Calendar No. 2380

81ST CONGRESS, 2d Session | SENATE | REPORT No. 2375

THE REVENUE ACT OF 1950

REPORT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

TO ACCOMPANY

H. R. 8920

A BILL TO REDUCE EXCISE TAXES, AND FOR OTHER PURPOSES

AUGUST 22 (legislative day, JULY 20), 1950.—Ordered to be printed

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

REPORT

[To accompany H. R. 8920]

The Committee on Finance, to which was referred the bill (H. R. 8920) to reduce excise taxes, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill, as amended, do pass.

I. GENERAL STATEMENT

Military action in Korea coupled with substantial increases in defense and related expenditures has made it necessary to convert the excise tax reduction bill passed by the House in June of this year into a bill to raise revenues. The bill as amended by your committee will increase tax liabilities by 4.5 billion dollars a year when fully effective, and will increase collections in the fiscal year 1951 by about 3 billion dollars. It is not anticipated that these increases will be of sufficient size to offset the new defense and related expenditures. However, this bill accomplishes all that can be done quickly.

Your committee deemed it unwise to delay the bill by attempting to include other methods of raising revenue, such as an excess profits tax, which would require several weeks of hearings and detailed study and analysis by the committee and its staff. To make the change in withholding rates on individuals effective on October 1 it is necessary that the bill become law as soon as possible in order that the withholding forms may be revised and printed in time. It is also advisable that the tax on corporations be adopted as promptly as possible since it affects the year 1950. The committee has instructed the staff to study the excess profits tax and other revenue-raising measures, so that they may be considered by your committee early next year, and has announced that any excess profits tax enacted at that time will be applicable to the income of the entire calendar year 1951.

Your committee's bill includes many of the loophole-closing measures, the minor excise increases contained in the House bill, and extends the 10-percent tax on radio receivers to television sets. The House plan to accelerate corporate income-tax payments is retained. However, the bulk of the additional revenue provided under the bill will come from the imposition of higher corporate and individual income-tax rates. The top corporate income-tax rate is raised from 38 to 45 percent. The percentage reductions in the wartime individual income taxes, made by the Revenue Acts of 1945 and 1948, are eliminated, increasing the effective starting rate from 16.6 to 20 percent, and the top rate from about 82 to 91 percent. The full increase in both corporate and individual rates will be effective in 1951 and subsequent years. The corporate income tax increase applies to approximately one-half, and the individual income-tax increase to about one-quarter of the income for the calendar year 1950. These changes in the corporate and individual income-tax rates involve few technical problems and there is general agreement that these rates must be raised in view of the new expenditures required by the crisis in international affairs.

II. REVENUE EFFECT OF THE BILL

Table 1 compares the effect of the Finance Committee bill and the House bill on collections in the fiscal year 1951 and on tax liabilities in a full year of operation. It is estimated that your committee's bill will increase tax liabilities in a full year of operation by $4.5 billion, while the House bill would have virtually no effect on over-all tax liabilities. In terms of collections it is estimated that in the fiscal year 1951 your committee's bill will increase revenues by slightly less than $3 billion as compared to slightly more than $600 million under the House bill. Estimated collections for the fiscal year 1951 in the case of both the House bill and your committee's bill take into account the acceleration of tax payments for corporations and the elimination of the installment payment privilege for trusts and nonresident aliens. No account is taken of these two provisions in the case of the columns relating to liabilities under either the House bill or your committee's bill, since these provisions do not affect the total tax which will eventually be paid by any corporation, trust, or nonresident alien. Nevertheless, these two provisions will increase collections in the fiscal years 1951 through 1956 by $4.9 billion.

To make comparisons possible between the provisions of the House bill and your committee's bill the estimates for both bills are based on current levels of income and profits. If the upward trend in business continues, this will, of course, result in an understatement of the increase in tax collections and liabilities. The estimates for the House bill shown in table 1 differ from those shown in the report of the Committee on Ways and Means since the international situation has had an important effect upon levels of income and profits.

In terms of the effect of the two bills on tax liabilities, there are three major variations. First, the House bill provides for a net excise tax reduction of $910 million, while your committee's bill increases excise tax liabilities by $55 million. Second, your committee's bill increases tax liabilities under the individual income tax by $2,745 million, while the House bill made no changes in this tax. Third, your committee's bill increases corporation income tax rates by $1,500 million, while the House bill would have increased these liabilities by only $450 million. On the other hand, your committee's bill does not contain all of the House loophole-closing and tax-adjustment provisions which would raise revenue. In terms of revenue the two most important such items, which are included in the House bill but not in your committee's bill, relate to withholding on dividends and lower interest rates on tax refunds.

In terms of the effect on collections in the fiscal year 1951, the revenue effects of the House bill and your committee's bill are much closer than is true in the case of tax liabilities. In the fiscal year 1951 collections under your committee's bill will exceed those which the House bill would provide by approximately $2.3 billion. Again the excise tax reductions provided by the House bill, the individual income tax rate increases provided in your committee's bill, and the larger corporate rate increases provided by your committee's bill account for the difference. The collections from the acceleration of corporate tax payments are somewhat greater under your committee's bill than under the House bill because of the higher tax rates your committee's bill makes effective.

TABLE 1.—*Comparison of the estimated effect of the Finance Committee's bill and the House bill on tax liabilities in a full year of operation and on collections in the fiscal year 1951*

[Increase (+) or decrease (−); in millions of dollars]

	Effect on liabilities in a full year of operation		Effect on collections in the fiscal year 1951	
	Finance Committee's bill	House bill [1]	Finance Committee's bill	House bill [1]
Income taxes:				
Corporations:				
Rate changes	[2]+1,500	[2]+450	[2]+320	[2]+177
Accelerated payments	0	0	+800	+780
Individual income-tax rates	+2,745		+1,624	
Charitable trusts, family foundations, educational institutions, etc	+60	+100		
Miscellaneous loopholes, etc	+68	+141	+18	+19
Percentage depletion		−35		−15
Life-insurance companies	+80	+70	+75	+166
Interest rate on refunds		+45		+5
Accelerated payment of income taxes of trusts and nonresident aliens	0	0	+90	+80
Withholding tax on dividends		+190		+78
Excise taxes (net)	+55	−910	[3]+30	[4]−670
Total net change	+4,508	+51	+2,957	+620

[1] These estimates are based on current levels of income and profits and hence differ from the estimates contained in the report of the Committee on Ways and Means.
[2] Net amounts after allowing for reduced individual income taxes because of lower dividends.
[3] Assuming the changes become effective on Oct. 1, 1950.
[4] Assuming the changes become effective on Sept. 1, 1950.

Source: Staff of the Joint Committee on Internal Revenue Taxation.

III. THE RATES UNDER THE INDIVIDUAL INCOME TAX

Your committee adopted the suggestion of the administration in respect to the individual income tax. This suggestion was to eliminate entirely for 1951 and subsequent years the percentage reductions made in the Revenue Act of 1945 and in the Revenue Act of 1948. These reductions are as follows:

17 percent of the first $400 of tentative tax;
12 percent of that part of the tax in excess of $400 and not in excess of $100,000;
9.75 percent on the tax in excess of $100,000.

For the year 1950, the tax in effect is increased for the quarter starting October 1, 1950. Thus, the withholding rate is raised, effective October 1, 1950, from 15 percent to 18 percent. However, to apply the increased rates to only that part of the income arising after October 1, 1950, would be unfair in the case of those taxpayers who derive the greater part of their income in the latter part of the year. Therefore, the procedure actually followed in the bill for 1950 was to cut the percentage reductions under existing law by approximately 25 percent. As a result, after a taxpayer has determined his tentative tax for calendar year 1950, he will, under the bill, make the following percentage reductions in such tax instead of the reductions provided for under existing law:

13 percent of the first $400 of tentative tax;
9 percent of that part of the tentative tax between $400 and $100,000;
7.3 percent of that part of the tentative tax in excess of $100,000.

In the case of individuals on a fiscal year basis, income for years ending prior to October 1, 1950, will be subject to the rates imposed under existing law. When the fiscal year begins prior to October 1, 1950, and ends subsequent to that date, the year will be divided into two parts for the purposes of the tax. To the extent that the taxable year precedes October 1, 1950, the individual will be taxed at the rates imposed under existing law. To the extent that the year follows September 30, 1950, the individual will be taxed at the rates imposed for 1951 and subsequent years. Individuals with fiscal years beginning after September 30, 1950, will be subject to the rates imposed for 1951.

While the House bill did not change the rates imposed on individual incomes, your committee has added to the bill provisions which will increase liabilities by about 2.7 billion dollars in a full year's operation at current income levels. Total liabilities will increase from 15.8 billion to 18.6 billion dollars, or about 17 percent. Under the bill the full increase will apply to incomes received or accrued in 1951 and subsequent years. Approximately one-fourth of the increase will apply to 1950 incomes in the case of individuals on a calendar year basis.

Table 2 compares the combined normal tax and surtax marginal rates imposed under the Revenue Act of 1944 (the wartime peak) and those imposed under the 1945 and 1948 acts (taking the percentage reductions into account) with the rates which will apply in 1951 and subsequent years under your committee's bill. The rates under the bill will be 3 percentage points lower in each bracket than those imposed under the 1944 act. The difference represents a 3 percentage point reduction in the rate schedule made in the Revenue Act of 1945, which is not removed by this bill.

This bill does not affect the increases in personal exemptions and dependency credits made in the Revenue Acts of 1945 and 1948. The Revenue Act of 1945 allowed the $500 per capita exemptions for both normal and surtax purposes. The Revenue Act of 1948 increased these exemptions from $500 to $600 per capita, instituted an additional exemption of like amount for taxpayers and their spouses if they are 65 years of age or over, and substituted a $600 exemption for blind taxpayers for the $500 deduction allowed under the previous law.

The bill also does not disturb the system of splitting the income of married couples adopted in the Revenue Act of 1948.

In order to keep collections on a current basis the withholding rate will be increased from 15 to 18 percent with respect to all wages and salaries paid on or after October 1, 1950. This is the full 20-percent increase in the withholding rate required under this bill.

The removal of the postwar percentage reductions in the tentative tax is the most desirable method of meeting the President's request for an immediate increase in revenue from the individual income tax. The change is simple and easily understood. The additional taxes which will result will be distributed in the same fashion as the decreases resulting from the postwar percentage reductions. Thus, the action taken at this time is no more than a partial return to the wartime tax burdens. Moreover, the elimination of the percentage reductions will simplify the calculations made on the individual's income-tax return.

Table 3 shows by net income classes the distribution of income, taxable returns and tax liabilities under existing law and under your committee's bill when the proposed change in rates is fully effective. The table indicates that the bill will make only a minor change in the apportionment of the total burden between the group of individuals whose incomes are less than $5,000 and the group whose incomes are $5,000 or more.

Table 4 compares the tax burdens under existing law, the burdens which will exist under the bill in 1950, and the burdens under the bill in 1951 and subsequent years in the case of a single individual with no dependents. Tables 5 and 6 contain similar comparisons for a married couple with no dependents and a married couple with two dependents. These tables indicate that, when expressed as a percentage of the tax due under present law, the increase under the bill is comparatively large in the case of taxpayers with smaller incomes. However, when the increase is expressed as a percentage of the spendable income remaining after tax under present law, the change in the lower income brackets is comparatively small and the increase in the upper income brackets is comparatively large.

Table 7 shows the effective rates of taxation under existing law, under your committee's bill in 1950 and under the bill in 1951 and subsequent years for a single person with no dependents. Tables 8 and 9 show similar data for a married couple with no dependents and a married couple with two dependents. These tables show that the increase in the effective rate is substantially larger in the case of large incomes than it is in the case of small incomes.

TABLE 2.—*Individual income tax rate schedule—the Finance Committee rates for 1951 and subsequent years compared with those used under the Revenue Acts of 1944, 1945, and 1948*

Surtax net income	1944 act (highest wartime rates)	1945 act [1]	1948 act [1] (present law)	Proposed rates, 1951 and subsequent years
	Percent	*Percent*	*Percent*	*Percent*
0 to $2,000	23	19.00	16.60	20
$2,000 to $4,000	25	20.90	19.36	22
$4,000 to $6,000	29	24.70	22.88	26
$6,000 to $8,000	33	28.50	26.40	30
$8,000 to $10,000	37	32.30	29.92	34
$10,000 to $12,000	41	36.10	33.44	38
$12,000 to $14,000	46	40.85	37.84	43
$14,000 to $16,000	50	44.65	41.36	47
$16,000 to $18,000	53	47.50	44.00	50
$18,000 to $20,000	56	50.35	46.64	53
$20,000 to $22,000	59	53.20	49.28	56
$22,000 to $26,000	62	56.05	51.92	59
$26,000 to $32,000	65	58.90	54.56	62
$32,000 to $38,000	68	61.75	57.20	65
$38,000 to $44,000	72	65.55	60.72	69
$44,000 to $50,000	75	68.40	63.36	72
$50,000 to $60,000	78	71.25	66.00	75
$60,000 to $70,000	81	74.10	68.64	78
$70,000 to $80,000	84	76.95	71.28	81
$80,000 to $90,000	87	79.80	73.92	84
$90,000 to $100,000	90	82.65	76.56	87
$100,000 to $136,719.10	92	84.55	78.32	89
$136,719.10 to $150,000			80.3225	
$150,000 to $200,000	93	85.50	81.2250	90
$200,000 and over	94	86.45	82.1275	91
Maximum over-all rate limitation	90	85.50	77.00	87

[1] After reduction from tentative tax.

TABLE 3.—*Estimated net income, taxable returns, and tax liability under present law and under the Finance Committee bill when the change in rates is fully effective*

[Money amounts in thousands]

Income classes after deductions but before exemptions	Net income	Number of taxable returns	Tax liability [1]		Increase in tax under Finance Committee's bill
			Present law	Finance Committee's bill [2]	
Under $1	$2,118,218	2,406,199	$111,971	$134,900	$22,929
$1 to $2	12,694,590	7,986,162	920,795	1,109,408	188,613
$2 to $3	31,757,704	12,528,019	2,440,298	2,940,115	499,817
$3 to $4	24,153,714	6,947,195	2,000,454	2,400,855	400,401
$4 to $5	20,593,211	4,600,934	2,014,164	2,416,118	401,954
Total under $5	91,317,437	34,468,509	7,487,682	9,001,396	1,513,714
$5 to $10	17,384,843	2,637,787	2,156,251	2,558,362	402,111
$10 to $25	12,620,469	847,563	2,382,662	2,743,294	360,632
$25 to $50	4,986,129	135,559	1,496,822	1,701,586	204,764
$50 to $100	2,117,456	31,053	856,063	963,180	107,117
$100 to $300	1,915,090	14,577	966,543	1,079,124	112,581
$300 to $500	301,046	922	177,723	195,241	17,518
$500 to $1,000	232,822	406	150,926	165,274	14,348
$1,000 and over	215,341	144	139,480	151,412	11,932
Total over $5	39,773,196	3,668,011	8,326,470	9,557,473	1,231,003
Grand total	131,090,633	38,136,520	15,814,152	18,558,869	2,744,717

PERCENTAGE DISTRIBUTION

Under $1	1.62	6.31	0.71	0.73	0.84
$1 to $2	9.68	20.94	5.82	5.98	6.87
$2 to $3	22.23	32.85	15.43	15.84	18.21
$3 to $4	18.43	18.22	12.65	12.94	14.59
$4 to $5	15.71	12.06	12.74	13.02	14.64
Total under $5	69.66	90.38	47.35	48.50	55.15
$5 to $10	13.26	6.92	13.63	13.79	14.65
$10 to $25	9.63	2.22	15.07	14.78	13.14
$25 to $50	3.80	.36	9.47	9.17	7.46
$50 to $100	1.62	.08	5.41	5.19	3.90
$100 to $300	1.46	.04	6.11	5.81	4.10
$300 to $500	.23	(3)	1.12	1.05	.64
$500 to $1,000	.18	(3)	.95	.89	.52
$1,000 and over	.16	(3)	.88	.82	.43
Total over $5	30.34	9.62	52.65	51.50	44.85
Total	100.00	100.00	100.00	100.00	100.00

[1] Includes normal tax, surtax, and alternative tax on net long-term capital gains.
[2] When the rate changes are fully effective.
[3] Less than 0.005 percent.

TABLE 4.—*Comparison of individual income tax liability under present law and under the Finance Committee bill for the calendar years 1950 and 1951*

SINGLE PERSON—NO DEPENDENTS

Net income before exemption	Amount of tax under—			Increase under Finance Committee bill		1950 increase as a percentage of—		1951 increase as a percentage of—	
	Present law	Finance Committee bill		1950	1951	Tax under present law	Net income after tax under present law	Tax under present law	Net income after tax under present law
		1950	1951						
						Percent	*Percent*	*Percent*	*Percent*
$600									
$800	$33	$35	$40	$2	$7	4. 8	0. 2	20. 5	0. 9
$1,000	66	70	80	3	14	4. 8	. 3	20. 5	1. 5
$1,500	149	157	180	7	31	4. 8	. 5	20. 5	2. 3
$2,000	232	244	280	11	48	4. 8	. 6	20. 5	2. 7
$3,000	409	428	488	19	79	4. 6	. 7	19. 2	3. 0
$5,000	811	843	944	32	133	4. 0	. 8	16. 4	3. 2
$8,000	1, 546	1, 604	1, 780	57	234	3. 7	. 9	15. 1	3. 6
$10,000	2, 124	2, 201	2, 436	77	312	3. 6	1. 0	14. 7	4. 0
$15,000	3, 894	4, 032	4, 448	137	554	3. 5	1. 2	14. 2	5. 0
$20,000	6, 089	6, 301	6, 942	212	853	3. 5	1. 5	14. 0	6. 1
$25,000	8, 600	8, 898	9, 796	298	1, 196	3. 5	1. 8	13. 9	7. 3
$50,000	23, 201	23, 997	26, 388	796	3, 187	3. 4	3. 0	13. 7	11. 9
$100,000	58, 762	60, 770	66, 798	2, 008	8, 036	3. 4	4. 9	13. 7	19. 5
$500,000	[1] 385, 000	396, 221	429, 274	11, 221	44, 274	2. 9	9. 8	11. 5	38. 5
$1,000,000	[1] 770, 000	[2] 800, 000	[3] 870, 000	30, 000	100, 000	3. 9	13. 0	13. 0	43. 5

[1] Taking into account maximum effective rate limitation of 77 percent.
[2] Taking into account maximum effective rate limitation of 80 percent.
[3] Taking into account maximum effective rate limitation of 87 percent.

Source: Staff of the Joint Committee on Internal Revenue Taxation.

TABLE 5.—*Comparison of individual income tax liability under present law and under the Finance Committee bill rates for the calendar years 1950 and 1951*

MARRIED PERSON—NO DEPENDENTS

Net income before exemption	Amount of tax under—			Increase under Finance Committee bill		1950 increase as a percentage of—		1951 increase as a percentage of—	
	Present law	Finance Committee bill		1950	1951	Tax under present law	Net income after tax under present law	Tax under present law	Net income after tax under present law
		1950	1951						
						Percent	*Percent*	*Percent*	*Percent*
$1,200									
$1,500	$50	$52	$60	$2	$10	4. 8	0. 2	20. 5	0. 7
$2,000	133	139	160	6	27	4. 8	. 3	20. 5	1. 5
$3,000	299	313	360	14	61	4. 8	. 5	20. 5	2. 3
$5,000	631	661	760	30	129	4. 8	. 7	20. 5	3. 0
$8,000	1, 206	1, 257	1, 416	50	210	4. 2	. 7	17. 4	3. 1
$10,000	1, 621	1, 686	1, 888	65	267	4. 0	. 8	16. 4	3. 2
$15,000	2, 829	2, 935	3, 260	106	431	3. 7	. 9	15. 2	3. 5
$20,000	4, 247	4, 402	4, 872	154	625	3. 6	1. 0	14. 7	4. 0
$25,000	5, 877	6, 087	6, 724	210	847	3. 6	1. 1	14. 4	4. 4
$50,000	17, 201	17, 797	19, 592	596	2, 391	3. 5	1. 8	13. 9	7. 3
$100,000	46, 403	47, 994	52, 776	1, 591	6, 373	3. 4	3. 0	13. 7	11. 9
$500,000	359, 662	370, 657	403, 548	10, 995	43, 886	3. 1	7. 8	12. 2	31. 3
$1,000,000	[1] 770, 000	792, 442	858, 548	22, 442	88, 548	2. 9	9. 8	11. 5	38. 5

[1] Taking into account maximum effective rate limitation of 77 percent.

TABLE 6.—*Comparison of individual income tax liability under present law and under the Finance Committee bill for the calendar years 1950 and 1951*

MARRIED PERSON—2 DEPENDENTS

Net income before exemption	Amount of tax under—			Increase under Finance Committee bill		1950 increase as a percentage of—		1951 increase as a percentage of—	
	Present law	Finance Committee bill 1950	Finance Committee bill 1951	1950	1951	Tax under present law	Net income after tax under present law	Tax under present law	Net income after tax under present law
						Percent	Percent	Percent	Percent
$2,400									
$3,000	$100	$104	$120	$5	$20	4.8	0.2	20.5	0.7
$5,000	432	452	520	21	88	4.8	.5	20.5	1.9
$8,000	974	1,016	1,152	43	178	4.4	.6	18.3	2.5
$10,000	1,361	1,417	1,592	56	231	4.1	.6	17.0	2.7
$15,000	2,512	2,607	2,900	95	388	3.8	.8	15.4	3.1
$20,000	3,888	4,030	4,464	142	576	3.6	.9	14.8	3.6
$25,000	5,476	5,672	6,268	196	792	3.6	1.0	14.5	4.1
$50,000	16,578	17,152	18,884	575	2,306	3.5	1.7	13.9	6.9
$100,000	45,643	47,208	51,912	1,565	6,269	3.4	2.9	13.7	11.5
$500,000	358,677	369,645	402,456	10,968	43,779	3.1	7.8	12.2	31.0
$1,000,000	769,314	791,430	857,456	22,116	88,142	2.9	9.6	11.5	38.2

TABLE 7.—*Comparison of individual income tax effective rates under present law and under the Finance Committee bill for the calendar years 1950 and 1951*

SINGLE PERSON—NO DEPENDENTS

Net income before exemption	Effective rates			Percentage point increase, Finance Committee bill over present law	
	Present law	Finance Committee bill 1950	Finance Committee bill 1951	1950	1951
	Percent	Percent	Percent	Percent	Percent
$600					
$800	4.2	4.4	5.0	0.2	0.9
$1,000	6.6	7.0	8.0	.3	1.4
$1,500	10.0	10.4	12.0	.5	2.0
$2,000	11.6	12.2	14.0	.6	2.4
$3,000	13.6	14.3	16.3	.6	2.6
$5,000	16.2	16.9	18.9	.6	2.7
$8,000	19.3	20.0	22.3	.7	2.9
$10,000	21.2	22.0	24.4	.8	3.1
$15,000	26.0	26.9	29.7	.9	3.7
$20,000	30.4	31.5	34.7	1.1	4.3
$25,000	34.4	35.6	39.2	1.2	4.8
$50,000	46.4	48.0	52.8	1.6	6.4
$100,000	58.8	60.8	66.8	2.0	8.0
$500,000	[1] 77.0	79.2	85.9	2.2	8.9
$1,000,000	[1] 77.0	[2] 80.0	[3] 87.0	3.0	10.0

[1] Taking into account maximum effective rate limitation of 77 percent.
[2] Taking into account maximum effective rate limitation of 80 percent.
[3] Taking into account maximum effective rate limitation of 87 percent.

TABLE 8.—*Comparison of individual income tax effective rates under present law and under the Finance Committee bill for the calendar years 1950 and 1951*

MARRIED PERSON—NO DEPENDENTS

Net income before exemption	Effective rates: Present law	Effective rates: Finance Committee bill, 1950	Effective rates: Finance Committee bill, 1951	Percentage point increase, Finance Committee bill over present law: 1950	Percentage point increase, Finance Committee bill over present law: 1951
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
$1,200					
$1,500	3.3	3.5	4.0	0.2	0.7
$2,000	6.6	7.0	8.0	.3	1.4
$3,000	10.0	10.4	12.0	.5	2.0
$5,000	12.6	13.2	15.2	.6	2.6
$8,000	15.1	15.7	17.7	.6	2.6
$10,000	16.2	16.9	18.9	.6	2.7
$15,000	18.9	19.6	21.7	.7	2.9
$20,000	21.2	22.0	24.4	.8	3.1
$25,000	23.5	24.3	26.9	.8	3.4
$50,000	34.4	35.6	39.2	1.2	4.8
$100,000	46.4	48.0	52.8	1.6	6.4
$500,000	71.9	74.1	80.7	2.2	8.8
$1,000,000	[1] 77.0	79.2	85.9	2.2	8.9

[1] Taking into account maximum effective rate limitation of 77 percent.

TABLE 9.—*Comparison of individual income tax effective rates under present law and under the Finance Committee bill for the calendar years 1950 and 1951*

MARRIED PERSON—2 DEPENDENTS

Net income before exemption	Effective rates: Present law	Effective rates: Finance Committee bill, 1950	Effective rates: Finance Committee bill, 1951	Percentage point increase, Finance Committee bill over present law: 1950	Percentage point increase, Finance Committee bill over present law: 1951
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
$2,400					
$3,000	3.3	3.5	4.0	0.2	0.7
$5,000	8.6	9.0	10.4	.4	1.8
$8,000	12.2	12.7	14.4	.5	2.2
$10,000	13.6	14.2	15.9	.6	2.3
$15,000	16.7	17.4	19.3	.6	2.6
$20,000	19.4	20.2	22.3	.7	2.9
$25,000	21.9	22.7	25.1	.8	3.2
$50,000	33.2	34.3	37.8	1.1	4.6
$100,000	45.6	47.2	51.9	1.6	6.3
$500,000	71.7	73.9	80.5	2.2	8.8
$1,000,000	76.9	79.1	85.7	2.2	8.8

IV. THE RATES UNDER THE CORPORATE INCOME TAX

Your committee's bill increases the corporate income tax liabilities which would result from the House bill. The full change will be effective in 1951 and subsequent years. Approximately one-half of the corporate increase will apply for the calendar year 1950. When fully effective at current levels of corporate profits, the proposed changes in the corporate rates will increase the corporate income tax liabilities by $1.6 billion annually. This is an increase of about 15 percent in the amount of the tax due and about 5 percentage points in the average rate of tax imposed. Taking into account the reduction in the taxable income of individuals that will accompany the lower level of dividend payments resulting from the increase in the corporate rate, the net increase in tax liabilities when the changes in the corporate rates made in this bill are fully effective will be $1.5 billion annually.

The rate changes under your committee's bill are designed not only to increase the revenue, but also to eliminate the 53-percent notch rate applied under existing law to incomes between $25,000 and $50,000.

(A) Existing Law

Under existing law corporations with taxable incomes of $50,000 and over pay a flat 24 percent normal tax and a flat 14 percent surtax, a total rate of 38 percent. To give smaller business a tax advantage, the effective rate of taxation is reduced for corporations with incomes below $25,000. This is accomplished by the application to such corporations of the following marginal or bracket rates:

Income bracket	Normal tax rate	Surtax rate	Total tax rate
	Percent	*Percent*	*Percent*
The first $5,000	15	6	21
The next $15,000	17	6	23
The next $5,000	19	6	25

As a result the effective or average rate of tax rises from 21 percent for corporations with incomes of $5,000 or less to 23 percent for corporations with an income of $25,000. Since the 38-percent rate applying to corporations with taxable incomes of $50,000 and over is applicable to the entire income, it is necessary to bridge the gap between $25,000 and $50,000 by applying a 53-percent rate to the income in this area. Thirty-one percentage points of this 53-percent rate represent the normal tax and 22 percentage points represent the surtax. This notch rate of 53 percent necessarily exceeds the 38-percent rate applicable to larger corporations by 15 percentage points, since the average rate of 23 percent on a corporation with an income of $25,000 is 15 percentage points below the 38-percent rate applied to larger corporations.

The 53 percent bracket rate is objectionable primarily because of its effect on the incentive to increase earnings for corporations which normally have incomes somewhat over $25,000. Under the notch rate 53 cents out of each additional dollar which these corporations earn, until they reach the $50,000-income level, is taken by the Federal Government in taxes, leaving only 47 cents out of each of these additional dollars for the stockholders. Corporations with incomes over $50,000 have a much greater incentive to expand their earnings, since the Government takes only 38 cents out of each additional dollar in their case, leaving 62 cents for the stockholders.

(B) The House Bill

To eliminate the 53 percent notch rate and to increase collections the House bill eliminates the complicated system of rates used under existing law and substitutes:

1. A $25,000 surtax exemption,
2. A flat 21-percent normal tax rate, and
3. A flat 20-percent surtax rate.

Thus, a corporation with an income of $25,000 or less would pay a flat 21 percent normal tax and no more. A corporation with an income in excess of $25,000 would pay a normal tax of 21 percent on its entire taxable income, and a surtax of 20 percent on that part of its income in excess of $25,000.

The substitution of a surtax exemption of $25,000, available to all corporations, for the present 53 percent notch rate preserves the tax advantages enjoyed by small business without introducing a system which is readily adaptable to a drastic graduation in rates. To introduce a system of steeply graduated rates it would be necessary to add additional exemptions, and at the same time to increase very substantially the flat tax rate applying to all corporations, a solution which is likely to appear unpalatable to small, as well as large, corporate taxpayers. A single exemption of the type in the bill best expresses the idea of a flat tax rate modified by a concession for small business. It is much simpler than a system of multiple exemptions and can be presented on the return form in a way which makes it easier for the taxpayer to compute the tax. A single exemption of this type also makes it possible to consolidate the normal tax and surtax computations on the return form. While this might also be possible in the case of a multiple-exemption plan or a graduated-rate plan, difficult problems would be presented under these plans in the handling of such items as partially tax-exempt interest and the special tax treatment accorded Western Hemisphere trade corporations and dividends paid by public utilities on certain preferred stock.

The changes made in the House bill would apply to all taxable years beginning after December 31, 1949.

The provisions of the House bill described above would increase the net corporate income-tax liabilities by $450,000,000 a year when fully effective.

(C) The Finance Committee Bill

Your committee adopted the suggestion of the administration for increasing the corporate income tax for 1951 and subsequent years. This proposal incorporated the plan of the House bill for eliminating the 53 percent notch rate but used corporate rates in excess of those in the House bill. As a result the top corporate rate will be 45 percent as compared with 38 percent under existing law. This is shown by the following table:

Surtax net income	Marginal rates		
	Present law	House bill	Finance Committee bill
	Percent	*Percent*	*Percent*
Not over $5,000	21		
Over $5,000 but not over $20,000	23	21	25
Over $20,000 but not over $25,000	25		
Over $25,000 but not over $50,000	53	41	45
Over $50,000	38		

Under your committee's bill corporations will pay a 25 percent normal tax on all of their taxable income and a 20-percent surtax on their income in excess of $25,000. Under the House bill they would pay a 21 percent normal tax on their entire taxable income and the same 20 percent surtax on their income in excess of $25,000.

Your committee did not deem it advisable to make such an increase in corporate rates, effective for 1950, since the year 1950 is almost three-fourths over. Your committee selected July 1, 1950, as the dividing line in determining when the increased rates would be effective.

For the calendar year 1950, the normal tax will be 23 percent and the surtax on incomes in excess of the $25,000 surtax exemption will be 19 percent, making a total top rate of 42 percent for the calendar year 1950 as compared with a top rate of 45 percent for 1951 and subsequent years.

Corporations with taxable years ending prior to July 1, 1950, will be taxed at the rates imposed under existing law. Years beginning prior to July 1, 1950, and ending after that date will be divided into two parts. The proportion of the corporation's taxable income which relates to the period preceding July 1, 1950 will be taxed at the rates used under existing law. To the extent that the corporation's taxable year follows July 1, 1950, its income will be taxed at the rates imposed for 1951 and subsequent years. Fiscal years beginning after July 1, 1950, will be subject to the rates imposed for 1951.

Table 10 shows the combined normal tax and surtax effective rates under your committee's bill for 1951 and subsequent years, as well as those under the House bill and existing law. The House bill did not change the rate imposed on corporations with incomes up to $5,000. For corporations with incomes between $5,000 and approximately $167,000 the effective rate under the House bill is less than under existing law, largely because in these cases the benefits from the elimination of the notch outweigh the increase in the marginal rate imposed on income in excess of $50,000. Since the reverse is true of corporations whose incomes exceed $167,000, the effective rate for such corporations is increased under the House bill. The maximum increase in the effective rate is slightly less than 3 percentage points and the maximum effective rate is just under 41 percent

Table 10 brings out clearly the fact that your committee's bill increases the effective rates imposed under the House bill by 4 percentage points for corporations in all income classes.

Corporations with incomes of $5,000 or less will be taxed 4 percentage points more under your committee's bill than under existing law. The net increase over existing law will be less than 4 points in the case of corporations with incomes between $5,000 and $31,250, the net increase in this area declining as the corporate income grows larger. For incomes between $5,000 and $25,000 this is due to the fact that a flat 25 percent tax rate on the first $25,000 of income is substituted for rates which under present law increase from 21 percent to 25 percent in this income area. For incomes between $25,000 and $31,250 the fact that the rates do not increase by 4 percentage points is due to the elimination of the notch. At $31,250 the effective rates under your committee's bill and existing law are identical. The benefits from the elimination of the notch are sufficient to produce a smaller effective rate under your committee's bill than under existing law for corporations with incomes between $31,250 and $71,429, at which point the rates under the bill and under existing law are again equal. For corporations with incomes in excess of $71,429 the effect of eliminating the notch is outweighed by the increase in the rate on income in excess of $50,000, and in these cases the effective rate under your committee's bill is higher than under existing law. The increase grows with the size of the income and reaches a maximum of just under 7 percentage points. Thus, the maximum effective rate under your committee's bill is approximately 45 percent.

Table 11 compares the tax burdens under your committee's bill in 1951 and subsequent years with those under the House bill and under existing law.

The effective rates and tax burdens which will be imposed for the calendar year 1950, the year of transition under your committee's bill, are shown in table 12. The rates under your committee's bill will be 2 percentage points higher than under existing law for corporations with incomes up to $5,000. The increase will be less than 2 percentage points for corporations with incomes between $5,000 and $25,000. A corporation whose income is precisely $25,000 will be subject to the same rate under the bill as under existing law. When the corporation's income falls between $25,000 and $118,750, the tax rate under the bill will be smaller than under existing law due to the elimination of the notch. At an income of $118,750 the rates under the bill and under existing law again will be identical. Corporations with larger incomes are subject to a heavier rate under the bill than under existing law, the difference increasing with the size of the income. The maximum increase will be just under 4 percentage points.

(D) Changes Made for the Purpose of Consolidating the Tax Computation on the Return Form

In addition to the elimination of the notch rate, both the House bill and your committee's bill provide a different method of computing the tax benefit to be given Western Hemisphere trade corporations and dividends paid by public utilities on certain preferred stock. The House bill also contained a provision preserving the present tax benefit for partially tax-exempt interest. Your committee's bill retains this feature for the calendar year 1950 when the normal tax will also be below the present normal tax rate. For 1951 and subsequent years this adjustment is unnecessary because the normal tax rate for those years will be 25 percent, while the existing normal tax rate is only 24 percent. Your committee's bill also makes a change in the method of computing the dividends-received credit where dividends are received on certain preferred stock of public utilities. These changes make it possible to combine the normal tax and surtax into a single tax computation on the corporate rate form.

