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**REVENUE AND EXPENDITURE CONTROL
ACT OF 1968**

**Explanation of the Bill
H.R. 15414
As Agreed to in Conference**



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EXPLANATION OF THE BILL, H.R. 15414, AS AGREED TO IN CONFERENCE

INTRODUCTORY STATEMENT

This explanation of the conference substitute to the text of the bill, H.R. 15414, supplements the explanation in the statement of managers on the part of the House and corresponds to the general explanation customarily included in reports from the Committee on Ways and Means and the Committee on Finance on major bills amending the Internal Revenue Code.

The short title of this bill is the "Revenue and Expenditure Control Act of 1968." The long title of the bill is "An act to increase revenues, to limit expenditures and new obligational authority, and for other purposes."

SUMMARY

A. The principal revenue amendments made by this bill are as follows:

1. An income tax surcharge at an annual rate of 10 percent is provided. Generally, this is effective for corporations beginning January 1, 1968, and for individuals April 1, 1968. In both cases the surcharge applies until July 1, 1969.

2. Provision is made for a speedup of corporate tax payments by increasing from 70 to 80 percent the percentage of estimated tax which a corporation must pay currently and by gradually eliminating (over a 10-year period) the present \$100,000 corporate exemption from estimated tax. In addition, provision is made for "quickie" refunds of overpayments of estimated tax; and the requirement for corporations to file a declaration, at the time of making the first estimated tax payment, is eliminated.

3. The excise tax rates on new passenger automobiles and telephone services are to continue at the May 1968 levels of 7 percent and 10 percent, respectively, until January 1, 1970. Thereafter, these excise taxes are to be gradually reduced until they are eliminated on January 1, 1973.

4. Taxpayers who mail a deposit of tax (such as withheld income tax, estimated tax, or excise tax) 2 or more days before the prescribed due date are to be considered as having made a timely deposit even though the deposit is received after the due date.

5. Interest on so-called industrial development bonds generally is to be taxable with respect to issues on or after May 1, 1968 (unless specified commitments were made prior to that time). An exception to this rule, however, is made for bond issues of less than \$1 million and also for certain specified categories which are to continue to be exempt.

6. Deductions are to be available for advertising expenses in a presidential convention program under certain limited circumstances.

7. Cooperative-type entities providing joint services solely for tax-exempt hospitals are to be treated as tax-exempt organizations where only limited, specified types of services are provided.

B. The principal expenditure control amendments made by this bill are as follows:

1. In the case of full-time permanent employees in the executive branch only three out of four vacancies in agencies or departments may be filled during any month when the employment level for the executive branch exceeds the June 30, 1966 level. Temporary and part-time employees in any department or agency generally are limited to the number of similar employees on the rolls in the corresponding month of 1967. In keeping with the June 30, 1966 date, the provision is carefully designed to that it can be operated in such a fashion that whenever any agency has reached its June 30, 1966 level, then it can be in a position to resume full appointment. To this end, the conferees believe that the more efficient operation of the Government means that the Director of the Budget generally should reassign vacancies to any agency which has reached its June 30, 1966 level. For example, in applying this provision in the case of the Veterans' Administration (including all such employees working in veterans hospitals), no reduction should be required in employee levels below that of June 30, 1966, in the case of permanent or full-time employees.

2. Federal expenditures and net lending in the fiscal year 1969 are to be reduced by \$6 billion, from the level of \$186.1 to \$180.1 billion except for increases which may occur for expenditures related to Vietnam operations, interest on the debt, veterans services and benefit payments, and payments from social security trust funds.

3. Total new obligational and loan authority provided for the fiscal year 1969 is to be reduced by \$10 billion, or from \$201.7 to \$191.7 billion, with the same exceptions as referred to above.

4. The President is to make a report including specific recommendations for legislation rescinding not less than \$8 billion of unobligated balances at the time he sends up the 1970 budget.

C. The public assistance amendments made by this bill are as follows:

1. The limitation on Federal financial participation in the AFDC program applicable under present law is postponed for 1 year from July 1, 1968, to July 1, 1969. The allowable level for any State under the AFDC program is to take into account any addition in the average monthly number of dependent children in a State who come within this category as a result of a court decision with respect to the State's residency or "man-in-the-house" requirements.

2. The prohibition under present law on payments of assistance with Federal participation to a family when the father receives unemployment compensation during any part of the same month is modified so that the family may receive assistance during any weeks that the father does not receive unemployment compensation.

3. The period in which the Federal Government is to continue making payments under title XIX coverage for medical services to aged medically needy persons in a State which has not purchased supplementary medical insurance on their behalf is extended from January 1, 1968, to January 1, 1970.

TITLE I—REVENUE AMENDMENTS

The revenue amendments deal with numerous subject matters which are described under the headings set forth below. The major feature of this title, however, is the 10-percent surcharge which gen-

ally is effective January 1, 1968, in the case of corporations and April 1, 1968, in the case of individuals.

The conference committee agreed with the Senate that it is necessary to reduce the prospective budget deficit to more manageable proportions by increasing taxes (subject to the expenditure and obligational authority reduction set forth in title II) in order to halt inflation, relieve pressures on the domestic financial markets, and strengthen international confidence in the value of the dollar.

Recent events make it clear that inflationary pressures are growing. Nearly half of the record increase in gross national product in the first 3 months of 1968 was attributable to price increases rather than real gains in production. Furthermore, prices increased at an annual rate of 4 percent during this period. This is not only unacceptably high but also indicates that the rate of price increase is accelerating. Moreover, these price increases occurred throughout the economy.

The overheated rate of expansion which has generated price increases has also been accompanied by a serious deterioration in the U.S. balance of payments. Within recent months, imports of lower priced foreign goods have risen, jeopardizing the entire program to close the balance-of-payments gap. In March, imports actually exceeded exports on a seasonally adjusted basis. Foreign confidence in the value of the dollar, already weakened in the aftermath of the devaluation of the British pound and the winter gold crisis, may lessen still more if the United States fails to demonstrate progress toward a reduction in the balance-of-payments deficit.

Recent trends in domestic financial markets bear a disturbing resemblance to the developments which caused such distress in 1966. Demands for credit, in an important measure attributable to Federal borrowing to cover a \$25 billion 1968 deficit, have pushed interest rates above the high levels reached in 1966 to the highest levels in a century. Furthermore, recently the rate at which funds are withdrawn from savings and loan associations has increased sharply, casting doubt on the ability of these institutions to supply needed funds for home mortgages.

An essential ingredient in any policy to restore price stability, strengthen international confidence in the dollar, and relieve domestic financial pressures is a sharp reduction in the size of the Federal deficit for 1969, which in the absence of this bill, will approach \$24 billion and could well be substantially more. Reducing expenditures and increasing taxes should restore a better balance between Federal expenditures and tax receipts and relieve inflationary pressures without jeopardizing the maintenance of full employment. It will also demonstrate conclusively to foreigners our willingness to reduce the balance-of-payments deficit to an acceptable level. Finally, a sharp reduction in the Federal demand for borrowed funds will help to restore normal domestic financial relationships.

The provisions of this bill will reduce the 1969 budget deficit to a figure far less than the \$25 billion estimated for the fiscal year 1968. Reductions in expenditures, provided in title II, account for a substantial part of this reduction. But the expenditure reductions that are feasible in view of the Nation's international and domestic commitments are not enough to accomplish the task. A tax increase is also necessary.

The table below indicates that in the fiscal years 1968 and 1969 it is expected that the bill as agreed to by the conferees will increase

receipts by \$15.5 billion; \$3 billion of this is attributable to the excise tax extensions and \$1 billion to the speedup of corporate tax payments in the fiscal years 1968 and 1969. The remainder—\$11.6 billion—is attributable to the impact of the surcharge on collections. The surcharge on the individual income tax will account for \$7.8 billion of the increase and the corporate surcharge, \$3.8 billion.

TABLE 1.—ESTIMATED REVENUE INCREASES DUE TO TAX PROVISIONS OF H.R. 15414—CONFERENCE ACTION
(In billions of dollars)

	Fiscal year	
	1968	1969
Excise taxes, extension of present rates:		
Automobiles.....	0.2	1.5
Telephone service.....	.1	1.2
Total, excise extension.....	.3	2.7
Corporations estimated tax payments ¹0	1.0
Surcharge: ¹		
Individuals.....	0	7.0
Corporations.....		3.8
Total surcharge.....	.0	11.6
Total revenue increase.....	.3	15.2

¹ Assumes enactment of this bill too late for Treasury receipts to reflect much, if any, increase in the case of the individual or corporate income tax payments in the fiscal year 1968.

Note: Detail may not add to total due to rounding.

Addendum: The surcharge; a full year liability at 1968 income levels:

	Billions
Individuals.....	35.8
Corporations.....	3.4
Total.....	10.2

Section 101. Amendment of existing law (sec. 101(b) of the House bill and sec. 5 of the Senate bill)

This section is essentially the same as provisions in both the House and Senate versions of the bill. It provides that whenever an amendment or repeal is expressed in this title of the bill, the expression refers to provisions of the Internal Revenue Code of 1954.

