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TAX-FREE WITHDRAWAL OF WINE UNFIT FOR BEVERAGE USE

AUGUST 3, 1967.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 1282]

The Committee on Finance, to which was referred the bill (H.R. 1282) to provide for the withdrawal of wine from bonded wine cellars without payment of tax, when rendered unfit for beverage use, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

The bill as passed by the House provides for the tax-free withdrawal from bonded wine cellars of wine and wine products where they are rendered unfit for beverage use. This tax-free withdrawal privilege is not to be available in the case of wine or wine products containing more than 21 percent alcohol. Your committee has adopted this provision with a minor perfecting amendment moving up the effective date.

In addition, your committee has amended this bill to add some technical perfecting amendments to the interest equalization tax as extended and amended by the recently enacted Interest Equalization Tax Extension Act of 1967. These amendments carry out the purpose of that act.

The Treasury Department has indicated that it has no objection to the enactment of the House-passed provision relating to wine and wine products and strongly endorses the enactment of the perfecting amendments to the interest equalization tax.

II. GENERAL STATEMENT

Present law imposes an excise tax on the withdrawal of wine from a bonded wine cellar at rates varying with the alcoholic content of

the wine and based on the natural or artificial carbonation of the wine. However, wine may also be withdrawn from bonded wine cellars free of tax for use in the production of vinegar and for certain other limited purposes.

Present law permits a drawback of all but $1 of tax per gallon in the case of distilled spirits where they are rendered unfit for beverage use, but no comparable provision is provided under present law in the case of wines.

Requests have been made that the tax-free withdrawal of wine from bonded wine cellars be permitted as a means of disposing of an oversupply in cases where there is a fruit surplus. The wines withdrawn in such cases would be used for salted cooking wines, in medicinal preparations or in food flavoring products, in producing agricultural feed and for other purposes.

Your committee sees no reason why a tax-free withdrawal privilege should not be available in the case of wines where they are withdrawn for nonbeverage purposes, since distilled spirits, through operation of the drawback provision in effect are subject to only a tax of $1 per gallon where they are used for nonbeverage purposes. It is important, however, that wines withdrawn in this manner are not used for beverage purposes and thus evade the taxes on alcoholic beverages.

To guard against evasion of the alcoholic beverage taxes, the bill provides that the wines so withdrawn must be rendered unfit for beverage use. "Unfit for beverage use" in this case means the same as when that term is used in the Internal Revenue Code in the case of drawbacks of the tax on distilled spirits used in the production of medicines, flavorings, and food products. However, it is provided in the bill that the wine or wine products before withdrawal may be treated in a manner to render them suitable for their intended use.

The bill excludes from coverage wines containing more than 21 percent alcohol. This is provided in part, because it is believed that the inclusion of wines with a higher alcoholic content might well result in attempted diversion for beverage use. In addition, a tax exemption for these high alcoholic content wines, because of their resemblance to distilled spirits, might place persons now using distilled spirits in nonbeverage products at a competitive disadvantage, since a net tax of $1 a gallon is paid on the distilled spirits used in such a manner.

Your committee has amended this bill to provide that the effective date of this provision is to be the first day of the first month which begins 90 days or more after the date of enactment of the bill rather than the date of enactment. This is to provide time for the preparation of regulations on the new provision.

It is expected that this bill will result in only a negligible revenue loss.

III. AMENDMENTS TO THE INTEREST EQUALIZATION TAX

1. Participating firm acting for its own account (secs. 2 (a) and (b)(4) of the bill and secs. 4918(b) and 4918(e)(2) of the code)

The procedures introduced by the Interest Equalization Tax Extension Act of 1967 are directed generally to the manner in which the exemption for prior American ownership and compliance can be established in situations where a participating firm is either acquiring foreign securities for the account of a customer or is selling foreign securities for the account of a customer. A participating firm, however,

may acquire foreign securities for its own account or it may sell securities which it owns as a dealer or underwriter. Although the participating firm is, in effect, its own customer in these situations, some of the requirements of the new procedures might not be technically satisfied.

