Calendar No. 905

86TH CONGRESS, 1st Session | SENATE | REPORT No. 878

TECHNICAL CHANGES IN CERTAIN EXCISE TAX LAWS

SEPTEMBER 2 (legislative day, AUGUST 31), 1959.—Ordered to be printed

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

REPORT

[To accompany H.R. 8725]

The Committee on Finance to whom was referred the bill (H.R. 8725) to amend the Internal Revenue Code of 1954 to make technical changes in certain excise tax laws, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF THE BILL

Last year Congress passed the Excise Tax Technical Changes Act of 1958 which constituted the first major revision of the excise tax laws. Experience under this act has shown that certain refinements and modifications need to be made in that act. This bill provides for six such changes:

(1) It deletes from the tax on jewelry "coral" when sold as a stone and not as a part of a piece of mounted jewelry.

(2) It makes it clear that the exemptions from the retailers', manufacturers', communications, and transportation of persons taxes for nonprofit educational organizations include parochial schools which are merely an activity of a church as well as those which are separate educational organizations. It also makes a similar modification in the case of the exemption for nonprofit educational organizations in the case of the admissions tax.

(3) It modifies the exemption from the club dues tax presently available in the case of capital improvements. This exemption is to be available for payments for capital improvements, whether made in connection with the dues tax or the initiation tax, which are spent for the construction or reconstruction within the 3 year period after the club receives the amount from the member. In addition, the exemption is to be available with respect to furnishings and fixtures for the use of the facility constructed or reconstructed.

(4) It restores the exemption, in the case of the communications taxes, formerly provided for common carriers and communication companies in the case of leased wires now classified as general telephone service which connect two stations for which a toll charge would otherwise be made.

(5) It modifies the documentary stamp tax applicable to transfers to make it apply in the case of stock rights or warrants on the basis of the value of the rights or warrants rather than on the basis of the value of the underlying stock.

(6) It reduces from $250 to $10 the occupational tax applicable to so-called claw, crane, or digger machines used at carnivals or fairs where the charge is not in excess of 10 cents, the merchandise prizes provided have a value of not more than $1, and the machines are activated by a nonelectrical mechanism.

II. GENERAL EXPLANATION OF BILL

Last year Congress in passing the Excise Tax Technical Changes Act of 1958 (H.R. 7125, 85th Cong., 2d sess.; Public Law 85-859; Sept. 2, 1958) undertook a comprehensive revision of the technical and administrative provisions of the Federal excise taxes. In a technical revision bill of this magnitude almost of necessity there are changes made which after experience in actual operations require further modifications. This bill is designed to make a series of six modifications required as a result of this revision. The changes made by the bill are discussed below in the order of the various sections of the bill.

1. Deletion of "coral" from the list of semiprecious stones subject to the 10 percent jewelry tax

Before the enactment of the Excise Tax Technical Changes Act of 1958 there was included in the base of the 10-percent retailers' excise tax on jewelry and related items (sec. 4001) "pearls, precious and semiprecious stones, and imitations thereof." However, uncertainty as to what constituted semiprecious stones and imitations presented problems for both the taxpayers and the Internal Revenue Service. In view of this, the 1958 act deleted the reference to "precious and semiprecious stones, and imitations thereof" and substituted a specific list of stones (real or synthetic) which are subject to tax.

Among these stones specifically listed in the 1958 act was "coral." However, it has been found that although some coral is sold for use as a gem the bulk of it is sold for ornamentation of fish bowls. Moreover, it is believed that coral has a relatively small value unless combined with mountings or settings. In view of this your committee believes that coral should be omitted from the list of stones subject to tax and has so provided in the first section of this bill.

The deletion of coral from the list of taxable stones will not affect the taxable status of necklaces, or other articles of adornment, contraining coral. In these cases the items will continue to be taxable under another provision of the tax on jewelry which taxes "all articles commonly or commercially known as jewelry."

This change is to become effective as of the first day of the first month beginning more than 10 days after the date of enactment of this bill.