Section 102. Imposition of tax surcharge (sec. 17 of the Senate bill and sec. 51 of the code)

This section imposes an income tax surcharge at an annual rate of 10 percent. For corporations this is generally effective January 1, 1968, and for individuals it is generally effective April 1, 1968. In both cases the surcharge applies until July 1, 1969. In substance, the section is the same as in the Senate amendment.

The surcharge which the section imposes is in addition to the income taxes which a taxpayer must pay under existing law. The surcharge, as it was under the Senate amendment, is a percent of these existing taxes (with certain adjustments).

In the case of an individual reporting on the calendar year, the rate of the surcharge is 7.5 percent for 1968 and 5 percent for 1969.¹ This is the approximate equivalent of a 10-percent tax from April 1 in 1968 and for the first half of the year in 1969. The result is that the calendar year individual taxpayer pays the surcharge at an annual rate of

¹ In the case of an individual reporting on a fiscal year basis, the surcharge is at an annual rate of 10 percent for the 18-month period beginning April 1, 1968, and ending June 30, 1969. The rate for any fiscal year only a part of which is within the surcharge period is prorated on a daily basis.

10 percent for the 15-month period of the surcharge. The rate of 7.5 percent for the calendar year 1968, and the rate of 5 percent for the calendar year 1969, applies to the entire tax of the applicable taxable year, whether attributable to income received before or after the aforementioned effective dates.

The tax surcharge does not apply to individual taxpayers whose income taxes (without regard to the surcharge) are below specified limits. The tax does not apply unless the taxpayer has taxable income above the first two tax brackets; that is, in the case of a single person, the tax applies only if the individual's tax exceeds \$145, or in the case of married persons filing joint returns, only if their tax exceeds \$290.³

An individual taxpayer whose tax (without regard to the surcharge) is just above the amount of the exemption is not to pay the surcharge at the full annual rate of 10 percent. To have required him to do so in effect would have imposed a special tax of \$15 (or \$29 for a married couple)⁴ on his income immediately above the exemption level. This would leave a taxpayer whose before tax income is immediately above the exemption level with a smaller after tax income than a taxpayer whose income is immediately below the exemption level.

To avoid the result described above, the section provides that the amount of the surcharge cannot exceed the surcharge which would result if the surcharge applied at twice the annual rate (i.e., 15 percent in 1968), but only to a taxpayer's income tax liability above the exemption level. This means, for example, that a single person whose 1968 tax (before the surcharge) is \$200 must only pay a surcharge of \$8 (or 15 percent of \$55) and not a surcharge of \$15 (or 7.5 percent of \$200). The result of phasing in the surcharge in this manner is to apply the surcharge at the lower rate provided by the phase-in provision only to those taxpayers whose taxes (without regard to the surcharge) are above the surcharge level but are not over about twice the level of the surcharge exemption. The section provides surcharge tables to reflect the surcharge up to the levels where the optional tax tables apply. As a result no taxpayer now determining his tax from the optional tax tables is to be required to compute the surcharge.

The exemption for the individual taxpayer does not apply to an estate or trust. Nor does it apply to a corporation. These latter taxpayers must pay the full amount of the surcharge at the annual rate of 10 percent. In the case of an estate or trust, the surcharge in effect applies (as it does in the case of an individual taxpayer) only for the 15-month period April 1, 1968, through June 30, 1969. In the case of a corporation, the surcharge applies for the 18-month period from January 1, 1968, through June 30, 1969. For a corporation reporting on a calendar year basis, the rate of the surcharge is a full 10 percent in 1968 and 5 percent in 1969.

The surcharge, as previously explained, is a percent of the amount of the income taxes (without regard to additions to tax or penalties) imposed by chapter 1 of the code with certain adjustments. With the exception of certain items, noted below, the surcharge applies with respect to all taxes imposed by chapter 1. For example, the surcharge applies with respect to the tax on capital gains (but not

³ The tax surcharge does not apply in the case of a head of household if the tax does not exceed \$220. For married couples filing separately, the exemption level is the same as for single persons, and for a surviving spouse, the same as for married couples filing joint returns.

⁴ Based on a 10-percent surcharge. With a 7.5-percent surcharge (applicable in 1968) the amounts are \$10.57 and \$21.75, respectively.

in the partial tax computation necessary to determine if the alternate capital gains tax is applicable); it also applies with respect to the tax on accumulated earnings of corporations, to the personal holding company income tax, etc. The surcharge does not apply to the flat 30-percent (or lower treaty rate) tax on the income of a nonresident alien individual which income is not effectively connected with the conduct of a trade or business in the United States, since this tax generally does not change with rate changes. Nor does the surcharge apply to the flat 30-percent (or lower treaty rate) tax on the income of a foreign corporation which income is not effectively connected with the conduct of a trade or business within the United States. The surcharge also does not apply to an increase in tax resulting from a recapture of a previously allowed investment credit, since the surcharge is applied before the allowance of the investment credit. Nor does it apply to an increase in tax resulting in certain instances when a taxpayer elects to aggregate mineral interests since the recapture in this case works only to the extent of the prior tax benefit.

The surcharge applies, as it did under the Senate amendment, before any allowance for credits against tax, such as the foreign tax credit or the investment tax credit, with one exception. The surcharge generally is applied before credits because this is the result which would occur in the case of a rate change. It also is necessary not to inflate the value of the credits. This treatment is consistent with the treatment provided in the past when there was a percentage change in tax.

The surcharge applies after allowance for the retirement income credit. The reason for the exception is to treat taxpayers who receive retirement income substantially in the same manner as individual taxpayers who receive social security benefits. Since social security benefits are exempt from tax, the surcharge does not increase the tax liability with respect to these benefits. Applying the surcharge after allowance for the retirement income credit maintains the present relationship.

Since the surcharge generally applies before the allowance of credits, the limitations on the amounts of the various credits which may be claimed increase as the result of the imposition of the surcharge. For example, the investment credit in any year cannot exceed \$25,000 plus 50 percent of a taxpayer's tax liability in excess of \$25,000. Since the surcharge increases the taxpayer's tax liability for the year, it also increases the maximum amount of the investment credit he can claim. The effect thus is to allow taxpayers to claim credits against the tax resulting from the surcharge.

In order to keep individuals as near current as possible with respect to the payment of their tax liabilities, the amendment provides a new set of wage withholding tables to reflect the surcharge. In addition, those taxpayers who pay their income taxes currently by quarterly payments of estimated tax are required to increase their estimated tax payments to take the amount of the surcharge into account. The provision of existing law which permits a taxpayer (individual as well as corporate) in determining whether or not he is subject to a penalty for underpayment of estimated tax, to rely on his tax shown on his return for the preceding taxable year, is suspended for any taxable year for which the surcharge is imposed. This is necessary to be sure that the

surcharge is more closely reflected in current taxpayments. Taxpayers, however, will not be subject to a penalty if they base their estimate on last year's income but apply the current year's rates (including surcharge). As provided in section 104 of the bill, an individual taxpayer is to increase his estimated taxpayments beginning with his first payment due on or after September 15, 1968. A corporate taxpayer is to take the effect of the surcharge into account beginning with its first taxpayment due on or after June 15, 1968. A special rule requires the Secretary of the Treasury to prescribe a date, not earlier than 15 days after the date of enactment for the payment by a corporation of the increase in its estimated taxpayment due on June 15 (or due later dates) as a result of the enactment of this bill.

The surcharge provision also provides a series of special rules in order to conform existing law to the amendments made by the surcharge. For example, there are specific rules relating to the special deduction for Western Hemisphere trade corporations and the special deduction with respect to dividends on the preferred stock of public utilities. Another rule provides that to the extent the tax imposed by the surcharge is attributable to a tax imposed by another section of the code, the tax is deemed to be imposed by the other section. This rule applies, for example, in the case of the treatment of certain distributions to shareholders of life insurance companies, and the required adjustments for taxes in computing accumulated taxable income, undistributed personal holding company income, and undistributed foreign personal holding company income. The rule also affects how the surcharge applies to an unincorporated business enterprise which has elected to be taxed as a domestic corporation.

The surcharge amendment also contains a special rule increasing required minimum distributions which a domestic corporation must receive from its foreign subsidiaries in order to avoid including the undistributed earnings of the foreign subsidiaries in its own income. In the absence of the minimum distribution, the domestic corporation would have to include a portion of its subsidiaries' income in its own income, even though the subsidiaries did not distribute the income to the parent. This change is necessary to assure that the tax on these corporations' income, domestic and foreign, is at least equal to the tax that would be paid if the income were earned entirely in this country.

Section 103. Speedup of corporate tax payments (sec. 3 of the House bill, sec. 7 of the Senate bill, and secs. 6154 and 6425 of the code)

Present law.—Present law requires a corporation with an estimated income tax (after credits) in excess of \$100,000 to file a declaration and make payments of estimated tax with respect to this excess in the current year; i.e., the year the income is earned. In general, the estimated taxpayments made during the current year must equal at least 70 percent of the tax liability in excess of \$100,000 in order to avoid an addition to tax. These taxpayments for calendar year corporations are payable in equal quarterly installments on April 15, June 15, September 15, and December 15. A corporation with estimated income tax (after credits) not exceeding \$100,000 is not required to make estimated taxpayments.

