Calendar No. 1691

89TH CONGRESS 2d Session } SENATE { REPORT No. 1723

INCOME TAX TREATMENT OF CERTAIN DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

OCTOBER 13, 1966.—Ordered to be printed

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

REPORT

[To accompany H.R. 11257]

The Committee on Finance, to which was referred the bill (H.R. 11257) relating to the income tax treatment of certain distributions pursuant to the Bank Holding Company Act of 1956, as amended, having considered the same, reports favorably thereon with an amendment and recommends that the bill (as amended) do pass.

I. SUMMARY

Your committee has accepted the House provision without change but has added an amendment relating to a different tax matter.

The provision in the House-passed bill which your committee has accepted without change is concerned with corporations which became bank holding companies as a result of the 1966 amendments to the Bank Holding Company Act of 1956. The 1966 amendments removed an exemption provided by prior law and, as a result, one or more companies will become a bank holding company without any action on its part. As a result of being classified as a bank holding company, such a corporation will have to dispose of either the banking or the nonbanking interests. This bill provides in these cases that the corporation may make a distribution of either one of these two categories of interests without the shareholders having to pay tax upon the stock or other property received so long as all distributions in kind are made on a pro rata basis to all shareholders.

Your committee has added an amendment to the bill to solve a problem faced by companies which provide mortgage insurance. They are subject to State regulation, and are almost uniformly required to place half of their earned premiums in contingency reserves for 15 years to provide protection to policyholders from losses which might result from adverse economic conditions. The committee amends the Internal Revenue Code of 1954 to provide a special deduction for additions to an extraordinary loss reserve for amounts which State law or regulations require a mortgage guaranty insurance company to add to such a reserve, but not in excess of 50 percent of earned premiums. However, the committee amendment provides that the special deduction is allowable only if the tax benefit obtained from the deduction of additions to the reserve is invested in a special issue of noninterest bearing tax and loss bonds. The tax and loss bonds may be used for payment of income taxes which will be due when the reserve is returned to income, or the bonds may be redeemed in the event of extraordinary losses during the period of the reserve.

The Treasury Department has indicated that it has no objection to the House-passed provision of the bill. With respect to the amendment made by your committee, the Treasury recommends that it be adopted by the Congress.

II. DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT

Reasons for the provision.—In 1956, Congress passed legislation placing certain corporations referred to as bank holding companies under the control of the Federal Reserve Board. In general, these were organizations controlling two or more banks. Under the legislation, a bank holding company was prohibited from engaging in any business other than banking. As a result, organizations which in 1956 controlled two or more banks and at the same time owned interests in other businesses generally were required to dispose of either their banking or their nonbanking interests. Corporations classified as bank holding companies under the Bank Holding Company Act of 1956 usually disposed of either their banking or their nonbanking interests by distributing one or the other of these classes of interests to their shareholders. Since Congress was requiring these corporations to distribute one of these classes of interests, in 1956 it provided generally that these stock distributions, to the extent they were made with respect to property acquired before May 15, 1955, could be made without tax consequences to the shareholders receiving the distributed stock. In the absence of the special tax provisions enacted in 1956, the stock distributions would have been treated as ordinary income (dividends) to the shareholders receiving them.

The 1956 act contained certain exceptions to the requirement that dispositions of either banking or nonbanking interests had to be made in the case of companies holding interests in two or more banks. One of these exceptions provided that a company was not to be considered a bank holding company if it was registered prior to May 15, 1955, under the Investment Company Act of 1940 (or was an affiliate of such a company) unless the company or its affiliate directly owned 25 percent or more of the voting shares of each of two or more banks. This exception permitted companies of this type to own indirectly a 25 percent, or larger, interest in two or more banks.

