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CORRECTION OF CERTAIN INEQUITIES IN TAXATION OF LIFE INSURANCE COMPANIES AND OTHER AMENDMENTS

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

REPORT

[To accompany H.R. 5739]

The Committee on Finance, to whom was referred the bill (H.R. 5739) to amend the Internal Revenue Code of 1954 to correct certain inequities with respect to the taxation of life insurance companies, having considered the same, report favorably thereon with amendments, and recommend that the bill as amended do pass.

I. SUMMARY

H.R. 5739 as passed by the House made three modifications in the present tax treatment of life insurance companies. Your committee has accepted these three provisions although modifying slightly two of them. In addition, it has added to the bill two other provisions relating to the taxation of life insurance companies and three provisions relating to other tax matters.

The House bill makes the 8-year loss carryover available for new life insurance companies without regard to whether they are affiliated with other companies. Under present law, where the new life company is affiliated with any other company except a fire or other casualty insurance company only the 5-year loss carryover is available. Your committee has accepted this provision without change. The Treasury Department has indicated that it has no objection to this provision.

The House bill amended present law to deny a double inclusion in the "shareholders surplus account" with respect to the excess of net long-term capital gains over net short-term capital losses. Your committee has accepted this provision but modified it to also provide that no addition is to be made to the shareholders' surplus account with respect to these excess capital gains where they are offset by net operating losses. The double inclusion of the capital gains which

35-010—64——1

is removed by the House bill would permit the distribution to shareholders of an amount equal to twice this excess capital gain without the payment of tax at the time of distribution. The modification made by your committee also prevents distributions to shareholders of an amount equal to this excess capital gain where no tax was paid on this gain because of the presence of a net operating loss. The Treasury Department recommended the modification made by your committee and favors the provision as amended.

The House bill makes certain modifications in the additions which are required to be made to the "policyholders surplus account." At the present time, certain deductions, although they create a loss which cannot be used in full or in part when carried back or forward to the extent permitted by present law, nevertheless are treated as additions to the "policyholders surplus account." Since a distribution to shareholders made out of the policyholders surplus account results in a tax at the company level at the time of the distribution, these deductions in effect are restored to the company's tax base at the time of the distribution even though the taxpayer has previously obtained no benefit from them. The House bill prevents this effect in most cases where the taxpayer obtained no tax benefit from the deductions. Your committee has accepted the House bill with two minor modifications dealing with unusual situations where its hearings disclosed that the House bill did not prevent the imposition of a tax at the time of distribution where the taxpayer obtained no tax benefits from the earlier deductions. The Treasury Department has indicated that it has no objection to this provision as modified.

An amendment added by your committee provides in certain cases that a "spinoff" of the stock of a subsidiary fire or casualty insurance company by a life insurance company is not to result in the imposition of a tax at the company level at the time of the distribution, The provision is carefully restricted to give assurance that amounts will not be distributed in this manner which represent earnings and profits of the life insurance company accumulated on a tax-free basis since the adoption of the Life Insurance Company Income Tax Act of 1959, The Treasury Department has indicated that it does not object to the adoption of this provision.

Another provision added by your committee dealing with the taxation of life insurance companies provides that the pension plan reserves of life insurance companies are to reflect the investment income of life insurance companies attributable to retirement annuities of public school systems. The earnings on qualified pension plan reserves are free of tax at the life insurance company level under present law but reserves attributable to annuities of public school systems, even though generally schoolteacher annuities are treated in the same manner as qualified pension plans, are not presently given this status. Your committee's amendment corrects this problem. The Treasury Department has indicated that it does not object to this provision.

Your committee has added an amendment providing that ores of beryllium are to receive the same percentage depletion treatment when domestically produced as domestically produced beryl. Beryl is eligible for a 23-percent depletion rate when produced from domestic deposits. Previously, beryl was the only domestic source of beryllium but now beryllium is also extracted from other ores. Your committee's amendment equates the percentage depletion allowance in these cases.

The Treasury Department has not indicated any objection to this provision.

Another amendment made by your committee provides a 10-year rather than 5-year carryover for capital losses arising from expropriations or similar takings of property by foreign governments. A provisions which is substantially similar to this is already available in the case of ordinary losses. The Treasury Department has indicated that it has no objection to this provision.

Your committee has also added a provision to the bill dealing with the manner of computing the constructive sales price for purposes of manufacturers' excise taxes imposed on an ad valorem basis. In the case of sales at retail and to retailers, present law provides a constructive sales price based upon the "highest" price to wholesale distributors. This amendment provides that this constructive price in these cases isto be based upon the "lowest" price to wholesale distributors.

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II. CORRECTION OF INEQUITIES IN TAXATION OF LIFE INSURANCE COMPANIES

A. EXPANSION OF AVAILABILITY OF 8-YEAR LOSS CARRYOVER PROVISION

Your committee has accepted without change the House-passed provision expanding the availability of the 8-year loss carryover provision in certain cases.

Present law.—Under present law, life insurance companies, like other corporations generally, have a 3-year carryback and 5-year carryforward for net operations losses. However, in the case of new life insurance companies, the Life Insurance Company Income Tax Act of 1959 provides an 8-year operations loss carryover. Generally, a life insurance company is treated as a "new company" for purposes of obtaining an 8-year loss carryover if it was first authorized to do business as an insurance company within the immediately preceding 5 years.[1] However, the insurance company must not be a "nonqualified corporation." Corporations which are nonqualified for this purpose are those whose stock—to the extent of 50 percent or more of the voting power of all classes of stock—is held by another corporation, or which have such a voting interest in the other corporation. In 1962, Congress provided an exception (Public Law 87-858, sec. 3(d)) to this nonqualified corporation rule and made the 8-year operations loss carryover available where a life insurance company either owned 50 percent or more of the voting stock of, or 50 percent or more of its voting stock was held by, a stock or mutual insurance company other than a life insurance company (e.g., a fire or casualty insurance company).

Reasons for provision.—In 1959, your committee initially provided a special 10-year carryforward of losses in the case of new life insurance companies. In the conference between the House and Senate this was subsequently changed to the present 8-year carryforward.

[1] The company also must have been organized in 1955 or a subsequent year to obtain the 8-year carryover of losses.

Your committee in its report gave the following reasons for providing this longer carryforward in the case of new life insurance companies:

> Your committee made this change because of its special interest in helping new companies in getting started. Also, your committee recognized that for such companies the net operations loss 3-year carryback provides very little assistance, since such companies are unlikely to have income in their early years to which they can carry back losses. Thus, in effect, they would have available to them (without this amendment) only the 5-year carryforward. A company is not considered as "new" for this provision if at any time during the loss-year it was a "nonqualified" corporation within the meaning of the bill.

The House concluded from its recent study of this provision that it is desirable to make the special 8-year carryforward available to new life insurance companies whether or not they are affiliated with another corporation. As indicated above, Congress has already made the 8-year loss carryforward available where a life insurance company is affiliated with a stock or mutual fire or casualty insurance company. The House saw no reason to deny the 8-year loss carryforward merely because the life insurance company either owns, or is owned by, a company carrying on a business venture other than that of a fire or casualty insurance business. Your committee is in accord with this conclusion. Life insurance business, whether there is such an affiliation with another company or not, is likely to give rise to losses in the early years of the business, and since a life insurance company may not file a consolidated return with other companies, this is a loss which cannot be absorbed except through subsequent income earned by the life insurance company itself.[2] In view of this, it appears appropriate both to the House and your committee to make the 8-year carryforward available in the case of all new life insurance companies without regard to their affiliation with other corporations.

When the 8-year loss carryover was denied "nonqualified" companies it was thought that this was necessary to prevent "trafficking" in losses of life insurance companies, or to prevent the acquisition of these companies merely to obtain the long-term loss carryover. However, despite the fact that the early business of life insurance companies tends to generate losses—during the period that new policies are being written and commission expenses are being written off—in later years these same policies can be expected to give rise to profits for the company involved. In view of this, it is unlikely that life insurance companies will be acquired to obtain benefits of their initial losses, since the nature of their business is such that in subsequent years these losses can be expected to be more than offset by income arising from the same source. Thus, this further reflection suggests that no loss is likely to remain to be used against gains from other non-insurance-type business operations.

Explanation of provision.—In view of the considerations set forth above, the House-passed bill makes the 8-year net operations loss carryforward available to any new life insurance company, whether

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[2] Although insurance companies cannot file consolidated returns with other types of corporations, they may file consolidated returns with companies taxable under the same section of the code (i.e., life insurance companies may file a consolidated return with other life insurance companies and fire or casualty companies may file consolidated returns with other fire or casualty companies). See sec. 1504(c) of the Internal Revenue Code.

or not it is affiliated with another corporation through common stock ownership of 50 percent or more. Your committee has accepted the House version of this provision without change. This result is achieved by deleting from present law all references to "nonqualified" corporations in connection with the definition of a new life insurance company for purposes of the 8-year carryforward. No change is made, however, in the age requirements which must be met by a life insurance company in order to qualify for the 8-year carryforward. Thus, as under present law, the 8-year carryforward is available to a life insurance company for losses incurred in any of the taxable years beginning during the first 5 years of its existence as an insurance company.

