93D CONGRESS
1st Session

SENATE

REPORT
No. 93-554

TAX TREATMENT OF MEMBERS OF THE ARMED FORCES AND CIVILIAN EMPLOYEES WHO ARE PRISONERS OF WAR OR MISSING IN ACTION AND CERTAIN OTHER AMENDMENTS ADDED BY THE COMMITTEE

NOVEMBER 27, 1973.—Ordered to be printed

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

REPORT

[To accompany H.R. 8214]

The Committee on Finance, to which was referred the bill (H.R. 8214) to modify the tax treatment of members of the Armed Forces of the United States and civilian employees who are prisoners of war or missing in action, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

H.R. 8214, as passed by the House, amends present law in several respects to provide relief for military and civilian personnel returning from the Vietnam conflict, and the families of those individuals who are listed as missing in action and are subsequently determined to have died at an earlier time. With minor technical changes, the committee agrees with the bill as passed by the House. However, in addition, the committee has added a series of amendments. The House-passed provisions and also the committee amendments are summarized below.

House provisions.—First, the bill extends the provision under present law, which permits military personnel who are hospitalized as a result of service in a combat zone to exclude military pay they receive during the period of hospitalization, to cover for a period of time the pay they receive while hospitalized after all combatant activities have terminated. Since the exclusion under present law only applies during the period in which there are combatant activities in a combat zone, the bill extends this exclusion for a period of time to

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cover a member of the Armed Forces who was hospitalized for an injury incurred in a combat zone in the waning days of the Vietnam conflict.

Second, the House bill extends the provision which forgives Federal income taxes on income other than combat pay, which is presently excludable under another provision, in the case of a member of the Armed Forces who dies while serving in a combat zone (or as a result of an injury incurred while serving in a combat zone) to cover the period he is in a missing status even though it is subsequently determined that he actually died at an earlier time. Present law forgives income taxes through the year of a serviceman's actual death. The committee agrees with the House that it is appropriate to prevent any additional hardship to his family which could result from the collection of taxes for years following his actual death and, therefore, is in accord with the House treatment extending this forgiveness to cover the years a serviceman is in missing status until his status is changed.

With respect to the first two changes, the committee agreed with the House that these special benefits should not extend longer than a reasonable period after the termination of combatant activities and, accordingly, is in agreement with the House bill which provided, in general, that these benefits are not to apply for more than 2 years after the termination of combatant activities. In the case of the Vietnam conflict, however, the benefits provided under the provisions described above will be available, in general, for a 2-year period after the bill is enacted.

Third, the House bill deals with the question of when the special tax rates available to a surviving spouse should be available for a spouse whose husband was reported in missing status and is subsequently determined to have died at an earlier time. The bill provides that the widow is to be eligible for surviving spouse tax treatment for the 2 years following the year in which her husband's missing status is changed rather than the 2 years following the year of actual death.

The House bill also clarifies existing law in two respects. First, present law provides an extension of time for performing various acts such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax in the case of an individual serving in the Armed Forces of the United States (or serving in support of the Armed Forces in a combat zone). Since it is common for these individuals and their spouses to file joint returns, the question has arisen as to whether their spouse is entitled to the benefit of these extensions. The bill clarifies this by providing that the spouse of a serviceman (or the spouse of an individual serving in support of the Armed Forces) in a combat zone is to have the same extension benefits as is available to her husband. Second, the bill also makes it clear that the spouse of an individual in missing status may file a joint return during the period he is in missing status even if it is subsequently determined that he had been killed in action in a prior year. In each of these two changes, the House bill also provides a similar 2-year limitation after the termination of combatant activities and with respect to the Vietnam conflict as described above.

The House bill also deals with the tax treatment of certain individuals who were illegally detained when the *U.S.S. Pueblo* was seized in 1968 by North Korea. In this regard, the bill provides an exclusion from income with respect to compensation received by the members of the crew to conform to the treatment available for prisoners of war in a combat zone.

Finally, the House bill removes the requirement that a serviceman must be serving during an "induction period" in order to be eligible for certain benefits otherwise accorded. This change is necessary since the Military Selective Service Act of 1967 has expired and there is no longer an induction period.

Committee amendments.—The first committee amendment is intended to make it clear that cooperative arrangements formed by educational organizations, and certain organizations supporting educational organizations, for the collective investment of their funds are to be exempt from Federal income taxation.

The second amendment deals with the treatment processes which are treated as mining in computing the percentage depletion allowance for trona. The committee's amendment provides that the decarbonation of trona is to be treated as an ordinary treatment process. The effect of this is to continue, as provided prior to 1971, to allow percentage depletion on trona based on the value of soda ash extracted from it.

The third committee amendment deals with the application of the moving expense provisions to members of the armed services. The Tax Reform Act of 1969 made certain revisions with respect to the deduction for moving expenses. Several of the changes made in the 1969 Act present significant problems with respect to their application to members of the armed services, especially with respect to the administrative aspects of the changes dealing with reporting and withholding for the Department of Defense. Since the enactment of the 1969 changes, the Internal Revenue Service has, by administrative determination, provided a moratorium with respect to the application of the new moving expense rules to members of the armed services. The most recent extension of this moratorium expires at the end of this year. The committee has by legislation extended this moratorium one more year until January 1, 1975, pending the development of a legislative solution.

The fourth committee amendment extends to distilled spirits brought into the United States from Puerto Rico and the Virgin Islands the same abatement or refund provisions in the case of loss or destruction that are presently applicable to imported or domestic spirits.

The fifth committee amendment deals with the provision relating to the use of appreciated property by corporations to redeem their own stock. Present law provides that if a stockholder owns at least 10 percent in value of a corporation's shares and completely terminates his interest in the corporation, the corporation will not recognize gain where it distributes appreciated property in redemption of the stock. Under present law the constructive ownership rules apply for purposes of determining whether a redemption of a shareholder's stock is in complete termination of his interest. This amendment applies the same constructive ownership rules for purposes of determining whether the shareholder has a 10 percent interest in the corporation.

The sixth committee amendment repeals the tax and other regulatory provisions on filled cheese in the Internal Revenue Code. These provisions serve no Internal Revenue purposes. Regulations as to the wholesomeness and purity of filled cheese products are enforced by the Food and Drug Administration outside of the provisions of the Internal Revenue Code.

The seventh committee amendment continues for one more year (until January 1, 1974) the treatment which has been available for taxable years ending before January 1, 1973, with respect to the deduction for accrued vacation pay.

The eighth committee amendment deals with certain disaster losses where taxpayers were allowed casualty loss deductions and subsequently were compensated for those losses based on claims of tort. The committee amendment provides that in these circumstances in lieu of taking the compensation into income immediately, the taxpayers may reduce the basis of their damaged property (or replacement property) by the amount of compensation they received up to a maximum of $5,000 of tax benefits. Excess benefits over this level are to be included in the income of a taxpayer over a five-year period.

The ninth committee amendment provides an exclusion under the unemployment compensation program, similar to the exclusion that exists under the Social Security program, for the services of students performed in the employ of an auxiliary non-profit organization which is organized and operated exclusively for the benefit of, and supervised or controlled by, the school, college, or university in which the student is enrolled.

The tenth committee amendment permits certain private foundations whose assets are largely invested in the stock of a multi-state regulated company (described in section 101(l)(4) of the Tax Reform Act of 1969) to exclude the value of this stock in computing the amount of their required charitable distributions under the private foundation provisions. This amendment is designed to effectuate the intent of Congress in the 1969 Act by preventing the charitable distribution provisions from resulting in a forced divestiture of stock that Congress determined certain types of foundations should be permitted to retain.

