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TAXATION OF CERTAIN DISPOSITIONS OF PROPERTY MADE PURSUANT TO ORDERS ENFORCING ANTITRUST LAWS

SEPTEMBER 29, 1962.—Ordered to be printed

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

REPORT

[To accompany H.R. 8846]

The Committee on Finance, to whom was referred the bill (H.R. 8846) to amend the Internal Revenue Code of 1954 with respect to the taxation of distributions of stock and dispositions of property made pursuant to orders enforcing the antitrust laws, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

This bill provides involuntary conversion treatment for property other than stock which is disposed of as a result of civil antitrust proceedings instituted by the Attorney General, or by a commission or board, under the Sherman Act or the Clayton Act. Thus, where property is disposed of as a result of a judgment, decree, or other order in one of these antitrust cases, and the proceeds are reinvested in other property, similar or related in service or use to the property disposed of, no capital gains tax is to be incurred at the time the first property is disposed of. Instead, the newly acquired property, to the extent that it is acquired with the proceeds from the property sold, is to have the same basis as the old property. The newly acquired property, however, must be a type which is in accord with the terms of the court decree, and it may not be stock of a corporation holding this type of property. The relief is denied if the sale is part of a plan having a principal purpose of tax avoidance. It is also denied where the disposition order resulted from acts which the taxpayer had substantial reason to anticipate would involve a violation of the Sherman Act or Clayton Act.

The bill will apply only to gains which would otherwise be recognized after December 31, 1960 (irrespective of the time of the sale or exchange).

II. Reasons for the Bill

Your committee is concerned about the imposition of tax on the occasion of a disposition of property as a result of antitrust proceedings instituted under the Sherman Act or the Clayton Act.

Presently tax relief is afforded in a number of situations where the taxpayer is compelled to divest himself of property as a result of statutory law, or regulations provided under these laws. Present law, for example, provides for the nonrecognition of gain or loss on exchanges or distributions of property in obedience to orders of the Securities and Exchange Commission. In such cases the basis of other property is reduced by the amount of this gain which otherwise would be recognized. Present law also provides for the nonrecognition of gain from sales or exchanges to effectuate the policies of the Federal Communications Commission. In this case, the gain which otherwise would be recognized must be reinvested in property similar or related in service or use to the divested propety, or the basis of other property which is subject to depreciation must be reduced by the amount of this gain which otherwise would be recognized.

The dispositions of property under the antitrust laws are closely related to the cases cited above in that they, too, are sales or exchanges required by governmental action. Antitrust cases, are frequently similar to the cases above described in another respect: the persons involved frequently were not in a position to know in the past, when they made acquisitions of property, that these acquisitions subsequently would be held to be in violation of the antitrust laws. Both the Sherman Act and the Clayton Act are expressed in such broad terms that in some cases it is quite difficult to determine whether a violation of these laws has occurred until the courts have had an opportunity to interpret the law as applied to the facts in the specific situations. Because these acts are couched in general terms, the law is actually made on the basis of the decided cases. This court-made law compares with the statutory or administrative law involved in the case of bank holding companies and in the case of divestitures required by the Securities and Exchange Commission and Federal Communications Commission. Moreover, in the case of the antitrust decisions, there appears to have been a decided shift in the thinking of the courts in recent years which would have been particularly difficult for persons to have forecast many years ago when making acquisitions.

The substantial tax on capital gains which may be incurred on a sale of property compelled by the antitrust laws may be, in effect, a harsh penalty. This is the case where, except for the legal action, the taxpayer did not plan to sell his property, and the capital gains tax on the proceeds of sale will make it difficult to finance the acquisition of an equivalent new property.

The antitrust laws contain appropriate provisions for civil remedies and criminal penalties. It seems clear that this additional tax penalty is not appropriate where the disposition order is an application of antitrust law in a situation where the taxpayer could not have reasonably anticipated it. Your committee believes that where antitrust laws are applied in relatively unpredictable cases, the tax laws should be neutral. They should not on the one hand result in the imposition

of a penalty, neither should they on the other hand result in an unexpected tax benefit. This neutrality can best be achieved by permitting the taxpayer to carry over the basis of the property he is forced to dispose of to the new property which he acquires.

