The original documents are located in Box 64, folder "10/15/76 HR7929 Deduction of Interest on Certain Corporate Indebtedness" of the White House Records Office: Legislation Case Files at the Gerald R. Ford Presidential Library

APPROVED
OCT 15 1976

10/15/76

THE WHITE HOUSE

WASHINGTON

October 13, 1976

ACTION

Last Day: October 18

Posted
10/15/76

Archives
10/15/76

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON

SUBJECT: H.R. 7929 - Deduction of Interest on Certain Corporate Indebtedness

Attached for your consideration is H.R. 7929, sponsored by Representative Fulton.

The enrolled bill would permit corporations which controlled 50% or more of the stock of another corporation prior to October 9, 1969, to deduct interest on indebtedness issued to acquire up to 100% of the stock of such other corporations.

A detailed description of the provisions of the enrolled bill is provided in OMB's bill report at Tab A.

OMB, Max Friedersdorf, Counsel's Office (Kilberg), Bill Seidman and I recommend approval of the enrolled bill.

RECOMMENDATION

That you sign H.R. 7929 at Tab B.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OCT 11 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 7929 - Deduction of Interest on Certain Corporate Indebtedness
Sponsor - Rep. Fulton (D) Tennessee

Last Day for Action

October 18, 1976 - Monday

Purpose

Permits corporations which controlled 50 percent or more of the stock of another corporation prior to October 9, 1969, to deduct interest on indebtedness issued to acquire up to 100 percent of the stock of such other corporations.

Agency Recommendations

Office of Management and Budget	Approval
Department of the Treasury	Approval
Department of Commerce	Approval
Securities and Exchange Commission	No recommendation received

Discussion

The Tax Reform Act of 1969, in an expression of concern over corporate mergers, generally disallowed tax deductions for interest on corporate debt obligations issued to acquire the stocks or assets of another corporation. An exception was provided for corporations that, on October 9, 1969, owned 50 percent or more of the stock of another corporation. Such corporations were allowed to issue new debt to acquire additional shares of corporations in which they held

majority ownership. That exception did not apply, however, to indebtedness issued to acquire stock in excess of 80 percent, the amount necessary for control for certain tax purposes.

The enrolled bill would eliminate the 80 percent limit. The Treasury Department does not object to this provision since the acquisitions in question have already occurred. In addition, minority shareholders of a corporation which is 80 percent controlled may find themselves without a ready market for their stock, unless the controlling corporation is able and willing to purchase their shares. The bill would result in a one-time revenue loss of less than $1 million.

James T. Lynn
Director

Enclosures

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

OCT 22 1976

Mr. James M. Frey
Assistant Director
for Legislative Reference
Office of Management and
Budget
Washington, D.C. 20045

Re: H.R. 7929

Dear Mr. Frey:

In response to your request, we have considered H.R. 7929, which would amend subsection (i) of Section 279 of the Internal Revenue Code of 1954 to remove limitations on deductions for interest paid or incurred by a corporation under certain circumstances where the debt is incurred in order to acquire the stock or assets of another corporation.

We have no objections to the enactment of this bill.

Sincerely,

Roderick M. Hills
Chairman

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: October 11 Time: 1000pm

FOR ACTION: Paul Leach
Max Friedersdorf
Bobbie Kilberg
Bill Seidman

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey

FROM THE STAFF SECRETARY

DUE: Date: October 12 Time: 1100am

SUBJECT:

H.R.7929-Deduction of interest on certain corporate indebtedness

ACTION REQUESTED:

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

REMARKS:

please return to judy johnston, ground floor west wing

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

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

K. R. COLE, JR.
For the President

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

OCT 07 1976

Dear Sir:

This is in response to your request for the views of the Treasury Department on the enrolled bill, H.R. 7929, "An ACT relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation."

The Act amends subsection (i) of section 279 of the Internal Revenue Code of 1954 by striking out the last sentence thereof. The amendment applies to taxable years ending after October 9, 1969.

Section 279 was added to the Code by the Tax Reform Act of 1969 (P.L. 91-172) because of the Congressional concern over the increasing number of corporate mergers in which debt, rather than equity, was being exchanged for control of acquired corporations. This trend was thought to have adverse implications for the economic health of the companies involved as well as the economy as a whole. Section 279 implements this Congressional policy by denying a corporate taxpayer a deduction for interest on debt issued to acquire another corporation if certain conditions exist. Generally, it applies to obligations which are subordinated to other debt, which are convertible into stock of the issuing corporation, and which create a debt-equity ratio in excess of two to one or where the annual interest expense to be paid on total indebtedness is not covered at least three times by projected earnings.

Section 279 is intended to apply to certain debt obligations issued in connection with corporate acquisitions regardless of whether or not these obligations qualify as debt under the tests of section 385 of the Code. Thus, section 279 does not resolve the debt-equity issue insofar as corporate obligations are concerned. It is intended to limit their use in certain acquisitions. In light of this intent, section 279 was limited in application to instances where the taxpayer had not obtained control of another corporation on October 9, 1969. Where the corporate taxpayer already had effective control of another corporation

(i.e., owned 50 percent or more of the stock) on that date, it was permitted to acquire additional stock for debt obligations without jeopardizing its interest deductions, but only up to 80 percent of the stock. Eighty percent stock ownership constitutes control for various tax purposes. Interest on debt issued for acquired stock beyond the 80 percent limit, however, is subject to the limitations of section 279.