This year (Public Law 89-485; H.R. 7371) Congress repealed this exception with the result that any company falling within this category now must divest itself of either its banking or nonbanking interests where its indirect ownership equals or exceeds 25 percent. It was stated that this exemption initially was granted because it was felt that regulation under the Investment Company Act of 1940 would provide adequate protection. However, it was indicated that experience has demonstrated that SEC's authority under the Investment Company Act is not a substitute for the type of control provided under the Bank Holding Company Act from the standpoint of banking policies. It was further stated that the exemption now applies only to the Financial General Corp., an affiliate of the Equity Corp. which is a registered investment company.[1]

The Financial General Corp., through subsidiary corporations, owns 25 percent or more of the stock of 21 banks in 5 States and the District of Columbia. In addition, it controls a number of nonbanking businesses, including insurance, financing, and manufacturing companies. Many of these interests were acquired after May 15, 1955 (the date before which the property must have been acquired for the 1956 tax relief to apply).

Since, the Congress, in 1956, provided that where it required disposition of either the previously held banking or nonbanking interests, there should not be tax consequences to the shareholders upon any distributions occurring as a result of this action, it seems appropriate to extend the same general treatment under the 1966 amendments. Therefore, the House-passed provision approved by your committee provides that any corporations required to divest their banking or nonbanking interests held before April 12, 1965, as a result of the passage this year of the Bank Holding Company Act Amendments of 1966 also are to have tax-free treatment available. This also is consistent with the treatment provided under present law where divestitures are required to effectuate the policies of the Federal Communications Commission or the Securities and Exchange Commission.

For these reasons, this bill extends the tax-free treatment originally provided with respect to distributions required as the result of the Bank Holding Company Act of 1956, to distributions of property acquired on or before April 12, 1965, which must be made as a result of the 1966 amendments to that act. However, to be sure that there is no opportunity for tax manipulation, this treatment is made available only if all of the distributions made in kind—i.e., other than in money—are made on a pro rata basis to all shareholders.

Explanation of provisions.—Under present law, as a result of the 1956 act, a corporation which is classified as a bank holding company is given its choice of two alternative courses of action: It may remain a bank holding company, in which event it must distribute its nonbanking interests; or it may retain its nonbanking interests and dispose of its banking interests to the extent required so it is no longer classified as a bank holding company.

Under the 1956 legislation, a corporation was classified as a "bank holding company" and, therefore, subject to the provisions of the bill if (1) the company directly or indirectly controlled 25 percent or more of the voting shares of two or more banks (or of bank holding companies); (2) the company controlled the election of a majority of the directors of two or more banks; or (3) trustees for the shareholders of the company held 25 percent or more of the stock of two or more banks (or of bank holding companies).

[1] However, it was indicated that there are roughly 300 companies that registered under the 1940 act before May 15, 1955, which apparently could take advantage of this provision had this exemption not been removed.

A number of exceptions to the classification specified above are included in the 1956 act. Among these is one which provides an exclusion for any company which is registered under the Investment Company Act of 1940 and was so registered prior to May 15, 1955 (or is affiliated with a company meeting these tests) unless the company (or the affiliate) directly owns 25 percent or more of two or more banks.

Thus, a company registered under the Investment Company Act (which was so registered before May 15, 1955) could indirectly own over 25 percent of the voting stock of two or more banks—e.g., this ownership could be divided among related corporations—without being classified as a bank holding company and without being required to dispose of either its banking or nonbanking interests (and without subjecting itself to Federal Reserve Board control). This exemption from the bank holding company provisions was removed by the 1966 amendments.

This bill provides in general that no tax is to be imposed on the shareholders where companies, because of the removal of this exemption in 1966, are required to make distributions of either their banking or nonbanking interests acquired on or before April 12, 1965. Present law, as amended by this bill, obtains the results referred to above, by permitting a corporation which becomes classified as a bank holding company, its choice of two alternative tax-free routes for disposing of its banking or nonbanking interests.