TABLE 10.—*Comparison of effective corporate income tax rates under present law, under the House bill, and under the Finance Committee's bill in 1951 and subsequent years*

Net income (normal and surtax)	Present law	House bill		Finance Committee's bill		
	Effective rates	Effective rates	Percentage point increase or decrease (−) over present law	Effective rates	Percentage point increase or decrease (−) over House bill	Percentage point increase or decrease (−) over Present law
	Percent	*Percent*		*Percent*		
$1,000	21.00	21.00	0	25.00	4.0	4.00
$2,000	21.00	21.00	0	25.00	4.0	4.00
$3,000	21.00	21.00	0	25.00	4.0	4.00
$4,000	21.00	21.00	0	25.00	4.0	4.00
$5,000	21.00	21.00	0	25.00	4.0	4.00
$6,000	21.33	21.00	−0.33	25.00	4.0	3.67
$7,000	21.57	21.00	−.57	25.00	4.0	3.43
$8,000	21.75	21.00	−.75	25.00	4.0	3.25
$9,000	21.89	21.00	−.89	25.00	4.0	3.11
$10,000	22.00	21.00	−1.00	25.00	4.0	3.00
$15,000	22.33	21.00	−1.33	25.00	4.0	2.67
$20,000	22.50	21.00	−1.50	25.00	4.0	2.50
$25,000	23.00	21.00	−2.00	25.00	4.0	2.00
$30,000	28.00	24.33	−3.67	28.33	4.0	.33
$31,250	29.00	25.00	−4.00	29.00	4.0	0
$35,000	31.57	26.71	−4.86	30.71	4.0	−.86
$40,000	34.25	28.50	−5.75	32.50	4.0	−1.75
$45,000	36.33	29.89	−6.44	33.89	4.0	−2.44
$50,000	38.00	31.00	−7.00	35.00	4.0	−3.00
$60,000	38.00	32.67	−5.33	36.67	4.0	−1.33
$70,000	38.00	33.86	−4.14	37.86	4.0	−.14
$71,428.57 plus	38.00	34.00	−4.00	38.00	4.0	0
$75,000	38.00	34.33	−3.67	38.33	4.0	.33
$100,000	38.00	36.00	−2.00	40.00	4.0	2.00
$150,000	38.00	37.67	−.33	41.67	4.0	3.67
$166,666⅔	38.00	38.00	0	42.00	4.0	4.00
$200,000	38.00	38.50	.50	42.50	4.0	4.50
$300,000	38.00	39.33	1.33	43.33	4.0	5.33
$400,000	38.00	39.75	1.75	43.75	4.0	5.75
$500,000	38.00	40.00	2.00	44.00	4.0	6.00
$750,000	38.00	40.33	2.33	44.33	4.0	6.33
$1,000,000	38.00	40.50	2.50	44.50	4.0	6.50
$5,000,000	38.00	40.90	2.90	44.90	4.0	6.90
$10,000,000	38.00	40.95	2.95	44.95	4.0	6.95

TABLE 11.—*Comparison of corporate income-tax liability under present law, under the House bill, and under the Finance Committee's bill in 1951 and subsequent years*

Net income (normal tax and surtax)	Combined normal tax and surtax						
	Amount of tax			Dollar increase or decrease (−) over present law		Percentage increase or decrease (−) over present law	
	Present law	House bill	Finance Committee's bill	House bill	Finance Committee's bill	House bill	Finance Committee's bill
$1,000	$210.00	$210.00	$250.00	0	$40	0	19.05
$2,000	420.00	420.00	500.00	0	80	0	19.05
$3,000	630.00	630.00	750.00	0	120	0	19.05
$4,000	840.00	840.00	1,000.00	0	160	0	19.05
$5,000	1,050.00	1,050.00	1,250.00	0	200	0	19.05
$6,000	1,280.00	1,260.00	1,500.00	−$20.00	220	−1.56	17.19
$7,000	1,510.00	1,470.00	1,750.00	−40.00	240	−2.65	15.89
$8,000	1,740.00	1,680.00	2,000.00	−60.00	260	−3.45	14.94
$9,000	1,970.00	1,890.00	2,250.00	−80.00	280	−4.06	14.21
$10,000	2,200.00	2,100.00	2,500.00	−100.00	300	−4.55	13.64
$15,000	3,350.00	3,150.00	3,750.00	−200.00	400	−5.97	11.94
$20,000	4,500.00	4,200.00	5,000.00	−300.00	500	−6.67	11.11
$25,000	5,750.00	5,250.00	6,250.00	−500.00	500	−8.70	8.70
$30,000	8,400.00	7,300.00	8,500.00	−1,100.00	100	−13.10	1.19
$31,250	9,062.50	7,812.50	9,062.50	−1,250.00	0	−13.79	0
$35,000	11,050.00	9,350.00	10,750.00	−1,700.00	−300	−15.38	−2.71
$40,000	13,700.00	11,400.00	13,000.00	−2,300.00	−700	−16.79	−5.11
$45,000	16,350.00	13,450.00	15,250.00	−2,900.00	−1,100	−17.74	−6.73
$50,000	19,000.00	15,500.00	17,500.00	−3,500.00	−1,500	−18.42	−7.89
$71,428.57-plus	27,142.86	24,285.71	27,142.86	−2,857.15	0	−10.53	0
$75,000	28,500.00	25,750.00	28,750.00	−2,750.00	250	−9.65	.88
$100,000	38,000.00	36,000.00	40,000.00	−2,000.00	2,000	−5.26	5.26
$150,000	57,000.00	56,500.00	62,500.00	−500.00	5,500	−.88	9.65
$166,666⅔	63,333⅓	63,333⅓	70,000.00	0	6,666⅔	0	10.53
$200,000	76,000.00	77,000.00	85,000.00	1,000.00	9,000	1.32	11.84
$300,000	114,000.00	118,000.00	130,000.00	4,000.00	16,000	3.51	14.04
$400,000	152,000.00	159,000.00	175,000.00	7,000.00	23,000	4.61	15.13
$500,000	190,000.00	200,000.00	220,000.00	10,000.00	30,000	5.26	15.79
$750,000	285,000.00	302,500.00	332,500.00	17,500.00	47,500	6.14	16.67
$1,000,000	380,000.00	405,000.00	445,000.00	25,000.00	65,000	6.58	17.11
$5,000,000	1,900,000.00	2,045,000.00	2,245,000.00	145,000.00	345,000	7.63	18.16
$10,000,000	3,800,000.00	4,095,000.00	4,495,000.00	295,000.00	695,000	7.76	18.29

TABLE 12.—*Comparison of effective corporate income tax rates and tax liability for 1950, under the Finance Committee's bill and under present law*

Net income (normal and surtax)	Effective rates			Combined normal and surtax			
	Present law	Finance Committee's bill	Percentage point increase or decrease (−)	Present law	Finance Committee's bill	Increase or decrease (−)	
						Amount	Percent
	Percent	*Percent*	*Percent*				
$1,000	21.00	23.00	2.00	$210	$230	$20	9.52
$2,000	21.00	23.00	2.00	420	460	40	9.52
$3,000	21.00	23.00	2.00	630	690	60	9.52
$4,000	21.00	23.00	2.00	840	920	80	9.52
$5,000	21.00	23.00	2.00	1,050	1,150	100	9.52
$6,000	21.33	23.00	1.67	1,280	1,380	100	7.81
$7,000	21.57	23.00	1.43	1,510	1,610	100	6.62
$8,000	21.75	23.00	1.25	1,740	1,840	100	5.75
$9,000	21.89	23.00	1.11	1,970	2,070	100	5.08
$10,000	22.00	23.00	1.00	2,200	2,300	100	4.55
$15,000	22.33	23.00	.67	3,350	3,450	100	2.99
$20,000	22.50	23.00	.50	4,500	4,600	100	2.22
$25,000	23.00	23.00	0	5,750	5,750	0	0
$30,000	28.00	26.17	−1.83	8,400	7,850	−550	−6.55
$35,000	31.57	28.43	−3.14	11,050	9,950	−1,100	−9.95
$40,000	34.25	30.13	−4.12	13,700	12,050	−1,650	−12.04
$45,000	36.33	31.44	−4.89	16,350	14,150	−2,200	−13.46
$50,000	38.00	32.50	−5.50	19,000	16,250	−2,750	−14.47
$75,000	38.00	35.67	−2.33	28,500	26,750	−1,750	−6.14
$100,000	38.00	37.25	−.75	38,000	37,250	−750	−1.97
$118,750	38.00	38.00	0	45,125	45,125	0	0
$150,000	38.00	38.83	.83	57,000	58,250	1,250	2.19
$200,000	38.00	39.63	1.63	76,000	79,250	3,250	4.28
$300,000	38.00	40.42	2.42	114,000	121,250	7,250	6.36
$400,000	38.00	40.81	2.81	152,000	163,250	11,250	7.40
$500,000	38.00	41.05	3.05	190,000	205,250	15,250	8.03
$750,000	38.00	41.37	3.37	285,000	310,250	25,250	8.86
$1,000,000	38.00	41.53	3.53	380,000	415,250	35,250	9.28
$5,000,000	38.00	41.91	3.91	1,900,000	2,095,250	195,250	10.28
$10,000,000	38.00	41.95	3.95	3,800,000	4,195,250	395,250	10.40

V. ACCELERATION OF TAX PAYMENTS OF CORPORATIONS

Under existing law corporate taxpayers are given the option to elect to pay their entire tax on the 15th day of the third month following the close of the taxable year or to pay one-fourth of the tax on that date and the balance in equal installments on the 15th day of the third, sixth, and ninth months following the first installment. For example, a corporation on the calendar-year basis may pay one-fourth of the tax for 1950 on the 15th of March, June, September, and December 1951. This method of payment contrasts sharply with that required of most individuals who pay the bulk of their tax during the year in which the income arises. The contrast is most striking in the case of a business which is operated as an individual enterprise or a partnership as compared with a similar business organized in the corporate form.

Your committee desires to reduce the time during which the corporate tax may be paid, but wishes to give the business community ample opportunity to adjust itself to the change. Therefore, section 205 of your committee's bill provides for a gradual transition covering a period of 5 years, at the end of which the installment option for corporations will be reduced to two payments of 50 percent of the tax due on the 15th day of the third month and the balance on the 15th day of the sixth month following the close of the taxable year. The form in which this transition is to be made is shown in table 13.

TABLE 13.—*Accelerated payments of corporation income taxes* [1]

	Percent of payments due in—			
	First quarter (percent)	Second quarter (percent)	Third quarter (percent)	Fourth quarter (percent)
First taxable year	30	30	20	20
Second taxable year	35	35	15	15
Third taxable year	40	40	10	10
Fourth taxable year	45	45	5	5
Fifth taxable year and subsequent years	50	50	0	0

[1] The accelerated payments would begin with taxable years ending on or after Dec. 31, 1950.

The first change in the method of payment will be effective with respect to corporate taxable years ending on or after December 31, 1950.

For the calendar-year corporations, which make up about three-fourths of the total, your committee's bill requires the payment of 30 percent of the 1950 tax on March 15 and June 15, 1951, and 20 percent on September 15 and December 15, instead of 25 percent on each of the quarterly payment dates as permitted under existing law. The payments on March 15 and June 15 will be increased to 35 percent of the tax due in 1952, 40 percent in 1953, 45 percent in 1954, and 50 percent in 1955, with corresponding reductions in the percentage of the tax payable on September 15 and December 15 in each of these years.

The estimated increase in collections resulting from accelerated payments is shown in table 14. In the fiscal year 1951 it is estimated that the additional collections will be about $800 million. The additional receipts in the fiscal year 1956, the last year in which collections are affected, will be about $90 million. The increase in each of the years 1952 through 1955 will be about $1 billion. The total additional collections during the full 6-year transition period aggregate about $4.8 billion.

TABLE 14.—*Estimated increase in corporate income tax collections resulting from accelerated payments*

[In millions of dollars]

Fiscal years	Increase in collections	Fiscal years	Increase in collections
1951	800	1954	970
1952	1,040	1955	970
1953	970	1956	90

Source: Staff of the Joint Committee on Internal Revenue Taxation.

Although these additional collections represent funds which would otherwise have been received in subsequent fiscal years, there will be no corresponding reductions in receipts in subsequent years if corporate profits remain at current levels. The revenues collected in the period of transition instead of in the years immediately following will be supplanted in those years by collections which would have been made in later years under existing law.

Of course, a down-turn in business with a consequent decline in corporate profits would produce a more rapid drop in collections from the corporate income tax if the latter is paid in two installments, as it will be in 1955 and subsequent years under your committee's bill, than if payment is spread over four quarterly payments as under existing law. However, the increase in collections during the subsequent period of revival would also be more rapid.

Over the long run, leaving the business cycle out of account, the additional collections obtained under the bill in the years 1951 through 1956 would, generally speaking, be offset by a corresponding reduction in later years only if the action now taken were reversed. It is true that where a taxpayer goes out of business or ceases to have a taxable net income the accelerated payments made during the transition years will be offset by reduced collections in subsequent years. On the other hand, there will be additional gains in future years as a result of the acceleration of the first tax paid by new corporations and by corporations which move for the first time into the taxpaying class. Moreover, an expansion of corporate earnings during future years will produce an additional gain because of the acceleration of the tax based on the net increase in taxable income. If, therefore, historical trends continue and corporate profits increase in the future along with an expanding economy, additional gains from acceleration will accrue and the Government will not lose, except temporarily during a period of depression, the additional collections received during the years 1951 through 1956.

The additional revenues obtained in each of the transition years are the result of concentrating in each of these fiscal years, collections based on the tax liabilities of more than 1 year. Although this bill speeds up the collection of the corporate income tax, it does not increase the tax liability of any corporation.

Available information indicates that, taken as a whole, the corporations of this country are unusually liquid and, therefore, in a position to finance the accelerated tax payments called for under the committee's bill with comparatively little difficulty. Table 15 shows the relation between accrued Federal income tax liabilities and the cash plus United States Government securites held by all corporations other than banks and insurance companies at the close of each quarter in the calendar years 1948 and 1949 and the first quarter of 1950. On these dates the aggregate accrued Federal income tax liability was never more than 30.6 percent of the sum of these very liquid assets. At the close of the first quarter of 1950 the accrued tax liabilities were less than one-fourth of the cash plus Government securities.

Table 16 shows similar statistics for manufacturing corporations only at the close of the first quarter of 1950, classified according to the size of the corporation. This table indicates that among the smaller corporations the accrued Federal income tax liabilities were an even lower percentage of cash plus Government securities than among corporations of greater size. Since about 36 percent of the taxable corporations do not elect the quarterly payment option but pay their entire tax in full on the 15th day of the third month following the close of their taxable year, and roughly 90 percent of the corporation tax is paid on the installment basis, it is evident that the small corporations are the ones which usually do not elect to pay in installments. This is consistent with the statistics shown in table 16 which indicate that on the average the smaller corporations have relatively large accumulations of very liquid assets.

Tables 15 and 16 reflect the average position of American industry. No doubt there will be a number of cases in which any acceleration of the payment will be difficult because the cash position of the corporation is weak and its credit at the banks poor. However, this problem is greatly reduced by the gradual transition to a two-payment system which occurs under section 205 of your committee's bill. For those cases where real hardship arises relief will be available under section 56 (c) (1) of the Internal Revenue Code which authorizes the Commissioner of Internal Revenue to extend the time for payment for a period up to 6 months. This power makes it possible to alleviate any real difficulties raised by the accelerated payment plan.

This plan is not to be confused with the pay-as-you-go system used under the individual income tax. While your committee's bill would gradually reduce the lag between the receipt of the corporation's income and the payment of its tax, all the payments would continue to be made in the year following the receipt of the income. Hence, the general argument that a system of current collection would be inappropriate for corporations does not bear on the accelerated payment plan contained in your committee's bill.

TABLE 15.—*Tax liabilities, cash, and U. S. Government securities of all corporations except banks and insurance companies*

[Dollar amounts in billions]

	Accrued Federal income taxes	Cash	U. S. Government securities	Total cash and U. S. Government securities	Percent Federal tax to total cash and Government securities
1948:					
First quarter	10.7	23.5	13.7	37.2	28.8
Second quarter	10.9	23.9	13.0	36.9	29.5
Third quarter	11.3	24.2	13.4	37.6	30.1
Fourth quarter	11.6	24.0	13.9	37.9	30.6
1949:					
First quarter	11.2	23.4	14.0	37.4	29.9
Second quarter	10.6	24.3	14.8	39.1	27.1
Third quarter	10.2	24.7	15.6	40.3	25.3
Fourth quarter	9.7	24.9	15.7	40.6	23.9
1950: First quarter	9.7	23.7	16.7	40.4	24.0

Source: Securities and Exchange Commission.

TABLE 16.—*Tax liabilities, cash, and U. S. Government securities of all manufacturing corporations, classified by size of assets, first quarter, 1950*

[Dollar amounts in millions]

Asset classes in thousands of dollars	Accrued Federal income taxes	Cash	U. S. Government securities	Total cash and U. S. Government securities	Percent Federal tax to total cash and Government securities
Under 250	60	312	58	370	16.22
250 to 1,000	246	766	269	1,035	23.77
1,000 to 5,000	635	1,476	737	2,213	28.69
5,000 to 100,000	1,984	3,986	2,595	6,581	30.15
100,000 and over	3,262	4,758	6,286	11,044	29.54

VI. RETURNS AND TAX PAYMENTS OF TRUSTS AND NONRESIDENT ALIENS

Under existing law fiduciaries may elect to pay the income tax in four quarterly installments. It has been brought to the attention of your committee that there is no necessity for this option in the case of trusts, and that in some cases the option is an embarrassment to trustees who would like to pay the tax at the time of filing the return but hesitate to do so because they believe their responsibilities to the beneficiaries of the trust require the retention of the funds until the final dates upon which the tax payments may be made so as to maximize the interest earned on the trust's assets. For these reasons, section 205 of your committee's bill eliminates the installment option in the case of trusts. The option is continued in the case of estates, where the problem of raising cash to finance the payment of taxes is apt to be serious.

Existing law requires the filing of the withholding returns for nonresident aliens on March 15 but does not require the payment of the tax by the withholding agent until June 15. Section 221 of your committee's bill conforms the date upon which the withholding agent must pay the tax with the date upon which he files the withholding return.

Existing law also gives nonresident aliens whose gross income is in excess of $15,400 or who have a trade or business in the United States the option to pay their tax in installments. Section 205 of your committee's bill eliminates this installment option.

These amendments are effective with respect to taxable years ending on or after December 31, 1950.

While these changes do not affect tax liabilities, the elimination of the installment option in the case of trusts and certain nonresident aliens will increase collections in the fiscal year 1951 by about $90,000,000. These are funds which would have been collected in the fiscal year 1952 under existing law. There will be no corresponding reduction in collections in 1952 since the funds collected on 1950 liabilities in the fiscal year 1951 will be replaced by funds that would (under existing law) have been received in the fiscal year 1953.

VII. EXCISE TAX CHANGES

The House bill provides for a gross excise tax reduction of $1,010 million, or a net loss of revenue of $910 million after the effects on income-tax collections are taken into account. Your committee has amended the bill to remove the excise-tax changes resulting in this loss of revenue. The House report points out that corporate and individual income taxes have been decreased substantially since the cessation of hostilities with Germany and Japan, while excise taxes have remained substantially at their wartime levels. Your committee agrees that prior to the beginning of the military action in Korea this constituted a good reason for reducing excise taxes. However, the necessary requests of the President for substantial increases in defense and related expenditures since the beginning of the Korean conflict make excise-tax reductions impossible at this time. Rather it is necessary to consider the elimination of most of the individual and corporate income-tax reductions which the House report indicates are the primary justification for excise reductions.

The House bill makes a number of salutary adjustments in the bases of various excise taxes in addition to the rate reductions. However, in the short run at least these adjustments will result in the loss of some excise-tax revenue. For that reason it is appropriate to postpone the consideration of these adjustments until next year when it will be possible to devote more time to the details of the excise-tax structure.

Your committee's bill retains those adjustments in excise taxes in the House bill which result in revenue increases. These—

(1) extend the retail taxes on furs and jewelry to cover auction sales, with an exemption of $100 for auctions in private homes;

(2) extend the manufacturers' tax on household-type refrigerators to cover units for the quick freezing or frozen storage of foods;

(3) increase the annual occupational license tax on coin-operated gaming devices from $100 to $150; and

(4) impose the 20-percent retail excise taxes and the various occupational excise taxes in the case of the United States Government or any of its agencies or instrumentalities unless an exemption is specifically provided.

Your committee has also amended the House bill to extend the 10-percent manufacturers' excise tax on radio receiving sets to cover television sets, and to close a loophole which has developed in the case of the taxes on the transportation of persons and property.

Instead of the net excise tax reduction of $910 million provided by the House bill, it is estimated that the bill as amended by your committee will result in an increase in excise tax revenues of $55 million in a full year of operation.

Generally, the excise tax amendments included in your committee's bill will be effective on or after the first day of the first month which begins more than 10 days after the date of enactment of the bill.

(A) Auction Sales

Under existing law the tax on jewelry and furs applies to the auction of such items only when the auction takes place in, or is conducted for, a retail establishment. Otherwise articles sold at an auction do not qualify as "articles sold at retail." As a result many auctions are held, especially in the case of jewelry, where tax-free sales are made to individuals intending to use or wear the jewelry or furs themselves. This constitutes unfair competition with the ordinary jeweler or fur retailer who must charge the 20-percent tax, and represents a particularly severe hardship to retailers located near organizations carrying on auction sales on a large scale. The question of new or old furs or jewelry is not involved, since an auctioneer may sell either new or old furs or jewelry free of tax, while a tax is imposed on either type of sale in the case of the retailer. H. R. 8920 as passed by the House corrects this inequity by treating as retail sales furs or jewelry sold at auction, with an exemption of $100 where such items are auctioned in a private home. Your committee has accepted this provision of the House bill. Under the House bill the rate of tax in the case of furs and jewelry would be reduced to 10 percent but under section 601 of your committee's bill the present 20 percent rates are retained. It is estimated that this will result in a small annual increase in excise tax revenues.

(B) Quick-Freeze Units

Since the tax on the household type of refrigerators was first imposed, a new type of household refrigerating apparatus has come into use; namely, units for the quick freezing or frozen storage of foods. These quick-freeze units are sold either separately or with ordinary household refrigerators. Your committee sees no reason why an excise tax should be imposed on one type of household refrigerating equipment and not on another. The House bill extends the manufacturers' tax on refrigerators to cover household-type quick-freeze units and apparatus. Your committee concurs in this provision. Under the House bill the rate of tax would have been 7 percent. Under section 606 of your committee's bill the 10-percent rate now applying to refrigerators is retained and also applied to the quick-freeze units. It is estimated that the extension of the tax on refrigerators to cover quick-freeze units and apparatus will increase excise-tax revenues by $8 million in a full year of operation.

(C) Coin-Operated Gaming Devices

Under present law the occupational tax on coin-operated gaming devices is $100 per year per machine. The House bill increases this tax to $150. The increase in this tax at the present time appears particularly appropriate in view of the fact that the Senate has recently passed a bill (S. 3357) banning interstate shipments of gaming devices. Your committee's bill (sec. 603) accepts the House provision. It is estimated that in a full year of operation the increase in this tax will raise excise tax collections by $5 million.

(D) Application of Certain Excise Taxes With Respect to Government Agencies

Until August 1, 1949, post exchanges were not collecting retail excise taxes, but since that time those within the United States have been collecting these taxes in accordance with the Treasury Department interpretation of present law as requiring them to do so. Moreover, some question has been raised as to whether military exchanges and other Government agencies are now subject to the occupational taxes, and in any case some Government agencies are not now paying these taxes. To exempt from these taxes Government agencies in competition with private business represents unfair competition. The House bill removes the possibility of this discrimination by providing that the United States Government or any of its agencies or instrumentalities in the United States shall collect the retail excise taxes with respect to any articles sold at retail which are generally subjected to these taxes unless sales by such agencies are specifically exempted. A similar provision in the House bill makes the various occupational taxes applicable in the case of these Government agencies. Sections 602 and 604 of your committee's bill concur in these two provisions of the House bill. It is estimated that there will be a small increase in revenues as a result of collecting occupational taxes from all governmental agencies. No increase is anticipated as a result of requiring Government agencies to collect the retail taxes since, as indicated above, these taxes already are being collected.

(E) Television Sets and Apparatus

The tax on radio receiving sets was first adopted in the Revenue Act of 1932. At that time there was no indication that a closely associated type of home entertainment, namely, television, would come into widespread use. Had this possibility been appreciated the tax on radio receiving sets might well have been drafted in such a fashion as to include television sets. In any case it appears undesirable to tax one of these forms of home entertainment and not the other. Moreover, television already is offering serious competition to motion-picture theaters and other types of entertainment subject to the tax on general admissions. Your committee believes that it represents unfair competition to levy a tax on one and not the other of these closely competitive forms of entertainment.

As a result of the defense effort it also appears probable that for some time to come limitations on production, rather than on demand, will be the factors determining the number of television sets sold. In view of this it appears improbable that the imposition of a moderate manufacturers' excise tax on television sets will have any material effect on the number of sets purchased. Thus, it is not anticipated that the imposition of a manufacturers' tax on television sets will affect the size of the television audience or influence the number of television stations which may be established in the next few years.

In view of the above considerations section 605 of your committee's bill amends the House bill to extend the present 10-percent manufacturers' tax on radio receiving sets and apparatus to television sets and apparatus. On the basis of a full year of operation it is estimated that this action will increase revenues by $42 million.

(F) Transportation of Persons and Property Where Amounts Are Paid Outside of the United States

The attention of your committee has been called to the fact that an increasing number of persons have been seeking to avoid the 15-percent tax on the transportation of persons and the 3-percent tax on the transportation of property by using various devices to pay the transportation charges outside of the United States. This practice has been increasing rapidly since the repeal of the Canadian tax on the transportations of persons in March of 1949. Many believed that payments outside the United States for transportation within the United States were tax-free because the sections levying these taxes (sec. 3469 (a) and (c) and sec. 3475 (a)) refer to "amounts paid within the United States." However, the Commissioner of Internal Revenue on September 2, 1949, issued a release defining payment within this country in case of the tax on the transportation of persons as including cases where:

> * * * persons mail or telegraph or send cash, checks, money orders, or other funds to ticket offices, travel agents, etc., in other countries (such as Canada or Mexico) for such tickets, or if persons arrange with travel or transportation offices in this country for the furnishing of such tickets from a foreign address.

In a release on July 7, 1950, the Commissioner stated that in the case of the tax on the transportation of property—

> there is no doubt that Congress intended to include all domestic shipments where all the transactions in connection with shipments of goods normally take place within the United States.

While there has been considerable dispute as to the correctness of these interpretations of the law by the Commissioner it is your committee's view that these rulings are an accurate interpretation of existing law. Moreover, the release relating to the transportation of persons clearly does not cover the case where a person himself pays the transportation charge outside of the United States nor does the release relating to the transportation of property necessarily impose the tax in all cases where the transportation is within the United States.

To clarify the application of these taxes section 607 of your committee's bill adds provisions to the sections of the Internal Revenue Code imposing the taxes on transportation of persons and property (secs. 3469 and 3475) indicating that where the transportation both begins and ends in the United States, the taxes apply even though payment is made outside the United States. While the resulting increase over present collections under these taxes will be small, your committee's action forestalls the possibility of a substantial revenue loss in the future.

VIII. EDUCATIONAL, CHARITABLE, AND CERTAIN OTHER TAX-EXEMPT ORGANIZATIONS, FOUNDATIONS, AND TRUSTS

Your committee's bill (secs. 301 to 341) includes a series of provisions which, under specified conditions, result in the imposition of taxes in the case of educational, charitable, and certain other tax-exempt organizations, foundations, and trusts; the denial of charitable deductions under section 162 to nonexempt trusts; and the denial of deductions for income, estate, and gift tax purposes to donors to these organizations. These provisions can be summarized as follows:

(1) All organizations exempt under section 101 (1), and (7), certain organizations exempt under section 101 (14), all organizations exempt under section 101 (6) except churches or associations of churches, and all trusts receiving charitable deductions under section 162 (a), are subject to income tax or denied charitable deductions with respect to income derived—

- (*a*) from operation of a business enterprise which is unrelated to the purpose for which such organization received an exemption, or
- (*b*) from rentals from property leased to others on a long-term basis where the property was purchased with borrowed funds;

(2) The filing of annual information showing such items as income, disbursements for charitable, etc., purposes, and accumulations will be required in the case of foundations, trusts, and certain other educational and charitable organizations exempt under section 101 (6) and trusts claiming deductions under section 162 (a), and this information will be made available to the public;

(3) "Feeder" organizations, or organizations whose primary activities are concerned with the operation of a business and turning the income earned over to organizations exempt under section 101 are denied exemption under section 101 (however, limitations are imposed on the denial of exemption in prior years); and

(4) If as a result of engaging in certain specified types of transactions with donors, funds are diverted from the charitable or educational purpose of foundations, trusts, or similar organizations—

- (*a*) the organizations lose their exemptions (or in the case of nonexempt trusts they are denied unlimited charitable, etc., deductions under section 162 (a)) prospectively only; except that exemption may be denied retroactively where the prohibited transaction was entered into with the purpose of diverting funds involving a substantial proportion of the assets or income of the organization and
- (*b*) deductions for contributions to organizations which have lost their exemption, or their right to unlimited charitable deductions, under (*a*) are denied, but only after the organization has lost its exemption, or deduction, except that deductions to donors may be denied retroactively where the donors themselves were involved in a prohibited transaction entered into with the purpose of diverting funds, and such diversion involved a substantial portion of the assets or income of the organization.

The provisions pertaining to unrelated business income and lease-backs (point 1 above) and those dealing with "feeder" organizations (point 3 above) are substantially the same as in the House bill except for the limitations imposed on the denial of exemptions in prior years. The provision that information, relating to accumulations and other items, which will be made available to the public, be required of certain organizations (point 2 above) is substituted for a House measure providing a tax on the accumulation of investment income (in excess of stated allowances) of foundations, trusts, and certain other educational and charitable organizations. The provision relating to the denial of exemption and deductions where certain types of transactions are made with donors (point 4) represents a modification of provisions in the House bill. Under the House bill if the foundations, trusts, and similar organizations engage in certain specified types of transactions with donors, officers, or trustees, the organizations would lose their exemption (or in the case of trusts coming under section 162, they would lose their unlimited charitable, etc., deduction).

The House bill also would require these foundations, trusts and similar organizations to stipulate in the instruments under which they are administered that they will not engage in the specified transactions with donors, officers, or trustees if contributions to such organizations are to be deductible to their donors. Also under the House bill deductions for charitable contributions would be denied where the contributions consist of stock in a corporation controlled by the donor and his family and are given to an organization or trust which the donor and his family control. These provisions are omitted entirely in your committee's bill.

(A) Unrelated Business Income

The House bill imposes the regular corporate income tax on certain tax-exempt organizations which are in the nature of corporations, and the individual income tax on tax-exempt trusts, with respect to so much of their income as arises from active business enterprises which are unrelated to the exempt purposes of the organizations. Trusts claiming the charitable, etc., deduction under section 162 (a) of the code also are denied this deduction with respect to their business income. The tax in the case of exempt organizations applies to the unrelated business income of the labor, agricultural, and horticultural organizations exempt under section 101 (1) of the Code; the literary, scientific, religious (other than churches), educational, and charitable organizations, including hospitals and foundations, exempt under section 101 (6); and the business and trade associations exempt under section 101 (7). The tax does not apply to income of this type received by a church even though the church is held in the name of a bishop or other church official. However, the tax does apply to other exempt institutions under the auspices of the churches.

The tax on unrelated business income under your committee's bill is imposed in the same manner and applies to the same organizations as under the House bill except that it is made clear that associations or conventions of churches also are excluded from the tax. It was pointed out to your committee that in the case of some denominations each local church is autonomous and that as a result the central association or convention might not be exempted from tax in these cases under the House bill.

The tax on unrelated business income, under both the House bill and your committee's bill, also applies to the so-called investment subsidiaries now exempt under section 101 (14) if their income is payable to section 101 (1), (6), or (7) organizations. However, since these organizations are presently limited to holding title to property, collecting income from it and turning the proceeds over to other exempt organizations, the only trade or business in which they can engage is the rental of property. Consequently the tax on unrelated business income can only apply to their rental income from the type of leases described under (2) below.

It is important to note that many organizations now exempt from income tax under section 101 of the Internal Revenue Code are not affected by these tax measures. For example, none of the business- or mutual-type organizations are affected. These include mutual savings banks; building and loan associations; cooperative banks and credit unions; cemetery companies; local life-insurance associations; mutual ditch or irrigation companies, mutual cooperative telephone companies or like organizations; mutual insurance companies other than life or marine; farm cooperatives; corporations which are subsidiaries of farm cooperatives; voluntary life, sick, or accident benefit associations of United States Government employees; local teachers' retirement fund associations; and voluntary employees' life, sickness, or accident benefit associations. In addition to these business- or mutual-type organizations, certain other organizations also are not affected. These include fraternal beneficiary societies; civic leagues; social welfare organizations; local associations of employees organized for charitable, educational or recreational purposes; social clubs; instrumentalities of the United States; and communal or apostolic religious organizations.

Your committee's bill also adds a new provision dealing with unrelated business income of section 101 (6), (1), or (7) organizations in years beginning prior to January 1, 1951. This provides that with respect to these prior years no such organizations shall be denied exemption on the grounds that they are carrying on trades or businesses for profit if the income from these sources would not be taxable under the provisions of your committee's bill dealing with unrelated business income, or if such organization would not be denied exemption under the amendment made to section 101 by this bill relating to "feeder" organizations. This provision will give assurance to such organizations that their exemption will not be denied with respect to these past years merely because their primary income is rental income (other than lease-back income).

(1) INCOME FROM AN UNRELATED TRADE OR BUSINESS OTHER THAN THE RENTAL OF PROPERTY

The problem at which the tax on unrelated business income is directed is primarily that of unfair competition. The tax-free status of section 101 organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes. Also, a number of examples have arisen where these organizations have, in effect, used their tax exemptions to buy an ordinary business. That is, they have acquired the business with little or no investment on their own part and paid for it in installments out of subsequent earnings—a procedure which usually could not be followed if the business were taxable.

In neither the House bill nor your committee's bill does this provision deny the exemption where the organizations are carrying on unrelated active business enterprises, nor require that they dispose of such businesses. Both provisions merely impose the same tax on income derived from an unrelated trade or business as is borne by their competitors. In fact it is not intended that the tax imposed on unrelated business income will have any effect on the tax-exempt status of any organization. An organization which is exempt prior to the enactment of this bill, if continuing the same activities, would still be exempt after this bill becomes law. In a similar manner any reasons for denying exemption prior to enactment of this bill would continue to justify denial of exemption after the bill's passage.

Some of the witnesses who appeared before your committee took the position that this unrelated business income should be taxed only if received by a subsidiary organization. However, it is difficult to see why a difference in tax treatment should be allowed merely because in one case the income is earned directly by an educational or charitable organization, while in the other it is earned by a subsidiary of such an organization. In both cases the income is derived from the same type of activities and disposed of in the same manner. Moreover, in most cases the business functions now carried on by subsidiaries could be transferred to the parent if the tax were applied only to the income of the subsidiaries.

Under the House bill and your committee's bill the tax is imposed on income derived from a trade or business "regularly carried on" by a tax-exempt organization if the business is not "substantially related" to the performance of the functions upon which the organization's exemption is based. However, the tax does not apply if substantially all the work done in the trade or business is performed without compensation, or if, in the case of a section 101 (6) organization, the trade or business is carried on primarily for the convenience of the members, students, patients, officers or employees of the tax-exempt organization.

Athletic activities of schools are substantially related to their educational functions. For example, a university would not be taxable on income derived from a basketball tournament sponsored by it, even where the teams were composed of students of other schools.

In the case of an educational institution, income from dining halls, restaurants, and dormitories operated for the convenience of the students would be considered related income and, therefore, would not be taxable. Income from a university press would be exempt in the ordinary case since it would be derived from an activity that is "substantially related" to the purposes of the university.

An amendment made by your committee also excepts from tax income derived from the sale of merchandise by tax-exempt organizations when the merchandise is acquired by gift. This is intended to exclude "thrift shops" run by tax-exempt organizations where those desiring to benefit the exempt organization contribute old clothes, books, etc., to be sold with the proceeds going to the exempt organization.

The House bill specifically exempts from tax income derived from research for the United States or any of its agencies, since most of this work is done on a cost basis. Your committee's bill exempts income derived from work performed under a contract for State and local governments, as well as the United States Government. The word "work" is used instead of "research" because it was pointed out to the committee that Government contracts given to universities frequently provide for development and instruction as well as research. Work done for State and local governments, as well as work done for the Federal Government, is excluded since it is not believed that such work is ordinarily undertaken on a profit-making basis.

A special exemption is provided under your committee's bill in the case of colleges, universities, and hospitals for income received from research done for anyone. This is not intended to imply, however, that funds received for research by other institutions necessarily represent unrelated business income. For example, a grant by a corporation to a foundation to finance scientific research would be a gift rather than trade or business income (either related or unrelated) if the results of the research were to be made freely available to the public. However, a "grant" by a corporation to be used for research by a foundation with the results of the research to be given only to the grantor would clearly not be a gift and would constitute unrelated business income.

In order to eliminate the cases in which the unrelated business income is incidental, both the House bill and your committee's bill include a specific exemption of $1,000. This, in addition to the requirement that such businesses must be carried on "regularly" to be taxable, will dispose of most of the nuisance cases. Moreover, imposition of the tax in cases where the income is below $1,000 would involve excessive costs of collection and payment.

In applying the tax, the House bill and your committee's bill provide for the consolidation of all of an organization's income from its various unrelated trade or business activities. To do otherwise would deny to the organizations the benefit now enjoyed by ordinary corporations of offsetting the losses on one venture against the gains on another.

The tax on unrelated business income does not apply to dividends, interest, royalties, and rents (other than certain rents on property acquired with borrowed funds). The House report indicated that for this purpose the term "royalties" would, of course, include overriding royalties. Your committee has amended the bill to include overriding royalties specifically in the term royalties and to make it clear that royalties may be measured by production or by gross or net income from the property.

The House bill also provided that the tax on unrelated business income did not apply to gains or losses from the sale of real property. Your committee's bill broadens this somewhat to exclude gains or losses from the sale of any property (including standing timber) other than stock in trade, property held for sale to customers, or timber cut by the organization.

Dividends, interest, royalties, most rents, capital gains and losses and similar items are excluded from the base of the tax on unrelated income because your committee believes that they are "passive" in character and are not likely to result in serious competition for taxable businesses having similar income. Moreover, investment-producing incomes of these types have long been recognized as a proper source of revenue for educational and charitable organizations and trusts.

(2) "LEASE-BACK" INCOME

As implied by its name, a lease-back involves the purchase of a property by a tax-exempt organization, and the leasing of the property, usually to the same business from which the property was purchased. In the early years of its use the device was applied almost exclusively to the purchase of retail store properties. Currently it also is being used for the purchase of other types of real property.

In many cases the exempt organization, in buying the property, does not use its own funds to make the payment, but borrows the purchase price and pays off the loan plus the interest charges thereon by applying part or all of the rental income received for a period of years to this purpose. Thus, the exempt organization, although investing little or nothing in the venture, obtains after a period of years an unencumbered title to the property.

The purchase and lease-back arrangement apparently is of recent origin. Nevertheless, it has already become big business and a recent writer has characterized it as "the most noteworthy financial device of the present century." It was reported that one real-estate broker had completed lease-back sales since the war totaling $40,000,000 and had authorizations from approximately 40 institutions for the purchase of an additional $100,000,000 worth of property under this type of arrangement.

There are three principal objections to the lease-back arrangements where borrowed funds are used. First, the tax-exempt organization is not merely trying to find a means of investing its own funds at an adequate rate of return but is obviously trading on its exemption, since the only contribution it makes to the sale and lease is its tax exemption. Therefore, it appears reasonable to believe that the only reason why it receives the property at no expense to itself is the fact that it pays no income tax on the rentals received.

The second objection to the lease-back is that it is altogether conceivable that if its use is not checked, exempt organizations in the not too distant future may own the great bulk of the commercial and industrial real estate in the country. This, of course, would lower drastically the rental income included in the corporate and individual income-tax bases. The fact that under present law an exempt institution need not use any of its own funds in acquiring property through lease-backs—borrowed funds may represent 100 percent of the purchase price—indicates that there is no limit to the property an exempt institution may acquire in this manner. Such acquisitions are not in any way limited by the funds available for investment on the part of the exempt institution. This explains why particular attention should be given to lease-backs which involve the use of borrowed funds. Where an exempt organization uses its own funds, expansion of its property holdings through the lease-back device must necessarily proceed at a much slower pace.

A third reason for proposing the taxation of lease-backs is the possibility which exists in each case that the exempt organization has in effect sold part of its exemption. This can occur either by the exempt organization paying a higher price for the property or by charging lower rentals than a taxable business could charge. Proof, of course, is difficult to obtain because the purchase price, or rental charge which a taxable business would agree to pay, is unknown.

In the case of ordinary investments there is no reason why an exempt organization could be expected to make an offer which would be much, if any, better than that which would be made by a taxable business. However, in the case of the lease-back arrangements the sellers seem to take the position that they will not sell at all unless they receive better terms than a taxable business can offer, and the exempt organization, because of its tax-free status, can afford to pay the higher price and still make a profit on the transaction. This is especially likely to occur where the exempt organization is presented an arrangement which does not require the commitment of any of its own funds.

The House bill and your committee's bill would resolve this aspect of the lease-back problem by taxing, as unrelated business income, certain income received from the lease of real property and personal property leased in connection with it. The organizations covered by this portion of the bill are the same ones which are subjected to tax on their other unrelated business income.

Under the House bill the tax applies only when the property owned by the organization is leased for a period of 5 years or more, or when the period of the lease plus options is 5 years or more. Your committee's bill makes only a slight modification in this. The leases to which it would apply are leases of more than 5 years, since it was brought to the attention of the committee that many short-term leases are for as many as 5 years. Under both bills the amount of rents included in gross income is restricted to the same proportion of the rents as the borrowed funds used to finance the purchase or improvement of the income-producing property bear to the adjusted basis of such property. This restricts the tax to the income which does not result from a simple investment of the trust or organization's capital funds, and eliminates the possibility that the tax-exempt organization will use its exemption alone as a means of acquiring property.

The tax applies not only to cases where the vendor and the lessee are the same person but also to those where they are not. Hence, the tax will apply in cases which do not conform strictly with the lease-back plan but which raise the same problem of unfair competition which the lease-back itself produces.

