and obtain the benefits of Supplement Q.

The venture capital company promises to serve as an instrument for directing an increasing portion of the current savings of the country into the small, innovating ventures which are so important for long-run economic progress. Therefore, section 336 of this bill amends section 361 of the code so as to permit venture capital companies to qualify as regulated investment companies. This is accomplished by waiving, under certain conditions, the 10 percent limitation as to certain types of holdings. To qualify for this exception the investment company must obtain a certification from the Securities and Exchange Commission which states that the investment company is a registered management investment company as defined in the Investment Company Act of 1940 and that its principal business is the furnishing of capital to companies principally engaged in the development or exploitation of inventions, technological improvements, new processes or products not previously generally available. This certification will be made under regulations to be issued by the Securities and Exchange Commission.

To forestall the possibility that this amendment will permit holding companies to obtain the benefits of Supplement Q, the bill also provides that the 10 percent rule shall not be waived in the case of an investment company which, at the close of the taxable year, has more than 25 percent of its funds invested in companies, the securities of which it has held for more than 10 years.

All the other limitations on regulated investment companies now imposed under Supplement Q are retained.

The House bill contains a provision which is substantially identical with section 336 of your committee's bill. Only minor, technical changes have been made in the House provision.

Section 336 is effective with respect to taxable years beginning after December 31, 1950. The revenue effect of this provision is negligible.

12. Additional withholding upon agreement by employer and employee

Frequently concern is expressed by taxpayers with income above the first surtax bracket because the entire amount of tax due is not withheld from their wages or salaries. They dislike the necessity of making a payment with their declaration of estimated tax in March, or the necessity of making quarterly payments. However, it is not feasible to establish a system of general application which will withhold the total tax due in all cases, because, as a result of such factors as variations in deductions and income not subject to withholding, the additional tax due differs widely from case to case.

In individual instances, however, where the taxpayer can estimate quite accurately the amount of the additional tax due and the employer finds the additional withholding is not burdensome, a voluntary system is feasible and would be a convenience to the taxpayer. For these reasons section 203 of your committee's bill, which is the same as section 223 of the House bill, amends section 1622 of the code to provide that additional withholding may be authorized by regulation where the employer and employee agree to it. No additional revenue is expected to be provided by this provision.

B. Provisions Added by Your Committee

1. Additional allowance for certain members of the Armed Forces

The Revenue Act of 1950 added a new section 22 (b) (13) to the code which excludes from taxable income the compensation of members of the Armed Forces of the United States received for active service in combat zones such as Korea. This exclusion covers all the pay of enlisted men and warrant officers and the first $200 per month paid to commissioned officers. The present exclusion only applies to services performed after June 24, 1950, and prior to January 1, 1952.

Section 305 of your committee's bill makes two changes in the existing provision. First, the exemption is extended for 2 years beyond the present termination date to January 1, 1954. Second, the exemption is extended to include the compensation of military personnel received while hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone.

These amendments will result in a revenue loss of $10 million annually until 1954.

The amendments made by your committee to section 22 (b) (13) are applicable to taxable years ending after June 24, 1950.

2. Sales of land with unharvested crops

Section 117 (j) of the code provides, in effect, that a net gain from sales of properties "used in the trade or business" of the taxpayer, including "real property" so used, if held more than 6 months is to be treated as a capital gain. In the case of a net loss, it is treated as an ordinary loss. Where unharvested crops are sold with the land, or unripe fruit is sold together with the land and the trees, a difficult question has arisen as to the proper application of the present law to the unharvested crops or the unripe fruit.

The Bureau of Internal Revenue has ruled that, whether or not such crops or fruit are regarded as a part of the real estate under local law, they constitute property held "primarily for sale to customers in the ordinary course of his (the taxpayer's) trade or business" and thus, under the provisions of section 117 (j), any gain on the sale of the unharvested crops or unripe fruit is to be separately determined and treated as ordinary income instead of as a capital gain. In several decisions the Tax Court (with some members dissenting) has taken a similar view, but two district courts have held that such fruits or crops constitute "property used in the trade or business" so that a gain from a sale of the land, trees, and fruit would be treated as a capital gain with the result that the entire gain from the sale of such property would constitute ordinary income.

Your committee believes that sales of land together with growing crops or fruit are not such transactions as occur in the ordinary course of business and should thus result in capital gains rather than in ordinary income. Section 323 of the bill so provides.

Your committee recognizes, however, that when the taxpayer keeps his accounts and makes his returns on the cash receipts and disbursements basis, the expenses of growing the unharvested crop or the unripe fruit will be deducted in full from ordinary income, while the entire proceeds from the sale of the crop, as such, will be viewed as a capital gain. Actually, of course, the true gain in such cases is the difference between that part of the selling price attributable to the crop or fruit and the expenses attributable to its production. Therefore, your committee's bill provides that no deduction shall be allowed which is attributable to the production of such crops or fruit, but that the deductions so disallowed shall be included in the basis of the property for the purpose of computing the capital gain.

The provisions of this section are applicable to sales or other dispositions occurring in taxable years beginning after December 31, 1950.

The revenue loss under this provision is expected to be about $3 million annually.

3. Elections to file joint or separate returns and to use the standard deduction

Under section 51 of the code, married taxpayers may file either separate returns or a single joint return. The election, once made, as to which type of return to file is binding with respect to the taxable year for which the return is filed.

Section 23 (aa) of the code permits an individual the use of an optional standard deduction in lieu of itemizing his deductions. The election to use either of these methods of handling deductions is likewise binding upon the taxpayer for the taxable year with respect to which the option is exercised.

As a proper election frequently requires informed tax knowledge not possessed by the average person, the binding elections referred to above may result in substantially excessive taxes. This result of making an improper election is particularly apt to occur during a period of high tax rates such as the present.

Your committee's bill contains two amendments directed at this problem. Section 312 of the bill provides that married individual income taxpayers who file separate returns may exercise the right to change their election and file joint returns at any time within the period of the statute of limitations. This provision is effective with respect to taxable years beginning after December 31, 1950. Section 308 of the bill also provides that individuals who have used the standard deduction when filing their return may substitute itemized deductions at any time within the period of the statute of limitations. Moreover, taxpayers who have itemized their deductions are also to have the option to amend their return within the same period in order to take advantage of the standard deduction. This provision is effective with respect to taxable years beginning after December 31, 1949.

It is anticipated that the revenue loss from these amendments will be negligible.

4. Pensions

Under section 165 of the code, payments made from an employees' retirement fund are taxable to the recipient as received. It has been reported to your committee that life insurance agents have been denied the benefits of this section because of a ruling that they are not technically "employees" for the purposes of the provision. As a result the entire lump-sum value of the pension in excess of any amount contributed to the fund by the employee is taxable as income of the agent in the year he retires when his right to his share of the company's contributions becomes nonforfeitable. Your committee believes this treatment to be inequitable, particularly inasmuch as Congress provided specifically that full-time life insurance agents are to be employees for social security purposes. Therefore, section 343 of the bill amends section 3797 (a) of the code to extend the benefits of section 165 to life insurance agents who are employees for social security purposes.

This amendment is effective with respect to taxable years beginning after December 31, 1948.

The revenue loss from this amendment will be negligible.

A case has also been brought to the attention of your committee in which an association providing retirement benefits desires to invest a portion of its funds in common stocks, thus providing for a hedge against inflation. A question has arisen as to whether the variable payments which will be made from this fund will qualify for section 165 treatment. It is reported that in the past such treatment has been limited to those retirement plans wherein the annuity contracts provide for the payment of fixed amounts. Your committee understands that treatment as annuities of payments which vary in amount is to be provided administratively under present law, thus permitting the recipients of these annuities to be taxed on the amounts as received instead of being taxed on the lump-sum value of the annuity at the time payments begin. The revenue effect of this provision is negligible.

5. Stock distributions of profit-sharing plans

Section 165 (b) of the code provides for the taxation of distributions to employees from exempt pension and profit-sharing funds. As a rule both the employee and the employer contribute to such funds. The amounts so contributed are then invested, usually in the stock of the employer company. Such amounts may or may not be credited to the accounts of individual employees at the time the purchases of stock are made. At the time that the total distributions payable with respect to any employee are paid to him within one taxable year on account of his separation from service, he is taxable at capital gain rates upon the entire value of the stock which was contributed by his employer. This is likewise true of any uninvested cash contributed to his account by the employer. The value of the withdrawal for tax purposes under present law is the sum of this uninvested cash and the market price of the stock at the time of withdrawal. It is frequently the case that the price the fund paid for the stock was substantially less than the current market price that is used in determining the taxable value of the employee's withdrawal. This results in the employee's being taxed on the amount of company contribution, the fund earnings, and any increase in the value of stock which was purchased for his account. Therefore, where companies select this method of providing for their employees' retirement rather than through the purchase of annuities, this accumulated value of the employer's contribution in the fund is bunched in one taxable year, thus subjecting it to tax in higher surtax brackets.

Your committee believes that the present tax on the stock appreciation in such cases substantially reduces the employees' profit-sharing accumulation and thus his retirement income. This is a discrimination against those employees who select this method of providing for their old age.

Therefore, section 334 of your committee's bill provides that in the case of such distributions consisting of stock in the employer corporation the appreciation in the value of the stock contributed by the employer which has arisen since being deposited in the fund is not to be subject to capital-gain tax until the employee sells the stock, rather than at the time it is distributed to him as under present law. This amendment makes no change in the present tax treatment of that portion of the value of such stock which does not represent appreciation in value.

This amendment applies to distributions made after December 31, 1950.

The revenue loss from this amendment will be negligible.

6. Death benefits to employees

Section 22 (b) (1) of the code excludes from gross income amounts received under a life-insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise. However, by its terms, this provision is limited to life-insurance payments, and the exclusion does not extend to death benefits paid by an employer by reason of the death of an employee. In order to correct this hardship, section 302 of your committee's bill excludes from gross income death benefits not in excess of $5,000 paid by any one employer with respect to any single employee's beneficiary or beneficiaries in accordance with a preexisting contract. The limitation of the exclusion to payments not in excess of $5,000 will prevent abuses under this new provision.

This provision is effective with respect to taxable years beginning after December 31, 1950.

The revenue loss from this amendment will be negligible.

7. Termination payments to employees

Some employment contracts provide for payments to the employee after the employment period, based on a share of future profits or a percentage of future gross receipts. Such payments when received are taxed under present law as ordinary income, inasmuch as they are in the nature of payments of additional compensation. However, if the employee chooses to receive a lump-sum payment in lieu of the contract rights upon termination of his employment, the entire lump sum is included in one year's income. The result may be to place the employee in an unusually high surtax bracket. Your committee believes this present treatment of such lump-sum settlements to be unduly harsh in view of the fact that the employee may not wish to leave his retirement income dependent upon the operation of the business subsequent to the severance of his connection with it.

As a result, section 328 of the bill provides, with certain restrictions, for capital-gain treatment of amounts received by an employee, upon termination of his employment, in exchange for his release of all of his rights to receive a percentage of future profits or receipts. This provision is limited to cases where the taxpayer has been employed for more than 20 years and has held such rights to future profits or receipts for at least 12 years.

This provision is effective with respect to taxable years beginning after December 31, 1950.

The revenue loss from this amendment will be negligible.

8. Restricted stock options

The Revenue Act of 1950 added a new section 130A to the code, which provides that the granting to employees of certain types of stock options will not give rise to taxable income to the recipient. To be excluded under this provision the option must fall within a defined category of "restricted stock options."

Section 130A requires that to qualify as a "restricted stock option" the option price at the time of the granting must be 85 percent or more of the fair market value of the stock. Ordinarily, when an option is used as an incentive device, the option price approximates the fair market value of the stock at the time the option is granted. The 15-percent leeway is allowed because many stocks are not listed on exchanges and therefore, the fair market value is difficult to determine. It has come to the committee's attention that the operation of the 85-percent limitation has resulted in a hardship in one respect. In many cases, the granting of stock options is subject to ratification by the corporation's stockholders. Thus, at the time of the action by a corporation's board of directors the option may be fully qualified as to the 85-percent limitation, but because of the delays typically incident to action by a corporation's shareholders, the fair market price may have so changed by the time of their ratification that the option no longer qualifies under the statute.

In order to correct this harsh operation of the present provision, section 330 of your committee's bill provides that the date of the granting of a restricted stock option which is subject to stockholder ratification shall be determined as if the option had not been subject to such approval.

This amendment will be effective as if it had been enacted as part of the stock option provision of the Revenue Act of 1950.

9. Medical expenses

Section 23 (x) of the code permits the deduction of a taxpayer's medical expenses only to the extent that such expenses exceed 5 percent of the taxpayer's adjusted gross income.

Section 307 of your committee's bill removes this 5-percent limitation for any taxpayer, if either the taxpayer or his spouse is aged 65 or over, but only with respect to the medical expenses of such taxpayer and his spouse. Persons in that age bracket have generally reached a period of lowered earning capacity. These same individuals typically are confronted with increased medical expenses. Disallowance of the deduction of many of these expenses under present law merely serves to accentuate this existing hardship.

This bill does not affect the maximum limitations of present law on the amount of the deduction.

This provision of your committee's bill is effective with respect to taxable years beginning after December 31, 1950.

It is estimated that the provision will involve a loss of revenue of about $15 million in a full year of operation.

10. Redemption of stock to pay death taxes

The Revenue Act of 1950 amended section 115 (g) of the code to provide that the redemption of stock in a decedent's estate in an amount not in excess of the estate, inheritance and succession taxes (including interest) on the estate is, in certain cases, not to be treated as a taxable dividend. Among other requirements, this provision is limited at present to cases where the value of the stock in the corporation comprises more than 50 percent of the value of the net estate of the decedent.

Your committee believes that the latter limitation imposes a hardship on those estates where the stock in a corporation forms a substantial part of the value of the net estate but falls short of meeting the restrictive 50 percent requirement. Therefore, section 320 of the bill extends the benefits of section 115 (g) to cases where the stock comprises more than 25 percent of the value of the decedent's net estate.

This amendment will be applicable only to amounts distributed on or after the date of enactment of the bill.

The revenue loss resulting from this section will be negligible.

11. Basis of joint and survivor annuities included in the gross estate.

Section 113 (a) (5) of the code provides that property acquired by bequest, devise, or inheritance shall have a basis for determining gain or loss equal to its fair market value at the date of the decedent's death or, if the decedent's executor elects the optional valuation date, at a date 1 year after the decedent's death. However, all property which is included in the decedent's gross estate for estate-tax purposes does not take a new basis upon the decedent's death.

A joint and survivor annuity is includible in the decedent's gross estate but is treated as a gift for basis purposes so that, for purposes of gain, it has the same basis as in the hands of the donor. Section 303 of your committee's bill amends sections 22 (b) (2) and 113 (a) (5) of the code to provide that where a joint and survivor annuity is included in the decedent's gross estate, its basis shall be the value of the property included in the estate.

This amendment is to apply only where the decedent dies after December 31, 1950.

No appreciable loss of revenue is anticipated from the amendment.

12. Abatement of income taxes for certain members of the Armed Forces dying in combat zones or as a result of injuries received in such zones

Individuals dying while in active service during World War II as members of the military or naval forces of the United States or other United Nations were forgiven their income tax with respect to the year of the death and the prior year. They also were relieved of unpaid income taxes at the time of their death.

Section 333 of your committee's bill provides similar treatment for members of the Armed Forces of the United States dying while serving in combat zones or while hospitalized as a result of wounds, disease, or injuries incurred while serving in combat zones.

Your committee's bill provides for the forgiving of income tax in the year of death of such individuals and in prior taxable years ending after the commencement of hostilities in Korea. Also, such individuals are relieved of any income taxes for any year unpaid at the date of their death. The provision is effective with respect to individuals dying after the commencement of hostilities in Korea and prior to January 1, 1954.

13. Individuals earning income abroad

Section 116 (a) of the code exempts from income tax citizens of the United States who are bona fide residents of a foreign country with respect to income earned outside the United States, and disallows deductions chargeable against this income. This provision is intended both to encourage citizens to go abroad and to place them in an equal position with citizens of other countries going abroad who are not taxed by their own countries.

However, the present law has two defects which section 321 of your committee's bill corrects. First, the exclusion is allowed only with respect to an "entire taxable year" with respect to which the individual is a bona fide resident of the foreign country. Thus, exemption is denied an individual in his first year abroad unless he becomes a bona fide resident of the foreign country as of January 1. Section 321 of your committee's bill corrects this defect of present law by granting the exclusion with respect to "an uninterrupted period which includes an entire taxable year" with respect to which an individual was a bona fide resident of a foreign country.

In addition, the term "bona fide" residence abroad has been construed quite strictly with the result that many persons who have gone abroad to work even for a relatively long period of time have been unable to meet the test of a "bona fide resident" of a foreign country. Sometimes this has occurred because the nature of the individual's work is such as to make it difficult to establish a "residence" in the more widely accepted use of the term. On other occasions it has resulted from the fact that individuals have gone abroad only for a stated period of time. Examples of this are managers, technicians, and skilled workmen who are induced to go abroad for periods of 18 to 36 months to complete specific projects. Your committee believes, in accord with the point 4 program, that it is particularly desirable to encourage men with technical knowledge to go abroad. As a result your committee has added a paragraph to section 116 (a) of the code providing that income earned abroad by a citizen of the United States who is present in a foreign country or countries for 17 out of 18 consecutive months is to be excluded from income, and that deductions chargeable to such income will be disallowed in computing his Federal income tax.

These two changes made by your committee's bill are effective with respect to taxable years beginning after December 31, 1950.

Your committee's bill also amends section 1621 (a) (8) (A) of the code to provide that there is to be no withholding by the United States where it is reasonable to believe that the income is paid to a person who will qualify for the exclusion on the basis of presence in a foreign country for 17 out of 18 consecutive months. In addition, it provides that there is to be no withholding of income taxes for the United States upon an amount earned for services performed in foreign country if withholding on that amount is required for a foreign country. These changes in your committee's bill are effective as of January 1, 1952, with respect to wages paid on or after that date.

The revenue effect of these provisions is negligible.

14. War losses

Section 127 of the code, in general, authorizes a war loss deduction for property in enemy hands when the United States entered World War II in 1941, for property which later came under enemy control and for property destroyed or seized in the course of military or naval operations. This deduction is limited to the taxpayer's depreciated cost or other basis of the property. Section 127 also provides that if any of the property was recovered, the fair market value of the recovered property, not the amount deducted, is to be taxed as ordinary income to the extent that the deduction resulted in a reduction of tax.

Where only one property was involved, there has been no difficulty with this rule, since in those cases where the fair market value of the recovered property exceeded the amount of the deduction, the value of the recovered property was includible in income only to the extent that the deduction resulted in a reduction in tax. The full fair market value was not included in income in such cases because it was believed appropriate to treat the taxpayer as nearly as possible as if he had held the property throughout the entire period and received no deduction for the temporary loss. In such a case appreciation in the value of the property would not, of course, be subject to tax. However, where the war loss embraces more than one property, the present rule does not always achieve this result. For example, where war loss deductions have been taken for two or more properties, and only one of these properties is recovered, if the recovered property has appreciated in value, the deduction previously taken not only with respect to this property but also with respect to the property not recovered is taken into consideration in determining how much of the fair market value of the property recovered represents a previous reduction in tax. In such a case the effect of the present provision is not to treat the property as if it has been held for the entire period since part or all of the appreciation in value of the property is subject to tax in the year of recovery merely because a deduction had also been taken for another property which has not been recovered.

To correct this situation section 340 of your committee's bill amends section 127 of the code to provide that, at the election of the taxpayer, in the case of war loss recoveries the tax for the year in which the deduction was taken is to be recomputed by reducing the deduction by the amount of the recovered property, taken at its depreciated cost on the date of the loss or its fair market value on the date of the recovery, whichever is lower, and by adding the increase, if any, in the tax so resulting to the tax for the year of the recovery.

The attention of your committee has also been brought to cases where war losses have been realized but no deduction was claimed. In such cases, if other war losses were deducted with a tax benefit, section 127 of the code operates to require the fair market value of the property on the date of the recovery to be included in income in the year of the recovery to the extent not in excess of the beneficial deductions for other war losses. Under section 340 of your committee's bill there would be no tax in the year of the recovery with respect to property for which no deduction was claimed in the year of the loss.

No interest is to be paid or assessed on refunds or deficiencies arising from this provision.

These amendments will have no permanent revenue effect.

15. Foreign tax credit for taxes paid by a foreign subsidiary

Existing law permits a domestic corporation, owning the majority of the voting stock of a foreign corporation, to claim a foreign tax credit for income taxes paid by the foreign corporation to a foreign government with respect to the profits of the foreign corporation which are paid as dividends to the domestic corporation. Your committee believes that the principle established by present law is correct but does not believe that the allowance of the foreign tax credit should be limited to those cases where the domestic corporation owns a majority of the voting stock of the foreign corporation. Irrespective of the proportion of the foreign corporation owned by the domestic corporation, the dividends received by the domestic corporation are equally likely to be affected by the taxes paid to a foreign government. Moreover, several foreign countries prohibit the ownership of as much as 50 percent of one of their domestic corporations by a foreign corporation. Thus, it is impossible for American corporations to operate a foreign subsidiary in these countries and receive the foreign tax credit with respect to dividends paid to them by the foreign corporation which they partially own. Also, in some cases a foreign corporation is owned jointly by two or more domestic corporations, and in such cases either none receive the foreign tax credit or one receives it while the others do not. For these reasons section 331 of your committee's bill amends section 131 (f) (1) of the code to provide that the foreign tax credit is to be allowed if the American corporation owns 10 percent or more of the voting stock of the foreign corporation. The 10 percent limitation is imposed for administrative reasons.

This provision is effective with respect to dividends received during taxable years beginning after December 31, 1950.

Under present law if a foreign subsidiary of an American corporation owns all of the voting stock of another foreign corporation, the dividends received by the American parent with respect to the earnings of the second subsidiary are eligible for a foreign tax credit. However, your committee sees no reason why it is necessary for the first foreign subsidiary of the American corporation to own all of the voting stock of the second foreign subsidiary in order for the American parent corporation to receive the foreign tax credit with respect to dividends paid from the profits of the second foreign subsidiary. On administrative grounds there is a basis for requiring majority ownership, but not complete ownership, of the second foreign subsidiary by the firts foreign subsidairy. Therefore, section 331 of your committee's bill extends the foreign tax credit to apply in the case of dividends received by American corporations in such cases of majority ownership.

These amendments are expected to result in a revenue loss of $30 million in a full year's operation.

This provision is effective with respect to dividends received by a foreign corporation during taxable years beginning after December 31, 1950.

16. Postponement of due date for returns of China Trade Act Corporations

Under present law China Trade Act Corporations are allowed a credit against their income for the net income derived from sources within China with respect to the portion of the stock of the corporation held by Chinese or American shareholders. Also, the corporation must distribute an amount at least equal to the amount of the income tax which ordinarily would be imposed in such cases in order to receive the full credit. As a result of hostilities and unsettled conditions generally in the Far East, it is impossible in many cases for corporations doing business in China to make a distribution of any earnings derived from China or even to know the size of such earnings. For that reason section 613 of your committee's bill amends present law to provide that the Secretary of the Treasury may postpone the due date up to the end of 1953 for the paying of any income tax and the filing of the return with respect to years beginning and ending in the period January 1, 1949, to September 30, 1953, if he deems such deferment reasonable under the circumstances. Since the requirement, that in order to receive the full credit the distribution of earnings derived from China must at least equal the income tax which otherwise would have been paid, need not be met prior to the time the taxes are due and payable, the postponement of the due date also has the effect of permitting the taxpayer to postpone the distribution of earnings.

This provision will have no permanent effect on the revenue.

17. Application of the intercorporate dividends-received credit in the case of resident foreign corporations

Under present law foreign corporations engaged in trade or business within the United States are subject to the regular corporate income taxes with respect to that portion of their income which is derived from sources within the United States. However, where such corporations pay dividends to a United States domestic corporation, no dividends-received credit is allowed the latter, although such credit would be allowed if the domestic corporation were receiving dividends from another domestic corporation. Thus, two full corporate taxes are paid with respect to dividend income received from foreign corporations engaged in trade or business within the United States (to the extent that the dividends are paid out of income derived from sources within the United States), while as a result of the intercorporate dividends-received credit, dividends paid by one domestic corporation to another are subject only to a little more than one full corporate income tax.

To remove this discrimination, section 311 of your committee's bill amends section 26 (b) of the code, relating to the dividends-received credit, to provide that under certain conditions dividends received from foreign corporations engaged in trade or business within the United States are to be eligible for the 85-percent intercorporate dividends-received credit. However, the credit is to be extended only with respect to so much of the income as was earned in the United States. Moreover, the credit is to be made available only with respect to income earned in the United States during an uninterrupted period in which the corporation was engaged in a trade or business within the United States. Also, for administrative reasons the credit is to be made available only where 50 percent or more of the gross income of the foreign corporation was derived from sources within the United States.

This provision of your committee's bill is effective with respect to taxable years beginning after December 31, 1950.

It is estimated that this provision will result in an annual loss of revenue of $1 million.

18. Net operating loss deductions

Section 329 of the bill permits net operating losses of 1948 and 1949 to be carried forward 4 years instead of 2. This provision is necessary in order to reduce the existing disparities in the treatment of different tax years.

The Revenue Act of 1950 provided that the net operating loss for a year may be carried back to offset income of the preceding year and may be carried forward to offset income of the 5 succeeding years. This provision was made effective for losses in 1950 and later years. Losses in years prior to 1950 may be carried back 2 years and carried forward 2 years. The effect of the change in the 1950 act was to permit losses in 1950 and subsequent years to be applied to offset possible income in six other years, whereas losses in 1949 and earlier years could be applied to offset possible income in only four other years.

So far as a taxpayer with income in 1950, 1951, or 1952 is concerned, the 1950 act had the effect of reducing the number of possible loss years whose net operating losses could be applied to offset the 1950, 1951, or 1952 income. This is because a loss in a year subsequent to 1949 may be carried back only 1 year instead of 2 years. For example, a taxpayer with income in 1947 had four potential loss years which might be applied against the 1947 income—1945, 1946, 1948, and 1949—whereas a taxpayer with income in 1950 has only three potential loss years which might be applied against the 1950 income —1948, 1949, and 1951. Also, a taxpayer with income in 1953 or 1954 would not have as many potential loss years which might be applied against his income in those years as a taxpayer with income in 1955 (when the provision in the 1950 act becomes fully effective), since 1953 income may be offset only by 1950, 1951, 1952, and 1954 losses (4 years) and 1954 income may be offset only by 1950, 1951, 1952, 1953, and 1955 losses (5 years), compared with an offset against six potential loss years in the case of income in 1955 and subsequent years.

By permitting 1948 and 1949 losses to be carried forward 4 years, the bill increases to four the number of loss years which may be applied to 1951 income and increases to five the number of loss years which may be applied to the income of 1952 and 1953. No comparable provision appears in the House bill.

Under present law, new corporations formed during the period 1946 to 1949 are at a competitive disadvantage as a result of the existing net operating loss provisions. For example, a corporation formed in 1947 with losses in that year obviously is unable to carry back its losses and can only carry them forward 2 years. A competitor, formed in 1950, can carry forward its losses 5 years to 1955. In order to correct this inequity, the bill provides that new corporations formed in a taxable year beginning after December 31, 1945, which sustain a net operating loss for any taxable year beginning after that date and before January 1, 1950, may carry forward such loss (to the extent not absorbed by a carry-back) for four taxable years, instead of two taxable years as under present law.

These provisions are applicable in computing the net operating loss deduction in taxable years beginning after December 31, 1948.

There will be no permanent revenue loss from these provisions.

19. Corporate reorganizations (spin-offs)

Section 317 of your committee's bill adds a new section 112 (b) (11) of the code to provide for the nonrecognition of gain from the receipt of stock in corporate exchanges carrying out transactions known as spin-offs. A spin-off occurs when a part of the assets of a corporation is transferred to a new corporation and the stock in the latter is distributed to the shareholders of the original corporation without a surrender by the shareholders of stock in the distributing corporations. It is intended that section 317 shall be applicable even though the portion of the business which is spun off is already organized as a separate corporation, with the result that it is the stock of that corporation, rather than the underlying assets, which is transferred to the new corporation whose stock is distributed. For example, if among the assets of corporation A is the stock of a subsidiary corporation B, whether or not wholly or even majority owned, and business reasons exist, unrelated to any desire to make a distribution of earnings and profits to its shareholders, for the separation of the assets consisting of such stock, such separation may be effected without recognition of gain to corporation A or its stockholders by transferring the stock of B to a newly organized corporation C in exchange for its stock, followed by the distribution of C's stock to the stockholders of A without the surrender of their stock.

This section has been included in the bill because your committee believes that it is economically unsound to impede spin-offs which break-up businesses into a greater number of enterprises, when undertaken for legitimate business purposes. A similar provision was concontained in the revenue revision bill of 1948 which passed the House but was not acted upon by the Senate, and a similar provision was included in the Senate version of the bill which became the Revenue Act of 1950.

Section 317 has been drafted so as to limit its benefits to reorganizations in which all of the new corporations as well as the parent are intended to carry on a business after the reorganization and where only stock (other than preferred) is distributed by the corporation or corporations. Nonrecognition of gain has been denied also in cases where the reorganization was principally a device for the distribution of the earnings and profits of the corporations which are parties to the reorganization.

Section 317 of the bill also adds a new section 113 (a) (23) to the code providing that, in the case of stock distributed in a spin-off, the basis of the new stock, and the old stock, respectively, in the shareholder's hands, is to be determined by allocating between the old stock and the new stock the adjusted basis of the old stock.

These provisions of your committee's bill are to be effective with respect to taxable years ending after the date of the enactment of this bill, but are to apply only to distributions of stock made after that date.

The revenue loss resulting from this provision is expected to be small.

20. Back mail pay of railroads

After an application for increased mail pay made by the railroads in February 1947, the Interstate Commerce Commission in December 1947, ordered an interim increase of 25 percent in mail-pay rates effective after February 19, 1947, pending further investigation. Amounts represented by this increase were reported for tax purposes by the railroads in the years in which the services were rendered. On December 4, 1950, the ICC awarded the railroads $312 million in back mail pay for the period from February 19, 1947, through December 31, 1950. Of this amount, about $160 represented the 25-percent increase previously granted on a temporary basis with respect to the services rendered in the period 1947–50, and about $158 million represented an additional increase with respect to those same services.

Your committee believes that this latter amount should receive the same tax treatment as the amount previously granted, inasmuch as both represent compensation for the same services. Therefore, in order to avoid any uncertainty, section 610 of your committee's bill provides that the additional payments authorized by the December 4, 1950, order shall be included in income for the years in which the railroads rendered the services for which the additional payments were made. It is specifically provided that no interest shall be due with respect to any period prior to July 1, 1951, for deficiencies resulting from the inclusion of the additional payments in the back years.

It is estimated that inclusion of these payments in the back years will result in about $10 million less revenue than if they were taxed in the year in which received.

21. Income from discharge of indebtedness

Section 22 (b) (9) of the code excludes from gross income, in the case of a corporation, the amount of income attributable to the discharge of indebtedness evidenced by a bond, debenture, note, certificate, or other evidence of indebtedness. The provisions of this section are temporary under existing law and expire automatically on December 31, 1951. Section 304 of your committee's bill provides for the permanent enactment of the section.

The exclusion provided by section 22 (b) (9) is to be applicable only if the corporation consents to a reduction in the basis of its properties under section 113 (b) (3) in accordance with the regulations then in effect. The reduction of basis under section 113 (b) (3) is in an amount equal to the income excluded under section 22 (b) (9). In the event an amount is excluded from gross income under these provisions, an adjustment is made for unamortized premium or unamortized discount on the discharged obligation.

The Secretary of the Treasury has authority under section 113 (b) (3) to prescribe regulations which will set forth rules under which the adjustment to basis shall be made. Existing regulations (sec. 29.113 (b) (3)-1 of Regulations 111) provide that an amount equal to the excluded income is first to be applied in reduction of the basis of the specific property (other than inventory, notes, or accounts receivable) in the acquisition of which the indebtedness was incurred. The reduction of basis in such case merely reflects an adjustment in the purchase price of the property. The reduction of basis under the regulations is then successively applied to the following classes of property: (1) Property securing the indebtedness, (2) other property of the taxpayer, and finally (3) inventory and accounts and notes receivable. Within these classes, the reduction in basis is applied proportionately to the property included in the class without regard to whether the property is depreciable or nondepreciable. In order to assure that the exclusion of income by operation of section 22 (b) (9) may result only in a temporary postponement of the tax liability, your committee understands that the Secretary of the Treasury will require by regulations that, after adjustment of the basis of certain property acquired with the purchase money indebtedness, whatever reduction in basis of property remains to be taken under section 113 (b) (3) will be taken, in general, against depreciable property or property subject to cost depletion and only as a last resort against nondepreciable property. Thus, in general, it is intended that a reduction in the basis of nondepreciable property will be made only after the exhaustion of depreciable property or property subject to cost depletion. This provision will assure the collection within a reasonable time of the taxes postponed and will, therefore, have no appreciable, long-run effect on the revenue.

Section 304 of your committee's bill makes a technical amendment to section 22 (b) (9) to allow for greater flexibility as to the time for filing the required consent to a reduction of basis. Under the present law, the taxpayer must file its consent with its return for the taxable year. The bill amends the section to provide that the consent shall be filed at such time as the Secretary of the Treasury may prescribe. Under this amendment, the Department could continue to require that the consent be filed with the return in the ordinary case, but might make provision for filing of the consent at a later date in appropriate hardship cases.

Your committee has provided that this amendment shall be effective with respect to taxable years ending after December 31, 1950.

Section 304 of your committee's bill extends for an additional 3-year period the exclusion provided for railroad corporations under section 22 (b) (10) of the code. Section 22 (b) (10) provides that the amount of income attributable to the discharge of any indebtedness of a railroad corporation, as defined in section 77 (m) of the National Bankruptcy Act, shall be excluded to the extent that such income is deemed to have been realized by a modification or cancellation of indebtedness pursuant to an order of the court in a receivership proceeding or a proceeding under section 77 of the National Bankruptcy Act. This section also expires automatically on December 31, 1951. Unlike section 22 (b) (9), section 22 (b) (10) does not require a reduction in the basis of the taxpayer's properties as a condition to the exclusion of the income. The extension of the expiration date of section 22 (b) (10) made by this section of your committee's bill is to December 31, 1954.

The revenue loss from these amendments is expected to be negligible.

22. Liquidation of corporations

Under the Revenue Act of 1950, domestic corporations, including personal holding companies, may be liquidated under section 112 (b) (7) of the code for a limited period without payment of capital gain tax by the stockholders on the appreciation in value of assets held by the companies. In general, in the case of gain on stock held by individuals only that portion of the distribution to the shareholders which represents accumulated earnings is to be taxed, to the extent of the gain, as ordinary income. So much of the remainder, to the extent of the balance of the gain as consists of money, or of stock or of securities acquired by the corporation after a basic date (August 15, 1950) is to be treated as a capital gain.

Under section 112 (b) (7) in its pre-1950 form, a similar election was available when the plan of liquidation was adopted after the date of enactment of the Revenue Act of 1943 and put into effect during the calendar year 1944. Under the amendment made by the Revenue Act of 1950, this election was restored for plans of liquidation adopted after December 31, 1950, and effected during any one calendar month in 1951.

Section 316 of your committee's bill extends the application of section 112 (b) (7) so that taxpayers may exercise a similar election to cover liquidations of corporations during 1952. This 1-year extension of the election will facilitate the liquidation of domestic personal holding companies. The committee believes it desirable to expedite the liquidation of such companies.

This provision of your committee's bill is effective with respect to taxable years ending after December 31, 1951.

It is anticipated that the revenue loss resulting from this amendment will be negligible.

23. Capital gains of corporations improperly accumulating surplus (sec. 102)

Section 102 of the code imposes an additional tax on corporations improperly accumulating surplus to avoid payment of surtax by stockholders. This additional tax is imposed on the undistributed "section 102 net income", which is, in general, net income minus the normal tax, surtax, and excess profits tax of the corporation. Under present law, the section 102 tax applies to the long-term capital gains of the corporation as well as to its ordinary income. Your committee is of the opinion, however, that the problem of avoidance of surtax by stockholders does not arise in the case of net long-term capital gains, since these gains would have been taxed at a maximum rate of 25 percent if they had been realized by the stockholder directly. Furthermore, with present high replacement costs, corporate capital gains must be reinvested in order to keep the corporation's business activities at their current level. Therefore, section 315 of your committee's bill amends section 102 in order to exclude net long term capital gains from the undistributed income subject to the section 102 tax. However, this amendment further provides that the capital gain tax is not to be allowed as a deduction in computing income subject to the section 102 tax.

This provision is effective with respect to taxable years beginning after December 31, 1950.

The revenue loss from this amendment is expected to be negligible.

24. LIFO method of accounting

Under the present law taxpayers using the LIFO inventory method have until the end of 1952 in which to make replacements of inventories involuntarily depleted during World War II. They have until the end of 1955 to make replacements of inventories involuntarily depleted during the present emergency. However, inventory replacements are required to be attributed to the most recent liquidations not already replaced, so that a replacement before the end of 1952 must be treated as a replacement of inventory liquidated during the present emergency before any inventory increases can be treated as replacements of inventory liquidated during World War II. This makes it difficult for taxpayers now suffering liquidations to replace World War II inventory liquidations before the end of 1952.

Section 306 of your committee's bill corrects this situation by providing, in effect, that replacements made prior to 1953 are first to be deemed to be replacements of liquidations during the World War II period rather than first being deemed to be replacements of liquidations during the present emergency.

This provision of your committee's bill is effective with respect to taxable years ending after June 30, 1950.

The revenue loss from this amendment is expected to be small.

25. Exchanges and distributions under SEC orders

Supplement R of chapter 1 of the Code provides, in general, that gain shall not be recognized to a corporation transferring property to another corporation which is a member of the same system group if the transfer is under order of the Securities and Exchange Commission. A "system group" is there defined as a chain of corporations connected with a common parent through 90-percent ownership of each class of stock other than stock preferred both as to dividends and assets.

A case has been brought to the attention of your committee in which a parent corporation owned over 96 percent of a $46 million stock issue but owned slightly less than 90 percent of a $15,000 stock issue which was preferred as to dividends but not as to assets. Thus, under the present provisions of Supplement R this corporation's failure to own 90 percent of the $15,000 issue results in the nonrecognition-of-gain provision being inapplicable in this case. Your committee believes this application of the rule to be unduly harsh in its results.

Therefore, section 337 of your committee's bill amends Supplement R to provide that, in addition to the present definition of a system group, corporations be permitted to qualify as a system group if the parent owns 90 percent of each class of stock other than preferred stock and other than stock which is preferred as to dividends but not as to assets if the value of such stock is less than 1 percent of the aggregate value of all classes of nonpreferred stock.

This amendment is effective with respect to taxable years affected by an exchange or distribution made after December 31, 1947.

The revenue loss under this amendment will be negligible.

26. Preferred stock of public utilities

Section 611 of your committee's bill is intended to correct section 15 (a) of the code which permits public utilities furnishing telephone service, electrical energy, gas, or water to take a partial credit against net income for dividends paid on preferred stock originally issued before October 1, 1942. The existing credit is designed to give these public utilities a tax saving equal to 14 percent of the amount of the preferred stock dividends. The provision of your committee's bill amends section 15 (a) with respect to taxable years beginning before April 1, 1951, to make the intercorporate dividends-received credit available in the case of dividends on preferred stock of public utilities if the special dividends paid credit for public utilities provided by section 26 (b) has not been received by the utility.

The revenue loss resulting from this amendment will be negligible.

27. Earnings of dependents

Section 25 (b) (1) (D) of the code allows a taxpayer, as a credit against net income, an exemption of $600 for each dependent whose gross income in the year is less than $500. Prior to the Revenue Act of 1948, the exemption for dependents amounted to $500. Thus, before the amendment made by that act, the amount of the exemption conformed with the amount of earnings which a dependent was allowed before the taxpayer was denied an exemption on his account. However, in increasing the exemption to $600, the 1948 act failed to make an equivalent increase in the amount of the dependent's allowable earnings.

Your committee believes that these provisions of present law should be brought into conformity. Not only is the present treatment inconsistent, but it leads inevitably to confusion on the part of taxpayers.

For this reason, section 310 of your committee's bill amends section 25 (b) (1) (D) in order to permit the exemption for dependents whose earnings are less than $600.

This amendment applies to taxable years beginning after December 31, 1950.

The revenue loss from this provision is expected to be small.

28. Mine exploration expenditures

It is generally recognized that the presently available mineral resources of this country are in many respects deficient in view of the ever-increasing demands of our economy, especially in an emergency period such as the present. Not only is this true with many common metals such as copper, zinc, and lead, but it is even more true with respect to many rare metals and nonmetallic minerals. Intensified and expanded efforts to find new deposits of ores and other minerals are highly desirable.

Under present law, expenditures for ascertaining the location, extent, and quality of mineral deposits cannot be deducted (unless such expenditures produce no useful results, in which case they can be deducted as with any other loss), but must be capitalized. Amounts so capitalized can be recovered for tax purposes only through depletion allowances. Moreover, if the depletion allowance is based upon a percentage of gross income from the property, this deduction is the same whether a large or a small sum was spent for exploration, so that there is no special tax incentive for increased exploration expenditures.

Your committee believes that a special incentive for increased exploration for mineral deposits is desirable, especially in the case of taxpayers with limited financial resources. Therefore, section 341 of your committee's bill provides that with respect to expenditures made to ascertain the existence, location, extent, or quality of any deposit of ore or other mineral (other than oil and gas), prior to the development stage of a mine, the taxpayer may elect to deduct in any taxable year any amount up to $75,000 paid or incurred in that year; or he may defer any amount up to $75,000 not deducted in the current year, and deduct that amount ratably as the minerals discovered or explored as the result of the expenditure are sold. Any taxpayer may treat such expenditures made in any 4 years, up to $75,000 per year, as deductible in either of these ways; after he has done this for 4 years, additional expenditures for exploration must be capitalized as under present law. Amounts so deducted will be a substitute for cost depletion based on such expenditures, but the allowances for depletion based upon a percentage of gross profit will not be affected.

The reduction in revenue resulting from this provision is expected to be ———— in a full year's operation.

The amendments made by this section of your committee's bill will apply to taxable years ending after December 30, 1950.

29. Corporate liquidations accompanied by reorganizations

Section 112 (c) (2) of the code provides, in effect, that if a distribution of cash or other property together with stock or securities is "made in pursuance of a plan of reorganization," but "has the effect of the distribution of a taxable dividend," then the excess of the value of the cash or other property and stock or securities received by the stockholder over the cost or other basis of his stock, which would otherwise be taxable as a capital gain to the extent of the cash or other property received, shall, to the same extent and to the extent of the earnings and profits so distributed, be taxed at ordinary rates as if the cash or other property had been received as a dividend.

This provision was intended to apply to a situation where a corporation with accumulated earnings and profits in the form of cash or the equivalent transferred its operating assets to a newly formed corporation in exchange for its stock and then distributed the cash and the stock of the new corporation to its stockholders. In such cases the corporation can continue its industrial or commercial operations under the new corporation's charter exactly as it would have done had there been no reorganization but merely the distribution of a cash dividend to its shareholders. In such cases the underlying realities and not the outward forms of the transaction should determine the tax consequences.

However, there are situations which involve a reorganization which is only incidental to the actual discontinuance and liquidation of a business, and where the reorganization is expedient to carry out certain necessary transactions. Such a case was brought to the attention of your committee. In that case a corporation which had been engaged in certain industrial operations for many years terminated those operations, sold its remaining industrial plant and equipment, collected its accounts receivable, and prepared to completely liquidate. However, among its assets, in addition to a substantial amount of cash obtained from the disposal of its operating assets, were several tracts of unimproved land. It was not desirable to sell the land, since valuable leases could be executed with respect to much of it. Neither was it expedient to distribute the land to a number of stockholders, living in different parts of the country, since joint execution of leases, collection of rents, etc. would be impracticable. So the land was transferred to a newly organized corporation for its stock and that stock, together with the proceeds of the sale of the operating assets, was distributed to the stockholders in complete liquidation and the old corporation was dissolved.

It appears that in such cases we have, not a continuation of an existing business with a mere change in corporate identity to afford an excuse for a distribution of earnings and profits in the guise of a liquidation, but a bona fide liquidation resulting from the termination of business operations, and the formation of a new corporation incidental thereto motivated by sound business reasons. Nevertheless, it seems probable that the Treasury Department will hold that in such taxes a taxable dividend was distributed, in view of the language of a decision of the Supreme Court (*Estate of Bedford*, 325 U. S. 283), which appears to indicate that any distribution of cash or the equivalent, where the corporation has undistributed earnings and profits, in connection with a reorganization, is a distribution of a taxable dividend.

To avoid hardships which might result from unduly rigid interpretations of section 112 (c) (2) of the code, your committee provides, in section 342 of the bill, that where a corporation, as part of a plan of liquidation, exchanges unimproved real estate which is only part of its assets for stock of a new corporation and thereafter distributes such stock and its remaining assets in liquidation, the gains to the shareholders resulting from such distribution shall be treated as capital gains and not as taxable dividends. This treatment is provided only if there was a "sound business reason" for the formation of the new corporation, if the corporation "was organized and is operated for the sole purpose of holding title to such real estate and collecting income from the leasing or sale thereof and if the business of the old corporation is discontinued." The provision is made applicable to taxable years beginning after December 31, 1947.

It is expected that the reduction in revenue resulting from this provision will be small.

C. Provisions of the House Bill Not Accepted by Your Committee

1. *Withholding on dividends, interest, and royalties*

Part I of title II of the House bill provides for withholding at the rate of 20 percent in the case of dividends, certain interest (principally corporate bond interest), and royalties. Under existing law recipients of such incomes are required to report the total amount received as income on their annual income-tax returns. Withholding is required of the payor only in the case of nonresident aliens.

The stated purpose of the House bill is to improve compliance on the part of taxpayers with respect to these types of investment income. Various estimates have been made to the effect that for calendar year 1951 underreporting in this area may reach as much as $3 billion.

While your committee recognizes that there may well be substantial underreporting of such income, largely through carelessness on the part of taxpayers, it does not believe that sufficient investigation of the problem has been made to justify such a drastic solution as the House bill proposes. Your committee believes that the withholding provisions of the House bill would work a great hardship upon many taxpayers and impose expensive administrative burdens upon the withholding agents.

The most obvious inequity which would result from adoption of the House provisions would, of course, be that withholding would be applied to many taxpayers who in fact have no income-tax liability. This hardship would be particularly severe, for example, with respect to an elderly retired individual living on a small investment income. As a result of withholding at the source, such a person's income would be reduced by 20 percent at the time he receives it. The taxpayer would be out-of-pocket this amount until such time as he could file a claim for refund and his claim could be acted upon. No system has yet been devised which, in your committee's opinion, would provide refunds speedily enough to mitigate this hardship. Your committee also fears that many taxpayers, especially those in the lower income brackets, would, either through misunderstanding or carelessness, fail to apply for the refunds due them, thus, being deprived permanently of a portion of their income.

This type of inequity can also be acute in the case of tax-exempt organizations which depend for their support largely upon investment income. While the House bill attempts to reduce this difficulty by permitting such organizations to take the refunds due them as a credit against any withholding tax liability with respect to their employees, your committee believes this to be only a limited solution, especially with respect to such organizations with small payrolls.

It has been argued that withholding on dividends, interest, and royalties will remove an existing discrimination against wage earners whose earnings are generally withheld upon today. However, it should be pointed out that under the House bill the proposed 20 percent withholding rate would be applied to the enumerated types of dividends, interest, and royalty payments without allowance for any personal exemptions. This is not true with respect to wage withholding. Thus the hardship imposed upon recipients of investment income, especially those with large family responsibilities, would be greater than any now imposed upon wage earners.

In addition to the hardships described above with respect to the individuals to be withheld upon under the House bill, your committee foresees the imposition of greatly increased administrative burdens upon the withholding agents if the plan were adopted. Although the proposal contains no provision which would require payor corporations to notify their stockholders of amounts withheld from dividends, it is obvious that good stockholder relations will in practice require that this be done in many cases. It is likewise probable that the burden will frequently fall upon the withholding agent to expl[illegible] to the income recipient why his payments have suddenly been reduced. These consequences, in addition to the statutory requirements of withholding in the case of each of many recipients and transmittal of these amounts to the Government, will clearly impose considerable expense upon withholding agents.

It has been noted that the House provision would also require withholding with respect to royalty payments. Your committee has not been shown any need for withholding in this area. Royalty payments are much more apt to represent large amounts than is true in the case of dividends and interest and are more apt to be received at regular intervals over a long period of time. For these reasons such payments are more likely to be included in the payee's income. Your committee believes it unlikely that there is any substantial underreporting in this area. It should be pointed out that royalty payments with respect to minerals are frequently subject to depletion and various expense deductions. The House bill makes no allowance for such deductions.

While the House bill requires withholding only on limited types of interest, principally interest on corporate bonds, your committee believes there are still many unresolved problems with respect to the interest upon which withholding has been proposed. This is true, for example, with respect to the treatment of transfers of certain types of coupon bonds.

Examination of income tax returns through a "sampling" technique is reported to indicate substantial underreporting of various forms of investment income. However, no effort has been made to determine the extent to which dividends, interest, and royalties are paid to persons who file no tax returns. Thus, no accurate information has been developed which would indicate either (1) the proportion of individuals not now required to file returns who receive income from dividends, interest, and royalties and would, therefore, be required to file for refunds if withholding were imposed, or (2) the number of individuals who receive dividends, interest, and royalties who do not file returns but who should do so. Information of this type is essential to any appraisal of the need and the desirability for legislation in this area. It is hoped that the Bureau of Internal Revenue will make every attempt to secure this information.

In view of the serious objections to the withholding plan of the House bill described above and the lack of essential information just referred to, your committee has not included the withholding provisions in its bill.

It has been estimated that the withholding provisions of the House bill would increase the revenues by $323 million annually.

The House bill requires the furnishing of information at the source as to all payments of interest subject to withholding of $300 or over and requires similar information as to all other interest payments of over $100. Below those amounts information could be required at the discretion of the Secretary of the Treasury. Under present law, interest payments of $600 or more are required to be reported. Section 332 of your committee's bill amends this provision to give the Secretary discretionary authority to require information returns as to interest payments of any amount. Moreover, the provisions of present law which authorize that payments of dividends in any amount be reported at the discretion of the Secretary are retained. Your committee believes that these informational requirements, in addition to the widespread publicity which has been given recently to the problem of underreporting of these types of investment income, should substantially improve taxpayer compliance in this entire area.

2. Surtax exemptions and minimum excess profits tax credits of related corporations

Under existing law the $25,000 corporate surtax exemption and the $25,000 minimum credit under the excess profits tax are available to each member of a group or chain of related corporations. It has been claimed that this treatment confers an unwarranted tax advantage on businesses carried out by means of a series of corporations, rather than a single corporation, and sets up an incentive for the artificial splitting-up of corporations. It is argued that this effect of the existing law is difficult to reconcile with the fact that the surtax exemption and the minimum credit were intended to confer tax advantages on small business. In an attempt to correct this situation, section 123 of the House bill would reduce to one the number of surtax exemptions which may be claimed by a group of "related" corporations and would limit the minimum excess profits tax credit to a single credit of $25,000 for the entire group.

Under the House bill the $25,000 surtax exemption and the $25,000 minimum excess profits credit would be divided equally among the related corporations unless they elect another method of apportionment. Such an election would be made by filing with the Secretary of the Treasury a consent indicating the portion of the $25,000 which would be taken by each of the related corporations as its surtax exemption for the taxable year. This election would permit the related corporations to absorb the full surtax exemption and the full minimum excess profits credit so long as the group has a combined surtax net income of $25,000.

A "related" group of corporations is defined in the House bill so as to include one or more chains of corporations connected through ownership with a common parent corporation when at least 95 percent of the voting power of all classes of stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations, and the common parent owns directly stock possessing at least 95 percent of the voting power of all classes of stock of at least one of the other corporations, excluding, in computing such voting power, stock held by such other corporations. A "related" group would also exist if at least 95 percent of the voting power of all classes of stock of each of two or more corporations were owned, directly or indirectly, by or for one individual, or if at least 95 percent were owned, directly or indirectly, by or for not more than five individuals each of whom owns substantially the same proportion of the voting power in each of the corporations.

In determining the extent of an individual's holdings of the stock of a corporation for this purpose under the House bill, he would be deemed to own stock held directly or indirectly by or for his spouse, and also that portion of the stock owned by a corporation, partnership, estate, or trust in which he holds an interest, which reflects the extent of his interest in such corporation, partnership, estate, or trust. If he and his spouse own directly or indirectly more than 50 percent of the voting power of a corporation he would be considered to own also the stock in that corporation held directly or indirectly by his ancestors and lineal descendants.

Your committee realizes that there may be some opportunities for tax avoidance under present law through the use of multiple corporations, although it should be pointed out that sections 45 and 129 of the code now afford the Government protection in cases where the principal purpose of the formation of multiple corporations can be shown to be the avoidance of taxes. However, the House bill is so broad in its attack on this problem that, if enacted, it could result in substantial injury to many businesses whose present corporate organization has not been motivated by tax avoidance.

Many businesses were organized in the form of multiple corporations long before the present surtax exemption and minimum excess profits tax credit were introduced. A business may be required to incorporate separately in each State in which it carries on its activities. Furthermore, State laws sometimes prohibit the chartering of a corporation for more than one business purpose. A related corporation frequently will be formed for the purpose of limiting liability with respect to the development of a new and risky enterprise. All of these are traditional and legitimate purposes for the creation of new and separate corporations, yet the House bill would strike at these bona fide corporate entities in the same manner as it would treat cases of true tax avoidance.

Corporations defined as "related" under the House bill may, in fact, be carrying on entirely unrelated types of business with few or no transactions between the members of the related groups. In such cases, failure to extend the full surtax exemption and the full excess profits tax credit to each corporation could affect seriously its competitive position with respect to other corporations of similar size carrying on the same type of business.

The provisions of the House bill would apply to corporations without regard to when they were formed. This would work a particular hardship on those related corporations which were organized in the past for legitimate business reasons. It should be noted that the denial of the full surtax exemption and the full minimum excess profits tax credit can result in a very substantial increase in tax liabilities, especially in the case of small corporations. On the other hand, to limit a provision such as that of the House bill to corporations created in the future would give rise to numerous competitive discriminations between new and old corporations.

For these reasons, your committee has eliminated entirely this provision of the House bill. Any future study undertaken to develop methods of limiting avoidance in this area should emphasize the importance of correcting the true cases of avoidance without working a hardship on legitimate business organizations.

It was estimated that the House provision would have increased the revenues by about $54 million annually.