In general, if a corporation's equal quarterly payments of estimated tax during a year in total are less than 70 percent of its tax over \$100,000 for the year, as subsequently shown on its income tax

return, an addition to tax is imposed amounting to 6 percent per annum on the amount of each quarter's underpayment. However, a corporation is not subject to this addition to tax if one of three exceptions applies. Two of these are related to the corporation's last year's experience; i.e., there is no addition to tax if the total of its estimated tax payments is equal to the income tax reported on its prior year's return less the \$100,000 exemption or if this total is equal to the amount in excess of the \$100,000 exemption derived by applying the current year's income tax rates to the corporation's taxable income in the previous year. A third alternative provides that there is no addition to tax if during the current year, as each quarterly payment comes due, the corporation pays an amount equal to 70 percent of the estimated income tax over \$100,000 which would be due if the corporation's income received throughout the entire year were received at the same rate as in the period prior to the due date of the installment in question. That is, no addition to tax is payable even though quarterly payments are unequal as long as the pattern of payments conforms closely to the pattern of the receipt of income and payments in total equal 70 percent of the amount of tax in excess of \$100,000.

Explanation of conference provision.—The House bill made four changes in the estimated tax procedure.

First, it repealed the requirement that a corporation, in paying its estimated tax, file a declaration of estimated tax. This action was taken on the grounds that there is no justification for requiring a corporation to continue filing a form which, under present practices, serves no useful purpose. The Senate bill made no change in this provision of the House bill and it is included in the conference agreement. With the shift in 1967 to the collection of estimated tax of corporations through the use of banks as depositaries, the filing of declarations of estimated tax by corporate taxpayers became unnecessary. The declarations formerly were used as a means of identifying and billing the taxpayer; but, since shifting to the depositary system, the Service supplies the taxpayer with deposit forms for each quarterly payment which contain the taxpayer's identifying number. The deposit forms provide both the Service and the corporation (through the retention of a stub) with a record of payments and also serve as a reminder to the corporation as to when payments are due.

The second change in estimated tax procedure made by the House bill eliminated, over a 5-year transitional period, the \$100,000 exemption for payment of estimated tax liability. The Senate bill used the same 5-year transitional period, but reduced the \$100,000 exemption generally¹ to \$5,500 (the tax on the first \$25,000 of income). Both the House bill and the Senate bill provided for estimated taxpayments only if the corporation's estimated income tax, after credits and its exemption, exceeded \$40. (Present law has a similar rule in the case of an individual taxpayer.) As the House and Senate reports indicate, this reduction in the corporate estimated taxpayment exemption, in addition to meeting the need for additional revenue, removes a competitive tax advantage to those operating in corporate form. The phaseout is provided to give the corporation time to arrange its financing.

The conferees agreed to eliminate the \$100,000 corporate exemption as provided in the House bill, but over two, instead of one, 5-year

¹ Throughout this part of the report the figure \$5,500 is used. This is applicable to corporations other than those who can reasonably expect their surtax exemption under sec. 11(d) to be less than \$25,000. In that case, the figure equal to 22 percent of their surtax exemption should be substituted for \$5,500.

transitional periods. In the first 5-year period (1968 to 1972, inclusive), a progressively smaller "transitional exemption" is to be employed which places all tax liabilities above \$5,500 on a current basis. The transitional exemption is a given percentage of the difference between the first \$100,000 of a corporation's estimated income tax liability (after credits) and \$5,500. Thus, if the corporation's estimated income tax liability (after credits) is less than \$100,000, the percentage applies to the difference between its estimated tax liability and \$5,500. This percentage, called the exclusion percentage, is to be 80 percent in 1968, 60 percent in 1969, 40 percent in 1970, 20 percent in 1971, and is to be eliminated in 1972, at which time the exemption is to be \$5,500.

In the second 5-year period (1973 to 1977, inclusive), the \$5,500 exemption is to be phased out entirely. In this case another transitional exemption (technically the "temporary estimated tax exemption") is to be available. It is to be the product of \$5,500 or, if less, the corporation's estimated income tax liability (after credits), times an applicable percentage equal to 80 percent in 1973, 60 percent in 1974, 40 percent in 1975, and 20 percent in 1976, and falls to zero in 1977.

These dual periods for the phaseout of tax liabilities over and under \$5,500 mean that eventually all taxable corporations (with \$40 or more of estimated tax) are to be required to pay their tax currently. However, a longer period is made available for the first \$5,500 of tax liability since this primarily affects small businesses.

The third estimated tax change made by both the Senate and the House versions of the bill, and included in the conference agreement, is to increase from 70 percent to 80 percent the percentage of estimated tax which must be paid currently (including the percentage payable currently if the quarterly annualization method is used) to avoid an addition to tax. This provision restores the balance between the corporate taxpayer and the individual which existed before the Tax Adjustment Act of 1966 advanced these percentage requirements from 70 percent to 80 percent for individuals. In addition, in raising the percentage tests (as in phasing out the existing exemption), corporations are brought closer to a full pay-as-you-go basis.

The following table shows the allowable exemptions for corporations with estimated income tax liabilities of \$100,000 or more in the first transitional period and with estimated income tax liabilities of \$5,500 or more in the second:

1ST 5-YEAR PERIOD

	Exclusion percentage	Exclusion base ¹	Transitional exemption ²
1968.....	80	\$94,500	\$78,000
1969.....	60	94,500	56,700
1970.....	40	94,500	37,800
1971.....	20	94,500	18,900
1972.....			5,500

2D 5-YEAR PERIOD

	Applicable percentage	Exclusion base	Temporary estimated tax exemption ³
1973.....	80	\$5,500	\$4,400
1974.....	60	5,500	3,300
1975.....	40	5,500	2,200
1976.....	20	5,500	1,100
1977 and later years.....			0

¹ \$100,000 less \$5,500 in 1st 5-year period.

² Payment of estimated tax required only if estimated tax exceeds exemptions by \$40 or more.

For a corporation with income tax liability of less than \$100,000 in the first 5-year period, the transitional exemption is the exclusion percentage multiplied by the estimated income tax less \$5,500. For example, assume that a corporation's estimated income tax liability for 1968 is \$96,000. The transitional exemption is to be \$72,400 (80 percent of \$90,500) making the required tax payment \$18,100 (\$96,000 minus the sum of \$5,500 and \$72,400). In the second 5-year period, the transitional exemption for those corporations with an estimated tax liability of less than \$5,500 is the applicable percentage multiplied by the estimated income tax.

The fourth change in estimated tax procedure made by the House and Senate bills relates to quick refunds of overpayments of estimated tax by corporations. As previously indicated, existing law requires a corporation with an estimated income tax in excess of \$100,000 to make payments of estimated tax in the current year. If the total of these payments exceeds the tax shown on the return, the corporation may claim the overpayment as a refund. It may not claim this refund, however, until it files its income tax return for the year. Unlike the individual, who makes his last installment payment after the close of the year, the corporation must complete its payments during the year, and therefore cannot reduce these payments to reflect yearend losses. Moreover, corporations may claim automatic 3- or 6-month extensions of time for filing their tax returns merely by filing requests (but are required to make payments of proper estimates of tax on the due date). The result is that corporations often do not file their income tax returns until more than 8 months after the close of their taxable years. Even then, the Internal Revenue Service may wait another 45 days before refunding any overpayment of taxes without paying interest on the overpayments. As a result, a total of 10 months may elapse between the close of the year and the time corporations receive refunds of overpayments of tax.

The House bill allowed a corporation to apply for a quick refund or, more technically, an adjustment of overpayment of estimated tax, immediately after the close of its taxable year. A corporation can do so when its current revised estimate of income tax liability shows that its estimated tax payments exceed its revised estimate by at least 5 percent of the revised estimate and that the excess amounts to at least \$200.

The Senate accepted the House provision, except that, to ease the administrative burden of the Internal Revenue Service, it provided that the overpayment of estimated tax must exceed the expected tax liability by 10 percent (instead of 5 percent) and must exceed \$500 (instead of \$200) to be eligible for the quick refund. The conferees accepted the Senate provision.

The amendments made by the provisions described above apply to taxable years beginning after December 31, 1967.

Section 104. Special rules for application of tax surcharge and speedup of estimated corporate taxpayments (sec. 7(f)(2) of the Senate bill)

This section of the conference substitute provides special rules with respect to the application of the tax surcharge to payments of the surcharge for taxable years which end before the date of enactment. It also contains special rules with respect to the application of the tax surcharge, and the amendment relating to the speedup in corporate

estimated taxpayments, for payments of estimated tax for taxable years beginning before the date of enactment of the bill.

With respect to the payment of the tax surcharge for a taxable year to which the surcharge applies which ends before the date of enactment of the bill, the conference substitute provides that the time prescribed for payment of the surcharge is not to expire before September 15, 1968. The Internal Revenue Service presumably will require a taxpayer to file a statement with his payment of the surcharge. The statement is not to constitute a return. This means, for example, that it is not to affect the period of limitations, the collection or assessment of tax, etc. No interest, penalty, or addition to tax, which is determined by reference to a period of underpayment, is to begin with respect to the surcharge before September 15, 1968. In the case of a corporate taxpayer, if it elects to pay its tax liability in two installment payments, that portion of the surcharge which otherwise should be paid (as a result of enactment of this bill) with an installment paid before September 15, 1968, must be paid on or before that date.

This section also has application where the tax surcharge and the speedup of estimated taxpayments required of corporations increase the estimated taxpayments required in the current year.

