

EXCLUSION FROM GROSS INCOME OF INCOME FROM
DISCHARGE OF INDEBTEDNESS

MAY 17, 1951.—Ordered to be printed

Mr. KERR, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 2416]

The Committee on Finance, to whom was referred the bill (H. R. 2416) relating to exclusion from income of income from discharge of indebtedness, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

The committee amendments are as follows:

On page 1, line 5, insert before "taxable years" the following: "discharge of indebtedness occurring within".

On page 2, strike out all after "(2)" in line 1 and all that follows through line 4, and insert in lieu thereof the following: "by striking out the last sentence thereof."

The amendments made by your committee are technical amendments which clarify the effective date of the bill so as to make it clear that nothing in the bill affects the application of section 22 (b) (9) of the code for taxable years ending before January 1, 1951. This bill does not change the law with respect to the effective date of changes made in section 22 (b) (9) by the Revenue Act of 1942.

GENERAL STATEMENT

H. R. 2416 provides for the permanent enactment of section 22 (b) (9) of the Internal Revenue Code and for the extension of section 22 (b) (10) of the code for a 3-year period. Under present law, both of these provisions would expire automatically on December 31, 1951.

Section 1 of the bill amends section 22 (b) (9) of the code to make such temporary provision permanent. Section 22 (b) (9) excludes from gross income, in the case of a corporation, the amount of income attributable to the discharge of indebtedness evidenced by a bond, debenture, note, certificate, or other evidence of indebtedness. The exclusion is applicable only if the corporation consents to a reduction in the basis of its properties under section 113 (b) (3) in accordance

with the regulations then in effect. The reduction of basis under section 113 (b) (3) is in an amount equal to the income excluded under section 22 (b) (9). In the event an amount is excluded from gross income under these provisions, an adjustment is made for unamortized premium or unamortized discount on the discharged obligation.

The Secretary of the Treasury has authority under section 113 (b) (3) to prescribe regulations which will set forth rules under which the adjustment to basis shall be made. Existing regulations (sec. 29.113 (b) (3)-1 of Regulations 111) provide that an amount equal to the excluded income is first to be applied in reduction of the basis of the specific property (other than inventory, notes, or accounts receivable) in the acquisition of which the indebtedness was incurred. The reduction of basis in such case merely reflects an adjustment in the purchase price of the property. The reduction of basis under the regulations is then successively applied to the following classes of property: (1) Property securing the indebtedness, (2) other property of the taxpayer, and finally (3) inventory and accounts and notes receivable. Within these classes, the reduction in basis is applied proportionately to the property included in the class without regard to whether the property is depreciable or nondepreciable. In order to assure that the exclusion of income by operation of section 22 (b) (9) may result only in a temporary postponement of the tax liability, your committee understands that the Secretary of the Treasury will require by regulations that, with respect to future discharges of indebtedness, after adjustment of the basis of certain property acquired with the purchase money indebtedness, whatever reduction in basis of property remains to be taken under section 113 (b) (3) will be taken, in general, against depreciable property or property subject to cost depletion and only as a last resort against nondepreciable property. Thus, in general, it is intended that a reduction in the basis of nondepreciable property will be made only after the exhaustion of depreciable property or property subject to cost depletion. This provision will assure the collection within a reasonable time of the taxes postponed and will, therefore, have no appreciable, long-run effect on the revenue.

The bill makes a technical amendment to section 22 (b) (9) to allow for greater flexibility as to the time for filing the required consent to a reduction of basis. Under the present law, the taxpayer must file its consent with its return for the taxable year. The bill amends the section to provide that the consent shall be filed at such time as the Secretary of the Treasury may prescribe. Under this amendment, the Department could continue to require that the consent be filed with the return in the ordinary case, but might make provision for filing of the consent at a later date in appropriate hardship cases. This amendment shall be effective with respect to taxable years ending after December 31, 1950.

Section 2 of the bill extends for an additional 3-year period the exclusion provided for railroad corporations under section 22 (b) (10) of the code. Section 22 (b) (10) provides that the amount of income attributable to the discharge of any indebtedness of a railroad corporation, as defined in section 77 (m) of the National Bankruptcy Act, shall be excluded to the extent that such income is deemed to have been realized by a modification or cancellation of indebtedness pursuant to an order of the court in a receivership proceeding or a

proceeding under section 77 of the National Bankruptcy Act. Unlike section 22 (b) (9), section 22 (b) (10) does not require a reduction in the basis of the taxpayer's properties as a condition to the exclusion of the income. The extension of the expiration date of section 22 (b) (10) by the bill is to December 31, 1954.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

SECTION 22 OF THE INTERNAL REVENUE CODE

SEC. 22. GROSS INCOME.

(a) General Definition.— * * *

(b) Exclusions from Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(1) Life insurance.— * * *

* * * * *

(9) INCOME FROM DISCHARGE OF INDEBTEDNESS.—In the case of a corporation, the amount of any income of the taxpayer attributable to the discharge, within the taxable year, of any indebtedness of the taxpayer or for which the taxpayer is liable evidenced by a security (as hereinafter in this paragraph defined) [if the taxpayer makes and files at the time of filing the return, in such manner as the Commissioner, with the approval of the Secretary, by regulations prescribes, its consent] *if the taxpayer, at such time and in such manner as the Secretary by regulations prescribes, makes and files its consent* to the regulations prescribed under section 113 (b) (3) then in effect. In such case the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. As used in this paragraph the term "security" means any bond, debenture, note, or certificate, or other evidence of indebtedness, issued by any corporation. [This paragraph shall not apply to any discharge occurring before the date of enactment of the Revenue Act of 1939, or in a taxable year beginning after December 31, 1951.]

(10) INCOME FROM DISCHARGE OF INDEBTEDNESS OF A RAILROAD CORPORATION.—The amount of any income attributable to the discharge within the taxable year, of any indebtedness of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, to the extent that such income is deemed to have been realized by reason of a modification in or cancellation in whole or in part of such indebtedness pursuant to an order of a court in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended. In such case the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. Paragraph (9) shall not apply with respect to any discharge of indebtedness to which this paragraph applies. This paragraph shall not apply to any discharge occurring in a taxable year beginning after [December 31, 1951] *December 31, 1954.*