3. Sale of property to controlled corporations

Section 310 of the House bill is intended to forestall a reported practice of selling depreciable assets to a corporation controlled by the taxpayer in order to obtain certain benefits available under existing law. For example, if the taxpayer owns a patent, or a building which has materially increased in value and which he sells to a corporation which he likewise controls, the capital gains tax must ordinarily be paid by the taxpayer, but the building then has, in the hands of the corporation, an adjusted basis which is greater than the basis in the hands of the taxpayer by the amount of the gain realized on the sale to the corporation. The property being depreciable, the corporation will then be able to write off the increase in the adjusted basis over the remaining life of the building. These additional depreciation charges are, of course, an offset to ordinary income. Thus, in effect, the immediate payment of the capital gains tax has been substituted for the elimination over a period of years of the corporate income taxes on an equivalent amount.

The House bill attempted to eliminate the tax advantage from such transactions by denying capital gain treatment to the transferor with respect to sales or exchanges of depreciable property between a husband and wife or between an individual and a corporation more than half of the outstanding stock of which is owned by or for him directly or indirectly. For the purpose of determining ownership of stock under the House bill an individual would be considered as owning a portion of the stock held by a corporation, partnership, state or trust which reflects his interest as a shareholder, partner, or beneficiary. He would also be considered as owning stock owned directly or indirectly by or for his spouse, and if he and his spouse owned more than 10 percent of the outstanding stock of the company, he would also be considered as owning stock held directly or indirectly, by or for his brothers and sisters, ancestors and lineal descendants.

Upon consideration of this problem by your committee, it is of the opinion that a closer examination into the reported cases should be made before an amendment of this type is adopted. It appears that the House provision would deny capital gains treatment to some bona fide transactions while failing to deny such treatment in cases of clear avoidance. For example, under the provision there would be no bar to the sale of property to a third person who then could sell it to the corporation. Your committee believes that action on this problem should be deferred until actual cases involving use of this avoidance device have been submitted for study. For this reason the bill eliminates the House provision.

It was estimated that the House provision would have increased the revenue by $1 million annually.

VII. STRUCTURAL CHANGES IN THE EXCESS PROFITS TAX

Your committee's action with respect to the over-all ceiling on the excess profits tax and its action relating to the House amendment which reduced the excess profits income credit from 85 to 75 percent of average base period net income have been discussed in part IV of this report pertaining to general corporate rate changes.

In addition, your committee's bill includes several new provisions which deal with various other excess profits tax problems of a relief nature. A great number of these problems were brought to the attention of the committee during its hearings on this bill, and these problems were examined by the staff. Your committee has confined its action to those cases which present the most immediate and pressing need for statutory change. Of necessity, the committee has deferred action upon the bulk of excess profits tax proposals even though a number of the suggestions undoubtedly are meritorious.

It is believed that further action in this entire area should be deferred until the excess profits tax returns have been filed and there has been an opportunity to evaluate the detailed operation of the law. It is anticipated that this will be possible early in 1952. In the meantime, the staff will continue its study of the problems involved in this entire field.

In general, the following excess profits tax amendments made by your committee are effective retroactively to the time the excess profits tax became effective.

It is estimated that the excess profits tax amendments discussed below will decrease revenues by $120 million in a full year of operation.

1. Extension of growth alternative to new corporations

Under section 445 of the present excess profits tax law, new corporations (those corporations which commenced business after the beginning of the base period) are entitled to compute a substitute earnings credit based on the industry rate of return applied to their total assets. They may also compute their earnings credit by averaging their base period earnings over 3 years, treating loss years and years in which they were not in business as zero. They are also entitled to the minimum excess profits credit of $25,000. They may also use the ordinary invested capital credit.

While considerable attention was given to the problem of new corporations in the preparation of the present excess profits tax law, the primary relief provided them, namely, the use of an alternative average earnings credit based upon their industry rate of return, often proves inadequate. Many new corporations have only limited assets to which they can apply the industry rate. Furthermore, the industry rate is often especially unrealistic in the case of new corporations because they frequently are engaged in relatively speculative undertakings and in various specialized activities which cannot be compared satisfactorily with the operations of established companies.

The major failure of the present treatment of new corporations is a failure to give adequate recognition to the growth typical of their normal development. New corporations are not entitled to the growth alternative under section 435 (e) of present law because this relief is available only to corporations which commenced business before the beginning of their base period (ordinarily January 1, 1946, and in no case later than April 1, 1946). The growth alternative was limited to corporations which commenced business before the beginning of the base period because the eligibility tests are based on comparisons of 1946 and 1947 with 1948 and 1949 or the first half of 1950, and it was believed that the extension of the growth formula to new corporations would prove unnecessary in view of the special alternative provided such taxpayers.

Your committee believes that equitable treatment of new corporations requires adequate recognition of the growth characteristic of them. Therefore, section 504 of your committee's bill removes the limitation now found in section 435 (e) (1) which prevents corporations which commenced business during the base period from applying the eligibility tests to their experience. Your committee's amendment will not apply to corporations which commenced business after the end of the base period since the eligibility tests under the growth formula are written in terms of base-period experience. However, such corporations formed in the excess profits tax period will have the benefits of the lower over-all tax ceilings provided by another section of your committee's bill for new corporations.

Corporations formed after 2 years of the base period had elapsed, and before the end of the base period, ordinarily will automatically become eligible for the growth alternative. This is because the eligibility requirements of section 435 (e) (1) (A) (other than the total asset limitation) are based upon a comparison of the taxpayer's total pay roll, or gross receipts, in 1946 and 1947 with its total pay roll, or gross receipts, in 1948 and 1949. Therefore, corporations formed in the latter half of the base period must automatically meet the tests of growth in those respects because such corporations had no pay rolls and no gross receipts in the first half of the base period. For corporations which commenced business prior to the middle of the base period (ordinarily January 1, 1948), qualification for the growth formula will not be automatic as in the case of the corporations described above, but should prove relatively easy in most cases since total payroll or gross receipts for 2 full years of the business in the second half of the base period will be compared with payroll or gross receipts for something less than 2 full years of business in the first half of the base period. This ease of qualification will diminish as the corporation's starting date approaches the beginning of the base period until for a corporation commencing business on the first day of the base period it will be on substantially the same footing as those old corporations now entitled to the growth alternative.

New corporations formed before the end of the base period which meet the eligibility requirements of section 435 (e) (1) (B) will also be entitled under your committee's bill to use the special growth alternative provided in section 435 (e) (2) (G). However, in order to qualify under that provision the corporation will have to have been in existence for all of 1949 and at least part of 1948 in order to meet the entrance requirement that their excess profits net income for the calendar year 1949 must have been not more than 25 percent of their excess profits net income for the calendar year 1948.

2. Special ceiling rate for new corporations

Although section 504 of your committee's bill extends the benefits of the growth alternative to certain new corporations commencing business after January 1, 1946, a number of new corporations will not be benefited by this. No new corporation formed after the end of the base period (usually December 31, 1949), for example, can be eligible for the growth alternative. Moreover, even new corporations commencing business during the base period may find the growth alternative of little benefit to them if their primary expansion in earnings came after 1950. In addition, your committee believes that despite the need for revenue in the present emergency every possible effort must be made to assure the creation and development of new techniques, new processes, and new corporations. This is desirable if the ability of this country to produce is to continue to expand.

As a result it is believed necessary to give assurance to new corporations in their initial period of development that the excess profits tax will not work undue hardship upon them. Section 501 of your committee's bill does this by providing a series of special ceiling rates available only to new corporations. As indicated on page — of this report your committee's bill provides a new type of ceiling rate of 17 percent with respect to excess profits tax liability. For ordinary corporations, this rate is to apply with respect to years beginning after March 31, 1951. On a similar basis, but retroactive to 1950, the first year the excess profits tax was in effect, your committee's bill provides the following series of ceiling rates applicable to excess profits net income which are to be available to certain new corporations organized after the beginning of their base period, with respect to the first $400,000 of their excess profits tax net income:

	Percent
In the first year of a new corporation's business	5
In the second year of a new corporation's business	5
In the third year of a new corporation's business	8
In the fourth year of a new corporation's business	11
In the fifth year of a new corporation's business	14

For that part of the excess profits net income in excess of $400,000, new corporations less than 6 years old are to be subject to a ceiling rate of 15 percent with respect to 1950, 16½ percent with respect to the calendar year 1951, and 17 percent with respect to taxable years beginning after March 31, 1951. Other corporations are also subject to the 16½ percent rate in the calendar year 1951 and the 17 percent rate with respect to taxable years beginning after March 31, 1951, but in their cases these rates are applied to their entire excess profits tax net income. In 1950 these other corporations in effect are subject to a ceiling rate on their entire excess profits tax net income which is at least as high as the 15 percent rate applicable to new corporations with respect to their excess profits tax net income in excess of $400,000.

In all cases the ceiling rates for small corporations will apply only to liability under the excess profits tax.

Your committee decided to provide a series of ceiling rates graduated according to the number of years a new corporation has been in business rather than providing a lower ceiling rate for one or two specific years for new corporations because it believes that the need of new businesses for this type of special relief varies in accordance with the number of years they have been in business. Also, a provision applying lower ceiling rates to specific years would create a notch problem leading to discrimination between companies formed before and companies formed after the "cut-off" dates.

These special ceiling rates, together with the effective income tax rates, will have the effect of providing for 1952 the following maximum effective rates of income and excess profits taxes for the excess profits net income levels shown:

Excess profits net income	Normal tax and surtax effective rates Senate Finance Committee action percent	Maximum effective rate of income and excess profits taxes				
		First and second year 5 percent	Third year 8 percent	Fourth year 11 percent	Fifth year 14 percent	Sixth and subsequent years 17 percent
$60,000	41.58	46.58	49.58	52.58	55.58	58.58
$75,000	43.67	48.67	51.67	54.67	57.67	60.67
$100,000	45.75	50.75	53.75	56.75	59.75	62.75
$200,000	48.88	53.88	56.88	59.88	62.88	65.88
$300,000	49.92	54.92	57.92	60.92	63.92	66.92

These special ceiling rates available to new corporations in their period of development are not to be available to new corporations created as the result of either a tax-free reorganization or a taxable transaction of the type where, under your committee's action, the purchasing corporation would be entitled to base its income credit on the earnings experience of the predecessor. Your committee believes that such corporations do not truly represent "new business." However, where the predecessor corporation in a reorganization or taxable transaction was itself eligible for the special ceiling rates, the new corporation will determine its eligibility on the basis of when its predecessor commenced business. Also these ceiling rates are not to be available to new corporations principally engaged in Government business. Such a corporation is defined as one which derives more than 50 percent of its gross income for the taxable year from a contract or contracts to which the provisions of the Renegotiation Act of 1951 or any prior renegotiation law are applicable. These new businesses are deriving their principal income from Government contracts providing predictable and secure markets for their products, leaving little need for special relief. The special ceiling rates are denied new corporations whose assets were transferred from old corporations under the same control in order to prevent assets being transferred to obtain the benefit of the special ceiling rates. They are also denied new corporations which are controlled by persons owning an old corporation engaged in the same business through old corporations.

The special ceiling rates are available only with respect to the first $400,000 of a new corporation's excess profits net income because it is believed that relief is not needed for new corporations which have rapidly become large corporations. However, making these ceiling rates available with respect to the first $400,000 of excess profits net income, even in the case of the larger corporations, prevents the development of a notch area and discriminatory treatment with respect to new corporations with incomes just over and just under $400,000.

3. Special relief provision for companies engaged in television broadcasting during the base period

The bulk of the television broadcasting stations have been developed and are owned by corporations previously engaged in radio broadcasting. The development of television broadcasting has resulted in large losses for a great portion of the combined radio-television broadcasting industry continuing through at least part of 1950. The result of this has been to doubly penalize the industry, because 1947–49 television broadcasting losses have decreased the average earnings of the industry during the base period, while the profits shown for television broadcasting commencing in 1951 have further increased the proportion of the industry's profits which are subject to excess profits tax.

Your committee believes that the problem presented by the radio-television broadcasting business represents a unique situation which deserves special relief. It is an example on an industry-wide basis of new business superimposed on existing business. As a result, the general relief formulas, where available, provide little relief for these cases, since the earnings of the entire industry were depressed during most of the base period when television losses were incurred, but expanded substantially after the end of the base period after the new portion of the industry had begun to reach maturity.

As a result, section 519 of your committee's bill grants corporations which derived, during the base period, part of their gross income from television broadcasting and part from radio broadcasting an alternative method of computing their average earnings base period net income for excess profits tax purposes. They are given two new alternative methods of computing a rate of return for the base period and are permitted to apply to their total assets at the end of their base period whichever rate of return results in the lower tax. The first alternative rate of return is to be computed by eliminating from the corporation's own income in the period 1946 to 1949 its television losses and by eliminating from its assets in the same period those used in the television business. The rate of return is then to be computed on the radio business by the division of the income (excluding television income and losses) by the assets used otherwise than in television business. The second optional method permitted such businesses in the computation of their rate of return is the use of the industry's rate of return for the period 1946 to 1949.

The above method of determining base period earnings, where the company's own experience is used, represents, in effect, what the company would have earned had it remained in the radio broadcasting business alone during the base period but had had the use of the assets held as of 1949 during the entire base period. Due to the lack of data on tax returns for the base period years as to television losses and assets devoted to television business, it is not possible to offer a similar alternative for those using the industry rate of return. Thus, in this case, it was only possible to permit the use of the unadjusted rate of return for the entire radio-television broadcasting industry.

In some cases corporations which are in the radio and television broadcasting business also derive part of their income from some other business, such as newspaper publishing. In order to permit such businesses to use the relief provision described above, section 519 of your committee's bill also provides that such other business may be treated, in effect, as if it were a separate corporation with respect to the computation of average base period net income. The radio and television business in such cases would then be eligible for the relief provision described above. To the average base period net income of the other business or businesses would be added an imputed average base period net income for the radio-television broadcasting portion of the corporation's operations, derived, in the way described in the preceding paragraph, by using either the individual corporation's rate or the industry rate as a return on the radio-television assets at the end of the base period.

4. Taxable exchanges

Part II of the Excess Profits Tax Act of 1950 provides rules under which an acquiring corporation may utilize the earnings experience of a predecessor corporation in computing its own average earnings base. However, under the Excess Profits Tax Act of 1950, the acquiring corporation may use this earnings experience only where the assets of the predecessor corporation were acquired in certain tax-free exchanges. In general, these tax-free exchanges occur where the assets of a predecessor corporation are acquired by the acquiring corporation in exchange for its stock. Under the present law the earnings experience of a predecessor corporation may not be used by an acquiring corporation where the assets were acquired by purchase for cash or in some other type of taxable exchange. This was also true under the World War II excess profits tax, but under that tax, the section 722 relief provisions, under certain conditions, provided for the reconstruction of an earnings record and the earnings experience of a corporation whose assets were purchased by a taxpayer provided, in some cases, a rough measure upon which to base such a reconstruction.

Your committee believes that, in the case of taxable exchanges, subject to certain limitations, where purchasing corporations have obtained substantially all of the assets of a predecessor corporation and such predecessor is liquidated, the earnings experience base of the predecessor corporation should be available to the purchasing corporation. Therefore, section 520 of your committee's bill provides that in the case of taxable exchanges occurring prior to December 1, 1950, where the predecessor corporation has been liquidated and a purchasing corporation has obtained substantially all of the predecessor corporation's assets, the purchasing corporation may use the predecessor corporation's base period experience in computing its average base period net income under the general average method. However, it is to be permitted the use of this base only to the extent that new funds were used for the purchase of these assets. These provisions are also to apply where the predecessor was a partnership, in which case the base period income of the predecessor is to be computed as if it were a corporation. A similar option is to be available for each of two or more corporations, if each new corporation purchased all the assets of a separate business of the predecessor, and the new corporations together purchased all the assets of the predecessor. Where the purchasing corporation purchased a business which comprises only a part of the assets of a predecessor which was liquidated, the portion of the base period experience of the predecessor which is to be made available to the purchasing corporation is to be determined under regulations providing an allocation based on the value or earning experience of the assets purchased by the purchasing corporation.

Your committee's bill further provides that in the case of taxable exchanges a purchasing corporation is not to be denied the use of the earnings base of a predecessor merely on the grounds that a franchise or license, which was an important source of earnings of the predecessor, cannot be transferred from the predecessor to the acquiring corporation, but must be obtained by the latter from the same source. An example of this would be an automobile dealer agency. In such cases the franchise to act as the representative of an automobile manufacturer generally must be acquired directly from the manufacturer.

Your committee's amendment is limited to taxable exchanges occurring before December 1, 1950, because of the possibility of abuse through purchase of corporate assets to obtain an increased excess profits credit if the provision were made applicable to the period after the excess profits tax provisions were known. Also it is believed that the greatest need for relief in the area is in the case of purchases which were made before the excess profits tax, when taxpayers had no way of knowing the future excess profits tax consequences which could result from a decision to enter into a taxable rather than a nontaxable exchange.

5. *Base period abnormalities*

Under present law, if an abnormality exists in the taxpayer's lowest year of earnings during the base period, that year is automatically eliminated from the average base period net income computation. However, if an abnormality occurred in one of the remaining periods of 12 months or less in the base period, section 442 of the code provides that the taxpayer may, if it was in business at the beginning of its base period, substitute for its actual excess profits net income for the period of the abnormality an amount determined by multiplying its total assets for the last day of the year of the abnormality by the rate of return of its industry for that period.

The alternative average base period net income provided by section 442 is available, if the taxpayer can establish for any taxable year within its base period either that its normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the taxable year, of events "unusual and peculiar" in the experience of the taxpayer or that the business of the taxpayer was depressed because of temporary economic circumstances unusual in its case. These tests frequently may involve extremely difficult evidentiary problems, particularly with respect to a determination of the extent that any single event has affected the taxpayer's normal production, output or operation.

The philosophy upon which the existing relief provisions, including section 442, were developed was that automatic formulas, both as to eligibility requirements and as to the extent of the relief granted, are preferable to the approach of the World War II law with its requirement of subjective analysis and decision. Your committee believes it is desirable to maintain this approach of present law. Therefore, your committee has adopted an additional alternative eligibility requirement under section 442 which would eliminate, in many cases, the difficulties of proof previously referred to. Section 509 of the bill provides that where the earnings of the taxpayer's third-best base period year were less than 35 percent of the average of the earnings of his two best base period years, the taxpayer will automatically be entitled to use its industry rate of return for the third best year. This new provision is limited, however, so that the substituted earnings may not in any case exceed the average of the taxpayer's two best years.

The requirement of present law that the substitute excess profits net income provided by section 442 may be utilized for a single abnormal year only if it exceeds 110 percent of the taxpayer's excess profits net income for that year computed without the substitution will not apply to taxpayers who are eligible under your committee's amendment. Such a limitation is not necessary in view of the fact that the amendment requires no showing of an abnormality.

6. Change in products committed to prior to close of base period

Section 443 of present law provides that where a corporation made a substantial change in the products or services it furnished during the last 3 years of its base period, and, within 3 years after the change, the new product accounted for more than 40 percent of gross income or 33 percent of net income and net income increased 25 percent, then the corporation is entitled to determine its average base period net income by multiplying its industry rate of return by its total assets.

As the above description indicates, present law confines this type of relief to corporations which actually introduced a new product before the end of the base period. The present law limited this relief to products introduced in the base period primarily to avoid the possibility of giving the advantage of an automatic formula to corporations developing new products during the present emergency. However, it is clear that the danger which was sought to be avoided does not exist when the change in product was definitely committed to prior to the end of the base period and construction of the facilities to produce the new product had actually commenced before the beginning of the present emergency. In such cases, negotiations may have started early in the base period with respect to the development of a new product, and with respect to the construction of the necessary additional facilities. In cases similar to this your committee sees no valid reason why the relief intended by section 443 should be denied if carefully restricted so as not to give the benefits to new products developed during the emergency period.

As a result, section 511 of your committee's bill provides that where a substantial change in the products produced by a taxpayer has been made after the end of the base period, such a change shall be deemed to have been made in the base period, for the purpose of qualifying for the alternative average base period net income available under section 443 of the code, if the taxpayer, prior to July 1, 1950, commenced the construction of the facilities necessary to the production of the new product, and if such construction and the production of the new product were in furtherance of a course of action to which the taxpayer (or corporation with which the taxpayer had the privilege of filing a consolidated return for its first excess profits tax year) was committed prior to the end of the base period. This commitment must have been evidenced, under your committee's amendment, by a contract with another person and that contract must have granted a license, franchise, or similar rights essential for the production of the new product.

7. Lessor railroad corporations

Section 448 of the code provides an alternative excess profits tax credit for certain regulated public utilities. In the case of railroads this alternative credit is equal to a return of 6 percent upon net assets after allowance is made for normal tax and surtax. To establish eligibility for this alternative credit a railroad corporation must be engaged "as a common carrier in the furnishing or sale of transportation by railroad" and must be subject to the jurisdiction of the Interstate Commerce Commission. Furthermore, such a railroad can qualify only if 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) is derived from the furnishing or sale of railroad transportation.

Although section 141 of the code permits the filing of consolidated returns by affiliated corporations which are regulated public utilities within the meaning of section 448, doubt has been raised as to whether a lessor railroad corporation which leases substantially all of its property to an operating lessee railroad corporation (which itself utilizes the public utility credit) may be joined with such lessee in the filing of a consolidated return. This problem has arisen because, although the lessor company is subject to the jurisdiction of the Interstate Commerce Commission, and although its properties are operated by the lessee as integral parts of its system in the furnishing or sale of transportation by railroad, and although its revenues, in the form of rental, are derived from such operation, the lessor does not itself operate the property and does not itself directly derive its revenues from the furnishing or sale of transportation.

The use of a consolidated return is desirable in the case of the affiliated corporations described above. Subsequent to the assumption of management and control of the lessor properties by the lessee, the facilities of the two corporations become, in practice, integrated parts of a unified transportation system.

As a result, section 514 of your committee's bill insures that certain lessor railroad corporations will be permitted to qualify for the regulated public utility credit where they file consolidated returns with their lessee railroad corporations.

8. Exempt excess output of sulfur, potash, metallurgical grade limestone and chemical grade limestone

Section 453 of the present law provides a partial exemption for coal and iron mines, timber properties, and natural gas and metal mining properties not in operation during the base period. One-third of the net income in the current taxable year of these properties is exempt from excess profits tax. These provisions are similar to those in effect during World War II and were adopted in order to provide a greater incentive for the opening up of new properties.

Coal and iron mines, timber properties and natural gas properties which were in existence during the base period are also extended special relief under this provision by exempting from excess profits tax one-half the income from excess output during the taxable year. The excess output is the production in excess of average annual production from the property (whether or not then owned by the taxpayer) during the period 1946–June 30, 1950.

Nonmetallic minerals are not provided the special treatment described above, either in the case of new or old properties. Your committee recognizes that critical shortages have developed in certain limited areas which would justify the further extension of these provisions. This is particularly true with respect to sulfur and potash deposits and with respect to metallurgical grade limestone and chemical grade limestone deposits. Sulfur and potash are vital to many defense industries and are in short supply, while metallurgical and chemical grade limestones are a necessity for the steel and chemical industries, which are crucial to defense. It is believed that every incentive should be given for the opening up of new deposits and for the energetic development of existing properties. Therefore, section 515 of your committee's bill extends the special treatment available under sections 453 (b) (2) and (4) to sulfur, potash, and metallurgical or chemical grade limestone deposits.

9. Reductions in inadmissible assets subsequent to the base period

Under the 1950 Excess Profits Tax Act, changes in inadmissible assets subsequent to the base period do not constitute a capital addition or reduction (although reductions in inadmissibles are subtracted from capital reductions and increases in inadmissibles are subtracted from capital additions).

This provision of the present act adversely affects any taxpayer computing its excess profits credit under the income method (and not having a capital reduction after December 31, 1949) if it had substantial investments in inadmissible assets in 1949 which it disposed of in 1950 or 1951 in order to obtain funds to finance expanding manufacturing operations, facilities and inventories. Such a taxpayer's increased earnings resulting from the additional facilities employed in manufacturing operations may, under present law, be treated entirely as excess profits. This is because the taxpayer receives no additional excess profits credit for the funds transferred from inadmissible assets, the income from which was exempt from excess profits tax, to manufacturing facilities and inventories, the income from which is subject to excess profits tax. If the taxpayer obtained the additional capital for manufacturing operations by sale of its own securities or by borrowings, it would obtain an increase in excess profits credit. For such a taxpayer not to receive an additional excess profits credit on additional working capital obtained from disposal of inadmissible assets appears inequitable.

To correct this situation, section 507 of your committee's bill provides that in computing the average earnings credit, reductions in inadmissibles subsequent to the base period are to be allowed a credit as capital additions provided that the additional capital is invested in operating assets. Operating assets are defined as tangible inventory items and tangible property used in the taxpayer's trade or business.

10. Inadmissible assets of banks

Under present law, both the taxpayer using the average earnings credit and the taxpayer using the invested capital credit are allowed to increase their credit by specified percentages of the net additions to their capital after 1949. However, except in the case of taxpayers with less than $5 million of capital who use the invested capital credit based on assets, and, except in the case of taxpayers who use the credit based on the historical invested capital, an increase in investment in inadmissible assets will offset dollar for dollar what would otherwise be a capital addition, even though the increase in total assets available for investment is greater than the increase in capital. For example, if a corporation increases its capital by $1 million on the first day of an excess profits tax year and then on the same day invests $500,000 of the new capital in inadmissible assets, it is only allowed under the present law to increase its credit for that year with respect to $500,000, because the $500,000 increase in inadmissibles is subtracted from the capital addition of $1 million in arriving at the net addition to capital which may be taken into account.

The treatment described above works a considerable hardship upon banks, since they invest additional funds deposited with them as well as their additional capital, so that, for example, investment of 10 percent of their additional assets in inadmissible municipal bonds may completely offset their capital additions. An increase in the capital of a bank makes possible an increase in deposits of several times that amount, total assets being increased by the sum of the new capital and increased deposits. Yet, even though its taxable income is thus increased, under present law the bank may have no additional credit based upon the new capital.

Section 506 of your committee's bill provides that while a bank's increase in inadmissibles in an excess profits tax year will still serve to reduce its increase in capital in the same year, the capital additions will be reduced by an amount based on the ratio of additional inadmissible assets to the additional total assets acquired since the beginning of its first excess profits tax year. A similar proportion is to be used where there is a decrease in inadmissible assets.

This section of the bill also provides an adjustment of the inadmissible asset factor in the computation of base period capital additions for banks which is based on the same ratio principle.

11. Dealers in municipal bonds

In computing the invested capital credit and in computing capital additions, certain adjustments are made to exclude from the invested capital certain assets known as "inadmissible assets." These include stock in other corporations, State and local government obligations and partially tax-exempt Federal obligations. The reason for this exclusion from invested capital of such assets is that the income from them is not subject to the excess profits tax.

However, dealers in municipal bonds are subject to excess profits tax on their profits from the sale of these bonds. This is because municipal bonds are their stock in trade or inventory and the gain on the sale of the bonds is treated, therefore, as ordinary income rather than as a capital gain. It is reported that municipal bonds frequently constitute 80 to 90 percent of the total assets of these dealers.

The above treatment is manifestly inequitable. Because municipal bonds are required to be excluded from the taxpayer's invested capital, he is in practice denied an invested capital credit with which to offset his normal earnings from the sale of such bonds. This inequity did not arise under the World War II excess profits tax because, under that law, taxpayers were permitted, at their option, to treat tax-exempt or partially tax-exempt bonds as admissible assets if they elected to include the interest received from such bonds in excess profits tax net income. Your committee believes that, while a similar option should not be extended to all taxpayers under the present law, because the invested capital credit rates, ranging from 8 to 12 percent, are completely disproportionate to the low-interest rates on tax-exempt bonds, such treatment should be extended to municipal bond dealers since most of their income with respect to these bonds arises from profit on their sale and such income is subject to excess profits tax.

As a result, section 508 of your committee's bill provides, in effect, that where tax-exempt bonds are held by a dealer primarily for sale to customers in the ordinary course of his trade or business, the dealer may elect to treat such bonds as admissible assets, provided that he also elects to include in his excess profits tax net income the interest on such bonds.

12. Regulated public utility credit for intrastate pipelines

The alternative excess profits tax credit for certain regulated public utilities provided by section 448 of the code extends, under present law, to corporations engaged as common carriers in the furnishing or sale of gas, oil or other petroleum products (including shale oil) by pipeline, if subject to the jurisdiction of the Interstate Commerce Commission. The alternative credit in these cases is, in effect, equal to a return of 6 percent upon total equity and borrowed capital after normal tax and surtax.

It has been brought to the attention of your committee, that, since the jurisdiction of the Interstate Commerce Commission extends only to interstate pipelines, the special credit provided by section 448 is denied those pipelines whose operations are entirely intrastate in character. This distinction appears inequitable with respect to these latter corporations if their operations are subject to regulation by State regulatory bodies. The necessity for guaranteeing these utilities a minimum return after normal tax and surtax before application of the excess profits tax would appear to be as clear in this area as with respect to interstate pipelines.

Section 513 of your committee's bill amends section 448 of the code to provide that pipeline common carriers subject to the jurisdiction of the public service commissions of any State shall be eligible for the regulated public utility credit. The same 6 percent credit is made applicable as in the case of interstate pipelines.

13. Management and technical service fees

Section 433 (a) (1) (A) of the present law provides the same 100-percent credit against excess profits net income for dividends received from foreign corporations as is allowed in the case of dividends from domestic corporations. Section 502 of your committee's bill extends a similar exclusion to management and technical service fees paid to domestic corporations by certain affiliated foreign corporations in return for information and other services furnished in connection with products of the type manufactured by the domestic corporation. Your committee believes that the rendering of technical assistance to foreign businesses by American corporations should not be discouraged by subjecting fees received for such services to the excess profits tax. In general, such management and technical service fees do not reflect profits from the domestic rearmament program and are usually small in amount. The exemption is limited so as not to exclude from excess profits tax the income of a corporation whose principal business is furnishing technical, etc., services.

The bill makes a conforming amendment in that it excludes these earnings of domestic corporations from their base period earnings, thus equating the treatment of both base period and excess profits tax period earnings. Likewise any expenses attributable to the production of this type of income are disallowed as deductions under your committee's amendment.

14. Technical amendment relating to new corporations

A new corporation computing its income credit under section 445 for any of its first 3 years which are excess profits tax years is, under the present law, entitled to apply the industry rate of return only to its total assets at the beginning of the excess profits tax period plus its net capital addition less its net capital reduction after the end of the base period. Thus, the industry rate can be applied only to increases in its equity capital and 75 percent of increases in its borrowed capital, to the extent that its assets are acquired after the beginning of its first excess profits tax year. This treatment is less favorable than that provided for other new corporations or that provided for corporations using other relief sections involving the industry rate of return because it provides for the inclusion of only 75 percent of borrowed capital.

Your committee's bill corrects this technical deficiency of present law. Section 512 of the bill provides that a new corporation computing its income credit under section 445 for any of its first 3 years which are excess profits tax years is to be entitled to its industry rate of return applied to equity capital plus 100 percent of borrowed capital, less interest on borrowed capital.

15. Technical amendment of growth alternative

Section 435 (e) (2) (G) of the code provides a special alternative average base period net income for corporations whose excess profits net income for 1949 is not more than 25 percent of its excess profits net income for 1948. In effect, such a taxpayer is granted an alternative average base period net income equal to the sum of one-half its excess profits net income for 1948 and 40 percent of its excess profits net income for 1950.

In order to qualify for the above alternative, present law requires that the taxpayer qualify for the growth credit "only" under the provisions of section 435 (e) (1) (B). The latter section permits the use (without limitation as to the amount of assets) of the general growth alternative if the taxpayer meets certain tests of increased net sales of new products in the base period. However, section 435 (e) (1) (A) has an alternative eligibility requirement for taxpayers whose total assets at the beginning of the base period did not exceed $20 million. This alternative eligibility requirement is based upon certain tests of increased payroll and gross receipts.

Your committee is unaware of any valid reason why the alternative average base period net income provided by section 435 (e) (2) (G) should be denied to taxpayers qualifying for the growth alternative both under section 435 (e) (1) (B) and 435 (e) (1) (A).

To correct this anomaly of present law, section 505 of your committee's bill extends the benefits of section 435 (e) (2) (G) to taxpayers qualifying under section 435 (e) (1) (B) whether or not they qualify under section 435 (e) (1) (A).

16. Base period of fiscal-year corporations

The present law provides certain variations in the base period with respect to corporations on a fiscal-year basis. Taxpayers with fiscal years ending after December 31, but before April 1, use as their base period 48 months ending with their last taxable year ending prior to April 1, 1950. For example, a taxpayer with a March 31 fiscal year has as its base period the 48 months from April 1, 1946, through March 31, 1950. A somewhat different procedure is followed in the case of taxpayers whose fiscal years end after March 31 and before December 31. Such taxpayers are required to use the 48-month period beginning on January 1, 1946, and ending on December 31, 1949. Thus, a taxpayer with fiscal years ending on June 30, for example, must compute its income for the first 6 months of 1946 by taking half its actual income for the year ended June 30, 1946. Such a taxpayer would have its average base period earnings affected by the last two quarters of 1945 and the first quarter of 1946. Inasmuch as those quarters were typified by low earnings generally, the inclusion of that period usually results in a reduction of the taxpayer's average earnings.

In order to correct this hardship, section 503 of your committee's bill provides that the base period of any taxpayer with a fiscal year ending after March 31, 1950, may, at its option, for purposes of the general average method of computing the excess profits credit, be the 48 months ending with March 31, 1950.

17. Consolidated returns

Section 612 of your committee's bill amends the consolidated return provisions of the code to permit a corporation exempt from excess profits tax under section 454 (f) of the code, which has filed a consent to be included in a consolidated return for a taxable year ending after June 30, 1950, the right to amend its election within 90 days after the effective date of this act.

Under the Excess Profits Tax Act of 1950, an affiliated group of corporations entitled to file a consolidated return may include corporations receiving at least 95 percent of their income from foreign sources if these corporations file consents in a taxable year ending after June 30, 1950. Corporations of this type would be exempt from excess profits tax under section 454 (f) of the code unless they file such consents, and these consents are irrevocable. Many of these consents were filed under circumstances where there was inadequate time for the taxpayers to adequately assess the effects of such action.

It is deemed proper to allow them a limited period of time to reconsider their action.

18. Capital reduction for loans made by parent corporations to subsidiaries

Section 510 of your committee's bill provides that where a subsidiary corporation computes its average earnings credit on the basis of the industry rate of return applied to its total assets and where such subsidiary has borrowed funds from its parent corporation on open account, the amount so borrowed shall be eliminated from its total assets.

This is necessary to close a loophole in the existing excess profits law. Under present provisions, a parent corporation does not incur a capital reduction by reason of amounts loaned on open account to subsidiaries. The subsidiary, however, would obtain an increase in the amount of its total assets to which the industry rate of return is applied under several of the relief sections. By excluding from the total assets of the subsidiary the amount represented by such loans from a parent corporation or from a member of a controlled group, the amendment made by your committee prevents duplication in computing the credits of the respective corporations.

This amendment is effective with respect to taxable years ending after the date of enactment of this bill.

19. Transitions from World War II production and increases in peacetime capacity

The attention of your committee has been called to cases where corporations have been fully engaged in war business during World War II and as a result have had difficulties during 1946 and 1947 in converting to peacetime production. As a result, their earnings in these years have been relatively low. Nevertheless, they have invested large amounts in plant and facilities in anticipation of securing a broad-gauge peacetime market. However, to a substantial degree many such corporations were not successful in tooling up for extensive production until 1949 or 1950. Thus, although they are not engaged in war production, such corporations find themselves subject to heavy excess profits taxes although the war economy has had little effect on their business. To the extent that such corporations had low earnings in 1949, they would receive little benefit from the growth provision generally available, even where they are eligible for it.

Your committee believes that corporations of this type whose profits are attributable to peacetime production should be able to use their earnings experience late in the base period and early in 1950 as the basis for the computation of their average earnings base for excess-profits-tax purposes. Therefore, section 516 of your committee's bill extends to corporations meeting certain requirements the benefits of the special growth formula described in section 435 (e) (2) (G) of the code. In general, this permits corporations to compute an alternative average base period net income on the basis of the sum of one-half of their income in 1948 and 40 percent of their income in 1950.

The requirements provided by your committee for the benefits of this provision are:

1. The adjusted basis of the corporation's real property and tangible depreciable property must not be in excess of $10 million on the first day of its base period.

2. Seventy percent of the corporation's income for the years 1942 through 1945 must be attributable to contracts with the United States or related subcontracts, but less than 20 percent of the corporation's income during the base period and in the calendar year 1950 must be attributable to contracts with the United States or related subcontracts.

3. The unadjusted basis of the corporation's real property and depreciable tangible property at the end of its base period must be 250 percent or more of the basis of such facilities on the first day of its base period.

4. Both the corporation's profits in 1945 and the average of its profits in 1948 and 1949 must be at least 300 percent of the average of its profits for 1946 and 1947.

20. Special relief provision for corporations suffering catastrophes

Section 442 of the code provides that, in the case of corporations having abnormalities in one of their three highest base-period years, their industry rate of return for the year of the abnormality, multiplied by their total assets in such year, may be substituted for the earnings in their year of abnormality. In the case of abnormalities in two or all of their three highest years, it provides that the average industry rate of return for the base period, multiplied by their average total assets for the base period, may be substituted for their base-period earnings. Although your committee believes that this is satisfactory in the case of most abnormalities, it appears that where a fire or explosion or other similar catastrophe has destroyed an important part of the corporation's productive facilities, the credit computed under section 442 may be inadequate. The corporation may have base-period experience prior to the catastrophe which indicates that in the absence of the loss it would have had earnings substantially above the earnings constructed by applying its industry's rate of return to its total assets.

Therefore, section 517 of your committee's bill provides that manufacturing corporations suffering from a catastrophe in the last 36 months of the base period may substitute their average excess profits net income in their base period, prior to the year in which the catastrophe occurred, for their earnings during the year in which the catastrophe occurred.

A catastrophe is defined as a fire, storm, explosion, or other casualty which rendered inoperative all of the facilities of a plant or plants accounting for at least 15 percent of a corporation's total facilities, for a period of at least 12 months during the last 3 years of the base period.

21. Consolidation of newspapers

Where two newspapers have consolidated a majority of their operational facilities, a failure to recognize the increased earnings attributable to that consolidation as normal earnings can result in considerable hardship to the taxpayers involved. This is because credits based on the earnings experience of two independent newspapers in the base period may not fairly represent what the earnings would in fact have been had they consolidated their operations early in or prior to the base period. The fact of consolidation may increase the rate of profit through a smaller overhead force and through the joint use of plant and equipment. Profits attributable to such increased efficiency should not be assumed to be excess profits.

In order to correct this situation, section 518 of your committee's bill extends the alternative average base period net income provided for growth companies under section 435 (e) (2) to any taxpayer which was engaged primarily in the newspaper publishing business prior to the end of the base period and which, after the middle of its base period and prior to June 30, 1950, consolidated substantially all of its mechanical, circulation, advertising, and accounting operations in connection with its newspaper publishing business with the similar operations of another corporation engaged in the newspaper publishing business in the same locality.

In order to be eligible for this alternative, the taxpayer must establish to the satisfaction of the Secretary that the consolidation resulted in substantial reductions in the expenses which would have been incurred had the consolidation not taken place. Furthermore, the deductions of the taxpayer for the taxable year following that of the consolidation must not have been in excess of 80 percent of the average of those deductions for the 2 years preceding the consolidation, and the taxpayer's income in the year following the consolidation must have been at least 125 percent of its average base period income. These eligibility requirements are designed to furnish automatic indications that an increase in income and a reduction in expenses have in fact occurred since the consolidation.

VIII. STRUCTURAL CHANGES IN ESTATE AND GIFT TAXES

A. Provision in the House Bill Also in Your Committee's Bill

1. United States bonds held by nonresident aliens

Section 603 of this bill and section 503 of the House bill contain identical provisions dealing with the status under the estate and gift taxes of obligations of the United States Government owned by nonresident aliens not engaged in trade or business in the United States. Prior to March 1, 1941, the transfers of such obligations were exempt by regulation even though the transfer of similar securities issued by domestic corporations was taxable when the evidence of the obligation was in the United States. This exemption was based on the theory that an exemption from "all taxation" of such bonds when held by foreign investors included exemption under the estate and gift taxes.

On March 1, 1941, a new regulation was issued which made the taxability of transfers of such securities under the estate and gift taxes depend on the same considerations which would apply in the case of bonds of domestic corporations. The new ruling was based on the theory that the exemption of such Government securities from "all taxation" meant exemption from direct taxes only and did not include exemption from the transfer taxes. The new regulation applied only to securities issued after March 1, 1941.

This revised regulation was held to be invalid in *Jandorf's Estate* v. *Commissioner* (171 F. (2d) 464), a decision of the Court of Appeals, Second Circuit, dated December 21, 1948, and in *The Pennsylvania*

Company v. *United States*, a decision of the Court of Appeals, Third Circuit, in November 1950.

Both your committee's bill and the House bill give statutory sanction to the policy of the March 1, 1941, regulation. The result will be that for estate and gift tax purposes United States Government securities will receive the same treatment as other types of domestic bonds. This treatment will also conform with the policy of taxing the interest on such Government bonds under the income tax when received by nonresident aliens.

The amendment will apply only to obligations issued by the United States on or after March 1, 1941, which are transferred in the estates of decedents who die after the date of enactment of the Revenue Act of 1951 or by gifts made after such date.

The revenue effects of this provision are minor.

B. Provisions Added by Your Committee

1. Estate taxes of servicemen killed in Korea

Your committee's bill provides the same estate tax treatment for members of the Armed Forces dying in combat zones or from wounds received in combat zones as was previously provided during World War II.

Section 605 provides that the estate tax shall not apply to the estates of decedents dying while in active service as a member of the military or naval forces of the United States if the decedent was either killed in action while serving in a combat zone, or died as a result of wounds or other injuries, or a disease, suffered while in line of duty by reason of a hazard to which he was subjected as an incident of such military or naval service.

This provision is effective with respect to deaths occurring after the commencement of hostilities in Korea (June 24, 1950) and before January 1, 1954.

2. Pre-1916 transfers with reversionary interests retained

Under the present law a transfer in trust prior to 1931 is not subject to estate tax by reason of the retention of a life estate and a transfer prior to October 8, 1949, is not subject to estate tax by reason of the retention of a reversionary interest unless the reversionary interest is express, rather than arising by operation of law, and exceeds 5 percent of the value of the property immediately before the decedent's death. The present law makes no distinction between transfers made before the enactment of the estate tax, September 8, 1916, and transfers made after that date. However, from 1927 to 1934 the regulations provided that transfers made before enactment of the estate tax would not be taxable. Also, prior to the decision of the Supreme Court in the *Hallock* case in 1940 it was felt that property would not be taxed in a decedent's estate by reason of his retention of a reversionary interest.

A case has been brought to the attention of your committee in which the decedent made a transfer in trust in 1903 retaining a reversionary interest which was worth about 14 percent at the time of her death in December 1949. As a result of the retention of this minor interest, the entire estate is subject to tax.

In order to avoid this severe hardship, section 608 of your committee's bill provides, in effect, that property will not be included in the estate of a decedent by reason of the retention of a reversionary interest in a transfer made prior to September 8, 1916, where the decedent died after February 10, 1939, the date of enactment of the Internal Revenue Code.

3. Reversionary interest of decedents dying prior to February 10, 1939

The provisions of the Technical Changes Act of 1949 apply only with respect to decedents dying after February 10, 1939, the date of enactment of the Internal Revenue Code. In the case of such decedents, property is included in the gross estate by reason of the retention of a reversionary interest in a transfer made before October 8, 1949, only if the reversionary interest is express and is worth more than 5 percent immediately before the decedent's death.

On March 18, 1937, Treasury Decision 4729 was issued by the Treasury Department, providing that property should not be taxed by reason of the retention of a reversionary interest. In order to treat the estates of decedents dying before February 11, 1939, and after March 18, 1937, in accordance with the law then in effect, section 606 of your committee's bill provides that property transferred by a decedent dying in such period is not to be included in the estate of the decedent because of a possibility of reverter if the regulations in effect at the time of the death of the decedent did not provide for the inclusion of property so transferred.

4. Decedents dying in 1950 with pre-1931 life estates retained

The Technical Changes Act of 1949 provided that, in the case of life estates retained in transfers made on or before March 3, 1931 (and in some cases before June 7, 1932), the property would not be included in the decedent's gross estate by reason of retention of the life estate if the decedent died before January 1, 1950. The 1949 act also provided that these life estates could be released free of estate and gift tax at any time during 1949 or 1950. The 1949 act containing this tax-free release provision became law on October 25, 1949. There have been several cases in which decedents died in 1950 before releasing their pre-1931 life estates, possibly because they were not aware of the tax-free release provision or were not in condition to effect a release.

Since these life estates could have been released at any time during 1950 without estate tax, it seems equitable to your committee that the January 1, 1950, date in the 1949 act be changed to January 1, 1951, so that the period in which death might occur without estate tax will be consistent with the period for tax-free release of these life estates.

Therefore, in the case of life estates retained in transfers made on or before March 3, 1931, section 607 of the bill provides that property will not be included in the decedent's gross estate by reason of retention of the life estate if the decedent died before January 1, 1951 (instead of January 1, 1950, as provided by present law).

5. Reversionary interests in life insurance—Decedents dying after October 21, 1942

The Revenue Act of 1942 provided that, in determining the proportion of life-insurance premiums paid by the decedent, premiums paid by a decedent on or before January 10, 1941, shall be included if the decedent at any time after that date possessed an incident of ownership in the policy. Since a reversionary interest was construed to be an incident of ownership, the retention of any reversionary interest, regardless of its size and regardless of whether it was express or by operation of law, had the effect of making the premiums paid by the decedent includible for purposes of the premium payment test. In order to make the treatment of life insurance consistent with the treatment of other property under the Technical Changes Act of 1949, the Revenue Act of 1950 provided that a reversionary interest should be considered an incident of ownership only if it were express and, at some time after January 10, 1941, exceeded 5 percent of the value of the policy. The provision in the 1950 act was an amendment of the Revenue Act of 1942, so that it was effective with respect to the estates of decedents dying after October 21, 1942. However, the 1950 provision did not provide for the reopening of closed cases. In this respect it was different from the 1949 amendment of section 811 (c), which provided a 1-year period during which claims for refund could be filed for closed cases.

In order to correct that deficiency, section 609 of your committee's bill amends section 503 of the Revenue Act of 1950 in order to permit the reopening of closed cases if a claim is filed within 1 year from the date of the enactment of this bill.

6. *Foreign estate tax credit*

Under present law the United States asserts estate tax liability with respect to the entire estate, wherever situated (except real property outside the United States), of decedents who were either domiciled in the United States or citizens of the United States. Since many other countries, like the United States, tax property situated within their boundaries, estates of nonresident citizens of the United States are quite likely to be subjected to a double tax. With a considerable number of foreign countries, the United States has entered into estate tax conventions which provide relief for this problem and other treaties at present are under consideration. However, in many other cases the possibility of double taxation still exists, and cases have been brought to the attention of your committee where, as a result of this double taxation, estates with foreign investments have been taxed much more heavily than similar estates subject only to domestic tax.

Section 602 of your committee's bill removes this double taxation by providing a foreign estate tax credit in the case of United States citizens and residents (subject to a limitation indicated below) where the double tax arises from the United States imposing a tax on the entire estate, and a foreign country imposing an estate tax on property situated within that country. The foreign estate tax credit is allowed both against the basic estate tax and the additional estate tax. As in the case of the income tax, a foreign tax credit is allowed in the case of those who were residents but not citizens of the United States only if the foreign country in which the decedent was a citizen allows a similar foreign tax credit in the case of citizens of the United States who are residents of that country. As in the case of the foreign tax credit allowed for income tax purposes, the foreign estate tax credit is limited in a manner which permits the offsetting of taxes paid the foreign country with respect to property situated in that country only to the extent that such property is taxed by the United States. Thus, if a foreign country imposes an estate tax at a higher effective rate than that provided by the United States, a credit is to be allowed only to the extent of the effective rate of tax imposed by the United States.

This provision is effective with respect to estates of decedents dying after the date of enactment of this bill.

7. Works of art loaned by nonresident aliens

Section 604 of your committee's bill provides that works of art owned by a nonresident alien which are loaned to public galleries or museums in the United States for exhibition purposes shall be exempt from estate tax if the nonresident alien dies while the works of art are in this country.

Present law (sec. 863 (c) of the code) limits the exemption to works of art loaned to the National Gallery of Art.

This provision is effective with respect to estates of decedents dying after the date of enactment of this bill.

The revenue loss from all of the changes in the estate and gift tax changes made by this bill are expected to decrease revenues by $2 million.

IX. EXCISE TAX CHANGES

It is estimated that at the levels of production anticipated in the fiscal year 1952 excise tax changes by your committee's bill, when fully effective, will raise revenues by $1,275 million as compared with $1,252 million under the House bill. As shown in table 11, almost all of the excise-tax revenue provided by both your committee's bill and the House bill is raised from the manufacturers' excises, the new taxes on gambling and the taxes on alcoholic beverages and tobacco. No rate increases are provided in the case of the retail excises, the excises on transportation and communication or the admissions taxes, because the rates of these taxes generally are already quite high. Not only are most of these taxes imposed at rates around 20 percent, but also they are based on the retail price or the amount charged the consumer, which may range up to twice the manufacturer's price. As a result, these rates now are generally three to four times as high as most of the manufacturers' excises, usually levied at a 10 percent rate on the manufacturers' prices.

TABLE 11.—*Excise-tax revenue raised by the bill by major sources*

[At estimated fiscal year 1952 levels of production and consumption but in a full year of operation]

Type of excise tax	Additional revenue	
	House bill	Committee bill
	Millions of dollars	*Millions of dollars*
Alcoholic beverages	$252	$252
Tobacco products	177	167
Manufacturer	447	488
Retail	−5	−7
Transportation and communication	−5	−14
Amusement and recreation	−21	−18
Gambling	407	407
Total	1,252	1,275

The excise-tax changes made by your committee's bill become effective on the first day of the first month which begins more than 10 days after the date of enactment of the bill. Your committee's bill also provides that the excise-rate increases are to expire on December 31, 1953. No termination date was provided for the excise-tax increases made by the House bill, but the same provision applied with respect to the time when the excise-tax changes were first to become effective. Assuming that November 1 is the effective date for these changes, it is estimated that your committee's bill will increase excise-tax revenues by $823 million in the fiscal year 1952 (this includes the floor stock taxes), raising total receipts for 1952 from excises to $9,383 million. With this same assumption, the House bill would increase excise collections in 1952 by $811 million, raising total excise receipts in 1952 to $9,371 million.

A. Alcoholic Beverages

The additional revenue estimated to be derived from the taxes on alcoholic beverages in a full year of operation is distributed among the various excises under both the House bill and your committee's bill as follows:

[In millions]

	House bill	Committee bill
Distilled spirits (including increased draw-back)	$168	$168
Beer	68	68
Wines	8	8
Occupational taxes on dealers in liquor	8	8
Total	252	252

1. *Distilled spirits*

Section 441 of your committee's bill increases the tax on distilled spirits imposed by sections 1650 and 2800 of the Internal Revenue Code from $9 to $10.50 per proof gallon. This is the same increase as is made by the House bill. The increase of $1.50 per proof gallon amounts to about 26 cents a fifth on the ordinary type of whisky bottled at about 85 proof. Under present law the $9 per gallon tax on distilled spirits averages about 40 percent of the retail price per bottle, including tax. The tax imposed by both your committee's and the House bills would raise this figure to about 43 percent. This assumes the addition in full of the tax to current prices, but no price mark-up on the tax.

During World War II and the immediate postwar years consumption of distilled spirits climbed almost continuously in spite of higher liquor taxes and prices, reaching a peak consumption in 1946 when consumers purchased more than 230 million wine gallons of distilled spirits for which they spent $5 billion, or 3 percent of their total disposable income. High income levels and the inability of consumers to purchase scarce durable goods probably were the most important factors in accounting for this high consumption level. Although consumption of liquor declined during the postwar years, since the outbreak of hostilities in Korea it has again been increasing, and the 1950 consumption of 190 million wine gallons was higher than in any prior years except 1945 and 1946. The acceleration of the defense program presents the likelihood that income levels again will rise and that consumers again will have to cut down their purchases of durable goods. Your committee believes that, under the conditions described above, it does not appear the increase provided by the bill will seriously affect the consumption level of liquor. Thus, it is not believed that the tax increase provided here will have much effect on the industry.

From the standpoint of the consumer it is not believed that this tax increase will prove to be particularly burdensome, since the limited data available suggest that up to income levels of $5,000 this tax bears about equally on the various income levels.

Your committee carefully reviewed the increase in the tax on distilled spirits with reference to the problem of bootlegging. It found that even under present tax rates there is a substantial financial incentive to engage in illicit operations of this type, which had been held at a relatively low level only as a result of enforcement measures. However, any increased financial incentive for illicit operations resulting from the tax increase provided by your committee's bill is likely to be more than offset by a tightening of the labor supply available for these operations and by higher incomes on the part of consumers, which will decrease the importance of the price differential between tax-paid and non-tax-paid liquor. Nevertheless, it was recognized that too large an increase in the tax on distilled spirits might well result in a sizable increase in illicit operations.

At the present time, although the general tax rate on distilled spirits is $9 a proof gallon, a draw-back of $6 per proof gallon is provided for distilled spirits used for medicines, medicinal preparations, food products, flavors, leaving a net tax of $3 per proof gallon in such cases. Draw-backs are used rather than reducing the rate of tax, because a lower rate might result in distilled spirits being diverted to beverage purposes on which the higher rate of tax should be paid. Using these medicines and nonbeverage food products as a source of revenue, however, appears to be in contradicition to the policy generally followed of not imposing excise taxes on medicines or food. In part this principle is recognized under present law by providing a draw-back of all but $3 of the tax per proof gallon. Both your committee's and the House bills recognize this principle in full by increasing these draw-backs so that a net tax of only $1 per proof gallon, sufficient to cover administrative costs, is finally paid. With the tax rate of $10.50 per proof gallon this is accomplished in section 452 of the bill providing in section 3250 of the code a draw-back of $9.50 per proof gallon.

It is estimated that in a full year of operation the changes made in the tax on distilled spirits by both your committee's and the House bill will increase revenues by $168 million.

2. Beer

Section 443 of the bill increases the tax imposed on fermented malt liquor, or beer, by sections 3150 and 1650 of the code by $1 per barrel, or from the $8 per barrel provided by present law to $9 per barrel. This represents the same increase as is made by the House bill. This is an increase in tax of 12½ percent as contrasted to an increase of 16⅔ percent provided in the case of distilled spirits. Under present law the tax on beer represents about 15 percent of the average retail price and under both your committee's and the House bills this is increased to between 16 and 17 percent. In the case of a 12-ounce bottle of beer the tax increase represents an increase of about one-third of 1 cent.

The increase provided for beer is smaller than that provided for distilled spirits because your committee believes that beer to a greater extent is consumed by the lower income groups and, therefore, that an increase in this tax generally is more burdensome than the tax on distilled spirits.

With the present high income and consumption levels it appears probable that much, if not all, of the tax increase provided for beer can be shifted by the industry to the consumer without seriously affecting the current level of consumption. Thus it is not anticipated that this tax increase will have any important effect on the industry.