Effective date.—The 8-year carryforward of net operation losses of life insurance companies is made fully available by both the House and your committee's version of this bill for losses originating in 1958 and subsequent years. In these cases, the fifth year of the carryforward for losses originating in 1958, or later years—the maximum carryforward for corporations generally—occurs in 1963, or subsequent years. Thus, the net operations loss carryforward extension to 8 years in such cases merely extends the life of a loss available for use in 1963 to the current year 1964 and subsequent years. The bill also provides an extension of the net operating loss carryforward in the case of losses incurred in "nonqualified corporations" and originating in 1956 and 1957, but only to the extent that the extension of the carryforward period will have current or prospective application. Thus, no carryforward of a 1956 loss to 1962 or 1963 is permitted, since these are past years which are beyond the fifth year of carryforward. Similarly, with respect to losses originating in 1957, no carryforward is permitted to 1963, since this is a past year which is beyond the fifth year of carryforward. However, operations loss carryforwards will be permitted for losses carried forward from 1956 to 1964, the current year, since this represents the eighth year of carryforward for such a loss. Similarly, with respect to losses carried forward from 1957 the carryforward will be available under the bill with respect to 1964 and 1965, the seventh and eight years of carryforward. In both of these cases, where carryforwards are not permitted from prior years to the years 1962 or 1963, no reduction in the carryforward available for use in 1964 or 1965 is to be made to the extent that these losses would have been offset in 1962 or 1963, since these loss offsets were not available with respect ot those years.

Revenue effect.—It is believed that this provision will result in a negligible loss in revenues.

B. TREATMENT OF CAPITAL GAINS IN SHAREHOLDERS ACCOUNT

Your committee has accepted the House provision denying a double allowance in the case of capital gains but has modified this provision to prevent unintended allowances in cases where capital gains are offset against operations losses.

Present law.—In the Life Insurance Company Income Tax Act of 1959, life insurance companies generally were made fully taxable on a current basis on their investment income (phase 1) plus half of their gains from operations, apart from their investment income (phase 2). The remainder of the gains from operation not taxed currently were

made taxable at the time this income is considered as being distributed to the shareholders. In addition, in the 1959 legislation, a separate flat 25-percent tax was provided for the excess of net long-term capital gains over net short-term capital losses. This method of taxing capital gains differed from that provided for most other corporations in that this 25-percent tax was not an alternative tax but the only procedure provided for taxing these net capital gains. Taxable investment income, which is the tax base for phase 1, did not include the excess of the net long-term capital gain over the net short-term capital loss, nor were these net gains included in gain from operation constituting the phase 2 tax base. Instead, as indicated above, a separate flat tax in all cases was imposed on any excess of net long-term capital gains over net short-term capital losses—whether or not other operations resulted in a gain or loss.

In legislation enacted in 1962 (Public Law 87–858) Congress modified the tax treatment of capital gains in the case of life insurance companies to conform the treatment of these gains more nearly with that accorded other corporations. As a result of that public law, a life insurance company computes its tax on the excess of net long-term capital gains over net short-term capital losses under two methods—a regular method and an alternative method. The regular method requires that these capital gains be included in the life insurance company taxable income.[3] (Thus the combined tax may be less than 25 percent of any net capital gain.) The alternative method of taxing capital gain is still essentially the same as was provided by the prior law (i.e., the tax consists of a partial tax computed without the capital gains, plus a separate flat tax of 25 percent on these capital gains).

Reasons for provision.—It came to the attention of the House that the legislation for insurance companies enacted in 1962 resulted unintentionally in a double allowance with respect to these capital gains under the phase 3 tax base for life insurance companies. The manner in which this occurs is set forth below.

In determining when a distribution to shareholders is made out of the previously taxed or untaxed portion of gain from operations—and therefore whether no tax or a tax results from the distribution—the life insurance company provisions set up two accounts: the shareholders surplus account and the policyholders surplus account. Gains from operations which have previously been taxed are accounted for in the shareholders surplus account, while the untaxed portion of gains from operations is placed in the policyholders surplus account. Subsequently, when any distribution is made to a shareholder it is first considered as coming out of the shareholders surplus account, to the extent of any balance in this account, and this amount, at the time of that distribution, is not subject to any tax. Therefore, the additions made to this account in the year the income is earned determine the portion of any subsequent distribution to shareholders which may be made without the imposition of tax at the time of distribution.

Among the additions to this account are "life insurance company taxable income" and also any excess of net long-term capital gains over net short-term capital losses. Before the enactment of the 1962 legislation this achieved the correct result insofar as the treatment of

[3] The excess of net long-term capital gains over net short-term capital losses is included in both gains from operations and taxable investment income. However, since in the final computation of the tax, taxable investment income, if smaller, is subtracted from gain from operations only the "phase 1" tax base, in the last analysis, generally includes this capital gains income.

capital gains were considered, since the excess of net long-term capital gains over net short-term capital losses then was never a part of life insurance company taxable income. Thus, the inclusion of these net gains as a separate addition to the shareholders surplus account then was appropriate. However, as indicated above, since the enactment of the 1962 insurance company legislation life insurance company taxable income also includes this excess of net long-term capital gain over net short-term capital losses. As a result, the excess of net long-term capital gains over net short-term capital losses is, in most cases, added to the shareholders surplus account twice: once as a part of life insurance company taxable income and once as a separate item.[4]
This permits the distribution, free of any further tax at the time of the distribution, of an amount equal to twice the capital gains which were taxed to the life insurance company.

The House concluded that this double inclusion was not intended in 1962 and therefore in this provision it removed this double inclusion of these capital gains.

Your committee agrees with the House that this double inclusion of capital gains was not intended in 1962. However, your committee has further concluded that the change made by the House does not entirely remove the unintended benefit in existing law. In addition to preventing the double inclusion of capital gains in the shareholders surplus account, your committee has also concluded that no amount attributable to capital gains should be added to this account which represents capital gains offset against operations losses and, therefore, not subjected to tax. In establishing the shareholders surplus account in the Life Insurance Company Income Tax Act of 1959, Congress intended that the amounts added to the shareholders surplus account represent amounts which had been taxed to the life insurance company and, therefore, were properly distributable to stockholders without further payment of tax.[5]

Explanation of provision.—For the reasons indicated above, your committee has modified the House provision, not only to remove the double inclusion of the excess net long-term capital gains over net short-term capital loss in the amounts added to the shareholder's surplus account, but also to provide that there be no inclusion of any excess net long-term capital gains over net short-term capital loss which has not, prior to the distribution, been taxed to the life insurance company. Thus, no amount with respect to such an excess of net long-term capital gains will be added to the shareholders surplus account where such capital gains have not been taxed to the life insurance company because of offsetting operations losses.

The result desired by your committee is obtained by providing that on and after January 1, 1962, the excess of net long-term capital gain over net short-term loss is not to be added to the shareholders surplus account as a separate amount (under sec. 815(b)(2)(A)(ii)). To the extent that such excess of capital gains is subject to tax at the life insurance level, it will be included in the life insurance company

[4] Sec. 815(b)(2)(A) actually provides for the addition to the shareholders surplus account of the excess of the sum of a series of items—including the life insurance company taxable income and the excess of net long-term capital gains over net short-term capital losses—over the taxes paid during the year under phases I and II.

[5] Congress specifically intended certain amounts to be distributed even though no tax (or not the full tax) had been paid with respect to these amounts. These amounts are tax-exempt interest, the small business deduction, dividends received, and partially tax exempt interest. However, there was no expressed intention to achieve this result with respect to capital gains offset by net operating losses, since these were always taxable at the 25-percent capital gains rates

taxable income and, therefore, is reflected in the addition made to the shareholders surplus account for life insurance company taxable income (under sec. 815(b)(2)(A)(i)).

This change is made effective as of January 1, 1962, because that is the effective date of the legislation enacted in 1962 (Public Law 87-858), when Congress for the first time provided for the inclusion of such excess capital gains in life insurance company taxable income.

Revenue effect.—It is believed that this provision will result in a negligible gain in revenues. The modification made by your committee will increase slightly the gain over that provided in the House bill.

C. TREATMENT OF CERTAIN DEDUCTIONS FOR PURPOSES OF POLICYHOLDERS ACCOUNT

The House bill modifies the treatment of certain deductions for purposes of additions to the policyholders surplus account. Your committee has accepted the basic provision in the House bill but has modified it in two respects to provide for types of cases it does not cover.

Present law.—As has previously been indicated, under the Life Insurance Company Income Tax Act of 1959, provision was made for the taxation at the life insurance company level of any income not previously taxed to the life insurance company when this income is distributed to the shareholders. However, the amounts which have already been taxed to the life insurance company are considered to be the first amounts distributed to shareholders. Thus to the extent of these previously taxed amounts there is no further tax at the time of distribution. Only when such amounts are used up is a tax imposed with respect to any additional distributions. The amounts already taxed to the life insurance company, and which may be distributed without further tax, are accounted for in what is called the "shareholders surplus account." The amounts which will result in additional tax at the time of distribution to shareholders are accounted for in the "policyholders surplus account."

At present there is added to the policyholders surplus account amounts not taxed under phase 2: (1) 50 percent of the gains from operation in excess of taxable investment income, (2) the deduction (in computing life insurance company taxable income or loss from operations) for nonparticipating contracts, and (3) the similar deduction for accident and health insurance and group life insurance.

Reason for provision.—The attention of the House was called to a type of situation where the accounts, referred to above, do not achieve the intended result. The deduction for nonparticipating contracts and the deduction for accident and health insurance and group life contracts may result in a loss from operations which may be carried back 3 years or forward 5 years (or in the case of new companies, forward 8 years). To the extent these deductions cannot be fully used to offset gain from operations in one of these years, there is no use made of these deductions. Nevertheless, these deductions, under present law, are required to be added in full to the policyholders surplus account. This results in a tax at the time a distribution is made even though the deductions gave rise to losses which could not be offset against gains and therefore it has not been possible for the life insurance company to gain any benefit from them.

To remove this imperfection in the present statute, the House provided that if any amount added to the policyholders surplus account for any year increases, or creates, a loss from operations and part or all of that loss cannot be used in any other year to reduce the company's taxable income, then the policyholders surplus account for the last year to which this loss may be carried is to be reduced by the amount of the unused loss or, if lesser, the amount in the policyholders account (before making any subtractions for that year).

A witness before your committee at the hearings held on this bill pointed out that the modification made by the House bill does not cover cases where dividends (or other distributions) are paid to stockholders during the period before the net operations loss carryover has expired. Dividend payments may well be made in such a period, despite current losses, since the losses may indicate that an insurance company is expanding its business (and therefore has immediate losses from commissions, etc.) and has the prospect of obtaining profits in the future. In such cases companies may be expected to pay out dividends based upon the prospect of future income arising from business "currently being put on the books."

