

suaded to begin my address by a discussion of this part of the bill which, according to the junior Senator from Florida, constitutes the most important part of the bill.

In the beginning, I state that I recognize that I believe the suggestion of the use of public funds to defray the cost of the conduct of our elections merits careful consideration.

I have suggested in previous speeches modes of such consideration.

I have always felt though, Mr. President, that the provision of public funds for campaign expenses must be tied closely and intimately with amendment of the Corrupt Practices Act and with a carefully considered bill for election reform.

Indeed, Mr. President, I doubt if any Member of either body of the Congress has devoted the time and study to the question of clean elections that the senior Senator from Tennessee has.

I wish to approach the subject on this basis. It is said that money is the root of all evil. Money is the root of political corruption. Money is the root of political influence. The use and volume of that money constitute the greatest danger in our elective system.

There is nothing evil per se about the expenditure of funds on elections. Indeed, if the electorate is to make a wise choice, then the issues, the records, and views of opposing candidates in a contest should receive wide dissemination.

This requires money in increasing amounts as our population increases and as mass communication media for hire become more widely used.

The evil which threatens our elective processes arises from the improper use of money, money in excessive amounts, sometimes from questionable sources and heavily in favor of special interest candidates or without full disclosure to the public.

If we are to eliminate or even minimize this evil and danger, then existing law affecting the use of money in Federal elections must, in my view, be substantially revised. Existing law is wholly inadequate, outmoded, and unrealistic. For the most part, it was enacted more than 40 years ago.

The inadequacies of existing law were fully illustrated by the report of the elections subcommittee on the 1956 general election campaign.

Earlier today reference was made to the investigation of that subcommittee, of which I was chairman, and the report which was filed. I have a copy of the report. Copies are no longer available. More than 1,000 requests for copies came after the supply was exhausted. It is the largest committee report that the Government Printing Office has ever printed, and it is factual.

We tabulated \$33 million, the source of the money, the recipient of the money,

and the purposes for which the money was expended.

So, Mr. President, I speak on this subject with some experience and knowledge and, even more, with conviction that reform of our election laws, amendment of our Corrupt Practices Act, now more than 40 years old, is urgent.

The freedom and the sanctity of the ballot box is at the very heart of our system of self-government.

One of our goals in world affairs is to assure to people the right of self-determination. We had better look about ourselves and assure our own people of a right of untrammelled determination without the undue influence of money.

The need for election law reform is widely recognized. The senior Senator from Tennessee is by no means the only one who recognizes this. While there is substantial agreement as to the need for election reform, there are differing views as to the details of what should or can be done.

In view of the failure of Congress to act in this field in more than a quarter of a century, I think it fair to say that the sense of urgency for measures to protect our elective process from corrupt practices, which I feel so keenly, must not be shared by all. As I see it, the cause of clean elections is a very important cause, indeed.

Mr. President, despite the studies that have been made, despite the fact that a clean elections bill is now dying on the calendar, we are here on Saturday afternoon, October 22, asked finally to approve, to take the last step, and to send to the White House, a bill containing a provision on which there has not been one day of hearings, on which not one witness testified, but which, instead of being accompanied with safeguards and protection, adequate amendment of the Corrupt Practices Act, merely pours more millions of dollars into the political pot. Does this make for clean elections?

Mr. SMATHERS. Mr. President, will the Senator yield, to straighten out the record?

Mr. GORE. I yield.

Mr. SMATHERS. Would the Senator not agree that there was a public hearing on this particular proposal, on which the Under Secretary of the Treasury testified, and on which several Senators testified with respect to their own proposals? I offered one proposal. The matter was pretty well discussed. There was considerable public discussion about it.

Mr. GORE. I agree that the Committee on Finance had a day of hearing on the general subject of campaign contributions and election reform. Indeed, there have been many such hearings, one of which, as I have said, I conducted over a period of months.

Mr. SMATHERS. I should like to commend the Senator. I stated earlier that I think that the most thorough

hearing I have heard about on this particular subject was that conducted by the Senator in 1956, and I think that the recommendations that he made at that time are excellent. The Senator knows a great deal about this subject. The point is that that was 10 years ago. I am afraid that if we do not pass some sort of legislation which all of us will agree is at least a step in the right direction, we will be debating for another 10 years on this matter, before we will ever get it enacted into law. Ten years later, after the Senator's thorough and lengthy and excellent hearings, we still do not have anything. I think we have to take this as a step in the right direction, hoping that after we have tried it for some time, we might be able to steer it forward, if it needs to be steered to a higher ground.

Mr. GORE. I thank the Senator for his generous comments.

I must say that I cannot feel, after careful consideration, that this would be taking a step in the right direction, if this is the only step we take. Indeed,

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this step, taken without safeguards, in my opinion would be a very bad step. It would make the situation far worse.

Just as tax reform, from a practical standpoint, can only successfully be coupled with tax reduction, I think that if we provide Government funds for campaign expenses, without trying to those benefits to our political process the necessary safeguards and protection, then protection is out the window, the benefits are in hand, and the cause of election reform and clean elections will have been dealt a death blow.

Mr. CLARK. Mr. President, will the Senator yield?

Mr. GORE. I yield.

Mr. CLARK. I, too, have a great deal of sympathy with the point of view which has just been expressed by the Senator from Tennessee with respect to election reform. I, too, should like to assure that the RECORD is straight.

While I do not purport to be the expert on the subject that the Senator from Tennessee is, I have, nonetheless, done a good deal of research work on the subject. Election reform, to be adequate, requires the collaboration of three committees of the Senate.

The first is the Committee on Finance, where provisions must be passed which, unfortunately, must originate in the House or, in the alternative, be tacked onto some other bill, as was done with the current proposal, by which the financing aspects of campaigns, insofar as there may be any participation by the Government, must be worked out and determined. With regard to that, there was at least 1 full day of hearings, I think, before the Committee on Finance.

Some time ago, the President of the United States did me the great honor of

asking me to introduce his bill dealing with clean elections and campaign financing, and I did so. The bill was referred to the Committee on Rules and Administration, the second committee concerned. For reasons best known to themselves, that committee refused to hold hearings on the President's bill, and I must say that I can find little favor with their decision. Instead, they reported to the calendar an utterly inadequate bill, on which no hearings have been held for 6 years, and which was clearly obsolete, inadequate, and inappropriate for the purpose. That is the bill which is now on the calendar, to which the Senator referred. It was not brought up on the floor, and I rather regret that, because, inadequate as the bill is, it would have given us the opportunity to amend it on the floor and provide some kind of decent vehicle for campaign financing and election reform. However, the leadership, in its wisdom, did not see fit to bring that bill up.

A third aspect of campaign reform and financing, in my opinion, is in the jurisdiction of the Committee on Commerce. That has to do with the extent to which the communications media, primarily radio and television, should be called upon to contribute some part of the cost to conduct an honorable financial campaign. Next year, I propose to introduce separate bills:

First, a bill which will be referred to the Committee on Finance, for financing along the lines which the Senator from Tennessee is now discussing.

Second, a bill to be referred to the Committee on Rules and Administration, which will deal with the administrative aspects of campaign practices, the Corrupt Practices Act, and the other aspects of campaign financing which are within the jurisdiction of the Committee on Rules and Administration under our rule. 25.

Third, a bill to be referred to the Committee on Commerce, which will deal with the part that radio and television should be called upon to play in this area.

The reason why I make these statements is that I was a witness before the Committee on Finance on this measure and said in substance what I have said just now on the floor of the Senate in this regard.

When the bill that is now under consideration first came before the Senate for consideration, I felt that it was a half-baked measure. I still think it is a half-baked measure. But I voted for it. Why did I vote for it? Because it seemed to me that it was one foot in the door in an area where many honorable Senators, including particularly the senior Senator from Tennessee [Mr. GORE], had been laboring for 10 years, and we had not got to first base. We had not, as the Senator from Florida [Mr. SMATHERS] said, come to the point where Congress had seriously considered how to remedy one of the great failures in our democracy.

So I felt, under the circumstances—and I honor the Senator from Tennessee for his differing view—that it was better to vote for this measure and get something started than not to vote for it at all.

I apologize to the Senator from Tennessee for this interjection, but I wanted the RECORD to show the current status of the problem. It is a problem we must deal with, and I hope we shall deal with it at the next session of Congress. We must seek a method of comprehensive election reform and a revision of the Corrupt Practices Act, through some sensible approach provided by the legislature, with the aid of the executive, to deal with a vexing problem which is one of the great failures in our American democracy.

Mr. GORE. Mr. President, the distinguished senior Senator from Pennsylvania need not apologize for his interjection. I appreciate it. It is an able observation. The Senator has devoted much time and study to the subject. He has confessed that he considered this a half-baked measure when he voted for it on the floor of the Senate.

I wish to make a confession. When the proposal came to a vote in committee, out of love and respect for the chairman, against whose amendment we naturally did not like to vote, I did not vote on the first rollcall; but then when I discovered that all Democrats except me had voted for it and that all Republicans had voted against it, I suppose that a little partisan spirit of the occasion arose and I made a statement. I said, "Mr. Chairman, I wish now to be recorded, but before doing so I wish to state my reasons." I expressed the view then that this was not a measure of which I could fully approve but that it had the merit, I thought, of provoking discussion upon a very vital problem of our Republic. On that basis I voted to bring it to the floor of the Senate with no thought whatsoever that the Senate would seriously consider its adoption without other provisions being added. But here we are. I was perfectly astounded by the vote in the Senate. I was more astounded when the conference committee accepted it. Now, we are asked to take the last act before this really revolutionary political concept in our body politic becomes law.

Mr. President, I say that the measure needs reconsideration. "Half-baked" is not a sufficient adjective to describe the measure. Before I go into the measure in detail, which I shall now do, I wish to say, while the distinguished majority leader is on the floor, that I am grateful that several Senators have been listening to the debate and within a reasonable, but fairly brief period of time, after he is able to assure me of a yea-and-nay vote, I shall ask for a vote on a motion which I shall then present.

Mr. MANSFIELD. Mr. President, will the Senator yield?

Mr. GORE. I yield.

Mr. MANSFIELD. I cannot begin to express my deep appreciation to the Senator for what he has just said, because I had no idea what the situation would be. Therefore, I am all the more grateful, especially for notifying the Senate in advance.

Mr. GORE. Throughout our years of service, I have kept the Senator advised of my attitudes and moves. Although he has not always found himself in agreement, he has always been advised of them.

I want to be explicit. This may not be the last vote we will have, but I shall be prepared to ask for a vote.

Mr. MANSFIELD. Would the Senator from Tennessee want the Senator from Montana to state a specific time?

Mr. GORE. I would prefer to proceed. Is the Senator prepared to do so?

Mr. MANSFIELD. Yes.

Mr. MONRONEY. Mr. President, will the Senator yield?

Mr. GORE. I yield.

Mr. MONRONEY. Before the Senator leaves the matter of financial presidential campaigns—

Mr. GORE. I am only now coming to it.

Mr. MONRONEY. In the Senator's discussion thus far, no mention has been made of the inadequacy of the bill with respect to preconvention activities of presidential candidates.

Is this not one of the wide open areas: influence of large sums of money unaccounted for, unreported, not required to be reported for participation in capturing delegates of various States, or even in the act of campaigning in presidential primaries which are conducted in many States?

It seems to me that had hearings been held there would have been a greater

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focus on the full aspects of the financing of presidential campaigns instead of only November elections and the general elections.

Mr. GORE. I was going to point that out. I appreciate the suggestion of the able Senator from Oklahoma [Mr. MONRONEY].

Not only does the measure omit any reference to conventions, party caucuses, or primaries for presidential campaigns, it also omits any reference to senatorial or congressional campaigns. Yet most of us are members of one of the two major political parties.

That brings up a point I had not intended to mention at this time, but let us consider the question of parties.

Suppose Senator STROM THURMOND wants to run for President again. After all, he ran at one time on the Dixiecrat ticket and I believe he won a majority in seven States. Now, should Senator THURMOND, or Governor Wallace, or some

other public figure wish to run for President again in 1968 on the Dixiecrat ticket, or some other ticket, there would be this situation: Whoever is the nominee of the Republican Party, and President Johnson, if he be the nominee of the Democratic Party, I assume would be the beneficiaries of this vast amount of money. But the other candidate or candidates would be penniless except for dependence upon private sources.

I do not wish to be sectional in this presentation.

Suppose there is a Bull Moose movement in the Republican Party. I think it would be a good thing for the Republican Party. They need a little new life. At least, they had such a movement at one time, and a candidate for President on that ticket. Suppose there is another Burton K. Wheeler from the Senate, from the Rocky Mountain region, who wants to run for President. But he will find we have passed a bill to finance the campaigns of President Johnson and Mr. Romney or Mr. Nixon, but which would render penniless and place at great disadvantage any other man who might aspire to the Presidency of our country. Is this the kind of immobility that we wish to freeze into our political system?

What do we think the Supreme Court would hold in this regard? Is this fair protection of the laws, or is this discrimination? I say to the Senate that we are dealing with something fundamental to the Republic, something basic to the conduct of our system of government.

We are asked to pass this bill on a Saturday afternoon just before adjournment. I have not suggested the absence of a quorum, and under the arrangements I have worked out with the majority leader, it is going to be unnecessary for me to do that, I think. At least, this subject deserves careful and serious consideration because once the step is taken, it may be irreversible except by the Supreme Court.

That brings up several questions, to one of which I have already referred, the equal protection of the laws. We would protect two candidates for President, with all the millions of dollars of a political slush fund out of the public Treasury, but we would deny any support at all to the candidate of a new party or of an independent group. How can a liberal support that political philosophy? How can a conservative? How can a Republican who believes in the republican form of government? How can a Democrat, dedicated to the tenets of our society?

Equal opportunity for political advancement is as fundamental to our political system as is equality of opportunity for employment, education, or other rights and privileges which we seek to promote.

I started to refer to one other of the several questions of legality and constitutionality that come to mind with respect to this unusual proposal. This amendment proposes to permit a private citizen to appropriate public funds for a purpose of his own choosing.

I hold in my hand a tax form. For years we have sought to simplify the income tax return. Now we propose to start on a course which would surely complicate it further.

To get to the question of appropriation, here is a tax return, and let us make it simple—suppose that John Doe owes \$1 of income tax to the U.S. Government. That is his total tax liability, but it is his liability and he owes it. He attaches \$1 in currency to his tax form and posts it to the Internal Revenue Service.

Is that his dollar, or is that the property of the U.S. Government?

That is a dollar owed the U.S. Treasury, and constitutes public funds. Yet by this amendment he would have the privilege of appropriating that dollar for a political purpose.

Under the Constitution, the appropriation of funds is the responsibility of Congress.

Mr. LAUSCHE. Mr. President, will the Senator from Tennessee yield?

Mr. GORE. I am happy to yield to the Senator from Ohio.

Mr. LAUSCHE. If a taxpayer is given the right by statute to designate how his dollars shall be spent, and has the right to direct that it shall be spent in political operations, would it not follow that at some subsequent time Congress would enact a law giving the taxpayer the right to designate how his money shall be spent for other purposes? Therefore, if we embark upon that kind of program, where are we likely to end?

Assume someone comes into the Senate next year and proposes a similar procedure to designate how his tax money shall be spent, not related to elections but related to some other operation of the Government. The Senator from Oklahoma [Mr. MONRONEY] mentions designating that the money should be applied to retirement on the national debt.

I ask, what is the danger of establishing this kind of precedent?

Mr. GORE. If the precedent should be held constitutional, which I doubt, then it would be a dangerous one and, ere long, this tax form which we have sought to simplify would have a number of boxes on it. Suppose we had a box giving a taxpayer the election of whether any part of his funds could be used in the Vietnam war? There are a number of pacifists in this country who stoutly contend that it is immoral and illegal to require them to pay taxes to support a war which is contrary to their religious or their moral concepts.

The Senator from Vermont [Mr.

AIKEN] made, I thought, a novel suggestion, that the way to end the Vietnam war was for the Senate to pass a resolution declaring that the United States had won the war. This may not be without merit but, at least, I found it amusing, as I am sure the author did, with his fine sense of humor; but I do not think it would be humorous at all to have a referendum of American taxpayers declaring whether their funds should be used in support of the Vietnam war. But my point is, which the Senator from Ohio has brought up—and his point, too—that if we can give the taxpayer an election in one respect, then we can give him an election in many other respects.

MR. LAUSCHE. Yes. That is, if it is constitutional to allow him to specify that one dollar of his tax money shall be used to promote political campaigns, then it would follow that it is constitutional, too, to declare that he may designate what part, if any, of his money shall be used for the payment of the national debt, participation in the Vietnam war, earmarking money for the help of the aged, earmarking money for education, and every other aspect of governmental operations. I do not believe that can be done.

MR. GORE. Well, if it can, then this is a very dangerous precedent.

MR. LAUSCHE. Yes, that is, even if it can.

MR. GORE. If it can, then the precedent is all the more dangerous.

MR. SMATHERS. Mr. President, will the Senator from Tennessee yield?

MR. GORE. I yield.

MR. SMATHERS. I congratulate the Senator on the comprehensive and light manner in which he is discussing this proposal. Is it not a fact, however, that the proposal which was made by the President to permit a \$100 tax incentive for the purposes of financing the political campaigns of both parties, and others—the one I had was for \$50—was calculated to encourage the taxpayer to give money so that the financing of political campaigns could be removed from the charge that too many wealthy people and too many wealthy organizations were putting up all the money?

We are trying to make it possible to distribute the costs of campaigns over as wide a group as is possible, so that, in truth and fact, nobody, or no one group, or no one segment of our economy, can say, "We are the ones who financed the campaign," thereby having a hold on the one who got elected.

Is it not a fact that these proposals start out with the idea that there is going to be a benefit to the taxpayer if he makes the deduction? He gets a certain amount of reduction in his taxes. Is that not a fact?

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MR. GORE. Mr. President, there is a vital and a legal difference between funds remaining in the hands of the taxpayer as a result of a legal deduction against his taxable income or against his tax liability, which Congress could by law provide and, on the other hand, money which legally belongs to and becomes a part of the U.S. Treasury. The sums from which the taxpayer is allowed a deduction or a credit against his tax liability are still his. They never become public funds. The reverse is true in the instance provided here. These are public funds over which the taxpayer is given an election to appropriate for a specific purpose, or to deny the appropriation for a specific purpose—a very vital and legal distinction.

It has been suggested that this provision is copied after the procedure involving funds earmarked for the highway trust fund. I want to draw a clear line of differentiation there. When I drive up to a filling station and buy gasoline, I pay taxes on that gasoline. I have no choice. There is an excise tax upon my purchase. The Congress has passed a law which earmarks the receipts from those taxes into a highway trust fund.

Here, however, the taxpayer does the earmarking, not the Government. There is a delegation of appropriating responsibility which I do not think can meet the test of legality and constitutionality. But even if it does meet it, as I said earlier, then the precedent is the more dangerous.

If this amendment is enacted into law, it will add an estimated \$60 million to the sums available to the major political parties for use in presidential campaigns without any provision whatsoever to safeguard funds from corrupt practices.

While a clean elections bill dies on the calendar, we have this measure, as I said, to pour many millions of public funds into the political pot. The bill provides no protection against fraud or misappropriation of these public funds, to say nothing of inadequate safeguards surrounding the use of additional funds which the parties would continue to be free to raise and spend.

A great deal has been said on the floor of the Senate about how this is a clean elections bill. By what right is this called a clean elections bill? How does it clean the elections? Is there any provision here to safeguard the use of the money? Is there any inhibition therein as to the receipt and expenditure of other money from questionable sources? Not on your life, Mr. President. Indeed, the situation is made worse and the identity of the money is made more difficult because there is provided the commingling of public money with private money, good money with bad money. I think it makes more difficult the accomplishment of election reform, and yet this is called a

step in the right direction. I say it would be a dangerous step to our elective process.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. GORE. I yield.

Mr. LAUSCHE. Does this bill guarantee at all that there will be less money spent privately to win an election?

Mr. GORE. Not at all.

Mr. LAUSCHE. All that it does is state that the Federal Government shall provide about \$70 million a year, \$35 million for each of the parties, to conduct a presidential election after the parties have nominated their candidates in June or July of the election year. Is that correct?

Mr. GORE. That is correct.

Mr. LAUSCHE. Does it in any manner prohibit the parties that have received the \$35 million each in the election year from continuing the solicitation of contributions from private sources?

Mr. GORE. That subject has not even been touched. I believe it will result in pouring many millions of dollars into the major political parties' pots.

Mr. LAUSCHE. And if money implicitly wins elections, all this bill will do is give to the parties \$35 million in an election year and allow them to go out and solicit, with all their ardor and efforts, additional private contributions. Is that correct?

Mr. GORE. That is true, and there are no safeguards as to its use.

Suppose we were in a presidential year now and these funds were available and the Democratic Party felt very strongly that a candidate for Governor on the Republican ticket, in a pivotal State, must be defeated, or that the Republican Party felt that a Democratic candidate for Governor, who had great prospect for being President in the future, or that a particular Senator, must be defeated. They could spend the entire amount of the slush fund in one State.

Mr. LAUSCHE. I concur in what the Senator has stated. His description of what might be done is an illustration of the lack of consideration and study which has been given to the broad ramifications involved in such a program.

Mr. GORE. It illustrates the need for careful consideration of the enactment of a measure so new and revolutionary as this is and so big and important as this is.

Mr. LAUSCHE. Is it not a fact that the proponents of this measure state, "Allow us to spend about \$70 million of the taxpayers' money in an election year, and take our word that we will support needed reforms at a later time"?

Is it the thought of the Senator that the reforms ought to be adopted concurrently with the proposal that we spend \$70 million of the taxpayers' money before we go forward?

Mr. GORE. If we do not achieve reforms and protection concurrently with the extension of the use of public funds for our elections, then the difficulty of achieving reforms is increased, if not made almost impossible.

I am one who believes in the principle of one man, one vote. I have resisted amendments here to overturn the reapportionment decision, even though my State legislature passed resolutions asking me to vote the other way. I believe in the dignity of man and in the equality of man, the equality of opportunity, rights, and privileges. One of the rights which I believe should be equal is the right to aspire to political preferment, to which I have already referred. Another is the right to have an equal influence on the selection of public officials.

We know, of course, that a man with vast financial means, under our present system, can exercise far more influence upon the outcome of an election by the use of his pocketbook than can the lowly citizen by the use of his one ballot. I think that argues well for the use of public funds. But, ah, Mr. President, when we but add public funds to and commingle them with the campaign money now obtained from special interest sources, we make the situation worse instead of better, and we will lose, perhaps, the opportunity of making necessary corrections.

In my view, this Congress has not dealt with a subject more fundamental to our society and to our system of government than that which is under consideration now. I trust that this expression on my part will indicate to my fellow Senators why I have insisted upon the right to debate this subject, and the right to have the Senate—well, it is not my right to have the Senate reconsider, I suppose, but it is my right to seek reconsideration, on the part of the Senate, of a measure on which I think it acted too hastily, and a measure which received no public hearings in the House of Representatives, but was carried there in a conference report to be voted up or down.

If this provision is enacted, I do not know just how one conflict is to be resolved. We have an existing law which limits the Republican National Committee or the Democratic National Committee to an expenditure of \$3 million. Yet we are asked here to write into law a provision that will give each of them an estimated \$30 million to \$35 million in a presidential year.

How can the Senate do that? How can we do so without amending the Corrupt Practices Act, unless by so doing we condone illegal practices, and encourage and entice our two major political parties to violate the Corrupt Practices Act?

Of course, \$3 million is inadequate; we recognize that. I have said it many times. But it is the law. We condemn

violations of law and order. But now we would provide \$35 million to the Democratic National Committee, and leave untouched a law which limits its expenditures to \$3 million.

Mr. President, I am advised by the majority leader that in his opinion, a quorum of the Senate is available for a yea and nay vote. Therefore, I shall conclude with a few summary paragraphs, and then present to the Senate a motion.

Mr. MANSFIELD. I thank the Senator very much.

Mr. GORE. Money is a threat to clean elections, a threat to our entire elective process. Money is used to manipulate elections, to thwart public will, and to defeat worthy purposes, as well as to elect good candidates and to promote worthy causes. The lack of proper controls over the raising and spending of money in political campaigns poses the greatest danger to the democratic elective process. This danger arises from the sources from which such money is ob-

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tained and the uses for which it is obtained, and also from the amount of money spent in an election.

It is said that this measure would provide a clean source of campaign funds, free from the taint of special interest. Perhaps that is so. But the availability of large sums of Federal tax money for political campaigns would do nothing at all to restrict parties and candidates from raising additional sums, in whatever amounts and from whatever sources they see fit, however questionable. Indeed, as I have said, good money would be commingled with bad money. Federal tax money would merely be added to what is otherwise available. Thus, the bill would increase rather than decrease the influence of money in Federal elections, multiply its abuses, and make more difficult the enactment of a clean elections bill.

Mr. President, the Foreign Investors Tax Act, as proposed by the administration and as passed by the House of Representatives, was a good bill, designed to improve the U.S. balance-of-payments situation by attracting more foreign capital to this country.

Unfortunately and unwisely, as I have said at some length, the Senate Finance Committee and the Senate itself added numerous nongermane amendments, which converted a good bill into a grab bag special interest tax measure, which in my opinion was unworthy of the Senate. The bill as approved by the conference committee, I wish in fairness to say, represents some improvement over the bill as passed by the Senate, but it is still a bad bill, and should not be enacted into law. The bill still contains a large number of provisions which grant tax favoritism to certain types of income and to certain special-interest groups.

As I said in the beginning, this has been ably discussed in part already. Unless the motion I shall soon make is carried, I shall wish to discuss other points in the bill.

I note, in passing, that the part of the bill which had wide appeal to Senators, which would provide aid to many needy old people, was dropped from the bill. Their voices, the voices of the needy, went unheeded. In this respect, the bill is a less meritorious measure.

I plead with the Senate to take a course of action which would bring to enactment the one feature of the bill that is in the public interest, in my view, that part of the bill which deals with foreign investors, contained in title I of the bill. How can that be done? That can be accomplished by tabling the conference report and quickly calling up for consideration a minor revenue measure already passed by the House and on the calendar of the Senate, and attaching title I to that bill as an amendment and dispatching it to the House.

No conference would be necessary. In addition to the other strictures under which we operate, we are advised by our majority leader that the other body will have no more conferences with the Senate. However, here is a bill that will not require a conference. All that the House must do is accept a noncontroversial measure which has already passed the House without objections, along with title I of the bill, to which no objection was raised during the consideration of the bill by the other body.

Mr. President, the senior Senator from Delaware and the senior Senator from Tennessee, instead of being obstructionists and trying to prevent public interest legislation, have offered to cooperate in this respect and in many other respects.

Here is a method and procedure that could bring the foreign investors portion of the bill to enactment within an hour's time, and the Senate and the House could adjourn and go to the people before sundown on this Saturday afternoon.

I ask how the country would be ill served by postponing until January for further study this bizarre—

Mr. LAUSCHE. Monstrosity.

Mr. GORE. Amendment with respect to campaign expenditures out of the Public Treasury.

Mr. HICKENLOOPER. Mr. President, will the Senator yield?

Mr. GORE. I yield.

Mr. HICKENLOOPER. Mr. President, not being on the committee, I am not too familiar with the ramifications of this legislation, but from the slight exposure that I have had, I think it is the most odorous bill I have seen in many years. I think it is utterly indefensible. I think it stinks to high heaven. The bill contains various ramifications, and much log rolling has gone into the legislation.

I commend the Senator from Tennessee for his valiant fight. I do not know that anything can be done now, but this legislation is not good in the interest of reliable or honest public legislation.

Mr. GORE. Mr. President, I thank the Senator for his encouragement.

Mr. HICKENLOOPER. My encouragement will not do the Senator any good.

Mr. GORE. It may.

Mr. HICKENLOOPER. I merely commend him for his fight on this measure. This bill has many facets. I do not see how it could be consented to by any stretch of legislative imagination.

Mr. GORE. Does the Senator concur that the procedure I have suggested, and which was previously suggested by the senior Senator from Delaware, offers an acceptable and a rapid way to achieve the worthy purposes here sought?

Mr. HICKENLOOPER. I think so, in the main. I think the facets of the bill are worthy, but it is, like many other bills, a pork barrel bill. Certain things are worthy, but certain other things cannot stand the light of analysis.

Mr. GORE. If we must take it all or leave it all, I think we should leave it all on the table of the Senate.

Mr. HICKENLOOPER. That is the way I will vote, for the information of the Senator, but I am not sure that we have any leeway in the matter now. I think we are handicapped. I think we are circumscribed.

Mr. GORE. We are. It is a difficult circumstance under which to wage a parliamentary fight or legislative battle.

Mr. HICKENLOOPER. I congratulate the Senator on his worthy fight.

Mr. GORE. I thank the Senator. I hope that the motion which I shall soon offer will receive a rollcall vote and be approved. If not, I shall proceed to discuss some of the other features of the bill to which I have not had time to make reference.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. GORE. I yield.

Mr. LAUSCHE. Mr. President, when the bill was originally before the Senate, the Senator from Delaware [Mr. WILLIAMS] offered an amendment to strike all but title I from the bill.

I remind the Senator from Tennessee that he suggested to the Senator from Delaware that the amendment be modified so as to permit the retention in the bill of the aid contemplated for the old.

The Senator from Delaware responded to the suggestion made by the Senator from Tennessee. The Senator from Tennessee is aware that that most vital provision—the provision which would help the old—which was argued vigorously when the bill was before us a few weeks ago, is no longer contained in the bill.

Mr. GORE. The Senator is correct. I regret that it is not.

Mr. LAUSCHE. Mr. President, the Senator stated a moment ago that certain provisions in the bill are good. However, it seems to me that the proponents of this logrolling, pork-barrel bill used the bait of aid to the old and got the bill passed. They have since stricken from the bill the provision for aid to the old and have in the bill nothing but unjustified tax grants to privileged groups.

Mr. GORE. Mr. President, I wish to modify the observations of the senior Senator from Ohio to this extent: I am sure that members of the Senate conference committee were earnestly and sincerely in favor of the provisions that would have been so beneficial to many needy, old people. It was the conferees representing the other body who would not accept it, and the Senate conferees yielded.

Mr. LAUSCHE. Yes, they yielded; but does not that mean that if we thought aid to the old was the only amendment that should be added to the objective of imposing equitable taxes on foreign investors, the bill had better be defeated in its whole, rather than to go along with what it now contains?

Mr. GORE. I regret that that provision is out of the bill; and when measured as a whole, if that must be the measurement, then the bill is bad. It has good features, but the bad features outweigh the good, and the bill should be defeated. But there is a way—and I have suggested it—to accomplish the worthy purposes.

Mr. LAUSCHE. And I agree with the Senator. I have one further question.

Thus far we have established, I think, about six instances in which special-privilege tax relief is given to special groups. No extended discussion has been had about H.R. 10, which contemplates giving to lawyers, doctors, and other self-employed individuals certain tax privileges. My question is: If H.R. 10 is contained in the final version of the bill, will it give to the self-employed—

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that is, lawyers, dentists, doctors, and others—greater tax privileges than are accorded to the members of the social security system?

Mr. GORE. Oh, yes; vastly greater. They are given the unusual privilege—and it is a privilege which only the well-to-do, people having substantial income, will find attractive—of deducting from their otherwise taxable income \$2,500 a year to be invested in a pension plan for their own personal benefit. In other words, the Treasury of the United States will be paying part of their insurance premiums. I shall not discuss this point at length now.

Mr. LAUSCHE. But the fact is that members of the social security system

will have to pay a greater tax percentage than will members of the H.R. 10 program.

Mr. GORE. The most eloquent speech made in opposition to this proposal was made by the distinguished majority leader [Mr. MANSFIELD] on October 12. I shall not take the time of the Senate, since I am advised that a quorum is in town, to read it. However, I ask unanimous consent that the speech against H.R. 10, delivered by the distinguished Senator from Montana [Mr. MANSFIELD] be printed at this point in the RECORD.

There being no objection, the speech was ordered to be printed in the RECORD, as follows:

Mr. MANSFIELD. This amendment would double the tax benefits now available for the retirement savings of doctors, lawyers, and other self-employed individuals. Under present law, a self-employed individual may contribute 10 percent of his earnings—up to \$2,500—to his pension plan and take a tax deduction for one-half of this contribution. The proposal—which was the main purpose of H.R. 10 passed by the House in June—would make the full contribution tax deductible.

This amendment would result in an estimated revenue loss for the first year it is effective of up to \$30 million. For the second year, the estimated revenue loss would be increased to about \$50 million.

This amendment would divert substantial Federal tax revenue to provide tax reductions for a very narrow group of highly paid professional people, at a time when the possibilities of a general tax increase are very much in the public mind. Revenue-losing measures such as this could well push the President and Congress closer to such a general tax increase.

In more detail—

The experience to date clearly indicates that self-employed pension plans represent a tax reduction arrangement for the better-off professional man, with doctors heading the list. Over 75 percent of the revenue loss involved in the amendment would go to doctors, lawyers, and dentists. Indeed, one-half of the total revenue loss would go to individuals in these professions with incomes over \$25,000.

The amendment would represent an automatic tax reduction for those self employed already making pension contributions since, without any change in their contributions, their tax deductions will double. Two-thirds of the revenue loss—about \$20 million—for the first year would be directed to this automatic tax reduction—of which \$15 million would go to better-off professional people.

For the future, it is likely that the increased tax benefits will only serve to attract more of the same class of high income self-employed into pension plans. These plans by their very nature can have only limited value to the plumber, the small shopkeeper, or the farmer—the savings of these people are needed for their businesses, to meet the social security tax on their self-employment income, and for their family obligations—and therefore are not generally available to be set aside in private retirement plans, and none at all for the ordinary laborer, the fellow we used to call the “working stiff.” It is apparent that self-employed pension plans are attractive only to a class with liquid

assets and already possessing sufficient security so that some assets can be set aside permanently until retirement. The only class meeting these conditions is the better-off professional group. This has been borne out by the Canadian experience over more than 6 years under a similar pension arrangement for the self-employed. The benefits of this arrangement have been highly concentrated in the upper income groups.

I would suggest, with no disrespect to the distinguished Senator from Indiana, that if he wishes to pursue H.R. 10 as such, it ought to be considered separately, and not as a part of the measure pending before us.

Mr. LAUSCHE. As I understand, H.R. 10 now is fully in the bill.

Mr. GORE. H.R. 10 now is fully in the bill. I might say, in conclusion, that as this bill worked its tortuous way through the Senate, it became increasingly bad, and finally became so bad that both the majority leader and the minority leader voted against it.

Mr. President, I am advised by the distinguished and able majority leader, whom I have found most cooperative in this battle, that he is now prepared to ask for yeas and nays on a motion which I send to the desk and ask to be stated.

The PRESIDING OFFICER. The clerk will state the motion.

The LEGISLATIVE CLERK. The Senator from Tennessee [Mr. GORE] moves that the conference report on H.R. 13103 be laid on the table.

Mr. MANSFIELD. Mr. President, I ask for the yeas and nays.

The yeas and nays were ordered.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk called the roll.

Mr. LONG of Louisiana. I announce that the Senator from Nevada [Mr. BIBLE], the Senator from Idaho [Mr. CHURCH], the Senator from Alaska [Mr. GRUENING], the Senator from Washington [Mr. JACKSON], the Senator from New York [Mr. KENNEDY], the Senator from Missouri [Mr. LONG], and the Senator from Washington [Mr. MAGNUSON] are absent on official business.

I also announce that the Senator from Virginia [Mr. BYRD] is absent because of the death of his father.

I further announce that the Senator from Alaska [Mr. BARTLETT], the Senator from Tennessee [Mr. BASS], the Senator from Nevada [Mr. CANNON], the Senator from Illinois [Mr. DOUGLAS], the Senator from Mississippi [Mr. EASTLAND], the Senator from North Carolina [Mr. ERVIN], the Senator from North Carolina [Mr. JORDAN], the Senator from South Dakota [Mr. MCGOVERN], the Senator from New Hampshire [Mr. MCINTYRE], the Senator from Minnesota [Mr. MONDALE], the Senator from Utah [Mr. MOSS], the Senator from Oregon [Mrs. NEUBERGER], the Senator from West Virginia [Mr. RANDOLPH], the Senator from Connecticut [Mr. RIBICOFF], the Senator from Georgia [Mr. RUSSELL], the Senator from Alabama [Mr. SPARKMAN], the

Senator from Missouri [Mr. SYMINGTON], and the Senator from Georgia [Mr. TALMADGE] are necessarily absent.

On this vote, the Senator from Idaho [Mr. CHURCH] is paired with the Senator from Mississippi [Mr. EASTLAND]. If present and voting, the Senator from Idaho would vote "nay" and the Senator from Mississippi would vote "yea."

On this vote, the Senator from New York [Mr. KENNEDY] is paired with the Senator from West Virginia [Mr. RANDOLPH]. If present and voting, the Senator from New York would vote "yea" and the Senator from West Virginia would vote "nay."

Mr. KUCHEL. I announce that the Senator from Vermont [Mr. AIKEN], the Senators from Colorado [Mr. ALLOTT and Mr. DOMINICK], the Senator from Delaware [Mr. Boggs], the Senators from Kansas [Mr. CARLSON and Mr. PEARSON], the Senator from New Jersey [Mr. CASE], the Senator from Kentucky [Mr. COOPER], the Senator from New Hampshire [Mr. COTTON], the Senators from Nebraska [Mr. CURTIS and Mr. HRUSKA], the Senator from Hawaii [Mr. FONG], the Senator from Michigan [Mr. GRIFFIN], the Senator from New York [Mr. JAVITS], the Senator from Idaho [Mr. JORDAN], the Senator from Iowa [Mr. MILLER], the Senator from South Dakota [Mr. MUNDT], the Senator from Massachusetts [Mr. SALTONSTALL], the Senator from Pennsylvania [Mr. SCOTT], and the Senator from Texas [Mr. TOWER] are necessarily absent.

The Senator from Illinois [Mr. DIRKSEN] and the Senator from Vermont [Mr. PROUTY] are absent because of illness.

If present and voting, the Senator from New York [Mr. JAVITS] and the Senator from Hawaii [Mr. FONG] would each vote "nay."

On this vote, the Senator from Nebraska [Mr. CURTIS] is paired with the Senator from Idaho [Mr. JORDAN]. If present and voting, the Senator from Nebraska would vote "nay" and the Senator from Idaho would vote "yea."

On this vote, the Senator from Iowa [Mr. MILLER] is paired with the Senator from Nebraska [Mr. HRUSKA]. If present and voting, the Senator from Iowa would vote "nay" and the Senator from Nebraska would vote "yea."

On this vote, the Senator from Vermont [Mr. AIKEN] is paired with the Senator from Kentucky [Mr. COOPER]. If present and voting, the Senator from Vermont would vote "yea" and the Senator from Kentucky would vote "nay."

On this vote, the Senator from Pennsylvania [Mr. SCOTT] is paired with the Senator from Texas [Mr. TOWER]. If present and voting, the Senator from Pennsylvania would vote "yea" and the Senator from Texas would vote "nay."

On this vote, the Senator from Colorado [Mr. DOMINICK] is paired with the Senator from New Jersey [Mr. CASE].

If present and voting, the Senator from Colorado would vote "yea" and the Senator from New Jersey would vote "nay."

On this vote, the Senator from Massachusetts [Mr. SALTONSTALL] is paired with the Senator from Michigan [Mr. P. 27604]

GRIFFIN]. If present and voting, the Senator from Massachusetts would vote "yea" and the Senator from Michigan would vote "nay."

The result was announced—yeas 15, nays 37, as follows:

[No. 309 Leg.]

YEAS—15

Fannin	Lausche	Simpson
Gore	McClellan	Stennis
Harris	Monroney	Thurmond
Hickenlooper	Morse	Williams, Del.
Kennedy, Mass.	Murphy	Young, Ohio

NAYS—37

Anderson	Hill	Pastore
Bayh	Holland	Pell
Bennett	Inouye	Proxmire
Brewster	Kuchel	Robertson
Burdick	Long, La.	Russell, S.C.
Byrd, W. Va.	Mansfield	Smith
Clark	McCarthy	Tydings
Dodd	McGee	Williams, N.J.
Eltender	Metcalf	Yarborough
Fulbright	Montoya	Young, N. Dak.
Hart	Morton	
Hartke	Muskie	
Hayden	Nelson	

NOT VOTING—48

Aiken	Douglas	Miller
Allott	Eastland	Mondale
Bartlett	Ervin	Moss
Bass	Fong	Mundt
Bible	Griffin	Neuberger
Boggs	Gruening	Pearson
Byrd, Va.	Hruska	Prouty
Cannon	Jackson	Randolph
Carlson	Javits	Ribicoff
Case	Jordan, N.C.	Russell, Ga.
Church	Jordan, Idaho	Saltonstall
Cooper	Kennedy, N.Y.	Scott
Cotton	Long, Mo.	Sparkman
Curtis	Magnuson	Symington
Dirksen	McGovern	Talmadge
Dominick	McIntyre	Tower

So the motion to lay on the table was rejected.

Mr. LONG of Louisiana obtained the floor.

Mr. MANSFIELD. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. MANSFIELD. Mr. President, may we have order? And, most important, will Senators please remain within shouting distance?

The PRESIDING OFFICER (Mr. TYDINGS in the chair.) The Senate will be in order.

Mr. LONG of Louisiana. Mr. President, I should like to explain what the conference report contains. The Senate voted to adopt 49 amendments, when the floor amendments accepted by this body are included. Of the 49, the Treasury felt that only 5 were not good amendments. The rest of the amendments were recommended by or subscribed to by the Treasury.

The bill passed the Senate by a vote of 58 to 18. Every agreement between

Senate and House in the conference moved the bill more toward the position favored by the Treasury and the position of those who had at first objected to the bill. So from the point of view of those who objected at first, the bill is a much better bill.

The revenue loss is reduced by 85 percent.

Of the amendments that the Treasury objected to, four were drastically modified or dropped completely, and the only one we could not modify drastically was H.R. 10, which happened to be an amendment adopted unanimously by the House. It was a Senate amendment; therefore, we had no power to reverse the judgment of the House on that matter.

Mr. President, this is a good bill. The President thinks it is a good bill. The House by its vote thinks it is a good bill. When the House voted to take 49 Senate amendments and agree to the conference report, it seems to me that it is a report that can be agreed to.

Mr. GORE. Mr. President, I wish to express appreciation to the leadership and the membership of the Senate for the consideration which this issue has been given. I do not aspire to be the conscience of the Senate nor thus to hold myself out.

I, and other Members of this body, felt very deeply about this issue—so deeply that we felt in duty conscience bound to make a fight against the final congressional step in passage of a bill which, in one instance, provides numerous examples of stark tax favoritism, and in the other, a bizarre, unwise, and, I think, dangerous innovation of the use of public money for political campaigns and the commingling of public money with private money, at the election of private citizens, in the appropriation of public funds.

But I feel that with this brief statement I have performed my duty. I am still convinced that had the senior Senator from Delaware [Mr. WILLIAMS] and I had the audience of the Senate, which now seems impossible, this measure would be defeated. But this is not the last day in the history of our Republic. Congress will be back soon to correct mistakes that may have been made, or perhaps make others, as well as to accomplish good.

I know that there are present, in order to achieve a quorum, Senators whose health is not well served by this exercise.

I am advised that other Members of the Senate have deaths in their families, that loved ones are in critical condition. I shall not personalize, but I feel for those friends.

So, with appreciation, I wish to make a brief statement and then ask for the yea and nays on adoption or rejection of the conference report. It shall be

divided into two parts, but I assure Senators again it will be brief.

The distinguished junior Senator from Louisiana [Mr. LONG] spoke of certain provisions which the Treasury favors. I wish to suggest to Senators, not all of the instances of rank, stark favoritism, but just two or three to illustrate the point.

The senior Senator from Delaware [Mr. WILLIAMS] referred to one at some length earlier. Let me just read from page 7 of the conference report:

The Senate amendment (in proposed section 201) amends section 48(a)(2)(B) to include among the exceptions from the general rule with respect to property used predominantly outside the U.S. property which is owned by a domestic corporation (other than a corporation entitled to the benefits of section 931 or 934(b)) or by a U.S. citizen (other than a citizen entitled to the benefits of sec. 931, 932, 933, or 934(c)) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States. Under the Senate amendment, this provision was effective with respect to property placed in service on or after January 1, 1966 (but no carryback of an investment credit attributable to this provision was permitted).

I read this language to illustrate how difficult it is for Senators, and more particularly citizens unlearned in tax law, to read the technical terms of conditions set forth in a committee report or conference report and detect what has been done.

Now, what, in laymen's language, does this provide? It provides a tax benefit retroactively to one large United States corporation, in excess of \$2 million.

What is its justification? There is none, in my view, it extends the investment credit retroactively for a large aluminum plant, already constructed and already under operation, in the Virgin Islands.

When we passed the Investment Credit Act, it was for the stated purpose of encouraging development in the United States—modernization of our plants, Senators will remember—in order to meet competition from overseas. We did not extend it beyond the limits of the United States proper. So this company built its plant there, in the full awareness that it was to be built with no expectation of receiving the benefit of the investment credit.

As I said, the investment is already made, and the plant is already operating.

This amendment which has been attached to the bill is, as has been stated, one of the Christmas packages, because it gives more than \$2 million for no purpose in which there is a public interest.

That is the first point. I could discuss it more fully, but let me go to another.

I refer now to another amendment. I shall not undertake to read the technicalities of it. It is even more technical

than the one I have just referred to, but what does it do? It provides for a swap, a merging of a diversity of assets, without the payment of the capital gains tax. Several organizations are already under way. They have made their applications. They have filed their plans with the Securities and Exchange Commission.

The Treasury Department issued a regulation which would have outlawed—maybe that is the wrong term; would have closed a glaring loophole, from which concerns sought to obtain benefit. And what did the Senate committee do? It put in an amendment outlawing the Treasury regulation. Why? I do not know why. The Treasury was opposed to it. The Under Secretary of the Treasury was there. He referred to the provision as one of the most glaring loopholes that he had ever seen.

The conference committee enlarged the loophole, in a sense. It opened it wide in the amendment now before the Senate, in which the conference report repeals the Secretary of the Treasury's regulation, thus taking the course of those who sought to take advantage of the loophole, which the Treasury sought to close, giving them a free ticket and

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permitting them to say, "Let us move before it is too late." Any company that qualifies between now and January 1 can have free entry into the loophole.

What is the justification for that? I do not think there is any, in good conscience.

I could detain the Senate from now until midnight with a discussion of the inequities and the unfairness of the tax amendments that are tacked onto this bill. I shall resist the temptation to do so.

I should like to refer to H.R. 10 just briefly. For years the House of Representatives has passed this bill. The Senate has resisted. But when this grab bag comes along, providing a 150-percent increase in the depletion for the processors of oyster shells and clam shells, providing all these unwarranted benefits, the temptation is great for the Senate to vote to extend benefits to the high-income doctors, dentists, and lawyers, who, as stated in the majority leader's speech, will receive 70 percent of the benefits under the H.R. 10 amendment.

Mr. President, this is no bill for the benefit of the average workingman. This is a special interest bill insofar as the taxpayers are concerned. Yet we are one vote from sending it to the White House.

I would now like to make some brief references to the provision with respect to campaign financing. Unfortunately, I was unable to talk to several Senators who are now here. I wish to suggest to those to whom I did not have the privi-

lege of speaking earlier that this is not a clean elections bill. This makes the situation worse. The danger to our elective process is the use of money, the volume of money, and the sources of the money.

Granted this comes from a good source, it is commingled with all the private financing. How will you differentiate? It permits private citizens to appropriate public funds for purposes of their own choosing. Is not that unusual?

I am not sure that Congress can delegate such a responsibility, under the Constitution. If it can, the precedent is all the more dangerous. Because if a citizen can, by a checkmark on his tax return, appropriate money for political campaigns or deny it to a political campaign, he can deny it for the war in Vietnam; he can deny it for the war on poverty; or he can appropriate it for another particular purpose.

So I say if this is constitutional—which I challenge—then it is all the more dangerous. Because once we are on this road, the tax forms which we sought to simplify will have one more option after another. It may be that consumers will want the right to deny the use of their tax money for a farm program; or that farmers will want to deny the use of their tax funds for urban renewal.

What are we doing at a quarter to 3 on Saturday afternoon, October 22, when, after Herculean efforts, we have managed to obtain a quorum?

I plead with the leadership of the Senate, and more particularly with the leadership of the Senate Finance Committee and the House Ways and Means Committee, to stop this annual practice of bringing sugar bills and technical tax bills before Congress in the closing hours, when there is no time for adequate consideration. This is when unworthy purposes can most easily be accomplished.

But we are not here to accomplish unworthy purposes, though admittedly there are differences of opinion as to what purposes are worthy or unworthy.

Mr. President, I am prepared to ask for the yeas and nays.

The yeas and nays were ordered.

Mr. MANSFIELD. Mr. President, the Senator has made a good argument about the lateness of the hour on these bills coming into the Senate, and I assure him that I intend to do everything I can from now on to insure that that practice is discontinued.

Mr. LONG of Louisiana. Mr. President, I can respond in 1 minute to certain statements which have been made which I think reflect on the honor of my committee, and I believe that I should.

Reference has been made to the fact that the amendment dealing with investment credit in U.S. possessions would be retroactive to a January date. Mr. President, when we first put the investment tax credit in the law, we had a January 1 date, though the investment tax credit

law went into effect about the following August. As a practical matter, it was retroactive, and it went into effect the same day for every corporation in America.

All the amendment says is that companies doing business in American possessions such as the Virgin Islands, Puerto Rico, Guam, and American Samoa receive the same treatment as companies doing business in the United States. We have negotiated tax treaties with first one underdeveloped nation and then another, saying that American people doing business there get the same tax treatment which this amendment provides for our own island possessions. It is customary, when you pass a tax bill, to make its effective date either January 1 or the end of the fiscal year.

The PRESIDING OFFICER. The Senate will be in order.

Mr. LONG of Louisiana. Mr. President, I have explained these other items in great detail, and I shall not go into them now, because Senators wish to vote. I am prepared to explain it in greater detail after the vote is over.

Mr. WILLIAMS of Delaware. Mr. President, may I have 2 minutes?

The PRESIDING OFFICER. The Senator from Delaware.

Mr. WILLIAMS of Delaware. I do not wish to leave the RECORD confused. The effective date, as applied to the Virgin Islands refers to buildings completed after December 31, 1965, but the tax credit is allowed on machinery which went into the buildings in 1963 and 1964, or prior to that date. This bill provides a retroactive \$2 million tax reduction for one company only—Harvey Aluminum Co. Why?

In that connection, I ask unanimous consent to have printed in the RECORD at this point a list of contributions officers of this company made to the President's Club. In addition, the record shows that Harvey Aluminum was the purchaser of a \$15,000 full-page ad in the 1965 Democratic ad book.

There being no objection, the list was ordered to be printed in the RECORD, as follows:

Sept. 1–Dec. 31, 1965:

H. Harvey, 19200 Southwest Ave., Torrence, Calif.-----	\$1,000
L. M. Harvey, 19200 Southwest Ave., Torrence, Calif.-----	1,000
L. A. Harvey, 19200 Southwest Ave., Torrence, Calif.-----	1,000

Mr. WILLIAMS of Delaware. Mr. President, I wish to read into the RECORD a short quotation which seems to be particularly appropriate at this time when Congress seems to be in such an extravagant mood. This statement was made 175 years ago by Dr. Alexander Tytler, professor of general history, of the University of Edinburgh. I think it would be well for Senators to take heed to these words. This statement was

made at the time when our Government was first established, and was Dr. Tytler's comment upon this new democracy:

A Democracy cannot exist as a permanent form of government. It can only exist until the voters discover that they can vote themselves largess out of the public treasury. From that moment on the majority always votes for the candidate promising the most benefits from the public treasury, with the result that a democracy will always collapse from a loose fiscal policy (burden of large public debt), always to be followed by a dictatorship.

Mr. President, I hope Congress will take heed to this statement before we go too far down the road of taking care of special interests in special interest legislation on the eve of elections. It would be well to remember that as Members of the Senate we are supposed to pass tax legislation which benefits the American people as a whole and not just the few who happen to have a special pipeline into the Treasury.

Mr. MURPHY. Mr. President, all Americans are concerned about the astronomical cost of presidential elections. Private citizens, journalists, legislators, historians, political scientists, and other students of government have all recognized that presidential campaign costs have gotten out of line and that ways must be found to reduce them. A great deal of this added cost has resulted from the use of television.

It seems clear that unless Congress acts, the already astronomical campaign costs of television and radio will continue to soar. The Federal Communications Commission estimated that the total campaign expenditures for local, State, and national offices amounted to \$200 million in 1964. This figure represents a 25 percent increase from 1960. For television and radio alone, the Federal Communications Commission estimated for 1964 a cost that amounted to \$35 million, and the Broadcasting magazine estimated that the combined radio and television costs for 1964 was \$40 million, of which approximately one-half was for presidential election.

Mr. President, there is little question that the networks and stations using the airways occupy a special trust and owe

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a special duty to the American people. They are issued a license by the Federal Communications Commission and must serve the general public. In my judgment, both the Congress and the FCC should explore the possibility of requiring networks and stations to make available free time to the major parties on an equal time basis. I am convinced that the networks would be willing to do this and by so doing not only will they help to reduce the astronomical campaign costs but also would help to formalize the presentation of candidates and issues

to the American people. Donated time for presidential elections should help to elevate the campaign dialog, clarify the issues, better inform the American people and, hopefully, eliminate some of the bad judgment and poor taste that have appeared in political advertisements over the past years.

Mr. President, I, as much as any Member of this body, would hope that the Congress would focus its attention on the increasing cost of financing campaigns. I speak from experience. In representing the great and large State of California and having had to campaign on a shoestring, I fully realize the urgency of the problem and the need for immediate reform. Yet, I do not approve of the hasty manner in which we approved of the new method of financing campaign elections as an amendment to a bill that had nothing to do with campaign expenditures. Most Members of the body, I feel certain, did not have an opportunity to study and reflect on this issue as much as we would like. The end of a session, when legislation is coming out of committees so rapidly and it is almost impossible to study completely all of the hearings, reports, and bills, is not the time to pass a measure dealing with a subject that is so important.

Mr. SMATHERS. Mr. President, for 12 years the very able and distinguished Congressman from New York [Mr. KEOGH] and myself have worked diligently to bring about an effective retirement plan for some 18 million self-employed and their employees.

We were successful in bringing about the enactment of what is known as the Self-Employed Individuals Tax Retirement Act in 1962. This was progress, but not progress enough. The act fell short of providing equality of treatment compared to that accorded corporate employees in the same income bracket.

This year the House of Representatives by a unanimous vote passed an amendment that would permit the self-employed to deduct 100 percent of their pension fund contributions for themselves and their employees for the purpose of putting these individuals on a parity with others.

The Senate adopted an amendment to the Foreign Investors Tax Act containing the same provisions as passed by the House with one exception, and that is that the plan would become effective after the taxable year ending December 31, 1967. Because Congressman KEOGH and myself have served long enough in Congress to become conferees we were successful in getting the conference committee to accept this amendment.

Our hopes and dreams over the years have now been realized because the objective for which we worked has been achieved.

I sincerely trust that the President will waste no time in signing the Foreign Investors Tax Act with this amendment which now provides equality of treatment to those who have been discriminated against over the years.

This measure will be helpful to the farmer, the small businessman, doctors, lawyers, certified public accountants and many others, together with their employees and the Treasury will suffer only a modest loss of revenue that it will recoup to a major extent when the self-employed and their employees draw their retirement.

I urge the adoption of the conference report.

The PRESIDING OFFICER. The question is on agreeing to the conference report. On this question, the yeas and nays have been ordered, and the clerk will call the roll.

The legislative clerk called the roll.

Mr. LONG of Louisiana. I announce that the Senator from Nevada [Mr. BIBLE], the Senator from Idaho [Mr. CHURCH], the Senator from Alaska [Mr. GRUENING], the Senator from Washington [Mr. JACKSON], the Senator from New York [Mr. KENNEDY], the Senator from Missouri [Mr. LONG], and the Senator from Washington [Mr. MAGNUSON], are absent on official business.

I also announce that the Senator from Virginia [Mr. BYRD], is absent because of the death of his father.

I further announce that the Senator from Alaska [Mr. BARTLETT], the Senator from Tennessee [Mr. BASS], the Senator from Nevada [Mr. CANNON], the Senator from Illinois [Mr. DOUGLAS], the Senator from Mississippi [Mr. EASTLAND], the Senator from North Carolina [Mr. ERVIN], the Senator from North Carolina [Mr. JORDAN], the Senator from South Dakota [Mr. MCGOVERN], the Senator from Minnesota [Mr. MONDALE], the Senator from Utah [Mr. MOSS], the Senator from Oregon [Mrs. NEUBERGER], the Senator from West Virginia [Mr. RANDOLPH], the Senator from Connecticut [Mr. RIBICOFF], the Senator from Georgia [Mr. RUSSELL], the Senator from Alabama [Mr. SPARKMAN], the Senator from Missouri [Mr. SYMINGTON], and the Senator from Georgia [Mr. TALMADGE], are necessarily absent.

I further announce that, if present and voting, the Senator from Idaho [Mr. CHURCH], and the Senator from West Virginia [Mr. RANDOLPH], would each vote "yea."

On this vote, the Senator from Mississippi [Mr. EASTLAND] is paired with the Senator from New York [Mr. KENNEDY]. If present and voting, the Senator from Mississippi would vote "yea" and the Senator from New York would vote "nay."