The eleventh committee amendment deals with the tax treatment of tuition and educational expenses paid on behalf of members of the uniformed services. The exclusion from gross income for certain amounts received as a scholarship at an educational institution or as a fellowship grant generally does not apply if the amounts received represent compensation for past, present, or future employment services. The Internal Revenue Service has notified the Department of Defense in response to its request for a ruling that certain amounts received by students toward their educational expenses while participating in the recently instituted Armed Forces Health Professions Scholarship Program are not excludable from their gross income because of the individual's commitment to future service with the Armed Forces; thus, under this position the individuals are subject to tax on the amounts received. The committee amendment provides that the exclusion for scholarship and fellowship grants is to apply to payments made by the Government for the tuition and certain other educational expenses of a member of the uniformed services attending an educational institution under the Armed Forces Health Professions Scholarship Program (or substantially similar programs) until January 1, 1975, pending a review by the staff of the effect of application of this provision.

The twelfth committee amendment makes a change in the tax deferral DISC provisions relating to export sales. The amendment provides that a corporation is not to be prevented from qualifying as a DISC if it holds accounts receivable which arise by reason of the export-related transactions of a related DISC. The present tax law requires that at least 95 percent of a corporation's assets be export-related in order to qualify as a DISC. These export-related assets include accounts receivable which arise in connection with the export transactions of the corporation. This corporation can retain these accounts receivable as its only assets and continue to qualify as a DISC. However, if these accounts receivable are transferred to another corporation, which retains these as its only assets, this transferee corporation cannot presently qualify as a DISC. The committee amendment would allow the transferee corporation to hold these accounts receivable and qualify as a DISC if they arise by reason of the export-related transactions (whether as principal or agent) of a related DISC.

II. GENERAL STATEMENT

A. Tax Treatment of Members of the Armed Forces and Civilian Employees Who Are Prisoners of War or Missing in Action

Congress has enacted several special rules for members of the Armed Forces and civilian employees to cover certain hardships with respect to the filing of income tax returns and the payment of tax during the period they are in a combat zone [1] and for certain subsequent periods. The committee has been informed that certain problems have arisen as a result of the Vietnam conflict. These are discussed below.

1. Military pay during hospitalization after termination of combatant activities.

Under present law (sec. 112), an exclusion is provided for pay received for active service by a member of the Armed Forces for any month during which he either served in a combat zone or was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone.[2] In the case of enlisted personnel, the exclusion applies to all of their pay. In the case of commissioned officers, the exclusion applies to the first $500 per month of their pay. In addition, military personnel and civilian employees who were serving in the Vietnam conflict and who are listed in a missing status [3] are entitled to the income tax exclusion for all compensation (without the $500 per month limitation in the case of commissioned officers) received for active service during the period they are in a missing status.

The exclusion for compensation received while hospitalized applied only to a month during which there are combatant activities in a combat zone. As a result, a member of the Armed Forces who is hospitalized for an injury incurred in a combat zone in the waning days of the Vietnam conflict will not get the benefit of this exclusion for any month following the month of his injury if all combatant

[1] The term "combat zone" means any area which the President of the United States designates as an area in which Armed Forces of the United States are or have engaged in combat. The President designated Vietnam and the waters adjacent thereto as a combat zone as of January 1, 1964. See Executive Order 11216, 1965-1 C.B. 62.

[2] Members of the Armed Forces who are serving in direct support of military operations in a combat zone and who qualify for Hostile Fire Pay (as authorized under section 9(a) of the Uniformed Services Pay Act of 1963 (37 U.S.C. 310)) are treated as serving in a combat zone. Accordingly, an individual who is serving in Cambodia, Laos, or Thailand may be eligible for this exclusion.

[3] The term "missing status" means the status of a member of a uniformed service who is officially carried or determined to be absent in a status of missing; missing in action; interned in a foreign country; captured beleaguered, or beseiged by a hostile force; or detained in a foreign country against his will (37 U.S.C. 551 (2)).

activities have been terminate. However, a serviceman injured at and earlier date whose period of hospitalization was entirely within the period of combatant activities would be able to treat his military compensation as combat pay and therefore exclude it from gross income. For this reason, the bill extends the exclusion to cover military pay received by a serviceman through the month his hospitalization ends even if all combatant activities have been terminated.

The committee has been informed that a serviceman who has been hospitalized as a result of wounds, disease or injury incurred while serving in a combat zone, as a general rule, either recovers and is returned to active duty, or is discharged and brought under the care of the Veterans' Administration, within 2 years from the date of hospitalization. Accordingly, the exclusion applies for any month beginning not more than 2 years after the termination of combatant activities. This will insure that a serviceman who is hospitalized at a time which is near the end of the combatant activities, will be able to exclude his military pay for up to 2 years and at the same time prevent the exclusion from continuing indefinitely. In the case of the Vietnam conflict, however, it is uncertain when the combatant activities will be officially terminated, but in view of the fact that a truce agreement has been signed, the bill provides that the exclusion for a serviceman who is hospitalized is to apply to any month beginning not more than 2 years after the date of enactment of this bill. In addition, the exclusion for those servicemen in a missing status is to apply for the 2-year period after the date of enactment even if there is a termination of the Vietnam combat zone designation by the President during that period.

2. Tax forgiveness in the case of missing servicemen subsequently determined to have died

Under present law (sec. 692), Federal income taxes are forgiven in the case of a member of the Armed Forces who dies while serving in a combat zone or as a result of wounds, disease, or injury incurred while serving in a combat zone. This forgiveness of tax applies to the taxable year in which the death occurs and also to any prior year ending after the member of the Armed Forces first served in a combat zone.[4]

Congress enacted this provision to alleviate some of the hardships borne by survivors of servicemen dying as a result of service in a combat zone. However, where a serviceman is reported in a missing status for a number of years and it is subsequently determined that he actually died at an earlier time, his income (other than his combat pay excluded under sec. 112) for taxable years after the year of his actual death is subject to tax.

The committee agrees with the House that the uncertainty as to a serviceman's status (when he is classified as missing) creates unusual difficulties in the case of the families of these servicemen. The imposition of a back tax liability resulting from a determination that a serviceman listed as missing died at an earlier date could have the effect of imposing a severe hardship on the surviving family at a most inopportune time. With respect to the survivors in these cases, the date of death of the serviceman is not as significant as the date his

[4] This provision, however, only applies to taxable years ending on or after June 24, 1950.

missing status is changed. The military pay his family had been receiving during the period he was in missing status is not required to be returned on account of a subsequent determination that he died at an earlier date. In addition, death benefits are made available to survivors at the time a serviceman's name is removed from missing status and a finding of death (or presumptive death) is made. Consistent with this policy and in order to alleviate any additional hardship that could result from imposing a tax on the serviceman's income from the date of his death (or presumptive death) until the date that his status is changed from missing, the bill extends the benefits of current law by forgiving the income taxes on his income other than combat pay, which is excluded under section 112, through the taxable year in which his missing status is changed rather than just through the year of his actual death.