This provision provides, in the case of individuals, that the increase in estimated taxpayments required as a result of the surcharge is not required to be paid until September 15, 1968. The individual is to take the surcharge into account in determining the amount of estimated taxpayments he must make in his installments due on September 15 and thereafter. This means, for example, that if an individual has two remaining installment payments due in the current taxable year, he is to pay one-half of his additional tax resulting from imposition of the surcharge on or before September 15 and the balance on or before January 15, 1969.

In the case of a corporate taxpayer, it must take any increase in estimated taxpayments required as a result of the imposition of the surcharge and enactment of the speedup requirements into account beginning with its first estimated tax payments due on or after June 15, 1968. However, the Secretary of the Treasury is to require the increase in estimated tax due with the June 15 payment (or payments due later) to be paid at a date not earlier than 15 days after the date of enactment.

Section 105. Excise tax on communication services and on automobiles (sec. 2 of the House bill, sec. 6 of the Senate bill, and secs. 4061 and 4251 of the code)

Present law; automobile tax.—The excise tax on passenger automobiles (imposed on the manufacturer's price) was 7 percent before May 1. On that date the rate, in the absence of the enactment of this bill, would fall from 7 to 2 percent and is scheduled to fall to a permanent rate of 1 percent on January 1, 1969.

Explanation of conference provision; automobile tax.—Both the House and Senate versions of this provision provided for the continuance of the 7-percent excise tax on passenger automobiles. They also substituted a new timetable for the scheduled reductions in the excise tax. Finally, they provided for the repeal of the tax effective January 1, 1973. The conferees, therefore, made no changes in this provision

(except changes to reflect the joint resolution continuing the 7-percent rate from March 31, 1968, to April 30, 1968).

The new timetable restores the 7-percent rate and postpones the scheduled reductions in the excise tax on passenger automobiles for a temporary period. At the same time it tempers the effect that the scheduled reductions would have on consumer purchases by providing for a gradual reduction in rate. Finally, the new timetable provides for the repeal of the tax at the end of the postponement period.

The 7-percent excise tax on passenger automobiles is restored effective May 1, 1968, to continue until January 1, 1970. On that date the rate is to fall to 5 percent. Further annual reductions of 2 percentage points each then are to occur on January 1, 1971, and January 1, 1972, as the rate falls from 5 to 3 percent and from 3 to 1 percent, respectively. On January 1, 1973, the tax rate is to fall to zero. As in the past, refunds are to be paid to dealers with respect to automobiles held in inventory on the date of any rate reduction. The following schedule of excise tax rates is to be applicable in the case of passenger automobiles:

Before Jan. 1, 1970.....	7
During 1970.....	5
During 1971.....	3
During 1972.....	1
Thereafter.....	0

Present law; communication tax.—The excise tax on amounts paid for local and toll telephone and teletypewriter exchange service was 10 percent before May 1, 1968. On that date, the rate, in the absence of the enactment of this bill, would fall to 1 percent and is scheduled to be repealed on January 1, 1969.

Explanation of conference provision; communication tax.—Both the House and Senate versions of the bill provided for the continuance of the 10-percent tax rate on telephone services and teletypewriter exchange service. They also provided for a graduated reduction in the rate before the rate falls to zero on January 1, 1973. The conferees made no changes in this provision (except for a change made to reflect the joint resolution continuing the 10-percent rate from March 31, 1968, to April 30, 1968).

The scheduled reduction and repeal of the excise tax on telephone services and teletypewriter service generally parallels the scheduled reduction and repeal of the excise tax on passenger automobiles. Thus, the 10-percent rate (restored effective May 1, 1968) is to apply until January 1, 1970, when it is to fall to 5 percent—the same rate then scheduled for the automobile excise tax. Annual reductions of 2 percentage points each then are to occur on January 1, 1971, and January 1, 1972, so that the tax rate is to be 3 percent in 1971 and 1 percent in 1972. On January 1, 1973, the tax is to cease. In applying these new rates, bills for services before November 1 of a calendar year are to bear the tax of that year even if the bill for the services is not rendered before the close of the year. As a result, the schedule of rates in the case of these telephone services is as follows:

	<i>Percent</i>
Before Jan. 1, 1970.....	10
During 1970.....	5
During 1971.....	3
During 1972.....	1
Thereafter.....	0

Section 106. Timely mailing of tax deposits (sec. 4 of the House bill, sec. 8 of the Senate bill, and sec. 7602(e) of the code)

Present law.—The Internal Revenue Service is placing increasing reliance on the deposit method for the collection of taxes and now is collecting about \$100 billion a year in this manner. Presently most withheld income taxes, estimated corporate income taxes, and excise taxes are collected in this manner. About 90 percent of the banks in the country are designated as depositories for this purpose. This allows most taxpayers to hand deliver deposits on or before the last day prescribed for deposit and avoid any addition to tax that would otherwise result.

Some taxpayers, however, find it more convenient to mail tax deposits than to hand deliver them. This may occur, for example, because a corporation with centralized financial management desires to make deposits with banks in the various communities in which its plants are located. Under the regulations, these deposits which are mailed are not considered as made until received by depositories. The responsibility for timely mail delivery thus falls on the taxpayers. This differs from the general rule which treats payments as made when mailed.

Explanation of conference provision.—This provision, which is the same in both the House and Senate versions of the bill, provides that where a taxpayer mails his tax deposit 2 or more days before the prescribed due date, the mailing is to be considered a timely deposit even though the deposit is received after the due date (but only if it is actually received). Thus, the Government, and not the taxpayer, bears the responsibility for timely mail delivery.

The mailing of a deposit 2 or more days before the due date for payment is to be considered as payment only where the taxpayer can establish that he timely mailed the deposit. In the case of a deposit sent by registered mail, the date of registration is to be deemed the date of mailing. The taxpayer, of course, could also establish the date of mailing by other competent evidence.

The conferees made no change in this provision.

This provision applies to mailings occurring after the date of enactment of this bill.

Section 107. Industrial development bonds (secs. 9 and 10 of the Senate bill and sec. 103 of the code)

Present law.—Present law provides an exemption from income tax for interest on obligations of a State or local government. The Internal Revenue Service in the past has ruled that so-called industrial development bonds were State or local bonds for this purpose. The Treasury Department, on March 6, 1968, announced (in TIR 972) that it was reconsidering its position as to whether interest paid on so-called industrial development bonds comes within the exemption. It also announced that, on or about March 15, it would publish proposed regulations holding that these bonds are not obligations of a State or local governmental unit.

On March 23, 1968, the Treasury Department published proposed regulations holding that industrial development bonds (as defined in the regulations) are not to be considered obligations of a State or local government within the meaning of the exemption provision of the code. Therefore, under the proposed regulations, interest on these industrial

development bonds is subject to tax. The proposed regulations, with certain exceptions for bonds in process of issue on March 15, apply to industrial development bonds initially sold after March 15, 1968. The exceptions for bonds in process of issue extend the March 15 effective date to bonds sold before September 15, 1968. (On May 14, the Internal Revenue Service announced (in IR-926) that it was postponing scheduled hearings on the proposed Treasury regulations until Congress acted on this bill.)

Explanation of conference provision.—The Senate adopted two amendments dealing with interest on industrial development bonds. The first (sec. 9 of the Senate bill) provided that, until a change in law hereafter enacted, interest on these bonds was to continue to be tax exempt in accordance with the regulations in effect on March 13, 1968 (2 days before the effective date of the proposed Treasury regulations) and in accordance with the principles set forth in certain prior revenue rulings. This amendment also authorized and directed the Internal Revenue Service to issue ruling letters with regard to the exempt status of industrial development bonds in accordance with the position stated in the regulations in effect on March 13, 1968, and the prior rulings. (See, Rev. Ruls. 54-106, 57-187, and 63-20.)

The second Senate amendment (sec. 10) dealing with industrial development bonds provided that interest on those bonds (as defined in the amendment) issued after January 1, 1969, was not to be considered tax-exempt interest. The amendment excepted bonds issued with respect to certain listed facilities. These excepted facilities included (among others) sport facilities, convention and tradeshow facilities, airports, docks, wharves, and grain storage facilities, parking and certain other transportation facilities, facilities for furnishing power, air or water pollution abatement facilities, and facilities used by a State or local government in an active trade or business.

The provision in the conference substitute dealing with interest on industrial development bonds is a modification of the two Senate amendments. The conference substitute in effect provides that industrial development bonds, as defined here, which are part of an issue of \$1 million or less, or which fall within certain specified categories, are to continue to be exempt obligations. Thus, interest on these bonds is to be tax exempt (as was true under sec. 9 of the Senate bill of bonds coming within the purview of the Treasury regulations in effect on March 13, 1968, and the prior revenue rulings). On the other hand, industrial development bonds, as defined here, which are part of an issue in excess of \$1 million, and which do not fall in one of the specified exempt categories, are to be considered obligations which are not those of States or local governments. Therefore the interest on these bonds is to be subject to tax (as was true of those coming within the purview of sec. 10 of the Senate bill and those coming within the purview of the proposed Treasury regulations).

