1969

The Federal Tax Enactments of 1969

James F. Dring

THE FEDERAL TAX ENACTMENTS OF 1969

JAMES F. DRING

Director, Legislation and Regulations Division
Office of Chief Counsel, Internal Revenue Service

My topic for this morning is the Federal Tax enactments of 1969. As you all know, the principal matter that has absorbed much of the time and energy of those of us involved in the tax legislative process, H. R. 13270, the Tax Reform Act of 1969, is not yet law. If it were, I don't know how I could handle my topic today because even a cursory review of the bill could not be undertaken in the time available for my talk.

Although it is not yet law, the reform bill has influenced the course of a number of other bills considered by the Congress during the past year. I believe it may aid our understanding of Congressional action during this first session of the 91st Congress to outline the more significant events affecting both the development of the reform bill and other important Federal tax legislative matters, particularly the extension of the 10% income tax surcharge and the repeal of the 7% investment credit.

As you may recall, section 110 of Public Law 90-364, the Revenue and Expenditure Control Act of 1968, the bill which enacted the surcharge, directed the President to submit to the Congress by December 31, 1968, proposals for comprehensive reform of the Internal Revenue Code. In identical letters dated December 31, 1968, to the Speaker of the House of Representatives and the President of the Senate, President Johnson advised that proposals for tax reform had been developed by the Treasury Department staff. These proposals were not then disclosed, in deference to the incoming Administration, and President Johnson's letter made it clear that they were not proposals of his Administration. On the same day, the concurrence in the President's action by the Chairmen of the House Ways and Means Committee and the Senate Finance Committee as well as the ranking minority members of those committees was announced by Chairman Mills of the Ways and Means Committee.

The Treasury Department tax reform studies and proposals developed during the Johnson Administration, not endorsed by either the Johnson or the Nixon Administration, were transmitted to Congress by the new Administration in an exchange of letters of January 29th and 30th, 1969, between Chairmen Mills and Long on the one hand and Secretary of the Treasury Kennedy on the other. They were then published on February 5, 1969 as a joint publication of the Finance and Ways and Means Committees. Public hearings before the Ways and Means Committee on the subject of tax reform commenced on February 18th and continued into April. This procedure was most unusual in that the Committee conducted its extensive hearings looking toward major tax reform without an Administration proposal before it. The Administration presented its proposals on tax reform to the Committee on April 22, 23, and 24, 1969. The bill was reported by the Committee after extensive executive sessions on August 2, 1969, and passed by the House on August 7, 1969. The Senate Finance Committee began its hearings on the bill with consideration of the Administration's position on September 4th and 5th, 1969. Public hearings thereafter continued until early October and a technical memorandum on the Treasury's position was published by the Committee on September 30, 1969. The Finance Committee thereafter reported the bill on November 21, 1969.

While the reform bill was under consideration, two other major proposals that might not normally be considered in the area of tax reform were also under consideration, continuation of the 10 percent income tax surcharge, scheduled under the Revenue and Expenditure Control Act of 1968 to expire on June 30, 1969, and termination of the 7 percent investment credit. In a message to the Congress of March 26, 1969, President Nixon had proposed that the income tax surcharge be continued for 1 year, or until June 30, 1970. He also recommended that scheduled reductions in the manufacturers excise tax on the sale of automobiles and the excise tax on telephone service be deferred for one year. These rates, 7% and 10% respectively, are scheduled, under the Revenue and Expenditure Control Act of 1968, to continue through December 31, 1969. Under existing law these rates will then be reduced over a 3 year period and both taxes will be eliminated as of December 31, 1972. Thereafter, in a message of April 21, 1969, the President, in addition to announcing the Administration's proposals on tax reform, recommended to the Congress that the investment credit be repealed. Because repeal of the investment credit will begin to produce a significant revenue effect during calendar year 1970, the President coupled his recommendation on repeal with a revision of his earlier recommendation concerning extension of the income tax surcharge. Specifically he recommended that it be continued at the full 10% rate through December 31, 1969, and at a 5% rate from January 1 through June 30, 1970.