In a full year of operations it is estimated that the $1 per barrel increase in the tax on beer will raise revenues by about $68 million.

3. Wines

Section 442 of the bill amends sections 3030 and 1650 of the code to provide for the same increase in the tax on wines as in the case of beer, namely, an increase of approximately 12½ percent. Thus, in the case of still wines, including vermouth, the tax per gallon would be—

(*a*) increased from 15 to 17 cents where the alcoholic content of the wine is not more than 14 percent,

(*b*) increased from 60 to 67 cents where the alcoholic content of the wine is over 14 percent but not over 21 percent; and

(*c*) increased from $2 to $2.25 where the alcoholic content of the wine is over 21 percent but not over 24 percent.[14]

In the case of sparkling wines, liqueurs, and cordials the tax per half pint would be:

(*a*) increased from 15 to 17 cents in the case of champagne or sparkling wines; and

(*b*) increased from 10 to 12 cents in the case of liqueurs, cordials, and artificially carbonated wines.

These are the same increases as are provided by the House bill.

Most of the wine consumption in the United States today is represented by the first two categories of still wines. Natural, or table, wines with an alcoholic content not over 14 percent and including such wines as sauterne, claret, and burgundy represent about one-quarter of the total consumption. Sweet or dessert wines with an alcoholic content between 14 and 21 percent and including such wines as port, sherry, tokay, and muscatel represent approximately three-fourths of the total consumption in the United States today. These wines are fortified with brandy or alcohol before the natural fermentation is completed. Sparkling wines account for most of the small remaining consumption in the United States today and in large part represent imports.

In terms of retail price the tax under present law represents about 4 percent of the retail price, including tax, in the case of table wines, and would be increased by about one-half of 1 percent under both your committee's and the House bills. The tax on sweet wines under present law represents about 15 percent of the retail price and under both bills this percentage would be increased by slightly more than 1 per-

[14] Wines with alcoholic content in excess of 24 percent are subject to the tax on distilled spirits.

centage point. The tax on sparkling wines represents about 25 percent of the retail price under present law and under both bills this would be increased to about 26½ percent. Thus the rate of tax under the bills will continue to be graduated in accordance with alcoholic content.

Your committee deemed it appropriate to make only a moderate increase in the case of the taxes on wines because of the importance of wines to the grape-growing industry. Between one-third and one-half of the total grape crop is customarily absorbed by wine. The demand for wine, therefore, also has an important effect on the prices which can be obtained by producers for raisins and fresh grapes, the two other important uses of grapes. Moreover, in view of the fact that it has been necessary for the Department of Agriculture at times since the end of World War II to support the price of raisins, it would appear inappropriate for your committee to make a substantial increase in the tax on wine which might have the effect of requiring further price supports. In addition it should be pointed out that wine consumption in the United States relative to consumption of other forms of alcoholic beverages is relatively low when compared to relationships generally established abroad. Moreover, the wine industry is one of the few industries which has been classified under the excess-profits tax as a depressed industry.

The effect of both your committee's bill and the House bill in the case of the taxes on wines is to raise revenues by an estimated $8 million in a year in which the increase is fully effective.

4. Occupational taxes on dealers in liquor

Retail dealers in liquor other than those dealing exclusively in wine and beer are required under section 3250 of the code to pay a special annual occupational tax of $27.50. Section 451 of the bill raises this occupational tax to $50 a year. This is the same increase as is made by the House bill. Under present law the low tax has made it impractical from an administrative standpoint for the Bureau of Internal Revenue to verify the names and addresses of persons paying this special occupational tax. Attention has been called to many cases where incorrect names and addresses have been given with the probable intention of avoiding detection by State and local liquor authorities. Your committee believes it feasible for the Bureau of Internal Revenue to establish a verification system for all payees of this tax and it is the intention of your committee that the Bureau of Internal Revenue do so. Severe penalties for fraudulent returns are already provided under existing law. It is estimated that this provision will increase collections by $7 million in a full year of operation.

Section 451 of your committee's bill also increases the occupational taxes on wholesale dealers in liquors and wholesale dealers in malt liquors. Section 3250 (a) (1) of the code imposes a special occupational tax of $110 on wholesale dealers in liquors. This includes wholesale dealers in wines, as well as wholesale dealers in distilled spirits. Both your committee's bill and the House bill raises this tax to $200. Section 3250 (d) of the code provides an occupational tax of $55 for wholesale dealers in malt liquor. This tax is raised to $100 by both bills. It is estimated that in a full year of operation the increase in these occupational taxes on wholesale dealers in liquors and malt liquors will raise revenues by $1 million annually.

B. Tobacco Products

The changes made in the excise taxes on tobacco are distributed between small ("standard" and "king" sized) cigarettes and snuff, fine-cut, scrap, plug and twist chewing tobacco as follows:

[In millions]

	House bill	Committee bill
Small cigarettes ("standard" and "king" sized)	$177	$177
Snuff and fine-cut, scrap, plug, and twist chewing tobacco	0	−10
Total	177	167

No changes are made in the present taxes on cigars and smoking tobacco.

1. *Small cigarettes*

In the case of small cigarettes, section 421 of your committee's bill increases the tax provided by section 2000 of the code from $3.50 per thousand to $4 per thousand. This is the same increase as is made by the House bill. In effect, this raises the tax on the ordinary package of 20 cigarettes from 7 cents to 8 cents. The present tax on cigarettes represents about 34 percent of the retail price including tax. The increase would raise this to about 37 percent.

The increase provided by both bills is as large as the combined increases made in this tax during and just before World War II. In view of the importance of the sales of tobacco to a large number of farmers in the country, this is as large an increase in this tax as your committee believes it is appropriate to make.

It is estimated that in a full year of operation this action will increase revenues by $177 million a year.

2. *Snuff and fine-cut, scrap, plug, and twist chewing tobacco*

In the case of snuff and fine-cut, scrap, plug, and twist chewing tobacco, section 423 of your committee's bill reduces the tax from 18 cents per pound to 10 cents per pound. In the case of smoking tobacco the tax remains at 18 cents per pound. No such reduction was provided in the House bill. Your committee believes that this reduction is desirable because the declining demand for snuff and chewing tobacco has worked hardships on the manufacturers, and also on the farmers raising these particular types of tobacco. Moreover, these tobacco products are used primarily by the lower income groups and, therefore, the present tax is believed to be highly regressive.

It is estimated that in a full year of operation this action by your committee will decrease revenues by about $10 million a year.

C. Manufacturers' Excises

The additional revenue it is estimated will be derived from manufacturers' excises is distributed among the various excises as follows:

[In millions]

	House bill	Committee bill
Gasoline, and diesel fuel used by highway vehicles	$220	$210
Passenger cars, motorcycles and house trailers	196	189
Automobile trucks, busses, and truck trailers	61	61
Automotive parts and accessories	56	56
Tires on toys, etc	−1	−1
Electric, gas, and oil appliances	18	69
Navigation receivers sold to the U. S. Government	None	None
Refrigeration equipment	0	Negligible
Sporting goods	Negligible	Negligible
Photographic apparatus and film	−23	−5
Electrical energy	−104	−104
Fountain pens, ball-point pens, and mechanical pencils	24	12
Cigarette, cigar, and pipe lighters	0	1
Total	447	488

1. *Gasoline and diesel fuel*

Section 479 of the bill provides for a one-half cent increase in the gasoline tax, raising the Federal gasoline tax, provided by section 3412 of the code, from 1½ to 2 cents per gallon. This is the same increase as is provided by the House bill. Since the tax on gasoline is a specific and not an ad valorem tax, the percentage relationship of the tax to the retail price will vary with the variation in the price of gasoline. Thus, although in 1950 the tax was 6 percent of the retail price, including tax, in 1940 it was 8½ percent of the retail price. This is accounted for by the rise in the average price of gasoline in the past 10 years. The average price in 1939, for example, was 13.3 cents per gallon before the State tax, while in 1950 the average price was 20 cents per gallon. The action by your committee, which would result in a tax equal to about 8 percent of the retail price of gasoline including tax, does not quite restore the relationship existing in 1940.

The consumption of gasoline has shown one of the most consistent patterns of increase over the last few decades. The production of gasoline in 1940, for example, amounted to 615 million barrels and in 1950 this had increased to 1,024 million barrels. The domestic demand for gasoline has grown at an average annual rate of 7 percent since the end of War War II and appears to be increasing somewhat more rapidly now. The 1950 demand for gasoline was 9 percent in excess of the demand for 1949 and the Bureau of Mines has estimated that the demand in 1951 will be 9½ percent in excess of the demand in 1950. This substantial increase can, of course, in large part be accounted for by the increased numbers of passenger automobiles and trucks on the road. For example, registration of automobiles and trucks in the period 1945 to 1950 increased over 50 percent. Under these conditions it appears probable that an increase in the gasoline tax of the size provided by this bill can readily be passed on to the consumers of gasoline. This appears especially likely in view of the fact that, in the case of gasoline, demand does not change much with variations in price.

Despite this strong demand, the increase in the gasoline tax is limited to a half cent per gallon. Payments for gasoline represent costs of doing business in the case of gasoline consumed by trucks and in the case of an important segment of the gasoline used in passenger cars. In addition to this, your committee recognizes that the gasoline tax represents an important source of revenue to the States. The usual State tax ranges from 4 to 5 cents per gallon but eight States have a 7 cents per gallon tax and one has a tax of 9 cents per gallon. Too substantial an increase in the gasoline tax by the Federal Government might affect the use of this revenue source by the States.

The House bill adds a new section 2450 to the code imposing a tax of 2 cents per gallon on diesel fuel for diesel-powered highway vehicles. The tax is imposed on the retailer selling the diesel fuel for highway use and also on persons using the diesel fuel in highway vehicles if no tax was collected from the retailer.

Your committee, although recognizing that the failure to tax diesel fuel used on highways on the same basis as gasoline is discriminatory against vehicles power by gasoline, does not include this provision in its bill. As provided by the House bill, the tax would be very difficult to collect. The retailer selling diesel fuel for highway use also sells the same fuel for fuel-oil furnaces in homes. Moreover, experience with this tax at the State level has also indicated a considerable amount of evasion where the tax is collected from the persons using the fuel oil in the highway vehicles, the second alternative collection method provided by the House bill. Because of these difficulties in the administration of this tax, your committee believes that it is desirable to postpone the consideration of this problem until it is possible to give it further study.

As a result of not imposing this tax on diesel fuel, the estimated revenue which it is anticipated will be collected in a full year of operation from the gasoline tax is $210 million instead of the $220 million estimated for the House bill.

2. Passenger cars and motorcycles

Section 471 of the bill increases the tax, provided by section 3403 of the code, on passenger cars and motorcycles from 7 to 10 percent of the manufacturers' price. However, your committee's bill removes the tax on house trailers. The increase provided for passenger automobiles and motorcycles is the same as that provided by the House bill, but the House bill left the tax at 7 percent in the case of house trailers instead of removing it. The present tax on passenger cars on the average represents 5 percent of the retail price, including tax. The increase provided by this bill will raise this to somewhat over 7 percent.

The demand for new passenger cars has continued at a very high level since the end of World War II not only because of the backlog of demand from the war period when new cars were not available, but also because high income levels have made the purchase of cars possible to many persons not formerly able to buy them. The unit output in 1950, for example, represented 232 percent of the output in 1939. Moreover, the value of the 1950 output was $8.8 billion, or about five times the value of the output in 1939.

Despite the recent temporary decline in the sales of passenger cars, it appears that the demand for them in the year 1951 as a whole will be at a very high level. However, it appears probable that the supply of automobiles available will be cut because of their substantial use of critical materials. Twenty percent of the total steel output, for example, has been going to the production of automobiles. Steel allocations for automobiles were reduced in the second and third quarters of 1951 and at the present time shortages of copper and stainless steel are affecting automobile production. The output of passenger cars in calendar 1951 will probably be approximately the 1949 level which was slightly over 5 million, and is expected to be substantially above the annual production in the 10 years prior to World War II.

Under these conditions it appears probable that an increase in tax of the size proposed by your committee can readily be passed forward to the consumer without any cut in the effective demand for new passenger cars. Since the tax is not imposed on second-hand cars, which in large measure represent the purchases made by the lower-income groups, it appears probable that the tax increase made by the bill will not bear heavily on these groups.

However, your committee recognizes that cars represent a necessity to a large segment of the population under present conditions and, therefore, deemed it inappropriate to increase the rate above 10 percent on the manufacturer's price, the rate applying in the case of most manufacturers' excises. Moreover, the purchase of a car represents a larger outlay on the part of the consumer than is true in the case of most other durable consumption items, with the result that the amount of the tax payment in these cases is larger than in the purchase of other durable goods and, therefore, likely to be considered more burdensome.

Your committee's bill removes the tax on house trailers because it recognizes that, during periods of emergency such as the present, the bulk of these house trailers are used for housing by defense workers, military personnel and others rather than as a means of transportation.

It is estimated that in a full year of operation this provision of the bill will increase revenues by $189 million.

3. *Automobile trucks, busses, and truck trailers*

Section 471 of the bill also increases the tax on automobile trucks, busses, and truck trailers, provided by section 3403 of the code, from 5 to 8 percent of the manufacturer's price. This increase is the same as that provided by the House bill.

Since, as previously noted, the tax on passenger cars is increased to 10 percent, this maintains the traditionally lower tax for the types of automotive transportation especially designed for business. Your committee believes that it is desirable to retain a lower tax on trucks and related types of automotive transportation because it recognizes that these represent operating costs to businesses. A high rate of tax in such cases would be likely to be passed on in the price of commodities generally. However, it is believed that the moderate increase provided by the bill is desirable on much the same grounds as the increase provided in the case of passenger automobiles: namely, the anticipated high demand for this type of automotive transportation coupled with the likelihood of a curtailment in the supply available.

It is estimated that in a full year of operation this provision will increase revenues by $61 million.

4. Automotive parts and accessories

Section 471 of the bill also increases the tax on automotive parts and accessories, provided by section 3403 of the code, from 5 to 8 percent of the manufacturer's price. This increase is the same as that provided by the House bill. Since the tax on automotive trucks, busses, and truck trailers likewise is raised to 8 percent, this will retain a uniform rate of tax for these two types of items, as is provided by present law. Even though new cars are taxed at 10 percent, the parts and accessories for them, when not purchased with the car, are included in the base of this 8-percent tax, because in many cases the parts for passenger cars and trucks are interchangeable. Morevoer, it is also believed desirable to impose a lower rate of tax on parts and accessories for passenger cars than on the new cars themselves, because the bulk of the parts and accessories are purchased by owners of old or second-hand cars who are largely in the lower-income groups.

With respect to reconditioned or rebuilt parts, where such sales are subject to the parts and accessories tax under present law, section 471 of both your committee's bill and section 481 of the House bill provide an amendment which excludes from the tax base the fair market value of any like part traded in for a reconditioned or rebuilt part. Where an automotive part is not performing satisfactorily and the car owner cannot afford a new one, he has the choice of either having the old one reconditioned, usually in a local shop, or of trading in the old part on a similar one which already has been reconditioned. The first of these alternatives, having the old part reconditioned, is not subject to the tax on automotive parts and accessories since there is no transfer of title. However, this alternative is not widely availed of because the car owner is not able to use his car during the reconditioning period. Under the second alternative, trading in the old part on a similar one which already has been reconditioned, there is a transfer of title and therefore such sales are subject to tax. The amount subject to tax in these cases is the charge to the car owner, plus the fair market value of the part he trades in. This not only presents the difficult administrative problem of determining the fair market value of the old part, but also is inequitable since trading in the old part is a substitute for repairing the car owner's old part. Only the value added in this case could be considered as new manufacturing, since in effect the car owner already owned the portion of the reconditioned part representing the value of the old part. To tax him on the fair market value of the part he turns in is to tax him on something he already owns. The exclusion of the value of the trade-in, as provided by your committee's amendment, removes this inequity. This also removes the difficult administrative problem of determining the fair market value of the old part, since the tax base will be limited to the cash payment required.

Section 471 of your committee's bill, like the House bill, also amends section 3443 of the code to provide for a credit or refund of the tax on automotive parts and accessories where the parts or accessories are used or resold for the repair or replacement of farm equipment parts. However, this crediting or refunding device is not made available in the case of spark plugs, storage batteries, leaf springs, coils, timers, and tire chains.

An exemption is already provided by existing regulations for automotive parts and accessories sold to manufacturers for use on new farm equipment with the exception of the items specifically listed above. The provision, therefore, merely applies the same policy to sales of repair or replacement parts, making use, in this case, of a crediting or refunding procedure. This appears desirable because it is not believed that Congress ever intended to subject farm tractors and equipment generally to this tax. With the exception of the specific items noted above on which the tax will still apply, it is believed that these credits or refunds will present no serious administrative problems.

It is estimated that the rate increase in the tax on automotive parts and accessories, taken together with the changes in the base of the tax, will increase revenues in a full year of operation by $56 million.

5. Tires on toys, etc.

Section 471 of the bill also makes a minor revision in the 5-cent-per-pound manufacturers' tax on tires. Section 3400 of the code is amended to exclude from this tax tires which are not more than 20 inches in diameter and one and three-fourths of an inch in cross section if the tires are of all-rubber construction. The bill also excludes tires with internal wire fasteners, irrespective of size. This exemption is the same as that provided by the House bill.

Under present law, the tax on tires is applicable to all tires regardless of the use for which they are intended. Consequently, it applies in the case of tires for baby buggies, lawn mowers, children's tricycles, scooters, coaster wagons, etc. Since the manufacturer's price on tires of these types is generally low, the 5-cent-per-pound tire tax may account for as much as 25 to 50 percent of the price of the tires. Thus, the tax on the tires of these toys, etc., appears unreasonably high in terms of ad valorem rates. Moreover, it is not believed that it is a primary purpose of the tax on tires to collect revenue with respect to articles of these types.

It is estimated that in a full year of operation this change will result in a revenue loss of approximately $1 million a year.

6. Electric, gas, and oil appliances

Section 475 of the bill expands the base of the 10 percent manufacturers' tax on electric, gas, and oil appliances provided by section 3406 of the code to include the following household types of items not subject to tax under present law:

1. Electric vacuum cleaners.
2. Electric washing machines.
3. Electric garbage disposal units.
4. Exhaust blowers.
5. Electric belt-driven fans.
6. Electric or gas clothes driers.
6. Electric door-chimes.
8. Electric dehumidifiers.
9. Electric dishwashers.
10. Electric floor polishers and waxers.
11. Electric food choppers and grinders.
12. Electric hedge trimmers.
13. Electric ice cream freezers.
14. Electric mangles.
15. Electric motion- or still-picture projectors.
16. Electric pants pressers.
17. Power lawn mowers.
18. Electric sheets and spreads.

It also deletes ~~electric~~ heating pads, industrial-type direct motor-driven fans and electric heaters of the blower type from the items presently subject to tax. The House bill did not impose a tax on electric vacuum cleaners, electric washing machines, or electric garbage disposal units, but did impose a tax on electric shavers. The House bill also did not delete industrial-type direct motor-driven fans from the base of the present tax.

Of the items added to the base of the tax, by far the most important in terms of revenue are the electric washing machines and vacuum cleaners. Of the remaining items, power lawnmowers, electric dishwashers, and electric and gas clothes driers are the most important revenue producers.

The tax under present law applies to—

1. Electric, gas, and oil water heaters.
2. Electric, gas, and oil appliances for cooking or warming food or beverages for consumption on the premises.
3. Electric direct motor-driven fans and air circulators.
4. Electric flatirons.
5. Electric air heaters (but not furnaces).
6. Electric immersion heaters.
7. Electric heating pads and blankets.
8. Electric mixers, whippers, and juicers.

The items added to the base of this tax by your committee are directly or indirectly competitive with many of the items now in the base of the tax. An example of direct competition exists in the case of the household-type direct motor-driven fans subject to tax under present law and the household-type belt-driven fans which are presently free of tax. Vacuum cleaners, washing machines, and garbage disposal units were added by your committee because these are electrical appliances of wide usage which are at least indirectly competitive with a large number of the items already subject to the appliance tax or made so by the House bill. However, your committee did not deem it appropriate to raise the rate of this tax in view of the fact that a number of items in its base are generally considered to be necessities.

As in the case of passenger cars, it is anticipated that with the current high income levels the demand for electric appliances will remain strong, while the supply available is likely to decline somewhat as a result of the shift of critical materials from civilian products to products needed for the defense effort. The steel used in electric appliances, for example, has been cut back by 30 percent for the third quarter of 1951. In view of these factors, it appears unlikely that expanding the base of this tax to include the new items listed above will have any appreciable effect upon the sales of the electric appliances industry.

From the standpoint of the consumer also, this tax does not appear to be very burdensome. The data available indicate that this tax tends to bear less heavily on the lower-income groups than most other excise taxes now imposed. Moreover, this 10-percent manufacturers' tax, when expressed as a percentage of the retail price of the electric, gas, and oil appliances, including tax, represents only about a 6-percent tax.

Electric heating pads were removed from the base of the tax on electric, gas, and oil appliances because these pads are extensively used for medical purposes, and your committee does not believe that such items are proper subjects for excise taxes. Electric shavers, although included in the House bill, are excluded from your committee's bill because they are competitive with safety razors and blades and straight razors which are not subject to excise tax. Industrial-type direct motor-driven fans are excluded from the base of the tax both because they are business cost items and because they are competitive with industrial-type belt-driven fans which are not subject to excise tax.

Under present law where the manufacturer sells an electric, gas, or oil appliance at retail, on consignment, or at less than the fair market price, the Commissioner is required to determine the competitive fair market price. In the case of one of the new items added to the base of this tax, vacuum cleaners, another type of selling arrangement is followed whereby the manufacturer negotiates the sale on behalf of the retailer. Since the price charged in such cases does not represent a fair price for purposes of a tax base, the Commissioner, under your committee's bill, is required to determine such a price where these selling arrangements are used in the same manner as where the manufacturer sells at retail or on a consignment basis.

It is estimated that in a full year of operation the new items added to the base of the electric-, gas-, and oil-appliances tax will increase revenues by about $71 million a year, while the exclusion of electric heating pads, industrial-type direct motor-driven fans and electric heaters of the blower type will reduce revenues by $2 million annually.

7. Navigation receivers sold to the United States Government

Section 472 of the bill makes a minor revision in the base of the 10-percent manufacturers' excise tax on radio receiving sets, television receiving sets, etc., imposed by section 3404 of the code. "A communication, detection, or navigation receiver of the type used in commercial, military, or marine installations," is exempted from this tax under your committee's bill if sold to the United States for its exclusive use. This change is the same as that provided by the House bill. This exemption is granted to remove compliance problems. No revenue is, of course, involved, since the tax in these cases today is ultimately paid by the United States Government.

8. Refrigeration equipment

Under present law, a 10-percent manufacturers' tax is imposed on household type mechanical refrigerators, quick-freeze units, and refrigerating and freezing apparatus. In the case of refrigerating and freezing apparatus, present law provides that the tax does not apply in the case of sales of refrigerator components to manufacturers of refrigerators, quick-freeze units or refrigerating or cooling apparatus. This latter provision prevents the double imposition of the refrigerator tax where sales are made from one manufacturer to another. However, in many cases refrigerating apparatus is sold first to a wholesaler or jobber, who in turn sells the apparatus to a manufacturer. Under present law, a double imposition of the refrigerator tax occurs in such cases unless the wholesaler is specifically registered with the Bureau of Internal Revenue as a vendee of articles for resale to manufacturers. Moreover, registration is limited to wholesalers who resell to manufacturers of taxable end products. Your committee believes that the present tax treatment discriminates against wholesalers and that this tax interferes with the normal channels of distribution. For these reasons, your committee provides in section 473 of the bill that, under regulations prescribed by the Secretary, the tax on refrigerating and freezing apparatus is not to apply to sales of refrigerator components to wholesalers or jobbers where the components are intended for resale to manufacturers or producers of refrigeration and freezing equipment, if the components are actually resold in this manner. This is accomplished by amending section 3405 (b) of the code. No similar provision is contained in the House bill.

It is estimated that the revenue effect of this provision of your committee's bill will be negligible.

9. Sporting goods

Section 474 of the bill makes two changes in the 10-percent manufacturers' tax imposed on sporting goods by section 3406 of the code.

Under present law this tax covers virtually all types of sporting equipment although toy or children-sized items are exempted from this tax in the case of certain types of sporting equipment. Also, a number of articles subject to the sporting goods tax are used largely as a part of school and college athletic programs. Sale for use in the public schools are exempt (as purchases by subdivisions of State governments) so that the net revenue from taxing these articles is quite small, although the administration of the exemption imposes a considerable burden on the sporting goods dealers. Moreover, the nonexempt sales of many of the taxed articles are made largely to private schools, which has been objected to on the grounds that it is discriminatory treatment. For these reasons, the first action of your committee with respect to the sporting goods tax is to remove from the application of the tax specific types of articles which are used predominantly for school sports and by children. This is the same as was provided in the case of the House bill with the following exceptions: your committee's bill exempts baseballs and baseball equipment while the House bill taxed them, and your committee's bill taxes cricket balls and bats, lacrosse equipment, skates, and snow toboggans and sleds while the House bill exempts these items.

The second action of your committee is to raise the rate of tax from 10 percent to 15 percent of the manufacturer's price with respect to the items remaining in the tax base, except fishing equipment. In this case your committee left the rate at 10 percent since the receipts from this source are not available for general expenditures. The rate increase from 10 to 15 percent provided by your committee is the same as that provided by the House bill with the exception that the House bill also raised the tax on fishing equipment to 15 percent. Under present law the tax is about 6 percent of the retail price including tax and under both bills will be between 10 percent and 11 percent of the retail price.

It is estimated that these two actions taken together will not have any effect on revenue collections, since it is believed that the additional revenue which will be derived from the higher rate of tax on the items remaining in the base will be approximately equal to the revenue lost with respect to the items which are excluded from the base.

10. Photographic apparatus and film

Section 3406 of the code imposes a 25-percent tax on sales at the manufacturers' level of photographic apparatus, which is defined as including cameras weighing 4 pounds or less, lenses, photographic apparatus and equipment, and any apparatus or equipment designed especially for photographic purposes. A 15-percent manufacturers' tax is also imposed on photographic films (except X-ray films), photographic plates, and sensitized paper. Under present law, the tax on film is about 9 percent, and tax on equipment is about 13 percent, of the retail price.

Section 476 of your committee's bill reduces the tax on photographic apparatus from 25 to 15 percent of the manufacturer's price. No change is made in the 15-percent tax now applying to film or in the items included in the bases of either of these taxes. Thus, under your committee's bill, the tax on film and equipment will be between about 8 and 9 percent of the retail price of these items.

The House bill decreases the 25-percent tax on photographic apparatus to 20 percent and increases the 15-percent tax on film to 20 percent. The House bill also revises the bases of these taxes so that they are imposed only on film, cameras, and lenses which, insofar as is administratively possible, do not represent a cost of doing business. In the case of the House bill, the tax on both film and equipment would represent a tax of between 11 and 12 percent of the retail price.

Although your committee's bill provides a 15 percent rate of tax for film and photographic equipment rather than the 20 percent provided by the House bill, the revenue loss under your committee's bill is much smaller because the business cost items are not deleted from the bases of these taxes. Your committee believes that in view of present revenue requirements it is not desirable to reduce the revenue obtained from the photographic taxes by as much as would be necessary in order to remove all of these business cost items from tax.

It is estimated that the combined effect of your committee's action with respect to these taxes is to reduce revenues in a full year of operation by $5 million. The changes provided by the House bill would reduce revenues by $23 million annually.

Your committee's bill also makes an additional minor amendment to the photographic tax providing that the tax on color positive print film is not to be in excess of the tax on black and white positive print film. This change is made to eliminate a discriminatory competitive problem. In some cases under present law colored film is subject to the photographic tax because the coloring is added to the film by the photographic manufacturer. This results in a relatively large tax base. In other cases the coloring is added to the film after it leaves the hands of the photographic manufacturer with the result that the tax base in this case is relatively small. Your committee's bill removes this discrimination by placing no higher tax on color film than on black and white film.

In the case of photoflash bulbs, the House bill provides floor stock refunds. That is, wholesalers, retailers and others having inventories of photoflash bulbs intended for sale on the date the revision in the tax becomes effective would be credited, or would receive a refund, with respect to the tax paid on their inventories of photoflash bulbs. No such floor stock refund is provided in the case of your committee's bill. Under the House bill, the tax on these photoflash bulbs was decreased from 25 percent to zero. Under your committee's bill, the tax is decreased from 25 to 15 percent. Your committee believes that this smaller decrease in tax substantially decreases the hardship which would arise in the absence of a floor stock refund on these photoflash bulbs. This, combined with the administrative problems involved in making floor stock refunds, accounts for the absence of this provision in your committee's bill.

11. Electrical energy

Section 3411 of the code imposes upon vendors of electrical energy sold to domestic or commercial consumers a tax equal to 3⅓ percent of the price charged. Section 478 of the bill repeals this tax. This tax is also repealed by the House bill.

A tax on electrical energy is not believed to be a desirable part of the excise-tax revenue system for several reasons. First, the tax is believed to be one of the more burdensome of the excise taxes with respect to the lower-income groups, since amounts paid by consumers for electrical energy tend to vary relatively little with variations in income. Thus, the electrical-energy tax paid by the higher-income groups does not generally represent as large a percentage of their income as is true of the lower-income groups. Second, power companies have found it difficult and burdensome to determine which customers are domestic or commercial consumers, and therefore taxable, and which are industrial consumers, and therefore exempt. This has presented a particularly difficult problem in the case of businesses engaged in both commercial and industrial activities. Third, the tax under existing law does not apply to publicly owned electric power plants or to systems owned and operated by cooperative or nonprofit corporations engaged in rural electrification. Thus, since there is general agreement that this tax is passed on to the consumers, the present tax treatment has the effect of imposing a tax on persons purchasing electrical energy from private utilities, while imposing no tax on persons purchasing electrical energy from municipalities, the Federal Government, or REA cooperatives. To impose the tax on some consumers and not on others is believed discriminatory, and since your committee believed that it was not desirable to extend this tax to municipalities, the Federal Government, or REA cooperatives, the bill repeals this tax.

It is estimated that in a full year of operation the repeal of this 3⅓-percent electrical-energy tax will reduce revenues by $104 million annually.

12. Fountain pens, ball-point pens, and mechanical pencils

Section 477 of your committee's bill adds a new section 3408 to the code imposing a 10-percent manufacturers' tax on fountain pens, ball-point pens, and mechanical pencils. The House bill also added this tax but provided a 20-percent rate. At the present time some pens and pencils are subject to the 20-percent retail tax on jewelry and related items where they have nonessential parts which are ornamented with precious metals. To prevent double taxation, these pens and pencils are not included in the base of the new manufacturers' tax.

Consideration was given to extending the tax on jewelry and related items to all fountain pens, ball-point pens, and mechanical pencils, but this was discarded because the inexpensive types of such items are frequently sold in stores which are not accustomed to the collection of the jewelry tax. Moreover, your committee lowered the rate of tax provided by the House bill to 10 percent since an important segment of the cheaper pens and pencils are purchased by school children.

It is estimated that in a full year of operation this action by your committee will increase revenues by $12 million annually The House provision would have increased revenues by $24 million a year.

13. Cigarettes, cigars, and pipe lighters

Section 477 of your committee's bill imposes a manufacturer's tax on all mechanical lighters for cigarettes, cigars, and pipes which are not now taxed as jewelry. The manufacturer's tax on mechanical lighters is imposed at a 10-percent rate, the general rate at which most manufacturers' taxes are imposed. The House bill provided a 20-percent tax at the retail level for these mechanical lighters. In view of the large number of retail outlets selling mechanical lighters, your committee believes that it is more desirable to impose this tax at the manufacturer's level.

It is estimated that in a full year of operation this action by your committee's bill will increase revenues by nearly $1 million a year. It is estimated that the provision in the House bill would increase revenues by about $2 million in a full year of operation.

D. Retail Excises

The revenue effect of the bill in a full year of operation with respect to retail taxes is as follows:

[In millions]

	House bill	Committee bill
Cigarette, cigar, and pipe lighters	$2	$0
Toilet preparations	−7	−7
Total	−5	−7

1. Cigarette, cigar, and pipe lighters

The House bill extends the 20-percent tax on jewelry and related items to cover all mechanical lighters for cigarettes, cigars, and pipes. Your committee's bill applies a manufacturers' tax to all mechanical lighters for cigarettes, cigars, and pipes not now taxed as jewelry and for that reason the discussion of the tax is included above with the manufacturers' excises.

2. Toilet preparations

Section 431 of your committee's bill makes two changes in the 20 percent retail tax on toilet preparations imposed by section 2402 of the code. These are the same changes as are made by the House bill.

The first of these changes exempts from this tax baby oils, powders, lotions, and other toilet articles unless they are advertised or sold as being usable by adults. Your committee believes that these items fall within the category of necessities and should not be subject to tax.

The second change exempts toilet preparations purchased by barber shops and beauty parlors for use in these establishments. Under present law these items are subject to tax at the time they are purchased by the barber shop or beauty parlor. However, toilet preparations purchased by a barber shop or beauty parlor for resale to customers are not taxable until sold to the ultimate user. To distinguish the purchases for resale made by the barber shop or beauty parlor from the purchases for their own use, the establishment is required to file a certificate, if no tax is paid at the time of purchase, indicating that the items will not be used in the establishment. Such certificates are not presently required in the case of tax-paid purchases for use in the establishment. This difference in treatment has resulted in considerable confusion among the barber shop and beauty parlor operators. Moreover, the taxing of the items used in the establishment itself represents the taxing of business cost items. The bill eliminates these problems by repealing the tax on toilet preparations purchased by barber shops, beauty parlors, and similar establishments if intended for use in such establishments. It is also intended by the adoption of this amendment to eliminate the requirement of exemption certificates in connection with sales of cosmetics to barbershops and beauty parlors either for professional use therein or for resale once the businesses have established their nontaxable status as barber shops or beauty parlors.

It is estimated that in a full year of operation the exclusions from the base of the tax on toilet preparations made by this bill will reduce revenues by $7 million annually.

E. Transportation and Communication Excises

The revenue effect of the House bill and your committee's bill in a full year of operation on the transportation and communication excises is distributed among the various taxes as follows:

[In millions]

	House bill	Committee bill
Domestic telegraph, cable, and radio messages	−$8	−$14
Long-distance telephone charges	0	Negligible
Transportation of persons	Negligible	Negligible
Transportation of property	3	Negligible
Total	−5	−14

1. *Domestic telegraph, cable, and radio messages*

Sections 1650 and 3465 of the code impose a 25-percent tax on amounts paid for domestic telegraph, cable, or radio dispatches of messages. Section 481 of your committee's bill reduces the tax on domestic telegraph, cable, or radio messages to 15 percent, instead of to the 20 percent provided by the House bill.

Since World War II, telegraph service in the United States generally has been carried on at a deficit. In the forepart of this year, the service was operated at a profit, but wage adjustments which have recently been made have again placed telegraph service in a deficit position. By reducing this tax on telegraph service, your committee anticipates that it will be possible to decrease the amount paid for telegraph messages, and that as a result the volume of business done will be increased and the profit position of the industry improved. Telegraph service not only is essential to the civilian economy but also is essential to national security. The 15-percent rate of tax provided by your committee's bill for domestic telegraph, cable, and radio dispatches is the same rate of tax as now applies to the major portion of the business done by those corporations which were the chief competitors of corporations rendering telegraph service.

In a full year of operation it is anticipated that reducing the tax on domestic telegraph, cable, and radio messages from 25 to

15 percent of the charge will reduce revenues by $14 million, as contrasted to a loss of $8 million if the rate were reduced to only 20 percent as provided by the House bill. In the long run, however, it is believed that much of the loss may be offset by an increased volume of telegraph business.

2. Long-distance telephone calls to or from members of the Armed Forces in combat areas

Section 482 of your committee's bill provides that the 25-percent tax on long-distance telephone calls is not to apply to calls from combat zones initiated by members of the Armed Forces. It has been brought to your committee's attention that the tax in these cases frequently comprises a very sizable amount. It believes that this tax should be removed in view of the morale significance of such communications. The House bill contains no similar provision.

The revenue loss from this amendment will be negligible.

3. Transportation of persons

Your committee's bill makes two changes in the 15-percent tax on amounts paid for the transportation of persons provided by sections 1650 and 3469 of the code. One of these exempts certain fishing trips from the tax on the transportation of persons. This provision is the same as that contained in the House bill. Under present law amounts paid for transportation in boats where the transportation takes place for the sole purpose of fishing from the boat have been held to be taxable under these sections. In the case of fishing-boat activities, it is customary for the operators of such boats to make a lump-sum charge for a fishing trip, including not only the charge for the transportation, but also charges for such services as the use of fishing tackle, a supply of bait, food served on the boat, etc. The necessity of breaking down this lump-sum charge to determine the proportion of the total which represents the taxable charge for transportation has been a difficult problem both for the fishing-boat operators and the Bureau of Internal Revenue. Moreover, although fishing trips are technically defined as transportation, they are not generally considered so by laymen. As a result the tax on fishing trips has brought numerous complaints from sportsmen and has also created troublesome collection and compliance problems for the Government. Section 483 of the bill exempts from the tax on the transportation of persons amounts paid for transportation by boat for the purpose of fishing from such boat.

The second change made by your committee in the tax on the transportation of persons excludes from the application of the tax amounts paid in the case of certain types of transportation by vessels. This provision is not contained in the House bill. In 1947 the tax on the transportation of persons was amended to exclude, from the application of the tax, amounts paid for transportation outside of the northern portion of the Western Hemisphere. However, amounts paid for transportation partially within United States, Canada or Mexico, and partially outside of the northern portion of the Western Hemisphere, were continued under the tax with respect to that part of the transportation "which is from any port or station within the United States, Canada, or Mexico to any other port or station within the United States, Canada, or Mexico." This has tended to discriminate against certain American, Canadian, and Mexican ports where vessels, if it were not for this tax, would make intermediate stops for servicing and refueling, but presently do not do so because this would increase the portion of the travel charge on which their passengers would have to pay tax. For example, under present law a vessel leaving New York for London is unlikely to stop at Boston for servicing or refueling, since to do so would subject a part of the tickets purchased by their passengers to the transportation tax. For that reason section 484 of your committee's bill provides that in the case of transportation by vessels making intermediate stops at ports in United States, Canada, or Mexico on voyages between United States and a port outside of the northern portion of the Western Hemisphere, the charge for the transportation between the intermediate stop and the port in the United States, where the transportation begins or ends, will not be subject to the transportation tax, if the vessels are not authorized to discharge or take on passengers at the intermediate stops.

It is believed that the revenue loss from these changes in the tax on the transportation of persons will be negligible.

4. Transportation of property

Under present law section 3475 of the code imposes a 3-percent tax on amounts paid for the transportation of property (in the case of coal the tax is 4 cents per short ton). In the case of building contractors, hauling dirt, rocks and other excavation material to some designated place the Bureau of Internal Revenue has held that a charge is being made for the transportation of property and, therefore, that such hauls are subject to tax. (Where excavation material has been removed without designating the place it is to be taken, no tax has been applied, since the Bureau has considered this to be merely the payment for removal of waste rather than a charge for the transportation of property.) However, since March 13, 1951, the Bureau of Internal Revenue has followed the rule laid down by the Third Circuit Court of Appeals in *Edward H. Ellis & Sons, Inc.*, v. *United States* that where excavation material has been hauled from one point on a construction project to another point on the same project, no transportation tax is due. However, tax still is imposed where the excavation material is taken off the construction project to some designated place, even though such place is adjacent to, or near the construction project. Your committee believes that the imposition of the tax in such cases, while no tax is imposed if the excavation material is not removed from the site of the construction project, represents too fine a line of distinction to be drawn. For that reason section 485 of your committee's bill exempts from this tax charges made for the use of motor vehicles by contractors for the movement of earth, rock, or other excavated material from a construction project to an adjacent area. No such exemption is provided by the House bill.

Your committee did not, however, accept the change made in the tax on the transportation of property by the House bill. The House bill extends the 3-percent tax on the transportation of property to the "fair charge" where shippers are transporting their own oil and in other cases where the amount paid for the transportation of oil is less than a fair charge. The tax on the transportation of property at present applies solely where property is transported for a charge. The House amendment would represent an exception to this rule, and your committee sees no more reason why a tax should be imposed where shippers are transporting their own oil than where an individual is transporting his own property by truck. Since such a general extension of the tax on the transportation of property is not administratively feasible, your committee believes that it would be undesirable to select the isolated case of the transportation of oil by owners for the imposition of a tax.

It is believed that your committee's amendment with respect to the hauling of excavation material will have a negligible effect on revenues. However, since your committee's bill does not contain the provision of the House bill imposing the transportation tax where shippers are transporting their own oil, it is estimated that revenue from the tax on the transportation of property will be about $3 million less per year than under the House bill, although there is no loss under your committee's bill as compared with present law.

F. Excises on Amusements or Recreation

It is estimated that the changes made in the excises on amusements and recreation under the House bill and under your committee's bill will result in a net loss in revenue in a full year of operation as follows:

[In millions]

	House bill	Committee bill
General admissions	−$22	−$18
Cabaret	Negligible	Negligible
Occupational tax on bowling alleys and billiard and pool tables	1	0
Total	−21	−18

1. *General admissions*

Sections 1650 and 1700 of the code impose a tax of 1 cent for each 5 cents or major fraction thereof charged for admission. Both the House bill and your committee's bill make two changes in the application of this tax.

Both your committee's bill and the House bill provide exemptions from the admissions tax where the proceeds inure to certain types of organizations. The exemptions provided by your committee's bill are, however, more restrictive. Section 402 of your committee's bill exempts from this tax admissions where all the proceeds inure to—

1. Churches or conventions of churches.
2. Educational organizations if such organizations normally maintain regular faculties and curricula and normally have regularly organized bodies of pupils or students in attendance at the places where their educational activities are regularly carried on.
3. Charitable organizations if such organizations are supported in whole or in part by funds contributed by the United States or any State or political subdivision thereof, or are primarily supported by contributions of the general public.
4. Societies or organizations conducted for the sole purpose of maintaining symphony orchestras or operas and receiving substantial support from voluntary contributions.
5. National Guard organizations.
6. Reserve officers' organizations.

7. Veterans' organizations.
8. Police or fire departments, pension or retirement funds set up for the benefit of their members and funds set up for the benefit of the heirs of members.

However, in the case of any of the above types of organizations, admissions are not exempt if they are to—

1. Motion-picture exhibitions.
2. Wrestling and boxing matches.
3. Carnivals, rodeos, or circuses where professionals participate for compensation.
4. Athletic contests unless the proceeds inure exclusively to the benefit of elementary or secondary schools.

Your committee's bill also exempts general admissions to nonprofit agriculture fairs, admissions to concerts conducted by nonprofit civic associations, admissions to swimming pools and other places providing facilities for physical exercise operated by a governmental unit, admissions to a home or garden which is temporarily opened to the general public as a part of a program conducted by a society or organization to permit the inspection of historical homes and gardens if no part of the proceeds inures to the benefit of any private person, and admissions to historical sites, houses, and shrines, and associated museums if operated by an organization for the preservation of such place and if no proceeds inure to any private person.

The exemptions as described above are similar to the exemptions provided in the House bill and the exemptions provided prior to the passage of the Revenue Act of 1941. However, they are more restrictive than either of these other two sets of exemptions in order to remove administrative problems, and also in an attempt to limit the benefit of the exemption to activities which it appears appropriate for the Government to encourage. Most of the activities to which these exemptions are applicable are a part of the legitimate functions of organizations or institutions which frequently are Government-supported or have been accorded tax exemption on their own income. Because it appears inconsistent to tax admissions to activities which are directly related to the legitimate functions of these organizations or institutions, your committee reinstates these exemptions, limited as provided above. However, your committee has attempted to continue the tax in those cases where the organizations are carrying on activities which are in direct competition with ordinary taxable businesses as is true, for example, in the case of motion picture exhibitions and certain types of carnivals, rodeos or circuses. It is estimated that these exemptions will result in a revenue loss of approximately $12 million in a full year of operation. It is estimated that the exemptions provided by the House bill would decrease revenues by $16 million.

The second change in the admissions tax, made by section 401 of this bill, deals with the amount paid for admission. This change is the same as that made by the House bill. Under present law a person admitted free or at reduced rates is required to pay the same amount of tax as a person who is charged the regular admission price, unless he is an employee, a municipal officer on official business, a child under 12, or (if admission is free) a hospitalized serviceman or veteran Your committee believes that requiring a person to pay a tax based on a larger admission price than the amount actually charged him is contrary to the general principal of an ad valorem tax. Moreover, it does not appear that the administration of the tax is facilitated by taxing free admissions at the established price, and it represents a source of irritation to the public. Section 401 of your committee's bill, therefore, exempts free admissions from tax and bases the tax on amounts actually paid where persons are admitted at reduced rates.

It is estimated that the revenue loss from this change in the base on which the admissions tax is paid will amount to $6 million in a full year of operation.

2. Cabarets

Section 404 of your committee's bill relates to the application of the 20-percent tax on cabarets to ballrooms and dancing halls. Some courts have construed the cabaret tax to apply in the case of ballrooms and dancing halls merely because it was possible to purchase incidental refreshments, services or merchandise in such places. Both your committee's bill and the House bill amend section 1700 (e) of the code to provide that the cabaret tax shall not apply in such cases. It is estimated that the revenue effect of this provision will be negligible.

3. Bowling alleys and billiard and pool tables

Section 3268 of the Internal Revenue Code imposes a special occupational tax on bowling alleys, billiard or pool tables of $20 per year per alley or table. The House bill raises this tax from $20 to $25, but your committee's bill retains the tax of $20 provided by existing law.

It is estimated that the House provision would have increased revenues by $1 million annually. Your committee's action will not change the revenues derived from this source under existing law.

G. Excises on Gambling

The additional revenue estimated to be derived from the taxes on gambling in a full year of operation is distributed among the various excises as follows:

[In millions]

	House bill	Committee bill
Occupational tax on coin-operated gaming devices	$7	$7
Tax on wagers Occupational tax on the business of accepting wagers	400	400
Total	407	407

With respect to the estimate of $400 million from the two wagering taxes, since this is a field of taxation with which the Federal Government has had no previous experience and because there is uncertainty as to the actual amount of the tax base, the committee recognizes that it is difficult to estimate too closely the actual revenue which these new taxes will yield.

Section 461 of your committee's bill adds a new chapter 27A to the code which imposes a 10-percent excise tax upon wagers of certain types, principally those placed with bookmakers and lottery operators, and a $50 per year occupational tax both upon persons engaged in accepting such wagers and upon persons who receive wagers for the persons so engaged. This is the same as the provision contained in the House bill.

Commercialized gambling holds the unique position of being a multibillion-dollar, Nation-wide business that has remained comparatively free from taxation by either State or Federal Governments. This relative immunity from taxation has persisted in spite of the fact that wagering has many characteristics which make it particularly suitable as a subject for taxation. Your committee is convinced that the continuance of this immunity is inconsistent with the present need for increased revenue, especially at a time when many consumer items of a seminecessity nature are being called upon to bear new or additional tax burdens.

The committee recognizes that, while Federal law imposes no general prohibition upon gambling, various forms of wagering are illegal under the laws of most States. As a result, proposals for a Federal tax on wagering are sometimes criticized as in effect sanctioning the carrying on of gambling activities in violation of such laws. The committee does not share this view. Since its inception, the Federal income tax has applied without distinction to income from illegal as well as legal sources, and it has never been generally supposed that such application carried with it any implied authorization to carry on illegal activities. Moreover, in the field of excise taxes the tax on coin-operated gambling devices has been applied without regard to whether or not the operation of a particular machine is in violation of State or local law. The present bill conforms to this pattern and imposes tax without regard to the legality or illegality of the particular wager.

The bill specifically provides that payment of either the tax on wagers or the occupational tax shall not serve to exempt any person from any penalties provided under either State or Federal law with respect to engaging in the taxed activities.

1. Tax on wagers

The wagering tax which both your committee's bill and the House bill imposes is placed upon wagers, without regard to the outcome of individual bets. This method of taxation is comparable to State taxation of pari-mutuel pools and is particularly appropriate with respect to wagering with bookmakers and in lotteries, especially of the type commonly known as the numbers game. The tax is limited (1) to wagers on sports events or contests placed with a person engaged in the business of accepting such wagers, (2) to wagers placed in a wagering pool which involves a sports event or contest, if the pool is conducted for profit, and (3) to wagers placed in a lottery conducted for profit. It is believed that wagering transactions of these types make up by far the largest proportion of the total gambling business.

While betting on horse races probably represents the largest single category of gambling activity, other than in lotteries, the tax will extend to wagers on any other sport, such as prizefights, basketball, baseball, or football, including sports exhibitions and trials. Moreover, the event wagered upon need not be a sports activity but can be any type of contest, such as an election or the outcome of primaries and nominating conventions.

Wagers on sports events or contests, to be taxable, must be placed with a person engaged in the business of accepting such wagers. The purpose of this requirement is to exclude from tax the purely "social" or "friendly" type of bet. A person is considered to be in the business of accepting wagers if he is engaged as a principal who, in accepting wagers, does so on his own account. The principals in such transactions are commonly referred to as "bookmakers," although it is not intended that any technical definition of "bookmaker," such as the maintenance of a handbook or other device for the recording of wagers, be required. It is intended that a wager be considered as "placed" with a principal when it has been placed with another person acting for him. Persons who receive bets for principals are sometimes known as "bookmakers' agents" or as "runners." It is not intended that to be "engaged in the business of accepting such wagers" a person must be either so engaged to the exclusion of all other activities or even primarily so engaged. Thus, for example, an individual may be primarily engaged as a salesman, and also, for the purposes of this tax, be engaged in the business of accepting wagers.

As previously stated, wagers placed in a wagering pool with respect to a sports event or a contest are taxable if the pool is conducted for profit. The requirement that the pool be operated for profit is designed to eliminate from the tax base those pools which are occasionally organized among friends or other associates, all of the contributions being distributed to the winner or winners. A pool would be considered as being operated for profit, if, for example, a person appropriated to himself a percentage of the amount contributed to the pool or required a fee for the privilege of contributing to the pool.

As in the case of bookmaking transactions, a wager will be considered as "placed" in a pool or in a lottery whether placed directly with the person who conducts the pool or lottery or with another person acting for such a person.

A contribution to a lottery will be considered a taxable wager only if the lottery is conducted for profit, as is the case with respect to wagering pools. Although the bill does not contain an all-inclusive definition of the term "lottery," in general the term is intended to mean any scheme for the distribution of property by chance among persons who have paid or have agreed to pay a valuable consideration for the chance, whether called a lottery, raffle, gift enterprise, or some other name. The bill specifically provides that the term includes "policy" or the so-called numbers game and similar types of wagering. Policy, or its various derivatives, is usually a scheme wherein a player selects a number, several numbers, or a series of numbers and pays or agrees to pay a certain amount in consideration of which the person to whom the money is paid engages to pay a prize if the number or numbers selected by the player appear or are published in combinations which constitute a winning combination. (Conceivably the use of letters or other symbols could be substituted for numbers, but this would not alter the fundamental nature of the game as a lottery.) The winning numbers in policy are usually based upon some regularly published series of numbers such as weekly sales reports of a stock exchange or commodity exchange, United States Treasury balance reports, or the winning horses of a series of previously numbered horse races. The above description is not intended to be restrictive as your committee is well aware of the possibility that existing methods of play may be changed in an effort to escape the tax which the bill imposes.

Because the term "lottery" is intended to be broadly construed in order to limit the opportunities for avoidance, your committee has specifically excluded from the term certain types of gambling games which might otherwise come within its technical meaning although perhaps not commonly so considered. Thus, both bills exclude from the term "lottery" any game of a type in which the wagers are usually placed, the winner or winners are usually determined, and the distribution of prizes or other property is usually made, in the presence of all persons placing wagers in the game. Among those games which are within the scope of the exclusion would be card games such as draw poker, stud poker, and blackjack, roulette games, dice games such as craps, bingo, and keno games, and the gambling wheels frequently encountered at country fairs and charity bazaars. On the other hand, punchboards would not normally be excluded under this definition.

Your committee has excluded the above types of gambling not because of any belief that they are not suitable subjects for taxation. However, the method of taxation provided, while particularly appropriate to bookmaking and to policy operation, does not appear readily adaptable to these other forms of gambling. For example, there are obvious practical difficulties in ascertaining the gross amount of wagers made in the course of a dice game and other games in which there is direct and continuous player participation. Moreover, with respect to card games it is frequently difficult to ascertain who, if anybody, is the person operating the game and what his tax liability should be. In some cases, a person may operate the bank directly. In other cases, he may take a percentage of, or impose a flat charge on, each pot or may simply levy a charge for the use of facilities such as a room. Moreover, many of these types of games are frequently engaged in on a friendly or social basis rather than professionally. A differentiation for tax purposes between friendly and professional games would create serious statutory and administrative problems. It is not expected that this problem will exist to any serious extent in the areas within which the bill does impose tax. For example, nonprofessional betting on horse races is probably insignificant in amount. Furthermore, while wagering games of the type excluded from the tax may represent important aspects of commercialized gambling in certain localities, they constitute a relatively small proportion of the total wagering transactions in the United States. Moreover, only a portion of such professional games are in fact carried on in gambling casinos or other permanent establishments which might conceivably be indentifiable for tax purposes. It appears that a substantial and perhaps predominant part of such activities are in the nature of "floating" games. That is, the operators of a game will establish themselves in a locality, often in a hotel room, for a period of time as short as 1 or 2 days, and then move on to another locality. The transiency of such activities is not characteristic of the wagering operations upon which the bill does impose tax. Bookmakers and policy operators both depend upon an established clientele, which requires a certain permanency of location. In any event, your committee believes that the tax provided will cover at least 90 percent of total commercial wagering.

Both bills provide specifically that the tax shall not apply with respect to wagers placed in pari-mutuel wagering enterprises licensed under State law. Such wagering is presently subject to substantial State and, in some instances, local taxation, and to superimpose a Federal tax upon these transactions would only serve to maintain the existing advantage which bookmakers enjoy over pari-mutuel betting by reason of their immunity from pari-mutuel taxes.

Also excluded from the tax are wagers placed in coin-operated devices with respect to which an occupational tax is imposed by section 3267 of the code. Your committee believes that, for administrative reasons, the method of taxation which is presently applied with respect to such machines is preferable to an extension of the wagering tax into this area.

The bills provide that, for the purposes of the tax, the term "lottery" does not include any drawing conducted by organizations exempt from tax under section 101 of the code where no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual. It is, of course, contemplated that the regulations will require the expenses of such a drawing, such as salaries paid to the actual operators, to be reasonable in amount if the exemption is to be allowed. Furthermore, any agreement to pay as compensation a percentage of the amounts contributed would be a clear indication that the drawing is not within the exempt category.

Liability for the wagering tax is placed upon the person who is engaged in the business of accepting wagers or who conducts the pool or lottery. Thus, the tax is to be collected from the bookmaker proper or from the person who conducts the pool or lottery as the principal. Monthly returns of tax are required.