The provision in the conference substitute deals exclusively with industrial development bonds as defined here; it is not intended to, and does not, reflect on the status of other types of obligations. Thus, for example, the provision does not deal with the status of so-called arbitrage bonds. The Internal Revenue Service has announced that it will not issue rulings on the tax status of these bonds. (See TIR 840, Aug. 11, 1966.)

The substitute provision provides that, for a bond to be an industrial development bond, two elements must be present, one relating to the use of the bond proceeds and the other relating to the security for payment of the bonds. A bond is an industrial development bond only if the use of its proceeds, and the security for its payment, both are within the terms of the definition.

The first element which must be present for a bond to be an industrial development bond is that it must be a part of a bond issue all or a major part of the proceeds of which are to be used, directly or indirectly, in any trade or business by a person other than an exempt person. The fact that the proceeds of a bond issue are used by an exempt person in what may be classified as a trade or business does not mean that the bond issue may not be an industrial development bond issue if the proceeds also are used in the trade or business of another person. For example, even though an exempt person may be using the proceeds of a bond issue in what might be considered a lending or leasing business, when it lends the proceeds or leases the property to other persons in a series of transactions, the bond issue nevertheless meets the first element of the definition of an industrial development bond if the person borrowing the proceeds or leasing the property from the exempt person uses the proceeds or property in his own business. Similarly, a bond issue meets this element of the industrial development bond definition when the exempt person sells property acquired with the proceeds of the bond issue in a series of transactions to other persons who in turn use the property in their trade or business.

In some cases the proceeds of a bond issue may be used in part in trades or businesses carried on by taxable persons, but not in major part. For example, bonds issued by a turnpike authority to cover both the cost of highway construction and the cost of erecting incidental facilities, such as gasoline service stations and restaurants which are leased or sold to private trades or businesses, are not industrial development bonds since a major portion of the proceeds are not used directly or indirectly in trades or businesses carried on by taxable persons.

An "exempt person" for purposes of the provision described above is a governmental unit or a tax-exempt religious, charitable, educational, etc., organization (exempt by reason of secs. 501(a) and 501(c) (3) of the code). In this latter case, however, the exempt organization is included only when it uses the proceeds of the bond issue in an activity which is not an unrelated trade or business as determined elsewhere under the tax laws (this determination is to be made whether or not the particular organization may be subject to the unrelated business income tax).

The result of these exemptions for governmental units and certain exempt organizations is to exempt bond issues such as those issued by a State or local governmental unit to finance dormitory facilities for tax-exempt educational institutions, or to finance hospital facilities for tax-exempt hospitals (charitable), since bond issues for the use of specified types of exempt organizations are not included in the first element of the definition of industrial development bonds. This results because no other person is directly or indirectly using the dormitory or hospital facilities in a trade or business. Therefore the interest on these bonds is not taxable whether or not the bond issue

comes within the terms of the second element in the definition described below.

The second element which must be present for a bond to be an industrial development bond is that it must be in whole or in major part either secured by an interest in property used in a trade or business, or in payments made with respect to this property, or it must be derived from payments in respect of property or borrowed money used (or to be used) in a trade or business. It is not necessary, in order for this second element to apply, for the property meeting this element of the industrial development bond definition to be the same property referred to in the first element of the definition; i.e., the property securing payment need not be the same property for which the bonds are issued. The fact that the bond issue may also be secured by the full faith and credit of the governmental unit does not prevent a bond from meeting the second element of the industrial development bond test as long as payment of the obligation also in major part is secured by or to be derived from the property or payments referred to above.

As does the Senate amendment providing for a tax on interest on industrial development bonds, the conference substitute also excepts bonds issued by a governmental unit to provide facilities for certain exempt activities even though the activities are carried on by a private person in a trade or business. These exceptions are in addition to the exemption for interest on bonds which are part of an issue of \$1 million or less.

The conference substitute, by providing an exception for a bond issued as part of an issue substantially all the proceeds of which are to be used for facilities for the following listed purposes, in effect provides that interest on bonds for these purposes is to be tax exempt. The exemption applies to bonds issued by a governmental unit to provide: (1) residential real property; (2) sports facilities; (3) facilities for a convention or trade show; (4) airports, docks, wharves, mass commuting facilities, parking facilities, or facilities for storage or training directly related to any of the foregoing; (5) sewage or solid waste disposal facilities, facilities for the local furnishing of electric energy, gas or water; and (6) air or water pollution control facilities.

The exemption for residential real property for family units relates to buildings containing one or more complete living facilities which are not intended to be used on a transient basis. The facilities to qualify must contain complete facilities for living, sleeping, eating, cooking, and sanitation. Hotels, motels, dormitories, fraternity and sorority houses, roominghouses, hospitals, sanitariums, rest homes, and parks and courts for mobile homes do not qualify. On the other hand, residential real property is intended to include facilities which are functionally related and subordinate to the space used for family units. In addition, the fact that a minor portion of a facility is used for other nonfamily unit purposes (such as a laundromat, drugstore, or other retail establishment) is not intended to foreclose qualification for the facility.

The exemption for bonds issued to provide sports facilities applies, as did the corresponding Senate amendment, both to spectator sport facilities and to participation sport facilities. Thus, the exemption applies to bonds issued by a governmental unit to provide such facilities as baseball and football stadiums and indoor sports arenas as well as to provide ski slopes, golf courses, tennis courts, swimming

pools, and gymnasiums. Facilities directly related to exempt sports facilities are intended to be considered sports facilities for purposes of this exemption. Facilities constructed in connection with, but not directly related to, a sports facility, such as a ski lodge to be built in connection with the development of a ski slope, are not to be considered sports facilities. Thus, interest on bonds issued in part to furnish the lodge is to be tax exempt only if this represents a very minor part of the total project and if in the case of the total project substantially all the proceeds are to be used to develop the ski slope and directly related facilities, such as a warming house and restaurant, etc.

The exemption for bonds issued to provide convention or trade show facilities applies only with regard to special-purpose buildings and structures constructed for convention or trade shows. This means, for example, that the exemption does not apply to bonds issued to finance a hotel even though the hotel expects and does a major part of its business in catering to delegates or participants at conventions or trade shows.

The exemption for storage or training facilities directly related to airports, docks, wharves, mass commuting and parking facilities is intended in the case of training to include facilities for flight training. In addition, facilities for storage with any of the foregoing is intended to include conveyors to move products from a ship to a silo or other storage facility on a wharf.

In addition to the exemption for the activities listed above, the conference substitute also exempts interest on a bond issued as part of an issue substantially all the proceeds of which are to be used for the acquisition or development of land as a site for an industrial park. An industrial park in general is a series of sites for industrial (including wholesaling and distributing) plants for which a plan has been developed and for which there usually are special zoning restrictions. The term "development of land" for this purpose includes providing water, sewage, etc., facilities, road, railroad, docking or similar transportation facilities, and power or communication facilities. Except for the facilities referred to above, the term does not include the provision of any buildings or structures.

The conference substitute, as previously noted, provides an exemption for an industrial development bond which is part of an issue of \$1 million or less. In determining whether a bond issue is within the \$1 million exemption, the proceeds of outstanding prior issues, as well as of issues of another governmental unit, in respect of the principal user of facilities constructed with the proceeds of the first issue are taken into account if the later facilities are located in the same county or municipality. Related persons (such as corporations whose stock is owned by the same individual) are considered as one for purposes of the \$1 million exemption.

The exemptions listed above with respect to certain exempt activities, the financing of an industrial park, and bond issues of \$1 million or less, do not apply to industrial development bonds during any period in which they are held by a person who is a substantial user of the facilities constructed with the proceeds of the bond. Thus, the interest on these bonds which come within the listed exceptions is to be taxable when received by a substantial user of the facilities.

The conference substitute applies with respect to industrial development bonds issued on or after May 1, 1968. As do the proposed regu-

lation in this regard, the substitute provides certain exceptions for bonds in process of issue on the effective date of the amendment. The exceptions for bonds in process of issue extend the May 1 effective date to bonds issued before January 1, 1969. The first two exceptions extend the effective date if, before May 1, the governmental unit issuing the bonds, or its voters, had authorized or approved the bond issuance, or the project in connection with which the proceeds are to be used, or the governmental unit had made a significant financial commitment in connection with the issuance.

A governmental unit is to be considered as having approved a bond issuance within the meaning of the first exception if it has committed the Government to issue the bonds in question. An authorization of a bond issue, however, does not require a binding commitment on the part of the governmental unit for this purpose. An agreement with the principal user of the facilities to be constructed with the bond issuance, a general resolution approving an industrial development project and a bond issuance, or a resolution of the governing body providing for submission of the bond issue to the voters is to qualify the bond issue for this purpose. Similarly, a resolution of a local governmental unit authorizing a bond issue but subject to approval of the State (or an agency or department of the State) is also to qualify the bond issue.

The third exception extends the May 1 effective date to bonds issued before January 1, 1969, if, before the earlier date, the private party who is to use the bond proceeds, or the property to be acquired or improved with the proceeds, had spent, or had committed himself to spend, for purposes related to the use of the property, an amount equal to 20 percent of the bond proceeds. A commitment to purchase power to be used in the operation of the property acquired with the proceeds of a bond issue is one example of a commitment for purposes of this provision. It is the total amount to be spent under a contract of this type (even if the contract is for a period of years) which is the amount of the commitment. Another example of a commitment or expenditure for this purpose is an expenditure or a commitment to spend amounts for raw materials to be used in connection with the property to be constructed with the bond proceeds. The expenditure of funds or the commitment to spend funds to buy timberland for use in a paper plant is still another example of what would constitute a commitment or expenditure for this purpose.