Antitrust dispositions which could not reasonably have been anticipated are very similar to cases in which property is involuntarily converted as a result of Government action under the right of eminent domain. The bill provides substantially similar tax treatment. Such involuntary conversions under present law do not involve current recognition of gain to the extent that the proceeds of the disposition are reinvested in property which is similar or related in use. Further, the basis of the new property is reduced by the amount of gain not recognized. Thus, the taxpayer has a larger gain by this amount when he later sells the newly acquired property or he has more ordinary income because of lower depreciation on the new property so long as he retains it.

The bill extends this involuntary conversion treatment to sales or exchanges of property (other than stock) resulting from an antitrust action under the Sherman or Clayton Acts with several limitations. Furthermore, the involuntary conversion treatment will not be extended unless the Attorney General or the commission or board instituting the antitrust action certifies that the acquisition of the replacement property by the taxpayer is not inconsistent with the Sherman or Clayton Acts or the terms of the judgment ordering the disposition. Furthermore, the involuntary conversion treatment is not extended if the violation of the Sherman or Clayton Acts was a part of a plan having as one of its principal purposes the avoidance of Federal income tax. Finally, the involuntary conversion treatment is denied for any sale or exchange occurring after date of enactment, unless the disposition order includes a finding that the disposition is required because of acts for which, at the time they were performed, there was no substantial reason for expecting that they would involve a violation of the Sherman Act or the Clayton Act.

TECHNICAL EXPLANATION OF THE BILL

The first section of the bill adds a new section 1112 to part IX of subchapter O of chapter 1 of the Internal Revenue Code of 1954. The new section relates to the disposition of property, other than stock, pursuant to a proceeding under the Sherman Act or the Clayton Act.

Subsection (a) of the new section 1112 provides that certain sales or exchanges are to be treated (with the limitations provided in subsecs. (b) and (c)) as an involuntary conversion of the property sold or exchanged within the meaning of section 1033 of the Internal Revenue Code of 1954. The property to which this section applies is property, other than stock, which is sold or exchanged as a result of a judgment, decree, or other order of a court or of a commission or board authorized to enforce compliance in a suit or other proceeding brought by the United States or such commission or board under the Sherman Act or the Clayton Act. The new section will also apply to sales or exchanges made under threat or imminence of such a judgment, decree, or other order while such proceeding is pending.

Subsection (b)(1) of the new section 1112 makes section 1112(a) inapplicable to any sale or exchange of property which is part of a plan having as one of its principal purposes the avoidance of Federal

income taxes. Section 1112(b)(2) provides that section 1112(a) is not to apply to any sale or exchange of property occurring after the date of the enactment of the bill, unless the judgment, decree, or other order includes a finding by the court, or by the commission or board, that the disposition of such property is required because of acts with respect to which, at the time of such acts, there was no substantial reason for believing that such acts would involve a violation of the Sherman Act or the Clayton Act.

Subsection (c) of the new section 1112 provides certain additional limitations on the operation of section 1033 as it relates to sales or exchanges of property described in section 1112(a). These limitations deal with the requirement in section 1033(a) that the replacement property must be similar or related in service or use to the property sold or exchanged.

The first limitation, provided by paragraph (1), requires that the party instituting the suit or other proceeding described in subsection (a), the Attorney General of the United States, or the commission or board, must certify that the acquisition of the replacement property is not inconsistent with the judgment, decree, or order referred to in section 1112(a), is not inconsistent with the Sherman Act, and is not inconsistent with the Clayton Act.

The second limitation, provided by paragraph (2), adds the restriction that the replacement property may not be stock.

The third limitation, provided by paragraph (3), makes section 1033(g) inapplicable. Section 1033(g) provides that the replacement property in certain circumstances need only be of a like kind.

Subsection (b) of the first section of the bill provides a clerical amendment to the table of sections for part IX of such subchapter O.

Section 2 of the bill contains the effective date provisions for the bill. Subsection (a) provides that the new section 1112 is to apply only with respect to amounts received after December 31, 1960.