A credit is provided in the case of so-called lay-off money. Bookmakers and policy operators generally attempt to balance one bet against another. A perfect mathematical booking of any race would insure a profit regardless of the ultimate outcome. However, horse-race bookmakers today seldom set their own odds but pay off winning bets upon the basis of the actual pari-mutuel pay-off at the track concerned. Furthermore, policy operators normally pay off on the basis of fixed odds, such as 700 to 1, which remain constant from day to day, although lower odds may be maintained with respect to certain heavily played numbers. Because they are unable to vary the odds in accordance with amounts wagered, bookmakers and policy operators sometimes find that they have accepted a greater amount of wagers upon a certain horse or number than they are willing to carry on their own account. In order to avoid the risk inherent in accepting such disproportionate amounts of wagers, the bookmaker or policy operator "lays off" a portion of his bets with another bookmaker or policy operator. In such cases it is the person with whom the bet is laid off who bears the actual risk of the wager even though it is the person with whom the bet was originally placed that the bettor looks to for his winnings or to whom he pays his losses. It is provided with respect to such laid-off wagers that the bookmaker or policy operator who originally accepts the wager shall be liable for the 10-percent tax upon it but may claim a credit or refund for the amount of the tax if the bet is laid off with another person who also is liable to the wagering tax. Thus, if a bookmaker accepts a $100 wager and lays off $60 of the wager with another bookmaker, he is taxable upon the $100 wager but may claim a credit or refund of tax with respect to the $60 laid off. In this manner, multiple taxation of the same wager is avoided. While certain "tracing" difficulties may be anticipated as a result of this provision, it is believed that the credit procedure will facilitate tax enforcement by making available to the collection agencies information of large bookmaking operations which might not otherwise be readily obtainable. It is contemplated that the regulations will require the maintenance of records which will insure that the person with whom the wager is laid off is identifiable as a person also subject to the wagering tax.

The credit will be allowable only with respect to amounts laid off with persons also liable to the tax on wagers. As a result of this limitation, no credit will be allowable with respect to amounts known in betting parlance as "come-back" money. Come-back money is essentially a wager which a bookmaker lays off at a track rather than with another bookmaker, and, as previously noted, wagers placed in State-licensed pari-mutuel enterprises will not be taxable. Come-back money serves the same purpose as a lay-off proper (that is, it provides the bookmaker with a "hedge") and, if made in large amounts, may have the additional effect of depressing the odds on the particular horse or horses wagered upon. The tax consequences of a combined lay-off and come-back transaction are illustrated by the following example: A bettor places a $1,000 wager with bookmaker A on horse X; A holds $100 of the wager and lays off $900 with bookmaker B; B holds $200 of the $900 and bets the remaining $700 at the track on the horse X. Bookmaker A is taxable with respect to the entire $1,000 wager but is allowed a credit with respect to the tax on the $900 laid off; B is taxable on the entire $900 and is allowed no credit for the $700 he bets at the track. Thus, cumulative tax liabilities arise of $190 (10 percent of $1,900, the aggregate amount of wagers and lay-offs) but a credit is allowable in the amount of $90 (10 percent of $900, the amount laid off), leaving a net tax of $100, or 10 percent of the original $1,000 wager.

A wager is intended, of course, to be the amount risked by the person placing the bet rather than the amount which he stands to win. Thus, if a person bets $5 against a bookmaker's $7 with respect to the outcome of a prize fight, the wager, for the purpose of the tax, is $5.

It is provided that the amount subject to tax will include not only the wager proper but also any charge incident to the placing of the wager. An example of such an additional charge which is to be included in the taxable amount would be so-called "insurance" money paid bookmakers. Horse-race bookmakers normally place an arbitrary ceiling on the odds upon which they are willing to base their pay-offs, such as, for example, 20 to 1 for win bets, 8 to 1 for place bets, and 4 to 1 for show bets. These ceilings are maintained irrespective of the actual pari-mutuel odds. Bookmakers may sometimes be willing to guarantee the bettor a pay-off based on the actual track odds, no matter how great, in consideration of a small additional charge paid by the bettor, usually 10 percent of the bet. This additional charge is known as insurance. Another example of an amount which would be included as part of a taxable wager would be a charge made by a lottery operator for the privilege of contributing to the pool or bank. On the other hand, the bills specifically provide that the taxable amount shall not include an amount equal to the tax if it has been collected as a separate charge from the bettor. This exclusion conforms to the pattern of the other excises and will avoid the difficult administrative problems involved in collecting a tax on a tax.

The bills contain provisions designed to prevent avoidance of the tax through transfer of wagering activities to points outside of the United States.

Any person who willfully fails to pay the tax provided or to make a return or to keep required records (including a daily record of the gross amount of wagers received) is made liable to criminal penalties (in addition to the civil penalties) of up to 1 year's imprisonment and a fine up to $10,000. Furthermore, a willful attempt to evade or defeat the tax will be a felony punishable by up to 5 years' imprisonment and up to $10,000 fine.

2. Occupational tax

In addition to the tax on wagers described above, both your committee's bill and the House bill impose an occupational tax of $50 per year upon any person liable to the tax on wagers and upon any person engaged in receiving wagers for or on behalf of such a person.

The committee conceives of the occupational tax as an integral part of any plan for the taxation of wagers and as essential to the collection and enforcement of such a tax. Enforcement of a tax on wagers frequently will necessitate the tracing of transactions through complex business relationships, thus requiring the identification of the various steps involved. For this reason, the bills provide that a person who pays the occupational tax must, as part of his registration, identify those persons who are engaged in receiving wagers for or on his behalf, and, in addition, identify the persons on whose behalf he is engaged in receiving wagers.

In general, the provisions of the occupational tax follow the pattern of the other occupational taxes imposed under the code and require registration, posting of special tax stamp by the taxpayers, the maintenance by the collector of a list of taxpayers for public inspection, etc.

Special penalties are imposed for failure to pay the tax or to post or exhibit the stamp. Furthermore, the penalties already described with respect to the tax on wagers will also apply to willful failures to pay the occupational tax. It should also be pointed out that, under the general provisions of section 1001 of Title 18 of the United States Code, any false or fictitious statement made knowingly with respect to the payment of the occupational tax, such as the giving of a false name or address, is subject to a fine of not more than $10,000 or imprisonment of not more than 5 years, or both.

Past experience indicates that the size of tax collections is directly related to adequacy of enforcement. Your committee believes, with respect to the wagering tax and the occupational tax on the acceptance of wagers, energetic enforcement measures during the period immediately following the introduction of these taxes to be particularly important. Your committee realizes, of course, that the introduction of any new taxes, such as those just described, which depend upon hitherto untapped sources of revenue, inevitably add to the administrative burden of the Bureau of Internal Revenue. Therefore, the Bureau should review the need for any additional administrative requirements in the light of actual experience with the enforcement of these taxes.

3. Coin-operated gaming devices

Section 3267 (a) of the code provides an occupational tax of $150 per year in the case of coin-operated gaming devices. Section 453 of the bill raises this to $250 per year. This is the same change as is provided by the House bill. It is believed that the imposition of a tax on wagering generally, from which coin-operated gaming devices are specifically exempted, requires an increase in this tax to provide equality of treatment. It is estimated that in a full year of operation this will increase revenues by $7 million annually.

H. Floor Stock Taxes and Refunds

Both floor stock taxes and floor stock refunds are imposed or granted one time only: a tax when an increase in rates occurs and a refund when a decrease in rates occurs. They are imposed or granted with respect to inventories of items which are beyond the point at which an excise tax ordinarily is imposed at the time the increase or decrease in rates occurs. They are used only in the case of taxes imposed at the manufacturers' level, since only in these cases are there any inventories of items held by persons other than consumers which have not been affected by recent changes in the excise rates. Floor stock taxes and refunds have traditionally been imposed in the case of alcoholic beverages and occasionally with respect to other products.

Floor stock taxes have been imposed for three primary reasons: (1) To prevent wholesalers and retailers from avoiding a tax increase by stocking up on items before a tax increase or new tax becomes effective, (2) to make the increase or new tax effective on items produced at an earlier date and thus increase revenues in the initial year of imposition, and (3) to prevent competitive discrimination in cases where some wholesalers and retailers have large stocks of items where the new or additional tax has not been imposed and others do not. In the case of floor stock refunds the primary reason for their provision is to prevent discrimination which would exist where some retailers and wholesalers have large tax-paid inventories, while their competitors do not. This is particularly important where the tax rate decreases are large and where, through various business arrangements, manufacturers are selling directly to consumers. However, in imposing floor stock taxes or granting floor stock refunds it is also necessary to consider the large amount of work which these taxes or refunds entail both for the taxpayer and the Government. The processing of floor stock returns is an extensive task and their application at both the wholesale and the retail levels affects hundreds of thousands of dealers. Because of these administrative considerations your committee's bill limits floor stock taxes refunds to those cases where there appears to be a strong need for them.

Under both the House bill and your committee's bill floor stock taxes are imposed with respect to the increases in the tax on distilled spirits, beer, wine, and cigarettes. In the case of gasoline a floor stock tax is also imposed but only with respect to stocks of gasoline held by retailers other than at their retail establishments and with respect to wholesalers. The rates of tax under these floor stock taxes are the same as the increases in tax provided for these items. It is anticipated that in the fiscal year 1952 these floor stock taxes will increase collections in that year, but only that year, by $120 million. Of this total, $98 million is accounted for by the floor stock taxes on alcoholic beverages, and the bulk of this is expected to be collected from distilled spirits since inventories are largest in this case. About $22 million is expected to be collected from the floor stock tax on cigarettes, but only a nominal amount from the floor stock tax on gasoline. In the latter case the floor stock tax is imposed, not with the expectation of receiving large revenues from it, but to give assurance that substantial revenues will not be lost by an unusually large transfer of title to gasoline prior to the effective date of the tax increase.

Consideration was also given to the imposition of floor stock taxes in the case of other manufacturers' excises. However, no action was taken with respect to them largely because the items are likely to be in relatively short supply when the excise taxes become effective, making it difficult for dealers to avoid tax by increasing their inventories prior to the effective date of the tax increase. Also, the large number of retailers and items involved in many cases make the imposition of the tax impractical in view of the size of the rate increases or the rates of the new taxes.

Your committee's bill also provides for floor stock refunds at the time of the termination, January 1, 1954, of the excise increases made by this bill. The refunds are to be limited to the items on which floor stock taxes are imposed at the effective date of the increase; that is, they are limited to distilled spirits, beer, wine, and cigarettes and to stocks of gasoline held by retailers at other than their retail establishments. The refunds are to be granted only with respect to the increases imposed by this bill, and only if the owner of the inventories can show that for 3 months after the reduction date the prices charged for the items reflect the tax decreases made.

X. TAX TREATMENT OF ILLEGAL ACTIVITIES

Several amendments have been proposed to the committee which would affect the tax treatment of gamblers and other persons who receive income from illegal sources. In summary, these amendments would—

(*a*) Disallow as a deduction from gross income any expenses incurred in illegal wagering and any losses resulting from illegal wagering;

(*b*) Require the keeping of more detailed records by wagering houses;

(*c*) Require the keeping of taxpayers' records for 7 years; and

(*d*) Require all individuals with a gross income during the current or five preceding taxable years in excess of $2,500 from illegal activities to file a net worth statement.

Your committee believes that additional time is necessary for detailed study of these suggestions and therefore believes that action on them should not be taken at this time. The committee is fully aware of the importance of a strict enforcement of the income tax laws in this area.

(The detailed discussion of the technical provisions of the bill will be printed separately and will appear as a supplemental report.)

CHANGES IN EXISTING LAW

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

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Calendar No. 737

82D CONGRESS, *1st Session* — SENATE — REPORT No. 781, PART 2

THE REVENUE ACT OF 1951

SUPPLEMENTAL REPORT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

TO ACCOMPANY

H. R. 4473

A BILL TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

SEPTEMBER 18 (legislative day, SEPTEMBER 13), 1951.—Ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1951

82D CONGRESS 1st Session | SENATE | REPT. 781 Part 2

REVENUE ACT OF 1951

SEPTEMBER 18 (legislative day, SEPTEMBER 13), 1951.—Ordered to be printed

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

SUPPLEMENTAL REPORT

[To accompany H. R. 4473]

DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

TITLE I—INCREASE IN INCOME TAX RATES

PART I—INDIVIDUAL INCOME TAXES

SECTION 101. INCREASE IN SURTAX FOR 1951, 1952, AND 1953

Subsection (a) of section 101 of the bill amends section 12 (b) of the code, relating to rates of surtax, to impose a tax increase with respect to individuals having as a taxable year the calendar year 1951, and to impose a further increase with respect to taxable years beginning after October 31, 1951, and before January 1, 1954. In the case of taxable years beginning after October 31, 1951, and before January 1, 1954, the increase provided is approximately 11 percent of tax liability under present rates or 8 percent of surtax net income after present taxes, whichever is lesser. In the case of the calendar year 1951, since the increase in rates is not to be effective until November 1, 1951, the increase provided is in the same proportion to the increase for a full taxable year as the number of calendar months after October 31, 1951, bears to the 12 calendar months in 1951, that is, an increase of approximately one-sixth of 11 percent of present tax liability, or one-sixth of 8 percent of surtax net income after present taxes, whichever is lesser. The amendment of section 12 (b) with respect to taxable years beginning after October 31, 1951, is not applicable to an individual who qualifies as the head of a household, who will be taxed as provided by subsection (c) of section 12 as amended by section 301 of the bill.

Paragraph (1) of subsection (b), as amended, contains a table which sets forth the increased tax for the calendar year 1951 for each level of surtax net income and paragraph (2) contains a similar table which is applicable to taxable years beginning after October 31, 1951, and before January 1, 1954, including the calendar years 1952 and 1953. Paragraph (3) has a table which sets forth the rates applicable under present law and which will be applicable for taxable years beginning after December 31, 1953. The bill provides no increase in the rates of tax applicable to individuals in the case of a taxable year ending before October 31, 1951, except in the case covered by section 104 of the bill of a joint return of husband and wife with different taxable years because of the death of either within the taxable year when the taxable year of the surviving spouse began before November 1, 1951, and ended after October 31, 1951.

Subsection (c) of section 101 amends section 12 (f) of the code relating to limitation on tax. Under paragraph (1) of subsection (f), as amended, it is provided that in the case of the calendar year 1951, the combined normal tax and surtax shall in no event exceed 87.2 percent of the net income for such taxable year. Paragraph (2) relates to taxable years beginning after October 31, 1951, and before January 1, 1954, and limits the amount of the combined normal tax and surtax for such taxable years to 88 percent of the net income. Under paragraph (3), applicable to taxable years beginning after December 31, 1953, the corresponding limitation is 87 percent of net income.

SECTION 102. INDIVIDUALS WITH ADJUSTED GROSS INCOME OF LESS THAN $5,000

Section 102 of the bill, which corresponds to the like-designated section of the House bill, amends section 400 of the code to provide three new tax tables for the use of taxpayers with adjusted gross income of less than $5,000. Table I is applicable to the calendar year 1951 and is for the use of single persons, married persons filing separate returns and married persons filing joint returns. Since the provisions of title III of the bill, relating to tax treatment in the case of a head of a household, do not apply to the calendar year 1951, a single person with adjusted gross income of less than $5,000 who might for subsequent years qualify for such treatment may use this table in computing income liability for the calendar year 1951. Table II applies to taxable years beginning after October 31, 1951, and before January 1, 1954, and is for the use of single persons, married persons filing separate returns, married persons filing joint returns, and any single person who qualifies as the head of a household under title III of this bill. The increases in tax imposed by this bill are reflected in tables I and II for each level of adjusted gross income. Table III is for the use of the same persons as may use table II and is applicable to taxable years beginning after December 31, 1953. Except for the computations applicable to a taxpayer who qualifies as the head of a household, the income tax liability reflected in table III for each level of adjusted gross income is the same as under the tax rates which are presently applicable:

SECTION 103. INAPPLICABILITY OF CERTAIN PENALTIES AND ADDITIONS TO TAX

This section of the bill, which has no corresponding provision in the bill as passed by the House, amends sections 145 and 294 (d) (2) of the code. Subsection (a) amends section 145 by redesignating the present subsection (f) as subsection (g) and by inserting a new subsection (f). The new subsection (f) makes certain penalties prescribed by section 145 inapplicable to a failure to take into account the increases in rates of tax imposed on individuals by this bill. Similarly, the sentence added by subsection (b) of this section to paragraph (2) of section 294 (d) makes the provisions of such paragraph relating to additions to tax for substantial underestimate of tax inapplicable to cases where the failure to meet the prescribed requirements with respect to estimated tax is by reason of the increases in rates of tax imposed on individuals by this bill.

SECTION 104. COMPUTATION OF TAX IN CASE OF CERTAIN JOINT RETURNS

Section 104, which corresponds to section 103 of the House bill and is identical except for references to applicable effective dates, applies to the situation where a joint return of a husband and wife is filed under the provisions of section 51 (b) (3) of the Internal Revenue Code, the husband and the wife having different taxable years because of the death of either, and the taxable year of the surviving spouse covered by such joint return began before November 1, 1951, and ended after October 31, 1951. In respect of such a case, section 104 provides that the amendments made by part I of title I of this bill, relating to income-tax rates, shall be applicable to the joint return as if the taxable years of both spouses covered by the joint return ended on the date of the closing of the surviving spouse's taxable year:

Section 51 (b) (3) and (4) of the code permit the filing of a joint return by a surviving spouse if the taxable years of each spouse began on the same day but ended on different days because of the death of either spouse, or both. Under the provisions of section 104, if one spouse dies during 1951 and the surviving spouse elects to file a joint return under section 51 (b) (3) of the code covering both his calendar year 1951 and the taxable year of the deceased spouse, the tax liability on the joint return will be computed at the rates applicable under this bill to a return for the calendar year 1951. It is immaterial, in such a case, whether the taxable year of the deceased spouse ended before or after November 1, 1951. If the taxable year of the surviving spouse which began before November 1, 1951, and ended after October 31, 1951, is not a calendar year, the tax liability on a joint return by the surviving spouse will be computed under the provisions of section 108 (h) of the code (as added by sec. 131 of this bill), and the computations required therein with respect to calendar months in the taxable year will be made by reference to the calendar months of the taxable year of the surviving spouse.

SECTION 105. EFFECTIVE DATE OF PART I

This section, which corresponds to section 104 of the House bill, provides that the amendments made by part I of the bill shall be applicable only with respect to taxable years beginning after October 31, 1951, and to the calendar year 1951, except as provided in section 104 of the bill. It also provides a cross reference to section 131 of the bill for treatment of taxable years (other than the calendar year 1951) beginning before November 1, 1951, and ending after October 31, 1951. The bill as passed by the House made the increases in individual rates provided therein applicable to taxable year beginning after August 31, 1951.

PART II—CORPORATION INCOME TAXES

SECTION 121. INCREASE IN RATE OF CORPORATION NORMAL TAX AND SURTAX

This section, which corresponds to section 121 of the bill as passed by the House, amends the corporate tax provisions to impose, in general, increases in tax on corporate income applicable to the calendar year 1951 and to taxable years beginning after March 31, 1951, and before January 1, 1954.

Subsection (a) of section 121 amends subsections (a) and (b) of section 13 of the code, relating to normal tax on corporations. As in the bill passed by the House, the amendment to subsection (a) of section 13 eliminates from the code provisions which are applicable to prior taxable years, and retains the definitions of "adjusted gross income" and "normal tax net income" added by the Revenue Act of 1950. The amendment to subsection (b) of section 13 increases the present 25-percent normal tax on corporation normal tax net income to 26½ percent for the calendar year 1951, and to 27 percent for taxable years beginning after March 31, 1951, and before January 1, 1954. For taxable years beginning after December 31, 1953, it is provided that a 25-percent rate shall be effective.

Subsection (b) of section 121 amends subsection (a) of section 15 to eliminate from the code provisions applicable only to prior taxable years and retains the definition of "corporation surtax net income" added by the Revenue Act of 1950. This part of the amendment made by subsection (b) corresponds to subsection (f) (2) of section 121 of the bill as passed by the House. Subsection (b) also amends subsection (b) of section 15 to impose increases in the surtax rate on corporation surtax net income. For the calendar year 1951 the surtax rate is increased from the present 22 percent to 24¼ percent of the corporation surtax net income in excess of $25,000, and for taxable years beginning after March 31, 1951, and before January 1, 1954, the increased rate provided is 25 percent of the corporation surtax net income in excess of $25,000. For taxable years beginning after December 31, 1953, it is provided that the surtax rate shall be 22 percent of corporation surtax net income in excess of $25,000, which is the rate presently applicable to taxable years beginning after June 30, 1950.

Subsection (c) of section 121, which corresponds to subsection (b) of section 121 of the House bill, amends section 430 (a) of the code, as added by section 101 of the Excess Profits Tax Act of 1950. Section

430 (a) presently imposes an excess profits tax of whichever is the lesser of (1) 30 percent of "adjusted excess profits net income" (as defined by sec. 431), or (2) an amount equal to the excess of 62 percent of the "excess profits net income" (as defined by sec. 433) over the tax which would be imposed for such taxable year if the normal tax rate and the surtax rate applicable for the taxable year were applied to the corporation's "excess profits net income" for the taxable year. The amendment made by this subsection makes the 62 percent ceiling rate provision of paragraph (2) of section 430 (a) (2) applicable only to taxable years ending before April 1, 1951, and designates such provision as subparagraph (A) under paragraph (2). It also adds to paragraph (2) new subparagraphs (B) and (C) which provide a different method for computing an alternative amount of tax which will be the maximum tax if less than the 30 percent tax provided by section 430 (a) (1). Subparagraph (B), which is applicable to the calendar year 1951, provides that the alternative shall be an amount equal to 16½ percent of the excess profits net income for the taxable year, except that such amount shall in the case of a consolidated return under section 141 be reduced by an amount which bears the same ratio (but not in excess of 100 percent) to the increase of 2 percent in the surtax imposed by reason of section 141 (c) as the amount of the consolidated excess profits net income bears to the amount of the consolidated corporation surtax net income. Subparagraph (C), which is applicable to taxable years beginning after March 31, 1951, provides that the alternative shall be an amount equal to 17 percent of excess profits net income and has the same provision as subparagraph (B) in respect of the reduction of such amount in the case of a consolidated return.

Subsection (d) of section 121, which corresponds to subsection (c) of section 121 of the bill as passed by the House, amends section 207 (a) (1), relating to normal tax and surtax on mutual insurance companies other than life or marine, and section 207 (a) (3), relating to the normal tax and surtax on interinsurers and reciprocal underwriters. Subsection (e) of section 121, which corresponds to subsection (d) of section 121 of the House bill, amends section 362 (b), relating to tax on regulated investment companies; and subsection (f), which corresponds to subsection (e) of section 121 of the bill as it passed the House, amends section 421 (a) (1), relating to imposition of tax on business income of certain section 101 organizations. The amendments made by these subsections reflect for each of these specialized types of corporations the increased normal tax and surtax rates which will be applicable to corporations in general under the amendments made to sections 13 (b) and 15 (b) by subsections (a) and (b) of this section of the bill. They also make provision for the rates of normal tax and surtax which will be applicable to such corporations for taxable years beginning after December 31, 1953, when the rates presently applicable will again be in effect. It is to be noted that in the amended provisions relating to mutual insurance companies other than life or marine, to interinsurers or reciprocal underwriters, and to regulated investment companies, a normal tax rate and a surtax rate is provided in each instance which will be applicable generally in computing the tax for taxable years which began after December 31, 1950, and before April 1, 1951, and which end after March 31, 1951. Thus, fiscal year taxpayers with a taxable year beginning on either the first day of February or the first day of March 1951, will be taxed on their income for such taxable year on the same basis as will a calendar year taxpayer for its taxable year January 1 to December 31, 1951. In this connection, the effective dates for the amendments made by part II of title I of the bill, as provided in section 124 of this bill, should also be noted.

Subsection (g) of this section, which corresponds to subsection (f) of the bill as it passed the House, is a technical amendment which eliminates from the code, by repeal of section 14, the provisions relating to normal tax on special classes of corporations with normal tax net income of less than $25,000. The various alternative rates provided in such section were applicable only in the case of a taxable year beginning before July 1, 1950.

SECTION 122. CREDITS OF CORPORATIONS

Subsection (a) of this section, which corresponds to the like designated provision of the bill as passed by the House, amends section 26 (b), relating to the credit for dividends received. The only change in paragraph (1) of subsection (b) is technical. Paragraph (2) presently provides for a credit of 59 percent of the amount received as dividends on the preferred stock of a public utility subject to income tax, in the case of taxable years beginning after June 30, 1950, and for a credit of 57 percent of such amount in the case of the calendar year 1950. As amended by subsection (a) of this section, the credit provided in paragraph (2) is (A) 61 percent of such amount in the case of the calendar year 1951, (B) 62 percent of such amount in the case of taxable years beginning after March 31, 1951, and before January 1, 1954, and (C) 59 percent of such amount for taxable years beginning after December 31, 1953. The present provisions of paragraph (2) which are applicable to prior taxable years are eliminated.

Under section 26 (b) (2) of the code, as amended by the bill, the credit for dividends received on the preferred stock of a public utility is limited to dividends with respect to which the credit provided in section 26 (h) (relating to credit for dividends paid on the preferred stock of a public utility) is allowable. Thus, the full 85 percent dividends-received credit provided in section 26 (b) (1) of the code will apply to dividends received with respect to which the dividends paid credit provided in section 26 (h) is not allowable.

Subsection (b) of this section, which corresponds to subsection (b) of section 121 of the House bill, amends the first sentence of paragraph (1) of section 26 (h), relating to the credit for dividends paid on certain preferred stock of a public utility. In its present form paragraph (1) provides for the credit in the case of the calendar year 1950 and in the case of taxable years beginning after June 30, 1950. The amendment made by this subsection eliminates these provisions and makes provision in clauses designated (A), (B) and (C) for the credit for the calendar year 1951, for taxable years beginning after March 31, 1951, and before January 1, 1954, and for taxable years beginning after December 31, 1953. Respectively, the credits provided for such taxable years are an amount equal to 28 percent, 27 percent, and 30 percent of whichever is the lower of (1) the entire amount of dividends paid by the public utility during the taxable year on its preferred stock or (2) the excess of the public utility company's adjusted net income for the taxable year over the amount of the credit for dividends received determined under section 26 (b) for such year.

Subsection (c) of this section, which corresponds to subsection (c) of section 121 of the House bill, amends section 26 (i) with respect to the credit allowed Western Hemisphere trade corporations in the determination of normal-tax net income and surtax net income. As amended, section 26 (i) provides, in the case of the calendar year 1951, that the credit shall be 27¾ percent of the normal-tax net income computed without regard to this credit. The percentage provided is 27 percent in the case of taxable years beginning after March 31, 1951, and before January 1, 1954, and 30 percent in the case of taxable years beginning after December 31, 1953. Under the present section 26 (i), the credit is 30 percent of normal tax net income in the case of taxable years beginning after June 30, 1950, and 33 percent in the case of the calendar year 1950. The corresponding provision in the House bill provided for a 27 percent credit applicable to all taxable years beginning after December 31, 1950.

SECTION 123. FILING OF CORPORATION RETURNS FOR TAXABLE YEARS ENDING AFTER MARCH 31, 1951, AND BEFORE OCTOBER 1, 1951

This section, which has no corresponding section in the bill as passed by the House and which is not amendatory of the Internal Revenue Code, makes provision for the case in which the return filed by a corporation prior to the enactment of the Revenue Act of 1951 will be affected by the amendments made to the code by such act with respect to computation of tax liability. It provides, in effect, that for taxable years which ended after March 31, 1951, but before October 1, 1951, corporations subject to income or excess profits tax shall, after the date of enactment of the Revenue Act of 1951, and on or before January 15, 1952, make and file returns for such taxable years with respect to the tax imposed by chapter 1 of the Internal Revenue Code (as amended by this bill) for such taxable years. It is further provided that such return, so made and filed, shall constitute the return for such taxable year for all purposes of the code, and that any return for any of the specified taxable years that may have been filed on or before the date of enactment of the Revenue Act of 1951 shall not be considered a return for such year for any of the purposes of the code.

The income or excess profits taxes imposed for any such taxable year (determined with the amendments made by the Revenue Act of 1951) are required by the section to be paid on January 15, 1952, in lieu of being paid on the date prescribed by section 56 (a) of the code. The provisions of section 56 (b) of the code (relating to installment payments) are, however, not affected and the taxes for the taxable year required by this section of the bill to be paid on January 15, 1952, can, at the election of the taxpayer, be paid in four installments (first two installments, 30 percent of the tax, and last two installments, 20 percent of the tax). Payments in respect of any income or excess profits tax for any of the specified taxable years made prior to the date of enactment of the Revenue Act of 1951, to the extent not credited or refunded, will, under the provisions of this section, be deemed to have been made at the time of the filing of the return required by the section on account of the tax for such taxable year determined under chapter 1 of the code as amended by the Revenue Act of 1951.

In treating such taxes as paid at the time of the filing of the return required by this section, such payment (in the event the return is filed before the due date prescribed by this section) will be subject to the provisions of section 322 (b) (4) of the code, which section provides special rules applicable for certain purposes where a tax payment is made at the time of filing a return which is filed before its due date.

SECTION 124. EFFECTIVE DATE

This section, which corresponds to section 125 of the bill as it passed the House, provides in general that the amendments made by part II of title I of the bill, shall be applicable only with respect to taxable years beginning after March 31, 1951, and to taxable years beginning on January 1, 1951, and ending on December 31, 1951. Exceptions are provided in the cases of the amendments made to section 207 (relating to certain insurance companies), to section 362 (relating to regulated investment companies) and to section 421 (relating to taxation of business income of certain section 101 organizations), it being provided that such amendments shall be applicable to taxable years beginning after December 31, 1950, and ending after March 31, 1951, that is, the calendar year 1951, fiscal years beginning on the first day of February or the first day of March 1951, and later taxable years. Accordingly, in the case of such taxpayers the amendments made by this part are not applicable to taxable years which ended before January 1, 1951, and fiscal taxable years which began in 1950 and ended on the last days of January, February, or March of 1951. Another special provision made by the section is to the effect that in the case of an insurance company subject to the tax imposed by section 207, the provisions of section 26 (b) of the code (relating to the credit for dividends received) applicable to the calendar year 1951 shall also be applicable to taxable years of such an insurance company beginning after December 31, 1950, and before April 1, 1951, and ending after March 31, 1951.

The sections also provides a cross reference to section 131 of the bill for provisions with respect to taxable years beginning before April 1, 1951, and ending after March 31, 1951.

PART III—FISCAL YEAR TAXPAYERS

SECTION 131. FISCAL YEAR TAXPAYERS

This section, which corresponds to the like-designated section of the bill as it passed the House, amends section 108 of the code, relating to both corporate and individual fiscal year taxpayers, to provide rules for the computation of tax in the cases of fiscal years which cut cross one or more of the effective dates of changes in the provisions affecting computation of tax made by the Revenue Act of 1950 and the Excess Profits Tax Act of 1950, and by the provisions of this bill.

Subsection (a) of this section, which corresponds to subsection (a) of section 121 of the bill as it passed the House amends section 108 (f) of the code to provide rules for the computation of the income tax of corporations in the case of fiscal years beginning before July 1, 1950, and ending after June 30, 1950. In the case of such a fiscal year which ends before April 1, 1951, the amendment made by the bill does not change the computation of the tax provided under existing law for such a year. If the fiscal year (beginning before July 1, 1950) ends after March 31, 1951, the amendment does affect a change in the existing law with regard to the computation of the tax for such a year under section 108 (f). In such a case the amendment provides for the computation and proration of three tentative taxes.

In computing the tentative taxes under paragraphs (1), (2), and (3) of section 108 (f), the net income, and the adjusted net income, of the corporation are not recomputed. However, in the case of a Western Hemisphere trade corporation, or a public utility which has paid dividends on its preferred stock, or any corporation which has received dividends on the preferred stock of a public utility with respect to which the credit provided in section 26 (h) is allowed, the amount of the normal-tax net income, and the amount of the corporation surtax net income, will be different for each of the three computations. A Western Hemisphere trade corporation, for example, will compute its tentative tax under paragraph (1) of section 108 (f) without computing a surtax, and its normal-tax net income will be computed without regard to the credit provided in section 26 (i) of the code; its tentative normal tax and tentative surtax under paragraph (2) of section 108 (f) will be computed on a normal-tax net income and a corporation surtax net income determined with the allowance of the 31-percent credit provided in section 26 (i) applicable to taxable years beginning on July 1, 1950 (determined without regard to the amendment of section 26 (i) made by the Excess Profits Tax Act of 1950); and its tentative normal tax and tentative surtax under paragraph (3) of section 108 (f) will be computed on a normal-tax net income and a corporation surtax net income determined with the allowance of the 27-percent credit provided in section 26 (i) applicable to taxable years beginning on April 1, 1951.

Subsection (a) of this section also amends section 108 (g) of the code to provide for the computation of the tax of a fiscal-year corporation for a taxable year beginning after June 30, 1951, and before April 1, 1951, and ending after March 31, 1951. In the case of such a fiscal year it is provided that the tax imposed by sections 13 and 15 shall be an amount equal to the sum of—

(1) that portion of a tentative tax, computed under the tax rates, and the credits provided in section 26, applicable to taxable years beginning on July 1, 1950, which the number of days in the fiscal year prior to April 1, 1951, bears to the total number of days in the taxable year, plus

(2) that portion of a tentative tax, computed under the tax rates, and the credits provided in section 26, applicable to taxable years beginning on April 1, 1951, which the number of days in the taxable year after March 31, 1951, bears to the total number of days in the taxable year.

The tentative tax under clause (1) will consist of a tentative normal tax at the rate of 25 percent of the normal-tax net income, and a tentative surtax of 22 percent of the corporation surtax net income in excess of $25,000. The tentative tax under clause (2) will consist of a tentative normal tax at the rate of 27 percent of the normal-tax net income and a tentative surtax of 25 percent of the corporation surtax net income in excess of $25,000. The net income of the corporation for the taxable year is not recomputed in determining the tentative tax under either clause (1) or (2). If the taxpayer paid or received dividends on preferred stock described in section 26 (h) of the code, or if the taxpayer is a western hemisphere trade corporation, the amount of the normal-tax net income, and the amount of the corporation surtax net income, applicable in the computation under clause (1), will differ from the amount used for the purpose of clause (2).

A new subsection (h) is also added to section 108 by this subsection of section 131 of the bill. This new subsection provides for the computation of the tax of a taxpayer, other than a corporation, for a fiscal year beginning before November 1, 1951, and ending after October 31, 1951. In the case of such a fiscal year, the tax imposed by sections 11 and 12, section 400, or section 421 (a) (2), shall be an amount equal to the sum of—

(1) that portion of a tentative tax, computed under the provisions of sections 11 and 12, or section 400, applicable to taxable years beginning on October 1, 1950, which the number of months in such taxable year prior to November 1, 1951, bears to the total number of calendar months in such taxable year, plus

(2) that portion of a tentative tax, computed under the provisions of sections 11 and 12, or section 400, applicable to years beginning on November 1, 1951, as if such provisions (other than the provisions relating to the head of a household) were applicable to such taxable year, which the number of calendar months in such taxable year after October 31, 1951, bears to the total number of calendar months in such taxable year.

The net income of the taxpayer for the fiscal year is not recomputed in determining the tentative tax under either clause (1) or clause (2). It is further provided that subsection (h) shall not apply in the case of a trust described in section 421 (b) (2) if the taxable year of such trust began before January 1, 1951.

A new subsection (i) is also added to section 108 by subsection (a) of section 131. For the purposes of section 108, it provides that a calendar month shall be disregarded if less than 15 days of such month fall within the taxable year, and that a calendar month shall be included as a full calendar month within the taxable year if more than 14 days of such month fall within the taxable year.

A new subsection (j) is added to section 108 by this subsection of section 131. This provides for the computation of tax in the case of taxable years of individuals beginning in 1953 and ending in 1954. Again the method of computation provided involves the computation and proration of two tentative taxes, the first computed upon the basis of the provisions of sections 11 and 12, section 400, or section 421 (a) (2), applicable to years beginning on January 1, 1953, and the second computed upon the basis of the provisions of such sections applicable to years beginning on January 1, 1954.

Provision for the computation of the tax of corporations in the case of taxable years beginning in 1953 and ending in 1954 is made in a new subsection (k) which is added to section 108 by this subsection of section 131 of the bill. The method of computation provided is again the computation and proration of two tentative surtaxes, the first computed upon the basis of the provisions of sections 13 and 15, or section 421 (a) (1), applicable to years beginning on January 1, 1953, the second computed upon the basis of the provisions of such sections applicable to years beginning on January 1, 1954.

Subsection (b) of section 131, which corresponds to a similar provision in the House bill, amends section 430 (b) of the code, relating to computation of the excess-profits tax for taxable years beginning before July 1, 1950, and ending after June 30, 1950. The amendment does not change the computation under existing law of the excess-profits tax for a taxable year which ends before April 1, 1951. In the case of a taxable year beginning before April 1, 1951, whether beginning before, on, or after July 1, 1950), and ending after March 31, 1951 (other than the calendar year 1951), the amendment will not affect the amount of the excess-profits tax for the fiscal year if the excess-profits tax is the tax computed under section 430 (a) (1), that is, if the excess-profits tax is 30 percent of the adjusted excess-profits net income. However, if the taxpayer's excess-profits tax for such fiscal year is the excess-profits tax computed with reference to the ceiling rate provided in section 430 (a) (2), the amendment will result in reflecting in the excess-profits tax for the taxable year the effect of the amendment made by section 121 (c) of the bill, changing the method of computing the ceiling rate for taxable years beginning after March 31, 1951.

Under the amendment, in the case of a taxable year beginning before April 1, 1951, and ending after March 31, 1951 (other than the calendar year 1951), a tentative excess-profits tax will first be computed (as provided in sec. 430 (b) (2) (A)) under the provisions of section 430 (a) of the code applicable to taxable years ending prior to April 1, 1951; that is, a ceiling rate of 62 percent is to be applied in the computation. In determining under section 430 (a) (2) the excess of 62 percent of the excess-profits net income over the income tax which would be imposed under sections 13, 14, and 15 of the code upon a normal-tax net income and corporation-surtax net income in an amount equal to the excess-profits net income for the taxable year, such tax must be computed under the provisions of section 108 (f) or (g), whichever is applicable. Such excess will be the tentative tax referred to in section 430 (b) (2) (A) unless 30 percent of the adjusted excess-profits net income results in a smaller tentative tax, in which case it will be such smaller tentative tax.

The computation of a tentative tax under section 430 (b) (2) (B) will be made under the provisions of section 430 (a) applicable to taxable years beginning on April 1, 1951. In computing such a tentative tax the new method of determining the maximum excess-profits tax provided under section 430 (a) (2) (C), described above, will be used. The tentative taxes computed under subparagraphs (A) and (B) of section 430 (b) (2) will then be prorated as provided in such section, and the excess-profits tax for the taxable year will be the sum of such prorated taxes.

If the corporation is a new corporation to which the special ceiling rates provided in section 430 (a) (3) and 430 (e) are applicable (see sec. 501 of the bill which amends sec. 430 of the code), then the computation of the tentative taxes for the fiscal year, in the manner described above, will take into account the special rates provided in subsection (e) of section 430 of the code.

Subsection (c) of section 131 provides a necessary technical amendment to paragraph (2) of section 108 (e) of the code and changes the designation of the present subsection (g) of section 108 to subsection "(1)."

TITLE II—WITHHOLDING OF TAX AT SOURCE

SECTION 201. PERCENTAGE METHOD OF WITHHOLDING

Section 201, which corresponds to section 221 of the bill as it passed the House, amends section 1622 (a) of the code by changing the percentage rate of withholding from 18 percent to 20 percent in the case of wages paid on or after November 1, 1951, and before January 1, 1954.

SECTION 202. WAGE BRACKET WITHHOLDING

This section, which corresponds to section 222 of the bill as passed by the House, amends section 1622 (c) (1), relating to wage-bracket withholding, to provide new tables which reflect the increased tax rates.

SECTION 203. ADDITIONAL WITHHOLDING OF TAX ON WAGES UPON AGREEMENT BY EMPLOYER AND EMPLOYEE

This section of the bill, which is identical with that of the House bill, adds to section 1622 of the code (relating to income tax collected at source on wages) a new subsection numbered (k) and entitled "Additional Withholding." This new subsection authorizes the Secretary to provide, by regulations, for withholding in addition to that otherwise required under section 1622 in cases in which the employer and the employee agree to such additional withholding. The Secretary is authorized to prescribe by regulations the form of such agreement and the conditions under which and the extent to which such an agreement shall be deemed proper. It is further provided by this new subsection that any amount actually withheld pursuant to such an additional withholding agreement entered into by and between an employer and an employee shall, for all purposes, be considered tax required to be deducted and withheld under applicable withholding provisions.

SECTION 204. EFFECTIVE DATE

This section, which corresponds to section 224 of the House bill, provides that the amendments made by title II shall be applicable only with respect to wages paid on or after November 1, 1951. It is immaterial whether the wages were earned before or after November 1, 1951. If they are paid on or after November 1, 1951, the new withholding rates will apply.

TITLE III—MISCELLANEOUS INCOME TAX AMENDMENTS

SECTION 301. TAX TREATMENT IN CASE OF HEAD OF HOUSEHOLD

This section, which corresponds to section 301 of the House bill, amends section 12 (c) of the code to provide a special computation of surtax for a taxpayer who qualifies as the head of a household. The effect of the amendment is that the combined normal tax and surtax of such a taxpayer will be an amount approximately equal to the combined normal tax and surtax as computed under sections 11 and 12 (b) reduced by one-quarter (instead of one-half as provided in the House bill) of the amount by which such combined tax exceeds the combined normal tax and surtax that would be determined if the return of the taxpayer were a joint return to which section 12 (d) was applicable. Section 12 (c) is applicable only with respect to taxable years beginning after October 31, 1951, instead of after August 31, 1951, as in the House bill.

Paragraph (1) of section 12 (c) contains a special surtax table prescribing the rates of surtax to be used in computing the tax of a head of a household for taxable years beginning after October 31, 1951, and before January 1, 1954, and paragraph (2) contains a similar table prescribing the rates applicable to taxable years beginning after December 31, 1953.

Paragraph (3) defines a head of a household as an individual who is not married at the close of his taxable year and who maintains as his home a household which constitutes for such taxable year the principal place of abode, as a member of such household, of one or more of certain classes of persons related to the taxpayer and described in subparagraphs (A) and (B) of paragraph (3). In no event, however, shall an individual be considered as maintaining a household unless he furnishes over half of the cost of maintaining such household during the taxable year. Thus, for purposes of section 12 (c), only one person can be considered as head of a particular household during a particular taxable year.

The persons described in subparagraph (A) include only a son or daughter of the taxpayer, or a descendant of either and a stepson or stepdaughter of the taxpayer. The persons described in subparagraph (B) are those persons (other than those described in subparagraph (A)) who are dependents of the taxpayer and for whom the taxpayer is entitled to an exemption for the taxable year under section 25 (b). Subparagraph (A) in the bill as passed by the House also included a descendant of a stepson or stepdaughter of the taxpayer. However, since such descendants do not constitute dependents of the taxpayer under section 25 (b) your committee has eliminated them from the class of persons through whom the taxpayer may qualify as head of household.

If the person, whose principal place of abode is the home of the taxpayer, is an unmarried person, as described in subparagraph (A), that is, a child or descendant of a child of the taxpayer, the taxpayer may (if the other requirements of sec. 12 (c) are met) qualify as a head of a household even though the taxpayer would not be entitled to an exemption for such person as a dependent under section 25 (b).

Thus, an unmarried taxpayer who maintains as his home a household which includes only himself and his unmarried son, may be the head of the household even though the taxpayer does not furnish more than half the support of the son and even though the son has gross income of $600 or more. If, however, the son is married at the close of the taxable year of the taxpayer, the taxpayer may not qualify as the head of the household by reason of the fact that the principal place of abode of the son is such household unless the taxpayer is entitled to an exemption for the son under section 25 (b), that is, unless the son receives more than half his support from the taxpayer, has gross income of less than $600 ($500 under the House bill) in the calendar year in which the taxable year of the taxpayer begins, and does not make a joint return with his spouse for his taxable year beginning in such calendar year.

A taxpayer whose status as head of a household depends upon the fact that such a household is the principal place of abode of a person described in subparagraph (B) cannot qualify as the head of a household unless such person, for the calendar year in which the taxable year of the taxpayer begins, received more than half of his support from the taxpayer, had gross income of less than $600 in such calendar year, and, if married, has not made a joint return with his spouse for his taxable year beginning in such calendar year. Thus, a taxpayer who maintains a home for himself and his mother does not qualify as head of a household even though his home constitutes the principal place of abode of his mother unless he is entitled to claim his mother as a dependent under section 25 (b).

A taxpayer will not be considered as the head of a household unless such household actually constitutes his home for the taxable year and also constitutes the principal place of abode for such taxable year of another member of the household who meets the requirements of section 12 (c) (3) (A) or (B). If such other member of the household dies during the taxable year, the taxpayer will not be denied the benefits of this subsection if the taxpayer's household constituted the member's principal place of abode during the taxable year up to the date of his death. Section 12 (c) is intended to apply only where the taxpayer and such other members of the household live together in such household during the entire taxable year (except for temporary absences due to special circumstances). The fact that a child may be at college during the college term does not prevent the home of the taxpayer from also constituting the principal place of abode of the child. However, such home will not be considered as the principal place of abode where the child establishes a separate habitation and only returns for periodic visits. Similarly, such home will not be considered as constituting the principal place of abode of a dependent of the taxpayer who is supported by the taxpayer for a substantial part of the year in lodgings other than those occupied by the taxpayer even though such person may at various periods live in the household, unless the residence of the dependent in other lodgings is not permanent and is due to necessity such as illness. It is also intended that the household constitute the actual place of abode of the taxpayer and it is not sufficient that the taxpayer maintain the household without being an occupant thereof.

Paragraph (4) contains rules for ascertaining the status of the taxpayer and other persons for the purpose of determining whether the taxpayer is the head of a household.

Paragraph (4) (A) provides that a legally adopted child of a person shall be considered a child of such person by blood.

Paragraph (4) (B) provides that an individual who is legally separated from his spouse under a decree of divorce or separate maintenance shall not be considered as married.

Paragraph (4) (C) provides that a taxpayer whose spouse is a nonresident alien shall be considered as not married at the close of the taxable year for the purposes of considering whether the taxpayer is the head of a household. Thus, a taxpayer whose spouse is a nonresident alien (so that such taxpayer may not compute his tax under the income-splitting provisions of sec. 12 (d)) and who, if unmarried, would qualify as a head of a household may be considered as unmarried despite the fact that he has a spouse.

Paragraph (4) (D) provides that a taxpayer whose spouse (other than a spouse who was a nonresident alien) dies during the taxable year shall be considered as married at the close of his taxable year for the purposes of section 12 (c). Such taxpayer, accordingly, may not be considered as a head of a household for such taxable year.

A taxpayer who at any time during the taxable year is a nonresident alien shall in no case be considered as a head of a household.

Subsection (b) of this section of the bill (relating to computation of tax by collector) is added by your committee and does not appear in the bill as passed by the House.

Subsection (b) (1) of this section amends section 51 (f) (1) of the code, which provides that an individual entitled to elect to pay the tax imposed by supplement T whose gross income is less than $5,000, and is entirely from wages, dividends, and interest (with not more than $100 from sources other than wages) may elect to have his tax computed by the collector in lieu of making his own computation on the return. Your committee's amendment adds a sentence to provide that the collector's computation shall be made without regard to the taxpayer's status as head of a household.

Subsection (b) (2) of this section of the bill makes a corresponding amendment to section 402 of the code (relating to the manner and effect of an election to pay the tax imposed by supplement T) to provide that if a head of a household elects to have his tax computed by the collector pursuant to the provisions of section 51 (f), and thereby elects under section 51 (f) (4) to pay the tax imposed by supplement T, the tax imposed by section 400 is to be computed without regard to the status of the taxpayer as the head of a household.

Under these amendments if a person otherwise entitled to have his tax computed at the rates provided for a head of household elects to have his tax computed by the collector under section 51 (f) (1) the collector will use for purposes of computing the tax the tables provided under section 400 for a single person. Such election is made under present practice by taxpayers filing Form 1040A. Such a person filing Form 1040A and electing to have his tax computed by the collector will not, of course, be required to submit any information respecting his status as head of a household as that status will have no significance in the collector's computation of his tax as a single person.

SECTION 302. PAYMENTS TO BENEFICIARIES OF DECEASED EMPLOYEES

This section, for which there is no corresponding provision in the House bill, amends section 22 (b) (1) of the code (relating to exclusion of insurance proceeds from gross income) to provide for a limited exclusion for amounts paid by an employer to the beneficiaries of an employee by reason of the employee's death. The amendment, which is contained in a new subparagraph (B) added to section 22 (b) (1), would restrict the application of the provision to cases where the payments are made pursuant to an express contract under which the employer is legally obligated to pay the amounts to the designated beneficiaries of the employee. In addition, the aggregate of the amounts to be excluded by all the beneficiaries of the employee with respect to amounts paid by an employer of such employee may not exceed $5,000. In cases where payments of the type described in section 22 (b) (2) (B) exceed $5,000 and are made to more than one beneficiary of an employee, the exclusion shall be allocated among the beneficiaries in accordance with such regulations as the Secretary may prescribe.

Where the amounts are held by the employer under an agreement to pay interest thereon, the interest payments (as in the case of interest payments where insurance proceeds are held by the insurer) are includible in gross income.

The amendment made by this section is applicable with respect to taxable years beginning after 1950.

SECTION 303. JOINT AND SURVIVOR ANNUITIES

This section, for which there is no corresponding provision in the House bill, amends sections 113 (a) (5) and 22 (b) (2) of the code to provide that the basis of a survivor's interest in a joint and survivor annuity, the value of which is required to be included in the estate of a decedent annuitant dying after December 31, 1950, shall be considered to be acquired by "bequest, devise, or inheritance" and that such basis (that is, the value of such survivor's interest at the time of the decedent's death) shall be considered, for purposes of determining the amount to be included in the income of the survivor, to be the consideration paid for the survivor's annuity.

Under existing law, amounts received as an annuity purchased by the annuitant are in general taxed to the extent of 3 percent of the aggregate consideration paid for the annuity until the full consideration has been recovered tax-free, after which the entire amounts received are taxable. Section 22 (b) (2) (A). In the case of an annuity purchased by an employer for an employee under a qualified pension or profit-sharing plan for which the employer's contribution is deductible under section 23 (p) (1) (B), the consideration for the annuity is considered to be the amount contributed by the employee so that the employee on receipt of the annuity payments is taxed to the extent of 3 percent of his contributions until he has recovered tax-free the amount of his contributions after which the full amount of the annuity payments constitute taxable income. (Where the employer's contributions are included in the income of the employee in the year when made, that is, where the pension or profit-sharing plan does not meet the requirements of sections 165 (a) (3), (4), (5), and (6) and the employee's rights under the contract are nonforfeitable, the amount of the employer's contributions is also considered to constitute part of the consideration paid.) Section 22 (b) (2) (B). In the case of a joint and survivor annuity, the aggregate consideration paid under the foregoing rules is considered to be the full amount paid for the entire annuity with the effect of taxing to the survivor annuitant 3 percent of such consideration (the amount paid for the annuity in cases under section 22 (b) (2) (A) and the contributions by the employee, or the employee and employer, in the case described in section 22 (b) (2) (B)) and with the further effect that where the consideration has been excluded from the income of the primary annuitant, the survivor is taxed on the full amount of payments received by him.

Under your committee's amendment to section 113 (a) (5), if the value of the survivor's interest is required to be included under applicable principles of law in the gross estate of the decedent annuitant (whether or not such estate exceeds $60,000 so as to require the filing of an estate-tax return under sec. 821 (a) (1)), the basis of such interest to the survivor annuitant is considered (except to the extent to which sec. 811 (j), relating to optional valuation, is applicable) to be the value at the time of the decedent's death and, under your committee's amendment to section 22 (b) (2), such basis is considered to constitute the consideration paid for the survivor's annuity for purposes of determining the taxable amounts of the annuity payments received by her. Thus, if a survivor annuitant is to receive an annuity of x dollars annually, and if the value of such annuity would be required to be included in the gross estate of the decedent annuitant and if the basis of such annuity under section 113 (a) (5) would be $5,000, the survivor is to include in his income each year an amount not in excess of $150 (3 percent of $5,000) and may exclude the balance of the amounts received until the amount of $5,000 has been recovered tax-free.

SECTION 304. INCOME FROM DISCHARGE OF INDEBTEDNESS

Section 304 corresponds to sections 1 and 2 of H. R. 2416 as recently passed by the House of Representatives and provides for the permanent enactment of section 22 (b) (9) of the Internal Revenue Code and for the extension of section 22 (b) (10) of the code for a 3-year period. A discussion of these provisions is contained in part I of this report, pages 59 and 60.

SECTION 305. COMPENSATION OF CERTAIN MEMBERS OF THE ARMED FORCES

This section, for which there is no corresponding provision in the House bill, amends section 22 (b) (13) of the Internal Revenue Code, relating to the additional allowance for certain members of the Armed Forces.

Section 22 (b) (13) of existing law excludes from gross income certain compensation received for active service in the Armed Forces of the United States for any month during any part of which the recipient served in a combat zone after June 24, 1950, and prior to January 1, 1952. Subsection (a) of this section extends this latter date from January 1, 1952, to January 1, 1954.

Subsection (a) of this section also extends the exclusion to certain compensation received for active service in the Armed Forces of the United States for any month during any part of which the recipient was hospitalized at any place as a result of wounds, disease, or injury incurred while serving in a combat zone after June 24, 1950, and prior to January 1, 1954, provided that during all of such month there are combatant activities in some combat zone.

Subsection (b) of this section amends section 22 (b) (13) (C) (iii) (relating to when service is performed in a combat zone) to provide that June 25, 1950, shall be considered the date of the commencing of combatant activities in the combat zone (Korea) designated in Executive Order 10195. The date June 25, 1950, used in this amendment refers to the date June 25, 1950, in the combat zone.

Subsection (c) of this section makes conforming amendments to section 1621 (a) (1) of the Internal Revenue Code, relating to the definition of the term "wages."

Subsection (d) of this section provides that the amendments made by subsections (a) and (b) shall be applicable to taxable years ending after June 24, 1950, and that the amendment made by subsection (c) shall be applicable with respect to wages paid after the tenth day following the date of enactment of the Act.