In cases where dividends are paid before the expiration of the net operations loss carryover period, the deductions previously referred to, are already items in the policyholders surplus account, and, therefore, when dividends are paid to the stockholders there is a tax at the insurance company level as substractions are made from the policyholders surplus account.[6]

Since the net operations loss may not be fully used in the 5-year carryover period, this means that the insurance company has not received any (or full) use from the specified deductions. Thus, it is not always determinable at the time the dividends are paid as to whether they should appropriately be considered as being paid out of the policyholders surplus account—and therefore giving rise to a tax at the insurance company level—or whether they should be treated as being paid out of accumulated earnings and profits attributable to the period before 1959 or paid out of capital. In either of these latter two cases, of course, it is inappropriate to provide a tax at the insurance company level with respect to dividend distributions.

Explanation of provision.—To provide for the types of cases referred to above, as well as the types of cases covered by the House provision, your committee has amended the House bill to provide that if any amount added to the policyholders surplus account for any year increases or creates a loss from operations and it is later shown that part or all of that loss cannot be used in any other year to reduce the company's taxable income, then the policyholders surplus account is to be reduced (as of the time the addition to the policyholders surplus account was made) by the amount of the unused loss to the extent these losses reflect the specified deductions. Refunds or credits will be allowed where the dividend distributions have already been made, if it subsequently is determined that no tax benefit will be derived from part or all of these deductions, and a tax has already been paid at the time of the distribution. In such cases a refund or credit of this tax (or appropriate part of this tax) will be made as if this tax

[6] This assumes no amounts are in the shareholders surplus account since dividends are considered as being paid first out of any amounts in this account.

(or part) had been paid for the last year to which the net operations loss may be carried.[7]

It is important to note that this provision does not always require waiting the end of the normal 5-year net operations loss carryover period (or 8-year period for certain new companies) before the reduction referred to here can be made in the policyholders surplus account. In some cases a life insurance company may have disposed of sufficient life insurance business so that it no longer qualifies as a life insurance company, and in other cases a company may be liquidated. In either of these cases, the last year to which a net operations loss attributable to life insurance business may be carried may well expire before the end of the 5-year (or 8-year) carryover period. In such cases the reduction in the policyholders surplus account can be made immediately before the company ceases to qualify as a life insurance company or liquidates, since this is the last year to which the net operations loss referred to here may be carried.

Effective date.—The House bill provided that the amendments in that bill were to apply to taxable years beginning after December 31, 1963. However, that effective date applied with respect to the year in which the "adjustment" or "reduction" could be made in the policyholders surplus account. Thus, in the normal case where the adjustment was made at the end of a 5-year carryover period, this meant that adjustments would be made in 1964 for unused deductions arising in 1959, the first year for which the policyholders surplus account was required to be established. However, in those cases where a company ceased to be a life insurance company or was liquidated before 1964, the House version of the bill would not have permitted an adjustment or reduction in the policyholders surplus account, since this would have occurred before the effective date. Your committee believes that since for most companies the House provision would have permitted adjustments with respect to unused 1959 deductions, adjustments should not be denied those companies in similar situations which were liquidated or ceased to be life insurance companies before 1964. For that reason your committee has amended the effective date provided by the House bill to provide that this provision is to apply to amounts "added" to policyholders surplus accounts for taxable years beginning after December 31, 1958.

Revenue effect.—It is believed that this provision will result in a negligible loss of revenue.

D. CERTAIN SPIN-OFFS OF CONTROLLED SUBSIDIARIES OF LIFE INSURANCE COMPANIES

This is a new provision added by your committee.

Present law.—As previously indicated, the Life Insurance Company Income Tax Act of 1959 provided for a tax on distributions to shareholders at the life insurance company level of any income not previously taxed to the company. This is the so-called "phase 3" tax on life insurance companies. Included among these distributions to shareholders which give rise to a phase 3 tax are most distributions in redemption of stock or in partial or complete liquidation of a subsidiary corporation. A limited exception to this rule was added in legislation enacted in 1962 (Public Law 87–858) permitting life insurance com-

[7] If the tax attributable to a distribution has not been paid in such a case, the deficiency is eliminated in the last year to which the loss may be carried.

panies to spin-off a fire and casualty insurance subsidiary in certain cases and distribute its holdings of stock in such a subsidiary to the life insurance company's shareholders without incurring a phase 3 tax. The 1962 legislation provided that the fire or casualty insurance subsidiary in such cases must have been acquired before January 1, 1963, in a stock-for-stock reorganization (sec. 368(a)(1)(B)), the spin-off of the subsidiary stock must have occurred before January 1, 1964, the fire and casualty company must have been 80 percent or more owned by the life insurance company, and the distribution must have been a tax-free distribution of a subsidiary's stock to the shareholders of its parent (to which sec. 355 applies).

Reasons for provision.—It was thought appropriate to permit the spin-off of the fire or casualty insurance company in the type of case referred to above without the imposition of a phase 3 tax because, where the subsidiary had been acquired in the past, it was clear that it had been acquired without the intent to avoid a phase 3 tax. This is further evidenced by the fact that such subsidiaries must have been acquired in a stock-for-stock reorganization, thus making it impossible for any of the earnings and profits of the life insurance company properly subject to a phase 3 tax to be siphoned off in such a stock distribution where the stock of the subsidiary is distributed to the shareholders of the life insurance company.

Since the enactment of the 1962 legislation, additional cases have come to the attention of your committee where life insurance companies desire to distribute the stock of subsidiaries to their shareholders but would, under present law, face the imposition of a phase 3 tax. In these cases also it is clear that none of the earnings and profits of the life insurance company are being siphoned off in the types of distributions referred to. For that reason your committee added an amendment to this bill to provide that the phase 3 tax is not to apply in certain additional cases not covered by present law of distribution of stock of a subsidiary to the shareholders of the parent life insurance company.

Explanation of provision.—As under the exception already in existing law, the new exception is to apply only to spin-offs of the stock of an 80-percent controlled fire or casualty subsidiary to the shareholders of the life insurance company (the spin-off must qualify under sec. 355). Your committee saw no reason in this case, however, to limit the spin-offs which qualify for this treatment to those which have already occurred. As a result this treatment will apply to spin-offs which occur in the future. This treatment is to be available where the subsidiary was 80 percent or more owned before January 1, 1958, without regard to whether it was acquired in a stock-for-stock reorganization. It is believed unnecessary in such a situation to limit the tax-free reorganization to a stock-for-stock reorganization since in any event the control was acquired by the life insurance company out of earnings and profits accumulated before 1958—the first year in which the Life Insurance Company Income Tax Act of 1959 was applicable—or out of capital held before that date.

In addition, the amendment covers cases where there was a 50 percent control of the subsidiary before 1958 if the additional stock necessary to reach the 80-percent control was acquired in a way which precluded the use of tax-free profits for this purpose. Thus the exception to the phase 3 tax also is to be available where the stock acquisitions in the subsidiary after 1957 necessary to acquire the 80-

percent control qualify as a stock-for-stock reorganization (sec. 368(a)(1)(B)).

A spin-off is also to qualify where the additional control (control above 50 percent up to the 80-percent control) was acquired through the use of a wholly owned subsidiary of the life insurance company established to acquire the assets of another subsidiary by exchanging for these assets the stock of the life insurance company. In this case, the wholly owned subsidiary can acquire the assets of the other subsidiary either in a statutory merger or consolidation or in a stock-for-assets reorganization (sec. 368(a)(1) (A) or (C)).

This exception from the phase 3 tax is not to apply under this new provision to any portion of a distribution of stock of the controlled corporation representing any increase in the adjusted basis of this stock after 1957 (except to the extent that this results from an acquisition of stock in the controlled corporation in the transaction in which the 80-percent control was acquired).

This amendment is to apply to taxable years beginning after December 31, 1963.

Revenue effect. This provision is expected to have a negligible effect on revenues.

E. LIFE INSURANCE COMPANY RESERVES ATTRIBUTABLE TO PENSION PLANS OF STATE OR LOCAL GOVERNMENTS

In the Life Insurance Company Income Tax Act of 1959, Congress included provisions relating to the computation of the amount of investment income attributable to the company's reserves for contracts sold under qualified pension or profit-sharing plans of private industry. In addition, these provisions dealt with reserves relating to pension plans of certain exempt organizations. The purpose of these provisions was to exclude from tax at the life insurance company level the full amount of the earnings realized on these reserves. This treatment was accorded the life insurance companies because the law already provided that where the qualified pension plans made use of trusts no income tax was payable at the level of the trust with respect to the earnings attributable to such qualified pension plans.

Present law provides this tax-free treatment for reserves attributable to contracts purchased under pension and profit-sharing plans which are treated as qualified plans under the internal revenue laws (sec. 401(a)) and also to retirement annuity contracts purchased by tax-exempt educational, charitable and religious organizations (described in sec. 501(c)(3)). These annuity contracts purchased by the educational, etc., organizations are, in general, treated the same as the qualified pension plans in that contributions made to these plans by the employers are not taxed to the employees until after retirement. Certain other tax advantages also are shared by these annuity contracts for the educational, etc., organizations and the contracts coming under the qualified pension plans.

In 1961 Congress (Public Law 87–370) extended this tax deferral for employees of tax-exempt educational, etc., organizations to annuities purchased by public school systems for their employees. At that time, however, no modification was made in the tax treatment of life insurance company pension reserves to permit the insurance companies to accumulate free of tax investment income attributable to the reserves on these public school teacher contracts in the same manner

as reserves under annuity contracts purchased by exempt organizations.