The Treasury Department believes that the limitation on the deductibility of interest where debt is issued to acquire stock beyond the 80 percent level makes no sense in the context of the purpose of section 279 to discourage acquisitions with debt. Consequently, section 279 should not apply to cases where control was already in the hands of the corporate taxpayer on the effective date regardless of how much additional stock the acquiring corporation intends to obtain.

The effect of H.R. 7929 is to exempt from the provisions of section 279 all debt issued after October 9, 1969 to acquire stock of any corporation in which the issuing corporation, on October 9, 1969 and all times thereafter, owns at least 50 percent of the stock. We estimate the revenue loss of the enactment of H.R. 7929 to be less than $1 million.

The Treasury Department recommends that the President approve H.R. 7929.

Sincerely yours,

Charles M. Walker
Assistant Secretary

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

GENERAL COUNSEL OF THE
UNITED STATES DEPARTMENT OF COMMERCE
Washington, D.C. 20230

OCT 8 1976

Honorable James T. Lynn
Director, Office of Management
and Budget
Washington, D. C. 20503

Attention: Assistant Director for Legislative Reference

Dear Mr. Lynn:

This is in reply to your request for the views of this Department concerning H. R. 7929, an enrolled enactment

"Relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation."

The purpose of H. R. 7929 is to amend section 279 of the Internal Revenue Code which disallows any deduction for interest paid or incurred by a corporation, under certain circumstances, where the debt is incurred in order to acquire the stock (or assets) of another corporation. The section presently contains a transition provision under which, if one corporation held at least 50% of the voting stock of another corporation on October 9, 1969, then the first corporation is permitted to acquire 80% control (but not more) of the second corporation without being subject to the nondeductibility provision.

H. R. 7929 eliminates the 80% limit. Thus, a corporation which held at least 50% of the voting stock in another corporation on October 9, 1969, would be allowed to acquire all the remaining stock of the second corporation without being subject to the nondeductibility provision.

This Department recommends approval by the President of H. R. 7929.

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

Sincerely,

General Counsel

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: October 11 Time: 1000pm

FOR ACTION: Paul Leach
Max Friedersdorf
Bobbie Kilberg
Bill Seidman

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey

FROM THE STAFF SECRETARY

DUE: Date: October 13 Time: 1100am

SUBJECT:

H.R.7929-Deduction of interest on certain corporate indebtedness

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

__X__ For Your Comments ____ Draft Remarks

REMARKS:

please return to judy johnston,ground floor west wing

approved

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

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

James M. Cannon
For the President

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: October 11 Time: 1000pm

FOR ACTION: Paul Leach
Max Friedersdorf
Bobbie Kilberg
Bill Seidman

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey

FROM THE STAFF SECRETARY

DUE: Date: October 13 Time: 1100am

SUBJECT:

H.R.7929-Deduction of interest on certain corporate indebtedness

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

__X__ For Your Comments ____ Draft Remarks

REMARKS:

please return to judy johnston,ground floor west wing

OK PLZ
10/12/76

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

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

James M. Cannon
For the President

MEMORANDUM WASHINGTON LOG NO.:

Date: October 11 Time: 1000pm

FOR ACTION: Paul Leach
Max Friedersdorf
Bobbie Kilberg
Bill Seidman

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey

FROM THE STAFF SECRETARY

DUE: Date: October 13 Time: 1100am

SUBJECT:

H.R.7929-Deduction of interest on certain corporate indebtedness

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

__X__ For Your Comments ____ Draft Remarks

REMARKS:

please return to judy johnston,ground floor west wing

Recommend Approval. JMC

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

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

James M. Cannon
For the President

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: October 1 Time: 1000pm

FOR ACTION: Paul Leach
Max Friedersdorf
Bobbie Kilberg
Bill Seidman

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey

FROM THE STAFF SECRETARY

DUE: Date: October 13 Time: 1100am

SUBJECT:

H.R.7929-Deduction of interest on certain corporate indebtedness

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

__X__ For Your Comments ____ Draft Remarks

REMARKS:

please return to judy johnston, ground floor west wing

no objection
K. Lazarus
10-3

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

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

James M. Cannon
For the President

Calendar No. 1201

94TH CONGRESS
2d Session

SENATE

REPORT
No. 94-1266

INTEREST ON CORPORATE DEBT TO ACQUIRE ANOTHER CORPORATION

SEPTEMBER 20, 1976.—Ordered to be printed

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

REPORT

[To accompany H.R. 7929]

The Committee on Finance, to which was referred the bill (H.R. 7929) relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation, having considered the same, reports favorably thereon with amendments and an amendment to the title and recommends that the bill as amended do pass.