Your committee believes that it is unnecessary to differentiate for this purpose between the situation where the participating firm is acquiring securities for its own account or is selling securities which it owns and the situation where the firm is effecting the acquisition or sale of securities for the account of a customer. Therefore, your your committee has added an amendment to the House bill which provides that, under the new procedures for establishing the exemption for prior American ownership and compliance, a participating firm which is acting for its own account will generally be treated in the same manner as if it were a customer for whom it is acting as broker.

This amendment is effective with respect to acquisitions of stock or debt obligations made after July 14, 1967.

2. Participating firm effecting sale for another participating firm (secs. 2(b) (1) and (4) of the bill and sec. 4918(e) of the code)

Under the new procedures introduced by the Interest Equalization Tax Extension Act of 1967, a participating firm effecting the sale of foreign securities may not indicate that the exemption for prior American ownership and compliance applies to the acquisition of the securities, unless certain conditions are satisfied. These conditions generally are directed to insuring that the customer for whom the securities are being sold has met any interest equalization tax obligations he may have had in connection with his acquisition of the securities and is eligible to dispose of the securities as a U.S. person. It has come to the attention of your committee that it is a normal market procedure for securities which are held for the account of a customer by one broker to be sold (when the customer so directs) by that broker through a second broker. It is of course the first broker, and not the broker actually effecting the sale, which possesses evidence that the prescribed conditions are satisfied. Your committee does not believe that it is necessary in transactions of this type to require the broker effecting the sale of the securities to possess the evidence that the prescribed conditions have been satisfied, if both it and the broker for which the sale is being effected are participating firms and if the latter broker possesses the necessary evidence.

For the reasons given above, your committee has added an amendment to the House bill which provides that a participating firm effecting a sale of foreign securities may indicate the exemption for prior American ownership and compliance applies to the acquisition of the securities, if the sale is being effected for another participating firm and that firm possesses evidence that the prescribed conditions have been satisfied.

This amendment is effective with respect to acquisitions of stock or debt obligations made after July 14, 1967.

3. Requirements for indicating the exemption applies (sec. 2(b)(3) of the bill and sec. 4918(e) of the code)

Under the procedures introduced by the Interest Equalization Tax Extension Act of 1967, unless certain conditions are satisfied, a participating firm effecting the sale of foreign securities may not

indicate that the exemption for prior American ownership and compliance applies to the acquisition of the securities. The attention of your committee was directed to the fact that it may be determined that there are other circumstances under which such sales can be made without impairing the effectiveness of the new procedures. Moreover, the methods by which foreign securities are traded may be modified from time to time, and it is possible that the enumerated requirements might not coincide with a modified form of trading.

Your committee believes it is desirable to provide a method by which the effectiveness of the procedures introduced by the Interest Equalization Tax Extension Act of 1967 can be maintained without, however, impairing normal trading activity if such a determination is made or if trading practices or methods are modified. Accordingly, your committee had added an amendment to the House bill which provides that the Secretary or his delegate may by regulations prescribe other conditions which, if satisfied, will allow a participating firm effecting the sale of foreign securities to indicate that the exemption for prior American ownership and compliance applies to the acquisition of the securities.

This amendment is effective with respect to acquisitions of stock or debt obligations made after July 14, 1967.

4. Possession of statement of U.S. person status under transfer of custody procedures (sec. 2(c) of the bill and sec. 4918(h)(2) of the code)

Under the new procedures introduced by the Interest Equalization Tax Extension Act of 1967, a participating firm or participating custodian may not issue a transfer of custody certificate in connection with the transfer of securities which it holds for a person, unless it possesses a statement of U.S. person status and ownership executed by that person. It is, however, a normal practice for a custodian which holds securities for a customer to deposit those securities with another custodian in order to facilitate the trading of the securities. In this case, however, the custodian actually transferring the securities would not possess the statement of U.S. person status and ownership executed by the customer of the depositing custodian. Your committee does not believe it is necessary in transactions of this type for the custodian transferring the securities to possess the statement of U.S. person status and ownership, if both it and the custodian for which the transfer is being effected are participating firms or participating custodians and if the participating firm or participating custodian for which the transfer is being effected possesses the statement.