In addition to the amendment already mentioned, your committee's bill makes four substantive changes in the House lease-back provision. All of these deal with meritorious exclusions from the application of this tax. The first excludes from the tax on lease-backs "related" leases even though the lessee is a taxable organization. "Related" is defined in a similar fashion as in the case of a related trade or business and is, for example, intended to exclude from the application of this tax leases by tax-exempt hospitals of part of the hospitals to doctors' associations to use as clinics. It is believed that leases of this type are entered into primarily to further the purpose of the exempt organization rather than to gain special benefits from tax exemption.

The second of these exclusions relates to property which was acquired by gift, bequest or devise before July 1, 1950, and at the time of acquisition was already subject to both a mortgage and a lease. This exclusion also applies to investment subsidiaries exempt under section 101 (14) where one-third of the stock in the subsidiary was acquired by gift and all of the stock was acquired prior to July 1, 1950. In the case of such subsidiaries indebtedness incurred prior to July 1, 1950, or indebtedness incurred after such date in improving property as required by a lease entered into before July 1, 1950, does not come under the lease-back tax. This second exclusion is designed to omit from the tax base property which has already been acquired by gift, since it appears unlikely that there was any intent to avoid taxes in these cases.

The third exclusion limits the application of the lease-back tax where only a part of the property is rented out under long-term leases. In these cases the tax is imposed only if either of two conditions is present:

(1) the rents derived from long-term leases represent 50 percent or more of the total rental payments received, or the space occupied by such leaseholders represents 50 percent or more of the rented area, or

(2) the rental payments derived from any single long-term leaseholder represent 10 percent or more of the total rents or the space occupied by any single long-term leaseholder represents 10 percent or more of the area rented out.

Thus, no tax would be imposed where a substantial part of the property is rented out on a short-term basis, and where the long-term leases which do exist are spread out among relatively numerous leaseholders. It is not believed that such arrangements represent an attempt to trade on tax exemption.

The fourth exclusion provided by your committee's bill relates to cases where an exempt organization has borrowed funds to build a building primarily designed for its own use, but has extra space which it desires to rent out under long-term leases. Your committee's bill excludes such leases from the application of the lease-back tax. In such cases tax advantages clearly are not the principal reason for acquiring the building.

(B) Publicizing Instead of Taxing Accumulated Investment Income

The House bill would subject to tax, with specified exceptions, that part of the investment income of certain section 101 (6) organizations which is not paid out on or before the 15th day of the third month following the close of the taxable year in which the income is received. The following section 101 (6) organizations would be subject to tax on their accumulated investment income under the House bill: (1) all trusts other than certain special trusts which, by their terms, are required to distribute all their income and corpus within 5 years after their creation; and (2) all other section 101 (6) organizations except (*a*) religious organizations, (*b*) organizations operated, supervised, controlled or principally supported by religious organizations, (*c*) schools and colleges with established faculties and student bodies in attendance, (*d*) and organizations supported by either the general public or the Government. Section 101 (14) organizations would be taxable on their accumulated investment income only if payable to section 101

(6) organizations taxable on their accumulated investment income. The House bill would also, with certain exceptions, deny trusts the charitable, etc., deduction under section 162 (a) if they do not distribute the income reserved for charitable, etc., purposes within 2½ months after the end of their taxable years. The tax (or denial of a deduction in the case of trusts coming under sec. 162) under the House bill would apply to the portion of the undistributed income of these organizations and trusts which consists of interest, dividends, rents, royalties (including overriding royalties) and income received from trusts. It would not apply to the unrelated business income which is subject to tax under other portions of the House bill and your committee's bill, nor would it apply to capital gains.

The tax under the House bill would not apply to income from property transferred in trust, subject to mandatory restrictions on its distribution, prior to June 1, 1950. The House bill also permitted the accumulation, tax-free, of income from property set aside in trust for a charitable, etc., purpose under the will of a decedent. However, this tax-free accumulation would be limited to a period of 25 years following the date of the decedent's death. A third exception under the House bill would permit organizations subject to tax on their accumulated investment income to set aside income without tax in special trusts which provide for expenditure of the funds so set aside and the income earned on these funds within 5 years after the trusts are created. Finally, the House bill provided that organizations and trusts subject to the tax on accumulated investment income could accumulate tax-free an amount equal to 1 year's investment income.

Your committee has rejected this accumulations tax and substituted for it the requirement that information disclosing the extent of accumulations must be made available to the public. Your committee does not question the contention that some organizations are abusing their tax-exempt privilege by undesirable accumulations of income. However, witnesses before, and statements presented to, your committee brought out quite clearly that the measure passed by the House was too inflexible and as a result would seriously injure many worth-while educational and charitable projects. To mention some problems under the House provision:

(1) A foundation could not use any of its income to endow another organization unless the latter was of a type not subject to the accumulations tax.

(2) A foundation could not set aside funds which, if subsequently matched by another organization, would be spent for some specific purpose.

(3) Foundations may find that as the result of a crisis, such as a war, they are unable to spend their funds for a period of time for the purposes for which they were organized.

(4) Funds irrevocably set aside in a 5-year trust fund as provided by the House bill may not be needed at the end of the 5-year period for the specific project for which they were set aside, and

(5) One year's earnings, the accumulations permitted by the House bill, may not be sufficient to even out variations in the earnings or needs for funds of a foundation.

It is believed that publishing information about the accumulations of these foundations and trusts will serve two purposes. First, full public information will encourage distributions. Second, it will reveal the extent of the accumulations problem.

The organizations required to file this information, which is to be made available to the public, include all organizations exempt under section 101 (6) now required to file informational returns (Form 990) under section 54 (f) of the code, and also trusts claiming charitable, etc., deductions under section 162 (a) of the code. This includes all of the organizations which under the House bill would be subjected to the accumulations tax.

The information to be required in the case of a section 101 (6) organization is:

1. its gross income for the year,
2. its expenses attributable to such income,
3. its disbursements out of current income for its educational, charitable, etc., purpose,
4. its accumulation of income within the year,
5. its prior accumulations of income,
6. its disbursements out of principal, and
7. a balance sheet.

Trusts claiming charitable, etc., deductions under section 162 (a) will be required to submit similar information.

(C) "Feeder" Organizations

The House bill provides that no organization operated primarily for the purpose of carrying on a trade or business (other than the rental of real estate) for profit shall be exempt under section 101 merely on the grounds that all of its profits are payable to one or more organizations exempt from tax under this section. Your committee has accepted this provision of the House bill. This amendment is not intended to affect the exemptions now provided for farm cooperatives, subsidiaries of these cooperatives or investment subsidiaries exempt under section 101 (12), (13), and (14).

The effect of this amendment is to prevent the exemption of a trade or business organization under section 101 on the grounds that an organization actually described in section 101 receives the earnings from the operations of the trade or business organization. In any case it appears clear to your committee that such an organization is not itself carrying out an exempt purpose. Moreover, it obviously is in direct competition with other taxable businesses. This amendment applies only with respect to taxable years beginning after December 31, 1950.

Your committee also amended the bill to provide that exemption shall not be denied to one of these organizations with respect to years prior to January 1951 if such organization was granted exemption in a letter from the Bureau of Internal Revenue, unless subsequently the exemption was revoked or inquiries were made by the Bureau of Internal Revenue relative to the exempt status of the organization. In any case the exemption may not be denied for periods prior to such revocation or inquiry. Your committee's bill also added a provision that no organization whose exemption under section 101 has not been granted, questioned or denied prior to the passage of this bill shall be denied exemption for any period prior to January 1, 1947, on the ground that it is carrying on a trade or business for profit. Moreover, the filing of an information return (Form 990) shall be deemed to be the filing of a return for the purpose of determining the 3-year period of limitations on the assessment of deficiencies. Organizations not required to file Form 990 also are treated for this purpose as if they had done so.

(D) Modification of House Bill Provisions Relating to Transactions Prohibited in the Case of Trusts and Exempt Foundations

The House report indicates that the Committee on Ways and Means in studying the operations of educational and charitable foundations and trusts has found that in a number of cases donors of trusts and foundations either have derived, or at least have had the opportunity to derive, substantial benefits from their dealings with the trusts or foundations.

It is pointed out in the House report that these benefits to the donors or trustees can arise in a number of different ways. They may take the form of selling securities to, or purchasing securities from, the trust or foundation under conditions which benefit the donor. They may arise from the borrowing of funds from the exempt organizations with the payment of abnormally low interest rates by the donor or the assumption of abnormal risk by the exempt organizations. They may take the form of the payment of excessive salaries to the donor or a member of his family as an official of the trust or foundation, or of rendering services on a preferential basis to the donor or a firm with which he is associated.

To check these abuses the House bill denies deductions to donors for income, estate, and gift tax purposes of gifts made after June 30, 1951, unless the instrument under which the recipient organization is established affirmatively provides that—

(1) no part of the organization's assets may be loaned to substantial donors of the organization or any of its officers or trustees, or any member of their families or to a corporation controlled by them,

(2) only a reasonable compensation for services actually rendered may be paid to such persons by the organization,

(3) the services of the organization may not be made available to such persons on a preferential basis,

(4) no substantial part of the assets of the organization may be used to purchase securities or other property from such persons; and

(5) no substantial part of the property of the organization may be sold to such persons.

This provision would apply, in general, only to gifts made to organizations which, under the House bill, are made subject to tax on their accumulated investment income. Gifts made to other exempt organizations such as universities, religious organizations, community chests and other public organizations would not be subject to these restrictions.

The House bill also would deny income tax exemption to a trust or foundation (and with respect to trusts coming under sec. 162 would deny the unlimited charitable, etc., deduction) where any of the above rules are violated in the operation of the organization. These provisions would be applicable with respect to taxable years beginning after December 31, 1950.

Your committee is in sympathy with the goals sought by the above provisions of the House bill but believes they would be unduly harsh in their application. No objection is seen to engaging in transactions with donors if these transactions are carried out at arm's length. Moreover, many foundations and trusts would find it either impossible or very difficult to stipulate in their instruments that they will not engage in the specified transactions even though they never have done so and never expect to do so. Nevertheless, donors to such organizations could not deduct their contributions under the income, estate, or gift taxes. Also an organization might unintentionally violate one of the requirements, such as paying what might be held to be an unreasonable salary, and then, when its return was examined several years later, find that it would lose its exemption for the past several years.

As a result your committee has recast the House provisions to remove their harshness. Prohibited transactions have been redefined as including only transactions in which an organization—

(1) lends any part of its income or corpus without adequate security or at an unreasonable rate of interest to donors, members of their families, or a corporation which they control,
(2) pays any compensation to such persons other than a reasonable allowance for personal services actually rendered,
(3) makes any part of its services available to such persons on preferential basis,
(4) makes any substantial purchase of securities or other property from such persons without adequate consideration,
(5) sells any substantial part of its securities or other property to such persons without adequate consideration, or
(6) engages in any other transaction which results in a substantial diversion of its income or corpus to such persons.

It is important to note in the above listing of prohibited transactions that under your committee's bill the prohibited transactions are restricted to transactions in which a donor (including a testator) or a member of his family is likely to gain some special benefit from the transaction. Moreover, these prohibited transactions do not apply to transactions between the exempt organization and its trustees, directors or officers.

Exemption (or the unlimited charitable deduction under sec. 162), is denied under your committee's bill in the case of an organization or trust participating in a prohibited transaction only with respect to years subsequent to the year in which it receives notification of a violation except where the prohibited transaction was entered into with the purpose of diverting funds involving a substantial proportion of the assets or income of the organization. In this latter case exemption may be denied retroactively. Provision also is made for one of these organizations or trusts which has engaged in a prohibited transaction to regain its exempt status (or the unlimited charitable, etc., deduction under sec. 162) by presenting information to the Commissioner of Internal Revenue which satisfies him that it is unlikely to again participate in one of these transactions.

For deduction of contributions to donors, your committee's bill only requires that the organization or trust be exempt at the time the contribution is made (stipulation in instruments is not required), unless the donors (or their families) personally are involved in one of these transactions for the purpose of diverting funds from the organization and such transaction involves a substantial part of the assets or income of the organization.

Under your committee's bill the provisions discussed here only affect trusts claiming charitable deductions under section 162 (a) and organizations exempt under section 101 (6) other than—

(1) Religious organizations,

(2) Educational organizations with an enrolled student body in residence,

(3) Organizations which receive a substantial portion of their support from a government or directly or indirectly from the general public (excluding in such computation income received by the organization in carrying on its exempt function),

(4) Organizations which are operated or principally supported by religious organizations, and

(5) Organizations providing medical or hospital care or medical education or medical research.

The organizations excluded from the application of these provisions are in general what might be called "public" organizations and because of this characteristic are not believed likely to become involved in any of these prohibited transactions.

(E) ELIMINATION OF HOUSE PROVISION PREVENTING THE USE OF TRUSTS AND FOUNDATIONS TO RETAIN CONTROL OF A FAMILY BUSINESS.

The House bill provided that no charitable deduction would be allowed to a contributor for income, estate, and gift tax purposes if both of the following conditions were present:

(1) The contributor, or members of his family, have voting control of the organization to which the contribution is made, and

(2) The contribution consists of stock in a corporation in which the contributor together with members of his family control 50 percent or more of the voting stock or 50 percent or more of the total stock, counting the stock held by tax-exempt organizations which the family control.

The House report pointed out that under the bill both of these conditions must be present before the deduction would be denied. A deduction would be granted with respect to a gift of stock in a family business given to an organization which the family does not control; and a deduction would be granted if stock in a family business were sold and the proceeds given to a charitable organization which the family did control.

In the House bill the term "voting control of the organization"—that is, the charitable organization—included those cases where the family has the power to fill vacancies. Also, the proposal provided that if any right is retained in the property transferred, other than a right in the income of the property, this is to be considered the same as controlling the organization.

Your committee has rejected this provision entirely.

The House report expressed the view that denial of deductions in such cases would simply be a recognition of the fact that where such control exists no completed gift for which a deduction should be granted has been made. In the opinion of your committee this overlooks the fact that the donor or his family must use the property set aside in the foundation or trust for charitable, etc., purposes rather than for personal purposes.

The view was also expressed in the House report that as a result of allowing these deductions there was avoidance of income, estate, and gift-tax deductions. Outweighing this in the view of your committee is the fact that if these deductions are not allowed still larger funds would be lost to private charity.

IX. TAX ON LIFE INSURANCE COMPANIES

Title IV of your committee's bill amends the formula used to determine the taxable net income of life insurance companies. This action is intended to terminate the tax exempt status of the life insurance companies which results from the operation of the formula contained in existing law, and to permit the study necessary to develop a permanent solution to the problem of the adequate taxation of such companies. The proposed formula is the same as that contained in the House bill and in House Joint Resolution 371 which was reported by your committee on April 10, 1950. (See S. Rept. No. 1434 of the 81st Cong., 2d sess.) Under your committee's bill this formula is applied to the years 1949 and 1950. Under the House bill it is applied also to 1947 and 1948.

Your committee does not believe it advisable to apply the formula retroactively to the years 1947 and 1948. The returns for those years were filed some time ago; the books of the companies have been closed; and in some cases no reserves were established to cover the Federal tax liability. Testimony before your committee in its hearings on House Joint Resolution 371 disclosed that some companies had made commitments in those years relying on the fact that no Federal income tax was payable under existing law. Hence, the payment of a tax now would impose a hardship upon the policyholders.

The committee believes that the constitutionality of a tax imposed at this time on 1947 and 1948 incomes is at least debatable. It is evident that some companies will contest the validity of such a tax and others may be forced to do so through action of their policyholders.

Even if your committee were of the opinion that a tax levied now on 1947 and 1948 incomes would be upheld by the Supreme Court, it would still oppose retroactive taxation extending over such a long period of time. The imposition of a tax on 1947 and 1948 incomes at this late date would be inconsistent with fundamental public policy which requires that a taxpayer's obligation to his Government be made definite and certain at the time the tax is due.

In attempting to justify the 1947 and 1948 taxes the House report stresses the history of the preliminary negotiations between the Treasury Department and the representatives of the two associations of life-insurance companies, which have been in process ever since the autumn of 1947. However, your committee does not regard the existence of these negotiations as putting the insurance companies on notice that the Congress might adopt retroactive legislation extending as far back as 1947 and 1948. In fact some of the witnesses before your committee testified that they had no notice that such retroactive legislation was contemplated, even by the Treasury Department, until August 1949.

On the other hand, the life-insurance companies have been on notice that a revision of the formula was being considered by the Congress for the year 1949, at least since October 10, 1949, the date House Joint Resolution 371 was introduced. This date is over 2½ months before the end of the calendar year 1949 and 5 months before the due date for filing 1949 returns.

It is estimated that the total additional revenue to be derived from your committee's bill will be approximately $122,000,000. Of this amount $42,000,000 will be derived from the year 1949 and $80,000,000 from the year 1950.

X. OTHER REVENUE-INCREASING CHANGES IN THE INCOME TAXES

(A) Measures Included in the Finance Committee Bill

(1) PREMIUMS ON TAX-EXEMPT BONDS HELD BY DEALERS

Recent bond issues by some States and municipalities have had peculiar characteristics; they include several series maturing within short periods but with extraordinarily high interest rates. An example is to be found in a recent issue of bonds by a State, the aggregate obligation being for $50,000 000. The first five series of those bonds, requiring payment by the State of $1,600,000 annually in 1952 to 1956, had an interest rate of 4½ percent, although they were intended to yield from 0.65 to 1.20 percent; whereas bonds maturing in 1957 to 1974, intended to yield from 1.20 to 2 percent, had an interest rate of 1¾ percent. Similarly, a midwestern city recently sold a group of serial bonds, those maturing from 1951 to 1954 having an interest rate of 6 percent, whereas those maturing from 1955 to 1977 had an interest rate of only 2 percent.

A person who acquires such a short-term, high-interest bond, whether directly from the State or municipality or indirectly from a dealer or another person, must pay a very high premium. To acquire a bond which would pay interest of $60 per year and $1,000 at maturity 5 years hence the purchaser would be required to pay about $1,250.

In the absence of special statutory provisions, a person who held such a bond for 5 years would receive $300 of interest, which would be excludable from gross income and thus exempt from tax. But since he had paid $1,250 and received only $1,000 at maturity he would have a loss of $250, which could be deducted from ordinary income, if the bond were held for sale to customers, or deducted from capital gains if the bond were held by an investor. Of course, such a "loss" is not a real loss at all, since the premium of $250 is an offset to the extraordinarily high interest. Actually, the yield on the bond over the 5 years is, roughly, $300 less $250 or $50, which is the equivalent of 1 percent per year on the par value; or, allowing for semiannual recoupments of part of the premium, there is a yield of about 1 percent per year on the actual investment, which is a normal yield on such short-term municipal bonds.

To avoid the inequitable tax effects which would result from the deduction of such artificial losses, sections 125 and 113 (b) (1) (H) were added to the Internal Revenue Code by the Revenue Act of 1942. With respect to State and municipal bonds, in the case of an investor, these provisions require the amortization of any premium paid. Thus, continuing the illustration, the basis of a bond acquired for $1,250, maturing in 5 years, would be reduced $50 per year, so that if it were sold for $1,200 at the end of 1 year, or redeemed for $1,000 at the end of 5 years, no capital loss would result. Since the interest on such bonds is exempt from tax, amounts of annual amortization of premium are not deductible.

Under existing law, however, dealers in securities, whether individuals, partnerships, or corporations, are not required to amortize such bond premiums. Section 125 (d) specifically excludes bonds which constitute "stock in trade of the taxpayer or any such obligation 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 any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Thus, a dealer in securities who inventories his securities on a cost basis or who does not maintain inventories can deduct as a loss the difference between the cost of such bonds and their selling price or the amount received at maturity. Dealers who inventory their securities at market prices automatically receive annual deductions of portions of the premiums, since an appropriate amortization is reflected in the market prices shown in their inventories, or in the selling prices if the bonds are sold or mature during the year. It appears that such artificial losses, in substantial amounts, are availed of by dealers in securities generally, and particularly by members of underwriting syndicates and the security-dealer affiliates of large banks, who have transactions amounting to millions of dollars in State and municipal bonds, to reduce their tax liability on other income.

Section 203 of your committee's bill is intended to prevent the deduction of such artificial losses, without unduly complicating the accounting procedures of dealers. With respect to State and municipal bonds which have been held more than 30 days and which have a maturity or call date not more than 5 years from the date of acquisition by the dealer, the premium paid must be amortized. In the case of dealers who carry their bonds at cost, this amortization will reduce the basis so as to eliminate an artificial loss in the year of the sale or other disposition of the bond, and in the case of dealers who carry their bonds at market prices the amount of the amortization for any year must be used to reduce the cost of sales for that year.

In the House bill this provision was effective for taxable years beginning after December 31, 1949. Witnesses who appeared at your committee's hearings pointed out that the use of this effective date would require extensive and costly reexamination of transactions which occurred before notice was given of a change in the law by the enactment of the House bill. Therefore, your committee has amended the bill so as to require the amortization of the premium on all securities purchased on or after July 1, 1950, but in the case of securities held on June 30, 1950, such amortization will be required only with respect to taxable years beginning after that date.

It is estimated that in the long run the revenues under this changed procedure will be about $20 million higher annually than they would be if existing law were continued.

(2) DIVIDENDS-RECEIVED CREDIT FOR DISTRIBUTIONS IN KIND

Under section 26 (b) of the Code, a corporation is allowed to deduct from net income a dividends-received credit equal to 85 percent of the amount it receives from other domestic corporations as dividends. The purpose of this credit is to prevent income which has been taxed in the hands of the corporation earning it from being taxed in full again in the hands of another corporation which receives this income in the form of a dividend. However, a corporation which receives a dividend in kind may be allowed a dividends-received credit of 85 percent of the fair market value of the property received, even though the property received as a dividend in kind has appreciated in value in the hands of the first corporation. It has been contended that no income-tax liability is incurred if the stockholder corporation then sells the property, because it has a basis in the hands of the stockholder corporation equal to its fair market value at the time of its distribution as a dividend. The result may be a loophole in the dividends-received-credit provision which may allow a subsidiary corporation and the corporation which holds its stock to dispose of property (by a dividend in kind and subsequent sale) with payment of an income tax on only 15 percent of its value even though the profit realized on the disposition of the property may greatly exceed 15 percent of the property's market value at that time.

Section 122 (a) of your committee's bill deals with this problem by providing that the dividends-received credit shall not exceed 85 percent of the adjusted basis of the distributed property in the hands of the distributing corporation. If gain is recognized to the latter corporation as a result of the distribution, the dividends-received credit would be allowed for 85 percent of the adjusted basis of the property plus the gain recognized to the distributing corporation.

This amendment is not intended to affect any interpretation of existing law with respect to a dividend in kind.

This limitation on the dividends-received credit will apply only to dividends received after the date of enactment of this bill. Under the House bill, the change would be applicable to dividends received after December 31, 1949.

It is estimated that this provision will increase revenues by about $6 million a year.

(3) STOCK REDEMPTION BY SUBSIDIARY CORPORATIONS

Section 115 (g) of the code provides that where a corporation redeems its stock in such a manner as to make the redemption essentially equivalent to the distribution of a taxable dividend, the amount distributed in redemption of the stock shall be treated as a taxable dividend to the extent that it represents a distribution of earnings or profits. Such a provision was necessary to prevent stockholders from drawing off accumulated corporate profits through the device of selling part of their stock to the corporation.

The recent case of *Commissioner* v. *Wanamaker* (178 Fed. (2d) 10), however, has revealed a loophole through which this result can be accomplished without coming within the scope of section 115 (g). Section 115 (g) was held in that case to be applicable only where a corporation cancels or redeems its own stock. It was held not to be applicable when a subsidiary corporation purchased the stock of its parent corporation from the shareholders of the parent, even though the effect was, in fact, practically identical with that which would have resulted if the parent had itself purchased the stock.

If the stockholders of a corporation which owns all the stock of a subsidiary corporation obtain cash from that subsidiary, in effect they have received a dividend to the same extent as would be the case if the cash had been paid by the subsidiary to the parent corporation and had then been distributed by the parent to the stockholders. And where such stockholders "sell" part of their stock in the parent corporation to the subsidiary they nevertheless retain ownership and control of both corporations, since the "sold" stock is one of the assets which the parent corporation owns by virtue of its possession of all the stock of the subsidiary. Therefore, section 209 of your committee's bill amends section 115 (g) of the code, so as to cover indirect redemption of shares in a parent corporation through purchases by its subsidiaries.

The House bill also extended the application of section 115 (g) to cases in which both the issuing corporation and the acquiring corporation are controlled directly or indirectly by the same interests. Your committee eliminated this provision because in this case it is not clear that the effect is the same as a redemption of stock by the issuing corporation.

This amendment will apply only to amounts received after the date of enactment. Under the House bill the change is applied to amounts received after December 31, 1949.

Your committee's amendment will yield a small amount of additional revenue, and prevent substantial loss through the utilization of this loophole in future years.

(4) CAPITAL GAINS TREATMENT OF INCOME FROM BOOKS AND OTHER ARTISTIC WORKS

When a person is in the profession of writing books, or creating other artistic works, his income from the sale of the products of his work is taxed as ordinary income. This is true whether he receives royalties from the use of his products or sells them outright, since the products of his work are held by him "primarily for sale to customers in the ordinary course of his trade or business" and are, therefore, not treated as capital assets.

If an amateur receives royalties on his book or other artistic work, they are treated as ordinary income, but if he holds his book or other artistic work for 6 months (3 months under this bill) and then sells it outright he can avail himself of a loophole which treats such a sale as the sale of a capital asset, not held primarily for sale to customers in the ordinary course of the taxpayer's trade or business. As a result the taxpayer receives long-term capital gain treatment on the product of his personal effort.

Sections 211 (a) and (b) of your committee's bill provide that when any person sells a book or other artistic work which is the product of his personal effort his income from the sale is taxed as ordinary income.

He would, of course, be able to average his income from such work if his activities covered a period of 36 months or more, to the extent permitted by section 107 (b) of the code. To avoid a loophole a gain received by a person who acquired the book or other artistic work as a gift from the creator is also taxed on ordinary income.

Your committee's amendment is applicable to taxable years beginning after the date of enactment.

It is estimated that this amendment may yield nearly $1 million annually in additional revenue.

The House bill also would have treated as ordinary income gains from the sale of an invention or patent by the occasional inventor. Your committee believes that the desirability of fostering the work of such inventors outweighs the small amount of additional revenue which might be obtained under the House bill, and therefore the words "invention," "patent," and "design" have been eliminated from this section of the bill.

(5) SHORT SALES OF CAPITAL ASSETS

At the present time it is possible for an investor in stocks to realize a capital gain in less than 6 months and obtain long-term capital gain tax treatment on it by making a short sale, which will assure his gain on his original investment, and then defer closing out the short sale until he has held his original stock investment for more than 6 months. A similar result may be obtained where the initial transaction is a short sale.

Much the same device may be used by a taxpayer to avoid tax on his profits from speculation in commodity futures. Regulations of the Department of Agriculture prohibit a broker from carrying for a customer simultaneous long and short positions in the same commodity, the same future period, and the same market. A taxpayer may achieve substantially the same result, however, by keeping the simultaneous long and short positions in two different markets.

Your committee's bill elsewhere (section 211 (c)) provides that capital gains and losses will be deemed long-term gains and losses if the property sold or exchanged has been held more than 3 months. This would increase the possibility of utilizing the short-sale device as a method of tax avoidance.

Section 212 of your committee's bill provides, in effect, that where a sale of "substantially identical" property is made, and thereafter simultaneous "long" and "short" positions are maintained so as to give an actual short-term transaction the appearance of a long-term transaction, gains and losses shall be treated for tax purposes as short-term gains or losses. On the other hand, where securities have been held for more than 3 months, and thereafter a short sale is made, any loss on the short sale shall be treated as a long-term loss, offsetting the long-term gain so that 50 percent of both will be taken into account, and not as a short-term loss 100 percent of which would be taken into account. These rules also apply where the taxpayer buys and his spouse sells substantially identical property, or vice versa.

Whether a short sale is of substantially identical property will depend on the circumstances at the time of the short sale. Securities of one company will not be regarded as substantially identical with securities of another company, except that "when issued" securities of a successor corporation may be substantially identical with the securities to be exchanged for them in a reorganization. It is specifically provided that a commodity future requiring delivery in one calendar month will not be regarded as substantially identical to a commodity future requiring delivery in a different calendar month.

The provisions of this section do not apply to "straddle" or arbitrage transactions in commodity futures where "long" and "short" contracts are executed on the same day and both are closed out on the same day.

A person who owns stock may buy a "put" which entitles him to sell his stock at any time within, for example, 30 days at a specified price. If the market price of the stock goes up he will, of course, sell at the market price rather than exercise the "put" option he has purchased. But if the market price goes down he is assured of getting the price specified in the "put" option he has bought. Therefore, a person who buys a "put" is assured that he will realize the appreciation in value of his stock just as though he had made a short sale. For this reason a short sale is defined as including a "put," or option to sell at a fixed price.

The provisions of this section would apply to taxable years beginning after the date of enactment of the act, but not to short sales made before such date.

It is estimated that the new procedure will result in about $2 million a year in additional revenue.

(6) COLLAPSIBLE CORPORATIONS

The collapsible corporation is a device which has been used in an attempt to convert ordinary income into long-term capital gain by use of a temporary corporation. The device has been used principally in the motion-picture industry. A legitimate corporation engaged in the business of producing motion pictures would ordinarily pay the corporate income tax on its net income and its shareholders would pay ordinary income tax on their dividends from the corporation. Producers have tried to avoid these results by organizing separate corporations for each motion picture. Upon completion of the film but prior to the realization by the corporation of any income therefrom, the corporation is liquidated and the assets are distributed. In such a case, the corporation pays no tax, claiming that it has realized no income. The producer pays tax upon the difference between his cost and the fair market value of the assets so distributed; but such gain is reported as long-term capital gain with a maximum effective rate of 25 percent. After liquidation, the fair market value of the released production is ordinarily amortized against the income from the film as it is received. If the income from the film does not exceed such fair market value, there is no further tax.

In addition to the motion-picture industry, it is understood that the collapsible-corporation device has also been used in the building-construction trade by contractors who have corporations construct buildings for sale and then liquidate the corporations and sell the buildings as individuals.

Under section 213 of your committee's bill the gain realized from the sale or exchange (including liquidation) of stock in a collapsible corporation will be treated as ordinary income for tax purposes, in the case of a stockholder owning 10 percent or more of the corporation's stock, if the gain realized from the sale or exchange of the stock during the year is more than 70 percent attributable to property produced by the corporation, and the gain is realized within 3 years following the completion of the manufacture, construction, or production of the property.

This provision is applicable only to gains realized after December 31, 1949, but no inference shall be drawn from the amendment with respect to gains realized prior to 1950.

It is estimated that the closing of the collapsible-corporation loophole will produce approximately $3 million additional revenue annually.

(7) CAPITAL GAINS OF NONRESIDENT ALIENS

Under existing law capital gains of nonresident alien individuals not engaged in trade or business in the United States are exempt from income tax. A number of cases have been brought to the attention of your committee in which such nonresident aliens are escaping the capital-gains tax, although in fact they are in this country for considerable periods and carry out transactions in this country by which capital gains are realized.

Section 215 of your committee's bill deals with this loophole by imposing a tax on the net amount of capital gains derived from sources within the United States by a nonresident alien individual not engaged in trade or business in the United States, but temporarily present therein. If such nonresident alien has been within this country for less than 90 days during the taxable year, the tax applies only to such gains as were realized during his presence in the United States. If he has been present 90 days or more, the tax applies to all such gains realized on transactions carried out within the United States personally or through an agent during the entire taxable year, whether or not he was present in the United States at the time the sales or exchanges occurred.

Generally, the rate imposed on such gains will be 30 percent, which is the rate applied under existing law to nonresident alien individuals not engaged in trade or business in the United States on their other income arising from sources within the United States. The 30-percent rate is somewhat higher than the maximum rate now applied to long-term capital gains, but, of course, well below the rates frequently applicable to short-term capital gains. Where the taxpayer's gross income from sources within the United States is $15,400 or more, the tax will be 30 percent or the amount calculated under the regular income tax rates, whichever is the larger.

This amendment, like other sections of your committee's bill, is limited by the general rule set out in section 213 of the bill, that—

No amendment made by this Act shall apply in any case where its application would be contrary to any treaty obligation of the United States.

This amendment will apply only with respect to gains realized after December 31, 1949.

It is anticipated that this amendment will increase the revenues by about $1 million annually.

(8) AMORTIZATION OF PREMIUM ON CONVERTIBLE BONDS

Under section 125 of the code the purchaser of a taxable bond who pays a price in excess of the amount recoverable at maturity is permitted a deduction which will amortize the premium paid. If the bond is noncallable, the premium is written off over the life of the security. If the bond is callable, the premium is written off over the period between the date of purchase and the earliest call date.

Section 125 was intended primarily to deal with the case where the premium was paid because the security bore a stated rate of interest higher than that prevailing in the current market for securities of a like risk and a similar life. Equity required the allowance of a deduction against ordinary income in cases of this sort.

However, a premium also may arise because the security purchased is convertible into another type of security. Here the premium paid may represent nothing more or less than a portion of the price paid for the security into which the bond is convertible, and the allowance of a deduction for a premium of this type is no more justifiable than it would be for the balance of the cost of the investment. Nevertheless, since no distinction was made in the drafting of section 125 of the code between premiums based upon the payment of an unusually high rate of interest and premiums based upon a conversion privilege, doubt arose concerning the availability of the amortization privilege with reference to premiums of the latter type. This question was resolved by the United States Supreme Court in the Korell and Shoong cases, decided on June 5, 1950. These cases involved the purchase of bonds at a substantial premium which was obviously based primarily upon the privilege of conversion into common stock. Since the securities were callable within the taxable year, the taxpayer's deduction of the difference between the purchase price and the call price in the taxable year when the bonds were purchased was sustained by the court. This results in a loophole since the effect is to grant the taxpayer a deduction against ordinary income equal to the amount of the premium paid for the conversion privilege, and the Government recoups its loss on this account, if at all, only to the extent that the adjustment in the basis of the security obtained as a result of the conversion leads to an additional capital gains tax at some later date.

Section 219 of your committee's bill eliminates this loophole by stipulating that the privilege of amortizing a bond premium allowed under section 125 of the code will not apply to that portion of the premium on a convertible bond which is attributable to the conversion features of the bond.

With respect to securities acquired on or before June 15, 1950, the amendment applies to taxable years beginning after that date. For instance, if a convertible bond purchased on January 2, 1950, matures on January 2, 1955, with no provision for earlier call, one-fifth of the actual premium paid could be amortized in 1950 by a taxpayer on the calendar year basis, but only that part of the premium not due to the conversion privilege could be amortized over the four subsequent years. However, with respect to bonds acquired after June 15, 1950, only that part of the premium not attributable to the conversion privilege may be amortized in 1950 or subsequently.

It is estimated that this provision will increase the revenue by $2 million annually when in full operation.

(9) UNITED STATES EMPLOYEES IN THE POSSESSIONS AND THE CANAL ZONE

Section 251 of the code exempts from tax the income of individual citizens and domestic corporations from sources outside the United States if 80 percent or more of their gross income is derived from sources within a possession of the United States and 50 percent or more of their gross income is derived from the active conduct of a trade or business within a possession of the United States. For the purposes of section 251, the Canal Zone receives the same treatment as a possession, but the Virgin Islands are not so treated. Individuals are entitled to this exemption whether they engage in a trade or business on their own account or as employees or as agents. The exemption has been interpreted as applying to military and civilian personnel employed by the United States.

Military and civilian personnel of the Government who are citizens of the United States are not exempt from income tax when they are stationed in any other part of the world, and their exemption while stationed in the possessions is not in any way related to the original purpose of section 251, which was to encourage American businesses in the possessions.

Section 223 of your committee's bill eliminates the special treatment accorded the military and civilian employees of the United States Government and its agencies who are stationed in the possessions. Wages paid to them in taxable years beginning after December 31, 1950, for services to the United States or its agencies performed in such possessions will not be considered income from within such possessions, in determining whether they are entitled to the benefits of section 251 of the code, and will be subject to tax as income from sources within the United States. Withholding on such wages will apply, effective January 1, 1951.

The provision in the House bill applied to taxable years beginning after December 31, 1949. Since no current payments of tax have been made and since it is likely that most of the individuals in question have carried on their affairs for more than half of 1950 without reserving funds with which to pay this tax, the imposition of a tax on 1950 incomes would probably result in considerable hardship. Hence, your committee has made the change effective for taxable years beginning after December 31, 1950.

It is estimated that this provision will increase the revenues by $31,000,000 annually when fully effective.

(10) TAX TREATMENT OF PUERTO RICAN RESIDENTS

Under the existing Federal individual income tax law a disparity exists between the treatment accorded two different groups of United States citizens who are residents of Puerto Rico, those who are citizens only by reason of the organic acts establishing the government of Puerto Rico and those who are citizens because they were born or naturalized in the United States. Puerto Rican residents who are United States citizens only as a result of the organic law are taxed by the United States on any income derived from sources in the United States in the same manner as nonresident aliens.

Citizens of the United States who are residents of Puerto Rico but derive their citizenship from the Puerto Rican organic law are also divided into two groups for tax purposes, depending upon whether or not they are eligible for the special treatment provided for income from sources within the United States possessions under section 251 of the code. To be eligible for this treatment 80 percent of the individual's gross income must be derived from United States possessions and 50 percent of his gross income must be derived from the conduct of a trade or business within a possession of the United States either on his own account or as an employee. These individuals are taxed by the United States only on income from sources within the United States. They receive the regular deductions to the extent that they are allocable to income from sources within the United States and are subject to the regular individual income-tax rates, but receive only a single personal exemption.

Those who do not qualify under section 251 are taxed by the United States on their income from all sources, including Puerto Rico, but receive a foreign tax credit on taxes paid to Puerto Rico or to any foreign country. They receive the ordinary deductions and exemptions.

For the purposes of its own individual income tax, Puerto Rico does not distinguish between those of its residents whose United States citizenship depends upon organic law and those who were born or naturalized in the United States. It taxes their income from all sources, including the United States, and allows a tax credit for tax paid to the United States or to a foreign country.

In the opinion of your committee the existing Federal income tax treatment of United States citizens in Puerto Rico is confusing and the discrimination against those who derive their citizenship from the organic law is unfair. Moreover, it is most unfortunate to classify citizens of the United States as nonresident aliens for tax purposes. Under section 224 of your committee's bill all United States citizens who are bona fide residents of Puerto Rico during the entire taxable year receive the same tax treatment with respect to taxable years beginning after December 31, 1950. They are not taxed under the Federal individual income tax with respect to any income derived from sources within Puerto Rico. The tax is limited to income derived from sources outside Puerto Rico, including income from the United States itself. The withholding tax of 30 percent of gross income will no longer apply to residents of Puerto Rico who are citizens of the United States only by reason of organic law nor are they to be deprived of exemptions and the benefits of income splitting as under existing law.

