CERTAIN COMMITTEE AMENDMENTS TO H.R. 10612

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

CERTAIN COMMITTEE AMENDMENTS TO

H.R. 10612

JULY 20, 21, AND 22, 1976

(Part 1 of 2 Parts)

Oral Testimony

July 20 and 21, 1976

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

74-712 O WASHINGTON : 1976

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $3.95

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CERTAIN COMMITTEE AMENDMENTS TO H.R. 10612

TUESDAY, JULY 20, 1976

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met at 9:05 a.m., pursuant to call, in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Talmadge, Hartke, Ribicoff, Byrd, Jr., of Virginia, Nelson, Gravel, Bentsen, Haskell, Curtis, Fannin, Hansen, Dole, Packwood, Roth, Jr., and Brock.

The CHAIRMAN. The committee will come to order.

The Finance Committee this morning begins 3 days of hearings on various provisions of the bill H.R. 10612, the Tax Reform Act of 1976. These hearings will give us an opportunity to hear testimony on the bill as it has been amended by the Committee and by the Senate.

In its present form, the bill contains provisions which, because they arose after our hearings or for other reasons, may not have been the subject of public comment. In addition, there are amendments which the committee agreed to recommend to the Senate on the floor. A description of the provisions which will be covered in the hearings was contained in the committee's press release of July 4.

Complaints have been voiced by several Senators that a number of provisions were added to the bill by the committee without sufficient public notice or comment. It is our intention in these hearings to allay such concern.

For several months we have been committed to a deadline which has denied the committee the time needed to explore all amendments as thoroughly as we would like. Everyone familiar with the legislative process knows that the need to move expeditiously has frequently forced the Senate to adopt amendments on the floor with the understanding they would be more thoroughly considered in conference.

This committee has on occasion been forced to make decisions under the pressure of a deadline with the clear understanding that its decisions will be more thoroughly considered at a later date, either in committee or in the next stage of the legislative process.

Tax legislation has been the subject of open discussion and debate throughout the Ninety-fourth Congress. The House Ways and Means Committee spent more than a year initiating this legislation. It conducted extensive public hearings and drafted the bill in public session.

The Finance Committee, for its part, held 20 days of hearings and heard testimony from 265 witnesses and it met in this room. In addition, the committee met in open markup in this hearing room over a period of 21 days. Extensive briefing materials were made available in advance to the members of this committee and to the public prior to each day's work. Committee decisions were recorded in detailed and often lengthy press releases which were made available almost immediately to the press and the public. By agreement, the committee's decisions were tentative and subject to reconsideration at the request of any member at any time. In this manner, committee decisions were subject to ongoing review and refinement. The public and media, from the beginning, have been involved in the legislative process to an unprecedented extent.

Accordingly, I believe the criticism of the committee's procedures is unwarranted. It is impossible to work against a deadline, and at the same time do business as though no deadline existed.

At the heart of the criticism of this bill is a fundamental disagreement over what tax legislation should do and what tax reform should be.

When you get down to specifics, you find as many different views of tax reform as there are people whose opinion you ask. Tax reform is in the eye of the beholder, and nothing but insufferable conceit would cause anyone to believe that his view is always right and that of others is always wrong.

Some people start with the premise that the Government has primary rights in all income and wealth. I don't share that view; nor do the American people.

Some people think tax reform is the way to finance large new spending programs. I don't agree; nor do the American people.

Some people believe that good tax reform can ignore the need for investment, capital formation, increased productivity, and expanded economic opportunities. Tax policy is a vital factor in assuring adequate investment to finance economic growth, and we should encourage it.

Finally, some people fail to understand that our tax laws are complex because our economy is complex and that to impose an invariable rule of uniformity to situations which are not uniform injects inconsistency and inequity into our tax laws.

I don't support every provision of this bill. I voted against several of its major provisions. However, the number of provisions that I favor vastly outnumber the provisions that I oppose.

I have a view of tax reform which I believe to be shared by a majority of my colleagues in the Congress and a majority of the American people. In fact, part of that view was adopted by me precisely because I believe it to be the view of the Senate and that of the American people. I believe that our goals should be tax simplification and the elimination of unjustified exemptions and deductions, not so we can raise effective tax rates but so that we can reduce them. An improved tax system would increase economic activity and in doing so it would yield us more revenue at lower rates. We should make certain that all taxpayers pay their fair share, but not by raising the tax rates of businesses and individuals to the point that they are counterproductive.

This is what the committee attempted to accomplish in the Tax Reform Act of 1976. We have proposed more than $1 billion in new taxes aimed at those who do very well and pay very little in the way of income taxes. At the same time, we have tried to reduce the tax burden of lower income taxpayers and those taxpayers who are paying too much to the Federal Treasury already.

Many of the committee's decisions will simplify our tax laws. For example, under the committee bill it is estimated that an additional 9 million taxpayers will begin using the standard deduction. This means that about 40 percent of those who presently itemize their deductions will shift to the simplified approach in the near future. In addition, under the committee bill, 92 percent of taxpayers will use simplified tax tables. Likewise, little attention has been given by the media to the approximately 50 committee decisions—including a major change in the minimum income tax—which close loopholes in present law.

These are the objectives which have guided the committee in its work and these are the issues which we will explore in our hearings during the next few days.

[The press release announcing these hearings follows:]

FINANCE COMMITTEE TAKES FURTHER ACTION ON H.R. 10612

The Honorable Russell B. Long (D., La.), Chairman of the Committee on Finance, announced that the Committee had agreed to defer consideration (i.e., to delete from H.R. 10612 and consider in the context of future legislation) a number of provisions previously agreed to as Committee amendments to H.R. 10612 in the Tax Reform Act. In addition, he noted that the Committee also agreed to modify certain provisions previously agreed to as amendments to the bill.

Set forth below is an itemized list of those provisions on which the Committee has agreed to defer consideration. They are referred to by section number in the bill and by item number and page number in the Committee pamphlet entitled, "Description of Provisions Listed for Further Hearings by the Committee on Finance on July 20, 21, and 22, 1976" dated July 19, 1976.

PROVISIONS ON WHICH ACTION HAS BEEN DEFERRED

Sec. 1021. Investment in U.S. Property by Controlled Foreign Corporations.

The Committee has deferred action on two exceptions to section 1021. These exceptions pertain to investments on the continental shelf and investments made after May 21, 1974. See Item 6 at pages 7 and 8 of the July 19 pamphlet.

Sec. 1024 (in part). Shipping Profits of Foreign Corporations.

The Committee has deferred action on two amendments to this section. These provisions would provide exceptions to foreign tax haven rules for shipping income in the case of short-term charters and certain investments in qualified shipping assets. See Item 8c. and d. at pages 10 and 11 of the July 19 pamphlet.

Sec. 1025. Limitation on Definition of Tax Haven Income for Agricultural Products.

See Item 9, page 11 of the July 19 pamphlet.

Sec. 1031. Repeal of the Per-country Foreign Tax Credit Limitation.

The Committee agreed to defer consideration of the special transition rules previously agreed to for mining companies and to businesses operating in Puerto Rico and other U.S. possessions. See item 10, page 12 of the July 19 pamphlet.

Sec. 1035(a). Transitional Rule for Carryback of Foreign Taxes on Oil and Gas Extraction Income.

See Item 12, page 15 of the July 19 pamphlet.

Sec. 1035(b). Transitional Rule for Recapture of Foreign Oil-related Losses.

See Item 13, page 16 on the July 19 pamphlet.

Sec. 1035(c). Definition of Foreign Oil-related Income.

The Committee agreed to defer action on two amendments which relate to the definition of foreign oil-related income in the case of a regulated public utility and in the case of the sale of stock in a foreign corporation joining in the filing of a consolidated return with a U.S. corporation. See Item 14b. and c., pages 16–18 of the July 19 pamphlet.

Sec. 1035(e). Creditable Taxes on Oil Payments Where No Economic Interest Exists.

See Item 16, page 19 of the July 19 pamphlet.

Sec. 1042. Sale or Exchanges Giving Rise to Dividends.

See Item 21, page 23 of the July 19 pamphlet.

Sec. 1052(b). Western Hemisphere Trade Corporations.

The Committee agreed to defer consideration of a special transition rule relating to Western Hemisphere Trade Corporations primarily engaged in mining and related transportation. See Item 24, page 28 of the July 19 pamphlet.

Sec. 1305. Prepublication Expenses.

See Item 28, page 32 of the July 19 pamphlet.

Sec. 1307. Treatment of Face Amount Certificates.

See Item 29, page 34 of the July 19 pamphlet.

Sec. 1311. Certain Franchise Transfers.

See Item 32, page 38 of the July 19 pamphlet.

PROVISIONS WHICH THE COMMITTEE HAS AGREED TO MODIFY

Sec. 802. Refunds of Unutilized Investment Tax Credits.

The Committee agreed to substitute a provision which would allow taxpayers to claim unused investment tax credits earned in prior years against current tax liability before applying investment tax credits earned in the current year against such liability. If the sum of prior year credits exceeds the amount of current tax liability which may be offset, unused credits from the most recent prior years and from the current year are to be carried forward to the next year. See Item 2 at page 4 of the July 19 pamphlet.

Sec. 1024 (in part). Shipping Profits of Foreign Corporations.

The Committee agreed to modify the provision granting an exception to the tax haven provisions in the case of drilling rig service companies. The Committee agreed to modify the provision so that it would be limited to activities on the continental shelf of the country in which the owner of the vessel is organized and the vessel is registered. See Item 8b., page 10 of the July 19 pamphlet.

Sec. 1035(f). Foreign Tax Credits Arising Through Oil and Gas Production Sharing Contracts.

The Committee agreed to revise this provision so that it will apply only to production-sharing contracts entered into before April 8, 1976, and will apply only with respect to taxes designated as having been paid under such contracts in taxable years beginning on or before January 1, 1977. See Item 17, page 20 of the July 19 pamphlet.

Sec. 1308. Income From Lease of Intangible Property as Personal Holding Company Income.

The Committee agreed to modify this provision to make it clear that it applies only where intangible property is rented in conjunction with a substantial part of the tangible property and both the intangible and tangible property are used in connection with the active conduct of a trade or business. In addition, the provision was broadened so that it will apply whether or not the person using the property is a shareholder of the corporation receiving rental payments from the leasing of such property. See item 30, pages 36 and 37 of the July 19 pamphlet.

Sec. 1507. Extension of Study of Salary Reduction and Cash or Deferred Profit-sharing Plans.

The Committee agreed to shorten the time granted for Congressional study of these areas to January 1, 1978. See item 42, page 50 of the July 19 pamphlet.

Sec. 2001. Residential Insulation Credit.

The Committee agreed to modify this provision. The credit will now not apply to the installation of clock thermostats. See item 46, page 55 of the July 19 pamphlet.

ADDITIONAL SUBMISSIONS IN SUPPORT OF PROVISIONS ON WHICH THE COMMITTEE HAS AGREED TO DEFER CONSIDERATION

The Committee also agreed persons interested in any of the provisions on which the Committee has deferred consideration would be afforded an opportunity to submit in writing any additional information not previously furnished which they may wish to bring to the attention of the Committee. Such information will assist the Committee in its additional deliberations with respect to those

proposed changes. Five copies of any additional material should be submitted to Michael Stern, Staff Director, Committee on Finance, 2227 Dirksen Senate Office Building, not later than Friday, August 20.

The CHAIRMAN. Our first witness today will be the Honorable Edward M. Kennedy.

Senator HASKELL. Mr. Chairman.

Senator RIBICOFF. Mr. Chairman.

The CHAIRMAN. I will call Senator Ribicoff first, and then Senator Haskell.

Senator RIBICOFF. Mr. Chairman, I am managing the Watergate Reform Act which has the first track during these coming days and while I want to stay here as long as I can, once I get a call from the floor I will have to leave to ~~go to the floor~~ to manage that bill, so if I am absent you will understand why. I will stay as long as I am allowed to.

Senator HASKELL. Mr. Chairman, I wonder if I could be permitted to make a statement.

I would concur with the chairman that people's views on what is tax reform can vary and that people can very legitimately have different viewpoints on that subject but what I would like to explore, however, and I would hope the chairman would agree with me, is a procedure that can be used by this committee in the future. Allegedly many of the provisions in the bill now on the Senate floor and some of the provisions to be the subject of this hearing are designed to help specific taxpayers thwart a tax bill. That is alleged, and it may be true or it may not be true. I think the hearing would be helpful in this regard. My concern is that if it is true, we develop a procedure which will not allow this to happen again.

Now I agree, and I think it is entirely appropriate, to have relief bills and tax matters as relief bills in any other matter but I would hope the committee would be thoughtful in developing a procedure where we can actually process relief bills as such and labeled as such assuming that the allegations made by the outside groups are correct.

The CHAIRMAN. Senator, we have made a great number of changes in the way we do business. So far as I am concerned, that is what reform is supposed to be, a change for the better. We will certainly entertain your idea and any other suggestions that someone has to make.

The way this committee operated in earlier days was far different from the way we do business today. Our predecessors were great men. As a matter of fact, all five Senators who were as great Senators some years back had served on this Finance Committee back in the days when they operated under a different procedure.

I thought that procedure was somewhat out of date. For one thing, there were only two telephone lines to this committee before I became chairman, and sometimes ~~500~~ people were trying to reach the committee at the same time to get information. We have changed a lot—I hope for the better.

We will certainly entertain your suggestion; I think we ought to discuss it later, however.

Senator HARTKE. Mr. Chairman, I have been called from the floor and although I am not on the Judiciary Committee I have been asked to manage part of the Watergate bill and will have to go to the floor. I will return as soon as possible.

The CHAIRMAN. Senator Kennedy.

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STATEMENT OF HON. EDWARD M. KENNEDY, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator KENNEDY. Thank you very much, Mr. Chairman.

I wonder if I could invite Senator Proxmire who is similarly interested in this provision to sit at the table. We are testifying jointly, Mr. Chairman.

I want to express at the outset my appreciation for the calling of these hearings and to submit my statement. You have a very complete list of witnesses here this morning and I would like to make my remarks relatively brief, but also I would hope that their brevity does not diminish what I consider to be their basic importance and usefulness and constructiveness and hopefully they will be interpreted that way by the members of the committee.

Mr. Chairman, you outlined in your opening comment and statement the differing views about tax reform and the particular issues we have been debating for the past 3 weeks on the floor of the U.S. Senate. We will continue to debate these issues, and we acknowledge that the chairman of this committee has been more persuasive than those of us who have been offering amendments during that discussion.

I do not intend to take the time of this committee to review some of the various proposals that we debated or discussed during that time or the questions that might come up before us during the remainder of the debate on the legislation.

We have differing views on a number of those proposals, and the place to resolve those ultimately is on the floor of the U.S. Senate and that is where they will be resolved.

My intention today, however, is to try and propose a procedure which might be considered by this committee. We shall differ on the substance of the various provisions but hopefully we can agree on the procedures which will be followed—procedures which basically have been accepted by the House Ways and Means Committee, the merits of which I hope would be appreciated by this committee.

I am sure they would be accepted by the Senate as a whole and by the American people. In the areas of the particular provisions which have been added which aid either individuals or individual companies, we could follow precisely the provisions that have been advanced by the House Ways and Means Committee that would permit the publication in advance of those various provisions, invite comment by the IRS and by the Treasury Department, indicate the amount of revenue loss and the beneficiaries of the provisions. I agree that there are some instances where individuals and individual companies need the kind of tax relief that can be included in legislation which comes from this Finance Committee.

We legislate in a general way. Obviously there are going to be interests adversely affected by general legislation in ways that Congress did not intend. They have to be remedied and so we accept that and we recognize and we feel that the best way that can be achieved is by the procedures which we have outlined here this morning.

There are also instances where provisions fall within a gray area, and there are a number of provisions which I feel are unjustified and unwarranted and involve tax expenditures of hundreds of millions that quite frankly have not received the kind of scrutiny by this committee that similar provisions would have received if they were in the form of authorizations and appropriations by other committees, and I do think that this situation should be remedied.

My precise recommendations, Mr. Chairman, with regard to the legislation——

The CHAIRMAN. If I can stop you at this point Senator, let me make this clear.

Senator KENNEDY. Yes.

The CHAIRMAN. Somewhat like you, Senator, I didn't make this world. I was born into it and I hope it will be a better place because the good Lord put me here temporarily and I would wish you the same result. [Laughter.]

Senator KENNEDY. Thank you, Mr. Chairman. [Laughter.]

The CHAIRMAN. About the best we can do is to try to move things to what we think will reach that end.

Now did I say I have changed some things? I am not sure I am always right. In fact, I don't believe anyone on this side of heaven is always right.

I will continue to do what I can to improve matters. I will be happy to have your views and if you don't object too much I will make available some of mine to you also.

Senator KENNEDY. Well, you have always done that. [Laughter.]

I intend to meet my responsibilities on these provisions in this legislation, Mr. Chairman, as a result of this hearing. I have outlined in my statement and comments the areas of prime concern that I have and I have listed some of those in the testimony; the recycling tax credit which is basically a windfall to the recycling industry and costs the Treasury up to $345 million. The refundable credit designed for the benefit of airlines and utilities costs $300 to $500 million. The chairman of this committee remembers very well the debate that we had on Lockheed when we were directing appropriations of hundreds of millions of dollars and the very closeness of that vote. Here we are providing benefits of anywhere from $300 to $500 million.

Some energy and oil provisions, benefiting Exxon and Mobil and other giants; the Natomas provision; the Sun Oil provision; the shipping industry provisions; the life insurance provision; and the provision for the giant U.S. grain exporters.

What I would hope on these, Mr. Chairman, is that we can have the guidance of IRS and the Treasury Department and the testimony that is raised here, in light of their importance and consequence. These provisions are so significant and the implications are so significant that if there is controversy surrounding those provisions, action should be deferred to another time until we can have the complete process and analysis that we have outlined in our statement.

If, with the views of Treasury Department and the Internal Revenue Service and the results of these hearings, there is not really any controversy about a provision, then I would hope that the provisions would remain in the legislation.

So those are the two primary recommendations that I have, Mr. Chairman—the establishment of procedures which would strengthen the understanding and awareness of the implications of these various provisions and strengthen the public's confidence in the committee's procedures; and with regard to the particular provisions included in the bill, if they can stand the scrutiny of these hearings and the recommendations of Treasury and IRS, they should be retained in the bill and the others deferred to a later time.

Finally, I thank the committee for the opportunity of being able to comment and make these recommendations and I hope that procedures can be developed as Senator Haskell and Senator Hathaway and other members of this committee have urged this committee to follow.

The CHAIRMAN. Well, Senator, for many years I have benefited from the philosophy of a group which did the best they could to direct their appeal toward Congress as well as all the people.

One of their principles was that none of these things should be decided based on who is right; they ought to be decided based on what is right.

Now, it is fine to identify someone who might benefit from a provision that we write into the tax law. I would like to think by now that I have been able to add something to the tax laws that would benefit everybody in this country, and most of them in more ways than one.

Even so, the question should be whether a provision is right—not so much who sponsored it, but whether it is what should be done.

Now, I would appreciate it if you would review your statement and let us know which provisions you think are wrong—not necessarily because they involved particular taxpayers. If a provision is right, I think you ought to do it, regardless of what taxpayer should be affected. If it is wrong, I don't think you should do it under any circumstances, no matter who is affected, be he the lowest or the highest.

Senator KENNEDY. Mr. Chairman, in any of my comments in referring to these particular provisions I have made it very clear that I felt that probably a third were completely justified, a third generally fell into a gray area, and a third were unwarranted.

I have my own particular views. The principal value I can serve here today is in urging the committee to establish a procedure so that the committee can receive recommendations from the Treasury Department and from the IRS and from its own obviously highly qualified and highly trained staff and that those matters can be made a part of the record.

We have no opportunity, for example, to examine the record of the Senate Finance Committee executive session to know what discussion took place about any of these various provisions themselves.

I asked to review it just in terms of the preparation for this particular meeting. It does not exist. I think it is important. Various provisions have been put before the Senate in the Senate Finance Committee bill, and we have no record on them.

I am hopeful as a result of these 3 days of hearings that both this committee and the Senate itself will have a more complete understanding and awareness of the implications of the provisions.

I would hope in terms of the future that we could establish the kinds of procedures which I would think would be welcomed by this committee and which I am sure would receive the support of the Members of the Senate. That is really the purpose of my appearance here, although I would be glad to make recommendations in terms of the particular provisions. We made some references to them in the course of the statement and I would be glad to supplement them in any way that the committee thinks would be useful.

The CHAIRMAN. Senator, we are happy to have your suggestion. May I give you a suggestion to take back to the committee on which you serve, because I think they might be able to improve their way of doing business also.

In this committee, when somebody brings up a suggestion we try to decide then and there, if we can, what we are going to do about it. If subsequently someone thinks about the matter and decides that that was not a good idea, we will reconsider it any time he wants to and as many times as he wants to do so. Sometimes we will have a position that will be considered a dozen times before we finally report that bill to the Senate. You would be surprised how much we can get done when we move on that basis.

Now any time we find ourselves in error, everyone ought to be willing to reconsider his position—even despite pride of authorship. That permits us to proceed a lot more rapidly than some people proceed on some occasions.

If something is agreed to, anytime someone finds something that can be in error, the matter can be reconsidered. It takes only one person to request reconsideration.

Senator KENNEDY. Senator, that is not a point I take issue with. The procedure I take issue with is the fact that there has been no orderly procedure established by the committee which invites the Treasury Department to make a judgment or a recommendation on these various special provisions or invites the Internal Revenue Service to make a judgment or provides for the publication of these various provisions in the Congressional Record.

The procedures that were followed in the area of the special provisions which I referred to did not allow for very much consideration, because most of them were considered in the final hours of the markup of the legislation. It is to try and deal effectively with that situation that I made these recommendations.

The CHAIRMAN. I am always pleased to have the views of the Treasury and they are available to us right now so that I believe you have them, too, Senator.

Anybody who wants the Treasury's views is privileged to have it. Sometimes I agree with them, and when I do I think the Treasury is very wise. I don't always agree.

Thank you.

Senator KENNEDY. Thank you very much, Senator.

[The written statement of Senator Kennedy follows:]

TESTIMONY OF SENATOR EDWARD M. KENNEDY

I am pleased to appear this morning before the Committee on Finance, and to testify at these hearings on various "special interest" provisions in the pending tax reform legislation now on the Senate floor.

