**The original documents are located in Box 20, folder "1975/01/03 HR421 Duty-free Treatment of Upholstery Regulators" of the White House Records Office: Legislation Case Files at the Gerald R. Ford Presidential Library.**



Exact duplicates within this folder were not digitized.

APPROVED
JAN 3 - 1975

THE WHITE HOUSE

WASHINGTON

ACTION

Last Day: January 4

January 2, 1975

Posted 1/4/75

To Archives 1/6/75

MEMORANDUM FOR: THE PRESIDENT

FROM: KEN COLE

SUBJECT: Enrolled Bill H.R. 421
Duty-free Treatment of Upholstery Regulators

Attached for your consideration is H.R. 421, sponsored by Representative Conte, which permits the duty free importation of upholster regulators and upholsterers' regulating needles and pins. There is no domestic commercial production of these articles.

The remainder of H.R. 421 consists of amendments to the tax laws, none of which were opposed by Treasury.

OMB recommends approval and provides additional background information in its enrolled bill report (Tab A).

Max Friedersdorf (Loen) and Phil Areeda both recommend approval.

RECOMMENDATION

That you sign H.R. 421 (Tab B).

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

DEC 2 9 1974

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 421 - Duty-free treatment of upholstery regulators
Sponsor - Rep. Conte (R) Massachusetts

Last Day for Action

January 4, 1975 - Saturday

Purpose

Permits the importation of upholstery regulators and upholsterers' regulating needles and pins free of duty; and contains numerous amendments to the tax laws.

Agency Recommendations

| | |
|---|---|
| Office of Management and Budget | Approval |
| Department of the Treasury | Approval |
| Council of Economic Advisers | No objection (Informally) |
| Department of Housing and Urban Development | No objection (Informally) |
| Department of Commerce | No objection (Section 1) |
| Department of State | No objection (Section 1) |
| Department of Labor | No objection (Section 1) |
| Office of the Special Representative for Trade Negotiations | No objection (Section 1) (Informally |
| Department of Justice | Defers to Treasury |

Discussion

The first section of the enrolled bill provides for the duty-free entry of upholstery regulators, upholsterers' regulating needles and upholsterers' pins. Since there is no domestic commercial production of these articles, the domestic upholstery trade is dependent upon imports, principally from West Germany and the United Kingdom. The annual value of imports of these items is very low.

In its report on H.R. 421 to the House Committee on Ways and Means, the Commerce Department stated:

> "Generally, the Department believes that duty removals should be accomplished through trade agreements, thus affording the United States an opportunity to obtain reciprocal tariff reductions of benefit to U.S. exporters. In view of the small quantity of imports and the unlikelihood of an opportunity for substantial reciprocal benefits in this case, however, we would not object to the enactment of H.R. 421."

The duty-free entry provided under the bill would be effective as of the date of enactment of H.R. 421. The bill also includes a provision which would treat the duty-free status as having been proclaimed by the President as being required or appropriate to carry out foreign trade agreements to which the United States is a party. This would make possible, at some future time, the extension of import relief, if appropriate.

The remainder of H.R. 421 consists of amendments to the tax laws. Treasury did not oppose any of the amendments.

Extension of special 5-year amortization provisions -- Section 3 would extend from December 31, 1974 to December 31, 1975 the provisions for rapid writeoff of expenditures for pollution control facilities, railroad rolling stock, rehabilitation of low-income housing, and certain coal mine safety equipment.

The one-year extension of these provisions would permit the Congress to examine in detail whether they should be continued or permitted to expire.

The revenue loss from section 3 would be about $5 million.

Accrued vacation pay deductions -- Section 4 would allow employers to take a deduction for accrued vacation pay which, except for contingencies such as termination of employment before vacation time arrives, has already been earned by the employees. Special rules are provided which would prevent a doubling up of deductions in cases of employers who are newly adopting the accrual pay system.

The revenue effect of section 4 would be negligible.

Repeal of application of class life system to real property -- The Revenue Act of 1971 provided a new unified system of class lives for depreciation purposes which may be elected by taxpayers for assets placed in service after 1970 (commonly referred to as the "ADR system"). The law provides that after 1973 this class life system is to apply to real estate. The Treasury Department has not yet devised a satisfactory manner of incorporating real estate into the ADR system.

At the request of Treasury, section 5 of the enrolled bill would repeal the provision applying the ADR system to real estate after 1973.

There would be no revenue effect from this provision.

Extension of special gain recapture provision re sale of subsidized housing projects -- Section 5 would extend from January 1, 1975 to January 1, 1976 the present rules providing a shorter period for recapture of gain on the sale of certain Government subsidized housing projects.

Under current law there is full recapture on projects such as FHA section 236 programs in the first 20 months of holding the property. The amount of recapture for these projects decreases rapidly thereafter, and there is no recapture after the end of 10 years. This recapture period is shorter than the general recapture period which applies to other types of property. This special rule for Government subsidized projects applies to property which is constructed or acquired before January 1, 1975. The effect of H.R. 421 would be to extend this rule for one year to property constructed or acquired after January 1, 1976.

This provision would have no revenue impact.

Treatment of foreclosure property income by real estate investment trusts -- In order to qualify for special tax treatment as a real estate investment trust ("REIT") under present law, a trust must distribute its income to investors each year and may receive only up to certain amounts of specific types of income. These restrictions are designed to allow REIT tax benefits only where there is a pooling of investment arrangement; the investment is basically in the field of real estate; and the trust's income is clearly passive income from real estate investments.

Section 6 of the enrolled bill would make two changes in the restrictions imposed on the sources of REIT income:

- -- a trust could receive income from real property acquired through foreclosure without being denied REIT status, inasmuch as such an acquisition is usually inadvertent on the part of the mortgagee. The trust could elect a two-year grace period so that it could liquidate the foreclosed property or arrange to convert this income to qualified source income in an orderly manner. During the grace period, the trust would pay corporate tax on nonqualified income received from property acquired through the foreclosure.
- -- trusts would be allowed to receive income from the sale of foreclosed property without being disqualified.

The revenue effect of section 6 would be negligible.

Increase in interest charged on tax deficiencies and overpayments -- Section 7 would increase from six to nine percent the rate of interest payable (a) by taxpayers to the Government on tax deficiencies and (b) by the Government to taxpayers on overpayments not refunded within prescribed time limits. It would also provide for further modifications of this rate of interest to be tied by formula to the prime rate.

The revenue gain from section 7 is anticipated to be $300 million.

<u>Exclusion of interest from deposits with persons carrying on banking business</u> -- Under a provision of current law which is due to expire on December 31, 1975, interest received by non-resident aliens and foreign corporations from deposits with banks or other savings institutions is exempt from the 30-percent withholding tax on income or gain not effectively connected with the conduct of a trade or business within the U.S.

Section 8 of the enrolled bill would extend this provision for an additional year through December 31, 1976, to avoid serious disintermediation when existing time deposits mature.

The revenue loss from section 8 is estimated at $50 million.

<u>Withholding tax exemption for interest paid by U.S. companies to foreign lenders</u> -- In 1971 legislation was enacted to permit U.S. firms to obtain funds from foreign lenders for use domestically or abroad, and to exempt such foreign lenders from the 30 percent withholding tax. In the event these obligations were transferred to U.S. persons, the Interest Equalization Tax ("IET") was imposed. Since the expiration of the IET on June 30, 1974, the withholding tax exemption has not been in effect for such borrowings.

Section 9 of the enrolled bill would provide an exemption for interest paid to foreign lenders except where the income is effectively connected with the conduct of a business or trade in the U.S. by the foreign lender. It would additionally exclude debt obligations from U.S. estate tax where the interest received by a decedent at the time of his death would qualify for the 30 percent withholding tax exclusion.

The revenue loss from section 9 would be about $10 million.

<u>Tax treatment of political parties and committees</u> -- The enrolled bill would generally treat political parties, committees, and separate campaign funds as tax-exempt organizations. Contributions to them would not be considered as income, although they would be subject to tax on unrelated business income, capital gains and investment income. Political organizations would not be subject to tax or required to file a return unless its gross income exceeds its directly-connected deductions by more than $100. (Section 10)

Political contributions would not be subject to the gift tax for transfers occurring after May 7, 1974. (Section 14) However, where gifts of appreciated property are made to political organizations, the contributor would be treated as having sold the property on that date and would be taxed on the difference between the fair market value of the transferred property and his basis for the property. (Section 13)

Individuals holding elective office or candidates for such office would be permitted to establish newsletter funds as tax-exempt political organizations. (Section 10) The tax credit or deduction allowed for political contributions would be expanded to cover contributions to newsletter funds. Such credit or deduction would be granted for contributions made in the calendar year prior to the year that an individual publicly announces his candidacy. (Section 11) Under present law, a deduction or credit is allowed only for the year in which the candidacy is announced.

The revenue effect of these provisions would be negligible.

Increase in political contributions credit and deduction -- Under current law a tax credit is available for one-half of the political contributions by an individual, with a maximum credit of $12.50 per individual, or $25 for a couple filing a joint return. Alternatively, a tax deduction may be taken for one-half of the contribution, with a maximum deduction of $50 per individual or $100 on a joint return.

Section 12 of the enrolled bill would double the maximum credit to $25 ($50 on a joint return) and double the maximum deduction to $100 ($200 on a joint return). The estimated revenue loss from these changes would be $26 million ($11 million from the increase in the credit and $15 million from the deduction increase).

Wilfred H Rommel

Assistant Director for
Legislative Reference

Enclosures

THE GENERAL COUNSEL OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C. 20410

DEC 31 1974

Mr. Wilfred H. Rommel
Assistant Director for
Legislative Reference
Office of Management and Budget
Washington, D. C. 20503

Attention: Ms. Mohr

Dear Mr. Rommel:

Subject: H. R. 421, 93d Congress, Enrolled Enactment

This is in response to your request for our views on the enrolled enactment of H. R. 421, an Act "To amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty."

This enrolled enactment contains provisions which would amend the Tariff Schedules of the United States and the Internal Revenue Code of 1954. Of interest to this Department are the provisions which relate to the Federal income tax treatment accorded real estate investments and investment trusts. These include proposed one year extensions (from January 1, 1975 to January 1, 1976) of Internal Revenue Code provisions which allow (i) a five year amortization of expenses incurred in rehabilitating rental housing for low- and moderate-income families (section 3(c)) and (ii) accelerated capital gains treatment of gain realized from the sale of low- and moderate-income housing assisted under section 221(d)(3) or 236 of the National Housing Act (section 5(c)).

We support these extensions. In our view, a close examination during the next Congress of the entire range of issues relating to tax incentives to encourage investment in real estate is imperative. Pending such a review, however, we believe continuation of the tax benefits involved is desirable, particularly in view of current economic conditions affecting housing.

The enactment also would defer application of the class life system (sometimes referred to as the assets depreciation range or ADR provision) until such time as the Treasury Department develops appropriate regulations for such application (section 5). Additionally, it would provide that a real estate investment trust (REIT) may not be denied so-called "pass through" tax treatment because of income received from foreclosure property, and it would allow a REIT to hold foreclosure property for sale (section 5(c)).

We have no objection to these provisions, but would defer to the Treasury Department as to their merits. Likewise, we would defer to that Department and other interested agencies as to the merits of the remainder of the enactment.

Sincerely,

Robert R. Elliott

Robert R. Elliott

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.: 912

Date: December 30, 1974

Time: 5:00 p.m.

FOR ACTION: Geoff Shepard ok
Max Friedersdorf sign
Bill Seidman no obj. Porter
Phil Areeda no obj

cc (for information): Warren Hendriks
Jerry Jones
Jack Marsh

FROM THE STAFF SECRETARY

DUE: Date: Monday, December 31 Time: 2:00 p.m.

SUBJECT:

Enrolled Bill H.R. 421 - Duty-free treatment of upholstery regulators

ACTION REQUESTED:

____ For Necessary Action

____ For Your Recommendations

____ Prepare Agenda and Brief

____ Draft Reply

____ For Your Comments

____ Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

K. R. COLE, JR.
For the President

THE WHITE HOUSE

ACTION MEMORANDUM | WASHINGTON | LOG NO.: 912

**Date:** December 30, 1974 | **Time:** 5:00 p.m.

**FOR ACTION:**
Geoff Shepard
Max Friedersdorf
Bill Seidman
Phil Areeda

**cc (for information):**
Warren Hendriks
Jerry Jones
Jack Marsh

**FROM THE STAFF SECRETARY**

---

**DUE: Date:** Monday, December 31 | **Time:** 2:00 p.m.

---

**SUBJECT:**

Enrolled Bill H.R. 421 - Duty-free treatment of upholstery regulators

**ACTION REQUESTED:**

____ For Necessary Action
____ For Your Recommendations
____ Prepare Agenda and Brief
____ Draft Reply
____ For Your Comments
____ Draft Remarks

**REMARKS:**

Please return to Judy Johnston, Ground Floor West Wing

Approval
H.C.S.

**PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.**

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Warren K. Hendriks
For the President

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.: 912

Date: December 30, 1974 Time: 5:00 p.m.

FOR ACTION: Geoff Shepard
Max Friedersdorf
Bill Seidman
Phil Areeda

cc (for information): Warren Hendriks
Jerry Jones
Jack Marsh

FROM THE STAFF SECRETARY

DUE: Date: Monday, December 31 Time: 2:00 p.m.

SUBJECT:

Enrolled Bill H.R. 421 - Duty-free treatment of upholstery regulators

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

____ For Your Comments ____ Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

No objection

P Areeda



**PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.**

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Warren K. Hendriks
For the President

THE WHITE HOUSE

WASHINGTON

December 31, 1974

MEMORANDUM FOR: WARREN HENDRIKS

FROM: Vern Loen for MAX L. FRIEDERSDORF

SUBJECT: Action Memorandum - Log No. 912

The Office of Legislative Affairs concurs with the Agencies that the enrolled bill should be signed.

Attachments

THE DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

DEC 26 1974

Dear Sir:

This is in response to your request for the views of the Treasury Department on the enrolled enactment, H.R. 421.

Section 1 of the enrolled Act would eliminate the duty on upholstery regulators, upholsterer's regulating needles, and upholsterer's pins. The Department has no objection to this provision.

Sections 2 through 14 of the Act amend several sections of the Internal Revenue Code of 1954 (the "Code"), the first substantive amendment being contained in section 3. The Department does not oppose any of such amendments.

Section 3 of the Act extends through December 31, 1975, the Code provisions permitting the 60 month amortization of expenditures for pollution control facilities, railroad rolling stock, rehabilitation of low income housing and coal mining safety equipment, which were due to expire December 31, 1974. The revenue effect of this provision is estimated to be -$5 million.

Section 4 of the Act deals with the method of accrual of vacation pay for a limited class of taxpayers. The revenue effect of the provision is estimated to be negligible.

Section 5 of the Act postpones the inclusion of depreciable real property in the Asset Depreciation Range Class Life System. There is no revenue effect from this provision.

Section 6 of the Act deals with income from the operation and gain or loss on the sale of property acquired by a real estate investment trust through foreclosure. The revenue effect of this provision is estimated to be negligible.

Section 7 of the Act increases the rate of interest charged and paid by the United States with respect to tax underpayments and overpayments from 6 to 9 percent annually and also increases certain additions to tax from 6 to 9 percent. Provision is also made for future rate adjustment. The revenue effect of the provision is estimated to be +$300 million.

Section 8 of the Act extends through December 31, 1976 the Code provision excluding from the gross income of certain non-resident aliens and foreign corporations interest from bank deposits in the United States which was due to expire December 31, 1975. The revenue effect of this provision is estimated to be -$50 million.

Section 9 of the Act provides that interest paid on certain debt obligations in existence on April 1, 1971 shall be treated as income from sources outside the United States, thus assuring that no tax need be withheld with respect to payments to foreign lenders. The revenue effect of this provision is estimated to be -$10 million.

Sections 10 through 14 of the Act contain new Code provisions and amendments to existing Code provisions dealing with the taxation of political parties and committees and political contributions. The revenue effect of these provisions is estimated to be negligible.

The Department recommends the President approve the enrolled enactment.

Sincerely yours,

Frederic W. Hickman
Assistant Secretary

Director, Office of Management and Budget
Attention: Assistant Director for
Legislative Reference, Legislative
Reference Division
Washington, D.C. 20503

THE UNDER SECRETARY OF COMMERCE
Washington, D.C. 20230

DEC 27 1974

Honorable Roy L. Ash
Director, Office of Management
and Budget
Washington, D. C. 20503

Attention: Assistant Director for Legislative Reference

Dear Mr. Ash:

This is in reply to your request for the views of this Department concerning H. R. 421, an enrolled enactment

> "To amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty."

This Department has no objection to section 1 of H. R. 421 which provides duty-free treatment under both Column 1 (MFN) and Column 2 (Communist countries, except Poland and Yugoslavia) of the TSUS for imports of "upholstery regulators, upholsterer's regulating needles, and upholsterer's pins."

While we have no objection to the other provisions of H. R. 421, we would defer to the views of the Department of the Treasury concerning their merits since they relate to amendments of the Internal Revenue Code.

Enactment of this legislation will not involve the expenditure of any funds by this Department.

Sincerely,

John K. Tabor

John K. Tabor

DEPARTMENT OF STATE

Washington, D.C. 20520

December 2[illegible], 1974

Honorable Roy L. Ash
Director, Office of
Management and Budget
Washington, D.C. 20503

Dear Mr. Ash:

I am replying to your communication (Office of Management and Budget Memorandum, dated December 24, and signed by Mr. Rommel) requesting our views and recommendations on H.R. 421, an enrolled bill to amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty.

The Department of State has no objection from the standpoint of foreign relations of the United States to the enactment of the legislation. The articles cited in the bill are used by craftsmen in the upholstery trade. United States requirements of these articles are supplied entirely by imports, which are estimated by trade sources to be valued at less than $20,000 annually.

The bill, however, includes various amendments of the Internal Revenue Code. With respect to these amendments, the Department of State defers to the appropriate agencies of the United States Government.

Cordially,

Linwood Holton

Linwood Holton
Assistant Secretary for
Congressional Relations

U. S. DEPARTMENT OF LABOR

OFFICE OF THE SECRETARY

WASHINGTON

DEC 27 1974

Honorable Roy Ash
Director, Office of Management
and Budget
Executive Office of the President
Washington, D. C. 20503

Dear Mr. Ash:

This is in response to the request of your Office for our views on the enrolled enactment of H.R. 421, "To amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty." This Department would have no objection to the President's approval of this measure insofar as it pertains to the rate of duty imposed on the items referred to above.

This Department defers to the Department of the Treasury regarding views on sections 2 through 14 of the enrolled enactment which would amend the Internal Revenue Code of 1954.

Sincerely,

Peter J Brennan

Secretary of Labor

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

# Department of Justice
Washington, D.C. 20530

DEC 2 4 1974

Honorable Roy L. Ash
Director, Office of
Management and Budget
Washington, D. C. 20503

Dear Mr. Ash:

In compliance with your request, I have examined a facsimile of the enrolled bill (H. R. 421) "To amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty."

Only the first of the fourteen sections in this bill is germane to its title. The other thirteen sections contain proposed amendments to the Internal Revenue Code of 1954 unrelated, generally, to each other and range from innocuous extensions of existing provisions to rather elaborate provisions dealing with the taxability of political organizations. Section 7 of the bill contains a particularly timely change in the interest rate with respect to the internal revenue from 6 percent to 9 percent with an "adjustment" provision based on the prime interest rate charged by banks.

Although there are some provisions in this bill with which one could disagree, they involve, generally, matters of policy within the purview of the Treasury Department. The Department of Justice defers to the Treasury Department as to whether this bill should receive Executive approval.

Sincerely,

WVRakestraw
W. Vincent Rakestraw
Assistant Attorney General

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.: 912

Date: December 30, 1974 Time: 5:00 p.m.

FOR ACTION: Geoff Shepard
Max Friedersdorf
Bill Seidman
Phil Areeda

cc (for information): Warren Hendriks
Jerry Jones
Jack Marsh

FROM THE STAFF SECRETARY

DUE: Date: Monday, December 31 Time: 2:00 p.m.

SUBJECT:

Enrolled Bill H.R. 421 - Duty-free treatment of upholstery regulators

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

____ For Your Comments ____ Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

No objections
LWS

R.P. called in 11:45 1/2/75

**PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.**

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Warren K. Hendriks
For the President

To:
H. Hendricks
12-30-74
11:00 a.m.

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

DEC 2 9 1974

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 421 - Duty-free treatment of upholstery regulators
Sponsor - Rep. Conte (R) Massachusetts

Last Day for Action

January 4, 1975 - Saturday

Purpose

Permits the importation of upholstery regulators and upholsterers' regulating needles and pins free of duty; and contains numerous amendments to the tax laws.

Agency Recommendations

| | |
|---|---|
| Office of Management and Budget | Approval |
| Department of the Treasury | Approval |
| Council of Economic Advisers | No objection (Informally) |
| Department of Housing and Urban Development | No objection (Informally) |
| Department of Commerce | No objection (Section 1) |
| Department of State | No objection (Section 1) |
| Department of Labor | No objection (Section 1) |
| Office of the Special Representative for Trade Negotiations | No objection (Section 1) (Informally) |
| Department of Justice | Defers to Treasury |

| | | |
|---|---|---|
| 93D CONGRESS<br>*2d Session* | HOUSE OF REPRESENTATIVES | REPORT<br>No. 93-972 |

# DUTY FREE IMPORTATION OF UPHOLSTERY REGULATORS AND UPHOLSTERER'S REGULATING NEEDLES AND PINS

APRIL 4, 1974.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. MILLS, from the Committee on Ways and Means, submitted the following

## REPORT

[To accompany H.R. 421]

The Committee on Ways and Means, to whom was referred the bill (H.R. 421) to amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 2, strike out the matter between lines 4 and 5 and insert the following:

| | | | |
|---|---|---|---|
| 651.06 | Upholstery regulators, upholsterer's regulating needles, and upholsterer's pins. | Free | Free |

Page 2, line 5, insert "(a)" immediately before "The amendments".

Page 2, after line 8, insert the following:

> (b) The duty free treatment applied to upholstery regulators, upholsterer's regulating needles, and upholsterer's pins under item 651.06 of the Tariff Schedules of the United States (as added by the first section of this Act) shall be treated as not having the status of a statutory provision enacted by the Congress, but as having been proclaimed by the President as being required or appropriated to carry out foreign trade agreements to which the United States is a party.

99-006

## Purpose

The purpose of H.R. 421, as reported, is to amend the Tariff Schedules of the United States to make duty free imports of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins.

## General Statement

H.R. 421 would provide duty free treatment for imports of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins by establishing a new item 651.06 in the Tariff Schedules of the United States (TSUS) under which all imports of these articles would be free of duty.

Upholstery regulators are similar to knitting needles and are used to stuff furniture being upholstered. They are currently dutiable under TSUS item 651.04 at 9.5 percent ad valorem under rate column numbered 1 (applicable to imports from countries accorded most-favored-nation treatment) and 45 percent ad valorem under rate column numbered 2 (applicable to Communist countries, except Poland and Yugoslavia).

Upholsterer's regulating needles are eyeless needles, about 12 inches in length, and are currently dutiable under item 651.47 at 8.5 percent ad valorem under rate column numbered 1 and 40 percent ad valorem under rate column numbered 2.

Upholsterer's pins are 3 inches in length with a loop instead of a head. These pins are dutiable under item 657.20 at 9.5 percent ad valorem under rate column numbered 1 and 45 percent ad valorem under rate column numbered 2.

Your committee is informed that there is no commercial production of these articles in the United States and that the domestic upholstery trade is dependent on imports of these articles, principally from West Germany and the United Kingdom. Imports of upholstery regulators and upholsterer's pins and regulating needles are not separately reported. However, it is known that the volume of such imports is small.

Bills of identical purpose to H.R. 421 on two previous occassions have been unanimously approved by the House, H.R. 10875 of the 91st Congress and H.R. 640 of the 92nd Congress. In each of these instances, however, the bill was not finally enacted before *sine die* adjournment because the Senate added unrelated amendments in which the House did not concur.