I. SUMMARY

Present law disallows any deduction for interest paid or incurred by a corporation, under certain circumstances, where the debt is incurred in order to acquire the stock (or assets) of another corporation. The Tax Reform Act of 1969, which enacted this provision, included a transition rule under which, if one corporation held at least 50 percent of the voting stock in another corporation on October 9, 1969, then the first corporation is permitted to acquire 80-percent control (but not more) of the second corporation without being subject to the nondeductibility provision.

This bill (H.R. 7929) eliminates the 80-percent limit. Thus, a corporation which held at least 50 percent of the voting stock in another corporation on October 9, 1969, is to be allowed to acquire all the remaining stock of the second corporation without being subject to the nondeductibility provision.

The committee amendments deal with the application of the unrelated business income tax to income which an exempt organization receives from lending securities to brokers in order to enable the brokers to make timely deliveries of securities to purchasers. Div-

idends, interest, annuities, royalties, rents, and capital gains are passive types of income that generally are excluded from the unrelated business income tax of most exempt organizations. It is not clear under existing law, however, whether payments made with respect to loans of securities are subject to the unrelated business income tax. The committee amendments provide that payments on securities loans are to be exempt from the unrelated business income tax; they also provide that those payments are to be treated in the same manner as dividends and interest for purposes of the excise tax on private foundations, for the 90-percent income test for regulated investment companies, and for the support test limitations on investment income in determining whether a charitable organization is a publicly supported organization rather than a private foundation. The amendments provide this treatment only for payments of security loans which are fully collateralized and which may be terminated on five business days' notice by the lending organization.

II. General Statement

A. Interest on Acquisition Indebtedness of Corporation (sec. 1 of the bill and sec. 279 of the Code).

PRESENT LAW

Under present law, a corporation generally is allowed to deduct interest paid or incurred on its indebtedness but is not allowed a deduction for dividends paid on its stock or equity. However, under certain circumstances, a corporation is not allowed an interest deduction (either for stated interest or unstated interest such as original issue discount) for indebtedness which it issues as consideration for the acquisition of stock in another corporation, or for the acquisition of assets of another corporation (sec. 279).

A number of exceptions or modifications are provided under existing law to this interest disallowance rule. Generally the disallowance of the deduction for interest in the case of acquisition indebtedness applies to interest paid or incurred with respect to indebtedness incurred after October 9, 1969. However, this provision is inapplicable in certain cases where the issuing corporation had at least a 50-percent voting interest in another corporation on October 9, 1969, even though the obligation is issued after that date; this exception does not apply to indebtedness issued to acquire stock in excess of the amount necessary for control for tax purposes (ie., 80 percent).

REASONS FOR CHANGE

The interest disallowance provision was added to the Code in 1969 because of a Congressional concern over the increasing number of corporate mergers in which debt, rather than equity, was being exchanged for control of acquired corporations. This trend was thought to have adverse implications for the economic well-being of the companies involved (by increasing corporate debt to dangerous levels) as well as for the economy as a whole. The purpose of the exception for acquiring corporations having 50-percent or greater control of another corporation on October 9, 1969, was to permit such acquiring corporations

to obtain the 80-percent control of the acquired corporation necessary for certain tax purposes.

The committee has concluded that the 80-percent limitation imposed in connection with pre-October 10, 1969, control situations does not appear to serve the purpose of the interest disallowance provision (which is to discourage the future use of debt acquisitions under certain prescribed circumstances). This is so since the acquisition, in such cases, has already occurred. In addition, minority shareholders of a corporation which is 80-percent controlled may find themselves without a ready market for their stock, unless the controlling corporation is able and willing to purchase their shares.

EXPLANATION OF THE PROVISION

Under the provision, the provision denying a deduction for interest on corporate acquisition indebtedness is not to apply where a corporation which had acquired at least 50 percent of the total combined voting power of all classes of stock of another corporation by October 9, 1969, incurs acquisition indebtedness in increasing its control over the acquired corporation. Thus, the 80-percent limitation (contained in sec. 279(i) of the Code) which applies under present law in such situations, is to be removed.

EFFECTIVE DATE

The provision bill applies to taxable years ending after October 9, 1969.

Under this provision, any refund or credit resulting from the removal of the 80-percent limitation is not to be barred (by the statute of limitations, by *res judicata* in a litigated case, by a closing agreement, or otherwise) if the claim is filed within 1 year of the date of enactment.

REVENUE EFFECT

This provision is estimated to result in a one-time revenue loss of less than $1,000,000.

B. Treatment of Amounts Received on Loan of Securities (sec. 2 of the bill and secs. 512, 509, 851, and 4940 of the Code).

PRESENT LAW

Exempt organizations—unrelated business income

The investment income of exempt organizations [1] generally is not subject to tax on unrelated business income.[2] The types of investment income sources listed as being generally free of this tax are dividends, interest, annuities, royalties, rents, and capital gains from the sale of investment assets (sec. 512(b) (1), (2), (3), and (5)).