SECTION 306. INVOLUNTARY LIQUIDATION AND REPLACEMENT OF INVENTORIES

This section of the bill, for which there is no corresponding provision in the House bill, amends section 22 (d) (6) (F) (iii) (relating to the application of the rule with respect to replacements to liquidations of inventories occurring in taxable years ending after June 30, 1950, and prior to January 1, 1954) so as to vary the application of that rule in certain cases insofar as replacements made within taxable years ending prior to January 1, 1953, are concerned. In general, section 22 (d) (6) (C) provides that, for the purpose of section 22 (d) (6), goods reflecting an increase in inventory for a taxable year are considered, in the order of their acquisition, as having been acquired in replacement of the goods most recently liquidated and not previously replaced, whether or not the liquidation of such goods was involuntary. To the extent that the liquidation was involuntary, the benefits of the subsection are applicable. Under subparagraph (A) of section 22 (d) (6), tax benefits are granted with respect to the replacement of goods which were involuntarily liquidated in taxable years beginning after December 31, 1940, and prior to January 1, 1948, where such goods are replaced in a taxable year ending prior to January 1, 1953. Under subparagraph (F), similar benefits are provided with respect to goods which were involuntarily liquidated in taxable years ending after June 30, 1950, and prior to January 1, 1954, where replacement of such goods is made in a taxable year ending prior to January 1, 1956.

The operation under present law of the provisions of subparagraph (C), dealing with replacements, insofar as involuntary liquidations of goods of the same class subject to the provisions of both subparagraphs (A) and (F) are concerned, is that the involuntary liquidations subject to the provisions of subparagraph (F) must be replaced before the involuntary liquidations subject to the provisions of subparagraph (A). To the extent, therefore, that goods of the same class as those which were liquidated in the earlier period are involuntarily liquidated in the later period, it is apparent that the operation of the present replacement rule requires that the replacement of all such liquidations must be made in taxable years ending prior to January 1, 1953, in order that the tax benefits of subparagraph (A) may be available with respect to the earlier liquidations.

Under the amendment made by this section of the bill, the application of the general replacement rule provided in subparagraph (C) is modified in such a way that, in any case involving involuntary liquidations of goods of the same class subject to the provisions of both subparagraphs (A) and (F), the involuntary liquidations of such goods subject to the provisions of subparagraph (F) shall, for the purpose of replacements made in taxable years ending prior to January 1, 1953, be considered as having occurred prior to the involuntary liquidations of such goods subject to the provisions of subparagraph (A).

The amendment made by this section is not applicable to voluntary liquidations occurring in the period to which subparagraph (F) is applicable.

The amendment of section 22 (d) (6) (F) (iii) made by this section also corrects an error in cross-reference which was previously contained in that clause.

Subsection (b) of the section provides that the amendment made by the section shall be applicable with respect to taxable years ending after June 30, 1950.

SECTION 307. MEDICAL EXPENSES

This section of the bill, for which there is no corresponding provision in the House bill, amends section 23 (x), relating to the deduction of medical, dental, etc., expenses. The effect of the amendment is to remove the 5-percent limitation with respect to medical expenses paid during the taxable year, not compensated for by insurance or otherwise, for the care of a taxpayer or his spouse if either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year. The limitation with respect to the maximum deduction allowable under section 23 (x) remains unchanged.

The determination of whether an individual is married at any time during the taxable year shall be made in accordance with the provisions of section 51 (b) (5).

Application of section 23 (x) as amended to the following examples illustrates the effect of the amendment.

Example 1.—A, who is 70 years of age on February 22, 1951, files his income-tax return on March 15, 1952 (calendar-year basis). During the calendar year 1951, A pays the following percentages of his adjusted gross income as specified: (*a*) 3 percent for the medical care of himself and his spouse, and (*b*) 2 percent for the medical care of his dependent son. A would be allowed to deduct an amount equal to 3 percent of his adjusted gross income, subject, however, to the maximum allowable under section 23 (x). Under existing law, A would not be allowed any deduction in this case.

Example 2.—Assuming the percentages for medical care specified in (1) are, respectively, 5 and 5, A would be allowed to deduct an amount equal to 5 percent of his adjusted gross income, subject, however, to the maximum allowable under section 23 (x). Under existing law, A would be allowed to deduct an amount equal to 5 percent of his adjusted gross income, subject to the same maximum.

In determining the amount of medical expenses deductible under section 23 (x) (2) (B), the amount deductible under section 23 (x) (2) (A) shall not be included for the purpose of meeting the 5-percent limitation.

This amendment is applicable to taxable years beginning after December 31, 1950.

SECTION 308. STANDARD DEDUCTION

This section, for which there is no corresponding provision in the House bill, amends section 23 (aa) of the Internal Revenue Code, relating to the optional standard deduction for individuals.

Under existing law, an election to take or not to take the standard deduction for any taxable year is irrevocable after the time prescribed for filing the return for such year. Subsection (b) of this section adds paragraph (7) to section 23 (aa) to expressly provide that, under regulations prescribed by the Secretary, an election to take or not to take the standard deduction for any taxable year may be changed after the time prescribed for filing the return for such year.

If, however, the spouse of the taxpayer filed a separate return for any taxable year that corresponds, for the purpose of paragraph (4) of section 23 (aa), to the taxable year of the taxpayer, the change may not be made unless, under regulations prescribed by the Secretary, (1) the spouse makes a change of election in such separate return with respect to the standard deduction consistent with the change of election sought by the taxpayer, and (2) the taxpayer and his spouse file with the Secretary a consent in writing to the assessment, within such period as may be agreed upon with the Secretary, of any deficiency of either, to the extent attributable to such change of election even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

A change of election for any taxable year shall not be permitted, however, if the tax liability of the taxpayer for the taxable year, or of the taxpayer's spouse for the taxable year corresponding, for the purposes of section 23 (aa) (4), to the taxable year of the taxpayer, has been compromised under the provisions of section 3761.

Although it is not expressly so stated, the change for any taxable year must be made within the period of time when a claim for credit or refund must be filed for such year in order for the taxpayer to receive a credit or refund attributable to such change since such period is not extended by this section.

Subsection (a) of this section amends paragraph (3) of section 23 (aa) to conform that paragraph to paragraph (7) of such section as added by subsection (b) of this section of the bill.

Subsection (c) of this section provides that the amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1949.

SECTION 309. EXPENDITURES IN THE DEVELOPMENT OF MINES

This section corresponds to section 302 of the bill as passed by the House. Your committee has added a provision allowing the taxpayer an election to deduct certain expenditures for the development of a mine or other natural deposit (other than an oil or gas well) either in the taxable year paid or incurred or ratably during the taxable years in which the produced ores or minerals are sold. Your committee has also made technical changes in the section.

Under existing law all expenditures in excess of net receipts from ores or minerals sold are required to be charged to capital account while a mine is in the development stage and are to be recovered through depletion. However, after a mine has reached the producing status, development costs, whether or not in excess of net receipts from ores or minerals sold, are not treated as capital charges recoverable through depletion but as operating expenses deductible in the year in which the produced ores or minerals benefited thereby are sold.

Section 309 of the bill amends section 23 of the code by adding a new subsection (cc). The corresponding provisions of the House bill would have inserted a new subparagraph (D) to section 23 (a) (1).

Paragraph (1) of subsection (cc) provides that all expenditures for the development of a mine or other natural deposit (other than an oil or gas well) paid or incurred after December 31, 1950, and after the existence of ores or minerals in commercially marketable quantities has been disclosed shall be deductible, except as otherwise provided in paragraph (2) of this subsection. These expenditures shall be deducted whether paid or incurred by the taxpayer while the mine or deposit is in the development or while in the producing status. Paragraph (1) further provides that this new subsection shall have no application to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 23 (l). However, allowances for depreciation shall be considered for the purpose of this new subsection as expenditures.

During the development stage, this new subsection is applicable to all expenditures of the taxpayer, unless otherwise excluded herein. However, after the producing status is reached, it is only those extraordinary expenditures which under existing law must be deferred and deducted ratably as the produced ores or minerals benefited thereby are sold which are affected by this subsection. The determination of when a mine or deposit passes from one stage into another shall be made under existing law.

Paragraph (2) of subsection (cc) allows the taxpayer to elect, in accordance with regulations, to treat such expenditures, whether paid or incurred during or after the development stage, in the same manner as such expenditures are now treated after the mine or deposit has reached the producing status. That is, such expenditures may be treated as deferred expenses and shall be deductible on a ratable basis as the units of produced ores or minerals benefited by such expenditures are sold. While the mine or deposit is in the development stage the election under paragraph (2) applies only to expenditures which are in excess of the net receipts during the taxable year from the ores or minerals produced from the mine or deposit. Accordingly, the amount of such expenditures which is not in excess of such net receipts for the taxable year while the mine or deposit is in the development stage shall be deductible in full. The election under this paragraph shall be applicable to the total amount of such expenditures, or of such excess, as the case may be, with respect to each mine or deposit and shall be irrevocable for the taxable year for which it is made.

This amendment is applicable to a taxpayer who has paid or incurred expenditures of the type described therein and accordingly has no application to that part of the cost of a mine or deposit attributable to such expenditures when acquired by purchase. Where a taxpayer has paid or incurred expenditures described in subsection (cc), has made an election under paragraph (2), and has thereafter leased the developed property retaining a royalty interest therein, such a taxpayer shall be allowed the ratable deduction provided in paragraph (2).

In order to determine the amount of the annual deduction allowable under paragraph (2), it will be necessary to estimate the number of units, benefited by such expenditures, in the reserve of the mine or deposit at the close of the taxable year for which an election is made. This estimate is, of course, subject to revision in the event it is ascertained as the result of operation or development work that the remaining recoverable units are materially greater or less than the number remaining from a prior estimate. As these units are produced and sold, the amount of the development costs to be deducted will be an amount which is in the same proportion to the total of such costs which are treated as deferred expenses as the number of units sold is to the number of units in the reserve.

In computing the amount of percentage depletion allowable for any taxable year, the deductions allowable for such year under paragraph (1) or (2) of subsection (cc) shall be taken into account in determining the taxpayer's net income for the purpose of the 50 percent limitation provided in section 114 (b) (4) (A) of the code.

Paragraph (3) provides that the amount of the expenditures which are to be deferred and deducted ratably under the election provided in paragraph (2) shall be taken into account in determining the cost of the mine or deposit for the purpose of sections 111, 112, and 113. However, no amount of such deferred expense shall be included in the adjusted basis of the property for the purpose of computing a deduction for cost depletion under section 114.

Subsection (b) of section 309 of the bill adds a new subparagraph (J) to section 113 (b) (1) (relating to adjusted basis of property) which provides that the basis of mines or natural deposits shall be adjusted for amounts allowed as deductions under section 23 (cc) (2) and resulting in a reduction of the taxpayer's taxes under chapter 1 of the code, but not less than the amounts allowable under such section for the taxable year and prior years. Accordingly, if a taxpayer purchases undeveloped mining property for $1,000,000 and at the close of the development stage has incurred development costs in excess of net receipts of $9,000,000, and has made the election with respect to such costs under section 23 (cc) (2) the basis of such property at such time for computing gain or loss will be $10,000,000. Assuming that the taxpayer in this example has operated the mine for several years and has deducted allowable percentage depletion in the amount of

$2,000,000 and has deducted, pursuant to an election under section 23 (cc) (2), allowable deferred development expenditures of $2,000,000, the basis of the property in the taxpayer's hands for purposes of determining gain or loss if sold will be $6,000,000.

Subsection (c) of section 309 makes a technical amendment to section 24 (a) (2) of the code (relating to items not deductible) in order to remove any doubt as to the deductibility under section 23 (cc) of the expenditures incurred in the development of a mine or deposit.

The amendments made by this section of the bill shall be applicable to taxable years ending after December 31, 1950.

SECTION 310. GROSS INCOME OF DEPENDENTS OF TAXPAYER

Under present law the $600 exemption for a dependent of the taxpayer may not be allowed if the gross income of the dependent for the calendar year in which the taxable year of the taxpayer begins is $500 or more. Section 310 (a) of the bill, for which there is no corresponding provision in the House bill, amends section 25 (b) (1) (D) of the Internal Revenue Code to provide that the exemption may be allowed if the gross income of the dependent is less than $600, instead of $500, as under present law. The amendment made by section 310 (a) is to be applicable with respect to taxable years beginning after December 31, 1950.

SECTION 311. CREDIT FOR DIVIDENDS RECEIVED

This section, for which there is no corresponding provision in the House bill, amends section 26 (b) and section 119 (a) (2) (B) of the Internal Revenue Code.

Under existing law the credit allowed corporations for dividends received is not permitted with respect to dividends received from a foreign corporation, whether or not such foreign corporation has been subjected to United States income tax on its earnings or profits.

This section amends section 26 (b) of the code so as to provide for a dividends received credit in the case of dividends received from a foreign corporation which is subject to income tax under chapter 1 of the code if, for an uninterrupted period of not less than 36 months ending with the close of the foreign corporation's taxable year preceding the declaration of the dividends, the foreign corporation has been engaged in trade or business within the United States and if, during such period, 50 percent or more of the gross income of the foreign corporation has been derived from sources within the United States. If the foreign corporation has been in existence less than 36 months at the close of the taxable year preceding the declaration of the dividends, then the applicable period to be taken into consideration in lieu of the uninterrupted period of 36 or more months is the entire period the foreign corporation has been in existence. The dividends received credit here provided will not be allowed in the case of dividends received from a foreign personal holding company amounts included in gross income under section 337 as dividends from a foreign personal holding company (as defined in section 331 of the code).

An uninterrupted period which meets the two tests (gross income and carrying on trade or business) may start at a date later than the date on which the company first commenced an uninterrupted period of doing business in the United States. If a corporation has carried on business in the United States for an uninterrupted period of 20 years prior to the close of the taxable year preceding the declaration of the dividend, and its gross income from United States sources during such period was only 40 percent of its total gross income during the 20-year period, but during the last 15 years of the 20-year period the gross income from United States sources constituted 50 percent of its total gross income during such last 15 years, the uninterrupted period which meets both tests would begin at the beginning of the 15-year period.

The amount of the credit to be allowed is 85 percent of the amount received as dividends from earnings or profits accumulated by the foreign corporation during the applicable period, that is, the uninterrupted period of 36 or more months (or the period permitted in lieu thereof when such corporation has been in existence less than 36 months) throughout which it has met the prescribed trade or business and percentage of gross income tests. In no case, however, will the amount of credit allowed be in excess of an amount which bears the same ratio to 85 percent of the amount received as dividends from earnings or profits accumulated by the foreign corporations during the applicable period as the normal-tax net income of the foreign corporation for such applicable period from sources within the United States bears to its entire normal-tax net income for such applicable period.

Since section 119 (a) (2) (B) of the code now provides that, for the purpose of section 131, dividends from a foreign corporation shall be treated as income from sources without the United States, a double benefit would (in the absence of an appropriate amendment to section 119) be available in some instances to a domestic corporation receiving dividends from a foreign corporation, in that the substantive amendment made by this section to section 26 (b) of the code would permit a dividends received credit to the domestic corporation with respect to the same dividends through the receipt of which under section 131 of the code the domestic corporation is entitled to a foreign tax credit.

In order to restrict the amount of foreign tax credit allowable with respect to dividends of foreign corporations allocable to income from sources outside the United States, this section amends section 119 (a) (2) (B) of the code so as to provide that, for the purpose of section 131, dividends from a foreign corporation shall be treated as income from sources without the United States only to the extent such dividends exceed the amount which is one hundred eighty-fifths of the amount of the credit allowable under section 26 (b) (3) in respect of such dividends. Under this formula, therefore, the portion of the dividends paid from earnings or profits derived from sources within the United States cannot be used as the basis of a foreign tax credit if such portion is subject to the dividends received credit rule of section 26 (b) (3).

The closing provisions of section 26 (b) of the code, which now follow immediately after paragraph (2) thereof, will be equally applicable to the provisions of paragraph (3), as added by this section. The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

SECTION 312. JOINT RETURN AFTER FILING SEPARATE RETURN

This section, for which there is no corresponding provision in the House bill, adds new subsection (g) to section 51 of the code to permit the filing of a joint return by a husband and wife in certain cases even though separate returns have already been filed for the taxable year.

Paragraph (1) of section 51 (g) provides that an individual who has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under section 51 (b) may make a joint return with his spouse for such taxable year even though the time prescribed by law for filing the return for the taxable year has expired. The joint return filed pursuant to section 51 (g) shall constitute the return of the husband and wife for such year, and all payments, credits, refunds, or other repayments, made or allowed with respect to the separate return of either spouse previously filed, are to be taken into account in determining the extent to which the tax on the joint return has been paid.

For the purpose of section 51 (g), the determination of whether an individual is married at any time during a taxable year shall be made in accordance with the provisions of section 51 (b) (5). The fact that the taxpayer and his spouse are legally separated after the filing of separate returns for the taxable year shall not deprive them of their right to file a joint return for the taxable year pursuant to section 51 (g).

Paragraph (2) of section 51 (g) provides that the following payments must be made at or before the time of the filing of the joint return if a joint return is to be filed pursuant to such subsection:

(A) All amounts previously assessed with respect to either spouse for such taxable year;

(B) All amounts shown as the tax by either spouse upon his separate return for such taxable year; and

(C) Any amount determined by the Commissioner, at the time of the filing of the joint return, as a deficiency with respect to either spouse for such taxable year if, prior to the filing of the joint return, a notice under section 272 (a) of such deficiency has been mailed.

Paragraph (3) of section 51 (g) provides that a joint return cannot be made pursuant to such subsection—

(A) After the expiration of 3 years from the last day prescribed by law for filing the return for such taxable year determined without regard to any extension of time granted to either spouse;

(B) After a notice of deficiency under section 272 (a), with respect to the taxable year, has been mailed to either spouse if the spouse files a petition with respect to such notice with the Tax Court within the time prescribed in section 272 (a), that is, within the 90-day period after the mailing of the notice;

(C) After either spouse has commenced a suit in any court for the recovery of any part of the tax for such taxable year; or

(D) After either spouse has entered into a closing agreement under section 3760 with respect to such taxable year, or after any civil or ciminal case arising against either spouse with respect to such taxable year has been compromised under section 3761.

Paragraph (4) of section 51 (g) provides that if a joint return is made under such section, any election (other than the election to file a separate return) made by either spouse in his separate return for the taxable year with respect to the treatment of any income, deduction, or credit of such spouse shall not be changed in the making of the joint return where such election would have been irrevocable if the joint return had not been made. Thus, if one spouse has made an irrevocable election to adopt and use the elective inventory method under section 22 (d), this election may not be changed upon making the joint return under section 51 (g).

Paragraph (5) of section 51 (g) provides that, if a joint return is made under such section after the death of either spouse, such return with respect to the decedent can be made only by his executor or administrator. Thus, in the case where no executor or administrator is appointed no joint return can be made under section 51 (g).

Paragraph (6) of section 51 (g) provides for additions to the tax in certain cases where the amount shown as the tax by the taxpayer and his spouse on the joint return made under such subsection exceeds the aggregate of the amounts shown as tax on the separate returns of the spouses. If any part of such excess is attributable to negligence, or intentional disregard of rules and regulations, at the time of the making of such separate return, but without any intent to defraud, 5 percent of such excess is to be assessed, collected, and paid in the same manner as if it were a deficiency. If any part of such excess is attributable to fraud at the time of the making of such separate return with intent to evade tax, 50 percent of such excess shall be assessed, collected, and paid in the same manner as if it were a deficiency. This addition is in lieu of the 50 percent addition to the tax provided in section 3612 (d) (2).

Paragraph (7) of section 51 (g) provides the rules for the application of sections 275 and 291, relating, respectively, to the period of limitations upon assessment and collection, and to delinquent returns. Under such rules, a joint return made under such section shall be deemed to have been filed—

(A) On the date the last separate return of either spouse was filed for the taxable year, but not earlier than the last date prescribed by law for filing the return of either spouse, where both spouses filed separate returns prior to making the joint return under section 51 (g);

(B) On the date of the filing of the separate return, but not earlier than the last day prescribed by law for the filing of such return, where only one spouse is required to file a return prior to the making of the joint return under section 51 (g); or

(C) On the date of the filing of the joint return under section 51 (g), where only one spouse filed a separate return prior to the making of the joint return under such subsection and the other spouse had gross income of $600 or more for the taxable year.

For the purpose of section 51 (g) (7), the last date prescribed by law for filing the return for the taxable year shall include any extension of time granted to either spouse.

Paragraph (8) of section 51 (g) provides that, for the purpose of section 322, relating to refunds and credits, a joint return made under section 51 (g) shall be deemed to have been filed on the last date prescribed by law for filing the return for such taxable year and that such date is to be determined without regard to any extension of time granted to either spouse.

Paragraph (9) of section 51 (g) provides that, in the case of a joint return made under such section, the period of limitations provided in sections 275 and 276 shall include 1 year immediately after the date of the filing of such joint return. The expiration of the 1 year is to be determined without regard to the rules provided in section 51 (g) (7), relating to the application of section 275 and 291 with respect to a joint return made under section 51 (g).

Paragraph (10) of section 51 (g) provides that, for the purposes of section 3809 (a), relating to criminal penalties in the case of a fraudulent return, the term "return" includes a separate return filed by a spouse for the taxable year for which a joint return is subsequently made under section 51 (g).

Subsection (b) of section 312 of the bill provides that section 51 (g), as added by subsection (a) of section 312, shall be applicable only with respect to taxable years beginning after December 31, 1950.

SECTION 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, AND COOPERATIVE BANKS

Section 313, for which there is no corresponding provision in the House bill, relates to income-tax treatment of mutual savings banks, building and loan associations, and cooperative banks, and is applicable only with respect to taxable years beginning after December 31, 1951.

Subsection (a) repeals section 101 (2) of the code (relating to exemption from tax of mutual savings banks).

Subsection (b) amends section 101 (4) of the code to repeal the exemption from tax of building and loan associations and cooperative banks. Credit unions without capital stock organized and operated for mutual purposes and without profit will remain tax-exempt under section 101 (4) of the code.

Subsection (c) amends section 5 (h) of the Home Owners Loan Act of 1933 (48 Stat. 132; 12 U. S. C., sec. 1464 (h)), to repeal the exemption of Federal savings and loan associations from Federal income tax in the case of taxable years beginning after December 31, 1951.

Subsection (d) amends section 23 (k) (1) (relating to deduction from gross income of bad debts) to provide in the case of certain organizations heretofore tax-exempt that the reasonable addition to a reserve for bad debts provided for under such paragraph shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserve existing at the close of December 31, 1951. This provision applies only to those organizations heretofore tax-exempt under section 101 (2), (4), and (15) who are denied exemption by the amendments made by this section of the bill; that is, it applies to a mutual savings bank not having capital stock represented by shares, a domestic building and loan association (see subsection (h) for definition), and a cooperative bank without capital stock organized and operated for mutual purposes and without profit. These organizations will all be included in the definition of the term "bank" under section 104 (a) of the code after its amendment by subsection (g). Each of these organizations may, subject to approval by the Secretary, select either the deduction method or the reserve method for bad debts on its first return of income. If the method selected is approved, it must be followed in returns for subsequent years, except as permission may be granted by the Secretary to change to another method. It is contemplated that in fixing rules for the determination of reasonable additions to a reserve for bad debts, all appropriate factors will be taken into account including the amount of the taxpayer's surplus and bad debt reserves at the close of December 31, 1951, reserve requirements of the Federal Deposit Insurance Corporation, and, if a moving average experience factor is used in determining the ratio of losses to outstanding loans, an appropriate period of experience. In the latter connection this will be an extended period of experience similar to that used in the case of commercial banks. Your committee believes a 25-year period should be used, in lieu of the 20-year period used for commercial banks, if such a period shows that larger bad debt reserves are required.

Subsection (e) amends section 23 (r) (relating to the deduction from gross income of certain dividends paid by banking corporations) to provide that in the case of mutual savings banks, cooperative banks, and domestic building and loan associations (for definition of domestic building and loan associations see section 3797 (a) (19) as added by section 313 (h) of the bill), there shall be allowed as deductions in computing net income any amounts paid to depositors or credited to the accounts of depositors as dividends on their deposits or withdrawable accounts.

Subsection (f) amends section 23 of the code (relating to deductions from gross income) to provide a deduction for repayment to the United States of certain loans made by the United States prior to September 1, 1951, by a mutual savings bank not having capital stock represented by shares. It provides that amounts paid by the taxpayer during the taxable year in repayment of loans made prior to September 1, 1951, by the United States or any agency or instrumentality thereof which is wholly owned by the United States shall be allowed as a deduction in computing net income of the taxpayer. An example for this purpose of an agency or instrumentality wholly owned by the United States would be the Reconstruction Finance Corporation.

Subsection (g) amends section 104 (a) of the code (defining the term bank) to include, within the definition of bank, a domestic building and loan association.

Subsection (h) amends section 3797 (a) of the code (relating to definitions for the purpose of the Internal Revenue Code) to define the term "domestic building and loan association" to mean a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members. This amendment is of a clarifying nature and is not intended to change the existing meaning of a domestic building and loan association.

SECTION 314. INCOME-TAX TREATMENT OF EXEMPT COOPERATIVES

Subsection (a) of section 314, for which there is no corresponding provision in the House bill, relates to the income-tax treatment of cooperatives. Subsection (a) of section 314 deals only with tax-exempt cooperatives and is applicable only with respect to taxable years beginning after December 31, 1951. Subsection (a) amends section 101 (12) of the code to bring the provisions presently contained therein under a subparagraph numbered (A) and to add after such subparagraph a new subparagraph numbered (B). Subparagraph (B) of section 101 (12) provides that an organization exempt from taxation under the provisions of subparagraph (A) shall be subject to the normal tax imposed on corporations by section 13 and to the surtax imposed on corporations by section 15 of the code, or to the alternative tax provided by section 117 (c) (1). However, in computing the net income of such an exempt cooperative for the purpose of such taxes there is allowed (in addition to the other deductions allowable under sec. 23 of the code) as deductions from gross income (i) amounts paid as dividends during the taxable year upon capital stock, and (ii) amounts allocated during the taxable year to patrons with respect to income not derived from patronage (whether or not such income was derived during such taxable year) whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. By the terms of section 101 (12) (A), the amounts which may be paid on capital stock is limited to the legal rate of interest in the State of incorporation of the cooperative or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued. The amounts covered in (ii), above, refer to items of incidental income which a cooperative may realize and still retain its exemption, such as rental income from lease of premises to the United States Government. Since such income is not derived from patronage, allocation thereof to members, though based on patronage, are not true patronage dividends. However, a deduction is allowed for amounts of such nonpatronage income, if allocated and paid to patrons on the basis of patronage. Such payments do not have to be made in cash but may be made in any manner that discloses to each patron the dollar amount allocated to him. If nonpatronage income is not allocated and paid to patrons according to patronage, the allocation or payment of such income to members or patrons would not be deductible under (ii).

The amounts for which deductions are allowed under section 101 (12) (B) (i) and (ii), as already indicated, are not patronage dividends as such term is commonly understood. Patronage dividends, rebates, or refunds are taken into account in computing the net income of a cooperative subject to 101 (12) (B) in the same manner as in the case of a cooperative organization not exempt under section 101 (12) (A). Patronage dividends, rebates, or refunds made after the close of the taxable year and on or before the 15th day of the third month following the close of such year are to be considered as made on the last day of taxable year to the extent they are attributable to patronage occurring before the close of such year.

It is to be noted that in computing (under sec. 122 of the code) the net operating loss deduction provided by section 23 (s) of the code, not only will the amounts allowable as deductions under section 101 (12) (B) (i) and (ii) of the code as amended by the bill be taken into account but such computation will also reflect the patronage dividends, refunds, and rebates made by the cooperative which are taken into account in computing net income.

Subsection (b) of section 314 amends section 101 of the Internal Revenue Code to provide that organizations described therein are exempt from tax except to the extent provided in paragraph (12) (B) of such section, and that, notwithstanding the fact that such organizations are subject to tax under paragraph (12) (B) of such section, they are still to be considered exempt from income tax for the purpose of any laws which refer to an organization exempt from income tax. Accordingly, such code provisions as section 26 (b) (credits for dividends received from a domestic corporation which is subject to tax) and section 141 (dealing with consolidated returns) do not apply to cooperatives taxable under section 101 (12) (B).

Subsection (c) of section 314 amends section 148 of the code (relating to return of information by corporations) to add at the end thereof a new subsection (f) entitled "Patronage Dividends." Such subsection provides that any corporation (whether or not exempt from tax) allocating amounts as patronage dividends, rebates, or refunds (whether in cash, merchandise, capital stock, revolving-fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund, or rebate) shall render a correct return stating (1) the name and address of each patron to whom it has made such allocations amounting to $100 or more during the calendar year, and (2) the amount of such allocations to each patron. If required by the Secretary, any such corporation (whether or not tax-exempt) shall render a correct return of all patronage dividends, rebates, or refunds made during the calendar year to its patrons, regardless of the amount or form thereof. The amendments made by subsection (c) of section 314 apply with respect to the calendar year 1951 and subsequent calendar years.

Subsection (d) of section 314 provides that in the event any law (other than secs. 143 and 144 of the Internal Revenue Code) enacted by Congress requires the withholding at source of tax on corporate dividends paid in cash, the requirement of withholding and the provisions of such law shall extend to patronage dividends, rebates, and refunds (whether paid in cash, merchandise, capital stock, revolving-fund certificates, retain certificates, or otherwise) in the same manner and to the same extent as is provided in such law with respect to corporate dividends paid in cash.

SEC. 315. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

This section, for which there is no corresponding provision in the House bill, amends section 102 (d) (1), which defines the term 'section 102 net income." The amendment adds a new subparagraph (D) which provides that the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by chapter 1 of the code attributable to such excess, shall be deducted from net income in computing section 102 net income. The taxes attributable to the excess of the net long-term capital gain over the net short-term capital loss shall be an amount equal to the difference between (1) the taxes imposed by chapter 1 of the code, except section 102, and (2) such taxes computed without including such excess in net income. The amendment made by this section is applicable only with respect to taxable years beginning after December 31, 1950.

SECTION 316. ELECTION AS TO RECOGNITION OF GAIN IN CERTAIN CORPORATE LIQUIDATIONS

This section, for which there is no corresponding provision in the House bill, amends section 112 (b) (7) of the code (relating to election as to recognition of gain in certain corporate liquidations), which section is applicable under existing law only in cases in which the liquidation was pursuant to a plan adopted after December 31, 1950, and the transfer of all the property under the liquidation occurred within one calendar month in 1951. The amendment made by this section extends section 112 (b) (7) for an additional year and makes it applicable to cases in which the liquidation is pursuant to a plan adopted after December 31, 1950, and the transfer of all the property under the liquidation occurs within one calendar month in 1951 or 1952. The effect of the section is, in general, to postpone the recognition of that portion of a qualified electing shareholder's gain on the liquidation which would otherwise be recognized and which is attributable to appreciation in the value of certain corporate assets unrealized by the corporation at the time such assets are distributed in complete liquidation.

Since the only amendment made by your committee to section 112 (b) (7) is the insertion of the date 1952 after the date 1951 where it now appears in subparagraph (A) (ii), the date August 15, 1950, is still applicable in subparagraphs (B), (E), and (F) of that section (relating to the definition of excluded corporations and relating to the recognition of gain to the shareholders from the receipt of money or of stock or securities acquired by the liquidating corporation after such date).

This section also makes a technical amendment to section 113 (a) (18) of the code, in order to make that section applicable to property acquired by an electing shareholder in a liquidation carried out under the provisions of section 112 (b) (7), whether before or after its amendment by this section.

The amendments made by this section are applicable to taxable years ending after December 31, 1951.

SECTION 317. CERTAIN DISTRIBUTIONS OF STOCK ON REORGANIZATION

This section amends sections 112 (b) and 113 (a) of the code to provide for the tax treatment of certain distributions of stock on reorganization. For discussion of these provisions, see page 57 in part I of this report.

SECTION 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE

This section, which corresponds to section 303 of the bill as passed by the House, adds a new subsection (n) to section 112 of the code, which relates to the recognition of gain or loss. Paragraph (1) of the new subsection provides, in general, that any gain from a sale of property used by the taxpayer as his principal residence (referred to hereinafter as the "old residence") will not be recognized if the taxpayer within a period beginning 1 year prior to the date of such sale and ending 1 year after such date purchases property and uses it as his principal residence (referred to hereinafter as the "new residence") except to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence. Such nonrecognition of gain is mandatory. The new subsection does not change the treatment under existing law of loss from the sale or exchange of the taxpayer's residence.

Whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence (in the case of a taxpayer using more than one place of residence), depends upon all of the facts and circumstances in each individual case, including the bona fides of the taxpayer. The term "residence" is used in contradistinction to property used in trade or business and property held for the production of income. Nevertheless, the mere fact that the taxpayer temporarily rents out either the old or the new residence may not, in the light of all of the facts and circumstances in the case, prevent the gain from being not recognized. For example, if the taxpayer purchases his new residence before he sells his old residence, the fact that he rents out the new residence during the period before he vacates the old residence will not prevent the application of this subsection.

Where part of a property is used by the taxpayer as his principal residence and part is used for business purposes or in the production of income (as in the case where a part of the building in which the taxpayer resides is used as a store or office or is rented or in the case of a farm property) allocation must be made to determine the extent to which the new subsection applies. If the old residence is used only partially for residential purposes, a proper allocation of the gain and of the selling price is necessary; only that part of the gain allocable to the residential portion may be not recognized under the new subsection and only so much of the selling price as is allocable to such part of the property need be reinvested in the new residence. If the new residence is used only partially for residential purposes, then only so much of its cost as is allocable to the residential portion is counted as reinvestment for the purpose of the new subsection.

Property used by the taxpayer as his principal residence may include a houseboat or a house trailer. Paragraph (5) provides that the taxpayer's principal residence may also include stock held by a tenant-stockholder in a cooperative apartment corporation as those terms are defined in section 23 (z) (2) of the code, if the apartment which the taxpayer is entitled to occupy as such stockholder is used by him as his principal residence. Property used by the taxpayer as his principal residence does not include personal property such as a piece of furniture, a radio, etc., which, in accordance with the applicable local law, is not a fixture.

Paragraph (2) (A) provides that an exchange by the taxpayer of his residence for other property shall be considered, for the purposes of the new subsection, to be a sale. Paragraph (2) (B) provides that where the taxpayer's residence (as a result of its destruction in whole or in part, theft or seizure) is compulsorily or involuntarily converted into property or money, the destruction, theft or seizure shall also be considered as a sale. Although paragraph (2) (B) does not specifically provide that an exercise of the power of requisition or condemnation shall be considered a sale, such events are nevertheless sales under the principle of *Hawaiian Gas Products, Ltd.* v. *Commissioner* (126 F., (2d) 4, cert. denied, 317 U. S. 653).

For the purposes of this subsection, the acquisition of property which is used as the taxpayer's principal residence upon an exchange of property by the taxpayer (under par. (2) (A)), or upon the compulsory or involuntary conversion of property used by the taxpayer as his principal residence as the result of its destruction, in whole or in part, theft, seizure, requisition, or condemnation (under par. (2) (B)), and the construction or reconstruction of a residence (under par. (2) (D)), shall be considered to be a purchase. The mere improvement of a residence, not amounting to reconstruction, does not constitute a purchase of such residence.

The words "taxpayer's selling price of the old residence" include the amount of any mortgage, trust deed, or other indebtedness to which such property is subject in the hands of the purchaser whether or not the purchaser assumes such indebtedness. Such words also include the face amount of any liabilities of the purchaser which are part of the consideration for the sale. Commissions and other selling expenses paid or incurred by the taxpayer on the sale of the old residence are not to be deducted or taken into account in determining the "taxpayer's selling price of the old residence." In the case of an exchange or conversion which is considered as a sale under this subsection, the amount realized by the taxpayer upon such exchange or conversion shall be considered (under par. (2) (C)) to be the "taxpayer's selling price of the old residence."

The words "taxpayer's cost of purchasing the new residence" also include such indebtedness to which the property purchased is subject at the time of purchase whether or not assumed by the taxpayer (including purchase-money mortgages, etc.) and the face amount of any liabilities of the taxpayer which are part of the consideration for the purchase. Commissions and other purchasing expenses paid or incurred by the taxpayer on the purchase of the new residence are to be included in determining the "taxpayer's cost of purchasing the new residence." In the case of an acquisition of a residence upon an exchange or conversion which is considered as a purchase under this subsection, the fair market value of the new residence shall be considered as the "taxpayer's cost of purchasing the new residence."

This section of the bill as passed by the House included in the "taxpayer's cost of purchasing the new residence" only so much of the cost as is attributable to acquisition, construction, reconstruction, or improvements made within the 2-year period of time in which the purchase of the new residence must be made in order to have gain not recognized under the amendment and which is properly chargeable to capital account rather than to current expense. Your committee has added a new subparagraph (G) to the proposed section 112 (n) (2) to extend from 1 year to 18 months the time after the sale of the old residence within which the taxpayer must use a new residence, the construction of which was commenced by the taxpayer prior to the expiration of 1 year after the date of such sale, in order to have any of the gain on such sale not recognized, and within which the costs of constructing such a new residence will be considered as the "cost of purchasing the new residence."

Where any part of the new residence is acquired by the taxpayer, for example, by gift, the value of such part is not to be included in determining the taxpayer's cost of the new residence. If the taxpayer acquires a residence by gift or inheritance, and spends $10,000 in reconstructing the residence, only $10,000 may be treated under paragraph (1) as the taxpayer's cost of purchasing the new residence.

Paragraph (6) of the proposed subsection provides that, if the taxpayer and his spouse, in accordance with the regulations which the Secretary shall prescribe pursuant to such paragraph, consent to the application of subparagraph (B) of such paragraph, the words "taxpayer's selling price of the old residence" shall mean the taxpayer's or the taxpayer and his spouse's selling price of the old residence, and the words "taxpayer's cost of purchasing the new residence" shall mean the cost to the taxpayer, or to his spouse, or to both of them, of purchasing the new residence, whether such new residence is held by the taxpayer, or his spouse, or both. Such subparagraph (B) provides that so much of the gain upon the sale of the old residence as is not recognized solely by reason of paragraph (6) and so much of the adjustment to basis of the new residence under paragraph (4) of the new subsection as results solely by reason of paragraph (6) shall be allocated between the taxpayer and his spouse as provided for in the regulations which the Secretary shall prescribe. Paragraph (6) is applicable only if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence. If the taxpayer and his spouse do not consent to the application of subparagraph (B), the recognition of gain upon the old residence shall be determined under the proposed subsection without regard to paragraph (6). The following examples will illustrate the application of paragraph (6):

Example (1).—A taxpayer, in 1951, sells for $10,000 the principal residence of himself and his wife, which he owns individually and which has an adjusted basis to him of $5,000. Within a year after such sale he and his wife contribute $5,000 each from their separate funds for the purchase of their new principal residence which they hold as tenants in common, each owning an undivided one-half interest therein. If the taxpayer and his wife consent to the application of section 112 (n) (6) (B), it is anticipated that the regulations which the Secretary shall prescribe under such section will provide that the gain of $5,000 upon the sale of the old residence will not be recognized to the taxpayer, and the adjusted basis of the taxpayer's interest in the new residence will be $2,500 and the adjusted basis of the taxpayer's wife's interest in such property will be $2,500.

Example (2).—A taxpayer and his wife, in 1951, sell for $10,000 their principal residence, which they own as joint tenants and which has an adjusted basis of $2,500 to each of them ($5,000 together). Within a year after such sale, the wife spends $10,000 of her own funds in the purchase of a new principal residence for herself and the taxpayer and takes title in her name only. If the taxpayer and his wife consent to the application of section 112 (n) (6) (B), it is anticipated that the regulations which the Secretary shall prescribe under such section will provide that the adjusted basis to the wife of the new residence shall be $5,000, and the gain of the taxpayer of $2,500 upon the sale of the old residence will not be recognized. The wife, as a taxpayer herself, will have her gain of $2,500 on the sale of the old residence not recognized under paragraph (1) of section 112 (n).

If the taxpayer sells or otherwise disposes of a new residence prior to the date of the sale of the old residence, paragraph (2) (E) provides that such new residence will not be considered as a new residence for the purposes of this subsection. And, if the taxpayer, within the specified period, purchases more than one property which is used by him as his principal residence during the 1 year succeeding the date of the sale of the old residence, paragraph (2) (F) provides that only the last of such residences so used by him shall be considered a new residence for the purposes of this subsection. However, if the taxpayer's new residence is destroyed, stolen, seized, requisitioned, condemned, or sold or exchanged under the threat or imminence of requisition or condemnation within the year succeeding the date of the sale of the old residence, then, for the purpose of the preceding sentence, such year is deemed to end on the date of the destruction, theft, seizure, requisition, condemnation, sale, or exchange. If within 1 year prior to the sale of the old residence, the taxpayer sold other property used by him as his principal residence at a gain, and any part of such gain was not recognized under this subsection, paragraph (3) provides that the subsection shall not apply with respect to the sale of the old residence. For the purposes of the preceding sentence, however, the destruction, theft, seizure, requisition, condemnation, or the sale or exchange under the threat or imminence of requisition or condemnation shall not be considered as a sale. The following example will illustrate this paragraph:

A taxpayer sells his old residence on January 15, 1951, and purchases a new residence on February 15, 1951. On March 15, 1951, he sells the new residence and purchases a second new residence on April 15, 1951. The gain on the sale of the old residence on January 15, 1951, will not be recognized except to the extent to which the taxpayer's selling price of the old residence exceeds his cost of purchasing the second new residence purchased on April 15, 1951. Gain on the sale of the first new residence on March 15, 1951, will be recognized. If, instead of selling the first new residence on March 15, 1951, such residence had been destroyed by fire on that date and insurance proceeds in cash had been received as a result thereof, the gain on the sale of the old residence on January 15, 1951, will not be recognized except to the extent to which the taxpayer's selling price of the old residence exceeds his cost of purchasing the new residence purchased on February 15, 1951. And, gain on the involuntary conversion by fire of the first new residence on March 15, 1951, will not be recognized except to the extent to which the amount realized from such conversion exceeds the taxpayer's cost of purchasing the second new residence purchased on April 15, 1951.

Paragraph (4) of the new subsection provides that where the purchase of a new residence results in the nonrecognition, under that subsection, of any part of the gain realized upon the sale of an old residence, then, in determining the adjusted basis of the new residence as of any time following the date of the sale of the old residence, the adjustments to basis shall include a reduction by an amount equal to the amount of the gain which was not recognized upon the sale of the old residence. Such a reduction is not to be made for the purpose of determining the adjusted basis of the new residence as of any time preceding the sale of the old residence. For this purpose the amount of the gain not recognized under this subsection upon the sale of the old residence includes only so much of the gain as is not recognized because of the taxpayer's cost, up to the date of the determination of the adjusted basis, of purchasing the new residence. The following example will illustrate this paragraph:

> On January 1, 1951, the taxpayer buys a new residence for \$10,000. On March 1, 1951, he sells for \$15,000 his old residence which has an adjusted basis to him of \$5,000. During April a wing is constructed on the new house at a cost of \$5,000 and in May he builds a garage at a cost of \$2,000. The adjusted basis of the new residence is \$10,000 during January and February, \$5,000 during March and April, and \$7,000 following the completion of the construction in May.

Whenever a taxpayer sells property used as his principal residence at a gain the statutory period prescribed in section 275 of the code for the assessment of any deficiency attributable to any part of such gain will not expire prior to the expiration of 3 years from the date the Secretary is notified by the taxpayer, in accordance with such regulations as the Secretary may prescribe, of the cost of purchasing the new residence which the taxpayer claims results in the nonrecognition of any part of such gain, or of the taxpayer's intention not to, or failure to, purchase a new residence within the period when such a purchase will result in the nonrecognition of any part of such gain. Such a deficiency may be assessed prior to the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which might otherwise bar such assessment.

Subsection (b) of the bill makes a number of technical amendments to other sections of the code which are necessitated by the addition of subsection (n) to section 112. The first such amendment provides that section 112 (f), relating to involuntary conversions, shall not apply in the case of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, condemnation, or sale or exchange under the threat or imminence of requisition or condemnation of such property occurred after December 31, 1950. The second such amendment provides that section 113 (a) (9), relating to basis of property acquired as a result of an involuntary conversion, shall not be applicable to property acquired as a result of a compulsory or involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, condemnation, or sale or exchange under the threat or imminence of requisition or condemnation of such property occurred after December 31, 1950. These sections are superseded in this situation by the new section 112 (n) and the new section 113 (b) (1) (K). The third such amendment adds a new subparagraph (K) to section 113 (b) (1), relating to adjusted basis of property, which provides a cross-reference from such section to section 112 (n) (4). The fourth such amendment adds a new paragraph (7) to section 117 (h), relating to the determination of the holding period, to provide that in determining the period for which the taxpayer has held a residence the acquisition of which resulted under section 112 (n) in the nonrecognition of any part of the gain realized on the sale, exchange, or involuntary or compulsory conversion of another residence, there shall be included the period for which such other residence had been held as of the date of such sale, exchange, or involuntary conversion. The last of such amendments adds a new subsection (e) to section 276, relating to the period of limitation upon assessment and collection, which provides a cross-reference from such section to section 112 (n) (7).

Subsection (c) of the bill contains the effective date of the amendments made by this section of the bill. Such amendments are to be applicable to taxable years ending after December 31, 1950, but the provisions of the proposed section 112 (n) (1) and (6) shall apply only with respect to residences sold, within the meaning of such section, after such date. A purchase of a new residence prior to December 31, 1950, or in a taxable year ending before January 1, 1951, shall, if otherwise qualified, be considered a new residence for the purpose of section 112 (n) (1) and (6).

SECTION 319. PERCENTAGE DEPLETION

This section corresponds to section 304 of the bill as passed by the House. The House bill granted a percentage depletion allowance at the rate of 5 percent in the case of deposits of asbestos, sand, gravel, stone (including pumice, scoria, and slate), brick clay, tile clay, shale, oyster shell, clam shell, granite, and marble. Your committee has granted percentage depletion in the case of asbestos at the rate of 10 percent and has added to the above list sodium chloride and, if produced from brine wells, calcium chloride, magnesium chloride, potassium chloride, and bromine. Your committee has removed slate from the parenthetical clause following stone and has included it as a separate item in this 5-percent category. The House bill increased the 5-percent rate of percentage depletion now allowed for coal to 10 percent. Your committee has followed this treatment in the case of coal and has included in this new 10-percent category those minerals which the House bill would have allowed percentage depletion at a rate of 15 percent. These minerals are borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, metallurgical grade limestone, and chemical grade limestone. Your committee has also added wollastonite, magnesite, dolomite, and brucite to this 10-percent list, and has added aplite to the listed materials now allowed percentage depletion at the 15-percent rate.

Subsection (b) of this section makes a technical amendment to paragraph (2) of section 114 (b) of the code in order to eliminate the necessity of listing by name those mines for which depletion based on discovery value is denied by reason of the allowance of percentage depletion.

Your committee has made technical amendments to section 114 (b) (4) (A) which do not alter its substance. The House bill changed the parenthetical clause, stating that thenardite produced from brines or mixtures of brine would be allowed percentage depletion, to state that thenardite, including thenardite from brines or mixtures of brine, would be permitted such allowance. Your committee believes that the same effect can be achieved by striking the parenthetical clause.

The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

SECTION 320. REDEMPTION OF STOCK TO PAY DEATH TAXES

This section, for which there is no corresponding provision in the House bill, amends section 115 (g) (3) of the code, relating to the redemption of stock to pay death taxes. Under that section, section 115 (g) (1), relating to the treatment as dividends of amounts distributed in redemption of stock, is made inapplicable to amounts distributed in redemption of stock the value of which is included in determining the value of the gross estate of a decedent provided, among other limitations, that the value of the stock in such corporation comprises more than 50 percent of the value of the net estate of the decedent. Under your committee's amendment this 50-percent limitation is reduced to 25 percent.

The amendment made by this section is applicable only with respect to taxable years ending on or after the date of enactment of this act but shall apply only to amounts distributed on or after such date.

SECTION 321. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

This section, for which there is no corresponding provision in the House bill, amends section 116 (a) (1) and (2), and section 1621 (a) (8) (A), of the Internal Revenue Code.

Under existing law an individual citizen of the United States is permitted to exclude from gross income all amounts received from sources without the United States if (1) the taxpayer establishes to the satisfaction of the Commissioner that he has been a bona fide resident of a foreign country or countries throughout the entire taxable year and (2) such amounts constitute earned income as specifically defined. Amounts paid by the United States or any agency thereof do not come within the exclusion privilege.

If a citizen has been a bona fide resident of a foreign country or countries for a period of at least 2 years before the date on which he changes his residence from the foreign country to the United States, he is also permitted under section 116 (a) (2), relating to taxable year of change of residence to the United States, to exclude from gross income earned income (as specifically defined) from sources without the United States which is attributable to that part of the period before the date of change in residence. This exclusion is also not permitted with respect to amounts paid by the United States or any agency thereof.

Two disadvantages of section 116 (a) (1) and (2), as now written, are (1) that the citizen who assumes bona fide residence in a foreign country in a given taxable year after a portion of such year has expired is in no case permitted the exclusion with respect to that year irrespective of the duration of the period of bona fide foreign residence in years subsequent to that in which such residence has been taken up, and (2) the residence requirement operates to deny the exclusion privilege to individual citizens of the United States who are employed in foreign countries for extended periods of time and have not in fact or law become a bona fide resident of a foreign country.

This section amends section 116 (a) (1) to provide that an individual citizen of the United States will be permitted to exclude from gross income all such earned income to which the section now relates which is attributable to an uninterrupted period of foreign residence, if the taxpayer establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for such uninterrupted period which includes an entire taxable year. This will permit the exclusion with respect to the part of the taxable year subsequent to the taxpayer's becoming a bona fide resident, if the taxpayer eventually comes within the other requirements of section 116 (a) (1). The qualifying period of bona fide foreign residence must be continuous and uninterrupted; however, trips to the United States for purposes of business or vacation will not disqualify the taxpayer from satisfying bona fide residence requirements. The bona fide residence rule is the same as the present law. Present section 116 (a) (2), relating to the taxable year of change of residence to the United States, is considered no longer to be necessary and is, therefore, deleted.

This section also adds a new section 116 (a) (2) under the provisions of which an individual citizen of the United States will be permitted to exclude from gross income all amounts received from sources without the United States which constitute earned income (as specifically defined) attributable to any period of 18 consecutive months during which the taxpayer is physically present in a foreign country or countries for a total of at least 510 full days. Thus, if a citizen is unable to satisfy the bona fide residence requirement of section 116 (a) (1), he has the alternative of satisfying the physical-presence test prescribed by section 116 (a) (2). In computing the minimum of 510 full days of physical presence in a foreign country or countries, all separate periods of such presence during the period of 18 consecutive months are to be aggregated. Amounts paid by the United States or any agency thereof do not come within this exclusion privilege.

This section also amends section 1621 (a) (8) (A) of the Internal Revenue Code in order (1) to adapt provisions respecting collection of income tax at source on wages to the substantive changes made by this section of your committee's bill and (2) to eliminate double withholding of income tax from wages in certain circumstances. By virtue of this amendment, collection of income tax at source on wages will not be required in the case of wages paid by any employer (other than the United States or any agency thereof) for services performed in a foreign country by a United States citizen, if it is reasonable to believe that such remuneration will be excluded from gross income under the provisions of section 116 (a) (1) or (2). However, wages paid to a citizen of the United States by a private employer for services performed in the United States will be subject to withholding, even though such citizen is a bona fide resident of a foreign country. In addition, section 1621 (a) (8) (A) is so amended by this section that collection of income tax at source on wages will not be required in the case of wages paid by any employer (other than the United States or any agency thereof) for services performed in a foreign country by a United States citizen if, at the time of payment of the wages, the employer is required by the law of such foreign country to withhold income tax upon such wages.

The amendment made to section 116 of the code will be applicable to taxable years beginning after December 31, 1950. The amendment made to section 1621 thereof will be applicable with respect to wages paid on or after January 1, 1952.

SECTION 322. CAPITAL GAINS AND LOSSES

This section, which corresponds to section 305 of the bill as passed by the House, revises the tax treatment of capital gains and losses in the case of a taxpayer other than a corporation.

Under present law, in the case of a taxpayer other than a corporation, gain or loss from the sale or exchange of a capital asset held for more than 6 months (long-term capital gain or loss) is only 50 percent taken into account in computing net income, and gain or loss from the sale or exchange of a capital asset held for 6 months or less (short-term capital gain or loss) is 100 percent taken into account in computing net income. Hence $1 of short-term capital loss may offset $2 of long-term capital gain. For example, an individual having a short-term capital loss of $1 million would pay no tax upon a long-term capital gain of $2 million.

In the case of a corporation present law requires that short-term capital loss (or gain) offset long-term capital gain (or loss) dollar for dollar instead of at the 2-to-1 ratio just described. Under the amendments made by this section of the bill, short-term capital loss (or gain) and long-term capital gain (or loss) will also offset each other dollar for dollar in the case of a taxpayer other than a corporation.

The essentials of the new treatment of taxpayers other than corporations are as follows:

1. Capital gains (whether long-term or short-term) will be 100 percent taken into account in computing gross income.
2. Capital losses (whether long-term or short-term) will be 100 percent taken into account as deductions in computing net income; except that (as under present law) such losses may be allowed only to the extent of capital gains plus the smaller of (a) $1,000 or (b) the net income (or adjusted gross income in case Supplement T is used) of the taxpayer computed without regard to capital gains and losses.
3. A new deduction from gross income is provided, to be computed as follows: As under present law, the taxpayer will merge his short-term capital gains and losses to obtain his net short-term capital gain or loss, as the case may be; and will merge his long-term capital gains and losses (taken into account 100 percent) to obtain his net long-term capital gain or loss, as the case may be. A taxpayer having a net long-term capital gain will then reduce it by any net short-term capital loss and will take as a deduction one-half of any remaining excess. This new 50-percent deduction for the excess of net long-term capital gain over net short-term capital loss supersedes the 50-percent inclusion of long-term capital gains and losses provided by present law.
4. As under present law, a taxpayer having an excess of net long-term capital gain over net short-term capital loss is permitted to compute an alternative tax by combining a flat percentage of such excess with a partial tax computed in the regular manner upon the balance of his net income.

Subsection (a) of this section adds a new subsection (ee) to section 23 of the code and amends section 117 (b) of the code (which heretofore has prescribed the percentages of gain or loss taken into account), so as to provide the new deduction for 50 percent of the excess of net long-term capital gain over net short-term capital loss. An estate or trust is required to exclude, in computing this deduction, capital gain which under section 162 (b) or (c) is includible as such by its income beneficiaries.

The following examples will illustrate the differences in the computation of net income under present law and under the new treatment ment in the case of an individual who, it is assumed, has net income of $8,000 computed without regard to capital gains and losses:

Example (1).—Assume that the individual realizes $2,000 of long-term capital gain and $1,500 of short-term capital loss during the taxable year. Under present law one-half of the gain ($1,000) is includible in gross income, the $1,500 loss is allowable, and the net income is $7,500. Under the new treatment the entire $2,000 of the gain is includible in gross income, the $1,500 loss is allowable, a deduction under section 23 (ee) is also allowed in the amount of $250 (one-half of the excess of the gain over the loss), and the net income is $8,250.

Example (2).—Assume that the individual realizes $3,000 of long-term capital loss and $2,000 of short-term capital gain during the taxable year. Under present law the $2,000 gain is includible in gross income, the one-half of the loss ($1,500) taken into account is allowable, and net income is $8,500. Under the new treatment the $2,000 gain is includible in gross income, the $3,000 loss is allowable, and net income is $7,000.