I welcome the hearing and the opportunity they afford for a fuller public airing and discussion of these numerous provisions, whose presence in the bill has become a source of controversy and concern to many of us involved in tax reform and the debate on the pending legis'ation.

At the outset let me say that, given the time available, it will require an effort comparable to the twelve labors of Hercules for the Committee and the Senate to reach an informed judgment on all of the complex provisions that are the subject of this week's hearings. The Committee's press release of July 8 lists 53 sections of the bill itself that are to be considered plus 18 additional provisions in the amendments which are to be offered as committee amendments to the bi'l but the details of which are not yet available.

Quite properly, these special interest provisions have become the subject of widespread public concern. Few things are more calculated to destroy the confidence of ordinary taxpayers in the fairness of the nation's tax laws than the mushrooming suspicion that numerous provisions are being surreptitiously written into the laws for the special benefit of certain wealthy individuals and corporations.

One of the first questions is whether all of the special interest provisions in the bill have come to light. Virtually all of the provisions listed as subjects of these hearings are those that had been identified by various public interest groups. To some extent, it requires a Sherlock Holmes to detect a special interest provision. I hope that the committee, as part of its new procedures for dealing with this issue, will be able to assure the Senate that all such provisions have been brought to light.

The special interest measures identified so far have had varying characteristics:

Some are written so narrowly that they are obviously intended to benefit only a single individual or corporation. Their hallmark is their "one-eyed bearded nan-with-a-limp" language—tax "fingerprints" designed to fit only one taxpayer. Sometimes, the provision leaps out from the page, revealing itself because of its narrow language in the midst of an otherwise general provision. Occasionally, as in the case of the Southern Scrap Material Co. provision, the language is drafted so narrowly that even the intended beneficiary fails to meet the test.

Other provisions have a larger group of beneficiaries, because they are designed to benefit favored industries like oil and waste recyclers, by giving them new tax advantages not available to less fortunate taxpayers.

In other cases, the special provisions are intended to reverse an unfavorable IRS ruling or court decision. In this way, taxpayers try to short-circuit the administrative process or bypass the courts. They skew the tax laws by obtaining redress from Congress that they cannot get on the merits from the executive or judicial branches of the government. In effect, these taxpayers are legally taking the law into their own hands, but in ways not open to the ordinary taxpayer without such ready access to the ear of Congress.

Perhaps the most questionable aspect of these provisions is the lack of analysis that many of them have received. That is why I welcome the reopening of the hearings this week, because the hearings can begin the process of close scrutiny and analysis that these provisions must have before they are enacted into law.

It is not too much to say that in many cases, the hand of the lobbyist or big campaign contributor or special interest group has been caught in the Treasury's cookie jar.

I would emphasize, however, that not all of these provisions fall into that category.

If past experience is any guide, the current provisions probably fall roughly into three categories—one third will be found meritorious, one third are in a gray area where the merits are not immediately clear, and one third will turn out to be bad apples.

In cases where a special interest provision does have merit, it is because it is designed to alleviate an unintended hardship caused by the application of a general tax law to a particular situation. Necessarily, Congress cannot always anticipate the precise impact of complex general tax provisions on specific facts and taxpayers. A responsible Congressional procedure is essential, therefore, to assess such situations and determine if relief is appropriate.

What is clear, however, is that the present procedure fails to meet that test. And I have serious doubts that the three days of hearings scheduled this week can do more than scratch the surface of the extremely complex issues involved in assessing the merits of the provisions.

The House of Representatives has developed a way of dealing with special interest provisions in its tax bills, and I would urge the Committee to follow those procedures in judging the provisions of the current bill. Under the House procedures, the following steps are taken:

Notice is given of special interest provisions, and an opportunity for hearings is provided in advance. Proposals are published in the Congressional Record, and staff summaries are prepared. The Treasury Department has an opportunity to consider the proposals and make recommendations on their merit.

Adequate time is also available to find the answers to two of the most crucial questions about these measures: Who receives the benefits? How much revenue loss to the Treasury is involved?

Then, when the necessary information is obtained and the questions are answered, the House Committee assesses the merits of the proposals and votes on whether to enact them into law.

Obviously, a large number of the special interest provisions in the pending bill have not been examined with anything resembling the degree of close scrutiny required for the Senate to judge them accurately. Adequate machinery can and should be developed to deal with future legislation.

But what about the pending bill? The assembly line hearings scheduled for this week can hardly fill the void.

My suggestion is that, given the controversy that has developed, the Committee should reconsider each of the special interest provisions and apply certain rules of thumb so far as the pending bill is concerned:

1. The Treasury Department and the IRS should be asked to analyze and comment on the merits of each provision, and make a recommendation to the Committee.

2. If there is no substantial controversy about a provision—which will usually mean that it is not opposed by either the Treasury or the various public interest groups that have analyzed it—the Senate can give the provision a clean bill of health and allow it to remain in the bill on the Senate floor.

3. But if a provision is the subject of significant controversy—and if it has not had a full and thorough public airing, either as part of the House proceedings or in the course of the earlier Finance Committee hearings—I feel that the Committee should withdraw it from the pending bill for further consideration, under conditions more conducive to accurate judgment than the present situation allows.

Obviously, a decision to defer consideration of a provision does not mean it will be killed. If additional analysis indicates that it is meritorious, there is ample time before the end of this session of Congress for such measures to be brought to the floor for final action.

In addition, some of these special interest provisions involve substantial future revenue losses, which is another ground for serious concern and special scrutiny. Some provisions involve losses running in the hundreds of millions of dollars:

The recycling tax credit, a windfall to the solid waste recycling industry, will cost the Treasury up to $345 million a year.

The refundable investment credit, designed for the benefit of airlines and utilities, will cost the Treasury $300–$400 million.

The ESOP employee stock ownership provision, written in large part to the specifications of AT&T, will cost the Treasury an astronomical $900 million.

Other provisions, particularly those benefitting the oil industry, will run up costs in the tens of millions of dollars:

Exxon, Mobil, and other giants in the Iranian oil consortium stand to gain up to $40 million a year from an exemption to the foreign tax credit rules that repeals part of the Tax Reduction Act of 1975.

Natomas and others involved in Indonesian oil operations stand to gain up to $25 million a year from similar exemptions that would reverse a recent IRS revenue ruling. Natomas also figures in a separate provision, worth up to $10 million a year, which allows a carryback of excess foreign tax credits.

Sun Oil Co. and others involved in North Sea oil operations stand to gain up to $21 million a year from special rules provided for foreign oil losses.

The shipping industry (particularly oil companies, banks and steel companies, who have large shipping fleets) will receive benefits up to $45 million a year from the extension of the investment credit to their so-called "Capital Construction Funds."

The ad hoc consortium of the nation's largest life insurance companies will receive benefits up to $55 million a year through a provision which allows the consolidation of life insurance and casualty insurance operations and which raises complex questions of equity and competition for the entire insurance industry.

The giant U.S. grain exporters will receive benefits up to $17 million a year from changes in the foreign tax rules.

Integrated oil and gas producers with retail sales of $5 million a year or less will receive benefits of up to $18 million a year through a provision restoring their percentage depletion allowances.

Mr. Chairman, it is difficult, if not impossible, to justify any of these provisions. The controversy over their merits is heightened by their substantial revenue loss. They deserve much more careful consideration than they have received so far before they are enacted into law.

And this is only the beginning of the list of special interest provisions that should give the Senate pause. In my statement on the Senate floor on June 28, I listed the special interest provisions in the bill and the beneficiaries known at that time. I am attaching a copy of that list to my testimony. The present hearings will bring substantial new information to bear on these provisions and others more recently identified. I look forward to working with the Committee in analyzing these provisions and in trying to restore the confidence of the average taxpayer in one of our nation's most important resources, the fairness of our tax laws.

Finally, and curiously, the Committee's announcement of these hearings mentions a Senate floor amendment offered by Senators Haskell, Hollings, Hathaway, and myself. The amendment, already adopted by the Senate, provides that limited partners would not be entitled to include in their tax basis any portion of nonrecourse financing obtained by the partnership.

The effect of this provision is to insure that limited partners will not be able to claim deductions for amounts in excess of their actual investment at risk. The amendment, in its application to real estate, is essentially similar to the "at risk" rules already adopted by the Committee and the Senate in the areas of farming, oil exploration, movies and equipment leasing. The estimated revenue loss from the amendment is $5 million in 1977 and $6 million in 1978, rising to $90 million in 1981.

In recent weeks, I have received a number of comments about the amendment which deserve consideration. To assist the Committee and the Senate, the following points on certain aspects of the amendment may be helpful.

First, the amendment is generally applicable to partnerships formed after June 30, 1976. This provision could reasonably be modified in three respects: First, the applicable date could be changed to December 31, 1976. Second, new partnerships formed after that date should be subject to the new rules; so also should limited partners who are admitted to the partnership after December 31, 1976, even if the partnership itself was formed before that date. Third, any substantial changes in investments or activities after December 31, 1976 should be treated as the formation of a new partnership with respect to such activities. These modifications will insure that artificial arrangements are not used to avoid the new rule.

Second, it has been brought to my attention that the law of some states classifies partners as "general partners" even though the nature of their interest is similar to that of a limited partner in other jurisdictions. It is the intent of the amendment that the new rule should apply to any partner whose liability is limited, however that result may be achieved by state law on contractual arrangements.

Third, the amendment provides that partnerships engaged in constructing or rehabilitating low income housing are to be exempt from the new rule until after 1981. The amendment refers to housing programs described in section 1039(b). That reference is technically outdated. The Finance Committee bill redefines low income housing in its proposed new section 1250(a)(1)(C). It is our intention that the exception in the amendment should likewise refer to the broader definition proposed in section 1250(a)(1)(C).

In addition, Mr. Chairman, with respect to the effect on real estate, I am submitting a memorandum prepared by the Library of Congress comparing the "at risk" rule adopted by the Senate with the LAL proposal as approved by the House. Contrary to the reaction of some who oppose the "at risk" amendment, it is actually a relatively mild reform that is likely to have no harmful effect on real estate or the housing and construction industry. Certainly, the extremely modest revenue estimates for the provision belie any deleterious impact on this vital industry.

The provision does stand out, however, as the only one that produces a revenue gain among the entire group of special interest provisions listed by the committee for these hearings.

PARTIAL LIST—SPECIAL INTEREST PROVISIONS IN H.R. 10612, THE TAX REFORM ACT OF 1976

1. Airlines and Utilities (Bill p. 288; report p. 177). Allows refunds for investment credits still unused after seven-year carryforward. Appropriately, the first refunds will occur in 1984. Revenue loss in 1984 estimated at $300–500 million.
2. Chrysler (Bill p. 289; Report p. 178). Two year additional carryforward of investment tax credits and foreign tax credits that expire in 1976.
3. Shipping Industry (Bill p. 323; Report p. 196). Allow investment tax credit for costs of building ships in U.S., even though the construction is financed with

previously untaxed profits in so-called "Capital Construction Funds." Revenue loss: $21 million in 1977; $45 million in 1981.

4. Foreign Trust Beneficiaries (Bill p. 452; Report p. 215); delay House effective date by 8 days for provision taxing grantors on income of foreign trusts.

5. Superior Oil Co. (Bill p. 463; Reports p. 225); retroactive exemption from tax on foreign earnings invested in drilling rig on continental shelf.

6. American Investors Group, Inc. (Bill p. 468; Report p. 229) exempt the firm's Bermuda operation from foreign tax haven rules.

7. Hall Shipping Corporation; Louisiana and Texas Oil Servicing Vessels; Cargill and other grain and commodity exporters. (Bill p. 469; Report p. 230), various exclusions of shipping profits from foreign tax haven rules.

8. Pittsburgh Plate Glass Co.; Freeport Sulphur Co. (Bill p. 478; Report p. 238): three years postponement of change in foreign tax rules for a mining company and for operations of PPG in Puerto Rico.

9. Boise Cascade Corp; Robert Hall Co. (Bill p. 485; Report p. 240); exception from foreign loss recapture rules for Chilean expropriation losses and for liquidation of a clothing company.

10. Natomas Corp. (Bill p. 496; Report p. 246). Special carryback for foreign tax credits or oil.

11. Sun Oil Co. (Bill p. 498; Report p. 247): Special transitional rule for recapture of foreign oil losses for North Sea operations.

12. Major Oil Companies (Bill p. 499; Report p. 248): Expands definition of "oil related income," against which foreign tax credits may be used, to include certain interest income.

13. Tenneco (Bill p. 499; Report p. 250): Benefit under oil-related income provisions for liquidation of Canadian subsidiary.

14. I. U. International Corp. (Bill p. 500; Report p. 250): Allow a Philadelphia conglomerate to consolidate gas utility income and non-oil income.

15. Iranian Oil Consortium (Bill p. 501; Report p. 251): Allow foreign tax credits until 1986, even though Mobil and other U.S. oil companies may no longer own an "economic interest in the oil and gas fields."

16. Natomas Corp. (Bill p. 502; Report p. 253): Reverse IRS ruling denying foreign tax credit for oil in Indonesia production-sharing contracts.

17. American Investors Group (Bill p. 504; Report p. 257): Allow foreign tax credit for income from insurance contracts written in U.S. on overseas risks.

18. H. H. Robertson Co. (Bill p. 516; Report p. 270): Retroactive benefit for a corporate liquidation.

19. Royal Bank of Canada (Bill p. 540; Report p. 276): Favorable capital loss carryforward rule.

20. Hanna Mining Co. (Bill p. 553; Report p. 284): Favorable treatment for a Canadian iron-ore subsidiary under foreign tax rules.

21. Political Consultants (Bill p. 813; Report p. 401): Allow a bad debt deduction in certain cases involving unpaid debts owed by candidates to professional political consultants.

22. Encyclopedia Britannica (Bill p. 814; Report p. 403): Overrule IRS position and allowed research costs and other prepublication expenses to be deducted immediately, rather than depreciation over the life of the publication.

23. Investors Diversified Services (Bill p. 817; Report p. 407): Overrule IRS position that interest on "face amount" certificates must be included currently in income.

24. Coca-Cola Co. (Bill p. 818; Report p. 409): Exempt a particular franchise from the personal holding company rules, which would require tax at 70 percent rate, not 48 percent corporate rate; 12-year retroactivity granted for exemption.

25. Texas Optical Co. (Bill p. 822; Report p. 414): allow capital gains treatment for the transfer of a professional practice before 1970.

26. Marriott Corp. and Restaurant Employee Unions (Bill p. 823; Report p. 416); Reverse IRS ruling requiring employers to include tip income stated on charge account slip in the employers' reports to the IRS.

27. Belco Petroleum Co. (Bill p. 829; Report p. 424): restore oil depletion allowance for independent producers with retail outlets in Israel.

28. Integrated Oil Companies (same); restore depletion allowance for companies with $5 million in retail outlet sales or less. Some of the largest oil and gas companies will benefit.

29. Oil Trusts (same); restore depletion allowance in cases where interests change hands by birth, death, or adoption; restore depletion allowance in certain other cases.

30. Major Life Insurance Companies (Bill p. 920; Report p. 454); permit companies to consolidate life insurance operations with casualty insurance operations.
31. Businessmen's Assurance Co. of America (Bill p. 924; Report p. 457): special treatment for inadvertent dividends; retroactive to 1958.
32. Honeywell (Bill p. 1472; Report p. 550); inclusion of clock thermostats in definition of insulation for which the home insulation credit will be available.
33. General Electric, Westinghouse (Bill p. 1482; Report p. 555); tax credit for residential heat pumps.
34. Union Oil Co.; Pacific Gas and Electric Co: (Bill p. 1498; Report p. 571); allow intangible drilling deduction and 22 percent depletion deduction for geothermal property.
35. Waste Recycling Industry (Bill p. 1503; Report p. 575); tax credit to recyclers for purchase of recyclable solid waste materials. Revenue loss: $9 million in 1977; $345 million in 1981.
36. Eaton Corp. (Bill p. 1515; Report p. 581); equalize treatment of propane and diesel fuel by exempting propane from excise tax.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. No questions.

The CHAIRMAN. Senator Dole?

Senator DOLE. No questions.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. Senator, I am curious if your objection is to the procedure or the substance of the provisions we have adopted even though we had long hearings and discussions of the bill, whether that is your criteria or whether your only real objection is to quite a number of provisions that were adopted in markup without any hearings at all.

Senator KENNEDY. That second is my primary concern Senator. The purpose that I can best serve is recommending that procedures be adopted by this committee similar to those that have been adopted by the House Ways and Means Committee.

I can give various recommendations and we can debate or discuss whether the Sun Oil Co. or the Natomas provision is justified. I think you have made a fair comment, Senator that there are many other instances of legitimate needs by individuals and companies that are not being expressed. They ought to have an opportunity to be heard.

What I am most interested in is that we establish the procedures. I have got my own views with regard to the provisions. I will be glad to debate or discuss those. We will probably have a chance to do it but I don't think that is the purpose of my presence here today—it is to establish a procedure by which this committee can be guided and really the Senate can be guided.

You might hear the Treasury Department or IRS, the Budget Committee or the CBO. What we are talking about is hundreds of millions of dollars in expenditures. That has implications in terms of the economy and in a number of those instances I would have thought the Budget Committee's recommendations would have been of value to this committee in its ultimate determination.

Senator PACKWOOD. I look at your first list of partial independent provisions which is refundable tax credit. That is what we had a couple days' testimony on. I started out against it. I became convinced, although not overwhelmingly, but it certainly had ample hearing and I think fair debate.

I look at another one on No. 30, the major life insurance companies——

Senator KENNEDY. Whether it did, Senator, I would certainly yield to your view. I testified here in terms of the refundable tax ~~credit as a~~ concept. I support it as a concept. This provision carries it beyond the method I proposed. I think it should be an incentive for new investment. Next, old credits are carried forward for 8 years. That is another kind of a question and I am not sure that the record would justify that type of provision, although I recognize that the committee had hearings on the proposal.

Senator PACKWOOD. In fairness we cannot conceivably have hearings on every conceivable thing you might later have legislation on. First, you don't think that far in advance and, second, you don't cover all the points.

I don't think you can say unless it was tacked exactly to some point in the hearings.

Senator KENNEDY. Referring to the airlines and just to the utilities and it is based in terms of their particular problems that they faced in losses over particular years.

Senator PACKWOOD. I understand. I have some misgivings. I changed my mind after the hearing. It was a thought-out deliberate conclusion. You refer to the major life and casualty operations. That again was not a casual decision.

Senator KENNEDY. I know you have had some days of hearings on Senator Ribicoff's proposal.

Senator PACKWOOD. That is right.

Senator KENNEDY. I think it has broad implications as to competition for small casualty companies. Unquestionably the larger companies would like to be able to consolidate their profits and losses. I know the argument is made that ITT can do it and why not a major kind of an insurance company.

The problem is the competitive implications of that particular provision for the middle size and smaller casualty companies. It is quite significant and profound.

I understand that is a factor that is being considered. It has very broad implications in terms of smaller casualty companies in my part of the country that were very much unaware, quite frankly, that this provision was to be put in here.

Senator PACKWOOD. When you say "unaware," I have small casualty companies in Oregon and they have misgivings about this provision but if they are unaware I don't know what to do. It was not secret. There were hearings on the issue and I don't know what more you can do.

The fact that everybody in this country does not know or everybody does not testify should not prevent us from testifying.

Let me ask you a last question. On one of the very last days of the markup, it may have been the last one, I can't recall, Senator Haskell popped out three provisions relating to trusts and the taxation of trusts and frankly totally surprised everybody. The committee turned down some but never a word about any kind of hearing. I take it you want this taken out of the bill.

Senator KENNEDY. I would want it governed by the same procedures that I have recommended here. If it is approved by IRS and the Treasury, and in light of these hearings is not controversial—it should be retained.

Senator PACKWOOD. We are talking about 3 or 4 days of hearings. We simply don't have a chance for a detailed IRS and Treasury analysis.

Senator KENNEDY. The procedures which I have outlined here are the ones being used by the Ways and Means Committee. Public disclosure in the Congressional Record, listing of the costs and beneficiaries, asking Treasury and IRS to make judgments. Whether they overrule a particular IRS ruling, for example, or a court decision would be of interest. Those are matters I hope would be submitted to this committee and the committee make its recommendations. There are going to be areas where we differ but it is the procedures that are important.

Senator PACKWOOD. I think the chairman has indicated we can live by that.

Senator KENNEDY. We don't have that now.

Senator PACKWOOD. I know. What is sauce for the goose is sauce for the gander.

Senator KENNEDY. I agree.

Senator PACKWOOD. I agree with the fact that the so-called reform group has hit this committee pretty hard on these secret provisions, yet it didn't bother the members of the committee who used the same tactic for the things they wanted to spring on this committee.

Senator KENNEDY. Senator Haskell can speak very well and does so eloquently. He is not here now and I wish that particular point could have been raised when he was here. I would hope that whatever provisions are offered, no matter who offered them, could follow these procedures.

Senator PACKWOOD. I would be happy to live with that. I also mean in fairness we would also be guided by the same process in offering amendments on the Senate floor, that we would not spring unknown amendments.

Senator KENNEDY. I have always found, Senator, that you can make a stronger case if you are able to have the position of the Treasury or IRS and be able to present it. I don't think we are ever going to be able to preclude or foreclose anybody.

Senator PACKWOOD. No; it will be offered by some people that I think will have no hearing in this committee or Treasury or any report on the floor.

Senator KENNEDY. I do feel that the amendments offered by our group—Senator Nelson, Senator Mondale, myself, Senator Haskell, Senator Hathaway and other Members—were provisions which were advanced before this Finance Committee durings its consideration.

I specifically testified on every one of those particular provisions and we have tried before to raise them. They are all items that we have had very extensive hearings on.

The CHAIRMAN. Senator Dole.

Senator DOLE. Would it be appropriate to describe your news release as sort of an indictment of this committee and the members of the committee?

Senator KENNEDY. No; I would not use those words, Senator.

Senator DOLE. Well, you made a sort of hit-and-run operation. You come into the committee with a three page statement. You have been on television at a quarter of 8, you have had numerous news releases, you impune the integrity of some of us and we don't like it.