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[1] In this report references to "exempt organizations" do not include social clubs (sec. 501(c)(7)) and employees' beneficiary associations (sec. 501(c)(9)), which may be taxable on investment income of all types. The term "exempt organizations," as used in this report, also does not include political organizations (as described in sec. 527) and homeowners' associations (as described in sec. 528).

[2] In the case of "debt-financed property", different rules apply, and the investment income may be taxable in part. Those rules are dealt with under section 514 of the Code (see sec. 512(b)(4)) and are not amended by this bill.

Exempt organizations—public charities

Certain organizations may be treated as public charities (i.e., not private foundations) if they normally receive more than one-third of their support from a combination of gifts, grants, contributions, or membership fees and gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities which are not unrelated trades or businesses. This rule applies only if the organization normally receives not more than one-third of its support from gross investment income plus the excess of the organization's unrelated business taxable income over the amount of the tax imposed on such income (sec. 509(a)(2)). Under this provision, the term "gross investment income" means the gross amount of income from interest, dividends, rents, and royalties, but not including any such income to the extent included in computing the unrelated business income tax.

Exempt organizations—private foundations

The Code imposes on each private foundation a tax equal to 4 percent of its net investment income for the taxable year (sec. 4940). For this purpose, net investment income is the amount by which the sum of gross investment income and net capital gain exceeds the deductions which are attributable to the earning of this income. For this purpose, gross investment income also means the gross amount of income from interest, dividends, rents, and royalties (but not including any such income to the extent it is included in computing the unrelated business income tax).

Regulated investment companies

For a corporation to qualify as a regulated investment company, at least 90 percent of its gross income must be derived from dividends, interest, and gains from the sale or other disposition of stock or securities (sec. 851(b)(2)). The Internal Revenue Service has ruled privately that payments on securities loans are not dividends or interest even if they are paid by the broker (borrower) as the equivalent of a dividend or interest payment on the underlying security.

REASONS FOR CHANGE

Because of time delays which a broker may face in obtaining securities to deliver to a purchaser (from the seller), brokers are frequently required to borrow securities from organizations with investment portfolios. In general, it is felt desirable that organizations (and individuals) with securities holdings should be encouraged to make them available for loan sine the greater the volume of such securities available for loan the less frequently will a broker be in a position where he must fail to deliver a security to a purchaser within the time required by the relevant market requirements.

The Securities and Exchange Commission provides rules governing the lending of securities by regulated investment companies. These rules, in general, require that the loan of security be fully collateralized (with adjustments made on a daily basis) by cash or marketable securities with a fair market value equal to the fair market value of the securities loaned and that the lender be able to terminate the loan with 5 business days' notice.

In general, the lender of securities is compensated for the loan in two ways. First, if a dividend or interest is paid with respect to the security during the term of the loan, the borrower pays the lender and amount equal to that dividend or interest payment. Second, a fee is paid for the use of the security. This fee may be computed by reference to the period for which the loan is outstanding and the fair market value of the security during that period, or it may be the income from the collateral security for that loan, or it may be income from the investment of the collateral secuirty.

As indicated above, the Internal Revenue Service has ruled privately that neither portion of this compensation constitutes dividend or interest income to regulate investment companies. Existing law is unclear as to whether such income is subject to the unrelated business income tax, but there is some concern that the Service might take that position. It does not appear that under existing law these payments would be treated as gross investment income for the purposes of whether the lending organization is a public charity or whether the income is subject to the private foundation excise tav on investment income. The Service also is unwilling to rule as to whether an organization is engaged in a trade or business when it holds its investment portfolio securities available for such loans. If so, the income therefrom would be subject to the unrelated business income tax. Also, gains from the sale of such securities might be treated as gains from the sale of property held for sale to customers in the ordinary course of business.

The committee believes that is is not desirable to discourage [3] exempt organizations and regulated investment companies from making their securities available for loans to brokers, because making such loans of securities can have a favorable impact on the liquidity of securities markets. The committee also belieevs that it is an appropriate use of markets. The committee also believes that it is an appropriate use of activity.

The committee has concluded that, where the loan is fully collateralized in accordance with the Securities and Exchange Commission requirements, the income from the lending of a security should be regarded as investment income which is similar to dividends and interest in the case of exempt organizations and regulated investment companies.

EXPLANATION OF THE PROVISION

The provision provides, in general, that payments in respect to securities loans which satisfy certain requirements are to be treated in the same manner as dividents and interest in the case of a lender who is an exempt organization or a regulated investment company. Thus, if an exempt organization lends a security [4] to another party, in order for the payments to qualify for the passive income treatment the agreement between the parties must provide for reasonable procedures to implement the obligation of the borrower to furnish collateral to the

[3] If a dividend or interest equivalent payment would be subject to tax, while the dividend or interest if paid directly would be not taxable, then in many cases the exempt organization would find itself with less income after tax if it lent the securities than would be the case if it kept the securities.