YEAS—31

Mr. KUCHEL. I announce that the Senator from Vermont [Mr. AIKEN], the Senators from Colorado [Mr. ALLOTT and Mr. DOMINICK], the Senator from Delaware [Mr. BOGGS], the Senators from Kansas [Mr. CARLSON and Mr. PEARSON], the Senator from New Jersey [Mr. CASE], the Senator from Kentucky [Mr. COOPER], the Senator from New Hampshire [Mr. COTTON], the Senators from Nebraska [Mr. CURTIS and Mr. HRUSKA], the Senator from Hawaii [Mr. FONG], the Senator from Michigan [Mr. GRIFFIN], the Senator from New York [Mr. JAVITS], the Senator from Idaho [Mr. JORDAN], the Senator from Iowa [Mr. MILLER], the Senator from South Dakota [Mr. MUNDT], the Senator from Massachusetts [Mr. SALTONSTALL], the Senator from Pennsylvania [Mr. SCOTT] and the Senator from Texas [Mr. TOWER] are necessarily absent.

The Senator from Illinois [Mr. DIRKSEN] and the Senator from Vermont [Mr. PROUTY] are absent because of illness.

If present and voting, the Senator from Kansas [Mr. CARLSON], the Senator from New York [Mr. JAVITS] and the Senator from Hawaii [Mr. FONG] and the Senator from Kansas [Mr. PEARSON] would each vote "yea."

On this vote, the Senator from Nebraska [Mr. CURTIS] is paired with the Senator from Idaho [Mr. JORDAN]. If present and voting, the Senator from Nebraska would vote "yea" and the Senator from Idaho would vote "nay."

On this vote, the Senator from Iowa [Mr. MILLER] is paired with the Senator from Nebraska [Mr. HRUSKA]. If present and voting, the Senator from Iowa would vote "yea" and the Senator from Nebraska would vote "nay."

On this vote, the Senator from New Jersey [Mr. CASE] is paired with the Senator from Colorado [Mr. DOMINICK]. If present and voting, the Senator from New Jersey would vote "yea" and the Senator from Colorado would vote "nay."

On this vote, the Senator from Kentucky [Mr. COOPER] is paired with the Senator from Vermont [Mr. AIKEN]. If present and voting, the Senator from Kentucky would vote "yea" and the Senator from Vermont would vote "nay."

On this vote, the Senator from Michigan [Mr. GRIFFIN] is paired with the Senator from Massachusetts [Mr. SALTONSTALL]. If present and voting, the Senator from Michigan would vote "yea" and the Senator from Massachusetts would vote "nay."

On this vote, the Senator from Texas [Mr. TOWER] is paired with the Senator from Pennsylvania [Mr. SCOTT]. If present and voting, the Senator from Texas would vote "yea" and the Senator from Pennsylvania would vote "nay."

The result was announced—yeas 31, nays 22, as follows:

Anderson
Bayh
Bennett
Brewster
Burdick
Byrd, W. Va.
Dodd
Ellender
Hart
Hartke
Hayden

Clark
Fannin
Fulbright
Gore
Harris
Hickenlooper
Hill
Kennedy, Mass.

Holland
Inouye
Long, La.
Mansfield
McCarthy
McGee
Metcalf
Montoya
Morton
Muskie
Pastore

Pell
Proxmire
Robertson
Russell, S.C.
Smathers
Stennis
Tydings
Williams, N.J.
Yarborough

NAYS—22

Kuchel
Lausche
McClellan
McIntyre
Monroney
Morse
Murphy
Nelson

Simpson
Smith
Thurmond
Williams, Del.
Young, N. Dak.
Young, Ohio

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NOT VOTING—47

Aiken
Allott
Bartlett
Bass
Bible
Boggs
Byrd, Va.
Cannon
Carlson
Case
Church
Cooper
Cotton
Curtis
Dirksen
Dominick

Douglas
Eastland
Ervin
Fong
Griffin
Gruening
Hruska
Jackson
Javits
Jordan, N.C.
Jordan, Idaho
Kennedy, N.Y.
Long, Mo.
Magnuson
McGovern
Miller

Mondale
Moss
Mundt
Neuberger
Pearson
Prouty
Randolph
Riis
Russell, Ga.
Saltonstall
Scott
Sparkman
Symington
Talmadge
Tower

So the conference report was agreed to. Mr. BYRD of West Virginia. Mr. President, I ask unanimous consent that I may be permitted to read a statement entitled "Private Pension Plans for the Self-Employed," prepared by my distinguished colleague [Mr. RANDOLPH], who could not be present in the Chamber this afternoon.

THE PRESIDING OFFICER. Without objection, it is so ordered.

STATEMENT BY SENATOR RANDOLPH READ BY SENATOR BYRD OF WEST VIRGINIA

Mr. RANDOLPH. Mr. President, it is pleasing that the Senate has seized an opportunity to help many of our fellow countrymen make more adequate provision for their financial security in retirement. The Self-Employed Individuals Tax Retirement Act has been liberalized and will stimulate and assist self-employed individuals in establishing private pension plans for their own benefit as well as for that of their employees.

As Chairman of the Subcommittee on Employment and Retirement Incomes of the Senate Special Committee on Aging, I have been deeply interested in adequacy of retirement incomes. During the early part of 1965, our subcommittee held a series of hearings and issued a report on the subject of extending private pension coverage. In our report, we noted that during the past 30 years there has been a remarkable increase in the number of active workers covered by private pension plans and in the amounts of annual benefits paid under such plans.

Between 1930 and 1962, the number of workers covered increased from 2,700,000 to 23 million, an increase of almost ten-fold. Annual benefits paid moved up from about \$90 million in 1930 to approximately \$2,160 million in 1962. However, we found that the least progress in providing private pension coverage has been made in businesses and professional units with the fewest employees, most of which are owned and managed by those who are self-employed.

At our hearings, we were told that very few private pension plans have been adopted as a result of the Self-Employed Individuals Tax Retirement Act of 1962, due principally to the restrictions in that act which make pension plans unattractive to self-employed individuals. One witness testified that only 15,000 persons have been covered by plans under that act, compared with the 7 million which the Treasury Department estimated could be covered by such plans. Today, we have an opportunity to remove those restrictions and to make it possible for millions of self-employed persons and their employees to have the benefit of private pensions.

The only logical argument which can be presented against the progressive amendments to the Self-Employed Tax Retirement Act is that it would entail some revenue loss. We of the Subcommittee on Employment and Retirement Incomes believe it is more accurate to consider this not as a revenue loss, but as a wise investment in the material well-being of America's elderly and in the prosperity and health of the Nation's economy as it affects Americans of all ages. A pension expert testified at our hearing that each dollar of Federal revenue loss from funding private pensions contributes to the production of a minimum of \$5.50 and a maximum of \$12.20 of pension income in retirement. If any of us had an opportunity to buy a piece of land or purchase stock with the assurance that each dollar invested would be transformed into at least \$5.50, we certainly would not consider that we were wasting dollars without any return. We would consider that we were making a wise and sound investment. And that is how we should regard the so-called revenue loss.

By stimulating the adoption of private pension plans, we not only help the elderly who will receive the supplementary retirement income. We improve economic conditions for Americans of all ages. We do so, first, by encouraging the savings which go into pension plans, which finances an expansion of productive capacity. This, in turn, raises the standard of living. Furthermore, we make the Nation's elderly a buoyant influence upon the economy. This is especially helpful in times of depression and economic distress, when enhanced purchasing power of the Nation's elderly can help to im-

prove the economy. On the other hand, in times like the present when inflation threatens, contributions to pension plans can prevent overheating the economy. In these ways, there is an improvement in the health of the economy as it affects Americans of all ages.

[November 10, 1966]

[P. A5724]

Foreign Investors Tax Act—H.R. 13103

EXTENSION OF REMARKS OF

HON. RUSSELL B. LONG

OF LOUISIANA

IN THE SENATE OF THE UNITED STATES

Saturday, October 22, 1966

Mr. LONG of Louisiana. Mr. President, at the end of the debate on the Foreign Investors Tax Act, I indicated that I had forgone making a speech in rebuttal to the statements of the Senator from Tennessee [Mr. GORE] and the Senator from Delaware [Mr. WILLIAMS] because the majority leader had urged that if I did so, we might lose the quorum then available on, or near, the Senate floor. At that time, however, I indicated that I would insert such a rebuttal in the CONGRESSIONAL RECORD. This is that reply.

The portion of the conference report on the Foreign Investors Tax Act to which both the Senator from Tennessee [Mr. GORE] and the Senator from Delaware [Mr. WILLIAMS] objected has been called the "Christmas tree" bill or the "grab bag" bill. Since these are quick and catchy names, these descriptions of the bill have also appeared frequently in the press. Of course, a description of this type is likely to be believed, or accepted as true, if repeated often enough. This is a well-known technique used to undermine a bill or provision, but that, of course, does not mean that the description is accurate.

It must have occurred to my many colleagues who voted with me on this conference report that if the opponents—who referred to it as being full of special interest provisions—can cite only three or four cases no matter how hard they try, their case must be questionable.

Let us examine the conference report from that point of view. First, as to title I of the bill which accounts for the first 10 sections and 100 pages of the bill, no questions have been raised. This is the Foreign Investors Tax Act portion of the bill and both the Senator from Tennessee [Mr. GORE] and the Senator from Delaware [Mr. WILLIAMS] agree that this is good, desirable legislation. It will both help our balance of payments and improve the equity of the tax system as it applies to nonresident aliens and foreign corporations.

Problems have been raised as to the Long Act; namely, title III of the bill which deals with the Presidential Election Campaign Fund Act—and I shall discuss them in just a moment—but I certainly do not believe that anyone can say that this represents special interest legislation. I realize that both of the Senators who led the attack on the bill have raised questions with respect to this portion of the bill, but these certainly are five more sections that cannot in any sense of the word be categorized as special interest provisions.

The remaining titles to the bill, title II and title IV as agreed to by the conferees, contain 18 sections. As near as I can tell, the entire discussion of special interest legislation as it is described revolves around four topics, accounting for seven sections of the bill. In other words, 11 more sections, make good structural changes in the law to which no question has been raised. Moreover, a review of these 11 sections discloses that in all cases they were either specifically endorsed by the Treasury Department or no objection was raised with respect to them. I shall attach to the end of my statement a brief description of these 11 clearly good structural changes.

Let us now examine the four remaining issues which apparently are responsible for the moniker which has been attached to this bill.

INVESTMENT CREDIT IN U.S. POSSESSIONS

One of these is the provision dealing with the investment credit in U.S. possessions. This amendment merely extends the application of the investment credit, now applicable to domestic investments, to investments in U.S. possessions for 1966 and subsequent years, on the same basis as the credit has been available here in the continental United States from 1962 forward. There have been statements to the effect that the Virgin Islands or Puerto Rico or some other possessions are already providing tax benefits with respect to their tax systems and, as a result, further tax benefits are not needed. This view represents a misunderstanding as to how the provision works. The tax credit provided by the bill is not available to offset Virgin Islands or Puerto Rican taxes. The investment credit can only be taken with respect to investments made by domestic corporations or U.S. citizens with respect to their U.S. tax—not on any tax which may be due a possession. In addition, this provision was carefully circumscribed so that it would not be available to any U.S. corporation or citizen already receiving special tax treatment under U.S. law with respect to investments in the possessions. This primarily is the exclusion for such income provided by section 931.

Corporations which receive the benefit of this provision will be domestic corporations with investments in posses-

sions. They also must be corporations which are paying U.S. income tax with respect to those investments. The Finance Committee could not see why we should discriminate against investments of this type in our possessions. The committee could not see why these investments should be treated less favorably than investments here in the United States. I might add that investments made in possessions during the period when the domestic credit is suspended will not be eligible for the investment credit.

The principal objections which have been raised to this provision are that it

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is "retroactive" and also that it is "tailor made" for the Harvey Aluminum Co. First, let me say that this provision applies only to assets, the use of which has begun in the current year, 1966. In the past when practically any amendment beneficial to taxpayers has been enacted, it has been made effective as of the year in which the legislative action was taken. In other words, making this provision effective with respect to assets the use of which began in 1966 is wholly consistent with what has been almost the universal practice in this regard in the past. Moreover, when the domestic investment credit was first provided, it, too, was made effective back to the first of the year 1962 although this act did not become law until October 16, 1962. I see very little difference in the circumstances involving the two provisions, yet I heard no complaint about the domestic investment credit applying as of the first of the year in which enacted.

As to this provision being tailor made for one company, let me say that it should be obvious that in all of the various possessions of the United States certainly more than one company made investments during the calendar year 1966. It is ridiculous to assume that this provision will have application to only one company, and when tax returns for 1966 are filed, I am sure it will be shown that this charge is not true.

A bill to accomplish the objectives of the Senate amendment had been introduced in the House on August 24, 1965, giving everyone plenty of time to review its merits. The Finance Committee agreed to the amendment this year only after the Treasury Department advised the committee that it was consistent with administration policy.

SWAP FUND PROVISION

Let me now turn to the so-called swap fund amendment. The misunderstanding of the "possession" provision is only exceeded by the misunderstanding of the swap fund provision. Section 351 of the Internal Revenue Code provides that gain or loss is not to be recognized if property is transferred to a corporation

by one person, or a group of persons, solely in exchange for stock or securities in the corporation, and immediately after the exchange the persons, or group of persons, is in control of the corporation.

In 1959 and 1960 and in the forefront of 1961 the Internal Revenue Service ruled that a group of persons holding stock in various companies could contribute this stock to a newly formed mutual fund corporation and receive in exchange for their contribution shares of this mutual fund. These are the so-called swap funds and the Service in these years ruled in 11 cases that there were no tax consequences resulting from the formation of one of these swap funds. It is true that beginning in 1961 the Service has not issued rulings on the tax status of the formation of swap funds. However, many private tax lawyers considered the formation of these funds to be a nontaxable transaction and operating on their advice a number of funds have been formed since that time.

Then, on July 14, 1966, the Treasury for the first time published regulations holding that the formation of these swap funds constituted a taxable transaction. At the time the Treasury took this position it offered closing agreements to existing swap funds which would provide that for past transactions, for all purposes of the tax laws, the formation of these funds would not constitute taxable transactions. In other words, for the future the Treasury applied its position as to what the law said, but because of the uncertainty which had previously existed it did not apply this position for the past. The effect of what Treasury did was to say that for the past, exchanges with swap funds were tax free, but for the future they were taxable.

Those concerned with swap funds initially made representations to members of the Finance Committee to the effect that the new regulations reversed the effect of the law even though there had been no change in the wording of the law. In other words, their position was that the Treasury was legislating by regulation. The majority of the Finance Committee voted to make it clear that swap funds were covered by section 351. I voted against this amendment in committee because I considered swap funds to be a loophole. While I understand the Treasury's opinion, nevertheless, I personally believe the Treasury's regulations do not reflect the clear wording of the law. In my opinion the tax-free formation of swap funds was provided for by the language of section 351.

I am glad to say that the conferees on the Foreign Investors Tax Act completely reversed the position on the Senate Finance Committee amendment. The action taken by the conferees makes it perfectly clear that the formation of swap funds will be viewed as a taxable transaction in all cases where exchanges are

made on or after July 1, 1967. Moreover, in the case of funds requiring registration with the Securities and Exchange Commission, registration statements must be filed by December 31 of this year and the stock of prospective shareholders must be on deposit with the funds by May 1, 1967. It was the view of the conference that the various tax-free exchange provisions of the code should not permit the tax-free diversification of investment assets.

In other words, the conference committee action in this case completely confirms what the Treasury sought to do by regulation. Moreover, it provides a statutory basis for this action which, in my opinion, the regulations of the Treasury did not have. It is true that this will cover funds where registration statements are filed with the SEC up to the end of this year. However, this, too, is in keeping with the concept in the Treasury regulations which provided tax-free treatment for all funds in certain stages of process up to the time of the issuance of the regulations. This provides essentially the same treatment for funds which have been started before the end of this year.

It is also worth pointing out that the conference committee action not only gives a statutory base for the Treasury regulations but that it in several respects provides a tighter rule than did the regulations. For example, under the conference committee action tax-free treatment is denied real estate swap funds and investment companies which have too few shareholders to be required to register with the SEC and the denial applies whether or not brokers or other intermediaries organize the fund where shareholders have rights to redeem their holdings at their option.

The conference committee action results in a much more restrictive provision than the Treasury regulations sought. As a result, it seems clear to me that what we have here is a "loophole closer" instead of a "loophole opener."

H.R. 10

Let us now turn to the third area of complaint with the Foreign Investors Tax Act. I refer here to the so-called H.R. 10 amendment, or the amendment which enlarges the deductions available to self-employed persons where amounts are set aside for their retirement years. I cannot say that I personally like this amendment. After all, the main thing that this amendment does is provide that when these self-employed persons set aside amounts for their retirement, they can deduct the full 10 percent of their wages up to a total of \$2,500, rather than one-half of this amount. I do not like this amendment because the principal provision it repeals was my own amendment several years ago, which I fought for and obtained on the floor of the Sen-

ate. The thrust of my amendment was to treat contributions for self-employed persons' retirement essentially like contributions are treated under the social security and railroad retirement system. In both of these instances—and in those instances where private pension plans are provided on a contributory basis—the employer's share of the total contribution is deductible for tax purposes but the employee's share is not deductible. Since we were dealing with self-employed persons in a dual capacity, I felt, and the Congress agreed with me in 1962, that giving a deduction for half the contribution would place self-employed persons on a par with employees. However, this year H.R. 10, repealing my amendment, was passed by the House by a vote of 291 to 0. The provision as an amendment to the Foreign Investors Tax Act was also separately acted upon, on a favorable basis, by the Senate. I think it is clear—although I personally disagree—that the majority of both the House and the Senate favor this amendment. I am not one to believe, even when I am in the minority, that minority rule in this respect should govern.

In all fairness to the advocates of this amendment I must admit that there are many cases under the prior law where self-employed individuals are much more severely limited in the amounts they may set aside for their own retirement than is true of many of the well-paid employees and managers of many of our largest companies. Many of their plans are not contributory and, therefore, if one were to equate the self-employed individual with these persons, then the 50 percent deduction should not be required. Actu-

[P. A5726]

ally, in my judgment, the whole area of the tax treatment of private pension plans needed reconsideration before this amendment was acted upon, and will still need reconsideration after the adoption of this amendment. In some cases self-employed individuals will have advantages over employees and in other cases they will be at a disadvantage. In my view, we probably will eventually want to see whether it is possible to more nearly equalize the treatment. In the meanwhile, however, I see no reason why we should insist upon a minority view prevailing over the majority view.

PERCENTAGE DEPLETION

The fourth area of complaint is concerned with the provisions relating to percentage depletion. Of course, there are people who fundamentally disapprove of percentage depletion, as such. To them any amendment in the area of percentage depletion is automatically wrong if it gives one cent more of deduction to anyone, simply because they do not agree with the underlying principle involved in percentage depletion.

— It seems to me that as long as we have percentage depletion in our tax system—and parenthetically I might add from my point of view this is something I hope is here for a long time to come—it is entirely appropriate that the percentage depletion rates be adjusted in a manner which allows for the competitive nature of the products. In other words, where two or more products are used for essentially the same purpose, good tax treatment—namely, the considerations of equity and fair competition—demands that they receive approximately the same percentage depletion deduction. This is no new, radical doctrine I am proposing here. This is, instead, the fundamental basis on which most of our percentage depletion rates are based at the present time.

Let us look now at the specific areas where the percentage depletion rates were changed, and I should point out that as a result of the conference committee action it is only a change in rates which occurred. No additional processes were classified as mining processes for any mineral. This is the area that the Senator from Tennessee [Mr. GORE] was so concerned with a number of years ago. We have not in the slightest modified the concepts of the mining processes, on which percentage depletion is based, from the concepts in present law which remains as he provided by legislation in 1960.

The first area in which a percentage depletion rate was made was in the case of domestic deposits of clay, laterite, and nephelite syenite, but only to the extent that they are used for the extraction of alumina or aluminum compounds. The percentage depletion rate for these minerals was raised from 15 to 23 percent. This only seems fair since this is the percentage depletion rate which presently applies to domestic deposits of bauxite, the principal source of alumina and aluminum. It also is the rate which applies to another site to the extent that alumina and aluminum compounds are extracted from it. The Finance Committee believed that a good case could be made not only for these percentage depletion rate increases but also for more liberal treatment with respect to mining processes. However, the House conferees would not agree to any changes in mining processes. Nevertheless, it is hard for me to see how anyone could object to treating these different sources for alumina and aluminum the same as we already treat the principal source for alumina and aluminum.

The second percentage depletion rate change applies in the case of clam and oyster shells. Now I am aware of the fact that percentage depletion for clam and oyster shells is a source of amusement for many who are unacquainted with the extent to which clam and oyster shells in the entire gulf area are used

as a substitute for limestone. The clam and oyster shells referred to in this act are those which have lain at the bottom of the sea for many hundreds or thousands of years. The ownership in these shells is in either the Federal or a State Government. The Government leases to private parties the right to remove these shells from certain specified areas. This gives them a right to property which is exhaustible and which is, therefore, eligible for percentage depletion. This is exactly the same concept which applies generally with respect to percentage depletion.

Clam and oyster shells of the type I have referred to already receive percentage depletion at the rate of 5 percent. However, clam and oyster shells in many cases are ground up and used for their calcium carbonate content in making cement.

Limestone—which also is essentially calcium carbonate—in other areas of the country is used for almost the identical purposes for which clam and oyster shells are used, yet limestone, except when used for road material or similar purposes, receives a 15-percent depletion rate. When it is used as gravel for making roads, the depletion rate is limited to 5 percent. All this amendment does is to give precisely the same treatment to clam and oyster shells which is already available in the other areas of the country where limestone is used for the same purposes. In other words, where clam and oyster shells are used as a substitute for gravel in making roads, the 5-percent depletion rate as at present will continue, but when clam and oyster shells are used for making cement, as in the case of limestone, the 15-percent rate will be available. Realistically, this does no more than give the same treatment to deposits of calcium carbonate found under water as is already accorded deposits of calcium carbonate found on land. This merely removes a competitive discrimination.

The final two percentage depletion rate changes represent very small changes indeed. The Senate action would have added sintering or burning to the processes classified as mining processes in the case of clay, shale, and slate used or sold as lightweight aggregates. These frequently are used for this purpose in concrete or in making cinder blocks. The Senate action, as a result of a floor amendment, would also have increased from 5 to 15 percent the percentage depletion rate applicable for clay and shale used in making sewer pipe and brick. In these cases the primary consideration was that other products used for similar purposes received a higher percentage depletion rate, or received more favorable treatment in the processes classified as mining processes.

In the case of clay used for sewer pipe, for example, this pipe is in competition

with concrete sewer pipe and the materials used in making the cement which goes into the latter is eligible for 15-percent depletion rate. It was on this basis that the increase in the rate from 5 to 15 percent was justified on the Senate floor. In the conference committee consideration of this, however, it was noted that contrary to a clay sewer pipe, only 15 to 20 percent of a concrete sewer pipe consists of cement. The remaining aggregates are sand and gravel which receive a 5-percent depletion rate. Because of this additional information available to the conferees, which was not available at the time this matter was considered on the floor of the Senate, the Senate conferees agreed that the depletion rate should be adjusted upward by merely 2½ percent, rather than by the 10 percent which would have been provided by the Senate amendment. As I have suggested, this was agreed to because of the realization that in the case of the clay pipe, the area of competitive discrimination is limited to 15 to 20 percent of the total value of the pipe. This represents a modest change in the depletion rates and one which is justified on the basis of the present competitive situation.

The Senate amendment relating to lightweight aggregates dealt with the treatment processes which were to be considered part of the cost of mining in working out the percentage depletion allowance. The House conferees, as I have indicated, were not willing to make any change in the treatment process provisions but they could see the merit of a larger deduction for these products when used as lightweight aggregates. The conferees decided to take the direct approach of giving a slightly larger depletion allowance rather than the indirect approach of increasing the base on which the present depletion allowance would be based.

THE LONG PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

It seems that the charges of special interest legislation which have been so freely flung at this bill evaporate into thin air once the facts are examined. Let me turn now to the area of political campaign contributions.

First, let me make it clear that this is an area on which the Senate Finance Committee has held hearings. An earlier version of the amendment adopted by the committee was presented in these hearings for consideration by the committee. This is also true of various other plans, including the tax deduction plan favored by the Senator from Delaware [Mr. WILLIAMS]. I might also add that the problem of political campaign contributions has been discussed on the

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Senate floor not merely in connection with this bill but also in connection with

earlier legislation. At the time we last raised the debt limitation the Senator from Delaware [Mr. WILLIAMS] sought to amend that bill with his provision providing for political contribution deductions. The matter was extensively considered by the Senate at that time and rejected. However, this proposal was analyzed in hearings on political contributions held by the committee as I promised at the time.

This is a matter which has been considered extensively, not only in the current year but in past years as well. As the Senator from Tennessee [Mr. GORE] indicated, this is a problem which he had under study some 10 years ago. The problem with these past studies, however, is that they were just studies—no action was taken. I can well understand this, because the area of political campaign contributions is a multiple problem. It is a problem which, in part, is appropriately considered by one committee and, in part, by other committees. In the past it has been difficult to obtain action on this problem because of the feeling that it was impossible to act on any one of these problems until action had been completed on the others. This, in turn, prevented action by all of the committees. Senator CLARK made this aspect of the situation quite clear in his discussion of the Presidential Election Campaign Fund Act.

I should make it clear that I do not consider the Long Act as a full answer to all of the problems in connection with political campaign contributions. First of all, this deals only with presidential campaigns. It may well be that after we see how this provision works in the case of presidential campaigns we may want to extend either this provision or some modified version of it, to cover congressional elections. I do not know the answer to this, and I think it would be unfortunate for us to reach an inflexible position in this regard until after we have tried this provision for a period of time in the case of presidential campaigns.

Second, I want to make it clear that in my view this bill does not replace the need for additional legislation regulating political contributions or requiring disclosure of the source of political campaign contributions. Moreover, this does not deal with other issues which we may have to face with respect to the division of television time or what organizations can properly make campaign expenditures. These are all issues, however, as to which it will be easier to come up with specific answers after my amendment is a part of the law, because it will give assurance of adequate financing for the most important of all political campaigns.

Nor do I contend that my provision itself even in the limited area in which it is intended to operate is, in all respects,

necessarily a perfect answer to the problem. I am sure that modifications will be necessary as we gain experience under this provision. Nevertheless, I view the Long Act as major legislation which will give assurance that presidential candidates are not necessarily obligated to any financial interests as a result of the necessity to raise funds to finance their campaigns. There are sizable groups of citizens in our country who suspect that these financial contributions have influenced governmental decisions. We should remove this shadow and prevent the possibility of anything like this in the future. To me this is the most important aspect of my amendment.

I realize that some say, "But you haven't prevented the other campaign contributions from being made in addition to the funds provided by your bill." I have two answers to this: first, as I have already indicated, this is not the last time that I expect legislation to be passed with respect to political campaign contributions. I will be prepared to support limitations to outlaw private contributions to presidential campaigns when such legislation is before the Senate, and now that we have assurance of adequate financing for presidential campaigns, it will, for the first time from a practical point of view, really be possible to consider limitations such as I have referred to.

Obtaining funds on a very small basis from a very wide group of our citizens is the best possible way of being sure that no financial group can be said to have gained undue influence. Others have tried to find a way of obtaining this broad participation through tax deductions or credits. However, the effort which would be required to obtain these contributions in amounts as small as \$1 from so many people raises the collection costs under these other devices to such an extent as to make them impractical. Moreover, a tax deduction or even a tax credit tends to provide more of an incentive for those in the higher income groups to make contributions than for taxpayers of more modest means. This is a kind of selection that I think is undesirable in attempting to influence political contributions.

Some have objected to my plan because it requires individuals to check a box on their tax return. What are the alternatives that we most frequently hear? The suggestions most usually made are for a tax deduction or tax credit. These involve not merely a checkmark on the tax return but also the recording of specific contributions made, and still leaves us with the auditing problem of determining whether, in fact, the contributions were made. The tax problems in these alternative solutions are much more complex and difficult than the simple checkmark on the tax return which the amendment provides.

Moreover, a tax deduction or credit to be verified must be checked with the party to whom the contribution was given. Who wants the internal revenue agents in examining his return to obtain information on his political affiliation?

In the absence of finding any other basis for objection to the Long Act, it is sometimes claimed that this is undesirable because individuals under this system are, in effect, designating how governmental funds are to be spent. To me the interesting thing about this argument is that those who make this charge fail to recognize that a deduction or tax credit for political contributions just as effectively takes money which would otherwise go into the Public Treasury and diverts it to another purpose. The only difference I can see in this regard is that the tax deduction or tax credit schemes divert the money just before it reaches the Treasury. Moreover, instead of diverting the money to the political campaigns, these deductions or credits merely recompense the taxpayer for part of the contribution he has already made. Moreover, frequently they repay the taxpayer needlessly for contributions he would have made in any case. There is no such waste under the amendment in this bill.

I have explained the mechanics of the Long Act previously, so I see no need to repeat it here. However, there are a few points that I would like to emphasize. First, this amendment treats equally all parties receiving 15 million votes or more. As a result, this will not favor the party in power.

Second. Provision is made for minority parties under this bill. Any party receiving 5 million votes or more—a 5 million deduction is provided not only for minority parties but for major parties as well—receives political campaign funds based upon its vote over 5 million, and if it reaches the 15 million vote level, is treated equally with the major parties. This is an honest attempt to give proper recognition to minority parties in this area of political contributions but not at the same time be unrealistic and eat fragment parties on the same basis as major parties. I believe that this represents a fair solution to this problem, and I am certainly willing to consider modifications in the future should the need to do so be established.

Third. This amendment is limited in several respects. Major parties cannot receive more than an equal share of the funds based upon the vote in the last presidential election. Therefore, even if taxpayers should check their tax returns freely in this regard, only limited funds would be available for expenditure. The funds are available only for presidential campaigns, and the Comptroller General is specifically authorized to examine the statements presented to him and to audit the books of the political parties to be sure that the contribu-

tions are spent for presidential campaigns and not for congressional or gubernatorial campaigns, and not for personal use, distinct from political purposes.

Fourth. It has been said that this provision runs contrary to the limitation in present law limiting contributions to political committees to \$3 million in any year. Those who say this cannot have examined the bill or present law very closely. Present law refers to contributions to political committees. The bill actually has nothing to do with contributions. The term "contribute" means to give or supply in common with others; to share in a joint effort. The financing by the Government after the passage of this bill is not a voluntary, joint effort to give funds. Rather, it is an appropriation of funds to which the parties have a right. Moreover, it

[P. A5728]

is not part of a joint effort. As a result, it is not a contribution and, therefore, does not come under the limitation of present law. Moreover, it involves a payment to political "parties" not payments to political "committees." As a result, it should be clear the present \$3 million limitation does not apply.

Fifth. Some have objected to the fact that the contribution in this case is divided between, or among, the major parties. Some have indicated that they would prefer making all of their contribution to one party or the other. This, of course, is not the way to assure good government. It may be a way of electing one party over another—by supplying it with a better financial base—but it does not assure good government. The way to assure good government is to be sure that sufficient campaign funds are available to both, or all, major parties, so that their positions can be fully understood by the electorate. It is only a well-informed electorate that can assure the continuation of our representative form of government.

Sixth. It has been suggested that there are no safeguards to prevent misuse of the funds made available to the political parties by this provision. Actually present law provides about as strict a fraud statute as can be imagined. Section 1001 of title 18 of the code specifies:

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or documents knowing the same to contain any false, fictitious or fraudulent statement or entry shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

Certainly I would not object to other safeguards being written into the law to prescribe even more definitively how

these funds may be used and how they many not be used, but I do feel that those who say there presently are no safe-guards have overstated their case.

Contrary to the general impression that some have tried to create, this is not a hastily concocted scheme.

It has long been suggested that Government should find some way to help finance the cost of these campaigns. Theodore Roosevelt suggested nearly 60 years ago that this should be done with public funds. Later the Special Committee To Investigate Campaign Expenditures of presidential, vice-presidential, and senatorial candidates in 1936 suggested that private contributions to political campaigns be prohibited entirely and that instead all election expenses should be defrayed from public funds. In 1959, Jasper B. Shannon, professor of political science at the University of Nebraska, recommended a similar plan in his book "Money and Politics." Earlier this year Prof. John Kenneth Galbraith suggested, in connection with State offices, that the Government "provide every regularly nominated candidate with a public grant of sufficient size to enable him to get his name, merit if any, and platform before the people. These grants would be available to candidates for statewide office, the general court and for the senate and house of representatives."

I introduced a bill on June 15 of this year to provide funds from the Treasury to help defray the cost of presidential campaigns. In doing this I was largely implementing a thought which had been before the people for discussion for nearly six decades. This is a matter which I have been studying for over a year and it is a matter which has been thoroughly analyzed by the Senate Finance Committee. The best minds of the staff of the Finance Committee and the staff of the Joint Committee on Internal Revenue Taxation, the Senate Legislative Counsel, the experts of Treasury, as well as other advisors to the President and the senior members of the House Committee on Ways and Means have all contributed meaningfully to the effort to find a proper answer. This is an important building block on which we can build a proper system for controlling political campaign contributions. Moreover, it is the first answer to this problem of financing political campaigns for which it has been possible to obtain majority support from Congress. This in itself is an important achievement in such a controversial field as this.

Let me conclude my comments on the presidential political campaign financing by saying that I consider this one of the most important and constructive pieces of legislation passed by Congress this year. I believe time will show that what I have said is true.

ELEVEN NONCONTROVERSIAL STRUCTURAL CHANGES

As I indicated previously, the bill includes 11 structural changes not relating to the Foreign Investors Tax Act but about which no questions have been raised. These are not hastily put-together provisions. For the most part they represent provisions which have been carefully studied by the tax committees and their staffs. Three of these provisions, for example, had been considered and were reported favorably by the House Committee on Ways and Means. Moreover, the provision relating to "straddles" had been the subject of an extensive technical study by the staff of the Joint Committee on Internal Revenue Taxation in cooperation with the Treasury Department staff. The provision relating to per unit retain allocations of cooperatives is a matter studied over a long period of time both by the affected industries and also by the technical staffs of Congress and the Treasury Department. Three of the structural changes constitute improvements in the interest equalization tax which have been carefully studied by the staffs. Another of the amendments provides for an annual report on contingent liabilities and assets available to cover them. This report is one Senator SALTONSTALL has sought for some time and is one which should aid all of us in getting a better insight of the Government's financial status. The Finance Committee had recommended the Saltonstall amendment to the Senate back in the 88th Congress and again in the 1st session of the 89th Congress. On both occasions the Senate approved the bill without objection.

These 11 amendments can be summarized, as follows:

First. Corporate acquisition of assets of another corporation: Under present income tax law, the purchase from an unrelated party by one corporation of at least 80 percent of the stock of another corporation followed by the liquidation of the acquired corporation within 2 years is treated as a purchase of the assets of the acquired corporation. This amendment expands the definition of "purchase" to include the purchase of stock from a 50-percent owned subsidiary if stock in the 50-percent owned subsidiary was also acquired by purchase. The change is to be effective with respect to acquisitions of stock made after December 31, 1965.

Second. Self-employed persons retirement plans—certain income of authors, inventors, and so forth: This amendment modifies present income tax law relating to self-employed individuals' retirement plans to permit authors, inventors, and so forth, to include gains—other than capital gains—from sales and other transfers of their works in their earned income base for the purpose of

computing deductions for contributions to such plans. This change will be effective for taxable years ending after the date of enactment of the act.

Third. Exclusion of certain rents from personal holding company income: This amendment provides, for taxable years beginning after the date of enactment of the act—and certain earlier years at the election of the taxpayer—that rent received from the lease of tangible personal property manufactured by a taxpayer is not to be treated as personal holding company income.

Fourth. Straddles: This amendment provides that, with respect to straddle transactions entered into after January 25, 1965, the income from the lapse of an option which originated as part of a straddle is to be treated as a short-term capital gain—instead of ordinary income. This permits it to be netted against any capital loss which may result from the exercise of the other option in the straddle while retaining what in most respects is ordinary income treatment for any excess of net short-term capital gain over net long-term capital loss.

Fifth. The taxation of per-unit retain allocations of cooperatives: This amendment clarifies present law dealing with the taxation of cooperatives and patrons to assure that a current single tax is paid, at either the cooperative or patron level, with respect to per-unit retain certificates. In so doing, the amendment makes the treatment of these certificates generally comparable to the treatment of patronage dividends under present law.

Sixth. The excise tax on hearses: This amendment provides that the sale of an ambulance, hearse, or combination ambulance-hearse vehicle is to be considered to be the sale of an automobile chassis or automobile body—rather than a truck [P. 45729]

chassis or body—for purposes of determining the manufacturers excise tax on motor vehicles. This change applies with respect to articles sold after the date of enactment of the act.

Seventh. Interest equalization tax—raw material source loans: Subsequent transfers of debt obligations to assure raw material sources are to be exempt from the interest equalization tax where the indebtedness is acquired without an intent on the part of the purchaser to sell it to other U.S. persons. This change is to be effective with respect to acquisitions of debt obligations made after the date of enactment.

Eighth. Interest equalization tax—certain acquisitions by insurance companies in developed countries: The present exemption for reverse asset pools of U.S. insurance companies is extended to allow the establishment of reserve asset pools where a U.S. insurance company commences activities in a developed country or where a less-developed country is designated as a developed country. This amendment is to take effect on the day after the date of enactment.

Ninth. Interest equalization tax—Euro-dollars: The President is given the authority to exempt from the interest equalization tax U.S. dollar loans of more than 1 year made by the foreign branches of U.S. banks. This change is to apply to acquisitions of debt obligations made after the date of enactment.

Tenth. Treasury bonds or certificates payable in foreign currency: This amendment expands the debt management authority of the Secretary of the Treasury to permit the issuance of U.S. notes payable in foreign currencies. This authority already exists in the case of bonds and certificates of indebtedness.

Eleventh. Reports on Federal contingent liabilities and assets: This amendment—as modified in conference—requires the Secretary of the Treasury to submit a report to the Congress each year indicating the full contingent liabilities of the Federal Government and the assets of the Federal Government which might be made available to liquidate such liabilities. The report is to be made on the first day of each regular session of the Congress with respect to the close of the preceding June 30—beginning with June 30, 1967.

SECTION 31
SENATE COMMITTEE ON FINANCE SUMMARY OF
PRESIDENTIAL ELECTION CAMPAIGN FUND ACT OF 1966
(TITLE III OF PUBLIC LAW 89-809)

1977

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United States Senate

COMMITTEE ON FINANCE

TOM VAIL, CHIEF COUNSEL

PRESIDENTIAL ELECTION CAMPAIGN FUND ACT OF 1966

(Title III of Public Law 89-809)

Background

In the past, political campaigns for the Presidency (and the Vice Presidency) have been financed generally through voluntary contributions by individuals and corporations. In some instances devices have been perfected to disguise these voluntary contributions as trade or business expenses in order to obtain a tax deduction for the amounts involved. Each time one of these devices has been detected Congress has acted to prevent its continuation, and, conversely, each time Congress has acted it has made political campaign financing more difficult.

Against this background, it has become increasingly clear that new methods of financing political campaigns must be found.

General Description

The Presidential Election Campaign Fund Act of 1966 authorizes individual taxpayers to designate on their annual tax returns that \$1 of their income tax may be placed in a presidential election campaign fund for the purpose of defraying expenses incurred by political parties in running candidates for President and Vice President. Under the act, only political parties whose candidates received at least 5 million votes in the preceding presidential election are eligible for payments from the fund.

The reimbursement rules are different under the act for major parties and minor parties, but they have three common features. First, all parties are to be subject to a \$5 million floor, for which no reimbursement is to be allowed. Second, payments to any political party are to be limited solely to reimbursement of presidential (and vice-presidential) campaign expenses actually incurred by the party in connection with a current election. Third, payments in every case are calculated on the basis of votes cast in the prior presidential election.

A minor party (one whose candidate for President polled more than 5 million but less than 15 million votes in the prior election) is to be eligible for reimbursements from the fund up to \$1 for each vote in excess of 5 million that its candidate received in the preceding presidential election.

A major party (one whose candidate polled 15 million votes or more in the preceding presidential election) is to be eligible for reimbursement from the fund of up to \$1 times the number of votes cast for the presidential candidates of all the major parties in the preceding election, divided by the number of major parties. As in the case of minor parties, the amount actually paid over to any major party is to be reduced by \$5 million.

On the basis of the 1964 presidential election, only two major parties would be entitled to reimbursements with respect to their 1968 campaigns. Approximately 70 million votes were cast for their candidates in 1964, and after a reduction of \$5 million for each major party, the maximum reimbursable amount would be fixed at approximately \$60 million. Each party would be eligible for reimbursement of up to \$30 million of expenses it actually incurs during the 1968 presidential campaign.

The Comptroller General of the United States is authorized to determine the campaign expenses of the political parties and to determine the amounts which may be paid to them. An advisory board is established to advise and assist the Comptroller General with his duties under this act.

Transfers to the Fund

Space will be provided on the income tax return forms to permit each individual taxpayer (other than a nonresident alien or an estate or trust) to designate, if he so desires, that \$1 of his tax is to be paid into the Presidential Election Campaign Fund. The voluntary act of a taxpayer will thus determine the size of the fund; and, unless he chooses to have a portion of his tax used for financing political campaigns, none of his tax will go into the fund.

Any taxpayer who shows an income tax liability of at least \$1 on his return for the year may make an assignment. On joint returns, both husband and wife may designate provided the tax liability shown on the return is at least \$2. The election is to be made at the time of filing the return or at such later time as may be provided in regulations (such as at the time of making a claim for refund of an overpayment of tax).

Payments From Fund

Under the act the amount to be available for reimbursing a political party for its presidential (and vice-presidential) campaign expenditures will be determined by the number of votes cast in the immediately preceding presidential election. The votes cast in the current election will determine the amount to be available for these purposes in the next presidential election. The rules for payments from the fund differ for major parties and minor parties.

Minor Party.—A political party whose candidate for President received more than 5 million votes in the preceding presidential election but less than 15 million votes will be reimbursed from the fund an amount equal to the lesser of (a) its actual campaign expenses, or (b) \$1 times the number of votes in excess of 5 million that its candidate received in the preceding election.

Major Party.—A political party whose candidate for President received 15 million votes or more in the preceding election is to be reimbursed on a different basis. An amount equal to \$1 for each vote received by all major parties in the last election reduced by \$5 million for each such major party, is to be divided equally between (or among) them. However, payments to any one party cannot exceed the expenses it incurs in the current campaign.

Example.—The preceding rules can be illustrated by assuming that 80 million popular votes are cast for candidates for President in the 1972 elections. These votes fix the amount in the fund to be available during the 1976 presidential campaign.

The votes are divided in this manner: 40 million for the candidate of party A; 30 million for the candidate of party B; and 10 million for the candidate of party C. Under the law parties A and B are "major parties," while party C is a "minor party." In 1976, party C would be eligible to receive from the Presidential Election Campaign Fund \$5 million—\$1 per vote in excess of 5 million votes cast for its candidate in 1972. In 1976, parties A and B would each be eligible to receive \$30 million from the fund. This is calculated by dividing (a) the total votes cast for major party candidates in the 1972 presidential election (70 million) by (b) the number of major parties (2) and then subtracting \$5 million from the amount for each of the major parties.

Administrative.—The payments will be made at times to be determined by Treasury regulations, but no payment for a given presidential election campaign can be made before September 1 of the year the election is held. Nor will there be any reimbursement for expenses related to a presidential primary campaign or to seeking nomination as a presidential candidate.

The Comptroller General is charged with the responsibility for certifying to the Secretary of the Treasury the amounts payable to eligible political parties, and the Secretary will disburse these amounts. In this certification the Comptroller General will take into account information supplied him by the treasurers of each political party regarding presidential campaign expenses incurred. Reimbursement may not be made for any item related to a candidate for any office other than President or Vice President. Nor will the expenses of a joint appearance with a candidate for another office be allowed if a principal purpose of the joint appearance is to further the campaign of the other candidate. The Comptroller General is also to certify the total vote received by each party in the preceding presidential election and his decision in this respect is to be final.

If, at the time payments are made, there is an insufficient amount in the fund to reimburse the parties for their allowable expenses, payments to all entitled parties will be reduced pro rata, and the additional amounts will be paid out in later years as the fund is replenished by new assignments.

Conversely, if an amount remains in the fund after all authorized payments have been made with respect to a presidential election, or if the fund exceeds the maximum amount which may be authorized for payment, the excess amount is to be returned to the general fund of the Treasury.

Advisory Board

A Presidential Election Campaign Fund Advisory Board is established to advise and assist the Comptroller General in connection with his duties under this act. The Board is to consist of two members from each major political party, to be appointed by the Comptroller General upon recommendations submitted by the parties, and three additional members selected by a majority of the Board's political party members.

The first Board is to serve until 60 days after the 1968 presidential election. Subsequent Boards will be appointed to serve for 4-year terms ending 60 days after each succeeding presidential election. Board members will be compensated at the rate of \$75 a day for the period they are actually engaged in performing the duties and functions of the Board. They will also receive travel expenses and a per diem in lieu of subsistence (at rates authorized for persons in intermittent Government service) when engaged in work away from their homes or regular places of business.

Effective Date

The designation is to be permitted with respect to income tax liability for each taxable year beginning after December 31, 1966. For most taxpayers this means calendar year 1967. Accordingly, income tax returns which must be filed on or before April 15, 1968, will be the first to contain a space in which the taxpayer may indicate whether he chooses to have \$1 of his tax used for presidential campaign purposes.

STATEMENT ON THE CONFERENCE REPORT

November 10, 1966

RUSSELL B. LONG, Chairman

Let me turn now to the area of political campaign contributions.

First, let me make it clear that this is an area on which the Senate Finance Committee has held hearings. An earlier version of the amendment adopted by the committee was presented in these hearings for consideration by the committee. This is also true of various other plans, including the tax deduction plan favored by the Senator from Delaware (Mr. Williams). I might also add that the problem of political campaign contributions has been discussed on the Senate floor not merely in connection with this bill, but also in connection with earlier legislation. At the time we last raised the debt limitation, the Senator from Delaware (Mr. Williams) sought to amend that bill with his provision providing for political contribution deductions. The matter was extensively considered by the Senate at that time and rejected. However, this proposal was analyzed in hearings on political contributions held by the committee as I promised at the time.

This is a matter which has been considered extensively, not only in the current year, but in past years as well. As the Senator from Tennessee (Mr. Gore) indicated, this is a problem which he had under study some 10 years ago. The problem with these past studies, however, is that they were just studies—no action was taken. I can well understand this, because the area of political campaign contributions is a multiple problem. It is a problem which, in part, is appropriately considered by one committee and, in part, by other committees. In the past it has been difficult to obtain action on this problem because of the feeling that it was impossible to act on any one of these problems until action had been completed on the others. This, in turn, prevented action by all of the committees. Senator Clark made this aspect of the situation quite clear in his discussion of the Presidential Election Campaign Fund Act.

I should make it clear that I do not consider the Long Act as a full answer to all of the problems in connection with political campaign contributions. First of all, this deals only with presidential campaigns. It may well be that after we see how this provision works in the case of presidential campaigns we may want to extend either this provision or some modified version of it, to cover congressional elections. I do not know the answer to this, and I think it would be unfortunate for us to reach an inflexible position in this regard until after we have tried this provision for a period of time in the case of presidential campaigns.

Second, I want to make it clear that in my view this bill does not replace the need for additional legislation regulating political contributions or requiring disclosure of the source of political campaign contributions. Moreover, this does not deal with other issues which we may have to face with respect to the division of television time or what organizations can properly make campaign expenditures. These are all issues, however, as to which it will be easier to come up with specific answers after my amendment is a part of the law, because it will give assurance of adequate financing for the most important of all political campaigns.

Nor do I contend that my provision itself even in the limited area in which it is intended to operate is, in all respects, necessarily a perfect answer to the problem. I am sure that modifications will be necessary as we gain experience under this provision. Nevertheless, I view the Long Act as major legislation which will give assurance that presidential candidates are not necessarily obligated to any financial interests as a result of the necessity to raise funds to finance their campaigns. There are sizable groups of citizens in our country who suspect that these financial contributions have influenced governmental decisions. We should remove this shadow and prevent the possibility of anything like this in the future. To me this is the most important aspect of my amendment.

I realize that some say, "But you haven't prevented the other campaign contributions from being made in addition to the funds provided by your bill." I have two answers to this: first, as I have already indicated, this is not the last time that I expect legislation to be passed with respect to political campaign contributions. I will be prepared to support limitations to outlaw private contributions to presidential campaigns when such legislation is before the Senate, and now that we have assurance of adequate financing for presidential campaigns, it will, for the first time from a practical point of view, really be possible to consider limitations such as I have referred to.

Obtaining funds on a very small basis from a very wide group of our citizens is the best possible way of being sure that no financial group can be said to have gained undue influence. Others have tried to find a way of obtaining this broad participation through tax deductions or credits. However, the effort which would be required to obtain these contributions in amounts as small as \$1 from so many people raises the collection costs under these other devices to such an extent as to make them impractical. Moreover, a tax deduction or even a tax credit tends to provide more of an incentive for those in the higher income groups to make contributions than for taxpayers of more modest means. This is a kind of selection that I think is undesirable in attempting to influence political contributions.

Some have objected to my plan because it requires individuals to check a box on their tax return. What are the alternatives that we most frequently hear? The suggestions most usually made are for a tax deduction or tax credit. These involve not merely a checkmark on the tax return but also the recording of specific contributions made, and still leaves us with the auditing problem of determining whether, in fact, the contributions were made. The tax problems in these alternative solutions are much more complex and difficult than the simple checkmark on the tax return which the amendment provides. Moreover, a tax deduction or credit to be verified must be checked with the party to whom the contribution was given. Who wants the internal revenue agents in examining his return to obtain information on his political affiliation?

In the absence of finding any other basis for objection to the Long Act, it is sometimes claimed that this is undesirable because individuals under this system are, in effect, designating how governmental funds are to be spent. To me the interesting thing about this argument is that those who make this charge fail to recognize that deduction or tax credit for political contributions just as effectively takes money which would otherwise go into the Public Treasury and diverts it to another purpose. The only difference I can see in this regard is that the tax deduction or tax credit schemes divert the money just before it reaches the Treasury. Moreover, instead of diverting the money to the political campaigns, these deductions or credits merely recompense the taxpayer for part of the contribution he has already made. Moreover, frequently they repay the taxpayer needlessly for contributions he would have made in any case. There is no such waste under the amendment in this bill.

I have explained the mechanics of the Long Act previously, so I see no need to repeat it here. However, there are a few points that I would like to emphasize:

First. This amendment treats equally all parties receiving 15 million votes or more. As a result, this will not favor the party in power.

Second. Provision is made for minority parties under this bill. Any party receiving 5 million votes or more—a 5 million deduction is provided not only for minority parties but for major parties as well—receives political campaign funds based upon its vote over 5 million, and if it reaches the 15 million vote level, it is treated equally with the major parties. This is an honest attempt to give proper recognition to minority parties in this area of political contributions but not at the same time be unrealistic and treat fragment parties on the same basis as major parties. I believe that this represents a fair solution to this problem, but I am certainly willing to consider modifications in the future should the need to do so be established.

Third. This amendment is limited in several respects. Major parties cannot receive more than an equal share of the funds based upon the vote in the last presidential election. Therefore, even if taxpayers should check their tax returns freely in this regard, only limited funds would be available for expenditure. The funds are available only for presidential campaigns, and the Comptroller General is specifically authorized to examine the statements presented to him and to audit the books of the political parties to be sure that the contributions are spent for presidential campaigns and not for congressional or gubernatorial campaigns, and not for personal use, distinct from political purposes.

Fourth. It has been said that this provision runs contrary to the limitation in present law limiting contributions to political committees to \$3 million in any year. Those who say this cannot have examined the bill or present law very closely. Present law refers to contributions to political committees. The bill actually has nothing to do with contributions. The term "contribute" means to give or supply in common with others; to share in a joint effort. The financing by the Government after the passage of this bill is not a voluntary, joint effort to give funds. Rather, it is an appropriation of funds. Rather, it is an appropriation of funds to which the parties have a right. Moreover, it is not part of a joint effort. As a result, it is not a contribution and, therefore, does not come under the limitation of present law. Moreover, it involves a payment to political "parties" not payments to political "committees." As a result, it should be clear the present \$3 million limitation does not apply.

Fifth. Some have objected to the fact that the contribution in this case is divided between, or among, the major parties. Some have indicated that they would prefer making all of their contribution to one party or the other. This, of course, is not the way to assure good government. It may be a way of electing one party over another—by supplying it with a better financial base—but it does not assure good government. The way to assure good government is to be sure that sufficient campaign funds are available to both, or all, major parties, so that their positions can be fully understood by the electorate. It is only a well-informed electorate that can assure the continuation of our representative form of government.

Sixth. It has been suggested that there are no safeguards to prevent misuse of the funds made available to the political parties by this provision. Actually, present law provides about as strict a fraud statute as can be imagined. Section 1001 of title 18 of the code specifies:

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or documents knowing the same to contain any false, fictitious or fraudulent statement or entry shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

Certainly I would not object to other safeguards being written into the law to prescribe even more definitely how these funds may be used and how they may not be used, but I do feel that those who say there presently are no safeguards have overstated their case.

Contrary to the general impression that some have tried to create, this is not a hastily concocted scheme.

It has long been suggested that Government should find some way to help finance the cost of these campaigns. Theodore Roosevelt suggested nearly 60 years ago that this should be done with public funds. Later the Special Committee To Investigate Campaign Expenditures of presidential, vice-presidential, and senatorial candidates in 1936 suggested that private contributions to political campaigns be prohibited entirely and that instead all election expenses should be defrayed from public funds. In 1959, Jasper B. Shannon, professor of political science at the University of Nebraska, recommended a similar plan in his book "Money and Politics." Earlier this year Prof. John Kenneth Galbraith suggested, in connection with State offices, that the Government "provide every regularly nominated candidate with a public grant of sufficient size to enable him to get his name, merit if any, and platform before the people. These grants would be available to candidates for statewide office, the general court and for the senate and house of representatives."

I introduced a bill on June 15 of this year to provide funds from the Treasury to help defray the cost of presidential campaigns. In doing this I was largely implementing a thought which had been before the people for discussion for nearly 6 decades. This is a matter which I have been studying for over a year, and it is a matter which has been thoroughly analyzed by the Senate Finance Committee. The best minds of the staff of the Finance Committee and the staff of the Joint Committee on Internal Revenue Taxation, the Senate Legislative Counsel, the experts of Treasury, as well as other advisors to the President and the senior members of the House Committee on Ways and Means have all contributed meaningfully to the effort to find a proper answer. This is an important building block on which we can build a proper system for controlling political campaign contributions. Moreover, it is the first answer to this problem of financing political campaigns for which it has been possible to obtain majority support from Congress. This in itself is an important achievement in such a controversial field as this.

Let me conclude my comments on the presidential political campaign financing by saying that I consider this one of the most important and constructive pieces of legislation passed by Congress this year. I believe time will show that what I have said is true.

APPENDIX
TEXT—PRESIDENTIAL ELECTION CAMPAIGN FUND ACT
(Title III of Public Law 89-809)

Sec. 301. SHORT TITLE.

This title may be cited as the "Presidential Election Campaign Fund Act of 1966."

Sec. 302. AUTHORITY FOR DESIGNATION OF \$1 OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) Subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to returns and records) is amended by adding at the end thereof the following new part:

"Part VIII—Designation of Income Tax Payments to Presidential Election Campaign Fund

"SEC. 6096. Designation by individuals.

"Sec. 6096. DESIGNATION BY INDIVIDUALS.

"(a) IN GENERAL.—Every individual (other than a nonresident alien) whose income tax liability for any taxable year is \$1 or more may designate that \$1 shall be paid into the Presidential Election Campaign Fund established by section 303 of the Presidential Election Campaign Fund Act of 1966.

"(b) INCOME TAX LIABILITY.—For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown in his return) allowable under sections 32(2), 33, 35, 37, and 38.

"(c) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year, in such manner as the Secretary or his delegate may prescribe by regulations—

"(1) at the time of filing the return of the tax imposed by chapter 1 for such taxable year, or

"(2) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary or his delegate."

(b) The table of parts for subchapter A of chapter 61 of such Code is amended by adding at the end thereof the following new item:

"Part VIII. Designation of income tax payments to Presidential Election Campaign Fund."

(c) The amendments made by this section shall apply with respect to income tax liability for taxable years beginning after December 31, 1966.

Sec. 303. PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) ESTABLISHMENT.—There is hereby established on the books of the Treasury of the United States a special fund to be known as the "Presidential Election Campaign Fund" (hereafter in this section referred to as the "Fund"). The Fund shall consist of amounts transferred to it as provided in this section.

(b) TRANSFERS TO THE FUND.—The Secretary of the Treasury shall, from time to time, transfer to the Fund an amount equal to the sum of the amounts designated by individuals under section 6096 of the Internal Revenue Code of 1954 for payment into the Fund.

(c) PAYMENTS FROM FUND.—

(1) IN GENERAL.—The Secretary of the Treasury shall, with respect to each presidential campaign, pay out of the Fund, as authorized by appropriation Acts, into the treasury of each political party which has complied with the provisions of paragraph (3) an amount (subject to the limitation in paragraph (3) (B)) determined under paragraph (2).

(2) DETERMINATION OF AMOUNTS.—

(A) Each political party whose candidate for President at the preceding presidential election received 15,000,000 or more popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to the excess over \$5,000,000 of—

(i) \$1 multiplied by the total number of popular votes cast in the preceding presidential election for candidates of political parties whose candidates received 15,000,000 or more popular votes as the candidates of such political parties, divided by

(ii) the number of political parties whose candidates in the preceding presidential election received 15,000,000 or more popular votes as the candidates of such political parties.

(B) Each political party whose candidate for President at the preceding presidential election received more than 5,000,000, but less than 15,000,000, popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a

presidential campaign equal to \$1 multiplied by the number of popular votes in excess of 5,000,000 received by such candidate as the candidate of such political party in the preceding presidential election.