First, if a corporation decides to remain a bank holding company, it may distribute its nonbanking interests, referred to as prohibited property, to its shareholders without the recognition of any gain by the shareholders on the distribution. The distribution is tax free to the shareholders only if the Federal Reserve Board certifies the corporation has disposed of all property necessary to effectuate the policies of the Bank Holding Company Act. For this purpose, "prohibited property" in general means stocks, securities, and other obligations or assets of nonbanking businesses, to the extent the bank holding company is required to divest itself of these assets under the Bank Holding Company Act. The term does not include cash, Government bonds, or certain short-term obligations. Generally, these do not come within the definition of assets which must be distributed by a bank holding company.

In the case of the distributing corporation, the usual provisions of the tax laws apply. Under these provisions, gain generally is not recognized to the distributing corporation except under unusual circumstances such as in the case of the distribution of LIFO inventory, the distribution of property subject to a liability in excess of its adjusted basis, or the distribution of certain installment obligations.

The distribution of "prohibited property" may be made either directly to the shareholders of the bank holding company or may be transferred to a wholly owned subsidiary created to receive the "prohibited property." In this latter event, the stock of the subsidiary must then be immediately distributed to the shareholders of the bank holding company for the distribution to be free of tax.

Second, if a corporation chooses not to be a bank holding company, it may distribute to its shareholders any bank stock or other property of the kind which causes it to be a bank holding company without the recognition of gain to the shareholders. In this case, for the distribution to be tax free to the shareholders, the Federal Reserve Board must certify within a specified period of time that the company has distributed sufficient property so that it no longer is a bank holding company. In this case the corporation may distribute to its shareholders all of its shares of bank stock without the recognition of gain even though it would be possible to retain shares of stock in one bank without being classified as a bank holding company.

The Bank Holding Company Act of 1956 restricted the nonrecognition treatment described above to property which was owned by a company on May 15, 1955. This restriction was considered necessary to prevent corporations from purchasing interests in banks or other businesses in order that their shareholders might benefit from the tax-free distribution treatment provided in these cases. While the May 15, 1955, date was, of course, appropriate for corporations which became bank holding companies in 1956, a later date is needed for a corporation which became a bank holding company because of the 1966 amendments. Therefore, this date is advanced to April 12, 1965, in the case of any company which became a bank holding company as a result of the enactment of the Bank Holding Company Amendments of 1966.

This is the date of introduction in the House of the bill which ultimately led to the enactment of the 1966 Bank Holding Company Amendments. Thus, the tax-free treatment is made available with respect to a company required to dispose of either its banking or its nonbanking interests as a result of the 1966 amendments, only with respect to property it held on the date it was indicated that this exemption might be removed.

Apart from the change in dates referred to above, the tax-free treatment in the case of distributions to shareholders in the case of corporations coming under the Bank Holding Company Act as a result of the 1966 amendments differs in only one respect from the provisions applicable to the companies becoming bank holding companies in 1956. The tax-free treatment for companies covered by the 1966 amendments is made available only if all distributions made in kind—i.e., made in other than money—are made on a pro rata basis. Thus, no corporation, under this amendment, will be able to acquire the stock of some of its shareholders with assets in kind (and in this manner avoid any subsequent tax to the corporation on the appreciation in the value of these assets) while at the same time distributing other property in kind to other shareholders on a tax-free basis under the terms of this bill.

III. MORTGAGE GUARANTY INSURANCE

Reasons for the provision.—Mortgage guaranty insurance companies guarantee the holder of a real estate mortgage against loss on its mortgage loan, in a manner somewhat comparable to the mortgage insurance written by FHA. However, FHA insures the entire amount of the mortgage, while mortgage guaranty insurance companies have an option to pay 20 percent of the face of the mortgage in full satisfaction of the liability. While as a practical matter 20 percent coverage presently may be sufficient to cover any likely loss on a defaulted mortgage, nevertheless in the event of a serious depression, that option may be significant. Moreover, FHA insures mortgages representing as much as 97 percent of the appraised value of the property, while mortgage guaranty insurance is not written on loans for more than 90 percent of the appraised value of the property. Premiums on these policies are sometimes paid in a lump sum when the contract is written, but in most cases, perhaps 80 percent, annual premiums are paid over the period of risk.