[4] For this purpose, the definition of a security is that provided by section 1236(c) of the Code, as "any share of stock in any corporation, certificate of stock or interest in any corporation, note bond, debenture, or evidence of indebtedness, or any evidence or an interest in or right to subscribe to or purchase any of the foregoing."

lender with a fair market value on each business day the loan is out-for the payments to qualify for this passive income treatment the agreement between the parties must provide for reasonable procedures to implement the obligation of the borrower to furnish collateral to the notice of no more than five business days.

Also, it is contemplated that the activity of an exempt organization in merely making available its securities for a loan is not to affect its status an an investor with respect to those activities nor is it to result in the organization's being treated as being in the trade or business of selling or lending securities so as to result in the gains from such securities being treated as subject to the unrelated business income tax. Similarly, payments on securities loans of this sort are to be treated as gross investment income for purposes of determining whether an organization has met the limitations on investment income as a percentage of support required under section 509(a)(2). These payments also are to be treated as gross investment income for the purpose of the excise tax on the investment income of private foundations (sec. 4940), and the expenses of earning such income are to be deductible in computing that tax.

Similarly, in the case of regulated investment companies, payments on securities loans are to be treated in the same manner as dividends and interest. However, where these payments are passed through to the shareholders of these companies, they would not be treated as dividends for the purpose of divided exclusions.

In making these provisions for payments on securities loans which meet the prescribed standards, the committee intends that no inference is to be drawn with respect to the active or passive classification of income from securities loans that lack the safeguards required in the bill, either for purposes of the unrelated business income tax, treatment as gross investment income, or for other income tax purposes, such as determining whether such income is personal holding company income.

It is not intended that this treatment be available if the securities which are loaned constitute inventory or are being held for sale to customers in the ordinary course of the organization's trade or business. These activities go beyond the concept of production of investment income that is intended to be exempted, or treated as passive income. Also, it is not intended that this bill detract from the court's decision in *Rœndall Foundation* v. *Riddell*, 244 F. 2d 803 (C.A. 9, 1957), that securities trading can be so large a part of the activities of an organization that the organization fails to meet the statutory test of being "organized and operated exclusively for religious, charitable, scientific," etc. purposes, and thus does not qualify for exemption from tax.

EFFECTIVE DATE

This amendmnt applies to amounts received after December 31, 1975, regardless of whether the organization involved is a calendar year taxpayer or a fiscal year taxpayer.

REVENUE EFFECT

This amendment is estimated to have, at most, a small effect (under $5 million per year loss) on the revenues.

III. Cost of Carrying Out the Bill and Committee Vote

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the effect on the revenues of this bill. The enactment of H.R. 7929, as amended, will result in a small annual revenue loss (under $5 million) and a one-time revenue loss of less than $1 million. The Treasury Department agrees with this statement.

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made relative to the vote of the Committee on reporting this bill. This bill was ordered favorably reported by the Committee by voice vote.

IV. Changes in Existing Law Made by the Bill

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the committee amendment, as reported).

○

94TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 94-1345

INTEREST ON CORPORATE DEBT TO ACQUIRE ANOTHER CORPORATION

JULY 19, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

REPORT

[To accompany H.R. 7929]

The Committee on Ways and Means, to whom was referred the bill (H.R. 7929) relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is as follows:

Page 1, strike out line 9 and insert:

> to taxable years ending after October 9, 1969. If refund or credit of any overpayment of income tax resulting from the amendment made by subsection (a) is prevented on the date of the enactment of this Act, or at any time within 1 year after such date, by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within 1 year from such date.

I. Summary

Present law disallows any deduction for interest paid or incurred by a corporation, under certain circumstances, where the debt is incurred in order to acquire the stock (or assets) of another corporation. The Tax Reform Act of 1969, which enacted this provision, included a transition rule under which, if one corporation held at least 50 percent of the voting stock in another corporation on October 9, 1969, then the first corporation is permitted to acquire 80-percent control (but not more) of the second corporation without being subject to the nondeductibility provision.

This bill (H.R. 7929) eliminates the 80-percent limit. Thus, a corporation which held at least 50 percent of the voting stock in another corporation on October 9, 1969, is to be allowed to acquire all the remaining stock of the second corporation without being subject to the nondeductibility provision.

II. General Statement

PRESENT LAW

Under present law, a corporation generally is allowed to deduct interest paid or incurred on its indebtedness but is not allowed a deduction for dividends paid on its stock or equity. However, under certain circumstances, a corporation is not allowed an interest deduction (either for stated interest or unstated interest such as original issue discount) for indebtedness which it issues as consideration for the acquisition of stock in another corporation, or for the acquisition of assets of another corporation (sec. 279).

A number of exceptions or modifications are provided under existing law to this interest disallowance rule. Generally the disallowance of the deduction for interest in the case of acquisition indebtedness applies to interest paid or incurred wth respect to indebtedness incurred after October 9, 1969. However, this provision is inapplicable in certain cases where the issuing corporation had at least a 50-percent voting interest in another corporation on October 9, 1969, even though the obligation is issued after that date; this exception does not apply to indebtedness issued to acquire stock in excess of the amount necessary for control for tax purposes (i.e., 80 percent).