The President's proposals were incorporated in H. R. 12290 along with a provision, designed to ameliorate the effect of the investment credit repeal on air and water pollution control, which would provide a 5 year amortization for air and water pollution control facilities completed in 1969 and later years and not eligible for the investment credit. The investment credit repeal was made effective as of April 19 and there was also added to this bill the Administration's proposal for a low income allowance contained in the President's April 21 message and the presentation of the Treasury to the Ways and Means Committee on April 22. This measure provided for an "additional allowance" of the difference between the minimum standard deduction and $1,100 for family units with 8 or less persons. It was designed to result in no tax liability for those below poverty income levels and to remove 5.2 million returns from the tax rolls. Beyond the new levels at which taxation would start as a result of the low income allowance, the allowance was to be phased out at the rate of $1.00 for every $2.00 of additional income.

H.R. 12290 was reported by the Ways and Means Committee on June 20, 1969, and passed by the House on June 30th. However, withholding rates would have reverted to pre-surcharge levels after June 30th, if additional action were not taken, notwithstanding ultimate retroactive passage of the surcharge extension. H.R. 4229 provided a temporary solution to this problem by continuing withholding at the surcharge levels for one month, or through July 31, 1969. This measure was quickly passed by the Congress and approved by the President on June 30th and became Public Law 91-36.

Efforts to couple extension of the surcharge with tax reform threatened to delay H.R. 12290 on the Senate side. However, the Senate Finance Committee, mindful of the July 31 expiration date for withholding at the surcharge levels, reported the bill without amendment on July 17, 1969. No further action was taken in the Senate on H.R. 12290 but an amendment to extend the 10% surcharge through December 31, 1969, was offered to H.R. 9951, a House passed bill to place the payment of Federal unemployment taxes on a quarterly basis. This bill as so amended was passed by the Senate on July 31 while the Treasury Department meanwhile requested employers to continue withholding at surcharge levels pending completion of action on the surcharge extension. H.R. 9951 was thereafter promptly passed by the House and signed into law by the President on August 7, 1969, as Public Law 91-53.

Meanwhile the House Ways and Means Committee included the remaining provisions of H.R. 12290 in the reform bill as reported by that Committee on August 2, 1969. These included the deferral of excise tax reductions, termination of the investment credit, and amortization of air and water pollution control facilities that had been contained in H.R. 12290, continuation of the surcharge at 5% from January 1, 1970, through June 30, 1970, and a modification of the low-income allowance eliminating, starting with 1971, the phase-out for income beyond the level at which taxation starts, in effect providing a minimum standard deduction of $1,100 for all taxpayers. For the year 1970, the phase-out would be retained.

In the Senate Finance Committee, repeal of the investment credit was briefly wedded to another House-passed bill, H.R. 7311, a bill to reduce import duties on stethoscope parts. This bill was ordered reported by the Committee on September 19 with a Committee amendment repealing the 7% investment credit with numerous modifications of the transitional rules previously approved by both the House and the Finance Committee in H.R. 12290. Thereafter in announcements of October 10, October 13, and October 29, all relating to the reform bill, the Finance Committee reaffirmed, with further modifications, its decision to repeal the investment credit but as part of the reform bill. As Senator Long stated on November 24 in his opening statement to the Senate on the reform bill, the Finance Committee had voted five different times and in three different bills to repeal the investment credit as of April 18.

The other provisions of H.R. 12290, incorporated in the House-passed reform bill, were also retained in the reform bill reported by the Finance Committee, the continuation of the surtax at 5% through June 30, 1970 and the extension of the excise taxes on passenger automobiles and communications services without change. The low-income allowance, under the bill as passed by the Finance Committee, would have a phase-out in both 1970 and 1971 and become in effect a new minimum standard deduction for all taxpayers in 1972. The provision allowing amortization of pollution control facilities was modified in accordance with proposals of the Treasury Department and would apply only to facilities placed in service before January 1, 1975.