Section 2(b) of the bill, as reported by your committee, provides for treating the duty free status of the articles covered by the bill as having been proclaimed by the President under trade agreements rather than as statutory enactments. This would make possible, at some future time, the extension of escape-clause relief if appropriate.

No unfavorable comment on H.R. 421 was received by your committee in response to its press release and announcement of December 21, 1973, issuing an invitation for submission of written statements by the general public on H.R. 421. No objection to its enactment has been received from the executive departments or from any other source. Favorable reports on the bill have been received from the Departments of State, Treasury, Commerce and Labor.





Your committee is unanimous in recommending passage of H.R. 421.

## Effect on the Revenues of the Bill and Vote of the Committee in Reporting the Bill

In compliance with clause 7 of rule XIII of the Rules of the House of Representatives, the following statement is made relative to the effect on the revenues of this bill. Imports of the articles for which duty-free treatment is provided in H.R. 421 are not separately classified, and, in the absence of import statistics, it is not possible to estimate accurately the amount of revenue loss. Based on information from firms supplying such items to the upholstery trade, it is estimated that annual imports of these items would be less than $20,000. Therefore, it is estimated that the revenue loss due to H.R. 421 would be less than $2,000 in its first full year of effectiveness.

In compliance with clause 27(b) of rule XI of the Rules of the House of Representatives, the following statement is made relative to the vote by your committee on reporting the bill. This bill was unanimously ordered favorably reported by your committee.

## Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

TARIFF SCHEDULES OF THE UNITED STATES

* * * * * * *

Schedule 6.—Metals and Metal Products

* * * * * * *

Part 3.—Metal Products

| Item | Articles | Rates of Duty 1 | Rates of Duty 2 |
|---|---|---|---|
| * | * * * * | * | * |
| | Subpart E.—Tools, Cutlery, Forks and Spoons | | |
| * | * * * * | * | * |
| | Handsewing or darning needles, bodkins, crochet hooks, embroidery stilettos, [upholstery regulators, and] other hand needles, *and upholstery regulators, upholsterer's regulating needles, and upholsterer's pins*, all the foregoing, of metal; and needle books and needle cases, furnished with assortments of hand needles only: | | |
| | Needle books and needle cases: | | |
| 651.01 | Valued under $1.25 per dozen books or cases | 19% ad val. | 45% ad val. |
| * | * * * * | * | * |
| 651.04 | Embroidery stilettos [and upholstery regulators] | 9.5% ad val. | 45% ad val. |
| | Other: | | |
| 651.05 | Hand sewing or darning needles | Free | Free. |
| *651.06* | *Upholstery regulators, upholsterer's regulating needles, and upholsterer's pins* | *Free* | *Free.* |

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93D CONGRESS
2d Session

SENATE

REPORT
No. 93-1357

# UPHOLSTERY REGULATORS

DECEMBER 16, 1974.—Ordered to be printed

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

## REPORT

[To accompany H.R. 421]

The Committee on Finance, to which was referred the bill (H.R. 421) amending the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty, having considered the same, reports favorably with an amendment and recommends that the bill as amended do pass.

### I. SUMMARY

The House-passed bill amended the tariff schedules of the United States to make duty-free imports of upholstery regulators, upholsterer's regulating needles and upholsterer's pins.

The committee's bill is a substitute for the provisions of the House bill and includes the House-passed provision relating to the duty-free importation of upholstery regulators and upholsterer's regulated needles and pins as well as a series of tax amendments on which the committee believes immediate action is needed this year rather than having them held over until next year for consideration in connection with tax reform legislation.

The first tax provision in the committee's substitute bill extends for one additional year through December 31, 1975, four 5-year amortization provisions. The four provisions were enacted in the Tax Reform Act of 1969 for a 5-year period to make available the special rapid amortization as an incentive for certain types of investments. The types of investment covered by these four provisions are: (1) rehabilitation of low and moderate income housing, (2) pollution control facilities, (3) railroad rolling stock, and (4) certain coal mine safety equipment. The committee believes it is desirable to extend these four amortization provisions through next year in order to afford the committee time to reexamine the question as to how much longer each provision should be continued.

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The second tax provision deals with the tax treatment of accrued vacation pay. A permanent solution for the treatment of accrued vacation pay is provided to allow an employer to take a deduction in the case of accrued vacation pay which, except for contingencies (such as termination of employment before vacation time arrives), has already been earned by the employees. However, to prevent a doubling up of deductions in the case of an employer who is not covered by the provisions relating to accrued vacation pay in the Technical Amendments Act of 1958, if the employer elects to take deductions under this new provision for accrued vacation pay, he may not currently take a deduction for payments of the contingent amounts which accrued (on this basis) in years prior to the year in which the employer elects this treatment. This amount is held in suspense and is available as a deduction only to the extent that the end of the year liability for accrued vacation pay (on the new basis) is less than the beginning amount held in the suspense account.

The third tax provision relates to the application of the class life system to real property. Present law provides that after 1973, the class life system (sometimes referred to as the asset depreciation range or ADR provision) is to apply to real estate. The committee believes that bringing real estate into the ADR system before devising a satisfactory class life system for real estate would be unworkable. As a result, the committee bill does not apply the ADR system to real estate until such time as the Treasury Department develops regulations on a class life system for real estate.

The fourth tax provision contained in the committee's substitute bill deals with the tax treatment of real estate investment trusts. Under present law, a real estate investment trust (REIT) must meet certain income source tests (among other requirements) to be treated as a REIT and to be allowed "pass through" tax treatment whereby the income is taxed to the shareholders and not the trust. A series of revisions would be necessary for the tax treatment of real estate investment trusts to take into account the current practices and economic problems of the industry. However, the committee dealt with only the most pressing current problems of the industry, those relating to the treatment of foreclosure property. In view of the current economic situation, these have become immediate problems for the industry. The committee's bill generally provides that a REIT is not to be denied the "pass through" because of income that it receives from foreclosure property which formerly was classified as qualified real estate income, before it became necessary to foreclose on real estate mortgages. In general, instead the REIT will be taxed on the income from the foreclosure property and will have a period of time to sell the property or convert it into qualified property. The trust, however, will not be denied the pass through tax treatment with respect to its other income. The committee's bill also takes into account the difficulty a REIT faces as a result of the provision of present law prohibiting it from holding any property for sale to customers. In this regard, the bill modifies the rule to a limited extent to allow a REIT to hold foreclosure property for sale.

The fifth tax provision increases the interest rate paid by taxpayers on tax deficiencies, and by the government on tax overpayments, from 6 percent to 9 percent per year effective for obligations



outstanding on July 1, 1975. In addition to updating the tax interest at this time, the committee believes it is appropriate to provide a procedure whereby the interest rate in the future will be kept up to date with changes in the money market rates. As a result, the committee provided a procedure whereby the tax interest rate may be adjusted as the prime rate quoted by commercial banks to large businesses changes. The government interest rate is to be 90 percent of this prime rate but to be at the nearest whole interest rate and not to be changed more than once every two years.

The sixth tax provision is concerned with the tax treatment of student loan funding programs. Present law exempts interest paid on most State and local governmental obligations from Federal income tax. The committee included in the list of obligations, the interest from which is exempt from Federal income tax, qualified scholarship funding bonds where the student loan programs are financed by nonprofit higher education authorities which are requested by governmental units, even though they do not constitute a State or local government bond. In addition, the committee's bill makes it clear that student loan incentive payments made by the Commissioner of Education under the Emergency Insured Student Loan Act of 1969 are not to result in the treatment of the obligations as arbitrage bonds and in this manner disqualify the financing of these student loan programs for tax-exempt status.

The seventh tax provision deals with the exclusion from gross income of interest on U.S. bank deposits held by nonresident aliens. Under present law, interest received by nonresident aliens from deposits with persons carrying on the banking business, from deposits (or other accounts with savings and loan institutions or other similar associations, and from amounts held by an insurance company under an agreement to pay interest) is exempt from the 30-percent withholding tax on income or gain not effectively connected with the conduct of a trade or business within the United States. This provision, however, expires as of December 31, 1975. The committee has agreed to extend the termination of this provision for one additional year to December 31, 1976, to prevent (during 1975) an outflow of funds held as certificates of deposits with U.S. savings institutions. During this time the committee will review U.S. tax policies affecting all such types of investments.

The eighth committee tax provision provides that (1) where companies had issues of indebtedness outstanding on the date of the enactment of the interest equalization tax, (2) which were guaranteed by U.S. persons, (3) which were treated under that Act as debt obligations of a foreign obligor, (4) the obligation does not have a maturity date exceeding 15 years as of June 30, 1974, and (5) the obligation has been purchased by one or more underwriters with the purpose of distribution through resale, then the interest on the obligations is to be exempt from the 30-percent withholding tax in the case of interest payments to nonresident aliens. In addition, these obligations are to be exempt from U.S. estate tax when held by nonresident aliens. This provision is needed because the only other procedure available to companies since the interest equalization tax is no longer in effect if they are to continue to avoid the payment of the 30-percent withholding tax is for the U.S. corporation to assume the obligations of its financing subsidiary. However, this would cause the financing subsidiary to realize income upon the discharge of indebtedness. The action taken with respect to the interest equalization tax was intended to exempt income from these obligations from tax and to make it possible to exclude them for estate tax purposes where they were held by foreigners. However, the repeal of this tax in practice inadvertently terminated these effects.

The final committee tax provision modified the tax treatment of political organizations in five major respects:

(1) It provided that political parties or committees (and separate campaign funds) are to be taxed on investment income and on income from a trade or business, but not on campaign contributions they receive. In addition, a $100 minimum is to be provided before any tax is payable on investment or business income. Generally, the political parties and committees are to be taxed as corporations but the surtax exemption is not to be allowed and the dividends received deduction is not to be available.

(2) The limited credit or deduction allowed under present law for campaign contributions to individual candidates (and parties and committees) is available only if a person has announced that he is a candidate for office in the year of the contribution. The committee's provision allows this credit or deduction in the year before a person announces his candidacy.

(3) Generally, newsletter committees (and separate funds) are to be treated for tax purposes in the same way as political campaign committees. That is, contributions received by the newsletter committees are not to be taxable to the individual or committee nor are the funds spent for a newsletter to be deductible. However, to the extent of any investment income or business income in the case of these funds, tax is to be imposed. Should funds be withdrawn from newsletter funds for personal purposes, however, tax is to be imposed at that time.

(4) Appreciated property transferred by a taxpayer to a political party or committee, if occurring after May 7, 1974, is to be taxed to the donor at the time of the transfer. A ruling already issued by the Internal Revenue Service taxes appreciation in property given before that date to the political party or committee receiving the property. However, this ruling is not to apply before August 2, 1973.

(5) Gift taxes are not to apply to contributions to political parties or committees.

Generally the provision outlined above has the effect of taxing the parties on any earnings, but not on the contributions they receive. At the same time, it prevents avoidance of tax by individuals by taxing them on any unrealized appreciation attributable to their contributions. It also makes clear that campaign contributions in reality are not a gift, but rather constitute contributions to further the general political or good-government objectives of the donor. Finally, the changes also deal with existing problems in connection with newsletter funds and technical difficulties arising in the case of the presently deductible or creditable political contributions.



## II General Explanation

### A. Duty-free importation of upholstery regulators and upholsterers' regulating needles and pins

The first section of H.R. 421 under the committee substitute would provide duty free treatment for imports of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins by establishing a new item 651.06 in the Tariff Schedules of the United States (TSUS) under which all imports of these articles would be free of duty.

Upholstery regulators are similar to knitting needles and are used to stuff furniture being upholstered. They are currently dutiable under TSUS item 651.04 at 9.5 percent ad valorem under rate column numbered 1 (applicable to imports from countries accorded most-favored-nation treatment) and 45 percent ad valorem under rate column numbered 2 (applicable to Communist countries, except Poland and Yugoslavia).

Upholsterer's regulating needles are eyeless needles, about 12 inches in length, and are currently dutiable under item 651.47 at 8.5 percent ad valorem under rate column numbered 1 and 40 percent ad valorem under rate column numbered 2.

Upholsterer's pins are 3 inches in length with a loop instead of a head. These pins are dutiable under item 657.20 at 9.5 percent ad valorem under rate column numbered 1 and 45 percent ad valorem under rate column numbered 2.

The committee is informed that there is no commercial production of these articles in the United States and that the domestic upholstery trade is dependent on imports of these articles, principally from West Germany and the United Kingdom. Imports of upholstery regulators and upholsterer's pins and regulating needles are not separately reported. However, it is known that the volume of such imports is small.

The bill, as reported by your committee, provides for treating the duty free status of the articles covered by the bill as having been proclaimed by the President under trade agreements rather than as statutory enactments. This would make possible, at some future time, the extension of escape-clause relief if appropriate.

No unfavorable comment on this provision was received by the committee. No objection to its enactment has been received from the executive departments or from any other source. Favorable reports on the bill have been received from the Departments of State, Treasury, and Commerce.

### B. Extension of certain amortization provisions for one year

(Sec. 3 of the bill and secs. 167(k)(1), 169(d)(4)(B), 184(e) (1) and (7) and 187(d)(3) of the code)

In the Tax Reform Act of 1969, four provisions were enacted to make available a special 5-year amortization as an incentive to make certain investments. The types of investment made eligible for rapid amortization include (1) rehabilitation of low and moderate income housing, (2) pollution control facilities, (3) railroad rolling stock, and (4) certain coal mine safety equipment.

In general, rapid amortization was made available as an alternative to the investment tax credit that was repealed in the 1969 Act. Each of the types of investment eligible for rapid amortization was considered important to the success of an existing social policy. Those programs relied entirely or partially upon private investment in order to accomplish their objectives, and Congress believed that an additional investment incentive restricted to these activities should be made available in lieu of the investment credit. When the investment credit was reenacted in 1971, Congress specifically provided that the investment credit and rapid amortization both would not be available for the same investment. A taxpayer may elect either the investment credit or rapid amortization.

All four of these special amortization provisions were enacted for a 5-year period which expires at the end of 1974.

After consultation with the appropriate Federal officials and public hearings during which interested private parties expressed their views, the committee concluded that there was still sufficient need for these provisions to warrant extending the expiration dates. Because of the late date in the year and the present state of the legislative calendar, the committee decided to extend each of the four provisions for one additional year, through December 31, 1975. Next year when it considers a tax reform bill, the committee plans to re-examine the question as to how long a time period each provision should be continued.

These four amortization provisions are summarized, as follows:

*Rehabilitation of low and moderate income rental housing (sec. 167(k))*.—Taxpayers may elect to compute depreciation on rehabilitation expenditures incurred after July 24, 1969, on low and moderate income rental housing under the straight line method over a period of 60 months, if the additions or improvements have a useful life of 5 years or more. This rapid amortization is available only for low-income rental housing where the dwelling units are held for occupancy by families or individuals of low or moderate income, consistent with the policies of the Housing and Urban Development Act of 1968. The 60-month rule does not apply to hotels, motels, inns, or other establishments, where more than one-half of the units are used on a transient basis.

To qualify for the 60-month depreciation, the aggregate rehabilitation expenditures as to any housing may not exceed $15,000 per dwelling unit and the sum of the rehabilitation expenditures for two consecutive taxable years—including the taxable year—must exceed $3,000 per dwelling unit.

*Pollution control facilities (sec. 169)*.—Taxpayers may elect to amortize a certified pollution control facility over a period of 60 months. The amortization deduction is limited to pollution control facilities added to plants (or other properties) which were in operation before January 1, 1969. Thus, the special amortization provision was not made available in the case of facilities included in new plants built after 1968. Amortization is available for the first 15 years of the normal useful life of a pollution control unit. For example, where the useful life of a unit normally is longer than 15 years, say 25 years, the first 15 years (or 60 percent of the total cost of the facility) could be



treated as a separate property and amortized in 5 years. The remaining 10 years of useful life (40 percent of the total cost) could be treated as a second property with a 25-year normal useful life and depreciated under currently applicable regulations.

Eligible equipment has to be certified as a pollution control facility to the Secretary of the Treasury by the appropriate Federal and State authorities. Each facility, moreover, must be a separate, identifiable treatment facility used to abate or control water or atmospheric pollution or contamination by removing, altering, disposing or storing of pollutants, contaminants, waste or heat. Facilities that only diffuse pollution, rather than abate it, are not pollution control facilities.

*Railroad rolling stock (sec. 184)*.—Specified classes of rolling stock are eligible for rapid amortization over 5 years, if the original use by the taxpayer is after December 31, 1968. The provision is available for the rolling stock of all domestic railroads, switching or terminal companies which are wholly owned by domestic railroads, and companies 95 percent or more of whose stock is owned by one or more railroads. Rapid amortization also is available to lessors for rolling stock leased to a domestic railroad or railroad company.

*Coal mine safety equipment (sec. 187)*.—Taxpayers may elect to amortize over a 5-year period certified coal mine safety equipment. For this purpose certified coal mine safety equipment means electrical face equipment which is required in order to comply with the Federal Coal Mine Health and Safety Act of 1969 and which is certified as permissible under this Act by the Secretary of Interior and which is placed in service before January 1, 1975.

The equipment covered by this provision is designed to prevent sparking of coal mine equipment. When sparking occurs in coal mines with a sufficient concentration of methane gas, it can cause ignitions and explosions. This provision was enacted to ease the cost burden on operators of so-called nongassy mines who were required to install this safe electrical face equipment under the Federal Coal Mine Health and Safety Act of 1969.

*Revenue effect*.—There will be a decline of $5 million in tax liabilities in 1975 as a result of the one-year extension, and further declines of $4, $3, $2 and $1 million in succeeding years as the amortization is completed, if there are no additional extensions of the provisions.

### C. ACCRUAL OF VACATION PAY

(Sec. 4 of the bill and secs. 81 and 463 of the code)

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 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. Thes 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 sections (P.L. 84–496, 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 reserve 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 receive no deduction for vacation pay. This would occur since the current year's vacation pay deductions would have been accrued in

[1] GCM 25261. C.B. 2, 44: I.T. 3956. C.B. 1949–1. 78.
[2] The last of these postponements was made in Revenue Ruling 57–325. C.B. 1957–2, 302, July 8, 1957.



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 would be prepared. A provision has been developed as a result of such study and insofar as accrued vacation pay is concerned the committee believes it represents the permanent legislation promised by the committees.

*Election.*—The committee's bill provides for an election by a taxpayer who computes his income by the accrual method of accounting to obtain a deduction as a trade or business expense (if the conditions for deductibility as a business expense are otherwise satisfied under sec. 162) for both the vested and contingent amounts of vacation pay (reflected as reasonable additions to a vacation pay accrual account maintained by the taxpayer) which were earned by the taxpayer's employees before the close of the taxable year and payable during that year or within 12 months thereafter.[3] For purposes of this provision amounts are to be treated as payable during a taxable year or within 12 months thereafter if the employees have a right to receive the payments during this period even though actually paid to them at some time subsequent to that period.

*Opening balances in account.*—To prevent a doubling-up of vacation pay deductions in the first year of the election provided in the bill, two rules are provided for computing the opening balance of the vacation pay accrual account. First, if the taxpayer maintained a predecessor account for vacation pay under the Technical Amendments Act of 1958 (sec. 97) (for his last taxable year ending before January 1, 1973 and makes the election for his first taxable year ending after December 31, 1972), the opening balance is the larger of the balance as of the close of the preceding year in the predecessor vacation pay accrual account maintained by the taxpayer or the amount determined as if the taxpayer had maintained such an account for the preceding year. Second, if the taxpayer did not maintain a predecessor account, then the opening balance is an amount equal to the largest closing balance the taxpayer would have had for any of the three years immediately preceding the first taxable year for which the election is in effect as if the taxpayer had maintained such an account throughout the 3 immediately preceding taxable years. The liabilty for vacation pay earned by the taxpayer's employees before the close of the year may include amounts which but for the provisions of this bill would not be deductible as an accrued trade or business expense because of contingencies. All payments for vacation pay must be charged to this account if the taxpayer elects to deduct vacation pay as provided under the bill.

*Suspense account.*—To prevent the permanent loss of vacation pay deductions contained in the opening balance of the vacation pay accrual account, the bill establishes a suspense account with an initial amount equal to the opening balance of the vacation pay accrual ac-

[3] In some cases, the taxpayer may also obtain a deduction in the amount of the reduction (as of the close of the year) in the special vacation pay suspense account provided for by the bill.

count minus the amount of the accrual which has been allowed as deductions in prior years (but not paid by the beginning of the first taxable year for which the election applies). This suspense account initial amount, if any, is determined at the beginning of the first year for which the taxpayer elects to determine his vacaton pay deduction under this bill. At the close of each year, the suspense account is reduced by the amount, if any, by which the beginning balance of the suspense account exceeds the ending balance of the vacation pay accrual account (after making all additions and charges for the year). The application of the suspense account to any amount attributable to a transfer to which section 381(a) applies is to be determined by regulations prescribed by the Secretary of the Treasury or his delegate.

To insure that the balance in the suspense account is only used when there is a permanent reduction in the vacation pay plan (and not when there are temporary reductions), the committee's bill provides that the balance in the suspense account is to be increased (but not in an amount greater than the initial balance in the suspense account). The increase is the excess (if any) of the balance in the accrued vacation pay account at the close of the taxable year (after making the additions and charges for the year) over the amount in the suspense account at the beginning of the taxable year. The amount of this increase is to be included in gross income (sec. 81(2)).

*Other rules.*—The election by the taxpayer to compute his business deduction for vacation pay under this bill may be made at the time and in the manner prescribed by the Secretary of the Treasury or his delegate. If an accrual basis taxpayer elects to compute his business deductions for vacation pay under this bill, he is not to be considered as having changed his method of accounting, and no adjustment is required in the computation of his income because of the treatment of vacation pay provided here. If a taxpayer treated his predecessor vacation pay accrual account under section 97 of the Technical Amendments Act of 1958 for his last taxable year ending before January 1, 1973, but fails to make the election provided by the bill for his first taxable year ending after December 31, 1972, he is to be treated as having initiated a change in accounting method for purposes of section 481, with respect to vacation pay. Under the amendment made by the bill a taxpayer who had previously deducted contingent liabilities for vacation pay, but who fails to make the election, cannot continue to take this deduction.

The term "vacation pay" as used in the bill includes amounts paid or to be paid to an employee during the time he is on vacation or amounts paid or to be paid to an employee in lieu of a vacation (so long as the choice is solely the employee's). However, vacation pay does not include amounts for items such as sick pay or holiday pay.

If a taxpayer is deducting vested vacation pay liabilities with respect to a vested plan, he need not make the election provided in the bill in order to continue to deduct the vested liabilities.

*Effective date.*—The provisions of the bill apply to taxable years beginning after December 31, 1973, except if the taxpayer maintained a predecessor account under the Technical Amendments Act of 1958 in which case it applies to taxable years ending after December 31, 1972.



*Revenue effect.*—The revenue effect of this provision is negligible (a loss of revenues of less than $500,000).

### D. APPLICATION OF CLASS LIFE SYSTEM TO REAL PROPERTY

(Sec. 5 of the bill)

The Revenue Act of 1971 provided a new unified system of class lives for depreciation purposes which may be elected by taxpayers for assets placed in service after 1970. (These new rules are commonly referred to as the asset depreciation range or the ADR provisions.) A taxpayer which elects to determine the useful life of assets it acquires during a taxable year under this class life system generally must use this system for all assets acquired during the year which fall within any class for which the Treasury Department has established a class life.

In the case of real estate, however, Congress in 1971 recognized that under the rules of the 1962 guidelines, taxpayers in many cases were permitted to depreciate real property over shorter lives than the guideline lives because of the particular facts relating to the property. If these taxpayers were, as a condition of electing the class life system, required to include the real property in the election, they would be substantially, adversely affected since they would have to use significantly longer lives for the real property than they had used in the past. In view of this, Congress in the 1971 Act provided a transitional rule for these taxpayers to enable them to elect the class life system for other assets while the Treasury Department studied the general matter of the appropriate lives for real property. As a result, in the case of real property placed in service during the 3-year period beginning on January 1, 1971, taxpayers who elect the class life system may exclude from the election real property in cases where for the first year a life shorter than the intially prescribed class life (which is to be the 1962 guideline life) is justified for the asset under the rules of the 1962 guidelines.