Your committee believes that the omission of an adjustment in pension plan reserves of life insurance companies with respect to these public school teacher contracts was an oversight which should be corrected to accord uniform treatment in the case of reserves for annuity contracts for public school teachers and for employees of private tax-exempt educational institutions.

Your committee has, therefore, added an amendment to the life insurance company provisions (sec. 805(d)(1)(D)) which has the effect of permitting the investment income of life insurance companies to remain free of tax to the extent attributable to reserves for retirement annuities of public school systems.

This amendment is to apply to taxable years beginning after December 31, 1963.

It is estimated that this will have a negligible effect on revenues.

III. OTHER PROVISIONS

A. EXTENSION OF 23 PERCENT DEPLETION RATE TO ALL ORES OF BERYLLIUM

Present law.—In 1954, Congress provided a 23-percent depletion rate for strategic and critical minerals produced from deposits within the United States. Among the minerals accorded this treatment was beryl.

Present law, after specifying specific percentage depletion rates for various minerals such as the 23 percent for the list of strategic and critical minerals referred to above, provides for all other minerals (with certain specified exceptions) a percentage depletion rate of 15 percent.

Reasons for the provision.—Beryl is used almost exclusively as a source for the metal beryllium. Beryllium is considered strategic and critical by the General Services Administration. It is used by the Atomic Energy Commission and also in aircraft and missiles. Beryllium oxide has, in addition, certain nuclear, refractory, and electronic uses.

A little over 500 tons of beryl was produced domestically in 1960. Most of the amount consumed in this country was imported. Because of the strategic and critical nature of beryllium, alternative domestic sources are being developed. These other ores of beryllium which are being developed domestically are bertrandite, chrysoberyl, helvite, phenscite, and hambergite.

Because only beryl of the ores of beryllium is listed as a strategic and critical mineral, the remaining ores of beryllium are eligible for percentage depletion only under the "All other" category of minerals at 15 percent, rather than at 23 percent which domestic beryl receives. Your committee has concluded that equity requires that the various ores of beryllium receive the same rate of percentage depletion. It is especially desirable to provide the same rate of depletion for these other ores of beryllium as for beryl, in order to encourage their domestic production.

Explanation of provision.—In view of the considerations set forth above, your committee has added a section to the bill amending the provisions of present law relating to percentage depletion (sec. 613(b))

by substituting for the word "beryl" in the list of strategic and critical minerals eligible for depletion at 23 percent the word "beryllium." This, therefore, includes in the 23-percent depletion category not only with respect to domestic deposits of beryl, but also with respect to domestic deposits of all other ores from which beryllium is produced.

Effective date.—This amendment is to apply to taxable years beginning after December 31, 1963.

Revenue effect.—It is expected that this will have a negligible effect on revenues.

B. TEN-YEAR CARRYOVER FOR CORPORATIONS OF FOREIGN EXPROPRIATION CAPITAL LOSSES

Present law.—For corporations, present law provides a net capital loss carryover of 5 years. No provision is made for carryback of capital losses. These capital losses when carried over are in all cases treated as short-term capital losses whether or not they arise from a short- or long-term capital loss initially.

In the case of individuals, present law, since the enactment of the Revenue Act of 1964, provides a net capital loss carryover for an unlimited period of time.

In the case of corporations with net operating losses, the loss ordinarily may be carried first back for 3 years and then, to the extent of any amount remaining, may be carried forward to the 5 succeeding years. However, in the Revenue Act of 1964, Congress provided a 10-year carryforward with no carryback for foreign expropriation losses. This was made available for expropriation losses arising in taxable years ending after December 31, 1958. As indicated in your committee's report, this date was selected because it included 1959, which was the year in which the Cuban expropriations began.

The expropriation loss provision referred to above is available only in the case of ordinary losses and not net capital losses.

Reasons for provision.—The attention of your committee has been called to a situation where an American company owns more than 50 percent of the stock of two Cuban subsidiary companies. The assets of these subsidiaries were expropriated by the Cuban Government in 1960. Under present law, securities which become worthless by reason of the confiscation of the underlying assets by a foreign government represent a worthless security loss which is treated as a loss from the sale or exchange of a capital asset. This is the treatment accorded unless the American corporation owns 95 percent or more of the stock of the subsidiary and 90 percent or more of its gross receipts are derived from active income sources (within the meaning of sec. 165(g)(3)(B)).

Generally, it is believed that the 5-year carryover provided corporations for net capital losses is a sufficient period to provide for the recovery of most of these losses. However, in cases like that called to the attention of your committee, where extraordinary circumstances make the 5-year period too short to provide for the offset of substantially all of the capital losses, your committee believes that a longer period of time is justified.

Provision for a 10-year loss carryover of foreign expropriation capital losses is consistent with the provision recently adopted by Congress in providing a 10-year carryover period in the case of net operating losses arising from foreign expropriation. It is also consist-

ent with the 10-year period provided in present law for those suffering losses arising under the Trade Expansion Act of 1962 and the 10-year period provided in the case of regulated transportation companies.

Explanation of provision.—For the reasons indicated above, your committee has added an amendment to the bill providing for corporations a 10-year carryover of foreign expropriation capital losses. This is a substitute for the 5-year carryover period generally available for corporate net capital losses.

A foreign expropriation capital loss (to the extent of any net capital gain for the year) will be treated separately from any remaining net capital losses for the same year. The regular net capital loss for the year will be carried forward to the first succeeding year and used first. Only after the regular capital loss is fully applied in the first carry-forward year in which there is a net capital gain will any expropriation loss from the same year be used in that year. Thus, the foreign expropriation capital loss will be considered the last portion of the total net capital loss applied in any case, although the foreign expropriation capital loss for a year will be applied before the regular net capital loss for any succeeding year.

A foreign expropriation capital loss is defined as the sum of the capital losses sustained by reason of the expropriation, intervention, seizure, or similar taking of certain property by the government of any foreign country, any political subdivision, or any agency or instrumentality of such a governmental unit. The property referred to here is property, taken into account in computing net capital losses, which has been taken by a foreign government and also property taken which is represented by securities which become worthless.

Effective date.—This provision applies with respect to foreign expropriation capital losses sustained in taxable years ending after December 31, 1958.

Revenue effect.—This provision is expected to result in a negligible loss of revenue.

C. MODIFICATION OF CONSTRUCTIVE SALES PRICE FOR CERTAIN MANUFACTURERS' EXCISE TAXES

Present law.—Present law (sec. 4216(b)) provides for a constructive sales price, as distinct from the actual sales price, as a base for the various ad valorem manufacturers' excise taxes where an article is sold—

1. At retail (i.e., to consumers);
2. On consignment;
3. At less than the fair market price if the transaction is not at arm's length; or
4. To retailers.

Where a manufacturer sells at retail or to retailers, the tax is generally based on either the actual price at which an article is sold or a constructive price equal to the "highest" price for which manufacturers sell to wholesale distributors. In the case of sales at retail, this may be the highest price for which others in the same industry sell to wholesale distributors or it may be the highest price at which the particular manufacturer in question sells to wholesalers (whichever is lower). In the case of sales to retailers, however, the constructive sales price provision is available only where the manufacturer

himself sells to one or more wholesale distributors in arm's-length transactions.[8]

A quite different result in tax burden is obtained where a manufacturer sells to a wholly owned sales subsidiary corporation. In such cases, the Internal Revenue Service in applying the constructive sales price provision applicable where a sale is made at less than fair market price in other than an arm's-length transaction holds that the tax base is the subsidiary's "lowest" selling price to unrelated wholesale distributors.[9]

Reasons for provision.—In the past, Congress has recognized the desirability of imposing manufacturers' excise taxes as nearly as possible on a uniform base even though various manufacturers may sell the same articles at different levels of distribution. Not to impose the manufacturers' excise taxes on as nearly a uniform base as possible means that the amount of tax paid would be different merely because one manufacturer chooses to sell an article to a distributor while another sells to a retailer. To permit a different tax in such cases means that the excise tax involved is not neutral between manufacturers carrying on their businesses in different ways. To obtain a greater measure of neutrality for manufacturers carrying on business in different ways, Congress has from time to time expanded the constructive sales price provisions to achieve a more nearly uniform excise tax base.

Probably the greatest discrepancy in present law, however, is the fact that where sales subsidiaries are used by a manufacturer, by ruling the Service has held that the constructive price is to be determined on the basis of the "lowest" price at which the manufacturer sells to wholesalers while, if a manufacturer does not use such a sales subsidiary, the constructive price applicable to his sales at retail or to retailers is his "highest" price to wholesale distributors.[10] This problem is particularly acute in the case of small manufacturers selling at retail whose constructive price is determined by the highest industry price.

Explanation of provision.—In view of the considerations set forth above, your committee has amended the constructive price provision to provide that the wholesalers price in the industry to be taken into account in the case of sales at retail is to be the "lowest" wholesaler price and the price to be taken into account in the case of sales either at retail or to retailers where the manufacturer involved himself sells to wholesale distributors is to be the "lowest" price at which he sells to wholesale distributors.

Effective date.—This provision is to apply with respect to articles sold on or after the first calendar quarter beginning more than thirty days after the date of enactment of this bill.

[8] Other restrictions are also provided which are not of significance here.

[9] This is determined before taking into account allowable exclusions and readjustments. The Service has by ruling provided for a reduction of 5 percent in this lowest wholesale price to account for these allowable exclusions and readjustments.

[10] In the case of sales at retail, this highest wholesale price may alternatively be dependent upon the highest wholesale price in the industry where the manufacturer involved makes no sale himself to wholesalers.