The committee agrees with the House that it is not appropriate to continue the forgiveness of Federal income taxes indefinitely, but that after the termination of combatant activities a reasonable period should be provided while the status of those servicemen who are missing is determined. Accordingly, the bill provides that, as a general rule, Federal income taxes will not be forgiven in the case of any taxable year beginning more than 2 years after the termination of combatant activities. In the case of the Vietnam conflict, however, it is uncertain when the combatant activities will be officially terminated, but in view of the fact that a truce agreement has been signed, the bill provides that with respect to the Vietnam conflict, Federal income taxes will not be forgiven in the case of any taxable year beginning more than 2 years after the date of enactment of the bill. In the case of those servicemen in a missing status, the taxes will be forgiven even though Vietnam is no longer designated as a combat zone if the date his missing status is changed is within any taxable year beginning not later than 2 years after the date of enactment of the bill.[5]

3. Filing of joint return by spouse during period her husband is in missing status

There has been some question during the Vietnam conflict with respect to the filing of joint returns in the case of spouses of servicemen in the combat zone, especially where the serviceman was listed in a missing status. Initially, there were varying practices; in some cases the spouse filed a separate return, others a joint return, and still others no return at all. As a result of this uncertainty, in 1966 the Internal Revenue Service announced that the spouse may file a joint return and need only indicate in the space provided for her husband's signature that he is in fact in Vietnam. In the case of those in missing status, it has been the administrative practice of the Internal Revenue Service to consider such a return as a valid joint return even if it is subsequently determined that the serviceman had been killed in action in a prior year. The bill clarifies existing law in this regard by providing that where the spouse of a missing serviceman or civilian elected to file a joint return, the election is valid even though it is subsequently determined that her husband died at an earlier time. In addition, the

[5] The bill also provides that in those cases where a return has been filed for any taxable year ending on or after February 28, 1961, without claiming any income tax forgiveness and a claim would otherwise have been allowed if the claim for forgiveness had been filed on the due date for the final return, a claim for refund or credit will be permitted to be filed if the claim is filed within one year from the date of enactment of this bill.

bill provides that where the spouse did not file a joint return in this case, she may elect to file one for those years he was in a missing status. Furthermore, any income tax liability of the serviceman or civilian (including his spouse and estate), except for purposes of the income tax forgiveness provisions, will be determined as if he were alive for the entire year during each of the years she elected to file a joint return.

If the spouse elects to file a joint return while her husband is in missing status, the election may be revoked by either the spouse or the returning serviceman prior to the due date for the taxable year involved (including extensions). In the case where it is determined that a serviceman listed in missing status has died, if an executor or administrator is appointed after the surviving spouse has filed a joint return, the executor or administrator may revoke the election by making, within one year after the last day (including extensions) prescribed by law for filing the return of the surviving spouse, a separate return for the deceased serviceman.

The bill provides that a spouse whose husband is listed in missing status may file a joint return only for any taxable year beginning not more than 2 years after the termination of combatant activities. In the case of the Vietnam conflict, however, the bill provides that a joint return may not be filed for any taxable year beginning more than 2 years after the date of enactment. In addition, the filing of joint returns in the case of those servicemen in a missing status is to apply for the 2-year period after the date of enactment even if there is a termination of the Vietnam combat zone designation by the President during that period.

4. Surviving spouse tax rates after change of missing status of previously deceased servicemen

Under present law, a surviving spouse (as defined in sec. 2 (a)) is accorded a special status for the 2 taxable years following the year of her spouse's death. The surviving spouse provisions (which are available to a widow with a dependent child) are intended to give the survivor a 2-year transitional period at the lower surviving spouse tax rates (which are the same as the joint return income tax rates) following the death of the spouse and before the single or head-of-household tax rates would apply.

The committee agrees with the House that there is an unusual problem in the case of a spouse whose husband was reported in a missing status for a number of years, and where it is subsequently determined that he died at an earlier time than the date on which his missing status is changed. The committee, like the House, believes that in this case, a transitional period is most needed by the widow after the date on which her husband's status is changed. For this reason, the bill provides that the widow is eligible for surviving spouse tax treatment for the 2 years following the year in which her husband's status as missing is changed rather than the 2 years following the year of actual death. However, as indicated above, the bill also permits the widow to file a joint return for the years her husband is in a missing status (but not for any taxable year beginning more than 2 years from the date of enactment in the case of the Vietnam conflict or more than 2 years from the termination of combatant activities in the case of any future conflict). The effect of these two changes is to allow the widow not only to file a joint return during the period her husband is in missing status (subject to the limitations discussed above with respect to the period after the termination of combatant activities) even though it is subsequently determined that he was already dead during that period, but also to file a return as a surviving spouse for the 2 years after it has been determined that he was killed and his status is changed.

5. Extension of time for performing certain acts in the case of the spouse of an individual serving in a combat zone

Under present law (sec. 7508), an extension of time is provided for performing various acts, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax. The extension of time applies to any individual who is serving in the Armed Forces of the United States or serving in support of such Armed Forces in a combat zone. Present law also provides for the extension of these benefits to the executor, administrator, or conservator of the estate of an individual entitled to them. The period of service in the combat zone (and the period of continuous hospitalization outside the United States, as a result of injury received in a combat zone) plus the next 180 days thereafter may be disregarded in determining whether the individual performed the various specified acts on time.

Although it is common for these individuals and their spouses to file joint returns, it was somewhat unclear at the beginning of the Vietnam conflict as to whether the spouse was entitled to this extension. The administrative practice of the Internal Revenue Service (announced April 8, 1968) has been to allow the spouse of a serviceman entitled to this extension of time to defer the filing of a joint return or payment of tax until the date the serviceman is required to file and pay the tax. The bill clarifies existing law by providing that the spouse of an individual serving in a combat zone is entitled to the benefits of this provision.

The bill provides, as a general rule, that this provision will apply to the spouse for any taxable year beginning not more than 2 years after the termination of combatant activities in a combat zone. In the case of the Vietnam conflict, however, the bill provides that the spouse will be entitled to the benefits of this provision for any taxable year beginning not more than 2 years after the date of enactment of the bill. In addition, in the case of those servicemen in a missing status these benefits are to apply for the 2-year period after the date of enactment even if there is a termination of the Vietnam combat zone designation by the President during that period.

6. Tax treatment of certain individuals serving on U.S.S. "Pueblo"

In 1970 Congress enacted P.L. 91–235 which dealt with the members of the crew of the *U.S.S. Pueblo* who were illegally detained by North Korea in 1968. The Act provided that the members of the crew were to be treated for purposes of the tax laws in the same manner as if they had served in a presidentially designated combat zone during the period of their detention by North Korea. This meant that for the period of their detention, members of this crew received an exclusion from income tax for their pay for service in the Armed Forces; for the member of the crew who was killed during this period there was a forgiveness of unpaid income taxes and a reduction of Federal estate taxes; and for all personnel on the ship there was an extension of time for filing tax returns, paying taxes, etc.

The exclusion from income tax provided in P.L. 91–235 for the crew aboard the *Pueblo* did not apply to the pay of any civilian employee and was limited to $500 per month in the case of a commissioned officer. This was because when Congress enacted P.L. 91–235, the exclusion of compensation received by individuals serving in a combat zone was not available to any civilian government employee and the exclusion for compensation in the case of a commissioned officer serving in a combat zone was limited to the first $500 per month. Subsequently, in 1972, Congress enacted P.L. 92–279 which extended the exclusion to compensation received by civilian employees and removed the $500 per month limitation for commissioned officers in any case where these individuals were in a missing status as a result of the Vietnam conflict. However, no corresponding amendment was made for those aboard the *Pueblo* who were illegally detained in North Korea.