Since this transitional period has expired, the application of the class life system to real estate is to apply after 1973. The Treasury Department has informed the committee that it has not yet completed its study for providing a system for incorporating real estate into the ADR system and has requested that the provision in the 1971 Act which applies the ADR system to real estate after 1973 be repealed. The committee is concerned that the effect of bringing real estate into the ADR system before devising a satisfactory system would be to unfavorably disturb the remainder of the system. As a result, the committee believes it is appropriate at this time not to apply the ADR system to real estate.

As a result, the committee's bill repeals the provision requiring the application of the ADR system to real estate after 1973 (paragraph (1) of section 109(e) of the Revenue Act of 1971). In the case of real property placed in service before class lives have been prescribed for real property, a taxpayer who has elected the ADR system may also elect to determine the useful life of depreciable real property under Revenue Procedure 62-21 as in effect on December 31, 1970 (to the extent the provisions of that revenue procedure are applicable to real estate), or on the basis of the facts and circumstances of the particular case.

*Effective date.*—The amendment made by this provision is to apply with respect to property placed in service after December 31, 1973.

*Revenue effect.*—It is not believed this provision will have any effect on revenues.

### E. REAL ESTATE INVESTMENT TRUSTS—TREATMENT OF FORECLOSURE PROPERTY

(Sec. 6 of the bill and secs. 856 and 857 of the code)

Under present law a real estate investment trust (REIT) must meet certain income source tests (among other requirements) to be treated as a real estate investment trust and to be allowed "conduit" tax treatment. Thus, for example, 75 percent of the income of the trust must be from certain qualified real estate income sources to meet these tests (and 90 percent of its income must be from these sources and certain other passive sources of income). In addition, certain types of income from real estate (such as rents which are based on profits) are not treated as qualified income because a REIT is intended to be wholly passive investor and not an active business competitor with businesses which do not receive conduit tax treatment. However, no allowance is made in present law for a situation where a REIT, inadvertently, as the result of an unanticipated default of its debtor, takes over real property under exisitng mortgages or leases that yielded nonqualified income.[1] Therefore, under present law a REIT must meet the income source tests even if it receives nonqualified income from foreclosed real property, and even if the trust has had no opportunity to influence the type of income received from such property. As a consequence, a trust may become disqualified involuntarily or may have to take action which is not economically sensible to remain qualified.

In addition, often the best course for a REIT that acquires real property on foreclosure is to sell off the property. However, under present law, such action could cause the trust to be disqualified as holding propety for sale to customers in the ordinary course of its trade or business. Under these circumstances, (and particularly in view of the present economic situation facing the real estate industry), the committee believes that relief should be granted to real estate investment trust that involuntarily acquire property on foreclosure.

*Foreclosure rules.*—As a result of these problems, the committee has provided in its bill that, generally, a REIT is not to be disqualified because of income that it receives from foreclosure property since the REIT is not to be held responsible for the type of lease or other transaction entered into by its mortgagor. At the election of the REIT, a two-year grace period—generally subject to one-year extensions—is to be allowed so that a REIT may liquidate the foreclosed property in an orderly manner, or negotiate changes in, *e.g.*, leases on the property so the income received is qualified. However, during the grace period the

[1] Present law does recognize that a REIT may involuntarily receive income when its property is condemned. In this case the 30 percent gain-from-sale limitation does not include gain from involuntary conversions. (Sec. 856(c)(4)(B).)



REIT is to pay corporate tax on nonqualified income received from property acquired on foreclosure.

The foreclosure rules of the bill are to be wholly voluntary. No real property will be treated as foreclosure property subject to these rules unless the REIT elects to have the new rules apply (in a manner to be prescribed in regulations). A REIT is to make the election (which is irrevocable) to have these rules apply by the date for filing its tax return (including extensions) for the year in which the trust acquires the property in question. Generally an election is to be made on a property-by-property basis.

Since the rules relating to foreclosure property are to apply to such property acquired after December 31, 1973, the general time for electing to have the rules apply may not be sufficiently long for trusts which report on a fiscal year basis. Consequently, the bill also provides that an election may be made up to 90 days after the date of enactment of the foreclosure provisions, if this would be later than the general time limit for an election.

*Foreclosure property.*—Foreclosure property which will be subject to the new rules of the bill (on the election of a REIT) generally is to be real property which is acquired by a REIT after default, or on imminent default, of a mortgagor to the REIT. Real property will be acquired on foreclosure when a REIT which holds an obligation secured by the real property bids in the amount of the secured obligation, etc., at a sale of the property.[2] In the case of a sale-leaseback arrangement (which is closely analogous to a mortgage), real property also will be foreclosure property when a REIT, which is a lessor, acquires possession of the property from its defaulting lessee.[3] It is not necessary for a REIT to go through a formal judicial or administrative process for property acquired on default to be foreclosure property; other mechanisms available under State or local law for acquisition on default will be sufficient. Additionally, it is not necessary that a debtor or lessee actually have defaulted on his obligation to the REIT for property acquired to be foreclosure property. Since acquisition from a debtor may occur when default is imminent, it is unnecessary to go through the act of a formal default (but there must, of course, be significant evidence that default was imminent).

Since the foreclosure rules of the bill are to provide relief for situations where a REIT inadvertently acquires property on foreclosure, the committee intends that the rules are not to apply with respect to real property acquired under a mortgage or lease that was entered into by the REIT (or acquired by the REIT) with an intent to foreclose or evict. Also, where a REIT acquires a mortgage or property subject to a lease when it knew or had reason to know that default would occur, the foreclosure rules are not to apply.

[2] Foreclosure could be under a mortgage, deed of trust or other instrument; a foreclosure sale could be a judicial sale, sale by a trustee, or other sale provided for by law; a REIT might bid in the amount of the obligation (plus interest and penalties), or might bid in cash, etc., as will satisfy local law. Of course when a REIT stands in the place of any third person unrelated to the property, if it acquires the property in a foreclosure sale (or imminent foreclosure) the new foreclosure rules will not be available.

[3] The committee expects, however, that in the case of a lease the Service will examine the matter carefully, to be sure that there was a reasonable expectation that there would not be a default under the lease, to prevent a situation where the REIT might attempt to use a straw man as lessee, use the straw to enter subleases paying unqualified rent, and then arrange a "default."

Foreclosure property includes personal property acquired on foreclosure if the personal property is incidental to (and, therefore, used with) the real property acquired on foreclosure. For example, where a REIT forecloses on a hotel and acquires all of the personal property of the hotel (e.g., furniture, appliances, etc.), this personal property will be treated as foreclosure property. However, foreclosure property does not include personal property acquired on foreclosure of a lien, where the personal property is not incidental to the real property.

*Subsequent leases.*—Under the bill, a REIT is not to enter into a lease after it acquires the foreclosure property, which would yield income that does not qualify for the 75 percent income test. The special foreclosure rules are designed to give a REIT time in which it can change the income received from nonqualified to qualified income, and it would be inconsistent with this objective to allow the REIT also to enter into leases which would yield nonqualified income.

The bill provides that if, after acquiring the property on foreclosure, a REIT enters into a lease with respect to the foreclosure property which, by its terms, will give rise to income which is not qualified real estate income under the 75 percent income source test, the property will immediately lose its status as foreclosure property. For example, a REIT is not to enter into a lease with respect to foreclosure property where any amount which will be received or accrued directly or indirectly by the REIT with respect to that property depends in whole or in part on the income or profits derived by any person from the property. Rents from this type of lease do not qualify for the income source test under present law (sec. 856(d)). Thus, on entering into such a lease, the property will immediately lose its status as foreclosure property.[4]

If a REIT enters into a lease which will yield a fixed rent, plus a contingent amount which is dependent on the profits in excess of a specified dollar figure, the lease by its terms will not definitely give rise to nonqualified income. However, if any amount is received or accrued by the REIT under the percentage of profits provision, at that time the property will lose its foreclosure property status.

Foreclosure status may also be terminated where the REIT enters indirectly into an arrangement that results in nonqualified income. For example, if the REIT enters into a lease where the rent is based on a percentage of the tenant's gross receipts or sales, and the tenant has a sublease based on a percentage of the sublessee's profits, then the rent received by the REIT would be nonqualified (as under present law) and the property would cease to qualify as foreclosure property.

Also, if a REIT delays foreclosure in order that the debtor might enter into a new lease with bad income, that is to be treated as if the REIT itself entered into the lease, and the property would not be entitled to the status of foreclosure property.

Where there is an extension or renewal of an existing lease and the REIT cannot control the terms of the lease, this will not be treated as a new lease, and the renewal will not terminate the status of the property as foreclosure property, even if nonqualified rent is payable under

[4] However, to improve the saleability of the property, the REIT could enter into a percentage-of-profit lease where the percentage of profit clause does not become effective until the REIT is no longer the owner of the property and where the REIT receives no rents from such a clause.



the lease. But, if the REIT had a right to renegotiate the terms of the lease, then it will be treated as having entered into a new lease.

Under the rule dealing with new leases, the real property in question is to be the entire property acquired by foreclosure. For example, if a REIT forecloses on a shopping center and the shopping center has individual leases with each store, the "property" for purposes of the lease rule is to be the shopping center. Consequently, if the REIT enters into a bad lease with any shopping center tenant, the shopping center as a whole is to lose its status of foreclosure property, since this lease would be evidence that the REIT is not following the foreclosure rules in good faith.

*Construction on foreclosure property.*—Under the foreclosure rules in the bill, a REIT will be able to complete construction of a project where there has been so much construction that it would be difficult to dispose of the property unless the project is completed. This is necessary for a REIT to make a project economically viable and for the REIT to preserve its investment. The bill provides, therefore, that a REIT may cause construction to take place on foreclosure property where more than 10 percent of the building (or other improvement) was completed before default became imminent. If the REIT causes construction in other circumstances, the property will lose its status as foreclosure property. (Any construction which a REIT causes is to take place through an independent contractor, as under present law.)

The 10 percent rule will not prevent a REIT from providing needed repair and maintenance to fix up a building for sale. But, repair and maintenance is not to be construed to include renovation of a building (such as remodeling apartments or changing an apartment building from rental units to a condominium, etc.); in this case the 10 percent rule must be met.

Under the 10-percent test, it is intended that the cost of construction is not to include architects' fees. While architects' work is vital to construction, this work generally will not make sale more difficult. To the contrary, if architectural work has been done with respect to property, this work probably will make it easier to sell the property. Therefore, the fact that architectural work has been done will not make it necessary to all ow a REIT to complete construction.

A similar principle applies in the case of other types of overhead expenses incurred in developing property, such as administrative costs of the developer or builder, or lawyers' fees and other expenses incurred in connection with obtaining zoning approval or building permits. In other words, the 10-percent test is to be applied by taking only the direct construction costs into account.

In determining whether 10 percent of construction has been completed, generally the property is to be examined building-by-building. For example, if a REIT acquires on foreclosure a project where two identical apartment buildings are being constructed on one piece of land, if one apartment is 80 percent finished and the other apartment is less than 10 percent finished, the REIT could complete the construction of the first building, but could not complete work on the second building. On the other hand, if an integral part of the first apartment building was a garage not yet begun at the time of foreclosure, the REIT would be able to have the garage constructed (if the garage and building considered together as one unit were more than 10 percent completed).

Likewise, where the REIT has foreclosed on land held by a developer building a housing subdivision, the REIT could complete construction of the homes where more than 10 percent of the construction had already been completed, but could not begin construction of other homes in the subdivision.

The 10 percent rule applies to the amount of construction completed before default became imminent. This time period is used in order to prevent last minute increases in the amount of construction in order to push the construction over the 10 percent limit, where it is clear that foreclosure will take place.

Since the 10 percent limit with respect to construction applies only to foreclosure property, to the extent that present law allows construction to be undertaken by a REIT it may do so where it acquires property on foreclosure, but does not elect to have the property treated under the new foreclosure rules of the bill.

*Property used in a trade or business.*—This bill also provides that if a REIT acquires, through foreclosure, real property which is used in a trade or business, the REIT is not to conduct the trade or business itself but is to use an independent contractor. Thus, if a REIT acquires a hotel on foreclosure, the REIT is to operate the hotel through an independent contractor during the grace period. However, the REIT is given 90 days to hire an independent contractor, and thus may itself operate the hotel for 90 days after acquisition on foreclosure. By requiring an independent contractor to operate a trade or business acquired on foreclosure, the bill preserves the REIT's basic character as a passive investment medium.[5]

*Extensions of time.*—If a REIT elects to have property treated as foreclosure property, it will be treated in this manner for two years after the date of acquisition on foreclosure by the REIT. Thus, a REIT initially is given two years to negotiate new leases and change the type of income received from foreclosure property from nonqualified to qualified income, or two years to dispose of the property.

If two years is not sufficient, extensions of time may be granted. The two-year period may be extended twice, and each extension may be up to a year, if the REIT establishes to the satisfaction of the Internal Revenue Service that an extension is necessary for the orderly liquidation of the trust's interest in the property (or an orderly change in the terms and conditions of leases on the property). It is expected that extensions will be granted in cases of significant difficulties in disposing of the property or in changing the type of income. The burden is to be on the REIT to show that good faith efforts have been made before applying for the extension to correct the situation resulting from the foreclosure.

*Taxation of income from foreclosure property.*—If a REIT elects to have real property treated as foreclosure property, all of the nonqualified income from that property is to be subject to tax. The REIT is to pay tax on this income as if it were a corporation subject to tax under section 11. The tax rate generally is to be the corporate tax rate,

[5] Under the bill, "independent contractor" is defined in the same way as under present law. See Regs. 1.856-4(b)(3)(i)(b).



without the surax exemption. On the other hand, any qualified income received from the foreclosure property would, of course, not be subject to tax (provided that it was distributed to the REIT's shareholders).

The income which is to be taxed under the bill is the gross income received from the foreclosure property which is not qualified under the 75 percent income source test (such as "bad" rents or income derived from the sale or other disposition of property held primarily for sale) less the direct (but not the indirect) expenses attributable to the production of this income. For example, if 100 percent of REIT's income prior to foreclosure qualified for the 75 percent income source test (and, therefore, also for the 90 percent test), but after foreclosure 11 percent of a REIT's income was converted to income from "bad" rents, then, if the REIT elected to use the foreclosure rules, it would continue to remain qualified, but the 11 percent of its income would be taxable. The direct expenses of earning this income would be deductible, but indirect expenses (including the general overhead and administrative costs of the REIT) would not be deductible.

All of the income from foreclosure property (whether or not otherwise qualified) will be treated as qualified income for purposes of the 90 percent and 75 percent income source tests.[6] Therefore, if a REIT has 10 percent of gross income sources, the REIT will not be disqualified if it receives additional nonqualified income from foreclosure property.

Under thes bill, as noted above, tax is imposed only on nonqualified net income from foreclosure property, and is not imposed on qualified income from that property. In this way, a REIT will be encouraged to change the type of income it receives from foreclosure property to qualified income.

Following the current requirement that a REIT act as a conduit of income, the bill also provides that 90 percent of net income from foreclosure property (in excess of the tax on such income) is to be distributed under the rules of present law.

Foreclosure property is to be treated as any other property for purposes of determining if the 75 percent (and 25 percent) assets tests are met. Since foreclosure property generally will be real property, it generally will qualify for the 75 percent test.

*Foreclosure property held for sale.*—Present law prohibits a REIT from holding any property for sale to customers. Under the bill, this rule is modified to allow a REIT to hold foreclosure property for sale. This is necessary to allow a REIT to sell off property that it inadvertently acquired on foreclosure. Any income from the sale of this property (less direct expenses of the sale) is to be taxed to the REIT at corporate rates. As with other foreclosure income, 90 percent of this net after-tax income is to be distributed to shareholders.

The committee recognizes that the holding-for-sale rule in general has caused problems for REITs. For example, questions have been raised with regard to whether income from specific transactions constitute holding-for-sale income in the context of a real estate investment trust. This is part of the overall problem that under present law

[6] This income will be included in both the numerator and denominator of the fractions. Of course, income from foreclosure property will not be treated as qualified income to the extent that it is derived from sources which produced unqualified income for the REIT prior to the foreclosure.

if a REIT does not meet the various income, asset, and distribution tests, the REIT will be disqualified from using the special tax provisions even in cases where the failure to meet a requirement occurred after a good faith, reasonable effort on the part of the REIT to comply. Disqualification would have the effect of not only changing the tax status of the REIT itself, subjecting its income to tax at corporate rates, but also could adversely affect the interests of the public shareholders of the REIT. These problems are numerous and complex, and consequently the committee does not believe that this is the appropriate time to consider these questions. However, the committee believes, and intends, that these problems should be addressed early in the next Congress.

*Effective date.*—These provisions are to apply to foreclosure property acquired after December 31, 1973.

*Revenue effect.*—The revenue effect of these provisions is believed to be negligible.

### F. INCREASE IN INTEREST CHARGED AND PAID FROM 6 PERCENT TO 9 PERCENT

(Sec. 7. of the bill and secs. 514, 6601, 6602, 6611, 6332, 6654, 6655, 7426 of the code and sec. 2411(a) of title 28 of the U.S. code)

In general, interest is payable by a taxpayer to the Government if the taxpayer fails to pay a tax on time (disregarding extensions) and, likewise, the Government will pay interest to a taxpayer if the taxpayer overpays his tax and the overpayment is not refunded within 45 days from the date when the return is due or, if later, the date when the return was filed. The interest rate is generally 6 percent per year.

Under present law a 6 percent annual interest rate also applies to any personal liability of a taxpayer who fails or refuses to surrender any property (or rights to property) on which a levy has been made (sec. 6332(c)(1)); to erroneous refunds recovered by the Internal Revenue Service (sec. 6602); and to certain wrongful levies by the Government on money or other property of a person other than the taxpayer (sec. 7426(g)).

There are a number of special situations under present law where a 4 percent annual interest rate, rather than 6 percent, is paid. Under present law the estate tax attributable to a closely held business included in a decedent's estate may be paid in ten annual installments if the business constitutes a large portion of the estate, subject to certain qualifications (sec. 6166). Payment of the estate tax may also be extended at an executor's election where the tax is imposed on the value of a reversionary or remainder interest included in the gross estate (sec. 6163). Further, if the Internal Revenue Service determines that payment of any part of the estate tax on any due date would impose undue hardship on the estate, extensions of time for payment may be granted (sec. 6161(a)). In each of these instances interest is payable at the rate of 4 percent per year (sec. 6601(b)).

A 4 percent interest rate also applies under present law to an extension of time to pay tax attributable to recovery of a foreign expropriation loss (sec. 6601(j)), and to refunds or credits for overpayments of tax on unrelated business income by an exempt organization under the so-called "neighborhood land rule" (sec. 514(b)(3)).



Most taxpayers are subject to withholding of tax on their salary or wages by their employers. If a taxpayer is not subject to withholding on his income or withholding is not sufficient to cover his tax liability, the taxpayer is required to make an estimate of his tax liability and make timely installment payments. In the case of an underpayment of an installment of estimated tax, an addition to the tax is imposed at an annual rate of 6 percent. The amount to which the 6 percent rate applies is the difference between the payment (if any) made on or before the due date of each installment and 80 percent (66⅔ percent in the case of farmers or fishermen) of the payment which would be due on the basis of the taxpayer's final tax on his annual return.

The present addition to tax on underpayment of estimated tax by a corporation is also 6 percent. A 6 percent addition to tax also applies to an excessive credit or refund claimed by a corporation (sec. 6655(g)).

Historically the 6 percent tax interest rate has been higher than the prevailing money market interest rate. The 6 percent rate on refunds has been in effect since 1921, and the 6 percent rate on underpayments or nonpayments of tax has remained unchanged since 1935. By way of comparison, in 1935 the average rate of interest on grade Aaa corporate bonds was 3.6 percent, or roughly 60 percent of the tax interest rate. The purpose for this differential was to provide an incentive for the taxpayer to pay his tax promptly and for the Government to credit or refund overpayments promptly. However, money market rates are currently (and for several years have been) at significantly higher levels than 6 percent. During the period 1969–1973, the average interest rate on grade Aaa corporate bonds ranged from just over 7 percent (in 1969) to just over 8 percent (in 1970). The average rate for 1973 was 7.44 percent and in the latter part of 1974, it has been in the neighborhood of 9 percent. There is little expectation that commercial interest rates will return to a rate lower than 6 percent in the foreseeable future. As a result, the present statutory interest rate no longer serves the purposes for which it was originally intended.

An increasing number of taxpayers are finding it more profitable to "borrow" tax funds at the present 6 percent rate rather than paying their taxes when due, and rather than using their own funds or borrowing funds at prevailing commercial rates. The present rate may also encourage taxpayers to claim more questionable deductions or other tax reducing items than they otherwise might, on the theory that a later disallowance will ony "cost" 6 percent. The trend in taxpayer postponement of tax payments is indicated in the fact that delinquent individual and business tax accounts totaled 2.8 million in 1973, an increase of approximately 400,000 over 1972. The dollar value of these delinquent accounts was approximately $5 billion, an increase of $1.5 billion, or 40 percent, over corresponding 1972 amounts. As a result of these developments, the committee believes that the interest rate should be increased to 9 percent per year and kept in line with money market rates in the future.

In those cases where the 4-percent interest rate applies, although an extension of time to pay a tax may be appropriate in certain cases in order to avoid unnecessary hardship, the committee sees no sound reason to permit some taxpayers to pay interest at a lower rate than other taxpayers are required to pay on underpayments of tax. Relief from the hardship of paying taxes in a lump sum should not also mean that the interest rate should be reduced if payments are made in installments. This is particularly so if a closely held business owned by an estate, or a business which has recovered an expropriation loss, is or can be earning a significantly higher return on the tax money which it presently can, in effect, borrow from the Government at 4 percent.

On the other hand, where a taxpayer is entitled only to 6 percent interest (or 4 percent in some cases) under present law on a refund or credit relating to an overpayment of tax, he is not receiving the value he could obtain by the use of his own funds. Moreover, since the Government must pay more than 6 percent for money, the incentive to make refunds promptly is no longer operative. For these reasons, the committee believes that this interest rate should be updated to 9 percent and kept in line with interest rate movements as well.

The increased interest rate is intended as a practical approximation or composite rate, and is not designed to reflect every money market factor which annually affects interest rates, such as the degree of risk or the demand or supply of loanable funds, etc. While the committee does not expect interest rates to decline to the area of 6 percent or increase to much higher levels in the foreseeable future, it is concerned that subsequent declines or increases in interest rates could create a significant gap between the 9-percent rate (as provided by the committee amendment) and prevailing money market rates. In order to avoid in the future the present wide gap between the interest rate charged on tax refunds and tax deficiencies and the prevailing money market rate (that has occurred over a long period of time when no adjustment in the interest rate on taxes was made), the committee concluded that it is appropriate to provide for a periodic, semi-automatic adjustment of the interest rate on tax payments to reflect significant changes in money market rates. For this purpose, the committee concluded that the prime lending rate which banks quote on short-term loans to large businesses is the appropriate money market rate to use as a guideline for adjustments, since it is sensitive to money market conditions and is widely known and accepted as a good indicator of interest rates generally.

Under the bill the present 6-percent rate on tax overpayments and underpayments, on underpayments of estimated tax by individuals and corporations, and on excessive adjustments of overpayments of estimated tax by a corporation, is increased to 9 percent. The bill also amends the United States Code (28 U.S.C. sec. 2411(a)) to increase from 6 to 9 percent the interest rate to be paid by the Government on a judgment for any overpayment of tax. A similar increase to 9 percent is also provided in the case of personal liability resulting from enforcement of a levy, recovery by the Government of an erroneous refund and recovery by certain persons of property on which a wrongful levy was made.

In addition, in those cases where the special 4-percent interest rate applies, the bill also increases the rate to the general 9-percent rate. Thus, in cases where the time for payment of an estate tax (either at the executor's election or in hardship situations) has been extended, or the time to pay a tax attributable to recovery of a foreign expropriation loss has been extended, interest at the rate of 9 percent per year must be paid on the unpaid balance of the tax and on the unpaid balance of any deficiency in the tax prorated to the installments. The 9-percent interest rate will also apply to refunds or credits for overpayments of tax by a charity on unrelated business income under the neighborhood land rule.



