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SENATE

} REPORT
No. 1404

AN ACT RELATING TO RECOGNITION OF GAIN OR LOSS IN CERTAIN
RAILROAD REORGANIZATIONS AND TO AMEND SECTION 108 (b)
OF THE INTERNAL REVENUE CODE OF 1954 AND SECTION 723
OF THE INTERNAL REVENUE CODE OF 1939

JANUARY 19 (legislative day, JANUARY 16), 1956.—Ordered to be printed

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

R E P O R T

[To accompany H. R. 7247]

The Committee on Finance, to whom was referred the bill (H. R. 7247) to amend the Internal Revenue Code of 1954 with respect to the treatment of gain in certain railroad reorganizations, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

At the end of section 3 insert the following:

SEC. 4. Section 108 (b) of the Internal Revenue Code of 1954 (relating to income of a railroad corporation from discharge of indebtedness) is hereby amended by striking out "December 31, 1955" and inserting in lieu thereof "December 31, 1957".

SEC. 5. Section 723 of the Internal Revenue Code of 1939 (relating to equity invested capital in special cases) is hereby amended by adding at the end thereof the following new subsection:

"(c) If a recapitalization of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, was effected after December 31, 1938, in pursuance of an order of the court having jurisdiction of such corporation—

"(1) in a receivership proceeding; or

"(2) in a proceeding under section 77 of the National Bankruptcy Act, as amended,

the equity invested capital of such corporation shall (at the election of the taxpayer) be the same as if the assets had been acquired in a transaction to which section 760 is applicable."

SEC. 6. The amendment made by section 5 of this Act shall be effective for taxable years beginning after December 31, 1941.

Amend the title so as to read:

An act relating to recognition of gain or loss in certain railroad reorganizations and to amend section 108 (b) of the Internal Revenue Code of 1954 and section 723 of the Internal Revenue Code of 1939.

SECTIONS 1, 2, AND 3. RECOGNITION OF GAIN OR LOSS IN CERTAIN RAILROAD REORGANIZATIONS**A. PURPOSE OF SECTIONS 1, 2, AND 3**

The purpose of sections 1, 2, and 3 is to add a new section 374 to the 1954 code to provide that no gain will be recognized to a railroad corporation where its properties are transferred, pursuant to a court order in a receivership proceeding or in a proceeding under the Bankruptcy Act, in a reorganization approved by the court in exchange solely for stock or securities in another railroad corporation. This establishes for railroad corporations substantially the same rule that now exists for other corporations.

6. GENERAL STATEMENT

Under section 373 of the 1954 code no loss is recognized where property of a railroad corporation is transferred pursuant to a court order in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act to another railroad corporation organized for the purposes of effectuating a plan of reorganization approved by the court. For purposes of this provision a railroad corporation is defined in the same manner as it is defined in section 77 (m) of the Bankruptcy Act. The basis of the property in such cases is the same in the hands of the successor railroad corporation as in the hands of the railroad corporation from whom the property was acquired. A similar provision was contained in section 112 (b) (9) of the 1939 code.

It has been brought to the attention of the committee that there may be instances in such railroad reorganizations where the transfer of property in the reorganizations would result in a taxable gain. Your committee's bill, therefore, adds a new section 374, applicable to transfers after July 31, 1955, to provide that gain will not be recognized in such receivership or bankruptcy reorganizations with respect to property of the transferor corporation which is exchanged solely for stock or securities of the transferee corporation. Where, however, the transferor corporation receives not only stock or securities which are permitted to be received without the recognition of gain but also other property or money (such other property or money being commonly referred to as "boot"), no gain will be recognized to the corporation receiving such boot provided that it distributes the boot in pursuance of the plan of reorganization. If the transferor corporation does not distribute the boot pursuant to the plan of reorganization, gain will be recognized to it in an amount which does not exceed the sum of any money and the fair market value of any other property received by it but not distributed.

Your committee has also provided that the basis of the property in the hands of the transferee corporation shall be increased in the amount of gain recognized to the transferor. In general, these provisions correspond to the provisions applicable under section 371 in the case of reorganizations by corporations other than railroads in receivership, foreclosure, or similar proceedings, or in a proceeding under chapter X of the Bankruptcy Act.

Section 373 has been amended so as to limit it to transfers before August 1, 1955.