2. Certain nonprofit educational organizations

The Excise Tax Technical Changes Act of 1958 provided an exemption for "nonprofit educational organizations" in the case of retailers' excises, manufacturers' excises, the taxes on communications services, and the tax on the transportation of persons. These exemptions are available for purchases of taxable articles and services by these organizations. The exemptions were added by the 1958 act on the grounds that not to do so would have been discriminatory. It was pointed out that prior to that act exemptions were provided from these taxes for public schools and colleges but not private nonprofit institutions.

Under the 1958 act an exempt "nonprofit educational organization" was defined as an educational organization described in section 503(b)(2) of the code which is exempt from income tax under section 501(a). Section 503(b)(2) of the code refers to

> an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Questions have been raised as to whether the reference to "educational organizations" in this definition covers parochial schools which are merely an activity of a church and not separate entities. In accord with the clear intent of Congress in enacting this legislation last year, the Treasury Department in Treasury Decision 6344 has taken the position that the exemption for "nonprofit educational organizations" did cover these parochial schools. The committee believes it is desirable to amend the code on this point so that it clearly reflects this position.

As a result, section 2 of this bill amends the pertinent sections for the retailers' taxes (sec. 4057), the manufacturers' taxes (sec. 4221(d)(5)) and the taxes on communications and transportation of persons (sec. 4294(b)), to add in each case a sentence providing that the term "nonprofit educational organization" includes a school operated as an activity of an exempt religious, educational, charitable, etc., organization if it maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

In addition the code also contains an exemption from the admissions taxes for educational institutions described in section 501(c)(3) which are exempt from tax under section 501(a). This also contains an exemption for educational organizations of governmental units having a regular faculty, curriculum, etc. Although this was not provided by the 1958 act, the committee believed that for purposes of consistency and uniformity in excise tax administration it was desirable to add a clause specifically including within the exemption schools carried on as an activity of other exempt religious, educational, charitable, etc., organizations in the same manner as in the case of the other taxes referred to above. No inferences, however, are to be drawn from this as to the extent of the existing exemptions.

The amendments made by this section, to the extent they relate to the changes made by the Technical Changes Act of 1958, are made as of the general effective date for title I of that act, namely, January 1,

1959. This date is provided since these amendments are declaratory of existing law.

The amendment to the admissions tax exemption is to be effective as of the beginning of the first month starting more than 10 days after the date of enactment of this bill.

3. Exemption for capital improvements in the case of the club dues tax

In the case of the 20 percent club dues tax, the Excise Tax Technical Changes Act of 1958 provided an exemption for assessments for capital improvements. It was indicated that this exemption was granted because the construction or reconstruction of capital facilities represents especially heavy burdens for many clubs and that it was unfortunate to add to this already heavy burden by the imposition of a tax.

Experience under this exemption has suggested the desirability of several refinements. First, reference to exemptions only for "assessments" for capital improvements has limited the application of the exemption to dues since the term "dues" is defined as including any assessment. This precludes an exemption for initiation fees even through the amounts collected are used for the construction or reconstruction of otherwise qualifying capital improvements.

Second, the exemption is not available in the case of assessments for required furnishings and fixtures since such amounts are not for the "facility" being constructed or reconstructed.

Third, there is no indication in the present exemption as to how long after the payment of the assessment the construction or reconstruction may occur, or how specific the plans must be for this construction or reconstruction.

In view of these problems section 3 of this bill rewrites this exemption to provide for the problems referred to above. First, it provides an exemption for amounts paid for dues or membership fees or as initiation fees (instead of referring only to assessments which relate only to dues).

Second, it provides an exemption not only in the case of the construction or reconstruction of a social, athletic, or sporting facility or for a capital addition or improvement in such a facility, but also for certain furnishings or fixtures (including installation charges) for such a facility. To qualify the furnishings or fixtures must be required by reason of the construction or reconstruction for the use of the facility upon the completion of the work. For example, this would include required furniture, drapes, carpeting, refrigerators, etc., for a new facility, or for any portion of an existing facility which is reconstructed.

Third, the exemption is limited to amounts spent for construction or reconstruction or required furnishings or fixtures within 3 years after the date of payment by the club member. The tax on amounts not so spent becomes payable immediately after the expiration of the 3-year period and in this case is payable by the club rather than the member. The shift in the incidence of the tax in this case is provided because of the problem which would otherwise be presented in attempting to trace back to members of the club 3 years earlier.