(C) Payments under paragraph (1) shall be made with respect to each presidential campaign at such times as the Secretary of the Treasury may prescribe by regulations, except that no payment with respect to any presidential campaign shall be made before September 1 of the year of the presidential election with respect to which such campaign is conducted. If at the time so prescribed for any such payments, the moneys in the Fund are insufficient for the Secretary to pay into the treasury of each political party which is entitled to a payment under paragraph (1) the amount to which such party is entitled, the payment to all such parties at such time shall be reduced pro rata, and the amounts not paid at such time shall be paid when there are sufficient moneys in the Fund.

(3) LIMITATIONS.—

(A) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign unless the treasurer of such party has certified to the Comptroller General the total amount spent or incurred (prior to the date of the certification) by such party in carrying on such presidential campaign, and has furnished such records and other information as may be requested by the Comptroller General.

(B) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign in an amount which, when added to previous payments made to such party, exceeds the amount spent or incurred by such party in carrying on such presidential campaign.

(4) The Comptroller General shall certify to the Secretary of the Treasury the amounts payable to any political party under paragraph (1). The Comptroller General's determination as to the popular vote received by any candidate of any political party shall be final and not subject to review. The Comptroller General is authorized to prescribe such rules and regulations, and to conduct such examinations and investigations, as he determines necessary to carry out his duties and functions under this subsection.

(5) DEFINITIONS.—For purposes of this subsection—

(A) The term "political party" means any political party which presents a candidate for election to the office of President of the United States.

(B) The term "presidential campaign" means the political campaign held every fourth year for the election of presidential and vice presidential electors.

(C) The term "presidential election" means the election of presidential electors.

(d) TRANSFERS TO GENERAL FUND.—If, after any presidential campaign and after all political parties which are entitled to payments under subsection (c) with respect to such presidential campaign have been paid the amounts to which they are entitled under subsection (c), there are moneys remaining in the Fund, the Secretary of the Treasury shall transfer the moneys so remaining to the general fund of the Treasury.

Sec. 304. ESTABLISHMENT OF ADVISORY BOARD.

(a) There is hereby established an advisory board to be known as the Presidential Election Campaign Fund Advisory Board (hereafter in this section referred to as the "Board"). It shall be the duty and function of the Board to counsel and assist the Comptroller General in the performance of the duties imposed on him under section 303 of this Act.

(b) The Board shall be composed of two members representing each political party whose candidate for President at the last presidential election received 15,000,000 or more popular votes as the candidate of such political party, which members shall be appointed by the Comptroller General from recommendations submitted by each such political party, and of three additional members selected by the members so appointed by the Comptroller General. The term of the first members of the Board shall expire on the 60th day after the date of the first presidential election following the date of the enactment of this Act and the term of subsequent members of the Board shall begin on the 61st day after the date of a presidential election and expire on the 60th day following the date of the subsequent presidential election. The Board shall select a Chairman from among its members.

(c) Members of the Board shall receive compensation at the rate of \$75 a day for each day they are engaged in performing duties and functions as such members, including travel time, and, while away from their homes or regular places of business, shall be allowed travel expenses, including per diem in lieu of subsistence, as authorized by law for persons in the Government service employed intermittently.

(d) Service by an individual as a member of the Board shall not, for purposes of any other law of the United States, be considered as service as an officer or employee of the United States.

Sec. 305. APPROPRIATIONS AUTHORIZED.

There are authorized to be appropriated, out of the Presidential Election Campaign Fund, such sums as may be necessary to enable the Secretary of the Treasury to make payments under section 303 of this Act.

SECTION 32

**SUMMARY OF THE FOREIGN INVESTORS TAX ACT OF
1966; PRESIDENTIAL ELECTION CAMPAIGN FUND
ACT; AND OTHER AMENDMENTS**

1987

SUMMARY OF THE FOREIGN INVESTORS
TAX ACT OF 1966; PRESIDENTIAL
ELECTION CAMPAIGN FUND ACT; AND
OTHER AMENDMENTS

(H.R. 13103; 89th Congress, Public Law 89-809)

PREPARED BY THE STAFF
OF THE
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ON
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**SUMMARY OF THE FOREIGN INVESTORS TAX ACT OF
1966; PRESIDENTIAL ELECTION CAMPAIGN FUND ACT;
AND OTHER AMENDMENTS (H.R. 13103, 89TH CONG.,
PUBLIC LAW 89-809)**

The four titles of H.R. 13103, as enacted, contain provisions dealing with the tax treatment of nonresident aliens and foreign corporations, the establishment of a presidential election campaign fund, the amendment of various other tax provisions, and amendments for other purposes. The more important provisions of the act are summarized as follows:

A. The Foreign Investors Tax Act

Interest on deposits in foreign branch banks of domestic corporations and partnerships.—Interest on deposits with foreign branch banks of U.S. corporations or partnerships is to be treated as foreign source income, and thus is to be free of U.S. income tax when paid to nonresident aliens and foreign corporations.

Source rules for bank deposit interest and similar income.—After December 31, 1972, all interest on U.S. bank deposits (other than those described above), whether or not effectively connected with a U.S. business, is to be treated as U.S. source income (and subject to U.S. income tax) in the case of nonresident aliens and foreign corporations. Until then, this interest on bank deposits, interest paid on accounts with mutual savings banks, domestic building and loan associations, etc., and interest on amounts held by insurance companies on deposit also are to be treated as foreign source income (unless effectively connected with a U.S. business) and thereby free of U.S. income tax.

Rules for determining the source of dividends and interest from foreign corporations.—The source rules with respect to dividends and interest paid by foreign corporations are amended to provide that dividends and interest received from a foreign corporation are to be considered as having a U.S. source only if 50 percent of the corporation's gross income for the prior 3 years was effectively connected with the conduct of a trade or business in the United States.

Compensation for personal services.—The existing special source rule, providing that certain payments of compensation for services performed in the United States by a nonresident alien are treated as foreign source income (and therefore free of U.S. tax) if the services are performed for certain foreign persons or a foreign office of a U.S. corporation, is extended to services performed for a foreign office of a proprietor who is a citizen or resident of the United States or for the foreign office of a domestic partnership.

Trading in stocks or securities or in commodities.—Except in the case of dealers and certain investment companies, trading in stocks or securities in the United States for one's own account, whether by a foreign investor physically present in the United States, through an

employee located here, or through a resident agent (whether or not the agent has discretionary authority) is not to constitute a trade or business in the United States for income tax purposes. A parallel rule is provided for those trading in commodities.

Income effectively connected with the conduct of a trade or business in the United States.—The benchmark to be used in determining whether income is to be subject to a flat 30-percent rate or taxed substantially the same as income earned here by a U.S. citizen or domestic corporation is whether or not the income is effectively connected with a U.S. business. In the case of investment and other fixed or determinable income and capital gains from U.S. sources the income is to be treated as effectively connected with a U.S. business if the income is derived from assets used or held for use in the conduct of a U.S. business or if the activities of the U.S. business are a material factor in the realization of the income. All other types of U.S. source income are to be considered to be effectively connected if there is a U.S. business. Income from sources without the United States is not to be treated as effectively connected with a U.S. business unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income is attributable to that place of business. Moreover, in general only rents and royalties from licensing, certain income from banking and so forth, and sales income are to be taken into account for this purpose and only to the extent the income is not "subpart F" income or income derived from a foreign corporation 50 percent owned by the nonresident alien or foreign corporation receiving the income. Also excluded from the definition of "effectively connected" foreign source income is (a) income derived from a transaction in which the U.S. office was not a material factor, (b) income not derived from the usual business activities of the U.S. office, and (c) income not properly allocable to the U.S. office. Additionally, a U.S. office is defined to exclude the office of certain agents. See also the related foreign tax credit provision.

Income tax on nonresident alien individuals.—The income of nonresident aliens which is effectively connected with a U.S. business is to be taxed at the regular graduated rates applicable to individuals and all income not so connected is to be taxed at a flat 30-percent rate (or lower applicable treaty rate). U.S. source capital gains of a nonresident alien not engaged in business in the United States are to be taxed only if the alien was in the United States for 183 days or more during the year. Deductions are allowable only to the extent allocable to income which is effectively connected to a U.S. business. Also, an election is provided which allows an alien to treat income from real property as U.S. business income in order to take deductions allocable to it.

Expatriation to avoid income tax.—U.S. source income and the effectively connected income of a citizen received for 10 years after expatriation is, in most cases, to be taxed at the regular U.S. tax rates if a principal purpose of the expatriation was the avoidance of U.S. income, estate, or gift taxes.

Withheld taxes and declarations of estimated income tax.—The Treasury Department is authorized to require payment of amounts withheld from nonresident aliens and foreign corporations on a more current basis, rather than the annual basis previously provided. Nonresident aliens who receive income which is effectively connected with

the conduct of a U.S. business are to be required to file declarations of estimated tax.

Income tax on foreign corporations.—The regular corporate income tax is to apply to income of foreign corporations which is effectively connected with a U.S. business. U.S. source income which is not so connected is taxable at a flat 30-percent rate (or at a lower treaty rate). Foreign corporations are given an election to treat real property income as business income similar to that afforded nonresident aliens.

Foreign corporations carrying on insurance business in the United States.—A foreign corporation carrying on a life insurance business within the United States is to be taxed under the existing special insurance company provisions on its income effectively connected with a U.S. business. The remainder of the income of this type of corporation from sources within the United States is to be taxed in the same manner as income of other corporations which is not effectively connected; that is, at a flat 30-percent rate. An adjustment also is made to avoid double taxation which might result from the interaction of the minimum surplus provision for life insurance companies under existing law and the new method of taxing foreign life insurance companies.

Discrimination and more burdensome taxes by foreign countries.—The act authorizes the President to reinstate the income, estate, or gift tax provisions in effect prior to the enactment of this act with respect to foreigners upon a determination that the foreign country in which they are residents or were incorporated is imposing more burdensome taxes on U.S. citizens or domestic corporations on income from sources within the foreign country than the U.S. tax on similar U.S. source income of foreigners. An additional amendment provides the President with authority in the case of discrimination by a foreign government against U.S. persons, to take such action as is necessary to raise the effective rate of U.S. tax on income received by nationals or corporations of that other country to substantially the same effective rates as are applied in the other country on income of U.S. citizens or corporations.

Foreign community property income.—A U.S. citizen who is married to a nonresident alien and resident in foreign country with community property laws, is to have an election for post-1966 years to treat the community income of the husband and wife as income of the person who earns it or, in the case of trade or business income, as income of the husband unless the wife manages the business. Income from separate property is to be treated as income of the person owning the property. All other community income is to be governed by the applicable foreign community property law. For open pre-1967 years, an election may also be made and the rules set forth above govern except that the other community income is to be treated as the income of the person who had the greater income from the other community income categories plus separate income.

Foreign tax credit.—A foreign tax credit is to be allowed nonresident aliens and foreign corporations with respect to foreign taxes on foreign source income which is effectively connected to the conduct of a U.S. business. This provision includes, as creditable taxes, both income taxes imposed by the country of the source of the income and the country of the residence of the business.

Similar income tax credit requirement.—Under prior law a foreign tax credit has been denied to citizens of a foreign country who were resident in the United States if the foreign country did not allow a similar credit to U.S. citizens who were resident in the foreign country. In the future the credit is to be denied only where the President finds that this is in the public interest and the foreign country refuses to grant U.S. citizens such a credit when requested to do so.

Separate foreign tax credit limitation.—The 10-percent exception to the separate application of the limitation on the foreign tax credit for interest income was amended so as to apply to a U.S. corporation which directly or indirectly owns 10 percent of the foreign corporation from which the interest is derived, or is a member of an affiliated group of corporations which has such ownership.

State tax rates, exemptions, and returns.—A separate schedule of estate tax rates is made applicable to estates of nonresident aliens. The rates are graduated from 5 percent on the first \$100,000 of a taxable estate to 25 percent on the portion which exceeds \$2 million. The exemption also is raised from \$2,000 to \$30,000. These two measures accord approximately the same tax treatment in the case of the estate of a nonresident alien as is accorded a similarly sized estate of a citizen eligible for a marital deduction. The filing requirement for returns for the estates of these nonresident aliens also is raised from \$2,000 to \$30,000.

Situs rule for bonds.—For purposes of the tax imposed on the estates of nonresident aliens, bonds of a U.S. person, the United States, a State, or political subdivision owned by a nonresident not a citizen of the United States, are to be considered property within the United States and therefore subject to U.S. estate tax. This rule already applies in the case of other forms of debt obligations.

Situs rule for bank deposits.—U.S. bank deposits of nonresident aliens are to be treated as property within the United States and therefore subject to U.S. estate tax after 1972.

Situs rule for deposits in foreign branch banks.—Deposits in a foreign branch bank of a U.S. corporation or partnership are to be treated as property without the United States and therefore not includible in a foreigner's U.S. estate tax base.

Expatriation to avoid estate tax.—The estate of a nonresident alien is to be taxed at the regular U.S. estate tax rates if, within 10 years of his death, the alien has expatriated from the United States with a principal purpose of avoiding U.S. taxes.

Tax on gifts of nonresident aliens.—Transfers of intangible property by nonresident aliens are not to be subject to gift tax whether or not they are engaged in business in the United States. However, gifts of intangibles made by citizens who become expatriates within 10 years of making the gift are to be subject to gift tax if the avoidance of income, estate or gift taxes was a principal purpose for their becoming an expatriate. In the case of a person who expatriated for tax avoidance reasons, debt obligations of a U.S. person, or of the United States or a State or political subdivision, are to be treated as having a situs in the United States.

Treaty obligations.—No amendment made by this act is to apply in any case where its application would be contrary to any treaty obligation of the United States. However, the granting of a benefit pro-

vided by an amendment made by this act is not to be considered to be contrary to a treaty obligation. Thus, even though a nonresident alien or foreign corporation has a permanent establishment in the United States, income which is not effectively connected with this business is to be taxed at the applicable treaty rate rather than at the regular individual or corporate rate.

B. Other amendments to the Internal Revenue Code

Application of the investment credit to certain property in U.S. possessions.—The investment credit is extended to property located in U.S. possessions provided the property is owned by a U.S. company or citizen, subject to U.S. tax on its income from possessions, would otherwise have qualified for the investment credit, and is not owned or used by U.S. persons who are presently exempt from U.S. tax under certain sections of the code. This amendment is effective with respect to property placed in service after December 31, 1965.

Corporate acquisition of assets of another corporation.—(a) *Purchase of stock.*—Under existing law, the purchase from an unrelated party by one corporation of at least 80 percent of the stock of another corporation followed by the liquidation of the acquired corporation within 2 years is treated as a purchase of the assets of the acquired corporation. The definition of “purchase” in this provision is extended to include the purchase of stock from a 50-percent owned subsidiary if stock in the 50-percent owned subsidiary was also acquired by purchase. The change is to be effective with respect to acquisitions of stock made after December 31, 1965.

(b) *Installment notes.*—When installment notes are transferred in the type of purchase and liquidation described above, gain is to be recognized to the distributing corporation in the same manner as if it had sold the notes.

Swap funds, etc.—The act provides that no gain or loss is to be recognized with respect to property that is transferred to an investment company in what constitutes an exchange of investment interests on or before June 30, 1967, if the registration statements of the investment company (where such statements are required) are filed with the SEC before January 1, 1967, and the property is deposited with the investment fund before May 1, 1967.

Removal of certain limitations to the deductibility of contributions to self-employed individuals' pension plans.—The act repeals the provision which limited the deduction from gross income which self-employed individuals could take with respect to contributions on their own behalf to a retirement plan to 50 percent of the contributions. Thus, self-employed persons may deduct the entire amount of their contributions subject to the limitation that the contributions cannot exceed the lesser of 10 percent of earned income or \$2,500. This provision is to be effective for taxable years beginning after December 31, 1967.

The act also permits a self-employed individual to include in his earned income all of his net profits (rather than not over 30 percent) when his income is derived from a business in which both the performance of personal services and capital are material income-producing factors. In such cases, however, the personal services provided by the self-employed person must clearly be a material income-producing factor.

Self-employed persons retirement plans: certain income of authors, investors, and so forth.—The act amends prior law relating to self-employed individuals' retirement plans to permit authors, inventors, and so forth, to include gains (other than capital gains) from sales and other transfers of their works in their earned income base for the purpose of computing deductions for contributions to such plans.

Exclusion of certain rents, from personal holding company income.—This amendment provides, for taxable years beginning after the date of enactment (and certain earlier years at the election of the taxpayer), that rent received from the lease of tangible personal property manufactured by a taxpayer (where he still is manufacturing similar property) is not to be treated as personal holding company income.

Percentage depletion in the case of certain clay-bearing alumina.—A percentage depletion rate of 23 percent (rather than 15 percent) is to be allowed for alumina and aluminum compounds extracted from domestic deposits of clay, laterite, and nephelite syenite.

Percentage depletion rate for clam and oyster shells.—Mollusk shells (including clam and oyster shells) are to be allowed percentage depletion at the rate of 15 percent unless they are used as riprap, ballast, road material, concrete aggregate, etc., in which case the percentage depletion rate is to remain 5 percent.

Percentage depletion rate for shale, clay, and slate.—The depletion rate is raised from 5 percent to 7½ percent for clay or shale used in making sewerpipe and brick and for clay, shale, or slate sintered or burned and used as light-weight aggregates.

Straddles.—With respect to straddle transactions entered into after January 25, 1965, the income from the lapse of an option which originated as part of a straddle is to be treated as a short-term capital gain (instead of ordinary income). This permits this income to be netted against any capital loss which may result from the exercise of the other option in the straddle while retaining what in most respects is ordinary income treatment for any excess of net short-term capital gain over net long-term capital loss.

The taxation of per-unit retain allocations of cooperatives.—The act clarifies existing law dealing with the taxation of cooperatives and patrons to insure that a current single tax is paid, at either the cooperative or patron level, with respect to per-unit retain certificates. In so doing, the amendment makes the treatment of these certificates generally comparable to the treatment of patronage dividends.

The excise tax on hearses.—This act provides that the sale of a hearse or combination ambulance-hearse vehicle is to be considered to be the sale of an automobile chassis or automobile body (rather than a truck chassis or body) for purposes of determining the manufacturers' excise tax on motor vehicles.

Interest equalization tax: raw material source loans.—Subsequent transfers of debt obligations to assure raw material sources are to be exempt from the interest equalization tax where the indebtedness is acquired without an intent on the part of the purchaser to sell it to other U.S. persons. This change is to be effective with respect to acquisitions of debt obligations made after the date of enactment.

Interest equalization tax: certain acquisitions by insurance companies in developed countries.—The existing exemption for reserve

asset pools of U.S. insurance companies is extended to allow the establishment of reserve asset pools where a U.S. insurance company commences activities in a developed country or where a less-developed country is designated as a developed country. This amendment is to take effect on the day after the date of enactment.

Interest equalization tax: Euro-dollars.—The President is given the authority to exempt from the interest equalization tax U.S. dollar loans of more than 1 year made by the foreign branches of U.S. banks. This change is to apply to acquisitions of debt obligations made after the date of enactment.

C. Presidential Election Campaign Fund Act

This title provides for public support of presidential election campaign financing. Individual taxpayers are to be able to designate on their annual tax returns that \$1 of their income tax liability is to be placed in a presidential election campaign fund. The amounts in the fund are to be made available to defray the expenses incurred by political parties in presenting candidates for President and Vice President. Amounts will only be paid to those political parties whose candidates received at least 5 million votes in the preceding presidential election.

Any major political party (one whose candidate polled 15 million votes or more in the preceding presidential election) is to be eligible to receive a payment from the fund computed on the following basis: \$1 times the number of votes cast for the presidential candidates of the major political parties in the preceding presidential election divided by the number of such major political parties and the result then reduced by \$5 million. A minor party (one whose candidate polled more than 5 million but less than 15 million votes) is to be eligible to receive a payment from the fund equal to \$1 for each vote in excess of 5 million votes that its candidate received in the preceding presidential election. The payment received by any political party is to be limited, however, to reimbursement of presidential campaign expenses actually incurred by the party in connection with the current presidential election.

The Comptroller General is authorized to determine the campaign expenses of the political parties and to determine the amounts which may be paid to such parties. An advisory board is established to advise and assist the Comptroller General with his duties under this act.

D. Miscellaneous provisions

Treasury bonds or certificates payable in foreign currency.—This amendment expands the debt management authority of the Secretary of the Treasury to permit the issuance of U.S. notes denominated in foreign currencies. This authority already exists in the case of bonds and certificates of indebtedness.

Reports on Federal contingent liabilities and assets.—This amendment requires the Secretary of the Treasury to submit, on the first day of each regular session of the Congress, a report to the Congress indicating the full contingent liabilities of the Federal Government and the assets of the Federal Government which might be made available to liquidate such liabilities, as of the preceding June 30. The first such report to be submitted is the report as of June 30, 1967.

I. EXPLANATION OF PROVISIONS

A. FOREIGN INVESTORS TAX ACT

1. INCOME TAX SOURCE RULES

a. Rules for determining source of certain interest payments (sec. 102(a)(1) of the act and secs. 861 (a) and (c) of the code)

Prior law.—Prior law provided that interest on deposits paid to foreign persons not engaged in trade or business in the United States was to be treated as income from sources without the United States and therefore not subject to U.S. tax if the interest was paid by a U.S. bank. The Internal Revenue Service interpreted this rule to apply, in addition to banks, to certain deposits with some types of State-chartered savings and loan associations. However, the Service did not interpret this provision as extending to interest paid on deposits with all savings and loan associations or all types of deposits. Additionally, interest on similar deposits with insurance companies was not accorded the benefits of this special rule.

Explanation of provision.—The act amends prior law to provide that after December 31, 1972, interest on deposits with U.S. banks paid to nonresident alien individuals or foreign corporations is to be treated as income from sources within the United States and therefore subject to U.S. tax. A provision was also added which subjects interest on deposits with U.S. branch banks of foreign corporations to these provisions. Therefore, until 1973 only bank interest received by nonresident aliens or foreign corporations which is effectively connected with the conduct of a trade or business in the United States will be subject to U.S. tax.¹ In addition, during the intervening 6-year period the act extends the application of the foreign source rule of prior law to interest (or so-called dividends) paid on deposits (or withdrawable accounts) with all chartered and supervised savings and loan associations or similar institutions, to the extent these amounts are deductible (determined without regard to section 265) in computing the taxable income of these institutions. Similar institutions for this purpose include mutual savings banks, cooperative banks, and domestic building and loan associations. Also, during this 6-year period, this special foreign source rule is to be applicable to interest on amounts held by insurance companies under an agreement to pay interest. The amounts paid by insurance companies to which this rule is extended include: (1) interest paid on policyholder dividends left with the company to accumulate; (2) interest paid on prepaid insurance premiums; (3) interest paid on proceeds of policies left on deposit; and (4) interest paid on overcharges of premiums.

Effective date.—Except for the provision repealing the special foreign source rule for certain interest as of December 31, 1972, these

¹ The term "effectively connected" is explained subsequently in No. 2(b) below.

amendments are effective with respect to taxable years beginning after December 31, 1966.

b. Interest on deposits in foreign branch banks of domestic corporations and partnerships (sec. 102(a)(2) of the act, sec. 861(a)(1)(F) of the code)

Prior law.—Prior law provided that interest paid to nonresident alien individuals or foreign corporations on deposits with foreign branches of U.S. banks, although paid by the foreign branch situated abroad, is treated as from sources within the United States if the recipient of the interest was engaged in a trade or business in the United States.

Explanation of provision.—The act provides that the interest on deposits paid by foreign branch banks of U.S. corporations and partnerships is to be treated as foreign source income. Thus, nonresident aliens and foreign corporations will not be subject to U.S. tax on this type of interest income.

Effective date.—This amendment is effective with respect to taxable years beginning after December 31, 1966.

c. Foreign central banks and the Bank for International Settlements (sec. 102(a)(4)(A) of the act and sec. 895 of the code)

Prior law.—Under existing law interest received by a foreign central bank of issue from obligations of the U.S. Government is exempt from U.S. tax unless the obligations are used by the central bank in commercial transactions. In addition foreign central banks of issue and the Bank for International Settlements are not subject to tax on interest income from their U.S. bank deposits since bank-deposit interest received by nonresident aliens and foreign corporations not engaged in a trade or business within the United States is deemed to be from sources without the United States.

The central banks of issue are generally the custodians of the banking reserves of their countries and usually carry on most of the monetary functions of their countries in much the same way as our Federal Reserve Board. The Bank for International Settlements is an international organization, in practice used primarily to aid European central banks of issue in their international financial operations, to promote cooperation among these central banks and to act as trustee in regard to certain international financial settlements. At present, all the central banks of Europe, except that of the Soviet Union, belong to the Bank for International Settlements and over 90 percent of the Bank's deposits are owned by these central banks.

Explanation of provision.—The act specifically exempts from U.S. tax interest received by foreign central banks of issue and the Bank for International Settlements from U.S. bank deposits unless the deposits are held in connection with commercial transactions of these banks. Therefore, after 1972, this will distinguish their tax treatment for interest on bank deposits from that accorded other foreign persons. Amendments were also made which would exempt interest received by the Bank for International Settlements from U.S. Government obligations. In addition, an amendment was adopted extending the governmental obligation rule to include obligations of agencies or instrumentalities of the United States (including beneficial interests, participations, and other instruments issued under sec. 302(c) of the Federal National Mortgage Association Charter Act).

Effective date.—These amendments are effective with respect to taxable years beginning after December 31, 1966.

d. Rules for determining the sources of dividends and interest from foreign corporations (secs. 102(a)(2), (a)(3), and (b) of the Act and secs. 861(a)(1)(B), (C), and (D), and (2)(B) of the code)

Prior law.—Prior law provided that all, or a portion of dividends paid by a foreign corporation to nonresident aliens or foreign corporations was considered to be from U.S. sources and therefore subject to U.S. tax if 50 percent or more of the income of the foreign corporation making the distribution was derived from sources within the United States during the preceding 3-year period. A similar rule provided that all the interest paid by a foreign corporation engaged in trade or business in the United States was considered to be U.S. source income and therefore subject to U.S. tax if 20 percent or more of the income of the foreign corporation paying the interest was from U.S. sources during the preceding 3-year period.

The portion of the dividend treated as being from U.S. sources, where the 50-percent test referred to above was met, was equal to that proportion of gross income from all sources that was derived from U.S. sources during the immediately prior 3-year period. However, in the case of this type of interest income there was no apportionment provision and therefore all of the interest paid by a foreign corporation meeting the 20 percent rule was treated as being from U.S. sources notwithstanding the proportion of the corporation's income which was from U.S. sources.

Explanation of provision.—The act amends the source rules with respect to dividends and interest paid by corporations to provide that no portion of the dividend or interest received from a foreign corporation is to be considered to be from U.S. sources unless 50 percent or more of the corporation's gross income for the 3-year period preceding the year in which the dividends or interest payments are made was effectively connected with the conduct of a trade or business in the United States. Also, the portion of the dividend or interest treated as being from U.S. sources is to be the same proportion of the dividend or interest which the effectively connected income of the foreign corporation during the immediately prior 3-year period is of its gross income from all sources for that period. Thus, when compared to prior law, the effect of these amendments is to decrease the amount of dividends and interest likely to remain subject to U.S. tax.

The act also contains a transitional rule providing that, in applying the new 50-percent test, any gross income of the foreign corporation from U.S. sources, for any period before the first taxable year beginning after December 31, 1966, is treated as effectively connected income. A special rule for determining the source of interest or dividends paid by newly incorporated corporations was also added.

Effective date.—These amendments are effective with respect to dividends received after December 31, 1966.

e. Compensation for personal services (secs. 102(c) and (d) of the act and secs. 861(a)(3)(C)(ii) and 864(b)(1) of the code)

Prior law.—Existing law provides that payments of compensation for services performed in the United States generally are treated as U.S. source income. An exception to this rule is provided for compensation received by a nonresident alien where certain conditions are

met. Thus, payments for personal services received by a nonresident alien are treated as foreign source income if (1) he was temporarily present in the United States for not over 90 days during the year; (2) the compensation does not exceed \$3,000; and (3) the services are performed for a foreign employer not engaged in a trade or business in the United States or for a domestic corporation if the services are performed for an office or place of business it maintains in a foreign country or U.S. possession. Also, existing law provides that the rendering of personal services in the cases described above is not to constitute engaging in a trade or business in the United States.

Explanation of provision.—The act amends the source rule of existing law relating to personal service income to provide that income from services performed by a nonresident alien temporarily present in the United States for not over 90 days in a year, if not in excess of \$3,000, is to be treated as foreign source income (and not subject to U.S. tax) not only in cases where the employer with the foreign office is a foreign person or a domestic corporation but also where such an employer is a U.S. citizen or resident or a domestic partnership. Similar changes are also made in the definition of a “trade or business within the United States” to provide that this term does not include personal services performed for employers who are U.S. citizens or residents or for domestic partnerships where the conditions set forth above are met.

Effective date.—These amendments are applicable with respect to taxable years beginning after December 31, 1966.

2. DEFINITIONS USED IN DETERMINING TAXABLE STATUS OF INCOME

a. Trading in stocks or securities or in commodities (sec. 102(d) of the act and sec. 864(b) (2) of the code)

Prior law.—Prior law specifically excluded from the activities which constitute engaging in a trade or business within the United States the trading activities conducted by a nonresident alien in stocks, securities, or commodities in the United States through a resident broker, commission agent, or custodian. This rule also applied with respect to foreign corporations. However, under prior law, the granting of discretionary authority to the broker or agent may have prevented a nonresident alien or foreign corporation from qualifying for this exclusion, with the result that income arising from these transactions and all other U.S. source income was subject to U.S. tax at the regular individual or corporate rates (based on a determination that such activities constitute carrying on a trade or business in the United States).

Explanation of provision.—Prior law was amended to provide specifically that the trading in stocks, securities, or commodities in the United States, for one's own account, whether by a foreign person physically present in the United States, through an employee located here, or through a resident broker, commission agent, custodian, or other agent—whether or not that agent has discretionary authority—does not constitute a trade or business in the United States. This treatment, however, does not apply to dealers in stocks, securities, or commodities or to a foreign investment corporation if it has its principal office here.

It is not intended that as a result of this provision a foreign investment company (other than a corporation which is, or but for section

542(c)(7) or 543(b)(1)(C) would be, a personal holding company) is to be permitted to locate its general business activities in the United States and avoid taxation at the regular corporate rates on its income and gains effectively connected with its business in this country. However, a foreign investment company conducting its general business activities in a foreign country (i.e., having its principal office there) can conduct trading activities in the United States through an agent with discretionary authority, without being considered as conducting a trade or business in the United States.

Whether a corporation's principal office is in the United States is to be determined by comparing the activities (other than trading in securities) which the corporation conducts from an office located in the United States with the activities it conducts from offices located outside the United States. For example, a corporation which carries on most or all of its stock and securities transactions through an agent with discretionary authority in the United States but maintains a general business office outside the United States in which its management is located and from which it communicates with its shareholders and the general public, solicits sales of its own stock, and maintains its corporate records and books of accounts, is not to be considered as having its principal office in the United States.

Although, under this provision, a dealer is specifically excluded from those who may grant discretionary authority and not be deemed to be conducting a business in the United States, he may trade in securities or commodities, for his own account, through an independent U.S. agent without being considered to be conducting a business in the United States. However, this rule does not apply if at any time during the year he has an office or place of business in the United States through which, or by the direction of which, transactions in stocks, securities, or commodities are effected.

Even though this provision does not free some dealers in stocks, securities, or commodities, and investment companies from the possibility that they may be considered as engaged in a trade or business in the United States, this does not mean that all such dealers or investment companies are so engaged. In such a situation, the question of whether a dealer or investment company is conducting a trade or business in the United States remains a question of fact to be determined under the rules of existing law.

Effective date.—These amendments apply with respect to taxable years beginning after December 31, 1966.

b. Income effectively connected with the conduct of a trade or business in the United States (sec. 102(d) of the act and sec. 864(c) of the code)

Prior law.—Under prior law nonresident aliens and foreign corporations were generally taxable at the regular individual or corporate rates on all their U.S. source income if they were engaged in trade or business in the United States and were taxable at a flat 30-percent rate (or lower treaty rate) on all fixed or determinable income if not so engaged. This difference in treatment applied whether or not there was any relationship between the different types of incomes (business and investment) derived from the United States.

Explanation of provision.—As a general rule, the act provides that income of a nonresident alien or foreign corporation will be subject

to the flat 30-percent (or lower treaty) rate if it is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to income which is effectively connected to the conduct of a U.S. trade or business. A foreigner may elect to treat real property income as if it were income effectively connected with a U.S. business so that the deductions attributable to this real property income can be deducted from it. The application of the effectively connected concept to different types of income is set forth below.

(i) *Income from U.S. sources treated as "effectively connected."*—In determining whether periodical income such as interest, dividends, rents and wages, and capital gains is effectively connected with the conduct of a trade or business within the United States two principal factors are to be taken into account. First, is the income derived from assets used or held for use in the conduct of the trade or business in the United States? Thus, for example, are the assets being held for future, or remittant, use in the business? In this regard, particular attention will be given to the relationship between the asset and the needs of the business. Second, were the activities of the trade or business a material factor in the realization of the income? Thus, in the case of this second factor, is there an immediate relationship between the income in question and the U.S. business activities of the foreign corporation? Also to be taken into account in weighing the relationship of the investment income to the trade or business, but not to be a controlling factor by itself, is whether or not the assets or income are accounted for through the U.S. trade or business.

All other income from sources within the United States (that is, other than the periodical income and capital gains described above) is to be treated as "effectively connected."

(ii) *Income from sources without the United States.*—(A) *General Rules.*—Income from sources without the United States is not to be treated as "effectively connected" with the conduct of a trade or business within the United States unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income, gain or loss is attributable to that place of business. Also, this provision applies to only three types of income from sources without the United States.

A foreign corporation which to a minimal extent, or occasionally, uses the U.S. office of a related corporation will not be treated as having a fixed place of business here. Moreover, the fact that top management decisions are made in the United States will not of itself mean that the foreign corporation has an office or fixed place of business here. For example, a foreign sales corporation which is a wholly owned subsidiary of a domestic corporation will not be considered to have a U.S. office because of the presence here of the officers of its domestic parent who are generally responsible only for its policy decisions, provided the foreign sales corporation has a managing director that conducts its day-to-day business from a foreign office. This person may or may not be an officer of the U.S. corporation. Also, in such a case, the managing director could regularly confer with the officers of the domestic parent and if necessary occasionally visit the U.S. offices of the domestic parent and, during such visits, temporarily conduct the business of the foreign subsidiary out of the domestic parent's office without thereby establishing a U.S. office.

As indicated above, this provision applies only to three specific types of income from without the United States. Furthermore, in no event does it apply with respect to income which is "subpart F" income or to dividend, interest or royalty income derived from a foreign corporation more than 50 percent owned by a nonresident alien or foreign corporation receiving the income. Of course, the subpart F income exception extends to income which is subpart F income but is excepted from its taxing provisions by the minimum distribution and export trade exceptions. The three types of income with respect to which this provision applies are:

(i) Rents and royalties derived from the active conduct of a licensing business;

(ii) Dividends, interest, or gain from stock or bond or debt obligations derived in the active conduct of a banking, financing or similar business; and

(iii) Certain sales income attributable to a U.S. sales office.

The sales income referred to above is not to be considered as "effectively connected" to a U.S. trade or business if the property is sold for use outside the United States and an office of the foreign person outside the United States contributes materially to the sale. In the case of foreign source income where the products are destined for the United States, the income will be treated as effectively connected with a U.S. business to the extent the sales activity is carried on by the U.S. office.

(B) *Determining Factors.*—This provision also contains rules regarding what is to be considered a sufficient nexus for assertion of U.S. tax jurisdiction as well as what foreign source income is to be subject to U.S. tax. In general, for purposes of determining whether a foreign corporation or nonresident alien has an office, the office or other fixed place of business of an agent is to be disregarded unless the agent is other than an independent agent operating in the ordinary course of his trade or business and unless he either has authority (regularly exercised) to negotiate binding contracts or has a stock of merchandise from which he regularly fills orders. This agency concept regarding the degree of economic activities which will subject a foreign corporation or nonresident alien to U.S. taxation on foreign source income is substantially similar to the permanent establishment concept present in many of the existing income tax treaties. It is not intended, however, that the interpretation of this provision be limited by the judicial decisions of foreign governments regarding such treaty provisions.

With respect to the determination of the income to be subject to U.S. tax, the rules provide that foreign source income will not be considered to be effectively connected with a U.S. business of a foreign corporation or nonresident alien if (a) a U.S. office of that business was not a material factor in the production of the income, (b) the income was not derived from the usual business activities of the U.S. business or (c) the income was not properly allocable to the activities of the U.S. business.

These rules delimit the application of the general rules of this provision, thereby subjecting to U.S. tax only income which has its economic genesis in the United States. For purposes of this provision, the activities of the U.S. office will not be considered to constitute a "material factor" unless it provides a significant contribution to the production of the income. Thus, the activities of the U.S. office must be an essential economic element in the production of the income.

Therefore, the fact that the board of directors of the foreign corporation meets in the U.S. office will not subject the worldwide sales income of that foreign corporation to U.S. taxation. On the other hand, the activities of the U.S. office need not necessarily be a major factor in the production of the income.

The requirement that the income must be derived from the usual business activities of the U.S. office, in effect, provides a de minimus exception. It is intended that this rule will exclude from U.S. tax jurisdiction all foreign income derived from casual sales. Thus, if the foreign corporation is engaged solely in a manufacturing business in the United States, the income derived by the U.S. plant as a result of an occasional foreign sale will not come within the ambit of the foreign source effectively connected rule where the sales operations for the products of the U.S. plant are located outside the United States. On the other hand, if a foreign corporation establishes a U.S. sales office to sell goods produced in Africa in the Western Hemisphere, occasional sales income derived from parts of the world other than the Western Hemisphere would not be excluded under this casual sales rule. In other words, the nature of the U.S. business would be the primary determinative factor for purposes of this exception.

(C) *Foreign Tax Credit*.—The act extends a foreign tax credit (sec. 906) to foreign source effectively connected income but only with respect to foreign taxes paid on non-U.S. source. A further discussion of this amendment is provided in the foreign tax credit portion of this summary.

(D) *Foreign Insurance Companies*.—In the case of a foreign corporation having a life insurance business in the United States, the act provides that income from sources without the United States is to be treated as effectively connected with the conduct of the business within the United States if the income is attributable to its U.S. life insurance business. This rule merely continues the treatment of existing law under which income of a foreign corporation from its U.S. life insurance business is subject to tax whether the income is from sources within or without the United States.

Effective date.—This amendment applies with respect to taxable years beginning after December 31, 1966. For purposes of determining whether foreign source sales income from a binding contract, entered into on or before February 24, 1966, is attributable to a U.S. office, none of the activities in the United States on or before that date, which were related to the negotiation or effectuation of the binding contract are to be taken into account. As a result in many cases the sales income from foreign sources under binding contracts entered into before February 25, 1966, will not come within the ambit of this provision.

3. TAXATION OF NONRESIDENT ALIENS

a. Income tax on nonresident alien individuals (Sec. 103(a) of the act and sec 871 of the code)

Prior law.—Prior law provided different tax treatment for nonresident alien individuals according to whether they were, or were not, engaged in a trade or business in the United States. Also, those not engaged in a trade or business in the United States were provided

different treatment according to whether their income was under or over \$21,200.

Nonresident alien individuals not engaged in trade or business in the United States whose annual U.S. source income of the types specified below was \$21,200 or less were taxed at a flat rate of 30 percent (or lower applicable treaty rate), on certain specified items of U.S. source income. This tax was in lieu of the regular U.S. graduated rates applicable to individuals. The items of income included were interest, dividends, rents, salaries, wages, and other fixed or determinable annual or periodical gains, profits, and income. Also specifically included in the income taxable at the flat 30-percent rate were certain amounts otherwise treated in the same manner as capital gains; namely, lump-sum distributions from exempt employees' trusts (sec. 402(a)(2)); amounts paid to beneficiaries under qualified annuity plans (sec. 403(a)(2)); timber, coal, and iron ore royalties (sec. 631 (b) and (c)); and amounts received on transfers of patent rights (sec. 1235).

Nonresident alien individuals not engaged in trade or business in the United States but with an annual U.S. source income of the types indicated above, of more than \$21,200, were taxed under prior law (in the absence of an applicable treaty provision) at whichever of the following produced the higher total tax; the regular U.S. rates applicable to individuals, or the flat 30-percent rate. In computing the tax at the regular graduated rates, such a nonresident alien was allowed deductions to the extent they were properly allocable to the income on which he was taxable.

Nonresident aliens not engaged in a trade or business in the United States—whether their income was over or under \$21,200—were subject to tax on regular capital gains only if one of two conditions existed: (1) if they were physically present in the United States at the time the capital gain was realized or (2) if they were present in the United States for a period or periods totaling 90 days or more during the year. These capital gains were taxed at the flat 30-percent rate if the individual's income from U.S. sources was \$21,200 or less. If his income from U.S. sources exceeded this amount, the regular capital gains tax rate applied, but only if the regular individual income tax rates (including the capital gains tax) on all the taxpayer's U.S. source income resulted in a higher tax than the flat 30-percent tax.

Nonresident alien individuals engaged in trade or business in the United States were taxable at the regular U.S. graduated (and capital gains) rates on their income derived from sources within the United States. In computing the tax, an alien in this category was allowed deductions to the extent attributable to his U.S. source income.

Explanation of provision.—The act substantially revises the prior income tax treatment of nonresident alien individuals by dividing their income, for tax purposes, into two basic categories according to whether or not the income is effectively connected with a U.S. trade or business.

(A) *Income not effectively connected with the conduct of a U.S. business.*—Income of a nonresident alien individual which is fixed or determinable (substantially the same categories referred to under prior law) and which is not effectively connected with the conduct of a trade or business in the United States is to be taxed at a flat 30-percent rate (or lower treaty rate).

Generally, the fixed or determinable income referred to here, as under prior law, includes such income as interest, dividends, rents, salaries, annuities, and certain income accorded capital gain treatment. The act adds two items not included in the list contained in prior law and has slightly modified the language of prior law so as to clarify this provision as it relates to certain amounts received from pensions or annuity plans, and certain timber, iron ore, and coal royalties. The two new items added to the list by the act are (1) certain gains with respect to the sale of a patent or other intangible property and (2) amounts received on retirement or exchange of bonds and other evidences of indebtedness issued after September 28, 1965, which are treated as gains from the sale of property which is not a capital asset. The reference in the act to section 1232 refers only to original issue discount on evidences of indebtedness held by a taxpayer for more than 6 months. Also, income constituting original issue discount received on the retirement or sale or exchange of bonds is to be considered as having the same source as interest paid by the corporation issuing the bonds.

The provision of the act regarding gains realized on the sale of a patent or other intangible property provides that gains realized on the sale of a patent or other intangible property, where the income from the sale is derived as a result of the use of such property in the United States, is not to be subject to U.S. tax as "fixed and determinable income" (taxed at 30 percent or lower treaty rate) unless a part of the income derived from the sale is contingent. If part of the profits from such sale are contingent, the amount subject to U.S. tax in any year would be the contingent amount, or if this contingent amount exceeds 50 percent of the total amount paid in any 1 year, the total amount will be taxed to the extent this amount represented gain realized on the sale of the property. For purposes of determining the source of this income the source rule for rentals, royalties, or other intangible property is to be used. This provision is to apply to gains derived from sales made after October 4, 1966. The provisions of prior law will continue to apply to transfers of patents made before that date.

In the case of a nonresident alien's net U.S. source capital gains (other than those specifically included in the list as taxable at the 30-percent rate) which are not effectively connected with the conduct of a trade or business within the United States, the act provides that no U.S. tax is to be imposed unless the nonresident alien has been present in the United States for at least 183 days during the taxable year. Prior law provided a 90-day test. For purposes of applying the 183-day test an alien will be treated as being on a calendar year basis unless he has previously established a different taxable year. The requirement of prior law which taxed capital gains when the alien was physically present in the United States at the time of realization was dropped entirely.

(B) Income effectively connected with the conduct of U.S. business.—Income of a nonresident alien individual that is effectively connected with the conduct of a trade or business in the United States, is taxable at the regular U.S. graduated rates applicable to individuals. Thus, this income is taxed the same as under prior law although the category itself is more limited since it only applies to income which is effectively connected to a U.S. trade or business instead of including all U.S. source income of an alien with such a trade or business. For

purposes of determining whether or not income is effectively connected with the conduct of a trade or business in the United States, the rules discussed above in connection with the definition of effectively connected income apply.

(C) *Miscellaneous types of income receiving special treatment.*—Under prior law certain types of income were provided special treatment. The act revises and extends these categories as indicated below.

(i) *Participants in exchange programs.*—The act retains the rule in prior law which treated nonresident aliens temporarily in the United States as part of a cultural exchange or training program as engaged in a trade or business in the United States even though they are actually not so engaged. The provision was modified by the act, however, to provide in such cases that this type of income is effectively connected to a U.S. trade or business. The effect of treating these categories of income as effectively connected to a U.S. trade or business (or under prior law as derived from a U.S. trade or business) is to impose the regular U.S. income tax on these aliens on the taxable portion of their scholarship or fellowship grants and certain other amounts incident to these grants. In this computation one exemption (except in the case of residents or contiguous countries) and the deductions allocable to this income are allowed. In the absence of this special provision, these aliens would be taxed on these grants (and amounts incident thereto) at the flat 30 percent rate. In most cases the 30 percent tax would substantially exceed the regular tax on this income.

The types of income referred to under prior law and the act as scholarship or fellowship grants, if received by a nonresident alien individual temporarily present in the United States as a nonimmigrant (under subpar. (F) or (J) of sec. 101(a)(15) of the Immigration and Nationality Act) or received by a citizen or resident, are, subject to a dollar limitation, exempt from U.S. tax.

Prior law also excluded from gross income compensation paid by a foreign employer to a nonresident alien for the period he was temporarily present in the United States as a nonimmigrant for the purposes of participating in a cultural or training program. Under prior law this was available where the "foreign employer" was a foreign person or a domestic corporation with an office in a foreign country or U.S. possession. The act extends this provision to cover an employee of a domestic partnership or a U.S. citizen or resident with such a foreign office.

(ii) *Income from real property.*—Under prior law, it was not clear what situations or arrangements for the ownership by a nonresident alien of real property located in the United States would cause the nonresident alien to be considered as engaging in a trade or business within this country. This, of course, was important since the question of whether or not the alien was engaged in a trade or business in the United States determined whether his U.S. source capital gains were subject to U.S. tax and whether his other U.S. source income was taxable at the regular individual income rates, with allocable deductions, or at the flat 30-percent rate on the gross amount. Taxing income on real property at a flat 30-percent rate without the allowance of allocable deductions—which in the case of this type of income may be relatively large—may have resulted in quite heavy tax burdens on this type of income.

The act deals with the problem described above by providing that nonresident aliens deriving income from real property held for the production of income and located in this country, or from an interest in this type of real property located in this country, may elect to treat all the income as effectively connected to the conduct of a U.S. trade or business. This permits the nonresident alien to utilize the deductions attributable to this real estate income and be taxed on only his net income from these sources.

The election is applicable with respect to gains from the sale or exchange of real property held for the production of income (or an interest therein) and rents or royalties from mines, wells, or other natural deposits, as well as certain timber, iron ore, and coal royalties. The election is not applicable to income not specifically covered by these provisions, such as distributions by real estate investment trusts. If the election is made, it applies to all the alien's income from U.S. real property for the taxable year which is not otherwise "effectively connected" with the conduct of a trade or business in this country. The election applies for all subsequent taxable years until revoked and can be revoked only with the consent of the Secretary of the Treasury or his delegate.

If the election is revoked, a new election may not be made for 5 years unless the Secretary of the Treasury or his delegate consents to an earlier reelection.

(iii) *Certain pension income.*—Under prior law a nonresident alien receiving pension or annuity income from a plan located in the United States was subject to U.S. tax (flat 30 percent or lower treaty rate) on the interest portion of the pension income notwithstanding the fact that the services qualifying the nonresident alien for the pension were entirely rendered outside the United States. This amendment exempts from U.S. tax the type of pension income described above if 90 percent of the persons under the plan are U.S. citizens. It is the understanding of the Congress that in general the regulations will provide that the plan paying the pension will be entitled to rely upon information presented by the annuitant or employer to determine whether or not the annuitant qualifies under this provision.

(iv) *Bond income of residents of the Ryukyu Islands, etc.*—At the present time the Ryukyu Islands (including Okinawa) are governed by the United States and large numbers of the individuals of these islands are in the employ of the U.S. Military Establishment. As such, their savings have frequently been invested in series E or H U.S. savings bonds. Interest income on U.S. savings bonds is, of course, U.S. source income. As a result, under prior law the residents of the Ryukyu Islands, as well as the Trust Territory of the Pacific Islands, were subject to a flat 30-percent tax on the income from these bonds. The act excludes from gross income subject to U.S. tax, income derived by nonresident aliens from U.S. savings bonds (series E or H) if the alien at the time of acquiring the bonds was a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

Effective date.—These amendments apply with respect to taxable years beginning after December 31, 1966.

b. Deductions (sec. 103(c) of the act and sec. 873 of the code)

Prior law.—In the case of a nonresident alien individual, prior law generally allowed deductions to the extent they were properly al-

locable to income from sources within the United States but only if the alien's U.S. income was subject to the regular income tax. However, where the regular income tax applied, the deduction of losses was allowed even though they were not connected with a U.S. trade or business if they were incurred in transactions entered into for profit provided that the transaction, had it resulted in a profit, would have been subject to U.S. tax. Also allowed were property losses not connected with a trade or business arising from certain casualties or thefts if the loss was of property located within the United States.

Explanation of provision.—The act generally limits the allowance of deductions in case of a nonresident alien individual to deductions allocable to income which is effectively connected with the conduct of a trade or business in the United States. The allowance of deductions is limited in this manner, since it is only effectively connected income which under the act is subject to the regular income tax.

In addition, the act deletes the provision relating to the deduction of losses not connected with a trade or business but incurred in transactions entered into for profit since the criteria for the allowance of deductions under the act is whether or not they are effectively connected with the conduct of a trade or business in the United States. However, the casualty loss deduction is to be available even if the property which gives rise to the loss is not effectively connected with the conduct of a trade or business in the United States if the property is located in this country. Also, the charitable contribution deduction is available even though not related to the trade or business.

Effective date.—These amendments apply with respect to taxable years beginning after December 31, 1966.

c. Expatriation to avoid tax (sec. 103(f) of the act and new sec. 877 of the code)

Prior law.—The U.S. individual income tax applies to U.S. citizens, U.S. residents, and to nonresident aliens, but in this latter case, generally only with respect to income derived from sources within the United States. Under prior law, if an individual who had been a U.S. citizen gave up this citizenship and became a nonresident, no tax was then imposed with respect to income he derived from sources without the United States. Moreover, under prior law the regular graduated rates applicable to a citizen applied in the case of an expatriate only if he was engaged in a trade or business in the United States or his income exceeded \$21,200.

Explanation of provision.—The act added a new section to the code which, in general, taxes both effectively connected income and any other U.S. source income of an expatriate at regular income tax rates, if he surrendered his citizenship within 10 years of the taxable year in question (and after March 8, 1965) and if one of the principal purposes of the expatriation was the avoidance of U.S. income, estate, or gift taxes. This treatment is not to apply if it results in a smaller U.S. income tax than would otherwise be imposed.

In addition, the new section contains special source rules to be used in determining an expatriate's U.S. source income. These rules provide that gains from the sale or exchange of property (other than stock or debt obligations) located in the United States, and gains on the sale or exchange of stock of a domestic corporation or debt obligations of U.S. persons or of the United States, a State or political subdivision,

or the District of Columbia are to be treated as income from sources within the United States regardless of where the sale or exchange occurs or title is transferred. Deductions are to be allowed only to the extent they are properly allocable to the gross income of the expatriate, determined under the above described provisions (except that the capital loss carryover provision is not to apply).

The new section contains a special rule with respect to the burden of proving the existence or nonexistence of U.S. tax avoidance as one of the principal purposes of the expatriation. Under this provision, the Secretary of the Treasury or his delegate must first establish that it is reasonable to believe that the expatriate's loss of U.S. citizenship would (but for the application of these special provisions) result in a substantial reduction in his taxes based on the expatriate's probable income for the taxable year.

If this is established, then the expatriate must carry the burden of proving that the loss of citizenship did not have, for one of its principal purposes, the avoidance of U.S. income, estate, or gift taxes. However, the new section excepts persons whose loss of citizenship occurs under circumstances where it is unlikely that tax avoidance was a principal purpose. For example, this provision does not apply where the person acquired dual citizenship at birth and loses his U.S. citizenship by residing, for a certain period, in the foreign country of which he is also a citizen by birth.

Effective date.—This amendment applies for taxable years beginning after December 31, 1966.

d. Partial exclusion of dividends from gross income (sec. 103(g) of the act and sec. 116(d) of the code)

Prior law allowed a nonresident alien the \$100 dividends received exclusion only if the individual was taxable on U.S. source dividends at the regular graduated rates applicable to individuals. The act amends this provision, effective for taxable years beginning after December 31, 1966, by limiting the availability of the exclusion to dividends which are effectively connected with the conduct of a trade or business in the United States. The exclusion is also allowed in the case of an expatriate subject to tax under new section 877.

e. Withholding of tax on nonresident alien individuals (secs. 103(h) and (k) of the act and secs. 1441 and 3401 of the code)

Prior law.—Prior law generally required the withholding of tax in the case of a nonresident alien on U.S. source fixed or determinable income from U.S. sources (of the types previously described). The withholding was at a 30-percent rate (except in the case of certain treaty rates) and applied whether or not the flat 30-percent tax applied to the individual.² Thus it applied not only in the case of a nonresident alien with a gross income of \$21,200 or less who was not engaged in a trade or business in the United States but also in the case of a nonresident alien with a larger gross income or to one who was engaged in a trade or business in the United States.

Explanation of provisions.—The act adds a new provision to the existing nonresident alien withholding provisions. Under the new provision, withholding is not required on payments to nonresident

² For a limited category of scholarship and fellowship income and related income the withholding rate was 14 percent.

alien individuals with respect to any item of income (other than compensation for services) which is effectively connected with the conduct of a trade or business within the United States. It is the understanding of the Congress that the person required to withhold will be relieved of any liability for failure to withhold if the failure was in reliance upon information as to whether or not the income was effectively connected, furnished (in accordance with regulations to be issued) by the person entitled to the receipt of the income. The act specifically provides for withholding on the following additional types of income: (1) the contingent income derived from the sale of patents and other intangibles; (2) a foreign partner's share of the U.S. income of a domestic partnership which is not effectively connected with the partnership's business; and (3) amounts received on retirement or exchange of bonds issued after September 28, 1965, which are treated as gains from the sale of property which is not a capital asset (sec. 1232).

In the case of salary and wage income, the act also correlates the 30-percent-withholding rate applicable to nonresidents aliens with the domestic graduated withholding rates. Thus, the act amends present law to provide that the Secretary of the Treasury or his delegate may, by regulations, exempt compensation for services performed by non-resident aliens from the 30-percent withholding and require withholding at the domestic graduated withholding rates.

The act also makes amendments of a technical nature to conform the language of the withholding provisions to the language used in the other taxing provisions.

Effective date.—The amendment relating to the 30-percent withholding rule applies with respect to payments made in taxable years beginning after December 31, 1966. The amendment relating to domestic wage withholding applies with respect to remuneration paid after December 31, 1966.

f. Withheld taxes and declarations of estimated income tax (secs. 103 (i) and (j) of the act and secs. 1461 and 6015 of the code)

Under prior law, persons who were required to withhold on amounts paid to nonresident aliens and foreign corporations were required to file a return and remit the taxes withheld during any calendar year by March 15 of the following year. This procedure was unusual since all other withheld taxes, such as the employees' social security taxes and domestic wage withholding, are required to be remitted (together with the return) at least quarterly.

The act amends prior law to provide the Treasury Department with the authority to require more current remittance of the taxes withheld on nonresident aliens and foreign corporations. This amendment is effective with respect to payments made after December 31, 1966.

The act also amends the provisions of prior law which require individuals to file declarations of estimated tax. The amendment continues prior law which includes nonresident aliens within the category of individuals required to file these declarations. However, the application of this provision to nonresident aliens is limited to those who receive income which is effectively connected with the conduct of a trade or business within the United States.

These amendments are effective with respect to taxable years beginning after December 31, 1966.

g. Foreign estates or trusts (sec. 103 (e) and (l) of the act and secs. 875 and 7701a(a) (31) of the code)

Prior law defined the terms "foreign trust" and "foreign estate" to mean a trust or estate whose income from sources without the United States was not included in gross income for U.S. income tax purposes. The act amends this definition to conform it to the effectively connected concept. As amended, the terms refer to estate or trusts whose income from sources without the United States, other than income which is effectively connected with the conduct of a trade or business within the United States, is not included in gross income for U.S. income tax purposes. This amendment applies for taxable years beginning after December 31, 1966.

Another amendment imputes the business activities of a trust or estate to its beneficiaries. In other words, if a trust, whether a foreign or a domestic trust, is engaged in a trade or business in the United States, its beneficiaries are deemed to also be engaged in that trade or business.

h. Citizens of possessions of the United States (sec. 103(m) of the act and sec. 932(a) of the code)

Under prior law, individuals who were citizens of possessions of the United States but not otherwise citizens of the United States, were taxed as nonresident aliens on their U.S. source income. This provision was amended by the act, effective for taxable years beginning after December 31, 1966, to conform to the changes made to the taxation of nonresident aliens generally.