For the reasons given above, your committee has added an amendment to the House bill which provides that a participating firm or participating custodian effecting a transfer of securities does not have to possess, in order to issue a transfer of custody certificate, a statement of U.S. person status and ownership executed by the person who owns the securities, if the transfer is being effected for another participating firm or participating custodian and that firm or custodian has the required statement in its possession.

This amendment is effective with respect to acquisitions of stock or debt obligations made after July 14, 1967.

5. Civil penalty for false statement of U.S. person status (sec. 2(d) of the bill and sec. 6681(a) of the code)

Under amendments made by the Interest Equalization Tax Extension Act of 1967, a civil penalty is provided in the case where a person knowingly executes a false statement as to his status as a U.S. person and his ownership of foreign securities. The penalty only applies, however, in situations where the person executes the statement for the purpose of allowing a participating firm to sell stock or debt obligations owned by the person pursuant to the new procedures for establishing that the exemption for prior American ownership and compliance applies to the acquisition of the securities. A similar statement of status and ownership must also be filed, however, with a participating firm or a participating custodian to enable the firm or custodian to transfer (rather than sell) securities owned by the person to another participating firm or custodian with a transfer of custody certificate.

Your committee believes it was intended that the civil penalty should also apply in cases where a person knowingly executes a false statement as to his status as a U.S. person and his ownership of foreign securities for purposes of the transfer of custody procedures. Accordingly, your committee has added an amendment to the House bill which makes the civil penalty applicable in this situation.

This amendment is effective as of the date of enactment of the bill.

6. Criminal penalty for fraudulent or false statement of U.S. person status (sec. 2(e) of the bill and sec. 7241(b) of the code)

The Interest Equalization Tax Extension Act of 1967 provided a criminal penalty in cases where a person willfully executes a false or fraudulent statement as to his status as a U.S. person and his ownership of foreign securities. The penalty only applies, however, when the statement is executed in connection with the new procedures for establishing that the exemption for prior American ownership and compliance applies to an acquisition of foreign securities. It does not apply when the statement is made for purposes of the transfer of custody procedures.

Your committee believes, as in the case of the civil penalty discussed in No. 5 above, that it was intended the criminal penalty should also apply where a person willfully executes a false or fraudulent statement as to his status as a U.S. person and his ownership of foreign securities for purposes of the transfer of custody procedures. Accordingly, your committee has added an amendment to the House bill which makes the criminal penalty applicable in this situation.

This amendment is effective as of the date of enactment of this bill.

IV. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

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

INTERNAL REVENUE CODE OF 1954

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CHAPTER 41—INTEREST EQUALIZATION TAX

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SEC. 4918. EXEMPTION FOR PRIOR AMERICAN OWNERSHIP AND COMPLIANCE.

(a) GENERAL RULE.—The tax imposed by section 4911 shall not apply to an acquisition of stock of a foreign issuer or a debt obligation of a foreign obligor if it is established in the manner provided in this section that—

(1) the person from whom such stock or debt obligation was acquired was a United States person throughout the period of his ownership or continuously since July 18, 1963, and was not ineligible, under the provisions of this chapter, to dispose of such stock or debt obligation as a United States person; and

(2) such person—

(A) had paid the tax imposed by section 4911 with respect to the acquisition of such stock or debt obligation by such person; or

(B) acquired such stock or debt obligation without liability for payment of such tax.