I hope the chronology outlined above will serve both to explain the dearth of tax enactments to date and how the major tax considerations of the past year, continuation of the surcharge and excise tax rates, repeal of the investment credit, and tax reform have affected each other and have also been brought together, except for the continuation of the surcharge through 1969, in H.R. 13270.

I would like now to describe briefly Federal tax legislation that has been enacted this year. As already stated, the surcharge was continued through 1969. The effect of section 5 of the Act of August 7, 1969 (P.L. 91-53) was to boost the effective rate of the surcharge for calendar year 1969 from 5% to 10% of tax liability. For fiscal year taxpayers, the surcharge is to be determined by multiplying the 10% by a fraction, the numerator of which is the number of days in the taxable year before January 1, 1970 and the denominator of which is the number of days in the taxable year. This has the effect, for a taxpayer whose taxable year ends after June 30, 1969 and before January 1, 1970, of boosting the surtax from a prorated figure to a full 10% of the tax liability. Amendments were also made to prevent imposition of penalties for underpayment of estimated taxes on amounts attributable to the surcharge extension and due before September 6, 1969, and to conform the withholding provisions and the minimum distribution requirements of section 963 to the extension.

With respect to the balance of the surcharge proposal, its continuation at a 5% rate for the period from January 1 through June 30, 1970, it may be noted that section 701 of the reform bill imposes a 2.5% surcharge for the entire year 1970. This avoids two separate tax rates applicable to the same taxable year for calendar year taxpayers. The withholding rates proposed in the bill, however, reflect the surcharge at a 5% level through June 30, 1969, and provide for reduced withholding after that date.

As already indicated, other provisions of P.L. 91-53 provided for the collection of the Federal Unemployment Tax on a quarterly basis. Under former law, this tax was to be computed and paid by the January 31 following the calendar year for which the tax was imposed. Switching to a quarterly basis required a change in the definition of employer. Under prior law, a person was an employer liable for the tax only if on at least 20 days, each in a different calendar week, he employed four or more individuals in qualified employment during the calendar year for which the tax was imposed. Under this test, a person could not be an employer until, at the earliest, the second quarter in the year. The definition of employer has been amended so that a person is an employer if he satisfies the test described above either during the current calendar year or the preceding calendar year. If a person was an employer during the preceding calendar year, he will be required to compute his liability for each of the first three quarters of the current calendar year. If he becomes an employer during the year, he must compute his liability for the period beginning with the first day of the year and ending with the quarter in which he becomes an employer, and for any quarter thereafter (except the last calendar quarter). The tax is to be computed by multiplying the amount of covered wages (limited to the first $3,000 paid during the year to each employee under 3306(b) of the Code) paid in the calendar quarter or other period by .4%. It may be noted that the tax computed for the first quarter may constitute a substantial portion of an employer's liability for the entire year where he has low turnover among his employees and sufficiently high wages so that the ceiling on covered wages is reached fairly early in the year.

The Service announced in T.I.R. 1024, November 17, 1969, that amounts computed for a quarter or other period under the amendment must be deposited on or before the last day of the first calendar month following the quarter or other period for which the computation is made. Employers will continue to file annual returns and to pay any tax for a calendar year which was not deposited, in January of the succeeding year. Under the amendment, the tax computed for any quarter or other period in 1970 is to be reduced by 66⅔%, and for any quarter or other period in 1971 it is to be reduced by 33⅓%. There is no reduction for 1972 and later years. The deposit requirement is phased in over the same three year period.