4. TAXATION OF FOREIGN CORPORATIONS

a. Income tax on foreign corporations (secs. 104 (a) and (b) of the act and secs. 881 and 882 of the code)

Prior law.—Prior law taxed foreign corporations not engaged in a trade or business in the United States at a flat rate of 30 percent on fixed or determinable income from sources within the United States. These items, which, with a few exceptions were the same as those previously taxed at the 30-percent rate to nonresident alien individuals not engaged in a trade or business in the United States, included: interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits, and income (including certain timber, coal, and iron ore royalties).

The U.S. source income of a foreign corporation engaged in business in the United States was taxed at the regular corporate rates. In computing the tax, deductions generally were allowed to the extent that they were properly allocable to the U.S. source income if a true and accurate return was filed by the corporation.

Explanation of provision.—The act substantially revises the income tax treatment of foreign corporations. Under the act the income of a foreign corporation is divided into two classifications.

(A) *Income not effectively connected.*—Fixed or determinable income of a foreign corporation from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States is taxable at a flat 30-percent rate (or lower treaty rate). The types of fixed or determinable income speci-

fied are the same as under prior law with the same two additions provided in the case of nonresident aliens: (1) contingent income received from the sale of patents and other intangibles, and (2) amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange of bonds or other evidences of indebtedness issued after September 28, 1965. As indicated in the case of the taxation of nonresident aliens, the source of this original issue discount is to be determined by the same rules as those applicable to interest income. As a result, if the corporation with respect to whose bonds the original issue discount arises is a domestic corporation which for the 3-year period preceding the year of redemption derives 80 percent or more of its income from foreign sources, then the original issue discount (interest), at the time of the retirement or sale or exchange of the bonds, also will be considered as foreign source income.

The act also clarifies the language of existing law which includes certain timber, coal, and iron ore royalties in the 30-percent list.

(B) *Income effectively connected.*—Income of a foreign corporation which is effectively connected with the conduct of a trade or business within the United States is taxable, under the act, at the regular corporate income tax rates. In determining “taxable income” for this purpose, gross income includes only gross income which is “effectively connected” with the conduct of the trade or business within the United States.

(C) *Income from real property.*—Under prior law (as explained with respect to nonresident alien individuals) it was not clear what situations or arrangements for the ownership by a foreign corporation of real property located in the United States would cause the foreign corporation to be considered as engaging in a trade or business within the United States. This was important because if a foreign corporation not engaged in a trade or business in the United States received rents from U.S. real property, this rental income was taxable at the flat 30-percent rate (or applicable treaty rate) on the gross amount of such rents, without the allowance of any deductions attributable to the rental income. Consequently, the tax liability generated by this rental income might have exceeded the net rental income the corporation received.

Since the provisions of this amendment parallel the amendment provided in the case of real estate income of nonresident alien individuals, the explanation is not repeated here (see No. 3(a)(C)(ii)).

(D) *Certain interest received by banks in U.S. possessions.*—The act provides that interest received by banks located in a U.S. possession from U.S. Government obligations will be treated as effectively connected with a U.S. trade or business whether or not the bank has such a business. Consequently, the interest received by a bank in a possession from U.S. Government obligations will be taxed on a net basis—gross interest income less allocable expenses.

(E) *Deductions.*—Deductions are allowed in computing the tax imposed at the regular corporate rates only to the extent that they are properly attributable to income which is effectively connected with the conduct of a trade or business within the United States. The deduction for charitable contributions, however, is allowed whether or not attributable to income which is effectively connected. Generally, as under prior law, deductions are permitted only if a true and accurate income tax return is filed.

Effective date.—These amendments apply with respect to taxable years beginning after December 31, 1966.

b. Withholding of tax on foreign corporations (sec. 104(c) of the act and sec. 1442 of code)

Under prior law, the fixed or determinable U.S. source income of a foreign corporation not engaged in trade or business in the United States, like that of a nonresident alien not engaged in a trade or business in the United States, was subject to a withholding tax of 30 percent. However, foreign corporations engaged in trade or business in the United States were not subject to the withholding tax.

The act amends the withholding provisions of prior law to conform to the effectively connected concept. Thus, under the act a withholding tax at the 30-percent rate will apply in the case of a foreign corporation to items of fixed or determinable U.S. source income which are not effectively connected with the conduct of a trade or business in the United States. It is the understanding of the Congress that the person required to withhold will be relieved of any liability for failure to withhold if the failure is due to reliance upon information (as to whether or not the income was effectively connected) furnished (in accordance with regulations to be issued) by the foreign corporation entitled to the receipt of the income. This 30-percent withholding provision is not to be applied if the Secretary of the Treasury determines that the withholding requirements impose an undue administrative burden and that the collection of the tax will not be jeopardized by an exemption.

c. Deduction for dividends received from foreign corporations (sec. 104 (d) and (e) of the act and sec. 245 (a) and (b) of the code)

Prior law.—In general, existing law allows corporations an 85-percent dividend-received deduction for dividends received from domestic corporations. Under prior law, in order for this deduction to have been available in the case of dividends from a foreign corporation, the latter must have been engaged in a trade or business in the United States for an uninterrupted period of at least 3 years and 50 percent of its gross income must have been from U.S. sources during that period. Where these conditions existed, an 85-percent dividend-received deduction was available for the same proportion of the dividend as the corporation's gross income, which was from U.S. sources, was of its total gross income.

Explanation of the provision.—The act substantially conforms the dividends-received deduction to the effectively connected concept. Under the act 50 percent or more of the foreign corporation's gross income for the uninterrupted period must be from income effectively connected with the conduct of a trade or business within the United States for the deduction to be available. Also, the deduction is limited to 85 percent of the same proportion of the dividend as the foreign corporation's gross income, which is effectively connected with a U.S. trade or business, is of that corporation's total gross income from all sources.

In addition, a 100 percent dividends-received deduction is provided to a domestic corporation for dividends received from a wholly owned foreign subsidiary which has a 100 percent effectively connected income. In such a situation a foreign corporation is subject to U.S. tax on all of its income, just as is a domestic corporation.

The act also contains a transitional rule which makes it unnecessary to apply the effectively connected income concept when any of the years which is taken into account for the 50-percent test is a pre-1967 year. This rule provides that, for purposes of computing this deduction, all of a foreign corporation's U.S. source income, for any period before its first taxable year beginning after December 31, 1966, is to be considered to be effectively connected income.

Effective date.—These amendments apply for taxable years beginning after December 31, 1966.

d. Unrelated business taxable income of certain foreign charitable organizations (sec. 104(g) of the act and sec. 512(a) of the code)

Under prior law the unrelated business taxable income of foreign charities was subject to tax if it was derived from sources within the United States.

The act conforms this provision to the effectively connected concept by providing that the unrelated business taxable income of a foreign charity is to be subject to tax only if it is effectively connected with the conduct of a trade or business in the United States.

This amendment applies for taxable years beginning after December 31, 1966.

e. Foreign corporations subject to personal holding company tax (sec. 104(h) of the act and sec. 542(c), 543(b), and 545 (a) and (d) of the code)

Prior law.—Under prior law any foreign corporation with U.S. investment income, whether or not doing business here, could be taxed as a personal holding company unless all its outstanding stock was owned (directly and indirectly) by nonresident alien individuals and its U.S. source gross income was less than 50 percent of its total gross income for that year. If taxable as a personal holding company the foreign corporation was subject to a special 70-percent tax on its undistributed U.S. source personal holding company income in addition to the flat rate 30-percent tax (or possibly the regular corporate tax). Also, if a foreign corporation was determined to constitute a personal holding company and the foreign corporation had not filed a return or had not filed a true and accurate return, the 70-percent personal holding company tax was assessed without allowance of the dividends paid deduction. In such cases, the combination of the regular 30-percent tax and the 70-percent personal holding company tax could have constituted a tax of about 80 percent of the income of the foreign corporation.

Explanation of provision.—The act modifies the provision in prior law excluding from the personal holding company definition only those foreign corporations whose U.S. source gross income was less than 50 percent of their total gross income and all of whose stock was held directly or indirectly by nonresident aliens. It substitutes a broader exemption which applies to any foreign corporation all of whose outstanding stock during the last half of its taxable year is owned by nonresident alien individuals (directly or indirectly through foreign estates, trusts, partnerships, or other foreign corporations).

This general rule contains three refinements. The first provides that the general exclusion from the personal holding company provision is not to be available to a foreign personal holding company if it has income from personal services which is personal holding company

income described in section 543(a)(7). In such a case the personal holding company tax is to be assessed on that personal service income. The second provides a de minimus rule under which foreign corporations with only 10 percent or less U.S. ownership are to be assessed the personal holding company tax only on the corporation's undistributed personal holding company income attributable to the U.S. shareholders' interest. The final refinement provides that a foreign corporation can claim all appropriate deductions in computing its personal holding company tax notwithstanding the general rule disallowing deductions where no return is filed. However, a 10-percent addition to taxes otherwise due is to be assessed.

Effective date.—This amendment applies with respect to taxable years beginning after December 31, 1966.

f. Foreign corporations carrying on insurance business in the United States (sec. 104(i) of the act and secs. 819, 821, 822, 831, 832, 841 and 842 of the code)

Prior law.—Prior law taxed a foreign life insurance company carrying on a life insurance business in the United States on all its income attributable to that business in substantially the same manner as a domestic life insurance company.³ Foreign insurance companies carrying on life insurance businesses in the United States generally interpreted this as providing they were not taxable on U.S. source income which was not income of the U.S. life insurance business of the company. However, a special rule was provided where the surplus of a foreign life insurance company held in the United States was less than a specified minimum figure. This figure was expressed as the same percent of the foreign life insurance company's liabilities on U.S. business as the average surplus of domestic corporations was of their total liabilities. The Secretary of the Treasury determined this ratio each year. If the foreign insurance company's surplus held in the United States was less than this proportion of the taxpayer's total insurance liabilities on U.S. business, then the policy and other contract liability requirements, and the required interest for computing gain from operations, were reduced by this deficiency multiplied by the rate of earnings on investments. This provision was designed to prevent foreign insurance companies doing business in the United States from avoiding tax that they would otherwise have had to pay to the United States merely by not holding a sufficient amount of surplus attributable to the U.S. business.

Explanation of provisions.—The act provides that a foreign corporation carrying on an insurance business within the United States is to be taxable in the same manner as domestic companies carrying on a similar business with respect to its income which is effectively connected with the conduct of a trade or business within the United States. The remainder of the U.S. source income of this type of a corporation is to be taxed in the same manner as income of other foreign corporations which is not effectively connected with a U.S. trade or business; that is, at a flat 30 percent (or lower treaty) rate. The determination of whether a foreign insurance company qualifies for the special domestic insurance treatment is to be made by considering only the income of the corporation which is effectively con-

³ A foreign life insurance company that is not carrying on a life insurance business in the United States is taxable under the provisions applicable to foreign corporations generally.

connected with the conduct of its insurance business carried on in the United States.

For purposes of determining whether or not income of a foreign life insurance company is effectively connected with the conduct of its U.S. life insurance business, the annual statement of its U.S. business on the form approved by the National Association of Insurance Commissioners will usually be followed. Also, certain foreign casualty insurance companies use this form to indicate their U.S. business connected investment income, and it is expected that this statement will continue to be utilized to reflect the effectively connected income of these companies. It is noted that all the income effectively connected with the foreign life insurance company's U.S. life insurance business, from whatever source derived, comes within the ambit of this provision. This a continuation of existing law.

It has been pointed out that the special rule in prior law referred to above with respect to foreign life insurance companies—where these companies held a lower ratio of surplus for their U.S. business than that held by the average domestic companies—could have lead to what in effect would have been a double tax. To meet this problem the act adds a paragraph to the provision described above which has the effect of reducing the income subject to the flat 30-percent tax (or lower treaty rate) by the amount by which the deductions under this special provision are reduced as the result of the application of the Secretary's ratio. This is accomplished by allowing a credit against the 30-percent tax (or lower treaty rate) for the tax levied on the hypothetical income attributed to the U.S. life insurance company business.

Effective date.—These amendments apply with respect to taxable years beginning after December 31, 1966.

g. Subpart F income (sec. 104(j) of the act and sec. 952(b) of the code)

Prior law.—Under existing law certain portions of the undistributed income of a controlled foreign corporation are taxed currently to its U.S. shareholders having a 10 percent or greater voting interest. This undistributed income so taxed is termed "subpart F income." In determining "subpart F income," there was, under prior law, an exclusion for income of a foreign corporation from U.S. sources which already was taxed by the United States because the corporation was engaged in trade or business in the United States. Prior law was interpreted in the income tax regulations as not excluding from "subpart F" income, income exempt from U.S. tax, or subject to a reduced rate of tax, in accordance with a treaty.

Explanation of provision.—The act amends prior law to provide that in determining "subpart F income" there is to be excluded only those items of income effectively connected with the conduct of a trade or business within the United States. It also makes it clear that "subpart F income" includes items exempt from U.S. tax or subject to a reduced rate of tax pursuant to a treaty.

Effective date.—This amendment applies with respect to taxable years beginning after December 31, 1966.

h. Gain from certain sales or exchanges of stock in certain foreign corporations (sec. 104(k) of the act and sec. 1248(d) of the code)

Prior law.—Prior law treated the gain realized by a 10-percent U.S. shareholder from the sale or exchange of stock of certain for-

foreign corporations as a dividend, to the extent the post-1962 earnings and profits of the corporation were attributable to the shares being sold or exchanged. In determining the earnings and profits to be taken into account in determining this gain, prior law excluded U.S. source income of a foreign corporation engaged in a U.S. trade or business. Consistent with the interpretation of similar language applicable to the determination of "subpart F income" explained above, these earnings and profits have been construed by the regulations as including income exempt from U.S. tax or subject to a reduced rate by treaty.

Explanation of provision.—This amendment provides that for taxable years beginning on or after January 1, 1967, the earnings and profits of the foreign corporation (for purposes of sec. 1248) are not to include income effectively connected with the conduct of a trade or business within the United States. In addition, the amendment makes it clear that the exclusion does not apply to income which is exempt from tax, or subject to a reduced rate of tax, pursuant to a treaty.

Effective date.—This amendment applies to sales or exchanges occurring after December 31, 1966.

5. MISCELLANEOUS INCOME TAX PROVISIONS, ETC.

a. Income affected by treaty (sec. 105(a) of the act and sec. 894 of the code)

Prior law.—Existing income tax treaties generally provide that the exemptions from tax, or the reduction in rates of tax, provided for in their provisions apply only to persons who do not have a permanent establishment in the United States. The "permanent establishment" concept of the treaties serves a purpose similar to the "engaged in a trade or business in the United States" concept of U.S. tax law. The effect of such a provision in a treaty, therefore, is to deny the benefits of a treaty exemption or reduced rate to a nonresident alien individual, or a foreign corporation, engaged in a trade or business in the United States through a permanent establishment.

Explanation of provision.—Under the tax treatment provided for such persons by the act, the "engaged in trade or business in the United States" criterion is no longer the sole determinant of the method of taxing particular items of a nonresident alien individual's, or a foreign corporation's, U.S. source income. The act seeks to tax all such persons alike on their noneffectively connected U.S. source income whether or not they also are engaged in a trade or business in the United States. This result would not be achieved under treaty provisions if some aliens or foreign corporations, because they have a permanent establishment in the United States, are denied the benefits of treaty rates or exemptions.

The act adds to the code a new subsection providing that for purposes of applying any exemption from, or any reduced rate of, tax granted by a treaty to which the United States is a party, with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. In other words, with respect to investment income not effectively connected with a trade or business, a nonresident alien or foreign cor-

poration will be taxed at the lower treaty rate if one is provided. This provision does not apply in computing the special tax applicable to U.S. citizens who become expatriates with a primary purpose of avoiding tax.

Effective date.—This new provision is effective for taxable years beginning after December 31, 1966.

c. Adjustment of tax on nationals, residents, and corporations of certain foreign countries (sec. 105(b) of the act and new sec. 896 of the code)

Explanation of provisions.—(A) *Imposition of more burdensome taxes.*—To prevent a deterioration in our position in negotiating treaties as a consequence of revising these statutory provisions, the act has added a provision to the tax laws which generally grants to the President the authority to apply the income tax law without regard to the amendments which this or later acts make to the provisions relating to the taxation of foreigners (including corporations) in the case of any country which imposes more burdensome taxes on U.S. citizens and corporations than the United States does on nonresident aliens and foreign corporations.

The new section gives special authority to the President where he finds that—

(1) under the laws of any foreign country, citizens of the United States (not residents of the foreign country) or U.S. corporations are being subject to more burdensome taxes on any item of income from sources within the foreign country than those imposed by the United States on similar U.S. source income of residents or corporations of the foreign country;

(2) the foreign country has not acted upon a request to revise or reduce its taxes to eliminate this condition; and

(3) it is in the public interest to reimpose the pre-1967 income tax provisions.

Where these conditions exist, the President may proclaim that the tax on similar income derived from U.S. sources by residents or corporations of the foreign country for taxable years beginning after the proclamation is to be determined by disregarding the amendments to the income tax law, as it relates to nonresident aliens and foreign corporations, made by this act or by subsequent acts.

If, after such a proclamation, the foreign country modifies the offending provisions of its tax law so that the President finds they are no longer more burdensome, he may proclaim that the U.S. tax on similar items of income derived from U.S. sources by residents or corporations of the foreign country, for taxable years beginning after such proclamation, is to be determined by taking into account the amendments made to the income tax provisions of the code relating to nonresident aliens and foreign corporations by this and later acts. Before the President makes a proclamation under this new provision he is to give the Congress 30 days notice of his intention so to do.

(B) *Imposition of discriminatory taxes by foreign country.*—This provision granting the President the authority to take such action as is necessary to raise the effective rate of U.S. tax on income received by nationals, residents, or corporations of a discriminating country to substantially the same rates as are applied in the other country was added.

Effective date.—These provisions are effective for taxable years beginning after December 31, 1966.

c. Foreign community property income (sec. 105(e) of the act and new sec. 981 of the code)

Prior law.—The general income tax provisions provide, in effect, that the worldwide income of a U.S. citizen is subject to tax from whatever source derived. In a recent case,⁴ it was held that an American citizen who acquired residence in a foreign country with community property laws, and who married a nonresident alien, had a sufficient interest in one-half of the marital partnership income—even though earned by the husband foreigner—to render her subject to U.S. taxation on that income.

Explanation of provisions.—The act provides U.S. citizens who are, during the periods involved, married to nonresident aliens with two separate elections, one for post-1966 years and one for pre-1966 years.

If an election is made for post-1966 years, the community income of husband and wife are to be treated as follows:

(1) Earned income (sec. 911(b)) is to be treated as income of the spouse who rendered the personal services.

(2) Trade or business income is to be treated as income of the husband unless the wife exercises substantially all the management and control over the business. Also, a partner's distributive share of income is to be wholly attributed to him (same as self-employment rules under section 1402(a)(5)).

(3) Other community income which is derived from separate property of one spouse is to be treated as income of that spouse. What is "separate property" for this purpose is to be determined under the applicable foreign community property law.

(4) All other community income is to be treated as provided in applicable foreign community property law.

For pre-1967 years the treatment of income of the types set forth in categories (1), (2), and (3) above is to be the same as described above, but the income described in category (4) above is to be treated as income of the spouse who, for the year involved, had the greater amount of income described in (1), (2), and (3) plus separate income. Thus, category (4) income is attributed to the marital partner whose earnings or property were most likely to have given rise to this income.

For purposes of this provision, the treatment of deductions is to be compatible with that accorded the income to which the deductions are attributable. In other words deductions are to follow the income they generate.

This provision provides qualified taxpayers with two elections, one for pre-1967 years and one for future years. Either election can be made for any year, at any time, so long as the year is still open. However, these elections are binding—if the election is exercised for any post-1967 year the treatment provided by this provision applies not only to the year of election but also to all years subsequent which are open and, if made for pre-1967 years, this provision applies for all open years prior to that date. It should be noted that either election can be made separately.

⁴ *Katrushka J. Parsons v. Commissioner*, 43 T.C. 331 (1964).

Generally, the election must be made by both spouses. However, with respect to the pre-1967 election, the foreign spouse need not join if the Secretary of the Treasury determines that (1) an election would not affect the U.S. tax liability of the foreign spouse for any taxable year, or (2) that the foreign spouse's U.S. tax liability for pre-1967 years cannot be ascertained and that to deny the election to the U.S. citizen would be inequitable and cause undue hardship. If either election is made, a period of 1 year is provided with respect to all open years for the making of assessments and the claiming of refunds. However, this 1-year period applies only if the deficiency or refund is attributable to the election. Also, no interest is due on a deficiency or refund resulting from the election for any period up to 1 year after the filing of the election.

d. Foreign tax credit—foreign corporations and nonresident aliens (sec. 106(a) of the act and secs. 874, 901, and new sec. 906 of the code)

Prior law.—Prior law did not grant a foreign tax credit to foreign corporations or nonresident aliens since such persons were subject to U.S. tax only on their U.S. source income. However, the code did provide a tax credit to U.S. persons with respect to foreign taxes on foreign income subject to U.S. tax.

Explanation of provision.—The act adds a new section to the code (sec. 906) to allow a foreign tax credit to nonresident aliens and foreign corporations with respect to foreign source income which is subject to tax in the United States because it is effectively connected with the conduct of a trade or business in the United States.

The credit is allowed under the existing foreign tax credit provision and is subject to the existing "per country" or "overall" limitation. The "per country" limitation restricts the credit to the proportion of the U.S. tax which the taxpayer's taxable income from sources within the particular country bears to his entire taxable income for the year. Similarly the "overall" limitation restricts the credit to the proportion of the U.S. tax which the taxpayer's taxable income, from sources without the United States, bears to his entire taxable income for the year. In determining the credit allowable to a nonresident alien individual or a foreign corporation under these limitations, the individual's or corporation's taxable income is to include only the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States. The credit is not allowable against U.S. taxes imposed at the flat 30-percent rate on income not effectively connected with the conduct of a trade or business in the United States.

Under some circumstances, existing law treats a portion of the foreign taxes paid by certain foreign subsidiaries of a domestic corporation as having been paid by the domestic corporation for purposes of computing its foreign tax credit. The act accords this same treatment to foreign corporations, but its application is limited to income effectively connected with the conduct of a trade or business within the United States.

Effective date.—These amendments apply for taxable years beginning after December 31, 1966. In applying the foreign tax credit carryback and carryover provisions of present law to nonresident aliens and foreign corporations no amount may be carried to or from a taxable year beginning before January 1, 1967.

e. Similar credit requirement (sec. 106(b) (2) and (3) of the act and secs. 901(c) and 2104(a) and new (h) of the code)

Prior law.—Under prior law, the foreign tax credit for income, etc., or death taxes are allowable to an alien who is a resident of the United States (or Puerto Rico) only if the foreign country in which the alien is a citizen or subject, in imposing its income, etc., or death taxes, allows a similar credit to citizens of the United States residing in such country.

Explanation of provision.—The act modifies the provision of prior law which in all cases denies a credit for citizens of a foreign country if it does not provide reciprocity for U.S. citizens residing there. Under the act the President is given some discretion as to the disallowance of the credits in such cases. The act provides that the President is to deny a foreign tax credit to residents who are subjects of a foreign country if he finds: (1) That a foreign country, in imposing income, war profits, and excess profits taxes or death taxes does not allow U.S. citizens residing in that country a credit for any taxes paid or accrued to the United States or any foreign country, similar to the foreign tax credit allowed by the United States to subjects of that foreign country residing in the United States; (2) that the foreign country, when requested to do so, has not acted to provide a similar credit to U.S. citizens residing in that foreign country; and (3) that it is in the public interest to allow the U.S. foreign tax credit to citizens or subjects of the foreign country who reside in the United States only if the foreign country allows such a similar credit to citizens of the United States residing in the foreign country.

The disallowance of the credit in any such case is to apply for taxable years beginning while a Presidential proclamation denying the credit is in effect.

f. Separate foreign tax credit limitation (sec. 106(c) of the act and sec. 904(f) of the code)

Prior law.—Generally, under existing law the limitation on the allowable foreign tax credit must be computed separately for all interest income on a "per country" basis. Prior to this act, the exceptions to this general rule were:

(1) Interest derived from any transactions directly related to the active conduct of a trade or business in a foreign country or U.S. possession;

(2) Interest derived in the conduct of a banking, financing, or similar business (such as an insurance company business);

(3) Interest received from a corporation in which the taxpayer owned at least 10 percent of the voting stock; and

(4) Interest received on obligations acquired as the result of the disposition of a trade or business actively conducted by a taxpayer in a foreign country or as a result of a disposition of stock or obligations of a corporation in which the taxpayer owned at least 10 percent of the voting stock.

Explanation of provision.—The Act amends the 10-percent exception in (3) above to provide that the special limitation on interest from foreign corporations is not to apply with respect to interest income received by a U.S. lending corporation which directly or indirectly owns at least 10 percent of the foreign corporation from which the interest is derived. For purposes of this provision stock owned directly or

indirectly by or for a foreign corporation is to be considered as owned proportionately by its shareholders.

Effective date.—The amendments made by this provision apply to interest received after December 31, 1965, in taxable years ending after that date.

g. Amendment to preserve existing law on deductions under section 931 (sec. 107 of the act and sec. 931(d) of the code)

Under existing law, U.S. citizens or domestic corporations earning income in possessions of the United States generally are taxable only on their U.S. source income (plus amounts received in the United States) if they meet certain requirements.⁵ In general, these requirements are that the citizen or corporation derive 80 percent of its gross income from sources within such a possession and 50 percent of its gross income from the active conduct of a trade or business within such a possession (both of these tests being applied with respect to income received in the prior 3 years).

A U.S. citizen or domestic corporation which qualifies for this treatment may exclude from its U.S. tax base gross income from sources without the United States (in the same way as nonresident aliens and foreign corporations not engaged in trade or business within the United States). The deductions allowed a U.S. person who qualifies for this exclusion are those which were allowable under prior law to nonresident aliens and foreign corporations engaged in trade or business in the United States. In general, these deductions were: (1) Those connected with U.S. source income, (2) those allocated or apportioned under regulations with respect to deductions related to income which is partially from within and without the United States, (3) losses not connected with the trade or business but incurred in transactions entered into for profit (if the profit, had the transaction resulted in a profit, would have been taxable by the United States), (4) casualty losses (if the loss is of property within the United States), and (5) the charitable contribution deduction.

Explanation of provision.—The act does not change the tax treatment of income qualifying for the exclusion relating to income from U.S. possessions but because it allows deductions to nonresident aliens and foreign corporations engaged in a trade or business in the United States only where the deductions are allocable to income effectively connected with this trade or business, it is now necessary in this provision to specify the deductions which may be taken. The act therefore makes applicable to U.S. citizens and domestic corporations engaged in trade or business in possessions, who qualify for the special tax treatment under existing law, the provisions of prior law which allow deductions to nonresident aliens or foreign corporations engaged in trade or business in the United States.

This amendment is effective for taxable years beginning after December 31, 1966.

G. ESTATE TAX PROVISIONS

a. Estate tax rates (sec. 108(a) of the act and sec. 2101(a) of the code)

Prior law.—Under existing law and that in effect prior to this act, the estate of a nonresident alien is taxed only on the transfer of prop-

⁵ Possession for purposes of this provision does not include the Virgin Islands or, in the case of U.S. citizens does not include Puerto Rico.

erty situated or deemed to be situated in the United States at the time of his death. While under prior law, the tax rates were the same as for citizens and residents of the United States, the deductions, credits, and exemptions were different: No marital deduction was allowed with respect to the estate of a nonresident alien; the specific exemption in determining the taxable estate was \$2,000 instead of the \$60,000 applicable in the case of U.S. citizens; no credit was allowed for foreign death taxes paid; and deductible expenses, losses, etc., were generally limited to the same proportion of these expenses which the alien's gross estate situated within the United States was of his entire gross estate.

Explanation of provision.—The act establishes a new schedule of graduated estate tax rates applicable to estate of nonresident aliens which will impose a tax on the U.S. estates of these persons in an amount which is generally equivalent to the tax imposed on an estate of similar value of a U.S. citizen with the maximum marital deduction. (As is explained subsequently the act also increases the specific exemption available with respect to estates of nonresident aliens.)

The new schedule of rates applicable to estates of nonresidents not citizens is as follows:

If the taxable estate is:	The tax shall be:
Not over \$100,000-----	5 percent of the taxable estate.
Over \$100,000 but not over \$500,000----	\$5,000, plus 10 percent of excess over \$100,000.
Over \$500,000 but not over \$1,000,000--	\$45,000, plus 15 percent of excess over \$500,000.
Over \$1,000,000 but not over \$2,000,000--	\$120,000, plus 20 percent of excess over \$1,000,000.
Over \$2,000,000-----	\$320,000, plus 25 percent of excess over \$2,000,000.

Table 1 shows a comparison of the effective rates for estates of nonresident aliens provided by this new schedule with the effective rates under prior law for nonresident aliens and U.S. citizens with and without a marital deduction. It will be noted that the effective rates resulting from the new schedule closely approximate those applicable in the case of the estate of a U.S. citizen with a marital deduction.

TABLE 1.—*Effective rates of U.S. tax on U.S. estates of nonresident aliens under prior law and under the act and on U.S. citizens under existing law*

U.S. gross estate ¹	Effective rate of tax			
	Prior treatment of nonresident alien	Tax treatment of nonresident alien provided by act ²	U.S. citizen	
			With marital deduction	Without marital deduction
\$2,000-----				
\$10,000-----	2.9			
\$30,000-----	7.7			
\$60,000-----	12.5	2.0		
\$100,000-----	17.3	3.0		3.0
\$500,000-----	25.8	7.4	8.0	22.1
\$1,000,000-----	28.8	10.1	11.1	26.7
\$5,000,000-----	43.0	17.8	16.9	42.3
\$10,000,000-----	53.3	20.6	21.2	52.8

¹ For purposes of these computations it is assumed 10 percent of gross estate is deducted for funeral and other expenses both in the case of U.S. citizens and nonresident aliens.

² Takes into account the increase in the exemption from \$2,000 to \$30,000.

Effective date.—These new rates are to be effective with respect to estates of decedents dying after November 13, 1966.

b. Limitation on credit for State death taxes (sec. 108(b) of the act and sec. 2102 of the code)

Prior law.—Under prior law, the estate of a nonresident alien was allowed a credit against its U.S. estate tax for death taxes it paid to any of the States of the United States. The only death tax some of the States impose is a so-called pickup tax, that is, a tax equal to the maximum credit for State death taxes allowable against the Federal estate tax. Other States impose a pickup tax in addition to their regular death taxes.

Explanation of provisions.—The act amends prior law to provide that the maximum credit for State death taxes allowable against the Federal estate tax imposed on estates of nonresidents not citizens is to be an amount which bears the same ratio to the credit (computed without regard to this limitation) as the value of the property upon which the State death taxes are paid (and which is includible in the gross estate) bears to the total gross estate for Federal tax purposes.

Effective date.—This amendment applies with respect to estates of decedents dying after November 13, 1966.

c. Bond situs rule (sec. 108(c) of the act and sec. 2104 of the code)

Prior law.—Under existing law, a nonresident alien is subject to the U.S. estate tax only with respect to property which is situated in the United States at the time of his death. The code provides so-called situs rules for determining under what conditions various types of property are to be considered as having a U.S. situs and therefore includible in the estate tax base of a decedent. Under these rules stock of a domestic corporation owned by a nonresident alien is considered to be property within the United States regardless of the location of the share certificates. In the case of bonds issued by U.S. corporations, no such statutory situs rule exists. Instead, under prior law, for Federal estate tax purposes, the debt represented by a bond of a domestic corporation was considered to be situated at the location where the certificate was held. Other intangible debt obligations of U.S. obligors have been treated as being situated within the United States.

Explanation of provision.—The act adds a new provision to the law providing that for purposes of the tax imposed on the estates of nonresidents not citizens, all debt obligations (including bonds) of a U.S. person, the United States, a State or political subdivision of a State, or of the District of Columbia owned and held by a nonresident not a citizen of the United States are to be deemed to be property situated within the United States. An exception to this rule is provided for debt obligations of U.S. corporations which have derived less than 20 percent of their gross income from U.S. sources for the 3 years prior to the nonresident's death. In such cases these debt obligations are to be considered as having a foreign situs. For purposes of this provision U.S. currency is not to be considered a debt obligation of the United States.

Effective date.—This amendment applies with respect to estates of decedents dying after November 13, 1966.

d. Deposits in U.S. banks or foreign branch banks of U.S. corporations (sec. 108(d) of the act and sec. 2105 of the code)

Prior law.—Prior law provided that, for purposes of estate tax, the deposits of nonresident aliens with U.S. persons carrying on the banking business were not considered to have had a situs within the United States if the decedent was not engaged in a trade or business in the United States at the time of his death. This rule applied to deposits in foreign branch banks of U.S. corporations as well as to deposits in domestic branches.

Explanation of provision.—The act provides that after 1972 deposits of nonresident aliens and foreign corporations with U.S. persons carrying on the banking business will be considered to have a situs within the United States. The 1973 effective date conforms this estate tax provision to the effective date of the income tax provision which taxes the interest derived from these deposits beginning after 1972. Also, the new situs rule provides that for purposes of the U.S. estate tax on estates of nonresident aliens, deposits in a foreign branch bank of a U.S. corporation or partnership, if the branch is engaged in the commercial banking business, are not to be deemed to be property within the United States. Therefore these deposits will not be included in the foreigner's taxable U.S. estate.

Effective date.—This amendment is applicable to the estates of decedents dying after November 13, 1966.

e. Definition of taxable estate (sec. 108(e) of the act and sec. 2106 (a) (3) of the code)

Prior law.—Under existing estate tax law, the estate of a citizen of the United States is entitled to a \$60,000 exemption. In the case of the estate of a nonresident alien, however, prior law allowed only a \$2,000 exemption. In the case of decedents who were residents of U.S. possessions at the time of death and were citizens of the United States solely by reason of being a citizen of the possession, or by reason of birth or residence in the possession, the exemption provided by prior law was the greater of \$2,000, or the proportion of the \$60,000 exemption which the value of that part of the decedent's gross estate which was situated in the United States bore to the value of his entire gross estate.

Explanation of provision.—Under the act, the estate of a nonresident not a citizen is allowed to deduct a \$30,000 exemption in computing the taxable estate. The exemption which the estate of a resident of a U.S. possession to which the special rule applies is allowed, under the act, is to be the greater of \$30,000 or the proportion of the \$60,000 exemption allowable under existing law.

Effective date.—These amendments apply to estates of decedents dying after November 13, 1966.

f. Expatriation to avoid tax (sec. 108(f) of the act and new sec. 2107 of the code)

Prior law.—The U.S. estate tax applies to U.S. citizens and U.S. residents with respect to their estate no matter where situated. However, a foreign estate tax credit is allowable with respect to foreign death taxes paid in the case of property having a situs outside of the United States. In the case of nonresident aliens, prior law provided that the U.S. estate tax applied but only with respect to property having a U.S. situs. Under prior law, if an individual who had

been a U.S. citizen gave up this citizenship and became a nonresident alien, no tax was imposed with respect to his estate to the extent the property was situated outside of the United States.

Explanation of provision.—The act adds a new section to the code which imposes the regular U.S. estate tax rates on the U.S. estate of a nonresident alien dying within 10 years after losing U.S. citizenship if one of the principal purposes of the loss of citizenship was the avoidance of U.S. income, estate, or gift taxes. This provision is not to apply to those who lost their citizenship on or before March 8, 1965. It also does not apply in the case of decedents dying on or before November 13, 1966.

In determining the value of the gross estate of such an expatriate (as in the case of nonresident aliens generally) only property situated in the United States that was owned by him at the time of his death is included. However, the U.S. estate tax base of these expatriate decedents is expanded in certain respects to prevent him from avoiding U.S. tax on his estate by transferring assets with a U.S. situs to a foreign corporation in exchange for its stock. Such a transfer by a nonresident alien would reduce the portion of his gross estate having a U.S. situs, since the stock of a foreign corporation has a foreign situs even though the assets of the foreign corporation are situated in the United States. The new provision specifies, if certain stock ownership tests are met, that the value of the expatriate's gross U.S. estate is to include the same proportion of the value of the stockholdings of the expatriate in the foreign corporation as its property having a U.S. situs bears to all its property.

The ownership tests that must be met for this special provision to apply are:

(i) The decedent must have owned at the time of his death 10 percent or more of the voting power of all classes of stock of the foreign corporation. Ownership for this test includes direct ownership and indirect ownership through another foreign corporation or through a foreign partnership, trust, or estate.

(ii) The decedent must have owned, at the time of his death, more than 50 percent of the total voting power of all classes of stock of the foreign corporation. Ownership for purposes of this test is ownership as described in (i) above plus ownership attributed to the expatriate under certain attribution rules of existing law (sec. 958(b) of the code). In general, these rules attribute to an individual ownership of stock held by members of his family, as well as by partnerships, trusts, estates, or corporations in which the individual has certain interests.

In addition, in determining whether the ownership tests are met, and in determining the portion of the U.S. situs property owned by the foreign corporation that must be included in computing the value of his gross estate, the expatriate is treated as owning the stock of a foreign corporation (at the time of his death) which he transferred during his life but which under U.S. estate tax law generally is not effective in excluding property from a gross estate. There transfers are:

- (i) Transfers in contemplation of death (sec. 2035).
- (ii) Transfers with retained life estate (sec. 2036).
- (iii) Transfers taking effect at death (sec. 2037).
- (iv) Revocable transfers (sec. 2038).

In computing the estate tax under this new provision the expatriate's estate is allowed the credit for State death taxes, the credit for gift tax, and the credit for tax on prior transfers.

The new section excepts from its application certain expatriates whose loss of U.S. citizenship occurs under circumstances which would make the application of the special taxing provisions inappropriate. These are the same exceptions provided with respect to the income tax expatriation provision (see No. 3(c) above).

The new provision, like the comparable income tax provision, contains a special rule dealing with the burden of proving the existence or nonexistence of U.S. tax avoidance as one of the principal purposes of the expatriation. Under this provision, the Secretary of the Treasury or his delegate must establish that it is reasonable to believe that the expatriate's loss of U.S. citizenship would (but for the application of this new provision) result in a substantial reduction in the estate, inheritance, legacy, and succession taxes.

If this is established, then the administrator of the expatriate's estate must carry the burden of proving that the loss of citizenship did not have as one of its principal purposes the avoidance of U.S. income, estate, or gift taxes.

Effective date.—This new provision is effective with respect to estates of decedents dying after November 13, 1966. It does not apply, however, to expatriates who lost their citizenship on or before March 8, 1965.

g. Application of pre-1967 estate tax provisions (sec. 108(f) of the act and new sec. 2108 of the code)

The unilateral reduction of estate tax rates applicable to nonresident aliens by this act may have the effect of making it more difficult to negotiate estate tax treaties. This is comparable to the similar problem arising from the revision of the income tax provisions applicable to nonresident aliens. As in the case of the income tax provisions therefore, the act has added a new provision which gives authority to the President to apply certain provisions of the estate tax law relating to estates of nonresidents not citizens without regard to the amendments made to these provisions by this, or any subsequent, act in the case of estates of residents of any country which imposes more burdensome death taxes with respect to estates of U.S. citizen decedents, not residents of that country, than does the United States on estates of residents of such a country, not citizens of the United States.

The new provision gives special authority to the President where he finds that:

- (1) Under the laws of a foreign country a more burdensome tax is imposed on the estates of U.S. citizens, not residents of the country, than is imposed on the estates of residents of that country by the United States;
- (2) The foreign country, when requested so to do, has not revised its taxes to eliminate this extra burden; and
- (3) It is in the public interest to reimpose the pre-1967 estate tax provisions.

Where these conditions exist the President may proclaim that the U.S. tax on estates of residents of the foreign country is to be determined under certain provisions of U.S. estate tax laws (secs. 2101, 2102, 2106,

and 6018) as in effect prior to amendment by this or any subsequent act. Such a proclamation is to apply to the estates of decedents dying after the date of the proclamation.

If after making such a proclamation the President finds that the laws of the foreign country have been revised to alleviate the excess burden on the estates of U.S. citizens he may proclaim that the tax on the estates of residents of the country is to be determined by taking into account the amendments made by this act, and any subsequent act. Such a proclamation is to be effective with respect to estates of decedents dying after its date.

Before issuing a proclamation under the new provision the President is required to give 30 days notice of his intent so to do to the Senate and the House of Representatives.

This new section is applicable with respect to estates of decedents dying after November 13, 1966.

h. Estate tax returns (sec. 108(g) of the act and sec. 6018 of the code)

Under prior law the executor of the estate of a nonresident alien was required to file a U.S. estate tax return if the U.S. estate exceeded \$2,000. The filing of returns with respect to these estates of over \$2,000 was required because only a \$2,000 exemption was granted to the estates of nonresident aliens. Since the act has increased the \$2,000 exemption to \$30,000, the return filing requirement is likewise increased by the act from \$2,000 to \$30,000. This amendment applies with respect to estates of decedents dying after November 13, 1966.

7. GIFT TAX PROVISIONS

a. Tax on gifts of nonresidents not citizens (sec. 109(a) of the act and sec. 2501 of the code)

Under prior law a gift of intangible property having a U.S. situs by a nonresident alien who was engaged in trade or business in the United States was subject to U.S. gift tax.

In practice this rule proved to be impossible to enforce, since there was no practical way for the Internal Revenue Service to find out when these gifts were made. Moreover, it did not occur to many nonresident aliens that these transfers were subject to U.S. gift tax. Thus the revenue significance of this provision was minimal.

The act amends prior law to provide that gifts of intangible property by nonresident aliens are not to be subject to the U.S. gift tax.

To prevent this new rule from becoming a means of tax avoidance by U.S. citizens, the act also provides that the rule is not to apply to gifts by donors who within the 10 years immediately before the gift became expatriates of the United States with a principal purpose of avoiding U.S. income, estate, or gift taxes.

As in the case of similar amendments with respect to the income and estate taxes, the new provision provides a special rule relating to the burden of proof. Under this rule if the Secretary of the Treasury or his delegate establishes that it is reasonable to believe that the individual's loss of U.S. citizenship will result in a substantial reduction in the gift tax payable by the donor, the burden of proving that tax avoidance was not one of the principal purposes rests with the donor. Certain types of losses of citizenship, as in the case of similar income

and estate tax provisions, are not to result in the application of this provision.

This amendment applies with respect to the calendar year 1967 and all calendar years thereafter.

b. Situs of bonds given by expatriates (sec. 109(b) of the act and sec. 2511 of the code)

Under prior law bonds issued by U.S. persons, unlike other debt obligations, were considered to be situated where the instrument was located for purposes of the gift tax applicable to nonresident aliens. Under that rule, a citizen who became an expatriate with a principal purpose of avoiding U.S. taxes escaped U.S. gift taxation. To prevent this result, the act amends the present gift tax laws to provide that debt obligations of a U.S. person, or of the United States, a State or political subdivision thereof, or the District of Columbia which are owned by such expatriates are deemed to be situated in the United States. This amendment applies with respect to the calendar year 1967 and all calendar years thereafter.

8. TREATY OBLIGATIONS

No amendment made by this act is to apply in any case where its application would be contrary to any treaty obligation of the United States. However, for purposes of this provision, the granting of a benefit provided by any amendment made by this act will not be considered to be contrary to a treaty obligation.

B. OTHER AMENDMENTS TO THE INTERNAL REVENUE CODE

1. Application of investment credit to property used in U.S. possessions (sec. 201 of the act and sec. 48(a)(2) of the code)

In general, under prior law the investment credit was not available for property located outside the United States. Therefore, with limited exceptions, property used in a possession was not eligible for the investment credit.

This amendment extends the application of the investment credit provision to property used in a possession by a U.S. person, or by a corporation organized in a possession, provided the property would otherwise have qualified for the investment credit. This rule is not extended if the property is owned or used in the possession by U.S. persons who are presently exempt from U.S. tax due to the application of the special provisions of the code which exempt U.S. persons who derive substantially all their income from a U.S. possession (secs. 931, 932, 933, or 934(b)).

This amendment is effective with respect to taxable years ending after December 31, 1965, but only with respect to property placed in service after that date. Additionally, for purposes of computing a carryback of investment credit, the amount of any investment credit generated by this provision is to be disregarded.

2. Basis of property received in liquidation of subsidiary (sec. 202 of the act and sec. 334(b)(2) and (3) and sec. 453(d) of the code)

(a) Purchase of stock.—Under existing law, if one corporation purchases 80 percent or more of the stock of another within a 12-month period and then causes the corporation acquired to be liquidated within

2 years of the last purchase, the basis of all the assets received is the amount paid for the stock. Under prior law, however, in order to prevent manipulation, stock purchased from a person related to the buyer by the attribution rules (under section 318) was not treated as stock "purchased."

Cases have been cited where it is necessary to acquire control of one corporation in order to obtain an 80 percent or greater stock interest in another corporation. For example, assume that one corporation desires to purchase the stock of a second corporation and does in fact purchase 45 percent of its stock directly. However, 40 percent of the stock of the second corporation is owned by a third corporation, and the third corporation does not wish to sell the stock of the second corporation. In order to acquire the stock of the second corporation, therefore, the first corporation purchases over 50 percent of the third corporation's stock and then causes this third corporation to sell to it the 40 percent of the stock of second corporation owned by the third. Under prior law, since at the time of the sale the first corporation owns more than 50 percent of the stock of the third corporation, the two corporations would have been classified as related under the attribution rules (sec. 318) and the first corporation would not have been treated as the purchaser of more than 80 percent of the stock of the second although it acquired directly or indirectly all of this stock for cash within a 12-month period.

The act amends present law to provide that stock purchased from a related corporation (after control of it is acquired) is to be treated as purchased if the stock of the related corporation (representing a controlling interest) was purchased within the specified period. The amendment provides that the 12-month period within which the desired stock must be acquired begins with the date of the first direct acquisition by purchase of such stock, or the date on which 50 percent of the stock of the corporation holding such stock was acquired, whichever is earlier.

The new definition of purchase applies with respect to acquisitions of stock after December 31, 1965. The provision for measuring the time period of stock acquisition applies with respect to distributions made after November 13, 1966.

(b) *Installment notes.*—When one corporation buys more than 80 percent of the stock of another within 12 months and causes the corporation acquired to be liquidated within 2 years of the last acquisition of stock, generally no gain is recognized to the distributing corporation (unless it is a corporation which elected sec. 341(f) treatment to avoid danger of being treated as a collapsible corporation, or unless the sections dealing with the recapture of depreciation apply).

Under prior law, if the property received on a liquidation of the type described above (to which sec. 334(b)(2) applies) consisted of installment notes, then the gain which would normally be taxed on the sale or collection of such notes might, in part or in whole, permanently escape income taxation. This resulted where the basis of such notes were raised to the amount paid for them by the acquiring corporation even though no gain was recognized to the distributing corporation.

The act provides that installment notes transferred in a liquidation of the type described above are to be treated as "disposed of" for purposes of the installment sale provision (sec. 453(d)). As a result,

gain is to be recognized to the distributing corporation, in the same manner as if it had sold the notes.

This amendment is effective with respect to distributions made after November 13, 1966.

3. *"Swap funds" (sec. 203 of the act and sec. 351 of the code)*

Prior law.—Under section 351 of the Internal Revenue Code, the transfer of property to a corporation by one or more persons in exchange for stock in the corporation is not to result in gain or loss if, immediately after the exchange, the person or persons in question are "in control" of the corporation.

In 1960 the Internal Revenue Service issued a limited number of rulings to the effect that no tax resulted from the exchange of appreciated stock for shares in an investment fund where, immediately after the exchange, the persons who transferred the stock to the corporation were in control of the corporation. Investment funds organized in this way have become known as "swap funds." In 1961, the Service stopped issuing these rulings and subsequently (in Rev. Proc. 62-32) announced that it would not issue rulings in this area. Notwithstanding this change in position, new swap funds continued to be formed, relying on the advice of private tax counsel that the exchange of stock for stock in these cases was nontaxable.

On July 14, 1966, the Treasury issued a proposed regulation to the effect that this type of exchange would be taxable. At the same time it offered to enter into closing agreements with existing swap funds which would provide that section 351 would be applied to past transfers for all purposes under the code, including the determination of basis.

Explanation of provision.—The act provides that no gain or loss is to be recognized with respect to property that is transferred to an investment company on or before June 30, 1967, if the transfer is solely in exchange for stock or securities in the investment company and immediately after the exchange the transferor or transferors are in control of the corporation. Gain or loss will be recognized, however, with respect to such transfers made after June 30, 1967.

For the purposes of this provision a transfer of property will only be considered as made on or before June 30, 1967, if—

(i) The registration statement of the investment company is filed with the Securities and Exchange Commission before January 1, 1967, and the aggregate issue price of the stock and securities of the company which are issued in the transaction does not exceed the amount specified in the registration statement as of the close of December 31, 1966,

(ii) The transfer of property to the investment company includes only property deposited before May 1, 1967, and

(iii) The transfer itself is made on or before June 30, 1967.

Effective date.—This provision applies with respect to transfers of property to investment companies made before, on, or after the date of enactment.

4. *Removal of certain limitations to deductibility of contributions to self-employed individuals' pension plans (sec. 204 of the act and secs. 401 and 404 of the code)*

Prior law.—Self-employed individuals may establish retirement plans and may deduct from their gross incomes contributions made to

these plans. Employees with more than 3 years of service must be covered, and contributions on their behalf are fully deductible.

Under prior law, a self-employed individual could deduct from his gross income 50 percent of the contribution on his own behalf, and the contribution was limited to the smaller of 10 percent of his earned income or \$2,500. Accordingly, the maximum deduction allowed to a self-employed person with respect to his own contribution was \$1,250.

Earned income for this purpose was defined as the income received from the performance of personal services. When capital as well as personal services was a material factor in the production of the income, earned income could not exceed 30 percent of the net profits from the business (except that where an individual rendered personal services on a substantially full-time basis, this 30-percent rule could not reduce the net profits considered as earned income below \$2,500).

Explanation of provisions.—The act removes two limitations to the deduction.

First, the limitation of the deduction on behalf of a self-employed person to 50 percent of the contribution (10 percent of earned income up to a maximum of \$2,500) is repealed. This will permit the self-employed individual to deduct from his gross income the full amount of this contribution toward his own retirement, in the same manner as he does the full contribution he makes for his employees eligible for coverage. No change, however, is made in the limitation on the size of his contribution for himself; it remains at 10 percent of his earned income or \$2,500, whichever is smaller.

Second, the restriction is removed which limited the share of income considered "earned," where both personal services and capital are important income-producing factors. The entire amount of net profits in such cases may be considered "earned." It is provided, however, that in such cases the net profits involved with respect to any self-employed person are to be treated as earned income only in the case of a trade or business in which the personal services of the particular self-employed individual involved are a material income-producing factor. By this, it is contemplated that substantially full-time employment will be treated as a material income-producing factor. In the case of less than full-time employment, in determining whether the personal services of the taxpayer are a material income-producing factor there is to be taken into account the respective contribution made by his personal services and by his capital.

Effective dates.—The removal of the 50-percent limitation on the deductibility of contributions is to be effective with respect to taxable years beginning after December 31, 1967. No specific effective date was provided in the act for the provision regarding the treatment of earned income.

5. *Treatment of certain income of authors, inventors, etc., as earned income for retirement plan purposes (sec. 205 of the act and sec. 401(c) (2) of the code)*

Prior law.—Under the provisions which permit self-employed persons to deduct contributions (within specified limits) made to pension or profit-sharing plans for the benefit of themselves and other employees covered by a voluntary retirement plan, coverage depends on "earned income," and such income is the basis for computing deductible contributions. This term includes professional fees and other com-

pensation for personal services from a trade or business (but does not include amounts which constitute a return on capital invested in the trade or business).

With respect to authors, the Internal Revenue Service took the position that if an author contracted to write articles for a given period or a book for a publisher who copyrighted the literary material and paid the author a stipulated amount of cash, plus a percentage of the income derived from the material, the consideration was for the author's personal services and constituted earned income. However, where the consideration received by an author was derived either from the sale, leasing, or renting of the author's writing, the consideration was held to be paid for the use or sale of property and not to constitute earned income. A similar position was taken by the Service with respect to inventors and others who created property through the application of their personal efforts.

Explanation of provision.—The act amends the self-employed individuals retirement plan provisions to provide that "earned income" includes gains (other than capital gains) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created the property.

Effective date.—This amendment applies to taxable years ending after November 13, 1966.

6. Exclusion of certain rents from personal holding company income (sec. 206 of the act and sec. 543 of the code)

Under prior law, if a company manufactured property and leased it to customers, the rents were treated as personal holding company income (unless the adjusted income from rents from all sources constituted 50 percent or more of the adjusted ordinary gross income and unless the sum of the dividends paid during the year had reduced the other personal holding company income below 10 percent of the ordinary gross income). However, where the property manufactured by the taxpayer was sold instead of leased, the income from the sale was not treated as personal holding company income.

The act provides that compensation for the use of any tangible personal property manufactured or produced by the taxpayer is not to be treated as rental income under the personal holding company provisions if the taxpayer during the taxable year is engaged in manufacturing the same type of property from which he is receiving the rents. The effect of this is to treat this income (after it is reduced by applicable depreciation, taxes, rent, and interest paid) as ordinary business income in determining whether or not the corporation is a personal holding company. It is intended, in order for the provision to be applicable, that the manufacturing or production activity be substantial and more than minor assembly processes. (Tangible personal property here has the same meaning as in the case of the investment credit provision.)

The amendments apply to taxable years beginning after date of enactment, but taxpayers may elect to have the amendments apply to years beginning on or before that date if such years end after December 31, 1965.

7. *Percentage depletion rate for certain clay bearing alumina (sec. 207 of the act and sec. 613 of the code)*

This provision raises the percentage depletion rate from 15 to 23 percent in the case of domestic deposits of clay, laterite, and nephelite syenite (to the extent alumina or aluminum compounds are extracted therefrom). This is the same rate of percentage depletion which is now allowed to domestic deposits of bauxite.

This provision is applicable only to taxable years beginning after November 13, 1966.

8. *Percentage depletion rate for clam and oyster shells (sec. 208 of the act and sec. 613 of the code)*

The act provides that in the case of clam shells and oyster shells (as well as other mollusk shells), a percentage depletion rate of 15 percent generally is to apply (rather than the 5 percent rate of prior law). However, as is true under existing law in the case of limestone and other calcium carbonates, a 5-percent rate is applicable if the shells are used, or sold for use, as riprap, ballast, road material, rubble, concrete aggregates, or for similar purposes.

The provision is applicable to taxable years beginning after November 13, 1966.

9. *Percentage depletion rate for certain clay, shale, and slate (sec. 209 of the act and sec. 613 of the code)*

Under prior law a 5 percent depletion rate was provided for clay used or sold for use in the manufacture of brick or sewerpipe, for shale, and for clay or slate used or sold for use as concrete aggregate or for similar purposes.

The act raises the depletion rate to 7½ percent for clay or shale used or sold for use in the manufacture of sewerpipe and brick, and for clay, shale or slate used or sold for use as sintered or burned lightweight aggregates.

This provision applies to taxable years beginning after November 13, 1966.

10. *Income from the lapse of straddle options (sec. 210 of the act and sec. 1234(c) of the code)*

*Nature of straddles.*⁶—Straddles are one form of an option; namely, an offer both to purchase and to sell a specified amount of property at a stated price for a limited period of time. Options to sell securities are known as “puts”—i.e., the purchaser of the option can “put” his shares to the writer or issuer of the option at the stated price. Options to purchase are known as “calls”—i.e., the purchaser of the option can “call” the shares from the writer at the stated price. A “straddle” is a combination of a put and call, with respect to the same security, for the same quantity, at the same purchase or sale price and available for the same period of time.

Straddles are likely to be written by persons with holdings of a security who believe that in the long run, the price of the stock will not vary greatly from its present price. Their inducement for writing the straddle is the receipt of a premium. Straddles generally are

⁶ Much of the material presented in this part was derived from the “Report on Put and Call Options,” a report published in August 1961 by the Securities and Exchange Commission, on the basis of an extensive study by the SEC’s Division of Trading and Exchanges.

granted to brokers or dealers who, in turn, customarily sell the put and call components to different purchasers. The majority of puts and calls originate in straddles. While the use of puts and calls is not a new development in the securities markets, their significance is relatively limited; for example, the total number of shares covered by options sold in recent years on the New York Stock Exchange has rarely exceeded 1 percent of the total shares sold.

Normally either (not both) the put or the call component of the straddle is exercised by the purchaser shortly before the end of the term for which the straddle is written. Frequently this is 6 months and 10 days after the straddle is issued. Which component of the straddle is exercised depends upon the market conditions at the time of exercise vis-a-vis market conditions at the time the straddle was written. If the market in that security has risen, the securities are likely to be "called" from the writer; if the market has fallen, the stock is likely to be "put" to the writer. While in the great majority of the cases, one component of the straddle is exercised and the other is allowed to lapse, occasionally (perhaps 10 to 15 percent of the time) neither option is exercised and in a few other cases (less than 1 percent of the cases) both components of the straddle are exercised.

Although options are purchased for hedging and other similar purposes by some investors, their primary use probably is as a method of investing by individuals with small amounts of money.

Prior law.—Under the 1939 code, premium income received from the writing of an option which lapsed without either the put or call being exercised was treated as a short-term capital gain (sec. 117(g)(2) of the 1939 code). When one component of the straddle was exercised, however, straddle writers generally allocated the entire straddle premium to the component option which was exercised. This practice apparently was not challenged by the Internal Revenue Service prior to the issuance of a revenue ruling in 1965 (Revenue Ruling 65-81). Since one component or the other of a straddle is exercised in the bulk of the cases, the fact that the premium in the case of the lapse of an option was treated as short-term capital gain was of relatively little significance. The important aspect was the treatment of the premium in connection with the portion of the straddle which was exercised.