IV. TECHNICAL EXPLANATION OF CERTAIN COMMITTEE AMENDMENTS

SECTION 2. TREATMENT OF CAPITAL GAINS IN SHAREHOLDERS SURPLUS ACCOUNT

Section 2 of the bill amends section 815(b)(2)(A)(ii) of the code (relating to additions to shareholders surplus account of life insurance companies). Under existing law, one of the items taken into account in computing the addition to the shareholders surplus account of a life insurance company for each taxable year is the excess of the net long-term capital gain over the net short-term capital loss. Under the bill as passed by the House, this item would, in the case of taxable years beginning after December 31, 1961, be reduced by the amount of the life insurance company taxable income (computed without regard to sec. 802(b)(3) of the code). Thus, under the bill as passed by the House, this part of the addition to shareholders surplus account would be eliminated, for taxable years beginning after December 31, 1961, except to the extent that the excess of the net long-term capital gain over the net short-term capital loss is greater than the life insurance company taxable income (as so computed). Under your committee's amendment, this part of the addition to the shareholders surplus account is eliminated completely for taxable years beginning after December 31, 1961.

The elimination of the separate inclusion of capital gains item to the shareholders surplus account, referred to above, is to apply in the case of any taxable year, beginning after December 31, 1961.

SECTION 3. TREATMENT OF CERTAIN DEDUCTIONS FOR PURPOSES OF POLICYHOLDERS ACCOUNT

(*a*) *Substantive provision.*—Subsection (a) of section 3 of the bill amends section 815(d) of the code (relating to special rules with respect to distributions to shareholders) by adding a new paragraph (5). Under the bill, as passed by the House, the new paragraph (5) requires certain reductions to be made from the policyholders surplus account if the conditions of subparagraphs (A) and (B) of the new paragraph (5) are met. Your committee's version of the new section 815(d)(5) of the code, differs from the version in the bill as passed by the House with respect to the taxable year for which the policyholders account shall be reduced.

Subparagraph (A) of new section 815(d)(5) provides that the reduction described below shall be made only if an amount added to the policyholders surplus account for any taxable year increased (or created) a loss from operations for such year. The amounts referred to are the special deductions for certain nonparticipating contracts provided by section 809(d)(5) and for accident and health insurance and group life insurance contracts provided by section 809(d)(6) to the extent such deductions contribute to a loss from operations, as as defined in section 809(b)(2).

Subparagraph (B) of new section 815(d)(5) provides that the reduction described below shall be made only if any portion of the increase (or amount created) in the loss from operations by the special deductions, referred to in subparagraph (A), did not reduce the life insurance

company taxable income for any taxable year to which such loss was carried under section 812(b)(2) of the code.

A special situation deserves comment. Under present law (sec. 809(d), an operations loss deduction is taken before the application of the limitations on the deductions referred to previously (under sec. 809(f)). Thus, a carryover or carryback is regarded as having reduced life insurance company taxable income even though the operations loss deductions results in an equivalent reduction of another deduction. This may be illustrated as follows: Assume that in the year in question a company had life insurance company taxable income of $100,000 and in that year the potential deduction for accident and health and group life insurance (sec. 809(d)(6)) was $400,000 but by the operation of a limitation (sec. 809(f)) was reduced to $300,000. Taxable investment income in this case is $350,000 and gain from operations computed without regard to the section 809(d)(6) deduction is $400,000. Assume further that that company incurs a loss in the next year which results in a carryback at an operations loss deduction of $50,000 to the prior year. The effect of the operations loss deduction will reduce the allowable deduction (and the addition to the policyholders surplus account for the first year) to $250,000. Thus the life insurance company taxable income is first reduced and then increased again to $100,000. Assuming that deduction provided by section 809(b) (5) or (6) contributed to the loss in the second year, no further adjustment to the policyholders surplus account would be required by the present amendment because the loss was used to reduce life insurance company taxable income. It may be noted in this example that the loss in the second year has already served to reduce policyholders surplus account through a smaller deduction for the first year.

Amounts subtracted from policyholders surplus account

Under the version of new paragraph (5) of section 815(d) provided in the bill as passed by the House, if the conditions required in the new provision are met the policyholders account for the last taxable year to which the loss referred to in section 815(d)(5)(A) is carried under section 812(b)(2) shall be reduced by the amount described in section 815(d)(5)(B) or, if lesser, by the amount in such account as of the close of such taxable year (computed before any subtractions for such taxable year). Under your committee's version of new paragraph (5) such reduction shall be made from the policyholders surplus account for the year described in subparagraph (A). Therefore, instead of reducing the policyholders surplus account for the taxable year at the end of the carryover period, under your committee's version the reduction is made from the account for the year of the loss. However, under either version, such reduction shall not be allowed until after the expiration of the carryover period, since the conditions of subparagraph (B) of the new paragraph cannot be met until such time.

Under your committee's version of new subparagraph (5) a reduction from the policyholders surplus account for a taxable year is made immediately after any addition and before any amounts are subtracted from the account. Since amounts which reduce policyholders surplus account are not included in life insurance company taxable income under section 802(b)(3), while under present law, subtractions are so included, overpayments of tax may arise by operation of new paragraph (5). This is because under present law subtractions which are made from the policyholders surplus account are

made only to the extent thereof. Therefore, if the retroactive reduction of the policyholders surplus account reduces the account for that year below the amounts originally subtracted from the account and included in income in such year, an overpayment of tax arises with respect to the excess of the actual subtractions taken (and upon which taxes were payable) over the new balance in such account (computed before subtractions). This may be illustrated as follows: Assume that $40,000 was added to the opening balance of $10,000 creating a balance prior to subtractions for the taxable year 1960 of $50,000. Assume further than $20,000 was subtracted from the account in such year, so that the company paid tax upon $20,000 which was included in life insurance company taxable income for the year under section 802(b)(3) of the code. Assume that it is determined after the carryover period that such account is to be reduced by $35,000. Under your committee's version of the new paragraph, the reduction is made immediately after the $40,000 is added to the account, so that the adjusted account as of 1960 is reduced to $15,000 ($10,000+$40,000−$35,000). Therefore, an overpayment of tax for 1960 arises with respect to $5,000, the excess of the actual subtraction of $20,000 over the $15,000 adjusted balance in such account (computed before subtractions). In addition, since the reduction from the account, under new paragraph (5), requires that corresponding adjustments be made to the policyholders surplus account for all taxable years subsequent to such reduction, similar overpayments can arise in subsequent years to the extent subtractions are in excess of the adjusted balance of the policyholders account for each such year. Thus, in the above example, the closing balance prior to the reduction was $30,000, but after the reduction, the closing balance is zero. Therefore, a corresponding adjustment must be made to reduce the opening balance of the succeeding year from $30,000 to zero. Therefore, if subtractions upon which tax has been paid exceed the closing balance of the account for such succeeding year after the $30,000 reduction, an overpayment of tax arises with respect to such excess. Thus, if $15,000 is added, but $25,000 is subtracted from the policyholders surplus account for such succeeding year prior to the adjustment, an overpayment with respect to $10,000 would arise after the account is reduced by $30,000 ($30,000−$30,000 +$15,000−$25,000).

(*b*) *Special period of limitations on assessment and collection.*—Subsection (b) of section 3 of the bill, which is a new subsection added to the bill as passed by the House, amends section 6501 of the code (relating to limitations on assessment and collection) by redesignating subsection (k) as subsection (l), and inserting after subsection (j) a new subsection (k). The new subsection (k) provides that in the case of a deficiency attributable to the application to the taxpayer of new section 815(d)(5), the deficiency may be assessed at any time before the expiration of the period within which a deficiency may be assessed for the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2). This provision in effect extends the statute of limitations on the assessment of a deficiency on account of the disallowance of an erroneous application of new section 815(d)(5) until the expiration of the statutory period of limitation on assessments attributable to the last taxable year of such carryover period.

(c) *Special period of limitation for filing claim for credit or refund.*—Subsection (c) of section 3 of the bill, which is a new subsection added to the bill, as passed by the House, amends subsection (d) of section 6511 (relating to limitations on credit or refund) by adding at the end thereof a new paragraph (6). Subparagraph (A) of new paragraph (6) provides that a claim for credit or refund relating to an overpayment arising by operation of new section 815(d)(5) may be filed at any time before the 16th day of the 39th month following the end of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2), or within the period prescribed in section 6511(c) in respect of such year (relating to special rules applicable to extension of time by agreement), whichever expires later. Subparagraph (A) of new paragraph (6) also provides that in the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in section 6511 (b)(2) or (c), depending on whichever is applicable, to the extent of the amount of the overpayment which arises by operation of section 815(d)(5).

Subparagraph (B) of new paragraph (6) of section 6511(d) provides rules for the application of the special period of limitation with respect to the operation of new section 815(d)(5). Subparagraph (B) provides that if the allowance of a credit or refund of an overpayment of tax arising by operation of section 815(d)(5) is otherwise prevented by operation of any law or rule of law other than section 7122, relating to compromises, such credit or refund may be allowed or made, if a claim therefor is filed within the period provided in section 6511(d)(6)(A). In the case of such claim for credit or refund, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the effect of the operation of section 815(d)(5), to the extent such effect of the operation of section 815(d)(5) was not in issue in such proceedings.

(d) *Rules relating to interest on underpayment, nonpayment or extensions of time for payment of tax.*—Subsection (d) of section 3 of the bill, which is a new subsection added to the bill as passed by the House, amends subsection (e) of section 6601 of the code (relating to income tax reduced by carryback with regard to interest on underpayment, nonpayment, or extensions of time for payment, of tax) by adding at the end thereof a new paragraph (3). The new paragraph (3) provides that if any tax imposed by subtitle A is reduced by operation of new section 815(d)(5) such reduction in tax shall not affect the computation of interest under section 6601 for the period ending with the last day of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2). Therefore, even if the underlying deficiency in tax is eliminated by operation of new section 815(d)(5), the liability for interest on such deficiency would remain unchanged for the carryover period under section 812(b)(2).