The Interest Equalization Tax Extension Act of 1969 (P.L. 91-128, approved November 26, 1969) has extended the interest equalization tax to acquisitions of stock of foreign issuers and debt obligations of foreign obligors made by U.S. persons on or before March 31, 1971. The previous termination date, July 31, 1969, was established in the extension act of 1967 (P.L. 90-59). While the 1969 extension act was pending before Congress, two successive interim statutes extended the termination date, first to August 31, 1969 (P.L. 91-50, approved August 2, 1969) and to September 30, 1969 (P.L. 91-65, approved August 25, 1969). There were no further interim extensions while the 1969 extension bill, H.R. 12829, was pending before Congress and, technically, the interest equalization tax was not in effect during the period from September 30th until November 26th. The Treasury on September 30th had announced that it would propose that the legislation be made effective with respect to acquisitions made after September 30, 1969, so as to assure uninterrupted applicability of the tax and the continuation of existing rates, rules, and proceduures pending enactment of the extension bill. See the Federal Register for October 2, 1969, 34 F.R. 15386. In addition to extending the interest equalization tax, P.L. 91-128 also grants the President authority to establish lower rates of tax for original or new issues of stock or debt obligations than for outstanding issues.

The statutory rate under existing law is 15% for acquisitions of stock and debt obligations with a period remaining to maturity of 28½ years or more. The statutory rate for obligations with shorter maturities starts at 1.05% for obligations with at least one year to maturity and increases for longer term securities in steps designed to produce the interest equivalent of 1% per annum, up to the maximum rate. The President had authority under prior law to vary the rate between zero and 1½ times the statutory rate but not to establish separate rates for new and outstanding issues. The rate currently applicable, under Executive Order 11464 dated April 3, 1969, is three-fourths the statutory rate, or 11.75% for stock acquisitions and acquisitions of long-term debt obligations. By permitting a lower rate to be set for new or original issues, P.L. 91-128 may make it possible to place less reliance on the interest equalization tax without the adverse effect on our balance-of-payments which might result if lower rates were also applicable to outstanding issues.

Other amendments under the Act effected the following changes:

1. A liberalization of the conditions prerequisite to an election available to a domestic corporation to be treated as a "foreign person" and thus not subject to tax when engaged in financing sales outside of the United States of goods or services of a parent or affiliate of such corporation or of goods or services essentially of United States origin.

2. Creation of a rebuttable presumption that money or other property transferred by a United States person to a foreign trust after June 9, 1969, is subsequently used by the trust to acquire foreign stock or debt obliga-

tions which would be taxable if acquired directly by the transferor. Unless this presumption is rebutted, the transferor incurs tax liability under section 4912 (b) (1) as of the date of transfer.

3. Amendment of section 4912 (j) (1) (A) to permit a domestic corporation acquiring exempt debt obligations arising out of export transactions to transfer such debt obligations to an affiliate without loss of exemption.

4. Amendment of section 4919 (c) to permit an underwriter or dealer, upon satisfying certain conditions, to obtain a credit or refund with respect to a taxable acquisition of a foreign security if the foreign security is resold to a foreign branch of a United States bank. In effect, the branch is treated as a foreign person for purposes of this section.

5. Amendment of section 6011 (d) (1) (B) to exempt dealers and underwriters from filing interest equalization tax transaction returns (Form 3780-A). Under existing law a return is required for any calendar quarter during which a person makes an acquisition subject to tax. If the stock or debt obligation is sold prior to the time for filing the quarterly return, a special transaction tax return must be filed on or before the date of sale. Dealers and underwriters will not be required to file a transaction tax return where they are entitled to a credit for any tax paid pursuant to provisions granting a resale exemption to dealers and underwriters.

6. Amendment of section 6011 (d) (3) and section 6680 to require a nonparticipating firm to file prescribed information returns in certain cases and maintain adequate records with respect to transactions involving the interest equalization tax; imposition of a maximum penalty of $1,000 for each failure to file the prescribed return. "Participating firms" are those which have agreed to comply with, and do comply with, record keeping and reporting requirements prescribed by the Service and which are therefore authorized to confirm the exemption for prior American ownership and compliance when acquisitions are effected through them. Proper administration of the tax necessitates similar record keeping and reporting requirements by nonparticipating firms, where the nonparticipating firm has received a validation certificate indicating a sale effected though it is entitled to exemption, or where it effects a transaction in which a United States person acquiring stock or debt obligations is subject to tax.

