Calendar No. 1059

86th Congress, 2d Session — SENATE — Report No. 1021

DOCUMENTARY STAMP TAX ON ISSUANCE OF SHARES BY REGULATED INVESTMENT COMPANIES

January 13, 1960.—Ordered to be printed

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

REPORT

[To accompany H.R. 6132]

The Committee on Finance, to whom was referred the bill (H.R. 6132) relating to the rate of tax on the issuance of shares or certificates of stock by regulated investment companies, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

Under present law the documentary stamp tax on original issues of stock is levied at the rate of 10 cents per $100 of actual value. The documentary stamp tax on stock transfers, on the other hand, is levied at the rate of 4 cents per $100 of actual value.

Regulated investment companies which operate as open-end mutual investment companies, however, do not usually provide for the trading of their securities. Instead they issue new securities to those desiring to buy their stock, and redeem the stock of those desiring to sell. As a result they pay a 10-cents-per-$100 issuance tax on transactions which to others would result in a transfer tax of 4 cents per $100 of actual value.

The bill provides that the issuance tax in the case of qualifying regulated investment companies is to be imposed at the rate of 4 cents per $100 of actual value, rather than the 10-cent rate otherwise applicable. This is to be effective for stock sold after the date of enactment of this bill.

II. GENERAL STATEMENT

Under present law a documentary stamp tax is imposed on the original issue of shares of certificates of stock issued by a corporation at the rate of 10 cents on each $100 (or major fraction thereof) of the actual value of the certificates or shares. In addition, present law imposes (subject to certain limitations) on each sale or transfer of shares or certificates of stock a tax at the rate of 4 cents on each $100 (or major fraction thereof) of the actual value of the certificates or shares.

A problem has arisen in connection with the application of these two taxes in the case of regulated investment companies. Regulated investment companies are mutual funds which, if they meet certain conditions (including the distribution of 90 percent or more of their income) under present law are not required to pay the corporate income tax on income they receive, to the extent that it in turn is distributed to their stockholders. Mutual funds represent an opportunity for those whose investment funds are relatively limited to diversify their investments and obtain expert investment counsel in much the same manner as larger investors are able to do directly. The omission of the corporate income tax in the case of the distributed earnings of these companies secures for their investors essentially the same tax treatment they would have received had they invested directly in the operating companies. Many of these regulated investment companies are so-called open-end investment companies whose stock is not generally traded in the open market. Persons desiring to invest in these companies usually buy newly issued shares in the company. Then, when they want to sell their stock, these companies redeem their shares at their current net asset value. Thus, unlike usual business corporations, the capital of these open-end investment companies varies from day to day as new shares are issued to some persons while outstanding shares are redeemed from others.

The effect of this is that the open-end investment company must pay a stock issuance tax at the rate of 10 cents for each $100 of actual valuation on transactions which, in the case of a usual corporation, would be a transfer tax at the rate of 4 cents per $100 of actual value. This is a discrimination of long standing but one which became a significant factor only with the changes made in the Excise Tax Technical Changes Act of 1958. In that act the documentary stamp issuance and transfer taxes generally were changed from a tax on par value to a tax on actual value.

In addition, it has also been pointed out that investment companies hold the stock of other companies and either buy or sell this stock as their own shareholders buy or sell their stock. As a result, in this case, in addition to the issuance tax payable when the investment company's stock is bought or sold, there is a transfer tax payable, as well, with respect to the securities held by the investment company, which it buys or sells as its stock is bought or sold. To a limited extent this also is true of other companies having stock portfolios. However, the regulated investment company is a type of company which Congress has specifically recognized in the case of the income tax as qualifying for special tax treatment because of the nature of the investment opportunities such companies make available to investors of small means.

In view of these considerations, this bill amends the provision imposing a documentary stamp tax on original issues of certificates or shares of stock (sec. 3401) to provide that this tax rate is to be 4 cents instead of 10 cents in the case of companies qualifying as regulated investment companies. The lower rate is to be available only where the company qualifies as a regulated investment company in the year during which the share of stock is issued.

In the case of new companies which have filed their notification of registration with the Securities and Exchange Commission under section 8(a) of the Investment Company Act of 1940, the 4-cent tax rate would apply if the company has notified its stockholders in writing that it intends to elect to be taxed as a regulated investment company, but only if it actually does so qualify. In any year in which a company fails to qualify as a regulated investment company it would be taxable at the 10-cent rate even though in prior years it had qualified.

The amendment made by this bill is to apply to shares and certificates of stock of qualifying regulated investment companies issued after the date of enactment of this bill.

In reporting on this legislation the Treasury Department expressed the following opinion:

> While the Treasury Department recognizes that investors often purchase newly issued shares of regulated investment companies in lieu of the purchase of outstanding shares of operating corporations, the Department is concerned as to the relationship of the proposed tax reduction to overall current revenue policy. The tax reduction would result in a revenue loss of about $1 million annually. The amount in and of itself is not very significant, but granting of tax relief in this area would be inconsistent with the President's budget position which points up the need for maintaining existing levels of taxation to meet Government expenditure needs and help maintain a sound financial policy. Arguments for repeal or reduction of many excise taxes, some with extremely good justification, have had to be turned down in recent years because of the budgetary situation which has required continuation of existing tax rates. In this particular case, the practical result of maintaining the present rate would not be unreasonable. The 10 cents per $100 issuance tax represents a tax of one-tenth of 1 percent. The proposed reduction to 4 cents in turn is only a matter of six-hundredths of 1 percent. The issuance tax thus would appear to be of minor importance to purchasers of regulated investment company shares, and there is much less justification for special treatment under this tax than under the corporate income tax from which these companies were granted relief in the past.

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 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):

SECTION 4301 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 4301. IMPOSITION OF TAX.

There is hereby imposed, on each original issue of shares or certificates of stock issued by a corporation (whether on organization or reorganization), a tax at the rate of 10 cents on each $100 (or major fraction thereof) of the actual value of the certificates (or of the shares where no certificates are issued); *except that such rate shall be 4 cents instead of 10 cents in the case of shares or certificates issued by a corporation to which subchapter M of chapter 1 applies for the taxable year during which such share or certificate is issued.* The tax imposed by this section shall be computed on the basis of all certificates (or shares) so issued by the corporation on each day.

O