Puerto Rican residents are singled out in this fashion because Puerto Rico is in a unique position. It is neither a foreign country nor an integral part of the United States. Moreover, it differs from all other possessions in that it has its own income tax law which takes the place of the Federal income tax law. For these reasons your committee believes it is desirable in the case of Puerto Rican residents to apply the United States tax only to income derived from sources outside of Puerto Rico; for income from sources within Puerto Rico the Puerto Rican income tax takes the place of the United States income tax.

Since Puerto Rico allows a credit for income taxes paid to the United States, the Puerto Rican tax would in effect apply only to income derived from Puerto Rico except when the Puerto Rican tax is higher than the United States tax. In such a case Puerto Rico would collect a tax equal to the difference between the Puerto Rican rates and the United States rates applicable to income derived from sources outside Puerto Rico.

There need be no fear that as a result of your committee's proposal anyone will gain a tax benefit by splitting his income in two and being subjected to tax on part of it by Puerto Rico and the other part by the United States. With respect to Puerto Rican residents, Puerto Rico, since it first includes the United States income in its tax base and then allows a credit for income taxes paid to the United States, will collect a tax at relatively high effective rates on the income from Puerto Rican sources, while the United States, since the bill allows an exclusion for income derived from Puerto Rican sources, would collect a tax at relatively low effective rates. Assuming the rate schedules were the same in both the United States and Puerto Rico, the combined tax would be the same as would be collected by either jurisdiction if the whole income had been subject to its taxes alone. In a similar fashion, if the individual is a resident of the United States, United States would collect the tax at the relatively high effective rates and Puerto Rico at relatively low effective rates.

It has been estimated that this provision will increase the revenues by $2,500,000 annually when fully effective.

Your committee has amended this portion of the House bill so as to make provision for the collection of taxes due the United States from residents of Puerto Rico. This latter amendment is made effective on the date of enactment.

(B) Measures Included in the House Bill Which Are Not Contained in the Finance Committee Bill

(1) THE INTEREST ELEMENT IN INSTALLMENT PAYMENTS OF LIFE INSURANCE

A beneficiary under a life-insurance policy usually may elect to receive a series of monthly or annual payments instead of taking the face value of the policy as a lump sum, or such installment payments may have been arranged for by the insured. The contract may provide for a specific number of such payments, or that the payments will continue until the beneficiary's death. Under section 22 (b) (1) of the code—

> amounts received under a life insurance contract paid by reason of the death of the insured whether in a single sum or otherwise—

are not included in the taxable income of the beneficiary.

Section 201 of the House bill provided that where the proceeds were paid in installaments, the interest element in each installment was to be subject to the income tax. Your committee believes that it would be unwise to tax such installment payments since it is desirable that widows and other beneficiaries of life-insurance policies be encouraged to receive the proceeds in installments over a period of years rather than as a lump sum which may be lost or dissipated.

(2) DIVIDENDS PAID OUT OF PRE-1913 EARNINGS

The House bill contained a provision (sec. 205) for the taxation as ordinary income to the stockholder of dividends paid out of corporate earnings and profits accumulated prior to March 1, 1913, or out of appreciation in the value of property which occurred before that date. Since 1916 the various revenue laws have contained provisions which specifically exclude such payments from the definition of taxable dividends, the payments being regarded as essentially equivalent to a return of capital and used to reduce the basis of the stock. During the intervening 34 years a great many stockholders have received dividends out of pre-1913 earnings or appreciation which have not been regarded as ordinary income. The number of corporations which would henceforth pay such dividends is relatively small and the number of stockholders who might receive such dividends is limited. Therefore, it seems inappropriate at this late date to change the tax treatment of such dividends. Hence, this provision of the House bill has been eliminated.

(3) TAX-FREE LIQUIDATION OF FOREIGN SUBSIDIARIES

The House bill contains a provision (sec. 206) revising the tax treatment of the liquidation of foreign subsidiaries of domestic corporations. Under existing law such liquidation may result in a capital gain, or may not be taxable if the liquidation complies with the requirements for a tax-free reorganization. The House bill would tax as ordinary income so much of the gain realized in liquidation as is not in excess of the proportionate amount of the foreign corporation's accumulated earnings and profits, provided over 50 percent of the stock in the foreign corporation is owned directly or indirectly by less than five domestic corporations.

This provision has not been included in your committee's bill. Your committee believes the provision in the House bill is unduly harsh, since it taxes distributions in liquidation as ordinary income and raises other troublesome problems.

(4) LOSS FROM SALE OF BUSINESS PROPERTY

Section 117 (j) of the Internal Revenue Code provides that the aggregate net gains from the sale of depreciable assets and land, held for more than 6 months and used in the taxpayer's business, shall be treated as long-term capital gain, but that the aggregate net loss from the sale of such property shall be treated as ordinary loss. This treatment was introduced in 1942 in order to stimulate the sale of business properties so that they would be more apt to come into the hands of the persons who could use them efficiently for the war effort.

Under the House bill (sec. 209) losses from the sale of property used in the trade or business would be treated as capital losses, while gains from the sale of such property would continue to be treated as capital gains, regardless of the period for which the assets were held, thus equating the tax treatment of gains and losses. Your committee received abundant testimony indicating that such treatment of losses arising from the sale or abandonment of property used in the taxpayer's business would result in great inequity, because in many cases taxpayers would have no offsetting capital gain. It is evident, for example, that a railroad which abandons a branch line or some other part of its property that can no longer be operated efficiently will have a very large loss but will almost never, either in that or in subsequent years, have sufficient capital gains to absorb the full amount of the loss incurred. Similarly, oil companies frequently abandon leases on property where no oil was found but rarely have offsetting capital gains. Similar situations will occur in other industries. For these reasons your committee deemed the action taken in the House bill to be unwise and made no amendment of section 117 (j) other than the reduction of the holding period from 6 to 3 months, and an amendment recognizing the change in the treatment of the sale of books and artistic works.

The changes made by this bill in the present section 117 (j) will not affect the status of livestock under existing law.

(5) WITHHOLDING ON DIVIDENDS

The House bill included a provision (sec. 601) requiring corporations to withhold a tax at 10 percent on all dividends paid to their stockholders. At your committee's hearings a great deal of objection was raised to this feature of the House bill. It was pointed out that the proposal involves the collection of a tax from individuals who have no tax liability because their income is less than their exemptions and deductions, and from organizations with a tax-exempt status. Additional expense is imposed upon the withholding agents.

At the present time corporations are required to report to the Bureau of Internal Revenue dividends paid to each stockholder in excess of $100 per year. The knowledge, on the part of the stockholder who receives a smaller amount, that the corporation will not report the dividends paid to him tends to encourage carelessness on his part, if not deliberate evasion. Existing law gives the Commissioner of Internal Revenue power to require corporations to report the payment of dividends in any amount to all stockholders. It is understood by your committee that the Commissioner proposes to revise the existing regulations so as to require complete reporting.

At the present time the dividend recipient is not required to itemize his dividends in his income-tax return. This also tends to reduce the accuracy of the reporting of income. It is understood that the Commissioner will amend the income tax return form so that the itemization of dividends will be required in the 1950 tax returns filed in 1951.

These two administrative changes will provide the Bureau of Internal Revenue with more adequate information for use in the discovery of evasion of the income tax on dividends. In the opinion of your committee these administrative changes will help to correct the problem at which the proposal for withholding on dividends was aimed.

The provision in the House bill extended withholding to the "patronage dividends" or refunds of certain cooperatives. The testimony before your committee revealed that in a large number of cases such withholding would not justify the expense and trouble imposed on the withholding agent and the taxpayer. For example it was stated that in one cooperative in 1948, 75 percent of the patronage dividends were for less than $5 and in a second case 63 percent were for less than $2.50. The undesirability of withholding in such cases was an additional reason for your committee's rejection of the plan contained in the House bill.

(6) INTEREST ON REFUNDS AND DEFICIENCIES

Under existing law overpayments refunded by the Government bear interest at the rate of 6 percent, the same rate as is paid by the taxpayer on deficiencies. Under the House bill (sec. 602) the interest paid by the Government on overpayments would be reduced to 3 percent. Your committee is of the opinion that the resulting difference between the interest rate paid and that received by the Government is discriminatory. Therefore, the House provision has not been included in your committee's bill.

XI. OTHER ADJUSTMENTS IN THE TAX LAW

(A) Measures Contained in the House Bill

(1) PERCENTAGE DEPLETION

Section 204 of the House bill would amend section 114 (b) of the code dealing with percentage depletion. The percentage allowed coal would be increased from 5 to 10; a number of items would be added to the list of nonmetallic minerals receiving the 15-percent rate; and a new group of nonmetallic minerals would receive percentage depletion at the rate of 5 percent. The House bill also includes an amendment intended to redefine the gross income upon which the percentage depletion rate is applied.

Section 208 of your committee's bill eliminates the increase in the rate on coal and the allowance of percentage depletion for the additional nonmetallic minerals enumerated in the House bill. An estimated revenue loss of $35,000,000 annually is involved, which is difficult to reconcile with the need for revenue at the present time. Moreover, your committee is not convinced that all of the items to which percentage depletion would be extended have a valid claim to such treatment. In those cases where a valid claim for some additional depletion allowance exists, it is not evident that the percentage rates used in the House bill are necessarily the appropriate ones. Thus, it appears desirable to postpone action on these proposals until your committee can carry out a more careful analysis of the problems involved.

Under the House bill the "gross income from the property" upon which percentage depletion is applied does not include any amount which reflects transportation beyond "the property." While this rule may be equitable when the first processing occurs on the property, it discriminates against the case where the first processing must be done elsewhere. Accordingly your committee has amended this provision so as to make it conform with what your committee believes is the intent of existing law. The code section here involved was added in the 1943 Revenue Act so that the law would clearly have the same meaning as that intended by the depletion provisions in the 1932 act and contemporary Treasury regulations interpretative thereof. Those regulations specified that the gross income computation for depletion purposes was to be "before transportation from the place where the last of the processes listed below was applied." Terrain, water supply, or other factors, sometimes permit the application of ordinary treatment processes directly on the mining property. At other times the plants to apply such processes to obtain the commercially marketable mineral products are normally located some distance from the mouth or opening of the mine, but are at the nearest practicable point at which such processes can be efficiently performed. The transportation to these plants and the ordinary treatment processes applied are included as a part of mining in determining gross income for percentage depletion purposes.

This rule, intended to be applied in accordance with normal standards, clearly would not extend to transportation to distant points far beyond the locations where mine operators would normally locate such plants. But the rule would be applicable when the location of the plant or mill is at a point not substantially more distant from the point of extraction than is reasonably necessary for efficient and economical operation.

In order to remedy another problem pointed out to your committee at its hearings, the bill defines "ordinary treatment processes" in the case of bentonite to include crushing, drying, pulverizing or granulating, and loading for shipment.

The amendments made by this section of your committee's bill will be applicable to taxable years beginning after December 31, 1949.

(2) DISTRIBUTIONS IN AID OF DECEDENTS' ESTATES

It has been brought to the attention of your committee that the problem of financing the estate tax is acute in the case of estates consisting largely of shares in a family corporation. The market for such shares is usually very limited, and it is frequently difficult, if not impossible, to dispose of a minority interest. If, therefore, the estate tax cannot be financed through the sale of the other assets in the estate, the executors will be forced to dispose of the family business. In many cases the result will be the absorption of a family enterprise by larger competitors, thus tending to accentuate the degree of concentration of industry in this country.

Two potential avenues of relief are available under existing law and regulations, but neither provides a truly satisfactory remedy. Section 822 (a) of the code permits the Commissioner of Internal Revenue to extend the time for payment of the estate tax in cases of undue hardship for a period not in excess of 10 years. Since this extension is completely at the discretion of the Commissioner, executors cannot feel secure in relying upon it as a means of solving their tax-payment problem. Moreover, an interest rate of 4 percent is imposed when the payment of the tax is postponed under section 822 (a). The earnings of the business which are paid over to the estate are, of course, subject to the corporate and individual income taxes. It is only the net return reduced by 4 percent remaining after these taxes that provides the margin out of which the tax may be accumulated during the period of postponement. Ordinarily this margin will not be sufficiently large to solve the problem at issue. Furthermore, under this approach the Government's receipt of the tax is delayed.

The other possible remedy exists because of a regulation which sets up an exception to the rule that the funds paid out through the redemption of the outstanding securities of a corporation out of accumulated earnings will be taxable as a dividend to the recipient. The regulation in question (Regulation 111, sec. 29.115–9) states that—

a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend.

While this regulation provides much-needed relief in certain cases, it does not constitute a satisfactory remedy for the problem at issue here, since in order to qualify under the regulation the estate must dispose of its entire holdings in the family business. In most cases this will be tantamount to the withdrawal of the family from the business.

Your committee is of the opinion that remedial action is desirable in order to prevent the enforced sale of the family businesses which are so vital and desirable an element in our system of free private enterprise. Therefore, section 210 of your committee's bill amends section 115 (g) of the code so as to remove from the category of a taxable dividend payments made under certain restricted circumstances in the redemption by the issuing corporation of a portion of its stock held by a decedent's estate. To qualify for such treatment the redemption must be made within the period of the statute of limitations for the assessment of the estate taxes due. The exemption from the provisions of section 115 (g) will apply only to so much of the proceeds of the stock as does not exceed the total of the estate, inheritance, legacy or succession taxes (including interest) imposed because of the decedent's death.

The House bill restricted the exemption to cases where the value of the stock in the family corporation included in the taxable estate was more than 70 percent of the value of the net estate. Your committee believes this 70 percent limitation is unduly restrictive. Therefore this provision was eliminated.

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 of your committee's bill will be small.

(3) HOLDING PERIOD FOR CAPITAL ASSETS

Under existing law the more favorable treatment accorded capital gains is restricted to gains on capital assets held for more than 6 months. Section 211 (c) of your committee's bill reduces the period for determining long-term gains and losses from 6 months to 3. Essentially the distinction between long- and short-term gains and losses is intended to confine the more favorable tax treatment to the gains and losses realized by "investors." The holding period requirement is the test by which the "investor" is distinguished from the "speculator," whose individual ventures in the markets for capital assets tend to be of comparatively short duration.

In the opinion of your committee the 6-month holding period requirement used in existing law is longer than necessary, and there are good reasons for reducing the requirement to the minimum consistent with the fundamental policy of the Congress on the taxation of capital gains. A long holding period has a disturbing effect on prices in the markets for capital assets, which is most unfortunate. When prices rise, as has been the case in the security markets during the last year and notably in the commodity markets during recent weeks, sales that would otherwise have occurred do not take place because the owners of the assets desire to hold them until they can qualify the gain as long-term and obtain the resulting tax benefits. The consequence is that a check on the price movement which would otherwise appear is missing.

In the opinion of your committee the reduction in the holding period from 6 months to 3 will not impair its effectiveness as a device for confining the more favorable tax treatment to the investor group.

The reduction in the holding period will be applicable to sales and exchanges made after the date of enactment of this bill.

(4) CARRY-OVER OF BUSINESS LOSSES

Section 217 of your committee's bill amends the net operating loss deduction provided under section 122 of the code. Under existing law a business loss in the taxable year may be carried back against income in the two preceding years, and carried forward against the income of the two subsequent years. Your committee's bill substitutes for this 2-year carry-back and 2-year carry-forward, a 1-year carry-back and a 5-year carry-forward.

One effect of this change is to extend the period over which business income can be averaged from 5 to 7 years, thus reducing the tax disadvantages which occur to businesses with fluctuating incomes. Such incomes are associated with unusual business risks and occur relatively frequently among small and new businesses. Hence the extension of the averaging period from 5 to 7 years will provide a real stimulus to venture capital generally and to small and new business in particular.

Your committee's amendment places greater emphasis on the loss carry-forward and less on the loss carry-back than is found in existing law. This change also provides a stimulus to business investment. A provision under which relief is granted primarily when the business is brought back to a profitable basis provides a greater incentive to management and investors alike than a provision which allows the losses of the present to be financed by the refund of taxes paid in the past. The increased emphasis on the carry-forward is to the marked advantage of new businesses, which do not benefit in any way from a carry-back, and established businesses which are undergoing a material expansion. Moreover, the carry-forward raises fewer administrative problems than a carry-back of equal length.

Although the advantages of the carry-forward are substantial, your committee recommends the retention of a 1-year carry-back in order to provide relief in particular circumstances where the carry-forward cannot be used or is inappropriate.

Under your committee's bill the 2-year carry-back and 2-year carry-forward will continue to apply to losses incurred in taxable years beginning before January 1, 1950. Losses incurred in taxable years beginning after December 31, 1949, will be subject to the new rule.

Since this amendment extends the period of averaging, some revenue loss is involved. However, no loss will be realized for several years. The time of appearance and the amount of the eventual revenue loss are very uncertain and will depend upon future business conditions.

(5) CONTEMPLATION OF DEATH

Section 501 of your committee's bill changes the rule under the estate tax dealing with the taxability of transfers in contemplation of death. Under existing law all such transfers are included in the gross estate and there is a rebuttable presumption that transfers made within 2 years prior to death are made in contemplation of death.

While the inclusion in the gross estate of transfers in contemplation of death has long been regarded as necessary to prevent avoidance of the estate tax, the administration of this feature of the estate tax law has always proved difficult. Principally this is due to the fact that contemplation of death deals with the intent of the transferor. Intent is extremely difficult to establish in any case and becomes increasingly so with the passage of time. Undoubtedly many gifts in contemplation of death have escaped the estate tax because of the difficulty which the Government encounters in reconstructing the motives of the deceased. On the other hand, complaints have been received that the Bureau of Internal Revenue has in some cases asserted that gifts made many years before death were in contemplation of death without having much basis for the assertion. As a result executors of estates are confronted with an unpleasant choice between compromising the asserted tax liability or engaging in expensive and difficult litigation. At the present time this problem hangs over any person who makes a gift, even though he expects to live for many years, unless he can prepare evidence demonstrating that the gift was made primarily for nontax reasons.

Section 501 of your committee's bill removes from the scope of the contemplation of death clause all transfers made more than 3 years prior to the date of death. On the other hand, the burden of showing that the transfer was not in contemplation of death will be borne by the estate in all cases where the transfer was made within a period of 3 years ending with the date of death. This will strengthen the position of the Government in cases where the transfer occurred between 2 and 3 years prior to the date of death.

The change will be effective only with respect to the estates of decedents dying after the date of enactment of this bill. It is estimated that this provision will reduce the revenues by about $4,000,000 a year when in full operation.

(6) ESTATE TAX DEDUCTION FOR SUPPORT OF DEPENDENTS

Section 812 (b) of the code allows the gross estate of a decedent to be reduced for estate tax purposes by amounts "reasonably required and actually expended" for the support of the decedent's dependents during settlement of the estate to the extent that such expenses are allowed by State law. This deduction is inconsistent with the concept of the estate tax as a tax on all properties transferred at death. In practice it has discriminated in favor of estates located in States which authorize liberal allowances for the support of dependents, and it has probably also tended to delay the settlement of estates.

Section 502 of your committee's bill repeals this particular feature of the estate tax law. This amendment will apply with respect to estates of decedents dying after the date of enactment of this bill.

It is estimated that this action will increase the revenues by about $3,000,000 annually.

(B) Measures Added by the Finance Committee

(1) EXCLUSION FOR MEMBERS OF THE ARMED FORCES

Section 202 of your committee's bill excludes from taxable income the compensation of members of the Armed Forces of the United States in combat zones such as Korea. The exclusion covers all the pay of enlisted men and warrant officers and the first $200 per month paid to commissioned officers.

The proportion of the annual pay of an enlisted man or a warrant officer which is excluded will be determined by dividing the number of months during any part of which he served in a zone of combat by the total number of months during which he was an enlisted man or warrant officer in the Armed Forces during his taxable year. In the case of a commissioned officer the exclusion for a taxable year is $200 times the number of months in any part of which he served as an officer in a combat area.

The President is authorized to designate as a combat zone any area in which he finds that the Armed Forces of the United States are engaged in combat. Such designation may be made applicable to any part of the period from June 24, 1950, to December 31, 1952, and the exclusion provided by this amendment shall apply with respect to compensation for services performed in such areas during such period.

This bill also provides that there shall be no withholding on the pay of members of the armed forces for any month during any part of which they were in a combat zone.

The principle of income tax relief for members of the armed services on active duty during a time of emergency is well established. During World War II an exclusion of a type similar to that provided under this bill was in effect. However, the World War II provision was allowed for all members of the Armed Forces no matter where they served, while the exclusion under this bill is available only to those serving in the designated zones of combat.

The World War II exclusion for commissioned officers was a maximum of $1,500 annually as compared with a maximum of $2,400 under this bill. It is believed that this increase is advisable to achieve a greater degree of equality in treatment as between enlisted men and officers.

(2) AMORTIZATION OF EMERGENCY FACILITIES

Section 218 of your committee's bill provides for the amortization over a period of 60 months of facilities certified as essential because of the present emergency. The amortization deduction is in lieu of depreciation. It may be elected by a taxpayer whose facility has been certified to have an emergency character and this election may be revoked on notice by the taxpayer. The provision is similar to section 124 of the code which authorized the amortization of emergency facilities during World War II.

The provision in your committee's bill differs from section 124 in the following respects:

The bill provides that the certifying authority is to be designated by the President in an Executive order, whereas in World War II this task was assigned to the Army and Navy Departments acting under regulations issued by the President. During the war the certifying authority was delegated to the War Production Board. The provision in the bill will permit greater flexibility in administration.

The bill provides that a portion of the facility may be designated as essential. There was no similar provision under the World War II legislation but certificates limiting amortization to a percentage of the total cost of a facility were issued in the closing months of the war.

Your committee's bill, like the World War II provision, stipulates that the emergency period in which facilities may be certified will end with a proclamation by the President that the issuance of such certifications is no longer required in the interests of national defense. The World War II legislation also provided that in the event the period of emergency was terminated prior to the conclusion of the 60-month amortization period on a given facility, the taxpayer could recompute his amortization over the period ending with the date of the Presidential proclamation. No similar provision is contained in your committee's bill.

This section of the bill is applicable with respect to facilities completed after December 31, 1949.

(3) EMPLOYEE STOCK OPTIONS

Your committee's bill (sec. 220) establishes a new set of rules for the tax treatment of certain employee stock options. Such options are frequently used as incentive devices by corporations who wish to attract new management, to convert their officers into "partners" by giving them a stake in the business, to retain the services of executives who might otherwise leave, or to give their employees generally a more direct interest in the success of the corporation.

At the present time the taxation of these options is governed by regulations which impede the use of the employee stock option for incentive purposes. Moreover, your committee believes these regulations go beyond the decision of the Supreme Court in *Commissioner* v. *Smith*, 324 U. S. 177 (1945). The resulting uncertainty as to whether these regulations are in accordance with the law is an additional reason for legislative action at the present time.

The rule applied under existing regulations is that an employee exercising an option to purchase stock from his employer corporation receives taxable income at the time the option is exercised to the extent of the difference between the market value of the stock at the time of exercise and the option (or purchase) price. The difference is taxed as ordinary income, rather than as a capital gain, on the theory that it represents additional compensation to the employee. Since the employee does not realize cash income at the time the option is exercised, the imposition of a tax at that time often works a real hardship.

An immediate sale of a portion of the stock acquired under the option may be necessary in order to finance the payment of the tax. This, of course, reduces the effectiveness of the option as an incentive device.

Under your committee's bill no tax will be imposed at the time of exercise of a "restricted stock option" or at the time the option is granted and the gain realized by the sale of the stock acquired through the exercise of the option will be taxed as a long-term capital gain. Such treatment is limited to the "restricted stock option" for the purpose of excluding cases where the option is not a true incentive device. Options which do not qualify as "restricted stock options" will continue to be taxed as under existing law.

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. However, many stocks are not listed on exchanges and therefore the fair market value is difficult to determine. Hence, your committee's bill requires that to qualify as a "restricted stock option" the option price at the time of issuance must be 85 percent or more of the fair market value of the stock.

A "restricted stock option" is entitled to the treatment provided by the bill only if it is exercised while the grantee is an employee, or within a period of 3 months following the termination of his employment. The benefits of this provision extend to cases where the employee of a parent corporation receives an option to purchase stock in a subsidiary and where the employee of a subsidiary receives an option to acquire stock in a parent corporation.

The stock acquired under a "restricted stock option" must not be sold less than 2 years subsequent to the date on which the option is granted, and the stock purchased under the option must be held for a period of not less than 6 months. Thus, under the bill the employee will receive special treatment only if he remains in the employment of the company for a substantial period after the time when he acquires the option and actually invests in the stock of the company for a considerable period.

"Restricted stock options" cannot be transferable except by will or by operation of the laws of intestate succession.

The status of a "restricted stock option" will be denied if the recipient of the option owns directly or indirectly more than 10 percent of the combined voting power of all classes of stock of the employer corporation or of the parent corporation at the time the option is granted. This rule is intended to prevent the use of stock options by employers who seek merely to convert the earnings of a corporation from ordinary income into a capital gain.

Since the options which qualify for special treatment are regarded as incentive devices rather than compensation, no deduction is allowed the corporation under section 23 (a) with respect to a transfer of stock pursuant to a restricted stock option.

The rules governing "restricted stock options" apply to options granted, modified, extended or renewed after December 31, 1946, and exercised after 1949.

(4) FAMILY PARTNERSHIPS

Section 222 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. Although there is no basis under existing statutes for any different treatment of partnership interests, recent judicial and administrative action in this field has 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 consistency with which the Tax Court, since the Culbertson decision, has held invalid family partnerships based upon donations of capital, and the many reasons advanced in the opinions for such decisions would seem to indicate that, although the opinions often refer to "intention," "business purpose," "reality," and "control," they have in practical effect established a rule of law to the effect that an intrafamily gift of a partnership interest, where the donee performs no substantial services, cannot 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.

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. The question of the taxability of the income of such interest depends, as in the case of any other donated property, on whether the donee is the real owner of the interest. The amendment is intended to make it clear that there is nothing peculiar in the tax law as applied to partnerships but, on the contrary, that they are governed by the ordinary rules which generally determine the person to whom income is to be taxed.

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.

Your committee's amendment requires that a true partnership relation exist in that each partner must be a real owner of an interest in the enterprise, just as an alleged donee of any other property must actually own it if the income is to be taxable to him rather than to the donor. In the case of a transfer of an interest in a partnership, as of any other property, it is not required that there be any particular motive for the transfer. There need be no purpose that the transfer benefit the business. It is a basic premise that a bona fide gift is not normally motivated by any business purpose; therefore, the fact that any partner's capital interest in a partnership was acquired from a relative in a purely donative and nonbusiness transaction is not to be considered as an adverse factor in determining whether he actually owns an interest in the enterprise. If he does own such an interest in the business, it is immaterial from whom he acquired it or what motivated the transferor in transferring it to him.

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. Your committee's bill therefore includes specific provisions to prevent the deflection of personal service income and to prevent the allocation of other income in disproportion to capital interests. Your committee's bill requires that the terms of the partnership agreement are to be disregarded where the allocation under the agreement does not substantially reflect the proportionate value of the services or capital of the family members. In this connection the new section 191 added to the code by your committee's bill while specifically providing that nonparticipation in the management or conduct of the partnership business shall not disqualify a person as a partner, provides that this nonparticipation shall be taken into account in determining the proportionate value of the services and capital of each partner. Where reallocation is necessary, a reasonable proportionate allowance for their services is to be made in determining the income of those partners who rendered services. Reallocation of income other than income from personal services may not be predicated upon the fact that the capital of one family member was acquired by gift from another.

The amendments made by this section are applicable for taxable years beginning after December 31, 1938.

(5) RECOGNITION OF GAINS IN THE LIQUIDATIONS OF DOMESTIC CORPORATIONS

Section 206 of your committee's bill restores for a specific interval the provisions of section 112 (b) (7) of the code. The amendment permits the stockholders of domestic corporations to elect to distribute the assets of the corporation in complete liquidation on the following terms. In general, in the case of stock held by individuals, only that portion of the distribution to the shareholders which represents accumulated earnings is to be taxed as ordinary income. So much of the remainder as consists of money, or of stock or securities acquired by the corporation after a basic date (August 15, 1950) is to be treated as a capital gain. In the case of stock held by corporations (other than corporations holding 50 percent or more of the voting power), the corporate shareholder is taxable on its ratable share of the accumulated earnings or on that portion of the assets acquired by it which consists of money, or stock or securities acquired by the distributing corporation after the basic date, whichever is greater.

Under the present form of section 112 (b) (7) 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 your committee's bill this election is restored for plans of liquidation adopted after December 31, 1950, and effected during any one calendar month in 1951. To avoid conversion of the assets of the corporation into stock or securities which could be distributed tax-free in anticipation of legislative action restoring section 112 (b) (7), the basic date referred to above, is made August 15, 1950, the date when this legislation was approved by your committee.

This election will facilitate the liquidation of certain domestic corporations, especially domestic personal holding companies. Your committee recognizes the undesirable character of domestic personal holding companies and wishes to expedite their liquidation.

(6) CIRCULATION EXPENDITURES OF NEWSPAPERS, MAGAZINES, AND OTHER PERIODICALS

Under the bill, publishers of newspapers, magazines, or other periodicals are allowed to deduct as ordinary expenses expenditures to maintain, establish or increase circulation, except expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of other periodicals. This follows, in general, the practice of existing law although in some instances expenditures to increase and establish circulation have been required to be capitalized. The bill removes any uncertainty by permitting all such expenditures to be taken as deductions. However, publishers may be allowed to capitalize instead of deducting the portion of such expenditures as, under regulations prescribed by the Secretary, is deemed to be chargeable to capital account.

This amendment is effective with respect to taxable years beginning after December 31, 1945.

(7) CORPORATE REORGANIZATIONS TAKING THE FORM OF "SPIN-OFFS"

Section 207 of the bill, relating to corporate reorganizations known as "spin-offs," is added by your committee. A "spin-off" occurs when some part of the assets of an existing corporation are transferred to a new corporation and the stock in the latter is distributed to the shareholders of the existing corporation. A "spin-off" also occurs when the stock of an existing corporation A, a controlled subsidiary of corporation B, is transferred to a new corporation C and the stock of the new corporation C is distributed to the stockholders of corporation B without surrender of their stock. On the other hand, a "split-up" occurs when a single existing corporation is replaced by two or more new corporations, the stock in the new corporations being distributed to the shareholders of the existing corporation which is completely liquidated.

Under existing law a corporate reorganization taking the form of a "split-up" may be, and usually is, tax-free. Your committee's bill provides the same treatment for "spin-offs." This is done because your committee believes that corporate reorganizations which accomplish substantially the same effect should be given the same tax treatment. Moreover, your committee considers it economically unsound to impede reorganizations which break business up into smaller units.

However, your committee's bill provides for the nonrecognition of gains or losses in the case of "spin-offs" only where both the corporation which is "spun-off" and the existing corporation are intended to continue carrying on business after the reorganization, and where the reorganization does not represent a device for the distribution of earnings and profits of the existing corporation. Moreover, the nonrecognition of gain does not apply if preferred stock is received in respect to the spun-off assets.

It is not anticipated that the nonrecognition of gain or loss in the case of "spin-offs" will result in an important loss of revenue, since it is already possible for corporations to accomplish much the same effect without recognition of gain or loss if the reorganization takes the form of what is frequently the more cumbersome type of reorganization, namely, a "split-up."

This amendment will apply only to distributions of stock made after the date of enactment of this bill.

(8) PERSONAL HOLDING COMPANY INCOME

If a closely held corporation receives most of its income from such sources as dividends, interest, certain rents, and royalties, indicating that the company is being used as an "incorporated pocketbook," it is designated for tax purposes as a personal holding company. Generally, such a company, in addition to paying the regular corporate income taxes, is subjected to an additional penalty tax at the rate of 75 percent or 85 percent on its undistributed income.

Included in personal holding company income are amounts received for the use of the corporation's property where 25 percent or more of the stock in the corporation is held by the individual renting the corporate property. The attention of your committee has been called to examples where, through a set of fortuitous circumstances, corporations have become closely held and also have rented most of their assets for use in the operation of businesses to the individuals holding the stock of the companies. Thus, unwittingly the corporations have become personal holding companies and subject to the penalty tax.

While your committee recognizes that such arrangements could result in tax avoidance, and, therefore, does not permit such practices in the future, it believes that relief for past years should be given where such arrangements have been unwittingly entered into with no thought of tax avoidance. Thus, your committee's bill in section 226 limits the application of section 502 (f) of the Code (defining personal holding company income) to eliminate, for taxable years ending after 1945 and before 1950, rents for the use of a corporation's property by persons holding 25 percent or more of the stock of the company where the property is used by such persons "* * * in the operation of a bona fide commercial, industrial, or mining enterprise * * *."

It is anticipated that the revenue loss from this proposal will be nominal.

(9) REGULATED INVESTMENT COMPANIES

Under existing law a corporation whose primary source of income is from dividends, interest and the sale of securities and whose security holdings are widely distributed may, if certain specified conditions are met, be treated for tax purposes as a "regulated investment company." Such investment companies are given special tax treatment under supplement Q of the code on the theory that they merely represent a means for a large number of small investors to pool their risks and secure good investment counsel. Where such a company distributes at least 90 percent of its net income for the taxable year, it is in general taxed at the corporate tax rates on only its undistributed income.

Sometimes these companies experience considerable difficulty in determining what constitutes 90 percent of their net income before the end of their taxable year, because of the receipt at, or very near, the end of the year of a substantial proportion of their dividend income. However, if their net income is not determined with sufficient accuracy so that they can distribute 90 percent of it by the close of the year, they lose the favorable tax treatment provided in supplement Q. To overcome this difficulty your committee has added section 225 to the bill, which permits such companies to elect to count as distributions during the taxable year certain dividends declared after the close of the year but before filing the return for such year.

(10) EXTENSION OF TIME IN THE CASE OF DISCHARGE OF CERTAIN INDEBTEDNESS

Section 201 of your committee's bill extends for an additional year the application of sections 22 (b) (9) and (10) of the code which permit railroads and other corporations to exclude from income amounts attributable to the discharge of certain indebtedness. Therefore, the bill extends this privilege to December 31, 1951.

(11) CAPITAL GAIN AND LOSS TREATMENT FOR ASSIGNMENTS OF CERTAIN OIL, GAS, AND MINERAL RIGHTS

Under existing law, as interpreted by the Bureau of Internal Revenue, if a person sells the right to obtain a stated amount of production from an oil, gas, or mineral property, while retaining a continuing interest in such property, the amount received is treated as ordinary income. Your committee believes that payments of this type based on physical volume of production are more in the nature of capital gains than ordinary income. It is your committee's view, for example, that when the owner of an oil well agrees to sell a specified number of barrels of oil out of future production he is in reality selling a part of his interest in the oil property rather than realizing ordinary income as would be true if he were to sell the oil at or after the time he takes it out of the ground.

As a result, your committee's bill has added a new subsection (n) to section 117 of the code, providing that where a person owns an economic interest in oil, gas, or minerals and sells the right to take oil, gas, or minerals produced from such property until a specified quantity has been obtained, the proceeds he receives from such assignment shall be treated as proceeds from the sale or exchange of a capital asset. It is important to note that this provision does not apply to assignments of interests in production measured in money and that it does not apply to assignments pledged for the development of the property.

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

(12) REVERSIONARY INTERESTS IN THE CASE OF LIFE INSURANCE

Under existing law, in general, the proceeds of a life-insurance policy on the life of the decedent payable to a beneficiary other than the executor are includible in his gross estate to the extent that he has paid the premiums on the policy, or entirely included if he possessed any incidents of ownership (other than a reversionary interest) in the policy. Under the provisions of the Revenue Act of 1942, premiums paid by the insured on or before January 10, 1941, are not to be considered in determining the extent to which the proceeds of a policy are includible in the insured's gross estate if the insured did not possess at any time after January 10, 1941, an "incident of ownership" in the policy. "Incident of ownership" for purposes of determining whether proceeds of the policy are includible by reason of premiums paid on or before January 10, 1941, includes a reversionary interest. Consequently, although the decedent may have transferred a policy prior to January 11, 1941, he would nevertheless have been considered as retaining an "incident of ownership" if, upon the death of the designated beneficiary prior to his own death, the right to name another beneficiary or otherwise enjoy the value of the policy would revert to him by virtue either of express provisions of the policy or by operation of law.

In H. R. 5268, which was enacted as Public Law 378 in 1949, the Congress dealt with possibilities of reverter in general. It was provided that property transferred prior to death should not be included in the gross estate of a decedent by reason of the retention of a reversionary interest if the value of such interest immediately before his death was not more than 5 percent of the value of the property interest to which it related, or if the property would revert to the decedent only by operation of law and not by express terms of the instrument of transfer.

This legislation did not apply, however, to such an "incident of ownership" in a life-insurance policy which resulted from the retention by an individual after January 10, 1941, of a reversionary interest in a policy on which he had paid premiums prior to that date.

Your committee has, therefore, included in this bill a provision, section 503, amending section 404 (c) of the Revenue Act of 1942 so that a decedent shall not be considered as retaining an "incident of ownership" by reason of retaining a reversionary interest if the value of such reversionary interest between January 10, 1941, and his death does not exceed 5 percent of the value of the policy, or if such reversionary interest arose solely by operation of law. The effect of this section is to treat possibilities of reverter with respect to certain insurance policies on a comparable basis with the treatment accorded possibilities of reverter generally under the estate tax law.

The provision applies to the estates of all decedents dying after October 21, 1942, the date of enactment of the Revenue Act of 1942. Provision is made for refunds without interest.

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 NORMAL TAX AND SURTAX ON INDIVIDUALS

This section, for which there is no corresponding section in the bill as passed by the House, amends sections 11 and 12 of the Internal Revenue Code, relating to the rates of the normal tax and surtax on individuals. The amendments made by this section of the bill (together with the amendments made by secs. 102 and 131 of the bill) result in an increase in tax for all taxable years ending after September 30, 1950. The bill provides no increase in the rates of tax applicable to individuals in the case of a taxable year ending on or before September 30, 1950, except in an unusual case described in section 103 of the bill (dealing with a joint return of husband and wife covering two different taxable years, one of which closes prior to October 1, 1950, by reason of the death of one spouse).

Under the amendments to sections 11 and 12, the normal tax and surtax in case of taxable years beginning after September 30, 1950, will be computed at the same rates which apply under present law in computing the tentative normal tax and tentative surtax, but the taxes so determined will not, as under existing law, be reduced under the provisions of section 12 (c) of the code, amended by section 101 (b) (3) of the bill. It is provided, however, (under section 12 (f) of the code as amended by section 101 (b) (4) of the bill) that the combined normal tax and surtax for a taxable year beginning after September 30, 1950, shall in no event exceed 87 percent of the net income for the taxable year.

In the case of the calendar year 1950 (taxable year beginning on January 1, 1950, and ending on December 31, 1950) the amendments provide for computing a tentative normal tax and a tentative surtax for such year in the same manner as that provided under existing law, but the amendment to section 12 (c) of the code provides for a reduction of the aggregate of such tentative taxes by an amount which is less than the reduction provided under existing law. It is further provided (under section 12 (c) (1) of the code as amended by the bill) that the combined normal tax and surtax for the calendar year 1950 shall in no event exceed 80 percent of the net income of the taxable year.