When all of the premium is allocated to the component which is exercised and this is the "put," the premium decreases the cost or basis of the stock put to the writer of the straddle. As a result, it increases his capital gain only when he disposes of the stock put to him. Generally, this results in a long-term capital gain (unless he holds the stock for less than 6 months). Where the call component is exercised and all of the straddle premium is allocated to it, the premium increases the income received by the writer at the time the stock is called from (i.e., sold by) him. As a result in these cases also, the total premium increases the writer's capital gain (or decreases his capital loss) and if the writer has held the stock for more than 6 months, the gain (or loss) is long term.

The 1939 code provision treating income from the lapse of an option as a short-term capital gain was not included in the 1954 code. As a result, where both options were permitted to lapse, the total straddle premium was reported as ordinary income. However, in the usual case where one option lapsed and the other was exercised, the practice

of allocating the straddle premium income to the side exercised was continued.

In the ruling (Revenue Ruling 65-31) issued on January 22, 1965, the Internal Revenue Service held that the premium for a straddle must be allocated between its put and call components on the basis of the relative market values of each. In a later technical information release, the Service announced that it would accept allocations of 55 percent of each straddle premium to the call component and 45 percent to the put component.⁷

Under the ruling, the part of the premium which arose from the writing of a single straddle could result in ordinary income (the portion of the premium allocated to the lapsed component) while the remaining portion of the premium could result in either a capital gain or a capital loss, which in the usual case would be a long-term gain or loss.

The manner in which prior law was applied under the ruling can be illustrated by the following example. Assume that a straddle writer issued a straddle for a stock when its price was \$100 a share and this was the option price. Assume that the straddle premium was \$8 per share. Assume further that the put component of the straddle was exercised by the purchaser when the price of the stock was \$80 per share. As a result, the writer of the straddle had to buy stock at a price of \$100 per share when its market value was \$80 per share. If the straddle premium allocable to the put component was \$3.60 per share, the short-term capital loss for the writer of the straddle was \$16.40 per share if he disposed of the stock shortly after receipt, when the market price was still \$80 per share. At the same time, the remainder of the straddle premium, \$4.40 a share, was allocated to the call component, which in such a case presumably was allowed to lapse. The \$4.40 per share was ordinary income while the capital loss of \$16.40 a share attributable to the put side of the option resulted in a short-term capital loss, which, except to the extent of the \$1,000 a year, could not be netted with the ordinary income attributable to the premium income of the other side of the straddle.

Explanation of provision.—The amendment adds a new subsection (c) to section 1234 of the code which provides that gain derived from the lapse of an option written as a part of a straddle (as defined in new section 1234(c)(3)) is, in effect, to be short-term capital gain. Thus, such gains will be added to any other short-term capital gains, to be netted against short-term capital losses, with the excess to be netted against any net long-term capital losses. Any remaining short-term capital gains will generally be taxed as ordinary income. This provision does not apply to a person who holds securities (including options to acquire or sell securities) for sale to customers in the ordinary course of his trade or business.

The new subsection defines a "straddle" as a simultaneously granted combination of an option to buy (a "call") and an option to sell (a

⁷ Rev. Proc. 65-29, issued on Nov. 15, 1965. This 55-45 ratio was selected because it represented a rounded approximation of relative market prices of separately written "puts" and "calls" of the same length for securities of approximately equal price. The revenue procedure concluded with the statement that "If a taxpayer does not use this method for a taxable year, then the allocation based on relative market values required by Revenue Ruling 65-31 must be used."

“put”) the same quantity of a security at the same price during the same period of time.

If a person grants a multiple option (a put plus a call plus one or more additional puts or calls) it is intended that the grantor of the multiple option must identify in his records which two of the component options constitute the straddle, if it is not clear from the options themselves. It is contemplated that the method of identification will be specified in regulations issued by the Secretary of the Treasury or his delegate. If there is no identification by the writer, this provision relating to straddles is not to apply. As a result, in such a case the gain on the lapsed option (or options) would result in ordinary income.

A corporate security for purposes of the definition of a straddle is the same as defined in section 1236(c) of the code—i.e., stocks, bonds, notes, etc. Accordingly, the term securities does not include commodity futures.

Effective date.—The amendments described above are to apply to straddles written after January 25, 1965, in taxable years ending after such date.

11. Tax treatment of per-unit retain allocations (sec. 211 of the act and secs. 1382, 1383, 1385, 1388, and 6044 of the code)

Prior law.—Although the practices of cooperatives are not uniform in this regard, generally a per-unit retain certificate is issued by a cooperative to a patron to reflect the retention by the cooperative of a portion of the proceeds from the marketing of products for the patron. These amounts are retained pursuant to an authorization (usually in the bylaws of the cooperative) and are computed on the basis of units of products marketed.

Prior to 1962, the Internal Revenue Code permitted cooperatives to deduct amounts paid to patrons as patronage dividends. Patronage dividends are limited by definition to amounts which are “determined with reference to the net earnings” of the cooperative. The treatment of per-unit retains, however, was not specifically dealt with in the code. The Revenue Act of 1962 substantially revised the income tax treatment of cooperatives and their patrons but the new provisions by their terms were applicable only to “patronage dividends.” Because per-unit retain allocations are determined on the basis of units of products marketed for the patrons rather than with reference to net earnings, the new provisions were generally considered as not being applicable to them. However by regulations issued on October 14, 1965, the Treasury Department provided for the income tax treatment of per-unit retain certificates in a manner that was in many respects parallel to the treatment prescribed in the Revenue Act of 1962 with respect to patronage dividends.

The per-unit retains may be considered as contributions to capital by patrons. For this to be true they first must have been considered as paid out by the cooperative. However, because the per-unit retain certificates issued by cooperatives may have a fair market value considerably less than their face amount, and in some cases have only a negligible fair market value, it was questioned whether they may be considered as paid out by the cooperatives and whether the patrons can be required to include them in their gross income.

Explanation of provisions.—The bill amends present law to provide tax treatment with respect to per-unit retain certificates which parallels, in general, the tax treatment applicable with respect to patronage dividends. Providing essentially the same treatment for per-unit retain certificates means, generally, that they are to be treated as income to the patron in the year in which the certificates are issued, if the patrons give their consent in writing to the inclusion of the face amount of these certificates in their income or if there is a provision in the by-laws or charter of the cooperative indicating that membership in the cooperative represents consent to such treatment. Under the amendment, the cooperative is permitted to take a deduction in arriving at gross income for a per-unit retain certificate when issued, but only when the certificate qualifies for the treatment specified above in the hands of the patron. Otherwise, the amount involved is deductible by the cooperative only at the time the certificate is redeemed.

Adoption of this provision is not intended to reflect on the validity of the regulations recently issued by the Treasury Department with respect to per-unit retain certificates, nor is it intended to reflect on the deductibility in the past of per-unit retain certificates to cooperatives or the includibility in the past of such certificates in the income of patrons.

(i) *Treatment of per-unit retains by cooperatives.*—The amendment provides that no decrease is to be made in the gross income of a cooperative because of per-unit retain allocations to patrons except for amounts paid in “qualified per-unit retain certificates” or in redemption of “nonqualified per-unit retain certificates.” (Both of these terms are explained subsequently.)⁸ If a cooperative has no taxable income for the year in which it redeems nonqualified per-unit retain certificates, the cooperative will, in effect, be permitted to carry back the deduction or exclusion to the year in which the certificate was issued.

(ii) *Treatment of per-unit retains by patrons.*—Under the amendment, a patron is required to include in his gross income the amount paid to him in qualified per-unit retain certificates and the amount received by him on the redemption, sale, or other disposition of nonqualified per-unit retain certificates.

(iii) *Definitions and special provisions.*—The amendment provides definitions of the terms used in providing for the treatment of per-unit retains. Under the first of these, the amount considered paid by a cooperative and received by a patron as a result of the issuance of a qualified per-unit retain certificate is to be the certificate’s stated dollar amount. The term “per-unit retain allocation” is defined, in general, as an amount paid (except amounts paid in money or other property) to patrons with respect to products marketed for them which is fixed without regard to the net earnings of the cooperative. The term “per-unit retain certificate” is defined to mean any written notice which discloses to the recipient the stated dollar amount of a per-unit retain allocation. The term “qualified per-unit retain certificate” is defined to mean a per-unit retain certificate which the patron has agreed to include in his income at the stated dollar amount. For this purpose, a

⁸ A special rule permits cooperatives to continue their existing practices with respect to the timing of the issuance of per-unit retain certificates for products marketed under a pooling arrangement and to take the tax deduction at the time the certificates are issued.

cooperative may enter into individual agreements with each of its patrons, or the agreement may be contained in a bylaw, a written notice and copy of which is given to each of the members. In general, agreements once made are effective for all subsequent years until revoked. A "nonqualified per-unit retain certificate" is defined to be any per-unit retain certificate other than one which is "qualified."

The amendment also requires the reporting by the cooperative of information with respect to per-unit retain allocations comparable to the reporting requirements with respect to patronage dividends under present law.

Effective dates and transition rule.—The amendments which relate to the substantive tax treatment of per-unit retains are to apply, generally, for taxable years of cooperatives beginning after April 30, 1966, and the information reporting provisions are to apply for calendar years after 1966.

If a cooperative has entered into individual agreements with its patrons with respect to per-unit retain allocations in compliance with the existing income tax regulations, new agreements would not be required under the amendment. Existing bylaw agreements with respect to per-unit retain allocations adopted under the Treasury regulations are to be effective for taxable years beginning before May 1, 1967. For years beginning after that date a bylaw agreement which conforms to the new statutory provisions is required.

12. Excise tax rate on hearses (sec. 212 of the act and sec. 4062 of the code)

A 10 percent excise tax is imposed on the sale by the manufacturer, importer, or producer of bodies and chassis of trucks. A rate of 7 percent is imposed on automobiles.⁹

Under prior law there was no statutory classification of hearses, ambulances, or combination ambulance-hearse vehicles for purposes of this excise tax. However, since 1921 the Internal Revenue Service, by administrative interpretation, had classified hearses as trucks while treating ambulances and combination ambulance-hearse vehicles as automobiles for the purpose of determining the appropriate excise tax rate.

The act classifies hearses, ambulances, and combination ambulance-hearses as automobiles (and not as trucks) for purposes of the excise tax on the sale of these vehicles by the manufacturer, producer, or importer.

This amendment is effective with respect to vehicles sold after November 13, 1966.

13. Interest equalization tax; loans to insure raw material sources (sec. 213 of the act and sec. 4914 of the code)

The interest equalization tax, in general, is a tax imposed on Americans with respect to the purchase of foreign securities. In the case of debt the tax rate varies with the period of time to maturity; in the case of stock the tax rate is 15 percent. The tax is designed to increase capital costs in the United States for foreigners by about 1 percent a year.

⁹ This 7-percent rate is scheduled for reduction to 2 percent effective Apr. 1, 1968, and to 1 percent effective Jan. 1, 1969. The 10-percent tax on trucks and hearses is a permanent rate.

Presently there is an exemption from the interest equalization tax—as the equivalent to a direct investment—for loans made by U.S. lenders to foreign subsidiaries of U.S. corporations producing foreign ores and minerals in short supply in the United States where the financing is secured by a so-called “take or pay” contract entered into between the foreign subsidiaries and the U.S. parent. However, under prior law these loans became subject to the interest equalization tax when and if they were subsequently transferred by the lender to another U.S. person, regardless of the intent of the investor at the time of acquisition.

This amendment provides that transfers by the original lender, subsequent to the original acquisition of the indebtedness which is exempted under this provision, will not be subject to tax where the indebtedness was originally acquired by the lender without an intent to sell the indebtedness to other U.S. persons (such as a bona fide investment representation). However, where in fact more than one sale of the indebtedness occurs after the debt is held by the initial lender, then for each such sale to be exempt the indebtedness must be purchased without any intent to resell. This amendment is to be effective with respect to debt obligations acquired after November 13, 1966.

14. Interest equalization tax; insurance company reserve funds (sec. 214 of the act and sec. 4914(e) of the code)

The interest equalization tax provisions presently provide a limited exception for acquisitions of otherwise taxable securities made to maintain the reserve assets of a U.S. insurance company doing an insurance business in foreign currencies abroad in developed countries. In addition, an exception for investments generally is provided with respect to those in “less developed countries.” Under prior law, in order to claim the exemption for life insurance companies operating in developed countries a company must “establish” a fund of assets for each developed country for which it does business without exception. However, the establishment of such a fund could only be made under prior law during the “initial” designation period which was the 30-day period between the enactment of the act, September 2, 1964, to October 2, 1964.

This amendment permits a U.S. insurance company commencing activities in a developed country to establish a fund with respect to that country provided it was ineligible to make an initial designation prior to October 2, 1964. The amendment also permits the establishment of a fund for a country if the status of that country was changed from a less developed country by an Executive order.

15. Interest equalization tax; dollar loans of foreign branches of U.S. banks (sec. 215 of the act and sec. 4931(a) of the code)

Prior to this act only foreign currency loans and dollar loans of less than one year made by foreign branches of U.S. banks were exempt from the application of the interest equalization tax.

This amendment authorizes the President to exempt from the interest equalization tax U.S. dollar loans made by the foreign branches of U.S. banks (regardless of the maturities involved). To the extent that this authority is exercised, the President subsequently may withdraw or modify the exemption in the event he determines such with-

drawal or modification is necessary to preserve the effectiveness of the interest equalization tax.

This amendment is to be effective with respect to acquisitions of debt obligations after November 13, 1966.

C. PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

Under prior law no provision was made for taxpayers to set aside any portion of their tax payments as a contribution to a political party. Nor was there any provision for an income tax deduction for political campaign contributions. The act under certain conditions, described below, provides taxpayers the opportunity to have limited amounts of their income tax payments set aside for the use by the political parties in presidential campaigns.

1. *Designation of income tax payments to presidential election campaign fund (sec. 302 of the act and sec. 6096 of the code)*

Space is to be provided on the income tax return forms to permit each individual taxpayer (other than a nonresident alien or an estate or trust) to designate, if he so desires, that \$1 of his income tax payment be appropriated from general revenues and paid into the presidential election campaign fund. All taxpayers who show an income tax liability of at least \$1 for the year are to be permitted to make a designation. On joint returns, both husband and wife are to be permitted to make a designation provided the tax liability shown on the return is at least \$2. The designation is to be made at the time of filing the return or at such later time as may be provided in regulations (such as at the time of making a claim for refund of an overpayment of tax). The designation is to be permitted with respect to income tax liability for each taxable year beginning after December 31, 1966.

2. *The presidential election campaign fund and payments therefrom (sec. 303 of the act)*

Amounts are only to be paid out of the presidential election campaign fund to reimburse certain political parties for expenses incurred in presenting candidates for President and Vice President in presidential elections.

Only those political parties whose candidates for President received at least 5,000,000 votes in the preceding presidential election will be eligible to receive payments from the fund.

A political party whose candidate received more than 5,000,000 votes in the preceding presidential election but less than 10 million votes will be authorized to receive from the fund an amount equal to the lesser of its actual campaign expenses or an amount equal to \$1 times the number of votes in excess of 5,000,000 that its candidate received in the last presidential election.

A political party whose candidate for President received 15 million votes or more in the preceding presidential election is to be reimbursed on a different basis. An amount equal to \$1 for each vote in excess of 5,000,000 received by each major party in the last election is to be divided equally between (or among) them, with the limitation that payments to any one party cannot exceed the expenses incurred by the party in the current campaign.

Expenses will only be reimbursed to the extent that they are incurred for political purposes. Personal expenses will not be reimbursed. Furthermore, the expenses must be incurred predominantly for the purpose of furthering the candidacy of the presidential and vice presidential nominees. Expenses incurred predominantly to support candidates for other offices will not be reimbursed, even if incurred by these nominees. This rule is not intended, however, to preclude the endorsement by presidential and vice-presidential candidates of candidates for other offices as long as the primary purpose of their appearance is to further their own candidacies. Finally, expenses will not be reimbursed unless sufficient proof is supplied to establish that they were actually made.

The Comptroller General is charged with the responsibility for certifying to the Secretary of the Treasury the amounts payable to eligible political parties. In this certification he will take into account information supplied him by the treasurers of each political party regarding campaign expenses incurred and on the basis of the votes cast in the preceding presidential election. The Comptroller General's decisions are to be final.

The payments will be made at times to be determined by Treasury regulations, but no payment for a given presidential election campaign can be made before September 1 of the year the election is held.

If at the time payments are made, there are insufficient moneys in the fund to meet the amounts specified under the rules set forth, payments to all entitled parties will be reduced pro rata, and the additional amounts paid out of later additions to the fund.

If any moneys remain in the fund after all the payments authorized have been made with respect to a given presidential election, or if the fund exceeds the maximum payments which may be authorized, the amount remaining is to be returned to the general fund of the Treasury.

3. The Advisory Board (sec. 304 of the act)

The bill establishes the Presidential Election Campaign Fund Advisory Board to advise and assist the Comptroller General in connection with his duties under this act. The board is to consist of two members from each political party whose candidate received 15 million or more votes in the last presidential election plus three additional members selected by a majority of the political party members. The first members of the board are to be appointed by the Comptroller General after the date of enactment of this act and their term will expire 60 days after the date of the first presidential election held after the date of enactment of this act. The next and succeeding boards will then serve 4-year terms ending 60 days after the date of each succeeding presidential election. Board members will be compensated at the rate of \$75 a day for each day they serve and will receive travel expenses and a per diem in lieu of subsistence (at rates authorized for persons in intermittent Government service) when engaged in work away from their homes or regular places of business.

D. MISCELLANEOUS PROVISIONS

1. Treasury notes payable in foreign currency (sec. 401 of the act)

Bonds or certificates of indebtedness may be issued by the Secretary of the Treasury payable both as to principal and interest in any foreign currency. However, under prior law there was no authorization for the Secretary of the Treasury to issue notes in foreign currency (31 U.S.C. 766).

The act contains an amendment to the Second Liberty Bond Act authorizing the Secretary of the Treasury to issue notes as well as bonds and certificates of indebtedness in foreign currencies. Notes are evidences of indebtedness issued by the Treasury Department with a maturity of from 1 to 5 years from date of issue.

2. Reports on Government contingent liabilities and assets (sec. 402 of the act)

This amendment requires the Secretary of the Treasury to submit, on the first day of each regular session of the Congress, a report to the Congress showing the amount (both on an aggregate and on an individual basis) of the contingent liabilities and the unfunded liabilities of the Federal Government, determined as of the close of the preceding June 30.

The contingent liabilities referred to by the amendment include (1) liability of the Government under its various trust funds (such as the old age and survivors insurance trust fund and the highway trust fund); (2) liabilities of Government-sponsored corporations (for example, the Commodity Credit Corporation); (3) indirect liabilities of the Federal Government not included as part of the public debt, such as Federal Housing Administration debentures; and (4) liabilities of Federal insurance and annuity programs.

Data with respect to these insurance and annuity programs (which include the civil service retirement system, veterans' pension, and war risk insurance programs) are to include information regarding their actuarial status.

The report is also to indicate the collateral pledged, or the assets available (or to be realized) as security for the specified liabilities. Thus, for example, in the case of federally insured home mortgages the assets available on foreclosures may, under favorable circumstances, offset the potential Federal liability. But the reporting of assets is not to stop with a recording of assets related to the liabilities. Under the amendment the Secretary of the Treasury is to set forth all other assets which would be available to liquidate liabilities of the Federal Government.

In order to provide flexibility and to prevent data included in the report from being misconstrued or misleading, the amendment provides that the Secretary of the Treasury may set forth such explanatory material (including such analysis of the significance of the liabilities in terms of past experience and probable risk) as he determines to be necessary or desirable. Under this provision, if he believes particular data are likely to lead to improper conclusions he may qualify these data sufficiently to negate such conclusions.

II. REVENUE EFFECT

The following table presents estimates of the revenue effect, based on current income levels, of various provisions of the Foreign Investors Tax Act of 1966:

Estimated revenue increase (+), revenue decrease (—), and expenditure increase (—) in the first full year under H.R. 13103 as reported by the Ways and Means Committee and passed by the House of Representatives, as reported by the Senate Finance Committee, as passed by the Senate, and as reported by the conference

[Millions]

Item	As reported by the Ways and Means Committee, Apr. 26, 1966, and passed by the House of Represent- atives, June 15, 1966	As reported by the Senate Finance Committee, Oct. 11, 1966	As passed by the Senate, Oct. 13, 1966	As reported by the conference, Oct. 19, 1966 ¹
A. FOREIGN INVESTORS TAX ACT OF 1966				
1. Elimination of progressive taxation of U.S. source income of nonresident alien individuals not engaged in trade or business in the United States.....	—\$1	—\$1	—\$1	—\$1
2. Estate tax at top rate of 25 percent on tangibles and intangibles with \$30,000 exemption.....	—3	—3	—3	—3
3. 1. Tax on excluded bank deposits.....	+(2)	+(2)	+(2)	+(2)
4. Taxation of foreign life insurance company income from nontrusted investments in the United States.....	+3	+3	+3	+3
5. Saving in interest cost to U.S. Government resulting from quarterly payment of withheld taxes ²	+2	+2	+2	+2
6. Tax on capital gains.....	—(4)	—(4)	—(4)	—(4)
7. Total.....	+1	+1	+1	+1
B. PRESIDENTIAL ELECTION CAMPAIGN FUND ACT OF 1966				
8. Payments to political parties, for incurred Presidential election expenses, out of a fund into which individuals have designated that \$1 of their income tax liability be paid.....		\$—70	\$—70	\$—60
C. PROVISIONS REGARDING PERCENTAGE DEPLETION AND MINING TREATMENT PROCESSES				
9. Increasing from 5 to 15 percent the percentage depletion rate for clay or shale used in the manufacture of sewer pipe and brick.....			—3	(6)
10. Mining process designation for sintering and burning of shale, clay, and slate to produce lightweight aggregates.....				(9)
11. Mining process designation for processes deriving alumina or aluminum compounds from clay, laterite, and nephelite syenite.....				
12. Increasing from 5 to 15 percent the percentage depletion rate for clam and oyster shells used for their calcium carbonate content.....		—1	—1	
13. Increasing from 15 to 23 percent the percentage depletion rate for alumina-yielding clay, laterite, and nephelite syenite.....				—1
14. Increasing from 5 to 7½ percent the percentage depletion rate for clay and shale used in the manufacture of sewer pipe and brick and for clay, shale, or slate sintered or burned to produce lightweight aggregates.....			(7)	
15. Total.....		—1	—4	—1

See footnotes at end of table.

Estimated revenue increase (+), revenue decrease (—), and expenditure increase (—) in the first full year under H.R. 13103 as reported by the Ways and Means Committee and passed by the House of Representatives, as reported by the Senate Finance Committee, as passed by the Senate, and as reported by the conference—Continued

(Millions)

Item	As reported by the Ways and Means Committee, Apr. 26, 1966, and passed by the House of Represent- atives, June 15, 1966	As reported by the Senate Finance Committee, Oct. 11, 1966	As passed by the Senate, Oct. 13, 1966	As reported by the conference, Oct. 19, 1966 ¹
D. OTHER PROVISIONS				
16. Removal of special limitations regarding deductibility of contributions to pension plans by self-employed individuals (H.R. 10).....			—\$30 to —\$45	—\$30 to —\$45
17. Elimination of 3 percent and 1 percent floors under medical and drug expense deductions of the aged for taxable years beginning after Dec. 31, 1966.....		—180	—180	
18. Coverage of certain drug expenses under supplementary medical insurance benefits.....		\$ —200	\$ —200	
19. Preservation from reduction of certain widows' benefits under title II of Social Security Act.....				
20. Increasing from \$2,500 to \$6,000 the minimum amount treated as earned income for retirement plans of self-employed persons.....				
21. Application of investment credit to property used in possessions of the United States.....				
22. Amending the basis of property received on liquidation of subsidiary.....				
23. Retention of tax-free status of transfers of stock and securities to corporations controlled by transferors.....				
24. Treatment of certain income of authors, inventors, etc., as earned income for retirement plan purposes.....				
25. Exclusion of certain rents from personal holding company income.....				
26. Treatment of income from lapse of a straddle option as a short-term capital gain.....				
27. Insuring that current single tax is paid with respect to per unit retain certificates of cooperatives.....			—4	
28. Treating, for purposes of manufacturers' excise tax, sale of hearse, ambulance, or ambulance-hearse as sale of automobile chassis and body (rather than truck chassis and body).....		—4		—4
29. Applicability of exclusion from interest equalization tax of certain loans to assure raw material sources.....				
30. Exclusion from interest equalization tax of certain acquisitions by insurance companies.....				
31. Exclusion from interest equalization tax of certain acquisitions by foreign branches of domestic banks.....				
32. Authorization of issuance of Treasury notes payable in foreign currency.....				
33. Requiring Secretary of Treasury to submit an annual report to Congress setting forth the amount of contingent and of unfunded liabilities of the Federal Government.....				
34. Total.....		—384	—414 to —449	—34 to —49
35. Grand total.....	+1	—454	—487 to —502	—94 to —109

¹ And enacted into law on Nov. 13, 1966 (Public Law 89-809).

² Less than \$500,000.

³ Quarterly payment of withheld taxes is estimated to result in a revenue gain of \$22,500,000 in fiscal year 1967.

⁴ Negligible.

⁵ This is a quadrennial expenditure occurring in each presidential election year.

⁶ See item 14.

⁷ See items 9 and 10.

⁸ Other estimates have placed this figure at \$100,000,000.

SECTION 33

**PRESS RELEASE, OFFICE OF THE WHITE HOUSE PRESS
SECRETARY (FREDERICKSBURG, TEX.) DATED NO-
VEMBER 13, 1966, STATEMENT BY THE PRESIDENT
UPON SIGNING THE FOREIGN INVESTORS TAX ACT
OF 1966—H.R. 13103**

STATEMENT BY THE PRESIDENT UPON SIGNING THE FOREIGN
INVESTORS TAX ACT OF 1966—H.R. 13103

I have today signed the Foreign Investors Tax Act of 1966.

This law ends the confusion and complexity that have long plagued our system of taxing the foreign investor. It makes our tax rules fairer and simpler, brings them up to date, and removes those tax roadblocks which have discouraged foreign investments in this country. The law will help to improve our balance-of-payments position and will thus strengthen our economy.

The act is the first major revision of the foreign investors tax structure in more than 30 years. It is the product of a task force of distinguished bankers and businessmen headed by Secretary of the Treasury Henry H. Fowler.

An important addition to this act breaks new ground in the financing of Presidential election campaigns.

As a Nation, we have long been concerned with the way Presidential campaigns are financed. More than 60 years ago, Theodore Roosevelt observed that the Federal Government should help pay the expenses of a man running for the Presidency to eliminate the danger of undue influence by wealthy campaign contributors.

In recent years, soaring political campaign costs have intensified our concern and our search for solutions.

The approach adopted by this act allows the individual taxpayer—voluntarily—to have \$1 of his tax payment placed into a Presidential campaign election fund.

Congress has wisely chosen the Comptroller General and a bipartisan advisory board to safeguard and supervise the fund, which is held in trust for all Americans.

Presidential candidates will no longer have to rely on special interest groups and the rich to meet the heavy financial burden of a campaign.

Instead, they will rely on all Americans from every walk of life—the ideal way in a free country.

And thus our deeply rooted system of free elective government will benefit.

The new law is only a beginning. It underscores the pressing need to reform our antiquated Federal laws on the disclosure and regulation of campaign financing. Indeed, that task must be pursued with even greater urgency.

Last May I recommended that the Congress enact the Election Reform Act of 1966. That proposal was aimed at modernizing, correcting, and systematically overhauling our campaign financing laws—which are now more loophole than law. It sought full disclosure by Members of Congress of gifts and income.

Next year, I shall call upon Congress again to consider these positive and corrective measures to insure public confidence in the elective

process. There is no higher duty of a democratic government than to insure that confidence.

I am also asking a bipartisan group of our very best political scientists and experts—headed by Prof. Richard Neustadt, of Harvard—to see how the promise of the new Presidential campaign fund law can be fully realized and to review the problems of election reforms and campaign financing in non-Presidential elections.

The Foreign Investors Tax Act contains a variety of other amendments. Many of these are minor technical changes usually dealt with by separate bills.

Others are more important. Several of these do not promote a fair and sound tax system. Instead they confer special tax windfalls and benefits upon certain groups. I deeply regret that these riders have been engrafted on this vital legislation.

However, the act's comprehensive and long overdue revision of our system of taxing foreign investors (thus helping our balance of payments position) and its precedent-setting provision for financing Presidential campaigns are far too important to all the people of America to be delayed until future years. It is because these provisions are of overriding significance to the public interest that I have signed the act into law today.

APPENDIX

2055

APPENDIX I

H.R. 10

**TO AMEND THE INTERNAL REVENUE CODE OF 1954
TO PERMIT PENSION AND PROFIT-SHARING PLANS
TO PROVIDE CONTRIBUTIONS OR BENEFITS ON A
NONDISCRIMINATORY BASIS FOR CERTAIN SELF-
EMPLOYED INDIVIDUALS WITHOUT SPECIAL LIMITA-
TIONS ON THE AMOUNT OF CONTRIBUTIONS
(Sec. 204 of Public Law 89-809)**

H. R. 10

IN THE HOUSE OF REPRESENTATIVES

JANUARY 4, 1965

Mr. KROGH introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to permit pension and profit-sharing plans to provide contributions or benefits on a nondiscriminatory basis for certain self-employed individuals without special limitations on the amount of contributions.

- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 That (a) paragraph (10) of section 404 (a) of the Internal
- 4 Revenue Code of 1954 (relating to special limitation on
- 5 amount allowed as deduction for self-employed individuals for
- 6 contributions to certain pension, etc., plans) is repealed.
- 7 (b) (1) Each of the following provisions of section 401
- 8 of such Code is amended by striking out “(determined

1 without regard to section 404 (a) (10))” each place it
2 appears:

3 (A) Subsection (a) (10) (A) (ii) .

4 (B) Subparagraphs (A) and (B) of subsection
5 (d) (5) .

6 (C) Subparagraph (A) of subsection (d) (6) .

7 (D) Subparagraphs (A) and (B) (i) of subsec-
8 tion (e) (1) .

9 (E) Subparagraphs (B) and (C) and the last
10 sentence of subsection (e) (3) .

11 (2) Subparagraph (A) of section 404 (c) (2) of such
12 Code is amended by striking out “(determined without re-
13 gard to subsection (a) (10) ”.

14 (3) Subparagraph (B) of section 404 (c) (2) of such
15 Code is amended by striking out “(determined without re-
16 gard to paragraph (10) thereof) ”.

17 SEC. 2. (a) So much of subsection (c) of section 404
18 of the Internal Revenue Code of 1954 (relating to special
19 limitations for self-employed individuals) as precedes para-
20 graph (2) is amended to read as follows:

21 “(c) SPECIAL LIMITATIONS FOR PROPRIETOR WHO
22 DOES NOT HAVE EMPLOYEES.—

23 “(1) IN GENERAL.—In the case of a plan included
24 in subsection (a) , (1) , (2) , or (3) , which provides
25 contributions or benefits only for an individual who is

1 an owner-employee within the meaning of section
2 401 (c) (3) (A), the amounts deductible under sub-
3 section (a) in any taxable year with respect to con-
4 tributions on behalf of such owner-employee shall, sub-
5 ject to the provisions of paragraph (2), not exceed
6 \$2,500, or 10 percent of the earned income derived by
7 him from the trade or business with respect to which the
8 plan is established, whichever is the lesser.”

9 (b) Subparagraph (A) of section 404 (e) (2) of such
10 Code (relating to overall limitation in case of contributions
11 made under more than one plan) is amended by inserting
12 “referred to in paragraph (1)” after “individual”.

13 (c) Section 401 (c) of such Code (relating to excess
14 contributions on behalf of owner-employees) is amended—

15 (1) by inserting “and” at the end of clause (i) and
16 at the end of clause (ii) of paragraph (1) (B), and by
17 striking out clauses (iii) and (iv) of such subparagraph,
18 and

19 (2) by striking out “subparagraphs (B) (ii),
20 (iii), and (iv)” in the last sentence of paragraph (3)
21 and inserting in lieu thereof “subparagraph (B) (ii)”,
22 and by striking out “such subparagraphs” in such last
23 sentence and inserting in lieu thereof “such sub-
24 paragraph”.

1 SEC. 3. The amendments made by this Act shall apply
2 to taxable years beginning after December 31, 1963.

DATA ON SELF-EMPLOYED RETIREMENT DEDUCTION FOR TAXABLE YEAR 1964

REPORT SUBMITTED TO THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
BY THE
DEPARTMENT OF THE TREASURY



APRIL 18, 1966

NOTE: This report has not been considered or approved by the Committee on Ways and Means. It is being printed for informational purposes only.

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II

SELF-EMPLOYED RETIREMENT DEDUCTION

The following report was prepared by the Department of the Treasury in response to the request of the Committee on Ways and Means on September 30, 1965.

DATA ON SELF-EMPLOYED RETIREMENT DEDUCTION FOR TAXABLE YEAR 1964

Under the provisions of Public Law 87-792, enacted in 1962, self-employed individuals may set up qualified retirement plans and deduct contributions (within specified limits) to the plans. A self-employed person establishing a plan for himself under this provision is required to provide comparable coverage in the plan for all his full-time employees with more than 3 years of service.

For a self-employed person, the contribution with respect to which a deduction may be claimed is limited to 10 percent of earned income, or \$2,500, whichever is less. The annual deduction from gross income for amounts contributed on behalf of the self-employed person is limited to 50 percent of the contributions to such plans for himself up to a maximum of \$1,250. Qualifying contributions for his employees are deductible in full.

1. *The present study*

Preliminary data are available from individual tax returns for 1964, filed during 1965. This permits an estimate of the total use for 1964 of the self-employed retirement deduction (covered in section 2 and table 1). These data are based on the regular sample drawn for Statistics of Income (SOI) for 1964, to the extent the returns were available near the end of 1965. The coverage in the preliminary data is relatively reliable in middle- and low-income levels where an adequate sample can be drawn from returns on hand. The data are more subject to change in the high-income brackets where the regular SOI, when it appears, will be based on 100 percent coverage.

A more detailed source of data on the self-employed retirement deduction is available from those returns in the SOI sample which had the form 2950-SE attached. This form should have been filed by all persons claiming the self-employed retirement deduction. A copy is attached.

Based on the preliminary data on tax returns, about 38,300 returns claimed self-employed retirement deductions in 1964 in an amount of \$26.3 million. The number submitting the form 2950-SE was only about 25,600 claiming deductions of \$20.7 million.

It should be kept in mind that the entire SOI tabulation is based upon unaudited data. It may be that some of the returns claiming the self-employed retirement deduction but not submitting the form 2950-SE will, on audit, prove to be ineligible for the deduction. There is no way to estimate this.

The various tables, other than table 1, are based upon analysis of a sample of returns which submitted form 2950-SE. In general, these figures understate the magnitudes involved because not all returns claiming the deduction filed a form 2950-SE. Most of the understatement occurs in the lower income brackets. This is illustrated by the following comparison of the estimated distribution by income classes of returns which filed form 2950-SE with the estimated distribution of all returns with the deduction (reported on line 4, pt. III, p. 2 of the return):

AGI class	Returns with form 2950-SE		All returns reporting deductions	
	Number of returns	Percent of total	Number of returns	Percent of total
Under \$5,000.....	1 1,200	4.7	14,573	11.9
\$5,000 to \$10,000.....	2,403	9.4	7,971	20.8
\$10,000 to \$25,000.....	8,445	33.0	11,436	29.8
\$25,000 to \$50,000.....	9,844	38.5	10,487	27.4
\$50,000 and over.....	3,673	14.4	3,870	10.1
Total.....	25,569	100.0	38,337	100.0

¹ Includes nontaxables.

All data, particularly those based on the special tabulation from form 2950-SE, are subject to deficiencies resulting from omission of SOI sample returns which could not be obtained in time for this study. In many cases the actual number of returns used in the special tabulation to produce the frequency estimates was very small. The estimates of both number of returns and corresponding amounts are subject to high sampling variability.

2. Taxpayers benefiting and amount of deduction

Preliminary data from individual income tax returns for 1964, filed during 1965, indicate that the self-employed retirement deduction was taken on 38,300 returns (table 1). (The number of self-employed individuals benefiting from the deduction is somewhat greater than the number of returns, since on joint returns the spouse may also be covered as a separate self-employed person). Self-employed individuals taking advantage of the retirement deduction constituted only about one-half of 1 percent of the total number of self-employed. In 1964, the self-employment tax for social security purposes was reported on an estimated 6.3 million returns, and this did not include 0.2 million self-employed doctors who were not then covered by social security.

As is indicated in table 1, the self-employed retirement deduction is not widely used by those in the lower income brackets. Only 30 percent of the taxable returns taking the deduction in 1964 had adjusted gross income of less than \$10,000, while 73 percent of returns with self-employment tax had incomes below this level. Almost 40 percent of the returns with the self-employed retirement deduction were in the \$25,000 and over income class, while only 6 percent of the returns with self-employment tax are at this level.

Of the total amount deducted for contributions to self-employed retirement plans in 1964, only 11 percent was accounted for by the under \$10,000 income group, and more than 60 percent by the \$25,000 and over group.

The special tabulation of forms 2950-SE shows for various occupation groups the total amount of earned income reported by individuals using the self-employed retirement deduction in 1964. A comparison of the average earned income of individuals in these occupation groups who use this deduction with the average net profit of all sole proprietorships in these same groups indicates that those in the higher income brackets make more use of the deduction. Table 2 shows, for example, that the average earned income of physicians using the deduction is \$35,000 compared with average net profits of \$20,000 for all physicians filing business tax returns with net profit. For lawyers the average earned income of those using the deduction is \$31,000 compared with average net profits of \$9,000 for all lawyers filing business tax returns with net profit.

In using these figures it should be kept in mind that they are based on forms 2950-SE. There were a relatively larger number of taxpayers in the low income brackets who took the self-employment retirement deduction but did not file a form 2950-SE. If these could be allocated to occupation groups, the average incomes shown in the third column of table 2 might tend to be lower.

3. *Extent to which occupation groups benefit*

The special tabulation indicates that in 1964 the largest group of taxpayers taking advantage of the self-employed retirement deduction was "physicians, surgeons, optometrists, and other medical services." This group accounted for 46 percent of the total returns with this deduction and 60 percent of the total amount deducted by all groups.

The two next largest groups were (1) lawyers and (2) those engaged in retail, wholesale, and manufacturing trade, each of which accounted for about 10 percent of the returns with the deduction. The extent to which the various occupation groups made use of the deduction is summarized below:

Returns with self-employed retirement deduction, 1964

Occupation	Percent of returns with deduction	Percent of deduction taken
Physicians, surgeons, optometrists, and other medical services.....	46.1	60.4
Legal services.....	9.5	10.0
Retail, wholesale, and manufacturing.....	9.4	7.5
Dentists and dental surgeons.....	5.8	6.0
Accounting and auditing.....	4.6	3.2
Finance, insurance, and real estate.....	4.0	2.5
All other occupations.....	20.5	10.3
Total returns with deduction.....	100.0	100.0

The participation rates in self-employed retirement plans in various occupations cannot be calculated directly. Some evidence is suggested by table 2 which indicates participation by about 8 percent of self-employed physicians, 2 percent of self-employed dentists, 2 percent of self-employed lawyers, 1 percent of self-employed accountants, and one-quarter of 1 percent of self-employed individuals in finance, insurance, and real estate, etc. These numbers, it should be recalled, are based on the special tabulation of returns filing forms 2950-SE. They would be higher if the returns claiming a self-employed retirement deduction, but not filing form 2950-SE, could be allocated to the

various professions. Available data provide no basis for allocating the returns of the nonfilers of form 2950-SE.

4. *Type of plan and method of funding*

About 65 percent of the returns with self-employed retirement deduction designated their plans as pension or annuity plans, 18 percent were profit-sharing plans, and the remaining 17 percent did not indicate the type of plan.

A number of choices are available as to the manner in which a self-employed retirement plan can be funded. As is indicated in table 3, the most common method of funding (used by approximately one-third of all plans) is a trust. Approximately 20 percent of the plans use custodial accounts, 15 percent are insured plans, and 10 percent invest in U.S. Government retirement plan bonds. Almost 20 percent of returns did not indicate the type of plan used.

5. *Size of deduction*

Table 4 shows the size of deduction by income classes based upon the special tabulation of forms 2950-SE. This would tend to overstate the typical deduction claimed. On all returns claiming the deduction, the average size of deduction was \$687. On the returns submitting form 2950-SE the average deduction was \$808.

As indicated by table 4, nearly 30 percent of the returns involved a deduction of less than \$500, and one-third involved a deduction of \$1,250, the maximum allowable. As income increases, the size of the deduction also increases. In the \$25,000 and over classes, the vast majority of the returns took the maximum deduction of \$1,250.

The distribution by size of deduction for the various occupation groups is shown in table 5. This breakdown by occupational groups is subject to high sampling variability. For some of the groups the classification by size of deduction is based on a very small sample of returns. It is useful, however, as a general indication of the extent to which the maximum deduction is used by various occupational groups. Of the returns of physicians with a self-employed retirement deduction, 55 percent took the \$1,250 maximum deduction, and these returns accounted for almost two-thirds of the total deduction taken by this group. More than one-third of the lawyers with the deduction took the \$1,250 maximum, and these returns accounted for more than half of the total deduction taken by this group.

On the other hand, a deduction of less than \$1,250 was taken by more than 75 percent of two groups: (1) dentists and dental surgeons, and (2) retail, wholesale, and manufacturing, and about 90 percent of those engaged in (1) accounting and auditing services and (2) finance, insurance, and real estate.

Table 6 shows for returns with a retirement deduction of less than \$1,250 the relationship of the deduction to earned income.¹ Under the law, the deduction may not exceed 5 percent of earned income. For 45 percent of these returns, the deduction was between 4 and 5 percent of earned income. For 13 percent of returns, it was between 3 and 4 percent of earned income, and for 33 percent of returns it was less than 3 percent of earned income.

Table 7 shows by adjusted gross income classes the distribution of (1) returns with a deduction equal to 5 percent or more of earned income and (2) returns with a deduction of \$1,250 and over. These

¹ Where the deduction is \$1,250 or more, the relation of the deduction to earned income is irrelevant because the \$1,250 limitation applies at all income levels above \$25,000.

two types of returns represent those which took the maximum allowable retirement deduction.

Because of high sampling variability, a detailed breakdown cannot be shown for income classes below \$25,000. However, for three income groups between \$5,000 and \$25,000, a total of only 11 percent of the returns took the maximum allowable deduction. In the \$25,000 to \$50,000 group (which constitutes about 40 percent of the returns in the special tabulation), the maximum deduction was taken by 60 percent of the returns. In the \$50,000 to \$100,000 group, 79 percent took the maximum deduction.

6. *Extent of coverage of employees*

The special tabulation indicates that self-employed retirement plans cover few employees. As is indicated in table 8, 20,000 of the 25,000 returns, or 80 percent of the total, had no covered employees. Contributions by the self-employed on behalf of covered employees amounted to less than 6 percent of the total contributions reflected in the returns. This total includes the actual amounts contributed on behalf of their covered employees plus the amounts (up to \$2,500) contributed on behalf of themselves which serve as a basis for the 50 percent deduction. It does not include amounts in excess of \$2,500 which may have been contributed by self-employed but which do not enter into the computation of the deduction.

Plans are permitted to exclude employees with a period of employment of less than 3 years and employees who are not full-time employees.

In the aggregate, sole proprietorships and partnerships in 1963 paid wages and salaries to employees of \$44.3 billion. The aggregate proprietorship-partnership income was \$50 billion. In terms of deductions, covered on forms 2950-SE, \$20.7 million was deducted with respect to self-employed individuals, and \$2.4 million was deducted with respect to employees. In view of the rule that only 50 percent of the contributions of the self-employed on behalf of themselves are deductible, the fact that deductions for employees were about one-tenth of deductions for employers would suggest that contributions must have been 20 times larger for employers than for employees. This contrasts with the fact that the aggregate income of proprietors in the whole area of unincorporated business is only about 1.1 times larger than the aggregate compensation of employees, and part of the proprietor income is a property return which would not be eligible for use as a basis for a self-employed retirement deduction.

In terms of numbers of employees, the aggregate wages and salaries of employees of sole proprietorships and partnerships would suggest that there must be about 9 million such employees in 1963, of which 6,700 were covered under self-employed retirement plans.¹ This represents about 0.07 of 1 percent of all employees of sole proprietorships and partnerships in 1963. The 25,000 employers claiming the deduction, however, represent about four-tenths of 1 percent of all of the individuals who filed self-employment tax returns in 1963.

These data cited above cover all types of employees of all unincorporated business. Under the law, full-time employees with at least 3 years of service must be covered if the self-employed person is to claim a deduction, and other employees may be excluded. The

¹ There are no comparable data readily available on the number of employees of all unincorporated businesses that would permit direct comparison with the figures on covered employees. Aggregate data do permit some inferences.

data on forms 2950-SE suggest that these rules permitting exclusion of certain employees, where plans exist, result in exclusion of about 60 percent of employees of self-employed persons taking the retirement deduction.

The covered and noncovered employees and their compensation as reported on the 1964 forms 2950-SE of self-employed taking the retirement deduction was as follows:

Covered employees:

Number of returns reporting covered employees.....	5, 059
Number of returns reporting compensation.....	4, 357
Number of employees.....	6, 719
Amount of compensation.....	\$26, 384, 000

Noncovered employees:

Number of returns reporting no covered employees.....	20, 510
Number of returns reporting compensation.....	3, 774
Number of employees.....	10, 552
Amount of compensation.....	\$17, 177, 000

The reporting of employees, however, is clearly incomplete. Of the 26,000 returns, 5,000 reported covered employees, but only about 4,400 reported compensation of covered employees; 21,000 showed no covered employees, and only about 3,800 showed compensation of noncovered employees. This implies that 17,000 persons claiming the deduction had no employees. This seems unlikely. It appears that reporting of both noncovered employees and compensation paid to them is incomplete.

The total number of covered and noncovered employees, as reported, was 17,000 of which only about 40 percent were covered. The coverage percentage would be lower if there is more nonreporting of noncovered employees than there is of covered employees. The following table shows for selected occupations the reported coverage of employees of self-employed claiming the retirement deduction:

Occupation of self-employed	Percent of total number of employees reported on form 2950-SE	
	Covered	Noncovered
Physicians.....	41	59
Dentists.....	24	76
Legal services.....	45	55
Finance, insurance, and real estate.....	24	76
Retail, wholesale, and manufacturing.....	52	48
Total.....	39	61

The table below indicates the average number of covered employees of the self-employed who take the deduction.

Occupation	Average number of employees reported on form 2950-SE	
	Covered	Total
Physicians.....	0.4	0.9
Dentists.....	.3	1.2
Legal services.....	.4	1.0
Accounting and auditing.....	.2	.3

Further information on the number of employees of self-employed in selected occupation groups is summarized in table 9. It indicates, on the basis of the 1962 Statistics of Income, "Business Tax Returns," the number of self-employed (including sole proprietors plus the number of partners) in various occupational groups. These totals can be compared with Bureau of the Census data on number of employees in these occupational groups. In the groups which make much use of the self-employed retirement deduction the average number of employees is not much different for persons reporting on form 2950-SE than it is for the occupational group as a whole (see table 9).

TABLE 1.—Returns with self-employment tax¹ and returns with self-employed retirement deduction for 1964; number of returns and amount of deduction by adjusted gross income classes

AGI class	Returns with self-employment tax ²		Returns with self-employed retirement deduction			
	Number	Percent of taxable returns	Number	Amount of deduction	Percent of taxable returns	Percent of total amount deducted
Taxable returns:				<i>Thousands</i>		
0 to \$5,000.....	1,645,000	35.0	3,037	\$529	8.2	2.0
\$5,000 to \$10,000.....	1,770,000	37.7	7,971	2,416	21.6	9.3
\$10,000 to \$25,000.....	1,010,000	21.5	11,496	7,175	31.1	27.5
\$25,000 to \$50,000.....	220,000	4.7	10,487	11,204	28.5	43.0
\$50,000 and over.....	55,000	1.2	3,870	4,733	10.5	18.2
Total.....	4,700,000	100.0	36,801	26,057	100.0	100.0
Nontaxable.....	1,800,000	-----	1,536	291	-----	-----
Grand total.....	6,500,000	-----	38,337	26,348	-----	-----

¹ The latest available data are for 1963. The figures given are an estimate for 1964, with provision made for coverage of approximately 170,000 self-employed physicians who are now subject to self-employment tax.

² The number of self-employed here shown is understated because it does not include (1) individuals with self-employment income who also have wages and salaries equal to or more than the \$4,800 maximum base for social security withholding in 1963 and (2) individuals with a net loss from self-employment who are not liable for self-employment tax.

Source: Statistics of Income 1963, and Advance Data from Individual Income Tax Returns for 1964, filed during 1965. The self-employed retirement deduction is reported on line 4, pt. III, p. 2 of form 1040.

TABLE 2.—Average earned income of returns with self-employment retirement deduction and average net profit on business tax returns of various occupation groups

Occupation	Returns with self-employed retirement deduction, 1964 ¹			Returns of sole proprietorship with net profit, 1962 ²		
	Number of returns	Total earned income	Average earned income	Number of businesses	Net profit	Average net profit
		<i>Thousands</i>			<i>Thousands</i>	
All returns.....	25,569	\$680,490	\$26,614	-----	-----	-----
Physicians.....	11,809	419,428	35,518	143,747	\$2,905,699	\$20,214
Dentists.....	1,475	37,257	25,259	80,620	1,094,906	13,581
Legal services.....	2,438	76,582	31,412	121,149	1,100,007	9,080
Accounting and auditing.....	1,180	22,568	19,125	90,385	347,274	3,842
Finance, insurance and real estate.....	1,017	16,631	16,353	391,224	1,768,651	4,521

¹ Special tabulation by Internal Revenue Service based on a sample of returns used in compiling "Advance Data from Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from returns which had the special form 2950-SE attached.

² Statistics of Income, 1962, Business Tax Returns, table 3, Sole Proprietorships. Data for later years are not available.

TABLE 3.—*Self-employed retirement plans: Number of returns and amount of deduction—By type of plan and method of funding*

	Number of returns	Amount of deduction	Percent of total returns	Percent of deduction
Type of plan:		<i>Thousands</i>		
Pension or annuity.....	16,646	\$12,422	65.10	60.11
Profit sharing.....	4,670	4,255	18.26	20.59
Not indicated.....	4,254	3,988	16.64	19.30
Total.....	25,569	20,664	100.00	100.00
Method of funding:				
Trust.....	8,278	7,398	32.38	35.80
Custodial account.....	5,567	4,698	21.77	22.74
Insured.....	3,729	2,022	14.59	9.79
U.S. Government Retirement Plan Bond.....	2,569	1,852	10.05	8.96
Other.....	588	297	2.30	1.44
Not indicated.....	4,836	4,397	18.92	21.28
Total.....	25,569	20,664	100.00	100.00

Source: Special tabulation by Internal Revenue Service based on a sample of returns used in compiling "Advance Data from Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from returns which had the special form 2950-SE attached.

NOTE.—Detail may not add to total because of rounding.

TABLE 4.—Size of self-employed retirement deduction by adjusted gross income classes

AGI classes	Returns with self-employed retirement deduction									
	Size of deduction					Percent of total				
	Under \$500	\$500 to \$1,000	\$1,000 to \$1,250	\$1,250	Over \$1,250	Total	Under \$500	\$500 to \$1,000	\$1,000 to \$1,250	Over \$1,250
Under \$5,000.....	1,200	0	0	0	0	1,200	100.0	0	0	0
\$5,000 to \$10,000.....	2,403	0	0	0	0	2,403	100.0	0	0	0
\$10,000 to \$15,000.....	1,807	1,151	0	0	0	2,958	61.1	38.9	0	0
\$15,000 to \$20,000.....	1,443	2,821	1,150	(1)	0	5,415	26.3	51.4	(2)	0
\$20,000 to \$25,000.....	573	1,886	1,625	5,710	104	9,838	5.8	10.2	16.5	58.0
\$25,000 to \$30,000.....	98	1,194	480	2,575	8	3,365	2.9	4.6	14.3	76.6
\$30,000 to \$100,000.....	14	35	35	220	8	312	4.5	11.2	11.2	70.5
\$100,000 and over.....	7,538	6,047	3,290	8,577	112	25,569	29.5	23.6	12.9	33.6
Total.....										.4
										100.0

¹ Estimate is not shown separately because of high sampling variability. However, the data are included in the appropriate totals.

² Percent is not shown for the reason stated in footnote 1.

NOTE.—Detail may not add to total because of rounding.

Source: Special tabulation by Internal Revenue Service based on a sample of returns used in compiling "Advance Data from Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from returns which had the special form 2050-SE attached.

TABLE 5.—Size of self-employed retirement deductions taken by various occupation groups—Returns with self-employed retirement deduction

SIZE OF DEDUCTION

	Total		Under \$500		\$500-\$1,000		\$1,000-\$1,250		\$1,250		Over \$1,250 ¹	
	Number of returns	Amount of deduction	Number of returns	Amount of deduction	Number of returns	Amount of deduction	Number of returns	Amount of deduction	Number of returns	Amount of deduction	Number of returns	Amount of deduction
1. Physicians ²	11,809	Thou- sands \$12,478		Thou- sands \$161		Thou- sands \$1,910		Thou- sands \$2,175		Thou- sands \$8,094		Thou- sands \$138
2. Legal services.....	2,438	2,078	654	275	2,635	1,444	1,903	1,903	6,475	1,103	77	
3. Dentists and dental surgeons.....	1,475	1,234	(³) 728	(³) 275	392	286	364	385	340	425	35	
4. Retail, wholesale, and manufacturing.....	2,414	1,538	1,035	263	(³) 720	529	331	354	327	409		
5. Accounting and auditing service.....	1,180	665	623	144	(³) 379	(³) 222	(³) 259	(³) 275	135	169		
6. Finance, insurance, and real estate.....	1,017	515	480	102	1,011	699			117	146		
7. All other occupations ⁴	5,231	2,132	3,645	752					300	375		
Total.....	25,569	20,664	7,538	1,820	6,047	4,319	3,290	3,586	8,577	10,722	112	217

PERCENT OF TOTAL

1. Physicians ²	100.0	100.0	5.5	1.3	22.3	15.3	16.7	17.4	54.8	64.9	.6	1.1
2. Legal service.....	100.0	100.0	29.9	13.2	24.5	21.4	9.2	11.6	36.2	34.4		
3. Dentists and dental surgeons.....	100.0	100.0	(³) 49	(³) 16.9	26.6	23.2	24.7	22.7	23.0	31.2		
4. Retail, wholesale, and manufacturing.....	100.0	100.0	42.9	21.6	29.8	34.0	13.7	(³) 22.7	13.6	26.2		
5. Accounting and auditing service.....	100.0	100.0	52.8	31.6	(³) 37.3	(³) 43.1	4.0	(³) 8.7	11.4	25.4	.3	1.0
6. Finance, insurance, and real estate.....	100.0	100.0	47.2	30.8	37.3	34.5	6.3	14.1	11.5	18.8		
7. All other occupations ⁴	100.0	100.0	62.7	30.8	23.4	34.5	6.3	14.1	7.2	18.8		
Total.....	100.0	100.0	29.2	8.7	23.8	20.9	12.9	17.4	33.7	51.9		
Grand total.....	100.0	100.0	29.5	8.8	23.6	20.9	12.9	17.4	33.5	51.9	.4	1.0

¹ Includes returns where more than one self-employed individual (husband and wife) qualified for the deduction.

² Includes physicians, surgeons, optometrists, and other medical services.

³ Estimate is not shown separately because of high sampling variability. However, the data are included in the appropriate totals.

⁴ Percent is not shown for the reason stated in footnote 3.

⁵ Includes agriculture, ministers and teachers, and other occupations.

NOTE.—Detail does not add to total because of rounding.

Source: Special tabulation by Internal Revenue Service based on a sample of returns used in compiling "Advance Data From Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from returns which had the special form 2950-SE attached.

TABLE 6.—*Self-employed retirement deduction as a percent of earned income where deduction is less than \$1,250—Returns with self-employed retirement deduction under \$1,250*

Deduction as a percent of earned income	Number of returns	Earned income	Amount of deduction	Percent of total		
				Number of returns	Earned income	Amount of deduction
Under 2	2,445	<i>Thousands</i> \$68,424	<i>Thousands</i> \$1,040	14.48	23.79	10.79
2 to 3	3,090	66,728	1,665	18.31	23.20	17.27
3 to 4	2,155	35,412	1,229	12.77	12.31	12.75
4 to 5	7,636	106,088	5,074	45.24	36.88	52.63
5 and over	1,554	11,008	633	9.21	3.83	6.57
Total	16,880	287,660	9,641	100	100	100

Source: Special tabulations by Internal Revenue Service based on a sample of returns used in compiling "Advance Data From Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from those returns which had the special form 2950-SE attached.

TABLE 7.—*Returns with self-employed retirement deduction of 5 percent or over of earned income, or \$1,250 or over, by adjusted gross income classes*¹

AGI classes	Returns with self-employed retirement deduction				
	Total number of returns	Returns with deduction of 5 percent or over of earned income	Returns with deduction of \$1,250 or over	Total returns with the maximum allowable deduction	Percent of returns with the maximum allowable deduction
Under \$5,000	1,200	(²)	-----	(²)	(²)
\$5,000 to \$10,000	2,403	1,227	(²)	1,299	11
\$10,000 to \$15,000	2,958				
\$15,000 to \$25,000	5,437	194	5,759	5,953	60
\$25,000 to \$50,000	9,844				
\$50,000 to \$100,000	3,362	(²)	2,630	2,642	79
\$100,000 and over	311	1	228	229	74
Grand total	25,569	1,554	8,689	10,243	40

¹ This breakdown is subject to high sampling variability. Many of the income class figures are based on a small sample of returns. The table is useful only as a general indication of the importance of the maxima.