(b) ESTABLISHING EXEMPTION FOR PRIOR AMERICAN OWNERSHIP AND COMPLIANCE.—

(1) CONCLUSIVE PROOF.—For purposes of the exemption for prior American ownership and compliance provided in subsection (a)—

(A) a validation certificate, evidencing that the person from whom stock of a foreign issuer or a debt obligation of a foreign obligor was acquired was a person described in subsection (a), issued by the Secretary or his delegate (or by any officer or employee of the United States designated by the Secretary or his delegate) and filed in accordance with the requirements prescribed by the Secretary or his delegate; or

(B) a written confirmation (referred to as an IET clean confirmation) received by the person acquiring such stock or debt obligation from a participating firm acting as a broker in effecting the acquisition (or acting for its own account) which contains no reference to liability for the tax imposed by section 4911,

shall be conclusive proof that such exemption applies with respect to the acquisition of the stock or debt obligation described in such certificate or confirmation, if the person making the ac-

quisition relies in good faith on the validity of such certificate or confirmation.

(2) OTHER PROOF.—If the person making an acquisition of stock or a debt obligation shows reasonable cause for his inability to establish such exemption under paragraph (1) he may furnish other evidence to establish to the satisfaction of the Secretary or his delegate that such exemption is applicable to such acquisition.

(3) CERTAIN ACQUISITIONS BY DEALERS.—For purposes of paragraph (1), if the person acquiring the stock or debt obligation is a participating firm acting for its own account and if such participating firm would be entitled to issue a written confirmation referred to in paragraph (1)(B) if it were acting as a broker in effecting such acquisition for the account of a customer, such participating firm shall be treated as having received a written confirmation referred to in paragraph (1)(B) with respect to such acquisition.

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(e) SALES EFFECTED BY PARTICIPATING FIRMS IN CONNECTION WITH EXEMPT ACQUISITIONS.—[A participating firm selling, or effecting the sale of, stock of a foreign issuer or a debt obligation of a foreign obligor may issue a written comparison or broker-dealer confirmation, which indicates the exemption for prior American ownership and compliance provided in subsection (a) applies to such acquisition, only if such participating firm has in its possession (except in the case of a sale for another participating firm or a participating custodian to which paragraph (4) applies) a statement, upon which such participating firm relies in good faith, executed under penalty of perjury by the person making the sale, establishing that such person is a United States person and is the owner of all stock of foreign issuers and debt obligations of foreign obligors carried in the records of such participating firm for the account of such person; and either—] *A participating firm selling, or effecting the sale of, stock of a foreign issuer or a debt obligation of a foreign obligor may issue a written comparison or broker. dealer confirmation, which indicates the exemption for prior American ownership and compliance provided in subsection (a) applies to the acquisition of such stock or debt obligation, only if such participating firm (or another participating firm for which the sale is being effected) has in its possession (except in the case of a sale by a participating firm selling for its own account and in the case of a sale for another participating firm or a participating custodian to which paragraph (4) applies) a statement, upon which such participating firm (or such other participating firm) relies in good faith, executed under penalty of perjury by the person making the sale, establishing that such person is a United States person and is the owner of all stock of foreign issuers and debt obligations of foreign obligors carried in the records of such participating firm (or such other participating firm) for the account of such person; and such participating firm (or such other participating firm) either—*

(1)(A) at the close of business on July 14, 1967, carried such stock or debt obligation in its records (on a trade-date basis) for the account of the seller; and

(B) included such stock or debt obligation in the transition inventory referred to in subsection (g) filed or to be filed on or before the due date by such participating firm with the Secretary

or his delegate in accordance with the provisions of such subsection;

(2) after July 14, 1967, *acquired such stock or debt obligation for its own account, if the exemption for prior American ownership and compliance provided in subsection (a) applied to such acquisition by reason of subsection (b)(3), or—*

(A) sold for its own account such stock or debt obligation to the seller, or acting as broker effected the acquisition of such stock or debt obligation by the seller, if the exemption for prior American ownership and compliance provided in subsection (a) applied to such acquisition by reason of subsection (b)(1)(B); and

(B) continuously carried in its records on a trade-date basis for the account of the seller such stock or debt obligation;