The bill provides that the 6-percent interest rate is to be increased to 9 percent for liabilities outstanding after July 1, 1975. This delay is to permit the Internal Revenue Service to revise its procedures and publications to take into account the new interest rate. Subsequently, the 9-percent rate is to be increased or decreased to keep it approximately equal to 90 percent of the prime rate (the current relationship of the new 9 percent rate with the prime rate of slightly over 10 percent). The 9-percent rate is, therefore, to become an "adjusted rate." This is done in the bill by providing an "adjusted prime rate" which is to be 90 percent of the prime rate. Under the bill the basic 9-percent rate will be changed if the adjusted prime rate is at least a full percentage point more or less than the interest rate then in effect (9 percent or whatever the subsequently modified rate may be). Thus, if the prime rate at the first adjustment period were to drop to 8 percent, the 9 percent would be reduced to 7 percent (90 percent of 8 percent rounded downward to the 7 percent rate according to the general rounding rule of one-half and over is rounded up and less than one-half is rounded down—a rule to ease the administrative complications of fractional rates).

The prime rate for this purpose is the predominant prime rate quoted by commercial banks to large businesses as regularly published by the Board of Governors of the Federal Reserve System. The review of the prime rate is to be made by the Secretary of the Treasury or his delegate based on the average rate for the month of September, announced by him on or before October 15, and made effective as of the following February 1 so that sufficient lead time will be available for taxes due on March 15 or April 15. Thus, the first change in the 9-percent rate could be made for February 1975. To prevent excessive adjustments in the interest rate which would present administrative problems for the Internal Revenue Service, a change in the rate cannot be made more often than once every 23 months. If the first change was made in October 1974 for February 1975, the next change could not be made before October 1976 applicable to February 1977.

Apart from increasing the rate of interest and the rate of additions to the tax, the bill does not change any substantive rules under present law relating to interest or to additions to the tax.

*Effective date.*—The amendments made by this provision take effect on July 1, 1975. The increased rates apply to a tax liability which initially arises on and after July 1, 1975, and to a liability which arose before that date and continues outstanding in part or whole thereafter (but only on the portion that remains outstanding after July 1, 1975). The 4- or 6-percent interest rate (as the case may be) under present law will continue to apply to interest accruing up to July 1, 1975.

*Revenue effect.*—The estimated increase in receipts from this increase in interest rates is $130 million in calendar year 1975, $300 million in 1976, and $330 million in 1977.

### G. TAX TREATMENT OF CERTAIN STUDENT LOAN FUNDING PROGRAMS

(Sec. 8 of the bill and sec. 103 of the code)

Under present law (sec. 103(a) of the code), interest paid on certain governmental obligations is exempt from Federal income tax. These obligations are, in general, those of the Federal Government, States and their political subdivisions, and of certain corporations organized under an Act of Congress as instrumentalities of the United States.

Present law, however, does not extend this tax-exempt status to what are referred to as "arbitrage bonds." These bonds which are used by State or local governments where all, or a major part, of the proceeds can be reasonably expected to be used (directly or indirectly) to acquire securities or obligations which may be reasonably expected, at the time of the issuance of the State or local obligation, to produce a yield which is higher than the yield on the State or local government bond issue.

The committee has been informed that certain student loan programs which are financed by nonprofit higher education authorities, rather than by political subdivisions of the State, do not qualify for tax-exempt status for bonds issued to finance student loans. This is because in certain States political subdivisions apparently do not have the governmental authority to issue bonds to finance their student loan programs and, as a result, certain organizations are created for this purpose. These organizations, although established pursuant to State law, are not political subdivisions of the State and, therefore, the obligations they issue are not exempt under section 103(a).

In addition, the committee understands that in certain cases even if these obligations were to qualify under section 103(a), they would nevertheless not be exempt because they would be treated as arbitrage bonds (under sec. 103(d) of the code). This is because of the provisions in the Emergency Insured Student Loan Act of 1969. This Act provides that the Commissioner of Education (of the Department of Health, Education, and Welfare) is authorized to provide incentive payments to institutions providing student loans. Although the maximum rate of interest to be paid by students on their loans is now set at seven percent, this yield, together with the incentive payments received by the institution making the loan from the Commissioner of Education, will constitute a yield that should be higher than the maximum yield the associations believe they will be able to pay on their bonds if they are to cover administrative expenses and maintain a solvent loan program. As a result, these bonds would be subject to the arbitrage bond provision and, thus, would not be entitled to tax exemption.

Although the Treasury temporary regulations (Regs. § 13.4(b)(3)(ii)(b)) provide, in general, that a bond issue is not to be classified as an arbitrage issue if the yield from the intended program will not exceed the yield from the governmental issue, *plus* administrative expenses, this rule further provides that administrative expenses may be taken into account for this purpose only if they are not payable with funds appropriated from other sources. In cases where the bonds are general obligation bonds and a State legislature is required to appropriate the funds necessary to pay the administrative expenses, as well as the principal of and interest on the bonds, if the program fails to generate the necessary revenue, the expenses would be "payable from other sources" and as result such bonds not meet the regulation's requirements. This means that they would be treated as arbitrage bonds.



The provision added by the committee amendment includes in the list of exempt obligations described in section 103(a) of the code certain qualified scholarship funding bonds. These are defined as obligations issued by a corporation which is nonprofit and is established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965. In addition, the corporation must be organized at the request of the State or political subdivision and must be required by its corporate charter and bylaws (or required by State law) to devote any income, after the payment of expenses and debt service, to the purchase of educational student loan notes or to pay over any income to the State or political subdivision. As a result of this provision, a nonprofit corporation which meets these requirements will qualify to issue tax-exempt bonds to finance student loan programs.

In addition, the arbitrage provision (sec. 103(d) of the code) is amended to make it clear that the student loan incentive payments made by the Commissioner of Education under the Emergency Insured Student Loan Act of 1969 are not to be taken into account in determining whether the yield on the student loan notes is higher than the yield on the bonds issued to finance the student loan program. As a result, these obligations issued to finance student loan programs will not be treated as arbitrage bonds.

*Effective date.*—The amendments made by the committee amendment will apply to obligations issued on or after the date of enactment.

*Revenue effect.*—The revenue loss from this provision is estimated at less than $1 million in 1975 and in 1976 and between $1 million and $2 million in 1977 if the associations that finance the student loan programs under this provision are limited to those the committee understands are in the planning stage. If formation of similar associations became more widespread, the revenue loss could be substantially larger.

### H. EXCLUSION FROM GROSS INCOME OF U.S. BANK DEPOSITS HELD BY NONRESIDENT ALIENS

(Sec. 9 of the bill, and sec. 861 of the code).

Present law provides, in general, that interest, dividends, and other similar types of income of a nonresident alien or a foreign corporation are generally subject to a 30-percent tax on the gross amount paid [1] if such income or gain is not effectively connected with the conduct of a trade or business within the United States (sec. 871(a) 881).[2] However, interest from deposits with persons carrying on the banking business, from deposits or other accounts with savings and

[1] This tax is generally collected by means of a withholding by the person making the payment to the foreign recipient of the income (secs. 1441 and 1442).

[2] If the interest, dividend or other similar income is effectively connected with a U.S. trade or business, that income is included in the normal income tax return which must be filed for the business.

loan institutions or other similar associations, and from amounts held by an insurance company under an agreement to pay interest are exempt under a provision which expires after December 31, 1975 (sec. 861(a) and 861(c)). In addition, for these types of debt obligations and deposits no U.S. estate tax liability is assessed if, upon the decedent's death, any interest received would be exempt from withholding tax (sec. 2105(b)).

The exemption for bank deposits and other similar types of deposits and debt obligations has aided in attracting substantial amounts of funds to the United States. Most of these funds are placed in certificates of deposits having a duration of 12 months or longer. Since the present exemption is to expire on December 31, 1975, it is understood that may of these one year certificates of deposits may not be renewed during 1975 unless the foreign depositors receive some assurance that the interest exemption will be continued.

For this reason, the committee has agreed to extend the termination date for the exemption for one additional year until December 31, 1976. Thus, interest on bank deposits and other similar types of deposits and debt obligations presently exempt from withholding tax will continue to be exempt through 1976. As a result of this extension, these deposits and debt obligations will also continue to be exempt from estate tax through the end of 1976.

The committee takes this action as an emergency measure to prevent during 1975 an outflow of funds held as certificates of deposits with U.S. savings institutions. The committee intends in the next Congress to review the withholding tax provisions for all types of interest obligations, as well as for other types of investments, and at that time to reach more comprehensive conclusions regarding U.S. tax policies affecting all such types of investments.

The amendments extending the exemption for bank deposits and other similar types of deposits and debt obligations are to be effective as of the date of enactment of this bill. Since these items are exempt under present law, the extension of this provision does not result in any additional revenue loss.

### I. CERTAIN INTEREST EQUALIZATION TAX OBLIGATIONS

*(Sec. 10 of the bill and secs. 861(a)(1) and 2104(c) of the code)*

The interest equalization tax (IET) contained a procedure whereby U.S. obligators could borrow money from foreign lenders without the foreign lenders being subject to the 30-percent withholding tax on interest or any U.S. estate tax. This procedure was accomplished by the U.S. obligor electing to subject its obligations to the IET (sec. 4912(c)). Furthermore, in order to permit U.S. companies to simplify their existing international financing structures, companies were permitted to use this procedure for outstanding obligations of an affiliated corporation by having the domestic parent assume those obligations. Those provisions are no longer applicable since the IET expired on June 30, 1974. However, obligations which were made subject to this IET procedure continue to receive the interest withholding and estate tax exemptions (secs. 861(a)(1)(G) and 2104(c)).



The purpose of this procedure was to enable companies to simplify their international financing operations by eliminating foreign or domestic financing subsidiaries which they were otherwise required to maintain. However, the requirement that the U.S. corporation assume the obligations of its finance subsidiary has prevented some companies from fully utilizing this procedure, since the change in interest rates would cause the finance subsidiary to realize income from discharge of indebtedness upon the assumption. These companies have been forced to retain the financing structures they established to satisfy the IET. Accordingly, the committee's bill provides U.S. companies which were entitled to make the IET election may make the interest paid on that obligation exempt from withholding tax.

The committee's bill limits this procedure to any issue of indebtedness outstanding on the date of the enactment of the Interest Equalization Tax Extension Act of 1971 if it was guaranteed by a U.S. person and was treated under that Act as a debt obligation of a foreign obligor. In addition, as under the requirements of existing law (sec. 861(a)(1)(G)) the obligation may not have a maturity date exceeding 15 years as of June 30, 1974, and when issued the obligation must have been purchased by one or more underwriters with the purpose of distribution through resale. Obligations the interest from which are exempt from tax under this provision are excluded from property in a foreign person's gross estate for estate tax purposes.

The income tax amendment applies to interest paid after date of enactment and the estate tax amendment applies to estates of decedents dying after the date of enactment. Since these obligations are presently held by financing subsidiaries and are treated as foreign obligations, the interest paid on them is presently not subject to U.S. withholding taxes. Thus, the enactment of this provision does not result in a revenue loss.

### J. POLITICAL ORGANIZATIONS

#### 1. Taxation of Political Parties and Committees (sec. 11 of the bill and sec. 527 of the Code)

Until recently, the tax status of political organizations has been somewhat uncertain. Historically, the Internal Revenue Service has not generally required the filing of income tax returns by political organizations.[1] Presumably, this practice resulted from the belief that virtually all of the receipts of political organizations were from gifts and that these organizations would not have taxable income. However, in 1968 the Internal Revenue Service announced that investment income of a political campaign fund constitutes gross income and may be reported on a fiduciary tax return, (Form 1041) with the tax due thereon paid with the filing of the return. Recently, as a result of the increasing practice of individuals making political contributions in the form of appreciated property, the Internal Revenue Service conducted a study of the tax consequences relating to these transactions. This study also included the tax status of political organizations in general.

On August 1, 1973, after conducting public hearings on these questions, the Internal Revenue Service announced that political parties and committees are taxable organizations and must pay tax on interest, dividends from investments, income from ancillary commercial activities, and gains from sales of appreciated property. In its subsequent ruling, the Service stated that campaign contributions are not includable in gross income and that expenditures for political purposes and expenses incurred for fund-raising activites are not deductible. On the other hand, expenses directly attributable to activities undertaken for the production of income which is taxable (interest, dividends, etc.) are deductible. Expenses attributable to the sale of appreciated property are to reduce gross proceeds in determining gain or loss realized on the sale. Under the ruling, political organizations may be treated as corporations, trusts, or possibly partnerships depending upon the facts and circumstances of the individual organization.

The Service also has ruled that political organizations with taxable incomes of $100 or less are not required to pay taxes or file returns for taxable years beginning before January 1, 1975.

Because the questions involved in this area require a delicate balance between the need to protect the revenue and of the need to encourage political activities which are the heart of the democratic process, the committee has examined the entire problem of the tax treatment of these organizations.

In general, the committee's bill provides that political organizations are to be treated as tax-exempt organizations, since political activity (including the financing of political activity) as such is not a trade or business which is appropriately subject to tax. However, where assets are not currently used by a political organization for political activities, but are invested for use at a later date, the income from the investment (less direct expenses incurred in earning that income) is to be subject to tax.

*Political organizations.*—Under the bill, special tax treatment is provided for political organizations which are organized and operated primarily for accepting contributions or making expenditures for activities related to the election, etc., of candidates for public or party office. The organizations that qualify for this treatment may include political parties, committees, associations, funds (including the trust of an individual candidate), or similar political organizations. A qualifying organization may be formally established under articles of incorporation, a charter, etc.; however, it is also anticipated that such an organization may be established informally.

To be treated as a political organization for tax purposes, the organization must be operated primarily to receive money or make expenditures for influencing or attempting to influence the selection, nomination, election, or appointment of individuals for Federal (or

[1] In a news release issued on October 3, 1972 (IR–1257), the Internal Revenue Service stated, "It is a matter of history that the Internal Revenue Service has never required the filing of income tax returns by political parties as such." However, it appears that the Government took a contrary public position on at least one occasion, in attempting to sustain an asserted income tax deficiency against the Communist Party. In that case (*Communist Party of the U.S.A.* v. *Commissioner*, 373 F.2d 682 (CAD.C., 1967)), the Court of Appeals stated that "the Government now assures us that all political parties, including petitioner[1] are taxable associations under the statute. That may be, but the Tax Court did not so rule; and petitioner is entitled to an adjudication in that court of its contention that the statute is not to be construed because the Commissioner and his predecessors have never so construed it." [Footnote omitted.] The case was remanded to the Tax Court, but the Government conceded virtually all of the asserted tax, and so the Tax Court never ruled on this question. The committee is not aware of any other instances in which the Internal Revenue Service has attempted to require a political party, as such, to file a Federal income tax return or to pay a Federal income tax.



regional), State (including D.C.), or local public office or for office in a Federal (or regional), State (including D.C.), or local political organization. It is recognized that between elections a political organization, such as a local political party, may not be supporting any specific candidate for election. In such a case, where the organization is engaged in activities that are related to and support the process of selection, nomination, election, etc., of candidates, it is to meet the operational test. For example, a local party that, between elections, prepares for the next party convention, engages in fund raising, transacts intraparty organizational business, etc., is engaged in qualifying activities. In addition, where an organization is established for a single campaign, it may continue to qualify after the election in order that it may wind up the campaign, pay off debts, put records in order, etc.

To qualify, an organization's activities must primarily involve receiving campaign contributions or making campaign expenditures. However, the organization need not engage in both raising and expending money.

It is expected that if an organization qualifies for purposes of the tax credit (or deduction) for political contributions, it will also qualify as a tax-exempt political organization. However, to qualify as a tax-exempt political organization, an organization does not have to be exclusively political. Thus, a local political club could carry on incidental social activities as long as it was organized and operated primarily to receive campaign contributions or make campaign expenditures. Similarly, a qualified organization could support the enactment or defeat of a ballot proposition, as well as support or oppose a candidate, if the latter activity was its primary activity.

An organization may qualify as a political organization if it indirectly receives or expends money for campaign purposes. For example, if a national organization receives political contributions indirectly through local organizations, it would be indirectly accepting contributions and would qualify under the bill. Similarly, a national organization that transfers money to local organizations for campaign expenditures would be indirectly making campaign expenditures. The committee expects that in such a case the national organization will take such care as is reasonable under the circumstances to see that the money transferred to the local organizations is spent for campaign purposes.

*Exempt income.*—Under the bill, a political organization is not to be taxed on the receipt of "exempt function income," including contributions of money or other property, or the receipt of membership fees, dues, or assessments from members of the organization. Whether a transfer of money or property constitutes a "contribution" is to be determined under present law (sec. 271(b)(2)). Generally, individual contributions of cash or property whether solicited personally or by direct mail will qualify as "contributions". However, in order to be exempt from tax, these amounts must be segregated in separate accounts to be used solely for nomination, etc. If contributions, etc., are received for campaign purposes, but are not segregated for such purposes, they will not be treated as exempt income. The income tax consequences of any diversion of segregated funds from campaign purposes are to be the same as under present law.

The committee also intends that filing fees paid by a candidate directly or indirectly to a political party in order that he may run in the primary election of that party (or run in the general election as a candidate of that party) are to be treated as exempt contributions. For example, some States provide that a certain percentage of the first year's salary of the office sought must be paid to the State as a filing (or "qualifying") fee and party assessment. The State then transfers part of this fee to the candidate's party. In such a case, the entire amount transferred to the party is to be treated as exempt function income, not taxable to the party. These filing fees also would be treated as contributions if the political party itself made the assessment and directly collected the money. In addition, to the extent that political organizations receive Federal, State, or local funds under the $1 "checkoff" provision or any other provision for public financing of campaigns, these amounts are to be treated as tax-exempt contributions.

Under the bill, political organizations are not to be taxed on proceeds received from political fund raising or political entertainment events, or proceeds from the sale of political campaign materials which are not received in the ordinary course of any trade or business. Thus, proceeds received from casual sporadic fund raising events or political entertainment events, such as an annual political dinner or an annual athletic exhibition, are to be treated as exempt function income. Similar fund raising events would include political breakfasts, receptions, picnics, dances, etc. However, in all of these cases the income would be exempt function income only if the event is a political event and is not carried on in the ordinary course of a trade or business. Factors to be taken into account in determining whether an activity is a trade or business, for purposes of this section, are to include the frequency of the event; the manner in which the event is conducted; and the span of time over which the event is carried on. Whether an event is a political fund raiser or a political entertainment event will depend upon the facts and circumstances of the particular event, taking into account the extent to which the event is related to a political activity aside from the need of the organization for income or funds.

In addition, amounts received on the sale of campaign materials are to be eligible for exempt function income treatment under the bill if the sale is not in the ordinary course of a trade or business, and is substantially related to the political activities of the organization. Thus, proceeds from the sale by a political organization of political items such as political memorabilia, bumper stickers, campaign buttons, posters, hats, shirts, political posters, stationery, jewelry, or cookbooks are generally not to be taxable to the political organization where the sale is closely related to other political activity, such as distributing political literature, organizing voters, etc. However, where these materials are sold in the regular course of a trade or business, the income derived from the sale is to be taxable.

*Other income.*—Under the bill, all income received by political organizations, other than exempt function income, is to be subject to tax. A political organization's taxable income is gross income (excluding the exempt income described above) less deductions otherwise allowed that are directly connected with producing that gross income. The dividends received deduction and other special deductions for corporations are not to be allowed.



Indirect expenses (such as general administrative expenses) are not to be allowed as deductions, since it is expected that these amounts will be relatively small and eliminating these deductions will greatly simplify tax calculations.

The bill provides a specific deduction of $100 against gross income. As a result, a political organization is not subject to tax and is not required to file a return unless its gross income exceeds its directly connected deductions by more than $100.

The bill provides that a political organization is to be taxed on its nonexempt income as if the organization were a corporation. However, in order to avoid proliferation of a number of organizations no surtax exemption will be allowed. Also, the alternate capital gains rate for the corporations (30 percent, under sec. 1201(a)) is to be available for net capital gains income.

*Exempt organizations which are not political organizations.*—Under present law, certain tax-exempt organizations (such as sec. 501(c)(4) organizations) may engage in political campaign activities. The bill generally treats these organizations on an equal basis for tax purposes with political organizations. Under the bill, organizations which are exempt under section 501(a) and are described in section 501(c), that engage in political activity, are to be taxed on their net investment income in part as if they were political organizations. Thus, an exempt organization is to be subject to this tax if it spends any amount on the nomination, election, etc., of a candidate for public office, etc. However, these organizations are to be taxed only to the extent they actually operate as political organizations (that is, to the extent of their political expenditures). Therefore, if the amount expended for political purposes is less than the net investment income, the lesser amount is to be the tax base. The bill does not require "tracing" in this regard. Thus, the tax is to apply even though the organization uses its investment income exclusively for nonpolitical purposes and makes its political expenditures entirely out of funds other than its investment income.

To avoid double taxation (and double deductions), the bill provides that income and deductions taken into account for purposes of the tax on unrelated business income of such exempt organizations are not to be included as either income or deductions in determining net investment income under the political organization provisions.

It is not intended that the section 501(c) exempt organization be absolutely liable for any expenditures made by an organization to which it gives funds. However, if the payment is made for any of the political purposes described in this section, then the exempt organization is to be treated as having indirectly made the political expenditure. Also, if there are reasonable questions as to whether funds will be spent for political purposes and the exempt organization wisses to avoid imposition of the tax, it would be expected to take reasonable steps to see that the recipient organization does not spend funds for political purposes. In administering this provision, the Internal Revenue Service could, for example, provide that establishment of trust funds or other appropriate methods of segregating the payments will be satisfactory in demonstrating that indirect political expenditures do not result from the payment by the exempt organization.

The committee expects that, generally, a section 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and disburse all funds related to nomination, etc., activities. In this way, the campaign-type activities would be taken entirely out of the section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.

Under present law (section 610 of title 18 of the United States Code), a corporation or a labor organization which is otherwise forbidden to make contributions or expenditures in connection with Federal elections to public office or to political party office, may nevertheless establish a "separate segregated fund" which is maintained by the corporation or labor organization. The separate segregated funds is permitted under the statute to be utilized for political purposes.

For purposes of the rule in this bill regarding the treatment of exempt organizations (and for purposes of the definition in this bill of "political organization"), a separate segregated fund maintained by an exempt organization (a labor union described in sec. 501(c)(5), a chamber of commerce, etc., described in sec. 501(c)(6)), is to be treated as an entity which is separate from the exempt organization maintaining the fund. In such a situation, where the contributions are collected by employees of the exempt organization and are placed directly into the accounts of the separate segregated fund, these contributions are not to be treated as having come from the exempt organization. The amount subject to tax on account of those contributed amounts is to be measured by the political organization taxable income and the capital gains of the separate segregated fund in the same manner as other political organizations, and not by the income of the exempt chamber of commerce or labor union.

The committee understands that, in a number of States, exempt chambers of commerce and labor unions may establish funds similar to the section 610 separate segregated funds. Although the requirements as to the manner of collection of contributions in those States, for State elections, may be somewhat different from the requirements under Federal law with regard to Federal elections, where the State statutes are similar to the Federal in this respect, then the separate segregated funds or their equivalents are to be treated the same as the section 610 separate segregated funds for purposes of this bill. In such a case, if the exempt organization technically receives the contributions or dues but the exempt organization does not receive any interest, etc., income on those contributions or dues and promptly transfers the contributions or dues to the separate segregated fund, then the chamber of commerce or labor union is to be treated as not having made a political expenditure of those contributions or dues.

This provision is not intended to affect in any way the prohibition against certain exempt organizations (e.g., sec. 501(c)(3)) engaging in "electioneering" or the application of the provisions of section 4945 to private foundations.