The committee agrees with the House that it is appropriate to provide the same treatment for the crew of the *Pueblo* (both military and civilian crew members) as was made available under P.L. 92–279 to those listed in a missing status as a result of the Vietnam conflict. Accordingly, the bill extends the exclusion to compensation received by those civilian government employees aboard the *Pueblo* and removes the $500 monthly limitation in the case of commissioned officers. Under the bill, those benefited by these changes will be permitted to file a claim for refund or credit if such claim is filed within one year from the date of the enactment of the bill.

7. *Induction period requirement*

Under present law an individual must be serving during an induction period in order to be eligible for the combat pay exclusion as well as certain other benefits. Since the Military Selective Service Act of 1967, as amended, expired on June 30, 1973, there is no longer an induction period so that the special provisions are not operative. Accordingly, the bill removes the requirement that there be an induction period in order for a serviceman to be entitled to these benefits. This change is effective on July 1, 1973, so that there will be no lapse of benefits on account of the expiration of the Military Selective Service Act.

B. Cooperative Investment Activities of Educational Institutions

The Common Fund ("the Fund"), a cooperative arrangement formed by a large group of educational organizations for the collective investment of their funds, has been held to be exempt from Federal income taxation under a ruling issued by the Internal Revenue Service in 1970. The Fund was organized by a number of educational institutions to provide a cooperative investment fund that could contract with professional advisors for research, advice, and actual investment of the colleges' and universities' contributions to the Fund. The Fund receives capital from the participating exempt organizations, which capital is then placed in one or more common funds and invested upon the advice of independent investment counsel retained by the organization. It now has more than $220 million in assets, including investment assets of approximately 270 participating colleges and universities.

The 1970 ruling issued to the Fund provided that its exempt status would continue only so long as the investment services of the Fund are provided to members at a charge substantially below cost. The practical effect of this requirement is that the Fund must receive support from outside sources, either in the form of grants or through income from an endowment fund. During the formative years of the Fund, its management and administrative expenses were met by start-up grants from a private foundation and the member organizations paid only a nominal fee for the services performed. However, since the start-up grants from the foundation have now been terminated and the Fund must depend solely upon member institutions for payment of continued operational costs, it appears to be in danger of losing its exemption.

This amendment would make it clear that cooperative arrangements for investment of the type represented by The Common Fund will be exempt from taxation. The new provision is limited to organizations formed and controlled by the investing educational institutions themselves, and is not to apply to any organization formed to promote the furnishing of investment services by private interests even though those services might be made available only to educational organizations. In other words, if the schools that were involved formed their own cooperative investing organization, then it would be exempt under this provision. However, if a private brokerage company or investment advisory company were to initiate the formation of a cooperative investing organization, in order to obtain customers for its business, such an organization would not be exempt under this provision even though it were limited to schools.

The new provision provides that the term "charitable" as used in section 501(c)(3) is to include a common investment fund of educational organizations, including government educational organizations and certain organizations organized for the benefit of these organizations. This means that such an organization would qualify under section 501(c)(3) only if the other relevant requirements of that provision are also met. In other words, the organization would still have to comply with the rules prohibiting electioneering, limiting lobbying, and prohibiting inurements of benefits to private shareholders. It is intended that school investment funds qualifying under section 501(c)(3) but organized separately from the particular college in connection with and for the benefit of which it operates, could participate (on the same basis as the school itself) in the cooperative investment organization, unless they represent private foundations. This type of fund is principally illustrated by a foundation that operates as an arm of a State college or university, and is already recognized as a "public charity" under the Internal Revenue Code (sec. 170(b)(1)(A)(iv)).

This amendment is to apply with respect to taxable years ending on or after January 1, 1974. However, it is not intended to imply that such a cooperative investing organization would not be exempt for prior years. Also, in adding this provision relating specifically to cooperative investment funds, it is not intended that any inference be drawn as to the exempt status of other organizations formed by educational institutions or by other charities on their behalf to carry out their normal functions in a cooperative manner.

C. Treatment Process of Decarbonation of Trona Ore To Be Considered as Mining

Under existing law, percentage depletion is allowed for certain minerals at specified rates. In computing the percentage depletion deduction, the rate of the depletion allowance is applied to the "gross income from the property." In the case of depletion on property other than oil or gas wells, present law provides (sec. 613(c)(1)) that the term "gross income" means "gross income from mining." Present law further provides that the term "mining" for this purpose (sec. 613(c)(2)), in general, includes not only the extraction of the ores or minerals from the ground, but also certain "ordinary treatment processes" (specified in sec. 613(c)(4)).

In the case of trona, percentage depletion is allowed at the rate of 14 percent. Trona ore, however, is not sold in its crude form as extracted from the ground. The valuable mineral in the ore is sodium carbonate, commonly known as soda ash, and treatment processes must be applied to separate the waste materials from the soda ash. One of the processes applied is a calcining process which separates the unwanted water and carbon dioxide from the soda ash. A controversy now exists as to whether the process of calcining to achieve the decarbonation is an ordinary treatment process in the case of trona (as it has been treated prior to 1971) so that percentage depletion will be allowed on the value added by that process.

The controversy which now has arisen with respect to the tax treatment of trona relates to the application in its case of the term "ordinary treatment processes" of extracted ores or minerals. Prior to 1961, the term "ordinary treatment processes" was described in the code as processes normally applied by mine owners or operators to extracted ores or minerals in order to obtain the commercially marketable product. In the case of trona, the first commercially marketable product is soda ash. Thus, it was held under this description that the calcining of trona to produce soda ash qualified as an ordinary treatment process. In 1960, however, this description of treatment processes was eliminated (in P.L. 86–564) and instead an exclusive specific list of the ordinary treatment processes which are to be considered as mining was substituted. This list did not specifically contain the process used in the case of trona which resulted in its marketable product "soda ash." In addition, the 1960 amendment contained a provision which set forth the treatment processes not considered as mining (unless specifically provided for or necessary or incidental to processes as provided for) and calcining was among the list.

The problem that exists relates to statements made during the hearings in 1959 before the Committee on Ways and Means with respect to the Treasury Department proposal which specified the treatment processes which would be considered mining for purposes of computing percentage depletion. (Essentially, this same proposal was contained in the Senate amendment which was enacted in 1960, as described above.) The Treasury representative in response to the question of whether the Treasury proposal would prohibit the present practice of allowing decarbonation of soda ash said that it was not intended.

In 1971, the Treasury Department announced, while finalizing regulations dealing with the new code provision relating to ordinary treatment process, that for the future it will disallow the so-called "decarbonation" or "calcining" process as an ordinary treatment process with respect to trona; in effect, this would treat it as a non-mining process. This means that percentage depletion would not be based on the market value of soda ash extracted from trona, but rather on the value of trona, as mined including certain other mining processes attributable to trona. Although the Treasury Department concedes there is some justification for the argument that there were assurances given in 1959 that in the case of trona no change was intended, the Treasury states that the 1959 representations were in error and based on mistaken assumptions. However, in view of these representations the Treasury has indicated that it will allow the calcining as an ordinary treatment process for all years through 1970 the year it announced its intention not to treat the "decarbonation" process of trona as a mining process.

The committee has concluded that the trona miners should be allowed to compute percentage depletion in the same manner as was allowed in the past and in the manner in which it was represented by the Treasury in 1959 would be the result under the new provision. The committee's decision is based on its belief that the decarbonation of the trona ore to eliminate water and carbon dioxide is essentially a concentration process which should be treated as an allowable mining process. To assure this result, the amendment provides that the decarbonation of trona is to be treated as an ordinary treatment process.