(3)(A) sold for its own account such stock or debt obligation to the seller, or acting as a broker effected the acquisition of such stock or debt obligation by the seller, if, by reason of subsection (b)(1)(B) (or by reason of subsections (c) or (d) as in effect with respect to acquisitions before July 15, 1967), the exemption for prior American ownership and compliance provided by subsection (a) (or the exemption for prior American ownership provided by subsection (a) as in effect with respect to acquisitions before July 15, 1967) applied to such acquisition; and

(B) after July 14, 1967, received from the seller the identical stock certificates or evidences of indebtedness which it had previously delivered to the seller with respect to such acquisition by the seller;

(4) receives possession of such stock or debt obligation from another participating firm or from a participating custodian, together with a transfer of custody certificate, as provided in subsection (h);

(5) receives from the seller stock which was registered before July 19, 1963, in the name of the seller by a participating custodian which acted as transfer agent or registrar in registering such stock;

(6) receives a validation certificate issued by the Secretary or his delegate evidencing that the seller is a person described in subsection (a) with respect to such stock or debt obligation and files such certificate with the Secretary or his delegate in accordance with the requirements prescribed by the Secretary or his delegate; [or]

(7) withholds from the proceeds of such sale (with the consent of the seller) an amount equal to the tax which would be imposed under section 4911 on the acquisition of such stock or debt obligation by the purchaser if such acquisition were not exempt from such tax under this [section.] *section; or*

(8) *conditions set forth in regulations prescribed by the Secretary or his delegate are met.*

The withholding under paragraph (7) shall be treated as the collection of the tax imposed under section 4911 on the acquisition by the seller of such stock or debt obligation and shall be paid over to the Secretary or his delegate or released to the seller at such time and in such manner as provided in regulations prescribed by the Secretary or

his delegate. *For purposes of paragraphs (2), (3), (5), and (7), the term "seller" does not include a participating firm selling for its own account.*

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(h) TRANSFER OF CUSTODY CERTIFICATE.—

(1) NATURE OF CERTIFICATE.—A certificate (designated as a transfer of custody certificate) may be issued in accordance with paragraph (2) by a participating firm or participating custodian in connection with a delivery of stock of foreign issuers or debt obligations of foreign obligors which are carried in its records for the account of a United States person to another participating firm or participating custodian.

(2) AUTHORIZED TRANSFERS OF CUSTODY.—A participating firm or participating custodian shall issue a transfer of custody certificate only if, with respect to the stock or debt obligations described in such certificate, [it has in its possession a statement, upon which it relies] *such participating firm or participating custodian (or another participating firm or participating custodian for which the delivery is being effected) has in its possession a statement upon which such participating firm or participating custodian (or such other participating firm or participating custodian) relies* in good faith, executed under penalty of perjury, by the person for whose account the delivery is being made, establishing that such person is a United States person and is the owner of all stock of foreign issuers and debt obligations of foreign obligors carried in its records for the account of such person, and if either—

(A) such participating firm or participating custodian—

(i) carried in its records (on a trade-date basis) at the close of business on July 14, 1967, for the account of a United States person the stock or debt obligation described in the transfer of custody certificate; and

(ii) includes such stock or debt obligation in the transition inventory referred to in subsection (g) filed or to be filed on or before the due date by such participating firm with the Secretary or his delegate in accordance with the provisions of such subsection;

(B) such participating firm or participating custodian received a like amount of stock or debt obligations described in the transfer of custody certificate from another participating firm or participating custodian accompanied by a transfer of custody certificate with respect to such stock or debt obligation;

(C) such participating firm—

(i) effected as broker (or for its own account) the acquisition of the stock or debt obligation described in the transfer of custody certificate, and the exemption for prior American ownership and compliance provided in subsection (a) applied to such acquisition by reason of subsection (b)(1)(B); and

(ii) continuously carried in its records for the account of the person who acquired such stock or debt obligation, or received from such person, the identical stock certificates or evidences of indebtedness which it

had previously delivered to such person in connection with such acquisition;

(D) such participating custodian received an IET clean confirmation in connection with the acquisition of the stock or debt obligation described in the transfer of custody certificate for the person for whose account such stock or debt obligation is carried in its records; or

(E) conditions set forth in regulations prescribed by the Secretary or his delegate are met.