*Disposition of unexpended funds.*—Under the bill a political organization may contribute any amount to or for the use of another



(qualified) political organization. Such a transfer is not to affect the tax status of the transferor organization, and the transfer is not to be treated as a diversion of funds for the personal use of the candidate, the governing board, or any other person. (Newsletter funds are to be treated somewhat differently—see below.) Similarly, a political organization may transfer funds to the general fund of the U.S. Treasury or of any State (including D.C.) or local government or to or for use of an exempt "public charity" (i.e., an organization which is exempt under sec. 501(c)(3) and is not a private foundation or an organization described in sec. 509(a) (3) or (4)). Since no one is to realize income on such a transfer, no deduction is to be allowed to the political organization or to any other person on account of a transfer to a charitable, etc., organization.

As under present law, when amounts are diverted from a political organization by a candidate for his personal use, the amount diverted is taxable income to the candidate in the year in which the funds are diverted.

If the payment satisfies a legal obligation of the candidate, then it may be treated as a diversion for his personal use. For example, if the candidate uses amounts from his campaign fund to pay his Federal income tax, then this is treated as a diversion, even though the amount is deposited "in the general fund of the Treasury." Similarly, use of a campaign fund to satisfy a legally binding pledge to make contributions to a public charity is to be treated as a diversion. In such a case, the candidate would include the diverted amounts in his gross income. In the illustration relating to Federal income taxes, there would be no offsetting deduction; in the illustration relating to charitable contributions, there would be an offsetting charitable contributions deduction (assuming that the candidate was itemizing his deductions and that the applicable deduction limits (the 50-percent, 30-percent, or, in the case of a contribution for the use of a "public charity," the 20-percent limit) were not exceeded).

Where unexpended funds are held by a candidate who dies, and these funds go to his estate or to his survivors, it is expected that the Internal Revenue Service will allow a reasonable period after death for these funds to be transferred to another political organization, charitable organization, or to the general fund of the U.S. Treasury, etc. However, the unexpended funds that are not so transferred constitute income of the decedent, since by arranging for the funds to go to his estate, the decedent will have exercised sufficient "control" to be in constructive receipt of the funds before death.

Under the bill, incidental amounts used by a political organization for the primary purpose of benefiting the candidate directly in connection with his campaign are not to be treated as amounts diverted for the personal benefit of the candidate. For example, self-improvement courses directly related to the campaign, such as voice and speech lessons, are not to be treated as diversions. Similarly, where a political organization pays for a candidate's transition expenses, these expenditures are not to be considered a diversion if the amount paid is reasonable.

### 2. Contributions to Political Organizations (secs. 13 and 14 of the bill and secs. 84 and 2501 of the Code)

Since 1932, the Internal Revenue Service has treated political campaign contributions as taxable transfers for purposes of the gift tax.[2]

Under present law, a $3,000 annual exclusion from taxable gifts is allowed for each donee. The Internal Revenue Service has ruled that for gift tax purposes political organizations (and not the candidates they support) generally are considered the donees of political contributions. The Service has further ruled that each political organization, if it is organized and operated as a bona fide committee or organization, will generally be treated as a separate donee for purposes of the annual gift tax exclusion where the committees are the actual recipients of the contributions.[3]

As indicated, there is some uncertainty in the law as to whether political contributions are properly taxable as gifts. The committee believes that it is inappropriate to apply the gift tax to political contributions because the tax system should not be used to reduce or restrict political contributions. Consequently, the committee's bill provides that the gift tax is not to apply to the transfer of money or any other property to a qualified political organization, where the transfer occurs after May 7, 1974.

However, if a decedent includes a political organization as a beneficiary of his estate, the amount so transferred is to be included in his estate.

As previously discussed, it is the position of the Internal Revenue Service that campaign contributions are taxable transfers for purposes of the gift tax. As a result, in the case of gifts of appreciated property, the donee takes over the contributor's "basis", i.e., his tax cost, for income tax purposes and no gain is recognized by the donor at the time of the transfer. However, the committee's bill provides that the gift tax is not to apply to transfers to political organizations which occur after May 7, 1974. The committee also believes that it is appropriate to tax the contributor on unrealized appreciation on property transferred to political organizations. This rule is to apply solely to contributions to political organizations and is not to apply, nor is any inference to be drawn with respect to, contributions of appreciated property to other organizations such as charitable organizations.

Under the bill, if a person transfers property to an exempt political organization, and at the time of transfer the fair market value of the property exceeds its adjusted basis to the contributor, then the contributor is to be treated as having sold the property on the date of transfer. The contributor then is to be treated as having realized an amount equal to the fair market value of the property on the date of transfer. The sales price is deemed to be fair market value at the time of contribution (rather than the proceeds received by the political organization on sale of the property) in order that the contributor may know what his tax liability is at the time he transfers the property. Since the property is to be treated as having been sold on the date of transfer to the political organization, the basis of the property to the organization is to be the basis to the transferor plus the amount of gain recognized to the transferor on account of the transfer. However, to avoid the selective recognition of losses by contributors, this provision does not apply where the fair market value of the property is less than its adjusted basis and the sale treatment would result in a loss to the contributee.

[2] However, one court has held that, in the circumstances in the particular case, political contributions were not taxable gifts because they were motivated by a desire to protect and advance a taxpayer's personal and economic interests. *Stern* v. *United States*, 436 F.2d 1327 (CA5, 1971). The Internal Revenue Service has announced that it will follow the *Stern* decision only in the Fifth Circuit; in that circuit, the Service will follow that decision in "any case on all-fours with the *Stern* case." Rev. Rul. 72–583, 1972–2 CB 534.

[3] However, one U.S. district court has ruled that political contributons by one donor to multiple committees established to further the nomination or election campaign of the same candidate are not to be treated as gifts to distinct persons for purposes of the $3,000 annual gift tax exclusion, *Tax Analysis & Advocates* v. *Shultz*, 376 F. Supp. 889 (DC D.C., 1974).



A transfer of appreciated property to a political organization generally is to be treated as a sale for all income tax purposes. Consequently, if gain on the sale would have been treated as ordinary income, it is to be taxed as ordinary income under this provision; if the gain would have been long-term capital gain, it is to be treated as long-term capital gain. Similarly, other provisions of the tax law, such as the minimum tax and recapture of depreciation, are to apply as if the property had been sold.

### 3. Newsletter Funds (secs. 11 and 12 of the bill and secs. 41, 218, and 527 of the Code)

At present, if an elected official receives contributions to a fund established to pay for his newsletter, the Internal Revenue Service treats the contributions as his income in the year received. Also, the amounts he spends in printing, addressing, etc., the newsletter are deductible as ordinary and necessary business expenses, so long as the elected official itemizes his deductions.

The committee believes that the present treatment of newsletter funds improperly affects the taxable income that must be reported by elected officials, since by reporting this income the individual's tax situation may be distorted. For example, since charitable contribution deductions cannot exceed a percentage of the taxpayer's adjusted gross income, inclusion of newsletter contributions in adjusted gross income could increase the charitable contribution deductions available to an elected official. By the same token, inclusion of newsletter contributions could increase the nondeductible "floor" for medical expense deductions, thereby decreasing the deductions available to the official. Also, if the individual does not spend the full amount he receives as contributions in the year received, newsletter income and deductions will not match each year, thereby increasing his income tax and reducing the amount available for newsletter purposes. Further, if an individual does not itemize his deductions he will not be allowed to deduct his newsletter expenses, thereby unfairly increasing his income tax.

In the usual case, it appears that income received by an individual from contributions to newsletter funds and the amounts paid out for expenses involved in publishing and distributing newsletters will be approximately equal over time. The committee believes that it is more appropriate not to tax the contributions received (and not to allow any deduction for expenses paid by the fund) for newsletters, to avoid the distortions of income described above. As a result, the bill provides that a newsletter fund is to be treated in a manner similar to an exempt political organization. Thus amounts received for printing and distributing the newsletter are not to be taxed and deductions attributable to the newsletter are not to be allowed.

*Taxation of newsletter funds.*—Under the bill, if an individual establishes a fund to be used exclusively to prepare and circulate his newsletter, the fund is to be treated as an exempt political organization, as described above. This tax treatment is to be available for an individual who holds any Federal, State (including the District of Columbia), or local elective public office. It also is to be available for a person who is a candidate for such office, and to individuals who have been elected to public office, but who have not yet begun to serve in that office.[4]

To be eligible for this tax treatment, the assets in a newsletter fund must be maintained in separate accounts and must be used solely for the purpose of preparing and circulating the newsletter. The cost of preparation is to include (but not be limited to) the cost of secretarial services and the cost of printing, addressing, and mailing the newsletter.

Amounts received as contributions, membership (or subscription) dues, or proceeds from fundraising events for the newsletter fund are not to be treated as taxable income to the fund. However, any other income received by the fund, such as interest, dividends, and gain on the sale of appreciated property, is to be subject to the tax which applies to exempt political organizations. With respect to the taxation of such income, however, the $100 deduction allowed to political organizations is not to be allowed for newsletter funds. The committee believes that this is necessary to avoid proliferation of such funds.

A qualified newsletter fund is to be treated for most purposes as an exempt political organization. For example, contributions to a qualified newsletter fund are not to be subject to the gift tax. Transfers of appreciated property to such a fund are to be treated as sales to the fund by the transferor on the date of transfer. Unexpended assets may be transferred to certain charitable organizations, and to the general fund of the United States or of any State (including the District of Columbia) or local government, and the transfer is not to be treated as the diversion of amounts for the personal use of any person. However, it is intended that transfers are not to be allowed from a newsletter fund to a political organization which is not a newsletter fund since, to qualify, newsletter fund assets must be used exclusively for newsletter (and not campaign) activities. If assets of the newsletter fund are used for any purpose other than preparing or circulating the newsletter, contributions to certain charitable organizations, or transfers to the general fund of Federal, State (including the District of Columbia), or local governments, these amounts are to be treated as diverted for personal use and, therefore, taxable as under present law. Since activities of a newsletter fund are to be tax-exempt, it is intended that no deduction may be taken by the fund or by an elected official for newsletter expenses that are paid for with assets of the fund.

[4] Of course, after an individual has completed his term of office, the newsletter provisions will not be available to him unless he again becomes a candidate.



*Tax credit for contributions to newsletter funds.*—In the Revenue Act of 1971 (Public Law 92–178) Congress added a provision to allow an individual taxpayer a credit against his income tax liability (or an itemized deduction) for a limited amount of political contributions. This was done to encourage more widespread financing of political campaigns by small contributions. By encouraging small-scale contributions and broadening the base of political financing, these provisions were designed to help reduce the dependency of candidates on large contributors and special interest groups.

No similar credit or deduction is at present allowed for contributions to newsletter funds. However, the committee believes that the governmental process is strengthened by encouraging such contributions. It is vital that citizens know what their elected public officials are doing in office, so the voters can evaluate their performance for future elections and can tell their officials what they want them to do and not to do. Consequently, the committee has extended the existing credit and deduction provisions for political contributions to contributions to newsletter funds. Under this provision, the maximum annual credit or deduction allowed for political contributions and newsletter fund contributions together is limited to the amount available under present law, e.g., $12.50 credit or $50 deduction for an individual ($25.00 credit or $100 deduction in the case of a joint return).

### 4. Tax Credit or Deduction for Political, etc., Contributions (sec. 12 of the bill and sec. 41 of the code)

Under present law, a credit against tax (or a deduction from income) is allowed for political contributions to an individual or to a campaign committee supporting the individual only if the individual has publicly announced in the taxable year in question that he is a candidate for election. However, it is understood that for various reasons an individual may not wish to publicly announce his candidacy at an early date even though there is a substantial likelihood that he ultimately will become a candidate. Among the factors that may influence a decision to become a candidate is the willingness of a number of individuals to make small contributions to sustain a campaign. Accordingly, the bill provides that the tax credit (or deduction) for small political contributions is to be allowed to taxpayers if the individual publicly announced his candidacy before the end of the calendar year following the calendar year in which the contribution is made. For example, under the bill if a taxpayer makes a contribution to the "Elect X for Mayor Committee" in 1977, and X has not announced his candidacy, the taxpayer is to be allowed a credit (or deduction) for 1977 if X becomes a publicly announced candidate by December 31, 1978. The committee expects that the Internal Revenue Service will require appropriate verification in such cases that the individual has made a timely announcement of his candidacy.

Similar rules are to apply to political committees for such candidates.

5. Returns (sec. 11(b) of the bill and sec. 6012 of the code)

Under the bill every exempt political organization that has gross income (less deductions directly connected with the production of that income) in excess of $100 is to file a tax return for the years in which it has such income. The bill also provides that political organizations with $100 or less of such income need not file tax returns for years beginning after December 31, 1971, and before January 1, 1975.

6. Effective Dates

The provisions of the bill regarding the taxation of exempt political organizations and newsletter funds are to apply to taxable years beginning after December 31, 1974.

The provisions of the bill treating as a sale the transfer of appreciated property to a political organization, and the provisions eliminating the gift tax on such transfers, are to apply to transfer made after May 7, 1974.

The provisions of the bill extending the tax credit (or deduction) to contributions to newsletter funds, and allowing the tax credit or deduction for contributions to political campaigns in the year before a candidacy is publicly announced, are to take effect for contributions made after December 31, 1974, in taxable years ending after that date.

In addition, the bill provides that political organization does not have to pay tax on gains from the sale of contributed property if the sale occurred before August 2, 1973.

7. Revenue Effect

The estimated revenue gain in 1974 from the provisions taxing the donor on transfers of appreciated property to a political organization is expected to be less than $1 million; the estimated revenue gain in 1975 from the provisions relating to the taxation of political organizations and newsletter funds is expected to be less than $1 million; the estimated revenue loss in 1974 from the provisions excluding transfers to political organizations from the gift tax is expected to be less than $1 million; and the estimated revenue loss in 1975 from the provisions allowing an individual taxpayer a credit or deduction for contributions to newsletter funds is expected to be less than $1 million. In the aggregate, these provisions are expected to have a negligible revenue effect.

## III. Costs of Carrying Out the Bill and Effect on the Revenues of the Bill

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the costs to be incurred in carrying out this bill and the effect on revenues of the bill.

Imports of upholstery regulators and upholsterer's regulating needles and pins, for which duty free treatment would be provided, are not separately classified, and, in the absence of import statistics, it is not possible to estimate accurately the amount of revenue loss. Based on information from firms supplying such articles to the upholstery



trade, it is estimated that annual imports of these articles would be less than $20,000. Therefore, it is estimated that the revenue loss resulting from this provision of H.R. 421 would be less than $2,000 during the first full year of its effectiveness.

Most of the tax provisions included in the committee bill are expected to have either no revenue effect or a negligible revenue effect. The only exceptions to this are the provision relating to the tax treatment of certain student loan funding provisions which is expected to result in a revenue loss of under $1 million in 1975 and 1976 and between $1 and $2 million in 1977, the four amortization provisions which are extended for one year which are expected to decrease revenues by $5 million in 1975, $4 million in 1976 and $3 million in 1977, and finally, the provision increasing interest rates charged and paid from 6 percent to 9 percent which are expected to result in revenue gains of $130 million in 1975, $300 million in 1976, and $330 million in 1977 (assuming the 9-percent rate remains effective in these 3 years).

## IV. Vote of Committee on Reporting the Bill

In compliance with section 133 of the Legislative Reorganization Act, as amended, the following statement is made relative to the vote of the committee on reporting the bill. This bill was ordered favorably reported by the committee without a roll call vote and without objection.

## V. 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).

○

93D CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
*2d Session* } { No. 93–1642

# UPHOLSTERY REGULATORS

DECEMBER 19, 1974.—Ordered to be printed

Mr. ULLMAN, from the committee of conference, submitted the following

# CONFERENCE REPORT

[To accompany H.R. 421]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 421) to amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

*SECTION 1. AMENDMENT OF TARIFF SCHEDULES.*

*(a) In General.—Schedule 6, part 3, subpart E of the Tariff Schedules of the United States (19 U.S.C. 1202) is amended—*

*(1) by striking out "upholstery regulators, and", and by inserting "and upholstery regulators, upholsterer's regulating needles, and upholsterer's pins," after "other hand needles," in the item description preceding item 651.01;*

*(2) by striking out "and upholstery regulators" in item 651.04; and*

*(3) by inserting after item 651.05 the following new item:*

| | | | | | |
|---|---|---|---|---|---|
| " | *651.06* | *Upholstery regulators, upholsterer's regulating needles, and upholsterer's pins* | *Free* | *Free* | ". |

*(b) Effective Date.—The amendments made by subsection (a) apply with respect to articles entered, or withdrawn from warehouse, for consumption on or after the date of enactment of this Act.*

*(c) Status of New Item.—The duty free treatment applied to upholstery regulators, upholsterer's regulating needles, and upholster-*

*er's pins under item 651.06 of the Tariff Schedules of the United States (as added by subsection (a)) shall be treated as not having the status of a statutory provision enacted by the Congress, but as having been proclaimed by the President as being required or appropriate to carry out foreign trade agreements to which the United States is a party.*

*SEC. 2. AMENDMENT OF INTERNAL REVENUE CODE.*

*Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.*

*SEC. 3. EXTENSION BY ONE YEAR OF PERIOD DURING WHICH POLLUTION CONTROL FACILITIES, RAILROAD ROLLING STOCK, REHABILITATION HOUSING, AND COAL MINE SAFETY EQUIPMENT MAY QUALIFY FOR 5-YEAR AMORTIZATION.*

*(a) Pollution Control Facilities.—Section 169(d)(4)(B) (defining new identifiable treatment facility) is amended by striking out "January 1, 1975" and inserting in lieu thereof "January 1, 1976".*

*(b) Railroad Rolling Stock.—Section 184(e) (relating to amortization of railroad rolling stock) is amended—*

*(1) by striking out "1975" in paragraph (1) and inserting in lieu thereof "1976", and*

*(2) by striking out "January 1, 1975" in paragraph (7) and inserting in lieu thereof "January 1, 1976".*

*(c) Rehabilitation of Low-Income Rental Housing.—Section 167(k)(1) (relating to expenditures to rehabilitate low-income rental housing) is amended by striking out "January 1, 1975" and inserting in lieu thereof "January 1, 1976".*

*(d) Coal Mining Safety Equipment.—Section 187(d)(3) (defining certified coal mine safety equipment) is amended by striking out "January 1, 1975" and inserting in lieu thereof "January 1, 1976".*

*SEC. 4. ACCRUAL OF VACATION PAY.*

*(a) In General.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deductions taken) is amended by adding at the end thereof the following new section:*

*"SEC. 463. ACCRUAL OF VACATION PAY.*

*"(a) Allowance of Deduction.—At the election of a taxpayer whose taxable income is computed under an accrual method of accounting, if the conditions of section 162(a) are otherwise satisfied, the deduction allowable under section 162(a) with respect to vacation pay shall be an amount equal to the sum of—*

*"(1) a reasonable addition to an account representing the taxpayer's liability for vacation pay earned by employees before the close of the taxable year and payable during the taxable year or within 12 months following the close of the taxable year; plus*

*"(2) the amount (if any) of the reduction at the close of the taxable year in the suspense acccount provided in subsection (c)(2).*



*Such liability for vacation pay earned before the close of the taxable year shall include amounts which, because of contingencies, would not (but for this section) be deductible under section 162(a) as an accrued expense. All payments with respect to vacation pay shall be charged to such account.*

*"(b) Opening Balance.—The opening balance of the account described in subsection (a)(1) for the first taxable year shall, under regulations prescribed by the Secretary or his delegate, be—*

*"(1) in the case of a taxpayer who maintained a predecessor account for vacation pay under section 97 of the Technical Amendments Act of 1958, as amended, for his last taxable year ending before January 1, 1973, and who makes an election under this section for his first taxable year ending after December 31, 1972, the larger of—*

*"(A) the balance in such predecessor account at the close of such last taxable year, or*

*"(B) the amount determined as if the taxpayer had maintained an account described in subsection (a)(1) for such last taxable year, or*

*"(2) in the case of any taxpayer not described in paragraph (1), an amount equal to the largest closing balance the taxpayer would have had for any of the taxpayer's 3 taxable years immediately preceding such first taxable year if the taxpayer had maintained such account throughout such 3 immediately preceding taxable years.*

*"(c) Suspense Account for Deferred Deduction.—*

*"(1) Initial suspense account.—The amount of the suspense account at the beginning of the first taxable year for which the taxpayer maintains under this section an account (described in subsection (a)(1)) shall be the amount of the opening balance described in subsection (b) minus the amount, if any, allowed as deductions for prior taxable years for vacation pay accrued but not paid at the close of the taxable year preceding such first taxable year.*

*"(2) Adjustments in suspense account.—At the close of each taxable year the suspense account shall be—*

*"(A) reduced by the excess, if any, of the amount in the suspense account at the beginning of the taxable year over the amount in the account described in subsection (a)(1) at the close of the taxable year (after making the additions and charges for such taxable year provided in subsection (a)), or*

*"(B) increased (but not to an amount greater than the initial balance of the suspense account) by the excess, if any of the amount in the account described in subsection (a)(1) at the close of the taxable year (after making the additions and charges for such taxable year provided in subsection (a)) over the amount in the suspense account at the beginning of the taxable year.*

*"(3) Section 381 acquisitions.—The application of this subsection to any acquisition to which section 381(a) applies shall be determined under regulations prescribed by the Secretary or his delegate.*

"(d) *Election.*—*An election under this section shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.*

"(e) *Changes in Accounting Method.*—

"(1) *Establishment of account not considered change.*—*The establishment of an account described in subsection (a)(1) shall not be considered a change in method of accounting for purposes of section 446(e) (relating to requirement respecting change of accounting method), and no adjustment shall be required under section 481 by reason of the establishment of such account.*

"(2) *Certain taxpayers treated as having initiated change.*—*If the taxpayer treated vacation pay under section 97 of the Technical Amendments Act of 1958, as amended, for his last taxable year ending before January 1, 1973, and if such taxpayer fails to make an election under this section for his first taxable year ending after December 31, 1972, then, for purposes of section 481, such taxpayer shall be treated as having initiated a change in method of accounting with respect to vacation pay for his first taxable year ending after December 31, 1972.*"

(b) *Clerical Amendment.*—*The table of sections for such subpart C is amended by adding at the end thereof the following:*

"*Sec. 463. Accrual of vacation pay.*"

(c) *Certain Increases in Suspense Account Included in Gross Income.*—

(1) *Section 81 is amended to read as follows:*

"*SEC. 81. CERTAIN INCREASES IN SUSPENSE ACCOUNTS*

"*There shall be included in gross income for the taxable year for which an increase is required*—

"(1) *Certain dealers' reserves.*—*The amount of any increase in the suspense account required by paragraph (4)(B)(ii) of section 166(g) (relating to certain debt obligations guaranteed by dealers).*

"(2) *Vacation pay.*—*The amount of any increase in the suspense account required by paragraph (2)(B) of section 463(c) (relating to accrual of vacation pay).*"

(2) *The table of sections for part II of subchapter B of chapter 1 is amended by striking out the item relating to section 81 and inserting in lieu thereof the following:*

"*Sec. 81. Certain increases in suspense accounts.*"

(d) *Effective Dates.*—

(1) *Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1973.*

(2) *If the taxpayer maintained an account for vacation pay under section 97 of the Technical Amendments Act of 1958, as amended, for his last taxable year ending before January 1, 1973, the amendments made by this section shall apply to taxable years ending after December 31, 1972.*

## *SEC. 5. APPLICATION OF CLASS LIFE SYSTEM TO REAL PROPERTY.*

(a) *General Rule.*—*In the case of buildings and other items of section 1250 property (within the meaning of section 1250(c) of the Internal Revenue Code of 1954) placed in service before the effective date of the class lives first prescribed by the Secretary of the Treasury or his delegate under section 167(m) of such Code for the class in which such property falls, if an election under such section 167(m) applies to the taxpayer for the taxable year in which such property is placed in service, the taxpayer may, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, elect to determine the useful life of such property*—

(1) *under Revenue Procedure 62–21 (as amended and supplemental) as in effect on December 31, 1970, or*

(2) *on the facts and circumstances.*

(b) *Repeal of Prior Transitional Rule.*—*Paragraph (1) of section 109(e) of the Revenue Act of 1971 (Public Law 92–178) is hereby repealed.*

(c) *Conforming Amendment.*—*Section 1250(a)(1)(C)(ii) is amended by striking "January 1, 1975" and in lieu thereof inserting "January 1, 1976".*