These private insurers are regulated by State insurance commissions. On the possibility that extraordinary losses may occur from mortgage defaults, for example in a depression, State insurance commissions regulating this industry generally require the company's establishment of a contingency loss reserve to protect against extraordinary losses. For example, under the regulations of one State commission, a guaranty company is required to add up to 50 percent of earned premiums to its contigency loss reserves.[2] These reserve additions are not related to loss experience and remain in the reserve for 15 years, in the absence of authorization from the State commission for prior restoration of income. Normal losses are charged to income currently, rather than to the reserve. The regulations of this particular State commission indicate that reserve invasions may be authorized when losses exceed, by more than 10 percent of premiums, the expected losses set forth in the rate formula. Unless losses exceed 40 percent of premiums (30 percent in the rate formula plus the 10 percent margin) the reserve may not be invaded to meet current losses under the existing regulations of this State commission.

The typical life of a real estate mortgage is about 8 years, even though the mortgage may have been written for a 20-year life or longer (as a consequence of property transfers, mortgage loans on the average are paid off somewhat earlier than the original period of the loan). Even though there has been earlier payment in full of mortgage loans, and consequent termination of the need for the reserve, the State commission's regulations do not restore the reserve to income until after the entire 15-year period is passed.

Under section 832(b)(4) of the code a deduction is now allowed for contributions to a reserve for "unearned premiums." The Internal Revenue Service has defined unearned premiums as "that portion which the company has not yet had time to earn, or more precisely, that portion paid by the policyholder which must be returned on cancellation of the policy, and which is in direct proportion to the unexpired time which the policy is to run." In 1960 the Internal Revenue Service issued a ruling to a company writing mortgage guaranty insurance stating that its contingency loss reserve required by the State commission was a reserve for unearned premiums within the meaning of section 832(b)(4). A similar ruling was subsequently issued to another company. Since that time requests for similar rulings from other companies have been submitted to the Internal Revenue Service, but the Service has not ruled on the requests.

The Service has now decided that its original rulings of 1960 also should be changed, although it has not yet revoked them. The tax returns of 10 or more other companies which did not receive favorable rulings, however, are being held in suspense. These other companies contend that they are competitively handicapped, and their ability to obtain equity capital is prejudiced because they have not received

[2] On loans for 80 percent or more of the appraised value of the property, 50 percent of earned premiums must be added to the reserve. On loans of less than 80 percent, 30 percent of earned premiums is added to the reserve. The likelihood is that most loans covered by this insurance are for 80 percent or more of appraised value.

a ruling similar to those issued in 1960. The Treasury Department believes that a legislative solution of the problem is desirable. Your committee agrees.

It is clear, where State law requires 50 percent of the earned premiums are required to be placed in a reserve for extraordinary losses, that it would be extremely difficult for any company to operate without continuing additions to working capital. Their current losses and other expenses have amounted to more than half of their earned premiums. If half of those premiums must be placed in reserve, some of the current expenses will have to be paid from working capital. A current tax on the earned premiums dedicated to the reserve will necessitate an even greater depletion of the working capital. Your committee's amendment is designed to solve this unique problem created by unusual State requirements, and affords uniform treatment to all companies engaged in writing mortgage guaranty insurance.