Subsection (b) of section 2 provides transition rules to deal with the application of section 1033 where the sale or exchange described in section 1112(a) occurred before January 1, 1961, and part of the payment is received thereafter. Paragraph (1) provides that only amounts received after December 31, 1960, are to be taken into account for purposes of determining the amount realized upon such sale or exchange. The gain taken into account is that portion of the gain which is allocable to amounts realized after December 31, 1960. Paragraph (2) provides that the period specified in section 1033(a)(3)(B) for the acquisition of replacement property is to be treated as beginning on January 1, 1961, and ending on December 31, 1962. Paragraph (3) provides that the period for making the election to have section 1033 apply (which is specified in sec. 1033(a)(3)(A)) is not to expire before the end of the 90th day after the date of the enactment of the bill.

The application of subsection (b) of section 2 of the bill may be illustrated by the following example: Assume that taxpayer A was required to dispose of a property with an adjusted basis of $1 million, under conditions described in section 1112(a), that A sold the property on January 2, 1958, for $3 million payable each January 2 in five consecutive annual installments of $600,000 beginning January 2, 1958, and that A had properly elected, pursuant to the provision of section 453, the installment method of reporting with respect to such sale. The new section 1112 could apply to the installments due in

1961 and 1962. The gain of $800,000 allocable to these two installments would not be recognized if the taxpayer elects within 90 days of the date of the enactment of the bill to have section 1033 apply and makes an investment, after December 31, 1960, and before January 1, 1963, of $1,200,000 in property which meets the requirements of section 1033 as modified by section 1112(c). If such investment during such period aggregated only $1 million, then gain of $200,000 would be recognized, and the remainder of the gain ($600,000) would not be recognized.

REPORT OF TREASURY DEPARTMENT

TREASURY DEPARTMENT,
Washington, September 27, 1962.

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

DEAR MR. CHAIRMAN: This is in response to your request for this Department's views on H.R. 8846 relating to divestitures of property other than stock pursuant to orders enforcing the antitrust laws.

H.R. 8846 would add to the Internal Revenue Code a new section 1112 which would, at election of the taxpayer, treat a sale or exchange of property, other than stock, pursuant to certain antitrust decrees as an involuntary conversion of property entitled to the nonrecognition of gain provisions of section 1033 of the code. If, therefore, as a result of an antitrust judgment, decree, or other order, property were exchanged for other property similar or related in service or use or were sold and the proceeds reinvested in such other property, gain on the sale or exchange would not be recognized. However, section 1112 would not apply if one of the principal purposes of such sale or exchange were the avoidance of Federal income tax.

Proposed section 1112 and the relating amendments are similar to the provisions contained in H.R. 8126 in the 86th Congress and are also similar in purpose to H.R. 7628 in the 85th Congress. The enactment of the latter was opposed by the Treasury Department in a report submitted to the Committee on Ways and Means on July 24, 1957. This report noted that special relief measures are objectionable in the absence of overriding considerations of general policy and the Treasury Department was unaware of any considerations which would justify any special tax relief for this type of antitrust divestiture.

In a letter to the chairman of the Committee on Ways and Means dated September 14, 1961, this Department opposed the enactment of this bill. That letter cited certain technical defects in the bill which have since been removed. However, this Department also stated certain basic objections to the bill which are still applicable.

The bill would apply to the divestiture by the Hilton Hotel Corp. of certain depreciable property which it disposed of in 1956 in accordance with an antitrust divestiture decree. The sales which occurred in that case were made on the installment basis, and the bill would apply to the income which has already been received since December 31, 1960.

On February 6, 1956, the Hilton Hotel Corp. entered into a consent decree requiring the corporation to divest itself of the Jefferson Hotel in St. Louis, the Mayflower Hotel in Washington and either the Hotel Roosevelt or the Hotel New Yorker in New York City. From

information submitted by representatives of the Hilton Hotel Corp. we understand that during 1955 and 1956 the corporation sold the above-mentioned hotels (including the stock of a subsidiary corporation which owns the Hotel Roosevelt). At the end of 1960, approximately 30 percent of the total consideration received from these sales remained unpaid and was represented by installment notes which will be collected periodically through the year 1966. We are informed that the Hilton Hotel Corp. sold these installment obligations in 1961, and therefore the entire amount of the gain realized on the disposition of these hotels has already been recognized.