It is understood that in some cases customers want a higher bulk density soda ash, and to meet that need soda ash which has already been decarbonated is placed in a second calciner to produce a denser product. This densification step was not treated as an ordinary treatment process under the past practice, and is not to be treated as an allowable process under the committee's amendment.

This provision is to apply to taxable years beginning after December 31, 1970. This will provide the continued treatment of the decarbonation process of trona as mining since the Treasury Department is allowing this treatment for all taxable years beginning before 1971.

With respect to its effect on revenues, the committee does not believe that this amendment should be viewed as resulting in a revenue loss, since the amendment continues the treatment of trona to the same extent as in the past. However, based on the position the Treasury Department is taking as to the treatment of trona for the future, it can be argued that the amendment will reduce revenues by about $2 million annually.

D. Application of Moving Expense Provisions to Members of U.S. Military Services

The Tax Reform Act of 1969 made a series of revisions in the tax treatment of moving expenses. Some of these allowed more generous treatment than prior law and some were more restrictive. In the first category the Act broadened the categories of deductible moving expenses to include three new categories of deductible moving expenses (under sec. 217): (1) pre-move househunting trip expenses; (2) temporary living expenses for up to 30 days at the new job location; and (3) qualified expenses of selling, purchasing or leasing a residence. These additional deductions were limited to an overall limit of $2,500, with a $1,000 limit on the first two categories. Prior law already allowed deductions for the moving of household goods to the new location and the traveling expenses for the family (including meals and lodging) to the new location.

On the other hand, however, the 1969 Act in certain respects restricted the moving expense treatment. First, it provided that all reimbursements of moving from one residence to another were to be included in the taxpayer's adjusted gross income as compensation for services (under sec. 82) but with the offsetting deductions allowed to the extent they were the type of moving expenses referred to above. Second, the 1969 Act increased the minimum 20-mile test to 50 miles for a move to qualify for the deduction and third it modified the existing 39-week rule, the rule requiring a taxpayer to be employed full time for 39 weeks out of the year following the relocation in order to be eligible for the moving expense deduction.[1]

According to the Department of Defense, the restrictive changes made in the 1969 Act present significant problems with respect to their application to members of the military services. It is reported that this is especially the case with the requirement (under sec. 82 and the regulations thereunder) that all moving expense reimbursements, whether in-kind or cash, be included in gross income as compensation and reported both to the individual and the Internal Revenue Service for withholding tax purposes. The Department of Defense has indicated that identification of in-kind "reimbursements" for each serviceman where the Department of Defense pays for the moving expense to the mover, or does the moving itself, would involve substantial administrative burdens for the department as well as increasing their costs at no revenue gain to the Treasury.

The Department of Defense also has indicated that the requirements that the new place of work be at least at a 50-mile move and that the individual work for at least 39 weeks at the new location represented hardships for military personnel since many mandatory personnel moves are made for less than 39 weeks and for less than 50 miles. As a result, the servicemen involved would not be allowed any deduction for their moving expenses, but still would be required to report the moving expense "reimbursement," whether paid by the Government or paid directly to them as a cash reimbursement.

Since the enactment of the 1969 changes, the Internal Revenue Service has by administrative determination provided a moratorium on withholding and reporting with respect to the application of the new moving expense rules to members of the military services.[2] The most recent extension of this Internal Revenue Service moratorium expires at the end of 1973. The moratorium does not apply to cash reimbursements of moving expenses, which are still required to be reported. In addition, where the moving expenses paid by a serviceman exceeds his reimbursements for his expenses, the excess amounts may be allowable as a deduction.

[1] The 39-week test is waived if the employee is unable to satisfy it as a result of death, disability, or involuntary separation (other than for willful misconduct). The Act also made the moving expense deduction available to the self-employed. Self-employed individuals have a 78-week rule, instead of the 39-week rule.

[2] Internal Revenue Service, Public Information, Fact Sheet, November 30, 1970 (letter to Secretary of Defense).

The Department of Defense has submitted legislative proposals to Congress this year dealing with the application of the deduction for moving expenses to the military. Since the present moratorium expires at the end of this year there is not sufficient time in this session of Congress to analyze these proposals. As a result the committee by legislative action is extending this moratorium as to the application of the 1969 changes in the moving expense rules to members of the military services for one more year, or until January 1, 1975. In the meantime, the committee has instructed the staff of the Joint Committee on Internal Revenue Taxation to review the proposed legislation and present an analysis to the committee for consideration during the next session of Congress.

This amendment will not have any effect on revenues since it continues existing administrative rules.

E. Treatment of Distilled Spirits Brought Into the United States From Puerto Rico and the Virgin Islands

Present law (sec. 5001(a)) imposes an excise tax both on distilled spirits imported into, and spirits produced in, the United States. A separate provision (sec. 7652) also applies this tax to spirits brought into the United States from Puerto Rico and the Virgin Islands. This provision states that goods from Puerto Rico and the Virgin Islands are to be taxed at a rate equal to the tax upon like articles of U.S. domestic goods.

Domestically produced spirts are not subject to tax until they are withdrawn from bonded premises. Similarly, when imported spirits or spirits brought into the United States from Puerto Rico or the Virgin Islands are placed on bonded premises upon arrival, the payment of the excise tax may be deferred (although liability is established) until the spirits are removed from these premises (sec. 5232). Another provision of present law (sec. 5008) provides that the distilled spirits tax is to be abated if spirits are lost or destroyed while on bonded premises and that a tax refund is to be made if, in certain circumstances, spirits removed from the bonded premises (after the payment of tax) are lost or destroyed.

The loss and refund provisions apply only to those spirits referred to in the provision (sec. 5001) that imposes the tax on imported and domestically produced spirits. However, as indicated above, in the case of spirits from Puerto Rico and the Virgin Islands, the tax is imposed by a separate provision (sec. 7652) and the loss refund provision is not made applicable in this case. The result is that even though spirits coming into the United States from Puerto Rico and the Virgin Islands are granted deferral of tax if placed on bonded premises in the same manner as spirits produced elsewhere, nevertheless they are not eligible for the decreased liability or refund treatment available to other imported or domestically produced spirits if the spirits are lost or destroyed.

The committee believes that this distinction in treatment is inadvertent, arising from the fact that this tax is imposed by a separate provision in the case of goods brought into the United States from Puerto Rico and the Virgin Islands. Since the committee sees no reason why spirits from Puerto Rico and the Virgin Islands should be treated differently in this respect than imported or domestically produced spirits, it has extended the loss and refund treatment referred to above to spirits from Puerto Rico and the Virgin Islands.

This amendment is to apply to spirits lost or destroyed after the date of enactment of this bill.

There will be no revenue loss to the United States because of this change in the law since the revenue from this tax is covered into the treasuries of Puerto Rico—or the Virgin Islands in the case of distilled spirits coming from these locations. Moreover, the revenue loss for Puerto Rico and the Virgin Islands from the enactment of this provision will be negligible and the committee has been informed that they have no objection to the enactment of this provision.

F. Use of Appreciated Property by Corporations to Redeem Their Own Stock

Present law (sec. 311 of the code) provides, in general, that no gain or loss is to be recognized to a corporation if it distributes property with respect to its stock. The Tax Reform Act of 1969, however, made several changes in this rule when Congress became aware that large corporations were redeeming substantial amounts of their own stock with appreciated property and thus were escaping any tax on the appreciation in this type of disposition. To correct this Congress in the 1969 Act amended this provision to provide that if a corporation distributes property to a shareholder in redemption of part or all of his stock and the property has appreciated in value (i.e., the fair market value of the property exceeds its adjusted basis), then gain is to be recognized to the distributing corporation to the extent of the appreciation.