In the case of a taxable year ending in 1950 but before October 1, 1950, the amendments provide for computation of the normal tax and surtax in the same manner as that provided under existing law. Thus in the case of a taxable year beginning October 1, 1949, and ending

September 30, 1950, or in the case of a taxable year which began January 1, 1950, and ended prior to October 1, 1950, by reason of the death of the taxpayer, no increase in tax is provided under the amendments.

If the taxable year begins before October 1, 1950, and ends after September 30, 1950 (other than a taxable year which is the calendar year 1950) the tax imposed by sections 11 and 12 for such year will be computed under the provisions of section 108 (e) of the code, as explained in the discussion of section 131 of the bill.

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

Section 102, for which there is no corresponding provision in the bill as passed by the House, amends section 400, relating to optional tax on individuals with adjusted gross income of less than $5,000, to provide new tables to reflect the increased income-tax rates on individuals provided in this bill.

SECTION 103. COMPUTATION OF TAX IN CASE OF CERTAIN JOINT RETURNS

Section 103, for which there is no corresponding provision in the bill as passed by the House, provides that if a joint return of a husband and wife is filed under the provisions of section 51 (b) (3) of the Internal Revenue Code in a case where the husband and the wife have different taxable years because of the death of either spouse, and the taxable year of the surviving spouse covered by such joint return begins before October 1, 1950 and ends after September 30, 1950, the amendments made by part I of title I of the bill, relating to individual income tax rates, shall be applicable in respect of such 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.

Under section 51 (b) (3) of the code, if the taxable years of husband and wife begin on the same day but end on different taxable days because of the death of either spouse or both, the joint return may nevertheless be made with respect to both taxable years. Thus, if one spouse dies during 1950 and the surviving spouse elects to file a joint return under section 51 (b) (3) of the code covering his calendar year 1950 and the taxable year of the decedent spouse, section 103 of the bill provides that the tax with respect to the joint return will be computed at the rates applicable under the bill to a return for the calendar year 1950. In such a case, it would be immaterial whether the taxable year of the decedent spouse ended before or after October 1, 1950. If the taxable year of the surviving spouse beginning before October 1, 1950, and ending after September 30, 1950, is not a calendar year, the tax in the case of the filing of a joint return by the surviving spouse would be computed under the provisions of section 108 (e) of the code (as amended by section 131 of the bill), and the computations required therein with respect to calendar months in the taxable year would be made by reference to the calendar months of the surviving spouse's taxable year.

SECTION 104. EFFECTIVE DATE OF PART I

The amendments made by part I of the bill are applicable with respect to taxable years ending after December 31, 1949, except that the amendment made by section 101 (b) (4) of the bill to section 12 (f) of the code applies only to taxable years beginning after September 30, 1950.

PART II—CORPORATION INCOME TAXES

SECTION 121. INCREASE IN RATE OF CORPORATION INCOME TAXES

This section, which corresponds to section 218 of the bill as passed by the House, amends the corporate tax provisions to impose, in general, a tax increase with respect to corporations having as a taxable year the calendar year 1950, and imposes a further increase with respect to taxable years beginning after June 30, 1950. There is no increase in rates for taxable years ending on or before June 30, 1950. Special provision is made for taxable years of corporations beginning prior to July 1, 1950 (other than the calendar year 1950) and ending after that date, so as to apportion the tax increase provided in this bill to such taxable years.

The section adopts for the calendar year 1950 and taxable years beginning after June 30, 1950, the method of taxing corporations provided in the bill as passed by the House. Accordingly, normal tax net income and corporation surtax net income are defined substantially in the manner provided by the House bill. The normal tax rate is made applicable to the entire normal tax net income of all corporations; the surtax rate applies to the corporation surtax net income in excess of $25,000. Under this plan, the so-called notch provisions are eliminated. It is not intended, however, that the exemption of the first $25,000 of a corporation's surtax net income from the surtax shall be abused by the splitting up, directly or indirectly, of a business enterprise into two or more corporations or the forming of two or more corporations to carry on an integrated business enterprise. It is believed that sections 45 and 129 will prevent this form of tax avoidance.

Subsection (a) of section 121 amends section 13, relating to the normal tax on corporations, with respect to taxable years ending after December 31, 1949. In section 13 (a) (2) (A), applicable to the calendar year 1950 and taxable years beginning after June 30, 1950, normal tax net income is defined as in section 218 of the bill as passed by the House. Credits applicable against normal tax net income are provided in the case of dividends paid on the preferred stock of a public utility and in the case of a Western Hemisphere trade corporation. (These credits are discussed below.) For taxable years beginning before July 1, 1950 (other than the calendar year 1950), section 13 (a) (2) (B) retains the present definition of normal tax net income.

Section 13 (b), as amended, relating to the imposition of the normal tax, provides the normal tax rates applicable in the case of taxable years ending after December 31, 1949. For taxable years beginning after June 30, 1950, a normal tax of 25 percent is imposed on all corporations; for the calendar year 1950, the normal tax is 23 percent. With respect to taxable years (other than the calendar year 1950) beginning before July 1, 1950, section 13 (b) retains the normal tax provisions of present law applicable to corporations with incomes over $25,000, but in the case of a taxable year (other than the calendar year 1950) beginning before July 1, 1950, and ending after June 30, 1950, the tax is computed under section 108 (f) of the code, added by section 131 of the bill.

Subsection (b) of section 121 amends section 14 (a), relating to the normal tax on certain classes of corporations, to restrict the application of the section to taxable years beginning before July 1, 1950 (other than the calendar year 1950). For the calendar year 1950 and for all taxable years beginning after June 30, 1950, section 14 of the code will have no application.

Subsection (c) of section 121 amends section 15, relating to the surtax on corporations, with respect to the definition of corporation surtax income and the surtax rate imposed. In the case of taxable years beginning after June 30, 1950, corporation surtax net income is defined as the net income minus the sum of the following credits (discussed below): (1) the credit for dividends received provided in section 26 (b) of the code, (2) in the case of a public utility, the credit for dividends paid on preferred stock provided in section 26 (h) of the code, and (3) in the case of Western Hemisphere trade corporations, the credit provided in section 26 (i) of the code. In the case of the calendar year 1950, the credit provided in section 26 (j) of the code is allowed in addition to the above three credits. In the case of taxable years beginning before July 1, 1950 (other than the calendar year 1950), the definition under present law of corporation surtax net income is retained.

Section 15 (b), as amended, imposes increased surtax rates for taxable years beginning after June 30, 1950, and for the calendar year 1950. For those years beginning after June 30, 1950, the surtax upon the corporation surtax net income is 20 percent of surtax net income in excess of $25,000. For the calendar year 1950, the surtax rate is 19 percent on corporation surtax net income in excess of $25,000. The surtax rates of the present law are retained as to taxable years beginning before July 1, 1950 (other than the calendar year 1950), but in the case of a taxable year (other than the calendar year 1950) beginning before July 1, 1950, and ending after June 30, 1950, the tax is computed under section 108 (f) of the code, added by section 131 of the bill.

The effect of the amendments to sections 13, 14, and 15 is to change the corporate tax rates and the corporate tax base for the calendar year 1950 and all taxable years beginning after June 30, 1950. The present system of graduated rates below $25,000 of income, notch rates between $25,000 and $50,000 of income, and uniform rates for incomes in excess of $50,000 are replaced by a single rate applicable to the entire normal tax net income and a surtax rate applicable to corporation surtax net income in excess of $25,000. In computing the tax for both the calendar year 1950 and years beginning after June 30, 1950, the new credits are taken into account in determining normal tax net income and corporation surtax net income.

For taxable years beginning prior to July 1, 1950 (other than the calendar year 1950), the normal tax and surtax rates of existing law will be applicable, subject to the provisions of section 108 (f). In the case of a taxable year which begins and ends prior to July 1, 1950, the existing tax rates and method of determining tax will apply. Thus there will be no increase in tax for a fiscal year beginning on July 1, 1949, and ending on June 30, 1950, or for a short taxable year beginning on January 1, 1950, and ending on May 31, 1950.

Subsection (d) of section 121 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 or reciprocal underwriters) to reflect the normal tax rates and surtax rates applicable to corporations for taxable years beginning after June 30, 1950, and for the calendar year 1950.

Subsection (e) of section 121 amends section 362 (b) (3) and (4) (relating to normal tax and surtax on regulated investment companies) to reflect the new rates provided by this section.

Subsection (f) of section 121, for which there is no corresponding provision in the bill as passed by the House, amends section 141 (c) (relating to computation and payment of tax on consolidated returns) to provide that in the case of an affiliated group of corporations including one or more Western Hemisphere trade corporations filing a consolidated return the 2 percent additional tax shall be applied on the amount by which the consolidated corporation surtax net income of the affiliated group exceeds the portion of the consolidated corporation surtax net income attributable to the Western Hemisphere trade corporations. If the consolidated corporation surtax net income of the Western Hemisphere trade corporations is less than zero, the 2 percent additional tax shall be applied against the consolidated corporation surtax net income of the entire affiliated group, including the Western Hemisphere trade corporations.

Subsection (g) of section 121 makes the necessary technical amendments to other provisions of the Internal Revenue Code. This subsection amends section 122 (c) (relating to the amount of net operating loss deduction) to provide that, in determining the net operating loss deduction, the normal tax net income of corporations shall be computed without regard to the credit provided in section 26 (h) for dividends paid on the preferred stock of a public utility or the credit provided in section 26 (i) for Western Hemisphere trade corporations. This subsection also amends section 201 (a) (1) (relating to tax on life-insurance companies) to reflect the new rates. Section 204 (a) (1) (relating to tax on insurance companies other than life or mutual) is amended so that the taxes on such companies will be computed as provided in sections 13 (b) and 15 (b). Section 204 (a) (2) (relating to definition of normal tax net income and corporation surtax net income of insurance companies other than life or mutual) is amended so that such companies, in computing their corporation surtax net income for the calendar year 1950, will be entitled to the surtax credit for partially tax-exempt interest provided in section 26 (j). This subsection also amends section 231 (b), relating to foreign corporations engaged in trade or business in the United States. For the calendar year 1950 and for taxable years beginning after June 30, 1950, such corporations will be subject to the normal tax imposed by section 13 (b) and the surtax imposed by section 15 (b).

SECTION 122. CREDITS OF CORPORATIONS

Subsection (a) of section 122, which corresponds to sections 203 and 214 (b) of the bill as passed by the House, amends section 26 (b), relating to the dividends-received credit. Section 26 (b), as amended, will provide that the dividends-received credit shall be the sum of: (1) 85 percent of all dividends received from a domestic corporation subject to the income tax, other than dividends received (in taxable years described in clause (2) of this sentence) on the preferred stock of a public utility; plus (2) in the case of any taxable year beginning after June 30, 1950, 59 percent of the amount received as dividends on the preferred stock of a public utility which is subject to the income tax, but not to exceed 59 percent of the stockholder's adjusted net income computed without regard to the net operating loss deduction provided in section 23 (s). For the calendar year 1950 the amount provided in (2), above, will be 57 percent of the amount received as dividends on the preferred stock of a public utility which is subject to the income tax, but not to exceed 57 percent of the stockholder's adjusted net income computed without regard to the net operating loss deduction. In no event is the total credit allowed by section 26 (b) to exceed 85 percent of the stockholder's adjusted net income computed without regard to the net operating loss deduction. Under the bill as passed by the House, the amendment providing that adjusted net income, for purposes of serving as a limitation on the dividends-received credit, shall be computed without regard to the net operating loss deduction, was to be applicable with respect to taxable years beginning after December 31, 1949. Under your committee's bill, the amendment will be applicable with respect to taxable years ending after December 31, 1949.

Section 203 of the bill, as passed by the House, restricted the allowance of the dividends-received credit in the case of dividends in kind. With the exception of a change in the effective date, your committee's bill contains the same provision. The dividends-received credit will be limited to an amount not greater than 85 percent of the adjusted basis of the property received as a dividend in the hands of the distributing corporation at the time of the distribution. For this purpose, the adjusted basis is to be increased in the amount of gain or decreased in the amount of loss, if any, recognized to the distributing corporation as a result of the distribution. The dividends-received credit in no event will be allowed in an amount greater than 85 percent of the fair market value of the property received as a dividend. Under the bill as passed by the House the amendment was to be applicable to taxable years ending after December 31, 1949, but only with respect to dividends received after such date. Your committee has changed the effective date so that the amendment will apply only to dividends received after the date of the enactment of this act.

Subsection (b) of section 122, which corresponds to section 218 (c) of the bill as passed by the House, amends section 26 (h) (1) to provide that, for the calendar year 1950, the credit under that section is an amount equal to 33 percent of the lesser of (1) the amount of dividends paid on the preferred stock of the public-utility company, or (2) the excess of the adjusted net income of the public-utility company over its dividends-received credit provided in section 26 (b) for such taxable year. For taxable years beginning after June 30, 1950, the credit is equal to 31 percent of the lesser of such amounts. This credit is applicable in computing both the normal tax net income and the corporation surtax net income.

Subsection (c) of section 122, which corresponds to section 218 (d) of the bill as passed by the House, amends section 26 by adding at the end thereof new subsection (i) which provides a credit (applicable to Western Hemisphere trade corporations) equal, for taxable years beginning after June 30, 1950, to 31 percent of the normal tax net income of the Western Hemisphere trade corporation, such normal tax net income being computed without regard to the credit provided in such subsection (i). For the calendar year 1950, the credit is equal to 33 percent of such amount. This credit is applicable in computing both the normal tax net income and the corporation surtax net.

Subsection (d) of section 122 corresponds to section 218 (e) of the bill as passed by the House, which allowed a surtax credit for partially tax-exempt interest with respect to taxable years beginning after December 31, 1949. Your committee has provided a similar credit under section 26 (j) applicable, however, only to the calendar year 1950 and reduced in amount. The credit allowed is the lesser of (1) 5.3 percent of the credit provided in section 26 (a) (relating to interest on partially tax-exempt obligations); or (2) 5.3 percent of the amount by which corporation surtax net income, computed without regard to the credit provided in subsection (j), exceeds $25,000. This credit is applicable only in computing corporation surtax net income.

SECTION 123. EFFECTIVE DATE OF PART II

Except as otherwise expressly provided, the amendments made by part II of the bill are applicable with respect to taxable years ending after December 31, 1949.

Part III—Fiscal Year Taxpayers

SECTION 131. FISCAL YEAR TAXPAYERS

Section 131, for which there is no corresponding provision in the bill as passed by the House, amends section 108, relating to fiscal year taxpayers. The present subsection (e) of section 108 is relettered as subsection (g) and two new subsections, (e) and (f), are added.

The new subsection (e) deals with the individual income tax in the case of taxable years (other than the calendar year 1950) which begin before October 1, 1950, and end after September 30, 1950. In the case of any such taxable year the individual income tax imposed by sections 11 and 12 or 400, whichever is applicable, will be determined by computing two tentative taxes and then adding together certain portions of such tentative taxes. The tax will be the sum of:

(1) that portion of a tentative tax, computed without regard to the provisions of section 108 (e), which the number of calendar months in the taxable year prior to October 1, 1950, bears to the total number of calendar months in such taxable year, plus

(2) that portion of a tentative tax, computed by applying the provisions of sections 11 (a), 12 (b) (1), 12 (d) and 12 (f), or table I

of section 400 (which are applicable to taxable years beginning after September 30, 1950), as if such provisions were applicable to such taxable year, which the number of calendar months in such taxable year after September 30, 1950, bears to the total number of calendar months in such taxable year.

For the purposes of section 108 (e), a calendar month shall be disregarded if less than 15 days of such month fall within the taxable year; if more than 14 days of the month fall within the taxable year, such month shall be considered a full calendar month.

The new subsection (f) deals with the corporate income tax in the case of taxable years (other than the calendar year 1950) which begin prior to July 1, 1950, and end after June 30, 1950. In the case of any such taxable year the corporate income tax imposed by sections 13, 14, and 15 will be determined by computing two tentative taxes and then adding together certain portions of such tentative taxes. The tax will be the sum of:

(1) that portion of a tentative tax, computed without regard to the provisions of section 108 (f), which the number of days in the taxable year prior to July 1, 1950, bears to the total number of days in such taxable year, plus

(2) that portion of a tentative tax, computed by applying the provisions of sections 13 (b) (1), 15 (b) (1), 26 (b) (2) (A), 26 (h) (1) (B), and 26 (i) (1) (which are applicable to taxable years beginning after June 30, 1950) as if such provisions were applicable to such taxable year, which the number of days in such taxable year after June 30, 1950, bears to the total number of days in such taxable year.

In computing the tax under section 108 (e) or (f), the net income of the taxpayer for the taxable year is not recomputed in determining the tentative tax under either clause (1) or (2) of section 108 (e) or (f).

Part IV—Increase in Withholding of Tax at Source on Wages

SECTION 141. PERCENTAGE METHOD OF WITHHOLDING

Section 141, for which there is no corresponding provision in the bill as passed by the House, amends section 1622 (a) by changing the percentage rate of withholding from 15 percent to 18 percent.

SECTION 142. WAGE BRACKET WITHHOLDING

Section 142, for which there is no corresponding provision in the bill as passed by the House, amends section 1622 (c) (1), relating to wage bracket withholding, to provide new tables to reflect the increased tax rates.

SECTION 143. EFFECTIVE DATE OF PART IV

The amendments made by this part are applicable only to wages paid on or after October 1, 1950. It is immaterial whether the wages were earned before or after October 1, 1950. If they are paid on or after October 1, 1950, the new withholding rates will apply.

TITLE II.—MISCELLANEOUS INCOME TAX AMENDMENTS

SECTION 201. EXTENSION OF TIME IN THE CASE OF DISCHARGE OF INDEBTEDNESS

This section, for which there is no corresponding section in the House bill, extends for 1 year the application of sections 22 (b) (9) and (10) of the Internal Revenue Code, which permit a corporation to exclude from income certain amounts attributable to discharge of indebtedness.

SECTION 202. INCOME TAX EXEMPTIONS FOR MEMBERS OF THE ARMED FORCES SERVING IN COMBAT AREAS

This section, for which there is no corresponding provision in the House bill, amends section 22 (b) (13) of the Internal Revenue Code to grant an additional allowance for members of the Armed Forces serving in combat zones.

This additional allowance is in the form of an exclusion of certain amounts from gross income. The determination of such amount depends, initially, upon the classification of such member as a commissioned officer or as an enlisted person. Unlike the provisions of section 22 (b) (13) in effect during World War II, a commissioned warrant officer is to be treated as an enlisted person. Noncommissioned warrant officers will continue to be treated as enlisted personnel.

Enlisted personnel will be entitled to exclude from gross-income, in the case of compensation received after June 24, 1950, and prior to January 1, 1952, for active service in the Armed Forces of the United States, that amount of such compensation received during the taxable year which bears the same ratio to the total of such compensation received during such taxable year as the number of calendar months during any part of which the member performed such service in a combat zone during such taxable year bears to the total number of calendar months during any part of which he performed such service at any place during such taxable year.

Commissioned officers will be entitled to exclude from gross income, in the case of compensation received after June 24, 1950, and prior to January 1, 1952, for active service in the Armed Forces of the United States, that amount of such compensation which is equal to $200 times the number of calendar months during any part of which he performed such service in a combat zone during the taxable year.

The determinations as to which specific areas are combat zones are to be made by the President of the United States by Executive order on the basis of whether the Armed Forces of the United States are engaged in combat therein since June 24, 1950. Service is to be considered as performed in such zones only if it is performed on or after the date designated by the President by Executive order as the date of the commencement of combatant activities in such zone and on or before the date designated by the President by Executive order as the date of the termination of combatant activities in such zone.

Subsection (b) of this section amends section 1621 (a) of the code to exclude from the definition of wages remuneration paid for active service as a member of the Armed Forces of the United States in a month during any part of which such member served in a combat zone as defined in section 22 (b) (13).

Subsection (b) is effective with respect to wages paid on or after the first day of the second calendar month which begins after the date of enactment of this act.

Subsection (c) of this section provides for the furnishing of certain additional information on the written statement required to be furnished to employees in the case of members of the Armed Forces entitled to the benefits of section 22 (b) (13).

SECTION 203. TREATMENT OF BOND PREMIUM IN CASE OF DEALERS IN TAX-EXEMPT SECURITIES

This section is the same as section 202 of the House bill, except that your committee inserts subsection (c) to change the effective date of the amendments made by the section.

Subsection (a) of this section amends section 22 of the Internal Revenue Code by adding a new subsection (o) to require dealers in securities to make an adjustment for bond premium on certain tax-exempt bonds. The adiustment is required only in the case of "short-term municipal bonds," which are defined as obligations issued by a government or political subdivision thereof on which the interest is excludible from gross income, except such obligations which are sold or otherwise disposed of by the taxpayer within 30 days after the date of acquisition by him, or the earliest maturity or call date of which is a date more than 5 years from the date on which it was acquired by him. Under this definition if a dealer in securities purchases or otherwise acquires a tax-exempt bond issued by a State or city and sells the bond to a customer within 30 days after the date of its acquisition the adjustment provided for by the amendment made by this section of the bill will not apply. Similarly, if for example, the tax-exempt municipal bond acquired by the dealer on January 1, 1951, matures January 2, 1956, and if such bond cannot be called before such date, the amendment made by this section will not apply.

The adjustment required, in the case of a dealer in securities who computes his gross income from such trade or business by the use of inventories and values such inventories on any basis other than cost, is the reduction of cost of securities sold during such year by the amount equal to the amortizable bond premium which would be disallowed as a deduction if the dealer were an ordinary investor holding such bond. The term "cost of securities sold" is specifically defined as the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum of the inventory value of the opening inventory for such year and the cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

If a dealer in securities computes his gross income without the use of inventories or if his inventories are valued at cost he is required to make an adjustment similar to that which he would make were he an ordinary investor. Thus, such a dealer who sells or otherwise disposes of a short-term municipal bond during the year is required to reduce the basis of the bond by the amount of the adjustment which would be required under section 113 (b) (1) (H) were he an ordinary investor.

Subsection (b) of this section amends section 113 (b) (1) by adding new subparagraph (I) thereto, and section 125 by adding new subsection (e), for the purpose of providing a reference in these related sections to the new provisions contained in section 22 (o).

Subsection (c) of this section, added by your committee, changes the effective date of the amendments made by the section, making such amendments applicable to taxable years ending after June 30, 1950, instead of to taxable years beginning after December 31, 1949. However, subsection (c) provides that, in the case of a taxable year beginning before and ending after June 30, 1950, the amendments shall be applicable only with respect to obligations acquired after such date.

SECTION 204. CIRCULATION EXPENSES OF NEWSPAPERS, MAGAZINES, AND PERIODICALS

This section of the bill, which was added by your committee, amends section 23 of the code (relating to deductions from gross income) by adding at the end thereof a new subsection (bb) to provide for the deduction from gross income (notwithstanding the provisions of section 24 (a), relating to items not deductible from gross income) of all expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical, other than expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of newspapers, magazines, or other periodicals. As an exception to this rule, the bill provides that the deduction shall not be allowed with respect to any portion of such circulation expenditures which is, under regulations prescribed by the Secretary, chargeable to capital account, if the taxpayer elects, in accordance with such regulations, to treat such portion as so chargeable. If the taxpayer so elects, the election must be for the total amount of such portion of the circulation expenditures which is chargeable to capital account, and shall be binding for all subsequent taxable years. With respect to the binding effect of such an election, it is provided, however, that the Secretary may, upon application by the taxpayer, permit a revocation of such election subject to such conditions as the Secretary deems necessary.

The bill also provides for a technical amendment of section 113 (b) (1) (A) of the code (relating to rules for determining adjusted basis of property) to conform such provision to the new section 23 (bb) of the code described above.

The amendments made by this section are retroactive, being made applicable with respect to taxable years beginning after December 31, 1945.

SECTION 205. PAYMENT OF INCOME TAX BY INSTALLMENT PAYMENTS

This section is identical with section 603 of the bill passed by the House.

This section of the bill amends section 56 (b) of the Internal Revenue Code with respect to payment of income taxes in installments. Under present law a corporation may pay its tax in four equal quarterly installments. Under section 56 (b), as amended, corporate income taxes will be required to be paid as follows: In the case of a taxable year ending on or after December 31, 1950 (and ending before December 31, 1951), a corporation will be required to pay 30 percent of its tax on its first quarterly installment date, 30 percent on its second quarterly installment date, 20 percent on its third quarterly installment date, and 20 percent on its fourth quarterly installment date; for its taxable year ending on or after December 31, 1951 (and ending before December 31, 1952), it will be required to pay 35 percent of its tax on each of the first two installment dates and 15 percent on each of the last two installment dates; for its taxable year ending on or after December 31, 1952 (and ending before December 31, 1953), it will be required to pay 40 percent of its tax on each of the first two installment dates and 10 percent of the tax on each of the last two installment dates; for its taxable year ending on or after December 31, 1953 (and ending before December 31, 1954), it will be required to pay 45 percent of its tax on each of the first two installment dates and 5 percent on each of the last two installment dates. For all taxable years ending on or after December 31, 1954, a corporation will be required to pay its tax in two installments, the first installment of 50 percent of its tax being due on the 15th day of the third month following the close of its taxable year, and the remaining 50 percent of its tax being due on the 15th day of the sixth month following the close of its taxable year.

This section further amends section 56 (b) so that the installment privilege, formerly provided for in the case of estates, trusts, and certain nonresident aliens, is provided for only in the case of estates. Under this amendment trusts and certain nonresident aliens heretofore afforded the privilege of electing to pay the tax in four equal installments will be required to pay the total amount of the tax on the date prescribed for such payment.

If the full amount of tax due on any installment date is not paid on such date, the entire unpaid amount of the tax, as under existing law, becomes due and payable. In the case of tax payable in four installments, the dates prescribed for the payment of each installment are determined in the same manner as under existing law.

The amendments made by this section are applicable to all taxable years ending on or after December 31, 1950.

SECTION 206. 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 Internal Revenue 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 the date of enactment of the Revenue Act of 1943, and the transfer of all the property under the liquidation occurred within one calendar month in 1944. The amendment made by this section makes section 112 (b) (7) 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. 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.

In order to adapt the balance of section 112 (b) (7) as it now appears in the code to liquidations occurring in 1951, the date August 15, 1950, is substituted for the date December 10, 1943, in subparagraphs (B), (E), and (F) of the section (relating to the determination of excluded corporations and relating to the recognition of gain 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 Internal Revenue Code, in order to make that section equally applicable to property acquired by an electing shareholder in a liquidation in 1944 (covered by section 112 (b) (7) prior to its amendment by this act) and to property acquired by an electing shareholder in a liquidation in 1951 (covered by section 112 (b) (7) as amended by this act).

The amendments made by this section are applicable to taxable years ending after December 31, 1950.

SECTION 207. CERTAIN DISTRIBUTIONS OF STOCK ON REORGANIZATION

This section, for which there is no corresponding provision in the House bill, amends section 112 (b) of the Internal Revenue Code by adding at the end thereof a new paragraph (11) providing that if there is distributed, in pursuance of a plan of reorganization, to a shareholder of a corporation which is a party to the reorganization, stock (other than preferred stock) in another corporation which is a party to the reorganization, without the surrender by such shareholder of stock, no gain to the distributee from the receipt of such stock is to be recognized unless it appears that (A) any corporation which is a party to such reorganization was not intended to continue the active conduct of a trade or business after such reorganization, or (B) the corporation whose stock is distributed was used principally as a device for the distribution of earnings and profits to the shareholders of any corporation a party to the reorganization.

The section is applicable only to the nonrecognition of gain, since a distribution of stock in pursuance of a plan of reorganization and without the surrender by the shareholder of any of his stock in the transferor corporation could not give rise to a loss.

Subsection (b) of this section amends section 113 (a) by adding a new paragraph (23). This paragraph provides that if property consists of stock distributed after the date of the enactment of the Revenue Act of 1950 to a taxpayer in connection with a transaction described in this section, or consists of stock in respect of which such distribution was made, then the basis of the new stock and of the old stock, respectively, shall in the shareholder's hands be determined by allocating between the old stock and the new stock the adjusted basis of the old stock; such allocation to be made under regulations prescribed by the Secretary.

Subsection (c) of this section provides that the amendments made are applicable to taxable years ending after the date of the enactment of this act but only with respect to distributions of stock made after such date.

SECTION 208. PERCENTAGE DEPLETION

The bill as reported by your committee strikes out section 204 (which related to allowances for depletion) of the House bill and inserts in lieu thereof this section which amends section 114 (b) (4) (B) of the Internal Revenue Code (relating to the definition of gross income from the property).

Subsection (a) provides, in effect, that in computing gross income from the property, there shall be included value added as the result of transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mill in which the ordinary treatment processes are applied thereto.

Subsection (b) adds a new subdivision (v) to section 114 (b) (4) (B), providing that in the case of bentonite, the term "ordinary treatment processes" includes crushing, drying, pulverizing or granulating, and loading for shipment.

Subsection (c) provides that the amendments shall be applicable with respect to taxable years beginning after December 31, 1949.

SECTION 209. TREATMENT OF CERTAIN REDEMPTIONS OF STOCK AS DIVIDENDS

This section corresponds to section 207 of the House bill, except that your committee amendment does not apply to cases where corporations are merely controlled by the same interests. Your committee has also changed the effective date of the section and made certain technical changes.

This section amends section 115 (g) of the code, which provides for the treatment as taxable dividends of amounts distributed by a corporation in cancellation or redemption of its stock if the cancellation or redemption and the related distribution are effected at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend.

In *Trustees of John Wanamaker* v. *Commissioner* (11 T. C. 365, affirmed 178 F. (2d) 10 (C. A. 3d, 1949)), the court held that the language of section 115 (g) was so limited as to apply only to the redemption by a corporation of "its" own stock and as not to apply to the purchase by a wholly owned subsidiary of stock of the parent company from the stockholders of the parent, even though, if the parent corporation had directly redeemed its stock, the redemption would have effected a distribution of its earnings and profits essentially equivalent to the distribution of a taxable dividend.

The amendment made by this section of the bill would add a new paragraph (2) to section 115 (g) of the code to require the application of the principles of section 115 (g) in the case where the acquisition of stock is made by a corporation controlled by the issuing corporation.

Under the amendment, where stock of a parent corporation is acquired by a subsidiary, the amount paid for the stock is treated, for the purposes of section 115 (g) (1), as though such amount had been distributed by the subsidiary to the parent and had then been applied by the parent in redemption of its stock. If the amount paid for the stock would, under those circumstances, be treated as essentially equivalent to the distribution of a taxable dividend by the parent under the principles of section 115 (g) (1), the amount when paid by the subsidiary to a shareholder of the parent shall, to the same extent, constitute a dividend in the hands of such shareholder.

For purposes of determining whether one corporation is so controlled by another as to be its subsidiary, control is defined to mean the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

Your committee has retained the provision in section 115 (g) of the code which provides that, in order to be taxable as a dividend, the amount so distributed in redemption of the stock must represent a distribution of earnings or profits accumulated after February 28, 1913, inasmuch as section 205 of the House bill, which would tax distributions of amounts accumulated prior to that date, has been omitted.

The House bill provided that the amendments would be applicable to taxable years ending after December 31, 1949, but only to amounts received after such date. Your committee has changed the effective date so that the amendment will apply to taxable years ending after the date of the enactment of this act but only with respect to amounts received after such date.

SECTION 210. REDEMPTION OF STOCK TO PAY DEATH TAXES

This section is the same as section 208 of the bill as passed by the House except that your committee has eliminated the proviso that the value of the stock in the corporation must comprise more than 70 percent of the value of the net estate and has made a technical amendment.

This section adds a new paragraph (3) to section 115 (g) of the code (relating to redemption of stock by a corporation) to except from the application of such subsection certain redemptions of stock.

Section 115 (g) provides in substance that an amount distributed in cancellation or redemption of stock shall be treated as a taxable dividend if the cancellation or redemption is effected at such time and in such manner as to make the distribution essentially equivalent to the distribution of a taxable dividend.

Under section 115 (g) (3), as added by this section of the bill, section 115 (g) is made inapplicable to amounts distributed with respect to stock the value of which is included in determining the value of the gross estate of a decedent under section 811, to the extent that the distributions do not exceed the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of the decedent's death. The exception made by section 115 (g) (3), however, applies only to distributions made after the death of the decedent and within the 3-year period of limitations for assessment of estate tax provided in section 874 (a), determined as provided under section 875 if applicable. Any other extensions of the period of limitations for assessment of estate tax will not operate as an extension of the time within which such distributions must be made.

The exception made by section 115 (g) (3) is applicable if the redeemed stock is includible in the decedent's gross estate whether or not the stock is owned by the decedent at the time of his death and whether or not the redemption is from the estate of the decedent. For example, the exception is applicable to the redemption of stock includible in the decedent's gross estate which the decedent had transferred in contemplation of death. The exception is also applicable to the redemption of stock includible in the decedent's estate if such stock was distributed by the estate prior to the redemption. The exception, however, is not applicable to the redemption of stock from a purchaser for value thereof even though such stock was includible in a decedent's gross estate.

The provisions of section 115 (g) (3) are applicable 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 211. CAPITAL GAINS AND LOSSES

This section corresponds to section 209 of the House bill. Your committee, however, has made several important changes.

SALES OF BUSINESS PROPERTY

Your committee has eliminated the amendments proposed to be made to the Internal Revenue Code by sections 209 (b) and (d) of the House bill, which would have changed the tax treatment of sales and exchanges of certain business property and abandonments of such property or capital assets.

COPYRIGHTS, LITERARY, MUSICAL OR ARTISTIC COMPOSITIONS, AND SIMILAR PROPERTY

Section 209 (a) of the House bill would amend section 117 (a) (1) of the code by revising the definition of "capital assets" so as specifically to exclude therefrom patents, copyrights, inventions, designs, literary, musical or artistic compositions, and similar property, in the hands of either (1) the person whose personal efforts created such property or (2) a person deriving a basis for the property, for the purpose of determining gain, from the person who created it. Your committee has limited the scope of this amendment (redesignated as sec. 211 (a) of the bill) to copyrights, literary, musical or artistic compositions, and similar property, and has eliminated the proposed change in the treatment of such property as inventions, patents, and designs. Under the committee amendment, a person who writes a book or creates some other sort of artistic work will be taxed at ordinary income rates, rather than at capital-gain rates, upon gain from the sale of the work regardless of whether it is his first production in the field or not. The amendment made by section 211 (a) will also exclude from the capital asset category any property similar to that specifically named; for example, a radio program which has been created by the personal efforts of the taxpayer. Your committee has found it necessary to make a clarifying amendment (contained in sec. 211 (b) of the bill) to section 117 (j) of the code to prevent the creator of such property from obtaining capital gains treatment by reason of the use of the property for a time in his trade or business. The interest of a sole proprietor in such a business enterprise as a photographic studio is not "similar property" even though the value of the business may be largely attributable to the personal efforts of the sole proprietor.

Where property has been created by more than one person, as for example, where three individuals collaborate in writing a book, the interest of each taxpayer in the property will be excluded from the capital-asset category and any gain derived from a sale of such interest will be taxed at ordinary rates.

The provisions of subparagraph (C) apply not only to copyrights and similar property in the hands of the taxpayer whose personal efforts created the property but also to such property held by a person in whose hands the basis of the property is determined (for the purpose of determining gain on a sale or exchange) in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created the property. Thus a sale of such property by one who received it by gift from the creator of the property would be taxed as ordinary income.

The amendments made by this section to section 117 of the code do not cover the situation in which the taxpayer contributes a copyright or similar property created through his personal efforts to a newly formed corporation in exchange for its stock and then sells the stock since such situation is dealt with in section 213 of the bill.

In cases where the writing or other product required 36 months or more to produce and 80 percent or more of the income therefrom is lumped into 1 year the provisions of section 107 (b) of the code will allow the averaging of the income from such work over a period of not more than 36 months. Under present law there is excluded from the benefits of section 107 (b) that part of the gross income from an artistic work or invention which is taxable as a gain from the sale or exchange of a capital asset held for more than 6 months. The exclusion of both artistic works and inventions from the definition of a capital asset, as proposed by section 209 (a) of the House bill, would have made the exception under section 107 (b) unnecessary; hence, section 209 (f) of the House bill would have made a technical amendment to section 107 (b) eliminating such exception. Since inventions will continue to receive capital-gains treatment under your committee's bill to the same extent as under present law, your committee has deleted the proposed technical amendment to section 107 (b).

In determining, for the purposes of section 107 (b), the tax which would be attributable to the gain on the sale of an artistic work if it had been received ratably in a taxable year before the enactment of this bill, such gain will be treated as ordinary gain. In the case of the sale, prior to the effective date of the amendment, of an artistic work by a creator who has elected the installment basis under section 44, the tax treatment of installment payments received after such effective date will be governed by the rule of *Snell* v. *Commissioner* (97 F. (2d) 891).

The amendments made by subsections (a) and (b) of section 211 will be applicable only with respect to taxable years beginning after the date of the enactment of the bill.

HOLDING PERIOD FOR CAPITAL ASSETS

Subsection (c) of section 211, which corresponds to section 209 (c) and (e) of the House bill, provides that the holding period used for determining whether a capital gain or loss is long-term or short-term shall be 3 months instead of 6 months as under present law. To accomplish this purpose, subsection (c) strikes out "six months" or "6 months" and inserts in lieu thereof "3 months" in sections 117 (a), (b), (j), and (k) of the code. Similar amendments are made to sections 12 (g) (2) (relating to the tax in case of capital gains); 23 (k) (4) (relating to nonbusiness debts); 107 (b) (relating to compensation for services rendered for a period of 36 months or more); 165 (b) (relating to taxability of beneficiary of an employee's trust); 169 (c) (relating to income of participants in a common trust fund); 182 (relating to tax of partners) and 362 (b) (6) (relating to treatment of capital gain dividends from regulated investment companies) to conform such sections to the proposed 3-month holding period.

The amendments made by subsection (c) will apply with respect to sales or exchanges made after the date of the enactment of the bill.

SECTION 212. SHORT SALES OF CAPITAL ASSETS

This section is the same as section 210 of the bill as passed by the House except that the designation of the subsection to be added to the Internal Revenue Code is (l) instead of (m).

This section amends section 117 of the code (relating to capital gains and losses) by adding a new subsection (designated (l)) to provide specific rules as to the tax consequences of certain short sales of property. These rules apply only to short sales of stocks or other securities, to transactions in stocks or securities on a "when issued" basis, and to transactions in commodity futures. Moreover, the rules apply only where the dealings are in such property which is a capital asset, as defined in section 117 (a), in the hands of the taxpayer. Hedging operations by operators of grain elevators, millers, producers of cloth, and so forth, which give rise to ordinary gain or loss rather than to capital gain or loss, are not subject to the rules.