(d) *Effective Date.*—*The amendments made by this section shall apply with respect to property placed in service after December 31, 1973.*



## *SEC. 6. REAL ESTATE INVESTMENT TRUSTS; TREATMENT OF FORECLOSURE PROPERTY.*

(a) *Foreclosure Property.*—*Section 856 (defining real estate investment trust) is amended by adding at the end thereof the following new subsection:*

"(e) *Special Rules for Foreclosure Property.*—

"(1) *Foreclosure property defined.*—*For purposes of this part, the term 'foreclosure property' means any real property (including interests in real property), and any personal property incident to such real property, acquired by the real estate investment trust as the result of such trust having bid in such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was default (or default was imminent) on a lease of such property or on an indebtedness which such property secured.*

"(2) *Grace period.*—*Except as provided in paragraph (3), property shall cease to be foreclosure property with respect to the real estate investment trust on the date which is 2 years after the date such trust acquired such property.*

"(3) *Extensions.*—*If the real estate investment trust establishes to the satisfaction of the Secretary or his delegate that an extension of the grace period is necessary for the orderly liquidation of the trust's interest in such property, the Secretary or his delegate may extend the grace period for such property. Any such extension shall be for a period of not more than 1 year, and not more than 2 extensions shall be granted with respect to any property.*

"(4) *Termination of grace period in certain cases.*—*Any foreclosure property shall cease to be such on the first day (occurring on or after the day on which the real estate investment trust acquired the property) on which*—

"(A) *a lease is entered into with respect to such property which, by its terms, will give rise to income which is not de-*

*scribed in subsection (c)(3) (other than subparagraph (F) of such subsection), or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day which is not described in such subsection,*

*"(B) any construction takes place on such property (other than completion of a building, or completion of any other improvement, where more than 10 percent of the construction of such building or other improvement was completed before default became imminent), or*

*"(C) if such day is more than 90 days after the day on which such property was acquired by the real estate investment trust and the property is used in a trade or business which is conducted by the trust (other than through an independent contractor (within the meaning of section (d)(3)) from whom the trust itself does not derive or receive any income).*

*"(5) Taxpayer must make election.—Property shall be treated as foreclosure property for purposes of this part only if the real estate investment trust so elects (in the manner provided in regulations prescribed by the Secretary or his delegate) on or before the due date (including any extensions of time) for filing its return of tax under this chapter for the taxable year in which such trust acquires such property. Any such election shall be irrevocable."*

*(b) Modification of Holding for Sale Rule.—Section 856(a)(4) (defining real estate investment trust) is amended by inserting after "property". the following: "(other than foreclosure property, as defined in subsection (e))".*

*(c) Tax on Income From Foreclosure Property.—Section 857(b) (relating to method of taxation of real estate investment trusts, etc.) is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:*

*"(4) Income from foreclosure property.—*

*"(A) Imposition of tax.—There is hereby imposed for each taxable year on the net income from foreclosure property of every real estate investment trust a tax determined by applying section 11 to such income as if such income constituted the taxable income of a corporation taxable under section 11. For purposes of the preceding sentence, the surtax exemption shall be zero.*

*"(B) Net income from foreclosure property.—For purposes of this part, the term 'net income from foreclosure property' means the excess of—*

*"(i) gain from the sale or other disposition of foreclosure property described in section 1221(i) and the gross income for the taxable year derived from foreclosure property (as defined in section 856(e)), but only to the extent such gross income is not described in subparagraph (A), (B), (C), (D), or (E) of section 856 (c)(3), over*

*"(ii) the deductions allowed by this chapter which are directly connected with the production of the income referred to in clause (i)."*



*(d) Technical Amendments.—*

*(1) Paragraphs (2) and (3) of section 856(c) (relating to limitations) are each amended by striking out "and" at the end of subparagraph (D), by adding "and" at the end of subparagraph (E), and by adding at the end thereof the following new subparagraph:*

*"(F) income and gain derived from foreclosure property (as defined in subsection (e));".*

*(2) Section 857(a)(1) (relating to requirements applicable to real estate investment trusts) is amended to read as follows:*

*"(1) the deduction for dividends paid during the taxable year (as defined in section 561, but determined without regard to capital gains dividends) equals or exceeds the sum of—*

*"(A) 90 percent of the real estate investment trust taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in section 561)); and*

*"(B) 90 percent of the excess of (i) the net income from foreclosure property over (ii) the tax imposed on such income by subsection (b)(4)(A), and".*

*(3) Section 857(b)(2) (defining real estate investment trust taxable income) is amended by adding at the end thereof the following new subparagraph:*

*"(F) There shall be excluded an amount equal to the net income from foreclosure property."*

*(4) Section 857(b)(2)(C) is amended by inserting before the period at the end thereof "and shall be computed without regard to that portion of such deduction which is attributable to the amount excluded under subparagraph (F)".*

*(e) Effective Date.—The amendments made by this section apply to foreclosure property acquired after December 31, 1973. Notwithstanding the provisions of section 856(e)(5) of the Internal Revenue Code of 1954 (as added by subsection (a) of this section) any taxpayer required to make an election with respect to foreclosure property sooner than 90 days after the date of enactment of this Act, may make that election at any time before the 91st day after the date of enactment of this Act.*

## *SEC. 7. INCREASE IN INTEREST CHARGED AND PAID IN CONNECTION WITH DEFICIENCIES, ETC.*

*(a) Increase in Interest Rate.—*

*(1) Chapter 67 (relating to interest) is amended by adding at the end thereof the following new subchapter:*

*"Subchapter C—DETERMINATION OF INTEREST RATE*

*"Sec. 6621. Determination of rate of interest.*

*"SEC. 6621. DETERMINATION OF RATE OF INTEREST.*

*"(a) In General.—The rate of interest under sections 6601(a), 6602, 6611(a), 6332(c)(1), and 7426(g) of this title, and under section 2411(a) of title 28 is 9 percent per annum, or such adjusted rate as is established by the Secretary or his delegate under subsection (b).*

*"(b) Adjustment of Interest Rate.—The Secretary or his delegate shall establish an adjusted rate of interest for the purpose of subsection*

(a) *not later than October 15 of any year if the adjusted prime rate charged by banks during September of that year, rounded to the nearest full percent, is at least a full percentage point more or less than the interest rate which is then in effect. Any such adjusted rate of interest shall be equal to the adjusted prime rate charged by banks, rounded to the nearest full percent, and shall become effective on February 1 of the immediately succeeding year. An adjustment provided for under this subsection may not be made prior to the expiration of 23 months following the date of any preceding adjustment under this subsection which changes the rate of interest.*

"(c) *Definition of Prime Rate.—For purposes of subsection (b), the term 'adjusted prime rate charged by banks' means 90 percent of the average predominant prime rate quoted by commercial banks to large businesses, as determined by the Board of Governors of the Federal Reserve System.*"

(2) *The following provisions are each amended by striking out "the rate of 6 percent per annum" and inserting in lieu thereof the following: "an annual rate established under section 6621":*

(A) *section 6601(a) (relating to interest on underpayments),*

(B) *section 6602 (relating to interest on erroneous refunds recoverable by suit),*

(C) *section 6611(a) (relating to interest on overpayments),*

(D) *section 6332(c)(1) (relating to interest with respect to failure to surrender property subject to levy), and*

(E) *section 7426(g) (relating to interest on judgments with respect to property wrongfully levied upon).*

*Section 2411(a) of title 28 of the United States Code (relating to interest on judgments for overpayments of tax) is amended by striking out "the rate of 6 per centum per annum" and inserting in lieu thereof: "an annual rate established under section 6621 of the Internal Revenue Code of 1954".*

(b) *Termination of Reduced Interest Rate in Certain Cases.—*

(1) *Certain extensions of time.—Section 6601 is amended by striking out subsection (b) (relating to extensions of time in the case of certain estates) and subsection (j) (relating to extensions of time in the case of certain expropriation lesses), and by redesignating subsections (c), (d), (e), (f), (g), (h), (i), (k),* and *(l) as subsections (b), (c), (d), (e), (f), (g), (h), (i), and (j), respectively.*

(2) *Debt-financed property.—Section 514(b)(3)(D) (relating to interest with respect to certain unrelated debt-financed income) is amended by striking out the last sentence.*

(c) *Increase in Penalty for Failure To Pay Estimated Income Tax.—Section 6654(a) (relating to failure by individuals to pay estimated income tax) and sections 6655 (a) and (g)(1) (relating to failure by corporations to pay estimated income tax) are each amended by striking out "the rate of 6 percent per annum" and inserting in lieu thereof the following: "an annual rate established under section 6621".*



(d) *Conforming Amendments.—*

(1) *Section 6163(c) is amended to read as follows:*

"(c) *Cross Reference.—*

*"For authority of the Secretary or his delegate to require security in the case of an extension under this section, see section 6165."*

(2) *Sections 6166(g) and 6167(e) are each amended by striking out the last sentence.*

(3) *Sections 6166(k) and 6167(h) are each amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.*

(4) *Section 6504(15) is amended by striking out 6601(h)" and inserting in lieu thereof "6601(g)".*

(5) *The table of subchapters for chapter 67 is amended by adding at the end thereof the following:*

*"Subchapter C. Determination of Interest Rate.".*

(e) *Effective Date.—The amendments made by this section shall take effect on July 1, 1975, and apply to amounts outstanding on such date or arising thereafter.*

## *SEC. 8. INTEREST ON CERTAIN DEPOSITS, ETC., IN THE UNITED STATES.*

*The last sentence of section 861(c) (relating to interest on deposits, etc.) is amended by striking out "December 31, 1975," and inserting in lieu thereof "December 31, 1976,".*

## *SEC. 9. EXCLUSION OF INTEREST ON CERTAIN OBLIGATIONS ISSUED PRIOR TO 1971.*

(a) *In General.—Section 861(a)(1) (relating to income from sources within the United States) is amended—*

(1) *by striking out "and" at the end of subparagraph (F),*

(2) *by striking out the period at the end of subparagraph (G) and inserting in lieu thereof a comma and the word "and", and*

(3) *by adding at the end thereof the following new subparagraph:*

"(H) *interest on a debt obligation which was part of an issue which—*

"(i) *was part of an issue outstanding on April 1, 1971,*

"(ii) *was guaranteed by a United States person,*

"(iii) *was treated under chapter 41 as a debt obligation of a foreign obligor,*

"(iv) *as of June 30, 1974, had a maturity of not more than 15 years, and*

"(v) *when issued, was purchased by one or more underwriters for the purpose of distribution through resale.".*

(b) *Conforming Amendment.—The last sentence of section 2104(c) (relating to debt obligations treated as property within the United States) is amended by striking out "or section 861(a)(1)(G)" and inserting in lieu thereof a comma and "section 861(a)(1)(G), or section 861(a)(1)(H)".*

(c) *Effective Date.—The amendment made by subsection (a) applies to interest paid after the date of enactment of this Act, and the amendment made by subsection (b) applies with respect to estates of decedents dying after such date.*

*SEC. 10. TAX ON CERTAIN INCOME OF POLITICAL ORGANIZATIONS.*

(a) *General Rule.—Subchapter F of chapter 1 (relating to exempt organizations) is amended by adding at the end thereof the following new part:*

*"PART VI—POLITICAL ORGANIZATIONS*

"Sec. 527. Political organizations.

*"SEC. 527. POLITICAL ORGANIZATIONS.*

"(a) *General Rule.—A political organization shall be subject to taxation under this subtitle only to the extent provided in this section. A political organization shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.*

"(b) *Tax Imposed.—*

"(1) *In general.—A tax is hereby imposed for each taxable year on the political organization taxable income of every political organization. Such tax shall consist of a normal tax and surtax computed as provided in section 11 as though the political organization were a corporation and as though the political organization taxable income were the taxable income referred to in section 11. For purposes of this subsection, the surtax exemption provided by section 11(d) shall not be allowed.*

"(2) *Alternative tax in case of capital gains.—If for any taxable year any political organization has a net section 1201 gain, then, in lieu of the tax imposed by paragraph (1), there is hereby imposed a tax (if such a tax is less than the tax imposed by paragraph (1)) which shall consist of the sum of—*

"(A) *a partial tax, computed as provided by paragraph (1), on the political organization taxable income determined by reducing such income by the amount of such gain, and*

"(B) *an amount determined as provided in section 1201(a) on such gain.*

"(c) *Political Organization Taxable Income Defined.—*

"(1) *Taxable income defined.—For purposes of this section, the political organization taxable income of any organization for any taxable year is an amount equal to the excess (if any) of—*

"(A) *the gross income for the taxable year (excluding any exempt function income), over*

"(B) *the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), computed with the modifications provided in paragraph (2).*

"(2) *Modifications.—For purposes of this subsection—*

"(A) *there shall be allowed a specific deduction of $100,*

"(B) *no net operating loss deductions shall be allowed under section 172, and*



"(C) *no deduction shall be allowed under part VII of subchapter B (relating to special deductions for corporations).*

"(3) *Exempt function income.—For purposes of this subsection, the term 'exempt function income' means any amount received as—*

"(A) *a contribution of money or other property,*

"(B) *membership dues, a membership fee or assessment from a member of the political organization, or*

"(C) *proceeds from a political fundraising or entertainment event, or proceeds from the sale of political campaign materials, which are not received in the ordinary course of any trade or business,*

*to the extent such amount is segregated for use only for the exempt function of the political organization.*

"(d) *Certain Uses Not Treated as Income to Candidate.—For purposes of this title, if any political organization—*

"(1) *contributes any amount to or for the use of any political organization which is treated as exempt from tax under subsection (a) of this section,*

"(2) *contributes any amount to or for the use of any organization described in paragraph (1) or (2) of section 509(a) which is exempt from tax under section 501(a), or*

"(3) *deposits any amount in the general fund of the Treasury or in the general fund of any State or local government,*

*such amount shall be treated as an amount not diverted for the personal use of the candidate or any other person. No deduction shall be allowed under this title for the contribution or deposit of any amount described in the preceding sentence.*

"(e) *Other Definitions.—For purposes of this section—*

"(1) *Political organization.—The term 'political organization' means a party, committee, association, fund or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.*

"(2) *Exempt function.—The term 'exempt function' means the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.*

"(3) *Contributions.—The term 'contributions' has the meaning given to such term by section 271(b)(2).*

"(4) *Expenditures.—The term 'expenditures' has the meaning given to such term by section 271(b)(3).*

"(f) *Exempt Organization Which Is Not Political Organization Must Include Certain Amounts in Gross Income.—*

"(1) *In general.—If an organization described in section 501(c) which is exempt from tax under section 501(a) expends any amount during the taxable year directly (or through another organization) for an exempt function (within the meaning of subsection (e)(2)), then, notwithstanding any other provision of law, there shall be included in the gross income of such organization* *for the taxable year, and shall be subject to tax under subsection (b) as if it constituted political organization taxable income, an amount equal to the lesser of—*

"(*A*) *the net investment income of such organization for the taxable year, or*

"(*B*) *the aggregate amount so expended during the taxable year for such an exempt function.*

"(*2*) *Net investment income.—For purposes of this subsection, the term 'net investment income' means the excess of—*

"(*A*) *the gross amount of income from interest, dividends, rents, and royalties, plus the excess (if any) of gains from the sale or exchange of assets over the losses from the sale or exchange of assets, over*

"(*B*) *the deductions allowed by this chapter which are directly connected with the production of the income referred to in subparagraph (A).*

*For purposes of the preceding sentence, there shall not be taken into account items taken into account for purposes of the tax imposed by section 511 (relating to tax on unrelated business income).*

"(*3*) *Certain separate segregated funds.—For purposes of this subsection and subsection (e)(1), a separate segregated fund (within the meaning of section 610 of title 18 or of any similar State statute, or within the meaning of any State statute which permits the segregation of dues moneys for exempt functions (within the meaning of subsection (e)(2)) which is maintained by an organization described in section 501(c) which is exempt from tax under section 501(a) shall be treated as a separate organization.*

"(*g*) *Treatment of Newsletter Funds.—*

"(*1*) *In general.—For purposes of this section, a fund established and maintained by an individual who holds, has been elected to, or is a candidate (within the meaning of section 41(c)(2)) for nomination or election to, any Federal, State, or local elective public office for use by such individual exclusively for the preparation and circulation of such individual's newsletter shall, except as provided in paragraph (2), be treated as if such fund constituted a political organization.*

"(*2*) *Additional modifications.—In the case of any fund described in paragraph (1)—*

"(*A*) *the exempt function shall be only the preparation and circulation of the newsletter, and*

"(*B*) *the specific deduction provided by subsection (c)(2)(A) shall not be allowed.*"

(*b*) *Requirement of Return.—Section 6012(a) (relating to persons required to make returns of income) is amended by striking out "and" at the end of paragraph (4), by inserting "and" at the end of paragraph (5), and by inserting after paragraph (5) the following new paragraph:*

"(*6*) *Every political organization (within the meaning of section 527(e)(1)), and every fund treated under section 527(g) as if it constituted a political organization, which has political organization taxable income (within the meaning of section 527(c)(1)) for the taxable year;*".



*Section 6012(a) is amended by striking out the last sentence thereof.*

(*c*) *Conforming Amendment.—Section 501(b) (relating to tax on unrelated business income and certain other activities) is amended by striking out "parts II and III" each place it appears and inserting in lieu thereof "parts II, III, and VI".*

(*d*) *Clerical Amendment.—The table of parts for subchapter F is amended by adding at the end thereof the following new item:*

"*Part VI. Political Organizations.*".

(*e*) *Effective Date.—The amendments made by subsections (a), (b), (c), and (d) shall apply to taxable years beginning after December 31, 1974.*

(*f*) *Exemption From Filing Requirement for Prior Years Where Income of Political Party Was $100 or Less.—In the case of a taxable year beginning after December 31, 1971, and before January 1, 1975, nothing in the Internal Revenue Code of 1954 shall be deemed to require any organization described in section 527(e)(1) of such Code to file a return for the taxable year under such Code if such organization would be exempt from so filing under section 6012(a)(6) of such Code if such section applied to such taxable year.*

(*g*) *Technical Amendment.—The Act entitled "An Act to amend the Internal Revenue Code of 1954 with respect to advertising in a convention program of a national political convention", approved June 18, 1968 (82 Stat. 183; Public Law 90–346) is repealed.*

*SEC. 11. EXTENSION OF EXISTING CREDIT AND DEDUCTION PROVISIONS FOR POLITICAL CONTRIBUTIONS TO CONTRIBUTIONS FOR NEWSLETTERS; TWO-YEAR RULE FOR ANNOUNCING CANDIDACY.*

(*a*) *General Rule.—Section 41(a) (relating to contributions to candidates for public office) is amended by inserting "and all newsletter fund contributions" after "all political contributions".*

(*b*) *Verification.—Section 41(b)(3) (relating to verification) is amended—*

(*1*) *by striking out "political contribution" the first place it appears and inserting in lieu thereof "political contribution or newsletter fund contributon", and*

(*2*) *by striking out "political contribution" the second place it appears and inserting in lieu thereof "contribution".*

(*c*) *Definition.—Section 41(c) is amended by adding at the end thereof the following new paragraph:*

"(*5*) *Newsletter fund contribution.—The term 'newsletter fund contribution' means a contribution or gift of money to a fund established and maintained by an individual who holds, has been elected to, or is a candidate for nomination or election to, any Federal, State, or local elective public office for use by such individual exclusively for the preparation and circulation of a newsletter.*"

(*d*) *Conforming Amendments in Deduction Provision.—Section 218 (relating to contributions to candidates for public office) is amended—*

(*1*) *by inserting "or newsletter fund contribution (as defined in section 41(c)(5))" after "section 41(c)(1)" in subsection (a); and*

*(2) (A) by striking out "political contribution" the first place it appears in subsection (b) (2) and inserting in lieu thereof "political contribution or newsletter fund contribution"; and*

*(B) by striking out "political contribution" the second place it appears in subsection (b) (2) and inserting in lieu thereof "contribution".*

*(e) Two-Year Rule for Announcing Candidacy.—Section 41 (c) (2) (A) (defining candidate) is amended by striking out "has publicly announced" and inserting in lieu thereof "publicly announces before the close of the calendar year following the calendar year in which the contribution or gift is made".*

*(f) Effective Date.—The amendments made by this section shall apply to any contribution, payment of which is made after December 31, 1974, in taxable years beginning after such date.*

*SEC. 12. INCREASE IN POLITICAL CONTRIBUTIONS CREDIT AND DEDUCTION.*

*(a) Increase in Credit.—Section 41 (b) (1) (relating to maximum credit for contributions to candidates for public office) is amended to read as follows:*

*"(1) Maximum credit.—The credit allowed by subsection (a) for a taxable year shall not exceed $25 ($50 in the case of a joint return under section 6013)."*

*(b) Increase in Deduction.—Section 218 (b) (1) (relating to amount of deduction for contributions to candidates for public office) is amended to read as follows:*

*"(1) Amount.—The deduction under subsection (a) shall not exceed $100 ($200 in the case of a joint return under section 6013)."*

*(c) Effective Date.—The amendments made by subsections (a) and (b) shall apply with respect to any contribution, the payment of which is made after December 31, 1974, in taxable years beginning after such date.*

*SEC. 13. TRANSFER OF APPRECIATED PROPERTY TO POLITICAL ORGANIZATIONS.*

*(a) Inclusion in Gross Income of Transferor.—*

*(1) In General.—Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:*

*"SEC. 84. TRANSFER OF APPRECIATED PROPERTY TO POLITICAL ORGANIZATIONS.*

*"(a) General Rule.—If—*

*"(1) any person transfers property to a political organization, and*

*"(2) the fair market value of such property exceeds its adjusted basis,*

*then for purposes of this chapter the transferor shall be treated as having sold such property to the political organization on the date of the transfer, and the transferor shall be treated as having realized an amount equal to the fair market value of such property on such date.*



*"(b) Basis of Property.—In the case of a transfer of property to a political organization to which subsection (a) applies, the basis of such property in the hands of the political organization shall be the same as it would be in the hands of the transferor, increased by the amount of gain recognized to the transferor by reason of such transfer.*

*"(c) Political Organization Defined.—For purposes of this section, the term 'political organization' has the meaning given to such term by section 527 (e) (1)."*

*(2) Clerical amendment.—The table of sections for such part II is amended by adding at the end thereof the following:*

*"Sec. 84. Transfer of appreciated property to political organizations."*

*(b) Effective Date.—The amendments made by subsection (a) shall apply to transfers made after May 7, 1974, in taxable years ending after such date.*

*(c) Nonrecognition of Gain or Loss Where Organization Sold Contributed Property Before August 2, 1973.—In the case of the sale or exchange before August 2, 1973, by an organization described in section 527 (e) (1) of the Internal Revenue Code of 1954 of property which such organization acquired by contribution (within the meaning of section 271 (b) (2) of such Code), no gain or loss shall be recognized by such organization.*

*SEC. 14. GIFT TAX NOT TO APPLY TO CONTRIBUTIONS TO POLITICAL ORGANIZATIONS.*

*(a) In General.—Section 2501 (a) (relating to taxable transfers for purposes of the gift tax) is amended by adding at the end thereof the following new paragraph:*

*"(5) Transfers to political organizations.—Paragraph (1) shall not apply to the transfer of money or other property to a political organization (within the meaning of section 527 (e) (1)) for the use of such organization."*

*(b) Effective Date.—The amendment made by subsection (a) shall apply to transfers made after May 7, 1974.*

Al Ullman,
James A. Burke,
Dan Rostenkowski,
Phil M. Landrum,
H. T. Schneebeli,
Joel T. Broyhill,
Barber B. Conable,
*Managers on the Part of the House.*
Russell B. Long,
Herman E. Talmadge,
Vance Hartke,
Wallace F. Bennett,
Carl T. Curtis,
*Managers on the Part of the Senate.*

## JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 421) to amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholster's pins free of duty, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

## JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 421) to amend the tariff schedules relating to the duty-free importation of upholstery regulators and upholsterer's regulated needles and pins, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate struck out all of the House bill after the enacting clause and inserted a substitute amendment. The committee of conference has agreed to a substitute for both the Senate amendment and the House bill.