The fourth exception extends the May 1 effective date to bonds issued before January 1, 1969, if, before the earlier date, a Federal or State economic development (or similar) agency had before it, or had approved, an application for financial assistance in conjunction with a project involving the bond issue and for which the agency extends financial assistance. For purposes of this exception, a loan or a grant in aid, or a guarantee of bonds issued by a local governmental unit, is to be considered financial assistance. Moreover, for this exception to apply, the financial assistance is not required to be extended directly to either the governmental unit issuing the bonds or to the person who is to use the property acquired or constructed with the bond proceeds. It is sufficient in this regard if the agency renders financial assistance in conjunction with a project which includes the property in respect of which the governmental unit issues the bonds.

Section 108. Advertising in a political convention program (sec. 13 of the Senate bill and sec. 276(c) of the code)

Present law.—Present law denies a deduction for an amount paid or incurred for advertising in a convention program of a political party. This limitation presently applies whether or not the amount paid or incurred might otherwise be deductible as an ordinary and necessary business expense.

Explanation of conference provision.—The conference substitute (which is substantially the same as the Senate amendment) modifies the present restriction denying a deduction for an amount paid or incurred for advertising in a political convention program to allow a deduction for the cost of this advertising under certain limited circumstances. An amount paid or incurred for advertising in a political convention program which is not deductible under this amendment is not deductible under any circumstance. The basic limitation of existing law which denies a deduction for indirect contributions to political parties produces this result.

This amendment allows a deduction for an amount paid or incurred for advertising in a political convention program only if the convention is one held to nominate candidates for the offices of President and Vice President of the United States. In addition, for the deduction to be available, the proceeds from the convention program must be used *solely* to defray the cost of conducting the convention (or a subsequent convention of the party held for the same purpose). Finally, under the amendment, an amount paid or incurred for advertising in a political convention program is deductible only if the amount is reasonable in light of the business the taxpayer may expect to receive (1) directly as a result of the advertising, or (2) as a result of the convention being held in an area where the taxpayer has a principal place of business.

This amendment does not permit a deduction for any amount paid or incurred which is not otherwise allowable as an ordinary and necessary business expense for advertising. On the other hand, the fact that the cost of advertising might otherwise be deductible as an ordinary and necessary business expense does not mean that the cost of advertising in a political convention program is necessarily deductible under this provision. In order for an ordinary and necessary business advertising expense to be deductible under the provision, the expense must satisfy the more restrictive tests for deductibility which the provision imposes.

For example, the cost of institutional or goodwill advertising, if reasonable in amount, generally is allowable as a business expense deduction under the code. Thus, the cost of an advertisement welcoming delegates to a nonpolitical convention generally is deductible even though the advertisement merely names the business concern and does not refer to its product or try to stimulate sales directly to the persons attending the convention. Under the limitations of the new amendment, however, an amount paid or incurred for institutional advertising of this type at a political convention is not deductible as a direct advertising expense. Such an advertisement could be deductible only if the taxpayer has a principal place of business in the area where the convention is held.

Under the amendment, a taxpayer may deduct an amount paid or incurred for advertising in a political convention program only if the

amount is reasonable in light of the business the taxpayer may expect to receive either directly as a result of the advertising or as a result of the convention being held in an area in which he has a principal place of business. This test of reasonableness applies throughout the amendment. It means that no deduction is allowable under the amendment unless the amount paid or incurred for advertising in a political convention program is no more than the amount which is (or would be) paid or incurred for comparable advertising in a comparable convention program of a nonpolitical organization involving comparable attendance.

These restrictions relating to direct advertising or principal place of business are intended to be such that in all events no amount is to be deductible which is essentially a political contribution.

The amendment applies with respect to amounts paid or incurred after January 1, 1968.

Section 109. Tax-exempt status of certain hospital service organizations (sec. 19 of the Senate bill and sec. 501(e) of the code.)

Present law.—The Internal Revenue Code does not now contain any provisions dealing specifically with the taxable status of organizations which render ordinary commercial services only to tax-exempt organizations. Accordingly, the Internal Revenue Service takes the position that if two or more tax-exempt hospitals join together to create an entity to perform ordinary commercial services for them this entity is not a tax-exempt organization.

Explanation of conference provision.—The Senate bill provided that certain entities which provide joint services solely to tax-exempt hospitals would be tax-exempt organizations (and treated like tax-exempt hospitals). As a result, they would pay no income tax and contributions to them would be deductible. The purpose of this type of joint service organization is to aid hospitals in lowering costs by performing administrative and other similar services on a joint basis.

To come within the Senate provision, an organization must—

(1) Provide services which if performed on its own behalf by a hospital would constitute part of its exempt activities.

(2) Be organized and operated to provide services solely for tax-exempt hospitals, including those owned and operated by any government agency.

(3) Be organized and operated on a cooperative basis (whether or not under a specific state statute on cooperatives) and make patronage refunds within 8½ months after the close of the taxable year.

(4) Have its capital stock (if there is stock) held solely by its patrons.

The conferees agreed to the Senate provision, but limited it to a joint enterprise which is organized and operated solely to perform one or more of the following services for hospitals: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel. Thus, an organization is not to qualify for exemption under this section if it performs any other services such as, for example, general laundry services or performs any services for other than a tax-exempt hospital.

The amendment is effective for taxable years ending after the date of enactment.

Section 110. Submission of proposal for tax reform (sec. 90 of the Senate bill)

This provision, added by the Senate, provides that not later than December 31, 1968, the President is to submit to the Congress proposals for a comprehensive reform of the Internal Revenue Code of 1954. The conferees accepted this provision without change.

TITLE II—EXPENDITURE CONTROLS (Secs. 2, 3, and 4 of the Senate bill)

The conference committee agrees with the Senate that positive action to impose controls on the level of Federal expenditures must accompany the provision which increases individual and corporate income taxes. The difficult decision to recommend an increase in taxes is taken because it is apparent that such action is required to halt inflation, relieve pressures on the domestic financial markets, and strengthen the international standing of the dollar. Unless expenditures also are controlled, however, the revenue gained from the surcharge might be dissipated by increased spending. Inflation will continue if a rapid increase in Federal expenditures is allowed to offset the impact of a tax increase. Continued inflation will increase speculation against the dollar and weaken the balance of payments. Continued large deficits will also increase the pressures in domestic financial markets which have already resulted in the highest interest rates in over a century.

Exercise of the necessary degree of control over expenditures cannot be assured without the approval of explicit provisions imposing ceilings on spending and grants of obligational authority.

To impose meaningful limits on Federal expenditures, action must be taken on several fronts. It is not enough to set a ceiling on the actual expenditures of a given fiscal year. Such a ceiling, although necessary, can in effect be avoided by postponing rather than reducing expenditures. Action must also be taken therefore to limit the grants of obligational authority under which future expenditures are made. Rescissions in existing amounts of unspent obligations are also important. The bill approved by the conferees, therefore, not only imposes a ceiling on the level of expenditures for the fiscal year 1969, but also imposes a similar ceiling on grants of new obligational authority and requires that proposals be submitted for rescissions in the amount of outstanding unobligated obligational authority. Consistent with the objective of expenditure control, the conferees also approved the imposition of a ceiling on the number of Federal civilian employees in the executive branch of the Government. These provisions are discussed below.

Section 201. Limitation on number of Government employees

The Senate bill provided that only two out of four vacancies were to be filled in the executive branch until such time as the number of full-time civilian employees (including the full-time equivalent of the number of part-time employees) in the executive branch was no higher than the number employed on September 20, 1966. The vacancies to be filled were to be determined on a Government-wide basis by the Director of the Bureau of the Budget. Excepted from this provision were employees of the Defense Department, CIA, postal field service, FBI, employees of the TVA engaged in its power program and paid

from other than appropriated funds, casual employees, employees employed without compensation and officers appointed by the President with the advice and consent of the Senate.

The bill approved by the conferees requires the number of these Federal civilian employees to be gradually reduced to, and subsequently maintained at the June 1966 level. Federal full-time permanent employment has already increased by about 244,000 since the end of the fiscal year 1966.

Under the conference provision, separate limitations are provided for full-time permanent employees and for part-time and temporary employees. With regard to the former, Federal executive agencies and departments are permitted to employ only as many new full-time employees as are required to fill three out of every four vacancies that occur by reason of the resignation, retirement, removal, or death of existing employees, until such time as the overall number of such employees is reduced to 2,366,317,¹ the number of full-time permanent employees on the rolls on June 30, 1966, as shown in table 2. Once this level is reached, new employees may be employed without restriction as long as the overall number of full-time civilian employees does not exceed this level. It is estimated that there were as of March 31, 1968, 2,610,304¹ full-time permanent civilian employees in the executive departments and agencies.