An exception to this rule enacted in the 1969 Act is provided where a substantial shareholder, who owns at least 10 percent in value of a corporation's stock for at least 12 months immediately preceding the distribution, completely terminates his interest in the corporation. For purposes of determining whether a shareholder has completely terminated his interest in a corporation, present law provides that constructive stock ownership rules (sec. 318) apply, except that a waiver of the family attribution rules can be made (sec. 302(c)(2)).[1] However, for purposes of determining whether a shareholder owns 10 percent of a corporation's stock before the redemption, these attribution rules do not apply.

The committee believes that in the interests of uniformity of treatment the same rules should apply for purposes of both tests. Accordingly, the committee's amendment provides that the attribution rules (of sec. 318 and the waiver provided by sec. 302(c)(2)) are to apply in determining whether an individual has been a 10-percent shareholder for the required period of time before the redemption, to the same extent as they apply in determining whether he has completely terminated his interest in the corporation following the redemption.

In effect the amendment will apply to situations where two or more related shareholders (including trusts, corporations, partnerships, and estates) redeem their stock at the same time (thus terminating their

[1] The present provisions of section 302(c)(2) permit a waiver of the family attribution rules (sec. 318(a)(1)), if certain conditions are met, for purposes of determining whether a shareholder has completely terminated his interest in a corporation through a redemption and thus the property received in the redemption can qualify for non-dividend treatment (under sec. 302(b)(3)). This same waiver of the family attribution rules is also permitted under present law for purposes of the termination of interest requirement of section 311(d).

interests), but where one or more of the redeeming shareholders does not own 10 percent of the corporation's stock. By applying the attribution rules for purposes of the 10 percent ownership test as provided under the amendment, shareholders related to a trust, corporation, partnership and estate through the attribution provisions (sec. 318(a)(2) and (3)) will be allowed to combine their holdings for purposes of the 10 percent ownership rule. Shareholders related through the family attribution rules (sec. 318(a)(1)) will be permitted to combine their holdings for purposes of the 10 percent rule if the shareholders do not file a waiver of those family attribution rules (under sec. 302(c)(2)). It is not intended, however, that shareholders who redeem their stock and who file a waiver of the family attribution rules will be allowed to attribute to themselves the stock of any other family shareholder if that stock is not redeemed as part of the same plan.

This amendment is to apply with respect to distributions made after the date of enactment.

The amendment is expected to have a negligible effect on revenues.

G. Taxation and Regulation on the Manufacture and Sale of Filled Cheese

Under present law an excise tax is imposed on the sale of filled cheese at a rate of one cent per pound for domestically manufactured cheese and at a rate of eight cents per pound on imported cheese. In addition, an occupational tax of $100 per year is imposed on each factory of a manufacturer of filled cheese, a $250 annual tax is imposed on each wholesale distributor and a $12 annual tax is imposed on each retail dealer. The code also provides certain other requirements as to the packaging, labeling and the posting of signs with respect to the marketing of filled cheese. Criminal penalties are provided for failure to pay these taxes or for violation of the stamping and labeling requirements.

Filled cheese is defined in the Internal Revenue Code (sec. 4846) to include "all substances made of milk or skimmed milk, with the admixture of butter, animal oils or fats, vegetable or any other oils, or compounds foreign to such milk, and made in imitation or semblance of cheese."

The filled cheese taxes and regulatory requirements were originally enacted in 1896. That legislation was one of a number of provisions enacted to insure purity and to inhibit the sale of factory-prepared foods in competition with natural foods.

Since the taxes imposed on filled cheese are relatively low, the taxes alone have not inhibited the production of filled cheese. It is the packaging and labeling requirements which in the past have had the effect of preventing all but a small amount of filled cheese from being sold, although there is presently an increasing interest in its marketability.

The committee believes that one of the original purposes of the filled cheese laws—to inhibit competition of factory-prepared foods with natural foods—is no longer appropriate. The second of the original purposes—to insure food purity—is no longer an appropriate activity to be carried on by the Internal Revenue Service. Any requirements as to the quality and labeling of cheese products fall clearly within the jurisdiction of the Food and Drug Administration and can be administered by that agency separate from the tax laws. Furthermore, the committee understands that the Food and Drug Administration presently has the authority to regulate the marketability of filled cheese. Since the provisions in the Internal Revenue Code serve no internal revenue purposes and since appropriate regulation as to the wholesomeness and purity of products falling in the filled cheese category are enforced by the Food and Drug Administration outside of the provisions of the Internal Revenue Code, the committee believes that these provisions are no longer needed as part of the Internal Revenue Code and should be repealed.

This amendment is to become effective after the date of enactment.

Since the filled cheese provisions were not intended for revenue raising purposes and actually only resulted in approximately $10,000 in revenues in 1973 fiscal year, the enactment of this amendment will result in a negligible effect on revenues.

H. Accrued Vacation Pay

Under the 1939 Code, deductions for vacation pay could be taken when these expenses were paid or accrued, or paid or incurred, depending upon the method of accounting, "unless in order to clearly reflect income the deductions should be taken as of a different period." Under the above quoted portion of this provision, it was held by the Internal Revenue Service that vacation pay for the next year could be accrued as of the close of the year in which qualifying services were rendered, provided all of the events necessary to fix the liability of the taxpayer for the vacation pay under the employment contract have occurred by the close of the current year. In determining whether the events necessary to fix the liability of the taxpayer for vacation pay had occurred, the fact that the employee's rights to a vacation (or payment in lieu of vacation) in the following year might be terminated if his employment ended before the scheduled period was not regarded as making the liability a contingent one instead of a fixed one. It was held that the liability in such a case was not contingent since the employer could expect the employees as a group to receive the vacation pay; only the specific amount of the liability with respect to individuals remained uncertain at the close of the year.[1]

In 1954, Congress enacted a provision (sec. 462) which provided for the deduction of additions to reserves for certain estimated expenses. Reserves for vacation pay, including accrual on a completion of qualifying service basis, would have been deductible under this provision and as a result it was concluded that it was no longer necessary to maintain the administrative position described above with respect to vacation pay. As a result, in Revenue Ruling 54-608 (C.B. 1954-2, 8), the Internal Revenue Service revised its position on the deductibility of vacation pay. In this ruling, it held that no accrual of vacation pay could occur until the fact of liability with respect to specific employees was clearly established and the amount of the liability to each individual employee was capable of computation with reasonable accuracy. It was thought that taxpayers accruing vacation pay under plans which did not meet the requirements of the strict

[1] GCM 25261, C.B. 1947-2, 44; I.T. 3956, C.B. 1949-1, 73.

accrual rule set forth in this ruling would utilize this new provision (sec. 462) providing for the deduction of additions to reserves for estimated expenses. This ruling was initially made applicable to taxable years ending on or after June 30, 1955.

Because the provision relating to the reserve for estimated expenses was later repealed, the Treasury Department in a series of actions postponed the effective date of Revenue Ruling 54–608 until January 1, 1959.[2] These actions rendered Revenue Ruling 54–608 inapplicable to taxable years ending before January 1, 1959.

Congress, in the Technical Amendments Act of 1958 (sec. 97), further postponed the effective date of Revenue Ruling 54–608 for two more years, making it inapplicable to taxable years ending before January 1, 1961. Subsequently, Congress in six actions (P.L. 86–496, P.L. 88–153, P.L. 88–554, P.L. 89–692, P.L. 91–172, and P.L. 92–580) further postponed the effective date of Revenue Ruling 54–608. The sixth of these laws postponed the application of the ruling until January 1, 1973.