The differences between the text of the House bill, the Senate amendment thereto, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by reason of agreements reached by the conferees, and minor drafting, clarifying, and other technical changes.

The bill as passed by the House amends the Tariff Schedules relating to the duty-free importation of upholstery regulators and upholsterers' regulated needles and pins. Section 1 of the Senate amendment and section 1 of the conference substitute make no change in this provision of the House bill.

The House bill contains no provisions corresponding to the following provisions of the Senate amendment.

### Clerical Amendment

Section 2 of the Senate amendment contains a clerical amendment relating to references to the Internal Revenue Code of 1954.

The conference substitute adopts this provision of the Senate amendment.

### One-Year Extension of Amortization Provisions

Section 3 of the Senate amendment extends for one additional year through December 31, 1975, four 5-year amortization provisions. These four provisions are: (1) rehabilitation of low and moderate income housing; (2) pollution control facilities; (3) railroad rolling stock; and (4) certain coal mine safety equipment.

The conference substitute adopts the provisions of section 4 of the Senate amendment.

### Accrual of Vacation Pay

Section 4 of the Senate amendment provides for a permanent solution for the treatment of accrued vacation pay. The Congress has





been continuing the temporary treatment in this area pending a permanent solution. The last extension expired in 1973. This treatment allows an employer to take a deduction in the case of accrued vacation pay which, except for contingencies (such as termination of employment before vacation time arrives), has already been earned by the employees. However, to prevent a doubling up of deductions in the case of an employer who is newly going on to the accrual pay system, this provision of the bill provides that the employer may not currently take a deduction for contingent amounts which accrued in years prior to the year in which he elected this treatment. This amount is held in suspense and is available as a deduction in subsequent years only to the extent that the end of the year liability for accrued vacation pay (on the new basis) is less than the beginning amount held in the suspense account.

The conference substitute adopts the provisions of section 4 of the Senate amendment.

### Extension of Real Estate Depreciation Recapture Rules on Federally, State and Locally-Assisted Housing Projects

Section 5 of the Senate amendment repeals the provision of present law (Revenue Act of 1971) requiring the application of the class life system to real property. Present law provides that after 1973 the class life system (sometimes referred to as the asset depreciation range or ADR provision) is to apply to real estate. The Treasury has not as yet devised a satisfactory class life system for real estate. The Senate amendment provides that the ADR system is not to apply to real estate until such time as the Treasury Department develops regulations on a class life system for real estate.

Section 5 of the Senate amendment also extends the real estate recapture rules on certain housing projects. The effect of the recapture rules is to tax the gain from such sales as ordinary income (rather than capital gain) to the extent of the deductions taken under accelerated depreciation in excess of straight-line depreciation. In the case of Federal, State, and locally assisted housing projects (which are limited as to the rate of return on the investment, such as the FHA 221(d)(3) and the FHA 236 programs) where the construction or acquisition occurs before January 1, 1975, there is to be full recapture during the first 20 months of holding and this is decreased by one percent a month thereafter (with no recapture at the end of 10 years). In the case of most housing, there is full recapture during the first 100 months after which there is a decrease of the amount recaptured by one percent a month (with no recapture after 16⅔ years). These general recapture rules apply to the governmentally assisted housing in the case of construction and acquisitions in 1975 and later years. The Senate amendment extends for one more year, until January 1, 1976, the shorter recapture period for the governmentally assisted housing projects.

The conference substitute adopts section 5 of the Senate amendment.

### Real Estate Investment Trusts: Treatment of Foreclosure Property

Section 6 of the Senate amendment deals with some of the tax problems of real estate investment trusts. Under present law, a real estate investment trust (REIT), if it derives most of its income from real estate investments (and meets certain other requirements), is not taxed on its distributed income but instead is allowed "pass through" tax treatment whereby the income is taxed to the shareholders and not the trust. A series of revisions had been proposed for the tax treatment of real estate investment trusts to take account of current practices and economic problems faced by the industry. The Senate amendment deals only with the most pressing current problems of the industry, those relating to the tax treatment of foreclosure property. The Senate amendment, in general, provides that a REIT is not to be denied the "pass through" treatment because of income it receives from foreclosure property. In general, under the Senate amendment the REIT will be taxed as a corporation on the income from the foreclosure property and will have a period of time to sell the foreclosed property or convert it into qualified property.

Section 6 of the Senate amendment also takes into account the difficulty a REIT faces as a result of the provision of present law prohibiting it from holding any property for sale to customers. In this regard, the Senate provision modifies the rule to a limited extent to allow a REIT to hold foreclosure property for sale.

The conference substitute adopts the provisions of section 6 of the Senate amendment.

### Increase in Interest Charged and Paid in Connection With Deficiencies, Etc.

Section 7 of the Senate amendment increases the interest rate paid by taxpayers on tax deficiencies, and by the government on tax overpayments, from 6 percent to 9 percent per year effective for obligations outstanding on July 1, 1975. In addition to updating the tax interest at this time, the amendment provides a procedure whereby the interest rate in the future will be kept up to date with changes in the money market rates. It provides that the tax interest rate is to be adjusted as the prime rate quoted by commercial banks to large business changes. The government interest rate is to be 90 percent of this prime rate but to be at the nearest whole interest rate and not to be changed more than once every two years.

The conference substitute adopts the provisions of section 7 of the Senate amendment.

### Interest on Certain Obligations

Section 8 of the Senate amendment deals with the tax treatment of student loan funding programs. Present law exempts interest paid on most State and local governmental obligations from Federal income tax. The provision adds a new category to the list of obligations, the interest from which is exempt from Federal income tax. The category added is qualified scholarship funding bonds where the students loan programs are financed, at the request of governmental units, by nonprofit higher education authorities even though the bonds do not constitute a State or local government bond. In addition, the provision makes it clear that student loan incentive payments made by the Commissioner of Education under the Emergency Insured Student Loan Act of 1969 are not to result in the treatment of the obligations as arbitrage bonds and in this manner disqualified the financing of these student loan programs for tax-exempt status.



The conference substitute does not include the provisions of section 8 of the Senate amendment. The managers have been advised by the Treasury Department that new regulations under section 103(a) will be promulgated shortly. These regulations will provide for the exemption of interest on obligations issued to finance student loan programs where such obligations are authorized pursuant to State law and are issued by nonprofit higher educational authorities at the request of a State or local governmental unit.

The managers understand that in certain cases even if these obligations qualify under section 103 they nevertheless would not be exempt because they would be treated as arbitrage bonds (under sec. 103(d) of the Code). These obligations are treated as arbitrage bonds if the interest to be paid by students on their loans together with any incentive payments represent a yield that may be materially higher than the yield on the bonds issued to finance the student loan program. Many of these obligations may be treated as arbitrage bonds because certain student loan incentive payments made by the Commissioner of Education (HEW) to cover the expenses of the student loan program are taken into account in computing the yield (and other amounts appropriated under State law may be so taken into account). The temporary regulations provide that the yield on the proceeds from the acquired program obligations may not exceed the yield produced over the term of the obligations issued to finance student loans by more than 1½ percent or such higher percentage as is shown to be necessary to cover administrative expenses.

The managers further understand that when final Treasury regulations are issued under section 103(d) they will provide that student loan incentive payments made by the Commissioner of Education under the Emergency Insured Student Loan Act of 1969 or amounts appropriated under State law to cover the expenses of the student loan program are not to be taken into account for purposes of determining the yield under section 103(d). However, any incentive payments are to reduce any stated percentage limitation (or any higher allowance for costs) which may otherwise be permitted under Treasury regulations for such programs.

### Interest on Certain Deposits, Etc., in the United States

Section 9 of the Senate amendment deals with the exclusion from gross income of interest on U.S. bank deposits held by nonresident aliens. Under present law, interest received by nonresident aliens from deposits with banks, with savings and loan institutions or other similar associations, and from amounts held by an insurance company under an agreement to pay interest is exempt from the 30-percent withholding tax on income or gain not effectively connected with the conduct of a trade or business within the United States. This provision, however, expires as of December 31, 1975. The Senate amendment extends the termination of this provision for one additional year to December 31, 1976.

The conference substitute adopts the provisions of section 9 of the Senate amendment.

### Exclusion of Interest on Certain Obligations Issued Prior to 1971

Section 10 of the Senate amendment provides that (1) where companies had issues of indebtedness outstanding on the date of the enactment of the interest equalization tax, (2) which were guaranteed by U.S. persons, (3) which were treated under that Act as debt obligations of a foreign obligor, (4) the obligation does not have a maturity date exceeding 15 years as of June 30, 1974, and (5) the obligation has been purchased by one or more underwriters with the purpose of distribution through resale, then the interest on the obligations is to be treated as foreign source income and as a result exempt from the 30-percent withholding tax in the case of interest payments to nonresident aliens. In addition, these obligations are to be exempt from U.S. estate tax when held by nonresident aliens. Since the interest equalization tax (under which these obligations were exempted from withholding tax) is no longer in effect, the only way finance subsidiaries can continue to avoid payment of the withholding tax is for their U.S. parent company to assume these obligations. However, this would cause the finance subsidiaries to realize income from the discharge of indebtedness. For this reason, these types of obligations were made exempt from the 30-percent withholding tax.

The conference substitute adopts the provisions of section 10 of the Senate amendment.

### Tax on Certain Income of Political Organizations

Section 11 of the Senate amendment provides that political parties or committees (and separate campaign funds) are to be taxed on investment income and on income from a trade or business, but not on campaign contributions they receive. In addition, a $100 minimum is to be provided before any tax is payable on investment or business income. Generally, the political parties and committees are to be taxed as corporations but the surtax exemption is not to be allowed and the dividends received deduction is not to be available.

Generally, newsletter committees (and separate funds) are to be treated for tax purposes in the same manner as political campaign committees. That is, contributions received by the newsletter committees are not to be taxable to the individual or committee nor are the funds spent for a newsletter to be deductible. However, to the extent of any investment income or business income in the case of these funds, tax is to be imposed. Should funds be withdrawn from newsletter funds for personal purposes, however, tax is to be imposed at that time.

The conference substitute adopts the provisions of section 11 of the Senate amendment, with an amendment to clarify the provision regarding separate segregated campaign funds established by exempt organizations to conform to State laws. In such a case, where appropriate under the safeguards of the laws of the relevant State, a separate segregated fund is permitted to have dues monies transferred to it by the exempt organization to be used for political campaign purposes, without those funds being treated as expenditures made by that exempt organization.



### Extension of Existing Credit and Deduction Provisions for Political Contributions to Contributions for Newsletters; 2-Year Rule for Announcing Candidacy

Section 12 of the Senate amendment extends the existing credit and deduction provisions for political contributions to contributions to newsletter funds.

Under the provisions of the Senate amendment, the limited credit or deduction allowed under present law for campaign contributions to individual candidates (and parties and committees) would be available only if a person has announced that he is a candidate for office in the year of the contribution. The provisions allow this credit or deduction in the year before a person announces his candidacy.

The conference substitute adopts the provisions of section 12 of the Senate amendment.

### Increase in Political Contributions Credit and Deductions

Section 13 of the Senate amendment increases the maximum credit and deduction for contributions to candidates for public office. The maximum credit is increased from $12.50 ($25 in the case of a joint return) to $25 ($50 in the case of a joint return). The maximum deduction is increased from $50 ($100 in the case of a joint return) to $100 ($200 in the case of a joint return).

The conference substitute adopts the provisions of section 13 of the Senate amendment.

### Transfer of Appreciated Property to Political Organizations

Under section 14 of the Senate amendment, appreciated property transferred by a taxpayer to a political party or committee, if occurring after May 7, 1974, is to be taxed to the donor at the time of the transfer. A ruling already issued by the Internal Revenue Service taxes appreciation in property given before that date to the political party or committee receiving the property. However, this ruling is not to apply before August 2, 1973.

The conference substitute adopts the provisions of section 14 of the Senate amendment.

### Gift Tax Not To Apply to Contributions to Political Organizations

Section 15 of the Senate amendment provides that gift taxes are not to apply to contributions to political parties or committees.

The conference substitute adopts the provisions of section 15 of the Senate amendment.

### Exemption of Interest on Certain Governmental Obligations

Section 16 of the Senate amendment exempts from Federal taxation the interest on obligations issued by the American Falls Reservoir District to finance and construct a dam and related facilities to replace the existing American Falls Dam of the Minidoka project, Idaho-

Wyoming, pursuant to a contract with the Secretary of Interior under authority contained in the Act of December 28, 1973 (87 Stat. 904).

The conference substitute does not adopt the provisions of section 16 of the Senate amendment. The conferees were informed that there are several electrical power companies and regional power systems that face this type of situation in which tax-exempt bonds may not be issued to finance electric generating facilities for an area that extends beyond two contiguous counties. The conferees believed that they would not be taking a constructive step now to enact this provision when a generalized approach is the proper course of action to follow. Therefore, the conferees have agreed that their respective committees will re-examine the present situation to provide a more general solution.

The action by the conferees should not be construed as a determination of the merits of the project or the issue of the exemption from taxation. However, the mention in the Internal Revenue Code of special situations is not favored. Moreover, the matter was not the subject of hearings in either the Senate or the House of Representatives. On the other hand, we understand the sense of urgency that prompted the offering of an amendment. We are informed that a delay of weeks now could mean a delay of one year in the construction schedule. As a result, whatever position it believes it should take, we urge the Internal Revenue Service to act expeditiously.

AL ULLMAN,
JAMES A. BURKE,
DAN ROSTENKOWSKI,
PHIL M. LANDRUM,
H. T. SCHNEEBELI,
JOEL T. BROYHILL,
BARBER B. CONABLE,
*Managers on the part of the House.*
RUSSELL B. LONG,
HERMAN E. TALMADGE,
VANCE HARTKE,
WALLACE F. BENNETT,
CARL T. CURTIS,
*Managers on the part of the Senate.*

O

H. R. 421

# Ninety-third Congress of the United States of America

AT THE SECOND SESSION

*Begun and held at the City of Washington on Monday, the twenty-first day of January, one thousand nine hundred and seventy-four*

# An Act

To amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. AMENDMENT OF TARIFF SCHEDULES.**

(a) IN GENERAL.—Schedule 6, part 3, subpart E of the Tariff Schedules of the United States (19 U.S.C. 1202) is amended—

(1) by striking out "upholstery regulators, and", and by inserting "and upholstery regulators, upholsterer's regulating needles, and upholsterer's pins," after "other hand needles," in the item description preceding item 651.01.

(2) by striking out "and upholstery regulators" in item 651.04; and

(3) by inserting after item 651.05 the following new item:

| | | | |
|---|---|---|---|
| " 651.06 | Upholstery regulators, upholsterer's regulating needles, and upholsterer's pins........................................ | Free | Free ". |

(b) EFFECTIVE DATE.—The amendments made by subsection (a) apply with respect to articles entered, or withdrawn from warehouse, for consumption on or after the date of enactment of this Act.

(c) STATUS OF NEW ITEM.—The duty free treatment applied to upholstery regulators, upholsterer's regulating needles, and upholsterer's pins under item 651.06 of the Tariff Schedules of the United States (as added by subsection (a)) shall be treated as not having the status of a statutory provision enacted by the Congress, but as having been proclaimed by the President as being required or appropriate to carry out foreign trade agreements to which the United States is a party.

**SEC. 2. AMENDMENT OF INTERNAL REVENUE CODE.**

Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

**SEC. 3. EXTENSION BY ONE YEAR OF PERIOD DURING WHICH POLLUTION CONTROL FACILITIES, RAILROAD ROLLING STOCK, REHABILITATION HOUSING, AND COAL MINE SAFETY EQUIPMENT MAY QUALIFY FOR 5-YEAR AMORTIZATION.**

(a) POLLUTION CONTROL FACILITIES.—Section 169(d)(4)(B) (defining new identifiable treatment facility) is amended by striking out "January 1, 1975" and inserting in lieu thereof "January 1, 1976".

(b) RAILROAD ROLLING STOCK.—Section 184(e) (relating to amortization of railroad rolling stock) is amended—

(1) by striking out "1975" in paragraph (1) and inserting in lieu thereof "1976", and

(2) by striking out "January 1, 1975" in paragraph (7) and inserting in lieu thereof "January 1, 1976".

(c) REHABILITATION OF LOW-INCOME RENTAL HOUSING.—Section 167(k)(1) (relating to expenditures to rehabilitate low-income rental housing) is amended by striking out "January 1, 1975" and inserting in lieu thereof "January 1, 1976".

(d) COAL MINING SAFETY EQUIPMENT.—Section 187(d)(3) (defining certified coal mine safety equipment) is amended by striking out "January 1, 1975" and inserting in lieu thereof "January 1, 1976".

**SEC. 4. ACCRUAL OF VACATION PAY.**

(a) In General.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deductions taken) is amended by adding at the end thereof the following new section:

**"SEC. 463. ACCRUAL OF VACATION PAY.**

"(a) Allowance of Deduction.—At the election of a taxpayer whose taxable income is computed under an accrual method of accounting, if the conditions of section 162(a) are otherwise satisfied, the deduction allowable under section 162(a) with respect to vacation pay shall be an amount equal to the sum of—

"(1) a reasonable addition to an account representing the taxpayer's liability for vacation pay earned by employees before the close of the taxable year and payable during the taxable year or within 12 months following the close of the taxable year; plus

"(2) the amount (if any) of the reduction at the close of the taxable year in the suspense account provided in subsection (c)(2).

Such liability for vacation pay earned before the close of the taxable year shall include amounts which, because of contingencies, would not (but for this section) be deductible under section 162(a) as an accrued expense. All payments with respect to vacation pay shall be charged to such account.

"(b) Opening Balance.—The opening balance of the account described in subsection (a)(1) for its first taxable year shall, under regulations prescribed by the Secretary or his delegate, be—

"(1) in the case of a taxpayer who maintained a predecessor account for vacation pay under section 97 of the Technical Amendments Act of 1958, as amended, for his last taxable year ending before January 1, 1973, and who makes an election under this section for his first taxable year ending after December 31, 1972, the larger of—

"(A) the balance in such predecessor account at the close of such last taxable year, or

"(B) the amount determined as if the taxpayer had maintained an account described in subsection (a)(1) for such last taxable year, or

"(2) in the case of any taxpayer not described in paragraph (1), an amount equal to the largest closing balance the taxpayer would have had for any of the taxpayer's 3 taxable years immediately preceding such first taxable year if the taxpayer had maintained such account throughout such 3 immediately preceding taxable years.

"(c) Suspense Account for Deferred Deduction.—

"(1) Initial suspense account.—The amount of the suspense account at the beginning of the first taxable year for which the taxpayer maintains under this section an account (described in subsection (a)(1)) shall be the amount of the opening balance described in subsection (b) minus the amount, if any, allowed as deductions for prior taxable years for vacation pay accrued but not paid at the close of the taxable year preceding such first taxable year.

"(2) Adjustments in suspense account.—At the close of each taxable year the suspense account shall be—

"(A) reduced by the excess, if any, of the amount in the suspense account at the beginning of the taxable year over the amount in the account described in subsection (a)(1) at the close of the taxable year (after making the additions and charges for such taxable year provided in subsection (a)), or

"(B) increased (but not to an amount greater than the initial balance of the suspense account) by the excess, if any of the amount in the account described in subsection (a)(1) at the close of the taxable year (after making the additions and charges for such taxable year provided in subsection (a)) over the amount in the suspense account at the beginning of the taxable year.

"(3) Section 381 ACQUISITIONS.—The application of this subsection to any acquisition to which section 381(a) applies shall be determined under regulations prescribed by the Secretary or his delegate.

"(d) ELECTION.—An election under this section shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

"(e) CHANGES IN ACCOUNTING METHOD.—

"(1) ESTABLISHMENT OF ACCOUNT NOT CONSIDERED CHANGE.—The establishment of an account described in subsection (a)(1) shall not be considered a change in method of accounting for purposes of section 446(e) (relating to requirement respecting change of accounting method), and no adjustment shall be required under section 481 by reason of the establishment of such account.

"(2) CERTAIN TAXPAYERS TREATED AS HAVING INITIATED CHANGE.—If the taxpayer treated vacation pay under section 97 of the Technical Amendments Act of 1958, as amended, for his last taxable year ending before January 1, 1973, and if such taxpayer fails to make an election under this section for his first taxable year ending after December 31, 1972, then, for purposes of section 481, such taxpayer shall be treated as having initiated a change in method of accounting with respect to vacation pay for his first taxable year ending after December 31, 1972."

(b) CLERICAL AMENDMENT.—The table of sections for such subpart C is amended by adding at the end thereof the following:

"Sec. 463. Accrual of vacation pay."

(c) CERTAIN INCREASES IN SUSPENSE ACCOUNT INCLUDED IN GROSS INCOME.—

(1) Section 81 is amended to read as follows:

"SEC. 81. CERTAIN INCREASES IN SUSPENSE ACCOUNTS.

"There shall be included in gross income for the taxable year for which an increase is required—

"(1) CERTAIN DEALERS' RESERVES.—The amount of any increase in the suspense account required by paragraph (4)(B)(ii) of section 166(g) (relating to certain debt obligations guaranteed by dealers).

"(2) VACATION PAY.—The amount of any increase in the suspense account required by paragraph (2)(B) of section 463(c) (relating to accrual of vacation pay)."

(2) The table of sections for part II of subchapter B of chapter 1 is amended by striking out the item relating to section 81 and inserting in lieu thereof the following:

"Sec. 81. Certain increases in suspense accounts.".

(d) EFFECTIVE DATES.—

(1) Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1973.

(2) If the taxpayer maintained an account for vacation pay under section 97 of the Technical Amendments Act of 1958, as amended, for his last taxable year ending before January 1, 1973, the amendments made by this section shall apply to taxable years ending after December 31, 1972.

SEC. 5. APPLICATION OF CLASS LIFE SYSTEM TO REAL PROPERTY.

(a) GENERAL RULE.—In the case of buildings and other items of section 1250 property (within the meaning of section 1250(c) of the Internal Revenue Code of 1954) placed in service before the effective date of the class lives first prescribed by the Secretary of the Treasury or his delegate under section 167(m) of such Code for the class in which such property falls, if an election under such section 167(m) applies to the taxpayer for the taxable year in which such property is placed in service, the taxpayer may, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, elect to determine the useful life of such property—

(1) under Revenue Procedure 62–21 (as amended and supplemented) as in effect on December 31, 1970, or

(2) on the facts and circumstances.

(b) REPEAL OF PRIOR TRANSITIONAL RULE.—Paragraph (1) of section 109(e) of the Revenue Act of 1971 (Public Law 92–178) is hereby repealed.

(c) CONFORMING AMENDMENT.—Section 1250(a)(1)(C)(ii) is amended by striking "January 1, 1975" and in lieu thereof inserting "January 1, 1976".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to property placed in service after December 31, 1973.

SEC. 6. REAL ESTATE INVESTMENT TRUSTS; TREATMENT OF FORECLOSURE PROPERTY.

(a) FORECLOSURE PROPERTY.—Section 856 (defining real estate investment trust) is amended by adding at the end thereof the following new subsection:

"(e) SPECIAL RULES FOR FORECLOSURE PROPERTY.—

"(1) FORECLOSURE PROPERTY DEFINED.—For purposes of this part, the term 'foreclosure property' means any real property (including interests in real property), and any personal property incident to such real property, acquired by the real estate investment trust as the result of such trust having bid in such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was default (or default was imminent) on a lease of such property or on an indebtedness which such property secured.

"(2) GRACE PERIOD.—Except as provided in paragraph (3), property shall cease to be foreclosure property with respect to the real estate investment trust on the date which is 2 years after the date such trust acquired such property.

"(3) EXTENSIONS.—If the real estate investment trust establishes to the satisfaction of the Secretary or his delegate that an extension of the grace period is necessary for the orderly liquidation of the trust's interest in such property, the Secretary or his delegate may extend the grace period for such property. Any such extension shall be for a period of not more than 1 year, and not more than 2 extensions shall be granted with respect to any property.