These changes are made effective for amounts paid on or after the first day of the first month beginning more than 10 days after the date of enactment of this bill. In addition, the amounts paid must be for construction or reconstruction of a facility begun on or after

January 1, 1959, or for furnishing or fixtures for such a facility upon its completion.

4. Exemption for certain telephone lines or channels used by common carriers, or communications companies

Because the excise taxes on communications services had, to some degree, become obsolete in their operation and because of technological changes in the industry, the Excise Tax Technical Changes Act of 1958 made a major revision in the terminology and definitions of the taxable types of services.

One of the former taxable categories was "leased wire, teletypewriter, or talking circuit special service." Part of this category was separated out into what is now known as teletypewriter exchange service. Most of the remainder of the old category is now in what is called wire mileage service. However, a portion of the old category now appears in the category known as general telephone service. Formerly, leased wires were included in local telephone service when they were entirely within a local exchange area. The 1958 act, however, dropped this distinction based on local exchange area and instead included in general telephone service, telephone service "which may be connected (directly or indirectly) to an exchange operated by a person engaged in the business of furnishing communication service." As a result the category "general telephone service" now includes some of the leased wire services beyond a local exchange area which were formerly in the category "leased wire, teletypewriter, or talking circuit special service." They are in this category in some cases because they are directly connected through telephone company switchboards and sometimes because they are indirectly so connected through switchboards the subscribing company may itself have.

The problem arising from this shift of some of the leased wire services to the general telephone service category relates to the exemption previously provided for "leased wire, teletypewriter, or talking circuit special services" in the case of common carriers (such as the railroads, airlines, and trucking companies) and telephone, telegraph, and radio broadcasting companies. The exemption for these carriers or communication companies was continued by the 1958 act for those services classified as "wire mileage service." It is not available, however, for the wire services classified as general telephone services. The denial of this existing exemption was not intended in the 1958 act and your committee in this bill is therefore correcting this oversight.

The bill in section 4 deals with this problem by expanding the exemption in present law relating to special wire service used in company business (sec. 4253(f)). At present this provides an exemption from the tax on wire mileage service and wire and equipment service used by a common carrier, telephone or telegraph company, or radio broadcasting station or network in the conduct of its business. The bill expands this to include any telephone (or radio telephone) line (or channel) constituting general telephone service used by one of these companies in the conduct of its business. However, this new exemption is available only if the telephone line (or radio telephone channel) connects stations between any two of which there would be a toll charge in the case of the usual telephone service. This latter limitation is in lieu of the former restriction to the effect that not all of the leased wire could be in a local exchange area for the exemption to

be available. The question as to whether there is a toll charge between two points is to be determined on the basis of whether there would be such a charge in the case of unlimited telephone service.

In determining what constitutes one or more lines, for purposes of determining whether or not a single line extends beyond a toll area, any switchboard connection interposed between two stations, which makes it possible to carry on two independent conversations at the same time, will result in the lines being considered as two lines In a case of this type, if one station and the switchboard just referred to were so located that otherwise there would be no toll charge for calls between these points, no exemption would be available for this portion of the service. On the other hand, if there is interposed between the two stations a so-called dropline, which makes it possible to carry on a conversation between either one of the stations and the point connected by the dropline (but it is impossible to carry on two conversations at once), then the entire service will be considered as one line. As a result if the two stations are so located that generally there would be a toll charge for calls between the two stations, the portion of the service between the station and the point connected by the dropline, even though there would otherwise be no toll charge between these points, will not result in this portion of the service being subjected to tax.

These changes are made effective as if they had been enacted as a part of the Excise Tax Technical Changes Act of 1958 at the time of its enactment. This will assure continuity of the exemption applicable to leased wire services. To accomplish this result this bill permits rebilling, or amending of bills, back to January 1, 1959.

5. Measure for documentary stamp transfer tax in the case of stock rights on warrants

Prior to the passage of the Excise Tax Technical Changes Act of 1958, the documentary stamp transfer tax in the case of stock was based primarily on the par or face value of the certificates or shares. The reports on the 1958 act pointed out that using par value as the basis for the tax was arbitrary and discriminated against stocks with low actual values. Therefore, that act, in general, changed this to a tax of 4 cents per $100 based on the actual value of the shares.