REASONS FOR THE BILL

The interest disallowance provision was added to the Code in 1969 because of a Congressional concern over the increasing number of corporate mergers in which debt, rather than equity, was being exchanged for control of acquired corporations. This trend was thought to have adverse implications for the economic well-being of the companies involved (by increasing corporate debt to dangerous levels) as well as

for the economy as a whole. The purpose of the exception for acquiring corporations having 50-percent or greater control of another corporation on October 9, 1969, was to permit such acquiring corporations to obtain the 80-percent control of the acquired corporation necessary for certain tax purposes.

Your committee has concluded that the 80-percent limitation imposed in connection with pre-October 10, 1969, control situations does not appear to serve the purpose of the interest disallowance provision (which is to discourage the future use of debt acquisitions under certain prescribed circumstances). This is so since the acquisition, in such cases, has already occurred. In addition, minority shareholders of a corporation which is 80-percent controlled may find themselves without a ready market for their stock, unless the controlling corporation is able and willing to purchase their shares.

EXPLANATION OF THE BILL

Under the bill, the provision denying a deduction for interest on corporate acquisition indebtedness is not to apply where a corporation which had acquired at least 50 percent of the total combined voting power of all classes of stock of another corporation by October 9, 1969, incurs acquisition indebtedness in increasing its control over the acquired corporation. Thus, the 80-percent limitation (contained in sec. 279(i) of the Code) which applies under present law in such situations, is to be removed.

EFFECTIVE DATE

The bill applies to taxable years ending after October 9, 1969.

Under the bill, any refund or credit resulting from the removal of the 80-percent limitation is not to be barred (by the statute of limitations, by *res judicata* in a litigated case, by a closing agreement, or otherwise) if the claim is filed within 1 year of the date of enactment.

III. Effect of the Bill on the Revenues and Vote of the Committee in Reporting the Bill

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effect of this bill on the revenues. Your committee estimates that this bill will result in a one-time revenue loss of less than $1,000,000. The Treasury Department agrees with this statement.

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made concerning the vote of the committee on the motion to report the bill. This bill, as amended, was ordered reported by voice vote.

IV. Other Matters Required To Be Discussed Under House Rules

In compliance with clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the following statements are made:

With respect to subdivision (A), relating to oversight findings, it was as a result of your committee's oversight activity concerning the treatment of interest on corporate debt to acquire another corporation

that it concluded that the provisions of this bill are appropriate so as to eliminate possible hardship in transition situations under section 279.

With respect to subdivision (B), after consultation with the Director of the Congressional Budget Office, your committee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

With respect to subdivision (C), the Director of the Congressional Budget Office has not made an estimate or comparison of the estimates of the cost of H.R. 7929, but has examined the committee's estimates and agrees with the methods and the dollar estimates resulting therefrom.

With respect to subdivision (D), your committee advises that no oversight findings or recommendations have been submitted to your committee by the Committee on Government Operations with respect to the subject matter of H.R. 7929.

In compliance with clause 2(l)(4) of Rule XI of the Rules of the House of Representatives, your committee states that the enactment of this bill is not expected to have an inflationary impact on prices and costs in the operation of the national economy.

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 and existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

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PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 279. INTEREST ON INDEBTEDNESS INCURRED BY CORPORATION TO ACQUIRE STOCK OR ASSETS OF ANOTHER CORPORATION

(a) GENERAL RULE.—No deduction shall be allowed for any interest paid or incurred by a corporation during the taxable year with respect to its corporate acquisition indebtedness to the extent that such interest exceeds—

(1) $5,000,000, reduced by

(2) the amount of interest paid or incurred by such corporation during such year on obligations (A) issued after December 31, 1967, to provide consideration for an acquisition described in paragraph (1) of subsection (b), but (B) which are not corporate acquisition indebtedness.

(b) CORPORATE ACQUISITION INDEBTEDNESS.—For purposes of this section, the term "corporate acquisition indebtedness" means any obligation evidenced by a bond, debenture, note, or certificate or other evidence of indebtedness issued after October 9, 1969, by a corporation (hereinafter in this section referred to as "issuing corporation") if—

(1) such obligation is issued to provide consideration for the acquisition of—

(A) stock in another corporation (hereinafter in this section referred to as "acquired corporation"), or

(B) assets of another corporation (hereinafter in this section referred to as "acquired corporation") pursuant to a plan under which at least two-thirds (in value) of all the assets (excluding money) used in trades and businesses carried on by such corporation are acquired,

(2) such obligation is either—

(A) subordinated to the claims of trade creditors of the issuing corporation generally, or

(B) expressly subordinated in right of payment to the payment of any substantial amount of unsecured indebtedness, whether outstanding or subsequently issued, of the issuing corporation,

(3) the bond or other evidence of indebtedness is either—

(A) convertible directly or indirectly into stock of the issuing corporation, or

(B) part of an investment unit or other arrangement which includes, in addition to such bond or other evidence of indebtedness, an option to acquire, directly or indirectly, stock in the issuing corporation, and

(4) as of a day determined under subsection (c)(1), either—

(A) the ratio of debt to equity (as defined in subsection (c)(2)) of the issuing corporation exceeds 2 to 1, or

(B) the projected earnings (as defined in subsection (c)(3)) do not exceed 3 times the annual interest to be paid or incurred (determined under subsection (c)(4)).