The first two rules, set forth in section 117 (l) (1), are applicable wherever property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for not more than 3 months or is acquired by him after the short sale and on or before the date of the closing thereof. In such a case:

Rule (1): Any gain upon the closing of the short sale shall, under the provisions of section 117 (l) (1) (A), be considered as a short-term capital gain. This rule applies without regard to when the property actually used to close the short sale was acquired.

Rule (2): The holding period of such substantially identical property shall, under the provisions of section 117 (l) (1) (B) and notwithstanding the provisions of section 117 (h), be considered to begin on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. If several quantities of property substantially identical to that sold short were acquired at different times not more than 3 months prior to the short sale and prior to the closing thereof, this rule shall apply to such property in the order of the dates of its acquisition.

The third rule, set forth in section 117 (l) (2), is applicable wherever property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for more than 3 months. In such a case:

Rule (3): Any loss upon the closing of the short sale shall, notwithstanding the provisions of section 117 (g) (2), be considered as a long-term capital loss. This rule, like rule (1), applies without regard to when the property actually used to close the short sale was acquired.

Rules (1) and (3) do not apply to so much of the property sold short as exceeds in quantity the substantially identical property described in sections 117 (l) (1) and 117 (l) (2), respectively; nor does rule (2) apply to so much of the substantially identical property described in section 117 (l) (1) as exceeds in quantity the property sold short.

The following examples illustrate the application of this section to short sales of stock:

Example (1): A taxpayer buys 100 shares of X stock at $10 per share on February 1, sells short 100 shares at $16 per share on April 1, and closes the short sale on May 2 by delivering the 100 shares bought on February 1 to the lender of the stock used to effect the short sale. Since 100 shares of X stock had been held by the taxpayer on the date of the short sale for not more than 3 months, the gain of $600 upon the transaction is, by application of rule (1), short-term capital gain.

Example (2): A taxpayer buys 100 shares of X stock at $10 per share on February 1, sells short 100 shares at $16 per share on April 1, closes the short sale on May 1 with 100 shares of stock purchased on that date at $18 per share, and sells the 100 shares of stock (purchased on February 1) at $18 per share on May 2. The $200 loss upon the closing of the short sale is, as under present law, short-term capital loss. By application of rule (2), the holding period of the stock bought on February 1 is considered to begin on May 1 (the date of the closing of the short sale); the $800 gain upon the sale of such stock is, therefore short-term capital gain.

Example (3): The taxpayer buys 100 shares of X stock at $10 per share on February 1, sells short 100 shares at $16 per share on June 1, sells the 100 shares of stock (purchased on February 1) at $18 per share on July 1, and closes the short sale on July 1 with 100 shares of stock purchased on that date at $18 per share. The $800 gain upon the sale of the stock bought on February 1 is, of course, long-term capital gain. Since the taxpayer had held 100 shares of X stock on the date of the short sale for more than 3 months, the $200 loss upon the closing of the short sale is, by application of rule (3), long-term capital loss.

Example (4): The taxpayer sells short 100 shares of X stock at $16 per share on February 1. He buys 250 shares of the same stock on March 1 at $10 per share and holds the latter stock until June 2 (more than 3 months) when 100 shares are delivered to close the short sale made on February 1. Since substantially identical property was acquired by the taxpayer after the short sale and before it was closed, the $600 gain is short-term capital gain. The holding period of the remaining 150 shares is not affected by section 117 (l), since to that extent the substantially identical property exceeds the quantity of the property sold short.

In the case of transactions in stocks or other securities on a "when issued" basis, the entry into a contract to sell such stocks or securities "when issued" shall be considered as a short sale and the performance of such contract or the assignment thereof for value shall be considered as a closing of such short sale. For the purpose of rules (1) and (2), but not for the purpose of rule (3), the acquisition of a "put" or other option to sell property at a fixed price shall be considered as a short sale, and the exercise or expiration (by reason of failure to exercise) of such option shall be considered as a closing of such short sale.

In the application of the three rules, the term "taxpayer" shall be read as "taxpayer or his spouse." As a result, if the spouse of the taxpayer holds property substantially identical to that sold short by the taxpayer, the three rules shall apply to the same extent as if such substantially identical property were held by the taxpayer. However, the three rules do not so apply where the taxpayer and his spouse are legally separated under a decree of divorce or of separate maintenance.

The three rules are also applicable to transactions in commodity futures. As applied to simultaneous long and short transactions in the same commodity, for delivery in the same future period and in the same market this section is consistent in purpose with Mimeograph 6243, issued by the Bureau of Internal Revenue on March 8, 1948.

In the case of commodity futures transactions, however, the three rules do not apply to what are commonly known as "arbitrage" or "straddle" transactions; that is, to a long position in one market and a short position in another market, requiring delivery in the same month of the same or substantially identical commodities, entered into on the same day and subsequently closed on the same day. However, where the quantity of the commodity involved in one market exceeds the quantity of the commodity involved in the other, the rules apply to such excess.

No general definition of substantially identical property is given in this section, since it is believed that the term must be applied in accordance with the actual circumstances of each transaction. As applied to securities, this term has for many years been in section 118 of the code, and various rulings and decisions have been made which will, in general, be equally applicable to the provisions of this proposed amendment. It is not believed that the term substantially identical should be applied to securities of different corporations (except in special situations as, for example, the securities of predecessor and successor corporations in a reorganization), nor, in general, to preferred stock or bonds as compared with common stocks. However, in special situations, such as where preferred stock or bonds are convertible into common stock of the same corporation, the relative values and price changes may be so similar as to make them substantially identical to the common stock. Different commodities, such as corn and wheat, which are not generally through custom of the trade used as hedges for each other, would not be substantially identical. Section 117 (l) (3) (B) (ii) expressly provides that different futures—for example, May wheat and July wheat—shall not be considered as substantially identical. Contracts on different markets may, depending upon the circumstances, be so similar as to be regarded as substantially identical; in each such case, the historical similarity in price movements in the two markets is a primary factor to be considered.

The amendments made by this section are applicable only with respect to taxable years beginning after the date of enactment of the bill. Even with respect to such taxable years, however, the amendments do not apply where the short sale was made on or before the date of enactment of the bill.

SECTION 213. TREATMENT OF GAINS TO SHAREHOLDERS OF COLLAPSIBLE CORPORATIONS

This section corresponds to section 211 of the bill as passed by the House. Your committee, however, has made technical amendments and changed the designation of the subsection to be added to the Internal Revenue Code from (n) to (m).

Your committee has also restricted the limitations on the application of the new subsection so as to make subject to the provisions thereof gain realized by a shareholder upon his stock in a collapsible corporation if such shareholder owned stock at any time after the commencement of the manufacture, construction, or production of the property which was considered as owned at such time by another shareholder who then owned, or was considered as owning, more than 10 percent in value of the outstanding stock of the corporation.

This section of the bill adds a new subsection (m), relating to collapsible corporations, to section 117 of the code. The collapsible corporation is a device whereby one or more individuals attempt to convert the profits from their participation in a project from income taxable at ordinary rates to long-term capital gain taxable only at a rate of 25 percent.

Under paragraph (1) of the subsection as added to the code, gain from the sale or exchange of stock of a collapsible corporation will be treated as gain from the sale or exchange of property which is not a capital asset. This treatment is to be effective, however, only to the extent that the use of the device is interpreted as giving rise to gain which gain is considered (but for the provisions of the subsection) as long-term capital gain.

The term "collapsible corporation" is specifically defined by paragraph (2) of the subsection to mean 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 by the corporation 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. The paragraph further states when a corporation shall be deemed to have manufactured, constructed, or produced property.

It will be noted that the term "collapsible corporation" is so defined as to include corporations lending themselves to the attempted tax-saving practice outlined above, whether they are the corporations commencing and completing the project or corporations made use of as holding companies having no other business than to separate the shareholders from the corporation undertaking the project. The corporation, furthermore, has been so defined as to describe corporations different in kind from those which ordinarily liquidate following normal business operations. This objective has been specifically strengthened by the statement made in subparagraph (i) above, to the effect that the sale or exchange or the distribution be made prior to the realization by the corporation of a substantial part of the net income to be derived from the property. Although in many cases an ordinary corporation may distribute property in kind in the course of its liquidation, or the stock in such a corporation may be sold prior to the realization by the corporation of the net income to be derived from some of its property, such a corporation could not be considered to have been formed or availed of principally for the manufacture, construction, or production of that property alone.

While the primary use made of collapsible corporations in the past has usually involved their liquidation in the manner indicated above, it is apparent that the shareholders forming or availing themselves of such a corporation could raise the same tax questions as would be raised by a liquidation by selling their stock to outside interests at the time and under the circumstances when the corporation might otherwise be liquidated. In like manner, the corporation might distribute the property in question without liquidating and, under section 115 (d), the value of the property distributed, to the extent that it was not a dividend, would first be applied against the adjusted basis of the stock to the shareholders and the excess, if any, would be taxable in the same manner as a gain from the sale or exchange of property. Paragraph (1) of the subsection, in prescribing the treatment to be given the gain from the sale or exchange of stock of a collapsible corporation, is deemed to refer to this excess value in the case of a distribution made by the corporation other than in liquidation. Such a distribution is specifically referred to in connection with the definition of the term "collapsible corporation" in paragraph (2) of the subsection. Both paragraph (1) and paragraph (2) of the subsection refer to a sale or exchange of the stock other than in liquidation.

Subparagraph (B) of paragraph (2) of the subsection states that a corporation shall be deemed, for purposes of the above definition, to have manufactured, constructed, or produced property if it engaged in the manufacture, construction or production of such property to any extent or if it holds property having a substituted basis under section 113 of the code determined by reference to the cost of property manufactured, constructed or produced by the corporation or by another. Under this statement the corporation need not have originated the manufacture, construction or production; neither need the manufacture, construction or production be completed by it. It will nonetheless be deemed to have manufactured, constructed or produced property in that its shareholders may realize gain with respect to the additional value added to the property by the manufacture, construction or production to the extent that it was carried out. Likewise, for example, a corporation which manufactured a motion picture and exchanged it with another corporation for a motion picture manufactured by that corporation in an exchange which would not be taxable would be considered for tax purposes as having manufactured, constructed or produced the motion picture thus received on the exchange. This latter type of provision is designed to cover an obvious device which might be utilized by a collapsible corporation in an attempt to circumvent the new provision.

Paragraph (3) of the subsection sets forth three limitations on the application of the subsection. First, the subsection shall not apply unless the shareholder selling or exchanging his stock has at some time subsequent to the commencement of the manufacture, construction, or production of the property by the corporation owned, or been considered as owning, more than 10 percent in value of the outstanding stock of the corporation, or owned stock which was considered as owned at such time by another shareholder who then owned, or was considered as owning, more than 10 percent in value of the outstanding stock of the corporation. In determining the ownership of stock of the corporation by a shareholder, the stock ownership rules set forth in section 503 (a) of the code to the extent that they are pertinent are made applicable with the additional provision that the family of an individual shall include, in addition to the persons mentioned in that section, the spouses of that individual's brothers and sisters (whether by the whole or half blood) and the spouses of that individual's lineal descendants. Second, the subsection shall not apply to the gain recognized by a shareholder from the sale or exchange of his stock unless more than 70 percent of such gain is attributable to the property so manufactured, constructed, or produced. Third, the subsection shall not apply to gain realized after the expiration of 3 years following the completion of the manufacture, construction or production of the property.

It is the purpose of the first limitation to insure that the provision will only be applicable to a shareholder who by virtue of his stock ownership can be presumed to be an interested party to the project whether at the time of its organization or at some intermediate date. The stock ownership rules are made necessary in order to prevent any one shareholder's disguising his interest by the placement of the stock of the corporation among the different members of his family. Both the second and third limitations relate to the gain realized from the sale or exchange of the stock, the second limitation being designed to insure that the application of the subsection will be limited to those corporations where the relationship between the gain realized and the property manufactured, constructed, or produced is substantial. The third limitation imposes an arbitrary time limit beyond which gain realized will not be subject to the subsection on the theory that a corporation will not be a collapsible corporation as defined in general terms in paragraph (2) if the shareholders do not realize their gain until after 3 years following the completion of the manufacture, construction, or production.

Paragraph (1) of the subsection refers to gain from the sale or exchange of a capital asset held for more than 3 months. Under section 117 of the code, prior to its amendment by this bill, gain from the sale or exchange of a capital asset held for more than 6 months is defined as long-term capital gain. Under section 211 (c) of this bill, this period would be changed to 3 months and paragraph (1) has been designed to accord with this change. It is specifically provided in subsection (b) of this section, however, that in the case of gain realized on or before the date of the enactment of this act the words "capital asset held for more than 3 months" shall be read as "capital asset held for more than 6 months."

The success of attempts under existing law to make use of a collapsible corporation and to take advantage of the liquidation of that corporation within the meaning of section 115 (c) has never been tested in the courts, and it is not clear that the individuals making use of the device will succeed in their objectives. Your committee believes, however, that the proposed amendment dealing specifically with the subject of collapsible corporations is desirable in order to insure that the use of the device in the future will result in no tax advantage.

The amendment made by the section is applicable to taxable years ending after December 31, 1949, but only with respect to gain realized after that date. It is specifically provided in the section that the determination of the tax treatment of gains realized prior to January 1, 1950, shall be made as if this section had not been enacted and without inferences drawn from the fact that the amendment made by the section is not made applicable to such gains and without inferences drawn from the limitations contained in the subsection as added to the code.

SECTION 214. ASSIGNMENT OF CERTAIN OIL, GAS, AND MINERAL RIGHTS

This section, for which there is no corresponding provision in the House bill, amends section 117 of the Internal Revenue Code by adding a new subsection (n) at the end thereof. This new subsection provides that the amounts received for the assignment by an assignor out of economic interests held by him of rights which entitle the assignee to oil, gas, or minerals produced, or the proceeds derived from an agreed share of production if, as, and when produced, until a fixed or determinable amount of oil, gas, or mineral has been received, shall be treated as amounts received from the sale or exchange of capital assets.

This amendment is intended to apply to the consideration received for assignments of rights such as in-oil payment rights, whether long or short-lived. It may be noted that the amendment does not apply to cases where the period of the assignment is to expire upon the receipt of an ascertainable sum of money.

In order to prevent any question arising, your committee has provided that this subsection shall not be applicable to an assignment by an operator if such operator is pledged to use the amounts received for such assignment in the development of the property.

The amendment made by this section will apply with respect to taxable years beginning after December 31, 1950.

SECTION 215. CAPITAL GAINS OF NONRESIDENT ALIEN INDIVIDUALS

This section is identical with section 212 of the bill as passed by the House. Section 211 (a) (1) of the code imposes a tax of 30 percent on the fixed or determinable annual or periodical gains, profits, and income received from sources within the United States by nonresident alien individuals not engaged in trade or business within the United States. The substance of this provision first appeared in section 211 (a) of the Revenue Act of 1936 which changed the method of taxing such individuals, with the result that they no longer were taxable on capital gains derived from sources within the United States. Under the present statute only those aliens who are resident in, or are engaged in trade or business within, the United States are taxable on such capital gains.

Section 211 (a) (1) (B), as amended by this section of the bill, broadens the taxable income base of nonresident aliens who have been present in the United States at some time during the taxable year but have not engaged in trade or business therein. Under the amendment such nonresident aliens will be subject to a tax of 30 percent on the net amount of capital gains in addition to the present tax of 30 percent on fixed or determinable annual or periodical income.

The effect of the amendment is, for purposes of taxing capital gains, to divide nonresident alien individuals not engaged in trade or business within the United States into three distinct categories:

(1) Those who have not been present in the United States at any time during the taxable year;

(2) Those who have been present therein for a period or periods aggregating less than 90 days during the taxable year; and

(3) Those who have been present therein for a period or periods aggregating 90 days or more during the taxable year.

A nonresident alien coming within category (1) above is not affected by this section of the bill, insofar as his capital gains derived in, or his capital losses allocable to, the United States are concerned. Gains derived in the United States on sales or exchanges of capital assets effected by such an individual during the taxable year are not subject to tax in the United States. Losses allocable to sources within the United States from such sales or exchanges are disallowed as deductions. A nonresident alien coming within category (2) above is taxable on the excess of his capital gains over his capital losses, determined as indicated below, derived from sources within the United States from sales or exchanges of capital assets effected during his presence within the United States. Gains or losses on such transactions effected during the taxable year at times other than during such presence in the United States are not to be taken into consideration in the computation of the net amount of capital gains subject to tax. A nonresident alien coming within category (3) above is taxable on the excess of his capital gains over his capital losses, determined as indicated below, derived from sources within the United States from sales or exchanges of capital assets effected at any time during the taxable year, even though he is not present in the United States at the time such sales or exchanges are effected. In computing the total period of presence in the United States for a taxable year all separate periods during the taxable year are to be aggregated. Mere physical presence in the United States at any time during the taxable year is the test for determining whether to apply the provisions of this amendment.

For the purposes of the computation under proposed section 211 (a) (1) (B), gains and losses are to be taken into account only to the extent that they would be recognized and taken into account, if the taxpayer had been engaged in trade or business within the United States. However, in determining the amount of gain or loss to be used in such computation, no regard will be given to the percentage provisions under section 117 (b) of the code or to the provision for the capital loss carry-over under section 117 (e) of the code.

Section 211 (a) (1) (B) merely imposes a tax upon the excess of capital gains over capital losses. The excess, if any, of such losses over such gains (whether or not exceeding $1,000) is of no significance for the purposes of section 211 (a) (1) (B).

Under section 211 (a) (2) of the code the tax of 30 percent imposed by section 211 (a) (1) is made inapplicable, when the aggregate of the amount of fixed or determinable income subject to tax under paragraph (1) exceeds $15,400. When such amount received by the taxpayer exceeds $15,400, he becomes subject under section 211 (c) of the code to the regular normal and surtax rates imposed by section 11 and section 12. The bill rewrites existing section 211 (a) (2) to incorporate in the present rule, rules for taking into cognizance the net amount of capital gains in the determination of the amount of $15,400.

When the aggregate amount determined in accordance with section 211 (a) (1) of the code, as amended by the bill, exceeds $15,400, the taxpayer becomes subject, under the amendment of section 211 (c), to both the normal tax and surtax imposed by sections 11 and 12, or in the alternative to the tax imposed by section 117 (c), on the total of his fixed or determinable income and his capital gains. In the rules proposed to be added to section 211 (c) in the case of capital gains and losses, the provisions of section 117 of the code will be fully applicable, except for the capital loss carry-over provision under section 117 (e), with respect to such capital gains and losses as are recognized for purposes of the computation. However, in effect, the present limitation of section 211 (c) is retained so that in no case shall the tax be less than 30 percent of the total amount of fixed or determinable income subject to tax under section 211 (a) (1) (A) plus the net amount of capital gains determined (without regard to sec. 117 (b) and (e) of the code) under proposed section 211 (a) (1) (B).

The amendments made by section 215 of the bill will not apply in any case where their application would be contrary to any treaty obligation of the United States. This rule is contained in section 216 of the bill.

SECTION 216. TREATY OBLIGATIONS

This section is identical with section 213 of the bill as passed by the House. It 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 217. NET OPERATING LOSS DEDUCTIONS

This section is identical with section 214 (a) of the bill passed by the House.

Subsection (a) of this section amends section 122 (b) of the Internal Revenue Code to provide that the net operating loss for any taxable year beginning after December 31, 1949, may be carried back to the preceding taxable year only; such net operating loss (to the extent it is not absorbed as a carry-back) also may be carried forward to the five succeeding taxable years.

The amendment made by subsection (a) of this section is applicable to all taxable years beginning after December 31, 1947, but the result of the provisions of section 122 as amended is to impose the new carry-back and carry-over provisions only with respect to net operating losses sustained in taxable years beginning after December 31, 1949. Net operating losses sustained in taxable years beginning before January 1, 1950, will continue, as under existing law, to be carried back for 2 years and carried over for 2 years. Thus, a net operating loss for 1949 (in the case of a taxpayer on the calendar year basis) could still be carried back to 1947 and 1948 and over to 1950 and 1951; whereas, a net operating loss for 1950 could be carried back only to 1949, but it could be carried over to 1951 to 1955, inclusive.

SECTION 218. AMORTIZATION OF EMERGENCY FACILITIES

This section of the bill, for which there is no corresponding provision in the House bill, has the same basic objectives as section 124 of the code (relating to the amortization of emergency facilities during World War II) but is different therefrom in several important respects, and is not intended in any way to affect the law, or its administration, under that section.

This section of the bill adds to the code a new section 124A which provides that every person may, at his election, take a deduction from gross income for the amortization of any emergency facility as defined in subsection (d) of section 124A. Such facilities are facilities, land, buildings, machinery, and equipment, or any part thereof, the construction, reconstruction, erection, or installation of which was completed after December 31, 1949, or the acquisition of which occurred after December 31, 1949, and with respect to which a certificate of necessity pursuant to the provisions of subsection (e) of section 124A has been made.

The amortization of the adjusted basis of any such facility is to be spread over a period of 60 months, the deduction to be in lieu of the present deduction for exhaustion, wear and tear, and obsolescence provided for in section 23 (l) of the code. The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

Subsection (b) of section 124A provides that an election to take the amortization deduction shall be made in the manner provided in regulations prescribed by the Secretary of the Treasury. Also, under subsection (b), the manner of making the election as to when the

60-month period for such amortization shall begin is to be controlled by regulations prescribed by the Secretary.

Subsection (c) of section 124A provides that if, after having elected to take the amortization deduction, the taxpayer desires to terminate such deduction and take the depreciation deduction provided by section 23 (l) of the code with respect to the remainder of the adjusted basis of the facility, he shall be permitted to do so upon written notice filed with the Secretary prior to the month which the taxpayer specifies in such notice as the month of discontinuance; and the taxpayer shall, in such event, not be entitled to any further amortization deduction with respect to such emergency facility.

Subsection (d) of section 124A defines the term "emergency facility." It also defines the term "emergency period" as meaning the period beginning on January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities certified under subsection (e) as necessary is no longer required in the interest of national defense. Subsection (d) also provides that no amortization deduction shall be allowed as to any emergency facility for any taxable year unless a certificate in respect thereof under such subsection shall have been made prior to the filing of the taxpayer's return for such taxable year. In the case of an emergency facility completed or acquired after December 31, 1949, and before the date of enactment of the Revenue Act of 1950, no amortization deduction shall be allowed therefor in respect of any taxable year unless a certificate in respect thereof shall have been made prior to the expiration of 12 months after the date of enactment of this bill.

Subsection (e) of section 124A provides that the adjusted basis of an emergency facility shall be determined by including only so much of the amount of the adjusted basis of the facility (computed without regard to section 124A) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as a certifying authority (to be designated by the President by Executive order) has certified as necessary in the interest of national defense during the emergency period (as defined in subsec. (d) of sec. 124A), and only such portion of such amount as the certifying authority has certified as attributable to defense purposes. Such certification shall be made under regulations prescribed by the designated certifying authority with the approval of the President. It is further provided that an application for a certificate of necessity must be filed at such time and in such manner as the certifying authority may, under such regulations, prescribe. However, such a certificate of necessity shall have no effect unless an application therefor is filed before the expiration of 6 months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, or before the expiration of 6 months after the date of enactment of this bill, whichever is the later. Subsection (e) further provides, in connection with the determination of the adjusted basis of an emergency facility, that after the completion or acquisition of a facility which has been certified under such subsection, any expenditure (attributable to such facility and to the period after the completion or acquisition) which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate of necessity is made, shall not be applied in adjustment of the basis of such facility, but a separate basis shall be computed therefor as if it were a new and separate emergency facility.

Subsection (f) of section 124A provides that if the adjusted basis of an emergency facility (computed without regard to sec. 124A) is in excess of the adjusted basis computed under subsection (e), the depreciation deduction provided by section 23 (l) of the code shall, despite the provisions of subsection (a) of section 124A, be allowed with respect to such facility as if its adjusted basis for the purposes of such depreciation deduction were an amount equal to the amount of such excess.

Subsection (g) of section 124A provides for the computation of the amortization deduction where compensation for the unamortized cost of an emergency facility is received by the taxpayer under a contract with the United States. If an amount is properly includible in the taxpayer's gross income on account of a payment with respect to an emergency facility and such payment is certified (under regulations prescribed by the President) by the designated authority as compensation to the taxpayer for the unamortized cost of the facility, then the amortization deduction for the month in which such amount is includible in gross income shall (in lieu of the amortization deduction for such month computed under subsection (a) of section 124A) be equal to the amount so includible, but not in excess of the adjusted basis of the facility as of the end of such month (computed without regard to any amortization deduction for such month). In order for this provision to be applicable, the payment to the taxpayer must be made because (1) a contract with the United States involving the use of the facility has been terminated, or (2) the taxpayer had reasonable ground for anticipating future contracts with the United States involving the use of the facility. If the taxpayer is not entitled to any amortization deduction with respect to such facility, the depreciation deduction allowable under section 23 (l) of the code, on account of the month in which such compensation is includible in gross income, shall be increased by the amount of such compensation, but such deduction, on account of such month, shall not be in excess of the adjusted basis of the facility as of the end of such month (computed without regard to any deduction allowable, on account of such month, under sec. 23 (l) or sec. 124A (g) (2) of the code).

Subsection (h) of section 124A provides that where property is held by one person for life with remainder to another person, the amortization deduction shall be allowable to the life tenant as if he were the absolute owner of the property.

This section of the bill also makes a technical amendment of section 23 (t) of the code so as to include therein a reference to the new section 124A of the code.

The amendments by this section of the bill are made applicable with respect to taxable years ending after December 31, 1949.

SECTION 219. AMORTIZATION OF BOND PREMIUM ON CONVERTIBLE BONDS

This section is identical with section 215 of the bill passed by the House. It amends section 125 (b) (1) of the code to require the exclusion from the amount of bond premium on a convertible bond of any amount attributable to the conversion features of the bond. The term "convertible bond" includes bonds issued with detachable stock-purchase warrants.

Calculation of the value of the conversion features of a particular bond may be accomplished simply by ascertaining the yield on which bonds of similar character (not having conversion features) are selling on the open market and adjusting the price of the bond in question to this yield. This adjustment may be made with the aid of standard bond tables. Suppose, for example, it is desired to appraise the bonds of the XYZ Company. Assume that these bonds have 5 years to run to maturity and have a coupon rate of interest of 5 percent. A study of similar bonds on which quotations are available shows that they sell at an average yield of 5.75. In order to reduce these bonds to a price which will give an equivalent yield, it is necessary only to turn to a standard bond table for 5-percent bonds with a 5-year maturity, and read across from 5.75. The corresponding price, 96.78 is the desired value. Subtracting this value from the amount paid for the bond will disclose the amount attributable to the conversion features of the bond.

In selecting quotations for comparative purposes bonds of the same classification and grade as the convertible issue should be chosen.

The amendment made by this section will be applicable to taxable years beginning after June 15, 1950. The amendment will also apply in the case of a taxable year beginning on or before June 15, 1950, with respect to convertible bonds acquired after such date. For example, the amortizable bond premium on a convertible bond acquired on July 1, 1950, by a taxpayer reporting on the basis of the calendar year 1950, must be adjusted to exclude the amount attributable to the conversion features of the bond. If such taxpayer acquired such bond on June 14, 1950, however, no adjustment will be required under the committee amendment until the taxable year 1951.

SECTION 220. STOCK OPTIONS

This section adds a new section 130A to the code to provide rules for the tax treatment of income resulting from the granting or exercise by an individual of a specially defined type of option ("restricted stock option") to purchase stock of an employer corporation or a parent or subsidiary of such employer corporation. The section contains no rules applicable to transactions respecting stock options which are not "restricted stock options" as defined in the section.

The restricted stock options, with respect to which the rules of section 130A are to be applicable, are defined in section 130A (c) to mean an option granted after 1946 by a corporation to an individual for any reason connected with the employment of such individual by the corporation or by a parent or subsidiary of such corporation, but only if—

(1) at the time the option is granted the option price is at least 85 percent of the fair market value at such time of the stock subject to the option;

(2) the option by its terms is not transferable otherwise than by will or the laws of descent and distribution, and is exercisable during his lifetime only by the employee;

(3) the employee at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation.

Section 130A (a) provides that if stock is transferred to an employee pursuant to his exercise after 1949 of a restricted stock option, and no disposition of such stock is made by the employee within 2 years from the date of the granting of the option nor within 6 months after the transfer of such stock to him—

(1) no income shall result at the time of the transfer of such stock to the employee upon his exercise of the option;

(2) no deduction under section 23 (a) is allowable at any time to the employer corporation or its parent or subsidiary corporation with respect to the stock so transferred; and

(3) no amount other than the option price shall be considered as received by either of such corporations for the stock so transferred.

In the application of subsection (a) of section 130A if, within the period prescribed, the employee disposes of stock acquired under the option, the rules of the subsection respecting income of the employee, respecting deduction allowable to the employer or other corporation, and respecting amount received for the stock do not, of course, apply. Transactions respecting the option and such stock revert to their status under existing law. The option itself does not, as to stock with respect to which the option is still exercisable, lose its character as a restricted stock option. Similarly if the stock disposed of is only part of the stock acquired under the option, the special treatment accorded by section 130A is not lost with respect to stock not disposed of.

Section 130A (a) contains a rule that the provisions of section 130A do not apply in any case where the holder of the option does not exercise it within 3 months after leaving the employment of the employer corporation, a parent or subsidiary. This rule does not, of course, mean that the employee may not shift employment from, for example, the original employer corporation to a parent or subsidiary corporation. Under this rule an exercise of an option after such 3-month period carries with it none of the special treatment of section 130A. Where an individual has exercised an option with respect to part of the stock covered by the option prior to leaving such employment, then leaves such employment, he cannot on an exercise of the balance of the option more than 3 months after leaving such employment, secure the benefits of section 130A as to the later exercise of the option although he may retain such benefits with respect to the earlier exercise of the option.

The period of time during which the employee must hold the stock to secure the benefits of the section may be illustrated by the following example (the example also illustrates the rules respecting parent and subsidiary corporations): In the case of corporations A, B, and C, C is a subsidiary of B and B is a subsidiary of A. X is employed by B corporation and (for reasons connected with his employment) receives from A corporation a restricted stock option (as defined in sec. 130A (c)) to acquire stock of C corporation. The option is granted January 1, 1951, and covers the purchase of 1,000 shares of C stock for $8.50 per share ($8,500), such stock on January 1, 1951, having a fair market value of $10 per share ($10,000). On July 1, 1952, when C corporation stock has a fair market value of $12 per share ($12,000), X, while still employed by B, exercises the option and acquires 1,000 shares of C stock for $8,500. On February 1, 1953 (2 years and 1 month from the date the option was granted, and 7 months from the date the stock was acquired) X disposes of the stock. Under such conditions, X is entitled (as far as the period requirements are concerned) to the benefits of section 130A.

If in the example given, X had exercised the option and acquired the stock on January 1, 1953 (2 years after the option was granted), and disposed of the stock on June 1, 1952 (5 months later), the transaction would not have met the 6-month holding period requirement applicable to the stock, and X would not be entitled to the benefits of section 130A.

Section 130A also contains definitions considered necessary to the rules of the section respecting restricted stock options, including definitions of parent and subsidiary corporations, and rules for the treatment of modifications, extensions, and renewals of options to purchase stock. In general, a modification, extension, or renewal is to be considered the granting of a new option. Under these rules a restricted stock option may, as a result of modification, cease to be a restricted stock option, or an option may by modification become a restricted stock option.

SECTION 221. PAYMENT OF TAX WITHHELD AT SOURCE FROM NONRESIDENT ALIENS

This section is basically the same as section 601 (d) of the bill passed by the House. Though the House amendments providing for the collection of income tax at source on dividends have been deleted by your committee, the amendment provided by this section has been retained with a minor change. By virtue thereof section 143 (c) of the code is amended with respect to the payment of the income tax withheld at source under section 143. Under existing law the withholding agent is required to make return of the tax on or before March 15 of each year and to pay the tax on or before June 15. The amendment proposed by your committee will require the withholding agent to make return and payment of the tax on or before March 15 of each year to the collector designated in section 53 (b) of the code. The effect of the amendment is to advance the payment date by requiring payment of the tax on the filing date of the return. The changes thus made will also apply to the return and payment of the tax withheld under section 144 of the code.

SECTION 222. FAMILY PARTNERSHIPS

This section, for which there is no corresponding provision in the House bill, amends section 3797 (a) (2) of, and adds a new section 191 to, the Internal Revenue Code to revise the tax treatment of family partnerships as explained in XI (B) (4) of the general discussion section of this report.

SECTION 223. EMPLOYEES OF THE UNITED STATES WORKING IN POSSESSIONS OF THE UNITED STATES OR IN THE CANAL ZONE

This section is the same as section 216 of the House bill, except that a change has been incorporated to make the amendment applicable with respect to taxable years beginning after December 31, 1950. Section 223 amends section 251 of the code by the addition of section 251 (j). Under section 251, as amended, amounts paid for services performed by a citizen of the United States as an employee of the United States or any agency thereof will, for the purposes of such section, be deemed to be derived from sources within the United States. The result of the amendment is that salaries or compensation paid by the United States or any agency thereof to an employee who is a citizen of the United States for services performed within a possession thereof will not be considered as income from such possession, in determining whether the employee is entitled to the benefits of section 251 of the code, and will be subject to tax as income from sources within the United States.

It is to be noted, however, that only for the purposes of section 251 of the code shall such amounts be deemed to be derived from sources within the United States. The proposed amendment does not disturb other source rules such as those set forth in section 119 of the code, relating to the determination of income from sources within and without the United States, so that those rules will be applicable for the purpose of determining the credit for taxes of foreign countries and of possessions of the United States.

SECTION 224. RESIDENTS OF PUERTO RICO

This section corresponds to section 217 of the bill passed by the House. The provisions of the House bill have been retained, but two new subsections have been added by your committee. The first of these, subsection (i), provides for the amendment of the Internal Revenue Code section relating to the collection of taxes in the Virgin Islands and Puerto Rico; the second, subsection (j), provides for the amendment of the sections of the code and of the Social Security Act which relate to the definition of net earnings from self-employment.

Section 224 of the bill makes provision for the extension of the Federal income-tax laws to Puerto Rico to the extent of subjecting individual citizens of Puerto Rico who are also United States citizens to the Federal tax on their world-wide income, as in the case of other United States citizens, and to the extent of subjecting to the same treatment alien individuals who are bona fide residents of Puerto Rico during the entire taxable year. Such aliens resident in Puerto Rico would be subject to tax as in the case of aliens resident in the United States. Any individual citizen of the United States, or any alien individual, who is a bona fide resident of Puerto Rico during the entire taxable year will, however, be permitted to exclude from gross income any income derived from sources within Puerto Rico, except amounts received for services performed as an employee of the United States or any agency thereof. Deductions allocable to such excluded income will not be allowed for purposes of the Federal tax.

In the case of an individual citizen of the United States who gives up his Puerto Rican residence after having been a bona fide resident of Puerto Rico for a period of at least 2 years before the date of such change in residence, any income derived from Puerto Rican sources which is attributable to the period of residence prior to the change may also be excluded from gross income, except amounts received for services performed as an employee of the United States or any agency thereof. Deductions allocable to such excluded income will not be allowed. Similar treatment is not extended to individual aliens who change their residence from Puerto Rico.

The above changes in the taxation of the income of individuals are accomplished by the amendment of section 251 of the code to make such section inapplicable to Puerto Rico in the case of citizens of the United States, by the amendment of section 252 (a) to make such section inapplicable to citizens of Puerto Rico and by the addition of new sections 116 (l) and 220 to the code. Section 116 (l), as added by section 224 (c) of the bill, provides for the exclusion from gross income of income from sources within Puerto Rico in the case of individuals who are bona fide residents of Puerto Rico during the entire taxable year. Section 220, as added by section 224 (d) of the bill, provides that supplement H of the code (relating to nonresident alien individuals) shall have no application to alien individuals who are bona fide residents of Puerto Rico during the entire taxable year and that such individuals shall be subject, as in the case of citizens and alien residents of the United States, to the taxes imposed by sections 11 and 12 of the code.

Withholding of tax at source under section 143 (a) and (b) of the code on fixed or determinable annual or periodical income will be continued in accordance with present provisions of the code in the case of alien individuals who are residents of Puerto Rico, even though such individuals are bona fide residents of Puerto Rico during the entire taxable year. Such treatment is obtained by amendments, as provided by section 224 (e) of the bill, to sections 143 (a) (1) and 143 (b) of the code. Credit for, or refund of, such withheld tax will be allowed in the case of those alien residents of Puerto Rico who become subject to tax under sections 11 and 12 of the code in accordance with proposed section 220.

Section 224 (f) of the bill makes provision for the amendment of sections 1621 (a) (6) and 1621 (a) (8) of the code relating to definition of wages with respect to the collection of income tax at source on wages. Pursuant to proposed section 1621 (a) (6) (B), withholding of income tax will be required on wages paid for services performed by an individual alien resident of Puerto Rico as an employee of the United States or any agency thereof.

Section 1621 (a) (8) (B), as amended by the bill, will no longer apply to Puerto Rico. In its application to any other possession of the United States, this section requires withholding of income tax on wages paid for services performed by a citizen of the United States in such possession as an employee of the United States or any agency thereof. The latter change is a corollary to the amendment provided by section 223 of the bill. Pursuant to section 1621 (a) (8) (C) withholding of tax will not be required on wages paid for services performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of that possession, unless the employer is the United States or any agency thereof.

Section 224 (g) of the bill amends section 58 (a) of the code to require alien individuals who are residents of Puerto Rico during the entire taxable year to make a declaration of estimated tax for the taxable year in accordance with the present requirements of the code. Gross income in such cases will not, of course, include the Puerto Rican source income excluded by virtue of section 116 (l) (1) of the code. Citizens of Puerto Rico who are also citizens of the United States, will, of course, be required to make the declaration prescribed by section 58 (a) of the code.

Section 224 (h) of the bill provides for the amendment of sections 131 (a) (2) and 131 (a) (3) of the code which relate to the credits against tax. Under the amendment to section 131 (a) (2) alien individuals who are bona fide residents of Puerto Rico during the entire taxable year will be allowed a credit for taxes paid or accrued during the taxable year to any possession of the United States with respect to income from sources in such possession subject to the Federal income tax. Pursuant to the amendment to section 131 (a) (3) such an alien individual will also be allowed a credit for taxes paid or accrued during the taxable year to any foreign country with respect to income from sources in such country subject to the Federal income tax, if the foreign country of which such alien resident is a citizen or subject, in imposing its income taxes, allows a similar credit to citizens of the United States residing therein. No credit will, of course, be allowed against the Federal income tax for taxes paid or accrued to Puerto Rico with respect to income derived from Puerto Rican sources but excluded from gross income for purposes of the Federal income tax. Similarly, no credit will be allowed for income taxes paid or accrued to Puerto Rico on income derived from sources in a foreign country, even though such income may have been subject to tax in (1) the United States, (2) the foreign country, and (3) Puerto Rico.