(e) *Rules relating to interest on refunds of income tax.*—Subsection (e) of section 3 of the bill, which is a new subsection added to the bill as passed by the House, amends subsection (f) of section 6611 of the code (relating to interest on refunds of income tax caused by carryback) by adding at the end thereof a new paragraph (3). The new paragraph (3) provides that for purposes of the payment of interest on an overpayment arising by operation of new section

815(d)(5), such overpayment shall be deemed not to have been made prior to the close of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2). Thus, if it is determined after 1964 (assuming a 5-year carryover) that by operation of new section 815(d)(5) an overpayment of tax for the year 1959 results, no interest will be allowed or paid in respect of such overpayment for any period prior to January 1, 1965.

(*f*) *Effective date.*—Subsection (f) of section 3 of the bill provides that the amendments made by section 3 shall apply with respect to amounts added to policyholders surplus account (within the meaning of section 815(c) of the code) for taxable years beginning after December 31, 1958. Except to the extent new section 6511(d)(6) applies, no provision of this section of the bill extends the period of limitations within which a claim for credit or refund may be filed for any taxable year.

SECTION 4. CERTAIN SPIN-OFFS OF CONTROLLED SUBSIDIARIES OF LIFE INSURANCE COMPANIES

Section 4 of the bill, which is a new section added to the bill as passed by the House, amends section 815 of the code relating to distributions to shareholders of life insurance companies.

(*a*) *Distribution defined.*—Paragraph (1) of section 4(a) of the bill amends subsection (a) of section 815 of the code by striking out the second and third sentences thereof.

Paragraph (2) of section 4(a) of the bill amends section 815 of the code by adding at the end thereof a new subsection (f). Paragraphs (1) and (2) of new subsection (f) restate the first sentence stricken from section 815(a) of the code by section 4(a)(1) of the bill. (The second sentence is not restated since it has no application to taxable years affected by this amendment.) Paragraph (3) of the new section 815(f) of the code is a new provision.

The new paragraph (3) provides that for purposes of section 815, the term "distribution" does not include any distribution after December 31, 1963, of the stock of a controlled corporation in a transaction to which section 355 applies (relating to distribution of stock and securities of a controlled corporation) if such controlled corporation meets the following requirements: Such controlled corporation is an insurance company subject to the tax imposed by section 831 (relating to tax on insurance companies other than life or certain mutual insurance companies), and such controlled corporation meets the conditions of either subparagraph (A) or subparagraph (B) of new paragraph (3).

Subparagraph (A) of the new section 815(f)(4) provides that new paragraph (3) may apply if control of the controlled corporation referred to in such paragraph was acquired prior to January 1, 1958. Thus, in the case of a controlled corporation, control of which was acquired prior to January 1, 1958, a distribution of such controlled corporation's stock shall not be deemed a distribution for purposes of section 815 if the controlled corporation is one to which section 355 applies and which is subject to the tax imposed by section 831. Therefore, subject to the limitation discussed below, such a distribution or spin-off shall not result in an inclusion in life insurance company taxable income under section 802(b)(3) (relating to amounts subtracted from policyholders surplus account).

Subparagraph (B) of new section 815(f)(3) provides that in cases where control of the controlled corporation referred to above is acquired after December 31, 1957, for new paragraph (3) to apply the requirements of either clause (i) or (ii) of subparagraph (B) must be satisfied. Clause (i) of new section 815(f)(3)(B) will be satisfied in cases where control has been acquired after December 31, 1957, in a transaction qualifying as a reorganization under section 368(a)(1)(B), but only if the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote and not less than 50 percent of the value of all classes of stock of the controlled corporation. Clause (ii) of new section 815(f)(3)(B) will be satisfied in cases where control of such controlled corporation has been acquired after December 31, 1957, solely in exchange for stock of the distributing corporation which stock is immediately exchanged by the controlled corporation in a transaction qualifying as a reorganization under section 368(a)(1)(A) or section 368(a)(1)(C), but only if the controlled corporation has at all times since its organization been wholly owned by the distributing corporation and only if the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock of the corporation, the assets of which have been transferred to the controlled corporation in the section 368(a)(1)(A) or 368(a)(1)(C) reorganization. Therefore, subject to the limitation discussed below, a distribution or spin-off of the stock of a controlled corporation which fulfills the requirements of either clause (i) or (ii) of new section 815(f)(3)(B), which is a controlled corporation to which section 355 applies and which is subject to the tax imposed by section 831, shall not be a distribution which results in an inclusion in life insurance company taxable income under section 802(b)(3).

Limitation upon application of section 815(f)(3)

The last sentence of new section 815(f) provides a limitation upon the application of new paragraph (3) of section 815(f). Such sentence provides that new paragraph (3) shall not apply to that portion of the distribution of stock of the controlled corporation referred to above, which portion is equal to the increase in the aggregate adjusted basis of such stock after December 31, 1957, except to the extent such increase results from an acquisition of stock in the controlled corporation in a transaction described in new section 815(f)(3).

(*b*) *Effective date.*—The amendment made by subsection (a) of this section shall apply to taxable years beginning after December 31, 1963.

SECTION 7. FOREIGN EXPROPRIATION CAPITAL LOSS CARRYOVERS

Section 7 of the bill, which is a new section added to the bill as passed by the House, amends section 1212(a) of the code (relating to capital loss carryovers of corporations) to provide a 10-year carryover of certain foreign expropriation capital losses. The treatment of the carryover of capital losses of corporations, other than those attributable to foreign expropriation capital losses, is not affected.

(*a*) *Existing law.*—Under the existing section 1212(a) of the code, relating to capital loss carryovers of corporations, the amount of any

net capital loss is a short-term capital loss in each of the 5 succeeding taxable years to the extent such amount exceeds the total of any net capital gains (determined without regard to any capital loss carryovers computed under section 1212) of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year.

Foreign expropriation capital loss carryover

Paragraph (1) of section 1212(a), as amended by your committee, provides that in the case of a corporation which has a net capital loss for any taxable year, all or any portion of which is attributable to a foreign expropriation capital loss (defined below), the portion of the net capital loss for such year attributable to the foreign expropriation capital loss shall be a short-term capital loss in each of the 10 succeeding taxable years. The rule under present law that a net capital loss is carried forward only to the extent the amount of such loss exceeds the total of any net capital gains (determined without regard to any capital loss carryovers computed under section 1212) of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year remains the same. The rule under present law that net capital losses for taxable years beginning before October 20, 1951, shall be determined under the applicable law relating to the computation of capital gains and losses in effect before such date has been omitted since it has no application to taxable years affected by your committee's amendment.

(b) *Definitions and special rules.*—Paragraph (2) of section 1212(a), as amended by your committee, provides certain definitions and special rules.

Foreign expropriation capital loss defined

Subparagraph (A) of section 1212(a)(2) provides that the term "foreign expropriation capital loss" means, for any taxable year, the sum of the losses taken into account in computing a net capital loss which are sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing and the losses from securities treated under section 165(g)(1) as losses from the sale or exchange of capital assets which become worthless by reason of the expropriation, intervention, seizure, or similar taking of property by such a government, agency, or instrumentality.

Portion of loss attributable to foreign expropriation capital loss

Subparagraph (B) of section 1212(a)(2) provides that the portion of any net capital loss for any taxable year attributable to a foreign expropriation capital loss is the amount of the foreign expropriation capital loss for such year (but not in excess of the net capital loss for such year). The application of the rule contained in subparagraph (B) of section 1212(a)(2) is illustrated by the following example:

Example.—Domestic corporation X owns 75 percent of the outstanding stock of Y, a foreign corporation operating in country O. In 1961, country O seizes all of the assets of Y, rendering X's stock

worthless and thus causing X to sustain a $40,000 foreign expropriation capital loss for its 1961 taxable year. In the same taxable year X has $30,000 of other losses from the sale or exchange of capital assets and has $50,000 of gains from the sale or exchange of capital assets. X's net capital loss for its 1961 taxable year is $20,000, and since the foreign expropriation capital loss exceeded this amount, the entire $20,000 will be treated as a foreign expropriation capital loss.

Priority of application

Subparagraph (C) of section 1212(a)(2) provides that if a portion of the net capital loss of any taxable year is attributable to a foreign expropriation capital loss, such portion shall be considered to be a separate net capital loss for such year to be applied after the other portion of such net capital loss. As under existing law, in applying net capital losses of two or more taxable years against the net capital gain of any subsequent taxable year, net capital losses are exhausted in the order of the years in which sustained.

The application of the provisions of section 1212(a) of the code as here amended are illustrated by the following example:

Example.—Domestic corporation L has a net capital loss of $50,000 for taxable year 1961, $30,000 of which is attributable to a foreign expropriation capital loss. Such $30,000 is a short-term capital loss carryover to each of the 10 taxable years succeeding 1961 and the remaining $20,000 is a short-term capital loss carryover to each of the 5 taxable years succeeding 1961. Corporation L has a $35,000 net capital gain (determined without regard to any capital loss carryover) for 1962. In offsetting the $50,000 capital loss carryover from 1962 against the $35,000 net capital gain for 1962, the $30,000 portion of such carryover attributable to the foreign expropriation capital loss is applied against the 1962 net capital gain after the $20,000 other portion of the carryover. At the end of the taxable year 1961 a $15,000 foreign expropriation capital loss carryover remains to be carried forward to the taxable year 1963. Corporation L has a net capital loss for 1963 of $10,000, no portion of which is attributable to a foreign expropriation capital loss. For 1964, L has a net capital gain of $22,000 (determined without regard to the capital loss carryovers from 1961 and 1963). In offsetting the capital loss carryovers from 1961 and 1963 against L's $22,000 net capital gain for 1964, the remaining $15,000 portion of the carryover from 1961 is applied against the 1964 net capital gain before the $10,000 capital loss carryover from 1963 is applied against such gain. At the end of taxable year 1964 there remains to be carried forward to L's taxable year 1965 $3,000 of the $10,000 capital loss carryover from 1963.

(c) *Effective date.*—Subsection (b) of section 7 of the bill, as added by your committee, provides that the amendments made by subsection (a) of section (7) shall apply with respect to net capital losses (to the extent attributable to foreign expropriation capital losses, as defined in section 1212(a)(2)(A) of the Internal Revenue Code of 1954) sustained in taxable years ending after December 31, 1958.