Then you say maybe a third are good, a third are gray and a third are bad. I think we ought to know if we are going to be exonerated by Senator Kennedy or not. The Senator from Kansas would like to know whether his amendments fall in the gray category or good or bad category.

You have advertised this to the Nation. The Senator from Massachusetts carries great weight, a lot of coverage. I think we have a right to know that.

Senator KENNEDY. Senator, I think the American people have a right to have an adequate procedure that is going to be followed by the tax writing committee on these provisions. We need to know the implications of any of the recommendations in terms of what it is going to cost the Treasury, what its implications are going to be in terms of the Internal Revenue Service, and also what its budgetary implications are going to be, so we have a full and complete record.

That is what I am advocating. That is not what has been done. That is not the procedure which has been followed by this committee and it is what I am recommending, Senator, to this committee.

It is being followed by the Ways and Means Committee in the House of Representatives and it seems to me that it is not asking too much for this committee to follow those similar procedures, so the members of the committee and Members of the Senate will be able to understand and make a judgment whether any of these are good, bad, or indifferent.

It is very difficult for me to make a judgment about the Senator's own amendments when there is not even a record that is kept by the Senate Finance Committee during the markup when those particular provisions are included, Senator.

Senator DOLE. I share that view. In fact, I wrote a letter to the chairman and asked that we have a verbatim transcript during the markups and that it be available to the public. There is a feeling that these are sort of sneaked in. That is not the case and the Senator knows that is not the case.

In public hearings the press was available, the staff was available. Whether or not they are meritorious is something else, they may be or not.

Senator KENNEDY. Senator, most of the provisions that we are referring to here were the last items that were included in the Senate Finance Committee legislation. I don't think it is fair to the Senator from Kansas, or to any other members of this committee, or to the Senate as a whole, not to have the kind of procedures which Senator Proxmire and I have suggested.

I think the Senator from Kansas carries a burden that he should not have to carry. But I think it will be carried until the Finance Committee follows a procedure which includes the reports of the Treasury and IRS.

Senator DOLE. But the burden is much heavier when a responsible colleague in effect makes a scatter gun charge that we have all committed some sin or some misdeed by offering an amendment.

Let me give an example of one. You say we should follow the House Ways and Means Committee. Look at Number 31 in your indictment.

This amendment did follow the House Ways and Means Committee procedure, it was passed out of the committee without opposition and passed overwhelmingly by the House. They did have hearings and still it appears in your indictment as Number 31.

Senator KENNEDY. Senator, you can use the word "indictment" but I am talking about procedures which are not being followed by the Senate Finance Committee and which are being followed by the House Ways and Means Committee. That is what I am urging here and that is what is not being done at the present time by this committee.

I do think that if the Finance Committee had followed those procedures which were outlined, then I think we would have a much clearer idea as to the implications, the beneficiaries, and the amounts of resources that would be lost.

Senator DOLE. Well, what about the $17 million? That "giant grain companies" provision. What amendment is that? Is that the one I offered with Senator Mondale?

Senator KENNEDY. Well, primarily it goes to grain exporters for grain grown overseas and sold overseas. They receive up to $17 million.

Senator DOLE. When the bell rings, does that mean I am finished?

The CHAIRMAN. I will let you go a while longer.

Senator CURTIS. May I yield my time to him, Mr. Chairman?

The CHAIRMAN. I think what you were talking about, Senator, was the amendment pushed by the Treasury staff. The Treasury wanted that.

Senator KENNEDY. Can we know who offered it?

Senator DOLE. I am just trying to clear myself now. It is all right, we can come back to the other Members later.

Because there have been rather serious statements made about this—in fact, the Senator said this morning on network television that there was a tie between contributions and those amendments that were offered, that is true in every case.

Senator KENNEDY. In many, many instances, the power of special interest groups involves large contributions and has a pernicious effect in terms of the tax legislation. Thas has been my experience, Senator; it is based upon my 14 years in the Senate.

Others can make other judgments about it. That is one of the reasons I was such a strong supporter of public financing elections. I think it is a justified comment. There are those that would differ but I can look in other areas—for example, in the area of health care—and I see contributions that are made by various groups that have special interests in our legislation. I will let the record speak for itself in that particular area, and I think there are others as well, Senator.

That is really not the purpose of the presentation today.

Senator DOLE. I am not certain what the purpose is.

Senator KENNEDY. Well, I have tried to——

Senator DOLE. You have gotten out of it all that you can. You have said in effect the members of this committee cannot be trusted, we are slipping in little amendments in the dark to change the procedure.

The Senator from Massachusetts and others call themselves reformers. Now maybe that is the case. Maybe you are reformers. The position is in the eye of the beholder but there are some of us who offer amendments based on conversation with the staff and Treasury and they are offered in good faith and they are accepted or not accepted.

We just don't like the honorable mention we received from the Senator from Massachusetts.

Senator KENNEDY. Does the Senator object to the provisions and the procedures that are now being followed by the House Ways and Means Committee?

Senator DOLE. I don't object to those, no.

Senator KENNEDY. Do you think they would be advantageous or helpful to the Finance Committee?

Senator DOLE. I don't know what procedure the Senator uses in his committee. Maybe they would be advantageous to your committee.

Senator KENNEDY. Senator, those provisions have been spelled out, they have been commented on by the Senator from Wisconsin and others. They are used by the members of the Ways and Means Committee. We are talking about procedures which I think have strengthened the analysis of the various special interest provisions by the Ways and Means Committee. The House Members understand the procedures which have been followed. Those procedures are not being followed by the Finance Committee today.

I urge that they be followed. Prior to the time that the Senator from Kansas entered the room, I went through them in some detail.

Senator DOLE. I was here when you started. I was present.

Not being argumentative with the Senator from Massachusetts, but I think your staff or whoever furnishes this material to you should go through and check those that should be forgiven—in other words maybe you have made a mistake. At least you say a third should not be indicted; they ought to be removed, you ought to have an amended indictment, and then maybe in the gray area you could have a separate indictment and the totally bad ones you could have a true bill and then we would know where we stand insofar as your evaluation because there are all kinds of rumors floating around.

I have been told in 1954 there was an amendment adopted in the House to help the Kennedy family and I have been told about the American Motors Corp.

Senator KENNEDY. What amendment in 1954?

Senator DOLE. Just a rumor floating around.

Senator KENNEDY. If you are mentioning it now I think we are entitled to know specifically, Senator.

Senator DOLE. I have not broadcast mine because I don't have the facts.

Senator KENNEDY. Then you don't know the facts on it. Let the record stand.

Senator DOLE. But I think the record should stand on the ones you know the facts on.

Senator KENNEDY. I know the facts. I do know the facts, Senator; there are a number of provisions which were included in the final hours of the markup of this legislation that never received the comments of the Treasury Department or the Internal Revenue Service, or how much money would be lost, or who the beneficiaries of these particular provisions are.

I do know that as a fact and the recommendation I am making here today is that this situation should be remedied. I think that is a fair and equitable situation and I fail to understand why the Senator from Kansas can't endorse that rather basic procedure which has been accepted and tried and followed in the House Ways and Means Committee.

Senator DOLE. I quarrel with the staging of what has been going on. I was one of those who offered my amendment late one evening. I am not on the top of the list senioritywise. I was here at 6 o'clock. It was not quite dark outside but I had to wait until 6 o'clock to be recognized. I just say that it seems to some of us that we appreciate being mentioned but we would like to know which category we fall in.

That is all I have.

The CHAIRMAN. Senator Hathaway.

Senator HATHAWAY. Thank you very much, Mr. Chairman.

I just want to state that I wholeheartedly endorse the recommendations of Senator Kennedy. I wanted to ask the Senator this. The procedure akin to what you have advocated is one that I have advocated and others have advocated for years to have the Internal Revenue Code come to a halt every so often so that those who have benefits for various tax expenditures could come in and justify them—in other words a sunset law for the Internal Revenue Code because the other laws, we know in the case of Andrews certain times the elementary secretary and most of our laws do have a termination date and we are forced to reexamine them before we reenact them whereas the Internal Revenue Code just goes on forever.

We don't know who the beneficiaries are, how some of the provisions are already in the Code. They may, too, be narrow interest benefits and if we had a sunset provision we would have a chance to examine existing provisions as well as amendments that are going to be offered.

I would like to ask the Senator if you want to go on record as in support of such a provision. I intend to offer such a provision on the floor at the appropriate time.

Senator KENNEDY. It seems to me to be warranted and justified. As the Senator knows, though, we didn't get into those provisions here today. There are many of these provisions. The most famous is the Philadelphia nun provision that was put in in 1924 and was used as a major loophole for 45 years before we got that out of the Internal Revenue Code.

So the concept is warranted and justified, and I look forward to the amendment of the Senator from Maine.

Senator HATHAWAY. Thank you.

Thank you, Mr. Chairman.

I would like to yield to Senator Haskell to respond to something that Senator Packwood said earlier.

Senator KENNEDY. Could I be excused in the meantime?

Senator HASKELL. Could I make a remark before you are excused?

I would hope that no member—I notice from the left side, the radical left of the bench, there seems to be a defense. I hope that we will be thoughtful on our procedure in this committee and I suppose I better at least give my frank impression in view of the conversation that is going on.

I suggested to Senator Nelson and Senator Hathaway when we were considering an amendment to remember the amendment that we put in a substitute bill. My comment at that time—whether it was valid or invalid, is not terribly material because it at least indicates my impression.

I believe I said to both of those Senators we better do this because we will never find out everything that is buried in that blank blank bill, and I don't know whether we ever will or not but at least that was my impression and, therefore, I would hope and my fellow members of the committee and my friends on the other side would not be wedded to current procedures and I would hope they would have an open mind on adopting something like the Ways and Means Committee or something better.

I can't believe, with all due respect to the gentleman from the Ways and Means Committee sitting down here in the front row, that this is the best of all possible worlds. There might even be something better. So that is merely a comment.

I understand that while I was over on the floor that Senator Packwood made some comment. I wonder if he would mind repeating it.

Senator PACKWOOD. Excuse me. I didn't hear the last.

Senator HASKELL. I understand while I was over on the floor, Senator, you made some comment about my having something to do with the amendment. I wonder if you would repeat that.

Senator PACKWOOD. I said either the last day or next to the last day you had three amendments relating to trusts, one of which is generation of trusts which had been popped in that we had had no hearings on and no background on and if you were going to adopt the standard that Senator Kennedy was recommending that I hope the same standard would apply to these and if you drop others.

Senator HASKELL. I think, Senator, that is a very proper observation. I think that much as I like my generation skipping trust amendment, nevertheless everyone—whether you believe it is good or whether you believe it is bad—should be subject to the hearing process, and I think you are right.

Senator KENNEDY. If the Senator would yield, I am reminded that the generation skipping provision was actually discussed during the hearings of this committee on the estate tax.

Senator HASKELL. Was it?

Senator KENNEDY. It was discussed. So it is a concept which has been debated and talked about. There was testimony. As a matter of fact, we had some recommendations on it, too, which are very similar to those of the Senator from Colorado.

Senator HASKELL. I thank the Senator from Massachusetts. I know the idea was around a long time, I was not aware there was testimony before this committee.

Thank you very much.

I have no further questions.

The CHAIRMAN. Senator Gravel.

Senator GRAVEL. I think, Senator Kennedy, the area that some of us would question are really the statements you make in your press release and what actually happened may be somewhat at variance. I was deeply involved in the recycling which, of course, the larger plan is in Saugus, Mass., which I understand lobbying used to support my position—unsuccessfully, I might say—because they can't sell their product.

In this recycling plan they have had to go to landfill. They realize the benefit of it, but then you read a statement that says other provisions have a larger group of beneficiaries because they are defined to favor industries like oil or recyclers.

Let me just say the beneficiaries as I would view the efforts that I have made in this regard deal with the whole support of the U.S. League of Cities and U.S. Mayors and National Governors Conference.

This is an issue that you have numbered in 35 here. I think the point you make has great merit and I am sure the committee is going to change some of its approaches so we do have a better approach.

There is great room for improvement but when this was lumped in here 2 years ago I fought to get this kind of amendment on a tax reform bill and an energy bill. This then was the subject of extensive hearings in the Senate, then was the subject of hearings in the House. It was fought on the floor of the House 2 years ago and failed and then was fought again 2 years ago and failed this last time.

I don't know how the subject can get more airy, more controversy, more press. I think some of it, unfortunately, is fair but besides that mechanically I think the procedures in this particular case to lump this category with that when it has had such broad attention, I would just question that being done in that regard and the fact of the windfall when it does not go to those who are presently recycling.

Now I can understand a windfall if those are recycling. I wanted to put those in the recycling. I think they need the help, but what the committee passed on was perspective toward new recycling efforts.

Senator KENNEDY. Well, Senator, on that particular provision, there is value and merit in the procedures which we have advanced, and they have been advanced by a number of the members of the committee.

In this particular provision I know that you are very much aware of the problems that various conservation groups and environmental groups and the Treasury have with this particular provision. Whether we are going to be spending $345 million in the energy area in this way is something that this committee makes a judgment on, and the Senate makes a judgment on. Whether it has had the kind of review that a direct appropriation would have had I really question. As I have indicated in earlier provisions, I am primarily concerned about the procedures. We will debate or discuss as we have over the period of the last 3 weeks the merits of particular provisions and we will call the roll on those provisions.

Senator GRAVEL. I think you have made a contribution in that regard but I think something of special interest when it is supported by local government and State government and it has been aired for a number of years here in the Senate is really toying with a broad brush.

Environmentalists—the Environmental Action Coalition of District of Columbia and New York City has been lobbying for it and is very much for it.

With respect to the cost, I dispute the cost and question of the several hundreds of millions of dollars. If we are successful in getting recycling accomplished, it will mean a diminution of a tax benefit that is already being received by virgin material.

I am really mystified by those who say that would categorically have money when in point of fact that money is already lost to the Treasury in virgin areas. What we are trying to do, we are trying to equate, to factor this country on a recycling area which I think is just sound intelligent practice.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman.

Senator, you have this long list of 36 items and I am wondering how it came about that you favored me by having me last on the list of the 36 items. The one that I introduced, you referred to it as equalize treatment of propane and diesel fuel by exempting propane from excise tax.

I am just wondering how you or your staff or whoever gave you this information that that amendment was for the Eaton Corp. I never heard of the Eaton Corp. You further refer to this amendment as a special interest deal for such corporations. It could even be used for the truck lifts in the Merchandise Mart or some place like that where there is a large utilization of this type of equipment. It is off the highway utilization.

Why should propane be treated any different than diesel in operating?

Senator KENNEDY. Mr. Chairman, I have tried not to repeat myself. I stated prior to the time the Senator came in that I would hope that we know about any of the groups that are going to benefit. What I am basically asking for is the procedures that would be followed, the groups that would benefit, the amount that would be lost, the opinion of the Treasury and the IRS, and whether there have been tax rulings that have been overruled. All of those particular matters should be before us in public form, so that any of us could review that.

That is the procedure which is not being followed.

Senator FANNIN. I could give you a list of 100,000. Do you want that list?

Senator KENNEDY. Types of users I think would be useful, yes.

Senator FANNIN. You want a list? Why did you pick on the Eaton Corp.?

Senatory KENNEDY. What?

Senator FANNIN. Why did you pick on the Eaton Corp.?

Senator KENNEDY. The fact of the matter is we are not finding out who are the beneficiaries. It was not published by the Finance Committee, Senator, and I think as a Member of the Senate, if I am going to vote on it, I am entitled to find out who the beneficiaries are going to be.

Senator FANNIN. I don't know how much trouble you went to to find out what the Finance Committee said. I know that you did not contact my office about this amendment.

Senator KENNEDY. We cannot even get a record of who suggested what in the debate in the Finance Committee on that particular point.

Senator FANNIN. This is an item that has been considered many times.

Senator KENNEDY. Can you show me in the record of any discussion during the course of the markup?

Senator FANNIN. Certainly.

Senator KENNEDY. You can't show it, Senator; it does not exist.

Senator FANNIN. It was put down.

Senator KENNEDY. It was not put down. I am asking you to put it down.

Senator FANNIN. Not only this time, it has been discussed before and if you knew anything about what you were talking about you would not make an issue of it.

Senator KENNEDY. I will let the record stand.

Senator FANNIN. There are five items here that I just picked out, the last five items that you have on this list, and it is just absurd. I don't know what you know about waste recycling. The Union Oil Co., Pacific Gas & Electric Co.—you have picked them out.

Senator KENNEDY. Whose was that, Senator?

Senator FANNIN. That was mine, that is why I am bringing it up.

Twenty-two percent depletion deduction for geothermal property. You said you knew Pacific Gas & Electric Co. was involved in that amendment.

The whole idea is to help companies all over the country where there is a potential for geothermal. And it is certainly not to help these giant companies. It is supposed to be available to companies that otherwise perhaps would not go into that particular phase of activity and that is the whole idea of the amendment.

We are trying to develop geothermal and we have not had very good luck in doing so. We are trying to get incentives. Are you against giving incentives?

Senator KENNEDY. No, I am not against giving incentives. No, Senator.

Senator FANNIN. Well, we have opportunities in many parts of the country to develop geothermal. We have not been successful in it because it is a costly procedure. We certainly need to do what we can to give the incentives that are needed so that these companies will go forward.

We have had this underway for many years, for at least 15 years, so I think I know something about what is involved.

Then, of course, we go on up the list to General Electric, Westinghouse.

Was that my timer?

I thank the Chairman.

Senator KENNEDY. I say that I am not against incentives. Sometimes, though, I wonder where the free enterprise system is in many of these areas.

Senator FANNIN. You know, you talk about holding hearings. We had extensive hearings on that particular item and we had extensive hearings not only from this committee but from the Interior Committee.

The CHAIRMAN. Senator Curtis is the next Senator who arrived on the scene.

Senator CURTIS. Senator Kennedy, have you ever remained in the Finance Committee for an entire executive session when we marked up a bill?

Senator KENNEDY. No, Senator.

Senator CURTIS. Have you, Senator Proxmire?

Senator PROXMIRE. No.

Senator CURTIS. What is the source of your information as to what takes place here, Senator Kennedy?

Senator KENNEDY. What is the source? It is just bits and pieces——

Senator CURTIS. No, what is the source of your information?

Senator KENNEDY. If I could finish, Senator.

It is probably not terribly reliable because it is not written down any place by the committee. It is very difficult for any Member of the Senate to get it because it is not recorded and it is not detailed and it is not made public and I think that is something which is regrettable.

Senator CURTIS. Have you had any conferences with any individuals such as Ralph Nader on what goes on here?

Senator KENNEDY. Have I had a conference with Ralph Nader about what went on here? No.

Senator CURTIS. What is the source of your information, Senator Proxmire?

Senator PROXMIRE. The source of my information, Senator Curtis, is the newspapers——

Senator CURTIS. You mean your own articles?

Senator PROXMIRE. Not my own articles, no. [Laughter.]

Senator CURTIS. You read Senator Kennedy's articles and that is the source of your information and he reads yours, is that it?

Senator PROXMIRE. As far as I know, Senator Kennedy has never been a newspaper reporter. I was a newspaper reporter and was fired from the job 25 years ago and I have never held a reporting job since then. I am not a reporter.

I read articles in the New York Times, the Washington Post and I suppose in the Omaha Herald I have read an article or two, but this is common knowledge. It has been reported, it has not been denied.

Senator CURTIS. What has not been denied?

Senator PROXMIRE. It has not been denied that no record is kept. Senator Kennedy has said at least six times this morning no Member here has denied it.

Senator DOLE. Here is a record.

Senator PROXMIRE. There is no record kept of the markup sessions and made available to the Members of the Senate who want to see it. It is not transcribed.

Do you have any minutes, Senator Curtis?

Senator CURTIS. Yes, we have minutes.

Senator PROXMIRE. Show me the minutes transcribed. Show me one session of minutes.

Show me one session.

Senator CURTIS. We have too much work to do here—

Senator PROXMIRE. Well, you don't have them.

Senator CURTIS. [continuing]. To provide demagogs with specified bills of particulars.

Senator PROXMIRE. You don't have them.

The CHAIRMAN. Wait a minute, Senator. I will get you one.

Senator CURTIS. Minutes are kept of our meetings. Let me add that as long as I am a member of this committe, and serve as the ranking member, when taxpayers or groups of taxpayers who are concerned with important segments of our economy want to come and talk to me about a tax proposal, I am going to listen to it.

My usual procedure is this. I see as many of them as I can. I feel that is my responsibility. When they come in, I usually ask them, if they don't have it, to set forth the problem in a memorandum. I keep them in a corner on my desk and I think it is about that high. I go over them, do some staff work. Part of them I submit to the staff of the Joint Committee on Internal Revenue to see what they feel. I consult briefly.

Then I do not agree to be their advocate but I agree to call it up for committee consideration.

Now this hearing here this morning is a strange thing. You would assume that we should legislate on the basis of who is involved. I think that a tax proposal should be judged on whether or not it is just. I can cite, just as the other members have, a lot of sheer demogoguery on this matter. It is nothing else.

For instance, coming back to the fuel oil pumps, I made an investigation and I found that there are many, many manufacturers of heat pumps. Furthermore, the tax credit allowed does not go to any of them. It will go to a few people, most of whom are living in an old house that is heated by electricity and has become exceedingly old and along with the incentives to use solar heat and to supply tax credit for insulation.

This committee took some action along that line. The beneficiaries are the homeowners involved.

Now the two companies that are mentioned here, which is an incomplete list of the companies, the same is true. I also adhere to the principle that the taxpayers should not be subject to retroactive changes in the tax law.

There is one item here, item 4, where I moved to change the effective date by 8 days. It corresponds with the date that the Ways and Means Committee gave notice of their action taken. To not enact that amendment may invalidate the provision because it would be unconstitutional.

The question involved is something that you gentlemen don't seem to have mentioned here this morning at all and that is what is just. You want us to make a record here so that everybody that wants to seek headlines can single out an individual or a concern and hold it up and say, "Here there is something corrupt; I am pure but there is something corrupt in another committee." I do not think that you should submit a list like this unless there is a bill of particulars to prove that you know something of what you are talking about.

That is all, Mr. Chairman.

The CHAIRMAN. Senator Nelson.

Senator NELSON. Oh, I am wondering when the chairman is going to have a rollcall because I want to cast the vote for the next Vice President before he shows up, I have his proxy.