TABLE 2.—FEDERAL CIVILIAN EMPLOYMENT—EXECUTIVE BRANCH

Month	June 1966-March 1968		
	Full-time permanent	Temporary and part-time employment	Total employment
1966—June.....	2,366,317	359,827	2,726,144
July.....	2,382,253	364,032	2,746,285
August.....	2,402,870	380,179	2,783,049
September.....	2,418,146	343,729	2,761,875
October.....	2,424,169	358,987	2,783,156
November.....	2,478,274	344,750	2,823,024
December.....	2,490,186	464,403	2,954,589
1967—January.....	2,508,631	327,800	2,836,431
February.....	2,524,958	327,638	2,852,596
March.....	2,538,575	332,374	2,870,949
April.....	2,545,545	342,311	2,887,856
May.....	2,554,374	338,353	2,892,727
June.....	2,572,236	365,678	2,937,914
July.....	2,581,684	418,043	2,999,727
August.....	2,583,267	398,107	2,981,374
September.....	2,582,715	318,582	2,901,297
October.....	2,605,855	311,416	2,917,271
November.....	2,619,667	307,682	2,927,349
December.....	2,608,867	421,524	3,030,391
1968—January.....	2,608,176	305,412	2,913,588
February.....	2,607,459	294,228	2,901,687
March.....	2,610,304	297,234	2,907,538

The number of temporary and part-time Federal Government employees in any one month is not to exceed the number of similar employees on the rolls in the corresponding month of the calendar year 1967. The monthly total of part-time employees in 1967 also is shown in table 2.

Exemptions are provided from the terms of this provision for persons appointed by the President with the advice and consent of the Senate, for casual employees, for employees serving without com-

¹ Does not take into account adjustments for exemptions described subsequently which make up only a very small percentage of the total.

pensation, and for up to 70,000 persons between the ages of 16 to 22 who may be provided summer employment under programs for the economically or educationally disadvantaged.

The limitations are to be applied by each executive agency and department. However, the Director of the Budget is authorized to reassign vacancies from one department or agency to another when in his opinion such reassignment is necessary or appropriate because of the creation of a new department or agency, because of a change in functions, or in order to obtain the more efficient operation of the Government.

It is important to note that this enables the Director of the Bureau of the Budget to prevent reductions in employment levels in any agency where this would seriously interfere with the operation of the Government by making larger reductions in employment in other agencies. In keeping with the June 30, 1966 date, the provision is carefully designed so that it can be operated in such a fashion that whenever any agency has reached its June 30, 1966 level; then it can be in a position to resume full appointment. To this end, the conferees believe that the more efficient operation of the Government means that the Director of the Budget generally should reassign vacancies to any agency which has reached its June 30, 1966 level. For example, in applying this provision in the case of the Veterans' Administration (including all such employees working in veterans hospitals), no reduction should be required in employee levels below that of June 30, 1966, in the case of permanent or full-time employees.

In addition, the Director is authorized, in effect, to pool all agencies with 50 or fewer full-time permanent civilian employees to permit the three out of four vacancy rule to be applied on an overall basis for these agencies without separate regard to the number of vacancies in any one of them. The determination of the vacancies to be filled in these pooled agencies is to be made by the Director of the Bureau of the Budget.

When a full-time permanent civilian employee is transferred from one department or agency to another, the agency from which the employee is transferred is to be permitted to fill the vacancy without regard to this provision. The agency to which the employee is transferred, however, must regard the employee as an appointment under the terms of this provision. This rule takes account of the fact that a transfer within the Government does not represent a reduction in the number of existing employees, but at the same time removes any incentive for agencies to recruit new employees from other agencies in an effort to avoid the impact of this provision.

As indicated previously, under the terms of the Senate amendment, Federal agencies (with the exceptions previously described) would have been permitted to fill only two out of every four vacancies until the total number of employees, including both the number of full-time permanent employees and the number of part-time and temporary employees (enumerated on a full-time-equivalent basis), was reduced to the number employed on September 20, 1966. The conferees concluded that the transition to the permanent limitation would be so rapid under the Senate bill as to cause severe dislocations in some agencies and departments. For this reason the conferees shifted over to a rule allowing three out of four vacancies to be filled instead of two out of four. With this modified rule the conferees concluded that

it was better to apply such a rule to all governmental agencies and not to exclude major departments or agencies which, although they perform essential functions, should be able to share in the reduction in employment.

The conferees agreed that it was appropriate to include part-time and temporary employees under a separate limitation to preclude the substitution of part-time employees for full-time employees. Including both categories under a single limitation would not take account of the normal seasonal fluctuations in the number of part-time and temporary Federal employees. By establishing a separate limitation for each group, the conferees provided for seasonal variations in part-time and temporary employment while maintaining the effect of the Senate provision.

The conferees agreed to establish a limitation based upon the number of employees on the Federal payroll at the end of the fiscal year 1966 because of the difficulty of determining accurately the number employed on September 20, 1966.

The conferees do not contemplate that the ceilings on employment provided by this provision are to be avoided by contracting work outside the Government. The expenditure limitations should aid in preventing this. However, in addition, it is expected that the Bureau of the Budget and the agency heads will see to it that contract work is not substituted for personal services performed by governmental employees.

The determinations of what constitutes a full-time employee, a permanent position, a temporary position and a part-time employee are to be based on the definitions used by the Bureau of the Budget. (See, for example, Circular No. A-64, revised, dated June 28, 1965.) A casual employee is to be considered one classified as an "intermittent" employee in the circular referred to.

Nothing in this section is to supersede or modify the reemployment rights of any person under section 9 of the Military Selective Service Act of 1967 or any other provision of law conferring reemployment rights upon persons who have performed active duty in the Armed Forces.

This section is to take effect on the first day of the first month which begins after the date of enactment of this bill.

Section 202. Reduction of \$6 billion in expenditures in fiscal year 1969

A reduction in Federal expenditures below the amounts estimated in the budget for the fiscal year 1969 as proposed in January is a vital part of the comprehensive effort to reduce the budget deficit to manageable proportions. A tax increase unaccompanied by controls over spending could merely result in an increase in Federal expenditures. Such an increase in expenditures would offset whatever effect a tax increase would have in dampening inflationary pressures.

Under the provisions of the bill approved by the conferees, expenditures and net lending during the fiscal year 1969 are not to exceed \$180,062 million except by the amount by which expenditures and net lending for any of the following exceed the budget estimates presented for it in January:

- (1) Amounts which the President may determine are necessary for special support of Vietnam operations (the amount included in the budget is \$26,264 million; see p. 83 of the budget document);

(2) Amounts for interest on Federal Government debt (the amount included in the budget is \$14,400 million; see p. 53 of the budget document);

(3) Amounts for veterans benefits and services (the amount included in the budget is \$7,342 million; see p. 161 of the budget document); and

(4) Amounts for payments from trust funds established by the Social Security Act (the amount included in the budget is \$36,042 million; see outlays of first four funds in table C-4, p. 488, of the budget document).

The budget submitted by the President in January proposed expenditures totaling \$186,062 million (budget document, p. 55). Thus, this provision requires that proposed spending be reduced by \$6 billion. Actual spending may exceed \$180,062 million if expenditures in the four excepted categories in total exceed the amounts proposed in the January budget, but in the absence of this limitation, any such increases would presumably also have been added to the total of \$186,062 million.

It is the hope of the conferees that the reduction in expenditures will be achieved by Congress through its action on the appropriations bills. It was realized, however, that congressional action might fail to reduce expenditures by the full required amount. For this reason, the conferees have approved a provision which requires that the President reserve from expenditure and net lending such amounts as may be necessary to carry out this provision. Therefore, to the extent that congressional action on appropriations bills does not reduce expenditures to the required amount, the President is to make reductions, in the manner which he considers most appropriate, until the \$6 billion reduction is reached.

Section 203. Reduction of \$10 billion in new obligational authority

Attempts to reduce expenditures will achieve little success in the long run unless they are accompanied by reductions in new obligational authority. Unless reductions are made in authorizations to spend, expenditure reductions may be merely temporary because they postpone rather than actually eliminate expenditures. The conferees, therefore, concluded that a reduction in expenditures should be accompanied by reductions in obligational authority.

Under the terms of this provision, total new obligational authority and loan authority provided in the fiscal year 1969 are not to exceed \$191,723 million, except for authority in excess of the amounts proposed in the 1969 budget for the following:

(1) Amounts necessary in the judgment of the President for special support of Vietnam operations (\$25,405 million as reported by the Bureau of the Budget);

(2) Amounts for interest on Government debt (\$14.4 billion; see p. 168 of the budget);

(3) Amounts for veterans benefits and services (\$7,817 million; see p. 161 of the budget); and

(4) Amounts for payments from trust funds established by the Social Security Act (\$41,765 million; see receipts of first four funds shown in table 4-C, p. 488 of the budget).

This is a reduction of \$10 billion below the level of \$201,723 million of proposed new obligational authority shown in the budget. (See p. 53 of the budget.)

As in the case of expenditures, the conferees urge Congress to reduce requests for new obligational authority to the extent necessary to meet the limitation imposed by this provision. In this connection, it should be noted that congressional action on appropriation bills directly determines the amounts of new obligational authority whereas it has only an indirect effect on expenditures in a given fiscal year. In the event that congressional appropriations of new obligational authority exceed the limitation, however, the President is to be required to reserve amounts of obligation and loan authority, in the manner he deems appropriate, to the extent necessary to reduce total grants of authority to the limitation imposed. The amounts which the President reserves in this manner (other than any amounts received from trust funds) are rescinded as of the close of the fiscal year 1969. The President, at the time of the submission of his budget for the fiscal year 1970, is to make a report to Congress identifying the amounts he has reserved under this provision.