Example (3).—Assume that the individual realizes $3,000 of long-term capital loss and $2,000 of short-term capital loss during the taxable year. Under present law net income is $7,000, and the taxpayer may carry forward, to be used as short-term capital loss in the five succeeding years, $2,500 (the short-term capital loss, $2,000, plus one-half of the long-term capital loss, $1,500, less the loss allowed in the current year, $1,000). Under the new treatment net income is also $7,000, but the taxpayer may carry forward, to be used as a short-term capital loss in the five succeeding years, $4,000 (the aggregate losses of $5,000 less the $1,000 allowed in the current year).

Subsection (b) of this section amends section 117 (c) (2) of the code (relating to alternative tax in the case of a taxpayer other than a corporation). The purpose of this amendment is to conform the computation of the alternative tax to the new treatment of capital gains and losses. Because of the deduction provided by sections 23 (ee) and 117 (b), as amended, net income under the new treatment will include only 50 percent of the excess of net long-term capital gain over net short-term capital loss. Hence it has been necessary to provide that the partial tax, to be computed at the rates and in the manner as if section 117 (c) had not been enacted, shall be computed upon the net income reduced by only such 50 percent of the excess. The amount to be added to the partial tax, to arrive at the total tax, is computed by taking 25 percent of the whole excess of net long-term capital gain over net short-term capital loss.

The application of section 117 (c) (2), as amended, may be thus illustrated: Assume that for the calendar year 1952 an individual has net income of $90,000 computed as follows: $50,000 of ordinary net income, and an $80,000 excess of net long-term capital gain over net short-term capital loss, with a deduction of $40,000 allowable under section 23 (ee) with respect to such excess. The first step is to compute a partial tax upon $50,000 under the provisions of sections 11 and 12; this partial tax is $28,672. The second step is to take 25 percent of \$80,000 (excess of net long-term capital gain over net short-term capital loss), which is \$20,000. The alternative tax is, therefore, \$48,672.

Subsection (c) (1) of this section amends section 22 (n) to provide that the new deduction allowed by section 23 (ee) shall be taken in computing adjusted gross income.

Subsections (c) (2) and (3) make conforming amendments to sections 117 (a) (2), 117 (a) (4), and 117 (j) (2) (A). As amended, these sections deal with specified types of gains "if and to the extent taken into account in computing gross income." Although the percentage inclusion provisions have been eliminated from section 117 (b), this limiting expression is necessary in order to eliminate any gain which for any reason is not includible in gross income for the taxable year.

Subsection (c) (4) of this section makes a conforming amendment to section 122 (d) (4) of the code (relating to computation of the net operating loss deduction). The principle enunciated by the Supreme Court in the *Reo Motors, Inc.* v. *Commissioner* (338 U. S. 442), (which disapproved the decision in *Commissioner* v. *Moore, Inc.* (151 F. (2d) 527)) will govern in applying the effective date provisions with respect to this amendment.

Subsection (c) (5) of this section amends section 162 (a) of the code (relating to deductions of a trust or estate). This amendment merely makes certain that the principle of *United States* v. *Benedict, et al.* (338 U. S. 692) and related cases will continue under the bill as under existing law, namely, that appropriate adjustment of the deductions under section 162 (a) is to be made on account of the applicable treatment of capital gains and losses.

Subsection (d) of this section provides that the amendments made by the section shall be applicable only with respect to taxable years beginning on or after the date of enactment of the bill. The treatment of capital gains and losses of years beginning before such date is not affected by these amendments for any purpose, including the determination under section 117 (e) of the amount of the capital loss or of the net capital gain for any taxable year beginning before such date. Thus, in the case of a taxpayer whose taxable year is a calendar year, a net capital loss for the calendar year 1950, and the net capital gain for 1951, would be computed without regard to the amendments even though the loss is carried forward under 117 (e) of the code to the calendar year 1952, a year to which the amendments will be applicable. In determining the amount of the net capital loss for 1950 which can be carried over under section 117 (e) to 1953, the computation of the net capital gain for 1952 would, of course, be computed with regard to the amendments made by this section.

SECTION 323. SALE OF LAND WITH UNHARVESTED CROP

This section, for which there is no corresponding provision in the House bill, amends section 117 (j) of the code (relating to sale, exchange, or conversion of property used in the trade or business) to provide that, under certain conditions, an unharvested crop shall be considered as property used in the trade or business. Whether gain or loss from the sale, exchange, or conversion of such a crop will, as a result of this amendment, be treated as gain or loss from the sale or exchange of a capital asset held for more than 6 months will depend upon the application of section 117 (j) to that and other transactions of the taxpayer.

Subsection (a) (1) of this section amends section 117 (j) (1) to provide that the term "property used in the trade or business" includes an unharvested crop to which paragraph (3) of section 117 (j) is applicable.

Subsection (a) (2) adds a new paragraph (3) to section 117 (j) to provide that when an unharvested crop on land used in the trade or business and held for more than 6 months is sold or exchanged (or compulsorily or involuntarily converted as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) with such land and at the same time and to the same person, such crop shall be considered as "property used in the trade or business." The length of time for which the crop, as distinguished from the land, has been held is immaterial.

Subsection (b) of this section amends section 24 of the code to add a new subsection (f) thereto and amends section 113 (b) (1) of the code to add a new subparagraph (L) thereto, so as to provide that deductions attributable to the production of an unharvested crop, which is considered as property used in the trade or business under section 117 (j) (3), shall not be allowed in computing net income but must be capitalized by making an appropriate adjustment to basis. Such deductions shall be so treated whether or not the taxable year involved is that of the sale, exchange, or conversion of such crop and whether they are for expenses, depreciation, or other items.

Subsection (c) of this section provides that the amendments made by this section shall be applicable only with respect to sales, exchanges, or conversions occurring in taxable years beginning after December 31, 1950.

SECTION 324. SALES OF LIVESTOCK

This section amends section 117 (j) of the code to provide for the tax treatment of livestock. See page 41 of part I of this report for the discussion of this amendment.

SECTION 325. TAX TREATMENT OF COAL ROYALTIES

This section corresponds to section 307 of the House bill. Your committee, however, has made several changes.

Subsections (a), (b), and (c) of this section of the bill amend sections 117 (j) (1) and 117 (k) (2) of the code, which relate, respectively, to the definition of property used in the taxpayer's trade or business and to gain or loss upon the cutting of timber.

The amendment to section 117 (k) (2) provides that if coal which has been owned by the taxpayer for more than 6 months is disposed of by him under any form or type of contract by virtue of which he retains an economic interest in the coal, the difference between the amount received for the coal and the adjusted depletion basis thereof under section 114 (b) (1) shall be treated as a gain or loss, as the case may be, upon the sale of the coal. The amendment to section 117 (j) (1) includes within the term "property used in the trade or business" coal to which section 117 (k) (2) is applicable. The net effect of these two amendments is to treat the difference between the amount received for the coal and the adjusted depletion basis thereof as gain or loss to which section 117 (j) is applicable; whether such gain or loss will be deemed to be gain or loss from the sale of a capital asset held more than 6 months will depend upon the application of section 117 (j) to these and other transactions of the taxpayer.

An owner shall not be entitled to the allowance for percentage depletion provided for in section 114 (b) (4) with respect to amounts received any part of which are considered to be received from the sale of coal under section 117 (k) (2), as amended by this section. The adjusted depletion basis under section 114 (b) (1) shall, for the purposes of section 117 (k) (2), as amended by this section, include adjustments for development and exploration expenditures and for deductions under section 113 (b) (1) (J) and (M), as added by sections 309 and 341 of this bill.

Your committee has expressly provided in this section that the term "coal" includes lignite.

Under the House bill it was provided that the amendment made by this section would not apply in any case where the taxpayer was personally obligated to pay any part of the cost of operations after the disposal of the coal with respect to the mining thereof. In lieu of this provision, it has been provided that the amendment made by this section shall not apply with respect to any of the income realized by the taxpayer as a co-adventurer, partner, or principal in the business of cutting the timber or mining the coal.

Your committee has added a provision to section 117 (k) (2) to the effect that the date of the disposal of the coal or timber shall be deemed to be the date such coal is mined or such timber is cut, rather than the date of the royalty contract as it was held in *Springfield Plywood Corporation* (15 T. C. No. 91 (1950)).

For the purpose of clarification, your committee has also expressly provided that, in determining the gross income, the adjusted gross income, or the net income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of section 117 (k) (2), as amended by this section.

Subsection (d) of this section makes a technical amendment to section 481 (a) (4) of the code so as to exclude gain or loss from the disposal of coal to which section 117 (j) is applicable in determining the net earnings of an individual from self-employment.

Subsection (e) of this section of the bill, for which there is no corresponding provision in the House bill, contains amendments designed to conform section 433 (relating to computation of excess profits net income) and section 440 (a) (1) (relating to definition of inadmissible assets) to the principles of the amendments made to sections 117 (j) (1) and 117 (k) (2).

A new subsection (d) is added to section 433 to provide in substance that excess profits net income for taxable years in the base period shall be computed as if the provisions of sections 117 (j) (1) and 117 (k) (2) which relate to disposals of coal, were a part of the law applicable to the taxable year in the base period for which the excess profits net income is being computed. The effect of this amendment is to treat the difference between amounts received upon the disposal of coal in the base period and the adjusted depletion basis thereof as gain or loss to which section 117 (j) is applicable if such would have been the effect of the transaction under section 117 (k) (2) if such section, as amended, had been applicable to the taxable year in which the amounts were received. Similarly, in the case of such a disposal of coal in a base period year, a further adjustment is to be made to eliminate any allowance for percentage depletion (to the extent such allowance exceeds the amount allowable for cost depletion) with respect to amounts received any part of which would be considered to be received from the sale of coal under section 117 (k) (2).

The amendment to section 440 (a) (1) would add a new subparagraph (C) so as to treat as an inadmissible asset the economic interest in the coal properties referred to in section 117 (k) (2), if the taxpayer is subject to the provisions of section 117 (k) (2) with respect to the income from such coal.

Except as provided in subsection (e), the amendments made by this section shall be applicable only with respect to taxable years ending after December 31, 1950 (whether the contract was made on, before, or after such date), but shall apply only with respect to amounts received or accrued after such date. The amendments made by subsection (e) shall be applicable for all purposes in computing the excess profits tax for taxable years ending after December 31, 1950. For example, in computing such tax for 1951 in the case of a taxpayer on the calendar-year basis, the new definition of inadmissible assets is applicable in computing yearly base period capital under section 435 (f), original inadmissible assets under section 435 (g), and total assets under section 442 (f).

SECTION 326. COLLAPSIBLE CORPORATIONS

This section corresponds to section 308 of the House bill. Your committee, however, has made the amendments made by this section applicable to taxable years ending after August 31, 1951 (but only with respect to gain realized after such date), rather than to taxable years beginning after December 31, 1950.

This section of the bill amends section 117 (m) of the code, relating to collapsible corporations. Section 117 (m) (2) (A) defines the term "collapsible corporation." Such a corporation is presently defined as a corporation formed or availed of principally for the manufacture, construction, or production of property, or for the holding of stock in a corporation so formed or availed of, with a view to (i) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, or producing the property of a substantial part of the net income to be derived from such property, and (ii) the realization by such shareholders of gain attributable to such property. This section of the bill adds to such definition the case of a corporation formed or availed of principally for the purchase of property which (in the hands of the corporation) is property described in section 117 (a) (1) (A) (stock in trade, etc.), or for the holding of stock in a corporation so formed or availed of, with a view to (i) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation purchasing the property of a substantial part of the net income to be derived from such property, and (ii) the realization by such shareholders of gain attributable to such property.

It is immaterial, for the purpose of the amendment made by this section of the bill, whether the purchase of the property in question is made from the shareholders of the corporation or from persons other than the shareholders of the corporation. The property, however, must be property which, in the hands of the corporation, is property of a kind described in section 117 (a) (1) (A). Section 117 (a) (1) (A) excludes from the definition of "capital assets" set forth in section 117 (a) (1), "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." It is assumed that property which, in the hands of an ordinary corporation, would be property of a kind described in section 117 (a) (1) (A) would also be such property in the hands of a corporation, formed or availed of within the meaning of section 117 (m).

In order to conform the other provisions of section 117 (m) to the above amendment, necessary changes have been made therein.

The amendments made by this section are applicable to taxable years ending after August 31, 1951, but only with respect to gains realized after such date, but it is specifically provided that the determination of the tax treatment of gains realized prior to September 1, 1951, shall be made as if this section had not been enacted and without inferences drawn from the fact that the amendments made by this section to section 117 (m) are not made applicable to such gains and without inferences drawn from the limitations contained in section 117 (m), as amended by this section.

SECTION 327. DEALERS IN SECURITIES—CAPITAL GAINS AND ORDINARY LOSSES

This section adds a new subsection (n), relating to the treatment of capital gains and ordinary losses by dealers in securities, to section 117 of the code. The section is the same as section 309 of the House bill except that the treatment of losses in the case of a bank is qualified so as to be consistent with the treatment provided in section 117 (i).

Under existing law, a taxpayer may be considered as a dealer with respect to certain securities and as an investor with respect to other blocks of securities. Under present court decisions, it is possible for a dealer to shift securities from an investment account to an inventory account or vice versa, thereby affording an opportunity for converting what should be ordinary gain into capital gain and what should be capital loss into an ordinary loss. Section 117 (n), as added by this section of the bill, provides rules designed to prevent a dealer from obtaining the most beneficial tax result by a shift in securities from one account to another, or by insufficient identification of the securities alleged to be within a particular account.

Paragraph (1) of subsection (n) provides rules for the treatment of capital gains by a dealer in securities. Under this paragraph, gain by such a dealer from the sale or exchange of a security shall in no event be considered as gain from the sale or exchange of a capital asset unless (A) the security is, prior to the expiration of the thirtieth day after its acquisition or after the date of enactment of this act (whichever is later), clearly identified in the dealer's records as a security held for investment; and (B) the security is not, at any time after the expiration of such thirtieth day, held by the dealer primarily for sale to customers in the ordinary course of the trade or business. It is contemplated that the regulations may prescribe the methods of identification which will adequately earmark the security as one held for investment.

The provisions of section 117 (n) (1) are intended to operate only in the case where gain from the sale of a security would, but for the provisions of such paragraph, be considered to constitute capital gain. Thus, if a security sold by a dealer would be considered, but for section 117 (n) (1), to constitute the sale of a security held for investment, gain from the sale of such security will nonetheless not be considered as capital gain unless the security has been properly identified within the 30-day period in the dealer's records as held for investment and is at no other time thereafter held for sale to customers in the ordinary course of the trade or business. However, the mere fact that a security, which is actually held by the dealer for sale to customers in the ordinary course of the trade or business, is identified as required by this section as a security held for investment, will not cause the gain from the sale of the security to be treated as capital gain.

Section 117 (n) (2) provides the rule for treatment of ordinary losses by a dealer in securities. This rule is that a loss from the sale or exchange of a security shall be considered as a capital loss if at any time after the thirtieth day following the date of enactment of this act the security was clearly identified in the dealer's records as a security held for investment. The effect of section 117 (n) (2) is that, if a security has once been identified as held for investment, a loss on the subsequent disposition of such security shall in no event be considered as a loss from the sale or exchange of property which is not a capital asset. Your committee has added a qualification not specifically contained in the House bill which excepts from the application of section 117 (n) (2) transactions described in section 117 (i), providing in substance that, in the case of a bank, if losses from sales or exchanges of certain types of obligations exceed the gains from such sales or exchanges, the excess of such losses are considered as ordinary losses. Under your committee's amendment, the provisions of section 117 (n) (2) will not apply if section 117 (i) is applicable.

For the purposes of section 117 (n) the term "security" means any share of stock in any corporation, any certificate of stock or interest in any corporation, a note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to any of the foregoing.

The amendment made by this section is applicable only with respect to sales or exchanges made after the expiration of the thirtieth day after the date of enactment of this act.

SECTION 328. RECEIPTS OF CERTAIN TERMINATION PAYMENTS BY EMPLOYEE

This section, for which there is no corresponding provision in the House bill, adds a new subsection (o) to section 117 of the code, to provide that certain payments received by an employee after the termination of his employment, which under existing law are taxable as ordinary income, shall be treated as gains from the sale or exchange of a capital asset held for more than 6 months.

The provisions of section 117 (o) are applicable solely to amounts received from the assignment or release by an employee of all his rights to receive, after termination of his employment, a percentage of future profits or receipts of his employer. (By future profits and receipts is meant only such as are attributable to a period subsequent to the termination of employment.) Under this section, capital gain treatment is accorded to such amounts provided that the following conditions are met:

(1) the employee must have been an employee of the employer whose future profits or receipts are involved for a period of at least 20 years prior to the assignment or release,

(2) the full rights to the percentage of the future profits or receipts which are the subject of the assignment or release must have been incorporated in the terms of the employment of the employee for a period of at least 12 years;

(3) the assignment or release must be made after a complete and bona fide termination of the employment and must convey all the rights of the employee to such future earnings and profits, and must convey no other rights of the employee; and

(4) the total of the amounts received for the assignment or release must be received after such bona fide termination of employment and in one taxable year of the employee.

The provisions of section 117 (o) are applicable to taxable years beginning after 1950.

SECTION 329. NET OPERATING LOSS CARRY-OVER

This section, for which there is no corresponding section in the bill as passed by the House, amends section 122 (b) (2) relating to the amount of net operating loss carry-overs. Subsection (a) of the section amends subparagraph (A) of paragraph (2) which in its present form provides that the net operating loss for a taxable year beginning before January 1, 1950, may (to the extent not absorbed as a carry-back) be carried forward to the next two succeeding taxable years. Under the amendment the provision for the 2-year carry-over is restricted to taxable years beginning before January 1, 1948, with a cross-reference to new subparagraph (D), added by subsection (b) of this section, which provides an exception to the provisions of subparagraph (A) as amended.

Subsection (b) of this section amends section 122 (b) (2) by adding, after subparagraph (B) thereof, two new subparagraphs, (C) and (D). Subparagraph (C) provides that a net operating loss for any taxable year beginning after December 31, 1947, and before January 1, 1950, may (to the extent that it is not absorbed as a carry-back) be carried forward to the four succeeding taxable years. Under the terms of the amendment this provision is applicable to corporate and noncorporate taxpayers alike and without regard to when such taxpayers commenced business. The added subparagraph (D), however, is made applicable only to corporations which commenced business after December 31, 1945, and provides that a net operating loss of any such corporation for a taxable year beginning after December 31, 1945, and before January 1, 1948, may also be carried forward to the four succeeding taxable years.

It will be noted, of course, that a corporation which began business in any of the years in the period 1946 through 1949, is covered under subparagraph (D) in respect of 1946 or 1947 net operating losses and under subparagraph (C), which applies to all taxpayers, for 1948 or 1949 losses.

This section of the bill does not change the 2-year carry-back provisions of existing law in respect of taxable years beginning before January 1, 1950, nor does it change the provisions of existing law for a 1-year carry-back and 5 years carry-over, applicable to taxable years beginning after December 31, 1949.

The amendments made by this section are not applicable in computing the net operating loss deduction for any taxable year beginning before January 1, 1949, but apply only to the computation of such deduction for taxable years beginning after December 31, 1948.

SECTION 330. STOCK OPTIONS

This section of the bill, for which there is no corresponding section in the bill as passed by the House, amends subsection (d) of section 130A, relating to definition of the term "restricted stock option." The introductory phrase "As used in this section," immediately after the heading of subsection (d), is changed by the amendment to read "For the purposes of this section" and a new paragraph (5) is added which provides that if the grant of an option is subject to stockholder approval, the date of the grant of the option shall be determined as if the option had not been subject to stockholder approval. The amendment relates solely to stockholder approval, and its effect is to eliminate stockholder approval as a factor to be considered in determining, for the purpose of section 130A, the time or date of the grant of an option made subject to such approval.

The amendment applies alike to conditions for stockholder approval that are express and those that may be implied from some pertinent provision of the corporation's articles of incorporation or bylaws or from applicable corporate law or regulation, and also applies to the situation where the grant of an option is voluntarily submitted to stockholders for approval notwithstanding the absence of any express or implied requirement that such approval be obtained.

The amendment applies not only to the original grant of an option subject to stockholder approval but to any modification, extension, or renewal of the terms of such an option which requires stockholder approval.

The amendment is made effective as if it had been enacted as a part of section 218 of the Revenue Act of 1950.

SECTION 331. CREDIT FOR TAXES OF FOREIGN CORPORATIONS

This section, for which there is no corresponding provision in the House bill, amends section 131 (f) (1) and (2) of the Internal Revenue Code.

Under the existing provisions of section 131 (f) (1) a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year will, for the purpose of section 131 under which a tax credit is allowed for taxes paid or accrued during the taxable year to any foreign country or possession of the United States, be deemed to have paid a specified proportion of any income, war profits, or excess profits taxes paid, or deemed to be paid, by such foreign corporation to any foreign country or possession of the United States upon or with respect to the accumulated profits (as specifically defined) from which the dividends were paid. Thus, the domestic corporation is allowed a credit, not only with respect to the foreign taxes actually paid or accrued by it, but also with respect to such taxes deemed to have been paid by it under the provisions of section 131 (f) (1).

If the foreign corporation (hereinafter referred to as the foreign parent) so controlled by the domestic parent corporation owns all the voting stock (except qualifying shares) of another foreign corporation (hereinafter referred to as the foreign subsidiary) from which it receives dividends in any taxable year, it in turn will, under current provisions of section 131 (f) (2), be deemed for the purpose of section 131 (f) (1) to have paid a specified proportion of any income, war profits, or excess profits taxes paid by the foreign subsidiary to any foreign country or possession of the United States upon or with respect to the accumulated profits (as defined) from which the dividends were paid. Such tax is then taken into consideration in the determination under section 131 (f) (1) of the amount of income, war profits, and excess profits taxes paid, or deemed to have been paid, by the foreign parent upon or with respect to its own accumulated profits from which dividends were paid by such foreign parent to its domestic parent corporation.

Your committee proposes to liberalize the stock-ownership requirements of section 131 (f) (1) and (2), without making any change in the existing procedure for computing the specified proportion of income, war profits, or excess profits taxes deemed to have been paid. Accordingly, this section so amends section 131 (f) (1) of the code that, effective with respect to dividends received by a domestic corporation from a foreign corporation during taxable years beginning after December 31, 1950, any domestic corporation which owns 10 percent or more of the voting stock (rather than a majority) of a foreign corporation from which it receives dividends in any taxable year will be deemed to have paid the specified proportion of taxes paid, or deemed to be paid, by such foreign corporation. In addition, this section so amends section 131 (f) (2) of the code that, effective with respect to dividends received by a foreign corporation from another foreign corporation in taxable years beginning after December 31, 1950, any foreign corporation (10 percent or more of whose voting stock is owned by the domestic corporation) which owns a majority of the voting stock of another foreign corporation (rather than all except qualifying shares) from which it receives dividends in any taxable year will be deemed for the purpose of section 131 (f) (1) to have paid the specified proportion of taxes paid by such other foreign corporation.

SECTION 332. INFORMATION AT SOURCE ON PAYMENTS OF INTEREST

Under existing law, except in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations and upon obligations of the United States or any agency or instrumentality thereof, persons making payment of interest may not be required to furnish an information return unless the payment of interest is $600 or more. This section of the bill amends section 147 to give the Secretary the authority to require information returns disclosing payments of interest, regardless of amounts. Such returns may be required to be filed under regulations prescribed by the Secretary by any individual, partnership, corporation, insurance company, bank, mutual savings bank, building and loan association, cooperative bank, homestead association, Federal savings and loan association, credit union, or any other payor of interest, irrespective of the type of obligation on which such interest is payable. Information returns may be required under this amendment in the case of constructive payments of interest, as well as actual payments.

SECTION 333. ABATEMENT OF INCOME TAX FOR CERTAIN MEMBERS OF ARMED FORCES UPON DEATH

This section, for which there is no corresponding provision in the House bill, amends Supplement D of chapter 1 of the Internal Revenue Code (relating to returns and payment of taxes) by adding a new section 154 thereto.

Such section 154 provides that, where any individual dies after June 24, 1951, and prior to January 1, 1954, while in active service as a member of the Armed Forces of the United States, if his death occurred while serving in a combat zone, as determined under section 22 (b) (13) of the code, or at any place as a result of wounds, disease, or injury incurred while so serving, (1) the tax imposed by chapter 1 of the code will not apply with respect to the taxable year in which falls the date of his death, or with respect to any prior taxable year which ended on or after the first day he was so serving in a combat zone after June 24, 1950, and (2) the tax (including interest, additions to the tax, and additional amounts) imposed by chapter 1 of the code and under the corresponding title of each prior revenue law for all taxable years preceding those specified in (1) above, which is unpaid at the date of his death shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

SECTION 334. EMPLOYEES' TRUSTS

This section, for which there is no corresponding provision in the House bill, amends section 165 (b) (2) of the code, relating to distributions to an employee by a trust which qualifies for exemption under section 165 (a).

Under section 165 (b), amounts distributed or made available to an employee by such a trust (in excess of the employee's contributions) are taxed to the employee only in the years in which distributed or made available and, if the total distributions are paid to the employee in one taxable year on account of the employee's separation from the service, the amount of the distribution (to the extent exceeding the employee's contribution) is taxed at capital gain rates (as from sale or exchange of a capital asset held for more than 6 months).

Under your committee's amendment, where such a total distribution occurs, and consists in whole or in part of securities of the employer corporation, that part of the excess (of the amounts distributed over the amount of the employee's contributions) as consists of net unrealized appreciation attributable to that part of the total distributions made in securities of such employer corporation shall be excluded from income in the year of distribution, and shall be subject to tax only when the securities are sold (or otherwise disposed of in a taxable transaction). The amount of the net unrealized appreciation which is excluded shall in the hands of the recipient not be included in the basis of the stock or other securities distributed.

The amount of the net unrealized appreciation which is to be excluded shall be determined in accordance with regulations, and the resulting adjustments to basis shall also be allocated to the securities distributed in accordance with regulations.

The postponement of tax provided by the amendment made to section 165 (b) by this section applies only to the net unrealized appreciation in stock of the employer corporation or bonds or debentures issued by such corporation with interest coupons or in registered form. The amendment is applicable only with respect to distributions made after December 31, 1950.

SECTION 335. LIFE INSURANCE COMPANIES

Under section 311 of the House bill, the special rule for 1949 and 1950, set forth in section 202 (b) (2) of the code for use in determining the reserve and other policy liability credit of life insurance companies, would have been extended to apply to taxable years beginning in 1951. Under your committee's amendment there is substituted for this provision a system for taxing such companies, for taxable years beginning in 1951, which is different from that contained in present law. Under this system, in lieu of allowing life insurance companies an adjustment of their normal tax net income and of their corporation surtax net income, by means of the reserve and other policy liability credit, for purposes of a tax imposed at the regular corporate rates, a low-rate tax is imposed on the normal tax net income of such companies without allowance of any such credit. Thus, under subsection (a) of this section, section 201 (a) (1) of the code, relating to the imposition of tax on life insurance companies, is amended to provide for the levy, collection and payment, for taxable years beginning in 1951, of a tax equal to 3¾ percent of the first $200,000 of 1951 adjusted normal tax net income and 6½ percent of the amount in excess thereof.

Under subsection (b) of this section, a new section 203A is added to the code, following section 203, subsection (a) of which defines the term "1951 adjusted normal tax net income" as the normal tax net income (as defined under present law) plus eight times the amount of the adjustment for certain reserves provided for in section 202 (c) and minus the reserve interest credit, if any, as defined in section 203A (b).

The addition to the normal tax net income under section 203A of eight times the amount of the adjustment for certain reserves provided for in section 202 (c) (an adjustment relating to the non-life-insurance business, if any, done by a life insurance company) is made so as to continue in effect essentially the same rate of tax with respect to that adjustment as is now imposed under present law. The figure eight is used under section 203A since a 6½-percent tax as provided for by the amendment made to section 201 (a) (1) is exactly one-eighth of a 52-percent total corporate rate of tax as provided for with respect to corporations generally by the amendments made to sections 13 (b) and 15 (b) of the code by section 121 of this bill.

The reserve interest credit provided for in subsection (b) of section 203 is a feature which has no precedent in present law and is designed to give relief from the tax imposed by your committee's amendment, to the extent of a maximum of 50 percent of such tax, in the case of companies the adjusted net income of which, as defined in subsection (c) of section 203A, is less than 105 percent of their required interest, as defined in subsection (d) of that section.

Adjusted net income is defined under subsection (c) as, in effect, the amounts of interest, dividends, and rents received by the companies, net after the deductions provided for under present law under section 201 (c) (7), but without a deduction for tax-free interest, and, in the case of a company doing a non-life-insurance business, less an amount equal to one-half of the amount of the adjustment with respect to that business provided for in section 202 (c). In permitting a deduction of only one-half of the amount of that adjustment, recognition is given to the fact that that adjustment, as first enacted in 1942, was recognized at the time as not reflecting the actual interest, dividends, and rents received by life insurance companies with respect to their non-life-insurance business.

The term "required interest" as defined in subsection (d) of section 203A takes into account the interest and policy commitments of the companies with respect to their life insurance business which are recognized under present law, as amended for the years 1949 and 1950 by the above referred to special rule, in determining the tax base under that law for the purposes of an imposition of a tax at the regular corporate rates provided for in sections 13 (b) and 15 (b) of the code.

Based upon the above factors, the reserve interest credit is made available to companies where the relationship between their adjusted net income and their required interest is such that the adjusted net income is less than 105 percent of the required interest. Where adjusted net income is 100 percent or less of the required interest, the reserve interest credit is determined as an amount equal to 50 percent of the normal tax net income. Where adjusted net income is 105 percent or more of the required interest, the reserve interest credit is stated as being zero. Where adjusted net income is more than 100 percent but less than 105 percent of the required interest, the reserve interest credit is computed by multiplying the normal tax net income by 10 times the difference between 105 percent and the actual percentage established. Thus, in a case where adjusted net income is 103 percent of the required interest, the difference between 105 percent and 103 percent would be 2 and the reserve interest credit would be the normal tax net income multiplied by 20 percent. It is contemplated that the percentage established by comparing adjusted net income to the required interest must be carried to at least the nearest one-tenth of a percentage point with the result that the multiplication by 10 of the difference between 105 percent and such percentage will be productive of a more accurately graduated figure than would be possible were no such fractional percentage to be allowed.

Since a 6½ percent tax on 1951 adjusted normal tax net income is expected to be productive for 1951 of approximately the same tax in the case of any one company as a tax at the regular corporate rates on the tax base provided under present law, it is apparent that the factors entering into the determination of the reserve and other liability credit adjustment under present law can be considered as taken into account under your committee's amendment, through the particular low rate selected, to the same extent that they are operative under present law. Thus, the figure used by every life-insurance company in determining its reserve and other liability credit is determined after, in effect, removing from the tax base for the industry as a whole the industry's adjustment for certain reserves with respect to a non-life-insurance type of business. Under the circumstances, therefore, in defining 1951 adjusted normal tax net income under section 203 A (a) as the company's total normal tax net income plus an adjustment for such reserves, the operation of the system is such, by reason of the effective rate of the tax, that, in effect, the normal tax net income can be considered as having been first adjusted on an industry-wide basis by the removal of income attributable to such non-life-insurance business.

In the same manner, the treatment under present law of tax-free interest insofar as the companies' policy obligations are concerned can be considered as carried over into the system established by this section.

Under present law, the normal tax on corporations is imposed, for taxable years beginning after June 30, 1950, at a rate of 25 percent of the normal tax net income and the surtax on corporations for such years is imposed at a rate of 22 percent on that amount of the corporation's surtax net income as is in excess of $25,000. The exemption granted under the surtax on corporations to the first $25,000 of corporation surtax net income is reflected under your committee's amendment by the imposition of a tax on the first $200,000 of 1951 adjusted normal tax net income of only 3¾ percent. This lowered percentage of that amount of 1951 adjusted normal tax net income is designed to produce the same effect under a 6½ percent tax as the exemption granted under the normal corporate rates to the first $25,000 of corporation surtax net income. Thus, taking into account the amendments of sections 13 and 15 of the code which would be made by section 121 of the bill, it will be noted that 3¾ percent of $200,000 will produce approximately the same amount of tax as the 27 percent normal tax rate proposed under section 121 would produce on $25,000.

Subsection (c) of section 335 as added to the bill by your committee's amendment makes several technical amendments to the code required in order to adapt certain provisions of the code to the simplified system established by your committee's amendment. Thus, for purposes of subchapter D, relating to the excess profits tax, the excess profits tax net income of life insurance companies for taxable years beginning in 1951 is defined in the manner provided under present law using, in lieu of the figure used under present law, in connection with the determination of the reserve and other policy liability credit, the figure 0.87. This figure is used since the 6½ percent tax was computed in the first instance on the assumption that such a figure would approximate the figure which, under the House bill, would be proclaimed by the Secretary for 1951.

SECTION 336. TAX TREATMENT OF CERTAIN INVESTMENT COMPANIES

This section, which corresponds to section 312 of the House bill, adds a new subsection (c) to section 361 of the code, which contains certain requirements applicable to regulated investment companies under supplement Q of chapter 1.

Subsection (b) of section 361 provides certain limitations on the types and amounts of securities which may be held by a regulated investment company if the company is to qualify for the tax treatment under supplement Q. Among such limitations is a requirement that at the close of each quarter of the taxable year of a company, at least 50 percent of the value of its total assets be represented by cash and cash items, Government securities, securities of other regulated investment companies, or securities in other companies limited in respect of any one issuer (1) to an amount not in excess of 5 percent of the value of the assets of the investment company, and (2) to not more than 10 percent of the outstanding voting securities of such issuer.

Section 361 (c), as added by this section of the bill, provides that in the case of a registered management investment company which is certified by the Securities and Exchange Commission as principally engaged in supplying capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes or products not previously available, the investment company, notwithstanding the 10-percent stock ownership limitation in section 361 (b), may include, in the 50 percent of its assets restricted under section 361 (b), the value of any securities of an issuer, even though the investment company holds more than 10 percent of the stock of such issuer; but only if the investment company has not continuously held any securities of such issuer (or of any predecessor company as determined under regulations prescribed by the Secretary) for 10 or more preceding years. However, this provision does not modify the 5-percent limitation with respect to the amount of assets which may be invested in securities of any one issuer. Section 361 (c) does not apply in any taxable year if at the close of any quarter of the taxable year more than 25 percent of the total assets of the investment company is represented by securities of issuers as to which (1) the investment company holds more than 10 percent of the outstanding voting stock and (2) the investment company has continuously held any security (or any security of a predecessor of such issuer) for 10 or more years, unless within 30 days after the close of such quarter the value of the total assets represented by such securities is reduced to 25 percent or less of the value of the total assets of the investment company.

In the determination by the Securities and Exchange Commission, consideration is to be given to the purpose and function of the investment company and to its continuing over-all operation. Ordinarily, for example, it would be requisite that a major portion of the assets of the investment company represent securities in operating companies developing and exploiting new processes and products. It is recognized, however, that such an investment company may find it desirable to invest a portion of its assets in other securities, such as Government bonds, which will provide operating income to meet the expenses incurred in making investments in companies developing new products, and so forth. An investment company would not qualify under subsection (c) if its principal purpose or activity is to establish and maintain control, as a holding company, over the operating companies and not merely to foster the initial development of such companies. Retention of an investment in one or more operating companies, however, would not necessarily imply holding-company status if the operations of the investment company, viewed as a whole, indicated that the retention of such securities is incidental to its principal activities.

An operating company will not be considered to be engaged in the development of new processes or products merely because the process or product is new to the company. It is essential that the process or product represent a substantial technological improvement, or be different to a material degree from a process or product previously available. Thus, a change in style, a new model, an adaptation of an existing product, or such improvements as are customarily made in the trade would not qualify.

For the purposes of subsection (c), a corporation which was, at the time of the first acquisition of its securities by the investment company, principally engaged in the development or exploitation of inventions, technological improvements, new processes, and so forth, will, ordinarily, be considered to be so engaged for at least 10 years after the date of such acquisition. Accordingly, an investment company which acquires the securities of another company which is then principally engaged in developing a new product may continue, for the purposes of subsection (c), to hold such securities even though during such period the subsidiary company may be actively marketing the product which it has developed.

The amendments made by your committee to the provision contained in the House bill are mainly of a technical or clarifying nature. Thus, for example, it is provided that an investment company will be considered, for purposes of the section, to be engaged in furnishing capital to any company whose securities it holds if such securities, or securities surrendered therefor, were acquired from the company within the 10 preceding years. The Securities and Exchange Commission may, however, in such cases as it considers appropriate, nevertheless determine that the investment company is not so engaged. Similarly the presumption with respect to the activities of the operating companies may be rebutted if a contrary determination is made by the Securities and Exchange Commission.

It is provided that the terms used in section 361 (c) shall have the same meaning as in section 361 (b) (3). For example, the term "value" as used in section 361 (c) means, with respect to securities (other than those of majority-owned subsidiaries) for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, the fair value as determined in good faith by the board of directors subject to the exception that the value of securities of majority-owned subsidiaries which are investment companies shall not exceed the higher of market value or asset value.

Section 361 (c) does not, except with respect to waiver of the 10-percent limitation on voting stock under the circumstances indicated, affect any of the requirements under section 361 or 362 which would otherwise be applicable to the investment company for purposes of the tax treatment under supplement Q.

Subsection (b) of section 312 provides a technical amendment to section 361 (b) (3) (A) of the code.

The amendments made by this section of the bill are applicable to taxable years beginning after December 31, 1950.

SECTION 337. EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

This section amends the definition of the term "system group" contained in section 373 (d) of the Internal Revenue Code. In order to secure the treatment accorded by Supplement R to exchanges and distributions made in obedience to orders of the Securities and Exchange Commission certain exchanges and distributions must be made by or to members of the same "system group." Under existing law "system group" is defined as one or more chains of corporations connected through stock ownership with a common parent corporation, provided all three of the following conditions are met:

(1) At least 90 percent of each class of the stock (other than stock which is preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations;

(2) The common parent corporation owns directly at least 90 percent of each class of the stock (other than stock which is preferred as to both dividends and assets) of at least one of the other corporations; and

(3) Each of the corporations is either a registered holding company or a majority-owned subsidiary company.

Section 337 amends only the first condition of the existing definition. Under this section in determining whether one or more of the corporations in the chain owns at least 90 percent of each class of the stock of another corporation in the chain there is excluded not only stock which is preferred as to both dividends and assets but stock which is limited and preferred as to dividends but is not preferred as to assets, provided that the total value of the entire class of such stock constitutes less than 1 percent of the aggregate value of all classes of stock which are not preferred as to both dividends and assets. This section makes no change in conditions (2) and (3) of the existing definition of "system group" contained in section 373 (d). The amendment made by this section is applicable to all taxable years affected by exchanges and distributions made after December 31, 1947.

SECTION 338. TAXATION OF BUSINESS INCOME OF STATE COLLEGES AND UNIVERSITIES

This section, for which there is no corresponding provision in the House bill, deals with taxation of business income of governmental colleges and universities. At present, Supplement U of chapter 1 of the Internal Revenue Code deals with taxation of business income of certain section 101 organizations. Among the organizations subject to Supplement U tax are private colleges and universities exempt under section 101 (6) of the code. At present, the Supplement U tax does not apply to State colleges and universities, since such organizations are not exempt under section 101 of the code. This section of your committee's bill, in effect, subjects colleges and universities run by governments to similar tax treatment under Supplement U with respect to their unrelated business activities as is now provided under Supplement U in the case of private colleges and universities exempt under section 101 (6) of the code. The amendments made by this section are to be applicable only with respect to taxable years beginning after December 31, 1951.

Subsection (a) of this section amends section 421 (b) (1) of the code (relating to organizations exempt under sec. 101 (1), (6), (7), and (14) which are taxable under sec. 421 (a) (1) at corporate rates on their unrelated business net income) to bring the provisions presently contained therein under a subparagraph numbered (A) and to add after such subparagraph a new subparagraph numbered (B). Section 421 (b) (1) (B) applies the taxes imposed by section 421 (a) (1) to any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof or by any agency or instrumentality of any one or more governments or political subdivisions. As here used, the word "government" includes any foreign government (to the extent not contrary to any treaty obligation of the United States) and all domestic governments (the United States and any of its Territories or possessions, any State, and the District of Columbia). In other words, any national, State, municipal or city college or university is brought within the scope of the Supplement U tax, but secondary schools run by such governments are outside such tax.

Section 421 (b) (1) (B) also applies the Supplement U tax to any corporation wholly owned by one or more governmental colleges or universities. Such a corporation would be subject to the tax imposed under Supplement U on income derived from an unrelated trade or business, including rents derived under a Supplement U lease.

Subsection (b) of this section amends section 422 (b), for the purpose of determining the unrelated business net income subject to the Supplement U tax, to define unrelated trade or business to mean, in the case of an organization described in section 421 (b) (1) (B), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance of any purpose or function described in section 101 (6) of the code. The purposes or functions described in section 101 (6) are religious, charitable, scientific, literary, educational, and the prevention of cruelty to children or animals.

Subsection (b) of this section also amends section 422 (b) (2) to provide that the term "unrelated trade or business" does not include any trade or business which is carried on, in the case of a college or university described in section 421 (b) (1) (B), by the organization primarily for the convenience of its members, students, patients, officers, or employees.

SECTION 339. FAMILY PARTNERSHIPS

Subsections (a) and (b) of this section amend section 3797 (a) (2) of, and add a new section 191 to, the code to provide for the tax treatment of family partnerships as explained beginning on page 38 in part I of this report.

Subsection (c) (1) provides that, in general, the amendments made by section 339 (a) and (b) are to be applicable only with respect to taxable years beginning after December 31, 1950. Section 339 (c) (2), however, provides that such amendments, at the election of the taxpayer made in accordance with regulations prescribed by the Secretary of the Treasury, shall also be applicable to taxable years beginning after December 31, 1938, and before January 1, 1951. The election does not have to be with respect to all such taxable years but will be applicable only to such years as are specified by the taxpayer in making the election. The election for any taxable year will not be valid unless, prior to the expiration of 90 days after the filing of the election (or such longer period as the Secretary may by regulations prescribe) each family partner of the taxpayer files, in accordance with the regulations, a written consent to have the amendments apply to his taxable years which corresponds to the taxable years for which the election is made by the taxpayer. In lieu of such consent by any family partner, however, there may be paid, under regulations prescribed by the Secretary and within the time provided for filing such consent, an amount equal to the deficiency and interest which would be assessed with respect to such family partner if he filed such consent. The election and any consent filed in respect of the election shall be applicable only to such partnerships as are specified in the election. The period of limitations provided in sections 275 and 276 of the Internal Revenue Code on the making of assessments and the beginning of distraint or a proceeding in court for collection shall, with respect to any deficiency and interest thereon resulting from such election or consent, include one year following the date such election or consent is filed if such period of limitations otherwise would expire prior to the end of such 1-year period; such assessment and collection may be made notwithstanding any provision of law or any rule of law which otherwise would prevent such assessment and collection. If an election by a taxpayer is filed for a taxable year for which allowance of credit or refund of an overpayment of tax is barred, at the time of filing such election, by any law or rule of law, then any consent filed by a family partner of a taxpayer with respect to such year shall be void.

Section 339 (c) (3) provides special rules for applying the amendments made by section 339 (a) and (b) in certain cases where the taxable year of the taxpayer or a family partner is different from the taxable year of the partnership. If a taxable year of a partnership which ends in 1951 ends within or with a taxable year of the taxpayer or a family partner which began before January 1, 1951, the amendments made by section 339 (a) and (b) shall be applicable, with respect to the distributive shares of income derived by the taxpayer and the family partners from such taxable year of the partnership, only pursuant to the provisions of section 339 (c) (2), notwithstanding the fact that the general rule provided in section 339 (c) (1) might otherwise be applicable to some of the partners. Similarly, if a taxable year of a partnership which ended in 1939 ended within or with a taxable year of a taxpayer or a family partner which began before January 1, 1939, the amendments made by section 339 (a) and (b) shall not be applicable with respect to any of the distributive shares of income derived by the taxpayer and the family partners from such taxable year of the partnership, notwithstanding the fact that the provisions of section 339, relative to the retroactive application of the amendments made by section 339 (a) and (b), might otherwise be applicable to some of the partners.

The term "family partner," for purposes of section 339 (c), means any person who, upon the filing of the consent described above, would be liable for a deficiency attributable to income which, but for the application of the amendments made by section 339 (a) and (b), would be considered as income of the taxpayer.

SECTION 340. WAR LOSSES

This section, for which there is no corresponding provision in the House bill, amends section 127 (c) and (d) of the code to provide an alternative treatment of war loss recoveries, in lieu of the rules stated in the present section, if the taxpayer elects to have such alternative method apply.

Subsection (a) amends section 127 (c), relating to recoveries included in gross income. Paragraph (1) of amended subsection (c) provides that upon the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year the amount of such recovery shall be included in gross income to the extent provided in paragraph (2), which retains existing law, unless the taxpayer elects under the provisions of paragraph (5) to have such recovery treated in accordance with the provisions of paragraph (3), which embodies the new elective treatment.

Paragraph (3) provides new rules for determining (a) the amount of a war loss recovery; (b) the amount of the adjustment to be made to the tax for the taxable year of the recovery in respect of prior deductions on account of property considered under subsection (a) as destroyed or seized; (c) the treatment of that part of the recovery which is in excess of allowable deductions in prior taxable years; and (d) a special rule for the inclusion of recoveries in gross income for certain purposes. Subparagraph (A) states the rule for valuing the amount of the recovery in the taxable year. If the same property or interest considered under subsection (a) as destroyed or seized is recovered, the fair market value of such property or interest shall not exceed the adjusted basis (for determining loss) of such property or interest in the hands of the taxpayer on the date of the loss. For example, the taxpayer on December 11, 1941, owned Blackacre, a property located in Germany. The adjusted basis of such property in the hands of the taxpayer on such date was $1,000,000. Under section 127 (a) such property was deemed destroyed or seized in the year 1941 and the taxpayer's loss of $1,000,000 was an allowable deduction for such year whether or not the taxpayer claimed such deduction. A recovery in respect to such loss is, under section 127 (c), required to be taken into account. Assume that in 1946 the taxpayer recovers this property and that on the date of recovery it has a fair market value of $2,000,000. If the taxpayer elects to proceed under the provisions of paragraph (3), the amount of the recovery respecting this property would be the amount of the adjusted basis as of the date of loss, $1,000,000. If in lieu of recovering the particular property which was deemed destroyed or seized the taxpayer receives another property in indemnity or substitution therefor and such other property has a fair market value on the date of the recovery of $2,000,000, that amount is to be considered the amount of the recovery in respect of the property deemed destroyed or seized, since the property recovered was not the property which was actually lost.

Subparagraph (B) provides the adjustment which is to be made to the tax in the taxable year of a recovery to which paragraph (3) is made applicable pursuant to the taxpayer's election. That part of the amount of the recovery which is not in excess of the allowable deductions in prior taxable years on account of the destruction or seizure of the property in respect of which the recovery is received, minus the aggregate amount of any prior recovery in respect of the same property, is not included in gross income for the taxable year of the recovery. In lieu of including any amount in gross income there is to be added to, and assessed and collected as part of, the tax imposed by chapter 1 for the taxable year of the recovery, the aggregate increase in the tax under chapter 1 and chapter 2 for all taxable years which would result from a decrease in such allowable deductions in prior taxable years by an amount equal to such part of the recovery. The increase in the tax for each taxable year resulting from a determination of the amounts resulting from adjustment in the amount of the allowable deductions in the prior taxable years is to be computed in accordance with regulations prescribed by the Secretary.

Subparagraph (B) provides that the regulations shall give effect to previous recoveries of any kind with respect to any prior year, and shall provide for the case where there was no tax for the prior year, but shall otherwise treat the tax previously determined for any year in accordance with the principles set forth in section 3801 (d) of the code. All credits allowable against the tax for any year and all carry-overs and carry-backs affected by so decreasing the allowable deductions shall be taken into account in computing the increase in the tax for the year in which the property was recovered. It is contemplated that the regulations will provide rules applicable to the diverse situations which can arise in those cases where an election made by the taxpayer for the application of paragraph (3) will apply to some, but not all, of the taxable years during which recoveries were had by the taxpayer.

Subparagraph (C) provides that to the extent the amount of any recovery in respect of property considered under subsection (a) as destroyed or seized is not subject to the provisions of subparagraph (B) such amount shall be considered for the taxable year of the recovery as gain on the involuntary conversion of property as the result of its destruction or seizure and shall be recognized or not recognized as provided in section 112 (f). This rule is applicable where the amount of the recovery as determined under subparagraph (A) exceeds the allowable deductions in prior taxable years on account of the destruction or seizure of the property.

Subparagraph (D) contains a special rule which provides that for the purposes of section 51, relating to the requirement of individual returns, section 52, relating to the requirement of corporation returns, and section 3801 (b), relating to inclusions and exclusions from gross income in making the adjustments required by such section, the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year shall be deemed to be an item includible in gross income for the taxable year in which the recovery is made.

Paragraph (4) of section 127 (c) provides that for the purpose of subsection (c) the restoration in whole or in part of the value of any interest described in subsection (a) (3), relating to investments referrable to destroyed or seized property, by reason of any recovery of money or property in respect of property to which such interest related and which was considered under subsection (a) as destroyed or seized shall be deemed a recovery of property in respect of property considered under subsection (a) as destroyed or seized. This is the same rule contained in section 127 (c) (3) of existing law. This section of the bill, however, adds a sentence which provides that in applying paragraph (3) such restoration shall be treated as a recovery of the same interest considered under subsection (a) as destroyed or seized.

Paragraph (5) provides for the election by the taxpayer for the application of the provisions of paragraph (3). Such election is to be made in accordance with regulations prescribed by the Secretary. If the taxpayer elects to have the provisions of paragraph (3) applicable to any taxable year in which he recovered any money or property in respect of property considered under subsection (a) as destroyed or seized, the provisions of paragraph (3) shall be applicable to all taxable years of the taxpayer beginning after December 31, 1940, other than a taxable year for which at the time of making such election a refund or credit of the entire amount of any overpayment (resulting from an application of paragraph (3) to such year) would be prevented by section 322 or by the provisions of any other law or rule of law. Thus, if the application of paragraph (3) to a taxable year would result in an overpayment of $10,000, and by reason of the limitations contained in section 322 (b) (2) (B) of the code only $4,000 of the overpayment could be refunded upon the filing (at the time of the making of the election) of a claim for refund, the provisions of paragraph (3) would not apply to such year, and the basis of the property recovered in that year would continue to be determined under the existing provisions of section 127 (d) of the code. Paragraph (5) further provides that if the provisions of paragraph (3) are applicable to any taxable year pursuant to the taxpayer's election, the time for the assessment and collection of—

(a) the amount to be added to the tax for such year under the provisions of paragraph (3), and

(b) any deficiency for such year or for any other taxable year, if and to the extent such deficiency is attributable to the redetermination of the basis of the recovered property under the provisions of subsection (d) (2) as amended by this section,

shall not expire prior to the expiration of 2 years following the time of the making of such election. Such amount and such deficiency may be assessed at any time prior to the expiration of such period, notwithstanding any law or rule of law which would otherwise prevent such assessment. No interest shall be assessed or collected with respect to the amount specified in clause (a) or with respect to any deficiencies specified in clause (b) for any period prior to the expiration of 6 months following the date of the making of the election by the taxpayer; nor shall interest be paid on any overpayment resulting from the making of such election, in the case of any taxable year ending before the date of the making of such election, for any period prior to the expiration of such 6-month period.

Subsection (b) of this section amends section 127 (d), relating to the basis of recovered property. Subsection (d) (1) as amended provides that the adjusted basis of property recovered in respect of property considered as destroyed or seized under subsection (a) shall be determined under subsection (d). The rule contained in paragraph (1) for the determination of the unadjusted basis of property is the same as that provided by existing law. Paragraph (2) provides a new and different rule if property is recovered in a taxable year to which the provisions of section 127 (c) (3) are applicable pursuant to an election made under the provisions of section 127 (c) (5). In such case, in lieu of the amount determined under paragraph (1) (which states the rule of existing law), the basis of the property shall be an amount equal to the value at which such property is included in the amount of the recovery under section 127 (c) (3) (A), reduced by such part of the gain under section 127 (c) (3) (C) which is not recognized under section 112 (f).

Subsection (c) of this section amends section 131 (a), relating to the allowance of credit for taxes of foreign countries and possessions of the United States, to provide that the foreign tax credit shall not be allowed against the additional tax imposed for the taxable year under the provisions of section 127 (c) (3) (B), as amended. Thus, if such provisions are applicable to a taxable year and pursuant thereto an increase in the tax imposed for such year is to be added to the tax, a foreign tax credit may not be allowed against the amount of such increase.

The amendments made by this section are applicable to taxable years beginning after December 31, 1940.

SECTION 341. DEDUCTION OF EXPENDITURES FOR MINE EXPLORATION

This section, for which there is no corresponding provision in the House bill, amends section 23 of the Internal Revenue Code (relating to deductions from gross income) by adding a new subsection (ff) thereto.

Paragraph (1) of such subsection provides that expenditures paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or mineral, and paid or incurred prior to the beginning of the development stage of the mine or deposit, shall be allowed as deductions in computing net income for the taxable year except to the extent that such expenditures exceed $75,000. The yearly limitation of $75,000 applies to all such described expenditures of the taxpayer and is not a total amount allowable with respect to each separate mine or deposit. A 4-year limitation is applicable, as described hereinafter.

This subsection, however, is applicable only to expenditures described and which, but for this subsection, would not be allowable as a deduction for the taxable year. Those expenditures that would be allowable without reference to this subsection continue to be allowable to the same extent as under existing law and are not to be taken into account in computing the $75,000 limitation. This subsection, also, is applicable only to expenditures paid or incurred prior to the beginning of the development stage of the deposit, or mine relating to such deposit. The determination of the beginning of the development stage is to be made, as under existing law, by reference to the time when the existence of ores or minerals in commercially marketable quantities is disclosed.

This subsection does not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 23 (l) of the code, but allowances for depreciation shall be considered, for the purposes of this subsection, as expenditures paid or incurred. This subsection, also, does not apply to expenditures for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil or gas.

Paragraph (2) of the subsection provides that, at the election of the taxpayer in accordance with regulations prescribed by the Secretary, he may treat as deferred expenses any portion of the amount deductible under paragraph (1). Such portion so treated shall not be deductible under paragraph (1) but shall be deductible on a ratable basis as the units of produced ores or minerals discovered or explored by reason of such expenditures are sold. An election made under this paragraph for any taxable year shall be binding for such year.

In order to determine the amount of the deduction allowable for any taxable year under paragraph (2), it will be necessary to estimate the number of units, discovered or explored by reason of such expenditures, in the reserve of the mine or deposit at the close of such taxable year. This estimate is, of course, subject to revision in the event it is ascertained as the result of operation or development work that the remaining recoverable units are materially greater or less than the number remaining from a prior estimate. As these units are produced and sold, the amount of such expenditures to be deducted will be an amount which is in the same proportion to the total amount of such expenditures with respect to which an election under paragraph (2) has been made as the number of units sold is to the number of units in the reserve.