"(4) TERMINATION OF GRACE PERIOD IN CERTAIN CASES.—Any foreclosure property shall cease to be such on the first day (occurring on or after the day on which the real estate investment trust acquired the property) on which—

"(A) a lease is entered into with respect to such property which, by its terms, will give rise to income which is not described in subsection (c)(3) (other than subparagraph (F) of such subsection), or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day which is not described in such subsection,

"(B) any construction takes place on such property (other than completion of a building, or completion of any other improvement, where more than 10 percent of the construction of such building or other improvement was completed before default became imminent), or

"(C) if such day is more than 90 days after the day on which such property was acquired by the real estate investment trust and the property is used in a trade or business which is conducted by the trust (other than through an independent contractor (within the meaning of section (d)(3)) from whom the trust itself does not derive or receive any income).

"(5) TAXPAYER MUST MAKE ELECTION.—Property shall be treated as foreclosure property for purposes of this part only if the real estate investment trust so elects (in the manner provided in regulations prescribed by the Secretary or his delegate) on or before the due date (including any extensions of time) for filing its return of tax under this chapter for the taxable year in which such trust acquires such property. Any such election shall be irrevocable."

(b) MODIFICATION OF HOLDING FOR SALE RULE.—Section 856(a)(4) (defining real estate investment trust) is amended by inserting after "property" the following: "(other than foreclosure property, as defined in subsection (e))".

(c) TAX ON INCOME FROM FORECLOSURE PROPERTY.—Section 857(b) (relating to method of taxation of real estate investment trusts, etc.) is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

"(4) INCOME FROM FORECLOSURE PROPERTY.—

"(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year on the net income from foreclosure property of every real estate investment trust a tax determined by applying section 11 to such income as if such income constituted the taxable income of a corporation taxable under section 11. For purposes of the preceding sentence, the surtax exemption shall be zero.

"(B) NET INCOME FROM FORECLOSURE PROPERTY.—For purposes of this part, the term 'net income from foreclosure property' means the excess of—

"(i) gain from the sale or other disposition of foreclosure property described in section 1221(1) and the gross income for the taxable year derived from foreclosure property (as defined in section 856(e)), but only to the extent such gross income is not described in subparagraph (A), (B), (C), (D), or (E) of section 856(c)(3), over

"(ii) the deductions allowed by this chapter which are directly connected with the production of the income referred to in clause (i)."

(d) TECHNICAL AMENDMENTS.—

(1) Paragraphs (2) and (3) of section 856(c) (relating to limitations) are each amended by striking out "and" at the end of subparagraph (D), by adding "and" at the end of subparagraph (E), and by adding at the end thereof the following new subparagraph:

"(F) income and gain derived from foreclosure property (as defined in subsection (e));".

(2) Section 857(a)(1) (relating to requirements applicable to real estate investment trusts) is amended to read as follows:

"(1) the deduction for dividends paid during the taxable year (as defined in section 561, but determined without regard to capital gains dividends) equals or exceeds the sum of—

"(A) 90 percent of the real estate investment trust taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in section 561)); and

"(B) 90 percent of the excess of (i) the net income from foreclosure property over (ii) the tax imposed on such income by subsection (b)(4)(A), and".

(3) Section 857(b)(2) (defining real estate investment trust taxable income) is amended by adding at the end thereof the following new subparagraph:

"(F) There shall be excluded an amount equal to the net income from foreclosure property."

(4) Section 857(b)(2)(C) is amended by inserting before the the period at the end thereof "and shall be computed without regard to that portion of such deduction which is attributable to the amount excluded under subparagraph (F)".

(e) EFFECTIVE DATE.—The amendments made by this section apply to foreclosure property acquired after December 31, 1973. Notwithstanding the provisions of section 856(e)(5) of the Internal Revenue Code of 1954 (as added by subsection (a) of this section) any taxpayer required to make an election with respect to foreclosure property sooner than 90 days after the date of enactment of this Act, may make that election at any time before the 91st day after the date of enactment of this Act.

**SEC. 7. INCREASE IN INTEREST CHARGED AND PAID IN CONNECTION WITH DEFICIENCIES, ETC.**

(a) INCREASE IN INTEREST RATE.—

(1) Chapter 67 (relating to interest) is amended by adding at the end thereof the following new subchapter:

## "Subchapter C—Determination of interest rate



**"SEC. 6621. DETERMINATION OF RATE OF INTEREST.**

"(a) IN GENERAL.—The rate of interest under sections 6601(a), 6602, 6611(a), 6332(c)(1), and 7426(g) of this title, and under section 2411(a) of title 28 is 9 percent per annum, or such adjusted rate as is established by the Secretary or his delegate under subsection (b).

"(b) ADJUSTMENT OF INTEREST RATE.—The Secretary or his delegate shall establish an adjusted rate of interest for the purpose of subsection (a) not later than October 15 of any year if the adjusted prime rate charged by banks during September of that year, rounded to the nearest full percent, is at least a full percentage point more or less than the interest rate which is then in effect. Any such adjusted rate of interest shall be equal to the adjusted prime rate charged by banks, rounded to the nearest full percent, and shall become effective on February 1 of the immediately succeeding year. An adjustment provided for under this subsection may not be made prior to the expiration of 23 months following the date of any preceding adjustment under this subsection which changes the rate of interest.

"(c) DEFINITION OF PRIME RATE.—For purposes of subsection (b), the term 'adjusted prime rate charged by banks' means 90 percent of the average predominant prime rate quoted by commercial banks to large businesses, as determined by the Board of Governors of the Federal Reserve System."

(2) The following provisions are each amended by striking out "the rate of 6 percent per annum" and inserting in lieu thereof the following: "an annual rate established under section 6621":

(A) section 6601(a) (relating to interest on underpayments),

(B) section 6602 (relating to interest on erroneous refunds recoverable by suit),

(C) section 6611(a) (relating to interest on overpayments),

(D) section 6332(c)(1) (relating to interest with respect to failure to surrender property subject to levy), and

(E) section 7426(g) (relating to interest on judgments with respect to property wrongfully levied upon).

Section 2411(a) of title 28 of the United States Code (relating to interest on judgments for overpayments of tax) is amended by striking out "the rate of 6 per centum per annum" and inserting in lieu thereof: "an annual rate established under section 6621 of the Internal Revenue Code of 1954".

(b) TERMINATION OF REDUCED INTEREST RATE IN CERTAIN CASES.—

(1) CERTAIN EXTENSIONS OF TIME.—Section 6601 is amended by striking out subsection (b) (relating to extensions of time in the case of certain estates) and subsection (j) (relating to extensions of time in the case of certain expropriation lesses), and by redesignating subsections (c), (d), (e), (f), (g), (h), (i), (k), and (l) as subsections (b), (c), (d), (e), (f), (g), (h), (i), and (j), respectively.

(2) DEBT-FINANCED PROPERTY.—Section 514(b)(3)(D) (relating to interest with respect to certain unrelated debt-financed income) is amended by striking out the last sentence.

(c) INCREASE IN PENALTY FOR FAILURE TO PAY ESTIMATED INCOME TAX.—Section 6654(a) (relating to failure by individuals to pay estimated income tax) and sections 6655 (a) and (g)(1) (relating to failure by corporations to pay estimated income tax) are each amended by striking out "the rate of 6 percent per annum" and inserting in lieu thereof the following: "an annual rate established under section 6621".

(d) CONFORMING AMENDMENTS.—

(1) Section 6163(c) is amended to read as follows:

"(c) CROSS REFERENCE.—

**"For authority of the Secretary or his delegate to require security in the case of an extension under this section, see section 6165."**

(2) Sections 6166(g) and 6167(e) are each amended by striking out the last sentence.

(3) Sections 6166(k) and 6167(h) are each amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(4) Section 6504(15) is amended by striking out "6601(h)" and inserting in lieu thereof "6601(g)".

(5) The table of subchapters for chapter 67 is amended by adding at the end thereof the following:

**"SUBCHAPTER C. Determination of Interest Rate.".**

(e) Effective Date.—The amendments made by this section shall take effect on July 1, 1975, and apply to amounts outstanding on such date or arising thereafter.

**SEC. 8. INTEREST ON CERTAIN DEPOSITS, ETC., IN THE UNITED STATES.**

The last sentence of section 861(c) (relating to interest on deposits, etc.) is amended by striking out "December 31, 1975," and inserting in lieu thereof "December 31, 1976,".

**SEC. 9. EXCLUSION OF INTEREST ON CERTAIN OBLIGATIONS ISSUED PRIOR TO 1971.**

(a) In General.—Section 861(a)(1) (relating to income from sources within the United States) is amended—

(1) by striking out "and" at the end of subparagraph (F),

(2) by striking out the period at the end of subparagraph (G) and inserting in lieu thereof a comma and the word "and", and

(3) by adding at the end thereof the following new subparagraph:

"(H) interest on a debt obligation which was part of an issue which—

"(i) was part of an issue outstanding on April 1, 1971,

"(ii) was guaranteed by a United States person,

"(iii) was treated under chapter 41 as a debt obligation of a foreign obligor,

"(iv) as of June 30, 1974, had a maturity of not more than 15 years, and

"(v) when issued, was purchased by one or more underwriters for the purpose of distribution through resale.".

(b) Conforming Amendment.—The last sentence of section 2104(c) (relating to debt obligations treated as property within the United States) is amended by striking out "or section 861(a)(1)(G)" and inserting in lieu thereof a comma and "section 861(a)(1)(G), or section 861(a)(1)(H)".

(c) Effective Date.—The amendment made by subsection (a) applies to interest paid after the date of enactment of this Act, and the amendment made by subsection (b) applies with respect to estates of decedents dying after such date.

**SEC. 10. TAX ON CERTAIN INCOME OF POLITICAL ORGANIZATIONS.**

(a) General Rule.—Subchapter F of chapter 1 (relating to exempt organizations) is amended by adding at the end thereof the following new part:

## "PART VI—POLITICAL ORGANIZATIONS



**"SEC. 527. POLITICAL ORGANIZATIONS.**

(a) General Rule.—A political organization shall be subject to taxation under this subtitle only to the extent provided in this section. A political organization shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

"(b) Tax Imposed.—

"(1) In general.—A tax is hereby imposed for each taxable year on the political organization taxable income of every political organization. Such tax shall consist of a normal tax and surtax computed as provided in section 11 as though the political organization were a corporation and as though the political organization taxable income were the taxable income referred to in section 11. For purposes of this subsection, the surtax exemption provided by section 11(d) shall not be allowed.

"(2) Alternative tax in case of capital gains.—If for any taxable year any political organization has a net section 1201 gain, then, in lieu of the tax imposed by paragraph (1), there is hereby imposed a tax (if such a tax is less than the tax imposed by paragraph (1)) which shall consist of the sum of—

"(A) a partial tax, computed as provided by paragraph (1), on the political organization taxable income determined by reducing such income by the amount of such gain, and

"(B) an amount determined as provided in section 1201 (a) on such gain.

"(c) Political Organization Taxable Income Defined.—

"(1) Taxable income defined.—For purposes of this section, the political organization taxable income of any organization for any taxable year is an amount equal to the excess (if any) of—

"(A) the gross income for the taxable year (excluding any exempt function income), over

"(B) the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), computed with the modifications provided in paragraph (2).

"(2) Modifications.—For purposes of this subsection—

"(A) there shall be allowed a specific deduction of $100,

"(B) no net operating loss deduction shall be allowed under section 172, and

"(C) no deduction shall be allowed under part VIII of subchapter B (relating to special deductions for corporations).

"(3) Exempt function income.—For purposes of this subsection, the term 'exempt function income' means any amount received as—

"(A) a contribution of money or other property,

"(B) membership dues, a membership fee or assessment from a member of the political organization, or

"(C) proceeds from a political fundraising or entertainment event, or proceeds from the sale of political campaign materials, which are not received in the ordinary course of any trade or business,

to the extent such amount is segregated for use only for the exempt function of the political organization.

"(d) Certain Uses Not Treated as Income to Candidate.—For purposes of this title, if any political organization—

"(1) contributes any amount to or for the use of any political organization which is treated as exempt from tax under subsection (a) of this section,

"(2) contributes any amount to or for the use of any organization described in paragraph (1) or (2) of section 509(a) which is exempt from tax under section 501(a), or

"(3) deposits any amount in the general fund of the Treasury or in the general fund of any State or local government,

such amount shall be treated as an amount not diverted for the personal use of the candidate or any other person. No deduction shall be allowed under this title for the contribution or deposit of any amount described in the preceding sentence.

"(e) OTHER DEFINITIONS.—For purposes of this section—

"(1) POLITICAL ORGANIZATION.—The term 'political organization' means a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.

"(2) EXEMPT FUNCTION.—The term 'exempt function' means the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

"(3) CONTRIBUTIONS.—The term 'contributions' has the meaning given to such term by section 271(b)(2).

"(4) EXPENDITURES.—The term 'expenditures' has the meaning given to such term by section 271(b)(3).

"(f) EXEMPT ORGANIZATION WHICH IS NOT POLITICAL ORGANIZATION MUST INCLUDE CERTAIN AMOUNTS IN GROSS INCOME.—

"(1) IN GENERAL.—If an organization described in section 501(c) which is exempt from tax under section 501(a) expends any amount during the taxable year directly (or through another organization) for an exempt function (within the meaning of subsection (e)(2)), then, notwithstanding any other provision of law, there shall be included in the gross income of such organization for the taxable year, and shall be subject to tax under subsection (b) as if it constituted political organization taxable income, an amount equal to the lesser of—

"(A) the net investment income of such organization for the taxable year, or

"(B) the aggregate amount so expended during the taxable year for such an exempt function.

"(2) NET INVESTMENT INCOME.—For purposes of this subsection, the term 'net investment income' means the excess of—

"(A) the gross amount of income from interest, dividends, rents, and royalties, plus the excess (if any) of gains from the sale or exchange of assets over the losses from the sale or exchange of assets, over

"(B) the deductions allowed by this chapter which are directly connected with the production of the income referred to in subparagraph (A).

For purposes of the preceding sentence, there shall not be taken into account items taken into account for purposes of the tax imposed by section 511 (relating to tax on unrelated business income).

"(3) CERTAIN SEPARATE SEGREGATED FUNDS.—For purposes of this subsection and subsection (e)(1), a separate segregated fund (within the meaning of section 610 of title 18 or of any similar State statute, or within the meaning of any State statute which permits the segregation of dues moneys for exempt functions (within the meaning of subsection (e)(2))) which is maintained by an organization described in section 501(c) which is exempt from tax under section 501(a) shall be treated as a separate organization.

"(g) TREATMENT OF NEWSLETTER FUNDS.—

"(1) IN GENERAL.—For purposes of this section, a fund established and maintained by an individual who holds, has been elected to, or is a candidate (within the meaning of section 41(c)(2)) for nomination or election to, any Federal, State, or local elective public office for use by such individual exclusively for the preparation and circulation of such individual's newsletter shall, except as provided in paragraph (2), be treated as if such fund constituted a political organization.

"(2) ADDITIONAL MODIFICATIONS.—In the case of any fund described in paragraph (1)—

"(A) the exempt function shall be only the preparation and circulation of the newsletter, and

"(B) the specific deduction provided by subsection (c)(2)(A) shall not be allowed."

(b) REQUIREMENT OF RETURN.—Section 6012(a) (relating to persons required to make returns of income) is amended by striking out "and" at the end of paragraph (4), by inserting "and" at the end of paragraph (5), and by inserting after paragraph (5) the following new paragraph:

"(6) Every political organization (within the meaning of section 527(e)(1)), and every fund treated under section 527(g) as if it constituted a political organization, which has political organization taxable income (within the meaning of section 527(c)(1)) for the taxable year;".

Section 6012(a) is amended by striking out the last sentence thereof.

(c) CONFORMING AMENDMENT.—Section 501(b) (relating to tax on unrelated business income and certain other activities) is amended by striking out "parts II and III" each place it appears and inserting in lieu thereof "parts II, III, and VI".

(d) CLERICAL AMENDMENT.—The table of parts for subchapter F is amended by adding at the end thereof the following new item:

"Part VI. Political Organizations.".

(e) EFFECTIVE DATE.—The amendments made by subsections (a), (b), (c), and (d) shall apply to taxable years beginning after December 31, 1974.

(f) EXEMPTION FROM FILING REQUIREMENT FOR PRIOR YEARS WHERE INCOME OF POLITICAL PARTY WAS $100 OR LESS.—In the case of a taxable year beginning after December 31, 1971, and before January 1, 1975, nothing in the Internal Revenue Code of 1954 shall be deemed to require any organization described in section 527(e)(1) of such Code to file a return for the taxable year under such Code if such organization would be exempt from so filing under section 6012(a)(6) of such Code if such section applied to such taxable year.

(g) TECHNICAL AMENDMENT.—The Act entitled "An Act to amend the Internal Revenue Code of 1954 with respect to advertising in a convention program of a national political convention", approved June 18, 1968 (82 Stat. 183; Public Law 90–346) is repealed.

**SEC. 11. EXTENSION OF EXISTING CREDIT AND DEDUCTION PROVISIONS FOR POLITICAL CONTRIBUTIONS TO CONTRIBUTIONS FOR NEWSLETTERS; TWO-YEAR RULE FOR ANNOUNCING CANDIDACY.**

(a) GENERAL RULE.—Section 41(a) (relating to contributions to candidates for public office) is amended by inserting "and all newsletter fund contributions" after "all political contributions".

(b) VERIFICATION.—Section 41(b)(3) (relating to verification) is amended—

(1) by striking out "political contribution" the first place it appears and inserting in lieu thereof "political contribution or newsletter fund contribution", and

(2) by striking out "political contribution" the second place it appears and inserting in lieu thereof "contribution".

(c) Definition.—Section 41(c) is amended by adding at the end thereof the following new paragraph:

"(5) Newsletter fund contribution.—The term 'newsletter fund contribution' means a contribution or gift of money to a fund established and maintained by an individual who holds, has been elected to, or is a candidate for nomination or election to, any Federal, State, or local elective public office for use by such individual exclusively for the preparation and circulation of a newsletter."

(d) Conforming Amendments in Deduction Provision.—Section 218 (relating to contributions to candidates for public office) is amended—

(1) by inserting "or newsletter fund contribution (as defined in section 41(c)(5))" after "section 41(c)(1)" in subsection (a); and

(2)(A) by striking out "political contribution" the first place it appears in subsection (b)(2) and inserting in lieu thereof "political contribution or newsletter fund contribution"; and

(B) by striking out "political contribution" the second place it appears in subsection (b)(2) and inserting in lieu thereof "contribution".

(e) Two-Year Rule for Announcing Candidacy.—Section 41(c)(2)(A) (defining candidate) is amended by striking out "has publicly announced" and inserting in lieu thereof "publicly announces before the close of the calendar year following the calendar year in which the contribution or gift is made".

(f) Effective Date.—The amendments made by this section shall apply to any contribution payment of which is made after December 31, 1974, in taxable years beginning after such date.

**SEC. 12. INCREASE IN POLITICAL CONTRIBUTIONS CREDIT AND DEDUCTION.**

(a) Increase in Credit.—Section 41(b)(1) (relating to maximum credit for contributions to candidates for public office) is amended to read as follows:

"(1) Maximum credit.—The credit allowed by subsection (a) for a taxable year shall not exceed $25 ($50 in the case of a joint return under section 6013)."

(b) Increase in Deduction.—Section 218(b)(1) (relating to amount of deduction for contributions to candidates for public office) is amended to read as follows:

"(1) Amount.—The deduction under subsection (a) shall not exceed $100 ($200 in the case of a joint return under section 6013)."

(c) Effective Date.—The amendments made by subsections (a) and (b) shall apply with respect to any contribution the payment of which is made after December 31, 1974, in taxable years beginning after such date.

**SEC. 13. TRANSFER OF APPRECIATED PROPERTY TO POLITICAL ORGANIZATIONS.**

(a) Inclusion in Gross Income of Transferor.—

(1) In general.—Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

**"SEC. 84. TRANSFER OF APPRECIATED PROPERTY TO POLITICAL ORGANIZATION.**

"(a) General Rule.—If—

"(1) any person transfers property to a political organization, and

"(2) the fair market value of such property exceeds its adjusted basis,

then for purposes of this chapter the transferor shall be treated as having sold such property to the political organization on the date of the transfer, and the transferor shall be treated as having realized an amount equal to the fair market value of such property on such date.

(b) Basis of Property.—In the case of a transfer of property to a political organization to which subsection (a) applies, the basis of such property in the hands of the political organization shall be the same as it would be in the hands of the transferor, increased by the amount of gain recognized to the transferor by reason of such transfer.

"(c) Political Organization Defined.—For purposes of this section, the term 'political organization' has the meaning given to such term by section 527(e)(1)."

(2) Clerical amendment.—The table of sections for such part II is amended by adding at the end thereof the following:

"Sec. 84. Transfer of appreciated property to political organizations."

(b) Effective Date.—The amendments made by subsection (a) shall apply to transfers made after May 7, 1974, in taxable years ending after such date.

(c) Nonrecognition of Gain or Loss Where Organization Sold Contributed Property Before August 2, 1973.—In the case of the sale or exchange before August 2, 1973, by an organization described in section 527(e)(1) of the Internal Revenue Code of 1954 of property which such organization acquired by contribution (within the meaning of section 271(b)(2) of such Code), no gain or loss shall be recognized by such organization.

**SEC. 14. GIFT TAX NOT TO APPLY TO CONTRIBUTIONS TO POLITICAL ORGANIZATIONS.**

(a) In General.—Section 2501(a) (relating to taxable transfers for purposes of the gift tax) is amended by adding at the end thereof the following new paragraph:

"(5) Transfers to political organizations.—Paragraph (1) shall not apply to the transfer of money or other property to a political organization (within the meaning of section 527(e)(1)) for the use of such organization."

(b) Effective Date.—The amendment made by subsection (a) shall apply to transfers made after May 7, 1974.

*Speaker of the House of Representatives.*

*Vice President of the United States and*
*President of the Senate.*

December 24, 1974

Dear Mr. Director:

The following bills were received at the White House on December 24th:

| | | | |
|---|---|---|---|
| S.J. Res. 40 | S. 3481 | H.R. 8958 | H.R. 14600 |
| S.J. Res. 133 | S. 3548 | H.R. 8981 | H.R. 14689 |
| S.J. Res. 262 | S. 3934 | H.R. 9182 | H.R. 14718 |
| S. 251 | S. 3943 | H.R. 9199 | H.R. 15173 |
| S. 356 | S. 3976 | H.R. 9588 | H.R. 15223 |
| S. 521 | S. 4073 | H.R. 9654 | H.R. 15229 |
| S. 544 | S. 4206 | H.R. 10212 | H.R. 15322 |
| S. 663 | H.J. Res. 1178 | H.R. 10701 | H.R. 15977 |
| S. 754 | H.J. Res. 1180 | H.R. 10710 | H.R. 16045 |
| S. 1017 | H.R. 421 | H.R. 10827 | H.R. 16215 |
| S. 1083 | H.R. 1715 | H.R. 11144 | H.R. 16596 |
| S. 1296 | H.R. 1820 | H.R. 11273 | H.R. 16925 |
| S. 1418 | H.R. 2208 | H.R. 11796 | H.R. 17010 |
| S. 2149 | H.R. 2933 | H.R. 11802 | H.R. 17045 |
| S. 2446 | H.R. 3203 | H.R. 11847 | H.R. 17085 |
| S. 2807 | H.R. 3339 | H.R. 11897 | H.R. 17468 |
| S. 2854 | H.R. 5264 | H.R. 12044 | H.R. 17558 |
| S. 2888 | H.R. 5463 | H.R. 12113 | H.R. 17597 |
| S. 2994 | H.R. 5773 | H.R. 12427 | H.R. 17628 |
| S. 3022 | H.R. 7599 | H.R. 12884 | H.R. 17655 |
| S. 3289 | H.R. 7684 | H.R. 13022 | |
| S. 3358 | H.R. 7767 | H.R. 13296 | |
| S. 3359 | H.R. 8214 | H.R. 13869 | |
| S. 3394 | H.R. 8322 | H.R. 14449 | |
| S. 3433 | H.R. 8591 | H.R. 14461 | |

Please let the President have reports and recommendations as to the approval of these bills as soon as possible.

Sincerely,

Robert D. Linder
Chief Executive Clerk

The Honorable Roy L. Ash
Director
Office of Management and Budget
Washington, D. C.