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Analysis of Tax Legislation Enacted and Proposed In 1963

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Last summer when I was asked to speak on 1963 Legislation enacted and pending, I thought that by this time, December 7, we would have a Revenue Act of 1963 to talk about. The Revenue Act of 1963 is still pending; it will be enacted, but it will then be called the Revenue Act of 1964, and there is practically nothing to talk about in the way of legislation enacted this year. I asked our Librarian yesterday to give me the slip laws on all public laws enacted by Congress this year that involved the income tax. She came up with four slips of paper, I dropped one of them somewhere this morning. This is all, the tax rate extension act, the annual thing they do, keeping the corporate rate at 52%. There was one bill enacted to allow a married woman who has been deserted by her husband and can't find him to deduct child care expenses. Another one dealing with accrued vacation pay, and the one that is missing some place around here was a bill dealing with the income tax treatment of Maryland ground rents and none of this merits any discussion today. But we do have this bill, HR 8363, which has passed the House of Representatives; it will be reported out next year, probably February or March, by the Senate Finance Committee. And it will be passed by the Senate. There will be, we know, a large number of amendments made to the bill, and then the bill will go to Conference which is held between the House and the Senate to resolve the differences. Now as you know when the Senate amends a tax bill, everything goes, there are no limitations on germaneness that mean anything. This bill, for example, has no excise tax amendments. If the Senate wants to amend this bill by reducing the rate of tax on beer, it can do so, but when it gets to Conference, the rules are quite different.

Since I have run into frequent misunderstandings on that score, let me just pause for a minute to tell you something about what can be done in Conference with respect to amendments. I think a couple of examples would be easiest to follow. The bill as it passed the House has a provision, section 218, to give capital gain treatment to iron ore royalties. Now it is in the Senate. Let us suppose the Senate says, that part is all right but let us also give capital gain treatment to sand and gravel royalties, and then we go to conference with that amendment. In conference, the House conferees may say, we will go along with capital gain for sand and gravel, but only if you agree to capital gain treatment for clam and oyster shell royalties. Now, they cannot do

that even if they so want in conference; they could not so amend the bill. The only choices they would have in conference would be to strike out or accept capital gain for the sand and gravel royalties. They could not decide to junk the whole section and not even give capital gain to iron ore royalties, because both Houses gave iron ore that treatment.

Let us take another example to show that it is a compromise proposition in conference. The House bill repeals in two steps the 4% credit allowed to individuals for dividends received from domestic corporations. Let's say, and this may not be completely unrealistic, that the Senate does not like the provision. In fact the Senate may say, the House is going in the wrong direction, let's not repeal the credit but let's increase it. So they send the bill over to conference with a credit of 6% in lieu of the repeal of the existing 4%. Now in conference it has to be compromise—the conferees can't say, well, let's make it seven instead of six, neither House had done that. But they could go anywhere in between repealing the 4% credit or raising it to six. They could leave it at 4 as present law.

Now, there is one more thing: usually in conference there will be five members from the Senate Finance Committee, usually based on seniority, three Democrats and two Republicans, and the same from the House Ways and Means Committee. When they get in conference and they are in disagreement over an amendment, it is not the majority rule of the ten conferees that settles the issues. For example, the bill has a provision, as you recall, that in the case of group life insurance coverage, an employee is to include as compensation the cost of the insurance in excess of \$30,000. Suppose the Senate says we don't like that at all, and we repeal the provision of the House bill. Then they get to conference. Suppose the five Senate conferees say, we are in favor of leaving the law where it is today, no compensation on group life coverage, and the two Republican members of the Ways and Means Committee say, we agree with the Senate. That makes seven. But the three Democratic members of the Ways and Means Committee say, nothing doing, we are going to tighten up in this area. Now there you have a vote of seven to three in favor of the Senate action. That doesn't settle the dispute. You have got to get a majority of each side to reach an agreement so that if the three Democratic members of the House stand pat they will not reach a compromise. If the dispute can be settled by raising the exemption from \$30,000 to \$50,000, then it would take a majority vote of each of the conferees, three from the Senate side and three from the House side. Then you have an agreement that can go back to the respective Houses for adoption.