The deductions allowable under this subsection are not, of course, subject to disallowance under section 24 (a) (2).

This subsection is applicable only to a taxpayer who has paid or incurred expenditures of the type described therein and accordingly has no application to that part of the cost of a mine or deposit attributable to such expenditures when acquired by purchase. The subsection intends that where a taxpayer has paid or incurred such expenditures, has made an election under paragraph (2), and has thereafter leased the mine or deposit, retaining a royalty interest therein, the taxpayer is to be allowed the ratable deduction provided in paragraph (2).

Paragraph (3) of the subsection provides that the subsection shall not apply to any amounts paid or incurred in any taxable year if in any four preceding years (not necessarily consecutive years) the taxpayer, or any individual or corporation (who has transferred to the taxpayer any mineral or ore property under circumstances which make the provisions of par. (7), (8), (11), (13), (15), (17), (20), or (22) of sec. 113 (a) of the code applicable to such transfer), has (1) been allowed a deduction under paragraph (1) of the subsection, or (2) made the election provided under paragraph (2) of the subsection. Thus, for example, if a taxpayer who makes his return on a calendar-year basis takes a deduction under the subsection in each of the years 1952, 1953, 1954, and 1956, he will not be entitled to any deduction under the subsection for 1957, or any other subsequent taxable year. This is true even though the amount of the deduction taken in each such year is for less than the $75,000 annual ceiling.

Paragraph (4) provides that the amount of the expenditures which are to be deferred and deducted ratably under the election provided in paragraph (2) shall be taken into account in determining the adjusted basis of the mine or deposit. However, no amount of such deferred expense shall be included in the adjusted basis of the property for the purpose of computing a deduction for depletion under section 114 of the code.

Subsection (b) of this section of the bill amends section 113 (b) (1) of the code (relating to adjusted basis of property) to add a new subparagraph (M) thereto. This subparagraph provides that the basis of a mine or deposit shall be adjusted for amounts allowed as deductions as deferred expenses under section 23 (ff) (2) of the code to the extent such deductions resulted in a reduction of the taxpayer's taxes under chapter 1 of the code, but not less than the amounts allowable under such section for the taxable year and prior years. No adjustments are to be made for such deductions, however, in determining the adjusted basis of the property for the purpose of computing a deduction for depletion under section 114 of the code.

Subsection (c) of this section of the bill provides that the amendments made by this section shall be applicable only with respect to taxable years ending after December 31, 1950.

SECTION 342. CORPORATE LIQUIDATIONS

This section, for which there is no corresponding provision in the House bill, amends section 115 of the code by adding a new subsection (n) which states a special rule for the treatment of gain upon the complete liquidation of a corporation where the distribution in liquidation includes stock in another corporation to which unimproved real estate has been transferred in anticipation of such liquidation. The new subsection (n) provides that if pursuant to a plan of liquidation a corporation (1) transfers part of its assets consisting of unimproved real estate to a newly organized corporation in exchange solely for the entire stock of the new corporation, and (2) within a period of 24 months from the date of the adoption of the plan of liquidation distributes in complete liquidation all its assets including the stock in the new corporation, the amounts distributed shall be treated as distributions in complete liquidation of the old corporation, and none of such distributions is to be treated as having been made in pursuance of a plan of reorganization and subject to the provisions of section 112 (c) (2). Thus, the entire recognized gain, if any, to the shareholders of the old corporation shall be treated as capital gain and no part of such gain shall be taxed as a dividend to the shareholders of the old corporation, notwithstanding any other provisions of chapter 1 of the code, including section 112 (c) (2). In other words, if in connection with the transaction described above all or part of the gain recognized upon the liquidation of the old corporation would otherwise be treated as the distribution of a taxable dividend and taxed as a dividend to the shareholders under the provisions of section 112 (c) (2), the new subsection (n) provides that in lieu of taxing such part of the gain as a taxable dividend to the shareholders, all of the gain shall be taxed as capital gain.

The benefit of section 115 (n) apply only if (1) the business of the old corporation is discontinued, (2) the new corporation to which the unimproved real estate is transferred was organized and is operated solely for the purpose of holding title to such real estate and collecting income from the leasing or sale thereof, and (3) there was a sound business reason for organizing such new corporation to hold title to the unimproved real estate.

The amendment made by this section applies to taxable years beginning after December 31, 1947.

SECTION 343. DEFINITION OF EMPLOYEE

This section, for which there is no corresponding provision in the House bill, adds a new paragraph (20), applicable to taxable years beginning after 1938, to section 3797 (a) of the code to provide in substance that a full-time life-insurance salesman shall be considered to be an "employee" for the purpose of applying the provisions of chapter 1 (such as secs. 22 (b) (2) (B), 23 (p), and 165) which determine the effect of contributions for the benefit of, and distributions to, "an employee" under a stock bonus, pension, profit-sharing, or annuity plan.

Section 165 (b) provides in substance that periodic distributions made to an employee by a pension or profit-sharing trust which conforms to the requirements of section 165 are taxed to the recipient as received in the same manner as annuity payments. However, since a full-time life-insurance salesman is not considered, under existing law, to be an "employee," the provisions of section 165 do not apply with respect to a trust for his benefit.

Under your committee's amendment, such a full-time life-insurance salesman is accorded the status of an employee for purposes of the application of section 165 if he is classified as an employee for purposes of the Federal old-age and survivor's insurance system or if, in the case of services performed before January 1, 1951, he would have been so classified if the services were performed in 1951.

TITLE IV—EXCISE TAXES

PART I—TAX ON ADMISSIONS AND CABARETS

SECTION 401. REMOVAL OF TAX ON FREE ADMISSIONS

As it passed the House, this section of the bill amends section 1700 (a) (1) of the code by striking out the second and fourth sentences thereof. The second sentence provides that persons (except bona fide employees, municipal officers on official business, and children under 12 years of age), admitted free or at reduced rates, shall pay the same tax as persons paying the regular admission charge. Thus, by striking out this sentence, there will be no tax on free admissions, and with respect to admissions at reduced rates, the tax will be determined by the first sentence of section 1700 (a) (1), as amended by section 1650, which imposes on admissions a tax of 1 cent for each 5 cents or major fraction thereof. The fourth sentence (relating to exemption from tax by regulation in the case of free admission of certain hospitalized veterans and members of the Armed Forces) of such section is stricken as surplusage upon the elimination of the second sentence. Your committee has further amended section 1700 (a) (1) by striking out the fifth sentence which was added thereto by Public Law 124, approved August 24, 1951. The fifth sentence of section 1700 (a) (1) provides for an exemption from tax in the case of free admission of members of the Armed Forces. This fifth sentence becomes surplusage upon the elimination of the second sentence.

SECTION 402. EXEMPTIONS FROM ADMISSIONS TAX

As it passed the House, subsection (a) of this section reinstates the applicability of section 1701 of the Internal Revenue Code, which exempted prior to October 1, 1941, certain admissions from the admissions tax. Your committee has retained this subsection.

As it passed the House, subsection (b) of this section amends section 1701 (a) of the code so as to retain certain of the exemptions from the admissions tax which existed prior to October 1, 1941.

Under the amendments made by the House bill to section 1701 (a), the admissions tax would apply to:

1. Admissions to all athletic games or exhibitions except those where the proceeds inure exclusively to the benefit of an elementary or secondary school. Under the pre-1941 law the exemption from the admissions tax was denied only with respect to admissions to such events the proceeds of which inured wholly or partly to the benefit of a college or university.
2. Admissions to all wrestling matches, prize fights, or boxing, sparring, or other pugilistic matches or exhibitions, regardless of to whom the proceeds are payable. Under the pre-1941 law admissions to such exhibitions were in some cases exempt from tax.
3. Admissions to carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation. There was no corresponding provision in the pre-1941 law.

Your committee has retained the amendments made by the House as they relate to the admissions listed above and, in addition, has further provided that the admissions tax will apply to admissions to any motion-picture exhibition, regardless of to whom the proceeds are payable, and the character of the person or organization sponsoring such a motion-picture exhibition.

Subsection (b), as it passed the House, eliminated from the pre-1941 exemptions (1) the exemption with respect to admissions all the proceeds of which inure exclusively to the benefit of societies or organizations conducted for the sole purpose of improving any city, town, village, or other municipality, and (2) the exemption with respect to admissions all the proceeds of which inure exclusively to the benefit of persons in the military or naval forces of the United States or to persons who have served in such forces and are in need. Your committee has retained the House amendments with respect to these activities, and, in addition, has provided for the elimination of the pre-1941 exemptions in the case of admissions all the proceeds of which inure exclusively to the benefit of societies for the prevention of cruelty to children or animals. The exemption previously afforded to societies or organizations conducted for the sole purpose of maintaining a cooperative or community center moving-picture theater has also been eliminated by your committee.

Under pre-1941 law the exemption from tax applied to admissions where the proceeds inured exclusively to the benefit of members of the police or fire department of any city, town, village, or other municipality or the dependents or heirs of such members. Under the amendment passed by the House the proceeds must inure exclusively to the benefit of a police or fire department (including a volunteer fire department) of any such locality or exclusively to a fund for the sole benefit of members of a police or fire department or the dependents or heirs of such members. Your committee has further limited this exemption so that the proceeds must inure exclusively to the benefit of a police or fire department of any city, town, village, or any municipality or exclusively to a retirement, pension, or disability fund for the sole benefit of members of such a police or fire department or to a fund for the heirs of such members.

Under pre-1941 law opera companies were exempted as educational institutions. The same result was contemplated under the bill as passed by the House. Your committee has included a specific exemtion from the admissions tax where the proceeds of the admission inure exclusively to a society or organization conducted for the sole purpose of maintaining symphony orchestras or operas, and receiving substantial support from voluntary contribution.

Under the House bill, as under section 1701 prior to October 1, 1941, the exemption from tax applies if the proceeds of the admissions inure exclusively to the benefit of religious, educational, or charitable institutions. Your committee, however, proposes to limit the exemptions to certain defined classes of institutions within these categories. Under the amendment proposed by your committee, religious institutions are restricted to churches or conventions or associations of churches. An educational institution, to be exempt, must have a regular faculty and curriculum, and a regular student body at the place where the educational activities are carried on. A charitable institution, in order to qualify for exemption, must be supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or must be primarily supported by contributions from the general public. For the exemption to attach in the cases of either an educational institution or a charitable institution, such institution must be exempt from income tax under section 101 (6).

Subsection (b), as it passed the House, would reinstate the pre-1941 exemption granted under section 1701 (b) of the code to admissions to agricultural fairs and to admissions to any exhibit, entertainment, or other pay feature conducted by the fair association as part of the fair. Your committee has amended section 1701 (b) to limit the exemption to the general admission charge to the fair only, and to eliminate the specific exemption to charges for admission to any exhibit, entertainment, or other pay feature put on as part of such fair.

Subsection (c) of this section, as it passed the House, adds a new subsection (d) to section 1701 of the code. This new subsection grants an exemption covering admissions to facilities for physical recreation, such as swimming pools, bathing beaches, and skating rinks (including exhibitions and tournaments conducted at such facilities) operated by, and with the entire proceeds inuring to, States and political subdivisions thereof, such as counties and cities, or the United States, and agencies and instrumentalities of the foregoing. The new exemption does not encompass spectator facilities, such as zoos and aquariums. Your committee has retained this exemption.

In addition, your committee has also provided for the addition of a new subsection (e) to section 1701 of the code. Subsection (e) (1) grants an exemption from the admissions tax covering admissions to a home or garden which is temporarily opened to the general public as part of a program conducted by a society or organization to permit the inspection of historical homes and gardens. Subsection (e) (2) grants an exemption from the admissions tax covering admissions to historic sites, houses, and shrines, and museums conducted in connection therewith, maintained and operated by a society or organization devoted to the preservation of such places. To qualify for the exemption under the new subsection (e) no part of the net earnings of the society or organization conducting the home or garden tour program, or maintaining or operating such historic sites, houses, and so forth, may inure to the benefit of any private stockholder or individual.

SECTION 403. EFFECTIVE DATE OF AMENDMENTS RELATING TO ADMISSIONS

This section is the same as section 403 of the House bill and provides that the amendments made by sections 401 and 402 shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this act for admissions on or after such first day.

SECTION 404. TAX ON CABARETS, ROOF GARDENS, ETC.

This section, which is identical with section 404 of the House bill, amends section 1700 (e) (1) of the code to exempt from the cabaret tax bona fide dance halls, ballrooms, and other similar places where the serving or selling of food, refreshments, or merchandise is merely incidental to the music and dancing privileges furnished unless the conduct of the place is such as to bring it within the normal concept of a roof garden, cabaret, or similar place. This determination will be made by reference to the over-all operation of the establishment, including such factors as the relative income from the several activities over a period of time, the relative portion of space devoted to the various activities, the type of refreshments served or sold, the scope and character of the entertainment furnished, and the hours of operation.

The purpose of this amendment is to make it clear that the principles set forth by the district court in the case of *Geer* v. *Birmingham* (88 F. Supp. 189) are controlling in the determination of whether the establishment involved is operating as a cabaret or as a dance hall, and to avoid the broad construction placed upon the statute in the case of *Avalon Amusement Corporation* v. *United States* (165 F. 2d 653) and in the court of appeals decision reversing the decision of the district court in the Geer case (*Birmingham* v. *Geer*, 185 F. 2d 82), which require that dance halls and similar establishments be taxed as cabarets, even though the serving or selling of food, refreshments, or merchandise is merely incidental.

The amendment made by this section shall take effect at 10 a. m., on the first day of the first month which begins more than 10 days after the date of the enactment of this act.

PART II—TAX ON CIGARETTES

SECTION 421. TAX ON CIGARETTES

Subsection (a) of this section as it passed the House amends section 2000 (c) (2) of the code (relating to the tax on cigarettes) to increase the rate of tax with respect to cigarettes weighing not more than 3 pounds per thousand from $3.50 to $4 per thousand. Your committee has amended this section to provide that the increased rate of tax shall be applicable only until January 1, 1954, at which time the rate of tax with respect to such cigarettes will revert to $3.50 pei thousand, the present rate of tax.

Subsection (b) provides that the increase in the rate of tax made by subsection (a) shall take effect on the first day of the first month which begins more than 10 days after the date of enactment of this act.

SECTION 422. FLOOR STOCKS TAX AND FLOOR STOCKS REFUND ON CIGARETTES

As passed by the House, this section amends section 2000 of the code (relating to the tax on tobacco, etc.) by adding a new subsection (f) which imposes a floor stocks tax equal to the increase in the tax made by section 421 (a) with respect to cigarettes weighing not more than 3 pounds per thousand which are held for sale on the day the increased rate of tax on such cigarettes takes effect.

Your committee has retained this amendment but has added an additional subsection (g) to section 2000 of the code. This added subsection provides for a credit or refund (without interest), on cigarettes weighing not more than 3 pounds per thousand which on January 1, 1954, are held and intended for sale or are in transit to the United States on which tax has been paid, in an amount equal to the difference between the tax paid on such cigarettes (including floor stocks tax) and the tax made applicable to such cigarettes on January 1, 1954. To be entitled to credit or refund, such cigarettes must, on January 1, 1954, be held and intended for sale; the person so holding the cigarettes must, prior to April 1, 1954, file claim for credit or refund; and he must also make, keep, and file records as required both before and after January 1, 1954 (but not extending beyond 1 year thereafter), and must establish to the satisfaction of the Secretary, with respect to cigarettes of the class for which credit or refund is claimed by him under this subsection, that on and after January 1, 1954, and before April 1, 1954, the price at which cigarettes of such class were sold (until a number equal at least to the number on hand at the first moment of January 1, 1954, were sold) reflected, in such manner as the Secretary may by regulations prescribe, the amount of the tax reduction. The Secretary will, under the regulations, establish a system for making credit or refund where the benefit of the tax reduction is passed on to the consumer. The regulations may prescribe the method of arriving at the price at which such cigarettes were sold before the tax reduction, and may also prescribe the method of ascertaining the reduced price reflecting the tax reduction, if a credit or refund is to be allowed. Credit or refund is not to be allowed under this subsection with respect to the cigarettes in respect to which credit or refund is claimed unless the requirements of the subsection and the regulations are satisfied.

SECTION 423. REDUCTION OF TAX ON SNUFF AND CHEWING TOBACCO

This section, which your committee has added to the House bill, amends section 2000 (a) of the code, relating to the tax on tobacco and snuff.

Subsection (a) of this section amends existing law so as to change the rate of tax on all snuff and chewing tobacco from 18 cents per pound to 10 cents per pound, but retains the present tax rate of 18 cents per pound on all smoking tobacco. Under this amendment a tax of 10 cents per pound would be imposed on snuff of all descriptions, and on all chewing tobaccos.

Subsection (b) provides that the changes in the tax rates made by subsection (a) shall take effect on the first day of the first month which begins more than 10 days after the date of the enactment of this Act.

PART III—RETAILERS' EXCISE TAXES

SECTION 431. RETAILERS' EXCISE TAX ON TOILET PREPARATIONS

This section, which is identical with section 432 of the House bill, amends section 2402 (a) of the code (relating to the tax on toilet preparations) by adding at the end thereof a new sentence to exempt from the tax thereby imposed toilet articles intended to be used or applied only in the care of babies. The determination of whether toilet articles are intended to be used or applied only in the care of babies will be made only by reference to the advertising with respect to, and the labeling contained on, the article. If an article is advertised and labeled as being for use in the care of babies and is not advertised or labeled as usable by persons other than babies the article is exempt from tax even though the particular purchaser buys it for adult use. On the other hand, an article which is represented by advertising or labeling as fit for adult use in addition to use in the care of babies will not be exempt from tax even though sold to a purchaser who intends to use the article only in the care of babies.

Under existing law toilet articles sold to a beauty parlor, barber shop, or similar establishment for use in the operation thereof are taxable when sold. Articles sold to such establishments for resale are not taxable until sold by them. Under existing procedures these establishments must submit exemption certificates to their vendors in order that toilet articles may be purchased tax-free for resale. Articles procured by such establishments tax-free for resale and actually used in operation of the place are taxable when first set apart for such use. Under the amendment made by section 431 (b) to section 2402 (b) of the code, toilet articles sold to such establishments, for resale or for use in the operation thereof, are exempted from tax. The resale of toilet articles at retail by such establishments will continue to be taxable, as under present law.

SECTION 432. EFFECTIVE DATE OF PART III

This section, which is the same as section 433 of the House bill, provides that the amendments made by part III (relating to retailers' excise taxes) shall apply only to articles sold on or after the first day of the first month which begins more than 10 days after the date of enactment of this act.

PART IV—LIQUOR

SECTIONS 441, 442, AND 443. DISTILLED SPIRITS, WINES, AND FERMENTED MALT LIQUORS

These sections are the same as sections 451, 452, and 453 of the House bill, except that provision is made for the elimination of the proposed increase in rates on and after January 1, 1954. These sections increase the rates of tax on distilled spirits, wines, and fermented malt liquors. The proposed increases are as follows: Distilled spirits, from $9 to $10.50 per proof gallon; still wines not over 14 percent alcohol, from 15 to 17 cents per gallon; still wines over 14 percent and not over 21 percent of alcohol, from 60 to 67 cents per gallon; still wines over 21 percent and not over 24 percent of alcohol, from $2 to $2.25 per gallon; sparkling wines, from 15 to 17 cents per one-half pint; artificially carbonated wines, from 10 to 12 cents per one-half pint; liqueurs, cordials, and similar compounds containing fortified sweet wine or fortified fruit or berry wines, from 10 to 12 cents per one-half pint; fermented malt liquors from $8 to $9 per barrel. These sections also impose equalizing floor stocks taxes on tax-paid distilled spirits and tax-paid wines held for sale or for use in the manufacture of any article intended for sale on the date the increased rates become effective; and on all tax-paid fermented malt liquors held for sale on the date the increased rate becomes effective. Provisions similar to those contained in the Revenue Act of 1943 are made for the filing of floor stocks tax returns and for the payment of such tax. Section 441 also increases the rate of tax on imported perfumes containing distilled spirits from $9 to $10.50 per wine gallon.

SECTION 444. FLOOR STOCKS REFUNDS

This section deals with refunds applicable with respect to alcoholic liquors upon the termination of the tax rate increases proposed for these products in the bill. It amends section 1656 (a) and (b) of the code. The House bill did not provide for a termination date for the proposed rate increases and, accordingly, made no provisions of refunds on the rate reduction date.

Section 1656 (a) and (b) of the code, as amended by this section, covers alcoholic liquors, including distilled spirits, imported perfumes containing distilled spirits, wines, including liqueurs and cordials, and fermented malt liquors. It provides for credit or refund (without interest) of the excess of the taxes (including floor stocks taxes) paid with respect to such liquors on account of the higher rates imposed by this bill over the taxes that would have been payable in the absence of the increased rates provided by this bill. To be entitled to credit or refund, the liquor must, on January 1, 1954, be held for sale or for use in the manufacture or production of an article intended for sale; the person so holding it must, prior to February 1, 1954, file claim for credit or refund; and he must also make, keep, and file records as required, and must establish to the satisfaction of the Secretary, with respect to each kind of article for which credit or refund is claimed by him under this section, that after December 31, 1953, and before April 1, 1954, the price at which articles of such kind were sold (until a number equal at least to the number on hand on January 1, 1954, were sold) reflected, in such manner as the Secretary may by regulations prescribe, the amount of the tax reduction. Under this section the Secretary will be authorized, under regulations, to establish a system for making credit or refund where the benefit of the tax reduction is passed on to the consumer. The regulations may prescribe the method of arriving at the price at which the article was sold before the tax reduction. The regulations may also prescribe the method of ascertaining the reduced price reflecting the tax reduction, if a credit or refund is to be allowed.

SECTION 445. CLERICAL AMENDMENT

This section is the same as section 454 of the House bill. The section amends section 1650 (relating to war tax rates on certain miscellaneous taxes) by striking out the provisions thereof relating to distilled spirits, imported perfumes containing distilled spirits, wines, and fermented malt liquors.

SECTION 446. EFFECTIVE DATE OF PART IV

This section is the same as section 455 of the House bill. The section provides that the amendments made by this part shall take effect on the first day of the first month which begins more than 10 days after the date of enactment of this act.

PART V—OCCUPATIONAL TAXES

SECTION 451. OCCUPATIONAL TAXES ON DEALERS IN LIQUORS

This section increases the rates of occupational taxes on wholesale dealers in liquors, retail dealers in liquors, and wholesale dealers in malt liquors. The proposed increases are as follows: Wholesale dealers in liquors, from $110 to $200; retail dealers in liquors, from $27.50 to $50; and wholesale dealers in malt liquors, from $55 to $100. The section is the same as section 461 of the House bill, except that provision is made for the elimination of the proposed increase in rate on and after July 1, 1954.

SECTION 452. DRAW-BACK IN THE CASE OF DISTILLED SPIRITS USED IN THE MANUFACTURE OF CERTAIN NONBEVERAGE PRODUCTS

This section corresponds to section 462 of the House bill. The section has, however, been redrafted to accomplish its objective by amending only section 3250 (l) (5) of the code and to provide for reduction of the amount of draw-back after December 31, 1953, to correspond with the proposed reduction in the rate of tax on distilled spirits on and after January 1, 1954. Subparagraph (5) (A) provides for payment of draw-back at the rate of $6 per proof gallon with respect to distilled spirits tax-paid at the rate of $9 per proof gallon prior to the effective date of section 452. Subparagraph (5) (B) provides for payment of draw-back at the rate of $9.50 per proof gallon with respect to distilled spirits tax-paid at the rate of $10.50 per proof gallon on and after the effective date of section 452. Subparagraph (5) (C) provides for payment of draw-back at the rate of $8 per proof gallon with respect to distilled spirits tax-paid at the rate of $9 per proof gallon after December 31, 1953.

The amendment shall be applicable only with respect to distilled spirits used on or after the first day of the first month which begins more than 10 days after the date of enactment of this act.

SECTION 453. TAX ON COIN-OPERATED GAMING DEVICES

This section, which is the same as section 463 of the House bill, amends section 3267 (a) of the Internal Revenue Code to increase the present rate of the special (occupational) tax thereby imposed with respect to coin-operated gaming devices from $150 to $250 per year.

SECTION 454. EFFECTIVE DATE OF PART V

This section is substantially the same as section 465 of the House bill, and provides that the amendments made by sections 451 and 453 shall take effect on the first day of the first month which begins more than 10 days after the date of the enactment of this act. In the case of the year beginning July 1, 1951, where the trade or business on which the occupational tax is imposed was commenced prior to the first day of the month specified in the preceding sentence, i. e., the month which begins more than 10 days after the date of the enactment of this act, the increase in the tax resulting from the amendments made by sections 451 and 453 shall be reckoned proportionately from the first day of such first month to and including the 30th day of June following and shall be due on, and shall be payable on or before, the last day of such specified month.

PART VI—WAGERING

SECTION 461. WAGERING TAXES

This section is identical with section 471 of the House bill. It adds to the Internal Revenue Code a new chapter entitled "Chapter 27A—Wagering Taxes," which imposes on wagers a tax equal to 10 percent of the amount thereof, and a special (occupational) tax of $50 per year on each person who is liable for the tax on wagers or who is engaged in receiving wagers for or on behalf of any person so liable. For a detailed discussion of these new taxes, see the explanation beginning on page 112 of the first part of this report.

SECTION 462. EFFECTIVE DATE OF PART VI

This section, which is the same as section 472 of the House bill, provides that the tax imposed on wagers by subchapter A of chapter 27A of the Internal Revenue Code, as added by section 461, shall apply only with respect to wagers placed on or after the first day of the first month which begins more than 10 days after the date of enactment of this act. The section further provides that the occupational tax imposed by subchapter B of chapter 27A of the code, as added by section 461, shall not be payable with respect to any period prior to the first month which begins more than 10 days after the date of enactment of this act. It is also provided that in the case of any person who is liable for tax under subchapter A of chapter 27A, or who is engaged in receiving wagers for or on behalf of any person so liable, and who commenced the activity which makes him subject to such tax, or who was engaged in receiving such wagers, prior to the first day of the first month specified in the preceding sentence, i. e., the month which begins more than 10 days after the enactment of the act, the tax under subchapter B of chapter 27A shall be reckoned proportionately from the first day of such month to and including the 30th day of June following and shall be due on, and payable on or before, the last day of such specified month.

PART VII—MANUFACTURERS' EXCISE TAXES

SECTION 471. AUTOMOBILES, TRUCKS, AND PARTS OR ACCESSORIES

This section is similar to section 481 of the House bill with the exception that your committee has amended subsections (a), (b), and (c) thereof to provide that the increases in rates of tax made by the House bill shall be applicable only until January 1, 1954, at which time the rates of tax now in effect under section 3403 of the code will be applicable. Also, your committee has eliminated the tax upon house trailers and parts and accessories sold on or in connection therewith. Under the House bill the present 7-percent tax upon such items would be continued.

Subsections (a) and (b) of this section respectively amend section 3403 (a) of the code to increase the manufacturers' excise tax from 5 to 8 percent on automobile trucks and other items included in section 3403 (a), and on passenger automobiles and all items now included in section 3403 (b) from 7 to 10 percent, except chassis and bodies for house trailers (including parts or accessories therefor sold on or in connection therewith or with the sale thereof), which will be exempt from tax.

Subsection (c) amends section 3403 (c) of the code to increase the tax on parts or accessories for any of the articles enumerated in section 3403 (a) and (b) of the code from 5 to 8 percent.

Subsection (d) adds a new sentence at the end of such section 3403 (c) to provide that in determining the sale price of a rebuilt automobile part or accessory, there shall be excluded from the price, in accordance with regulations prescribed by the Secretary, the value of a like part or accessory accepted in exchange.

Subsection (e) is a technical amendment of section 3403 (e) to provide rates of credit allowable to manufacturers for tax-paid tires, inner tubes, or automobile radio or television receiving sets used in the manufacture of automobiles, etc., equal to the rates of tax imposed on automobiles, etc.

Subsection (f) amends section 3443 (a) (3) (A) by adding a new clause (vi) to provide a credit or refund to a manufacturer of automobile parts or accessories when a part or accessory (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains) is resold for use as a replacement part for farm equipment. Under existing procedure a farm equipment manufacturer may buy for use as component parts of such equipment, parts or accessories primarily designed for automotive use (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains) under a certificate of intent to use them as original equipment, but may not buy automobile parts or accessories tax-free for resale for repair or replacement purposes on nontaxable articles. Thus, under the amendment a credit or refund is allowable with respect to those parts or accessories which under existing law and procedures may be sold tax-free to the manufacturer of the original nontaxable equipment.

The credit or refund may not be allowed under section 3443 (a) (3) (A) (vi) with respect to spark plugs, storage batteries, leaf springs, coils, timers, and tire chains or with respect to any part or accessory taxable under section 3403 (c) resold for use as repair or replacement parts for any of the articles taxable under section 3403 (a) and (b) of the code.

Subsection (g) provides that the amendment made by subsection (f) shall be effective with respect to articles purchased by the user thereof on or after the first day of the first month which begins more than 10 days after the date of the enactment of this act.

Subsection (h) of this section amends section 3400 (a) of the code to exempt from the tax thereby imposed on tires those of all-rubber construction without fabric or metal reinforcement, whether hollow center or solid, if they are not more than 20 inches in diameter and not more than 1¾ inches in cross section, and those of extruded tiring with internal wire-fastening agent.

SECTION 472. NAVIGATION RECEIVERS SOLD TO THE UNITED STATES

This section, which is substantially the same as section 482 of the House bill, deals with "communication, detection, or navigation receivers of the type used in commercial, military, or marine installations" hereafter in this paragraph referred to as "navigation receivers." Subsection (a) amends section 3404 (a) of the code to exempt from the tax thereby imposed on radio and television receiving sets, etc., the sale of navigation receivers to the United States for its exclusive use. Subsection (b) amends section 3404 (b) of the code to exempt from the tax thereby imposed on component parts of radio and television receiving sets, etc., the sale of any article for use by the vendee as material in the manufacture or production of, or as a component part of, navigation receivers to be sold by him to the United States for its exclusive use. Subsection (c) amends section 3443 (a) (1) of the code to allow a manufacturer or producer of navigation receivers a credit or refund of tax paid on articles taxable under section 3404 (b) purchased for use by him in the manufacture or production of, or as a component part of, navigation receivers if such navigation receivers have been sold by him to the United States for its exclusive use. Subsection (d) amends section 3443 (a) (3) (A) of the code to allow a credit or refund to a manufacturer, producer, or importer of navigation receivers in the amount of tax paid by him with respect to the sale thereof if he has in his possession such evidence as regulations may require that such navigation receivers have been resold to the United States for its exclusive use. Subsection (e) amends section 3444 (b) of the code to exempt from the tax thereby imposed on the use of taxable articles by the manufacturer, producer, or importer thereof, articles taxable under section 3404 (b) used in the manufacture or production of, or as a component part of, navigation receivers sold to the United States for its exclusive use. Subsection (f) specifies the various effective dates of the amendments made by the foregoing subsections.

SECTION 473. TAX-FREE SALES OF REFRIGERATOR COMPONENTS TO WHOLESALERS FOR RESALE TO MANUFACTURERS

This section, which does not appear in the House bill, amends section 3405 (b) of the code to provide for the tax-free sale of refrigerator components (i. e., cabinets, compressors, condensers, condensing units, evaporators, expansion units, absorbers, and controls) by the manufacturer thereof to a wholesaler or dealer for resale to a manufacturer of complete refrigerators, refrigerating or cooling apparatus, or quick-freeze units (hereinafter referred to as "refrigerating equipment"), if such components are in due course so resold. The present law permits the tax-free sale of refrigerator components by the manufacturer thereof to a wholesaler or dealer for resale to a manufacturer of taxable refrigerating equipment. However, such tax-free sales of components to wholesalers for resale to manufacturers of refrigerating equipment may not be made, under present law, if the refrigerating equipment in which the components are used is nontaxable. On the other hand, refrigerator components may be sold tax-free by the manufacturer thereof direct to a manufacturer of refrigerating equipment whether or not such refrigerating equipment is taxable.

Under the amendment proposed by your committee, sales of refrigerator components may be made tax-free to wholesalers and dealers for resale to manufacturers of refrigerating equipment whether or not such refrigerating equipment is taxable.

With respect to tax-free sales of refrigerator components to a wholesaler or dealer under the amendment, the present administrative regulations relating to the tax-free sale of articles for further manufacture of taxable articles will be applicable. Under these administrative regulations, in the case of a sale of refrigerator components by a manufacturer thereof to a wholesaler or dealer for resale to a manufacturer of refrigerating equipment, the tax liability of the manufacturer of the refrigerator components will be suspended for a period of 2 months pending submission by the wholesaler or dealer to the manufacturer of satisfactory evidence that the components purchased by him tax-free were, in fact, resold to a manufacturer of refrigerating equipment. If the required evidence is not received within the 2-month period, the temporary suspension of liability will cease and the manufacturer of the components sold tax-free will become liable for the tax on such components. If the required evidence is furnished to the manufacturer of the components after the 2-month period has elapsed, a credit or refund is to be allowed with respect to any tax previously paid by the manufacturer on those components originally sold tax-free, but upon which tax was paid at a later date by reason of the termination of the temporary suspension of tax liability.

SECTION 474. SPORTING GOODS

This section corresponds to section 483 of the House bill. As it passed the House section 483 amended section 3406 (a) (1) of the Internal Revenue Code to exclude from the tax on sporting goods the following named items:

Basketballs
Boxing gloves and other boxing equipment
Cricket balls and bats
Fencing equipment
Footballs and other football equipment
Gymnasium equipment and apparatus
Hockey equipment
Indoor baseballs and other indoor-baseball equipment
Lacrosse equipment
Mass balls
Pushballs
Skates
Snow toboggans and sleds
Soccer balls
Softballs and other softball equipment
Track hurdles
Vaulting equipment
Volleyballs and other volleyball equipment
Water-polo equipment
Wrestling head-harness

On the items not so excluded, the tax was raised from 10 percent to 15 percent under the House bill.

Your committee has revised the taxable list of sporting goods to exclude from tax baseballs, baseball bats, baseball body protectors and shin guards, baseball gloves and mitts, and baseball masks. However, your committee has reinstated as taxable sporting goods the following items which were excluded from tax under the House bill: Cricket balls and bats, lacrosse equipment, skates, and snow toboggans and sleds. Moreover, your committee has provided that the tax on fishing equipment shall remain at the present rate of 10 percent.

SECTION 475. ELECTRIC, GAS, AND OIL APPLIANCES

This section is similar to section 484 of the House bill. As passed by the House, section 484 amends section 3406 (a) (3) of the code (relating to manufacturers' excise tax on electric, gas, and oil appliances) (1) to include in the list of articles subject to the tax at the rate of 10 percent electric sheets and spreads, and the following appliances of the household type: Electric belt-driven fans; electric or gas clothes driers; electric door chimes; electric dehumidifiers; electric dishwashers; electric floor polishers and waxers; electric food choppers and grinders; electric hedge trimmers; electric ice-cream freezers; electric mangles; electric motion- or still-picture projectors; electric pants pressers; electric shavers; and power lawn mowers; and (2) to remove electric heating pads from the application of such tax. Your committee has retained these amendments, except for the inclusion of electric shavers in the list of taxable articles, and has added thereto the following household applicances: Electric exhaust blowers; electric vacuum cleaners; electric washing machines; and electric garbage-disposal units. In addition, your committee has deleted from the taxable list electric direct motor-driven fans of the industrial type and electric air heaters of the blower type, whether or not designed for household use.

Subsection (b) of this section (which did not appear in the House bill) amends section 3441 (b) of the code (relating to sale price of a taxable article) to make the provisions of such section applicable to a situation where a taxable article is sold at retail under an arrangement whereby the manufacturer negotiates the sale on behalf of the retailer. In such a case the tax shall be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner. This amendment to section 3441 (b) is to be applicable only in those cases where it is established that the manufacturer has a bona fide plan or method of actually performing substantially all sales negotiations with the consumer, through the efforts of a selling staff trained and directed by the manufacturer.

SECTION 476. PHOTOGRAPHIC APPARATUS

This section corresponds to section 485 of the House bill. As passed by the House, section 485 amends section 3406 (a) (4) of the code to exclude from the application of the tax certain photographic apparatus and film generally used by commercial enterprises and to subject the remaining items to a uniform tax rate of 20 percent. Provision is also made in the House bill for a floor-stocks refund or credit with respect to photographic bulbs held for sale on the effective date of the elimination of the tax on such bulbs.

In lieu of the provisions of the House bill, your committee has amended section 3406 (a) (4) so that a uniform tax rate of 15 percent will apply to all photographic items subject to tax at the present time. Moreover, your committee has added to this section of the code a provision whereby the amount of tax on a sale of unexposed 35-millimeter color positive print motion-picture film shall be computed, in lieu of, on the price for which so sold, on the price for which an equivalent quantity of unexposed 35-millimeter black-and-white positive print motion-picture film is sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary.

SECTION 477. TAX ON PENCILS, FOUNTAIN AND BALL-POINT PENS, AND MECHANICAL LIGHTERS FOR CIGARETTES, CIGARS, AND PIPES

This section corresponds to section 486 of the House bill, which amends chapter 29 of the code (relating to manufacturers' excise and import taxes) by adding a new section which provides under subsection (a) thereof for the imposition of a tax of 20 percent on the sale by the manufacturer, producer, or importer of mechanical pencils, fountain pens, and ball-point pens. Subsection (b) of section 486 of the House bill provides for an exemption from the manufacturers' excise tax under this new section if any of the foregoing articles are subject to the 20-percent retailers' excise tax on jewelry under section 2400 of the code.

Your committee has retained this amendment, but has provided for a tax rate of 10 percent instead of 20 percent under the House bill, and has included in the tax base mechanical lighters for cigarettes, cigars, and pipes. These latter articles, under section 431 of the House bill, were included in the list of articles subject to the 20 percent retailers' excise tax under section 2400 of the code (relating to jewelry, etc.).

In order to prevent the pyramiding of taxes, your committee has provided that where a pen, pencil, or lighter is sold and a tax of 10 percent is paid under this section and such pen, pencil, or lighter is thereafter decorated, plated, or ornamented so as to be subject to the 20-percent jewelry tax when sold at retail, the retailer shall, in the computation of his tax liability, be entitled to a credit or refund in an amount equal to the tax paid under this section.

SECTION 478. REPEAL OF TAX ON ELECTRICAL ENERGY

This section is substantially the same as section 487 of the House bill. Subsection (a) repeals section 3411 of the code (relating to the tax on electrical energy for domestic or commercial consumption) and certain related sections in the nature of cross-references, namely, sections 3441 (d) and 3447 (c).

Subsection (b) provides in paragraph (1) that except as provided in paragraph (2), such repeal shall apply to electrical energy sold on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act, and in paragraph (2) that in the case of a sale of electrical energy which is billed to the customer for a period beginning before such effective date and ending on or after such effective date, the provisions of subsection (a) shall apply only to that portion of the amount billed for the electrical energy sold during the entire period which the number of days in such period beginning with the effective date bears to the total number of days in such entire period. This section shall not apply to electrical energy sold before such effective date for which a bill was rendered prior thereto.

SECTION 479. TAX ON GASOLINE

Subsection (a) of this section amends section 3412 (a) of the code to increase the tax on gasoline from 1½ cents to 2 cents a gallon. Subsection (b) adds a new subsection (f) to section 3412 of the code to impose a floor-stocks tax on gasoline subject to tax under such section which, on the effective date of the increase in tax, is held or intended for sale, at the rate of one-half cent per gallon. It is provided that such floor-stocks tax shall not apply to gasoline in retail stocks held at the place where intended to be sold at retail or to gasoline held for sale by a producer or importer of gasoline. These provisions correspond to section 488 of the House bill.

Your committee, however, has amended the provisions of the House bill to provide under subsection (a) that the increase in rate of tax to 2 cents shall be applicable only until January 1, 1954, at which time the rate of tax with respect to gasoline will revert to 1½ cents per gallon, the present rate of tax. In addition, your committee has, in subsection (b), added a new subsection (g) to section 3412 of the code. This added subsection provides for a credit or refund (without interest) to the producer or importer in an amount equal to so much of the difference between the tax paid on such gasoline and the amount of tax made applicable to such gasoline on and after January 1, 1954, as has been paid by such producer or importer to the person holding such gasoline for sale as reimbursement for the tax reduction on such gasoline. However, no credit or refund shall be allowable with respect to gasoline in retail stocks held at the place where intended to be sold at retail nor with respect to gasoline held for sale by a producer or importer of gasoline. To be entitled to a credit or refund, the producer or importer must file claim with the Secretary prior to April 1, 1954, and establish that he has in his possession satisfactory evidence of the inventories with respect to which he has made reimbursement to persons holding such gasoline on January 1, 1954. He must also establish to the satisfaction of the Secretary that with respect to the quantity of gasoline for which credit or refund is claimed that on and after January 1, 1954, such quantity of gasoline was sold to the ultimate consumer thereof at a price which reflected the amount of the tax reduction. This latter provision is incorporated into subsection (g) of section 3412 in order to prevent any person selling the gasoline for which refund is claimed from being unjustly enriched by having received reimbursement from the producer and also receiving from consumers a price for such gasoline which represented the tax at the rate of 2 cents a gallon.

SECTION 480. EFFECTIVE DATE OF PART VII

This section provides that, except as otherwise provided in part VII, the amendments made by such part shall take effect on the first day of the first month which begins more than 10 days after the date of enactment of this act.

PART VIII. MISCELLANEOUS EXCISE TAX AMENDMENTS

SECTION 481. REDUCTION OF TAX ON TELEGRAPH DISPATCHES

This section corresponds to section 491 of the House bill. As it passed the House, section 491 (a) reduced the tax imposed by section

3465 (a) (1) (B) of the code on domestic telegraph, cable, or radio dispatches or messages from 25 percent to 20 percent.

Your committee's amendment further reduces the tax on domestic telegraph, cable, or radio dispatches or messages to 15 percent.

Subsection (b) fixes the time when the amendment made by subsection (a) shall take effect in relation to the "rate-reduction date", which is defined in subsection (d) as the first day of the first month which begins more than 10 days after the date of enactment of this act. Pursuant to subsection (b) the amendment applies with respect to amounts paid on or after the rate-reduction date for services rendered on or after such date. Subsection (c) provides that the amendment does not apply with respect to amounts paid pursuant to bills rendered prior to the rate-reduction date. The amendment applies with respect to amounts paid pursuant to bills rendered on or after the rate-reduction date for services for which no previous bill was rendered, except with respect to such services as were rendered more than 2 months before such date. Services rendered more than 2 months before such date are governed by the provisions of sections 1650 and 3465 of the code in effect at the time such services were rendered.

SECTION 482. EXEMPTION OF CERTAIN OVERSEAS TELEPHONE CALLS FROM THE TAX ON TELEPHONE FACILITIES

This section, which does not appear in the House bill, amends section 3466 of the code, relating to exemptions from the tax imposed upon telegraph, telephone, radio messages, and so forth. Subsection (a) provides for the redesignation of subsection (c) of section 3466 as subsection "(d)" and for the insertion of a new subsection "(c)" after subsection (b). The new subsection provides that no tax shall be imposed under section 3465 (a) (1) (A) upon any payment received for any telephone or radio telephone message which originates within a combat zone as defined in section 22 (b) (13) from a member of the Armed Forces of the United States performing services in such combat zone as determined under such section. To obtain the exemption, the person making payment for the telephone or radio telephone message will be required to furnish a certificate to the person receiving such payment containing such facts relating to the telephone or radio telephone message as the Secretary may by regulations prescribe.

Subsection (b) provides that the amendment may by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of enactment of this act for telephone or radio telephone messages made on or after such date.

SECTION 483. EXEMPTION OF FISHING TRIPS FROM TAX ON TRANSPORTATION

This section is the same as section 492 of the House bill. Subsection (a) of this section amends section 3469 (b) of the Internal Revenue Code to add to the exemption from the tax on the transportation of persons thereby granted, an additional exemption covering amounts paid for transportation by boat for the purpose of fishing from such boat.

Subsection (b) provides that the amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this act for transportation on or after such first day.

SECTION 484. TAX ON TRANSPORTATION OF PERSONS

This section, which does not appear in the House bill, amends section 3469 (a) of the code (relating to tax on transportation of persons). Subsection (a) provides that in the case of transportation by water on a vessel which makes one or more intermediate stops at ports within the United States, Canada, or Mexico on a voyage between the United States and a port outside the northern portion of the Western Hemisphere, the payment for the transportation between the intermediate stop and the port in the United States, where the transportation begins or ends, will not be subject to the transportation tax, if the vessel in stopping at any such intermediate port is not authorized both to discharge and to take on passengers. It is also provided that a port or station within Newfoundland shall not be considered as a port or station within Canada in applying the foregoing test.

Example I.—A purchases a steamship ticket in New York City for transportation from New York City to Southampton, England. The vessel on which A sails makes an intermediate stop during the course of such voyage at Boston, Mass., to take on passengers. The vessel is not, however, authorized to discharge passengers at such port. No tax applies to the portion of the transportation between New York City and Boston, since A's voyage involved transportation between a port within the United States and a port outside the northern portion of the Western Hemisphere and the vessel on which A traveled was not authorized both to discharge and to take on passengers at the intermediate port at which it stopped.

Example II.—B purchases a steamship ticket in San Francisco for a voyage from San Francisco to Manila. The vessel on which he travels makes a stop at Honolulu, T. H., to discharge passengers. The vessel is not, however, authorized to take on passengers in Honolulu. No tax shall apply to that portion of the transportation between San Francisco and Honolulu, since B's voyage involved travel from a port within the United States to a port outside the northern portion of the Western Hemisphere and the vessel on which he traveled was not authorized to both discharge and to take on passengers at Honolulu, the intermediate point at which it stopped.

The purchase of a round-trip ticket in either of the above examples would not change the result since (although the transportation covered by the ticket may begin and end within the United States) the return trip constitutes a separate voyage.

Subsection (b) provides that the amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this act for transportation on or after such first day.

SECTION 485. TRANSPORTATION OF MATERIAL EXCAVATED IN THE COURSE OF CONSTRUCTION WORK

This section, which does not appear in the House bill, amends section 3475 of the code (relating to tax on transportation of property).

Subsection (a) provides that the tax imposed on the transportation of property shall not apply to the transportation of earth, rock, or other material excavated within the boundaries of, and in the course of, a construction project and transported to any place within, or adjacent to, the boundaries of such project.

To come within the exemption two tests must be met: (1) The property must be earth, rock, or other material excavated within the boundaries of, and in the course of, a construction project, and (2) the transportation of the excavated material must be within the boundaries of the construction project or to a place adjacent thereto.

In determining the area of a construction project, due regard will be given the type of construction operation which is involved and the area which is required to perform and carry out the necessary work. For example, in the case of a road-building operation, the boundaries of the project would embrace the area covered by the length and width of the roadway, plus any adjoining right-of-way. In the case of the construction of an airport, the boundaries would include the outermost limits of the airport.

The amendment made by this section shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this act for transportation on or after such first day.

SECTION 486. ARTICLES FROM FOREIGN-TRADE ZONES

This section is the same as section 494 of the House bill. The section will prevent the receipt in customs territory of the United States of the articles specified in code sections 2000 (c) (2) (cigarettes), 2800 (a) (distilled spirits), 3030 (a) (wines), and 3150 (a) (fermented malt liquors) which were in foreign-trade zones when the increase in the tax on such articles became effective by this act, until there is collected the full amount of all taxes which would have been imposed upon such articles if they had been subjected to tax in customs territory of the United States on such effective date.

Subsection (a) provides that with respect to such articles on which the internal-revenue taxes have been determined, pursuant to section 3 of the act of June 18, 1934, as amended by the act of June 17, 1950 (19 U. S. C. 81c), prior to the effective date of the rates of tax imposed on such articles by the bill, which on or after such date are brought from foreign-trade zones into customs territory of the United States, there shall be levied, assessed, collected, and paid on such articles, in addition to the tax so determined, an additional tax at rates equal to the increases in rates of tax made applicable to such articles by this act.

Under the first proviso of section 3 of the act of June 18, 1934, as amended, the collector of customs now has authority, upon request, to take under supervision any lot or part of a lot of foreign merchandise in a foreign-trade zone and cause it to be appraised and taxes determined and duties liquidated thereon. It may thereafter be sent into customs territory upon the payment of such liquidated duties and determined taxes. Inasmuch as such proviso authorizes a finding of taxes and duties only once and a finding once made would thereafter govern the dutiable and taxable status of the foreign merchandise whenever it was sent into customs territory, it is necessary to provide affirmatively for the levy, assessment, collection, and payment (in addition to the tax determined prior to the effective date of the rate of tax imposed on the named articles) of the additional tax at rates equal to the increases in rates of tax made applicable to such articles by section 486 (a) of the bill.

It is further provided that with respect to such imported articles, the tax imposed by section 486 (a) shall be collected, paid, and accounted for at the same time and in the same manner as the tax on such articles is collected, paid, and accounted for when brought from the foreign-trade zone into the customs territory.

Under the second proviso of section 3 of the act of June 18, 1934, as amended, certain articles may be taken into a foreign-trade zone from customs territory and may thereafter be brought back to customs territory free of duty and tax. With respect to cigarettes, distilled spirits, wines, and fermented liquors which were taken into such zone pursuant to such second proviso prior to the effective date of the rates of tax imposed on such articles by this bill, subsection (b) of section 486 provides that when, after such effective date, they are returned (without loss of identity) from such foreign-trade zones to customs territory, there shall be levied, assessed, collected, and paid on such articles an additional tax at rates equal to the increases made by the bill in rates of tax applicable to such articles and that the additional tax so imposed shall be collected, paid, and accounted for at the same time and in the same manner as if such articles had been taken into the foreign-trade zone free of tax.

SECTION 487. REFUNDS ON ARTICLES FROM FOREIGN-TRADE ZONES

This section makes provision for refunds with respect to certain cigarettes and alcoholic liquors brought from foreign-trade zones into customs territory of the United States on and after January 1, 1954.

Section 487 (a) covers cigarettes and alcoholic liquors, including distilled spirits, imported perfumes containing distilled spirits, wines, including liqueurs and cordials, and fermented malt liquors. It provides for refund or credit (without interest) of the excess of the tax determined pursuant to section 3 of the act of June 18, 1934, as amended (19 U. S. C. 81c), prior to January 1, 1954, and paid on and after such date upon bringing the article from the foreign-trade zone into customs territory, over the tax that would have been payable in the absence of the increased rates provided by this bill. To be entitled to refund or credit claim must be filed within 30 days after payment of the tax.

Section 487 (b) covers the same articles named in section 487 (a) on which the internal revenue tax (including floor stocks tax) has been paid at the applicable rate and which are taken into a foreign-trade zone from customs territory of the United States and placed under supervision of the collector of customs pursuant to the second proviso of section 3 of the act of June 18, 1934, as amended (19 U. S. C. 81c), prior to January 1, 1954, and which on and after such date are (without loss of identity) returned to customs territory of the United States. This section provides for a refund or credit (without interest) equal to the difference between the tax so paid and the amount applicable to such articles on and after January 1, 1954. To be entitled to refund or credit claim must be filed within 30 days after the return of such article to customs territory.

TITLE V—EXCESS PROFITS TAX

SECTION 501. MAXIMUM TAX FOR NEW CORPORATIONS

This section, for which there is no corresponding provision in the bill as it passed the House, amends section 430 of the code (relating to imposition of excess profits tax) to provide for an alternative maximum rate of excess profits tax, with respect to the first $400,000 of excess profits net income of a new corporation, for the taxable year in which it commences business and the four succeeding taxable years. This alternative rate, which will generally be lower than the maximum rate applicable to corporations generally, is provided in a new subsection (e) (1) of section 430. Under this new subsection, the excess profits tax of a new corporation during its first five taxable years commencing with its commencement of business will not exceed the sum of the following:

(1) A specified percentage of its first $400,000 of excess profits net income for the taxable year (5 percent for the taxable year in which it commenced business and for the first succeeding taxable year, 8 percent for the second succeeding taxable year, 11 percent for the third succeeding taxable year, and 14 percent for the fourth succeeding taxable year; and

(2) A specified percentage of excess profits net income in excess of $400,000 for the taxable year (15 percent of such excess if the taxable year ends before April 1, 1951, 16½ percent of such excess if the taxable year is the calendar year 1951, and 17 percent of such excess if the taxable year is a year (other than the calendar year 1951) which ends after March 31, 1951).

The amount computed under this formula will be the maximum excess profits tax of such corporation if less than the amount computed under section 430 (a) (2) of the code.

Subparagraph (B) of paragraph (2) provides rules for determining when a taxpayer shall be considered, for the purpose of subsection (e), to have commenced business and to have had taxable years during the period from such date. It is contemplated that the Secretary will, by regulations, provide for the determination of such constructive taxable years by reference to the annual accounting period first established by the taxpayer. The following corporations are taken into account for the purpose of determining a constructive date of commencement of business and constructive taxable years from such date:

(i) Any corporation which is a party with the taxpayer to a transaction described in section 445 (g) (whether or not such transaction is described in section 461 (a)), determined as if the date "December 1, 1950" in section 445 (g) read "January 1, 1946."

(ii) Any corporation (in a business substantially similar to that of the taxpayer) if a group of not more than four persons who control the taxpayer at any time during the taxable year also control such corporation at any time during the taxable year or controlled such corporation at any time during the period beginning 12 months preceding the acquisition by such group of control of the taxpayer. The term "control" for the purpose of this provision is defined as the ownership of either more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock.

(iii) Any corporation which is a selling corporation in a part IV transaction in which the taxpayer is a purchasing corporation. Part IV is added to the excess profits tax law by section 520 of this bill.

(iv) Any corporation which, under regulations prescribed by the Secretary, is determined by one or more applications of clauses (i), (ii), and (iii) to stand indirectly in the same relation to the taxpayer as though such corporation were described in any such clause.

Paragraph (3) of subsection (e) provides, in effect, that the benefits of the special limitation provisions under section 430 (e) (1) shall be denied to any taxpayer which derives more than 50 percent of its income for the taxable year from contracts or subcontracts to which title I of the Renegotiation Act of 1951 or to which any prior renegotiation act is applicable. However, determination of whether a corporation meets this 50-percent requirement will be made without regard to whether the receipts and accruals from any such contract or subcontract are subject to renegotiation under the Renegotiation Act of 1951, which exempts from renegotiation receipts and accruals of less than $250,000 in any taxable year. Thus, a corporation which has income for the taxable year of $200,000, of which $150,000 is derived from a war contract to which the Renegotiation Act of 1951 applies, would not be eligible for the benefits of the proposed alternate maximum tax, inasmuch as 75 percent of its income was derived from a contract to which the Renegotiation Act of 1951 applies, even though the $150,000 received would not be renegotiated.

SECTION 502. PAYMENTS FROM FOREIGN SOURCES FOR TECHNICAL ASSISTANCE, ETC.