Since section 224 of the bill broadens the application of the income-tax laws to individuals in Puerto Rico, proposed section 3811 (a) provides that, notwithstanding any other provision of law (such as Puerto Rican organic law) respecting taxation in Puerto Rico, all taxes imposed by chapter 1 of the code (including those imposed by the Self-Employment Contributions Act), by the Federal Insurance Contributions Act, and by subchapter D of chapter 9 (collection of income tax at source on wages), shall be collected under the direction of the Secretary and shall be paid into the Treasury of the United States as internal-revenue collections. In addition, this proposed subsection provides that all provisions of the laws of the United States (including the provisions relating to the Tax Court of the United States) applicable to the administration, collection, and enforcement of any tax imposed upon the incomes of individuals, estates, and trusts by chapter 1 (including the tax imposed by the Self-Employment Contributions Act), and of any tax imposed by the Federal Insurance Contributions Act or by subchapter D of chapter 9 (collection of income tax at source on wages), shall, in respect to such tax, extend to and be applicable in Puerto Rico in the same manner and to the same extent as if Puerto Rico were a State, and as if the term "United States" when used in a geographical sense included Puerto Rico.

Section 224 (j) of the bill, added by your committee to the House bill, provides for the amendment of section 481 (a) (7) of the Internal Revenue Code and of section 211 (a) (7) of the Social Security Act, each of which contains special rules for the computation of net earnings from self-employment in the case of Puerto Rico.

Proposed section 481 (a) (7) (A) provides in effect that, with respect to any taxable year beginning before the effective date specified in section 3810 of the code (i. e., the date on which the provisions of title II of the Social Security Act are extended to Puerto Rico), the Puerto Rican source income of a United States citizen will be taken into account in determining whether such citizen of the United States meets the requirements of section 251 of the code, and thus in determining whether or not gross income means only United States source income for purposes of the self-employment tax. In other words, this proposed amendment preserves for purposes of the self-employment tax the rule, should the effective date specified in section 3810 be no earlier than January 1, 1952, which would have existed in the absence of the amendments proposed by section 224 of the bill.

Proposed section 481 (a) (7) (B) provides in effect that, with respect to any taxable year beginning on or after the effective date specified in section 3810 of the code, any resident of Puerto Rico, whether or not a bona fide resident thereof during the entire taxable year, and whether or not an alien, a citizen of the United States, or a citizen of Puerto Rico, shall compute his net earnings from self-employment in the same manner as would a citizen of the United States residing in the United States. For purposes of the self-employment tax, the gross income of such a resident of Puerto Rico will include income from Puerto Rican sources.

The amendment proposed by section 224 (j) (2) of the bill to section 211 (a) (7) of the Social Security Act conforms such section 211 (a) (7) to proposed section 481 (a) (7) of the Internal Revenue Code.

SECTION 225. REGULATED INVESTMENT COMPANIES

This section, for which there is no corresponding provision in the House bill, amends section 362 (b) of the Internal Revenue Code to add a new paragraph, designated (8), thereto.

Under existing law a regulated investment company, in computing its Supplement Q net income and Supplement Q surtax net income, is entitled to a credit for dividends paid (other than capital gain dividends). It is entitled, also, to reduce the excess of its net long-term capital gain over its net short-term capital loss by the amount of capital gain dividends paid to shareholders.

In order to obtain the benefits of these provisions, however, a regulated investment company must distribute its income and capital gains to stockholders in the taxable year in which such income and gains are received. In respect of income or gains received by such a company near the end of its taxable year, it may be difficult to meet this requirement. The new paragraph (8) accordingly provides that, for the purposes of subsection (b) of section 362, any dividend or portion thereof which is declared by a company after the close of its taxable year and prior to the time for the filing of its return for such taxable year (including the period of any extension of time granted for filing such return) shall, to the extent the company so elects in such return, be treated as having been paid during such taxable year provided that the distribution of such dividend (the entire dividend declared, and not merely the portion covered by election) is actually made to the shareholder within the 12-month period following such taxable year and not later than the date of the first regular dividend payment made after such declaration.

This paragraph enables a company to treat certain dividends as having been paid in a taxable year preceding that of their actual payment for the purpose of computing the Supplement Q net income, the Supplement Q surtax net income and the excess of net long-term capital gain over net short-term capital loss plus capital gain dividends paid, as well as for the purpose of determining whether such company distributed 90 percent of its net income (other than net capital gains) during the taxable year as taxable dividends (other than capital gain dividends). This paragraph, however, does not affect the taxability of the shareholder with respect to such dividend receipts; the dividend will continue to be taxable to a shareholder in the year in which received by him.

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

SECTION 226. PERSONAL HOLDING COMPANY INCOME

Section 502 (f) of the Internal Revenue Code provides in general that amounts received as compensation for the right to use property of a corporation 25 percent or more of the value of the outstanding stock of which is owned, directly or indirectly, by or for an individual entitled to the use of the property are personal holding company income.

This section provides that section 502 (f) of the code shall not apply with respect to rents received during taxable years ending after December 31, 1945, and prior to January 1, 1950, if such rents were received for the use by the lessee in the operation of a bona fide commercial, industrial, or mining enterprise, of property of the taxpayer.

TITLE III.—TREATMENT OF INCOME OF, AND GIFTS AND BEQUESTS TO, CERTAIN TAX-EXEMPT ORGANIZATIONS

This title corresponds to title III of the House bill. Numerous changes and technical amendments have been made by your committee and will be noted in the discussion of the various provisions under this title.

Title III of the bill changes the present tax treatment of the income of certain tax-exempt organizations and trusts; and the deductions for gifts and bequests to such organizations and trusts. This title is divided into four parts, (I) Taxation of Business Income of Certain

Tax-Exempt Organizations, (II) Charitable, Etc., Deductions of Trusts Not Exempt From Taxation, (III) Loss of Exemption Under Section 101 (6) and Disallowance of Certain Gifts and Bequests, and (IV) Information To Be Made Available to the Public.

PART I.—TAXATION OF BUSINESS INCOME OF CERTAIN TAX-EXEMPT ORGANIZATIONS

SECTION 301. INCOME OF EDUCATIONAL, CHARITABLE, AND CERTAIN OTHER EXEMPT ORGANIZATIONS

Subsection (a) of section 301 of the bill adds to the Internal Revenue Code certain provisions imposing a tax on the unrelated business net income of educational, charitable, etc., organizations. As the existing Supplement U of the code is now obsolete, the new provisions are inserted in lieu of the present provisions of Supplement U, and are numbered as sections 421 through 424 of the Internal Revenue Code. This supplement is entitled "Taxation of Business Income of Certain Section 101 Organizations." For convenience of reference, the tax will be referred to in this report as the "Supplement U tax."

SECTION 421. IMPOSITION OF TAX

Subsection (a) of section 421 imposes a tax upon the Supplement U net income (as defined in subsection (c)) of certain organizations now exempt from Federal income tax by reason of section 101 (1), (6), (7), or (14) of the Internal Revenue Code. This tax is effective for taxable years beginning after December 31, 1950.

Rates

Subsection (a) of section 421 also prescribes the rates of the Supplement U tax. Under paragraph (1) thereof, organizations, which if not exempt would be taxed as corporations, are subjected to a normal tax of 25 percent on their Supplement U net income and a surtax of 20 percent on the amount of such income in excess of $25,000 (the corporate income tax rates provided in the bill). Under paragraph (2) thereof, trusts, which if not exempt would be subject to the provisions of Supplement E of the Internal Revenue Code, are taxed at the individual rates prescribed in sections 11 and 12 (b) of the code.

Organizations subject to tax

Subsection (b) of section 421 defines the organizations whose income is subject to the Supplement U tax. Paragraph (1) thereof provides that the following organizations, with the exceptions noted below, are subject to the tax at corporate rates:

Labor, agricultural, and horticultural organizations, exempt under section 101 (1) of the code; charitable, scientific, literary, educational, religious organizations (other than a church, or a convention or association of churches), and organizations for the prevention of cruelty to children or animals, exempt under section 101 (6) of the code; business leagues, chambers of commerce, real-estate boards, or boards of trade, exempt under section 101 (7) of the code; corporations described in section 101 (14), organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses to any of the above-listed exempt organizations which themselves are subject to the Supplement U tax, or to a church or a convention or association of churches.

While churches, and associations or conventions of churches, such as the Southern Baptist Convention, are exempt from the Supplement U tax, religious organizations are subject to such tax even though organized under church auspices. This is also true of organizations with charitable, educational, etc., purposes which are organized under church auspices. Likewise, a section 101 (14) corporation holding property for a church, or a convention or association of churches, would be, as indicated above, subject to the Supplement U tax.

Subsection (b) (2) of section 421 brings within the scope of the Supplement U tax any trust which would be subject to the provisions of Supplement E of the code if it were not exempt from taxation by reason of section 101 (6) of the code.

Definition of Supplement U net income

The income subject to the Supplement U tax is the Supplement U net income, which is defined in subsection (c) of section 421 as the unrelated business net income (as defined in sec. 422) in excess of $1,000.

Foreign organizations

Subsection (d) of section 421 provides that the Supplement U net income of a foreign organization subject to the Supplement U tax is the amount of such income derived from United States sources determined in accordance with the rules of section 119 and sections 212, 213 (a), 231 (c) and (d), and 232 (a) of the code.

SECTION 422. UNRELATED BUSINESS NET INCOME

This section describes the unrelated business net income which is subject to Supplement U tax. Unrelated business net income is defined in subsection (a) of section 422 as the gross income derived by any organization (to which Supplement U applies) from any unrelated trade or business regularly carried on by it, less the deductions allowed by section 23 of the code which are directly connected with the carrying on of such trade or business, subject to certain exceptions, additions, and limitations. In the case of an organization which regularly carries on two or more unrelated businesses, its unrelated business net income is its gross income (as described below) from all such unrelated businesses, less the deductions allowed with respect to all such unrelated businesses.

Definition of unrelated trade or business

As used in this section, the term "trade or business" has the same meaning as it has elsewhere in the code, as, for example, in section 23 (a) (1). The definition of unrelated business net income in section 422, however, includes only income from unrelated trades or businesses which are regularly carried on. Thus, in determining whether the income of an exempt organization from a trade or business is subject to the Supplement U tax, it is first necessary to determine whether it is income from a trade or business which is regularly carried on, or is income from a sporadic activity. If a charitable organization, exempt under section 101 (6) of the code, gives an occasional dance to which the public is admitted for a charge, hiring an orchestra and entertainers for the purpose, this would not be a trade or business regularly carried on within the meaning of section 422. Likewise, an organization which operates a sandwich stand during the week of an annual county fair is not regularly carrying on a trade or business. On the other hand, if an organization operates a public parking lot one day each week, the organization would be regularly carrying on a trade or business. Similarly, if an organization owned a race track, this would not be considered an occasional activity even though the track was operated only a few weeks every year, since it is usual to carry on such a trade or business only during a particular season.

If a trade or business is regularly carried on, it is still not subject to the Supplement U tax unless such business is unrelated within the meaning of section 422 (b). That section defines the term "unrelated trade or business" to mean, in the case of an organization subject to the Supplement U tax, 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 by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101 of the code.

For example, a wheat farm operated by an exempt agricultural college as part of its educational program would be considered a related business. Of course, income of an educational organization from charges for admissions to football games would not be deemed to be income from an unrelated business, since its athletic activities are substantially related to its educational program. Similarly, in the case of a nonprofit hospital, where some patients are charity patients and some pay their own way, the income from patients in either category is considered related income and, therefore, not taxable. However, the manufacture and sale of automobile tires by a college would ordinarily be considered an unrelated business. A trade or business which is otherwise unrelated would not become related merely because some incidental use is made of the business facilities to further the exempt purpose. For example, the tire business noted above would not become substantially related even though some students as part of their educational program performed some minor clerical or bookkeeping functions. Nevertheless, an organization exempt under section 101 (6) of the code and engaged in the rehabilitation of handicapped persons would not be subjected to the Supplement U tax on any income it derives from the sale of articles made by such persons since such business would be a necessary part of its rehabilitation program.

However, the term "unrelated trade or business" does not include any trade or business—

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) carried on by an organization exempt under section 101 (6) of the code primarily for the convenience of its members, students, patients, officers, or employees; or

(3) which consists of selling merchandise, substantially all of which has been received by the organization as gifts or contributions. This paragraph has been added to section 422 (b) as passed by the House in order to remove activities commonly known as thrift shops from the application of the tax.

An example of the operation of the first of the limitations mentioned above would be an exempt orphanage running a second-hand clothing store and selling to the general public. If substantially all the work in carrying on such trade or business is performed for the organization by volunteers without compensation, the profits of the business would not be subject to the Supplement U tax.

An example of the second limitation would be a laundry operated by a college for the purpose of laundering dormitory linens and the clothing of students. However, a laundry operated by a college apart from its campus primarily for the purpose of making a profit from laundering the clothing of the general public would be unrelated and not within the scope of this limitation.

Exceptions, additions, and limitations

(a) All dividends, interest, annuities, and royalties, and the deductions directly connected therewith, are excluded from the concept of unrelated business net income. This exception applies not only to investment income, but also to such items as business interest on overdue open accounts receivable. Your committee has added a provision to make it clear that the term "royalties", as used in this section, includes overriding royalties and that royalty payments may be measured by production or by gross or net income from the property. However, where an organization owns a working interest in a mineral property, and is not relieved of its share of the development costs by the terms of any agreement with an operator, income received from such an interest would not be excluded.

(b) In general, rents from real property (including personalty leased therewith) and the deductions directly connected therewith are also excluded. However, certain rent received from a Supplement U lease, as defined in section 423, is included as an item of gross income derived from an unrelated trade or business. The term "rents from real property" does not include income from the operation of a hotel but does include rents derived from a lease of the hotel itself. Similarly, income derived from the operation of a parking lot is not considered "rents from real property." Income received from a business of renting personal property is excluded under section 422 (a) (3) only if the personal property is leased with real property.

(c) Your committee has extended the exclusion from tax provided in the House bill for gains and losses on real property to gains or losses from the sale, exchange, or other disposition of property other than stock in trade of the organization or other property of a kind which would properly be included in the inventory of the organization if on hand at the close of the taxable year, or property held by the organization primarily for sale to customers in the ordinary course of an unrelated trade or business regularly carried on by the organization. This exclusion does not apply with respect to the cutting of timber which is considered, upon the application of section 117 (k) (1), as a sale or exchange of such timber. The term "other disposition" includes an involuntary conversion, such as theft or destruction of the property.

(d) The net operating loss deduction provided in section 23 (s) of the code is allowed as a deduction against gross income in computing the unrelated business net income. The net operating loss carry-back or carry-over is determined under section 122 of the code without, however, taking into account any income or deduction which is excluded under Supplement U in computing the unrelated business net income. For example, a loss attributable to an unrelated trade or business would not be diminished for purposes of determining the net operating loss carry-back or carry-over by reason of the receipt of substantial dividend income. For the purposes of this provision, the terms "preceding taxable year" and "preceding taxable years" as used in section 122 of the code do not include any taxable year for which the organization was not subject to the provisions of Supplement U.

(e) Your committee has extended the exclusion provided in the House bill for income received for research done for the United States, or its agencies, to exclude all income derived from work performed under a contract with the United States or any of its agencies or instrumentalities, or with any State or political subdivision thereof, and all deductions directly connected with such income are also to be excluded.

Your committee has also added a new paragraph designated (8) to section 422 (a) which excludes income, and deductions directly connected therewith, derived from research performed for any person by a college, university, or a hospital.

(f) The so-called charitable-contribution deduction allowed by sections 23 (o) and 23 (q) of the code is to be allowed against gross income in computing the unrelated business net income in the case of any trust described in section 421 (b) (2) and in the case of any other organization described in section 421 (b) (1), respectively, whether or not the contribution is directly connected with the carrying on of the trade or business. The deduction for contributions is limited to 15 percent or 5 percent, as the case may be, of the unrelated business net income computed without benefit of the charitable-contribution deduction itself, according to whether the organization's Supplement U net income is taxable at individual or corporate rates. In computing such deduction for a trust taxed at individual rates, there are to be taken into account not only voluntary gifts or contributions made by the trust to or for the use of donees, but also distributions made pursuant to the trust instrument to qualified beneficiaries described in section 23 (o) of the code.

The contribution, whether made by a trust or other exempt organization, must be paid to another organization to be allowable. For example, a section 101 (6) incorporated educational institution operating an unrelated business would be allowed a deduction up to 5 percent of its unrelated business net income for amounts of income from any source paid over to the Red Cross but would not be allowed any deduction for amounts which are used to defray its own expenses in administering its own educational program.

In the event an organization to which Supplement U applies is a member of a partnership which is regularly engaged in a trade or business which is unrelated to the functions and purposes of the organization, the organization would include in computing its unrelated business net income, so much of its share (whether or not distributed) of the partnership gross income as is derived from that unrelated business and its share of the deductions attributable thereto, and make the necessary adjustments for the exceptions, additions, and limitations which have been discussed above. For example, if an exempt educational institution is a silent partner in a partnership which runs a barrel factory and such partnership also holds stock in a pottery manufacturing corporation, the exempt organization would include in its unrelated business income its share of the barrel factory income, but not its proportionate share of any dividends received by the partnership from the pottery corporation. If the taxable year of the organization is different from that of the partnership, the amounts to be so included or deducted in computing the unrelated business net income are to be based upon the income and deductions of the partnership for any taxable year of the partnership ending within or with the taxable year of the organization.

SECTION 423. SUPPLEMENT U LEASE

Your committee's bill taxes as unrelated business net income the income which a Supplement U organization receives from the long-term lease of its real property (including personal property leased with the real property) in the same proportion that unpaid indebtedness respecting the property at the close of the lessor's taxable year bears to the adjusted basis of the property.

The bill deals only with tax consequences to be imposed on the lessor organization, and, of course, no implication is to be drawn from this limited treatment of the problem as to the tax consequences of such arrangements under existing law to the vendors and lessees of the property. That is a separate problem, not dealt with here, and the application of existing law to the vendors and lessees is not changed by the bill.

Section 423 defines the type of lease subject to the Supplement U tax, and sets forth the rules respecting the ascertainment of the part of such rents which is to be subject to the tax.

DEFINITION OF SUPPLEMENT U LEASE

Your committee has changed the definition of the term "Supplement U lease" as defined in section 423 (a), as it appeared in the House bill, so that it includes, subject to exceptions hereafter discussed, any lease for a term of more than 5 years of real property by an organization (or by a partnership of which it is a member), but only if at the close of the lessor's taxable year there is a Supplement U lease indebtedness, as defined in section 423 (b), with respect to such property.

In computing the term of the lease, the period for which a lease may be renewed or extended by reason of an option contained therein is considered as part of the term. For example, a 3-year lease with an option for renewal for another such period would be considered a lease for a term of 6 years. Another example would be a 1-year lease with option of renewal for another such term, where the parties at the end of each year renew the arrangement. Under this set of facts, during the fifth year, the lease would fall within the 5-year rule, since the lease would have involved 5 years and there would remain an option for the sixth year. Therefore, the rental receipts for the fifth year would fall within the scope of the Supplement U tax to the extent that the borrowed funds rule of section 423 (b) is applicable.

If the property is acquired subject to a lease, the term of such lease is considered to begin on the date of such acquisition. For example, if an exempt organization purchases, in whole or in part with borrowed funds, real property subject to a 10-year lease which has 3 years left to run, and such lease contains no right of renewal or extension, the lease will be treated as a 3-year lease and hence, will not meet the definition of a Supplement U lease in section 423 (a). However, if this lease contains an option to renew for a period of 3 years or more, it is a Supplement U lease.

Your committee has amended section 423 (a) as it appeared in the House bill to provide that no lease shall be considered a Supplement U lease if such lease is entered into primarily for purposes which are substantially related (aside from the need of such organization for income or funds, or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101. For example, where a hospital leases a clinic to an association of doctors, the rents derived under such lease would be excluded from the tax imposed by this section if the lease was made for purposes substantially related to the carrying on of hospital functions.

Your committee has also eliminated from the definition of a Supplement U lease, as it appeared in the House bill, a lease of premises in a building primarily designed for occupancy by the organization.

Your committee has amended section 423 (a) as it appeared in the House bill to provide that if a lease for more than 5 years to a tenant is for only a portion of the real property, and space in the real property is rented during the taxable year under a lease for less than 5 years to any other tenant of the organization, the leases of the real property for more than 5 years are to be considered as Supplement U leases during the taxable year only under one or more of the following conditions: (1) the rents derived from the real property during the taxable year under such leases represent 50 percent or more of the total rents derived during the taxable year from the real property; or the area of the premises occupied under such leases represents, at any time during the taxable year, 50 percent or more of the total area of the real property rented at such time; or (2) the rent derived from the real property during the taxable year from any tenant under such a lease, or from a group of tenants (under such leases) who are either members of an affiliated group (as defined in section 141 of the code) or are partners, represents more than 10 percent of the total rents derived during the taxable year from such property; or the area of the premises occupied by any one such tenant, or by any such group of tenants, represents at any time during the taxable year more than 10 percent of the total area of the real property rented at such time.

For example, in 1951 an educational organization begins the erection of an 11-story apartment building using funds borrowed for that purpose and immediately leases for a 10-year term the first floor to a real estate development company to sublet for stores and shops. As fast as the new apartments are completed, they are rented out on an annual basis. At the end of 1956, all except the tenth and eleventh floors are rented. Those two floors are completed during 1957 and rented out. Assume that for 1951 and each subsequent taxable year through 1956 and for the taxable year 1960, the rental for the first floor represents more than 10 percent of the total rents derived during the taxable year from the building. Under this set of facts the 10-year lease would be considered to be a Supplement U lease for all except the taxable years 1958, 1959, and 1961.

DEFINITION OF SUPPLEMENT U LEASE INDEBTEDNESS

Your committee has amended section 423 (b) to clarify the term "Supplement U lease indebtedness" as it appeared in the House bill. As now defined the term means, with respect to any real property leased for a term of more than five years, the unpaid amount of—

(1) the indebtedness incurred by the lessor in acquiring or improving such property;

(2) the indebtedness incurred prior to the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(3) the indebtedness incurred subsequent to the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of the indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Accordingly, the rules respecting Supplement U leases cover cases where the leased property itself is not mortgaged. They are intended, for example, to reach cases such as the following: A university pledges some of its investment securities with a bank for a loan which is used to purchase a building that is leased for a long term. This would be an example of a Supplement U lease indebtedness incurred prior to the acquisition of the property. If the building itself were later mortgaged to raise funds to release the pledged securities, the lease would continue to be a Supplement U lease. Likewise, if a scientific organization mortgages its laboratory to replace working capital used in remodeling another building, otherwise free of indebtedness and leased for a long term to a grocery store chain, the lease would be a Supplement U lease inasmuch as the indebtedness, incurred subsequent to the improvement of such property, would not have been incurred but for such improvement and the incurrence of the indebtedness was reasonably forseeable at the time of such improvement, since the organization knew it must have working capital to continue current operations.

Where only a portion of the real property is subject to a Supplement U lease, allocation of the indebtedness applicable to the whole property must be made to the premises covered by the lease.

Where real property is acquired subject to a mortgage or similar lien, whether the acquisition be by gift, devise, or purchase, the amount of the indebtedness secured by such mortgage or lien is considered Supplement U lease indebtedness even though the lessor does not assume or agree to pay the indebtedness. For example, a university pays $100,000 for real estate valued at $300,000 and subject to a $200,000 mortgage. For the purposes of the Supplement U tax, this purchase would be treated as if $200,000 of borrowed funds had been used to buy the property. However, your committee has added to section 423 (b) several exceptions to this rule not found in the House bill. The first provides that where real property was acquired by gift, bequest, or devise, prior to July 1, 1950, subject to a mortgage or other similar lien, the amount of such mortgage or other similar lien shall not be considered as an indebtedness of the lessor incurred in acquiring such property. The second provides that where real property was acquired by gift, bequest or devise prior to July 1, 1950, subject to a lease requiring improvements in such property upon the happening of stated contingencies, indebtedness incurred in improving such property in accordance with the terms of such lease shall not be considered as indebtedness for the purposes of this subsection. The third provides that in the case of a corporation described in section 101 (14), all of the stock of which was acquired prior to July 1, 1950, by an organization described in paragraph (1), (6), or (7) of section 101 (and more than one-third of such stock was acquired by such organization by gift or bequest), any indebtedness incurred by such corporation prior to July 1, 1950, and any indebtedness incurred by such corporation on or after such date in improving real property in accordance with the terms of a lease entered into prior to such date, will not be considered as an indebtedness for the purposes of this subsection.

The bill covers arrangements worked out by the use of a subsidiary corporation of the type exempt under section 101 (14) of the code. For example, assume a parent organization borrows funds to purchase realty and sets up a separate "section 101 (14)" corporation as a subsidiary to hold the property. Such subsidiary corporation leases the property for a period of 6 years or more, collects the rents and pays over all of the income, less expenses, to the parent which uses the rents to amortize the indebtedness. The lease by the section 101 (14) subsidiary corporation would be a Supplement U lease, and the rental income would be subject to the tax, whether the subsidiary itself assumes the indebtedness or not. Since the existing provisions of section 101 (14) already prevent subsidiary corporations exempt under that section from engaging in any active business enterprise, it may be noted that the only type of unrelated income held by such subsidiary corporations on which an income tax would be imposed is income from a Supplement U lease.

For the purposes of section 423, provision is made in subsection (c) thereof that the term "real property" and the term "premises" include personal property of the lessor leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate.

TREATMENT OF SUPPLEMENT U LEASE RENTS AND DEDUCTIONS

Under section 423 (d) (1) a formula is set out for computing the amount of the rental income with respect to a Supplement U lease which is to be included in the computation of unrelated business net income under section 422 (a). The amount of rent to be included is the same percentage (but not in excess of 100 percent) of the total rents derived during the taxable year under each such lease as (A) the Supplement U lease indebtedness, at the close of the taxable year, with respect to the premises covered by such lease, is of (B) the adjusted basis, at the close of the taxable year, of such premises.

Assume, for example, that an educational institution purchased property for $500,000, and leased it for a period of 20 years and the adjusted basis of such property at the close of the first taxable year was also $500,000. If the full $500,000 purchase price actually came from the school's own funds, the rental income from this leased property would not be treated as unrelated business income. However, if the institution borrowed either part or all of the $500,000, at least a portion of the rental income would be unrelated business income. If it had borrowed $200,000 to acquire the property, since this is two-fifths of the adjusted basis, two-fifths of the rental income received from the leased property would enter into the computation of unrelated business net income under section 422 (a) (4). If, in a subsequent year, the indebtedness were reduced to $100,000, assuming the adjusted basis were still $500,000, one-fifth of the rental income would be included as an item of gross income in computing the unrelated business net income.

Similarly, if an educational institution which owned a building site worth $20,000 borrowed $50,000 to erect a building thereon and then leased the entire property for a period of 6 years or more, five-sevenths of the rental income from the property (assuming the adjusted basis to be $70,000) would be included in computing unrelated business net income at the end of the first year.

Where only a portion of the property, with respect to which an indebtedness exists, is subject to a Supplement U lease, proper allocation to the portion of the premises covered by such lease must be made of the indebtedness related to the property. For example, assume that an exempt organization owns a four-story building having an adjusted basis of $100,000, that it spends $100,000 of borrowed funds in improving the whole building, and that the first floor is then rented under a 6-year lease at a rental of $4,000 a year. The second, third, and fourth floors are leased out on a yearly basis. Assume also, for simplicity of example, that the basis adjusted to the end of the taxable year is $200,000, allocable equally to each of the four stories. Under this set of facts, only one-fourth of the property would be covered by the Supplement U lease. The formula for computing the percentage of rents to be taken into account in the above example could be represented as follows:

The amount of the Supplement U lease income

$$= \frac{\text{(Allocable part of Supplement U lease indebtedness)}}{\text{(Adjusted basis of Supplement U leased premises)}} \times \text{Rent.}$$

The numerator in the above example $= \frac{1}{4} \times \$100,000$.

The denominator $= \frac{1}{4} \times \$200,000$.

Therefore, applying the formula to the example, the percentage of Supplement U lease income would be one-half of $4,000, or $2,000, which amount under section 423 (d) (1) is an item of gross income derived from an unrelated trade or business.

The above examples do not take into consideration adjustments to the basis due to depreciation of the premises covered by the Supplement U lease. The basis of the premises would, of course, be changed each year by adjustments for depreciation, capital additions, etc. It is therefore clear that in years in which the indebtedness applicable to the leased premises is not reduced, reduction of the basis by depreciation adjustments might result in a higher percentage of rents being included in the computation of the unrelated business net income than in the immediately prior year.

PERCENTAGE OF DEDUCTIONS TAKEN INTO ACCOUNT

Section 423 (d) (2) and (3) respectively set forth the percentage of the sum of the deductions which is to be taken into account with respect to each Supplement U lease and the deductions that are allowable in computing the sum of deductions. The percentage rule respecting the deductions is comparable to that explained above respecting the rents from Supplement U leases. The sum of the deductions is the sum of the following deductions allowable under section 23 of the code:

(A) Taxes and other expenses paid or accrued during the taxable year upon or with respect to the real property subject to the Supplement U lease.

(B) Interest paid or accrued during the taxable year on the Supplement U lease indebtedness.

(C) A reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescence) of the real property subject to such lease.

Where only a portion of the real property is subject to the Supplement U lease, there is taken into account only those amounts of the above-listed deductions which are properly allocable to the premises covered by such lease.

The percentage of the sum of the deductions allowed with respect to the Supplement U rents is taken into account in computing the unrelated business net income under proposed section 422 (a). Under section 422 (a), additional deductions, namely, for net operating losses, and charitable contributions, are then applied. Conceivably, the net operating loss and the charitable contribution deductions allowed under section 422 (a) could offset gross income from a Supplement U lease. On the other hand, a loss with respect to a Supplement U lease might itself produce a net operating loss under the provisions of section 422 (a) relating to determination of unrelated business net income.

ACCUMULATED INVESTMENT INCOME

Your committee has eliminated those provisions of the House bill which would have added sections 421 (c) (2), 424, and 425 to the Internal Revenue Code, which would have subjected to the Supplement U tax certain accumulated investment income of trusts and certain other organizations exempt under section 101 (6) of the code.

SECTION 424. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES

Section 424, which corresponds to section 426 as it appeared in the House bill, is a technical provision to provide necessary rules for the application of the foreign-tax credit (under section 131 of the code) in the case of any domestic organization doing business in a foreign country or possession of the United States and which is subject to the Supplement U tax. The section provides that the amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States is to be allowed as a credit against the Supplement U tax to the extent provided in section 131 of the code. The section further provides that the term "normal-tax net income" and the term "net income" as used in section 131 of the code is to be read as "Supplement U net income" in the case of organizations coming within the scope of the Supplement U tax.

SECTION 301 (b). FEEDER ORGANIZATIONS

Subsection (b) of section 301 of the bill adds a paragraph at the end of section 101 of the code to provide that an organization (which term includes a trust) operated for the primary purpose of carrying on a trade or business for profit is not to be exempt under any paragraph of section 101 of the code on the ground that all of its profits are payable to one or more organizations exempt from taxation under that section. It is also provided that for the purposes of this paragraph the term "trade or business" does not include the rental by an organization of its real property (including personal property leased therewith).

The determination of the tax treatment of such feeder organizations for taxable years beginning prior to January 1, 1951, is to be made as if this subsection of the bill had not been enacted and without inference drawn from the fact that the amendment made by this subsection of the bill is not expressly made applicable to such taxable years. In the area covered by this amendment there has been litigation as to the application of such a rule under existing law (cf. *Roche's Beach, Inc.* v. *Commissioner* (C. C. A. 2, 1938), 96 F. (2d) 776; *Universal Oil Products Co.* v. *Campbell* (C. A. 7, 1950), 181 F. (2d) 451; *Willingham* v. *Home Oil Mill* (C. A. 5, 1950), 181 F. (2d) 9; *C. F. Mueller Co.*, 14 T. C. No. 111½ (May 25, 1950)). The amendment is intended to show clearly what, from its effective date, the rule is to be, without disturbing the determination in present litigation of the rule of existing law.

It is not intended that this paragraph have any effect on cooperatives formed by other cooperatives under section 101 (12) of the code, on section 101 (13) of the code (dealing with certain other corporations organized by associations exempt under sec. 101 (12) of the code, or by members of such associations), or on section 101 (14) of the code (dealing with certain corporations organized to hold property and pay the net income therefrom to an organization except under sec. 101 of the code).

The paragraph applies to organizations operated for the primary purpose of carrying on a trade or business for profit, as for example, a feeder corporation whose business is the manufacture of automobiles for the ultimate profit of an educational institution.

This amendment to section 101 will automatically be applicable for the purposes of those provisions of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act which refer to section 101 or a particular paragraph thereof.

SECTION 301 (c). TECHNICAL AMENDMENTS

Subsection (c) of section 301 of the bill, corresponding to subsection (d) of section 301 of the House bill, contains a number of technical amendments. Paragraph (1) thereof amends section 101 of the Internal Revenue Code to provide that the organizations described therein are exempt except to the extent provided in Supplement U, and that notwithstanding the fact that such organizations are subject to tax under Supplement U, they are still to be considered as exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

Paragraphs (2) and (3) amend section 117 (c) of the code to provide for the application to an organization subject to the Supplement U tax the alternative tax rates set out in that section in any taxable year in which the net long-term capital gain of such organization exceeds its net short-term capital loss. This provision can apply only in the case of an organization carrying on an unrelated trade or business and which has a profit, treated as a capital gain, from the sale of property such as timber held by the organization primarily for sale to customers in the ordinary course of an unrelated trade or business regularly carried on by the organization. It has no application to capital gains derived from sales of stocks, bonds, and the like, since such capital gains will not be included in computing Supplement U net income.

Paragraph (4) amends section 143 of the code (relating to withholding tax at source on payments to nonresident aliens, etc.) by adding at the end of that section a new subsection to be designated subsection (h) and entitled "Withholding on Certain Foreign Tax-Exempt Organizations." This subsection is designed to apply to foreign organizations which have income from United States sources subject to the Supplement U tax, the income-tax withholding provisions of section 143 of the code (nonresident aliens), and section 144 of the code (foreign corporations). The withholding provisions of sections 143 and 144 of the code will be applied to rents includible under section 422 in computing the unrelated business net income of foreign organizations, but only to the extent and subject to such conditions as may be provided in regulations.

Paragraphs (5) and (6) respectively amend Supplement H of the code (dealing with the taxation of nonresident alien individuals) and Supplement I of the code (dealing with the taxation of foreign corporations) to provide a cross reference to the special provisions relating to foreign educational, charitable, and certain other exempt organizations subject to Supplement U and included in section 421 (d).

SECTION 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS

Section 302 of the bill, for which there is no corresponding provision in the House bill, deals with possible tax liability for years beginning prior to 1951 of certain organizations which for such years were considered exempt from income tax under section 101 of the Internal Revenue Code; the deductibility of contributions to those of such organizations as were considered exempt under section 101 (6) is also dealt with.

In view of the character of litigation which has developed with respect to certain organizations claiming the benefits of section 101 (6), your committee considered it advisable to prescribe certain rules respecting possible assertion of tax liability for past years against certain organizations which might be affected by the ultimate outcome of pending litigation (cf. *Roche's Beach, Inc.*, v. *Commissioner* (C. C. A. 2, 1938), 96 F. (2d) 776; *Universal Oil Products Co.* v. *Campbell* (C. A. 7, 1950), 181 F. (2d) 451; *Willingham* v. *Home Oil Mill* (C. A. 5, 1950), 181 F. (2d) 9; *C. F. Mueller Co.*, 14 T. C. No. 111½ (May 25, 1950)). It will be noted that the provisions in section 302 of the bill deal only with the tax-exempt status of organizations for taxable years beginning prior to January 1, 1951, and have no applica tion to taxable years beginning after December 31, 1950, for any organization. Also, section 302 applies only where a denial of exemption might be made on the ground that the organization was carrying on a trade or business for profit, and nothing therein limits the denial of exemption for failure to meet other requirements of section 101.

TRADE OR BUSINESS NOT UNRELATED

Section 302 (a), as added by your committee, provides that for any taxable year beginning prior to January 1, 1951, no organization shall be denied exemption under paragraph (1), (6), or (7) of section 101 of the Internal Revenue Code on the ground that it is carrying on trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U, as amended by this bill, or if such trade or business would not be included within the meaning of the term "trade or business" as used in section 101 of the code, as amended by the bill. This is to assure that no more strict rule will be applied for such years than will be applied in the future under the bill.

TRADE OR BUSINESS INCOME AND EXEMPTION PREVIOUSLY GRANTED

Section 302 (b), as added by your committee, provides that for any taxable year beginning prior to January 1, 1951, no organization which has been advised by the Bureau of Internal Revenue in a letter to such organization that such organization was exempt from taxation under section 101 of the code shall be denied exemption from income tax under such section on the ground that it is carrying on a trade or business for profit, unless, prior to such date the Bureau of Internal Revenue has, in a letter to such organization, informed such organization that its exemption under such section was withdrawn or requested further information from such organization relative to its exempt status. In no event shall exemption be so denied for any such taxable year prior to the taxable year in which such letter requesting information was mailed to such organization, or, if no letter so requesting information was mailed, prior to the taxable year in which such letter, informing the organization that its exemption was withdrawn, was mailed.

EXEMPTION NOT PREVIOUSLY GRANTED, QUESTIONED OR DENIED

Section 302 (c), as added by your committee, provides that an organization whose exemption under section 101 of the code has not been approved, questioned, or denied by the Bureau of Internal Revenue prior to the date of enactment of this act in a letter to such organization shall not be denied exemption for any period prior to January 1, 1947, on the ground that it is carrying on a trade or business for profit. In the case of such an organization, the filing of an information return required by section 54 (f) of the code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the filing of a return for the purposes of section 275 of the code (relating to period of limitation upon assessment and collection) with respect to taxable years beginning prior to January 1, 1951. In the case of such an organization which was, by the provisions of section 54 (f) of the code, specifically not required to file such information return, a return shall be deemed to have been filed, for the purposes of the preceding sentence, at the time when such return should have been filed had it been required for taxable years beginning prior to January 1, 1951.

DENIAL OF DEDUCTIONS

Section 302 (d), as added by your committee, provides that a gift or bequest for religious, charitable, etc., purposes to an organization carrying on a trade or business for profit, otherwise allowable as a deduction under the appropriate income, estate, or gift tax provisions may not be denied under such deduction provisions for any taxable year beginning prior to January 1, 1951, if a denial of exemption to the recipient organization for the time in which such contribution was made is prevented by the provisions of subsection (a), (b), or (c) of this section.

SECTION 303. EFFECTIVE DATE OF PART I

Section 303 of the bill provides that the amendments made by part I of title III of the bill (the Supplement U tax rules so far discussed) are to be applicable only with respect to taxable years beginning after December 31, 1950.

PART II—CHARITABLE, ETC., DEDUCTIONS OF TRUSTS NOT EXEMPT FROM TAXATION

SECTION 321. CHARITABLE, ETC., DEDUCTIONS OF TRUSTS

Section 321 of your committee's bill corresponds to section 321 of the House bill, which section has been rewritten by your committee to eliminate those provisions of the House bill which would have denied a deduction under section 162 (a) of the code with respect to income of any taxable year beginning after December 31, 1950, which was accumulated, and also the privilege of election which would have been granted trustees by the House bill to deduct under section 162 (a) distributions made after the close of the taxable year.