If they do something they are not supposed to do in conference and adopt an amendment which is outside the limits of compromise, that action is subject to a point of order. If a bill comes out of conference and goes back to the House and the Senate for approval, if a single

Senator or Congressman gets up and makes a valid point of order, against the Conference Report, the Report will not be adopted. So the conferees will not violate their powers unless they are satisfied that no one will raise the point of order. Occasionally that will happen. I remember one case when that happened, in 1951, because I was involved with it. The Senate in the Revenue Act of 1951 added a provision rewriting the rules on war losses—I was in charge of the drafting—there was no provision in the House bill on it. It was hastily drafted and when we got to conference we discovered that the thing did not work at all. In order to do what the Senate wanted to do we had to deal not just with open years, the years of recovery, but we had to go back and open up the old years, the years of the war losses. Now that was clearly beyond the powers of the conference. It was explained to the conferees and they said well we want to clean up the mess, the Treasury does not object, does anybody here object? Nobody objected—they did it. Except for the occasional case like that the conferees stay clearly within their prescribed powers.

One more thing about the Senate amendments. You may have an amendment which you prepared and sent to your Congressman to be put into the bill. You are told your amendment was adopted and then when the bill comes out you will find that they did not use your language at all. I can say that is usually par for the course. The language that is submitted by taxpayer's representatives and by the Congressmen themselves to a bill usually is not actually the language that appears in the reported bill. The Senate Finance Committee and the Ways and Means Committee rely implicitly on their draftsman to draft their amendments and bills. They use the legislative counsel's office of the two Houses. Not all committees do that. When I was working on the Hill, some of the Committees relied on the attorneys down town in the Department to do the technical drafting of the bills. But the Committees of Senate Finance and Ways and Means do not. And if there is a dispute as to whether the taxpayer's attorney knows how it should be drafted or the legislative counsel, the taxpayer's attorney is going to lose.

Now, here we have it. H.R. 8363, there are 310 pages in it; it has passed the House. Incidentally there is one thing about this number that may be of some interest. This bill amends the Internal Revenue Code of 1954. The '54 Code was H.R. 8300 of the 83rd Congress. It just happened that by the time Dan Reed got ready to introduce the bill they were near the 8300 mark, so he got the number of 8300. This year, apparently, Mr. Mills wanted his bill to be the '63 version of H.R. 8300. It is easy to remember—the '63 version of H.R. 8300; it does undo some things which were enacted in 1954. For example, he wants to repeal the 4% credit on dividends received; he wants to tighten up on stock options. This bill, as you know, started out to be a real reform

bill, in addition to a rate reduction bill. The Ways and Means spent a lot of time on it. They had 195 witnesses. The printed hearings come to over 4,000 pages. But there isn't really much reform in it. Treasury proposed lots of reform and got very, very little of it through. And as you know, Secretary Dillon says he will take this bill right now, just the way it stands, with one exception, which I will refer to a little later on. I honestly think he would be happy to take it just as is. But for those interested in reform, let me call your attention to an article in this month's issue of *Harper's* entitled, "The Slow, Quiet Murder of Tax Reform." I'll just read you two sentences from it. This is an interesting article. "On the morning of last June 6th, the House Ways and Means Committee, plodding slowly through the administrative tax reform proposals, came at last to the hottest of hot potatoes, the oil depletion allowance. But even before Treasury spokesman could begin to explain their plan for a mild tightening of the special tax reductions enjoyed by the oil industry, a motion was made and carried to by-pass the entire subject without further debate." It is an interesting article.

The Senate, of course, is going to amend this bill and let us first look at some of the things I think you can expect to be offered with some kind of a chance of being added to the bill. I am only going to talk about amendments by the Senate Finance Committee. The Senate has a practice of printing proposed amendments to bills. Only twenty-six amendments so far have been printed for this tax bill. Most of the amendments are by members of the Finance Committee. For example, here is amendment no. 228 proposed by Senator Long. This is not the 228th amendment to the tax bill, it is the 228th amendment that has been introduced at this session of the Senate, to the bills pending in the Senate. Senator Long from Louisiana is, of course very important. He is next to Senator Byrd, Chairman of the Finance Committee, and it may not be too long before Senator Long will be Chairman of that Committee. He has introduced a few amendments that I want to comment on briefly. The first one I mention is called the Simplified Tax Method. I think you have read about it in the papers. I don't believe this one will be adopted, but it is interesting enough to comment on briefly. He provides that instead of getting all of the deductions, what he calls the gimmicks, a taxpayer, a married man, filing a joint return, can elect to pay 40% of his income up to \$100,000, 50% on anything over it, but if he wants that tax rate he has to include in his tax return his municipal bond interest, state bond interest, and some other items which are now excluded such as payments to a pension, or profit sharing plan. And then in turn he cannot deduct intangible drilling costs and he cannot deduct percentage depletion. In describing this amendment on the floor of the Senate, the Senator had what I thought was the audacity to refer to intangible drilling costs and percentage depletion costs as gimmicks. I say that because no one is a stronger defender of

percentage depletion than Senator Long. I don't look for the amendment to be added to the bill, but there is a chance for it.