(c) RULES FOR APPLICATION OF SUBSECTION (b)(4).—For purposes of subsection (b)(4)—

(1) TIME OF DETERMINATION.—Determinations are to be made as of the last day of any taxable year of the issuing corporation in which it issues any obligation to provide consideration for an acquisition described in subsection (b)(1) of stock in, or assets of, the acquired corporation.

(2) RATIO OF DEBT TO EQUITY.—The term "ratio of debt to equity" means the ratio which the total indebtedness of the issuing corporation bears to the sum of its money and all its other assets (in an amount equal to their adjusted basis for determining gain) less such total indebtedness.

(3) PROJECTED EARNINGS.—

(A) The term "projected earnings" means the "average annual earnings" (as defined in subparagraph (B)) of—

(i) the issuing corporation only, if clause (ii) does not apply, or

(ii) both the issuing corporation and the acquired corporation, in any case where the issuing corporation has acquired control (as defined in section 368(c)), or has acquired substantially all of the properties, of the acquired corporation.

(B) The average annual earnings referred to in subparagraph (A) is, for any corporation, the amount of its earnings and profits for any 3-year period ending with the last day of a taxable year of the issuing corporation described in paragraph (1), computed without reduction for—

(i) interest paid or incurred,

(ii) depreciation or amortization allowed under this chapter,

(iii) liability for tax under this chapter, and

(iv) distributions to which section 301(c)(1) applies (other than such distributions from the acquired to the issuing corporation),

and reduced to an annual average for such 3-year period pursuant to regulations prescribed by the Secretary or his delegate. Such regulations shall include rules for cases where any corporation was not in existence for all of such 3-year period or such period includes only a portion of a taxable year of any corporation.

(4) ANNUAL INTEREST TO BE PAID OR INCURRED.—The term "annual interest to be paid or incurred" means—

(A) if subparagraph (B) does not apply, the annual interest to be paid or incurred by the issuing corporation only, determined by reference to its total indebtedness outstanding, or

(B) if projected earnings are determined under clause (ii) of paragraph (3)(A), the annual interest to be paid or incurred by both the issuing corporation and the acquired corporation, determined by reference to their combined total indebtedness outstanding.

(5) SPECIAL RULES FOR BANKS AND LENDING OR FINANCE COMPANIES.—With respect to any corporation which is a bank (as defined in section 581) or is primarily engaged in a lending or finance business—

(A) in determining under paragraph (2) the ratio of debt to equity of such corporation (or of the affiliated group of which such corporation is a member), the total indebtedness of such corporation (and the assets of such corporation) shall be reduced by an amount equal to the total indebtedness owed to such corporation which arises out of the banking business of such corporation, or out of the lending or finance business of such corporation, as the case may be;

(B) in determining under paragraph (4) the annual interest to be paid or incurred by such corporation (or by the issuing and acquired corporations referred to in paragraph (4)(B) or by the affiliated group of which such corporation is a member) the amount of such interest (determined without regard to this paragraph) shall be reduced by an amount which bears the same ratio to the amount of such interest as the amount of the reduction for the taxable year under subparagraph (A) bears to the total indebtedness of such corporation; and

(C) in determining under paragraph (3)(B) the average annual earnings, the amount of the earnings and profits for the 3-year period shall be reduced by the sum of the reductions under subparagraph (B) for such period.

For purposes of this paragraph, the term "lending or finance business" means a business of making loans or purchasing or discounting accounts receivable, notes, or installment obligations.

(d) TAXABLE YEARS TO WHICH APPLICABLE.—In applying this section—

(1) FIRST YEAR OF DISALLOWANCE.—The deduction of interest on any obligation shall not be disallowed under subsection (a) before the first taxable year of the issuing corporation as of the last day of which the application of either subparagraph (A) or subparagraph (B) of subsection (b)(4) results in such obligation being corporate acquisition indebtedness.

(2) GENERAL RULE FOR SUCCEEDING YEARS.—Except as provided in paragraphs (3), (4), and (5), if an obligation is determined to be corporate acquisition indebtedness as of the last day of any taxable year of the issuing corporation, it shall be corporate acquisition indebtedness for such taxable year and all subsequent taxable years.

(3) REDETERMINATION WHERE CONTROL, ETC., IS ACQUIRED.—If an obligation is determined to be corporate acquisition indebtedness as of the close of a taxable year of the issuing corporation in which clause (i) of subsection (c)(3)(A) applied, but would not be corporate acquisition indebtedness if the determination were made as of the close of the first taxable year of such corporation thereafter in which clause (ii) of subsection (c)(3)(A) could apply, such obligation shall be considered not to be corporate acquisition indebtedness for such later taxable year and all taxable years thereafter.