7. Extension of the existing exclusions for acquisitions of debt obligations arising out of the lease of tangible personal property by producing exporters to include all leasing including cases where the lessor is not the producer of the leased property, in which at least 85 percent of the value of the leased property consists of property of United States origin.

8. Amendment of section 4920(a)(1)(A) to provide that the definition of a "debt obligation" includes an obligation arising under a lease entered into principally as a financing transaction.

Other legislative proposals have been given consideration by the Congress and the most important of these, the Airport and Airway Revenue Act of 1969, is well down the legislative road. It constitutes Title II of the Aviation Facilities Expansion Act of 1969, H.R. 14465. This bill was passed by the House on November 6, 1969 and a description of Title II follows.

In general, the most important taxes imposed by Title II of the bill are the tax on aviation fuel, the passenger-ticket tax and the tax on property shipped by air. The concept of noncommercial aviation was chosen as the distinguishing criterion for determining whether any one use of an aircraft would be subject to either the aviation fuel tax or the ticket and property tax. In no case would a single use of an aircraft be subject to both the aviation fuel tax and the ticket or property tax. A summary of the taxes contained in Title II, as passed by the House, follows.

Aviation Fuel Tax

The bill would impose a tax of 7 cents a gallon on any liquid (other than gasoline) sold to or used by an owner, lessee, or other operator for use as fuel in an aircraft flown in noncommercial aviation. In the case of gasoline, a tax of 3 cents is imposed, which will be in addition to the current tax of 4 cents imposed by section 4081. The current refund of 2 cents a gallon for gasoline which is used in other than a highway vehicle will not apply to aircraft used in noncommercial aviation. However, the entire 4 cents will be refunded for gasoline used in aircraft in commercial aviation.

The term noncommercial aviation means any use of an aircraft, other than use in a business of transporting persons or property for compensation or hire by air. The term also includes all aircraft which have a maximum certificated takeoff weight of 6,000 pounds or less (whether or not the aircraft is used in a business of transporting persons or property for compensation or hire), except when such aircraft is operated on an established line. Finally, the term includes use of an aircraft owned or leased by one member of an affiliated group when charges are made to another member of the group for transportation services furnished in connection with the use of the aircraft, provided that the aircraft is not available for hire by persons who are not members of such group.

Tax on Transportation of Persons by Air

The bill would increase from 5 percent to 8 percent the present tax on amounts paid within or without the U.S. for the transportation of a person by air within the U.S. In addition, passengers on flights destined for points without the U.S. would be subject to a $3.00 "head tax" if their flight originated in the U.S.

Tax on Transportation of Property by Air

A new 5-percent tax would be imposed on amounts paid within or without the U.S. for the transportation of property by air from one point in the U.S. to another. Property transported by air from without the U.S. to within the U.S. would be subject to a 5 percent tax on the amount paid for that portion of the flight that takes place within the U.S.

Exemptions from the Transportation-by-Air Taxes

International organizations, as defined in section 7701 (a) (18) of the Code, and the Red Cross would be exempted from paying the taxes imposed on the transportation of persons or property by air. Also exempt would be noncommercial transportation of persons or property as described above.

Tax on Use of Civil Aircraft

The bill would impose an annual tax on the use by a taxable engine-driven aircraft of the navigable airspace of the U.S. Aircraft which are registered, or are required to be registered, under section 501 (a) of the Federal Aviation Act of 1958, or are owned by or for a U.S. person, would be taxable. The tax would be computed at a base rate of $25.00 per year plus 2 cents per pound for each pound of maximum certificated takeoff weight. Turbine engine-powered aircraft would pay an additional 1½ cents per pound of maximum certificated takeoff weight.