Under the committee amendment, deductions for additions to a reserve for mortgage guaranty insurance losses resulting from adverse economic cycles will be allowed, but not in excess of 50 percent of premiums earned during the year. Any amount added to the reserve must be restored to income at the close of 10 years (rather than 15 years as is generally required under State regulations). The deduction is not allowed, however, unless the company purchases a special issue of "tax and loss" bonds in the amount of the tax benefit of the deduction. These bonds will be noninterest bearing, nontransferable, and redeemable only when the amounts added to the reserve are restored to income. It is expected that these bonds will be recognized, by both accountants and State insurance commissions, as an asset for statement purposes. At the time of restoration of the reserve to income, the bonds purchased when the addition was made to the reserve may be utilized to pay the resulting income tax. If the company has no tax to pay in the year of redemption because of other deductions, the bonds would be redeemable for cash.

The committee's amendment is less favorable to the taxpayer than the rulings issued by the Internal Revenue Service in 1960, since any amounts added to the reserve must be restored to income at the end of 10 years (rather than 15 years) and the tax benefit from the deduction must be invested in non-interest-bearing Federal bonds.

The bill amends the Second Liberty Bond Act to authorize the Secretary of the Treasury to issue the non-interest-bearing bonds for the purposes of the new tax provisions described above.

While the amendment of the Internal Revenue Code is applicable to taxable years beginning after December 31, 1966, the committee's amendment (subsec. (g) of sec. 2 of the bill) provides special rules for additions made prior to 1967 to reserves for mortgage guaranty insurance losses. These special rules are designed to validate the deductions taken in past years by all companies that made additions to such reserves. As a result, all companies in the industry will be treated alike. Tax-and-loss bonds are not required for past years, but the additions to reserves made prior to 1967 must be included in income at the end of 10 years following the year for which the addition was made. In addition, losses incurred for taxable years beginning after 1966, to the extent the losses exceed 35 percent of earned premiums for the year, are to be charged to the pre-1967 reserve rather than against current income.

Technical explanation of provision.—Section 2(a) of the bill adds a new subsection (f) to section 832 of the Internal Revenue Code. The new subsection (f) provides special rules in the case of taxable years beginning after December 31, 1966, for a company which writes mortgage guaranty insurance. Such a company may be organized under a special State statute relating solely to such insurance companies or organized under a general statute relating to credit guaranty insurance companies.

Subparagraph (A) of the new subsection (f)(1) refers to a reserve which is in substance a contingency reserve for extraordinary or unusual mortgage guaranty insurance losses. Mortgage guaranty insurance companies are generally required by certain State statutes or regulations to set aside an amount, usually a certain portion of their premiums, for a definite period of time in such a reserve for unusual losses. Such a reserve is not available for general corporate purposes, but subject to the approval of the State insurance commissioner is available in the event that the losses of a company in any year exceed its "normal losses."

Except as otherwise provided, in order for the deduction to be allowed under new subsection (f)(1), tax-and-loss bonds referred to in new subsection (f)(2) shall be purchased on or before the date that any taxes (determined without regard to new subsec. (f)) due for the taxable year for which the deduction is allowed are due to be paid, as if no election to make installment payments under section 6152 is made. If a company would make payments of estimated tax if new subsection (f) did not apply, then whether or not such company pays estimated tax after the application of subsection (f), such bonds must be purchased on or before the date for paying such estimated tax in order for them to be considered purchased on or before the date that any taxes due for the taxable year are to be paid. If an obligation to make payments of estimated tax is eliminated by the allowance of the deduction under new subsection (f)(1), in order to qualify for such deduction the company is required to purchase these tax-and-loss bonds at the time the estimated tax payments are due to be paid and in the amount of such payments.

The Secretary of the Treasury is authorized under the bill to prescribe the terms and conditions under which such bonds shall be purchased, and may provide, for example, that deposits may be made toward the purchase of such bonds. At the time the company's tax return is filed, the deposits could be so applied, or to the extent not needed for such purchases or for the payment of the company's taxes, such amounts could be refunded to the company. In accordance with the provisions of new section 832(f)(1), all amounts are to be taken into account on a first-in-time basis, including for purposes of determining the deposits which have been applied to purchase bonds.