V. CHANGES IN EXISTING LAW

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

INTERNAL REVENUE CODE OF 1954

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SEC. 613. PERCENTAGE DEPLETION.

* * * * * * *

(b) PERCENTAGE DEPLETION RATES.—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

(1) 27½ percent—oil and gas wells.

(2) 23 percent—

(A) sulfur and uranium; and

(B) if from deposits in the United States—anorthosite (to the extent that alumina and aluminum compounds are extracted therefrom), asbestos, bauxite, [beryl,] celestite, chromite, corundum, fluorspar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grade), rutile, block steatite talc, and zircon, and ores of the following metals; antimony, *beryllium*, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

(3) 15 percent—

(A) metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite; and

(B) if paragraph (5)(B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties.

(4) 10 percent—asbestos (if paragraph (2)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

(5) 5 percent—

(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

(B) clay used, or sold for use, in the manufacture, of building or paving brick, drainage, and roofing tile, sewer pipe, flower pots, and kindred products; and

(C) if from brine wells—bromine, calcium chloride, and magnesium chloride.

(6) 15 percent—all other minerals (including, but not limited to, aplite, barite, borax, calcium carbonates, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite limestone, magnesite, magnesium carbonates, marble, phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2)(B) does not apply) bauxite, [beryl,] flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that,

unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

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SEC. 805. POLICY AND OTHER CONTRACT LIABILITY REQUIREMENTS.

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(d) PENSION PLAN RESERVES.—

(1) PENSION PLAN RESERVES DEFINED.—For purposes of this part, the term "pension plan reserves" means that portion of the life insurance reserves which is allocable to contracts—

(A) purchased under contracts entered into with trusts which (as of the time the contracts were entered into) were deemed to be (i) trusts described in section 401(a) and exempt from tax under section 501(a), or (ii) trusts exempt from tax under section 165 of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws;

(B) purchased under contracts entered into under plans which (as of the time the contracts were entered into) were deemed to be plans described in section 403(a), or plans meeting the requirements of section 165(a)(3), (4), (5), and (6) of the Internal Revenue Code of 1939;

(C) provided for employees of the life insurance company under a plan which, for the taxable year, meets the requirements of section 401(a)(3), (4), (5), (6), (7), and (8); or

(D) purchased to provide retirement annuities for its employees by an organization which (as of the time the contracts were purchased) was an organization described in section 501(c)(3) which was exempt from tax under section 501(a) or was an organization exempt from tax under section 101(6) of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws, *or purchased to provide retirement annuities for employees described in section 403(b)(1)(A)(ii) by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing.*

* * * * * * *

SEC. 812. OPERATIONS LOSS DEDUCTION.

(a) * * *

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[(e) RULES RELATING TO NEW COMPANIES.—

[(1) NEW COMPANY DEFINED.—For purposes of this part, a life insurance company is a new company for any taxable year only If such taxable year begins not more than 5 years after the first day on which it (for any predecessor, if section 381(c)(22) applies or would have applied if in effect) was authorized to do business as an insurance company.

[(2) LIMITATIONS ON 8-YEAR CARRYOVER.—

[(A) IN GENERAL.—For purposes of subsection (b)(1)(A)(iii), a life insurance company shall not be treated as a new

company for any loss year if at any time during such year it was a nonqualified corporation. If, at any time during any taxable year after the loss year, the life insurance company is a nonqualified corporation, subsection (b)(1)(A)(iii) shall cease to apply with respect to such loss for such taxable year and all subsequent taxable years.

[(B) NONQUALIFIED CORPORATION DEFINED.—For purposes of subparagraph (A), the term "nonqualified corporation" means any corporation connected through stock ownership with any other corporation (except a corporation taxable under part II or part III of this subchapter), if either of such corporations possesses at least 50 percent of the voting power of all classes of stock of the other such corporation. For purposes of subparagraph (A), a corporation shall be treated as becoming a nonqualified corporation at any time at which it becomes a party to a reorganization (other than a reorganization which is not described in any subparagraph of section 368(a)(1) other than subparagraphs (E) and (F) thereof).]

(e) NEW COMPANY DEFINED.—For purposes of this part, a life insurance company is a new company for any taxable year only if such taxable year begins not more than 5 years after the first day on which it (or any predecessor, if section 381(c)(22) applies or would have applied if in effect) was authorized to do business as an insurance company.

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SEC. 815. DISTRIBUTIONS TO SHAREHOLDERS.

(a) GENERAL RULE.—For purposes of this section and section 802(b)(3), any distribution to shareholders after December 31, 1958, shall be treated as made—

(1) first out of the shareholders surplus account, to the extent thereof,

(2) then out of the policyholders surplus account, to the extent thereof, and

(3) finally out of all other accounts.

[For purposes of this section, the term "distribution" includes any distribution in redemption of stock or in partial or complete liquidation of the corporation, but does not include any distribution made by the corporation in its stock or in rights to acquire its stock, and does not (except for purposes of paragraph (3) and subsection (e)(2)(B)) include any distribution in redemption of stock issued before 1958 which at all times on and after the date of issuance and on and before the date of redemption is limited as to dividends and is callable, at the option of the issuer, as a price not in excess of 105 percent of the sum of the issue price and the amount of any contribution to surplus made by the original purchaser at the time of his purchase. Further, for purposes of this section, the term "distribution" does not include any distribution before January 1, 1964, of the stock of a controlled corporation to which section 355 applies, if such controlled corporation is an insurance company subject to the tax imposed by section 831 and control has been acquired prior to January 1, 1963, in a transaction qualifying as a reorganization under section 368(a)(1)(B).]

(b) SHAREHOLDERS SURPLUS ACCOUNT.—

(1) IN GENERAL.—Each stock life insurance company shall, for purposes of this part, establish and maintain a shareholders surplus account. The amount in such account on January 1, 1958, shall be zero.

(2) ADDITIONS TO ACCOUNT.—The amount added to the shareholders surplus account for any taxable year beginning after December 31, 1957, shall be the amount by which—

(A) the sum of—

(i) the life insurance company taxable income (computed without regard to section 802(b)(3)),

(ii) in the case of a taxable year beginning after December 31, 1958, *and before January 1, 1962*, the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss,

(iii) the deduction for partially tax-exemption interest provided by section 242 (as modified by section 804 (a)(3)), the deductions for dividends received provided by sections 243, 244, and 245 (as modified by section 809(d)(8)(B)), and the amount of interest excluded from gross income under section 103, and

(iv) the small business deduction provided by section 809(d)(10), exceeds

(B) the taxes imposed for the taxable year by section 802(a), determined without regard to section 802(b)(3).

(3) SUBTRACTIONS FROM ACCOUNT.—

(A) IN GENERAL.—There shall be subtracted from the shareholders surplus account for any taxable year the amount which is treated under this section as distributed out of such account.

(B) DISTRIBUTIONS IN 1958.—There shall be subtracted from the shareholders surplus account (to the extent thereof) for any taxable year beginning in 1958 the amount of distributions to shareholders made during 1958.

(c) POLICYHOLDERS SURPLUS ACCOUNT.—

(1) IN GENERAL.—Each stock life insurance company shall, for purposes of this part, establish and maintain a policyholders surplus account. The amount in such account on January 1, 1959, shall be zero.

(2) ADDITIONS TO ACCOUNT.—The amount added to the policyholders surplus account for any taxable year beginning after December 31, 1958, shall be the sum of—

(A) an amount equal to 50 percent of the amount by which the gain from operations exceeds the taxable investment income,

(B) the deduction for certain nonparticipating contracts provided by section 809(d)(5) (as limited by section 809(f)), and

(C) the deduction for accident and health insurance and group life insurance contracts provided by section 809(d)(6) (as limited by section 809(f)).

(3) SUBTRACTIONS FROM ACCOUNT.—There shall be subtracted from the policyholders surplus account for any taxable year an amount equal to the sum of—

(A) the amount which (without regard to subparagraph (B)) is treated under this section as distributed out of the policyholders surplus account, and

(B) the amount (determined without regard to section 802(a)(3)) by which the tax imposed for the taxable year by section 802(a) is increased by reason of section 802(b)(3).

(d) SPECIAL RULES.—

(1) ELECTION TO TRANSFER AMOUNTS FROM POLICYHOLDERS SURPLUS ACCOUNT TO SHAREHOLDERS SURPLUS ACCOUNT.—

(A) IN GENERAL.—A taxpayer may elect for any taxable year for which it is a life insurance company to subtract from its policyholders surplus account any amount in such account as of the close of such taxable year. The amount so subtracted, less the amount of the tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account as of the beginning of the succeeding taxable year.

(B) MANNER AND EFFECT OF ELECTION.—The election provided by subparagraph (A) shall be made (in such manner and in such form as the Secretary or his delegate may by regulations prescribe) after the close of the taxable year and not later than the time prescribed by law for filing the return (including extensions thereof) for the taxable year. Such an election, once made, may not be revoked.

(2) TERMINATION AS LIFE INSURANCE COMPANY.—

(A) EFFECT OF TERMINATION.—Except as provided in section 381(c)(22) (relating to carryovers in certain corporate readjustments), if—

(i) for any taxable year the taxpayer is not an insurance company, or

(ii) for any two successive taxable years the taxpayer is not a life insurance company,

then the amount taken into account under section 802(b)(3) for the last preceding taxable year for which it was a life insurance company shall be increased (after the application of subparagraph (B)) by the amount remaining in its policyholders surplus account at the close of such last preceding taxable year.

(B) EFFECT OF CERTAIN DISTRIBUTIONS.—If for any taxable year the taxpayer is an insurance company but not a life insurance company, then any distribution to shareholders during such taxable year shall be treated as made on the last day of the last preceding taxable year for which the taxpayer was a life insurance company.