In order to prevent foreign commercial aircraft from gaining a competitive advantage, U.S. commercial aircraft would be allowed a partial refund of the use tax paid based on the amount of their use in foreign air commerce.

Miscellaneous

The bill makes provision for a study and investigation, by the Secretary of Transportation, to determine whether the taxes imposed will have to be revised in order to assure that the tax burden is equitably distributed among the various classes of persons using the airports and airways of the United States. A final report encompassing the results of that study and investigation is to be made no later than March 1, 1972.

On November 13, 1969 the House passed H.R. 14705, the "Employment Security Amendments of 1969" which would further amend the Federal Unemployment Tax Act (previously amended this year by Public Law 91-53, as explained above). This bill would increase the number of employers subject to the Act and, in general, provide extended unemployment compensation coverage through a number of amendments taking effect in 1972 and 1973. In addition, the bill would increase the tax by .1% beginning in 1970 and would increase the wage base subject to tax from $3,000 to $4,200 beginning in 1972.

As I speak to you this morning, the reform bill is under consideration on the floor of the Senate. While a number of floor amendments have been adopted during the past several days, one that can be described as most critical directly bears on the question of the form that tax relief provided by the bill will ultimately take. The conversion of the Administration's proposed low income allowance into a new minimum standard deduction, which I have already described, was a part of the total tax relief consisting, in addition, of a liberalization of the maximum standard deduction and a reduction in rates for all taxpayers. Such a tax relief package was a feature of both the House-passed bill and the bill reported out by the Senate Finance Committee. On Wednesday of this week the Senate adopted an amendment which would eliminate most of this relief and substitute an increase in the allowance for personal exemptions, from $600 to $700 in 1970 and to $800 in 1971. This would be coupled with a flat $1,000 standard deduction for all taxpayers and a retention of existing tax rates. However, a separate rate schedule would be provided for single individuals, also a feature of the Finance Committee's bill, ameliorating the burden of single taxpayers as compared with those filing joint returns. There would also be an adjustment of the rates applicable to heads of households, to maintain their position halfway between rates applicable to joint and separate returns. Thus, one of the most critical issues facing the House-Senate conferees on the bill will be the form that tax relief should take.

Editor's Note—The foregoing paper was presented on December 6, 1969, at which time the author had available to him only the Senate Finance Committee's version of the Reform Bill plus certain Senate floor amendments. All comments should, therefore, be read with this fact in mind.

Special attention is called to the comments in the closing paragraph relating to the nature of relief likely to be provided individuals in respect to such items as the low income allowance, standard deduction, personal exemptions and rates. It should be noted that the law as finally enacted provided as follows:

Low income allowance—of $1,100 for 1970, $1,050 for 1971, and $1,000 for 1972 and subsequent years, with a phase out provision applicable only to the years 1970 and 1971.

Standard deduction—The percentage Standard Deduction is the larger of the Standard Deduction or the Low Income Allowance. The percentage Standard Deduction for 1971 is 13% with a maximum of \$1,500; for 1972, 14% with a maximum of \$2,000; and, for 1973 and subsequent years, 15%, with a maximum of \$2,000.

Personal exemption—The effective personal exemption allowance is \$625 for 1970 calendar year taxpayers; \$650 for 1971; \$700 for 1972; and, \$750 for 1973 and subsequent years.

Rates—A new rate schedule has been established for single persons (other than surviving spouses and heads of households) which provides rates for single persons which are not more than 20% above the rates for married couples filing joint returns. The schedule is effective for 1971 and subsequent years.

A new rate schedule has also been provided for 1971 and subsequent years for heads of households establishing rates half way between the new single person's rates and the existing rates for joint returns.

A new and lower marginal maximum rate has also been established with respect to earned taxable income, namely, 60% for taxable years beginning after December 31, 1970, and before 1972; and, 50% for taxable years beginning after December 31, 1971.