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CHAPTER 51—DISTILLED SPIRITS, WINES AND BEER

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Subchapter F—Bonded and Taxpaid Wine Premises

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SEC. 5362. REMOVALS OF WINE FROM BONDED WINE CELLARS.

(a) WITHDRAWALS ON DETERMINATION OF TAX.—Wine may be withdrawn from bonded wine cellars on payment or determination of the tax thereon, under such regulations as the Secretary or his delegate shall prescribe.

(b) TRANSFERS OF WINE BETWEEN BONDED WINE CELLARS.—Wine on which the internal revenue tax has not been paid or determined may, under such regulations as the Secretary or his delegate shall prescribe, be transferred in bond between bonded wine cellars. For the purposes of this chapter, the removal of wine for transfer in bond between bonded wine cellars shall not be construed to be a removal for consumption or sale.

(c) WITHDRAWALS OF WINE FREE OF TAX OR WITHOUT PAYMENT OF TAX.—Wine on which the tax has not been paid or determined may, under such regulations and bonds as the Secretary or his delegate may deem necessary to protect the revenue, be withdrawn from bonded wine cellars—

(1) without payment of tax for export by the proprietor or by any authorized exporter;

(2) without payment of tax for transfer to any foreign-trade zone;

(3) without payment of tax for use of certain vessels and aircraft as authorized by law;

(4) without payment of tax for transfer to any class 6 customs manufacturing warehouse;

(5) without payment of tax for use in the production of vinegar;

(6) without payment of tax for use in distillation in any distilled spirits plant authorized to produce distilled spirits;

(7) free of tax for experimental or research purposes by any scientific university, college of learning, or institution of scientific research;

(8) free of tax for use by or for the account of the proprietor or his agents for analysis or testing, organoleptic or otherwise; and

(9) free of tax for use by the United States or any agency thereof, and for use for analysis, testing, research, or experimenta-

tion by the governments of the several States and Territories and the District of Columbia or of any political subdivision thereof or by any agency of such governments. No bond shall be required of any such government or agency under this paragraph.

(d) WITHDRAWAL FREE OF TAX OF WINE AND WINE PRODUCTS UNFIT FOR BEVERAGE USE.—Under such regulations as the Secretary or his delegate may deem necessary to protect the revenue, wine, or wine products made from wine, when rendered unfit for beverage use, on which the tax has not been paid or determined, may be withdrawn from bonded wine cellars free of tax. The wine or wine products to be so withdrawn may be treated with methods or materials which render such wine or wine products suitable for their intended use. No wine or wine products so withdrawn shall contain more than 21 percent of alcohol by volume, or be used in the compounding of distilled spirits or wine for beverage use or in the manufacture of any product intended to be used in such compounding.

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Subtitle F—Procedure and Administration

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SEC. 6681. FALSE EQUALIZATION TAX CERTIFICATES

(a) FALSE STATEMENT OF UNITED STATES PERSON STATUS.—In addition to the criminal penalty imposed by section 7241, any person who, for purposes of section 4918(e) *or 4918(h)*, knowingly executes a statement as to his status as a United States person and ownership of stock and debt obligations which contains a misstatement of material fact shall be liable to a penalty equal to 125 percent of the amount of the tax imposed by section 4911 on the acquisition of any stock or debt obligation which, but for the provisions of section 4918, would be payable by the person acquiring such stock or debt obligation.

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SEC. 7241. PENALTY FOR FRAUDULENT EQUALIZATION TAX CERTIFICATES.

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(b) Any person who, on or after the date of the enactment of the Interest Equalization Tax Extension Act of 1967, willfully executes, for purposes of section 4918(e) *or 4918 (h)*, a statement as to his status as a United States person and ownership of stock and debt obligations which is known by him to be fraudulent or to be false in any material respect shall be guilty of a misdemeanor and, upon conviction thereof, shall for each offense be fined not more than $1,000, or imprisoned not more than 1 year, or both.

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