(3) TREATMENT OF CERTAIN INDEBTEDNESS.—If—

(A) the taxpayer makes any payment in discharge of its indebtedness, and

(B) such indebtedness is attributable to a distribution by the taxpayer to its shareholders after February 9, 1959,

then the amount of such payment shall, for purposes of this section and section 802(b)(3), be treated as a distribution in cash to shareholders, but only to the extent that the distribution

referred to in subparagraph (B) was treated as made out of accounts other than the shareholders and policyholders surplus accounts.

(4) LIMITATION ON AMOUNT IN POLICYHOLDERS SURPLUS ACCOUNT.—There shall be treated as a subtraction from the policyholders surplus account for a taxable year for which the taxpayer is a life insurance company the amount by which the policyholders surplus account (computed at the end of the taxable year without regard to this paragraph) exceeds whichever of the following is the greatest—

(A) 15 percent of life insurance reserves at the end of the taxable year,

(B) 25 percent of the amount by which the life insurance reserves at the end of the taxable year exceed the life insurance reserves at the end of 1958, or

(C) 50 percent of the net amount of the premiums and other consideration taken into account for the taxable year under section 809(c)(1).

The amount so treated as subtracted, less the amount of the tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account as of the beginning of the succeeding taxable year.

(5) REDUCTION OF POLICYHOLDERS SURPLUS ACCOUNT FOR CERTAIN UNUSED DEDUCTIONS.—If—

(A) an amount added to the policyholders surplus account for any taxable year increased (or created) a loss from operations for such year, and

(B) any portion of the increase (or amount created) in the loss from operations referred to in subparagraph (A) did not reduce the life insurance company taxable income for any taxable year to which such loss was carried,

the policyholders surplus account for the taxable year referred to in subparagraph (A) shall be reduced by the amount described in subparagraph (B).

* * * * * * *

(f) DISTRIBUTION DEFINED.—For purposes of this section, the term "distribution" includes any distribution in redemption of stock or in partial or complete liquidation of the corporation, other than—

(1) any distribution made by the corporation in its stock or in rights to acquire its stock;

(2) except for purposes of subsection (a)(3) and subsection (e)(2)(B), any distribution in redemption of stock issued before 1958 which at all times on and after the date of issuance and on and before the date of redemption is limited as to dividends and is callable, at the option of the issuer, at a price not in excess of 105 percent of the sum of the issue price and the amount of any contribution to surplus made by the original purchaser at the time of his purchase; or

(3) any distribution after December 31, 1963, of the stock of a controlled corporation to which section 355 applies, if such controlled corporation is an insurance company subject to the tax imposed by section 831 and if—

(A) control was acquired prior to January 1, 1958, or

(B) control has been acquired after December 31, 1957—

(i) in a transaction qualifying as a reorganization under section 368(a)(1)(B), if the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the controlled corporation, or

(ii) solely in exchange for stock of the distributing corporation which stock is immediately exchanged by the controlled corporation in a transaction qualifying as a reorganization under section 368(a)(1) (A) or (C), if the controlled corporation has at all times since its organization been wholly owned by the distributing corporation and the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the corporation the assets of which have been transferred to the controlled corporation in the section 368(a)(1) (A) or (C) reorganization.

Paragraph (4) shall not apply to that portion of the distribution of stock of the controlled corporation equal to the increase in the aggregate adjusted basis of such stock after December 31, 1957, except to the extent such increase results from an acquisition of stock in the controlled corporation in a transaction described in such paragraph.

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SEC. 1212. CAPITAL LOSS CARRYOVER.

[(a) CORPORATIONS.—If for any taxable year a corporation has a net capital loss, the amount thereof shall be a short-term capital loss in each of the 5 succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this section, a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years, and a net capital loss for a taxable year beginning before October 20, 1951, shall be determined under the applicable law relating to the computation of capital gains and losses in effect before such date.]

(a) CORPORATIONS.—

(1) IN GENERAL.—If for any taxable year a corporation has a net capital loss, the amount thereof shall be a short-term capital loss—

(A) in each of the 5 succeeding taxable years, or

(B) to the extent such loss is attributable to a foreign expropriation capital loss, in each of the 10 succeeding taxable years,

to the extent such amount exceeds the total of any net capital gains (determined without regard to this paragraph) of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year.

(2) Definitions and special rules.—

(A) Foreign expropriation capital loss defined.—For purposes of this subsection, the term "foreign expropriation capital loss" means, for any taxable year, the sum of the losses taken into account in computing the net capital loss for such year which are—

(i) losses sustained directly by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing, or

(ii) losses (treated under section 165(g)(1) as losses from the sale or exchange of capital assets) from securities which become worthless by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing.

(B) Portion of loss attributable to foreign expropriation capital loss.—For purposes of paragraph (1), the portion of any net capital loss for any taxable year attributable to a foreign expropriation capital loss is the amount of the foreign expropriation capital loss for such year (but not in excess of the net capital loss for such year).

(C) Priority of application.—For purposes of paragraph (1), if a portion of a net capital loss of any taxable year is attributable to a foreign expropriation capital loss, such portion shall be considered to be a separate net capital loss for such year to be applied after the other portion of such net capital loss.

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SEC. 4216. DEFINITION OF PRICE.

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(b) Constructive Sale Price.—

(1) In general.—If an article is—

(A) sold at retail,

(B) sold on consignment, or

(C) sold (otherwise than through an arm's length transaction) at less than the fair market price,

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary or his delegate. In the case of an article sold at retail, the computation under the preceding sentence shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the [highest] *lowest* price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary or his delegate. This paragraph shall not apply if paragraph (2) applies.

(2) Special rule.—If an article is sold at retail, to a retailer, or to a special dealer (as defined in paragraph (3)), and if—

(A) the manufacturer, producer, or importer of such article regularly sells such articles at retail, to retailers, or to special dealers, as the case may be,

(B) the manufacturer, producer, or importer of such article regularly sells such articles to one or more wholesale distributors (other than special dealers) in arm's length transactions and he establishes that his prices in such cases are determined without regard to any tax benefit under this paragraph,

(C) in the case of articles upon which tax is imposed under section 4061 (a) (relating to automobiles, trucks, etc.), 4191 (relating to business machines), or 4211 (relating to matches), the normal method of sales for such articles within the industry is not to sell such articles at retail or to retailers, or combinations thereof, and

(D) the transaction is an arm's length transaction.

the tax under this chapter shall (if based on the price for which the article is sold) be computed on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the [highest] *lowest* price for which such articles are sold by such manufacturer, producer, or importer to wholesale distributors (other than special dealers).

(3) SPECIAL DEALER.—For purposes of paragraph (2), the term "special dealer" means a distributor of articles taxable under section 4121 who does not maintain a sales force to resell the the article whose constructive price is established under paragraph (2) but relies on salesmen of the manufacturer, producer, or importer of the article for resale of the article to retailers.

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SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

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(k) REDUCTIONS OF POLICYHOLDERS SURPLUS ACCOUNT OF LIFE INSURANCE COMPANIES.—In the case of a deficiency attributable to the application to the taxpayer of section 815(d)(5) (relating to reductions of policyholders surplus account of life insurance companies for certain unused deductions), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2) may be assessed.

[(k)] *(l)* JOINT INCOME RETURN AFTER SEPARATE RETURN.—For period of limitations for assessment and collection in the case of a joint income return filed after separate returns have been filed, see section 6013(b) (3) and (4).

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SEC. 6511. LIMITATIONS ON CREDIT OR REFUND.

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(d) SPECIAL RULES APPLICABLE TO INCOME TAXES.—

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(6) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO REDUCTION OF POLICYHOLDERS SURPLUS ACCOUNT OF LIFE INSURANCE COMPANIES.—

(A) PERIOD OF LIMITATION.—If the claim for credit or refunds relates to an overpayment arising by operation of section 815(d)(5) (relating to reduction of policyholders surplus

account of life insurance companies for certain unused deductions), in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 39th month following the end of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2), or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of overpayment arising by operation of section 815(d)(5).

(B) APPLICABLE RULES.—If the allowance of a credit or refund of an overpayment arising by operation of section 815(d)(5) is otherwise prevented by operation of any law or rule of law, other than section 7122 (relating to compromises), such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. In the case of any such claim for credit or refund, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has beocme final, shall be conclusive except with respect to the effect of the operation of section 815(d)(5), to the extent such effect of the operation of section 815(d)(5) was not in issue in such proceeding.

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SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

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(e) INCOME TAX REDUCED BY CARRYBACK *OR ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS*.—

(1) NET OPERATING LOSS CARRYBACK.—If the amount of any tax imposed by subtitle A is reduced by reason of a carryback of a net operating loss, such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the net operating loss arises.

(2) INVESTMENT CREDIT CARRYBACK.—If the credit allowed by section 38 for any taxable year is increased by reason of an investment credit carryback, such increase shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the investment credit carryback arises.

(3) ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS OF LIFE INSURANCE COMPANIES.—If the amount of any tax imposed by subtitle A is reduced by operation of section 815(d)(5) (relating to reduction of policyholders surplus account of life insurance companies for certain unused deductions), such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2).

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SEC. 6611. INTEREST ON OVERPAYMENTS.

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(f) REFUND OF INCOME TAX CAUSED BY CARRYBACK *OR ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS*.—

(1) NET OPERATING LOSS CARRYBACK.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a carryback of a net operating loss, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such net operating loss arises.

(2) INVESTMENT CREDIT CARRYBACK.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from an investment credit carryback, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such investment credit carryback arises.

(3) ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS OF LIFE INSURANCE COMPANIES.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A arises by operation of section 815(d)(5) (relating to reduction of policyholders surplus account of life insurance companies for certain unused deductions), such overpayment shall be deemed not to have been made prior to the close of the last taxable year to which the loss described in esction 815(d)(5)(A) is carried under section 812(b)(2).

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