Section 204. Specific recommendations for \$8 billion rescission in old obligational authority

As indicated in connection with the prior provision, attempts to make expenditure reductions effective will achieve little success in the long run unless they are accompanied by reductions in obligational authority, since otherwise expenditures may be merely postponed to subsequent years. The reduction of \$10 billion in new obligational authority specified in the prior provision gives assurance that grants of new authority will not give rise to sharply increased expenditures in future years. However, to be sure that obligational authority created in prior years is not available after the fiscal year 1969 to maintain higher expenditure levels, it is also necessary that carryovers of obligational authority be reduced. It is difficult, however, to determine in advance the specific areas in which these reductions can be made.

Therefore, this provision provides that the President is to make a specific study and analysis of unobligated balances of appropriations and other obligational and loan authority which remain available for obligation or commitment after the fiscal year 1969. He is to make a report on these unobligated balances to Congress and include specific recommendations for legislation rescinding not less than \$8 billion of these unobligated balances. This report is to be submitted at the time of the submission of the 1970 budget to Congress.

The budget document estimates that there will be unspent authorizations enacted in prior years totaling \$222,301 million available for expenditure or net lending at the start of the fiscal year 1969. Of this amount \$140,063 million is expected to be unobligated at the beginning of the fiscal year 1969. By the end of 1969 unspent obligational authority is expected to have increased to \$236,380 million and of this \$145,672 million is expected to be unobligated. It is out of this latter unobligated balance that the recommended \$8 billion of rescissions is to be made.

Section 205. Applications of certain formulas

Under present law, in the case of certain appropriations, the grant or other distribution of the funds among the recipients of the funds is determined automatically under the law by the application of a formula involving the amount appropriated or made available for distribution.

With regard to the expenditure reduction set forth in section 202, and the reduction in new obligational authority set forth in section 203, it is hoped that Congress will make most of these reductions itself, but failing that, it is believed imperative that the President make the remaining reductions. To the extent that the distribution of funds among recipients occurs automatically under a formula relating to the amount appropriated, the President presumably could not under present law reserve any such funds. This section enables him to do so by specifying that after the President has reserved any appropriations where these formulas apply in order to bring about the \$6 billion expenditure reduction or the \$10 billion obligational reduction, the amount after the reduction by the President is to be substituted for the amount appropriated or otherwise made available under the formula in determining the amount which is to be distributed to the recipients.

TITLE III—SOCIAL SECURITY ACT AMENDMENTS

Section 301. Limitation on Federal financial participation with respect to aid to families with dependent children (sec. 14(a) of the Senate bill)

Present law.—The Social Security Amendments of 1967 set a limitation on Federal financial participation in the AFDC program which is related to the proportion of the child population under age 18 in a State who may receive aid because of the absence of a parent from the home. Under the limitation, this proportion is based upon the ratio of the average monthly number of children in a State dependent because of the absence of a parent during the first calendar quarter of 1968 to the child population in such State on January 1, 1968. This limitation would become effective July 1, 1968.

Explanation of conference provision.—The Senate bill would have deleted the limitation of present law. The conferees postponed the effective date of the provision in present law from July 1, 1968, to July 1, 1969.

In addition, the ratio which determines the percentage limitation of Federal Government financial participation is to include a higher average monthly number of cases when the caseload is increased because of a State's complying with a judicial decision by a U.S. court of competent jurisdiction with respect to State laws establishing duration of residence requirements or the so-called man-in-the-house rules. In this event, the average monthly number of cases is to include the additional children who receive assistance under the AFDC program during the calendar quarter beginning on April 1, 1969 as a result of a State's complying with such court decisions.

For example, a particular State with a child population of 1 million in January 1968 might have 30,000 children on its welfare rolls during January, February, and March 1968 because of the absence of their father from the home. Under present law, Federal participation in AFDC payments to this type of child would be limited to 3 percent of the child population of this State (30,000 is 3 percent of 1 million). Under the amendment agreed to by the conferees, if a subsequent court decision results in an addition of 10,000 such children to the rolls during April, May, and June 1969, these 10,000 children will be added to the original 30,000, and the percentage limitation will be increased from 3 to 4 percent (40,000 is 4 percent of 1 million).

Section 302. Unemployed fathers—unemployment compensation (sec. 14 (c) and (d) of the Senate bill)

Present law.—Under present provisions of the AFDC program, assistance payments under the unemployed fathers provision are prohibited for any month for which the father receives any unemployment compensation for any part of the month.

Explanation of conference provision.—The Senate bill would have eliminated this prohibition, permitting AFDC to be received in the same month as unemployment compensation. The conferees provided that assistance payments under the AFDC program with respect to an unemployed father are to be denied only with respect to any week or part of a week for which the father receives unemployment compensation. Thus, if the unemployment compensation is received for the first week in a month, this is not to prevent AFDC payments with respect to later weeks in the month.

Section 303. Medical assistance (medicaid) program (sec. 16 of the Senate bill)

Present law.—Present law prohibits, effective January 1, 1968, the payment of Federal matching funds under title XIX toward the cost of services which would have been covered under the supplementary medical insurance program if a State had purchased such coverage for its medicaid eligibles.

Explanation of conference provision.—The conferees accepted the Senate provision under which the effective date of the provision described above has been postponed until January 1, 1970. This action coordinates the effective date with the date on which States are required under existing law to have title XIX programs in operation and the date until which they may exercise their option to purchase supplementary medical insurance on behalf of aged medically needy persons under title XIX.

IV. SENATE AMENDMENTS NOT INCLUDED IN CONFERENCE SUBSTITUTE

Income from advertising in periodicals of exempt organizations (sec. 11 of the Senate bill)

This section, which the conferees deleted, would have provided that the advertising income which an exempt organization receives in publishing a periodical is to be exempt from the tax on unrelated trade or business income if the publication of the periodical is substantially related to the exempt activities of the organization. Under Treasury regulations adopted on December 11, 1967, advertising income from publishing an exempt periodical is subject to tax effective for taxable years beginning after December 12, 1967. Under the regulations, advertising income is taxable to the extent it exceeds any deductions properly attributable to it, plus any losses on the feature or editorial portions of the magazine in excess of subscription income.

The section would have applied to all taxable years to which the Internal Revenue Code of 1954 applied.

Import quotas on textile articles (sec. 18 of the Senate bill)

The Senate amendment contained a section, which the conferees deleted, imposing import quotas on textiles. The quotas were to

apply to natural and manmade fibers (but not to unprocessed natural fibers such as raw cotton and raw wool). The quotas were to be based on the average imports in each category during the 6-year period 1961 through 1966. Adjustments in the quotas established by this procedure were to be permitted if domestic consumption of the textiles in a given category increased (or decreased). In such cases, the quota would be increased (or decreased) in proportion to the increase (or decrease) in domestic consumption provided the annual change was more than 5 percent.

A provision of the Senate amendment specified that the quotas were not to apply if the President was able to obtain agreements with the foreign countries supplying textiles under which shipments of foreign textiles into the United States would be limited. To give the President time to negotiate these agreements, the quotas were to become effective 180 days after the date of enactment.

Concurrently with the announcement of the conference decision, Chairman Wilbur D. Mills, of the House Ways and Means Committee, announced that on June 4 the Committee on Ways and Means would begin extensive public hearings on the subject of the foreign trade of the United States. These hearings include not only the administration trade bill, but also a broad variety of proposals relative to both imports and to exports. Such subjects, for example, as quotas, either on an across-the-board or an item-by-item basis, American selling price, and antidumping are included.

Foreign nations indebted to the United States (sec. 19 of the Senate bill)

The Senate amendment contained a section which would have required the Secretary of the Treasury to demand payment, from all countries that are more than 90 days in arrears, of principal or interest on debts owed to the United States, including debts which arose from either World War I or World War II. The amendment would also have prohibited redemption in gold of dollars presented to the Treasury by a country that is in arrears by requiring that the dollars be credited against the debts owed to this country.

The conferees deleted this provision subject to an understanding that the Secretary of State and the Secretary of the Treasury would make a study of appropriate and practical terms and conditions for payment of the amounts of indebtedness of foreign countries to the United States which are past due and unpaid and report the results of this study to the Congress.

Prior work for unemployed fathers under AFDC program (sec. 14(b) of the Senate bill)

Present law provides that a father must have a specified history of prior employment in order for the family to be eligible for aid to families with dependent children by reason of the father's unemployment. The Senate bill would have eliminated this prior work requirement. The conference agreement by omitting this provision retains the work requirement of present law.

Effective date of family planning services requirement under AFDC (sec. 15 of the Senate bill)

The Social Security Amendments of 1967 provided that family planning services be offered to all appropriate AFDC participants. The Senate provision provided that in the case of a State which

does not now provide the required family planning services, the amendment in the Social Security Amendments of 1967 would not apply to that State until after the close of the State's first regular legislative session beginning after April 1, 1968.

The conferees omitted this provision. The conference committee did this because it does not believe that the provisions of existing law in this regard require any State to provide family planning services contrary to State statute and expects the Department of Health, Education, and Welfare to so interpret and administer this provision.

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