He does have some other amendments. He has an amendment to repeal section 274, or practically repeal it. That is the section that went in last year governing travel and entertainment deductions. Senator Long has been quite active in trying to get steam underway in support of this amendment. Actually when the regulations came out this year on sec. 274, I thought that would just about end any talk on repealing section 274 because if ever a set of regulations deactivated a statute, I thought those did. It may be that those regulations will save Senator Long's amendment from being adopted. Then he has a bill dealing with Cuban losses which is of narrow interest but there is a possibility of it being enacted. Senator Gore has introduced a number of amendments. One is the interest equalization tax which deals with the balance of payments problem. That is the bill that Ways and Means Committee reported out day before yesterday. Mr. Gore's amendment is the same, I think, as that proposed by the Administration and it might have a chance of being tacked on to this bill. He is introducing all his bills to tighten up on the taxation of foreign income. I don't think Senator Gore has any chance on that. He, of course, is asking again for the repeal of the stock option provision and he should have Treasury support on that since Treasury did recommend to the Ways and Means Committee that the stock options provisions be repealed. But I am not sure that the Treasury will back it at this time, and without Treasury support Mr. Gore will get no place with his stock option provisions. In fact I think that what the Senate Finance Committee will do will be to loosen up a little bit on what the House did in the way of tightening up on restricted stock options. Then he has one other amendment which I should mention. Secretary Dillon said he recommended a 21% rate on capital gains, but he did so with the expectation that the Ways and Means Committee would then provide that at death you do not get a full step up in basis. What Senator Gore's amendment does is to say that at death you take the decedent's cost basis and add to that the estate tax on any appreciation that has occurred before death, so that he would get some step-up in basis if there has been any appreciation. Likewise the decedent's estate would keep decedent's basis of cost if it was higher than the fair market value at death. This amendment should get Treasury support. You will recall that just the day before they finished up on the tax bill on the House side, the Ways and Means Committee had decided to do what Senator Gore is proposing. In came a draft that the Ways and Means Committee spent about three hours going over that had all of the rules on how to compute the tax basis after adding the estate and inheritance tax on appreciation in value. The Committee then announced that the draft was too complicated. And that was the end of it. But in the same bill there is a provision that takes

the complicated language to apply in a very isolated situation. Section 216(j) of the bill has a provision dealing with the basis at death of stock in a foreign personal holding company. Under present law if a shareholder in a foreign personal holding company dies, there is no step-up in basis. The estate takes over the decedent's basis in the stock. This bill will say that when that shareholder dies you will add to the decedent's basis in the foreign personal holding company stock the estate tax attributable to any appreciation. It is not very complicated. The Gore proposal goes this much further, it deals with the inheritance taxes on appreciation as well as estate taxes. It is this provision for some kind of a carry-over of the decedent's basis at death that I think has a chance, but not a good chance, of being adopted by the Senate Finance Committee. I believe that Secretary Dillon will not make a big fight for it.

There is another amendment that is being proposed that has a chance of being adopted. Senator Ribicoff of Connecticut has introduced an amendment to this bill to give a credit, not a deduction, against tax for the taxpayer's college costs of his child. In fact it doesn't have to be a child but that is the normal case. The credit would be this: the taxpayer can take a credit against tax of 75% of the first \$200; 25% of the next \$300, and 10% of everything over \$500 but not over \$1500. This is a credit against tax, not a deduction, but it has the limitation that you have to reduce the credit by 1% of the taxpayer's income in excess of \$25,000. Senator Ribicoff is serious about this amendment, and he has been beating the bushes in support of it. I have been told that this is going to be a bloody battle. The Administration will oppose it.

Senator Hartke has a number of amendments—some of which probably have a chance. He is asking that in the case of the depreciation guidelines, which the Treasury announced two years ago with the provision that at the end of a three year grace period there will be a testing of results by the application of a reserve ratio test, that the reserve ratio test be eliminated. There is a possibility on this one.