Information made available to us by the Department of Justice on March 19, 1962, indicates that insofar as the Department of Justice is able to ascertain, none of the cases presently pending in its Antitrust Division in which divestiture is sought would result in the application of the bill. It appears, therefore, that at this time the only known application of the bill is the 1956 divestiture by the Hilton Hotel Corp.

It should be noted that the sale of the depreciable property in that case was subject to capital gains rates (and that would normally be the case with respect to a sale of business property under a divestiture decree). Hence, the gain from such a sale, under existing law, is taxed at a rate of only 25 percent. Furthermore, the sale was a 10-year installment sale subject to the installment method of reporting provided in section 453 of the code. Thus, the tax on the gain was spread out over the period during which the proceeds were received. The Department believes, therefore, that existing law provides ample relief in the case of a sale of business property under the antitrust laws.

It is true that with respect to the so-called Du Pont legislation (Public Law 87-403) this Department took the view that it did not object to that relief legislation if Congress believed that the equities of the situation justified such relief. Those equities included the protection of 300,000 stockholders of General Motors Corp. (which corporation had not been found in violation of the antitrust laws), as well as protection against an adverse impact upon the stock market generally, due to the divestiture of stock acquired many years ago under circumstances which did not then appear to involve any violation of antitrust laws. An additional consideration was the antitrust advantage obtained in this case if the divestiture was achieved within 3 years, as opposed to the anticipated period of 10 years in the absence of legislation. Moreover, in the *du Pont* case the relief accorded permitted what would otherwise have been ordinary income to be treated generally as capital gains, whereas in the *Hilton* case, as indicated above, capital gains treatment is already accorded under existing law. Finally, the Du Pont legislation, which did not confer any tax relief on the Du Pont Co. itself, was entirely prospective in application.

No equities comparable to those involved in the *du Pont* case are present here. The hotels which were sold by the Hilton Hotel Corp. had been acquired by it in 1954, shortly prior to the institution of antitrust proceedings in 1955. (The requirement in the bill that there be a finding that the divestiture is required because of acts with respect to which "there was no substantial reason for believing that such acts would involve a violation of the Sherman Act or the Clayton Act" applies only to divestitures occurring after date of enactment, and does not apply to the *Hilton Hotel* case.) If the sale

of the hotels resulted in any adverse impact on the market value of the stock of the Hilton Hotel Corp. (which is listed on the New York and Pacific Coast Stock Exchanges), presumably this impact occurred in 1955 and 1956, when the hotels were sold and the tax consequences were established. Granting retroactive tax relief now would provide a windfall not only to the corporation and its shareholders generally, but particularly to those shareholders who acquired their stock since 1956. The *Hilton Hotel* case involves no aspect of improving the enforcement of antitrust divestiture, since the divestiture was successfully completed several years ago under the rules of existing tax law. Moreover, the Department of Justice, in its report on H.R. 8846 to the Committee on Ways and Means, stated that no useful antitrust purpose would be served by the bill.

Finally, it should be noted that the bill is retroactive not only because it changes the tax consequences of sales occurring several years ago, but also because it changes the character of payments already received by the Hilton Hotel Corp. after December 31, 1960.

For the above reasons, the Department opposes the enactment of the bill.

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

Sincerely yours,

STANLEY S. SURREY, *Assistant Secretary.*

CHANGES IN EXISTING LAW

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

PART IX OF SUBCHAPTER O OF CHAPTER 1 OF THE INTERNAL REVENUE CODE OF 1954

PART IX—DISTRIBUTIONS PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

SEC. 1111. DISTRIBUTION OF STOCK PURSUANT TO ORDER ENFORCING THE ANTITRUST LAWS.

(a) GENERAL RULE.—Notwithstanding sections 301, 312, and 316, a distribution of divested stock (as defined in subsection (e)), to a qualifying shareholder (as defined in subsection (b)), to which section 301(c)(1) would, but for this section, apply, shall be a distribution which is not out of the earnings and profits of the distributing corporation for purposes of this subtitle.