(4) SPECIAL 3-YEAR RULE.—If an obligation which has been determined to be corporate acquisition indebtedness for any taxable year would not be such indebtedness for each of any 3 consecutive taxable years thereafter if subsection (b)(4) were applied as of the close of each of such 3 years, then such obligation shall not be corporate acquisition indebtedness for all taxable years after such 3 consecutive taxable years.

(5) 5 PERCENT STOCK RULE.—In the case of obligations issued to provide consideration for the acquisition of stock in another corporation, such obligations shall be corporate acquisition indebtedness for a taxable year only if at some time after October 9, 1969, and before the close of such year the issuing corporation owns 5 percent or more of the total combined voting power of all classes of stock entitled to vote of such other corporation.

(e) CERTAIN NONTAXABLE TRANSACTIONS.—An acquisition of a corporation of which the issuing corporation is in control (as defined in section 368(c)) in a transaction in which gain or loss is not recognized shall be deemed an acquisition described in paragraph (1) of subsection (b) only if immediately before such transaction (1) the acquired corporation was in existence, and (2) the issuing corporation was not in control (as defined in section 368(c)) of such corporation.

(f) EXEMPTION FOR CERTAIN ACQUISITIONS OF FOREIGN CORPORATIONS.—For purposes of this section, the term "corporate acquisition indebtedness" does not include any indebtedness issued to any person to provide consideration for the acquisition of stock in, or assets of, any foreign corporation substantially all of the income of which, for the 3-year period ending with the date of such acquisition or for such

part of such period as the foreign corporation was in existence, is from sources without the United States.

(g) AFFILIATED GROUPS.—In any case in which the issuing corporation is a member of an affiliated group, the application of this section shall be determined, pursuant to regulations prescribed by the Secretary or his delegate, by treating all of the members of the affiliated group in the aggregate as the issuing corporation, except that the ratio of debt to equity of, projected earnings of, and annual interest to be paid or incurred by any corporation (other than the issuing corporation determined without regard to this subsection) shall be included in the determinations required under subparagraphs (A) and (B) of subsection (b)(4) as of any day only if such corporation is a member of the affiliated group on such day, and, in determining projected earnings of such corporation under subsection (c)(3), there shall be taken into account only the earnings and profits of such corporation for the period during which it was a member of the affiliated group. For purposes of the preceding sentence, the term "affiliated group" has the meaning assigned to such term by section 1504(a), except that all corporations other than the acquired corporation shall be treated as includible corporations (without any exclusion under section 1504(b)) and the acquired corporation shall not be treated as an includible corporation.

(h) CHANGES IN OBLIGATION.—For purposes of this section—

(1) Any extension, renewal, or refinancing of an obligation evidencing a preexisting indebtedness shall not be deemed to be the issuance of a new obligation.

(2) Any obligation which is corporate acquisition indebtedness of the issuing corporation is also corporate acquisition indebtedness of any corporation which becomes liable for such obligation as guarantor, endorser, or indemnitor or which assumes liability for such obligation in any transaction.

(i) CERTAIN OBLIGATIONS ISSUED AFTER OCTOBER 9, 1969.—For purposes of this section, an obligation shall not be corporate acquisition indebtedness if issued after October 9, 1969, to provide consideration for the acquisition of—

(1) stock or assets pursuant to a binding written contract which was in effect on October 9, 1969, and at all times thereafter before such acquisition, or

(2) stock in any corporation where the issuing corporation, on October 9, 1969, and at all times thereafter before such acquisition, owned at least 50 percent of the total combined voting power of all classes of stock entitled to vote of the acquired corporation.

[Paragraph (2) shall cease to apply when (at any time on or after October 9, 1969) the issuing corporation has acquired control (as defined in section 368(c)) of the acquired corporation.]

(j) EFFECT ON OTHER PROVISIONS.—No inference shall be drawn from any provision in this section that any instrument designated as a bond, debenture, note, or certificate or other evidence of indebtedness by its issuer represents an obligation or indebtedness of such issuer in applying any other provision of this title.

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94TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 94-1345

INTEREST ON CORPORATE DEBT TO ACQUIRE ANOTHER CORPORATION

JULY 19, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

REPORT

[To accompany H.R. 7929]

The Committee on Ways and Means, to whom was referred the bill (H.R. 7929) relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is as follows:

Page 1, strike out line 9 and insert:

> to taxable years ending after October 9, 1969. If refund or credit of any overpayment of income tax resulting from the amendment made by subsection (a) is prevented on the date of the enactment of this Act, or at any time within 1 year after such date, by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within 1 year from such date.

H. R. 7929

Ninety-fourth Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Monday, the nineteenth day of January, one thousand nine hundred and seventy-six

An Act

Relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (i) of section 279 of the Internal Revenue Code of 1954 (relating to interest on indebtedness incurred by a corporation to acquire stock or assets of another corporation) is amended by striking out the last sentence thereof.

(b) The amendment made by subsection (a) shall apply to taxable years ending after October 9, 1969. If refund or credit of any overpayment of income tax resulting from the amendment made by subsection (a) is prevented on the date of the enactment of this Act, or at any time within one year after such date, by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year from such date.

Speaker of the House of Representatives.

Vice President of the United States and
President of the Senate.