Subsection (a) of section 321 of your committee's bill adds to section 162 of Supplement E of the Internal Revenue Code a new subsection designated (g), designed to bring the treatment of the charitable, etc., deductions allowed trusts taxable under Supplement E in line generally with the treatment provided trusts, and other organizations exempt under section 101 (6) of the code. Paragraph (1) of section 162 (g) provides that in computing the deduction allowable under subsection (a) of section 162 of the code to a trust for any taxable year beginning after December 31, 1950, no amount otherwise allowable under subsection (a) of section 162 as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its Supplement U business income for such year. As used here, the term "Supplement U business income" means an amount equal to the amount which, if such trust were exempt under section 101 (6) of the code from taxation, would be computed as its unrelated business net income under section 422 (relating to income derived from certain business activities and from certain leases).

Section 422 (b) provides that in the case of a Supplement E trust computing its net taxable income under Supplement U, the term "unrelated trade or business" includes any trade or business regularly carried on by such a trust, or by a partnership of which it is a member. The Supplement U business income of such a trust would in effect be its net income derived from any regularly carried on business activity (including the percentage of rents taken into account under a Supplement U lease).

OPERATION OF TRUSTS

Paragraph (2) of section 162 (g) contains provisions designed to limit the amount otherwise deductible by a trust under section 162 (a) of the Internal Revenue Code where the trust is so operated that certain defined classes of persons receive special benefit. Also, provision is made denying charitable, etc., deductions to donors for gifts or bequests made in trust for charitable, etc., purposes where the recipient trust has engaged in a transaction which diverts either income or corpus from the charitable, etc., purposes for which it had been set aside to the special benefit of a donor or creator of such trust. There are similar provisions, applicable to organizations exempt under section 101 (6) of the code, in part III of title III of your committee's bill. A more detailed analysis of these provisions will be found in that part of your committee's report which discusses part III of title III of the bill.

LIMITATION ON CHARITABLE, ETC., DEDUCTIONS

Subparagraph (A) of paragraph (2) of section 162 (g), which is similar to paragraph (4) of section 162 (g) as it appeared in the House bill, limits the amount otherwise deductible under section 162 (a) of the code to 15 percent of its net income in the case of a trust which has engaged in any prohibited transaction as defined in subparagraph (B) of paragraph (2) of section 162 (g).

PROHIBITED TRANSACTIONS

Subparagraph (B) of paragraph (2) of section 162 (g) lists the types of transactions which are deemed prohibited for purposes of this paragraph. Included, are loans, purchases, payments, sales and certain other acts, which result in diversion of trust income or corpus (which has been permanently set aside or is to be used exclusively for charitable or other purposes described in sec. 162 (a) of the code), directly or indirectly, to the creator of such trust, or any person who has made a substantial contribution to such trust.

The list of specific categories of transactions which are prohibited is similar to that contained in the comparable House provision except that your committee has limited the categories to transactions which are not at arm's length. For example, the House bill would have prohibited any transaction whereby any part of the income or corpus of such trust was loaned to a certain defined class of persons. Under your committee's bill the only lending which is considered a prohibited act is the lending of income or corpus which has been permanently set aside or is to be used for charitable, etc., purposes, and then only where such income or corpus is lent without the receipt of adequate security and a reasonable rate of interest, since only this type of loan is not at arm's length. Your committee has added to the list of prohibited transactions as it appeared in the House bill a general category comprising any transaction which results in a substantial diversion of such income or corpus to the special class of persons.

TAXABLE YEARS AFFECTED

Subparagraph (C) of paragraph (2) of section 162 (g) provides that the limitation on deduction privileges under section 162 (a) of the code because of engaging in a prohibited act as defined above applies for taxable years subsequent to the taxable year in which the trust is notified that it has engaged in a prohibited transaction. However, such deduction privilege may be so limited with respect to any taxable year if such trust entered into such prohibited transaction with the purpose of diverting such corpus or income from its charitable etc., purpose and such transaction involved a substantial part of such income or corpus.

Subparagraph (D) of paragraph (2) of section 162 (g) provides rules for the recovery of the allowance of the unlimited charitable deduction privilege accorded trusts under section 162 (a) of the code. In any taxable year subsequent to the taxable year in which notice of the limitation of deduction by reason of section 162 (g) (2) has been received, the trust may, under regulations, file claim for restoration of its privilege of unlimited deduction under section 162 (a). This claim is to be granted if the Secretary is satisfied that such trust will not knowingly again engage in a prohibited transaction. The period of renewed unlimited deduction under section 162 (a) of the code begins with the taxable year subsequent to the taxable year in which such claim was filed.

DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS

Subparagraph (E) of paragraph (2) of section 162 (g) provides that no gift or bequest (defined in subsection (f) to include any gift, contribution, bequest, devise, legacy, or transfer) for religious, charitable, etc., purposes otherwise allowable as a charitable, etc., deduction under the appropriate income, estate, and gift tax provisions of the Internal Revenue Code, is to be allowed if made in trust, and, such trust at the time the gift or bequest is made has been disallowed the unlimited deduction privilege under section 162 (a) by operation of the provisions of this paragraph.

However, where the deduction privilege of the trust has been limited by reason of its having engaged in a prohibited transaction with the purpose of diverting corpus or income from its charitable, etc., purpose and such transaction involved a substantial part of such income or corpus, the deductions of the donor are to be disallowed for gifts or bequests made prior to or during the taxable year of the trust during which the prohibited transaction occurred, if the donor or (if an individual) any member of his family (defined to include only brothers and sisters whether by whole or half-blood, spouse, ancestors and lineal descendants) was a party to such prohibited transaction.

SECTION 321 (b). TECHNICAL AMENDMENTS

Subsection (b) of section 321 of the bill is the same as paragraph (1) of section 321 (b) of the House bill. It provides that the deductions under section 162 (a) of the code are to be subject to the provisions of subsection (g).

Your committee's bill omits the technical amendment provided in paragraph (2) of section 321 (b) of the House bill, which amendment provided that supplement E was not to apply in the case of any trust which is exempt (except as provided in supplement U) from taxation by reason of section 101 (6) of the code. If present law achieves such a result, the provision of the House bill is unnecessary; if present law does not achieve such result, your committee does not desire to change the law at this time.

SECTION 322. EFFECTIVE DATE OF PART II

Section 322 of the bill provides that the amendments made by part II of title III of the bill are to be applicable only with respect to taxable years beginning after December 31, 1950, except that subparagraph (E) of paragraph (2) of section 162 (g), added by section 321 (a) of the bill, shall apply only with respect to gifts or bequests made on or after January 1, 1951.

PART III—LOSS OF EXEMPTION UNDER SECTION 101 (6) AND DISALLOWANCE OF CERTAIN GIFTS AND BEQUESTS

Part III of title III of your committee's bill is a combination of section 301 (c) and part III of title III of the House bill.

Section 301 (c) of the House bill set up specific standards under which an organization exempt under section 101 (6) must operate in order to retain its exempt status. Part III of title III of the House bill provided that these standards of operation must be set forth in the instrument under which the trust or other organization was operated in order for contributions to such organization to be deductible. The principal change made by your committee is that the denial of charitable deductions is made contingent upon whether the recipient organization has engaged in some prohibited act for which it is denied tax exempt status, and the provisions of the House bill which required the charter of the recipient organization to prevent it from engaging in such prohibited acts have been stricken from the bill by your committee.

SECTION 331. EXEMPTION OF CERTAIN ORGANIZATIONS UNDER SECTION 101 (6) AND DEDUCTIBILITY OF CONTRIBUTIONS MADE TO SUCH ORGANIZATIONS

Section 331 of your committee's bill amends chapter 38 of the Internal Revenue Code, adding a new section to be numbered section 3813, entitled "Requirements for Exemption of Certain Organizations Under Section 101 (6) and for Deductibility of Contributions Made to Such Organizations."

ORGANIZATIONS TO WHICH SECTION APPLIES

Subsection (a) of section 3813 lists the organizations to which that section applies. It applies to any organization described in section 101 (6) with certain exceptions. In general, those excepted are religious organizations (other than trusts) and organizations operated, supervised, controlled, or principally supported by such religious organizations, certain educational organizations, certain medical organizations, and certain organizations supported by the general public or the Government. These excepted categories of organizations are in general the same as those excepted in the comparable section of the House bill except that the category of publicly supported organizations has been broadened to make clear that an organization which normally receives a substantial part of its support (exclusive of income received in exercise or performance of its exempt function) indirectly from the general public through such organizations as the Community Chest is excepted from the provisions of this section. Also, your committee has added an express exception for an organization, the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research.

PROHIBITED TRANSACTIONS

Subsection (b) of section 3813 lists the types of transactions which are deemed prohibited for the purposes of this section. Included, are loans, purchases, payments, sales and certain other acts, which result in the diversion of income or corpus of the organization, directly or indirectly, to any person who has made a substantial contribution to such organization. The list of specific categories of transactions which are prohibited is similar to that contained in the comparable House provision except that your committee has limited the categories to transactions which are not at arm's length. For example, the House bill would have prohibited any transaction whereby any part of the income or corpus of such an organization was loaned to a certain defined class of persons. Under your committee's bill the only lending which is prohibited is the lending of income or corpus without the receipt of adequate security and a reasonable rate of interest, since only this type of loan is not at arm's length. Your committee has added to the list of prohibited transactions as it appeared in the House bill a general category comprised of any transaction which results in a substantial diversion of income or corpus to a certain defined class of persons.

DENIAL OF EXEMPTION TO ORGANIZATIONS ENGAGING IN PROHIBITED TRANSACTIONS

Subsection (c) of section 3813 provides that any organization described in section 101 (6) of the Internal Revenue Code (except an organization excepted by subsec. (a) of sec. 3813) which has engaged in any prohibited transaction (as described in subsec. (b) of sec. 3813) shall not be exempt from taxation under section 101 (6) for any taxable year subsequent to the taxable year in which it is notified by the proper administrative authority that it has engaged in such prohibited transaction. However, exemption may be denied with respect to any taxable year if such organization entered into such prohibited transaction with the purpose of diverting income or corpus from its exempt purpose and such transaction involved a substantial part of the income or corpus of such organization.

For example, A creates a foundation in 1955 ostensibly for educational purposes. B, as trustee, accumulates the income until 1960 when he uses this accumulated income to send A's children to college, the real purpose of the foundation from its inception. Such foundation may lose its exemption for all years since its inception, that is, for taxable years 1955 through 1960 and future taxable years.

The above amendment is intended to deny tax-exempt status under section 101 (6) to organizations which are manipulated to the private advantage of any substantial donors of such organizations. The fact that the above specific standards are made applicable to certain section 101 (6) organizations does not imply that similar criteria may not be used in determining whether other section 101 (6) organizations are operated exclusively for exempt purposes.

FUTURE STATUS OF ORGANIZATION DENIED EXEMPTION

Subsection (d) of section 3813 provides rules for the recovery of tax-exempt status by an organization denied exemption under section 101 (6) of the code by reason of the provisions of section 3813. Such an organization may file claim for exemption, under regulations, in any taxable year following the taxable year in which notice of denial of exemption was received. This claim for exemption is to be granted if the Secretary is satisfied that such organization will not knowingly again engage in a prohibited transaction. The period of new exemption begins with the taxable year subsequent to the year in which such claim is filed.

For example, a foundation engages in a prohibited act in its taxable year 1960 without the purpose of diverting income or corpus from its exempt purpose. It is notified in its taxable year 1961 that it has engaged in such transaction. It therefore loses its tax exemption for its taxable year 1962. However, it files claim for exemption in its taxable year 1962, and the Secretary acts favorably on this claim. Under this set of circumstances, such organization will be exempt for its taxable year 1963 and for subsequent taxable years.

DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS

Subsection (e) of section 3813 provides that no gift or bequest (defined in subsection (f) to include any gift, contribution, bequest, devise, legacy, or transfer) for religious, charitable, etc., purposes otherwise allowable as a charitable, etc., deduction under the appropriate income, estate, and gift tax deduction provisions of the Internal Revenue Code, is to be allowed if made to an organization which at the time the gift or bequest is made is not exempt under section 101 (6) of the code by reason of the provisions of section 3813.

However, where the recipient organization is not exempt because it has engaged in a prohibited transaction with the purpose of diverting income or corpus from its exempt purpose and such transaction involved a substantial part of its income or corpus, the deductions of the donor are to be disallowed for gifts or bequests made prior to or during the taxable year of the organization during which the prohibited transaction occurred, if the donor or (if an individual) any member of his family (defined to include only brothers and sisters whether by whole or half blood, spouse, ancestors, and lineal descendants) was a party to such prohibited transaction.

For example, corporation A in 1954 creates a foundation purportedly for charitable purposes and takes a charitable deduction therefor, reporting on a calendar-year basis. In 1955 corporation A makes a subsequent gift to this foundation and takes a charitable deduction; likewise, in 1956 and 1957 corporation B makes similar contributions and takes similar deductions. Assume that in the year 1955 the foundation had purposely diverted a large part of its corpus to the benefit of corporation A. and had received notice to that effect in 1956. Under this set of facts, both corporation A and corporation B would lose a charitable deduction for the year 1957. Moreover, the charitable deductions that corporation A took for the years 1954, 1955, and 1956 might also be disallowed since corporation A was a party to this prohibited transaction.

SECTION 332. TECHNICAL AMENDMENTS

Section 332 of the bill amends sections 23 (o) (2), 23 (q) (2), 162 (a), 505 (a) (2), 812 (d), 861 (a) (3), 1004 (a) (2) (B), and 1004 (b) of the Internal Revenue Code to provide a cross reference to sections 3813 and 162 (g) (2) for disallowance of certain charitable, etc., deductions otherwise allowable, and amends section 101 (6) of the code for cross reference to section 3813 for loss of exemption under certain circumstances.

SECTION 333. EFFECTIVE DATES OF PART III

Section 333 of the bill provides that the amendments made by subsections (c) and (d) of section 3813, added by section 331 of this bill, shall apply with respect to taxable years beginning after December 31, 1950, and that subsection (e) of section 3813 shall apply with respect to gifts or bequests made on or after January 1, 1951.

PART IV—INFORMATION TO BE MADE AVAILABLE TO THE PUBLIC

SECTION 341. INFORMATION WITH RESPECT TO CERTAIN CHARITABLE, ETC., EXEMPTIONS AND DEDUCTIONS

Section 341 of your committee's bill amends Supplement D of chapter 1 of the Internal Revenue Code to add a new section designated section 153, entitled "Information Required From Certain Tax-Exempt Organizations and Certain Trusts." There is no comparable provision in the House bill.

This new section requires that any organization exempt under section 101 (6) of the code and subject to the requirements of section 54 (f) of the code furnish the following information annually at such time and in such manner as the regulations may prescribe:

(1) its gross income for the year,
(2) its expenses attributable to such income and incurred within the year,
(3) its disbursements out of income within the year for the purposes for which it is exempt,
(4) its accumulation of income within the year,
(5) its aggregate accumulations of income at the beginning of the year,
(6) its disbursements out of principal in the current and prior years for the purposes for which it is exempt, and
(7) a balance sheet showing its assets, liabilities and net worth as of the beginning of such year.

Trusts claiming charitable, etc., deductions under section 162 (a) of the code shall be required to file the following information annually at such time and in such manner as the regulations may prescribe:

(1) the amount of the charitable deduction taken under section 162 (a) within such year (showing separately the amount of such deduction which was paid out and which was permanently set aside for charitable etc., purposes during such year),
(2) the amount paid out within such year which represents amounts for which charitable etc., deductions have been taken in prior years,
(3) the amount for which charitable etc., deductions have been taken in prior years but which has not been paid out at the beginning of such year,
(4) the amount paid out of principal in the current and prior years for charitable etc., purposes,
(5) the total income of the trust within such year and the expenses attributable thereto, and
(6) a balance sheet showing the assets, liabilities and net worth of the trust as of the beginning of such year.

It is left to administrative discretion as to whether this new information is to be returned on a separate form prescribed for this purpose or on an information return form now in use, revised to include the new information. The degree of detail and particularity which may be called for in reporting the required information will be determined by regulations. The names and addresses and other information required of these trusts and other organizations are to be made available to the general public, in such manner as the Secretary may prescribe. Any trust or other organization which is required to furnish this information and willfully fails to do so is subject to the penalties provided in section 145 (a) of the code. The amendments made by this section are effective for taxable years beginning after December 31, 1949.

TITLE IV. INCOME TAXES OF LIFE INSURANCE COMPANIES FOR 1949 AND 1950

This title of the bill revises the present statutory formula used in determining the income tax of life insurance companies. The revision is similar to that provided for by House Joint Resolution 371. Under that resolution, as passed by the House on January 26, 1950, the revised formula would apply to the taxable years 1947, 1948, and 1949.

Title IV of this bill as passed by the House adopted the provisions of that resolution and extended the application of the revised formula to the year 1950. Under House Joint Resolution 371 as amended and passed by the Senate, on April 13, 1950, the revised formula would apply only to the taxable years 1949 and 1950.

SECTION 401. CORRECTION OF FORMULA USED IN COMPUTING INCOME TAXES OF LIFE INSURANCE COMPANIES FOR 1949 AND 1950

This section, as reported by your committee, would adopt the provisions of House Joint Resolution 371 as passed by the Senate. The operation and effect of the amendments made by this section are explained in detail in Senate Report No. 1434, Eighty-first Congress, second session, accompanying House Joint Resolution 371, which reads, in part, as follows:

PART II.—DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE JOINT RESOLUTION

Under existing law, income taxes (normal and surtax) are imposed on life-insurance companies at the rates provided for corporations generally. The taxes are imposed, however, only with respect to adjusted normal-tax net income (as defined in sec. 202 of the Internal Revenue Code) and adjusted corporation surtax net income (as defined in sec. 203). In the determination of the adjusted normal-tax net income and the adjusted corporation surtax net income of a life-insurance company, the company is allowed a credit which is, in both cases, called the "reserve and other policy liability credit." These credits are arrived at by multiplying the normal-tax income of the company for the taxable year, or its corporation surtax net income, as the case may be, by a figure which is determined and proclaimed for each taxable year by the Secretary of the Treasury. Existing law (sec. 202 (b) of the code) provides that the figure so determined and proclaimed shall be based on such data, for the preceding taxable year, with respect to life-insurance companies as the Secretary considers representative, and that the figure shall be computed in accordance with a formula based upon the ratio which the aggregate of three specified types of items for such companies bears to the aggregate of the net incomes (computed with certain adjustments) of such companies.

Subsection (a) of the first section of the joint resolution, as reported, amends the second sentence of section 202 (b) of the Internal Revenue Code. Although this amendment leaves unchanged the formula to be used in arriving at the income taxes payable by life-insurance companies for taxable years other than taxable years beginning in 1949, and 1950, it does make two changes is such formula for taxable years beginning in 1949 and 1950. Both changes result in a smaller numerator, in the computation of the ratio referred to in the preceding paragraph, than is obtained under existing law. Neither change affects the amount of the denominator of such ratio. Under existing law, one of the three items which make up the numerator of the ratio is the product of (i) the mean of the adjusted reserves at the beginning and end of the taxable year and (ii) the reserve earnings rate (defined in sec. 201 (c) (4) of the code). The first change made by the amendment is to provide that in computing such product there shall be used, in lieu of the reserve earnings rate, the average rate of interest assumed in computing life-insurance reserves. Such average rate shall be determined in the manner provided in the second sentence of section 201 (c) (4) of the code.

The second change provides that if the Secretary of the Treasury, in computing the ratio, finds that the net effect of including the data with respect to any life insurance company is to increase the numerator more than such data increases the denominator, he shall limit the net change in the numerator resulting from the inclusion of such data to the net change in the denominator resulting therefrom.

The following will illustrate the application of the second change made by the amendment. The Secretary of the Treasury, having selected the data of life-insurance company X as representative, finds that the net income (adjusted as required by sec. 202 (b)) of company X for the taxable year 1948 was $100,000.

This $100,000 will be used by the Secretary in making up the denominator of the ratio which will determine the figure to be used for the taxable year 1949. The Secretary further finds from the data of company X for the year 1946 that the sum of (A) 2 percent of its reserves for deferred dividends, (B) interest paid by it, and (C) the product of (i) the mean of its adjusted reserves at the beginning and end of the taxable year 1948 and (ii) the average rate of interest assumed in 1948 by company X in computing its life-insurance reserves, was $105,000. Were it not for the second change made by the amendment, the Secretary would add $105,000 to the numerator of the ratio, thereby increasing the numerator $5,000 more than the inclusion of the data of such company increased the denominator of the ratio. Under the amendment, only $100,000 would be added to the numerator of the ratio.

In the case of a few life insurance companies the Secretary of the Treasury may find that the net effect of including data with respect to such companies is a subtraction from the denominator of the ratio. In the treatment of the data of such a company, the effect of the second change made by the amendment would be to require the Secretary, in lieu of making an addition to the numerator of the ratio, to subtract from the numerator an amount equal to the amount subtracted from the denominator by reason of the inclusion of such data.

Subsection (b) of the first section of the joint resolution amends section 203 (b) of the code to make it clear that the figure to be used in computing the reserve and other policy liability credit under section 203 (b) (for the purposes of the surtax) for any taxable year beginning in 1949 or 1950, is the same figure which the Secretary of the Treasury shall determine and proclaim for such year under section 202 (b) of the code as amended by subsection (a) of the first section of the joint resolution.

Subsection (c) of the first section of the joint resolution provides that the amendments made by the joint resolution shall be applicable to taxable years beginning after December 31, 1948. However, as noted above, the amendments do not effect a change in the formula to be used in computing the income taxes of life-insurance companies for taxable years beginning after 1950, since the legislation is proposed merely as a stopgap measure pending the development and enactment of a satisfactory long-range basis for the taxation of life-insurance companies. Subsection (c) also provides that the Secretary of the Treasury shall, within 60 days after the date of the enactment of the joint resolution, determine and proclaim the figures to be used by life-insurance companies in computing their reserve and other policy liability credits for taxable years beginning in 1949. * * *.

SECTION 402. FILING OF RETURNS FOR TAXABLE YEAR 1949

This section, as reported by your committee, is the same as section 402 of the House bill, except that the section has been restricted to the filing of returns for taxable years beginning in 1949. The section provides for the filing of returns and the payment of taxes by life-insurance companies with respect to taxable years beginning in 1949.

Under these provisions, every life-insurance company subject to the taxes imposed by section 201 of the code is required to file a return for 1949, even though under existing law it may have filed a return for such year. The return required under these provisions for such year may not be filed before the Secretary has proclaimed (after the enactment of this Act) the figure to be used in computing the reserve and other policy liability credits for such year and must be filed on or before the 15th day of the third month following the close of the month in which this Act is enacted. Any such return shall constitute the return for the taxable year for all purposes of the code, must meet the requirements of section 52 (a), and shall be filed as required by section 53 (b) (2) and other relevant provisions of the code. Thus, such a return shall constitute the return for the purposes of Supplement L, relating to the assessment and collection of deficiencies; Supplement M, relating to interest and additions to the tax; and Supplement O, relating to overpayments. No return with respect to the taxes imposed by section 201 of the code for a taxable year beginning in 1949, which is filed by a life-insurance company on or before the date of the Secretary's proclamation required under section 401 (a), shall be considered for any of such purposes, or for any other purpose, of the code as the return for such year.

The provisions of section 56 (a) of the code (relating to the time of payment) will not be applicable to the payment of taxes for the taxable year 1949. Instead, such taxes shall be due and payable on the 15th day of the third month following the close of the month in which this Act is enacted. The provisions of section 56 (b) of the code (relating to installment payments) are, however, not affected, and a life insurance company may, at its election, pay the taxes due for such year in four equal installments in accordance with the provisions of that section.

Section 402 further provides that all payments, if any, made with respect to the taxes for 1949 imposed by section 201 of the code under the law in effect prior to the enactment of this Act, to the extent that they have not been credited or refunded, shall be deemed to be payments made at the time of the filing of the return required by this Act on account of the taxes for such year. The amount which will be so credited will include, in addition to the tax itself, any amounts paid as interest, penalty, or additions to the tax.

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 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.

TITLE V—ESTATE TAX

SECTION 501. TRANSFERS IN CONTEMPLATION OF DEATH

This section of the bill, which is identical with section 501 of the bill as passed by the House, amends section 811 of the code, relating to the gross estate, by adding a new subsection, designated (l), to change in two respects the rules with respect to transfers in contemplation of death.

First, the new subsection (l) provides that (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) the transfer of an interest in property, the relinquishment of a power described in section 811 (d), or the exercise or release of a power of appointment, as defined in section 811 (f), effected by a decedent within 3 years prior to his death shall, unless shown to the contrary, be deemed to have been made in contemplation of death. This 3-year rebuttable presumption replaces the similar 2-year presumption heretofore provided by the last sentence of section 811 (c) (1) (A) and paragraph (4) of section 811 (d).

Second, the new subsection (l) provides that no such transfer, relinquishment, exercise, or release made more than 3 years prior to the decedent's death shall be deemed or held to have been made in contemplation of death.

The amendments made by this section are applicable only with respect to estates of decedents dying after the date of enactment of the bill.

SECTION 502. REPEAL OF DEDUCTION FOR SUPPORT OF DEPENDENTS

This section of the bill, which is identical with section 502 of the bill as passed by the House, amends section 812 (b) of the code (relating to deductions from gross estate of a decedent) to eliminate, effective with respect to estates of decedents dying after the date of enactment of the bill, the deduction for amounts expended for the support, during the settlement of the estate, of dependents of the decedent.

Under existing law amounts expended in accordance with the local law for support of the surviving spouse of the decedent are, by reason of their deductibility under section 812 (b), not allowable as a marital deduction under section 812 (e) of the code. However, as a result of the amendment made by this section, such amounts heretofore deductible under section 812 (b) will be allowable as a marital deduction subject to the conditions and limitations of section 812 (e).

SECTION 503. REVERSIONARY INTERESTS IN CASE OF LIFE INSURANCE

This section, which was not in the bill as passed by the House, amends section 404 (c) of the Revenue Act of 1942 to change the rules governing the inclusion in the gross estate of a decedent for estate tax purposes of proceeds of life-insurance policies purchased by him upon his own life and receivable by persons other than his executor.

The present formula for determining the extent to which proceeds of a life-insurance policy receivable by persons other than the insured's executor are includible in the gross estate of the insured by reason of the payment of premiums or other consideration directly or indirectly by him is as follows: Such proceeds are includible in the proportion that the amount of premiums or other consideration paid directly or indirectly by the insured bears to the total premiums paid (sec. 811 (g) (2) (A) of the Internal Revenue Code); however, if the insured possessed no incident of ownership in the policy at any time after January 10, 1941, then the proceeds are includible (under sec. 811 (g) (2) (A) only in the proportion that the amount of premiums or other consideration paid directly or indirectly by the insured after that date bears to the total premiums paid (sec. 404 (c) of the Revenue Act of 1942). A reversionary interest is regarded as an incident of ownership for this purpose.

Section 503 of the bill modifies this formula by redefining the term "incident of ownership" to include a reversionary interest only if such reversionary interest (1) at some time after January 10, 1941, exceeded in value 5 percent of the value of the policy and (2) arose by the express terms of the policy or other instrument and not by operation of law.

The following example illustrates the application of this amendment: The decedent, prior to January 10, 1941, assigned a $100,000 policy of insurance upon his life to a trust providing that at his death the proceeds should be collected and held for the benefit of his son if then living; but if the decedent's son was not then living, the proceeds were to be distributed to the decedent's executor. The decedent retained no incident of ownership in the policy other than this possibility of reverter. The decedent was survived by his son. Premiums aggregating $50,000 were paid for the policy, of which the decedent paid $25,000 on or before Jauuary 10, 1941, and $15,000 after that date. The remaining premiums of $10,000 were paid by the son. If at any time after January 10, 1941, the decedent's reversionary interest exceeded in value 5 percent of the value of the policy, then the insurance proceeds are includible in his gross estate under section 811 (g) (2) (A) to the extent of $80,000 (that proportion of the proceeds, $100,000, which the amount of premiums paid by the decedent, $40,000, bears to the total premiums paid for the policy, $50,000). However, if the reversionary interest at no time after January 10, 1941, exceeded in value 5 percent of the value of the policy, then the proceeds are includible under section 811 (g) (2) (A) to the extent of only $30,000 (that proportion of the proceeds, $100,000, which the amount of premiums paid by the decedent after January 10, 1941, $15,000, bears to the total premiums paid for the policy, $50,000).

The decedent's reversionary interest is to be valued by recognized valuation principles, pursuant to regulations prescribed by the Secretary of the Treasury, and, of course, without regard to the fact of the decedent's death. The value of the reversionary interest and of the policy as of any date shall be ascertained as though the decedent were, upon that date, making a gift of the policy and retaining the reversionary interest. The rule of *Robinette* v. *Helvering* (318 U. S. 184), under which a reversionary interest not having an ascertainable value under recognized valuation principles is considered to have a value of zero, is to apply. A reversionary interest which, for example, exists in only one-half of a policy shall be computed as a percentage of the value of such one-half.

The term "reversionary interest" includes a possibility, whether vested or contingent, that the policy or the proceeds thereof may return to the decedent or his estate or may become subject to a power of disposition by the decedent. A possibility that the decedent may be able to dispose of the policy under certain conditions shall be deemed to be as valuable as a right to the return of the property to him under those conditions.

The amendment made by this section of the bill does not restrict the includibility in the decedent's gross estate of proceeds of insurance policies upon his life under any provision other than section 811 (g) (2) (A). For instance, proceeds which, by reason of the enactment of this section, are not includible in the gross estate under section 811 (g) (2) (A) may, in the case of the estate of a decedent dying on or before the enactment of the bill and hence unaffected by the amendment made by section 501 thereof, be includible under section 811 (c) (1) (A) as a transfer in contemplation of death.

The amendment made by section 503 is applicable only with respect to estates of decedents dying after October 21, 1942, the date of enactment of the Revenue Act of 1942. No interest shall be allowed or paid on any overpayment resulting from the enactment of section 503 with respect to any payment made prior to the enactment of the bill.

TITLE VI.—EXCISE TAXES

SECTION 601. AUCTION SALES OF JEWELRY AND FURS

This section is identical with section 102 (e) of the House bill.

Under existing law sales of jewelry or furs by auctioneers or other agents on behalf of estates of decedents not engaged in the business of selling like articles, and on behalf of other persons (including minors, incompetents, and other persons represented by legal representatives) not engaged in such business, are not considered sales at retail. The amendment adds a new section 2412 to the Internal Revenue Code making such sales taxable. The amendment does not affect any of those auction sales at which articles sold at retail are taxable under present law, such as sales by an auctioneer on his own behalf of articles to which he holds title, and sales by an auctioneer on behalf of a person, or the estate of a decedent, engaged in the business of selling taxable articles at retail.

Under the amendment the auctioneer or other agent is considered the person who makes the taxable sale, and must therefore make the return and pay the tax. A limited exemption is provided in the case of such an auction held at the home of the owner of the jewelry or furs. Articles (otherwise taxable by reason of the amendment) may be sold tax-free in an amount of $100. Thus, for example, if jewelry were first sold in the owner's home for $40 and a fur coat were next sold at the same sale for $150, the sale of the jewelry would be tax-free and the remaining $60 of the $100 exemption would be applied against the coat leaving it taxable to the extent of $90 of its sales price. Sales of nontaxable articles would not be considered in applying the $100 exemption. Only one exemption is to be allowed regardless of the period of time during which the auction sale takes place. For the purposes of this exemption, sale at the home of a decedent is considered as at the home of the owner. This amendment has no effect upon auction sales of abandoned property by railroads, post offices, etc., where such sales are conducted by employees thereof rather than by auctioneers or other agents on their behalf.

SECTION 602. RETAIL SALES BY UNITED STATES OR BY ITS AGENCIES OR INSTRUMENTALITIES

This section is identical with section 104 of the bill as passed by the House. In order to clear up any doubts relative to the taxability of articles sold at retail within the United States (including Alaska and Hawaii) by the United States or any agency or instrumentality thereof, including post exchanges, ships stores, etc., this section of the bill adds section 2413 to the Internal Revenue Code so as to expressly provide that the taxes on articles sold at retail shall apply to articles sold by the United States or any agency or instrumentality thereof unless sales by such agency or instrumentality are specifically exempted therefrom by statute. While the amendment is subject to the effective date provisions set forth in section 608 of the bill, it is believed that the amendment does not change existing law.

SECTION 603. TAX ON COIN-OPERATED GAMING DEVICES

This section corresponds to section 142 (a) and (c) of the bill as passed by the House. Subsection (a) 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 $100 to $150 per year.

Subsection (b) provides that the amendment made by this section 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 604. FEDERAL AGENCIES OR INSTRUMENTALITIES

This section is identical with section 144 of the bill as passed by the House. In order to clear up doubts relative to the application to agencies and instrumentalities of the United States, such as post exchanges, ships stores, etc., of the special (occupational) taxes imposed by chapter 27 of the Internal Revenue Code, this section adds to the Internal Revenue Code a new section designated 3283, which expressly makes such taxes apply to such agencies and instrumentalities which are not specifically exempted therefrom by statute.

SECTION 605. IMPOSITION OF TAX ON TELEVISION RECEIVING SETS

There is no corresponding provision for this section in the House bill. Subsection (a) of this section amends section 3404 (a) of the Internal Revenue Code to impose on all television receiving sets and on such sets in combination with either or both radio receiving sets or phonographs, when sold by the manufacturer, producer, or importer a tax equivalent to 10 percent of the price for which sold. In connection with the imposition of such tax, subsection (b) of section 3404 is also amended by striking out the words "reproducing units, power packs" and inserting in lieu thereof the words "speakers, amplifiers, power supply units". This is done to describe adequately the component parts of television receiving sets to which the tax applies, without otherwise affecting the application of subsection (b) as so amended to articles enumerated in such subsection prior to this amendment.

Subsections (b) and (c) of this section amend sections 3403 (c) and (e), 3442, 3443 (a) (1) and 3444 (a) (relating to tax in case of sale of tires, tubes, and automobile radio receiving sets to manufacturers of automobiles, etc., and credit on sale) to allow, with respect to automobile television receiving sets sold or used in connection with the sale of automobiles and similar articles, a credit similar to that allowed with respect to tires, tubes, and automobile radio receiving sets.

SECTION 606. IMPOSITION OF TAX ON QUICK-FREEZE UNITS

This section amends section 3405 of the Internal Revenue Code to impose a new tax at the rate of 10 percent on household type units for quick freezing or frozen storage of foods, operated by electricity, gas, kerosene, or gasoline and on articles suitable for use as parts of or with such units. Thus this section corresponds in part to section 155 of the House bill which also imposed a tax (but at the rate of 7 percent) on household type quick-freeze units. Household type refrigerators are now taxed at the rate of 10 percent under section 3405, and combinations of such household type refrigerators and quick-freeze units are taxed at the rate of 10 percent under this amendment. Under existing law no tax is imposed on the sale of certain articles suitable for use as parts of or with household type refrigerators used by the vendee in the manufacture or production of, or as component parts of, such refrigerators. Under the amendment, which in this respect also corresponds with section 155 of the House bill, no tax will apply in the case of sales of certain articles suitable for use as parts of or with household type refrigerators or units for quick freezing or frozen storage to a manufacturer or producer of complete refrigerators, refrigerating or cooling apparatus, or quick-freeze units, whether or not of the household type. If any such articles are resold by such vendee otherwise than on or in connection with, or with the sale of, complete refrigerators, refrigerating or cooling apparatus, or quick-freeze units, manufactured or produced by him, then he shall be considered the manufacturer or producer of such articles so resold.

SECTION 607. TRANSPORTATION WHICH BEGINS AND ENDS WITHIN THE UNITED STATES

This section, for which there is no corresponding provision in the House bill, amends sections 3469 and 3475 of the Internal Revenue Code (relating respectively to the tax on the transportation of persons and property).

Subsection (a) relates to the tax on transportation of persons. Section 3469 (a) of the code now imposes a tax upon the amount paid within the United States for the transportation of persons by rail, motor vehicle, water, or air, within or without the United States. Under the amendment the tax would also be applicable to amounts paid without the United States for such transportation which begins and ends in the United States. Section 3469 (c) of the code now imposes a tax upon the amount paid within the United States for seating or sleeping accommodations in connection with transportation with respect to which a tax is imposed by subsection (a). Under the amendment the tax would also be applicable to amounts paid without the United States for seating or sleeping accommodations in connection with transportation with respect to which a tax is imposed by subsection (a). The amendment continues the rule now contained in the second sentence of section 3469 (d) that each person receiving any payment specified in section 3469 (a) or (c) shall collect the amount of the tax imposed from the person making the payment for the transportation, but excepts from such rule the case in which payment is made outside the United States for a prepaid order, exchange order, or a similar order, and requires that the person furnishing the initial transportation in the United States pursuant to such order shall collect the amount of the tax. Forms of such orders and the provisions contained therein are so varied that no attempt is made to enumerate the types of orders to which this exception applies. It is intended to cover any form of order accepted by a carrier in exchange in whole or in part for transportation or seating or sleeping accommodations in the United States. The requirement of subsection (d) as it now exists is modified to make its provisions respecting collection and return of the tax specified in section 3469 (a) and (c) applicable to the person furnishing the initial transportation pursuant to orders specified in the foregoing exception when payment therefor is made outside the United States.

Subsection (b) relates to the tax on transportation of property. Section 3475 (a) of the code now imposes a tax upon the amount paid within the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Under the amendment the tax would be applicable to such amounts paid for the transportation of property, whether the payment is made within or without the United States.

The Commissioner of Internal Revenue has issued press releases which indicate that the Bureau is taking a position in accordance with the intent of Congress to impose the tax on transportation within the United States in cases where attempts are made to avoid the tax by unusual methods purporting to make payment outside the United States. It is your committee's view that the position of the Bureau properly applies existing law, and, therefore, that with respect to the situations covered by the press releases, the amendments are merely declaratory of existing law. However, the Bureau has not held that the tax is applicable if a person physically outside the United States purchases a ticket for his transportation which begins and ends in the United States. Subsection (c) provides that the amendments 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 enactment of the act for transportation which begins on or after such first day.

SECTION 608. EFFECTIVE DATE OF SECTIONS 601, 602, 605, AND 606

This section provides that the amendments made by sections 601' 602, 605, and 606 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 the enactment of the act. For such purpose an article is considered to be sold when possession or the right to possession passes to the purchaser. For example, in the case of a lease or conditional sales contract under which right to possession of the article passed to the lessee or purchaser prior to such first day, existing law will continue to apply with respect to any rental or installment payment made after such first day on such lease or conditional sale, even though, in the case of such conditional sale title to the article does not pass to the purchaser until after such first day. Even though for security purposes, the legal right to possession of an article may remain in the seller, if the purchaser in fact takes actual possession prior to such first day, existing law will likewise continue to apply.

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).