² Estimate is not shown separately because of high sampling variability. However, the data are included in the appropriate totals.

³ Percent is not shown for the reason stated in footnote 1.

NOTE.—Detail may not add to total because of rounding.

Source: Special tabulation by Internal Revenue Service based on a sample of returns used in compiling "Advance Data From Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from returns which had the special Form 2950-SE attached.

TABLE 8.—*Extent to which employees of self-employed benefit under the self-employed retirement deduction—Returns with self-employed retirement deduction*

	Number of returns	Number of covered employees	Contributions	
			Amount	Percentage
Self-employed:			<i>Thousands</i>	
Total returns.....	25,569		¹ \$41,328	94.4
With no covered employees.....	20,510		¹ 30,963	
With covered employees.....	5,059		¹ 10,365	
1 to 2 covered employees.....	4,728			
More than 2 covered employees.....	331			
Covered employees of self-employed.....		6,719	² 2,451	5.6
Total.....			43,779	100.0

¹ This figure does not represent total contributions which self-employed made themselves to retirement plans set up under this provision. It was obtained by doubling the amount of the retirement deduction shown on the returns of self-employed. The permissible annual deduction is 50 percent of contributions up to \$2,500. Self-employed who are not owner-employees, however, are not subject to the \$2,500 limit with respect to contributions (although the annual amount deductible may not exceed \$1,250, or 50 percent of \$2,500), and contributions which were made in excess of \$2,500 are not taken into account here.

² This amount represents the actual amount of the employer's contribution for covered employees included in the retirement plan.

Source: Special tabulation by Internal Revenue Service based on a sample of returns used in compiling "Advanced Data From Individual Income Tax Returns for 1964, filed during 1965." The sample was drawn from returns which had the special form 2950-SE attached.

TABLE 9.—*Estimates of number of self-employed and employees of self-employed selected occupational groups, 1962*

Occupation	Number of self-employed ¹	Number of employees of self-employed ²	Average number of employees
Physicians.....	180,000	266,000	1.5
Dentists.....	86,000	96,000	1.1
Legal services.....	197,000	159,000	.8
Accounting, auditing and bookkeeping.....	123,000	110,000	.9

¹ Sum of sole proprietors and partners, "Statistics of Income, Business Tax Returns," 1962.

² Bureau of Census, "County Business Patterns," 1962. (Physicians, includes osteopaths and chiropractors.)

FORM 2950 SE U.S. Treasury Department Internal Revenue Service	SELF-EMPLOYED RETIREMENT DEDUCTION (Statement in support of deduction for payment to a qualified pension, profit-sharing, annuity or bond purchase plan for self-employed individuals)	1964
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Name and address (Please print or type)

1. Name of plan																																	
2. Is your plan part of a master or prototype plan? ☐ Yes ☐ No. If "Yes," give IRS serial number		3. Type of plan ☐ Pension or annuity ☐ Profit-sharing																															
4. Name and address of trustee, custodian, or insurance company																																	
5. Effective date of your plan		6. If a favorable determination letter or Form 3673 has been received indicating that this plan qualifies under section 401 of the Code, give date of the most recent determination and District Director's office.																															
7. Medium of funding: (A) Trust ☐ Insurance ☐ General investments ☐ Other (B) Custodial account ☐ Mutual funds ☐ Insurance (C) Insured ☐ Group contract ☐ Individual contract (D) U.S. Government Retirement Plan Bonds ☐ (E) Other (specify) ☐		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="text-align: left;">8. COVERAGE:</th> <th style="width: 15%;">Self-employed</th> <th style="width: 15%;">Other</th> </tr> <tr> <td rowspan="4" style="width: 15%;">Total number covered</td> <td rowspan="4" style="width: 15%;">Number excluded because of:</td> <td style="width: 20%;">Years of service</td> <td></td> </tr> <tr> <td>Part-time or temporary</td> <td></td> </tr> <tr> <td>Other (specify)</td> <td></td> </tr> <tr> <td colspan="2"></td> </tr> <tr> <th colspan="4" style="text-align: left;">9. COMPENSATION (or earned income):</th> </tr> <tr> <td colspan="2">(a) Covered</td> <td>\$</td> <td>\$</td> </tr> <tr> <td colspan="2">(b) Excluded</td> <td></td> <td></td> </tr> <tr> <td colspan="2">(c) TOTAL</td> <td>\$</td> <td>\$</td> </tr> </table>		8. COVERAGE:		Self-employed	Other	Total number covered	Number excluded because of:	Years of service		Part-time or temporary		Other (specify)				9. COMPENSATION (or earned income):				(a) Covered		\$	\$	(b) Excluded				(c) TOTAL		\$	\$
8. COVERAGE:		Self-employed	Other																														
Total number covered	Number excluded because of:	Years of service																															
		Part-time or temporary																															
		Other (specify)																															
9. COMPENSATION (or earned income):																																	
(a) Covered		\$	\$																														
(b) Excluded																																	
(c) TOTAL		\$	\$																														
10. (a) Employer contributions made on behalf of participants who are not self-employed (enter here and on line 20, Schedule C of Form 1040; or col. 3, Part III, Schedule F of Form 1040; or line 24, Form 1065)..... \$		10. (b) Dates paid																															
11. (a) Employer contributions made on behalf of self-employed individual(s)..... \$		11. (d) Dates paid																															
(b) Less amount allocable to insurance protection (see instruction C).....																																	
(c) Net contributions..... \$																																	

COMPUTATION OF ALLOWABLE DEDUCTION FOR EMPLOYER CONTRIBUTIONS MADE ON BEHALF OF SELF-EMPLOYED INDIVIDUAL
 (If more than one plan is involved, combine amounts for line 12 for all plans and enter result on one form only)

12. (a) 50% of line 11(c).....	
(b) Earned income (see instruction D).....	
(c) 10% of line 12(b).....	
(d) 50% of line 12(c) not to exceed \$1,250.....	
(e) Amount allowable as a deduction (line 12(a) or 12(d), whichever is lesser). Enter here and on line 4, Part III, page 2, Form 1040.....	

INFORMATION RELATING TO PRIOR YEARS

Total accumulated contributions in prior years made on behalf of self-employed individual.....

Total accumulated deductions on Form 1040 in prior years on behalf of self-employed individual.....

SCHEDULE A—SUMMARY OF TRUST OR CUSTODIAL ACCOUNT

1. Balance at beginning of year.....	
2. (a) Employer contributions during the year.....	
(b) Employee contributions during the year.....	
(c) Earnings.....	
(d) Adjustments (attach schedule).....	
3. TOTAL (add lines 1 and 2).....	
4. Less distributions for the year.....	
Balance at end of year.....	

INSTRUCTIONS

(References are to the Internal Revenue Code)

A. Who Must File.—Self-employed individuals (including partners) and partnerships claiming a deduction for contributions to a qualified pension, profit-sharing, annuity, or bond purchase plan where such plan includes self-employed individuals must file this form to substantiate the deduction. For plans which do not include self-employed individuals, file Form 2950.

A self-employed individual is an individual or partner who has earned income as described in instruction D from an unincorporated trade, business or profession.

B. Filing of Return.—File this form with your tax return for the taxable year in which a deduction is claimed.

A separate Form 2950 SE must be filed for each plan. However, where more than one form is required, the overall limitation in item 12 need be completed on only one form.

If a favorable determination letter has not been received with respect to your plan and your plan is not part of a master or prototype plan, in addition to filing Form 2950 SE, you must submit the information required by Section 1.404(a)-2, Income Tax Regulations, to the extent applicable for the first year a deduction is claimed.

If your plan has been amended since the last favorable determination letter was received, and your plan is not part of a master or prototype plan, in addition to filing Form 2950 SE, you must submit the information required by paragraph (b)(1) of Section 1.404(a)-2, Income Tax Regulations.

Partnerships.—Partnerships need complete only items 1 through 11, and Schedule A.

Partners.—A partner who is covered only by a partnership plan need complete only items 1, 11 and 12.

A partner who is covered by more than one plan must file a form for each plan. Complete lines 1 and 11 for each partnership plan and lines 1 through 11 and Schedule A for each individual plan. The overall limitation as computed on line 12 need only be summarized on one form for all the plans.

C. Amount of Deduction.—You may deduct contributions for employees, only to the extent that they are ordinary and necessary trade or business expenses and to the extent they are within the limitations of section 404.

Contributions allocable to insurance protection.—For purposes of determining the amount deductible with

respect to contributions on behalf of a self-employed individual, amounts allocable to the purchase of life, accident, health, or other insurance protection shall not be taken into account. Enter such amounts on line 11(b). The amount of a contribution allocable to insurance shall be an amount equal to a reasonable net premium cost for such amount of insurance for the appropriate period.

D. Earned Income.—In general, earned income means net earnings from self-employment if personal services are actually rendered.

However, for this purpose doctors of medicine, and Christian Science practitioners; duly ordained, commissioned or licensed ministers of churches in the exercise of their ministry and members of religious orders; and certain individuals, excluded for self-employment tax purposes under section 1402, shall compute their earned income in the same manner as if they were included under such section.

(1) *Personal services only.*—If personal services are the only material factor in the production of income from a trade or business, then, in general—

Earned income is 100 percent of net earnings from self-employment.

(2) *Personal services and capital.*—If both personal services and capital are material factors in the production of income from a trade or business, then,

if total net profits are:	earned income is:
0 to \$2500	actual net profits
\$2500 to \$8333.33	\$2500
over \$8333.33	not in excess of 30% of your share of net profits

(3) *Personal services plus personal services and capital.*—If you are engaged in one or more trades or businesses in which only personal services are a material income-producing factor, and you are also engaged in one or more trades or businesses in which both personal services and capital are material income-producing factors, then earned income is determined under the provisions of section 401(c)(2)(B) and the regulations thereunder.

For a more detailed explanation of earned income, see section 401(c) and the regulations thereunder.

89TH CONGRESS
2D SESSION

H. R. 10

[Report No. 1557]

IN THE HOUSE OF REPRESENTATIVES

JANUARY 4, 1965

Mr. KEOGH introduced the following bill; which was referred to the Committee on Ways and Means

MAY 26, 1966

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italic]

A BILL

To amend the Internal Revenue Code of 1954 to permit pension and profit-sharing plans to provide contributions or benefits on a nondiscriminatory basis for certain self-employed individuals without special limitations on the amount of contributions.

- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 ~~That (a) paragraph (10) of section 401(a) of the Internal~~
- 4 ~~Revenue Code of 1954 (relating to special limitation on~~
- 5 ~~amount allowed as deduction for self-employed individuals for~~
- 6 ~~contributions to certain pension, etc., plans) is repealed.~~
- 7 (b) (1) Each of the following provisions of section 401
- 8 of such Code is amended by striking out “(determined

1 without regard to section 404(a)(10))” each place it ap-
 2 pears:

3 (A) Subsection (a)(10)(A)(ii).

4 (B) Subparagraphs (A) and (B) of subsection
 5 (d)(5).

6 (C) Subparagraph (A) of subsection (d)(6).

7 (D) Subparagraphs (A) and (B)(i) of subsec-
 8 tion (e)(1).

9 (E) Subparagraphs (B) and (C) and the last
 10 sentence of subsection (e)(3).

11 (2) Subparagraph (A) of section 404(c)(2) of such
 12 Code is amended by striking out “(determined without re-
 13 gard to subsection (a)(10))”.

14 (3) Subparagraph (B) of section 404(c)(2) of such
 15 Code is amended by striking out “(determined without re-
 16 gard to paragraph (10) thereof)”.

17 SEC. 2. (a) So much of subsection (c) of section 404
 18 of the Internal Revenue Code of 1954 (relating to special
 19 limitations for self-employed individuals) as precedes para-
 20 graph (2) is amended to read as follows:

21 “(c) SPECIAL LIMITATIONS FOR PROPRIETOR WHO
 22 DOES NOT HAVE EMPLOYEES.—

23 “(1) IN GENERAL.—In the case of a plan included
 24 in subsection (a), (1), (2), or (3), which provides
 25 contributions or benefits only for an individual who is

an owner-employee within the meaning of section 401(c)(3)(A), the amounts deductible under subsection (a) in any taxable year with respect to contributions on behalf of such owner employee shall, subject to the provisions of paragraph (2), not exceed \$2,500, or 10 percent of the earned income derived by him from the trade or business with respect to which the plan is established, whichever is the lesser."

(b) Subparagraph (A) of section 404(c)(2) of such Code (relating to overall limitation in case of contributions made under more than one plan) is amended by inserting "referred to in paragraph (1)" after "individual".

(c) Section 401(c) of such Code (relating to excess contributions on behalf of owner-employees) is amended—

(1) by inserting "and" at the end of clause (i) and at the end of clause (ii) of paragraph (1)(B), and by striking out clauses (iii) and (iv) of such subparagraph, and

(2) by striking out "subparagraphs (B) (ii), (iii), and (iv)" in the last sentence of paragraph (3) and inserting in lieu thereof "subparagraph (B) (ii)", and by striking out "such subparagraphs" in such last sentence and inserting in lieu thereof "such subparagraph".

1 ~~SEC. 3.~~ The amendments made by this Act shall apply
2 to taxable years beginning after December 31, 1963.

3 That (a) paragraph (10) of section 404(a) of the Internal
4 Revenue Code of 1954 (relating to special limitation on
5 amount allowed as deduction for self-employed individuals
6 for contributions to certain pension, etc., plans) is repealed.

7 (b)(1) Each of the following provisions of section 401
8 of such Code is amended by striking out "(determined with-
9 out regard to section 404(a)(10))" each place it appears:

10 (A) Subsection (a)(10)(A)(ii).

11 (B) Subparagraphs (A) and (B) of subsection
12 (d)(5).

13 (C) Subparagraph (A) of subsection (d)(6).

14 (D) Subparagraphs (A) and (B)(i) of subsec-
15 tion (e)(1).

16 (E) Subparagraphs (B) and (C) and the last
17 sentence of subsection (e)(3).

18 (2) Subparagraph (A) of section 404(e)(2) of such
19 Code is amended by striking out "(determined without re-
20 gard to subsection (a)(10))".

21 (3) Paragraph (1) and subparagraph (B) of para-
22 graph (2) of section 404(e) of such Code are each
23 amended by striking out "(determined without regard to
24 paragraph (10) thereof)".

1 *SEC. 2. Section 401(c)(2) of the Internal Revenue*
2 *Code of 1954 (relating to definition of earned income for*
3 *certain pension and profit-sharing plans) is amended to read*
4 *as follows:*

5 “(2) *EARNED INCOME.*—*The term ‘earned income’*
6 *means the net earnings from self-employment (as de-*
7 *finied in section 1402(a)), but such net earnings shall*
8 *be determined—*

9 “(A) *only with respect to a trade or business*
10 *in which personal services of the taxpayer are a ma-*
11 *terial income-producing factor,*

12 “(B) *without regard to paragraphs (4) and*
13 *(5) of section 1402(c),*

14 “(C) *in the case of any individual who is*
15 *treated as an employee under sections 3121(d)(3)*
16 *(A), (C), or (D), without regard to paragraph*
17 *(2) of section 1402(c), and*

18 “(D) *without regard to items which are not*
19 *included in gross income for purposes of this chapter,*
20 *and the deductions properly allocable to or charge-*
21 *able against such items.*

22 *For purposes of this paragraph, section 1402, as in*
23 *effect for a taxable year ending on December 31, 1962,*

1 *shall be treated as having been in effect for all taxable*
2 *years ending before such date."*

3 *SEC. 3. The amendments made by this Act shall apply*
4 *with respect to taxable years beginning after December 31,*
5 *1965.*

CONTRIBUTIONS BY SELF-EMPLOYED INDIVIDUALS TO PENSION PLANS, ETC.

MAY 26, 1966.—Committed to the Committee of the Whole House on the State
of the Union and ordered to be printed

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

R E P O R T

[To accompany H.R. 10]

The Committee on Ways and Means, to whom was referred the bill (H.R. 10) to amend the Internal Revenue Code of 1954 to permit pension and profit-sharing plans to provide contributions or benefits on a nondiscriminatory basis for certain self-employed individuals without special limitations on the amount of contributions, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert:

That (a) paragraph (10) of section 404(a) of the Internal Revenue Code of 1954 (relating to special limitation on amount allowed as deduction for self-employed individuals for contributions to certain pension, etc., plans) is repealed.

(b) (1) Each of the following provisions of section 401 of such Code is amended by striking out “(determined without regard to section 404(a)(10))” each place it appears:

(A) Subsection (a)(10)(A)(ii).

(B) Subparagraphs (A) and (B) of subsection (d)(5).

(C) Subparagraph (A) of subsection (d)(6).

(D) Subparagraphs (A) and (B)(i) of subsection (e)(1).

(E) Subparagraphs (B) and (C) and the last sentence of subsection (e)(3).

(2) Subparagraph (A) of section 404(e)(2) of such Code is amended by striking out “(determined without regard to subsection (a)(10))”.

(3) Paragraph (1) and subparagraph (B) of paragraph (2) of section 404(e) of such Code are each amended by striking out “(determined without regard to paragraph (10) thereof)”.

SEC. 2. Section 401(c)(2) of the Internal Revenue Code of 1954 (relating to definition of earned income for certain pension and profit-sharing plans) is amended to read as follows:

"(2) **EARNED INCOME.**—The term 'earned income' means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined—

"(A) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor.

"(B) without regard to paragraphs (4) and (5) of section 1402(c),

"(C) in the case of any individual who is treated as an employee under sections 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

"(D) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

For purposes of this paragraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date."

SEC. 3. The amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1965.

I. SUMMARY

Your committee's bill provides for the repeal of two limitations on the deduction from gross income a self-employed individual may take with respect to contributions on his own behalf to a retirement plan. First, the bill repeals the provision which limits the *deduction* to 50 percent of the contribution. However, your committee has retained the provision restricting the *contribution* for self-employed persons to the lesser of 10 percent of earned income or \$2,500. Second, the bill also permits a self-employed individual to include in earned income all of his net profits when his income is earned from a business in which both the performance of personal services and capital are material income-producing factors. However, in such cases the personal services of the self-employed person involved must be material income-producing factors.

The provisions of H.R. 10 are to be effective for taxable years beginning after December 31, 1965.

II. BACKGROUND AND REASONS FOR THE BILL

Under present law, self-employed individuals may establish retirement plans and may deduct from their gross incomes contributions made to these plans. Employees with more than 3 years of service must be covered, and contributions on their behalf are fully deductible.

The self-employed individual may deduct from his gross income 50 percent of the contribution on his own behalf, but the contribution is limited to the smaller of 10 percent of his earned income or \$2,500. Accordingly, the maximum deduction allowed to a self-employed person with respect to his own contribution is \$1,250.

Earned income for this purpose is defined as the income received from the performance of personal services. When capital, as well as personal services, is a material factor in the production of the income, earned income may not exceed 30 percent of the net profits from the business (except that where an individual renders personal services on a substantially full-time basis, this 30-percent rule cannot reduce the net profits considered as earned income below \$2,500).

The Self-Employed Individuals Tax Retirement Act of 1962 was enacted in order to give self-employed individuals an opportunity to defer tax on a portion of their income set aside for retirement purposes

in much the same way as they and others could already do for their employees under the provisions of the then existing law. Congress provided this deferral for the self-employed individual at that time in order to remove this discrimination in tax treatment against the self-employed. However, the response of the self-employed to the tax deferral provided by this act has been exceedingly small so far. While, of course, to some extent this may occur because the deferral privilege for the self-employed still is relatively new (and, undoubtedly, the number covered by this will increase as more self-employed begin a plan of setting aside amounts for retirement), nevertheless, the extent to which this plan has been used to date has been disappointing. A report by the Treasury Department with respect to the self-employed retirement deduction in the taxable year 1964 shows that only about one-half of 1 percent of the self-employed individuals took advantage of this deduction in that year.

Your committee believes that Congress intended that this tax deferral should be available for self-employed individuals for their retirement in a comparable manner to that for employees. However, your committee has concluded that the two limitations described above are thwarting this objective of Congress. This is indicated by the fact that when the Self-Employed Individuals Tax Retirement Act of 1962 was enacted, the Treasury Department estimated that the cost of the act in the first full year of operation would be \$115 million; yet, the actual cost as late as 1964 amounted to only \$9 million. Certainly, this demonstrates that the act, as finally approved, did not carry out the objectives of the original act.

The requirement that a self-employed individual must not only provide a pension plan for his employees of more than 3 years, but also must tie up twice as much for his own retirement as he receives a tax deduction for, has discouraged the self-employed from making provision for their own retirement. The 50-percent requirement was added as a means of equating the tax treatment of the self-employed with employees covered by contributory plans. However, in fact, most employees are not covered under contributory plans. In 1965, 25 million employees were covered under the 34,110 corporate pension plans filed with the Secretary of Labor. Nearly three-fourths of these—72.9 percent—were financed entirely by employer contributions covering an estimated minimum of 18.5 million employees. On the other hand, only an estimated 5.8 million employees are covered under plans requiring contributions from employers and themselves. Moreover, over the past several years the trend has been away from contributory pension plans. Thus, requiring self-employed pension plans to be contributory, in reality, creates discrimination against the self-employed, vis-a-vis employees, rather than removing it. For this reason, your committee has concluded that the 50-percent requirement should be removed. Not only will this remove discrimination against the self-employed, but it should also encourage them to make provision for their own old age, which was a principal objective of the 1962 act.

Your committee also believes that the 30-percent limitation on income derived from a mixture of capital and personal services represented too restrictive a rule with respect to the income likely to be attributable to personal services. Therefore, this limitation also has tended to discourage small proprietors, and especially farmers, from

making provision for their retirement through the deduction for amounts set aside for their retirement plans.

Therefore, your committee concluded that where both capital and personal services were material income-producing factors, it would be better to permit the self-employed individuals in most cases to treat the entire amount as earned income for purposes of deductions for these retirement plans. Your committee in arriving at this conclusion took into account the fact that, in any event, only 10 percent of this earned income, not to exceed \$2,500, would be available as a deduction. Your committee recognized, however, that in some cases there is a mixture of capital and personal services producing the income where the taxpayer contributes very little, if anything, to the income in the form of rendition of personal services. Situations of this type are likely to arise, for example, in the case of silent partners, absentee landlords, etc. To forestall the treatment of what is essentially a return on capital from being used by these individuals as earned income giving rise to deductions for retirement plans, your committee has defined earned income for this purpose so as not to include those cases where personal services of the taxpayer were not a material income-producing factor.

III. REVENUE EFFECT

The revenue loss from enactment of this bill is estimated to be \$20 to \$30 million arising from income in 1966 and \$35 to \$60 million in 1967. The greater range of the estimates in 1967 and the increase over 1966 reflect the possibility of larger growth of self-employment retirement plans stimulated by the amendments in this bill as more time elapses after the adoption of these amendments and more self-employed come under the plan. The range in estimates for both years reflects varying assumptions as to the number who will avail themselves of the deductions. The range of \$20 to \$30 million for 1966 income assumes coverage of 1 to 1.5 percent of the self-employed. The range of \$35 to \$60 million for 1967 income assumes coverage of 1.5 to 3 percent of the self-employed.

Estimating the revenue loss from the provisions of this bill involves more uncertainty than usual. Presently, there is information available concerning coverage under these retirement plans for 1963 and 1964. This is too brief a period to offer even a satisfactory base for projecting a normal rate of increase in coverage under the provisions of present law. In addition, neither this base of information nor the detailed information that it contains furnishes a very reliable starting point for estimates of the revenue effect of the amendments in the bill or the increased coverage that can follow its enactment.

IV. GENERAL EXPLANATION

For the reasons given above, the bill as amended makes two amendments to the provisions of present law relating to retirement plans for the self-employed. The bill removes from these provision two limitations which seriously discourage broader use of the deduction for amounts set aside for retirement.

First, the present limitation of the deduction on behalf of a self-employed person to 50 percent of the contribution (10 percent of earned income up to a maximum of \$2,500) is to be repealed. This

will permit the self-employed individual to deduct from his gross income the full amount of this contribution toward his own retirement, in the same manner as he does the full contribution he makes for his employees eligible for coverage. No change, however, is made in the limitation on the size of his contribution for himself; it remains at 10 percent of his earned income or \$2,500, whichever is smaller.

Second, your committee has removed the restriction which limits the share of income considered "earned," where both personal services and capital are important income-producing factors. Presently, only 30 percent of net profits in such cases may be considered "earned" in determining the allowable size of the contribution except that the amount so treated is not to be less than \$2,500 in the case of substantially full-time employment. In removing the restriction which limits the share of income treated as earned where both personal services and capital are important income-producing factors, your committee's bill, nevertheless, imposes a restriction designed to prevent those who are not contributing significant personal services from receiving retirement plan deductions with respect to what is, in reality, income from their capital. This is accomplished by providing in such cases that the net profits involved with respect to any self-employed person are to be treated as earned income only in the case of a trade or business in which the personal services of the particular self-employed individual involved are a material income-producing factor. By this, it is contemplated that substantially full-time employment will be treated as a material income-producing factor. In the case of less than full-time employment, in determining whether the personal services of the taxpayer are a material income-producing factor there is to be taken into account the respective contribution made by his personal services and by his capital.

The provisions of this bill are to be effective for taxable years beginning after December 31, 1965.

V. 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):

INTERNAL REVENUE CODE OF 1954

* * * * *

SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.

(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

* * * * *

(10) In the case of a plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3))—

(A) paragraph (3) and the first and second sentences of paragraph (5) shall not apply, but—

(i) such plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of or on behalf of employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, and

(ii) such plan shall not be considered discriminatory within the meaning of paragraph (4) solely because under the plan contributions described in subsection (e)(3)(A) which are in excess of the amounts which may be deducted under section 404 [(determined without regard to section 404(a)(10))] for the taxable year may be made on behalf of any owner-employee; and

(B) a trust forming a part of such plan shall constitute a qualified trust under this section only if the requirements in subsection (d) are also met.

* * * * *

(c) DEFINITIONS AND RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—For purposes of this section—

(1) EMPLOYEE.—The term “employee” includes, for any taxable year, an individual who has earned income (as defined in paragraph (2)) for the taxable year. To the extent provided in regulations prescribed by the Secretary or his delegate, such term also includes, for any taxable year—

(A) an individual who would be an employee within the meaning of the preceding sentence but for the fact that the trade or business carried on by such individual did not have net profits for the taxable year, and

(B) an individual who has been an employee within the meaning of the preceding sentence for any prior taxable year.

[(2) EARNED INCOME.—

[(A) IN GENERAL.—The term “earned income” means the net earnings from self-employment (as defined in section 1402(a)) to the extent that such net earnings constitute earned income (as defined in section 911(b) but determined with the application of subparagraph (B)), but such net earnings shall be determined—

[(i) without regard to paragraphs (4) and (5) of section 1402(c),

[(ii) in the case of any individual who is treated as an employee under sections 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

[(iii) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

For purposes of this subparagraph, sections 911(b) and 1402, as in effect for a taxable year ending on December 31, 1962, and subparagraph (B), as in effect for a taxable year beginning on January 1, 1963, shall be treated as having been in effect for all taxable years ending before such date.

[(B) EARNED INCOME WHEN BOTH PERSONAL SERVICES AND CAPITAL ARE MATERIAL INCOME-PRODUCING FACTORS.—In applying section 911(b) for purposes of subparagraph (A), in the case of an individual who is an employee within the meaning of paragraph (1) and who is engaged in a trade or business in which both personal services and capital are material income-producing factors and with respect to which the individual actually renders personal services on a full-time, or substantially full-time, basis, so much of his share of the net profits of such trade or business as does not exceed \$2,500 shall be considered as earned income. In the case of any such individual who is engaged in more than one trade or business with respect to which he actually renders substantial personal services, if with respect to all such trades or businesses he actually renders personal services on a full-time, or substantially full-time, basis, there shall be considered as earned income with respect to the trades or businesses in which both personal services and capital are material income-producing factors—

[(i) so much of his share of the net profits of such trades or businesses as does not exceed \$2,500, reduced by

[(ii) his share of the net profits of any trade or business in which only personal services is a material income-producing factor. The preceding sentences shall not be construed to reduce the share of net profits of any trade or business which under the second sentence of section 911(b) would be considered as earned income of any such individual.]

(2) *EARNED INCOME.*—The term “earned income” means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined—

(A) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor, (B) without regard to paragraphs (4) and (5) of section 1402(c),

(C) in the case of any individual who is treated as an employee under sections 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

(D) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

For purposes of this paragraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date.

(3) *OWNER-EMPLOYEE.*—The term “owner-employee” means an employee who—

(A) owns the entire interest in an unincorporated trade or business, or

(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

To the extent provided in regulations prescribed by the Secretary or his delegate, such term also means an individual who has been an owner-employee within the meaning of the preceding sentence.

(4) *EMPLOYER.*—An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

(5) CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—The term “contribution on behalf of an owner-employee” includes, except as the context otherwise requires, a contribution under a plan—

(A) by the employer for an owner-employee, and

(B) by an owner-employee as an employee.

(d) ADDITIONAL REQUIREMENTS FOR QUALIFICATION OF TRUSTS AND PLANS BENEFITING OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the following requirements of this subsection are met by the trust and by the plan of which such trust is a part:

* * * * *

(5) The plan does not permit—

(A) contributions to be made by the employer on behalf of any owner-employee in excess of the amounts which may be deducted under section 404 [(determined without regard to section 404(a)(10))] for the taxable year;

(B) in the case of a plan which provides contributions or benefits only for owner-employees, contributions to be made on behalf of any owner-employee in excess of the amounts which may be deducted under section 404 [(determined without regard to section 404(a)(10))] for the taxable year; and

(C) if a distribution under the plan is made to any employee and if any portion of such distribution is an amount described in section 72(m)(5)(A)(i), contributions to be made on behalf of such employee for the 5 taxable years succeeding the taxable year in which such distribution is made.

Subparagraphs (A) and (B) shall not apply to any contribution which is not considered to be an excess contribution (as defined in subsection (e)(1)) by reason of the application of subsection (e)(3).

(6) Except as provided in this paragraph, the plan meets the requirements of subsection (a)(4) without taking into account for any purpose contributions or benefits under chapter 2 (relating to tax on self-employment income), chapter 21 (relating to Federal Insurance Contributions Act), title II of the Social Security Act, as amended, or any other Federal or State law. If—

(A) of the contributions deductible under section 404 [(determined without regard to section 404(a)(10))], not more than one-third is deductible by reason of contributions by the employer on behalf of owner-employees, and

(B) taxes paid by the owner-employees under chapter 2 (relating to tax on self-employment income), and the taxes which would be payable under such chapter 2 by the owner-employees but for paragraphs (4) and (5) of section 1402(c), are taken into account as contributions by the employer on behalf of such owner-employees,

then taxes paid under section 3111 (relating to tax on employers) with respect to an employee may, for purposes of subsection (a)(4), be taken into account as contributions by the employer for such employee under the plan.

* * * * *

(e) EXCESS CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—

(1) EXCESS CONTRIBUTION DEFINED.—For purposes of this section, the term “excess contribution” means, except as provided in paragraph (3)—

(A) if, in the taxable year, contributions are made under the plan only on behalf of owner-employees, the amount of any contribution made on behalf of any owner-employee which (without regard to this subsection) is not deductible under section 404 [(determined without regard to section 404(a)(10))] for the taxable year; or

(B) if, in the taxable year, contributions are made under the plan on behalf of employees other than owner-employees—

(i) the amount of any contribution made by the employer on behalf of any owner-employee which (without regard to this subsection) is not deductible under section 404 [(determined without regard to section 404(a)(10))] for the taxable year;

(ii) the amount of any contribution made by any owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees;

(iii) the amount of any contribution made by any owner-employee (as an employee) which exceeds the lesser of \$2,500 or 10 percent of the earned income for such taxable year derived by such owner-employee from the trade or business with respect to which the plan is established; and

(iv) in the case of any individual on whose behalf contributions are made under more than one plan as an owner-employee, the amount of any contribution made by such owner-employee (as an employee) under all such plans which exceeds \$2,500; and

(C) the amount of any contribution made on behalf of an owner-employee in any taxable year for which, under paragraph (2)(A) or (E), the plan does not (for purposes of section 404) meet the requirements of subsection (d) with respect to such owner-employee.

For purposes of this subsection, the amount of any contribution which is allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

* * * * *

(3) CONTRIBUTIONS FOR PREMIUMS ON ANNUITY, ETC., CONTRACTS.—A contribution by the employer on behalf of an owner-employee shall not be considered to be an excess contribution within the meaning of paragraph (1), if—

(A) under the plan such contribution is required to be applied (directly or through a trustee) to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of such owner-employee issued under the plan,

(B) the amount of such contribution exceeds the amount deductible under section 404 [(determined without regard to sec-

tion 404(a)(10))】 with respect to contributions made by the employer on behalf of such owner-employee under the plan, and

(C) the amount of such contribution does not exceed the average of the amounts which were deductible under section 404 [(determined without regard to section 404(a)(10))], with respect to contributions made by the employer on behalf of such owner-employee under the plan (or which would have been deductible under such section if such section had been in effect) for the first 3 taxable years (i) preceding the year in which the last such annuity, endowment, or life insurance contract was issued under the plan and (ii) in which such owner-employee derived earned income from the trade or business with respect to which the plan is established, or for so many of such taxable years as such owner-employee was engaged in such trade or business and derived earned income therefrom.

In the case of any individual on whose behalf contributions described in subparagraph (A) are made under more than one plan as an owner-employee during any taxable year, the preceding sentence shall not apply if the amount of such contributions under all such plans for such taxable year exceeds \$2,500. Any contribution which is not considered to be an excess contribution by reason of the application of this paragraph shall, for purposes of subparagraphs (B)(ii), (iii), and (iv) of paragraph (1), be taken into account as a contribution made by such owner-employee as an employee to the extent that the amount of such contribution is not deductible under section 404 [(determined without regard to section 404(a)(10))] for the taxable year, but only for the purpose of applying such subparagraphs to other contributions made by such owner-employee as an employee.

* * * * *

SEC. 404. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN.

(a) **GENERAL RULE.**—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income); but, if they satisfy the conditions of either of such sections, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

* * * * *

[(10) **SPECIAL LIMITATION ON AMOUNT ALLOWED AS DEDUCTION FOR SELF-EMPLOYED INDIVIDUALS.**—Notwithstanding any other provision of this section, the amount allowable as a deduction under paragraphs (1), (2), (3), and (7) in any taxable year with respect to contributions made on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall be an amount equal to one-half of the contributions made on behalf of such individual in such taxable year which are deductible under such paragraphs (determined with the application of paragraph (9) and of subsection (e) but without regard to this paragraph). For purposes of section 401, the

amount which may be deducted, or the amount deductible, under this section with respect to contributions made on behalf of such individual shall be determined without regard to the preceding sentence.】

* * * * *

(e) SPECIAL LIMITATIONS FOR SELF-EMPLOYED INDIVIDUALS.—

(1) IN GENERAL.—In the case of a plan included in subsection (a)(1), (2), or (3), which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1), the amounts deductible under subsection (a) [(determined without regard to paragraph (10) thereof)] in any taxable year with respect to contributions on behalf of any employee within the meaning of section 401(c)(1) shall, subject to the provisions of paragraph (2), not exceed \$2,500, or 10 percent of the earned income derived by such employee from the trade or business with respect to which the plan is established, whichever is the lesser.

(2) CONTRIBUTIONS MADE UNDER MORE THAN ONE PLAN.—

(A) OVERALL LIMITATION.—In any taxable year which amounts are deductible with respect to contributions under two or more plans on behalf of an individual who is an employee within the meaning of section 401(c)(1) with respect to such plans, the aggregate amount deductible for such taxable year under all such plans with respect to contributions on behalf of such employee [(determined without regard to subsection (a)(10))] shall not exceed \$2,500, or 10 percent of the earned income derived by such employee from the trades or businesses with respect to which the plans are established, whichever is the lesser.

(B) ALLOCATION OF AMOUNTS DEDUCTIBLE.—In any case in which the amounts deductible under subsection (a) (with the application of the limitations of this subsection) with respect to contributions made on behalf of an employee within the meaning of section 401(c)(1) under two or more plans are, by reason of subparagraph (A), less than the amounts deductible under such subsection determined without regard to such subparagraph, the amount deductible under subsection (a) [(determined without regard to paragraph (10) thereof)] with respect to such contributions under each such plan shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(3) CONTRIBUTIONS ALLOCABLE TO INSURANCE PROTECTION.—For purposes of this subsection, contributions which are allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

* * * * *

VI. SUPPLEMENTAL VIEWS OF CONGRESSMAN THOMAS B. CURTIS

Although I strongly support the bill and disagree with the conclusions contained in the Treasury report on H.R. 10, I feel that it should be made a part of the official committee report. Therefore, I am setting it forth in my supplemental views.

TREASURY DEPARTMENT,
Washington, D.C., May 26, 1966.

HON. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: This report sets forth the views of the Treasury Department on the bill, H.R. 10, which has been ordered reported by your committee. The Department strongly objects to this bill.

H.R. 10, as amended and ordered reported by your committee, would liberalize the tax benefits applicable to self-employed pension and profit-sharing plans in two respects:

(1) The present law permits a self-employed individual to contribute each year for himself up to 10 percent, or \$2,500 (whichever is less) of his earnings to a pension or profit-sharing plan, but limits his tax deduction to one-half of his contribution. H.R. 10 would eliminate the one-half limitation and permit a tax deduction for the full contributions of the self-employed.

(2) Under the basic framework of the present law, the 10-percent limitation on the amount a self-employed may contribute each year to a pension plan is applied against his earnings from personal services. If the individual is in a business where both personal services and capital are material factors, no more than 30 percent of the profits from the business, subject to a minimum of \$2,500, may be treated as personal service earnings for this purpose. H.R. 10 would permit the individual in this situation to apply the 10-percent against the entire net profits from the business.

The Treasury Department strongly opposes the enactment of H.R. 10 for the following basic reasons:

(a) *Revenue.*—The bill would involve an estimated revenue loss for fiscal year 1967 of \$20 to \$30 million, of which \$18 to \$27 million would be attributable to the first amendment and \$2 to \$3 million to the second. For fiscal year 1968, the estimated revenue loss would increase to \$35 to \$60 million; with \$30 to \$50 million attributable to the first amendment and \$5 to \$10 million to the second.

The upper end of the revenue loss range for fiscal year 1968 is based on the assumption that 3 percent of the self-employed will be participating in pension plans as of the end of 1967. The annual revenue loss could increase substantially if the amendments encourage a larger percentage of the self-employed to adopt pension plans. For instance, if 5 percent of the self-employed participate, the annual revenue loss would increase to an estimated \$120 million.

The revenue loss from H.R. 10, especially for 1967, is completely inconsistent with the recent actions which have been taken in light of Vietnam and the economic situation. These include the postponement of excise tax reductions and the adoption of graduated income tax withholding and the other provisions in the Tax Adjustment Act of 1966 which put the payment of individual and corporate taxes on a more current basis.

In this regard, the President has stated: "Against a background calling for fiscal restraint, I cannot this year endorse any specific legislative measure, however meritorious, involving significant net tax reduction." Certainly the needs of the self-employed who would be benefited by H.R. 10 are not so pressing as to override the need for fiscal restraint.

(b) *Benefits would mainly go to high-paid doctors, dentists, and lawyers.*—Most (\$15 to \$20 million) of the 1967 revenue loss from the first amendment would represent an automatic tax reduction for the year 1966 for those self-employed already participating in pension plans since, without any change in their contributions, their tax deductions will double. Over 75 percent of this benefit—an automatic 1966 tax reduction of \$11 to \$15 million—will go to doctors, lawyers, and dentists, and, indeed, almost one-half of the total will go to individuals in these professions with incomes over \$25,000.

Moreover, it is very likely that the liberalizations will only serve to attract more of the same class of high-income self-employed into pension plans. This is because, by its very nature, this type of pension plan requires that the individual have savings that he can afford to devote to a long-term nonliquid financial investment. Individuals in businesses that require capital, such as farmers and retailers, usually must reinvest much of their earnings in their businesses. In addition, many lower and middle income professional people will find that their social security tax payments are all they can afford to devote to their retirement; their remaining savings being necessary to meet other commitments, such as the education of their children, life insurance, and mortgage payments on their homes. The result will be that the additional revenue devoted to self-employed pension plans through this bill will accrue mainly to higher income professional people, a small minority of the total self-employed and an even smaller minority of all taxpayers.

The fact that self-employed pension plans are attractive primarily to higher income people is clearly shown by the advance data for 1964. This data indicates that only 11.3 percent of self-employed pension deductions in 1964 were taken by individuals with adjusted gross incomes of \$10,000 or less. On the other hand, almost 43 percent were taken by self-employed with adjusted gross incomes of between \$25,000 and \$50,000 and over 18 percent by individuals with incomes of \$50,000 and over, making a total of 61 percent taken by those with incomes of \$25,000 and over.

Even aside from the current fiscal considerations, piecemeal legislation for this restricted group is highly undesirable. The matter of the tax treatment of self-employed pension plans should not be taken up except in the context of an overall reevaluation of the private retirement system where many basic issues are involved.

(c) *Removal of 30-percent rule permits contributions from investment income.*—The special tax treatment for pensions has historically been limited to pension contributions out of wages and earnings from

personal services. It represents a method for deferring tax on part of an individual's earnings until after retirement. Where an individual invests both his time and capital in a business, the profits consist of both compensation for his services and a return on his investment. By permitting a self-employed individual to make pension contributions out of the entire net profits from his business, H.R. 10 in effect would allow him to defer tax on investment income. This is inconsistent with the basic concept of the pension provisions. If anything is to be done in this area, it should be to raise the minimum amount which may be treated as personal service earnings—perhaps from \$2,500 to \$6,600, the social security tax base for the self-employed.

There is attached a memorandum which more fully discusses the amendments and the reasons for the Treasury's opposition to them.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

MAY 25, 1966.

MEMORANDUM ON H.R. 10

H.R. 10, as ordered reported by the Ways and Means Committee, includes two liberalizing amendments to the tax provisions applicable to pension plans of the self-employed. These amendments are separately discussed below.

I. REMOVAL OF 50-PERCENT DEDUCTION LIMITATION

A. Description of amendment

The first amendment would increase the amount which a self-employed individual may claim as a tax deduction with respect to his contributions to a qualified pension or profit-sharing plan. A self-employed individual who participates in a tax qualified pension or profit-sharing plan may, each year, contribute to the plan (on his own behalf) amounts up to 10 percent of his earned income or \$2,500, whichever is the lesser. Under present law, only one-half of any such contribution is allowed as a tax deduction to the self-employed individual. This amendment would remove this "one-half" limitation, with the result that a self-employed individual would be allowed to deduct the full amount of his contribution within the above-described limits. In other words, under this amendment, a self-employed individual would be permitted a tax deduction for contributions up to 10 percent of his earned income or \$2,500, whichever is the lesser, instead of 5 percent or \$1,250, as under present law. The amendment would become applicable with respect to deductions for taxable years beginning after December 31, 1965.

This revenue loss is entirely inconsistent with the recent actions which have been taken by both the Congress and the administration to meet the current fiscal and economic

situation. In this regard, Congress, on the recommendation of the administration, recently enacted the Tax Adjustment Act of 1966 which postponed certain excise tax reductions and instituted a graduated income tax withholding system and other provisions to put the payment of individual and corporate taxes on a more current basis. A tax reduction for self-employed people—in the nature of larger tax deductions for their retirement savings—would seem clearly inappropriate in this context.

It is important to note in this respect that, while the purpose of the amendment is to encourage increased participation by the self-employed in retirement plans, most (\$15 to \$20 million) of the estimated 1967 revenue loss would be in the nature of an automatic tax reduction for those self-employed who are already participating in pension plans. This is because, without any change in their pension contributions, their tax deduction will automatically double. According to the available data,¹ over 75 percent of the deductions are now taken by professional doctors, lawyers, and dentists. Thus, this group would be the beneficiary of an immediate tax reduction of \$11 to \$15 million. Looking at individual cases, the amendment would result in an additional \$400 of tax savings in 1967 for a \$25,000 a year married doctor with a pension plan; for a \$50,000 a year doctor, the additional annual tax savings would be \$625.

B. Treasury Department position

The Treasury Department is strongly opposed to this amendment for the following reasons:

(1) *Revenue loss inappropriate at this time.*—It is estimated that this amendment would produce an \$18 to \$27 million revenue loss for fiscal year 1967 and a \$30 to \$50 million revenue loss for fiscal 1968. The lower end of the range for fiscal year 1967 assumes that 1 percent of the self-employed will participate while the upper end of the range assumes that 1.5 percent participate. In the case of the loss for fiscal year 1968, the lower end of the range assumes participation by 1.5 percent of the self-employed and the upper end of the range assumes participation by 3 percent of the self-employed.

The annual revenue loss could increase substantially over the next few years if the liberalized tax benefits result in a higher percentage of the self-employed participating in pension or profitsharing plans. If the participation rate rises to 5 percent, the annual loss would be \$120 million; whereas, if 10 percent participate, the annual loss would jump to \$260 million.

Finally, in his Economic Report, President Johnson stated: "Against a background calling for fiscal restraint I cannot this year endorse any specific legislative measure, however meritorious, involving significant net tax reduction." Certainly, the needs of this high-income group are not so pressing as to override the need for fiscal restraint.

¹ Data on Self-Employed Retirement Deduction for Taxable Year 1965, p. 3.

(2) *Benefits of amendment would accrue primarily to high income professional people.*—The apparent purpose of the increased tax benefits under the amendment is to encourage broader participation by the self-employed in retirement programs. While the present provisions have not had the widespread attraction that was contemplated, the Treasury Department is of the opinion that increased tax deductions will not materially alter this situation. Rather, the basic framework of the self-employed pension provisions is such as to make them usable mainly by only a narrow class of high-income professional people with the result that the increased tax benefits will accrue primarily to this group.

First, the existing provisions require that the self-employed place his savings in financial investments under what is intended to be a long-term, nonliquid retirement program. This immediately eliminates many self-employed individuals in businesses which require significant amounts of capital investment since they usually must reinvest their earnings to keep up with competition. For example, a farmer may have to reinvest all his earnings in his farm through buying land, buildings, and equipment. This, in turn, will give him an equity which he can lease or sell when he is ready to retire. This is one reason why it is so conspicuous in the data that the pension plan provisions appeal to doctors, lawyers, and dentists and why there are so few retailers, wholesalers, and farmers covered. Because of this characteristic, removal of the deduction limitation will simply increase the inherent discrimination in these provisions rather than bring in new classes of the self-employed.

Second, even among the professional group, pension plans of the type involved are, and will in all likelihood remain, attractive only to higher income people. For middle and lower income people, social security tax payments represent a significant financial outlay toward retirement. For example, a self-employed person with earnings of \$6,600 must, in 1967 and 1968 pay 6.4 percent of his income toward social security and medicare. A \$10,000 a year man must devote 4.2 percent of his income for this purpose. These percentages will rise to 7.1 and 4.7, respectively, in 1969. It is doubtful that many individuals at these income levels can afford to devote appreciably more to their retirement in the form of a long-term program.

Moreover, at these income levels, total savings as a percent of income are much lower than they are for people with higher incomes. For example, according to computations by the Survey Research Center, individuals at the \$6,000 income level on the average devote only 8.8 percent of their income to savings while people with incomes of \$15,000 and over save on the average of 23.8 percent of their income. Furthermore, much of these savings are, of course, not available for retirement plans of the type involved here. Instead, they must be used for other needs, such as insurance, mortgage payments, and college education of children.

Finally, as is generally the case, tax deductions for pension savings are per se more valuable to higher income people by virtue of their higher marginal tax brackets.

Therefore, despite liberalized tax deductions, self-employed pension plans will undoubtedly remain a vehicle primarily for the retirement savings of only the high-paid professional class. This is a very narrow group and it seems highly inappropriate to devote substantial Federal tax revenues to it, especially at this time.

Moreover, there are much broader issues that should be considered in the pension field as a whole. Instead of taking piecemeal action at this time for a very limited group, the Treasury Department believes that any changes in the present self-employed pension provisions would best be considered in the context of congressional consideration of the overall pension recommendations outlined in the report of the President's Committee on Corporate Pension and Other Private Retirement and Welfare Programs.

(3) *Self-employed not comparable to corporate employees.*—Supporters of the amendment contend that a professional who works for a corporation now has an advantage over the self-employed professional in that, when the professional works for a corporation, the pension plan contributions made for him are entirely excludable from his income, whereas the equivalent pension provision by the self-employed professional is only 50 percent deductible. This is given as a rationale for the removal of this 50-percent limitation. This comparison is not essentially valid. More often than not, the contribution for the corporate employee is not vested and may not become vested unless he remains with the company until retirement. Thus, he may never get the pension or he may get the pension only at the cost of giving up highly attractive opportunities to change employment. On the other hand, when the self-employed individual makes a pension contribution he is investing his own money and has vested rights to it. He can invest it in any way that he wants. He can select the pension plan that he wants. For the employed professional, he can only take the pension plan that is already available whether or not it fits his needs.

In the other words, for the self-employed, a pension plan is in many respects comparable to individual retirement savings or employee contributions to a pension plan, neither of which are tax deductible. The present 50-percent deduction rule treats a self-employed as both an employer and employee with respect to his pension contributions. It is comparable to the ratio in which the employer and employee contribute under the civil service retirement plan and the social security system. When viewed in this context, it is a rational rule. Removal of the 50-percent limitation would be inconsistent with this and cannot be justified on the grounds of equality with corporate employees.

II. REMOVAL OF LIMITATION ON COMPUTING EARNED INCOME

A. Description of amendment

This amendment would increase the amount which self-employed individuals in businesses involving both capital and services may contribute on their own behalf to qualified pension or profit-sharing plans. The 10-percent limitation on the amount a self-employed individual may contribute to a qualified pension or profit-sharing plan is applied against his "earned income." Section 401(c)(2) of the Internal Revenue Code presently defines the "earned income" of a self-employed individual for pension plan purposes to mean his net earnings from self-employment (as defined in section 1402(a)) to the extent that such net earnings constitute earned income (as defined in section 911(b)). The amendment would revise this definition of "earned income" to mean a self-employed individual's net earnings from self-employment without regard to what part of such net earnings constitutes earned income under section 911(b). The amendment would apply to taxable years beginning after December 31, 1965.

The amendment would primarily concern self-employed individuals who are engaged in a trade or business in which both personal services and capital are material income-producing factors. At present, section 911(b) provides that such a self-employed individual may not treat more than 30 percent of the net profits from his trade or business as "earned income." Under a special provision, the 30-percent limitation does not operate, however, to reduce a self-employed individual's earned income below \$2,500 for pension plan purposes. The amendment would have the effect of removing this 30-percent limitation with the result that a self-employed individual could treat the entire net profits from his trade or business as earned income for purposes of computing the amount he may contribute to a qualified pension or profit-sharing plan.

B. Treasury position

The Treasury Department is opposed to the amendment in this form.

Where both capital and personal services are material income-producing factors in a trade or business, it logically follows that a portion of the net profits from that trade or business represents a return on the individual's investment in the business. Historically, the primary purpose for the special tax provisions applying to pension and profit-sharing plans has been to permit individuals to defer tax on part of their wages or personal service income until after retirement. It would be inconsistent with this to permit self-employed individuals to contribute and take tax deductions with respect to amounts which represent a return on their investment rather than compensation for personal services. Moreover, such a provision would give self-employed people a decided tax advantage over corporate employees who cannot take their investment income into account under pension

plans. The amendment would not, therefore, be a desirable extension of the provisions applying to pension and profit-sharing plans of self-employed people.

Moreover, the amendment would involve an estimated revenue loss of \$2 to \$3 million for fiscal year 1967 and \$5 to \$10 million for fiscal 1968. As indicated above, such a loss in Federal revenues is not appropriate at this time.

It is our understanding that the primary purpose of this amendment is to permit self-employed individuals in small businesses to make significant contributions to pension plans. This objective could more appropriately be achieved by raising the present \$2,500 minimum amount which may be treated as earned income. A reasonable figure might be \$6,600, the present self-employment tax base for social security purposes. It is estimated that an amendment of this type would reduce the 1967 revenue loss to less than \$0.3 million and the 1968 loss to less than \$1 million.

OFFICE OF THE SECRETARY OF THE TREASURY.
OFFICE OF TAX LEGISLATIVE COUNSEL.

(Signed) THOMAS B. CURTIS.

[June 6, 1966]

[P. 11672]

CONTRIBUTIONS BY SELF-EMPLOYED INDIVIDUALS TO PENSION PLANS, ETC.

Mr. KEOGH. Mr. Speaker, I move to suspend the rules and pass the bill (H.R. 10) to amend the Internal Revenue Code of 1954 to permit pension and profit-sharing plans to provide contributions or benefits on a nondiscriminatory basis for certain self-employed individuals without special limitations on the amount of contributions, with the committee amendment printed in the bill.

The Clerk read as follows:

H.R. 10

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (10) of section 404(a) of the Internal Revenue Code of 1954 (relating to special limitation on amount allowed as deduction for self-employed individuals for contributions to certain pension, etc., plans) is repealed.

(b) (1) Each of the following provisions of section 401 of such Code is amended by striking out "(determined without regard to section 404(a)(10))" each place it appears: (A) Subsection (a)(10)(A)(ii).

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(B) Subparagraphs (A) and (B) of subsection (d)(5).

(C) Subparagraph (A) of subsection (d)(6).

(D) Subparagraphs (A) and (B) (1) of subsection (e)(1).

(E) Subparagraphs (B) and (C) and the last sentence of subsection (e)(3).

(2) Subparagraph (A) of section 404(e) (2) of such Code as amended by striking out "(determined without regard to subsection (a)(10))".

(3) Paragraph (1) and subparagraph (B) of paragraph (2) of section 404(e) of such Code are each amended by striking out "(determined without regard to paragraph (10) thereof)".

SEC. 2. Section 401(c)(2) of the Internal Revenue Code of 1954 (relating to definition of earned income for certain pension and profit-sharing plans) is amended to read as follows:

"(2) (EARNED INCOME.—The term 'earned income' means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined—

"(A) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor,

"(B) without regard to paragraphs (4) and (5) of section 1402(c),

"(C) in the case of any individual who is treated as an employee under sections 3121(d)(3)(A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

"(D) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items. For purposes of this paragraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date."

SEC. 3. The amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1965.

The SPEAKER pro tempore (Mr. Boggs). Is a second demanded?

Mr. BYRNES of Wisconsin. Mr. Speaker, I demand a second.

The SPEAKER pro tempore. Without objection, a second will be considered as ordered.

There was no objection.

Mr. KEOGH. Mr. Speaker, I yield myself such time as I may consume.

(Mr. KEOGH asked and was given permission to revise and extend his remarks.)

GENERAL LEAVE TO EXTEND

Mr. KEOGH. Mr. Speaker, I ask unanimous consent that all Members may have 5 legislative days within which to extend their remarks on this bill.

The SPEAKER pro tempore. Is there objection to the request of the gentleman from New York?

There was no objection.

Mr. KEOGH. Mr. Speaker, the 6th day of the 6th month in the 66th year is a rather appropriate day that, by your grace, the House considers the amendments to H.R. 10, for it will have been exactly 15 years ago tomorrow, from June 7 of 1951, when those who sought to achieve a degree of equity and justice for the self-employed professional and businessmen of the country caused to be introduced the first form of the bill which eventually became the Self-employed Individual's Tax Retirement Act of 1962.

By your grace, Mr. Speaker, yes, it is today.

I acknowledge dutifully my appreciation to you for having scheduled this important bill today. Included in my expressions of appreciation are the majority leader; the majority whip, who is a cosponsor of the bill; and, last but not least, the great and able chairman of the Committee on Ways and Means, without whose cooperation we would not here be marching forward taking another step in the direction of making the practice of one's private profession or the engaging in one's own business something that is truly American, something that is more constructive, and something that provides a greater incentive for the maintenance of those 10 million people who with their approximately 10 million employees constitute as they do the bulk of the great middle class of this country, the very existence of which distinguishes this great country from so many others in the Western World and all of those in the Eastern World.

The pending bill is H.R. 10 amended, Mr. Speaker, but it might very well be any one of the following bills introduced by distinguished Members of this

body on both sides of the aisle. Those bills are:

Bills introduced in the House of Representatives similar to the Keogh-Watts-Byrnes bill, H.R. 10

KEOGH (D., New York)-----	H.R. 10.
BYRNES (R., Wisconsin)-----	H.R. 7588.
WATTS (D., Kentucky)-----	H.R. 8023.
LOVE (D., Ohio)-----	H.R. 8247.
CAREY (D., New York)-----	H.R. 9162.
FOGARTY (D., Rhode Island)-----	H.R. 9453.
BROYHILL (R., Virginia)-----	H.R. 10033.
LIPSCOMB (R., California)-----	H.R. 10070.
HORTON (R., New York)-----	H.R. 10643.
CRAMER (R., Florida)-----	H.R. 10777.
POFF (R., Virginia)-----	H.R. 11173.
ABBITT (D., Virginia)-----	H.R. 11242.
BETTS (R., Ohio)-----	H.R. 11299.
JENNINGS (D., Virginia)-----	H.R. 11328.
ROSTENKOWSKI (D., Illinois)-----	H.R. 11337.
STEED (D., Oklahoma)-----	H.R. 11694.
WYATT (R., Oregon)-----	H.R. 11786.
ROGERS (D., Colorado)-----	H.R. 12795.
DERWINSKI (R., Illinois)-----	H.R. 12926.
SCHNEEBELI (R., Pennsylvania)-----	H.R. 12944.
MAY (R., Washington)-----	H.R. 14084.
BOGGS (D., Louisiana)-----	H.R. 14452.
VANTIK (D., Ohio)-----	H.R. 14475.
BURKE (D., Massachusetts)-----	H.R. 14670.
KARSTEN (D., Missouri)-----	H.R. 14686.
FULTON (D., Tennessee)-----	H.R. 14729.
HALL (R., Missouri)-----	H.R. 15168.
KUPFFERMAN (R., New York)-----	H.R. 15246.