I agree with what Senator Haskell said. I think that he can follow a more orderly procedure and it would be profitable and useful.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Mr. Chairman, I think part of the problem comes from the fact that in the interest of trying to get a tax bill through this committee, with the kind of schedule we are facing in the Senate, that we accepted an unattainable and unrealistic deadline for completing committee action.

This committee met in long sessions day after day. There was a special dispensation on the part of the leadership that we be able to meet while the Senate was in session. I don't know of anyone on this committee who wants to keep secret the sponsor or the beneficiary of any amendment. I certainly don't.

I sponsored a number of amendments to this bill because I thought that they were equitable amendments to correct inequities. When the press asked me who were the beneficiaries, to the best of my knowledge, I told them and I told them what I understood the cost to be.

Now I asked the chairman to hold additional hearings on the specific amendments and the chairman has complied with that. I think we ought to have all the disclosure we can have and I am for that. We have a committee pamphlet that states the sponsor of each of these amendments, the cost of each of the amendments and to the best of our knowledge who the beneficiary is.

I am sure you will never find every beneficiary of these amendments but a pamphlet has been prepared and is available to all of the Members of the Senate and to the public and that is the way I think it ought to be done.

I don't think there is any desire here, and there should not be, to try to in any way conceal a sponsor, or the best estimate we can get of cost or who those beneficiaries are and this pamphlet outlines that in detail and I support that procedure.

Senator KENNEDY. I welcome the comments of the Senator from Texas. It seems to me that if that had been available sometime ago, at least some of these issues would have been resolved. I don't think that the Senator from Texas ought to be put in the place where, when he does believe that a legitimate case can be made and advances a particular amendment, he is looked upon with any kind of suspicion.

I think this is unwarranted and unjustified. It would not occur with the procedures the Senator from Texas has just outlined. It seems to me the House Ways and Means Committee has really escaped that problem because they have followed what the Senator from Texas has outlined, which is basically what we are suggesting here this morning.

The CHAIRMAN. Senator Roth.

Senator ROTH. I thank the Senator.

The CHAIRMAN. If the committee desires it, I would be happy to seek to attain the funds and provide for a reporter to be in the room at all times. I served on the Interior Committee about 20 years ago when they had that procedure. From what I can see it is a waste of money and a waste of time. The reporter would be late and you could not start and you had to stop to wait for the reporter to change tape in the recording machine. Then nobody ever read his remarks, nobody ever bothered to correct them to see if they read the right way. But I am willing to try anything once, as some comic strip character used to say, and I wish the Senate would do the same thing.

So if the committee would like to see it, I would be happy to bring a reporter in the room to report everything that every Senator says, but I predict with confidence it will not do half as much good as my egg time.

Senator ROTH. Mr. Chairman, as one of the chief sponsors of the sunshine legislation, very much for making sure that everything is opened up, it seems to me we have created a new committee on committees and that part of its responsibilities would be looking to the practices of all committees, because I think there have been practices in many of them that could be improved on.

So I don't think we should single out this committee in particular; I think that we need to look very tough at all committees and make certain what the practices are because the same kinds of problems arise in other areas and, Mr. Chairman, I would urge that the committee take a look at all committee practices.

Senator HANSEN. Mr. Chairman, if I understood Senator Kennedy correctly or at least if what was said reflects in a general way what the facts may be, it would be helpful and would be appreciated by this Senator if you might indicate, by going through this list of some 36 specific items, those special provisions that you feel ought to be condemned and those to which you would apply different gradations of the condemnation.

I take it from the exchange with Senator Dole that maybe you don't mean to apply the same condemnation to each of them as might be inferred would be. Is that an accurate observation?

Senator KENNEDY. It is. Senator, what I indicated at the outset of my presentation is that this committee has been kind enough to hear my testimony at other times. We have differing views on a number of different provisions that are in the legislation that is before the Senate. We debated those over the period of the last 3 weeks and are going to continue for the next several days.

What I specifically was recommending here today are the procedures which this committee would follow in the future, so that where there are legitimate and valuable and worthwhile provisions that must be included in the Internal Revenue Code, they can be included. But procedures would be followed that would invite publication in the Congressional Record, an invitation from the Treasury Department and IRS, revenue estimates, a budgetary committee recommendation on the budget implications, and the persons who would benefit. This committee will make its judgment, then the Senate will make its judgment, and that is the way we ought to do it.

In a number of these provisions, that, of course, clearly was not done. What I am primarily urging today is that we follow the procedures which we have outlined, and that this committee invite comments of both the Treasury and IRS in each of these areas that are listed here. To the extent that those are noncontroversial, they should be retained in the bill and I will support them to the extent that they are conroversial, they should be deferred to a later time.

That is basically the procedure which I am recommending and which I think would strengthen the legislation in this committee.

Now, we have differing views on some of those and I have elaborated on them to a limited extent. We will debate them ourselves on the floor of the Senate over the period of the next few days. I don't know whether we want to delay the committee longer in reviewing some of those various provisions, but that is my position.

Senator HANSEN. Just for your benefit, Senator Kennedy, let me say that the situation and the modus operandi described by Senator Curtis, I think, is rather typically observed here to this extent. I, too—as, I am certain, is true with every member of this committee—am approached by a number of people. I suspect, because I happen to come from an oil producing State, it might be understandable that perhaps I have more oil people coming into my office than might be true in Senator Roth's case.

I think it may be worthwhile to note this: that in each of these requests for a piece of legislation, I have made it a practice to do three things: (1) to talk with Dr. Woodworth, the chief of staff of the Joint Committee on Internal Revenue Taxation; to talk to the Finance

Committee staff here; and to talk with Treasury. And almost without exception I think every one of the proposals that you have listed here has gone through that same sort of a hearing process.

So this is not a case of things being slipped in under cover of darkness; it is not a case of representatives from the Treasury Department not knowing about it. I believe they are here all of the time that we are in session and Dr. Woodworth is here all of the time and, of course, staff members are here all the time. I think that is an accurate statement. If it is not I would like to be corrected but, to my knowledge, that is the way it has been.

I think there is a certain amount of protection, a very important amount of protection, that is afforded by the examination that the representatives of those three groups give each of these proposals.

If I were to be specific I could point out here No. 27, Belco Petroleum Co., to restore oil depletion allowance for independent producers with retail outlets in Israel. I was prepared to present that; it happened that I didn't. Mr. Belteo happens to have quite a few oil properties in my State of Wyoming. The only retail outlets he has happened to be in Israel.

I signed a number of letters supporting Israel; the last couple I did not sign. I could not see any reason—what I thought was basically the concern of people on this committee and of the Congress generally—to deny the benefits of the depletion allowance to those with the retail oil outlets to apply to Israel. Maybe I am wrong about that.

As I say, I didn't happen to present it. I was prepared to and I would have been happy to because it seemed to me that here again the case of equity that Senator Curtis spoke about was inherent in the proposition that Mr. Belteo thought ought to be applied to him.

That is all I have, Mr. Chairman. Thank you very much, Senator Kennedy.

The CHAIRMAN [indicating]. Here are some of our draft minutes—if you want to see them you can look them over—of committee meetings. They are usually a few days behind our meetings writing them up because the Senator's don't ask to see them. Here they are. They can go back and read their notes and explain what each Senator had to suggest and what the various amendments were and what basically each ~~person~~ had to suggest. I really feel that they are adequate for our use. I was once a minutes clerk and I must say that the staff keeps better minutes than I kept when I had the job doing the same thing for a State legislature.

So there are records, minutes of what we do in our executive sessions and all Senators can have access to them.

Senator DOLE. Mr. Chairman, is there a staff document being prepared?

Senator BENTSEN. Yes.

The CHAIRMAN. But the Government Printing Office can't get it over here yet. They now say it will be here at 11 o'clock.

Senator DOLE. I know a couple amendments. I think the Washington Post carried a story about the Belco amendment, saying I offered it. I didn't offer it. I don't know what happened to the amendment I offered.

Another one, railroad ties—I learned about it when I called my office from St. Louis on the way to Kansas. So my only point is that

I hope when the draft is offered, it makes some explanation about the staff, about just what did happen.

The CHAIRMAN. I just want to make one further statement. Once in debate—perhaps more than once—I made the mistake of challenging one of my colleagues by suggesting that my frustration of achieving my way was in large measure occasioned by the fact that the people on the other side had made campaign contributions to support people who were running for office, and those who agreed with me had not done so. In due course I found it my duty to go to that Senator and offer him a profound apology. And to anybody who has been offended by such statements by me in the past, I want to extend the same apology.

I personally like the public-financing concept. I think I pushed harder for it and have more to show for it than anyone else in the Congress. But unless and until we extend that concept, people will still find it necessary to help out their friends and will think that they are doing a good job and will help to keep them in office.

As long as that is the way it is, you will have campaign contributions from those that think that people have done a good job and that their service ought to be continued.

Senator KENNEDY. Would the Senator yield at that point?

I want to acknowledge what I think all the Members of the Senate realize, and that is that the dollar checkoff was the brainchild of the Senator from Louisiana. We have public financing now with regard to the Presidential elections; we still don't have it with regard to House and Senate elections even though a clear majority of the Senate went on record in favor of it. I hope we can do it. The leadership has been provided by the chairman of the committee.

The CHAIRMAN. Some people think when a fellow makes a campaign contribution to someone, be he a Senator or a Member of the House or someone else, that we ought to close the door and not ever let him come in and talk to us. But that does not happen to be the way the American Government was organized, and I really think that it discriminates against those who are elected to office. I would think those who do so would come to have a high political mortality rate.

Senator Proxmire has awaited his turn long and patiently. Senator, we will be happy to hear from you.

STATEMENT OF HON. WILLIAM PROXMIRE, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator PROXMIRE. Thank you very much, Mr. Chairman. It is a very appropriate introduction because your description of how you apologized leads me to start off as I should here. Let me say that I owe you and the committee an apology. My statement on the floor last month in which I criticized this committee for including in the pending tax legislation provisions that benefit specific firms may well have implied an attack on the integrity of committee members. I intended nothing of the sort.

This is not only one of the most powerful committees in the Senate. It is not only one of the most expertly staffed committees. It is not only one of the most intelligently and persuasively manned and led.

by a chairman who knows the tax code about as thoroughly as the Pope knows the Lord's Prayer. But—and this may not have been clear in my statement last month—as far as I am concerned every member of this committee is thoroughly honest and is convinced that the provisions in this bill that he supports are right, just and in the public interest.

The difference is simply in how I regard what is right, what is just and what is in the public interest.

There is one other profound difference. I vigorously disagree with the procedures this committee has followed until this morning in considering provisions in the bill that are primarily designed to benefit particular companies.

If you want to tell me what is wrong with the procedures of the Senate Banking Committee I will welcome the criticism. I may disagree with it. But I am sure I would find it constructive and useful.

In the same spirit I suggest that the Senate Finance Committee may benefit from adopting the provisions used by the House Ways and Means Committee with respect to sections of the bill that provide tax benefits to particular concerns.

As you know, Mr. Chairman, the Ways and Means Committee now has a three-member task force to screen all amendments to the tax code. Any special interest bill with a significant revenue impact is referred to Treasury for comment and is the subject of a full and frank staff report. The committee holds hearings on these proposed amendments to discuss the revenue loss, the real author and beneficiary and to give opponents an opportunity to testify.

I understand that procedure is not always followed, that they depart from it from time to time but they follow it generally.

Unfortunately, special interest bills are still processed in the traditional manner in the Senate. They were not offered or analyzed far enough in advance to permit full hearings with opposition witnesses until today.

And so we have a long list of amendments, some possibly justified on their merits and some not, bearing informally the names of their author and beneficiary—the Coca-Cola amendment, the Robert Hall amendment, the Natomas amendment, the IDS amendment, the Texas Optical Co. amendment, the Hanna Mining Co. amendment and on down the list. It is almost a corporate status symbol to have your own special tax bill.

Most of these amendments are so surgically tailored for a particular beneficiary that they might as well include the company's name or corporate logotype. More disturbingly, some 50 of these provisions were quietly added on the final day of committee markup, last May 27. Some were the subject of committee analysis, Treasury comment and opposing testimony. Most were not.

I would submit, Mr. Chairman, that this entire process is embarrassing and demeaning. Just as the Founding Fathers had the good sense to ban bills of attainder or special legislation to punish a given individual, we should have the good sense not to pass bills of attainder in reverse. And that is what these provisions are—special, private legislation to benefit a particular individual or individual corporation.

Apart from the purported merits of specific cases, there must be a strong presumption against all such narrow interest tax legislation.

When the average individual has a bad year in his business or makes a miscalculation in his personal finances, he simply does not have available as a remedy the opportunity to hire a high-priced tax lawyer or a well-connected lobbyist to fashion a private raid on the Treasury. The average person simply suffers the consequences.

Narrow interest tax legislation is the worst kind of special privilege for the well-connected and the well-to-do. It undermines both the substance of tax equity and the public's confidence in tax equity as well as the integrity of the legislative process.

The main purpose of my appearance today is to urge you to insure that in the future all such amendments be subject to full scrutiny well in advance. It should not be necessary for the public interest groups to play detective at the last hour in order to ferret out just who is behind some of these provisions.

Mr. Chairman, according to this morning's New York Times the list that I inserted in the Congressional Record of beneficiaries is still incomplete. In other words, there are still amendments tucked away in the bill written for particular companies and individuals that neither the tax reform groups nor Members of the Senate who will vote on this legislation have been able to identify. I am speaking of provisions other than those which were mentioned.

I would like to ask you, Mr. Chairman, whether or not you would consider having your staff prepare a complete listing of all narrow interest provisions in this bill with an estimate of the revenue laws and beneficiary and sponsor.

Occasionally, where Congress has unintentionally injured a particular class of taxpayers, there is no harm in having a full discussion. The remedy will stand up on its merits. On the other hand, it is almost never justified for a particular company or individual to quietly make an end run to Congress solely to frustrate a ruling of the IRS or the tax court or in order to reap a windfall.

The 50 or so narrow interest provisions contained in the bill before us run the gamut from arguably defensible provisions to pure ripoffs. Let me focus on a few of the worst.

Consider the Natomas amendment and the Mobil Oil amendment. In the 1975 Tax Reduction Act, Congress wisely provided that companies that ceased to have an economic interest in foreign oil—that is, companies which simply purchased crude oil from foreign governments or government-controlled companies—could not define their payments as foreign taxes to shelter their profits from U.S. income taxes.

In a recent revenue ruling the IRS rules that the Natomas Corp.'s gimmick to get around the 1975 law—a production-sharing agreement in Indonesia—would still fail to qualify for the desired tax credit and that the company would actually have to pay some tax in the United States.

In the case of Mobil Oil, Mobil designed section 1035 E of this bill as a private grandfather clause giving Mobil's Iranian interests a 10-year exemption from the loophole which was closed in the 1975 Tax Reduction Act.

Under the Mobil amendment, any interest owned as of March 29, 1975, could continue to qualify for the foreign tax credit for 10 more years. Result: The bill would create the fiction that Mobil owned the oil-yielding property and, based on that fiction, permit a foreign tax credit, not for months or a year but for a solid decade.

The cost of these two provisions, incidentally, has been estimated at upwards of $65 million per year, depending on who else takes advantage of it. What kind of public policy is this? Are Mobil and Natomas really hardship cases?

Section 806 of the bill is also unwarranted, in my view. At present, shipbuilding companies can shelter their earnings from tax to the extent that they plow them back into a capital construction fund. This shelter is the equivalent of a 17-percent investment tax credit. On top of that, the shipbuilders want to take the 10-percent investment tax credit. This is nothing more than a double dip, which would cost the Treasury more than $20 million the first year, rising to $45 million by 1981. Again, I've seen no evidence that the shipbuilding corporations are welfare cases. If they are, we should consider separate legislation for them. Relief for them does not in my view constitute tax reform legislation.

Section 1025 is another unacceptable special interest provision. The intended beneficiaries are the major grain traders, Cargill, Bunge, Cook, Continental, and so on. Under present law, if a grain exporter sets up a subsidiary in a foreign tax haven to sell foreign-grown agricultural products, he must pay U.S. tax on earnings to the extent that he pays no tax or a lesser tax overseas. Under section 1025, profits from products grown overseas and marketed in a foreign tax haven could escape U.S. taxation altogether, with a cost to the Treasury of more than $15 million a year, and more as others begin to use the loophole.

Obviously, this can't be defended as aiding U.S. agriculture. It hurts American agriculture. Why? Because it gives a competitive advantage to foreign products. From everything I read, the big grain companies are not hardship cases.

I oppose most of these special interest provisions. I wanted to single out some of the worst for special comment. I have identified others in my floor statement of June 28, which I am including for the record.

The fact that the committee has scheduled these hearings to give some of these special interest amendments an airing is a welcome sign. In future years, I hope you will provide for a full analysis of all such amendments well in advance of floor action, with testimony by proponents and opponents, Treasury comment and staff analysis on the specific provisions proposed to be added in markup.

Mr. Chairman, in my view, a new tax expenditure should be tolerated only as a last resort, when there is an overriding public policy purpose that cannot be obtained as efficiently through a direct subsidy. The test should be rigorous. The social benefit clear and emphatic. Obviously in the cases I have discussed no social benefit, none, has been the motivating force.

Finally, Mr. Chairman, as you may recall, some years ago. I think perhaps about 10 years ago, I was one of those who was instrumental in offering a special tax amendment to favor a corporation in my State and the chairman of that corporation was an old friend of mine I knew for many years. He came to my office and asked me to help him draft legislation to help the American Motors Corp. American Motors by far is the biggest employer in the State of Wisconsin. He was convinced, and some of his people were, that if he didn't get this tax break they might literally have to go out of business which would mean they would lose 28,000 jobs. I thought it was meritorious not only from the standpoint of Wisconsin, and I had a special interest here, but from the standpoint of the company. This was a small firm but it had 18 percent of all this country's automobile exports overseas. Obviously we could have lost a lot of jobs. So I pushed hard for that legislation. It was opposed as being a rip-off for the big corporation, American Motors, a billion dollar corporation. It was opposed vigorously by the Milwaukee Journal which is a fine newspaper in my State. It was opposed by John Byrnes, the ranking Republican in the House. Many other people thought it was special interest legislation but I sponsored that.

Now I tell that story because I think that this is exactly the position that some members of the Finance Committee are in. I applaud them when they go to bat for their constituents though the firm they may favor may not find public favor among others who think it is not equitable or just for the generality of taxpayers. I think it is a good and healthy thing to have viewpoints presented vigorously on this committee to represent a particular interest.

What I am calling for is when that representation is given that we should have, as Senator Bentsen said, full disclosure. We should have a full record. We should know who the beneficiaries are, we should know what the Treasury position is, we should know it in advance, we ought to have a chance to have it exposed and discussed so we have an understanding that will permit us to come to a reasonable conclusion. I think that in some of these cases we have simply not had that opportunity with the provisions that were added on the last day of the hearing. That is why I ask for a change in your procedures.

[The written statement of Hon. William Proxmire follows:]

STATEMENT BY SENATOR WILLIAM PROXMIRE

Mr. Chairman, first let me say that I owe you and the Committee an apology. My statement on the floor last month in which I criticized this Committee for including in the pending tax legislation provisions that benefit specific firms may well have implied an attack on the integrity of committee members. I intended nothing of the sort.

This is not only one of the most powerful committees in the Senate. It is not only one of the most expertly staffed committees. It is not only one of the most intelligently and persuasively manned and led, by a chairman who knows the tax code about as thoroughly as the Pope knows the Lord's Prayer. But—and this may not have been clear in my statement last month—as far as I am concerned every member of this committee is thoroughly honest, and is convinced that the provisions in this bill that he supports are right, just and in the public interest.

The difference is simply in how I regard what is right, what is just, and what is in the public interest.

There is one other profound difference. I vigorously disagree with the procedures this committee has followed until this morning in considering provisions in the bill that are primarily designed to benefit particular companies.

If you want to tell me what's wrong with the procedures of the Senate Banking Committee, I'll welcome the criticism. I may disagree with it. But I'm sure I would find it constructive and useful.

In the same spirit, I suggest that the Senate Finance Committee may benefit from adopting the provisions used by the House Ways and Means Committee with respect to sections of the bill that provide tax benefits to particular concerns.

As you know, Mr. Chairman, the Ways and Means Committee now has a three member task force to screen all amendments to the Tax Code. Any special interest bill with a significant revenue impact is referred to Treasury for comment, and is the subject of a full and frank staff report. The Committee holds hearings on these proposed amendments, to discuss the revenue loss, the real author and beneficiary, and to give opponents an opportunity to testify.

Unfortunately, special interest bills are still processed in the traditional manner in the Senate. They were not offered or analyzed far enough in advance to permit a full hearing with opposition witnesses until today. And so we have a long list of amendments, some possibly justified on their merits, some not, bearing informally the names of their author and beneficiary—the Coca Cola amendment, the Robert Hall amendment, the Natomas amendment, the IDS amendment, the Texas Optical Company amendment, the Hanna Mining Company amendment, and on down the list. It is almost a corporate status symbol to have your own special tax bill.

Most of these amendments are so surgically tailored for a particular beneficiary that they might as well include the company's name or corporate logotype. More disturbingly—some fifty of these provisions were quietly added on the final day of Committee mark-up, last May 27. Some were the subject of Committee analysis, Treasury comment, and opposing testimony. Most were not.

I would submit, Mr. Chairman, that this entire process is embarrassing and demeaning. Just as the founding fathers had the good sense to ban bills of attainder or special legislation to punish a given individual, we should have the good sense not to pass bills of attainder in reverse. And that is what these provisions are—special, private legislation to benefit a particular individual.

Apart from the purported merits of specific cases, there must be a strong presumption against all such narrow-interest tax legislation. When the average individual has a bad year in his business or makes a miscalculation in his personal finances, he simply does not have available as a remedy the opportunity to hire a high priced tax lawyer or a well-connected lobbyist to fashion a private raid on the Treasury. The average person simply suffers the consequences. Narrow-interest tax legislation is the worst kind of special privilege for the well-connected and the well to do. And it undermines both the substances of tax equity and public's confidence in tax equity, as well as the integrity of the legislative process.