(b) QUALIFYING SHAREHOLDER.—For purposes of this section, the term "qualifying shareholder" means any shareholder other than a corporation which may be allowed a deduction under section 243, 244, or 245 with respect to dividends received.

(c) SPECIAL RULES.—

(1) DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.—Subsection (a) shall not apply to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or of the corporation whose stock is distributed, or both.

(2) STOCK.—For purposes of this section, the term "stock" includes rights to fractional shares.

(d) DEFINITION OF ANTITRUST ORDER.—For purposes of this section, the term "antitrust order" means, in the case of any corporation, a final judgment rendered after January 1, 1961, by a court with respect to such corporation in a court proceeding under the Sherman Act (26 Stat. 209; 15 U.S.C. 1–7) or the Clayton Act (38 Stat. 730; 15 U.S.C. 12–27), or both, to which the United States is a party, if such proceeding was commenced on or before January 1, 1959.

(e) DEFINITION of DIVESTED STOCK.—For purposes of this section, the term "divested stock" means stock meeting the following requirements:

(1) the stock is the subject of an antitrust order entered after January 1, 1961, which—

(A) directs the distributing corporation to diverst itself of such stock by distributing it to its shareholders (or requires such distribution as an alternative to other action by any person);

(B) specifies and itemizes the stock to be divested; and

(C) fixes the period of time within which the distributing corporation must divest itself of all stock to be disposed of by it by reason of the suit, and such period expires not later than 3 years from the date on which such order becomes final (appeal time having run or appeal having been completed); and

(2) the court finds—

(A) that the divestiture of such stock, in the manner described in paragraph (1)(A), is necessary or appropriate to effectuate the policies of the Sherman Act, or the Clayton Act, or both;

(B) that the application of subsection (a) is required to reach an equitable antitrust order in such suit or proceeding; and

(C) that the period of time for the complete divestiture fixed in the order is the shortest period within which such divestiture can be executed with due regard to the circumstances of the particular case;

but no stock shall be divested stock if the court finds that its divestiture is required because of an intentional violation of the Sherman Act, or the Clayton Act, or both.

SEC. 1112. DISPOSITION OF PROPERTY (OTHER THAN STOCK) TO EFFECTUATE ANTITRUST POLICIES

(a) NONRECOGNITION OF GAIN.—If property (other than stock) is sold or exchanged as the result of a judgment, decree, or other order (or the threat or imminence thereof while the proceeding is pending) of a court or of a commission or board authorized to enforce compliance in a suit or other proceeding brought by the United States or such commission or board under the Sherman Act (26 Stat. 209; 15 U.S.C. 1–7), or the

Clayton Act (38 Stat. 730; 15 U.S.C. 12–27), such sale or exchange shall be treated as an involuntary conversion of such property within the meaning of section 1033.

(b) EXCEPTIONS.—Subsection (a) shall not apply—

(1) to any sale or exchange which is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax; and

(2) to any sale or exchange of property occurring after the date of the enactment of this section, unless the judgment, decree, or other order includes a finding by the court, or by the commission or board, that the disposition of such property is required because of acts with respect to which, at the time of such acts, there was no substantial reason for believing that such acts would involve a violation of the Sherman Act or the Clayton Act.

(c) OTHER LIMITATIONS.—For purposes of this section—

(1) The purchase of other property shall not be treated as satisfying the requirements of section 1033 unless—

(A) the Attorney General of the United States, if the proceeding described in subsection (a) was instituted by the Attorney General, or

(B) the commission or board, if the proceeding described in subsection (a) was instituted by such commission or board, certifies that such purchase is not inconsistent with the terms of the judgment, decree, or order referred to in subsection (a), is not inconsistent with the Sherman Act, and is not inconsistent with the Clayton Act.

(2) The purchase of stock for the purpose of replacing the property described in subsection (a) of this section shall not be treated as satisfying the requirements of section 1033.

(3) In applying section 1033, the determination as to whether other property is similar or related in service or use to the property sold or exchanged shall be made without regard to section 1033(g).

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