This section, for which there is no corresponding provision in the House bill, amends section 433 of the code to provide for the exclusion from normal tax net income, in the computation of excess profits net income, of income of a domestic corporation which constitutes remuneration for certain services rendered by such domestic corporation to its related foreign corporation. The term "related foreign corporation" is defined as a foreign corporation, at least 10 percent of the outstanding stock of which is owned by the domestic corporation rendering the services. To qualify for exclusion under the subparagraph the income must constitute remuneration for technical assistance, engineering services, scientific assistance, or similar services (including the furnishing of information) rendered to the foreign corporation (while it is a related corporation) related to the production or improvement of products of the same type as those manufactured by the domestic corporation, and it must constitute income derived from sources without the United States.

The amendment provides also for the disallowance, in transforming normal tax net income into excess profits net income, of deductions in connection with or properly allocable to the rendering of services of the specified types.

These adjustments to normal tax net income are required, in computing excess profits net income for excess profits tax taxable years, by new subparagraph (R) of section 433 (a) (1) (added by subsection (a) of this section of the bill) and, in computing excess profits net income for base period years, by new paragraph (16) of section 433 (b) (added by subsection (b) of this section of the bill).

SECTION 503. AVERAGE BASE PERIOD NET INCOME IN THE CASE OF CERTAIN FISCAL YEAR TAXPAYERS

Under existing law, a taxpayer with a fiscal year beginning before January 1, 1950, and ending after March 31, 1950, in computing its average base period net income by the general average method provided by section 435 (d) of the code, must use its excess profits net income for the 48 calendar months beginning January 1, 1946, and ending December 31, 1949.. This section, added to the bill by your committee, allows such a taxpayer to compute its average base period net income under the general average method by reference to the period of 48 consecutive months ending March 31, 1950, instead of by reference to its base period, if such computation produces a lesser excess profits tax for the taxable year. The determination of the base period for such a taxpayer remains unchanged, the amendment being inapplicable for the purpose of any computations other than the determination of the average base period net income under the general average method. This provision is applicable only in the case of a taxpayer whose first excess profits tax taxable year was a taxable year which began before January 1, 1950, or whose first excess profits tax taxable year was preceded by a taxable year beginning before January 1, 1950, and ending after March 31, 1950.

SECTION 504. AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH IN CASE OF NEW CORPORATIONS

This section, for which there is no corresponding provision in the House bill, amends section 435 (e) of the code (relating to the alternative based on growth) to permit a new corporation which commenced business before the end of its base period to qualify for the alternative average base period net income based on growth, providing it can meet the other requirements of such section. For the purpose of determining qualification under section 435 (e) the amount of a new corporation's total assets, total payroll, gross receipts, net sales, excess-profits net income, etc., for any period of time during which such corporation was not in existence, will be taken into account under section 435 (e) at zero. For example, a new corporation would, unless it is a member of an affiliated group for its first excess profits tax taxable year, automatically satisfy the total assets requirement of section 435 (e) (1) (A) (i), since its total assets as of the first day of its base period would be zero. A corresponding amendment has been made in part II (relating to the excess-profits credit based on income in connection with certain exchanges).

SECTION 505. AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH

This section, for which there is no corresponding provision in the House bill, amends section 435 (e) (2) (G) of the code (relating to the growth alternative) to eliminate the word "only" so that a corporation can compute its credit under subparagraph (G) even though it qualifies as a growth corporation under section 435 (e) (1) (A) as well as under section 435 (e) (1) (B).

SECTION 506. ADJUSTMENTS FOR CHANGES IN INADMISSIBLE ASSETS IN CASE OF BANKS

This section, added to the bill by your committee, provides for a limitation in the case of a bank, as defined in section 104 of the code, on the amount of the adjustment to the net capital addition or reduction for the taxable year and to the base-period capital addition which is attributable to inadmissible assets.

Subsection (a) of this section adds a new paragraph (8) to section 435 (g) of the code (relating to net capital addition or reduction). Subparagraph (A) of this new paragraph provides that the amount of the adjustment under section 435 (g) (1) (relating to the computation of the net capital addition) for an increase in inadmissible assets shall not exceed an amount which bears the same ratio to the net capital addition computed without regard to such adjustment as the increase in inadmissible assets for the taxable year, determined under section 435 (g) (5), bears to the increase in total assets for the taxable year. The determination of the amount of the increase in the taxpayer's total assets for the taxable year shall be made in the manner provided in section 435 (g) (5) but shall be made with respect to all assets whether admissible or inadmissible assets as defined in section 440.

The application of this subparagraph will be effective in cases where the increase in total assets exceeds the net capital addition. Thus, if a bank has a net capital addition for the taxable year of $40,000, before any adjustment with respect to its inadmissible assets, an increase in total assets of $200,000, and an increase in inadmissible assets of $50,000, the net capital addition for the taxable year would be $30,000 ($40,000 less an adjustment of $10,000 for the increase in inadmissible assets), instead of being entirely eliminated by reason of the inadmissible asset increase as under present law.

Subparagraph (B) provides a corresponding limitation on the inadmissible asset adjustment where there is a decrease in such assets for the taxable year. In such a case the amount of the adjustment under section 435 (g) (2) (relating to the computation of the net capital reduction) for a decrease in inadmissible assets shall not exceed an amount which bears the same ratio to the net capital reduction, computed without regard to such adjustment for inadmissibles, as the decrease in inadmissible assets for the taxable year determined under section 435 (g) (5), bears to the decrease in total assets for the taxable year. The determination of the amount of the decrease in the taxpayer's total assets for the taxable year shall be made in the same manner as in the case of an increase in total assets, that is, under section 435 (g) (5) and with respect to all assets, whether admissible or inadmissible assets as defined in section 440.

Subsection (b) of this section amends section 438 (relating to new capital credit changes in the case of a taxpayer using the asset method for computing its invested capital) to provide a limitation on the amount of the adjustment for an increase in inadmissible assets which corresponds to that provided in paragraph (8) (A), as added by subsection (a) described above.

Subsection (c) of this section amends section 435 (f) (relating to capital additions in the base period) by expressly providing that the amount of the yearly base-period capital for any taxable year shall not be reduced below zero by the inadmissible asset adjustment. This provision is applicable to any taxpayer (including a bank) and clarifies the existing law.

Subsection (c) also adds a new paragraph (6) to section 435 (f), applicable only in the case of a bank. This new paragraph limits the amount of the reduction in the yearly base-period capital for amounts of inadmissible assets.

Subparagraph (A) of this new paragraph (6) provides that a tentative yearly base-period capital shall be computed under section 435 (f) (1) but without regard to the inadmissible asset adjustment under subparagraph (A) of such section. Subparagraph (B) of this new paragraph (6) provides that such tentative yearly base-period capital shall then be reduced by an amount which bears the same ratio to it as inadmissible assets bear to total assets. The ratio of inadmissible assets to total assets is to be determined under section 440 (b) of the code, using the daily amount of such assets for the first day of the taxable year. The yearly base-period capital is the tentative yearly base-period capital so reduced.

SECTION 507. DECREASE IN INADMISSIBLE ASSETS

Under existing law, a decrease in inadmissible assets during an excess-profits-tax taxable year is not reflected in an upward adjustment in the excess-profits credit for such year. In the case of a taxpayer using the income credit, such a decrease acts instead as an offset to the amount of the net capital reduction for the taxable year. This section, added to the bill by your committee, provides, if certain conditions are met, that a decrease in inadmissible assets, to the extent that it exceeds the net capital reduction for the taxable year, shall be an addition to the excess-profits credit computed under the income method.

This section adds two new paragraphs (9) and (10) to section 435 (g). Paragraph (9) provides that the excess of the amount computed under section 435 (g) (2) (A) or (B) (relating to adjustments to the net capital reduction where there is a decrease in inadmissible assets for the taxable year) over the amount of the net capital reduction for the taxable year (such net capital reduction being computed without regard to decrease in inadmissible assets) shall be considered the net capital addition for the taxable year. Where the computations under section 435 (g) (2) result in no net capital reduction for the taxable year, before adjustment for a decrease in inadmissibles, the amount determined under paragraph (9) shall be an item to be added to the net capital addition for such year computed under section 435 (g) (1).

Paragraph (10) sets forth certain exceptions and limitations applicable to computations under paragraph (9). Subparagraph (A) of paragraph (10) provides a limitation to the adjustment to the decrease in inadmissible assets under section 435 (g) (2) (B) which section is applicable under present law where such decrease is in excess of the net capital reduction computed before any reduction by reason of such decrease and computed without regard to section 435 (g) (4) (C) and (E) (relating respectively to decrease in borrowed capital and to increase in loans to a member of a controlled group). Under the bill, the limitation in such a case is to an amount not greater than 25 percent of the excess of the net capital reduction (unadjusted for inadmissible asset decrease) computed without regard to the 75-percent limitations provided in section 435 (g) (4) (C) and (E), over the net capital reduction computed under such sentence without regard to section 435 (g) (4) (C) and (E). Thus, under this subparagraph, the amount of the adjustment to the decrease in inadmissible assets under section 435 (g) (2) (B) is limited (for purposes of section 435 (g) (9)) to 25 percent of the sum of the amount of the decrease in borrowed capital and the amount of the increase in loans to members of a controlled group.

Subparagraph (B) of paragraph (10) provides an over-all limitation on the amount determined under paragraph (9) (after applying paragraph (10) (A)) in order to insure that where there is a decrease in inadmissible assets that there shall be a corresponding increase in the taxpayer's operating assets before any increase in credit is allowed. Accordingly, subparagraph (B) provides that the amount so determined under paragraph (9) shall not be greater than the excess of the increase in operating assets for the taxable year over the net capital addition (determined without regard to paragraph (9) and determined without regard to the 75-percent limitation provided in paragraphs (3) (C) and (4) (C) and (E) of section 435 (9)).

The increase in operating assets for the taxable year shall be determined in the same manner as the increase in inadmissible assets for such year is determined under section 435 (g) and as though that section referred instead to operating assets. The term "operating assets" means property used in the taxpayer's trade or business within the meaning of section 117 (j) (1), stock in trade or other property of a kind which would properly be includible in the inventory of the taxpayer if owned at the close of the taxable year, and property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. Excluded from such term are inadmissible assets, stock, securities, and intangible property (such as evidence of indebtedness). For the purpose of such exclusion intangible property is not limited to the definition of intangible property in section 441 (i).

Subparagraph (C) of paragraph (10) provides that the adjustment to the net capital addition for a decrease in inadmissible assets provided in paragraph (9) shall not apply in any case in which the Secretary determines that the increase in operating assets is the direct or indirect result of an increase in indebtedness of the taxpayer, other than indebtedness which constitutes borrowed capital as defined in section 439 (b). For example, this limitation may be applied to prevent a taxpayer from obtaining a net capital addition under paragraph (9) where its addition to operating assets is accompanied by increased open account indebtedness to members of a controlled group including the taxpayer.

SECTION 508. ELECTION WITH RESPECT TO CERTAIN INADMISSIBLE ASSETS

Subsection (a) of this section, for which there is no corresponding provision in the House bill, adds a new subsection (c) to section 440 of the code to permit a dealer in Government securities to elect for any taxable year, in accordance with regulations prescribed by the Secretary, to increase its excess-profits net income by an amount equal to the amount by which the interest received or accrued during the taxable year on Government obligations exceeds the sum of (A) the interest paid or accrued during such year which is not allowed as a deduction under section 23 (b) of the code, and (B) the amount of the adjustments required for the taxable year under section 22 (o) of the code (relating to adjustment for certain bond premiums). The amount of the section 22 (o) adjustment shall not be in excess of the amount of interest received or accrued during the taxable year on obligations to which such section is applicable. The Government obligations for which an election is available are obligations described in section 22 (b) (4), the interest on which is wholly exempt from taxation under chapter 1 of the code. The election is available only with respect to obligations which are not capital assets in the hands of the taxpayer.

The effect of making the election provided in this paragraph is to allow such obligations to be treated as admissible assets for the purposes of all computations in determining the excess profits tax liability for the taxable year for which the election is made. Thus, with respect to the taxable year for which an election is made, such obligations shall also not be considered inadmissible assets in determining either original inadmissible assets under section 435 (g) (5) or yearly base period capital under section 435 (f).

For the purpose of determining the excess profits credit based on income for any taxable year for which an election has been made, the excess profits net income computed for base period years under section 433 (b) shall also include the amount by which the interest received or accrued during each such taxable year on Government obligations exceeds the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23 (b) and, if the taxable year ends after June 30, 1950, the amount with respect to such year required as an adjustment under section 22 (o).

SECTION 509. ALTERNATIVE AVERAGE BASE PERIOD NET INCOME

Subsection (a) of this section adds a new subsection (h) to section 442. The taxpayer is entitled to compute an alternative average base period net income under this new subsection if it commenced business on or before the first day of its base period and if the aggregate of the excess profits net income for each of the 12 months for which a substitute excess profits net income is to be computed is less than 35 percent of one-half of the aggregate of the excess profits net income for each of the 24 months remaining after selecting the 12 months to be so adjusted. For the purpose of this eligibility test, deficits in excess profits net income shall be taken in account.

The first step in the computation of the alternative average base period net income is the computation of the excess profits net income (or deficit therein) for the 36 months from which the 12-month period is to be selected. This computation is to be made in the manner provided in section 442 (b) by selecting ordinarily the 36 months which produce the highest aggregate excess profits net income or the lowest aggregate deficit in excess profits net income. The second step is the selection, from the 36 months determined under the first step, of 12 months the elimination of which will result ordinarily in the highest remaining aggregate excess profits net income or the lowest remaining aggregate deficit in excess profits net income. This selection is made by determining either the 12 consecutive months the elimination of which produces the highest remaining aggregate excess profits net income or the lowest remaining aggregate deficit in excess profits net income, or the 12 months which remain after retaining the 24 consecutive months which produce the highest aggregate excess profits net income or lowest aggregate deficit. The third step is the computation, for each month in the 12-month period so selected, of a substitute excess profits net income under section 442 (e), which is in general based on the product of the taxpayer's total assets for the last day in the year in which such month falls and the appropriate industry base period yearly rate of return.

The fourth step is the determination of the aggregate of such substitute excess profits net income for each month in the selected 12-month period. This is based upon the amount computed under the third step, limited, however, to an amount equal to one-half of the aggregate excess profits net income for each month in the 24-month period remaining after the computation required under the second step above. For the purpose of this limitation deficits in excess profits net income for such 24-month period are taken into account. To the amount of such aggregate so determined the aggregate of the excess profits net income for the 24-month period is added, such excess profits net income for this purpose being computed in the manner provided in the second sentence of section 435 (d) (1) which allocates to each month a portion of the excess profits net income for the taxable year in which such month falls and provides that the excess profits net income for any month shall not be less than zero. The final step in the determination of the alternative average base period net income under this subsection is to divide by 3 the amount ascertained under the fourth step.

If the taxpayer is entitled to the benefits of this provision and is also entitled to compute its average base period net income under subsection (c) of section 442 because of abnormalities during its base period, the taxpayer shall compute its average base period net income under whichever of the applicable subsections produces the lower excess profits tax. The same rule applies where the taxpayer is entitled to the benefits of either the new provision or section 442 (d). In order to be entitled to the alternative average base period net income computation under subsection (h), the taxpayer need not demonstrate the presence of abnormalities in its base period.

Your committee has made technical amendments to section 442 in order to conform that section to the addition of this new subsection and has amended section 435 (f) (3) to provide that the base period capital addition of a taxpayer computing an alternative average base period net income under this new subsection (h) shall be computed in the same manner as the base period capital addition in the case of a taxpayer to which section 442 (e) (relating to abnormalities during the base period which affect 12 or fewer months) is applicable.

SECTION 510. DEFINITION OF TOTAL ASSETS FOR PURPOSES OF SECTIONS 442-446

Section 510, for which there is no corresponding provision in the House bill, amends section 442 (f) of the code (relating to the definition of total assets) to require that in determining total assets a reduction shall be made equal to the amount of any indebtedness (other than borrowed capital as defined in sec. 439 (b) (1)) to a member of a controlled group, as defined in section 435 (g) (6), which includes the taxpayer. Section 442 (f) of the code now provides that total assets for any day shall be determined as of the end of such day and shall be an amount equal to the sum of the cash and the property (other than cash, inadmissible assets, and loans to members of a controlled group as defined in sec. 435 (f)) held by the taxpayer in good faith for the purposes of the business. Thus, at present, section 442 (f) includes borrowed funds in determining total assets, even though such indebtedness may be to a member of a controlled group which includes the taxpayer and such loans may be of a type that are not taken into account, as loans to members of a controlled group in determining the capital position or capital changes of the lender for the purposes of the excess-profits tax. The amendment in effect provides that open account indebtedness, and other indebtedness not meeting the definition of borrowed capital, shall reduce total assets if such indebtedness is owed to a member of the same controlled group.

This section is effective with respect to taxable years ending after the date of enactment of this bill.

SECTION 511. AVERAGE BASE PERIOD NET INCOME—CHANGE IN PRODUCTS OR SERVICES

Section 511, for which there is no corresponding provision in the House bill, amends section 443 (f) of the code (relating to changes in products or services) to provide that if after the end of the base period of the taxpayer there was a substantial change in the products furnished by such taxpayer, such change shall be considered to have occurred on the last day of the base period if the taxpayer prior to July 1, 1950, was constructing the facilities used to manufacture such new product and if such construction and the production of such new product are in furtherance of a course of action to which it (or a corporation with which it has the privilege of filing a consolidated return under sec. 141) was committed before the end of its base period by a contract which granted to it a license, franchise, or similar right to produce such new product. At present, section 443 (a) (1) requires that the change in products occur during the last 36 months of the base period. The amendment in effect modifies this requirement of section 443 (a) (1). However, the other requirements of section 443 (a) (1) and the tests of section 443 (a) (2) and (3) must still be satisfied before a taxpayer, which is considered to have made a change of product by reason of the amendment of section 443 (f) made by this section of the bill, may qualify to compute its average base period net income under section 443.

SECTION 512. AVERAGE BASE PERIOD NET INCOME—NEW CORPORATION

Section 512 for which there is no corresponding provision in the House bill, amends section 445 (c) of the code (relating to total assets for the first 3 years of new corporations). At present, a new corporation computing its average base period net income under section 445 for the purpose of determining the tax for any of its first three taxable years which is an excess profits tax taxable year, is entitled to apply its industry rate of return only to the sum of its total assets (as defined in sec. 442 (f)) for the last day of its taxable year immediately preceding its first taxable year ending after June 30, 1950, such total assets first being increased by the net capital addition determined under section 435 (g) for the excess profits tax taxable year, or decreased by the net capital reduction for such taxable year. Although under such formula additions to equity capital are fully reflected, only 75 percent of the increase or decrease in borrowed capital is taken into account in determining total assets. The amendment includes the full amount of borrowed capital in the amount to which the industry rate of return is applied.

SECTION 513. EXCESS PROFITS CREDIT—REGULATED PUBLIC UTILITIES

Section 513, for which there is no corresponding provision in the House bill, amends section 448 (c) (3) of the code (relating to alternative excess profits credit for regulated public utilities) to include therein a corporation engaged as a common carrier in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipeline if such corporation is subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State. At present, oil pipelines are not included in section 448 (c) (3), unless they are subject to the jurisdiction of the Interstate Commerce Commission. Section 448 (d) defines a "regulated public utility" for the purposes of the alternative excess profits credit as a corporation described in section 448 (c) which derives a certain percentage of its gross income from sources described in section 448 (c). The amendment thus allows intrastate as well as interstate oil pipelines to qualify as regulated public utilities if they meet the requirements of the section.

SECTION 514. CONSOLIDATED RETURNS OF REGULATED PUBLIC UTILITIES

Section 514, for which there is no corresponding provision in the House bill, amends section 448 (e) of the code (relating to consolidated returns of regulated public utilities) to provide that for the purposes of filing a consolidated return with its railroad lessee corporation, a railroad lessor corporation described in section 434 (d) of the code shall be considered a corporation described in section 448 (c) (3). In effect, this amendment permits a railroad corporation which has leased substantially all of its railroad properties to another railroad corporation to file a consolidated return, using the alternative credit provided by section 448, with its affiliated lessee railroad corporation, if both such corporations otherwise qualify to use section 448.

SECTION 515. NONTAXABLE INCOME FROM CERTAIN MINING PROPERTIES

This section, for which there is no corresponding provision in the House bill, allows to producers of potash, sulfur, and metallurgical grade and chemical grade limestone the alternative method for computing nontaxable income from exempt excess output provided in section 453 (b) (2) of the code where the properties were in operation during the normal period. Where these mineral properties were not in operation during the normal period, the net income from such properties is accorded the benefits of section 453 (b) (4) now available in the case of metal and coal mines, timber blocks, and natural-gas properties.

Your committee has also made technical amendments to these sections and to section 453 (a) (13) in order that they may conform to the amendment made by this section of the bill.

SECTION 516. TRANSITION FROM WAR PRODUCTION AND INCREASE IN PEACETIME CAPACITY

Section 516, for which there is no corresponding provision in the House bill, adds subsection (a) of a new section 459 to part I of subchapter D of chapter 1 of the code. Subsection (a) of section 516 provides for the computation of an average base period net income based upon the excess profits net income for the last 6 months of 1948 and a percentage of the first 6 months of 1950 as provided in section 435 (e) (2) (G). It is provided that the credit shall be applicable to any taxpayer which has commenced business before January 1, 1940, and since such date has been primarily engaged in manufacturing.

A taxpayer may qualify for the computation under this subsection only if it meets the requirements of paragraphs (1) to (4) of the subsection. Paragraph (1) provides that the adjusted basis of its total facilities (as defined in sec. 440 (d)) on the first day of its base period when added to the total facilities for such day of corporations with which it was affiliated must not exceed $10,000,000. Paragraph (2) provides that the unadjusted basis for determining gain of the taxpayer's total facilities on the last day of its base period must be at least 250 percent of the unadjusted basis for determining gain of its total facilities on the first day of its base period. Paragraph (3) provides that during the period 1942 through 1945, 70 percent of the taxpayer's gross income must have been from contracts with the United States either as a prime contractor or as a subcontractor. It is further provided that in all taxable years ending after 1945 and before 1950 less than 20 percent of its income must be from such sources and that less than 20 percent of the income must be from such sources for all taxable years ending after December 31, 1949, and beginning before July 1, 1950.

Paragraph (4) provides that the monthly average of the excess profits net income of the taxpayer for all taxable years ending with or within the last 24 months of its base period (that is, the aggregate of the excess profits net income for each month in such taxable years divided by the number of such months) and for the last taxable year ending before its base period (similarly determined) shall each be at least 300 percent of the monthly average excess profits net income for all taxable years ending with or within the first 24 months of its base period (that is, the aggregate of the excess profits net income for each month in such taxable years divided by the number of such months).

Subsection (b) of section 516 provides for amendments to section 435 (c) to include this and other subsections of section 459 among the various methods of computing average base-period net income which are available to the taxpayer if they result in a lesser excess-profits tax. One additional effect of this amendment is to make clear that no base-period capital addition is allowable if the average base-period net income determined under this subsection is used.

SECTION 517. BASE PERIOD CATASTROPHE

This section, for which there is no corresponding provision in the House bill, adds a new section 459 (b) to the code to grant to a taxpayer which has suffered a catastrophe during the last 36 months of its base period the alternative, in computing its average base period net income under the general average method, of substituting for the excess-profits net income for each month of the taxable year in which the catastrophe occurred the average of the excess-profits net income for each month in the base period preceding the taxable year in which the catastrophe occurred. The benefits of this subsection are available to a taxpayer which was engaged throughout its base period primarily in manufacturing if it meets the eligibility tests described in paragraphs (1) to (3), inclusive.

Paragraph (1) requires that the taxpayer must have suffered during the last 36 months of its base period a catastrophe by fire, storm, explosion, or other casualty, destroying or rendering inoperative a production facility constituting a complete plant or plants having in the hands of the taxpayer immediately prior to the catastrophe an adjusted basis for determining gain equal to 15 percent or more of the adjusted basis for determining gain of all the taxpayer's production facilities at such time. The term "production facility" means a factory (including equipment and machinery which are part of the factory) and similar manufacturing plants.

Paragraph (2) requires that the taxpayer's normal production or operation be substantially interrupted for a period of more than 12 consecutive months as a result of such catastrophe.

Paragraph (3) requires that the taxpayer must have replaced the destroyed or inoperative production facility prior to the end of its base period with a production facility which at the end of its base period had in its hands an adjusted basis for determining gain in an amount not less than such adjusted basis, immdiately prior to the catastrophe, of the destroyed or inoperative production facility.

For the purpose of section 435 (a) (1) (B), the average base period net income determined under this subsection is considered an average base period net income determined under section 435 (d). Accordingly, the computation of the average base period net income under this subsection does not reduce the amount of the base period capital addition to which the taxpayer would otherwise be entitled.

SECTION 518. CONSOLIDATION OF NEWSPAPERS

This section, added to the bill by your committee, adds a new section 459 (c) to the code, applicable in the case of a taxpayer engaged primarily in the newspaper-publishing business which, after the first half of its base period and before July 1, 1950, consolidated its mechanical, circulation, advertising, and accounting operations with such operations of another newspaper-publishing corporation in the same area. In the case of a taxpayer entitled to the benefits of this subsection, its average base period net income shall be the amount computed under section 435 (e) (2) (relating to the computation of the average base period net income based on growth), but computed without regard to subparagraph (G) of such section. In order to be eligible for the benefits of this subsection the taxpayer must qualify under the conditions set forth below.

Paragraph (2) of the new subsection requires that the taxpayer establish to the satisfaction of the Secretary that, during the period beginning with the consolidation and ending with the close of the first taxable year beginning after the consolidation, there were substantial reductions in the amount of expenses which would otherwise have been paid or incurred in conducting the operations described under paragraph (1), and that such reductions were attributable to the consolidation.

Paragraph (3) of the new subsection requires that for the first taxable year beginning after such consolidation the total deductions of the taxpayer under section 23 of the code, computed without regard to section 23 (s) (relating to the net operating loss deduction) and without regard to section 23 (bb) (relating to circulation expenditures), must not be in excess of 80 percent of the average of such deduction for the two taxable years of the taxpayer next preceding the taxable year in which such consolidation began.

Paragraph (4) of the new subsection requires that the excess profits net income of the taxpayer, computed as provided in section 433 (b) (relating to the excess profits net income for taxable years in the base period), for the first taxable year of the taxpayer beginning after such consolidation must be 125 percent or more of the amount determined under section 435 (d) (4) (relating to average base period net income determined under the general average method). For the purpose of the test set forth in this paragraph, the excess profits net income shall be computed in the manner provided in section 433 (b) whether or not the first taxable year of the taxpayer beginning after the consolidation is an excess profits tax taxable year.

The benefits of this subsection shall not be available to any taxable year of the taxpayer unless the consolidation was continued throughout such taxable year.

SECTION 519. TELEVISION BROADCASTING COMPANIES

Section 519 of the bill, for which there is no corresponding provision in the House bill, adds subsection (d) to section 459 of the code, section 459 (a), (b), and (c) being added to the code by sections 516 to 518 of the bill. Subsection (d) of section 459 provides for the computation of an average base period net income in the case of corporations engaged in the television broadcasting business, including both station and network operations. Subsection (d) (1) provides that the average base period net income determined under this subsection shall be available only to corporations which were engaged in the business of television broadcasting prior to January 1, 1951, and have remained in such business continuously throughout the period ending with the close of the taxable year for which the tax is being computed.

Subsection (d) (1) (A) provides for the computation of an average base period net income in the case of a corporation which is engaged only in the business of television broadcasting, and in no other business, at the end of its base period. In the case of such a corporation, the average base period net income is determined by multiplying its total assets (as defined in sec. 442 (f)) on the last day of its base period by the base period rate of return for the industry classification which includes radio broadcasting.

Subsection (d) (1) (B) provides for the computation of an average base period net income in the case of a corporation which is engaged only in the business of television and radio broadcasting, and in no other business, at the end of its base period. Two alternative methods of computation are provided. One is the same as that provided in paragraph (1) (A) and the other is computed by multiplying its total assets (as defined in sec. 442 (f)) on the last day of its base period by its individual rate of return. The computation of the individual rate of return is described in paragraph (2) of subsection (d).

Subsection (d) (1) (C) provides for the computation of an average base period net income in the case of a corporation which at the end of its base period was engaged in the television broadcasting business and in another business or businesses other than radio broadcasting. For example, section 459 (c) (1) (C) may be applicable to a corporation engaged at the end of its base period in the television broadcasting business, the radio broadcasting business, and another business, and to a corporation engaged at the end of its base period in the television business and in a business other than the radio broadcasting business. The average base period net income in the case of such a corporation shall be determined under this subsection by first computing an average base period net income under the general average method (sec. 435 (d)) for the business other than radio or television, such computation being made without regard to income, deductions, losses, or other items from the radio and television broadcasting business. To this is added an amount computed by applying to the total assets, on the last day of its base period used in the radio broadcasting business (if the taxpayer was engaged in such business) and in the television broadcasting business, either the industry rate of return for radio broadcasting or the individual rate of return as determined under subsection (d) (2).

Subsection (d) (1) (D) provides for the computation of an average base period net income in a case in which the television broadcasting business is acquired by the taxpayer after the close of its base period and before the end of the calendar year 1950. In such case the average base period net income shall first be computed without regard to this section, and then there shall be added thereto an amount computed by applying either the industry rate of return for radio broadcasting or the taxpayer's individual rate of return (determined under subsec. (d) (2) on the basis of the radio broadcasting business, if any, in which the taxpayer was engaged during its base period) to the amount of total assets which would be included with respect to the television business if such business had been acquired on the last day of its base period.

Subsection (d) (1) authorizes the Secretary to provide by regulations the rules applicable in the case of a taxpayer determining its average base period net income under this subsection. Examples of the rules to be prescribed by regulations are rules for the method of determining the income, deductions, losses, and other items relating separately to television broadcasting, to radio broadcasting, and to businesses other than television and radio broadcasting; for the method of determining the average base period net income for any business of the taxpayer other than television and radio broadcasting; for the method of determining the assets attributable to the television broadcasting business and to the radio broadcasting business, and for the method of determining the excess profits net income of the radio broadcasting business, which determinations are appropriate to the determinations to be made either under this subsection or under subsection (d) (2). Further rules would relate to the elimination of duplication where assets used during the base period in another business of the taxpayer are directly or indirectly transferred into assets to which the industry or individual rate of return is applied, and for the elimination of duplication where assets held at any time during its base period are used in acquiring the television business in a case described in subsection (d) (1) (D).

Subsection (d) (2) provides for the computation of the individual rate of return, the use of which is prescribed in subsection (d) (1). Such rate of return shall be determined by first averaging the total assets attributable to the radio broadcasting business at the close of each month in the base period. The aggregate of the excess profits net income of the radio broadcasting business, determined without regard to income, deductions, losses, or other items attributable to any other business, including the television broadcasting business, for each month during the base period is then to be computed and divided by 4. The average of the excess profits net income is then divided by the average of the assets to obtain the individual rate of return.

Subsection (d) (3) provides an adjustment, applicable if the industry rate of return is used, for interest paid by the taxpayer. This adjustment corresponds to that required under existing provisions of the excess-profits tax. It is provided, however, that the reduction of the amount computed by reference to the industry rate of return shall in cases under subsection (d) (1) (C) and (D) be only by such portion of the interest paid as the total assets to which the industry rate of return is applied is of the total assets of the taxpayer. Thus, the interest paid is attributed ratably among all the assets held by the taxpayer.

Subsection (d) (4) provides that the Secretary shall by regulations provide for the application of part II of subchapter D (relating to certain tax-free transactions) in the case in which a corporation otherwise entitled to the benefits of this section is an acquiring corporation in a part II transaction.

SECTION 520. EXCESS-PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS

Section 520 for which there is no corresponding provision in the House bill adds a new part IV to subchapter D of chapter 1 and provides for certain technical amendments of parts I and II of subchapter D relating to such new part.

Subsection (a) of section 520 adds part IV which consists of one section, section 474. Subsection (a) thereof comprises definitions. Subsection (a) (1) defines the term "purchasing corporation." Subsection (a) (1) (A) defines as a purchasing corporation any corporation which, before December 1, 1950, acquired substantially all of the assets of another corporation or of a partnership in a transaction other than a transaction described in section 461 (a).

Subsection (a) (1) (B) provides that a corporation shall be a purchasing corporation if it acquires only part of the assets of another corporation (in a transaction other than a part II transaction) provided (1) the properties acquired in such transaction are all of the properties of a separate business of the other corporation and (2) that in the furtherance of a plan of complete liquidation by such other corporation substantially all of its other properties were transferred to one or more other corporations. For the purpose of subsection (a) (1) (B) (as distinguished from subsection (a) (1) (A)), the acquisition must be from a corporation. Thus, the acquisition of part of the assets of a partnership will not qualify the purchaser as a purchasing corporation under subsection (a) (1) (B).

It is further provided (subsec. (a) (1) (C)) that a taxpayer can be a purchasing corporation if it receives solely as paid in surplus or a contribution to capital in respect of voting stock owned by another corporation substantially all of the properties which such other corporation acquired immediately prior thereto in a part IV transaction with respect to which such other corporation was a purchasing corporation as defined in subsections (a) (1) (A) or (a) (1) (B).

For the purpose of the above subsections the properties acquired need not include cash.

Subsection (a) (2) defines as the selling corporation the corporation or partnership whose assets were acquired by the purchasing corporation.

Subsection (a) (3) defines as a part IV transaction any transaction described in subsection (a) (1).

Subsection (b) of section 474 provides that the average base period net income of a purchasing corporation under the general average method provided in section 435 (d) shall be determined by computing the excess-profits net income of the purchasing corporation without regard to the fact that it is such a purchasing corporation (that is, without reference to pt. IV) or by applying the provisions of part IV in computing its excess-profits net income, whichever produces the lesser excess-profits tax for the taxable year. If the taxpayer applies part IV, the excess-profits net income for each month of the base period of the purchasing corporation shall be computed by adding to the actual excess-profits net income (or deficit therein) of the purchasing corporation for such month the excess-profits net income (or deficit therein) for each such month of the business acquired by the purchasing corporation.

Subsection (c) of section 474 provides for the following limitations: First, that immediately after the part IV transaction (that is, the purchase of assets by the purchasing corporation) the selling corporation discontinued all business activities and was completely liquidated in a transaction other than a transaction described in section 461 (a). Thus, if the liquidation of the selling corporation is pursuant to section 112 (b) (6), the provisions of part IV may not be applied by the purchasing corporation. The requirement of discontinuance of business activities and liquidation in a case in which only part of the assets of a corporation were acquired may be postponed until after the last part IV transaction by the selling corporation in furtherance of its single plan of complete liquidation.

The second limitation requires that the properties acquired in the part IV transaction were all or substantially all of the properties (other than cash) used by the selling corporation (or by a component corporation thereof) in the operation of the business whose assets were acquired. Thus, if any substantial portion of the assets used in the business by the selling corporation had been sold or distributed to others prior to the transaction, part IV may not be applied to the purchasing corporation. It is further provided that in any case in which the business was operated under a franchise or license, such franchise or license shall be deemed to have been acquired by the purchasing corporation from the selling corporation if it acquires a substantially identical franchise or license from the same person who granted the one used by the selling corporation. Thus, in a case in which an automobile manufacturer had previously granted a franchise or license to the selling corporation, which franchise or license was not transferrable, the purchasing corporation will be deemed to have acquired such franchise or license from the selling corporation if the same manufacturer grants to the purchasing corporation a substantially identical franchise or license.

The third limitation requires that the business acquired from the selling corporation be operated by the purchasing corporation from the date of the transaction to the end of the taxable year. It is contemplated that where the purchasing corporation becomes a component corporation in a part II transaction the business must have been operated by the purchasing corporation (if it held it for any period of time) and, after the part II transaction, by the acquiring corporation until the end of the taxable year.

Subsection (d) of section 474 provides that in determining whether property is acquired solely as paid-in surplus or a contribution to capital the assumption by the purchasing corporation of a liability of the transferring corporation or the fact that the property acquired is subject to a liability shall be disregarded.

Subsection (e) of section 474 provides that the Secretary shall by regulations prescribe the rules for the application of part IV to all of the parties to a part IV transaction. It is specified in the subsection that those rules are to be consistent with the principles of part II as applied to transactions described under that part. In particular, the subsection provides that the regulations shall prescribe rules for the application under part IV of the principles described in section 462

(j) (1) and in other provisions of part II relating to the prevention of duplication. It is anticipated that rules will be issued, based upon the principles set forth in section 462 (b), for use in combining the excess profits net income of the purchasing corporation with the excess profits net income attributable to the business acquired; that rules will be issued, based upon the principles of sections 463 and 464, relating to capital changes, for use, in conjunction with an application of the principles of section 462 (j) (1), in determining the capital changes of the purchasing corporation after the transaction; and that rules will be issued, based upon the principles of section 462 (i), relating to allocations in the case of certain part II transactions, including, in proper cases, the principles set forth in section 462 (i) (6) relating to identifiable earnings experiences, for use in determining that part of the excess profits net income received by the selling corporation during its base period and prior to the transaction (and that part of the capital changes during the base period and thereafter while the properties were held by the selling corporation) which is attributable to the properties which were purchased by the purchasing corporation and which is properly allocable to that corporation.

Subsection (b) of section 520 of the bill makes two technical amendments to subchapter D of chapter 1 of the code. A cross reference to part IV is inserted at the end of section 435 (a) (3) (relating to the amount of excess profits credit). Section 462 (b) in part II of the subchapter is amended by adding a new paragraph (4) to the effect that the Secretary shall provide by regulations for the application of that subsection in any case in which a purchasing corporation, as defined in part IV, is a component corporation in a transaction described in that part II. No amendment is made to those subdivisions of section 462 which deal with the various alternative average base period net incomes since the benefits of part IV relate only to the computation by a purchasing corporation of its average base period net income under the general average method provided in section 435 (d) and, thus, to the use by the acquiring corporation of that experience for a similar limited purpose. It was not deemed necessary to make a conforming amendment either to section 461 (e) or to section 463 (b), relating to successive part II transactions, or to section 462 (i), relating to allocations in the case of certain part II transactions, since the amendment of section 462 (b) necessarily requires that the principles of those latter sections be made applicable. The amendment of section 462 (b) is made for purposes of transactions involving acquiring corporations as defined under section 461 (a) of part II.

TITLE VI—MISCELLANEOUS PROVISIONS AND AMENDMENTS

SECTION 601. EXEMPTION OF CERTAIN ORGANIZATIONS FROM INCOME TAX FOR PRIOR TAXABLE YEARS

Section 601 of the bill, which section is identical with section 501 of the House bill, adds a subsection at the end of section 302 of the Revenue Act of 1950 to provide that for any taxable year beginning prior to January 1, 1951, an organization (which term includes a trust) operated for the primary purpose of carrying on a trade or business for profit, no part of the net earnings of which inures to the benefit of any private shareholder or individual and all of the net earnings of which inure to the benefit of an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on, shall not be denied exemption from taxation under any paragraph of section 101 of the code on the ground that it is carrying on a trade or business for profit.

An example of the application of the amendment would be the case of a feeder corporation whose business is the manufacture of automobiles for the ultimate profit of a university.

SECTION 602. FOREIGN ESTATE TAX CREDIT

This section, for which there is no corresponding provision in the House bill, amends sections 813 and 936 of the code to provide that, where property included for Federal estate tax purposes in the gross estate of a resident or citizen of the United States is situated in a foreign country and subjected to a death tax by such country, a credit shall be allowed against the estate tax for such foreign death tax. The amendment applies only with respect to estates of residents and citizens dying after the date of enactment of the bill.

The credits for foreign death taxes are to be deducted after deducting the existing credits under section 813 (b) of the code for State inheritance taxes and under sections 813 (a) and 936 (b) for Federal gift tax.

The credits provided under this section are allowable (under principles developed under the foreign income tax credit authorized by sec. 131 of the code), not only for death taxes of foreign states in the international sense, but also for such taxes of possessions or political subdivisions of foreign states. Credit in the estate of a particular decedent is allowable, however, only for estate, inheritance, legacy, or succession taxes imposed with respect to the death of such decedent. Where credit for a particular foreign death tax is authorized by treaty, there is to be allowed either the credit computed under the treaty or that computed under this section, whichever is greater. For example, if a portion of the estate of a citizen of the United States is situated in the Province of Quebec and is subjected to Dominion and Provincial succession duties, the credit for the Dominion duty computed under the estate tax treaty with Canada, or the credit for the Dominion and provincial duties computed under this section, whichever is greater, is to be allowed.

In the case of a decedent who was a resident but not a citizen of the United States, the credit is to be allowed only if the country of which the decedent was a national, in imposing death taxes, allows a similar credit in the case of a citizen of the United States resident in such country. This "similar credit requirement" is analogous to that contained in section 131 (a) (3) of the code, relating to the foreign income tax credit.

The credit is not allowable for any portion of the foreign tax which is paid with respect to property situated outside the territory of the foreign country imposing such tax. The determination of the country in which property is situated for the purposes of determining whether the credit is allowable is to be made in accordance with the principles applicable in determining whether property is situated within or without the United States for purposes of the imposition of the Federal estate tax on the estate of a nonresident not a citizen of the United States.

Credit is to be allowed only with respect to property which meets three conditions: (1) Subjection to the death tax of a foreign country, (2) situs within such foreign country, and (3) inclusion in the gross estate for the purpose of the Federal estate tax. Where property which fails to meet condition (2) or condition (3) is also subjected to the foreign tax, a ratio is to be used in determining the amount of the foreign tax attributable to the property with respect to which credit is allowable. The method of computing this ratio, which is the first limitation on the amount of the foreign tax credit, is stated in paragraphs (2) (A) and (3) (A) of section 813 (c) and paragraphs (2) (A) and (3) (A) of section 936 (c).

A second limitation on the amount of the credit is stated in paragraphs (2) (B) and (3) (B) of section 813 (c) and paragraphs (2) (B) and (3) (B) of section 936 (c). Under this limitation the credit is not to exceed the portion of the Federal estate tax attributable to the property which meets the three conditions stated in the preceding paragraph.

The two limitations on the credit are to be separately computed for the tax of each foreign country. Where the foreign country imposes more than one kind of death tax or imposes taxes at different rates upon the several shares of an estate, or where the foreign country and a political subdivision thereof each imposes a death tax, the first limitation but not the second limitation is to be separately computed for each such tax.

The credit is to be allowed only upon submission of all necessary evidence by the executor. Sections 813 (c) (5) and 936 (c) (5) provide limitations on the allowance of the credit or of refund based on the credit, which are identical with those now contained in section 813 (b), relating to credit for State inheritance taxes. Refunds based on the credit are to be made without interest.

Subsection (c) of this section of the bill makes a technical amendment to section 927 to provide an extended period, in cases in which payment of the estate tax attributable to a reversionary or remainder interest is postponed, for the claiming of credit for foreign death taxes allowable against such part of the estate tax.

Subsection (d) of this section of the bill amends section 874 (b) (relating to exceptions to the general periods of limitation on assessment and collection of estate tax) by adding a new paragraph (3). The new paragraph requires the executor to notify the Commissioner of any recovery of State or foreign death taxes for which credit has been claimed, and authorizes a redetermination of the Federal tax on the basis of such recovery.

SECTION 603. ESTATE AND GIFT TAX TREATMENT OF UNITED STATES BONDS HELD BY CERTAIN NON-RESIDENT ALIENS

This section is identical with section 503 of the bill as passed by the House. This section amends section 861, relating to the computation of net estate of a decedent nonresident not a citizen of the United States, and section 1000 (b), relating in part to application of gift tax in the case of a transfer by a nonresident alien, by the addition of specific provisions defining the treatment for purposes of estate tax and gift tax of certain obligations of the United States held or transferred by a nonresident alien not engaged in business in the United States.

The United States Supreme Court, as early as 1900, established the principle that a statutory provision which in general terms exempts property from taxation applies only to a direct tax on such property and does not apply to excise taxes, such as the estate tax or the gift tax which is imposed not on the property itself but on the transfer of the property. *Murdock* v. *Ward* (178 U. S. 139); *Plummer* v. *Coler* (178 U. S. 115). However, the Courts of Appeals for the Second and Third Circuits have, in a number of recent cases, held that section 4 of the Victory Liberty Loan Act of March 3, 1919 (40 Stat. 1311; 30 U. S. C. 750), exempted United States Government bonds owned by a nonresident alien individual, not engaged in business within the United States, from estate tax as well as from direct taxes. See *Estate of Karl Jandorf* v. *Commissioner* (C. A. 2, 1948), 171 F. (2d) 464; *Estate of Irene DeGuebriant* v. *Commissioner* (C. A. 2, 1951), 186 F. (2d) 307; and *Pennsylvania Co. for Banking and Trusts* (*Estate of Henry Wallace Burne*) v. *United States* (C. A. 3, 1950), 185 F. (2d) 125.

Your committee believes that United States obligations in the hands of a nonresident alien not engaged in business in the United States are and should be subject to the principle of *Murdock* v. *Ward* and *Plummer* v. *Coler*; accordingly subsection (a) adds a new subsection (c) to section 861 of the code affirmatively so providing in the case of the estate tax. However, in the interest of equity, two exceptions are provided to this rule. First, United States obligations issued before March 1, 1941, are not to be included in the gross estate of a deceased nonresident alien who was not engaged in business in the United States since such issues are exempt under present Treasury regulations. Secondly, the amendment expressly provides that such obligations issued on or after March 1, 1941, are to be included in the gross estate of such a decedent only if the decedent dies after the date of the enactment of the bill.

Subsection (b) of this section is designed to provide a similar result in the case of the gift tax, except that the amendment does not concern itself with gifts made on or before the date of the enactment of the bill. Under the amendment, a gift of such obligations made after the date of the enactment of the bill, by a nonresident alien not engaged in business in the United States, will be subject to the gift tax only if such obligations were issued on or after March 1, 1941. As to gifts made on or before the date of the enactment of the bill, the amendment does not affect any liability for gift tax which may exist under present law, and is not intended to disturb the rule of existing gift tax regulations which exempts from tax the transfer of such obligations issued before March 1, 1941.

SECTION 604. ESTATE TAX EXEMPTION FOR WORKS OF ART LOANED BY NONRESIDENT ALIENS

This section, for which there is no corresponding provision in the House bill, amends section 863 (c) of the code to extend the estate tax exemption granted by that section with respect to works of art loaned by a nonresident alien to the National Gallery of Art, Washington, D. C., to works of art loaned to other public galleries or museums.

Section 863 (c) of existing law provides that, with respect to estates of decedents dying after September 1, 1950, works of art owned by a nonresident not a citizen of the United States shall not be deemed to be property situated in the United States for purposes of inclusion in the net estate of the nonresident alien if such works of art are (1) imported into the United States solely for exhibition purposes, (2) loaned to the Trustees of the National Gallery of Art solely for exhibition purposes, and (3) at the time of death of the owner, on exhibition, (or en route to or from exhibition) in such National Gallery of Art or in such other public gallery or museum as the Trustees of such National Gallery of Art may have designated.

Under your committee's amendment, the exemption in section 863 (c) will apply not only to works of art loaned to the National Gallery of Art, but also to works of art loaned to other public galleries or museums in the United States no part of the net earnings of which inures to the benefit of any private stockholder or individual. The conditions of the exemption parallel the conditions in existing law, that is, the importation must be solely for exhibition purposes, the works of art must be loaned to the public gallery or museum, and the works of art must, at the time of death of the owner, be on exhibition (or en route to or from exhibition) in a public gallery or museum.

The amendment to section 863 (c) made by this section is applicable only to estates of decedents dying after the date of enactment of this act.

SECTION 605. EXEMPTION FROM ADDITIONAL ESTATE TAX OF MEMBERS OF ARMED FORCES UPON DEATH

This section, for which there is no corresponding provision in the House bill, amends section 939 of the code to provide that the tax imposed by section 935 (the additional estate tax) shall not apply to the transfer of the net estate of a citizen or resident of the United States dying after June 24, 1950, and before January 1, 1954, while in active service as a member of the Armed Forces of the United States, if such decedent (1) was killed in action while serving in a combat zone, as determined under section 22 (b) (13), or (2) died at any place as a result of wounds, disease, or injury suffered, while serving in a combat zone (as determined under section 22 (b) (13)) and while in line of duty, by reason of a hazard to which he was subjected as an incident of such service.

SECTION 606. TRANSFERS CONDITIONED UPON SURVIVORSHIP

This section, for which there is no corresponding provision in the House bill, provides that, in the case of a decedent dying after March 18, 1937, the date of approval of Treasury Decision 4729, and before February 11, 1939, the determination of whether property is to be included in the gross estate of the decedent under section 302 (c) of the Revenue Act of 1926 as a transfer intended to take effect in possession or enjoyment at or after his death shall be made in conformity with the provisions of article 17 of Regulations 80, as amended by such Treasury decision.

SECTION 607. TRANSFERS WITH INCOME RESERVED

This section, for which there is no corresponding provision in the House bill, amends section 7 (b) of Public Law 378, Eighty-first Congress (the Technical Changes Act of 1949). Section 7 (b) now provides that the provisions of section 811 (c) (1) (B) of the code, providing for inclusion in a decedent's estate of property transferred with reservation of rights in income, shall not be applicable to transfers made before March 4, 1931 (and, in some cases, before June 6, 1932), if the decedent died before January 1, 1950. Under your committee's amendment, inapplicability of section 811 (c) (1) (B) is extended to estates of decedents dying before January 1, 1951.

SECTION 608. TRANSFERS TAKING EFFECT AT DEATH

This section, for which there is no corresponding provision in the House bill, amends section 7 (b) of Public Law 378, Eighty-first Congress (the Technical Changes Act of 1949) to provide that the provisions of section 811 (c) (1) (C) of the code (relating to inclusion in gross estate of transfers intended to take effect in possession or enjoyment at or after death) shall not apply to transfers made before September 8, 1916. The effect of the last sentence of this section, which makes section 7 (c) of such public law inapplicable to overpayments resulting from the enactment of this section of the bill, is to limit refunds of such overpayments to those situations in which the refund is not prohibited by the statute of limitations or some other law or rule of law.

SECTION 609. REVERSIONARY INTERESTS IN CASE OF LIFE INSURANCE

This section, for which there is no corresponding provision in the House bill, permits the making of refund or credit of any overpayment resulting from the application of section 503 of the Revenue Act of 1950, if claim therefor is filed within 1 year from the date of enactment of the bill, even though the making of such refund or credit is otherwise prohibited by the statute of limitations or any other law or rule of law (other than section 3760 or 3761 of the code which relate, respectively, to closing agreements and compromises). The effect of section 503 of the Revenue Act of 1950 was to provide that proceeds of life-insurance policies attributable to premiums paid on or before January 10, 1941, should not be included in the gross estate of the insured person for estate-tax purposes by reason of the fact that the premiums were paid by him, unless on January 10, 1941, or thereafter he had substantial rights in the life-insurance policy.

SECTION 610. INCOME PURSUANT TO AWARD OF INTERSTATE COMMERCE COMMISSION

Section 610, for which there is no corresponding provision in the bill as passed by the House, provides that amounts received pursuant to an award under the order issued under the Railway Mail Pay Act of 1916 by the Interstate Commerce Commission on December 4, 1950, as compensation for the transportation of mail during 1950 and any prior years shall be deemed to be income which accrued in the taxable years in which the services to which such compensation relates were rendered. No interest shall be assessed or collected for any period prior to July 1, 1951, with respect to that part of any deficiency which the Secretary of the Treasury determines to be attributable to the inclusion of income in a taxable year by reason of the application of section 610. A deficiency which is attributable to the inclusion of income in any taxable year by reason of the application of section 610 may be assessed, notwithstanding any provision of law or rule of law which would otherwise prevent such assessment, at any time prior to the expiration of the period for assessment with respect to that taxable year of the taxpayer which includes December 4, 1950.

SECTION 611. CREDIT IN PRIOR TAXABLE YEARS FOR DIVIDENDS RECEIVED ON PREFERRED STOCK OF A PUBLIC UTILITY

The Revenue Act of 1943 amended section 26 (h) (1) of the code by inserting after the first sentence two sentences which excluded from the computation of the credit for dividends paid on the preferred stock of a public utility amounts distributed with respect to dividends unpaid and accumulated in any taxable year ending prior to October 1, 1942. The 1943 act did not contain a conforming amendment to include in the computation of the dividends received credit the amounts excluded from the computation of the credit for dividends paid.

In the case of the calendar year 1951 and taxable years beginning after March 31, 1951, the amounts excluded from the computation of the dividends paid credit will (by reason of the amendments made by section 122 (a) of the bill) be included as dividends to which the 85 percent credit will apply. Section 611 provides the same treatment for taxable years beginning before April 1, 1951.

SECTION 612. CONSOLIDATED RETURNS—INCLUDIBLE CORPORATION

This section of the bill, for which there is no corresponding section in the House bill, provides that, if an affiliated group making a consolidated return with respect to the first taxable year of the group ending after June 30, 1950, included a corporation described in section 452 (f) of the code pursuant to the consent provided in section 141

(e) (7) of the code, such corporation may withdraw such consent at any time within 90 days after the enactment of the Revenue Act of 1951. If such consent is withdrawn under this section the tax liability of the affiliated group and its several members for the taxable year shall be determined, assessed, and collected as if such corporation had never joined in the making of the consolidated return.

SECTION 613. TIME FOR PERFORMING CERTAIN ACTS POSTPONED IN CASE OF CHINA TRADE ACT CORPORATIONS

This section, for which there is no corresponding provision in the House bill, amends section 3805 of the code to provide December 31, 1953, as the due date for China Trade Act corporations, for the filing of returns and paying of the income tax for taxable years beginning after December 31, 1948, and ending before October 1, 1953. The section is to apply only to corporations and for taxable years which the Secretary of the Treasury, under regulations prescribed by him, determines reasonable under the circumstances in China. This provision recognizes that while the present situation in China makes it impossible for many such companies to have access to their records for the purpose of paying tax, certain China Trade Act corporations are fully able to comply with requirements of existing law as to the due dates of income tax returns and the due dates of tax payments.

The December 31, 1953, due date specified in this section is subject to the power of the Secretary to extend the time for filing returns or paying tax as in other cases.

SECTION 614. TREATY OBLIGATIONS

This section, for which there is no corresponding provision in the House bill, provides that no amendment made by the bill shall apply in any case where its application would be contrary to any treaty obligation of the United States.

SECTION 615. REORGANIZATION PLAN NO. 26 OF 1950

Under this section of the bill, which is identical to section 504 of the House bill, the applicable provisions of Reorganization Plan No. 26 of 1950, respecting the Department of the Treasury, particularly section 1 (a) of such plan, transferring certain functions to the Secretary of the Treasury, shall apply to all functions stated to be vested by the Revenue Act of 1951 in any officer, employee, or agency of the Department of the Treasury, even though by such act any function is stated to be vested elsewhere than in the Secretary of the Treasury. Thus, as an example, a requirement in the Revenue Act of 1951 that returns shall be made and taxes due paid by the taxpayer to the collector for the district in which is located the taxpayer's principal place of business, or if he has no principal place of business in the United States, then to the collector at Baltimore, Md., will be given the same effect as a similar requirement in effect at the time when the plan became effective.

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