The main purpose of my appearance today is to urge you to insure that in the future all such amendments be subject to full scrutiny, well in advance. It should not be necessary for the public interest groups to play detective at the last hour in order to ferret out just who is behind some of these provisions.

Occasionally, where Congress has unintentionally injured a particular class of taxpayers, there is no harm in having a full discussion. The remedy will stand up on its merits. On the other hand, it is almost never justified for a particular company or individual to quietly make an end run to Congress solely to frustrate a ruling of the IRS or the tax court, or in order to reap a windfall.

The fifty or so narrow interest provisions contained in the bill before us run the gamut from arguably defensible provisions to pure rip-offs. Let me focus on a few of the worst:

Sections 802 and 803 of the bill would require the Treasury to pay companies, beginning in 1984, an amount equal to unused investment tax credits, and would extend for two years investment and foreign tax credits that would otherwise expire at the end of this year. This provision, incidentally, is not quite as narrow as some. It would benefit the Chrysler corporation and several airlines, in the case of Section 803, and utilities as well as airlines in the case of Section 802.

My concern is less the worthiness of the intended beneficiary than whether there has been sufficient discussion of the merits of the underlying policy question. The issue here is a very fundamental one. After a taxpayer has run out of income to offset tax credits, should the Treasury start paying the taxpayer—in a kind of negative corporate income tax, which will cost other taxpayers half a billion a year? I'm very skeptical about a negative income tax payment to individual taxpayers—such a step—paying a non-taxpayer out of other taxpayer funds—may or may not be a sound welfare policy. But to begin a corporate welfare policy by a negative income tax for corporations, certainly merits separate consideration and should not be buried in an alleged tax reform bill.

At least that provision involves a relatively broad question of tax policy. Even less defensible are the provisions written for a single company, or written to overturn a tax ruling, or written to benefit companies that are in no way hardship cases.

Consider the Natomas amendment and the Mobil Oil amendment. In the 1975 Tax Reduction Act, Congress wisely provided that companies that ceased to have an economic interest in foreign oil, that is companies which simply purchased crude oil from foreign governments or government controlled companies, could not define their payments as foreign taxes to shelter their profits from US income taxes. In a recent revenue ruling, the IRS rules that the Natomas Corporation's gimmick to get around the 1975 law—a production sharing agreement in Indonesia—would still fail to qualify for the desired tax credit, and that the company would actually have to pay some tax in the United States.

In the case of Mobil Oil, Mobil designed Section 1035 E of this bill as a private grandfather clause giving Mobil's Iranian interests a ten year exemption from the loophole which was closed in the 1975 Tax Reduction Act. Under the Mobil amendment, any interest owned as of March 29, 1975, could continue to qualify for the foreign tax credit for ten more years. Result: the bill would create the fiction that Mobil owned the oil yielding property and based on that fiction permit a foreign tax credit—not for months or a year but for a solid decade.

The cost of these two provisions, incidentally, has been estimated at upwards of $65 million per year, depending on who else takes advantage of it. What kind of public policy is this? Are Mobil and Natomas really hardship cases?

Section 806 of the bill is also unwarranted, in my view. At present, shipbuilding companies can shelter their earnings from tax to the extent that they plow back into a capital construction fund. This shelter is the equivalent of a 17 percent investment tax credit. On top of that, the shipbuilders want to take the 10 percent investment tax credit. This is nothing more than a double dip, which would cost the Treasury more than $20 million the first year, rising to $45 million by 1981. Again, I've seen no evidence that the shipbuilding corporations are welfare cases. If they are we should consider separate legislation for them. Relief for them does not in my view constitute tax reform legislation.

Section 1025 is another unacceptable special interest provision. The intended beneficiaries are the major grain traders, Cargill, Bunge, Cook, Continental, and so on. Under present law, if a great exporter sets up a subsidiary in a foreign tax haven to sell foreign-grown agricultural products, he must pay US tax on earnings to the extent that he pays no tax or a lesser tax overseas. Under Section 1025, profits from products grown overseas and marketed in a foreign tax haven could escape U.S. taxation altogether, with a cost to the Treasury of more than $15 million a year, and more as others begin to use the loophole.

Obviously, this can't be defended as aiding U.S. agriculture. It hurts American agriculture. Why? Because it gives a competitive advantage to foreign products. From everything I read, the big grain companies are not hardship cases.

I oppose most of these special interest provisions. I wanted to single out some of the worst for special comment. I have identified others in my floor statement of June 28, which I am including for the record.

The fact that the Committee has scheduled these hearings to give some of these special interest amendments an airing is a welcome sign. In future years, I hope you will provide for a full analysis of all such amendments well in advance of floor action, with testimony by proponents and opponents, Treasury comment and staff analysis on the specific provisions proposed to be added in mark-up.

Mr. Chairman, in my view, a new tax expenditure should be tolerated only as a last resort, when there is an overriding public policy purpose that cannot be obtained as efficiently through a direct subsidy. The test should be rigorous. The social benefit clear and emphatic. Obviously in the cases I have discussed no social benefit, none, has been the motivating force.

The CHAIRMAN. Senator, you said in your statement that the average person simply suffers an inequity and does nothing about it. I don't think it need be that way. Many times in drafting these bills we look at what we know, and based on the information that we have available we do something. Then we find out that there were unintended consequences that no one could have anticipated. Now when we undertake to undo those unintended consequences and to provide relief for those cases that we could not have anticipated, we are sometimes charged with special interest legislation to help just a small number of people.

In most cases I have no objection to saying that I have in mind a particular person. In some cases I don't know whether we ought to do it that way. I am willing to try, but I don't know if it is the best answer.

I have in mind one case, for example, where I had a modest amount of success. There was a man who was dying who had enormous medical expenses—around-the-clock nurses and blood transfusions to try to keep the man alive. He was a very successful man, not in a big city, but the pillar of his community. Those medical expenses were completely consuming all the estate that that man had actually built up over a long and productive life.

I found that on other occasions Members of Congress have had an amendment to say that you could deduct those expenses. At that time we had a limitation on how much you could deduct. It took a while but I was successful in passing an amendment to remove the limitation.

Now other Members of Congress had tried to do the same thing and they dropped interest in the matter when they found that their constituent died so it would not benefit him, just benefit some person in the future who might find himself in the same unfortunate situation. I don't know that it serves much purpose to say, "All right, here is this gentleman, here is what his name is, here is what his expenses are, here is what it would cost the Treasury."

In most cases where a particular person is interested I think it might make a difference. I think in other cases we might be better advised simply to look at the principle and ask, "Is this right?" I think it is well to ask, "How much do you think it will cost to do it?" I don't know whether it serves a purpose, particularly in compassionate cases, to identify the individual.

Senator PROXMIRE. I understand that viewpoint. Understand the principle and precedent may be far more important than the instant beneficiary, but it would seem to me that it is helpful in some cases at least, and it is hard to tell when those cases are. We know who the principal beneficiary is, what the cost to Treasury is and so forth. In many cases in this bill we don't know that. This may in some cases cause us to do injustice.

The CHAIRMAN. I think you would agree that there is another side where you have a compassionate case. He is really being crucified by the tax law, he is not asking for charity. In a case like that it is not desirable that we should have to identify that person. Perhaps we should be able to say the type of situation we have in mind, for anyone who finds himself in that situation. I think he should be permitted to deduct those medical expenses.

Senator PROXMIRE. That may be but I think in the overwhelming majority of cases that no injustice is done by having public knowledge and public discussion. I have seen very few cases.

The CHAIRMAN. I would say, Senator, that I am willing to try it either way.

If I might be permitted to repeat this story, there was a fellow who wanted to teach in a small town in Louisiana. The school board wanted to know what his views were on a certain aspect of geography:

Some people think the Earth is round and some think it is flat. We want to know your views on that.

Gentlemen, I came prepared to teach it either way.

[Laughter.]

So far as I am concerned I would be happy to try any suggestion that seems to have substantial merit and see how it works. I just wish we could persuade the Senate to do the same and judge by the results, because I know of no better way than trial and error to find out who is right about some of these things.

Thank you for your statement.

Senator Talmadge.

Senator TALMADGE. No questions.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. No questions.

The CHAIRMAN. Senator Ribicoff.

Senator RIBICOFF. No.

The CHAIRMAN. Senator Haskell.

Senator HASKELL. No. I don't have any questions.

The CHAIRMAN. Senator Dole.

Senator DOLE. I don't have any questions.

I agree with the statement of the Senator from Wisconsin. I think there should be some change, in fact I have already recommended at least a full reporting. We can go to the minutes ourselves and find out what the facts are because they are offered sometimes very quickly for distribution but it is difficult in a minute to have an accurate accounting of what did transpire. Something from that standpoint is very helpful and I think there may be some.

Senator Kennedy's suggestion was a third of these amendments belong in heaven, a third in hell, and a third in purgatory but he has not identified where they should be so we are at a loss to know. He just made a general statement in effect offering every amendment. I think we should go to bat for our constituents like you do, not get hit over the head with a bat in the process if our cause is just.

I have no questions.

The CHAIRMAN. Senator Hathaway.

Senator HATHAWAY. No questions.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. No questions.

The CHAIRMAN. Senator Gravel.

Senator GRAVEL. I agree that some change should be made, otherwise we would not be getting hit over the head the way we are by the press for doing what we think is right. As soon as we can dispose of this and develop a system, then I think it is going to operate for our own protection.

The CHAIRMAN. Senator Fannin.

Senator FANNIN. Thank you, Mr. Chairman.

Senator Proxmire, I appreciate what you have stated as far as the main purpose of your appearance today and we cannot disagree with that although I do feel that there is a great misunderstanding as far as the depth of inquiry that has been made on many of these amendments. I think to take a wide scope like Senator Kennedy did is absolutely wrong. I think you have been very specific and I appreciate that you have.

I know that some of these amendments which I authored, were certainly in order. Just because they pertain to petroleum product they are picked up as being improper and I just think that that is certainly not the way that the good amendments have been treated. When they pick up the name and apply it to an amendment without any relationship, then I object strenuously to it. That is what has happened in many of these 36 items that Senator Kennedy has submitted so I think you will agree that to just take a brush and say that all of these are wrong just because they happen to be connected in one way or another with the oil industry is not proper.

Senator PROXMIRE. Senator Kennedy did indicate two things. Some of these narrow tax provisions are probably good, some of them he indicated were perhaps good and some bad. His problem is that he just did not have the information to make this judgment and the various groups here who have been very diligent and anxious to make an analysis of each of these provisions feel they don't have the information. That is the problem.

Senator FANNIN. This little booklet prepared by the committee has been available. I notice staff has this booklet. If he had just taken the time to go through this report, he could have had the information. He could also have inquired from the staff of those who introduced the amendments under question.

Senator PROXMIRE. Senator, if you or the members of the committee would appreciate it, the New York Times reported this morning that there are still tucked away in the bill, written for a particular company or individuals, provisions that benefit firms and this information they still cannot get entirely. What I am asking the chairman to do is to provide a list the best he can, if he would, of all of the provisions that may benefit the individuals, specific firms. I realize that is asking a lot and I realize it will take some judgment.

Senator FANNIN. Did you make any effort to find out from the members that you had stated who introduced these particular amendments as to what the reasoning was behind them or why they were introduced? Did you make any effort at all? I know in my case you attributed one amendment to me. I had nothing whatever to do with it. I don't know where you received your information but I think that you could have received that information if you had contacted my office.

Senator PROXMIRE. I don't recall attributing to you, Senator Fannin, or other particular members. What I have said here is we have a number of provisions here which seem to be for special interests.

Senator FANNIN. Of course I cannot say the press was correct in making your statement but your statement did have that implication.

Senator PROXMIRE. To the best of my knowledge, and my staff tells me that that is their understanding, too, we didn't know. I didn't know who introduced them. I didn't know who was the sponsor.

Senator FANNIN. In that case the news reporter must have gone beyond your statement without verifying their information.

Senator PROXMIRE. He may have found out.

Senator FANNIN. I will accept your explanation but I know that there have been instances where the claim was that you had submitted that information.

Senator PROXMIRE. Yes, sir.

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Senator Proxmire, our economy is not simple. It is complex. These tax bills are usually very large. The Ways and Means Committee worked many, many months to finally agree on some language. My experience has been the staff is under terrific time pressures. At any rate, they act. The bill has passed the House. It is printed. Individual taxpayers or groups look at the bill and they say, "If this bill is enacted, why did this language get in?" In certain industries it does not fit the overall objective that the Ways and Means Committee had in mind. So these groups come to the Senate. They point that out.

Suppose it passes all the tests of being reasonable. Somebody called it up. The staff said, "Yes, this is good law, it is just, it is right, it is in accord with accepted accounting practices." Is that a special interest provision?

Senator PROXMIRE. Well, I am not sure, Senator Curtis, that I understand what specifically——

Senator CURTIS. Well, I don't think you know about taxes. I think you could serve your State and Nation a great deal if you would quit looking under the bed for the name of somebody. Study the tax law, examine the procedures that are laid out fully in the bill and in the reports, and equip yourself so you could decide whether this is a just and fair provision as a matter of tax policy.

Senator PROXMIRE. Senator Curtis, I understand that is your view and you have expressed it vigorously. You may be right, but I could not disagree with you more. In some cases, as the Chairman has indicated, the name of the beneficiary may or may not be relevant but in some cases it is relevant. If a particular firm is anxious to get a tax provision that is going to benefit them for millions or tens of millions of dollars if designed to benefit them to get it particularly, I think we have a right to know and the public has a right to know.

Senator CURTIS. My question was quite simple.

Senator PROXMIRE. That happens over and over again.

Senator CURTIS. My question was quite simple. The taxpayer says, "What is done in the House bill treats me unfairly, therefore I would like to have a proposal to change the language." The best experts we can get say, "Yes, that is fair, that is right, that is in accordance with good accounting practices and good law" and it is done. Is that a special privilege?

Senator PROXMIRE. It may or may not be. It may or may not be. The best experts don't overwhelm me, they don't overwhelm you either. Experts can be wrong, too. They can make their own judgment on it. We have the responsibility for the votes, not the experts. We cast the votes, we make the determination.

Senator CURTIS. I simply wonder if you believe that a tax proposal should be judged on its justness and whether it is right and whether it is good law.

Senator PROXMIRE. Of course it should, Senator Curtis. Certainly.

Senator CURTIS. What difference does it make who it benefits? Should we have one rule of law for popular people and another rule for unpopular people?

Senator PROXMIRE. No. These things are very hard to evaluate in an intangible generalized sense. When you see the specific impact that a proposal has on a particular firm that may benefit from it, then you are likely to get an insight and understanding. I think the *American Motors* case is a good example of that——

Senator CURTIS. I am not talking about——

Senator PROXMIRE. I think it was good to know that American Motors benefited. I think it was desirable and necessary to know whether we should vote for or against it.

Senator CURTIS. There are additional arguments. Now it may have been that the American Motors' proposal met those.

Senator PROXMIRE. Senator Curtis, we don't operate in a vacuum. You and I know these are applications whether it is just or not, whether it is right or not.

Senator CURTIS. I have asked a similar question that if an amendment is offered in the second body that considers the tax bill that prevents an injustice, is that special privilege legislation?

Senator PROXMIRE. I get your question now. It is a perfectly proper question. Let me see if I can answer.

The question is that it depends on what the facts are and what the facts show. Part of those facts are who benefits.

Senator CURTIS. I have been reading your releases and speeches and you have not been hampered by a lack of facts. [Laughter.]

Senator PROXMIRE. Senator, I am glad you read my releases and speeches.

The CHAIRMAN. Let's have order in the room. Our guests are here not to participate but to observe. Indirectly they do participate but they should not participate while the hearing is going on.

Senator CURTIS. That is all.

The CHAIRMAN. Senator Nelson.

Senator NELSON. I just want to thank my colleague for a very fine presentation. I think I have been to every major economic interest in my State for being on the wrong side and yesterday afternoon after long discussion with a very fine group representing appropriations in my State I told them that after listening to all the proponents of the various provisions of the tax code I come to the conclusion it is not the most perfect tax code in the world, any time you want to change one there is an economic interest group who makes a very persuasive argument for leaving it like it is, no matter what you may think of it as a loophole or not.

Senator HASKELL. Mr. Chairman, you passed on the question. I wonder if I could get a little time just to ask one thing.

Senator Proxmire brought up a good point—many good points. Excuse me, Senator. I didn't mean to indicate it was only one. One of the good points he brought up, we have certain allegations here that certain of these provisions benefit certain people and there is a suspicion that possibly certain other provisions affect principally or solely certain other specific people. I would like to reiterate Senator Proxmire's request, Mr. Chairman, that the staff be asked to set forth a memorandum in writing as to all the provisions in particular which they have reason to believe may be made to benefit a limited specified group. I would like to make that request, Mr. Chairman.

The CHAIRMAN. Senator, I believe we have that for you already. I believe the request has been made, and I suggest you check and see what they have already.

Senator HASKELL. No, I think the letter that Senator Nelson and Senator Hathaway and myself addressed requesting the information dealt only with specific sections. If I am wrong, then obviously the whole thing is covered. If I am right, why then we need to broaden the request. So I don't know. It is a factual question.

The CHAIRMAN. The information that you requested in your letter is being obtained for you, and I think most of it is available now. I would be glad to discuss the matter with you and see what else it is you want. If we can get it. I will try to accommodate you.

Senator HASKELL. Mr. Chairman, if the letter is not sufficiently broad to cover the request, is it my understanding you have no objection to asking the staff to do whatever is necessary?

The CHAIRMAN. Well, I would like to see what it is that you want in addition to what you have already requested.

Senator HASKELL. I will repeat my question.

I would like the staff to put down in memorandum form the specific provision which they have in any way reason to believe would benefit a limited one taxpayer. To the extent that this request in the letter was not that broad, I would like to broaden the request.

The CHAIRMAN. After this meeting is over I suggest that you and I meet with the staff and we will discuss the matter. I see no reason why not, but I would like to see what the request is, what it is you are asking for and the extent to which we have it for you.

Senator PROXMIRE. Senator Haskell, could I just follow up that request by saying that what I am talking about is that all the beneficiaries of the narrow interests provisions of the bill be identified. That was my suggestion.

Senator HASKELL. Yes.

Senator PROXMIRE. As fully as possible. I realize it is a matter of judgment.

The CHAIRMAN. That is going to be hard to do. Look at Senator Kennedy; he starts out with the suggestion. on which I claim some pride of authorship, that the tax credit should be refundable, that if the people cannot get the benefit out of it in the beginning that they get the benefit at the end. That could affect every company in the country and for that matter every individual.

It just takes a lot of doing when you take something that seeks to extend a principle someone thinks is right and try to find who all the people are who benefit. If we know a particular person came and said, "I cannot take advantage of my tax credit," I don't think that it is fair to act as though he is the only one who would benefit. In the case of the refundable tax credit, that was just my own idea, nobody suggested that to me. I guess you might say that between Senator Nelson and myself, we are the authors of the refundable tax credit which started with the earned income credit, and if a person does not earn enough money to pay you an income tax you should at least give him back some of his social security tax.

Senator PROXMIRE. What I am talking about is just the narrow interest provisions and just the two or three companies that are the principal beneficiaries.

The CHAIRMAN. I understand. If it is a narrowly drawn provision, who will benefit?

Senator PROXMIRE. Yes.

The CHAIRMAN. I will try to get that.

Senator Bentsen.

Senator BENTSEN. No further comments.

The CHAIRMAN. Senator Roth.

Senator ROTH. Thank you very much, Senator. We appreciate your statement here today and we will do the best we can to provide benefits. All the advice that you have offered, and I am sure in good faith, we will consider it in the spirit it was intended.

The CHAIRMAN. Is Senator Gary Hart here?

Senator John Durkin?

Then we will call on the Honorable Charles Vanik, Representative from Ohio.

STATEMENT OF HON. CHARLES A. VANIK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. VANIK. Mr. Chairman and members of the committee, I am here to make recommendations to your committee on a procedural matter which has been a great matter of discussion here this morning. I want to tell you simply that our House Ways and Means Committee procedures are working better—not perfectly—but they are certainly working better. I would say simply that legislative history crumbles if there is no record of the markup procedures. I am encouraged by the proposal you suggested, Mr. Chairman, that perhaps it is something you should try.

I want to point out that there are certain advantages to markup reporting. If these proceedings are made a matter of stenographic record, you can very often more easily and more readily check back on the representations that are made during markup, particularly by representatives of the Treasury concerning the revenue law.

Now, I will give you a case in point. When we dealt with the matter of the DISC—the Domestic International Sales Corp.—the Treasury estimates of revenue loss I think were over 250 percent in error. You have no way really to check back on representations of revenue loss from a specific provision if the representations of the Treasury can't later be challenged or checked.

Now I think certainly we ought to be able to have a record to which we can refer to determine the accuracy of our estimators and to determine whether or not these people should be retained in their positions or whether they should be changed. I think this is a very important thing. I would also hope that the proceedings in conference be made a matter of stenographic record and published. I don't know how the House will react but I expect to offer a proposal on the House side to instruct the conferees that there be a stenographic transcript of the proceedings in conference. I don't think this would interfere with the conference but it will merely make a record of what happened, what was the legislative intent.

In the area of legislative intent—in its most critical process of tax-writing—we are kept entirely in the dark, particularly in all cases with respect to conferences and in some cases with respect to committee proceedings in markup. Now markup records have not solved all of the problems in the House Ways and Means Committee, but I think we are making substantial progress. I commend that kind of process to your attention.

I am here right now on a substantive problem that I see in the action that your committee has taken. I am talking specifically about the so-called Aramco amendment which was enacted in the conference in the Tax Reduction Act last year. This act passed the Congress on March 29, 1975, just before and under the pressure of the Easter recess. The Aramco amendment gave four of our largest multinational oil companies a tax break worth $35 million a year. Now your committee has recommended that this special provision be expanded to benefit a handful of other multinational oil companies and result in a revenue loss of over $90 million a year.

The first advantage, the $35 million loss related to dividends and excluded all of the dividends, as you know, of Aramco from taxation. Other corporations pay taxes on 15 percent of dividends received. In the Aramco situation we created a unique situation, strange and extraordinary to every part of taxation under our system, under which we excluded all or 100 percent of the dividends received in this special situation.