In computing the aggregate amount in the State reserve for purposes of new subsection (f)(5)(B), such amount shall be reduced, for example, by the amount of losses incurred which is permitted to be charged to such reserve under State law or regulation. Although under new subsection (f)(1) such a charge to the reserve does not affect the computation of losses incurred, such reserve, nevertheless, shall be reduced by the amount of such charge.

The application of new subsection (f) may be illustrated by the following example: Company A was organized on January 1, 1967, and is required by State law or regulation to set aside 50 percent of premiums earned on insurance contracts (as defined in sec. 832(b)(4)) with respect to mortgage guaranty insurance in a reserve referred to in new paragraph (1)(A). For 1967 the amount so set aside is $300x. However, company A's taxable income, computed without regard to the deduction allowed by new paragraph (1) or any carryback of a net operating loss, was only $100x and, thus, such deduction could not exceed $100x. By purchasing the amount of tax and loss bonds required by new paragraph (2) company A was allowed a deduction of $100x under new paragraph (1) for 1967 and reduced its taxable income to zero. Company A added $100x to its mortgage guaranty account.

In 1968 company A suffered a net operating loss computed without regard to new paragraph (5)(C) of $50x. Under State law or regulation company A was required to set aside $30x for 1968 in such reserve but was required to reduce such reserve by $75x, a net reduction of $45x. Consequently, for purposes of new paragraph (5)(B) the aggregate amount remaining in such reserve for 1968 was $255x ($300x+$30x−$75x). Since no deduction was allowed under new paragraph (1), because company A had no taxable income for 1968, no amount was added to the mortgage guaranty account for 1968. As a result, for purposes of new paragraph (5)(B) the aggregate amount in such account was $100x.

Since no amount can be added to company A's mortgage guaranty account for years prior to 1967, no amount is subtracted from such account or included in gross income for 1968 under new paragraph (5)(A) with respect to amounts added to such account for the 10th preceding taxable year. In addition, since for 1968 there is no excess of the aggregate amount in the mortgage guaranty account ($100x) over the aggregate amount ($255x) in the reserve referred to in new paragraph (1)(A), no amount is subtracted or so included in gross income under new paragraph (5)(B) for 1968.

However, $50x would be subtracted from the mortgage guaranty account and included in gross income for 1968 under new paragraph (5)(C), since in 1968 company A suffered a net operating loss of $50x computed without regard to new paragraph (5)(C). As a consequence, the inclusion of $50x in gross income under new paragraph (5)(C) offsets any net operating loss for 1968.

In this connection, it should be noted that section 26 of the Second Liberty Bond Act as added by section 2(f) of the bill provides in part that with respect to any taxable year in which amounts are subtracted from such mortgage guaranty account, an amount of tax and loss bonds which was purchased under new section 832(f)(2) with respect to the amount so subtracted shall be redeemed. In the above example, since $50x of the $100x which was allowed as a deduction in 1967 under new paragraph (1) was so subtracted in 1968, 50 percent ($50x/$100x) of the bonds so purchased in 1967 shall be redeemed. No amount, however, is subtracted under more than one subparagraph of new paragraph (5).

In determining the amount of the deduction under new paragraph (1) (as limited by taxable income computed without regard to such paragraph or any carryback), net operating loss carryovers or amounts which are subtracted from the mortgage guaranty account and included in gross income for the taxable year under new paragraph (5) are, of course, taken into account.

Nothing in this bill shall be construed as requiring the Secretary of the Treasury to redeem tax and loss bonds as a result of improper subtractions under subparagraph (A), (B), or (C) of new paragraph (5). New subparagraph (D) only applies after such bonds have been redeemed. Such bonds, however, shall be treated as redeemed when applied to pay tax, by other tax and loss bonds, or otherwise redeemed.