SECTION 4. EXTENSION FOR 2 YEARS OF THE APPLICATION OF SECTION 108 (B) OF THE INTERNAL REVENUE CODE OF 1954 (RELATING TO INCOME OF A RAILROAD CORPORATION FROM DISCHARGE OF INDEBTEDNESS)

A. PURPOSE OF SECTION 2

Section 4, which was added by your committee, extends for 2 years the expiration date contained in section 108 (b) of the Internal Revenue Code of 1954. Under existing law, the provisions of section 108 (b) do not apply to any discharge of indebtedness occurring in a taxable year beginning after December 31, 1955. This latter date is extended to December 31, 1957, under this provision.

B. GENERAL STATEMENT

Under section 108 (b) of the 1954 code, income from the discharge of indebtedness of a railroad corporation is excluded from gross income if the discharge is effected pursuant to a court order issued in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act. In such cases, the basis of the property of the railroad corporation is not reduced by reason of the exclusion from gross income of the amount of income attributable to the discharge of indebtedness.

A provision corresponding to section 108 (b) was contained in section 22 (b) (10) of the 1939 code. This provision was first added to the Internal Revenue Code by the Revenue Act of 1942 effective for taxable years beginning after December 31, 1939, and before January 1, 1946. Its application was extended in subsequent revenue acts to December 31, 1954, and was further extended to December 31, 1955, by the 1954 code. Because certain railroad receivership proceedings have not yet been concluded and no court order has been issued in these cases, the bill extends the applicability of the provision so that it will also apply to any discharge of indebtedness occurring in a taxable year beginning after December 31, 1955, and before January 1, 1958.

It is estimated that the revenue effect of this provision will be negligible.

SECTIONS 5 AND 6. RAILROAD CORPORATIONS SUBJECT TO RECEIVERSHIP OR BANKRUPTCY PROCEEDINGS

A. PURPOSE OF SECTIONS 5 AND 6

This section, which was added by your committee, amends section 723 of the Internal Revenue Code of 1939 (relating to the computation of equity invested capital in special cases under the World War II excess-profits tax) to provide at the election of the taxpayer that, in the case of a recapitalization of a railroad corporation pursuant to receivership or bankruptcy proceedings, the equity invested capital is to be the same as if the corporate assets were transferred to a new corporation. Where the properties of a railroad corporation are transferred to a new corporate entity in receivership or bankruptcy proceedings, the equity invested capital is determined under section 760 of the World War II excess profits tax and reflects the basis of the

transferred assets. The treatment thus provided in the case of a new corporation results from the addition of sections 112 (b) (9) and 113 (a) (20) to the 1939 code by section 142 of the Revenue Act of 1942.

B. GENERAL STATEMENT

The report of the Senate Finance Committee accompanying the Revenue Act of 1942 (S. Rept. No. 1631, 77th Cong., 2d sess.) indicates that the purpose of the committee was to provide equal treatment whether a new corporation was organized, or the existing corporate entity was used, to effectuate the plan of reorganization. It has been brought to the attention of your committee, however, that, because of subsequent court decisions, some doubt exists that a recapitalization of an existing corporate entity in receivership or bankruptcy proceedings would be accorded as favorable treatment as where the assets are transferred to a new corporation. The adoption of this amendment thus carries out the expressed intent of the committee in connection with the changes affecting such reorganizations adopted in the Revenue Act of 1942.

Under the amendment, the equity invested capital of a railroad corporation which has been recapitalized after December 31, 1938, in pursuance of an order of the court having jurisdiction of such corporation, either in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, at the election of the taxpayer will be determined in the same manner as if the assets which the corporation held immediately following the recapitalization had been transferred to a new corporation in a transaction to which section 760 of the Internal Revenue Code of 1939 is applicable. The election allowed by this section may be made under such regulations as the Secretary or his delegate may prescribe. For this purpose, all of such assets are to be considered as having been transferred to a new corporation in exchange for the stock, securities, and other liabilities existing immediately after the recapitalization. The amendment is effective with respect to taxable years beginning after December 31, 1941.

It is estimated that the revenue effect of this provision will be negligible.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of 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 italics; existing law in which no change is proposed is shown in roman):

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INTERNAL REVENUE CODE OF 1939

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SEC. 723. EQUITY INVESTED CAPITAL IN SPECIAL CASES.