Now the Tax Reduction Act contained a reform package designed to achieve two objectives: first, to limit the amount of foreign tax credit resulting from a rise in OPEC prices and, second, to impose some U.S. tax on foreign income generated from oil production.

These objectives were thwarted, however, when the conference committee in March 1975 inserted a special provision to benefit the four corporate owners of Aramco. These companies were allowed to treat their dividend income from Armaco as "oil-related income." That is income the oil companies may shelter from U.S. tax with the use of foreign tax credits which have been artificially inflated with OPEC's manipulation of the posted price system. As a result, it is likely that no U.S. tax can be collected on the profits Aramco distributes to its owners.

As a member of that conference committee I have no recollection of this matter ever being discussed. I have interrogated other members and staff and have been unable to determine where this special provision for Aramco ever came up. I never left the conference for 1 minute and my hearing is acute and accurate.

Now your committee has taken one additional step. It has expanded this loophole in order to benefit other U.S. multinational oil companies. Specifically, the committee's amendment shelters from U.S. tax "interest income" received by one domestic corporation from another domestic corporation. This income arises when a U.S. oil company borrows capital from another U.S. oil company to conduct oil operations abroad. Including interest income in the definition of oil related income is simply an expansion of the Aramco loophole and will lose the Treasury $90 million each year. This $90 million will be spread over a small number of multinational companies.

What concerns me, Mr. Chairman, is that we are developing in this process a new category of corporate consortium which will have special tax advantages over those and over and beyond those of all other American corporations.

Mr. Chairman, we are seeing the birth and growth of another special tax benefit. This loophole, like so many others in our tax laws, was born in the secrecy of the conference committee. I urge the committee to reject both the Aramco amendment and its expansion to include the $90 million loss here with respect to the expansion. It is time these companies make at least a token contribution to this Government which provides them with security and assistance worldwide.

Mr. Chairman, I appreciate your time to bring these matters of concern to your committee's attention.

[The written statement of Hon. Charles A. Vanik follows:]

STATEMENT OF CONGRESSMAN CHARLES A. VANIK OF OHIO

I appreciate the opportunity to appear before your committee on such short notice. My testimony will be brief.

Your committee's version of the Tax Reform Bill raises serious questions about the so-called ARAMCO amendment which was enacted in the Tax Reduction Act (P.L. 94-12). This Act passed the Congress on March 29, 1975. The ARAMCO amendment gave four of our largest multi-national oil companies a tax break worth $35 million a year. Now your committee has recommended that this special provision should be expanded to benefit a handful of other multi-national oil companies. The revenue loss from this proposal is another $90 million a year.

The Tax Reduction Act contained a reform package designed to achieve two objectives: first, to limit the amount of foreign tax credits resulting from a rise in OPEC prices; and, second, to impose some U.S. tax on foreign income generated from oil production.

These objectives were thwarted, however, when the conference committee, in March 1975, inserted a special provision to benefit the four corporate owners of ARAMCO. These companies—Texaco, SoCal, Exxon, and Mobil—were allowed to treat their dividend income from ARAMCO as "oil-related income." That is income the oil companies may shelter from U.S. tax with the use of foreign credits which have been artificially inflated with OPEC's manipulation of the posted price system. As a result, it is likely that no U.S. tax can be collected on the profits ARAMCO distributes to its owners.

As a member of that conference committee, I have no recollection of this matter ever being discussed. I have interrogated other members and staff and have been unable to determine where this special provision for ARAMCO ever came up.

Now your committee has taken one additional step. It has expanded this loophole in order to benefit other U.S. multi-national oil companies. Specifically, the committee's amendment shelters from U.S. tax "interest income" received by one domestic corporation from another domestic corporation. This income arises when a U.S. oil company borrows capital from another U.S. oil company to conduct oil operations abroad. Including interest income in the definition of oil-related income is simply an expansion of the ARAMCO loophole and will lose the Treasury $90 million each year. This $90 million will be spread over a small number of multi-national companies.

Mr. Chairman, we are seeing the birth and growth of another special tax benefit. This loophole, like so many others in our tax laws, was born in the secrecy of the conference committee. I urge the committee to reject both the ARAMCO Amendment and its expansion. It is time these companies make at least a token contribution to this government which provides them with security and assistance world-wide.

Mr. Chairman, I appreciate your time to bring these matters of concern to the committee's attention.

[From the Congressional Record. House of Representatives, Dec. 2, 1975]

CONFERENCE COMMITTEE ON TAX BILL MUST BE OPEN TO PUBLIC

(By Hon. Charles A. Vanik of Ohio)

Mr. VANIK. Mr. Speaker, during the coming week, the House will be debating H.R. 10612, the Tax Reform Act of 1975. After passage, the bill will go to the Senate where at least some part of it is expected to be approved before the end of the 1st session of the 94th Congress. In particular, title IV of the bill relating to the extension of individual and corporate income tax reductions—some $15.5 billion worth of tax reductions—mut be enacted before December 31, 1975. Action within the month is needed in order to prevent a major increase in employee withholding rates, an action which would destroy any economic recovery which may be underway.

Therefore, it appears that there will be a House-Senate conference committee later this month to iron out the differences—which may be substantial—between H.R. 10612 and any Senate passed bill.

If I am a conferee on the part of the Ways and Means Committee, I will move that the conference be open to the public and that a stenographic record be kept of its proceedings.

If I am not a conferee, I will move to instruct the House conferees to vote for an open and recorded conference.

On November 6, the Senate adopted language in S. 5, the Government in the Sunshine Act, to require open conferences. The language reads as follows:

SEC. 103. (a) CONFERENCE COMMITTEES.—The Legislative Reorganization Act of 1946 is amended by inserting after section 133C, as added by section 101(a) of this Act, the following new section:

"OPEN CONFERENCE COMMITTEE MEETINGS

"SEC. 133D. Each conference committee between the Senate and the House of Representatives shall be open to the public except when the managers of either the Senate or the House of Representatives in open session determine, by a rollcall vote of a majority of those managers present, that all or part of the remainder of the meeting on the day of the vote shall be closed to the public.".

(b) Title I of the table of contents of the Legislative Reorganization Act of 1946 is amended by inserting immediately below item 133C, as added by section 101(c) of this Act, the following:

"133D. Open conference committee meetings.".

I am introducing this language as a separate bill in the House of Representatives with additional language requiring the maintenance of an official transcript of the proceedings of each and every conference:

An accurate stenograpic record shall be kept of each meeting of a Conference Committee. whether open or closed to the public and shall be maintained in the offices of the Committees of jurisdiction of the matter before the Conference Committee. This record shall be available to the public at reasonable times and places, unless declared an executive record by a rollcall vote of a majority of those managers present. An executive record shall be available for inspection by Members, together with their staffs.

Conference committees are really a third legislative body. The House can pass a bill, and the Senate can pass another bill, and by the time a conference committee gets through with it, you have another, entirely new bill. The final product can look like a legislative Frankenstein—a final product that no one recognizes and no one wants to claim. Because many of the most important conferences resolve their work in the closing days of a Congress, the members of the parent chambers have little or no opportunity to determine what exactly happened and what they are voting on in approving the conference report. The confusion which often accompanies a conference committee and the approval of its work leaves the system open to abuse—to the last minute insertion of new language or language that benefits a particular group or set of individuals.

Open conferences and recordings of the debates and decisions in conferences can help protect the public against these types of abuses.

PERSONAL EXPERIENCE IN CONFERENCE ON TAX REDUCTION ACT

This spring, I had a personal experience with the type of problem I have just described. I was appointed on behalf of the House and the Ways and Means

Committee to the conference on the Tax Reduction Act of 1975, which subsequently became Public Law 94-12.

The bill which passed the House did not touch the foreign tax credit provisions of the Internal Revenue Code. The bill was amended on the Senate floor, however, to completely eliminate the foreign tax credit—FTC—for the oil companies. Thus as the bill went to conference, there was wide latitude left to the conferees: they could drop all reference to changing the foreign tax credit—as in the House version—they could eliminate the foreign tax credit—as in the Senate version—or they could provide some modified foreign tax credit for oil and gas production.

The conferees elected to provide a modification of the FTC which placed some limits on its use, but which did not go as far as the Senate in repealing its use for the oil companies.

Where did the language for the modification come from That was relatively easy. During 1974, the Ways and Means Committee had spent months and months working on energy legislation and oil windfall profits proposals. On April 30, 1974, the committee approved a bill, H.R. 14462, the Oil and Gas Energy Tax Act of 1974. That bill contained a provision limiting the use of the FTC by oil companies. However, for various reasons, this major piece of legislation was not brought to the floor of the House. However, on November 21, 1974, a larger bill containing both energy tax changes and individual tax relief was reported from the committee. This bill, H.R. 17488, included language identical to that in H.R. 14462 limiting the use of FTC by the oil companies. Unfortunately, this bill also died in the closing days of the last Congress.

Since the Ways and Means Committee had twice approved language providing a formula for limiting the oilmen's use of FTC's, the conferees felt that at least this proposal had some support and had been carefully worked out by the legislative draftsmen. So the language from the bills of the 93d Congress was lifted out and put in the Tax Reduction Act.

The bill was brought to the floor under the most hectic of conditions. The Easter recess was beginning and a large number of Members had made irrevocable commitments in their districts. A quorum was rapidly disappearing, so the conference bill was brought to the floor with only 90 mimeod copies of the bill available for distribution to the House Members. Under these conditions, careful scrutiny of the final language was not possible.

But then several weeks later, Prof. J. Reid Hambrick, professor of law at George Washington University and one of the Nation's experts on oil taxation and foreign tax credits, asked me how certain language in section 907 had been added to the bill.

Language for section 907 which deals with the FTC for oil had been drawn from section 202 of H.R. 14462 and from an identical section 122 of H.R. 17488—the two bills which had been approved by the Ways and Means Committee but which had failed to pass the Congress in 1974. But as Professor Hambrick pointed out, there was "new" language in section 907 which had not been included in either the House or Senate passed versions of the Tax Reduction Act of 1975 and had not been included in either of the 1974 bills.

Following is the present section 907(c)(3). I have capitalized the language which was not included in either of the two bills voted on by Ways and Means in 1974:

"(3) Dividends, INTEREST. Partnership, Distribution, Etc.—The term 'foreign oil and gas extraction income' and the term 'foreign oil related income' include—

"(A) dividends AND INTEREST from a foreign corporation in respect of which taxes are deemed paid by the taxpayer under section 902.

"(B) DIVIDENDS FROM A DOMESTIC CORPORATION WHICH ARE TREATED UNDER SECTION 861(a)(2)(A) AS INCOME FROM SOURCES WITHOUT THE UNITED STATES.

"(C) amounts with respect to which taxes are deemed paid under section 960 (a), and

"(D) the taxpayer's distributive share of the income of partnerships.

to the extent such dividend, INTEREST, amounts, or distributive share is attributable to foreign oil and gas extraction income, or to foreign oil related income, as the case may be; EXCEPT THAT INTEREST DESCRIBED IN SUBPARAGRAPH (A) AND DIVIDENDS DESCRIBED IN SUBPARAGRAPH (B) SHALL NOT BE TAKEN INTO ACCOUNT IN COMPUTING FOREIGN OIL AND GAS EXTRACTION INCOME BUT SHALL BE TAKEN INTO ACCOUNT IN COMPUTING FOREIGN OIL-RELATED INCOME.

What does the "new" language mean? According to the staff of the Joint Committee on Internal Revenue Taxation, it means about $35 million per year, probably most to ARAMCO—the giant consortium of oil companies operating in Saudi Arabia. It appears to ensure that dividends from ARAMCO to its parent companies—Mobil, Standard of California, Exxon, and Texaco—will be counted as foreign source income. This will permit the use of FTCs to offset any U.S. tax which might otherwise be levied against this dividend income.

Where did this "new" language come from? I have written to the members of the conference committee asking if they could recall this special new section. No conferee could recall such a section. Members of my staff have interviewed the offices of the House and Senate legislative counsels. They do not know where the language came from, and they do not recall any discussion of the provision in conference.

This complex new language, fitting deftly into a difficult section of the tax code, did not come from the Easter bunny. At this date, I believe that I may never find out exactly how this "new" language and this paragraph of the tax code was brought to life.

There is no question that it is another tax loophole. I believe that if the full implications of the section had been understood in the conference or in the House, it would have been rejected. But now it is in the code—and loopholes in the code die hard. A month ago I moved in Ways and Means to strike this new language. I lost by a vote of 17 to 19.

I believe that if the conference committee process were opened to the public and a record of conference committee proceedings were maintained, that the type of subversion of the legislative process demonstrated by section 907(c)(3) would be made more difficult and the public's interest would be better protected. A recorded conference is also necessary to provide a legislative history which sets forth and explains the legislative purpose.

For these reasons, I believe we all must work to ensure that the next tax bill conference is an open and recorded conference.

The CHAIRMAN. Thank you very much, Mr. Vanik.

Mr. Vanik, your suggestions will certainly be considered along with the other side of the argument. I am all in favor of having both sides of an argument when we vote on something.

Any questions, gentlemen?

Senator DOLE. What is the position of IRS and Treasury on this, Charlie?

Mr. VANIK. Treasury's position is rather indefinite.

I have studied the transcript. This is one of the reasons the transcript is so important. The transcript merely deals with the revenue loss. I think that the Treasury's position——

Mr. RUDKER. Our position is stated at page 21 of the memorandum which we filed here this morning. I believe you have a copy.

Senator DOLE. Are you for it or against it?

Mr. VANIK. I am glad you asked the expert now. Let me refer to Dr. Rudker.

Mr. RUDKER. It is a complicated item. What the Division does in expanding the oil basket is to include interest income. Now the Treasury basically feels that the oil basket which was brought into being by the Tax Reduction Act of 1975 is itself highly illogical and the best thing to do would be to get rid of the oil basket and go back to the Treasury's initial proposal for a 48 percent limitation on taxes paid by oil companies that was credited but if the Senate, if the House decides that they wish to repay the oil basket, then we cannot see a distinction between dividend income and interest income and we think that both should be included in the oil basket as oil related income.

Senator FANNIN. Mr. Chairman, it says, "* * * object to this because it is considered within the inclusion of oil or gas industry from the domestic corporation, foreign sources." I think the deposition is clear.

Mr. VANIK. As I see it the Treasury position is based on whether it should be logically included or excluded, but the fact of the matter is that it is the combined loss on these two provisions, $125 million, which is a rather substantial loss to the Treasury. We won't know if that figure is accurate for at least 4 or 5 more years until we can really calculate what the total cost of that language is going to be.

Senator DOLE. I would not disagree with your comments to the conference committee but you were not suggesting to this committee that we have not had that?

Mr. VANIK. No, no. I merely hope that Senator Long's suggestion that stenographic proceedings be kept a matter of record be extended to the conference. We would have a better idea as to the accountability for the existence of a section after the Congress has acted in conference so that we can develop a legislative history as to what was the reason, what was the purpose, what was the objective of the language and what were the purported losses as estimated by Treasury.

The CHAIRMAN. Senator Haskell.

Senator HASKELL. No questions.

The CHAIRMAN. Senator Fannin.

Senator FANNIN. Just one question. Is it proper to say that it is unlikely that any U.S. tax can be collected on the profits ARAMCO distributes to its own line? Would they pay dividend taxes on the dividends to stockholders?

Mr. VANIK. I have no idea, Senator. They pay dividends of course to their stockholders. Many exclude them under the 85-percent rule. It would be very, very difficult to ever find out whether there was any tax paid subsequently down the line. My fear is that they have not. They will not because——

Senator FANNIN. But you do not know that no U.S. tax can be collected because it certainly can be collected if there are profits going to the regular income and naturally they would and they would have dividends paid some time or other. Those companies all pay dividends and the Standard Oil Company of California, Exxon, and Mobil all pay taxes.

Mr. VANIK. But the recipients have an 85-percent exclusion and those in the ARAMCO consortium have a 100-percent exclusion. The only way these dividends may be taxed is that which goes to individual taxpayers, which is a very, very small trickle-down income.

Senator FANNIN. Well, if paid though you cannot say that no U.S. tax can be collected on the profits because down the line they could be.

Mr. VANIK. Senator, I just want to say that our committee has really—and I don't believe the Senate Finance Committee has ever really—looked at the tax returns of the American oil companies abroad. We just don't do it, it has not been our practice. I would be very surprised if there is now a substantial amount of taxes that are paid out of the tremendous earnings that are generated through posted price policies and other factors.

Senator FANNIN. Well, when we see their statements as to the amount of income they have from foreign operations that is in their statement that they do have for tax purposes, then why wouldn't taxes be down the line?

Mr. VANIK. We don't see their statements. All we see are the reports they make to the Securities and Exchange Commission and those are not a complete or accurate source of information.

Senator FANNIN. It is up to the Treasury then to see to that.

Senator CURTIS. Were you a conferee on this bill?

Mr. VANIK. Yes, I was a conferee.

Senator CURTIS. Were you the authority?

Mr. VANIK. Yes.

Senator CURTIS. Did you vote to approve the conference report?

Mr. VANIK. I voted to approve the conference report and I have no recollection whatsoever of the ARAMCO section. I raised that question I think 2 or 3 weeks after the conference. When I discovered this provision I immediately wrote to every member of the Senate Finance Committee, I wrote to every member of the House Ways and Means Committee. I am certain I wrote to every conferee and asking if any conferee could recall any discussion of the so-called ARAMCO amendment. As a result of that my House conferees substantially told me they didn't recollect it. I had no confirmation from any of the Senate conferees concerning that provision.

Senator CURTIS. There were Members of the House who relied on the fact that you signed a conference report?

Mr. VANIK. Yes, and this is what terrifies me, the fact that I as a conferee had no awareness of this provision and I sat through that conference, as Chairman Long will report, without leaving the table for 1 minute. I was very actively involved in the discussions that took place in that conference and I simply am unable to recall a single moment in which we discussed the extension to ARAMCO of a 100-percent exclusion on its dividend income. At least if it was discussed, it was not discussed in language that expressed it in a way that I could understand it.

Senator CURTIS. Did you check with the staff?

Mr. VANIK. I checked with the staff. I made complete comprehensive checks with the staff. I was referred to statements that were made on the conference report on the floor of the House but I sat through those discussions and I didn't hear the word said. Under our rules they don't have to be said but I didn't hear them said, and of course I was not able to read them until the Congressional Record was printed 3 or 4 or 5 days afterward and it came out during the course of the Easter recess.

The CHAIRMAN. Any questions, Senator Haskell?

Senator HASKELL. No questions.

The CHAIRMAN. Senator Nelson.

Senator NELSON. No.

The CHAIRMAN. Thank you very much, Mr. Vanik.

The next witness will be the Hon. Fortney H. Stark, a U.S. Representative from California.

STATEMENT OF HON. FORTNEY H. STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. STARK. Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before you today, not just as a member of the Ways and Means Committee but as a witness opposed to the many special interest provisions which are the subject of this hearing.

While the House may give some more exposure to these types of amendments, the Ways and Means Committee still is far from perfect. You may recall the Ross Perot amendment which sneaked into the Tax Reform Bill during our committee markup. After hearing the discussion this morning by the distinguished Senators and my colleague from Ohio I am convinced, as my children used to think, that not a tooth fairy but a tax fairy flits in and out of conferences and deposits these little goodies when the rest of us are obviously asleep.

I would like to talk about one provision adopted on the infamous day of May 27, and that is known as the IDS amendment. The IDS amendment is not all that big a revenue loser—not to exceed $5 million a year. But what I think was overlooked by you gentlemen on the Finance Committee and was initially certainly overlooked by the members of the House Ways and Means Committee was that real devastation in the IDS amendment is not the $5 million a year, but the fact that through the tax code we are aiding and abetting one of the most unconscionable, shyster, financial rip-offs that exists in America today. Several States—the State of California and the State of Wisconsin included which have blue sky laws—won't allow these certificates within their borders. They are sold at an interest rate of 3 percent. The average American cannot get his investment back unless he holds these certificates back 8 years.

Fifty percent of all the certificates sold by IDS are cashed in before maturity and the people don't even get their principal back. It is a great bonanza for the salesman. If this IDS amendment stays in, I submit that what the Senate Finance Committee is doing is lifting a rock out from under every unsavory financial representative in the country to peddle certificates as a tax avoidance gimmick.

Senator DOLE. Where did that amendment come from?

Mr. STARK. From the Senate Finance Committee and it was tried, I might add, in the House Ways and Means Committee. It was defeated 18 to 12 and on reconsideration was defeated 20 to 14. I cite this just as an example of the importance of examination of these so-called technical provisions. All the other provisions come into the tax code and——

The CHAIRMAN. I am sure I must have voted for the amendment, or not opposed it, but I just don't recognize it by the description. [Laughter.]

Mr. STARK. It is more specifically, Mr. Chairman, section 1307.

Senator PACKWOOD. Does it have an author?

Mr. STARK. Located in the State of Minnesota. [Laughter.]

I am not sure, Senator. In the House it was offered by the Congressman from St. Paul, Mr. Karth. Again without a record of the proceedings I only have to assume that, again, it was left on the table during the markup session.

I would just like to say that the result of both committees' actions speak for themselves. In one tax reform bill we have now benefited United Airlines, Chrysler Corp., Sun Oil Co., Mobil Oil Co., Hanna Mining Co., the Marriott Corp., Boise Cascade, Natomas and Tenneco. Few of these corporations pay as high a tax rate as the poorest constituent in my district.

If anything attests to what is wrong with the way our tax laws are written, it is a list of beneficiaries such as this. As in the case of IDS—whose past and present Board of Directors includes names like Richard Nixon, Melvin Laird, Paul McCracken, Donald Kendall, former Ways and Means ranking member John W. Byrnes—these companies are the most influential in the country.

Senator HANSEN. If there are any Democrats on the list, would you name them?

Mr. STARK. I don't really believe there are, Senator Hansen. I would be glad to review the record. This Member of the House wants really to go on the record as opposed to the continuation of the so-called "tax reform" process for even 1 more day. The changes have to come from this committee beginning right here in this room hopefully this summer before another bogus "Tax Reform" bill is passed by this Congress. It has to be done equally by the House and the Senate, and I submit this is the golden opportunity to take a step in the right direction. These special interest provisions—I call them "special giveways" of billions of dollars—can be removed from the bill before the Senate completes action so we can go into conference with something close to "reform" legislation.