A problem has arisen with this "actual value" tax, however, in the case of stock rights and warrants. The statute imposes a tax not only on the sale or transfer of shares or certificates of stock but also on the "rights to subscribe for or to receive" such shares or certificates, However, the only tax base referred to in the statute is the actual value of the "certificates (or of the shares where no certificates are sold or transferred)." As a result, the Treasury Department has held that in the case of the transfer of rights to subscribe for, or to receive, stock, the tax is based, not on the value of the rights sold or transferred, but rather on the value of the underlying shares of stock which may be acquired upon the exercise of the rights. Thus, the tax imposed in the case of stock rights or warrants may be several times the tax which would be imposed if it were imposed with respect to the value of the rights or warrants.

The discrimination referred to can be illustrated by an example. Assume a person sells for $1,000 a block of 100 warrants to buy a specific stock at $20 a share. Assume further that the stock is then

selling for $29 a share with the result that the 100 shares of stock underlying the warrants have a value of $2,900. Under present law at a rate of 4 cents per $100 of this value, this means a stamp tax of $1.16 on the block of 100 warrants. However, if the tax were based on the value of the warrants, namely, the $1,000, rather than the value of the stock, the tax would be 40 cents or about a third of the tax now imposed.

The bill in section 5 corrects this inequitable treatment of stock rights and warrants by basing the tax in the case of "rights to subscribe for or to receive" shares or certificates on the actual value of the "rights" rather than on the actual value of the shares or certificates.

Under present law the tax on any sale or transfer may not be more than 8 cents per share or less than 4 cents on the sale or transaction. Under this bill the minimum of 4 cents on the sale or transaction will also apply to the sale of stock rights or warrants on a transaction basis. The maximum of 8 cents per share, however, is to continue to apply, in the case of stock rights or warrants, to the underlying shares of stock.

This change is to be effective as of the first day of the first month beginning more than 10 days after the date of enactment of this bill.

6. Gaming devises commonly known as claw, crane, and digger machines

Under present law an occupational tax of $10 per year is levied with respect to a music or amusement machine or with respect to certain 1-cent vending machines dispensing merchandise prizes with a retail value of not more than 5 cents. Other slot or gaming machines are subject to an occupational tax of $250 per year per machine. Included in this latter category are certain so-called claw, crane, and digger machines. The particular type of machine referred to here is one which is not electrically activated and, therefore, the question of whether or not a prize is obtained depends, to a substantial extent, upon the skill of the operator in handling the crank operating the claw, crane, or digger machine. Moreover, the $250 tax in the case of the machines dispensing prizes of relatively small value and providing for charges of only 5 cents or 10 cents, constitutes such a heavy burden that is is not possible in many cases to operate the machines at a profit. Where machines of this type are operated as a part of carnivals or county or State fairs, it appears undesirable to in effect deny this type of amusement by the imposition of such a tax burden.

In view of these considerations, your committee has provided that devices commonly known as claw, crane, or digger machines are to be subject to a $10 a year tax, instead of the regular $250 gaming machine tax, if the following four conditions are met:

(1) The charge for each operation of the machine is not more than 10 cents;

(2) The prizes dispensed by the machine are merchandise with a retail value of not more than $1, there is no advertisement to the effect that any prize other than that dispensed by the machine is offered, and no such other prize is given;

(3) The device is activated by a crank and has a nonelectrical mechanism; and

(4) The device is not operated other than in connection with carnivals or county or State fairs.

The reference to carnivals or county or State fairs is intended to distinguish between the temporary use of such machines at fairs and carnivals from the more permanent use of such machines in arcades of amusement parks, etc.

This reduced rate covers both the coin-operated and the similar machines which are operated without the insertion of a coin, token, or similar object. Where a machine qualifies for the reduced rate, the owner paying only $10 on July 1 of a year, and then subsequently the machine is diverted to use requiring the payment of the full $250 tax, the higher rate tax is to become applicable but only for the portion of the year (computed on a monthly basis) beginning with the month in which such new use occurs.

This amendment is made effective for periods beginning after June 30, 1960.

CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate in order to expedite the business of the Senate in connection with this report.

○