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(c) *If a recapitalization of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, was effected after December 31, 1938, in pursuance of an order of the court having jurisdiction of such corporation—*

(1) *in a receivership proceeding; or*

(2) in a proceeding under section 77 of the National Bankruptcy Act, as amended, the equity invested capital of such corporation shall (at the election of the taxpayer) be the same as if the assets had been acquired in a transaction to which section 760 is applicable.

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INTERNAL REVENUE CODE OF 1954

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SEC. 108. INCOME FROM DISCHARGE OF INDEBTEDNESS.

(a) SPECIAL RULE OF EXCLUSIONS.— * * *

(b) RAILROAD CORPORATIONS.—No amount shall be included in gross income by reason of the discharge, cancellation, or modification, in whole or in part, within the taxable year, of any indebtedness of a railroad corporation, as defined in section 77 (m) of the Bankruptcy Act (11 U. S. C. 205 (m)), if such discharge, cancellation, or modification is effected pursuant to an order of a court in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act. In such cases, the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income, and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. Subsection (a) of this section shall not apply with respect to any discharge of indebtedness to which this subsection applies. This subsection shall not apply to any discharge occurring in a taxable year beginning after December 31, [1955] 1957.

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SEC. 357. ASSUMPTION OF LIABILITY.

(a) GENERAL RULE.—Except as provided in subsection (b) and (c), if—

(1) the taxpayer receives property which would be permitted to be received under section 351, 361, [or 371] 371, or 374 without the recognition of gain if it were the sole consideration, and

(2) as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability,

then such assumption or acquisition shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351, 361 [or 371] 371, or 374, as the case may be.

(b) TAX AVOIDANCE PURPOSE.—

(1) IN GENERAL.—If, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer with respect to the assumption or acquisition described in subsection (a)—

(A) was a purpose to avoid Federal income tax on the exchange, or

(B) if not such purpose, was not a bona fide business purpose, then such assumption or acquisition (in the total amount of the liability assumed or acquired pursuant to such exchange) shall, for purposes of section 351, 361, [or 371] 371, or 374 (as the case may be), be considered as money received by the taxpayer on the exchange.

* * * * *

(c) LIABILITIES IN EXCESS OF BASIS.—

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(2) EXCEPTIONS.—

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(B) section [371] 371 or 374 applies.

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SEC. 373. GAIN OR LOSS NOT RECOGNIZED IN CERTAIN RAILROAD REORGANIZATIONS

(a) NONRECOGNITION OF LOSS.—No gain or loss shall be recognized if property of a railroad corporation, as defined in section 77 (m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205), is [transferred in pursuance] transferred before

August 1, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

- (1) in a receivership proceeding, or
- (2) in a proceeding under section 77 of the Bankruptcy Act, to a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding.

* * * * *

(b) BASIS.—

(1) RAILROAD CORPORATIONS.—If the property of a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) was acquired after [December 31, 1938] December 31, 1938, and before August 1, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

- (A) in a receivership proceeding, or
 - (B) in a proceeding under section 77 of the Bankruptcy Act,
- and the acquiring corporation is a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, the basis shall be the same as it would be in the hands of the railroad corporation whose property was so acquired.

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"SEC. 374. GAINS OR LOSS NOT RECOGNIZED IN CERTAIN RAILROAD REORGANIZATIONS.

"(a) EXCHANGES BY CORPORATIONS.—

"(1) NONRECOGNITION OF GAIN OR LOSS.—No gain or loss shall be recognized if property of a railroad corporation, as defined in section 77 (m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205), is transferred after July 31, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

- "(A)** in a receivership proceeding, or
- "(B)** in a proceeding under section 77 of the Bankruptcy Act, to another railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other railroad corporation.

"(2) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by paragraph (1) to be received without the recognition of gain, but also of other property or money, then—

- "(A)** if the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but
- "(B)** if the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

"(3) LOSS FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

"(b) BASIS.—If the property of a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) was acquired after July 31, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

- "(1)** in a receivership proceeding, or
 - "(2)** in a proceeding under section 77 of the Bankruptcy Act,
- and the acquiring corporation is a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, the basis shall be the same as it would be in the hands of the railroad corporation whose property was so acquired, increased in the amount of gain recognized under subsection (a) (2) to the transferor on such transfer.

"(c) ASSUMPTION OF LIABILITIES.—In the case of a transaction involving an assumption of a liability or the acquisition of property subject to a liability, the rules provided in section 357 shall apply."