[The written statement of Hon. Fortney H. Stark follows:]

STATEMENT OF REPRESENTATIVE FORTNEY H. STARK, JR.

Mr. Chairman and Members of the Committee, I am pleased to have this opportunity to appear before you today, not just as a member of the Ways and Means Committee, but as a witness opposed to the many special interest provisions which are the subject of this hearing.

The House has obviously been far from perfect in keeping special interest provisions out of its own bills. You're all familiar with the "Ross Perot amendment" which sneaked into the Ways and Means Committee Tax Reform bill late one night, much to everyone's professed surprise. Fortunately, thanks to good work by the press, we were able to reverse this giveaway on the House floor. Yet the fact that this "Perot amendment" is not an isolated case attests to the need for thorough review of all special interest loopholes and favors.

This entire process of special interest tax legislation, obviously, has its roots in earlier days of secret and closed Committee meetings with little or no public input. When no outsiders, and certainly no members of the press even knew what the tax-writing Commitees would be considering on a given day, public accountability was not even imaginable. The provisions, carefully tailored to the needs of the influential taxpayers, were simply included in complex tax bills, and then signed into law before any outsiders could begin to figure out who was being benefitted, or how they put their cases across to the Committees.

Many of us thought that those days were behind us. The new "sunshine" atmosphere has begun to have some results. The Ways and Means Committee, for example, has a new procedure for considering its special interest bills, known as Members Bills, or the so-called "technical" provisions. We hold hearings on the bills at one time, receiving testimony from the proponents, as well as a staff and Treasury analysis of each one. Then several weeks later, after the Committee members, public interest groups and the press have had time to study carefully the impact of each bill, we have an open mark-up session. The bills are then amended or voted up or down on the merits.

It was during this type of proceeding that the Ways and Means Committee considered a bill for Investors Diversified Services, Inc. (IDS). It was defeated outright in Committee, thus preventing it from even reaching the House floor. The consensus was simply that the change IDS wanted wasn't merited. Since this same provision, however, was added to this Commitee's bill on the infamous date of May 27, I'd like to go into some background on it to illustrate why we were able to decide, through a careful study, that it didn't belong in the Tax Code:

First, these face-amount certificates are one of the biggest rip-offs in the country. You must hold them for 8 years before you can get your principal back in full. Currently, one-half of all purchasers cash them in within 8 years, which means they lose from 2.5% to 19% of their original investment. Then, even if they are held to full-term, the interest is only 3%—after 20 years! (information from the Prospectus). One of the biggest selling points of them was their special tax status: Unlike similar investment plans offered by banks, the purchaser did not have to pay taxes, annually, on the interest earned amortized over the full term. That is the reason IDS came before us late last year.

Under IRS Regulations effective January 1, 1976, this tax-deferral feature was to be denied. IDS wanted to overrule the proposed Regulation, contending that without this tax deferral, they would be unable to continue their sales. In fact, they suspended sales of these installment plan certificates when the Regulations went into effect, and will resume only if this provision in your bill becomes law. But look a little more closely at why the IRS took the position they did in this Regulation, and at the nature of these installment plan certificates. This summary of the legislative history gives a good indication:

Until 1954, "discount", or the interest on face-amount certificates, was treated under the Code as capital gains. In 1954, this was changed to ordinary income treatment under Section 1232. However, at the same time, a cross-reference was added for the "special treatment of face-amount certificates on retirement" to Section 72, which deals with the 3-year averaging treatment upon retirement. Regulations arising out of the 1954 Act were finally written in 1957, stating that the tax treatment of face-amount certificates was to be governed by Section 72, as for endowment contracts, and not by Section 1232, covering "discount" interest. In 1964, the language of Section 72 on income-averaging was repealed, to be replaced by the new general averaging rules. But the cross-reference from Section 1232 on face-amount certificates was not repealed. No one is certain how this happened, and whether this was a deliberate omission, or simple inadvertence.

The question we face today arises out of what happened in the 1969 Act. Language was included that year to require that bond holders must compute original discount annually, and pay taxes ratably over the life of the bond. However, the language did not specifically refer to face-amount certificates, or to the cross-reference between Section 1232 and Section 72. Regulations on this provision were issued in 1971, and did explicitly refer to bank discount certificates, which accordingly were withdrawn from the market. Again, no reference was made to face-amounts. But in October, 1973, further Regulations specified that the ratable inclusion rules *were* to apply to face-amount certificates.

The IRS twice postponed implementation of this Regulation to give IDS (which has 95% of the market in these certificates) the chance to persuade Congress to legislate the clarification of the 1969 Act they wanted, exempting face-amounts from the new rule. Since no such bill was passed, IDS filed for a declaratory judgment in November 1975, for the Regulations to be found invalid. The District Court here in D.C. refused to issue such a declaratory judgement, thereby stating its position that the government had reasonable basis for its position in the Regulations. In addition, the Court took the unusual step of going even further, stating that it found the interpretation of the law by the IRS to be correct, and that clearly IDS was covered by Section 1232, the ratable inclusion rules on "discount".

It was at this point that the Ways and Means Committee took up the bill for IDS, to overrule the Regulation. It was our consensus, based on the legislative history alone, and the aspect of competition with banks, that there was no justification for opposing the IRS. The fact that these certificates are also as bad an investment as can be found anywhere was not central. But we decided that IDS should not be given, in effect, a special tax advantage to peddle them. The bill was defeated in the Ways and Means Committee 18–12, and then again, 20–14.

I cite this case as a perfect example of the importance of careful examination of these so-called "technical" provisions. Moreover, I cite it because in spite of all our careful study of this bill, your Committee, following its usual procedure, simply slipped it in, as if the Ways and Means Committee had never devoted the time and attention it did to this matter.

This is how all the other special interest provisions have filled the Tax Code. But what is different this time is that it no longer has to be done that way. We in the Ways and Means Committee have begun to move away from this time-honored tradition. While our new procedure is far from circumspect, it does have some semblance of public accountability. An infamous day such as May 27 would be less likely under House procedures.

The result of this Committee's actions speaks for itself: Income Tax Reform bill, you have benefitted the following taxpayers: United Airlines, Chrysler Corporation, Sun Oil Company, Mobil Oil Company, Hanna Mining Company, the Marriott Corporation, Boise Cascade, and Tenneco, to name a few. The list goes on, numbering perhaps as many as 40 such well-heeled corporate taxpayers—few of which pay as high a tax rate as my poorest constituents. If anything attests to what is wrong with the way our tax laws are written, it is a list of beneficiaries such as this. As in the case of IDS—whose past and present Board of Directors includes names like Richard Nixon, Melvin Laird, Paul McCracken, Donald Kendall, former Ways and Means Ranking Member John W. Byrnes—these companies are the most influential in the country. They can afford the most expensive lawyers and lobbyists, and have direct access to influential members of Congress, such as this Committee, to plead their case. Naturally, the Tax Code is tipped in their favor, time and time again.

This Member of the House, and of the Ways and Means Committee, wants to go on record as opposed to continuation of such a process for even one more day.

The Tax Code can no longer be the source of private relief for the wealthy few. We have to stop providing subsidies for airlines, insurance companies, oil companies and anybody else with influence, and take this same revenue and distribute it where it is needed—to the average taxpayer, for social services, education, health care, and so on down the line. The changes have to come from this Committee, beginning right here in this room, this summer, before another such bogus "Tax Reform" bill is passed by this Congress. It has to be done equally by the House and Senate, and, I submit, this is the golden opportunity to take a step in the right direction. These special interest provisions—I call them "special giveaways" of billions of dollars—can be removed from the bill before the Senate completes action, so we can go into Conference with something close to "reform" legislation.

Senator DOLE. I understand the author of this amendment has gone fishing. [Laughter.]

Mr. STARK. I really don't know.

Senator BROCK. Would you describe the amendment again? [Laughter.]

Mr. STARK. The amendment is known, Senator, as section 1307.

Senator BROCK. I was being facetious. I wanted to hear the harsh words.

Senator PACKWOOD. There is a record being made of this.

The CHAIRMAN. We will let you know who offered the amendment.

Mr. STARK. If I could repeat what Senator Proxmire said, it is certainly no mystery that the distinguished Senator from Minnesota more than likely had an interest in representing one of the largest corporations in Minneapolis as one of the matters covered on the Ways and Means side. Actually the revenue loss is a fly spec on the budget, it is minuscule.

What is overlooked in it is the consumer feature. Malcolm Forbes, for instance, editorialist, is against these kinds of certificates. I point this out as an indication that our tax code can have implications far beyond the mere revenue loss or gain and we ought to be very cautious in seeing what is brought into us in these proceedings.

Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Stark.

Next we will hear from the Honorable Donald C. Alexander, Commissioner of Internal Revenue. I am pleased to have you again before this committee, Mr. Commissioner. I think you perhaps share with me the distinction of being subject to the most ad hominem, and I will be pleased to have your views on this measure.

STATEMENT OF HON. DONALD C. ALEXANDER, COMMISSIONER, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY

Mr. ALEXANDER. All things considered, I would prefer that neither one of us share that honor. I have not enjoyed it, particularly, but you mentioned this morning, Mr. Chairman, that none of us is perfect. I am surely not perfect. Tax administration is not perfect. We don't walk on water; we are underwater part of the time. What I am worried about are certain provisions of the bill and the schedule of the bill. They may put us a little deeper underwater.

Senator HASKELL. Could the Commissioner pull the mike a little closer.

Mr. ALEXANDER. You didn't miss anything. [Laughter.]

Senator HASKELL. I am sure I did.

Mr. ALEXANDER. I was surprised this morning to hear Senator Proxmire compare the Internal Revenue Code with the Lord's Prayer; it is a little longer than the Lord's Prayer; all things considered, and perhaps not quite as easy to understand.

We are grateful to see this committee adopting some provisions that would simplify the Code. We are sorry to see this committee adopting some provisions that overturn a number of rulings we issued recently and to reverse some audit determinations; but there is only one I would like to discuss with you, section 1312 of the bill, which tells us that we cannot put out a new ruling, which was upheld in a recent suit in Federal court, to require reporting to us on charged tips.

We have a real problem, Mr. Chairman, in connection with trying to administer this law that you write up here, where you have a combination of transfers of cash and lack of records. That problem is made much more difficult when the transfers of cash are substantial.

On pages 10 and 11 of my statement, I have some statistics, and we think they are reliable. We talk about the universe of tip-related income. Taking a conservative estimate of tips at about 12 percent, we find that we have over $4 billion paid annually in tips. We believe, on the basis of information supplied by, among other things, the National Restaurant Association, that about 25 percent of that amount is charged. We think, further, that this is a growing universe.

Those of you who saw the Washington Post this morning, may have seen in the financial pages the recent increase in revenues of the American Express Co. and the increased earnings reported by this company.

We have had, as you would expect, great noncompliance in this area. Our estimate of revenue loss is nearer $100 million than the $5 million mentioned in the report of this committee. In reaching this revenue estimate we have assumed only a 35-percent noncompliance rate. Actually the audits that we have made show a higher noncompliance rate.

This is a situation for Gresham's law; particularly applicable here: The bad drives out the good—if one maitre d' is not reporting tips, another is less likely to. We would like to be able to call upon those who receive records of tips in written form to make available to the tax administration system a report of these charged tips. That is all we are talking about with our new ruling. That would be negated by the enactment of section 1312.

Administering the law is not easy, and adding 300 pages to the law is not going to make it any easier for us; but, when we are denied the opportunity to call reasonably upon those who have written records to share information with us to try to correct an area of massive noncompliance, we think that is going too far. We respectfully urge this committee to reconsider section 1312 and drop it out of the bill.

There is one other problem that he have addressed, Mr. Chairman. This morning a letter was delivered to you and to Chairman Ullman—I hope it can be made a part of the record of these proceedings—talking about the effect on next year's filing period of the delayed enactment of a bill that has massive effects on a large number of people.

[The letter referred to above follows:]

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, D.C., July 19, 1976.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
United States Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I want to bring to your attention some of the problems which the Internal Revenue Service is going to encounter as a result of the apparent timetable being followed by the Congress in its consideration of the Tax Reform Act of 1976 (H.R. 10612). The concerns of the Service in this area fall into two groups.

First, the timing of the legislation impacts upon the schedule which the Service had established for the development, printing, and distribution of the forms, schedules, instructions, and taxpayer publications. Second, the Service's preparation for the processing of returns is most definitely affected by the timing of the legislation.

As I am sure you recognize, the Service's tax form and publication program is undoubtedly the largest and most logistically complex printing and distribution operation of any Federal agency. It involves the services of the Government Printing Office, contracts with 100 commercial printers across the United States, who will use 31 million pounds of paper, print 1½ billion copies of various "flat" tax forms and instructional pamphlets for distribution through approximately 30,000 outlets, and the printing, addressing, and mailing of five different individual "tax packages" to about 85 million taxpayers. The contracting and arrangements for the tax package program, which is the largest mail-out program in the United States, started in April. The production of the paper for these packages is already underway.

Under the present contract arrangements, printing and distribution of the tax packages is currently programmed for a 90-day production period. To change this time frame would require additional printers at increased costs. Even to delay the schedules 10 to 20 days would require printers to reschedule their production in a situation where they have scheduled their production 2 to 4 months ahead in a market that utilizes very costly equipment on an around-the-clock basis.

Of course, the tax forms, instructions, and publications must be developed, revised, and reviewed for technical adequacy, accuracy, and administrative feasibility prior to their being released with an "O.K. to Print" to the printers. To do this requires the concentrated work of highly experienced and professional experts to make sure that the final set of forms and instructions meet the needs of the Service and the taxpaying public. The format and wording must be meticulously done within the constraints of space limitations while, at the same time, conveying in nonlegal terminology, the technically correct meaning of the law to taxpayers. Separate publications to assist taxpayers, e.g., "Your Federal Income Tax," "Farmer's Tax Guide," etc. must also be updated to reflect changes in the law. These publications contain filled-in copies of tax forms and provide vital information to taxpayers as well as to our own taxpayer service assisters. Additionally, these taxpayer publications are used in Service training programs as well as in training programs outside the Service. Any delay in enactment will adversely affect the availability of these publications.

A second area of concern relates to the processing of tax returns, related refunds and bills, and the demands to be met by our taxpayer service function. These are by necessity carefully scheduled operations. We recruit temporary help to supplement our regular work force so we can meet the anticipated volume of inquiries and return filings made by taxpayers. A delay in passage of this bill, with its many and varied provisions, means a severe compression of our required pre-processing period preparations. More specifically, it will involve significant additional expenditures in the areas of recruiting, training, systems development, and pre-operational testing. Testing is of special importance in this instance, because of the tremendous amount of change involved in the bill.

The programmatic aspects of our return processing program will also encounter difficulty. Normally, we start our major developmental work over a year in advance of a processing need of the following January. The intervening period is filled with development of the computer program requirements by late March; coordination and clarification of these requirements in April; concurrent with initial computer program development the handbooks for our field office procedures are developed by mid-August; Systems Acceptability Testing (SAT) takes place from mid-August to late December covering all facets of our various computer programs and operational handbook procedures; and during this SAT phase final refinements are made to our documentation so that it can be ready for publication and distribution as an aid in pre-operational training, etc.

With the major changes presented by this pending bill so late in the year, the timetable I indicated is obviously destroyed. In addition, there are various ripple effects for other processes which stem from the processing of our major returns and especially with regard to a delay in finalizing what the return package will look like.

By way of example, if the approval to print the final "1040" packages cannot be given until late October or early November, this would result in not completing mailout to the taxpayers until mid- to late-January 1977 (as opposed to the usual late December delivery). With late receipt of the forms design, our computer programs would not be available until mid-January, on even an accelerated schedule, as opposed to our normal September/October time frame. Testing, which is so critical, would extend to late March 1977. This would mean that in order to meet our processing demands, we would have to start production with less than fully "shaken-down" computer programs. Such a process can result in the type of erroneous output (e.g., erroneous refunds and tax bills) which we have labored so hard to avoid and which has plagued other agencies to the extent they have been the subject of much adverse criticism over the past few months.

Notwithstanding the above, we are still faced with the need to process returns on the type of schedule which the public has come to expect, and which is also so vital to returning refunds into the economy. We estimate the late mailout will result in a shift of 1,236,000 returns from January to February receipts. Because of our delayed accessioning of temporary personnel normally brought on in January, we would need 39 staff-years at about $371.000 to play "catch-up." Even so, we estimate 74,000 refund checks involving $31 million would be shifted from January to February issuances.

Delayed legislation will also cause problems for State tax administrators since many income tax States base their tax forms and instructions on specific line references to the Federal Forms 1040/1040A. A draft format of the Federal form is normally provided to States for planning purposes around August 1 of each year. Any significant departure from this schedule will obviously disrupt the orderly preparation of State returns, instructions and related computer processing programs.

The Service's program and plans relating to tax forms printing and distribution and returns processing are geared to an "O.K. to Print Date" of September 17, 1976. If the progress of the pending legislation does not result in its enactment by September 1, we will have to take some steps to provide for a later printing of Forms 1040/1040A and their related schedules. This process is, of course, not without additional costs, both financial and otherwise. For example, a later date than September 1 will mean considerable disruption for forms printing and distribution on returns processing procedures. The Form 1040 tax packages will be mailed later in January and "flat" copies of the forms and instructions will not be available until late in January or February.

The schedules which the Service has adopted not only recognize the Service's own requirements but those of taxpayers. who have demonstrated for many years that they need their tax forms as early in January as practicable. For example, in 1976, about 8.1 million taxpayers filed their tax returns by the end of January. Some filed their returns prior to January 31 to avoid having to make payment of the fourth installment of estimated tax. Others, who need the cash, file early to get quick refunds. For example, through January 29, 1976, the Service had made refunds of almost $300 million to about 756,000 taxpayers on their 1975 returns. Experience indicates that roughly one-third of Forms 1040/1040A are filed in January and February, another one-third in March, and the remaining one-third in April. A delay in the availability of forms and related materials to taxpayers will, of course, have a corresponding impact upon the processing of returns by the Service and will affect such matters as the mailing of refund checks.

If legislation is delayed beyond September 1, 1976, there will necessarily be corresponding delays in forms development, printing and distribution schedules, costs will be increased substantially, refunds will be delayed, and taxpayer complaints will increase.

If the pending legislation is finally approved by September 1, 1976, steps which the Service now takes can reduce to a minimum the adverse effects upon tax administration, although even with an enactment date at or about that time there will certainly be some taxpayer inconvenience, additional costs and general delay in returns processing. If the enactment date is any later than September 1, 1976, the consequences upon all of these aspects of tax administration which I have been discussing could be dire. The later the enactment, the more serious and costly the consequences. For example, if enactment is postponed until late September, the development and printing of our forms will be further put off schedule with the result that the mailing and receipt of the Form 1040 packages could not occur until early February.

With kind regards,

Sincerely,

DONALD C. ALEXANDER,
Commissioner.

Mr. ALEXANDER. We have to have some time to try to prepare forms, correct them, test them, prepare computer programs and to test them, to teach our taxpayer service people how to respond to questions they will receive on such things as the solar energy credit. We need that time before the filing period commences, and the later the day of enactment, the more difficult it is for us to render to the American people the quality of tax administration that they deserve.

So what can we do? We will do our best and we are doing our best right now to anticipate what may happen, but we hope that the timetable won't be materially deferred, Mr. Chairman, or, if it must be deferred, that provisions affecting individual taxpayers might be made effective next year rather than this year.

That is all I have to say.

[Mr. Alexander's prepared statement follows:]

STATEMENT OF DONALD C. ALEXANDER, COMMISSIONER OF INTERNAL REVENUE SERVICE

In my appearance this morning it is my purpose to address the committee solely as one who is responsible for the administration of the tax laws. My concern in reviewing the provisions of H.R. 10612 that are referred to in the Senate Finance Committee press release of July 8, 1976, has been to determine the effect that some of these provisions may have on the ability of the Internal Revenue Service to administer the tax laws effectively. I also want to comment upon the effect which the Congress timetable for its consideration of the pending bill will have on the printing and distribution of our forms and publications and the processing of returns, refunds, and bills for unpaid taxes.

A number of provisions of the bill appear to be inappropriate in light of their likely effect on public confidence in the fairness of the tax laws. I am concerned, also, by the fact that a number of provisions of the bill propose to overrule by statute recent rulings of the Service. Although the Congress clearly has the power to act as a final court of appeals over the resolution of controversies between the Internal Revenue Service and taxpayers, a frequent pattern of such action will cause the Congress to be deluged by application for such relief by those persons who have, or believe they have, the ability to achieve their specific objective by legislative means, and may result in reduced public confidence in the fairness and effectiveness of the tax system and its administration. I think, too, that it can be seriously questioned whether the patchwork legislation which results from reversing specific rulings of the Service results in the kind of broad legislative overview which Congress perhaps should be giving questions of this sort. I certainly am concerned about the effect which such specific legislative responses have upon the rulings process specifically and tax administration generally. Chief among the provisions of the bill in this regard is section 1312 which would nullify Revenue Ruling 76-231 (despite the fact that the approach contained therein has been specifically found by the U.S. District Court to be consistent with existing laws) with respect to employer reporting of tips paid by charge account customers.

The experience of the Service has confirmed the common sense conclusion that in businesses conducted largely in cash and without basic accounting records there is widespread underreporting of income. One of the areas in which this problem occurs is tip income of employees in service industries, primarily restaurants.

Failure to report income from tips is a chronic and persistent compliance problem. Since the early sixties the Service has periodically directed special efforts at the local level to detect and take corrective enforcement actions to improve compliance with tip reporting requirements. The results of such enforcement actions have been disappointing in that repeat audits have revealed that taxpayers receiving tips often revert to prior habits of nonreporting. Collection of additional taxes from such taxpayers, who may have used the income for living expenses, is costly. Obtaining compliance with the tax laws by those employees is complicated by the itinerant nature of many of the individuals.

Few tip recipients maintain adequate records for verification of taxable income. To determine tip income it is necessary to obtain information from third parties.