This bill comes to you with the active support of a long, distinguished list of national small business, professional and farm associations. I do not intend to list them for fear of omitting and offending the many who might unintentionally not be included.

During the past 15 years I have been privileged to have as cosponsors from the other side of the aisle, several of the finest gentlemen to ever grace the House of Representatives. I regret the absence today from our body of the late distinguished members, Mr. Reed of New York, Mr. Jenkins of Ohio, and Mr. Simpson of Pennsylvania, all of whom contributed immeasurably as pioneers in the sponsorship of this legislation. In the 87th Congress, I was joined by the very able Congressman from California [Mr. TUTT].

The ranking minority member of our Committee on Ways and Means, the gentleman from Wisconsin [Mr. BYRNES], and the energetic committee member, the gentleman from Kentucky [Mr. WATTS], have added great prestige to this legislation by their sponsorship. I would be remiss in my duty if I did not at this time also pay tribute to the invaluable assistance given me by the highly competent staff of the Committee on Ways and Means—Chief Counsel, Leo Irwin, Assistant Chief Counsel, John M. Martin, Jr.

Mr. Speaker, H.R. 10 is a familiar designation to many in this chamber today who commenced with me over 15 years ago in an endeavor to do a modicum of justice to the self-employed people of this country with respect to their establishment of voluntary retirement plans.

It will be recalled that in the course of that protracted and arduous effort, the House on three occasions passed legislation to make available tax deferral benefits to self-employed individuals on a basis comparable to that afforded employees.

Our perseverance, persistence, and patience were finally rewarded, Mr. Speaker, when the other body approved—with extensive amendments, however—H.R. 10 of the 87th Congress, the Self-Employed Individuals Tax Retirement Act of 1962."

Members of the House will recall that the Senate version of that measure was far more restrictive than the bill as passed by the House. In the conference that followed the Senate passage, the House conferees, of which I was privileged to be a member, were only partially successful in removing some of the more controversial and confining Senate amendments. The measure that was finally approved admittedly fell short of measuring up to the relief that would have been provided in the House bill.

It was the price that had to be paid, Mr. Speaker, to initially insert in the tax statutes recognition and adoption of a policy that would seek to afford self-employed citizens access to retirement plans on a basis similar to that given employees whose employers had established for their benefit pension, profit-sharing, or stock bonus plans.

Many of us in this Chamber were convinced at the time of the final enactment of H.R. 10 of the 87th Congress—and so stated on the floor of the House—that the amendments of the other body were unnecessarily restrictive and might effectively thwart the objectives of that legislation. Experience over the past 4 years has reinforced, substantiated and vindicated our convictions in this regard.

Today we bring to the floor of the House a bill, overwhelmingly approved by the Committee on Ways and Means, to remove two of these limitations from the law.

Mr. Speaker, the bill, H.R. 10, the bill before the House, as amended and reported by the Committee on Ways and Means, would repeal two limitations on the deduction from gross income that a

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self-employed individual may take with respect to contributions on his own behalf to a retirement plan. The first of these limitations to which I refer is the provision of present law that limits the actual tax deduction to 50 percent of the self-employed persons' contributions to his retirement plan. It will be recalled that a self-employed individual may contribute up to 10 percent of his earned income or \$2,500, whichever is the lesser, to his retirement plan. His deduction is limited to one-half of his contribution, however, and thus the maxi-

mum deduction allowed to a self-employed person with respect to his own contribution is \$1,250 under present law. H.R. 10 would remove this 50-percent limitation, and the deduction in such a case would under the bill simply be 10 percent of earned income or \$2,500, whichever is the lesser.

The second limitation that would be removed by the pending bill is that which restricts the amount of income that is considered as earned income in situations where both personal services and capital are material income producing factors in a business. Presently, only 30 percent of net profits in such cases may be considered earned income in determining the allowable size of the annual contribution, except that in the case of substantially full-time employment, the amount so treated is not to be less than \$2,500. H.R. 10 would remove this 30-percent limitation and would allow a self-employed individual to include in his earned income all of his net profits so long as his personal services are a material income producing factor in his business.

Mr. Speaker, the Self-Employed Individuals Tax Retirement Act of 1962 was enacted in order to give self-employed individuals an opportunity to defer tax on a portion of their income set aside for retirement purposes in much the same manner as they and others could already do for their employees under the provisions of the then existing law. It was intended to encourage the self-employed to make adequate provision for their old age.

That these objectives have been foiled and frustrated by certain limitations in that act, including the two restrictive provisions that would be removed by the pending bill, is beyond peradventure or question. A report of the Department of the Treasury with respect to the use of the self-employed retirement deduction in the taxable year 1964 shows that only about one-half of 1 percent of self-employed individuals took advantage of this deduction in that year. Moreover, when the 1962 legislation was originally enacted the Department estimated that the cost of the act in the first full year of operation would be \$115 million, whereas the actual cost as late as 1964 turned out to be only \$9 million.

The Committee on Ways and Means, after careful study of the operation of this law and the statistical information furnished by the Department of the Treasury relative to its use, has concluded that there is no justification for the two limitations which I have discussed and which would be removed by the pending bill. Furthermore the committee is convinced that these restrictive provisions have been major contributors to the discouragement of self-employed individuals, particularly small proprietors and farmers, in claiming the tax benefits that

were intended in the enactment of the 1962 legislation.

I firmly believe that we have traveled too far down the road of the obviously sound, basic philosophical concept that the workers of this country should be able adequately to provide for their superannuation to turn back. No one can take exception to the oft-repeated statement that pension plans promote the general welfare not only by helping to meet the individual's material needs in old age, but also by making the Nation's elderly a positive force in the economy, rather than a negative force or burden upon it.

Millions of words have been said and written about this legislation both in and outside the Congress. One of the most articulate, yet briefest paragraphs on this subject appeared in the 1965 hearings of the Subcommittee on Employment and Retirement incomes to the special Senate Committee on Aging:

A private pension plan is attractive to an employee because it assures him of greater independence in his retirement years. He is assured of greater freedom of choice as to how he lives and spends his money. Pension plans help employers to maintain an efficient work force with good morale and help to assure an effective market for goods and services among the retired population. Private pension plans advance the government's objective of a growing, yet stable private enterprise type of economy for the benefit of all citizens.

In 1942, the 77th Congress enacted an amendment that gave use to the tremendous growth of qualified private pension plans approved by the Treasury Department. Prior to this step, there were approximately 4 million covered; today the figure is 25 million and according to a recent Federal report the total by 1980 should be in the neighborhood of 42 million covered employees. We provided the impetus in 1942 and the American business community responded by approximately 1 million new faces annually.

I was privileged to cast an affirmative vote on that momentous day in 1942. June 6, 1966, is an eventful day for the self-employed and their employees, because today this distinguished body will extend to them a privilege which is presently enjoyed by over 25 million corporate employees.

Recent Treasury statistics indicated that approximately 39,000 self-employed, or less than one-half of 1 percent, were covered in 1964. Today we have an opportunity similar to the one we experienced in 1942; only this time we are going to provide the impetus for the self-employed. Granted it is 24 years later and the beneficiaries of the future will be the sons and daughters of those who were unintentionally excluded in 1942.

So, Mr. Speaker, joined as I am today by a distinguished roster of men and women in this body on both side of the

aisle, I say that these amendments are amendments that we contemplated would normally and naturally be necessary by reason of the restrictive vote that the basic act took in 1962. It is doing no violence to the fiscal policies of the United States. It is not doing any more than just achieving a slight degree of equity for those who work proudly for themselves.

The pending measure is just, meritorious, anti-inflationary, and a savings incentive. It removes an obvious inequity and should receive the overwhelming support of this House.

Mr. HORTON. Mr. Speaker, will the gentleman yield?

Mr. KEOGH. I will be delighted to yield to the distinguished gentleman from New York.

Mr. HORTON. Mr. Speaker, I want to commend the gentleman for his efforts in this Congress to get these amendments to the present act. I also want to commend him and the other members of the committee for instituting this program. I can tell him from the personal knowledge I have of my district and the many people I have talked to who have benefited from this present bill that they are indeed grateful for his personal efforts and the efforts of the others on this committee in order to make this program possible. Throughout my journeys in the 36th District of New York I have found there has been a real need for amendments to this act. I think the amendments proposed here today are good ones and that the gentleman from New York [Mr. KEOGH] should be commended in the twilight of his career in the House for providing these benefits for the self-employed.

Mr. KEOGH. Mr. Speaker, if I may delay my taking my seat for just a moment, I appreciate my friend's obviously able and astute evaluation of the commendation that I deserve, but I hasten to tell him that the form of the pending bill is one that combines the bills of the very able and distinguished minority member of the Committee on Ways and Means, the gentleman from Wisconsin [Mr. BYRNES], and another bill by Representative WATTS of the Commonwealth of Kentucky. It is to them that the major portion of the commendation should go today. Without their able, active, and intelligent assistance in the committee, we would not have reached this point in the parliamentary process.

Mr. HORTON. Mr. Speaker, will the gentleman yield further?

Mr. KEOGH. I have no choice but to submit to yielding to the gentleman from New York.

Mr. HORTON. Mr. Speaker, I certainly would want to include in my remarks the tribute that is needed to be paid to the gentleman from Wisconsin [Mr. BYRNES] and all of those others

who have worked on this bill. However, I want to emphasize again that I think the gentleman's diligence and willingness to spearhead these efforts has meant a great deal, first of all, to getting the program started and also toward making these very vital amendments to the program.

Again I want to say also, as one who sponsored legislation in this field for

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amendments to this act, I am grateful to the gentleman and the others on the committee who have made it possible for us today to vote on this legislation.

Mr. KEOGH. Mr. Speaker, I refuse further to resist the gentleman's insistence and I appreciate his kind remarks.

(Mr. HORTON asked and was given permission to revise and extend his remarks and include extraneous matter.)

Mr. HORTON. Mr. Speaker, it is with a great sense of accomplishment that I participate today in approving H.R. 10, to eliminate the discriminatory effect of Internal Revenue laws on the retirement pension funds of self-employed persons.

In 1962, Congress acted to allow pension-fund deductions to self-employed individuals. But the limitations imposed in the 1962 act were so stringent, that it is estimated that less than one-half of 1 percent of self-employed individuals in the Nation have utilized the new law. Today, we are acting, in line with our original intent, to encourage participation in such plans by self-employed persons by removing some of these unattractive limitations and restrictions. As the sponsor of H.R. 10643, a bill similar to that before us today, I am particularly pleased to remove the 50 percent deduction limitation so that 100 percent of funds contributed will be deductible from taxable gross income.

Throughout my years in the House of Representatives, few proposals have won the wide-spread constituent support that has been given H.R. 10. With this support behind me, coming from nearly every vocation from farming to law and medicine, I join with my colleagues in giving my unqualified approval to this measure.

With the permission of my colleagues, I would like to insert the following sampling of correspondence on this measure into the CONGRESSIONAL RECORD:

HON. FRANK HORTON,
House of Representatives,
Rayburn Building,
Washington, D.C.

DEAR CONGRESSMAN: Our association initially sponsored and has continued to support the principle of H.R. 10.

Understand this coming up for vote Monday, June 6. Sincerely urge your presence and support of bill on Monday.

JOHN E. BERRY,
Executive Director,
New York State Bar Association.

AMERICAN BAR ASSOCIATION,
Washington, D.C., October 29, 1965.
Re H.R. 10643.
Congressman FRANK HORTON,
House Office Building,
Washington, D.C.

DEAR MR. HORTON: You may be interested in the enclosed copy of the ABA Washington Letter which is sent to several thousand bar leaders throughout the country. I call your attention particularly to page two regarding your legislation to improve the opportunity for self-employed individuals to participate in retirement plans.

The improvements which are being sought are of utmost concern to lawyers and other professional individuals as well as to small businessmen and farmers. Your active leadership on behalf of this legislation is greatly appreciated.

Sincerely,

DONALD E. CHANNELL.

Enclosure.

cc: New York State Bar Association, Association of the Bar of the City of New York.

NEW YORK FARM BUREAU,
Ithaca, N.Y., June 2, 1966.

Hon. FRANK J. HORTON,
House Office Building,
Washington, D.C.

DEAR MR. HORTON: Knowing that you have introduced a bill relative to retirement programs for self-employed persons which is similar to H.R. 10, you will be interested in the enclosed copy of letter which is going to the entire New York State delegation.

Yours sincerely,

NEW YORK FARM BUREAU,
C. K. BULLOCK,
Director, Commodity Department.
"NEW YORK FARM BUREAU,
"Ithaca, N.Y., June 2, 1966.

"Re: H.R. 10.

"To: New York Congressmen.

"GENTLEMEN: It is our understanding that the above bill is scheduled for consideration on the floor of the House early next week.

"The Self-Employed Individuals Tax Retirement Act of 1962 was aimed at correcting discrimination that had previously existed with regard to types of self-employed. However, it has failed to correct inequities existing with farmer 'owner-employees.' The earnings of such farmers are a joint product of personal services and invested capital, and under the 1962 Act earned income is considered to be not more than the larger of \$2,500 or 30% of the taxpayers' earnings from self-employment.

"The 1962 Act also limits tax deferral to 50% of the contributions. This results in a serious inequity with respect to self-employed retirement programs with a consequence that very few retirement programs have been established.

"We urge your support of H.R. 10 when it comes up for consideration on the House Floor. We believe it would correct major inequities in existing law and would result in self-employed farmers being able to establish their own retirement system, which I am sure you will agree is highly desirable.

"Yours sincerely,

"NEW YORK FARM BUREAU,
"C. K. BULLOCK,
"Director, Commodity Department."

MEDICAL SOCIETY
OF THE COUNTY OF MONROE, INC.,
Rochester, N.Y., January 17, 1966.

Hon. FRANK J. HORTON,
New House Office Building,
Washington, D.C.

DEAR FRANK: Just a brief note on behalf of the Legislative Committee of the Medical Society of the County of Monroe thanking you for your interest and your proposal to amend the Keogh Bill.

We are, of course, heartily in support of any endeavor which will place the self-employed in a favorable tax position comparable to that enjoyed by corporate and institutional employees. If you have any suggestions by which we may be of assistance in obtaining this improved legislation, we would be most happy to cooperate.

Sincerely yours,

MEDICAL SOCIETY OF THE COUNTY
OF MONROE, INC.,

DONALD M. IRISH,
Executive Director.

ROCHESTER, N.Y.,
June 1, 1966.

Hon. FRANK J. HORTON,
House of Representatives,
Capitol Building,
Washington, D.C.

DEAR SIR: This is written to urge your active support for H.R. 10 as recently reported by the House Ways and Means Committee. This bill would permit self-employed individuals a full deduction for amounts contributed to retirement plans established by them. Present law permits deduction for only one-half of contributions and is thus inequitable to self-employed individuals. Proposed H.R. 10 would remove this inequity and would encourage self-employed individuals to provide for their own retirement.

Respectfully,

D. ROBERT NICHOLSON.

NEW YORK, N.Y.,
May 27, 1966.

FRANK J. HORTON,
Senate Office Building,
Washington, D.C.:

On behalf of our State society membership of 15,000 certified public accountants in New York State respectfully urge your support of H.R. 10 as reported by House Ways and Means Committee. This amended version of H.R. 10 calls for full deduction of allowable money contributed by self-employed individuals. This bill is a further step toward establishing tax equity for hundreds of thousands of professional men and women and self-employed individuals. It is squarely in the public interest and we urge your full support.

WILLIAM P. STOWE,
President, New York State Society of
Certified Public Accountants.

ROCHESTER, N.Y.,
May 31, 1966.

Hon. Congressman FRANK HORTON,
House of Representatives,
Capitol Building,
Washington, D.C.

DEAR FRANK: This is written to urge your active support for H.R. 10 as recently reported by the House Ways and Means Committee. This bill would permit self-employed

individuals a full deduction for amounts contributed to retirement plans established by them. Present law permits deduction for only one-half of contributions and is thus inequitable to self-employed individuals. Proposed H.R. 10 would remove this inequity and would encourage self-employed individuals to provide for their own retirement.

Sincerely,

WILLIAM D. GASSER.

Mr. Speaker, at this point, I want to publicly express my gratitude to one of the leading attorneys in Rochester, N.Y., who worked tirelessly to bring the facts on H.R. 10 to the attention of his colleagues, and to seek removal of the restrictions I have spoken of. Scott Stewart, Esq., of Nixon Hargrave, Devons & Doyle, deserves the thanks of all self-employed persons who will benefit from H.R. 10.

Mr. KEOGH. Mr. Speaker, I now yield to the Representative of the Commonwealth of Kentucky [Mr. WATTS].

Mr. WATTS. Mr. Speaker, I certainly rise in support of H.R. 10. I, too, would like to add my commendations to the gentleman from New York. This is a matter that has been very close to his heart for a number of years. He is to [P. 11676]

be congratulated not only by the House but by the whole country for taking the attitude he has in trying to provide some type of retirement for folks who have been left out heretofore. I had a small portion of this bill which dealt with the inequity imposed on small business people and farmers.

(Mr. WATTS asked and was given permission to revise and extend his remarks.)

Mr. WATTS. Mr. Speaker, I believe its passage is a matter of urgent necessity if we are to remove basic injustices in our tax laws.

An inequity existed as to the tax treatment accorded self-employed persons who desired to establish private retirement plans. Employer contributions to retirement plans have been tax deductible for some time and nontaxable to the employees until retirement benefits are actually received. The law discriminated against self-employed persons by requiring them to pay taxes on income they set aside for retirement. Farmers, ranchers, and other small businessmen make up a large portion of this group.

Congress recognized that discrimination did exist and enacted the Self-Employed Individuals Tax Retirement Act of 1962. This measure has tended to reduce the discrimination, but it has fallen demonstrably short of achieving its objective, especially with respect to farmers and other small businessmen.

Under the Self-Employed Individuals Tax Retirement Act of 1962, most farmers are classified as "owner-employees." Owner employees are authorized to con-

tribute up to 10 percent of their earned income but not more than \$2,500 per year, to a retirement plan and to claim a Federal tax deferral for 50 percent of such contributions.

However, in the case of farmers, the benefits of this act are drastically limited by a restrictive definition of "earned income." If the earnings of an "owner-employee" are a joint product of personal services and invested capital, as is the case with most farmers, not more than the larger \$2,500 or 30 percent of the taxpayer's earnings from self-employment may be treated as "earned income."

Limiting the deferral to 50 percent of the contributions has retained a serious inequity with respect to self-employed retirement programs. Consequently, very few retirement programs have been established. The restriction that earned income must be arbitrarily computed at 30 percent of net earnings has made the program meaningless to farmers and other self-employed who must invest capital as well as labor in their enterprises.

I do not believe that farmers should be penalized because they must invest capital as well as labor into their farming operations. That is why I introduced H.R. 8023 during the first session of this Congress.

The Ways and Means Committee has given careful consideration to this matter, and I am pleased that the decision was made to include the provisions which I introduced in H.R. 10, as reported by the committee. The effect of these provisions quite simply is to permit—not force—farmers and others who must invest capital in their enterprises to participate in self-help retirement programs on the same basis as other self-employed. This law does not provide a subsidy; it does not provide tax abatement; it simply permits all self-employed to contribute 10 percent of their net earnings to a qualified retirement program and defer tax payments until the benefits of such a program are received. At last, we will be giving the self-employed the same opportunity as the employee of a corporation.

Mr. Speaker, some misinformed people have commented that the Self-Employed Individuals Tax Retirement Act has operated for the benefit of only those with very large incomes. The fact of the matter is that, because of the restrictive provisions in the act, the program has been virtually inaccessible to the average self-employed. It is by removing these arbitrary and unrealistic restrictions that we open the door of opportunity to the individual with an average income so that he, too, can prepare for his retirement years.

H.R. 10, as reported by this committee, is a bill designed to help farmers and

other small businessmen; or more accurately—it is a bill to permit them to help themselves. I believe its passage will be a matter of pride for every Member of this Congress.

Of special interest to the House is the recommendation of the Subcommittee on Employment and Retirement Income to the Special Subcommittee on Aging of the U.S. Senate made just last June:

Recommendation No. 3. The subcommittee recommends that the Internal Revenue Code be amended to eliminate or liberalize the provision specifying that where both capital and personal services are material income-producing factors in a trade or business, not more than 30 percent of the self-employed taxpayer's net income from the trade or business may qualify as "earned income" (Internal Revenue Code, sec-401(c) (2) (B)).

Where this provision is applicable, the self-employed individual's net earnings must be at least \$83,333.33 for the year if he is to make the maximum pension contribution of \$2,500 (30 percent of \$83,333.33) is \$25,000; 10 percent of \$25,000 is \$2,500). One of the largest occupational groups which are severely handicapped by this provision in taking advantage of the Smathers-Keogh Act are farmers. Testimony of the American Farm Bureau Federation showed how unreasonable and inflexible the arbitrary 30-percent provision is with reference to American farms, on many if not most of which the percent of net income attributable to operator labor is considerably over 30 percent. The subcommittee feels that this arbitrary concept should be eliminated or that, at the very least, the inflexible percentage should be raised to a more reasonable figure than 30 percent.

Incidentally, making it possible for more farmers to obtain self-employment pension coverage would assist in solving the Nation's farm problems and in providing better opportunities for younger farmers. In a letter reproduced in the hearings record, Dr. John A. Schnittker, who was then Director of Agricultural Economics of the Department of Agriculture (now Under Secretary of Agriculture), said: "the fact that many continue to farm past the age of 65 indicates that more attractive plans are needed. Pension plans based on voluntary contributions of farmers have promise. However, they probably could not be made sufficiently attractive to have much impact unless present tax laws were changed. Only small numbers take advantage of the present tax exemptions permitted for pension plans of the self-employed. If attractive to farmers, this type of plan could make a contribution to releasing resources to other farmers because there would likely be greatest participation among those farmers who have relatively high sales and who control much land . . . a program designed to be attractive to older farmers on larger farms would allow an impressive fraction of farm resources to become available to younger operators, including a small number of 'new' farm operators.

"Your committee might be interested in reviewing the experience of the Netherlands, which relies on programs to induce early retirement of farmers as a major instrument of achieving needed structural adjustments in the agriculture of the country."

Further along this line, the American Farm Bureau Federation said in its testimony:

"The technological revolution has combined with the initiative and accomplishments of American farmers to bring about the most efficient agriculture in the world. In order to cope with what many consider an over-expanding plant, numerous proposals have been and are being made for land retirement programs. While such programs can be helpful, they require considerable Federal expenditures and deal with only one factor of agricultural production. As fewer and fewer farmers are capable of producing a greater and greater amount of food and fiber, it seems obvious that we must make allowance for human retirement as well as land retirement."

Needless to say, this improvement would also extend pension coverage in other occupational groups in which both capital and personal services are material income-producing factors.

The purposes of this recommendation would be accomplished by enacting either S. 1939 (Talmadge) or H.R. 8023 (Watts).

Mr. KEOGH. Mr. Speaker, the gentleman from Kentucky had much more than a small portion of the pending bill. He has furnished a great deal of leadership in bringing us to the point on the road at which we have arrived.

Now, Mr. Speaker, I hope I can reserve the balance of my time.

Mr. BYRNES of Wisconsin. Mr. Speaker, I yield myself 5 minutes.

Mr. Speaker, this bill merely carries out the basic intention of the House of Representatives when back in 1961 we passed H.R. 10 to set up this system so that the self-employed would have an opportunity to provide for their own retirement and that of their employees on a basis somewhat analogous to the pension plans that corporations could set up for their officers and employees. As originally enacted by the House, I think that purpose could more nearly have been accomplished than is the situation today under the law as it was amended by the Senate. As a result of action in the other body there was adopted—and the conferees accepted it as a part of a compromise—an amendment which not only adopted the \$2,500 maximum amount that could be contributed by the employer on his own behalf, but limited the deduction to one-half of the amount contributed.

That is the principal limitation which we seek to eliminate now by the passage of this legislation, because that amend-
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ment, adopted in the other body and accepted by the conference, really left very little incentive in the bill.

Mr. Speaker, I pointed this fact out at the time the conference report came to the House, and subsequent events have confirmed this conclusion. Since that time there have been a number of plans developed. Some 40,000 self-employed employers have established plans but, in the words of the committee report, this has been a great disappointment. You will find that it is only those with a high

income—and one or two employees—that have adopted these plans. The individual with a small business finds this limitation particularly onerous.

Mr. Speaker, the bill which we are considering today seeks to narrow the gap between what is available to corporations in making provisions for their officers and employees and what is available to the self-employed in providing for the retirement of himself and his employees.

Mr. Speaker, the bill would still retain the maximum limitation of \$2,500 on the amount which the self-employed can contribute on his own behalf, a limitation which does not apply to corporate contributions on behalf of its officers. However, the bill would permit the self-employed to deduct the full amount of that contribution, just as he deducts the full amount of the contribution on behalf of his other employees.

Mr. Speaker, in addition to removing the 50-percent limitation upon the amount the self-employed can deduct, the bill also amends the definition of "self-employed income," in order to conform to the definition used in the social security law. Under existing law, where capital, as well as personal services, is a material income-producing factor, earned income is limited to 30 percent of the net profits of the business. This means that in addition to all other limitations, only 30 percent of the profits of such an unincorporated business can be treated as self-employment income. The remaining 70 percent must be treated as investment income, not subject to the provisions of H.R. 10. For all practical purposes, unincorporated farmers were thus precluded from setting up pension plans for themselves and their employees. Adoption of the social security rule removes another impediment to the more widespread use of self-employment retirement plans.

Mr. Speaker, also, let us not forget that whenever an employer adopts such a plan to protect himself against his old age and retirement, he is also extending that same protection to his employees. So by this method a large group of employees in this country who today are without this added protection can be brought in and given this protection. We are not talking just about the self-employed individual himself.

Now, Mr. Speaker, it should be quite clear to all the Members of the House that the Department of the Treasury opposes this bill.

The SPEAKER pro tempore (Mr. Boggs). The time of the gentleman from Wisconsin has expired.

Mr. BYRNES of Wisconsin. Mr. Speaker, I yield myself 3 additional minutes.

The SPEAKER pro tempore. The gentleman from Wisconsin is recognized for 3 additional minutes.

Mr. BYRNES of Wisconsin. But, Mr. Speaker, let it be remembered that the Department of the Treasury has opposed legislation in this field from the very beginning. It opposed the original legislation when it was pending before the House of Representatives. It was the Department of the Treasury that succeeded, in a sense, in almost gutting the bill when it was pending 4 years ago before the other body. And, Mr. Speaker, I have no doubt that they will probably attempt to load the bill down with crippling amendments when it gets into the other body again. But this time, however, I would hope that when the House of Representatives reiterates its position, as I fully expect it will today, that our conferees will stand firm and I think the other body should be on notice that the House of Representatives does not intend to have these kind of limitations put upon this program.

Of course, when one says the Treasury opposes the bill and did oppose it before, I do not think that should necessarily have an influence on this House in this instance. I would cite just a little example of a situation earlier this year when the Treasury and the administration fought almost to the dying end to prevent the inclusion in the Tax Adjustment Act of 1966 of a provision for social security payments to those people over 72 years of age under the Social Security Act. But, when the bill got down to the White House to be signed, the President was all for it—and the administration claimed great credit for having that enacted into law. Yet it was enacted into law only over the vigorous objection of the Treasury Department and of the executive agencies concerned.

So, I would hope that on this bill, we might have a similar experience—that although the Treasury opposes it today, when it goes to the President that then the administration will be all for it.

Mr. Speaker, it is indeed anomalous that this administration which purports to have such great interest in the aged, and we heard considerable about that over the weekend, should oppose this legislation when its purpose is to provide a system whereby individuals can take care of themselves and take care of their employees in their older age and in their retirement.

There has been and there must continue to be expansion in the service trades. More and more of our workers will be in the service industries. It is in this area that the small businessman with a few employees—the self-employed—can make the greatest contribution to our economy. We should encourage them and not penalize them. We should encourage the skilled workers to prefer to run their own business rather than to work for the larger corporate establishments.

This is not exclusively, as the Treasury would have us believe, a doctor's and lawyer's bill. In a sense, Mr. Speaker, this can be considered a plumber's bill, and a painter's bill—a bill to help the an electrician's and a carpenter's bill, small shopkeeper and the small independent farmer—to help these people who are self-employed set aside something for their old age and retirement. This is good bill and it deserves the unanimous support of the House of Representatives.

The SPEAKER. The time of the gentleman has expired.

(Mr. DON H. CLAUSEN (at the request of Mr. KEOGH) was granted permission to extend his remarks at this point in the RECORD.)

Mr. DON H. CLAUSEN. Mr. Speaker, we have before the House today H.R. 10, a bill to amend the Internal Revenue Code of 1954 to permit pension and profit-sharing plans to provide contributions or benefits on a nondiscriminatory basis for certain self-employed individuals. While this bill is on the consent calendar, indicating no substantial opposition to passage, I want to raise my voice, nevertheless, to extol the virtues of this proposal.

H.R. 10 is an attempt to do what the Congress tried to do in 1962, and I hope this time we will fully succeed. As the Members will recall, Mr. Speaker, the Congress passed the Self-Employed Individuals Tax Retirement Act of 1962 for the purpose of encouraging employers to set up retirement programs for themselves in much the same way as they and others could already do for their employees under provisions of the law. However, although these employees could defer profit taxes on the entire amount they set aside in retirement plans for their employees, they were restricted to deferring the tax on only half of the amount they set aside for their own retirement. The results, as indicated in Government reports, showed that less than 1 percent of self-employed individuals availed themselves of this new provision and, as a result, we can only conclude that the intent of the Congress was not successful.

The amendments before us today would permit these self-employed individuals to defer the tax on all of the funds they set aside for their own retirement up to \$2,500 per year, or 10 percent of their earned income, whichever is smaller. In addition, it permits self-employers whose income is derived from both services and capital to have the same deferment privilege providing they are contributing significant personal services in earning their income.

It is my hope, Mr. Speaker, that these amendments will encourage self-employed persons to take advantage of the congressional intent to motivate self-

employers in providing for their own retirement. The philosophy behind the 1962 act was very good, in my opinion, but it did not succeed in motivating self-employers to provide for their own futures. This philosophy is most gratifying, Mr. Speaker, in that it does not take the hard line in requiring small businessmen and other self-employers to shoulder an extra load imposed by the Government, via taxes, in order to provide for their own retirement. Instead, it permits them to defer the tax on the amount they pay in for their own retirement just as the tax is deferred on the amount they pay in for their employees. It has long been my own philosophy that the tax system of the United States can be used

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as a most effective and constructive tool to encourage taxpayers to meet their own responsibilities, rather than a destructive tool to weigh them down and discourage responsibility. The latter course can only hasten the day when the Government may have to be responsible for those things which a little encouragement now may solve.

Mr. Speaker, this is a fine example of putting the tax structure to work for us and encouraging individuals to meet their own responsibilities, and I wholeheartedly congratulate the Committee on Ways and Means and the gentleman from New York [Mr. KEOGH] for their fine work on this bill.

Mr. KEOGH. Mr. Speaker, we have no further request for time.

Mr. BYRNES of Wisconsin. Mr. Speaker, I yield 5 minutes to the gentleman from Missouri [Mr. CURTIS].

(Mr. CURTIS asked and was given permission to revise and extend his remarks.)

Mr. CURTIS. Mr. Speaker, this bill comes before the House under very unusual circumstances.

First, I want to apologize to the House for the fact that the hearings in executive session which were taken down are not available to the House. I think it is wrong not to have this material available to the House. Incidentally, I feel these hearings should never have been in executive session. This has to do with some basic procedures.

I am very concerned over the kind of procedures that we have been following and increasingly so here in the House of Representatives. I happen to favor this legislation and I am very strongly in favor of it. But I think it is about time that those of us who favor something recognize that if there is going to be honest deliberation and debate that those who disagree with us should be given an opportunity to have their disagreement considered.

If the hearings were available, the membership would read some very strange remarks. For after the commit-

tee unanimously voted out the bill, and for the reasons that the gentleman from New York has given and for the reasons given by the gentleman from Wisconsin with which I agree—after this was done the Assistant Secretary of the Treasury, Mr. Stanley S. Surrey, said, "I want it to be known that the administration is strongly opposed to this bill."

Of course, the administration spokesmen made their opposition quite clear as we developed these issues during the executive session. I think the gentleman from Wisconsin [Mr. BYRNES] and I engaged in colloquy somewhat along the lines—well after all, the committee report accompanying the bill will contain the administration's point of view and the reasons for it opposing the bill. Then it was developed that this was not necessarily so, and apparently it is not the procedure in our committee necessarily to print the administration's views in opposition.

I think it should be. It is not, but I said in a half-joking fashion, "Mr. Secretary, of the 17 Democrats on the committee, all you have to do is to get one of them to have supplemental views, and even though he disagrees with you, he will put the administration remarks in the committee report."

The statement was, Well, he was not quite sure whether he could get one of the 17 Democrat members to do this. Then he turned to me and asked me, Would I put the Treasury views in the committee report if he could not get one of the 17 Democrats to do so. This shocked me a little bit, but when I thought it over I said, "Yes." To my amazement, I was taken up on this. I got a call from the Secretary of the Treasury asking me if I would do that.

If Members will turn to page 12 of the committee report, they will find my supplemental views. I want to read them:

Although I strongly support the bill and disagree with the conclusions contained in the Treasury report on H.R. 10, I feel that it should be made a part of the official committee report. Therefore, I am setting it forth in my supplemental views.

So that any of you who would be interested in knowing why the administration is opposed can have the benefit of their logic. I do not agree with their logic.

Mr. KEOGH. Mr. Speaker, will the gentleman yield?

Mr. CURTIS. I yield to the gentleman from New York.

Mr. KEOGH. I simply wanted to say that this is another example of the great service which the gentleman from Missouri performs. What you have done has been done in the regular, orderly way. If anyone should inquire of you as to why you took that action, I suppose the best answer would be that when one has no one on his side, he will take help from wherever he can get it.

Mr. CURTIS. I think the gentleman has stated it correctly.

The issue I wanted to point out stated by the administration in its views is that the revenue loss from H.R. 10—talking about \$30 million and \$35 million in fiscal year 1966 to \$60 million in fiscal 1968—the revenue loss, especially from 1967, is "completely inconsistent with the recent actions which have been taken in light of Vietnam and the economic situation." There is no question that this revenue loss has not been budgeted.

I have been trying to fight for the President's budget. In fact, I think it is too much and we need to cut it. This means a great deal to me. Therefore, I have to determine in my own thinking, in terms of priorities. What is the significance of this \$30 million in relation to other expenditure programs that we have? Does this assume a great priority in my judgment? Indeed it does. I think we have continued too long with this very serious imbalance that exists between the corporate form of doing business and the professional form of doing business and in respect to the self-employed. It has been damaging to the professions; and to small business, farmers and entrepreneurs. Every year this imbalance has been in the law corporations have been able to deduct from taxes that which they put in their approved pension plans for their employees, but private practitioners—lawyers, doctors, dentists and the self-employed—could not do this for themselves or their employees, and this has been an underlying economic evil.

This is a matter of tax equality. So my disagreement with the President is not the disagreement that we badly need every penny of revenue that we can get, and that we need to hold expenses down. My argument is that this does take priority over a great deal that is in the budget. The President should have budgeted this program, in my opinion. If this becomes law it will become necessary for the President to cut other expenditures out to make way for this particular program because it should be given the highest priority.

Mr. TEAGUE of California. Mr. Speaker, will the gentleman yield?

Mr. CURTIS. I yield to the gentleman from California.

Mr. TEAGUE of California. Mr. Speaker, I congratulate the gentleman from Missouri [Mr. CURTIS] for having been the recipient today in the Washington Post of a highly complimentary and well deserved editorial, complimenting him on his attitude and his findings concerning our trade problems. It is not very often the Washington Post has a kind word to say about a Republican, particularly one who generally is in the conservative camp. I congratulate the gentleman.

Mr. CURTIS. I thank the gentleman. I hope I still am in the conservative camp.

Mrs. MAY. Mr. Speaker, will the gentleman yield?

Mr. CURTIS. I yield to the gentleman from Washington.

(Mrs. MAY asked and was given permission to revise and extend her remarks.)

Mrs. MAY. Mr. Speaker, I also add my congratulations to those of my colleague from California, to my good friend from Missouri.

Also at this time I rise in support of H.R. 10 and offer my commendation to the gentleman from New York [Mr. KEOGH] and to the gentleman from Wisconsin [Mr. BYRNES] and the gentleman from Missouri [Mr. CURTIS] and to all those who have had a part in bringing this legislation before us.

As a long-time cosponsor of H.R. 10, I supported the original version of H.R. 10 when it passed the House in 1962. As you know, the Senate managed to weaken the legislation before it was sent to the President for signature, and the legislation before us today, which I am also pleased to cosponsor, will correct this inequity.

Today's version of H.R. 10 will extend to an estimated 10 million of our citizens—many of them middle income small businessmen—the chance to set aside retirement funds for themselves, the same as they are now required to do for their employees. This will be accomplished by repeal of the two amendments added to the original 1962 version of H.R. 10 after it left the House. The amendments, as time has now proven, were of such nature that a very small number of self-employed individuals have chosen to make use of the pro-

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visions enacted in 1962. The report before us today, I believe, estimates that only about one-half of one percent of self-employed individuals made use of the deduction in 1964. On the other hand, it is estimated that the bill before us today will greatly improve this disappointing situation by encouraging participation as much as sixfold by 1967.

This is a good bill, worthy of the support of the Congress, and one in which I am proud to be a cosponsor on behalf of the many, many small businessmen and farmers of my district.

When the gentleman from Wisconsin was speaking, he pointed out that this was not just a bill for professional people, that it certainly is a bill for electricians and plumbers and small business employers, but he left out one very important group, and that is our farmers.

Mr. CURTIS. The gentleman is correct.

Mr. BYRNES of Wisconsin. Mr. Speaker, I yield 1 minute to the gentleman from Missouri [Mr. HALL].

(Mr. HALL asked and was given per-

mission to revise and extend his remarks.)

Mr. HALL. Mr. Speaker, I want to join in the accolade to my colleague from Missouri, extended by the gentleman from [Mr. TEAGUE], and the gentlewoman from Washington [Mrs. MAY], concerning the gentleman from Missouri [Mr. CURTIS], and his statement on our economy and our trade and his findings, as reported in the editorial in this morning's Washington Post.

Mr. Speaker, I rise in support of H.R. 10, to permit pension and profit-sharing plans to provide contributions or benefits on a nondiscriminatory basis, for certain self-employed individuals, without special limitations on the amount of contributions. I speak of one who would be participating if still in professional practice, but being here am not eligible.

Earlier this year, I introduced similar legislation, H.R. 15168, in recognition of the unequal tax treatment that exists today between self-employed persons and those who work for corporations.

The legislation has two basic purposes: to eliminate the provision allowing deduction of only 50 percent of the self-employed's contribution, and to remove the crippling 50-percent limitation on the maximum percentage of earned income which might be set aside annually.

This bill is of particular significance to lawyers, accountants, engineers, architects, doctors, dentists, and other self-employed people.

This law is needed to correct the inequities that were added in the Senate to the original Keogh bill, and which limited annual contributions on behalf of the self-employed to one-half of 10 percent of earned income, or \$2,500, whichever was less.

Recently, the American Bar Association reported that less than 1 percent of its members have elected to participate in that association's retirement plan.

Other professions have had similar experiences, and it surely is time to correct these inequitable and unfounded limitations that are frustrating the worthwhile goal of the Self-Employed Individuals Retirement Act. This bill provides that an owner-employee may deduct the full amount of such contributions, up to a maximum of 10 percent of his earned income, but not to exceed \$2,500 in any one year. Thus, within that limitation, the tax incentive for him to establish retirement plans for himself and his employees would be increased twofold, as compared with existing law.

The self-employed and the owner-employed will be called upon to a greater and greater degree to provide additional jobs for our growing work force. At a time when there is a growing trend on the part of young people to go to work for others, I think it is important that we do everything we can to encourage the independent entrepreneur to strike out

on his own. Their independence is a valuable asset to our society.

The self-employed individual, as an employer of his own services, occupies the same position as the manager of a small business owned by a corporation. There is no reason, as a matter of equity, why that portion of his compensation, which is committed for the provision of retirement income, should not be treated exactly alike in both cases. Removal of the present inequitable treatment would do much to encourage the extension of pension coverage to both the self-employed and their employees.

The list of associations endorsing this legislation includes: The American Bar Association, the National Society of Professional Engineers, the National Milk Producers Association, National Society of Public Accountants, American Optometric Association, American Medical Association, American Dental Association, the American Hotel & Motel Associations, the National Livestock Tax Committee, and the Authors League of America, Inc.

I commend the members of the Ways and Means Committee, on both sides of the aisle, for their hard work on this measure, and I urge its adoption.

Mr. POFF. Mr. Speaker, I would like to underscore the need for this legislation on the grounds of equity.

Under legislation passed by the Congress in 1942, corporation employers and other employers who have purchased supplemental retirement programs for their workers are permitted to deduct the full amount of the premiums paid as business operating costs. Until 1962, self-employed people, such as farmers, lawyers, accountants, doctors, dentists, engineers and small businessmen, had no equivalent opportunity. In that year, Congress graciously granted them half a loaf. Although the House had passed legislation granting a whole loaf, the other body adopted an amendment which said in effect that a self-employed worker could deduct only 50 percent of the amount he invested in a retirement program up to 10 percent of his earned income, or \$2,500, whichever is less.

Now, Mr. Speaker, if the Congress acknowledged the existence of an inequity, how can Congress remain content to ignore half the inequity? It is time now to do a complete justice. The 50-percent limitation must be lifted.

It think it is important also to emphasize that this legislation can function as an important weapon in the war against inflation. Essentially, payments into the type of retirement program eligible under this statute are the same as deposits in savings accounts. They have the effect of reducing total currency in circulation and this tends to bring the supply of goods and services into better balance with the supply of money. This in turn helps to promote the integrity

of the dollar and stabilize the purchasing power of the paycheck.

Accordingly, I earnestly trust that this legislation will be promptly approved here and in the other body.

Mr. ABERNETHY. Mr. Speaker, there are a great many farmers and small businessmen in my congressional district and State who come under the category of self-employed persons. They will benefit from this bill.

Under the Self-Employed Individuals Tax Retirement Act of 1962 most farmers are classified as "owner-employees." As such they are authorized to contribute up to 10 percent of their earned income, but not more than \$2,500 per year, to a retirement plan and claim a Federal tax deferral for 50 percent of such contributions. However, in the case of farmers, the benefits of this act are drastically limited by a restrictive definition of "earned income." If the earnings of an "owner-employee" are a joint product of personal services and invested capital, as is the case with most farmers, not more than the larger of \$2,500 or 30 percent of the taxpayer's earnings from self-employment may be treated as "earned income."

Limiting the deferral to 50 percent of the contributions has retained a serious inequity with respect to self-employed retirement programs. The restriction that earned income must be arbitrarily computed at 30 percent of net earnings has made the program meaningless to farmers and other self-employed who must invest capital as well as labor in their enterprises.

This bill removes both the 50-percent and 30-percent limitations. I have long felt that this inequity should be eliminated and want to commend the Committee on Ways and Means for reporting H.R. 10, which will be a major step in assisting the self-employed, particularly our farmers and small businessmen, to set up retirement programs.

Mr. KUPFERMAN. Mr. Speaker, I am pleased to support this bill, H.R. 10, based upon legislation originally introduced by the gentleman from New York [Mr. KEOGH] as a beneficial and necessary change in our present tax law and designed to encourage the self-employed individual.

Mr. Speaker, in 1942 our tax laws were changed to offer substantial tax benefits to corporations and their employees in the field of pension and profit-sharing plans. Corporate employers were allowed 100-percent tax deductions for contributions when made to retirement plans. As a result of the 1942 legislation, self-employed persons and their employees were discriminated against.

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In 1962, the original H.R. 10 was passed by Congress—Public Law 87-792, 76 Stat.

809—and, for the first time, recognition was given to the problem of tax discrimination and unfair treatment offered the self-employed individual.

The Self-employed Individual's Tax Retirement Act of 1962 was a substantial step in the right direction, but it did not fully accomplish the needed tax encouragement of the many professional persons, small businessmen and even farmers which come within the scope and meaning of self-employed persons. For example, under existing law—subsection 404(a) (10) Internal Revenue Code of 1954—the deduction which may be taken for amounts contributed to a qualified retirement plan by any self-employed individual for his own benefit is limited to 50 percent of such contribution.

Mr. Speaker, I have introduced H.R. 15246, which would amend the Internal Revenue Code of 1954 to remove the 50-percent limitation and would permit the self-employed person to deduct the entire amount of the contribution made in his behalf to a retirement plan.

In addition, my bill would change the definition of "earned income" applicable with respect to the retirement plan so as to eliminate the ceiling on deductible contributions that could be placed in the retirement plan.

Mr. Speaker, among those individuals who would benefit most from the legislation which I have introduced, H.R. 15246, and from the substantially similar bill—H.R. 10—before us today, are the members of the medical and dental profession. As self-employed individuals, they are presently permitted by our tax laws to deduct only 50 percent of the contributions made in their behalf to a retirement plan.

In addition to repealing the limitations upon the contribution made by the self-employed, the legislation being considered today would permit a self-employed individual to include in earned income all of his net profits when his income is earned from a business in which both the performance of personal services and capital are material income-producing factors. In this way, medical and other professional and self-employed persons would be given the same or equal treatment as our tax laws presently afford corporations and their employees.

Mr. Speaker, I fully support H.R. 10, and hope that my colleagues will give every consideration to its passage.

Mr. Speaker, I would like at this point in the CONGRESSIONAL RECORD to include a statement regarding H.R. 10, written by the Honorable Edward W. Kuhn, president of the American Bar Association, which appeared in the February 1966 issue of the American Bar Journal, and which in a thorough and scholarly manner sets forth the history behind H.R. 10 and illustrates the need for its passage:

THE PRESIDENT'S PAGE

(By Edward W. Kuhn)

A recent Senate report emphasizes the need for changes in our tax laws to encourage professional persons to participate in private pension plans. Twenty-five million Americans are now covered under private plans; they constitute an estimated half of the persons in private nonfarm employment. The largest segment of our population not participating is composed of persons in the professions, small business and agriculture. In only fifteen years, it is estimated, three out of five employees, a total of 42,000,000 persons, will be covered under private plans, but unless there is a change in our tax laws, the participation is likely to include very few professional individuals in private practice.

The practicing lawyer has a peak earning period of about twenty years, generally between 45 and 65 years of age. The average income in 1962 for those in individual practice was about \$8,200 and for those in partnerships \$18,000. Some 200,000 lawyers are engaged in private practice but are denied a deferral of federal income taxes on the full amount of retirement savings because they have a self-employed status.

The number of lawyers employed in private concerns, primarily industry, has increased 127 per cent since 1951. Studies indicate that a major factor has been the attractive retirement benefits offered to corporate employees.

In 1942, our tax laws were changed to offer substantial tax benefit to corporations and their employees in the establishment of pension plans, supplementing social security. The tax effects of these plans are:

First, the contributions by the employer for the employee, although in the nature of additional compensation, are not taxable to the employee until the retirement benefits are received in later years.

Second, the employer gets a tax deduction for the contributions when made.

Third, the earnings from the retirement fund are tax exempt until distributed.

Fourth, the retirement benefits are distributed at a time when the employee would normally be in a lower tax bracket.

The result of the legislation enacted in 1942 was to discriminate in favor of employed persons and against all self-employed persons and their employees. To correct this obvious inequity, the American Bar Association led an effort in Congress to secure a measure of equality with corporate officers and employees in respect to the tax treatment of earnings set aside for retirement purposes. Finally, in 1962, the Smathers-Keogh Bill (H.R. 10) was passed by Congress and, for the first time, recognition was given to the problem of the self-employed in this field.

Although the Self-Employed Individuals Tax Retirement Act of 1962 was a step forward, it by no means provides an adequate method for the average self-employed individual to save for retirement. During the long struggle for passage, the legislation was weakened considerably. In the final days of the 87th Congress, an amendment to H.R. 10 was added on the Senate floor; it substantially diminished the intended value of the legislation by limiting the self-employed individual to a deduction of only one half the amount that he contributes in his behalf to a noncontributory plan. This limitation is even more severe in a contributory plan and results in possibly a deduction of only 25 per cent.

Since the enactment of the 1962 act, the Association's Committee on Retirement Benefits Legislation has given careful scrutiny to the new law to ascertain its shortcomings with an eye towards supporting remedial legislation.

Although there are several defects in the 1962 act, this Association is concentrating its support on the two most needed amendments. H.R. 10, introduced by Representative EUGENE KEOGH (Democrat of New York), would permit the self-employed person to deduct the entire amount of the contribution made in his behalf to a retirement plan. It also would eliminate the ceiling on deductible contributions that could be placed in such plans, provided, of course, that employees are covered. Seventeen bills to improve the 1962 act are pending before the Ways and Means Committee, including sponsorship by the ranking minority member, JOHN BYRNES (Republican of Wisconsin).

The following hypothetical case points out the reason that the 50 percent limitation is serving as a major deterrent to participation in retirement plans under the 1962 act:

"Assume a lawyer at age 40 with a wife and two children filing a joint return has an income of \$15,000 and has \$2,000 in deductible expenses. Under the Keogh Act, he could contribute to a retirement plan 10 per cent of his income, which would be \$1,500. Because of the 50 per cent limitation, he would have a reduction of only \$750 which would in this case leave him a taxable income of \$9,850 and his tax would be \$1,787. If the full deduction were permitted, he would have a taxable income of \$9,100, paying a tax of \$1,622. The savings of \$165 per year in taxes invested at 6 per cent over a 25-year period would amount to \$9,052. If the lawyer did not participate in the plan at all, he would pay a tax of \$1,952, which is \$330 more in taxes than if he had a plan permitting a full deduction. This \$330 invested for a period of 25 years at 6 per cent would total \$18,105."

It is apparent by this illustration that although the 1962 act provide some inducement to the private practitioner, it falls far short of providing him comparable tax treatment with a lawyer under a corporate plan.

Because of the inadequacy of the 1962 act, there has been increasing agitation by many professional persons to seek another approach to the problem by forming professional corporations or associations. Although some thirty states have enacted laws authorizing members of the various professions to form corporations, the Treasury Department has indicated that it did not recognize such professional associations as corporations for income tax purposes under the Internal Revenue Code. Therefore, this avenue has been virtually closed to the professional individual. H.R. 8347 and several bills are pending in the Ways and Means Committee that would require that such professional corporations be treated as corporations for income tax purposes.

In addition to individual or firm plans under H.R. 10 type legislation and the use of professional corporations, a third possible avenue for the self-employed person and his employees would be to participate in association or other group plans. The American Bar Association after careful study established a plan in 1963 for its members, but because of the severe restrictions in the 1962 act, the participation in this plan is extremely limited. In fact, of the 120,000 members of the American Bar Association, fewer than

1,000 persons, including lawyers and their employees, are now participating in the Association's plan. Undoubtedly, participation in such group plans would be greatly enhanced by passage of legislation like the new H.R. 10.

A report of the Senate Special Committee on Aging, issued in June, 1965, recommends enactment of provisions included in H.R. 10. It also recommends legislation "clarifying and reaffirming Congressional intent that professional corporations and associations are corporations within the meaning of that term as used in the Internal Revenue Code."

This Association, with the support of the state and local bar groups, and other organizations, is giving priority attention to bringing about much needed improvements in our tax laws to correct further an inequity which has existed for more than two decades. This should be of direct concern to every practicing lawyer.

Mr. KEITH. Mr. Speaker, in considering this bill it seems reasonable that an individual who is self-employed—who

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has had the courage to go out in the business world and make his own way—should be given the same tax break on his retirement plan as are the employees who work for him—and as are those holding similar positions of responsibility in corporate enterprise.

By refusing to allow the sole proprietor, the partner, or the self-employed lawyer, accountant, or doctor to provide for his own future in the same way that he provides for his employees is, in my view, an inequity that should be corrected.

The legislation authorizing pensions for the self-employed which we approved in 1962 was intended to give him a fair break. According to the estimates made by the Treasury Department, though, this—for the most part—did not occur. Apparently, a majority of self-employed business and professional men and women have been forced to choose therefore not to provide adequately for their own retirement.

The amendments which we are considering here today will overcome this inequity. Hopefully, they will encourage the small businessman to establish pension plans in which they themselves can participate.

I hope that the Senate will concur in our action and that the President will in turn approve the legislation. If these amendments become law, the small businessman will have an opportunity for security—which is long overdue.

Mr. ROGERS of Florida. Mr. Speaker, today we have a chance to encourage self-employed citizens to help themselves through passage of the amendment to the Internal Revenue Code of 1954.

The self-employed individual has been given only a small chance to make proper plans for his financial security after retirement in the 1954 code and the amendment of 1962. The amendment now standing before the House offers self-

employed individuals incentive to save for their future through a more reasonable tax allowance.

The fact that only one-half of 1 percent of all self-employed individuals took advantage of the 1962 amendment is witness to the inequities of the bill. They have shown that under this bill they have been burdened with unfair financial contributions.

I urge that we encourage these citizens to help themselves by allowing a fair tax deduction which will be more attractive to them and more beneficial to the entire social security structure.

Mr. SCHMIDHAUSER. Mr. Speaker, I support H.R. 10 because it is my belief that this tax reform measure will help establish parity of tax treatment on retirement programs for self-employed persons in small businesses and on the farms, and in the professions. For many years in the past, self-employed people in those categories were not allowed deductions for contributions to their own retirement funds.

This bill, H.R. 10, will end discrimination against the self-employed farmer and small businessman. At the present time, self-employed persons whose income comes from capital and labor are at a great disadvantage; they can only use 30 percent of their total income under the retirement law, and therefore are at a great disadvantage.

The old law was particularly hard on farmers; for example, our farm producers earn their income from both their hard work and the money they have invested in land, equipment, and so forth. If a farm producer earns \$9,000, only \$3,000 of his income is considered for the purpose of computing the deduction of \$150, in spite of the fact he probably is contributing much more toward his retirement. Under the provision of H.R. 10, the farmer or small businessman will be eligible for a full 10-percent deduction of his earned income of \$9,000 or \$900.

I believe this legislation will contribute much to the strengthening and development of our free enterprise system. I also believe the Federal Government should encourage small employers and professional people to set aside retirement funds for themselves as well as for their employees. Passage of this bill will end the discrimination of the old law, strengthen our free enterprise system, and help our family farm producers and our small businessmen, and I strongly support its approval.

The SPEAKER. The question is on the motion of the gentleman from New York [Mr. Keogh] that the House suspend the rules and pass the bill H.R. 10, as amended.

The question was taken; and the Speaker announced that it appeared that two-thirds of the Members present had voted in favor thereof.

Mr. YOUNGER. Mr. Speaker, I ob-

ject to the vote on the ground that a quorum is not present, and make the point of order that a quorum is not present.

The SPEAKER. Evidently a quorum is not present.

The Doorkeeper will close the doors, the Sergeant at Arms will notify absent Members, and the Clerk will call the roll.

The question was taken; and there were—yeas 291, nays 0, not voting 141, as follows:

[Roll No. 125]

YEAS—291

Abbott	Donohue	Keogh
Adair	Dowdy	King, Calif.
Adams	Downing	King, N.Y.
Addabbo	Dulski	King, Utah
Albert	Duncan, Tenn.	Kirwan
Anderson, Ill.	Edwards, Calif.	Kluczyński
Anderson, Tenn.	Edwards, La.	Kunkel
Andrews,	Erlenborn	Kupferman
George W.	Evans, Colo.	Laird
Andrews,	Farnsey	Langen
Glenn	Fascell	Latta
Andrews,	Feighan	Lennon
N. Dak.	Findley	Lipscomb
Arends	Fisher	Long, La.
Ashbrook	Flood	Long, Md.
Ashmore	Ford,	McCarthy
Aspinall	William D.	McClary
Ayres	Fountain	McCulloch
Bandstra	Friedel	McDade
Baring	Fulton, Pa.	McEwen
Barrett	Fulton, Tenn.	McFall
Bates	Fuqua	McGrath
Battin	Gallagher	MacGregor
Beckworth	Garmatz	Machen
Belcher	Gathings	Mackie
Bennett	Gettys	Madden
Betts	Gibbons	Mahon
Boggs	Gilligan	Mailliard
Boland	Gonzalez	Marsh
Bow	Goodell	Matthews
Brademas	Gray	May
Bray	Green, Oreg.	Meeds
Brock	Green, Pa.	Michel
Broomfield	Griffiths	Mills
Brown, Clarence J., Jr.	Gross	Minshall
Broyhill, Va.	Grover	Mize
Buchanan	Gubser	Moeller
Burke	Hagen, Calif.	Monagan
Byrne, Pa.	Haley	Moore
Byrnes, Wis.	Hall	Moorhead
Cahill	Halleck	Morgan
Callan	Halpern	Morris
Carey	Hamilton	Mosher
Carter	Hanley	Murphy, Ill.
Casey	Hansen, Idaho	Murphy, N.Y.
Cederberg	Hansen, Iowa	Natcher
Chamberlain	Hansen, Wash.	Nedzi
Chelf	Harsha	Nelsen
Clancy	Harvey, Ind.	O'Brien
Clark	Harvey, Mich.	O'Hara, Ill.
Cleveland	Hathaway	O'Hara, Mich.
Collier	Hays	O'Konski
Conable	Hechler	Olsen, Mont.
Conte	Henderson	Olsen, Minn.
Cooley	Herlong	Ottinger
Corbett	Hicks	Passman
Corman	Horton	Patman
Craley	Hull	Patten
Cramer	Hungate	Pepper
Culver	Huot	Perkins
Cunningham	Ichord	Philbin
Curtin	Jacobs	Pickle
Curtis	Joelson	Pike
Daddario	Johnson, Calif.	Pirnie
Dague	Johnson, Okla.	Poage
Davis, Ga.	Johnson, Pa.	Poff
Davis, Wis.	Jonas	Price
Dawson	Jones, Ala.	Pucinski
Delaney	Jones, Mo.	Race
Denton	Jones, N.C.	Randall
Derwinski	Kasten	Redlin
Devine	Karth	Rees
Diggs	Kastenmeier	Reid, Ill.
Dole	Kee	Reid, N.Y.
	Keith	Reuss
	Kelly	Rhodes, Ariz.