The application of Revenue Ruling 54–608 results in the denial of a deduction in a year where the accrual of vacation pay has not been clearly fixed with respect to specific employees. With the provisions for reserves for estimated expenses no longer a part of the law, this creates hardships for taxpayers who have been accruing vacation pay under plans which do not meet the requirements of the strict accrual rules set forth in this ruling. For such taxpayers if this ruling were to go into effect, they would have one year in which they would receive no deduction for vacation pay. This would occur since the current year's vacation pay deductions would have been accrued in the prior year and the next year's vacation pay does not meet the tests of accrual of this ruling.

Since the repeal of the provision relating to the reserve for estimated expenses in 1955, the House and Senate committees have indicated that this problem needed to be studied before permanent legislation could be prepared. This problem has been studied and it is anticipated that a permanent solution can be considered next year. In the meantime, it is necessary to continue the existing rules until next year. Accordingly, this amendment postpones for one more year the effective date of Revenue Ruling 54–608. As a result, deductions for accrued vacation pay, if computed by an accounting method consistently followed by the taxpayer since 1958, will not be denied for any taxable year ending before January 1, 1974, solely because the liability to a specific person for vacation pay has not been clearly established or because the amount of the liability to each individual cannot be computed with reasonable accuracy.

This postponement will not reduce revenues from present levels since it continues existing rules.

I. Treatment of Certain Disaster Losses

Under present law (sec. 165), taxpayers generally are allowed to deduct their losses sustained during the year and not compensated for by insurance or other means. Individuals generally are allowed to deduct their losses of property (not connected with their business) only to the extent the amount of the loss exceeds $100; losses attribu-

[2] The last of these postponements was made in Revenue Ruling 57–325, C.B. 1957–2, 302, July 8, 1957.

table to an individual's business are fully deductible. In the case of any loss attributable to a major disaster which occurred in an area authorized by the President to receive disaster relief a special rule allows the loss, at the election of the taxpayer, to be deducted on the return for the year immediately preceding the year of the disaster (that is, the return generally filed in the year of the disaster). If the disaster loss would have generated a refund for the prior year and the taxpayer has already filed his return for that year he could then file an amended return which would allow him to receive the refund in the year of the disaster. This provision was designed to provide immediate tax relief in the case of these major disasters.

Cases have come to the attention of the committee, however, where taxpayers who have claimed refunds arising by reason of deductible disaster losses, have been reimbursed for these losses in later years where this was not anticipated in advance. (Tax deductions may not be taken to the extent losses are compensated for by insurance or other means.) In this case, the taxpayer is generally required to include the reimbursements in income for the year in which the reimbursement is received. This procedure must generally be followed in lieu of recomputing the tax for the year in which the deduction was originally taken.

Recently, the tax treatment of disaster losses resulting from floods has produced severe hardships on the part of the people affected by them. In these cases the taxpayers often were either not covered by insurance or their losses were in excess of their coverage and they claimed their disaster losses, with the result that they usually received tax refunds. Subsequently, these taxpayers in many cases were compensated for their losses based upon claims of tort. In cases of this type, where compensation for losses occurs shortly after the disaster but in a different year from the one in which the deduction was taken, the taxpayers often are still in a severe hardship situation. Moreover, in the cases called to the committee's attention many of the taxpayers had spent both the tax refunds and the reimbursements before they were aware of the tax consequences. As a result, the committee believes it is appropriate not to require the immediate inclusion of the compensation in their income.

The committee amendment provides that the taxpayer may elect to exclude from his income the amount of any compensation which he properly did not take into account in computing the disaster loss deduction (that is, the payment of the compensation was unexpected at the close of the taxable year in which the disaster occurred or at the time of making the election to claim the deduction in the year immediately preceding the year of the disaster). However, if the taxpayer makes this election, he must enter into an agreement with the Treasury Department to reduce the basis of the repaired or replacement property by the compensation he received. This basis adjustment with respect to the repaired or replacement property is to be made to the extent of the compensation received first by reducing the basis of any repaired or replacement property which is depreciable, then to reduce the basis of any such trade or business property (other than depreciable property), and finally to any other such affected property.[1]

[1] In the case of replacement property, the basis adjustment is to apply only to property which is like the kind of property originally destroyed and only if the replacement property is acquired within 3 years of the disaster. If replacement property is not acquired within 3 years of the disaster (apart from the adjustments made to any damaged property), then no other tax consequences are to arise with respect to this part of the tax benefit.

The committee believes, however, that this tax deferment procedure should be available only for the first $5,000 of tax benefit. Thus, a taxpayer may elect this treatment for the first $5,000 of tax benefits and must make the corresponding basis adjustment to reflect the compensation received up to but not in excess of $5,000 of tax benefits. If the compensation received resulted in a tax benefit in excess of $5,000, the amount of compensation representing the excess is to be included in the income of the taxpayer. (There is no basis adjustment for this excess amount.) The committee believes, however, that since these taxpayers may also still be suffering from hardships, it would not be appropriate to require the inclusion of this excess compensation in income in one year. Consequently, the committee has provided that the excess compensation is to be included in the taxpayer's income in equal installments over a 5-year period, commencing with the year in which it was received.

In order for the taxpayer to elect the benefits of this provision, he must originally have been allowed to claim a loss attributable to a disaster occurring during calendar year 1972, although he need not have made the election to take the loss in the year immediately preceding the year in which the disaster occurred. In addition, he must have received the compensation (which was not taken into account when computing the amount of the loss deduction attributable to the disaster) in settlement of his claim against another person for that other person's liability in tort for the damage or destruction of his property in connection with the disaster.

This amendment applies to compensation received in calendar year 1972 or later if the taxpayer deducted the disaster loss on his return either for the tax year immediately preceding the tax year in which the disaster occurred or for a later year.

The decrease in tax liability resulting from this amendment would be small for each of the income years 1972–1974.

J. Exclusion From Unemployment Compensation Coverage of Students Employed by Nonprofit Organizations Auxiliary to Schools, Colleges and Universities

Under present law, services of a student or the spouse of a student performed in the employ of a private nonprofit organization which is auxiliary to a school, college, or university at which the student is enrolled and in regular attendance must generally be covered under the State unemployment compensation program. These auxiliary nonprofit organizations may operate such enterprises as bookstores, housing, publishing, or food service.

When a similar situation under the social security program was brought to the attention of Congress last year, the Social Security Act was amended to exclude these services from coverage. The Committee bill provides for the exclusion from unemployment compensation coverage of the services of a student or the spouse of a student performed in the employ of an auxiliary nonprofit organization which is organized and operated exclusively for the benefit of and supervised or controlled by the school, college, or university

The exclusion would be effective with respect to services performed after December, 1972.

It is estimated that this provision would decrease annual tax liability by less than $5 million.