In order to qualify for this deduction under new section 832(f) a company is required to make timely installment payments or deposits toward the purchase of bonds. The Secretary of the Treasury would be authorized under the bill to delay issuing bonds until the company's tax return is filed, and then to issue bonds backdated to the date of the installment payments. The Secretary of the Treasury is also authorized to provide, for example, that installment deposits may be applied toward the purchase of bonds, or if not otherwise used, such deposit may be returned to the company.

In general, the date (determined without regard to new sec. 832(f)) on which such bonds may be redeemed is the due date of any tax due (other than estimated tax) for the taxable year for which an amount is so subtracted from the account and included in income. However, since subtraction from the mortgage guaranty account and inclusion in income are made under new subsection (f)(5)(A) with respect to amounts added to the account for the 10th preceding year, such bonds may be redeemed 10 years from the date purchased. Thus, if, for example, the Secretary of the Treasury requires a company to make deposits toward the purchase of bonds on or before the due date for paying estimated tax in order to qualify for the deduction under new subsection (f)(1), such bonds (unless redeemed for an earlier taxable year) may be redeemed 10 years from the date of the deposit to the extent of the deposit. In lieu of the application of tax due as a result of the inclusion of amounts in gross income under new section 832(b)(1)(E), the Secretary of the Treasury may permit the bonds to be redeemed to be applied toward the purchase of other tax and loss bonds.

Under the bill in special circumstances, the Secretary of the Treasury could redeem such bonds at an earlier date than would otherwise be the case. Such a special circumstance could be, for example, when a company suffers heavy losses and needs to pay claims with the proceeds from the redemption of such bonds.

A reserve described in subsection (g)(1) of section (2) of the bill would be a reserve of the type described in new section 832(f)(1)(A).

Under the second and third sentences of subsection (g)(1) of section 2 of the bill, in determining, for example, the earned premiums for 1967, the amount of unearned premiums on outstanding business at the end of both 1966 and 1967 shall be computed without any amount which had been treated as unearned premiums under such subsection (g)(1).

Subsection (g) of section 2 of the bill may be illustrated as follows: For taxable years beginning before 1968, a company has added an aggregate of $\$100x$ to such a reserve. However, pursuant to reductions ordered by a State insurance commissioner, the amount thereof which remains in the reserve at the close of 1968 is $\$80x$. For all taxable years beginning before 1967 $\$100x$ was so treated as unearned premiums, and for 1967 $\$7x$ had been included in gross income under such subsection (g)(2). For 1968 $\$5x$ is included in gross income under subparagraphs (A) and (B) of such subsection (g)(2). In applying subparagraph (C) to 1968 the aggregate amount so treated as unearned premiums for all taxable years beginning before 1967 (\$100x) less the total of the amounts included in gross income under subsection (g)(2) for prior taxable years (\$7x) and the amounts included in gross income under subparagraphs (A) and (B) for 1968 (\$5x) is \$88x (\$100x −\$12x). The excess of such amount (\$88x) over the aggregate of the additions made for taxable years beginning before 1967 which remain in the reserve at the close of 1968 (\$80x) is \$8x (\$88x −\$80x). Thus, \$8x is so included in gross income under subparagraph (C).

Subsection (g)(2) further provides that for purposes of section 832 (f) of the code and of such subsection (g), if part of such reserve is reduced under State law or regulation, such reduction shall first apply to the extent of amounts added to the reserve for taxable years beginning before 1967, and only then to amounts added thereafter. As previously stated, the reserve referred to in subsection (g)(1) of the bill is the same reserve referred to in section 832(f)(1)(A) of the code as added by section 2(c) of the bill. Thus, a State insurance commissioner, for example, could order a reduction in such a reserve which contains amounts added to the reserve both for years prior to 1967 and subsequent to 1966. In such a case, subsection (g)(2) provides that a first-in-time rule shall apply. As a consequence, no amount which is included in income under such subsection (g)(2) shall also be included in income under new code section 832(f)(5).

Amounts shall be included in gross income under such subsection (g)(2) in accordance with the usual limitations of section 111 of the code.

IV. 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).

O