Well, now these are things that can happen to this bill. The things that are now in the bill you have had an opportunity to look at, but just let me briefly thumb through a few of these provisions in my remaining time. First as to rate reduction. It is an important rate reduction. The bottom bracket goes down from 20% to 14%; the top bracket goes down from 91% to 70%—takes two years to get all the way. In the present law there is an overall limitation, the tax cannot exceed 87% of your entire adjusted gross income. This bill does not have any comparable figure. In the case of a married person filing a joint return, everything over \$200,000 would be taxed at 70%. They have done something with respect to the standard deduction which I think is worth commenting on. They provide that an individual, take a single person, gets a minimum standard deduction of \$300. A single person today has

to pay a tax if he is over \$600 plus a 10% standard deduction. Thus he can earn \$667 without a tax. Under the new provision this single person has to earn over \$900, \$600 plus the minimum standard of \$300 to be subject to a tax. It is a very neat way, without increasing exemptions, in doing what increased exemptions will do. My recollection is that Dr. Atkeson first suggested this approach about eight years ago. This is a cheap way from the standpoint of revenue loss to accomplish what raising the exemptions would do for those with very small incomes.

The investment credit, we heard something about that this morning, with reference to reducing the basis by the amount of credit. The House has eliminated the reduction. In other words, you will get your credit and still have your full tax basis. If you pay \$100 for a piece of equipment, you get a credit against tax of \$7 for it, and under present law your basis is \$93. If the Senate keeps the House provision your basis will be \$100 to be recovered through depreciation. Last year Senator Long insisted on reduction of the basis by the credit. I have been told he is willing to accept this amendment this year. If that is so, I think that it is a cinch to go through. It will not apply for last year though; you will not get any refunds through this change but you will presumably add back the 7% credit on any property you bought before June of this year. You would add it back and then take depreciation on that amount over the remaining life of the property.

The House bill does nothing at all for corporations in the capital gains field. They still pay 25% alternative tax. The House bill allows an individual to carry forward a capital loss indefinitely. It removes the present limitation of five years. Corporations will still have the five year rule under the bill as it passed the House. But the House did reverse the surtax and the normal tax rates for corporations. The normal tax goes down from 30% to 22%, and as a result the surtax goes up to 26%. As you know, the Secretary recommended that in an affiliated group you get only one surtax exemption, to be divided among the members as they see fit. It became much more important, in view of the fact that the normal tax is going to be lower than the surtax, to do something about the multiple surtax exemption of \$25,000 that applies in case of affiliated corporations. The solution, a partial solution, by the House was this—if you are filing a consolidated return there is no problem, you just get one surtax exemption, but you don't pay the 2% consolidated return tax anymore. But if you have a group that is affiliated within the definition of the bill, a controlled group, and you decide you want to take the multiple surtax exemption, you can take it, but you then add 6% to your normal tax rate on the first \$25,000 of taxable income, so that instead of paying 22% on your first \$25,000, you will pay 28%. Normally it will pay to do that. The Secretary made one other suggestion in this field which the House did not adopt. If an affiliated group does not file a consolidated return, there should nevertheless

be a 100% dividends received deduction on dividends received between members of the group. I know there is a group that is actively working on the Senate side to get that provision into the bill, but at the expense of giving up the multiple surtax exemption. If you have a parent corporation with three or four subsidiaries that do not want to file a consolidated return (there may be a number of reasons for it, one reason may be different taxable years), if they will consent to give up the multiple surtax exemption then the dividends will come to the parent with 100% rather than 85% dividends received deduction. The Treasury, I have been told, does not oppose the amendment and so there is some chance that that might be added to the bill by the Senate. In other words you get that result without filing a consolidated return.

I can't possibly touch on all of the important provisions in this bill but I want to mention the section dealing with sales of real estate. As you know there is a provision for a partial recapture—if you sell real estate after 1963 at a profit—there may be a partial recapture at ordinary income tax rates of some of the depreciation taken since 1963. But if you have held it for ten years before sale you can forget about it, except for any special improvements you may have made to the real estate during the last ten year period. One more thing I should mention, personal holding companies. There are many companies today that are not personal holding companies that will become personal holding companies under the House passed bill. There is a good chance that the Senate will accept those results. The easiest example is the corporation with \$50,000 of dividends and interest combined and \$50,000 of rents. It is not a personal holding company under present law because the rents are not personal holding company income since they amount to 50% of total income. That is true under present law even though there is a loss on the rents because the expenses in connection with the rental property exceed the gross rents. Under this bill and the facts stated, the company would be a personal holding company. Moreover instead of the 80% test in present law on personal holding company income, it is reduced to 60%. You people who have corporations with any substantial amount of personal holding company income had better very carefully take a look at these new provisions as soon as they are enacted.