K. Exception to the Charitable Distribution Requirements for Certain Private Foundations

Present law limits the involvement of private foundations in business enterprises by requiring divestiture of business holdings in excess of certain prescribed percentages. An exception to this rule was provided in the Tax Reform Act of 1969 (sec. 101(1) (4)). That exception permitted the retention of 51 percent of a business' stock in the case of any foundation incorporated before January 1, 1951, where substantially all of its assets on May 26, 1969, consisted of more than 90 percent of the stock of an incorporated business enterprise which is licensed and regulated, the sales and contracts of which are regulated, and professional representatives of which are licensed, by State regulatory agencies in at least 10 States. In addition, in order to qualify for the provision the foundation must have received its stock solely by gift, devise or bequest.[1]

Under this exception, the Herndon Foundation is permitted to retain up to 51 percent of the stock in the Atlanta Life Insurance Company. However, it has come to the committee's attention that the charitable distribution provisions, which require a private foundation to distribute currently the greater of its adjusted net income, or a stated percentage of its investment assets (the minimum investment return), are forcing divestiture of the stock that Congress determined the Herndon Foundation should be permitted to keep.

As a result, the intent of Congress in 1969, that foundations like the Herndon Foundation should be able to retain 51 percent of the stock of a company, is being frustrated because of the operation of the minimum investment return provision. To overcome this result, the committee has provided that in the case of a private foundation of the type referred to above (described in sec. 101(l)(4) of the Tax Reform Act of 1969) the minimum investment return and the adjusted net income are to be determined without regard to the foundation's stock holdings (or divided income on such holdings) in the company in question. The dividend income derived from such stock, however, is to be added to the amount that the private foundation is otherwise required to distribute currently.

This amendment shall apply with respect to taxable years beginning after December 31, 1971.

This amendment will not have any effect on the revenues to the Treasury.

L. Tax Treatment of Tuition and Educational Expenses Paid on Behalf of Members of the Uniformed Services

Present law (sec. 117 of the code) provides, subject to certain limitations and qualifications, that gross income of an individual does not include amounts received as a scholarship at an educational institution or as a fellowship grant. This provision, however, does not apply with respect to any amount paid or allowed on behalf of an individual if the amount represents compensation for past, present, or future employment services, or in certain other cases, such as where the studies or

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[1] Stock of a company placed in trust before May 27, 1969, with provision for the remainder to go to the foundation also is treated as coming under this provision if the foundation held on May 26, 1969, without regard to such trust, more than 20 percent of the stock of enterprise.

research are primarily for the benefit of the grantor. In these types of cases, the amounts are considered as compensation designed for services or designed to accomplish an objective of the grantor and are not excludable from gross income; and consequently, these amounts are subject to tax to the individual.

The Internal Revenue Service notified the Department of Defense in response to its request for a ruling that the tuition and other educational expenses paid to or on behalf of participants in the recently instituted Armed Forces Health Professions Scholarship Program are not excludable from the individual's gross income, and, therefore, are subject to tax and withholding. It was noted that under this scholarship program the student was required to serve a prescribed period of active duty with the Armed Forces in return for payment by the Government of certain educational expenses, such as tuition and fees, books, and other related expenses.

The Department of Defense has raised a question about the effect of this ruling on the students under the Armed Forces Health Professions Scholarship Program. In addition, although the ruling only specifically applies to this program, the Department of Defense has expressed a concern with respect to its other educational programs where there are requirements of a prescribed period of active military duty or some other service or obligation in return for the payments. The Department of Defense has submitted a legislative proposal dealing with the application of the "scholarship" exclusion provision with respect to the payments by the Government for the tuition and other educational expenses of a member of the uniformed services attending an educational institution.

The Committee believes that the Defense Department's proposal deserves detailed consideration. To permit the time for this consideration, the committee has decided to postpone the application of the effect of the ruling until January 1, 1975, not only with respect to the Armed Forces Health Professions Scholarship Program but also to other substantially similar educational programs of the uniformed services (as determined by the Secretary of the Treasury), pending a study by the staff of the effect of the application of the proposal to members of the uniformed services. Accordingly, the committee amendment provides that a member of a uniformed service who is receiving training under the Armed Forces Health Professions Scholarship Program (or any other program which is determined by the Secretary of the Treasury to have substantially similar objectives) from an educational institution will not be subject to tax on any payment from the Government with respect to his tuition and certain other educational expenses, including contributed services, accommodations and books. (The committee intends that the phrase "substantially similar objectives" is to include any undergraduate or graduate programs paid for by appropriated funds.) This is applicable whether the member is receiving the educational training while on active duty or in an off-duty or inactive status, and without regard to whether a period of active duty is required as a condition of receiving the educational payments.

The amendment applies with respect to amounts received in calendar years 1973 and 1974.

It is estimated that this amendment will reduce annual Federal individual income tax liability by less than $10 million at 1973 levels.

M. Transfers of Accounts Receivable to Related DISCs

Under present law, the profits of a Domestic International Sales Corporation (DISC) are not to be taxed to the DISC but instead are to be taxed to the shareholders subsequently when distributed to them. To qualify as a DISC, at least 95 percent of a corporation's gross receipts must arise from export sale or lease transactions and other export-related investments or activities. In addition, at least 95 percent of the corporation's assets must be export-related. Included in export-related assets are accounts receivable and evidences of indebtedness of the corporation (or if the corporation acts as agent, the principal) held by the corporation which arose in connection with qualified export sale, lease, or rental transactions (including related and subsidiary services) of the corporation or the performance of managerial, engineering, or architectural services producing qualified export receipts by the corporation.

Accounts receivable and evidences of indebtedness can only be treated as qualified export assets if they arise by reason of the transactions of the corporation itself, and a corporation can qualify as a DISC if these accounts receivable are its only assets. However, if these accounts receivable and evidences of indebtedness are transferred to another related corporation, they would not be treated as qualified export assets in the hands of that transferee corporation. Therefore, if these were the only assets held by the transferee corporation, it could not qualify as a DISC.

It has come to the attention of the committee that a corporation may want to have its sales operations in one DISC and its financing operations in another DISC. A corporation might adopt this corporate structure because it believes it eases its ability to receive outside financing. In view of this, the committee has adopted an amendment which enables a DISC to treat as qualified export assets the accounts receivable and evidences of indebtedness acquired as a result of the export related transactions (whether as principal or agent) of a related DISC.

This amendment applies with respect to taxable years beginning after 1973, and at the election of the taxpayer (if the election is made within 90 days after the date of the enactment of this amendment) to any taxable year beginning after 1971 and before 1974.

This amendment will have no direct effect on revenues to the Treasury.

III. EFFECT ON REVENUES OF THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statements are made relative to the effect on the revenues of this bill. From the standpoint of the level of revenues with respect to present law as it operated on June 30, 1973, the provisions of the House bill relating in general to the tax treatment of members of the armed forces and civilian employees who are prisoners of war or missing in action are expected to result in a decrease in receipts of approximately $4 million spread over the next several fiscal years. However, the fact that the "induction period" (a requirement for certain benefits) has been allowed to lapse as of June 30, means that there would have been an increase in receipts of approximately $12.5 million, primarily in fiscal year 1974. With the changes made in this bill, this increase in revenue will not occur. The Department of Treasury agrees with these statements.

The committee amendments either have no effect, or a small or negligible effect, on existing revenues (as described in each case in the explanation of the provisions above), except in the case of the amendment dealing with the exclusion from the unemployment compensation program (less than $5 million), the amendment dealing with the tax treatment of tuition and educational expenses paid on behalf of members of the uniformed services (less than $10 million), and the amendment dealing with the treatment process of trona. Based upon the Treasury Department regulations this amendment is estimated to reduce revenues by about $2 million. However, the committee believes the treatment provided is a clarification of present law and therefore that this provision should not be viewed as resulting in a revenue loss.

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made relative to the vote by the committee on the motion to report the bill. The bill was ordered reported unanimously by voice vote.

IV. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

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