Rhodes, Pa.	Shriver	Tuck
Rivers, Alaska	Sikes	Tunney
Ribson	Sisk	Tuten
Rodino	Skubitz	Udall
Rogers, Colo.	Slack	Ullman
Rogers, Fla.	Smith, Calif.	Utt
Rogers, Tex.	Smith, Iowa	Vanik
Ronan	Smith, N.Y.	Vigorito
Roncalio	Smith, Va.	Vivian
Rooney, Pa.	Stafford	Waggonner
Rosenthal	Stagers	Walker, N. Mex.
Roudebush	Stanton	Watts
Roush	Stephens	Weitner
Rumsfeld	Stratton	White, Idaho
Ryan	Stubblefield	White, Tex.
Satterfield	Sullivan	Whitener
Schisler	Taylor	Widnall
Schmidhauser	Teague, Calif.	Wolff
Schneebell	Teague, Tex.	Wright
Schweiker	Tenzer	Wylder
Secrest	Thompson, Tex.	Yates
Selden	Thomson, Wis.	Young
Shipley	Todd	Younger

NAYS—0

NOT VOTING—141

Abernethy	Ford, Gerald R.	O'Neal, Ga.
Annunzio	Fraser	O'Neill, Mass.
Ashley	Frelinghuysen	Pelly
Bell	Glaimo	Pool
Berry	Gilbert	Powell
Bingham	Grabowski	Purcell
Blatnik	Greigg	Quie
Bolling	Grider	Quillen
Bolton	Gurney	Reifel
Brooks	Hagan, Ga.	Reinecke
Brown, Calif.	Hanna	Resnick
Broyhill, N.C.	Hardy	Rivers, S.C.
Burleson	Hawkins	[P. 11682]
Burton, Calif.	Hébert	Roberts
Cabell	Helstoski	Rooney, N.Y.
Burton, Utah	Holfield	Rostenkowski
Callaway	Holland	Roybal
Cameron	Hosmer	St Germain
Celler	Howard	St. Onge
Clausen,	Hutchinson	Saylor
Don H.	Irwin	Scheuer
Clawson, Del	Jarman	Scott
Clevenger	Jennings	Senner
Cohelan	Kornegay	Sickles
Colmer	Krebs	Springer
Conyers	Landrum	Stalbaum
Daniels	Leggett	Steed
de la Garza	Love	Sweeney
Dent	McDowell	Talcott
Dickinson	McMillan	Thomas
Dingell	McVicker	Thompson, N.J.
Dorn	Macdonald	Toll
Dow	Mackay	Trimble
Duncan, Oreg.	Martin, Ala.	Tupper
Dwyer	Martin, Mass.	Van Deerlin
Dyal	Martin, Nebr.	Walker, Miss.
Edmondson	Mathias	Watkins
Edwards, Ala.	Matsunaga	Watson
Ellsworth	Miller	Whalley
Everett	Minish	Whitten
Evins, Tenn.	Mink	Williams
Fallon	Morrison	Willis
Farbstein	Morse	Wilson, Bob
Farnum	Morton	Wilson,
Fino	Moss	Charles H.
Flynt	Multer	Wyatt
Fogarty	Murray	Zablocki
Foley	Nix	

So (two-thirds having voted in favor thereof) the rules were suspended and the bill was passed.

The Clerk announced the following pairs:

Mr. Rooney of New York with Mrs. Bolton.
Mr. Multer with Mr. Fino.
Mr. Fogarty with Mr. Gerald R. Ford.
Mr. Miller with Mr. Don H. Clausen.

Mr. Cohelan with Mr. Talcott.
Mr. Annunzio with Mr. Pelly.
Mr. Griegg with Mr. Broyhill of North Carolina.
Mr. Love with Mr. Callaway.
Mr. Gilbert with Mr. Tupper.
Mr. O'Neill of Massachusetts with Mr. Morse.
Mr. Matsunaga with Mr. Gurney.
Mr. Dyal with Mr. Bob Wilson.
Mr. Morrison with Mr. Martin of Massachusetts.
Mr. Holfield with Mr. Hosmer.
Mr. Thompson of New Jersey with Mrs. Dwyer.
Mr. Leggett with Mr. Reinecke.
Mr. Cameron with Mr. Del Clawson.
Mr. Burton of California with Mr. Bell.
Mr. Brown of California with Mr. Saylor.
Mr. Glaimo with Mr. Walker of Mississippi.
Mr. Roybal with Mr. Reifel.
Mr. Charles H. Wilson with Mr. Wyatt.
Mr. Hanna with Mr. Nix.
Mr. Moss with Mr. Mathias.
Mr. Macdonald with Mr. Conyers.
Mr. St. Onge with Mr. Frelinghuysen.
Mr. O'Neal of Georgia with Mr. Watson.
Mr. Fraser with Mr. Quie.
Mr. Grabowski with Mr. Morton.
Mrs. Mink with Mr. Rivers of South Carolina.

Mr. Whitten with Mr. Steed.
Mr. Williams with Mr. Scheuer.
Mr. Colmer with Mr. Resnick.
Mr. Abernethy with Mr. Dorn.
Mr. Burleson with Mr. Berry.
Mr. Stalbaum with Mr. Hawkins.
Mr. Jennings with Mr. Flynt.
Mr. Brooks with Mr. Holland.
Mr. Howard with Mr. Springer.
Mr. Hébert with Mr. Quillen.
Mr. Kornegay with Mr. Hutchinson.
Mr. Grider with Mr. Whalley.
Mr. Van Deerlin with Mr. Burton of Utah.
Mr. Trimble with Mr. Watkins.
Mr. Zablocki with Mr. Martin of Nebraska.
Mrs. Thomas with Mr. Edwards of Alabama.
Mr. Senner with Mr. Ellsworth.
Mr. Roberts with Mr. Martin of Alabama.
Mr. Ashley with Mr. Bingham.
Mr. Jarman with Mr. Helstoski.
Mr. Rostenkowski with Mr. Scott.
Mr. Sickles with Mr. Sweeney.
Mr. McDowell with Mr. Toll.
Mr. Pool with Mr. Farnum.
Mr. Evins of Tennessee with Mr. Farbstein.
Mr. Edmondson with Mr. Dow.
Mr. Dent with Mr. Dingell.
Mr. Celler with Mr. Clevenger.
Mr. Daniels with Mr. Powell.
Mr. Purcell with Mr. Minish.
Mr. Everett with Mr. Fallon.
Mr. Foley with Mr. de la Garza.
Mr. Cabell with Mr. Irwin.
Mr. Blatnik with Mr. St Germain.
Mr. Mackay with Mr. McMillan.
Mr. Landrum with Mr. Krebs.
Mr. McVicker with Mr. Willis.
Mr. Duncan of Oregon with Mr. Hardy.

The result of the vote was announced as above recorded.

The doors were opened.

A motion to reconsider was laid on the table.

APPENDIX II
H.R. 11765
INCOME TAX TREATMENT OF CERTAIN
STRADDLE TRANSACTIONS
(Sec. 210 of Public Law 89-809)

H. R. 11765

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 22, 1965

Mr. KEOGH introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend section 1234 of the Internal Revenue Code of 1954.

1 *Be it enacted by the Senate and House of Representa-*

2 *tives of the United States of America in Congress assembled,*

3 That section 1234 of the Internal Revenue Code of 1954,

4 relating to options, is amended as follows:

5 Subsection (c) is redesignated as subsection (d) and

6 the following new subsection (c) is added at the end of sub-

7 section (b) :

8 “(c) SPECIAL RULE FOR CREATORS OF STRADDLES.—

9 “(1) GAIN ON LAPSE.—In the case of gain on lapse

10 of an option that was granted as part of a straddle (as

11 defined in paragraph 2), the gain shall be deemed to

1 be gain from the sale or exchange of a capital asset held
2 for less than six months on the day that the option
3 expires.

4 “(2) DEFINITIONS.—

5 “(A) For purposes of this section a ‘straddle’
6 is defined as a combination of an option to buy and
7 an option to sell, giving the holder the right to both
8 buy and sell a specified quantity of a security at a
9 fixed price for a stated period of time.

10 “(B) For purposes of this paragraph ‘security’
11 shall not include contracts to buy or sell commod-
12 ities.

13 “(3) EXCLUSION OF DEALERS.—This subsection
14 shall not apply to any person who holds securities for
15 sale to customers in the ordinary course of his trade or
16 business.”

17 EFFECTIVE DATE

18 SEC. 2. This Act shall apply to options granted after
19 January 25, 1965.

STAFF REPORT
ON
INCOME TAX TREATMENT OF
INCOME RESULTING FROM LAPSE
OF OPTIONS WRITTEN AS PARTS OF
STRADDLES

FOR
THE JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION



DECEMBER 28, 1965

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1966

JCS-13-65

STAFF REPORT ON INCOME TAX TREATMENT OF INCOME RESULTING FROM LAPSE OF OPTIONS WRITTEN AS PARTS OF STRADDLES

PART ONE—INTRODUCTION

A "straddle" is a combination of an option to buy (a "call") and an option to sell (a "put") a specified amount of a certain security at a fixed price for a stated period of time.

In a ruling (Rev. Rul. 65-31) issued on January 22, 1965, the Internal Revenue Service held that the premium for a straddle must be allocated between its component parts on the basis of relative market values. Under the ruling, the portion of the premium received by the writer (the person who grants the options) for the component that is exercised is to be taken into account by him as a reduction in his basis for the security purchased ("put" to the option writer) or as a part of the amount realized on the security sold ("called" from him). As a result, this portion of the premium can either increase the capital gain or decrease the capital loss realized upon the sale or exchange of the security.¹ This can be either a long- or short-term gain or loss depending upon the period of time the security was held. Under the revenue ruling, the remaining portion of the premium, attributable to the expired component of the straddle, constitutes ordinary income. This ruling, which applied prospectively only, to straddle transactions entered into on or after January 26, 1965, is set forth as appendix I to this report.

In a technical information release (TIR-778) issued on November 15, 1965, the Internal Revenue Service determined that in the case of straddle contracts involving corporate stock, 55 percent of the premium may be allocated to the "call" and 45 percent to the "put."² However, if this allocation is used, it must be used by the taxpayer in allocating premiums on all straddle contracts issued on or after January 26, 1965.³ Those who do so must attach a statement to their Federal income tax returns so indicating. This release is set forth as appendix II to this report.

On January 27, 1965, Congressman Wilbur D. Mills, chairman, and Senator Harry F. Byrd, vice chairman, of the Joint Committee on Internal Revenue Taxation, instructed the staff of the joint committee to study any problems raised with respect to the January ruling on straddles and to present comments and suggestions to the committee with respect to it. The public announcement of these instructions is

¹ If the taxpayer is a dealer in securities, the gain will be an ordinary gain unless the provisions of section 1236 of the code are complied with. See section 1236(b) for treatment of losses.

² The Internal Revenue Service indicated that since the market values of "puts" and "calls" are subject to price fluctuations, it may be necessary for the Service to adjust this allocation ratio periodically.

³ Although TIR-778 is not clear on this point, it seems that this election is to be made for 1 taxable year at a time.

set forth as appendix III to this report. More recently, at its meeting on October 21, 1965, the committee directed the staff to prepare and release a report on this subject. In compliance with these directions, the staff has prepared this report setting forth comments and suggestions for legislation on the tax treatment of straddles. The Treasury Department staff has worked with the Joint Committee staff on this report but the Treasury Department has as yet taken no official position on the suggestions contained herein.

PART TWO—BACKGROUND: FACTUAL SETTING⁴ AND PRIOR LAW AND PRACTICE

The option to purchase or sell specified property at a stated price for a given period of time has long been used for planning in many fields of endeavor. One variation of this device which has become standard in the securities field is the combination of an option to buy and an option to sell a specified amount of a certain security at a fixed price for a stated period of time. This combination of an option to buy and an option to sell is known as a "straddle".⁵ Normally, the price at which either or both of the options in a straddle may be exercised is the market price of the stock at the time the straddle is written.⁶

The person who issues (or grants) a straddle is known as the "writer." Straddles are normally granted to brokers or dealers who specialize in such transactions and who almost always sell the component parts of the straddles to different purchasers.⁷ The rights granted in each option are normally exercised, if at all, shortly before the end of the term for which the straddle is written.⁸ Which component option is exercised will depend upon the market conditions at the time of exercise vis-a-vis market conditions at the time the straddle was written.⁹ The "call" (the option to purchase from the straddle writer) is likely to be exercised if the market in that security has risen, while the "put" (the option to sell to the straddle writer) is likely to be exercised if the market has fallen. In rare cases,¹⁰ where the price of a security has fluctuated to a great extent, both component options may be exercised. Where the market price of the security at the end of the option term is approximately the same as the price for which the option was granted, it may happen that neither component of the straddle will be exercised.

The majority of puts and calls originate as straddles.¹¹ Although the use of puts and calls is not a new development in the securities field,¹² the total number of shares covered by options sold in any one year from 1937 through 1960 rarely exceeded 1 percent of the total number of shares sold on the New York Stock Exchange that year.¹³ The number of shares covered by options sold in June 1959 constituted only 2.2 percent of the total number of shares sold on the New York and American Stock Exchanges of the 50 issues as to which the most options were written in June 1959.¹⁴ Options appear to be an even smaller factor in the market for less active issues.¹⁵

⁴ Much of the material presented in this part was derived from the "Report on Put and Call Options," a report published in August 1961 by the Securities and Exchange Commission, on the basis of an extensive study by the SEC's Division of Trading and Exchanges; hereinafter referred to as "SEC Report."

⁵ During June 1959, the period selected in the SEC Report for its intensive study, "more straddles were written than any other type of option." SEC Report, p. 6; see pp. 15, 31, 32, 33.

⁶ SEC Report, p. 9.

⁷ SEC Report, pp. 6, 10-14, 15-17, 56, 59, 65.

⁸ SEC Report, pp. 6, 47-49, 51.

⁹ SEC Report, pp. 47, 50.

¹⁰ Less than 1 percent, according to SEC Report, p. 52. (See p. 15.)

¹¹ Straddles supplied 66 percent of the puts and 60 percent of the calls during June 1959. SEC Report, pp. 51-53.

¹² The use of puts and calls originated in Europe more than 200 years ago. SEC Report, p. 9.

¹³ SEC Report, pp. 19, 20, 22.

¹⁴ SEC Report, p. 35-37.

¹⁵ In June 1959 the 87 most active issues on the New York Stock Exchange accounted for 57.2 percent of the option volume in NYSE stocks but only 39.7 percent of the total trading volume. In contrast, the 500 least active issues accounted for only 3.6 percent of the option volume, but 9.7 percent of the total trading volume. SEC Report pp. 43-44.

It is clear that, although options have a number of possible uses by sophisticated investors, they are in fact used primarily as a method of investing by individuals with small amounts of money.¹⁶

Before 1954, income from the writing of an option that lapsed was treated as short-term capital gain. The statutory provision (sec. 117(g)(2) of the 1939 Code)¹⁷ requiring such treatment was not included in the 1954 Code.¹⁸

It is understood that, before 1954, however, straddle writers generally allocated the entire straddle premium to the component option that was exercised. This meant that, in practice, the gain from the lapse of one option in a straddle was often treated as long-term capital gain and many times was not recognized until a later taxable year.

In the case of "calls," the total straddle premium was treated as increasing the amount received by the writer when the stock was called from, i.e., sold by, him (and the "put" was allowed to lapse). The total premium thereby increased his capital gain (or decreased his capital loss, depending upon the circumstances of the individual case). If the writer had held the stock more than 6 months, the gain (or loss) would be long-term.

When the "put" was exercised (and the "call" was allowed to lapse), the total straddle premium was treated as reducing the basis of the stock put to (i.e., sold to) the writer. He could transform the total straddle premium into long-term capital gain by holding the stock for more than 6 months. If he sold the stock after the end of the taxable year, he could thereby postpone taxation of the entire straddle premium.¹⁹

This practice of allocating the entire premium to the option that was exercised apparently was not then challenged by the Internal Revenue Service.

It is understood that from 1954 until the issuance of Rev. Rul. 65-31, straddle writers continued to allocate the entire premium to the side of the straddle that was exercised.²⁰ The practical effect of this was to continue essentially the same treatment for straddles under the 1954 Code up to 1964 as existed in practice under the 1939 Code.²¹

It should be noted that prior to the issuance of Rev. Rul. 65-31, neither the statute nor the regulations or rulings indicated whether the premium for a straddle should be allocated between the two options or allocated entirely to the option which was exercised. As has been indicated, however, writers apparently did allocate the entire premium to the option exercised and there is no evidence that, prior to the ruling, the Treasury Department objected to allocations of this type.

¹⁶ SEC Report, pp. 42, 76-77.

¹⁷ SEC. 117. CAPITAL GAINS AND LOSSES.

(g) GAINS AND LOSSES FROM SHORT SALES, ETC.—For the purpose of this chapter—

(2) gains and losses attributable to the failure to exercise privileges or options to buy or sell property shall be considered as short-term capital gains or losses; * * *

¹⁸ However, sec. 1234 (a) and (b) of the 1954 Code provide that, where an option lapses, the purchaser of the option is deemed to have sold property (the option) on the day the option lapsed. So, if the option is a capital asset in the hands of the purchaser, he has a capital loss from the lapse and this loss may be either long-term or short-term, depending upon his holding period for the option.

¹⁹ See Lucey and Bradley, "Income Tax Consequences of Investing in Puts and Calls," 50 ABAJ 494, 496 (1964).

²⁰ *Ibid.*

²¹ The only difference between the early 1954 Code treatment and the 1939 Code treatment exists in the relatively rare case where both the "put" and "call" are allowed to lapse. In this case, since there is no basis adjustment to make, the entire amount of the premium under the 1954 Code results in ordinary income instead of the short-term capital gain treatment accorded under the 1939 Code.

PART THREE—EFFECTS OF REVENUE RULING 65-31

Rev. Rul. 65-31 requires that the premium paid for a straddle be allocated between its two component parts. This allocation is to be made on the basis of the relative market values of the "put" and the "call". The portion of the premium allocated to the straddle component that lapses becomes ordinary income.

This result flows from the following portion of the ruling:

However, a "straddle," although commonly referred to as one contract embodying both a "put" and a "call," is, in fact, two separate option contracts. Each, neither, or both may be sold or exercised, by the same or different persons. The holder of a "put" or a "call" written pursuant to a "straddle" contract has rights and liabilities no greater or less than he would have had if a "put" and "call" were purchased separately but simultaneously on the same terms. A "straddle" contract, accordingly, contains two separately identifiable options. See *Bertha Silverman v. Alfons Landa et al.*, 200 Fed. Supp. 193 (1961), affirmed, 306 Fed. (2d) 422 (1962), where the court describes a "straddle" at page 195 as follows:

"A 'straddle' consists of two separate options, one a 'call' and one a 'put.' Both the 'put' and 'call' are identical as to stock, contract price and time expiration."

The ruling gave rise to two problems: (1) the method of allocating a straddle premium between the put and the call element and (2) the likelihood that, with any allocation, the writing of a single straddle could well result in producing both ordinary income and capital loss to the writer.

A problem arises in allocating the straddle premium between the put and the call elements because "puts" and "calls" are not traded on stock exchanges. The price a put and call dealer will pay the writer of a straddle is an individually negotiated price.²² Similarly the price at which the dealer resells is a negotiated price. In addition, to the writer, a straddle has certain characteristics which are different from the characteristics of a simple "put" plus a simple "call". The negotiation between the straddle writer and the broker is influenced by, but does not equal, what each imagines to be the current fair value of an option to purchase and the current fair value of an option to sell.²³

The difficulties in apportioning the straddle premium between its two elements were recognized by the Treasury Department, and, on November 15, 1965, the Internal Revenue Service, in TIR-778, published Revenue Procedure 65-29. In this revenue procedure the Internal Revenue Service announced that it would accept allocations of straddle premiums in the ratio of 55 percent to the call and 45 percent to the put. This 55-45 ratio was selected because it represented a rounded approximation of relative market prices of separately written "puts" and "calls" of the same length on securities of approximately equal price. The procedure concluded with the statement that "If a taxpayer does not use this method for a taxable year, then

²² SEC Report, pp. 80, 83-95.

²³ The SEC Report, pp. 8, 83, indicates that the average premium received by writers was \$404 for a call, \$239 for a put, and \$572 for a straddle. See example at p. 16. (See pp. 86, 87.)

the allocation based on relative market values required by Revenue Ruling 65-31 must be used."

This "rule of thumb" seems to be an acceptable solution to the first problem.

The second of the problems which have arisen as a result of the ruling does not seem susceptible to an administrative resolution. This stems from the fact that the writer of a straddle normally receives different kinds of income or loss from his writing of straddles.

To illustrate these various types of income or loss assume first that the market rises after the straddle is written and that the "call" is exercised. If the straddle writer purchases stock to cover the "call" at the time of exercise, he will then suffer a loss to the extent the market price (and his cost for the stock) exceeds the call price. This loss is reduced (or possibly eliminated), however, by the straddle premium. That part of the premium allocated to the "call" is treated as an additional receipt from the sale of the called stock. Thus, this income is taken into account in determining the loss on the called stock. The result, in this case, may well be a short-term loss. However, the portion of the premium resulting from the lapsed option, is ordinary income under the 1954 Code.²⁴ Thus, the straddle writer could have ordinary income and capital loss resulting from the writing of one straddle.

The same result would obtain if the market fell and the "put" was exercised. If the market price falls more than the premium allocable to the "put", then the writer of the straddle who is required to purchase stock at the price of the market when the straddle was written, would be holding stock with a "built-in" capital loss. If he sells the stock and thereby realizes this loss, in this case also he would have both a capital loss and ordinary income arising from the writing of one straddle.

Apart from the \$1,000 per year deduction against income for capital losses (sec. 1211(b) of the code), the capital loss could not be used to offset ordinary income. Thus, even though the straddle writer may suffer a net economic loss, he may nevertheless be required to pay taxes on ordinary income derived from the straddle transaction.

²⁴ As indicated above, it would have been short-term capital gain under the 1939 Code, and so could have been netted against the other two types of straddle income.

PART FOUR—POSSIBLE SOLUTION

It would appear that, in general, what originates as one transaction should result in either a single taxable consequence or a set of taxable consequences that may be netted against each other if some of those consequences are profits and some are losses. Accordingly, the staff explored the possibility of identifying the profits and losses attributable to the writing of any one straddle. It was hoped that a method could be provided for setting off such profits and losses against each other. It soon became apparent that difficulties would arise in determining the portion of gain or loss attributable to a straddle in the event of the exercise of one component of the straddle. Difficulties would arise in determining the price of a stock at the moment the option was exercised; extensive records would have to be kept; and a new category of income would be added to the existing categories of ordinary income, long-term capital gains, short-term capital gains, and section 1231 income.

On the other hand, it was concluded that an approach which modified the treatment of only the income resulting from lapse of an option would present few of these difficulties. Much of the desired netting effect could be accomplished by treating all the types of receipts from the writing of straddles (premium income from lapsed options, premium income from exercised options, and gain or loss from the purchase or sale of securities at other than the current market price) as ordinary income or as capital gains or losses. The capital gains or losses alternative appears preferable because (1) it has long been accepted that purchase and sale of securities by one who does not hold securities for sale to customers in the ordinary course of his trade or business are capital transactions; (2) it is similarly accepted that premium income from exercised options result in adjustments to capital asset transactions; (3) a change in these rules with respect to the gain or loss attributable to the straddle element that is exercised (even if otherwise desirable) would result in substantial problems in distinguishing, in the gain or loss from a sale or purchase, between the straddle elements and the nonstraddle capital elements; (4) purchasers of options are treated as sustaining capital losses when they permit options to expire (sec. 1234, I.R.C. 1954); and (5) the 1939 Code (sec. 117(g)(2)) provided for capital gain treatment of option lapse income.

The joint committee staff concluded that the problem described above could probably best be dealt with by providing that income derived from the lapse of an option written as a part of a straddle is to be taxed as a short-term capital gain. Insofar as straddles are concerned, this is similar to the treatment provided in section 117(g)(2) of the 1939 Code.

This treatment achieves the primary purpose of permitting the netting of different kinds of income or losses arising from a straddle, since short-term capital gains are first offset against short-term capital losses and, to the extent of any excess still remaining, are next offset against net long-term capital losses. Thus, should the portion of the straddle premium allocated to the part of the straddle exercised give

rise to either short- or long-term capital losses, there will be an opportunity for netting against this loss any income obtained from the side of the straddle allowed to lapse. In addition, treating the premium income attributable to the lapse as a short-term capital gain will still mean that after netting against capital losses—either short-term or long-term—any excess gain still remaining will be treated in the same manner as ordinary income since this is the treatment uniformly accorded any such excess of short-term capital gains over capital losses. This, therefore, while generally providing for the netting with respect to the two sides of the straddle, still maintains the position of the Internal Revenue Service (as reflected in its ruling) that income from the lapse of a portion of a straddle option represents ordinary income.

By comparison with the practice prior to January 1965, this suggestion (combined with allocation of premiums between the components of straddles) would result in some shifting from long-term capital gain to short-term capital gain and in earlier recognition (and therefore earlier subjection to tax) of option-lapse income. By comparison with the rules in effect since January 1965, this proposal would result in some earlier effective recognition of capital losses and their use to offset option-lapse income otherwise taxable at ordinary rates.

The proposed treatment of straddle option lapse income as short-term capital gains would not apply to dealers—i.e., persons who hold securities for sale to customers in the ordinary course of their trades or businesses.

Since the problem that gave rise to the study—a single transaction resulting in ordinary income which cannot be netted against a possible capital loss from the same straddle—does not arise in the case of the writing of separate options to buy or sell, it is suggested that any such change be limited to income from the lapse of options that originate as parts of straddles.

The problem which gave rise to this study centered about straddles in issued stocks. However, such option devices are occasionally used in bonds and, perhaps, convertible debentures, when issued stocks, warrants, and similar securities. The same considerations would seem to apply in the case of such property and it is believed that the proposed treatment of straddle option lapse income probably should apply to securities generally.

It is not clear whether the term “securities” includes commodities futures.²⁵ Since we have received no suggestion that Rev. Rul. 65-31 has created any problems regarding commodities futures, no need is seen for applying proposed change to options on contracts to buy such items.

Since Rev. Rul. 65-31 applies only to transactions entered into after January 25, 1965, and since the staff study of the problems arising out of the ruling began at about that time, it is suggested that any legislation along the lines suggested probably should apply to straddles written after January 25, 1965. This will minimize the number of changes in applicable law.

²⁵ There appears to be a conflict on this point within the context of the “wash sales” provisions of section 1091 of the 1954 Code, the successor to section 118 of the 1939 Code. Compare *Trenton Cotton Oil Co. v. Commissioner*, 147 F. 2d 33, 36-37, 33 AFTR 610 (C.C.A. 6, 1945), holding that commodities futures are securities for these purposes, with *Corn Products Refining Co. v. Commissioner*, 215 F. 2d 513, 516-517, 46 AFTR 523 (C.A. 2, 1954), affirmed on another point, 350 U.S. 46 (1955), holding that they are not.

APPENDIX

APPENDIX I—REVENUE RULING 65-31*

For immediate release, Friday, January 22, 1965.

TIR-683

The U.S. Internal Revenue Service today announced that the following revenue ruling relating to the treatment of premiums received by taxpayers who write "straddle" options will appear in Internal Revenue Bulletin No. 1965-9, dated March 1, 1965:

Rev. Rul. 65-31

Since a "straddle" contains two options (a "put" option and a "call" option) each of value, it is necessary to allocate the premium received by the writer thereof to each option. The allocation of the premium should be made on the basis of the relative market value of the "put" and "call" options contained therein, at the time of the issuance of the "straddle." A portion of the premium received by the writer for the option contained in the "straddle" that was exercised is to be taken into account in determining gain or loss on that transaction, while the portion of the premium which is attributable to the expired option will be treated as ordinary income.

The Internal Revenue Service has been requested to state its position with respect to the treatment for Federal income tax purposes of premiums received by a taxpayer who writes "straddle" options where only one of the options contained therein is exercised.

A "straddle" is a combination of a "put" and a "call" option on the same stock or commodity, both options describing the same quantity at the same price that the stock or commodity may be "called" from or "put" to the writer thereof.

A "put" is an option to sell certain property, usually stock or commodities, to the writer thereof at a designated price within a designated time. If a "put" is exercised, the premium the writer has received decreases his basis in the property purchased ("put" to him) from the optionee. (See Rev. Rul. 58-234, C.B. 1958-1, 279.)

A "call" is an option to buy certain property, usually stock or commodities, from the writer thereof at a designated price within a designated time. If a "call" is exercised, the premium the writer has received for writing the "call" is added to the amount realized on sale of the "called" property to the optionee. (See Rev. Rul. 58-234.)

If the optionee permits a "put" or a "call" to expire without exercise, the premium the writer has received for the privilege of keeping an obligation open is considered ordinary income (Sec. 1.1234-1(b) of the Income Tax Regulations).

The question presented is whether the premium received by the writer of a "straddle" should be allocated by him wholly to the exercised option under circumstances where one option is exercised and the other is not. If the correct rule were that it should be allocated wholly to the exercised option and, for example, the optionee exercised only the "put," the entire premium received for writing the "straddle" would reduce the writer's cost basis in the property "put" to him. Conversely, if the "call" were the only option exercised, the premium received for writing the "straddle" would be added to the amount realized on the property "called" from him.

However, a "straddle," although commonly referred to as one contract embodying both a "put" and a "call," is, in fact, two separate option contracts. Each, neither, or both may be sold or exercised, by the same or different persons. The holder of a "put" or a "call" written pursuant to a "straddle" contract has rights and liabilities no greater or less than he would have had if a "put" and "call" were purchased separately but simultaneously on the same terms. A "straddle" contract, accordingly, contains two separately identifiable options. See *Bertha Silverman v. Alfons Landa et al.*, 200 Fed. Supp. 193 (1961), affirmed,

*Printed at 1965-1 Cumulative Bulletin 365.

306 Fed. (2d) 422 (1962), where the court describes a "straddle" at page 195 as follows:

"A 'straddle' consists of two separate options, one a 'call' and one a 'put.' Both the 'put' and 'call' are identical as to stock, contract price and time expiration."

In view of the above, it is necessary to allocate the premium received for writing the "straddle" contract to the "put" option and to the "call" option. The allocation of the premium should be made on the basis of the relative market values, at the time of the issuance of the "straddle," of the "put" and "call" options contained therein.

Accordingly, if the "call" is exercised and the "put" is not, the amount of the premium properly allocable to the "put" would be considered ordinary income to the writer; conversely, if the "put" were exercised and the "call" were not, the amount of premium properly allocable to the "call" would be considered ordinary income to the writer. Naturally, if both options are exercised the amount of the premium allocated to the "call" option would be added to the amount realized on the sale of the property "called" from the writer, and the amount of the premium allocated to the "put" option would reduce the cost basis of the property purchased by ("put" to) the writer. Also, if neither option is exercised the amount of premium received by the writer constitutes ordinary income.

Pursuant to the authority contained in section 7805(b) of the Internal Revenue Code of 1954, this revenue ruling will be applied prospectively only with respect to a "straddle" transaction entered into on or after Tuesday, January 26, 1965.

APPENDIX II—REVENUE PROCEDURE 65-29

For release Monday, November 15, 1965

TIR-778

The U.S. Internal Revenue Service today announced that the following revenue procedure will appear in Internal Revenue Bulletin 1965-48, dated November 29, 1965:

Rev. Proc. 65-29

Guidelines for allocating the premium received by writers of "straddle" contracts with respect to corporate stock.

SECTION 1. PURPOSE

The purpose of this revenue procedure is to furnish taxpayers with a guide for allocating the premium received by writers of "straddle" contracts with respect to corporate stock.

SECTION 2. BACKGROUND

Revenue Ruling 65-31, I.R.B. 1965-9, 26, requires that the premium received by a writer of a "straddle" with respect to corporate stock be allocated between the "put" option and the "call" option contained therein, on the basis of the relative market values at the time of the issuance of the "straddle."

SECTION 3. ALLOCATION OF PREMIUM

.01 In the interest of uniform application of Revenue Ruling 65-31 the Revenue Service has determined with respect to "straddle" contracts involving corporate stock that 55 percent of the premium may be allocated to the "call" option and 45 percent of the premium to the "put" option. Since the market values of "puts" and "calls" are subject to price fluctuation, it may be necessary for the Revenue Service to adjust this allocation ratio periodically.

.02 The Revenue Service will accept an allocation on this basis for all such "straddle" transactions entered into on or after January 26, 1965 (the effective date of Revenue Ruling 65-31), provided the ratio or ratios determined by the Revenue Service are used by the taxpayer in allocating premiums on all such "straddle" contracts issued on or after such date.

.03 Option writers deciding to use the allocation method provided in this revenue procedure must attach a statement to their Federal income tax returns so indicating. If a taxpayer does not use this method for a taxable year, then the allocation based on relative market values required by Revenue Ruling 65-31 must be used.

APPENDIX III—PRESS RELEASE OF JOINT COMMITTEE ON INTERNAL REVENUE
TAXATION

For the press, for immediate release Wednesday, January 27, 1965

CHAIRMAN WILBUR D. MILLS AND VICE-CHAIRMAN HARRY F. BYRD ANNOUNCE
THAT STAFF OF JOINT COMMITTEE ON INTERNAL REVENUE TAXATION WILL
STUDY NEW IRS RELEASE ON TAX TREATMENT OF WRITERS OF "STRADDLE"
OPTIONS

Congressman Wilbur D. Mills, chairman of the Joint Committee on Internal Revenue Taxation, and Senator Harry F. Byrd, vice chairman, in a joint statement released today, state that questions have been raised with respect to a newly issued technical information release of the Internal Revenue Service dealing with the taxation of the income of writers of straddle options. The staff of the Joint Committee on Internal Revenue Taxation has been instructed to study the situation created by the new TIR and to give comments and suggestions to the committee with respect to it.

A "straddle" is a combination of an option to sell stock (usually referred to as a "put") and an option to buy stock (usually referred to as a "call"). Under the new TIR, the taxpayers who grant (or "write") a straddle option must divide the premium they receive between the two parts of the option. One part of the option ordinarily expires unexercised and the premium assigned to this part of the option will be regarded as ordinary income under the TIR. The premium allocated to the other part of the option is treated as an adjustment to the basis of the stock sold or acquired pursuant to the option. Thus, if the put were exercised, this portion of the premium would reduce the cost to the writer of the stock sold to him and if the call were exercised the premium allocated to the call would increase the price he received on the sale of the stock. In either case, the other part of the premium would be regarded as ordinary income.

If the stock subject to the straddle went down more than the amount of the premium allocated to the put, the taxpayer would have ordinary income from the expiration of the call and a potential capital loss on the stock that was put to him. In a series of such transactions, the taxpayer might have an overall loss but would be regarded as having ordinary income that could not be reduced by his capital loss in excess of \$1,000.

It has been the practice of most taxpayers who write straddles to allocate their entire premium to the side of the option that was exercised so that the entire gain or loss on the transaction would be capital gain or loss. Whether the gain or loss was long term or short term would depend on how long the stock was held.

89TH CONGRESS
2D SESSION

H. R. 11765

[Report No. 2174]

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 22, 1965

Mr. KEOGH introduced the following bill; which was referred to the Committee on Ways and Means

OCTOBER 3, 1966

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italic]

A BILL

To amend section 1234 of the Internal Revenue Code of 1954.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 *That section 1234 of the Internal Revenue Code of 1954,*
4 *relating to options, is amended as follows:*

5 Subsection (e) is redesignated as subsection (d) and
6 the following new subsection (e) is added at the end of sub-
7 section (b):

8 “(e) SPECIAL RULE FOR CREATORS OF STRADDLE.—

9 “(1) GAIN ON LAPSE.—In the case of gain on lapse
10 of an option that was granted as part of a straddle (as
11 defined in paragraph 2), the gain shall be deemed to

1 be gain from the sale or exchange of a capital asset held
 2 for less than six months on the day that the option
 3 expires.

4 “(2) DEFINITIONS.—

5 “(A) For purposes of this section a ‘straddle’
 6 is defined as a combination of an option to buy and
 7 an option to sell, giving the holder the right to both
 8 buy and sell a specified quantity of a security at a
 9 fixed price for a stated period of time.

10 “(B) For purposes of this paragraph ‘security’
 11 shall not include contracts to buy or sell commod-
 12 ities.

13 “(3) EXCLUSION OF DEALERS.—This subsection
 14 shall not apply to any person who holds securities for
 15 sale to customers in the ordinary course of his trade or
 16 business.”

17 EFFECTIVE DATE

18 SEC. 2. This Act shall apply to options granted after
 19 January 25, 1965.

20 *That section 1234 of the Internal Revenue Code of 1954 (re-*
 21 *lating to options) is amended by redesignating subsection (c)*
 22 *as subsection (d) and by inserting after subsection (b) the*
 23 *following new subsection:*

24 “(c) SPECIAL RULE FOR GRANTORS OF STRADDLES.—

25 “(1) GAIN ON LAPSE.—In the case of gain on lapse

1 *of an option granted by the taxpayer as part of a straddle,*
2 *the gain shall be deemed to be gain from the sale or ex-*
3 *change of a capital asset held for not more than 6 months*
4 *on the day that the option expired.*

5 *“(2) EXCLUSION OF DEALERS.—This subsection*
6 *shall not apply to any person who holds securities for sale*
7 *to customers in the ordinary course of his trade or busi-*
8 *ness.*

9 *“(3) DEFINITIONS.—For purposes of this subsec-*
10 *tion—*

11 *“(A) The term ‘straddle’ means a simultane-*
12 *ously granted combination of an option to buy, and*
13 *an option to sell, the same quantity of a security at*
14 *the same price during the same period of time.*

15 *“(B) The term ‘security’ has the meaning as-*
16 *signed to such term by section 1236(c).”*

17 *SEC. 2. The amendments made by the first section of this*
18 *Act shall apply to straddle transactions entered into after*
19 *January 25, 1965, in taxable years ending after such date.*

INCOME TAX TREATMENT OF CERTAIN STRADDLE TRANSACTIONS

OCTOBER 3, 1966.—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

R E P O R T

[To accompany H. R. 11765]

The Committee on Ways and Means, to whom was referred the bill (H. R. 11765) to amend section 1234 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment strikes out all after the enacting clause and inserts a substitute text which appears in the reported bill in *italic type*.

I. SUMMARY

A "straddle" is a combination of an option to buy and an option to sell a predetermined amount of a specified security at a fixed price for a limited period of time. The two component options are identical as to the security involved, the amount and price to which the options apply, and the length of time the options are available. The Internal Revenue Service requires the premium received for the straddle to be apportioned between these two component options. As a result, in the usual case where one option is exercised and the other is allowed to lapse, part of the premium (attributable to the lapsed option) gives rise to ordinary income, while the other part (attributable to the exercised option) becomes an adjustment in the cost or price of the security purchased or sold resulting in either an increase in a capital gain or a decrease in a capital loss. It is possible, therefore, for a single straddle transaction to give rise to both ordinary income and a capital loss, which it may not be possible to net against each other.

This bill provides that the income from the lapse of an option which originated as part of a straddle is to be treated as a short-term capital

gain (instead of ordinary income). This permits it to be netted against any capital loss which may result from the exercise of the other option in the straddle while retaining what in most respects is ordinary income treatment for any excess of net short-term capital gain over net long-term capital loss.

This bill is reported unanimously by your committee and the Treasury Department has indicated that it does not object to its enactment.

II. NATURE OF STRADDLES¹

Straddles are one form of an option; namely, an offer both to purchase and to sell a specified amount of property at a stated price for a limited period of time. Options to sell securities are known as "puts"—i.e., the purchaser of the option can "put" his shares to the writer or issuer of the option at the stated price. Options to purchase are known as "calls"—i.e., the purchaser of the option can "call" the shares from the writer at the stated price. A "straddle" is a combination of a put and call, with respect to the same security, for the same quantity, at the same purchase or sale price and available for the same period of time.

Straddles are likely to be written by persons with holdings of a security who believe that in the long run, the price of the stock will not vary greatly from its present price. Their inducement for writing the straddle is the receipt of a premium. Straddles generally are granted to brokers or dealers who, in turn, customarily sell the put and call components to different purchasers. The majority of puts and calls originate in straddles. While the use of puts and calls is not a new development in the securities markets, their significance in the securities markets is relatively limited; for example, the total number of shares covered by options sold in recent years on the New York Stock Exchange has rarely exceeded 1 percent of the total shares sold.

Normally either (not both) the put or the call component of the straddle is exercised by the purchaser shortly before the end of the term for which the straddle is written. Frequently this is 6 months and 10 days after the straddle is issued. Which component of the straddle is exercised depends upon the market conditions at the time of exercise vis-a-vis market conditions at the time the straddle was written. If the market in that security has risen, the securities are likely to be "called" from the writer; if the market has fallen, the stock is likely to be "put" to the writer. While in the great majority of the cases, one component of the straddle is exercised and the other is allowed to lapse, occasionally (perhaps 10 to 15 percent of the time) neither option is exercised and in a few other cases (less than 1 percent of the cases) both components of the straddle are exercised.

Although options are purchased for hedging and other similar purposes by some investors, their primary use probably is as a method of investing by individuals with small amounts of money.

¹ Much of the material presented in this part was derived from the "Report on Put and Call Options," a report published in August 1961 by the Securities and Exchange Commission, on the basis of an extensive study by the SEC's Division of Trading and Exchanges.

III. DEVELOPMENT OF PRESENT TAX TREATMENT

Under the 1939 code, premium income received from the writing of an option which had lapsed was treated as a short-term capital gain (sec. 117(g)(2) of the 1939 code). However, until the issuance of a revenue ruling in 1965 (Revenue Ruling 65-31) straddle writers generally allocated the entire straddle premium to the component option which was exercised, and this practice apparently was not challenged by the Internal Revenue Service prior to the issuance of the ruling. Since one component or the other of a straddle is exercised in the bulk of the cases, the fact that the premium in the case of the lapse of an option was treated as short-term capital gain was of relatively little significance. The important aspect was the treatment of the premium in connection with the portion of the straddle which was exercised.

If all of the premium is allocated to the component which is exercised and this is the "put," the premium decreases the cost or basis of the stock put to the writer of the straddle. As a result, it would increase his capital gain only when he disposed of the stock put to him. Generally, this would result in a long-term capital gain (unless he held the stock for less than 6 months). Where the call component is exercised and all of the straddle premium is allocated to it, the premium would increase the income received by the writer at the time the stock is called from (i.e., sold by) him. As a result in this case also, the total premium increases the writer's capital gain (or decreases his capital loss) and if the writer had held the stock for more than 6 months, the gain (or loss) would be long term.

The 1939 code provision treating income from the lapse of an option as a short-term capital gain was not included in the 1954 code. As a result, where both options are permitted to lapse, the total straddle premium is now reported as ordinary income. However, in the usual case where one option lapsed and the other was exercised, the treatment of allocating the straddle premium income to the side exercised in practice remained unchanged.

In the ruling (Revenue Ruling 65-31) issued on January 22, 1965, the Internal Revenue Service held that the premium for a straddle must be allocated between its put and call components on the basis of the relative market values of each. In a later technical information release, the Service announced that it would accept allocations of 55 percent of each straddle premium to the call component and 45 percent to the put component.²

Under the ruling, part of the premium arising from the writing of a single straddle can result in ordinary income (the portion of the premium allocated to the lapsed component) while the remaining portion of the premium may result in either a capital gain or a capital loss, which in the usual case will be a long-term gain or loss.

IV. REASONS FOR THE BILL

The difficulty with the present tax treatment of premium income from the writing of straddles lies in the fact that by dividing the pre-

² Rev. Proc. 65-29, issued on Nov. 15, 1965. This 55-45 ratio was selected because it represented a rounded approximation of relative market prices of separately written "puts" and "calls" of the same length for securities of approximately equal price. The revenue procedure concluded with the statement that "If a taxpayer does not use this method for a taxable year, then the allocation based on relative market values required by Revenue Ruling 65-31 must be used."

mium income into two parts, one part may be reported as ordinary income (the portion allocated to the lapsed option) while the other portion may merely decrease a capital loss. Your committee believes that it is hard to justify treating part of the transaction as resulting in ordinary income, while the other portion gives rise to a capital loss which cannot be offset (apart from the \$1,000 per year deduction of net capital losses against ordinary income) against ordinary income.

The problem can be illustrated by the following example. Assume that a straddle writer issues a straddle for a stock when its price is \$100 a share and this is the option price. Assume that the straddle premium is \$8 per share. Assume further that the put component of the straddle is exercised by the purchaser when the price of the stock is \$80 per share. As a result, the writer of the straddle must buy stock at a price of \$100 per share when its market value is \$80 per share. If the straddle premium allocable to the put component is \$3.60 per share, the short-term capital loss for the writer of the straddle will be \$16.40 per share if he disposes of the stock shortly after receipt, when the market price is still \$80 per share. At the same time, the remainder of the straddle premium, \$4.40 a share, is allocated to the call component, which in such a case presumably was allowed to lapse. The \$4.40 per share would be ordinary income while the capital loss of \$16.40 a share attributable to the put side of the option would result in a short-term capital loss, which, except to the extent of the \$1,000 a year, could not be netted with the ordinary income attributable to the premium income of the other side of the straddle.

The writer of the straddle in these cases is, of course, entering the transaction in the hope of obtaining a profit; he naturally views the transaction as a single one and cannot see why he must pay ordinary income on a portion of the transaction while being denied full use of his capital loss attributable to the other component of the transaction (in those cases where he does not have capital gains sufficient to offset his capital losses and his losses exceed the \$1,000 which may be offset against ordinary income). Moreover, the marketplace treats the straddle as a single transaction in that a smaller premium is paid for a straddle than for a separate put and call on the same stock, since the combined risk involved is less. Additionally, the writer of the straddle knows that in almost all cases, only one of the two options in the straddle will be exercised. He views this as the side for which he is being paid the premium.

Your committee agrees that it is desirable to provide for this netting of a gain or loss arising from the two components of a straddle option. Nevertheless, it appears appropriate where the transaction on a net basis results in a gain, that the premium income result in ordinary income. The netting of the two components in a straddle can be achieved and still have any net premium gain result in what is essentially ordinary income, by treating the premium income allocated to the lapsed option as a short-term capital gain. Where this is done, any capital loss from the straddle transaction attributable to the side exercised (where the stock is disposed of in the same year in which the lapse of the option occurs) can be offset against the short-term capital gain attributable to the premium income from the side of the option which lapsed. Should the short-term capital gain in such a case exceed the capital loss, it will still be treated in essentially the same manner as ordinary income.

As a result, your committee's bill provides that any gain on the lapse of an option granted by a taxpayer as a part of the straddle is to be treated as a short-term capital gain. This treatment is not to be available, however, in the case of dealers (that is, persons who hold securities for sale to customers in the ordinary course of their trades or businesses). This treatment is made inapplicable in the case of dealers because their security transactions in any event are generally required to be treated as resulting in ordinary income. This treatment is applied to securities and not to commodity futures since there is no evidence that a problem has been created in this latter area.

The change made by your committee's bill applies to all straddle transactions entered into after January 25, 1965, the effective date of the ruling which first required the allocation of the straddle premium between the put and the call components.

V. EXPLANATION OF PROVISIONS

The bill inserts a new subsection (c) to section 1234 of the code. The first paragraph of this new subsection provides that gain derived from the lapse of an option written as a part of a straddle (as defined in new section 1234(c)(3)) is, in effect, to be short-term capital gain, as defined in section 1222(1) of existing law. Thus, such gains will be added to any other short-term capital gains, to be netted against short-term capital losses, with the excess to be netted against any net long-term capital losses. Any remaining short-term capital gains will generally be taxed as ordinary income.

Paragraph (2) of the new section 1234(c) provides that this provision does not apply to dealers. For this purpose, a dealer is a person who holds securities (including options to acquire or sell securities) for sale to customers in the ordinary course of his trade or business.

Paragraph (3) of the new subsection defines a "straddle" as a simultaneously granted combination of an option to buy (a "call") and an option to sell (a "put") the same quantity of a security at the same price during the same period of time.

If a person grants a multiple option (a put plus a call plus one or more additional puts or calls) it is intended that the grantor of the multiple option must identify in his records which two of the component options constitute the straddle, if it is not clear from the options themselves. It is contemplated that the method of identification will be specified in regulations issued by the Secretary of the Treasury or his delegate. If there is no identification by the writer, this provision relating to straddles is not to apply. As a result, in such a case the gain on the lapsed option (or options) would result in ordinary income.

A corporate security for purposes of the definition of a straddle is the same as defined in section 1236(c) of the code—i.e., stocks, bonds, notes, etc. Accordingly, the term securities does not include commodities futures.

The amendments described above are to apply to straddles written after January 25, 1965, in taxable years ending after such date.

VI. 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 italics, existing law in which no change is proposed is shown in roman):

SECTION 1234 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 1234. OPTIONS TO BUY OR SELL

(a) **TREATMENT OF GAIN OR LOSS.**—Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, a privilege or option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the option or privilege relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him).

(b) **SPECIAL RULE FOR LOSS ATTRIBUTABLE TO FAILURE TO EXERCISE OPTION.**—For purposes of subsection (a), if loss is attributable to failure to exercise a privilege or option, the privilege or option shall be deemed to have been sold or exchanged on the day it expired.

(c) **SPECIAL RULE FOR GRANTORS OF STRADDLES.**—

(1) **GAIN ON LAPSE.**—*In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.*

(2) **EXCLUSION OF DEALERS.**—*This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.*

(3) **DEFINITIONS.**—*For purposes of this subsection—*

(A) *The term "straddle" means a simultaneously granted combination of an option to buy, and an option to sell, the same quantity of a security at the same price during the same period of time.*

(B) *The term "security" has the meaning assigned to such term by section 1236(c).*

[(c)] (d) NON-APPLICATION OF SECTION.—This section shall not apply to—

(1) a privilege or option which constitutes property described in paragraph (1) of section 1221;

(2) in the case of gain attributable to the sale or exchange of a privilege or option, any income derived in connection with such privilege or option which, without regard to this section, is treated as other than gain from the sale or exchange of a capital asset;

(3) a loss attributable to failure to exercise an option described in section 1233(c); or

(4) gain attributable to the sale or exchange of a privilege or option acquired by the taxpayer before March 1, 1954, if in the hands of the taxpayer such privilege or option is a capital asset.

[October 11, 1966]

[P. 25026]

INCOME TAX TREATMENT OF CERTAIN STRADDLE TRANSACTIONS

Mr. MILLS. Mr. Speaker, I ask unanimous consent that the Committee of the Whole House on the State of the Union be discharged from further consideration of the bill H.R. 11765 to amend section 1234 of the Internal Revenue Code of 1954, which was reported to the House unanimously by the Committee on Ways and Means, and ask for its immediate consideration.

The Clerk read the title of the bill.

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

Mr. CURTIS. Mr. Speaker, reserving the right to object, and I shall not, I should like to ask the chairman of the committee to explain briefly the bill.

Mr. MILLS. Mr. Speaker, will the gentleman yield?

Mr. CURTIS. I yield to the gentleman from Arkansas.

Mr. MILLS. Mr. Speaker, this bill, H.R. 11765, is intended to permit the netting of gains and losses resulting from the granting of certain types of options to buy and sell corporate stock.

The transactions I have referred to in stock market parlance are known as "straddles." Briefly, a straddle is a combination of an option to buy and an option to sell the same quantity of a security at the same price during the same period of time. The option to buy is known as a "call." The option to sell is known as a "put." Typically, the combination—the straddle—is written by a person who owns the stock and does not believe that it is likely to fluctuate in value very much over the long run. The inducement to write the straddle is the receipt of a premium for it. A straddle is sold by the writer to a dealer, who then normally separates out the component options and sells the put—the option to sell to the writer—to one investor and the call—the option to purchase from the writer—to another investor. Normally, if the market in that security moves upward, the call is exercised and the put option is allowed to lapse. If the market in that security moves downward, then the put is apt to be exercised and the call allowed to lapse. Sometimes—generally about 10 to 15 percent of the time—the movement in the stock is so slight that neither option holder exercises his option. Rarely—less than 1 percent of the time—the stock fluctuates so much that both component options are exercised. This bill is intended to have its primary effect in the overwhelming majority of the cases—where one component option is exercised and the other is not.

Under the 1939 Internal Revenue Code and under the 1954 code until January

1965, it was the usual practice for the writer of a straddle to treat the entire premium as either an increase in the amount received for the stock when the call was exercised, or as a decrease in the writer's cost of the stock when the put was exercised. As a result, the premium merely increased a capital gain or decreased a capital loss.

Under a ruling issued in January in 1965, the Internal Revenue Service has been requiring the writer of a straddle to apportion his premium between the put option and the call option. That part of the premium allocated to the option that ultimately is exercised would continue, as in the past, to either increase the writer's capital gain or decrease his capital loss. The part of the premium allocated to the option that ultimately lapses is treated as ordinary income. Consequently, a single straddle transaction now might well result in the writer realizing both ordinary income and a capital loss. Since net capital losses can be used to offset ordinary income only to the extent of \$1,000 a year, a writer's straddles transactions may well result in both ordinary income and capital losses which could not be netted against each other.

Straddles are viewed by those who write them as giving rise to a single transaction. This seems to be borne out by the facts in these cases, for example, the premium received by the writer of the straddle is less than the premium received by the writer of an option to buy plus a completely separate option to sell. Also, the stock exchange company that endorses the option—guarantees that it will be honored if it is exercised—will require considerably less collateral from the writer of a straddle than it will from the writer of a separate option to buy and a separate option to sell.

Because of this combination of characteristics, the Ways and Means Committee concluded that some method ought to be found to permit the gains and losses resulting from the straddle transactions to be netted against each other.

This bill permits just such netting by treating the option lapse income in these cases as short-term capital gains. Since all the gains and losses from a straddle would be capital gains and losses, they could be netted against each other. However, any net profits would normally result in short-term capital gains, and would be taxed generally as ordinary income.

The problem giving rise to this bill was examined by the staff of the Joint Committee on Internal Revenue Taxation at the request of former Senator Harry F. Byrd and myself, in our capacities as vice chairman and chairman last year of the joint committee. The requested study was announced in a

press release dated January 27, 1965. This staff has consulted with Treasury staff on this bill. This bill, reported unanimously by the Ways and Means Committee, is consistent with the suggestions of the joint committee staff; and the Treasury does not object to the bill.

The joint committee staff report on this bill stated:

Since Rev. Rul. 65-31 applies only to transactions entered into after January 25, 1965, and since the staff study of the problems arising out of the ruling began at about that time, it is suggested that any legislation along the lines suggested probably should apply to straddles written after January 25, 1965. This will minimize the number of changes in applicable law.

This bill specifically adopts that suggestion.

This bill is not expected to have any appreciable effect on revenues. However, this bill will bring the tax laws into greater conformity with the economic considerations that move people to write straddles and buy options. It will remedy an unfair quirk in the tax laws. It should be adopted.

Mr. CURTIS. Mr. Speaker, I thank the gentleman. I withdraw my reservation.

[P. 25027]

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

The Clerk read the bill, as follows:

H.R. 11765

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1234 of the Internal Revenue Code of 1954, relating to options, is amended as follows:

Subsection (c) is redesignated as subsection (d) and the following new subsection (c) is added at the end of subsection (b).

"(c) SPECIAL RULE FOR CREATORS OF STRADDLES.—

"(1) GAIN ON LAPSE.—In the case of gain on lapse of an option that was granted as part of a straddle (as defined in paragraph 2), the gain shall be deemed to be gain from the sale or exchange of a capital asset held for less than six months on the day that the option expires.

"(2) DEFINITIONS.—

"(A) For purposes of this section a 'straddle' is defined as a combination of an option to buy and an option to sell, giving the holder the right to both buy and sell a speci-

fied quantity of a security at a fixed price for a stated period of time.

"(B) For purposes of this paragraph 'security' shall not include contracts to buy or sell commodities.

"(3) EXCLUSION OF DEALERS.—This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business."

EFFECTIVE DATE

Sec. 2. This Act shall apply to options granted after January 25, 1965.

With the following committee amendment:

Strike out all after the enacting clause and insert the following:

"That section 1234 of the Internal Revenue Code of 1954 (relating to options) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) SPECIAL RULE FOR GRANTORS OF STRADDLES.—

"(1) GAIN ON LAPSE.—In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.

"(2) EXCLUSION OF DEALERS.—This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) The term 'straddle' means a simultaneously granted combination of an option to buy, and an option to sell, the same quantity of a security at the same price during the same period of time.

"(B) The term 'security' has the meaning assigned to such term by section 1236(c)."

"Sec. 2. The amendments made by the first section of this Act shall apply to straddle transactions entered into after January 25, 1965, in taxable years ending after such date."

Mr. MILLS (interrupting the reading). Mr. Speaker, I ask unanimous consent that further reading of the amendment be dispensed with and that it be printed in the Record.

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

The committee amendment was agreed to.

The bill was ordered to be engrossed and read a third time, was read the third time, and passed, and a motion to reconsider was laid on the table.

APPENDIX III

S. 1013

**TO CLARIFY THE COMPONENTS OF, AND TO ASSIST
IN THE MANAGEMENT OF, THE NATIONAL DEBT AND
THE TAX STRUCTURE
(Sec. 402 of Public Law 89-809)**