Therefore, enforcement actions have primarily been directed to identifying entities employing individuals who receive tip income and obtaining information on employees to determine omitted income. The reconstruction of income is a difficult procedure which requires that a sample of different types of employees (such as maitre d', waiters, bartenders, etc.) be audited in depth, that a ratio of tips to income be established for the various sections of each restaurant, and that the ratio be applied to gross sales made by all employees. Allowances must also be made for tip splitting practices. Variations of auditing techniques are employed depending on the records maintained by restaurants and tip recipients. In some situations, average tips per hour is computed and applied to the hours worked. Despite the difficulty in using this method of proof, the courts have recognized the Service's problems in this area by almost unanimously supporting the reconstruction of income in over 50 cases dating back to the early sixties.

In 1964, Congress addressed the problem of unreported tip income by enacting section 6053 of the Internal Revenue Code. The basic thrust of section 6053 is to require the employee to file monthly reports with his employer stating the amount of tips received. The employer is then required to withhold income and FICA taxes based on the amount reported.

The requirement of section 6053 has not, however, reduced materially the problem of underreporting of tips by service employees. In general, the problem is that an employee who is willing to file an income tax return underreporting his tip income will not be reluctant to underreport his tip income—whether it be cash tips or charged tips—on his monthly reports to his employer.

As a partial step toward reducing the problem of underreporting of tip income, the Internal Revenue Service published a ruling under section 6041 of the Code requiring that a person employing waiters, such as a restaurant owner, who collected tip along with the price of a meal by reason of a charge purchase and then paid the tip over to the employee, must report to the Internal Revenue Service those charged tips of which the employer has a record, and which the employee did not report, as required, to the employer. The original ruling, Revenue Ruling 75-400 was widely criticized by the industry and attacked in court as invalid. In *National Restaurant Association v. Simon* (D.C.D.C. 1976), 76-1 USTC Para 9311, the court specifically held that the ruling was not in conflict with the provisions of the Code but was consistent therewith. However, because of our sensitivity to the concerns of the industry, that ruling has been extensively reconsidered within the Service.

The Service's recent modification of its 1975 Revenue Ruling (which resulted in Revenue Ruling 76-231) made every effort to be responsive to the concerns of both the restaurant owner and operator and the employee. The new Revenue Ruling sets out very clearly the manner in which the employer will report charged tips on the employee's Form W-2. This is information which the restaurant owner has—via the customer's charge account slips—readily available. The new Revenue Ruling also provides for a postponed effective date—January 1, 1977—for the new reporting procedures. This will give employers a sufficient amount of time to make the necessary arrangements for the minor bookkeeping procedures which will be involved in reporting the charged tip income on the Form W-2. Insofar as the employee is concerned the modified Revenue Ruling informs employees how they can, in instances where they engage in tip splitting or pooling arrangements, explain the discrepancy between the tip income shown on their W-2 and their net income after splitting or pooling.

Unlike cash tips there is a paper record of charged tips. This record is on the credit card charge slip which the restaurant owner receives when the customer makes the charge. By requiring the restaurant owner-employer to report the amount of the charged tip on the employee's Form W-2, the tax system is able to take advantage of the fact that there is a written record of the amount paid as a charged tip. If the employer does not report the full amount of the charged tips received by an employee on the employee's Form W-2, the record of that payment is lost to the tax administration. When the high level of noncompliance in the tip income area is considered it seems extremely unwise not to take advantage of this written record—especially in view of the fact that voluntary compliance in this area will be encouraged by having these tips placed on the employer's Form W-2. Further, by utilizing the record of the charged tip the Service is in a position to obtain information from the employee concerning the identity of the person with whom he or she split the tip—for example, the bus boy or wine steward.

I think it is important for the Committee to have some appreciation of the amount of tip income and probable revenue impact that is involved in this amendment. Our statistical people have done a thorough analysis of the tip income area and have concluded (by applying a conservative 12 percent tipping rate to a $36½ billion tip related sales income figure) that tip income in the United States amounted to $4.4 billion in 1975. Based on data obtained from the National Restaurant Association and a certified public accounting firm specializing in restaurant accounts, we then determined that 25 percent of the tips paid on sales of food and beverages were shown on credit cards. In this manner we estimated that $1.1 billion of tip income in 1975 was paid by credit card. If we assume, again conservatively, that the noncompliance in the tip income area is 35 percent, we are able to estimate that approximately $385 million in charged tip income was unreported during 1975. Applying low effective tax rates to such amounts, it can be conservatively estimated that the revenue loss attributable to the failure to allow full implementation of Revenue Ruling 76–231 would amount to about $100 million.[1]

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[1] The Service does not have comprehensive statistics in this area. Some examples of findings on trip reporting are indicative of the overall problem:

(a) Examination of those receiving tips from one large key club revealed that the employees reported $107,753 as both cash and charge tips. However, an analysis of the club's records revealed that $370,247 had been paid to the employees as their share of the charge tips only.

(b) The examination of a hotel and country club revealed that the average charge tip income underreported by 550 employees was $3,512 for 1973 and $4,810 for 1974.

(c) The examination of a supper club recently revealed that waiters and waitresses were reporting less than 5% of their share of gross food sales as tip income. However, an analysis of charge sales revealed that tips received amounted to 18.8% on charge sales.

(d) The following is a quotation from one project report: "The overall results of the project revealed that employees were reporting only 10% of their tip income for Federal tax purposes, with the remaining 90% escaping taxation. The average annual understatement approximated $3,500 per employee. In some instances, employees were reporting no tip income whatsoever. To our knowledge, all employees audited realized that tips constituted taxable income. There were only a few isolated instances in which the employee kept a record of their tip income. Many of the taxpayers audited admitted they knowingly understated tip income. Their standard excuse for not reporting all tip income was that no one else does, so why should they."

(e) A revenue agent during the audit of the corporation income tax return of a well-known private club determined that employees were not reporting tips in full to their employer. Tips charged on various charge cards were $45,000. Tips reported to the employer for the entire year were $23,000. A total tip figure of $122,000 was computed by the agent based on a combination of cash and charge sales.

(f) In the examination of one club the IRS found that the total tips disbursed as reflected in the employer's records were $281,634. Total tips reported by employees amounted to $78,222 resulting in an underreporting of $203,412.

Several other provisions of the Bill are similarly addressed to the reversal of specific rulings or regulations, and are therefore subject to the same observations which I have made. For example, section 1035(f) which would delay for five years the effective date of Revenue Ruling 76–215 holding that certain amounts denominated as taxes under production-sharing contracts entered into with an agency of the government of Indonesia are royalties, and not taxes, and therefore are not eligible for the foreign tax credit.

Section 1305 of the Bill would authorize taxpayers to disregard Revenue Ruling 73–395 dealing with the accounting methods utilized by publishers. The published revenue ruling provided that certain amounts expended in the publishing business must be capitalized rather than deducted currently as expenses. Under the bill, the Internal Revenue Service will be precluded from applying the traditional capital expenditure/deductible expense principles which are applicable to other taxpayers until such time as it promulgates new regulations.

There are other examples of Service ruling positions being overruled by this Bill. Section 1322 of the bill would reverse Revenue Ruling 75–557 which concluded that certain connection fees received by a public utility water company from its customers are taxable income to the utility and do not represent contributions to capital of the utility. Some early cases decided by the Board of Tax Appeals in the 1920's and 1930's had held that these connection fees and other similar fees received by utilities were nontaxable contributions to capital and the Internal Revenue Service acquiesced in these cases. In recent years, however, the Supreme Court and other federal courts have adopted a more realistic view of what is income and what constitutes a contribution to capital. Because of this new authority, the Service reconsidered the old Board of Tax Appeals cases and changed its position. This change in position was announced by Revenue Ruling 75–557.

Section 2106 of the Bill would amend section 513 of the Code to exclude from the definition of unrelated trade or business "qualified public entertainment activities and "qualified convention and trade show activities." The proposed public entertainment activity amendment would legislatively overturn Revenue Ruling 68–505, in which the Service ruled that an exempt county fair association that conducts a horse racing meet with parimutuel betting is carrying on unrelated trade or business.

With respect to trade shows, section 2106 of the Bill would also overrule the holdings in Revenue Rulings 75–516 through 75–520. The changes proposed by this section of the Bill tend to undermine the fundamental concept of the unrelated business income tax provisions and lay the foundation for a piecemeal approach to the tax's repeal.

In conclusion I would like to ask that the Committee give special attention to the practical problem of translating changes in the Code into those actions which the Service must take to administer the law.

As you know, the Tax Reform Act (H.R. 10612) is presently being debated in the Senate. This massive Bill, if enacted, will have a major impact on the Service. I would like to bring to your attention some of the problems which the Service will encounter if the Bill is not enacted until fall but a number of its provisions affecting individuals are made effective for calendar year 1976.

The timing of the legislation impacts heavily upon (a) the development, printing, and distribution of the forms, schedules, instructions, and taxpayer publications; (b) the processing of tax returns; and (c) the rendering of taxpayer service.

The Service's tax form and publication program involves the printing of 1½ billion copies of various "flat" tax forms and instructional pamphlets for distribution through 30,000 outlets, and the printing, addressing, and mailing of "tax packages" to about 85 million taxpayers. Under present contract arrangements, printing and distribution of the tax packages are currently programmed for a 90-day production period. To change this time frame would require additional printers at increased costs.

Tax forms, instructions, and publications must, of course, be developed, revised, and reviewed for technical adequacy, accuracy, and administrative feasibility prior to their being released with an "O.K. to Print". The format and working must be meticulously done to convey, in non-legal terminology, the technically correct meaning of the law to taxpayers, within tight space limitations. Separate publications to assist taxpayers, e.g., "Your Federal Income Tax", "Farmers Tax Guide", etc., must also be updated to reflect changes in the law. Any delay in enactment of the bill will adversely affect the availability of these publications.

Our next areas of concern relate to the processing of tax returns, related refunds and bills, and the demands to be met by our taxpayer service function. These are by necessity carefully scheduled operations. We recruit and train temporary help to supplement our regular work force so that we can meet the anticipated volumes of inquiries and return filings made by taxpayers. A delay in enactment means a severe compression of our required pre-filing period preparations which will lead to significant additional expenditures for recruiting, training, systems development, and pre-operational testing.

The schedules which the Service has adopted not only recognize the Service's own requirements, but those of taxpayers. Experience indicates that roughly one-third of Forms 1040/1040A are filed in January and February. Some taxpayers file their returns prior to January 31 to avoid having to make payment of the 4th installment of estimated tax. Others file early to get quick refunds. A delay in the availability of forms and related materials to taxpayers will, of course, have a corresponding impact upon the processing of returns by the Service and will affect such matters as the prompt mailing of refund checks.

If the legislation is approved by September 1, we can minimize the problems discussed above. However, even with an enactment date at or about that time, there will certainly be some taxpayer inconvenience, additional costs and general delay in returns processing. If the enactment date is later than September 1, 1976, the consequences upon all these aspects of tax administration which I have been discussing could be dire. The later the enactment, the more serious and costly the consequences.

The CHAIRMAN. I think I can go along with you in requiring that the motels and hotels and restaurants make available to you all the records that they do have. I have some difficulty requiring that they have to keep a lot of additional records with regard to taxes that they themselves do not owe, taxes that someone else owes.

You know I supported your theory with regard to withholding interest on dividends. Some of those who proclaimed themselves to be reformers supported that as well, but you didn't get much help up the line where you are sitting, and I didn't get as much help as I needed to require withholding on dividends, but I hope that will come some day.

Mr. ALEXANDER. I hope so.

The CHAIRMAN. Thank you very much. Senator Fannin.

Senator FANNIN. Mr. Chairman.

We have all talked about your kind of business—not this Government alone but of business—and I think that what you presented to us was a far cry from what is needed. In other words, you were placing a greater burden and, in fact, you state that the amount involved is much greater than we anticipated; then you make a blanket condemnation of every employee that is involved.

In other words, you are saying that they are going to steal. I think that here we have a sufficient number of people who are being condemned as well as the large businessmen. You are saying that they are crooks. Now you come along and say that people all the way down the line are crooked, and when you make a blanket comment like that I resent it. I don't think the people are dishonest.

In 1965 you could handle this matter on form 4070. I don't know why that has not been sufficient. It is my understanding that there is an equitable way of computing tips and that this is a requirement. What is wrong with the form 4070?

Mr. ALEXANDER. It is not working very well, Senator Fannin. I don't mean to condemn anyone. I think the American taxpayer is doing a fine job but, where we have large amounts of cash, where we have no records, we do have noncompliance problems. On page 12 of my statement I give a number of examples which show a much higher noncompliance rate, Senator Fannin, than those which we have assumed in our revenue estimate.

Senator FANNIN. Mr. Commissioner, I think the comment you made before the committee indicated that people were not giving this information to employers. Certainly it can be required. The employer can be required. He can dismiss an employee if he does not turn in the required form 4070 or the form that you consider proper. If that form is completed, then you do not have a problem, is that right?

Mr. ALEXANDER. If the form is completed and completed accurately and completed fully there is no problem, but there is a problem as shown by the examples on page 12 of my statement. There is a major problem.

Senator FANNIN. But I think that some examples you give perhaps indicate carelessness on the part of the IRS, and I don't think that we should blame either the employer or the employee for that negligence.

I know that we have discussed this before and I don't want to go into it at length but I think that the procedure that we have followed is fair and equitable to the Department and to the employer and employee and that is the only objective that we had in adopting this particular amendment.

Mr. ALEXANDER. Senator Fannin, the IRS can be blamed for many things, and properly so, but I am not sure that we can be blamed for correcting noncompliance of the type described in the examples on page 12. We can be blamed for failure to correct noncompliance on the part of all those who receive cash income which is recorded, but I hope the IRS is never so big as to reach that magic state where there is one revenue agent for each nonrevenue agent taxpayer.

I hope the IRS resources are not sufficient in the future to have massive audits of all the taxpayers in this country; and I think that unless we have that, the alternative is to call for better—and, we think, reasonable—reporting. We think it is very little additional burden on the restaurant owner to give us the records that we ask for in the ruling which would be overruled legislatively.

Senator FANNIN. If the restaurant owner does not comply with the completion of that and the employer does not keep that record properly, yes, you have a case; but it seems to me that if this is a procedure that the IRS will follow and certainly hold the employer responsible for getting those forms from the employee, then we eliminate a tremendous amount of paperwork that is involved that is unnecessary.

It is that type of paperwork that we are trying to get away from here in the Congress and we are loading that onto the employee. You should take into consideration the cost of it which will probably amount to hundreds of millions of dollars to the employers. I just think it is unfair; it is inequitable and it is unnecessary.

We have many small instances of ma and pa operations that have a difficult time complying with all of your regulations whereas if they just have to fill out the Form 4070 and if this has been followed, I think you agree that we would not have a problem.

So I think we should stand on that basis and I think it would be fair and equitable to follow our original intent in this area.

The CHAIRMAN. Are there any further questions? Senator Packwood.

Senator PACKWOOD. On page 15, Mr. Commissioner, you say:

Section 2106 of the bill would amend section 513 of the code to exclude from the definition of unrelated trade or business "qualified public entertainment activities".

Then you say we are going to overturn Revenue Ruling 68–505.

Two questions: (1) The only court decision you have ever had as far as it related to these county fairs, the Commission law for 1956 refuses to appeal it and refuses to follow it and then that Revenue Ruling 68–505 went contrary to court decision. What do you suggest the committee should do? I genuinely think that your interpretation is wrong, and your interpretation is a revenue ruling and you are objecting to our reversing it.

Mr. ALEXANDER. This committee is, of course, entitled to take an action which it thinks is in the best interests of the tax system and taxpayers. And, as I said, Internal Revenue surely is not perfect. We think that this ruling is correct. We think that it should be applied. We think there is a tax problem of no small dimension here and we do not favor the reversal of this revenue ruling.

Nevertheless, we fully respect the right of this committee to reverse this ruling or any other ruling if it so chooses.

Senator PACKWOOD. That is the only decision that shares the committee position and the IRS refuses to repeal the decision.

Mr. ALEXANDER. I am not sure about that, Senator. I have no reason to disagree with what you said but I do not know, of my own knowledge, whether that is the only case in point. I do know there are a number of district court cases that follow and a number of district court cases that we don't and can't follow. Sometimes we don't appeal a case because we have made an inadvertent stipulation of fact or we cannot otherwise win the case on appeal; we look for another case and try to establish a correct proposition of law. We try to do this fairly and correctly. We don't always succeed, but we try.

Senator PACKWOOD. No other questions, Mr. Chairman.

The CHAIRMAN. Senator Brock.

Senator BROCK. Mr. Alexander, you would have a proposed new short form. Is that the result of the requirement of this committee and this bill or is that something that you have recommended to us?

Mr. ALEXANDER. Senator Brock, you and I served on the Commission on Federal Paperwork and it has been trying, somewhat unsuccessfully, to reduce the paperwork imposed on the public.

This bill provides for some additions to what is already on that form. We are going to have to devise a way of coping with the problem of the taxable income credit and the earned income credit, as the chairman mentioned a few minutes ago.

The Form 1040–A, which I was working on last night, is going to present a more formidable picture next year. And this year's form is too complicated.

Senator BROCK. The sample short form that will be required by this new modification of the law and hence the Commissioner has proposed—I gave it to the staff of the Commission on Paperwork and I gave it to my own staff, all of whom have college degrees or more. The rate of error on the paperwork was 63 percent and the rate of error on my own staff was 65 percent, all using the same base calculation.

What it says is that the average American citizen simply cannot comply with the tax code if he does not understand it. And this is the short form, not the long form. There is something wrong when we cannot even get a form—we call it a short form or simple form and the average citizen can't fill it out.

Mr. ALEXANDER. It is much too complicated, Senator Brock. We think it is going to be worse next year.

Senator BROCK. That is what I am talking about.

Mr. ALEXANDER. I think the statistics do prove that your staff does a better job than the Paperwork Commission. [Laughter.]

Senator BROCK. That is not saying a whole lot. I have a doggone good staff of young people and I had a 55-percent rate.

Mr. ALEXANDER. That is why we need some time to try to get a better form for next year, to try to get an accurate form, to try to get good computer programs and to try to teach our people who are going to assist in filling out these forms how to do it correctly.

Senator BROCK. Thank you.

The CHAIRMAN. Are there any questions? Senator Hansen.

Senator HANSEN. Mr. Commissioner, is there any significant difference in the number of national taxpayers reporting this year than was the case a year ago?

Mr. ALEXANDER. Not very much, Senator Hansen except in one particular way: We did not get the earned income credit population that we expected to get and that both the congressional staffs and our experts predicted we would get. The number of people predicted who would be getting something back from the tax system even though they had not paid any income tax was 3 million. We have received only about 500,000, or perhaps even less returns, from those people although we are trying to do our best to try to get them to come in and file.

Senator HANSEN. If I understand you, these are persons to whom the Treasury would owe a refund. Is that what you are implying?

Mr. ALEXANDER. By reason of the refundable credit to which the Chairman referred.

Senator HANSEN. And roughly about one out of six of those so far have not filed; is that what you are saying?

Mr. ALEXANDER. That is about it. I don't have an exact figure for you but that is my best guess. The figure is very much lower than what had been predicted. We are doing our best to try to reach those people and we are going to have another campaign to try to reach them. We think the people are afraid of the system.

Senator HANSEN. Afraid of the system?

Mr. ALEXANDER. Afraid of the tax system, yes.

Senator HANSEN. Insofar as the filing of returns voluntarily, you see no appreciable difference this year? I mean for the last tax year and the year before.

Mr. ALEXANDER. No; we received slightly less individual returns this year than last year, but that is because a number of people went off the rolls as far as filing was concerned, so that is understandable. We had more requests for extensions this year than last year; people had more trouble coping with the returns, and that is also understandable; they are more complex.

Senator HANSEN. But as you analyze these returns nationally, you see no appreciable difference in the willingness or at least an effort being made to comply with the tax laws——

Mr. ALEXANDER. No.

Senator HANSEN [continuing]. By those persons who should file the return this year or this last year and the similar number of the comparable group that would have been obliged to file a return the year before; is that correct?

Mr. ALEXANDER. That is correct; we don't see any.

Senator HANSEN. Pardon?

Mr. ALEXANDER. Your statement is correct; we don't see any tax revolt. We think the numbers are substantially as expected. We think the only missing element is those entitled to this credit—those who would be filing solely to obtain the credit.

Senator HANSEN. I have no further questions, Mr. Chairman.

The CHAIRMAN. Are there any further questions, gentlemen? Senator Nelson.

Senator NELSON. On the income question, are you saying that the IRS ruling would require that the restaurant employer report to the IRS that income received from tips through the charge account, credit card route? Is that what you are talking about?

Mr. ALEXANDER. That is right.

Senator NELSON. What percentage of meals would be paid for by that method now?

Mr. ALEXANDER. About 25 percent.

Senator NELSON. And what is the total restaurant sales?

Mr. ALEXANDER. The total sales, subject to tips, of course, including beauticians—a lot of people get tips—barbershops, et cetera, we think, is over $36 million.

Senator NELSON. This would not apply to barbershops or that sort of thing?

Mr. ALEXANDER. Not unless somebody puts them on the charge card, and I think most people pay in cash, except possibly in hotel barbershops or fancy hair stylists.

Senator NELSON. You are saying 25 percent of the restaurants' business is paid for by charge cards of some kind now?

Mr. ALEXANDER. That is right.

Senator NELSON. And that would be what total dollar amount of sales?

Mr. ALEXANDER. That would be a little bit over $1 billion in tips now, taking just tips rather than the aggregate.

Senator NELSON. In actual tips paid through the credit card route?

Mr. ALEXANDER. Yes, in actual tips, and we computed those tips at a 12-percent rate. We think that is pretty conservative because for only 12 percent, you get at least a frown, unless you are tipped on the way out.

Senator NELSON. You are saying that amounts to 25 percent of all tips paid?

Mr. ALEXANDER. Twenty-five percent of the tips charged would equal about $1,100,000,000, according to our estimates, using a 12-percent tip rate.

Senator NELSON. My concern is also the paperwork question and the imposition of additional paperwork upon the restaurateur. Your rules would require, then, that the owner of the restaurant make out a special withholding slip or slip of some kind telling the IRS that this individual by name received through credit card payments *x* dollars in tips during the year; is that what you are saying?

Mr. ALEXANDER. We would require that the owner of the restaurant, on the employee's W-2, indicate the excess of charged tips actually paid by the employer over tips reported by the employee. Under the present system it is recognized that the restaurant owner does not know, but for the employee telling him, what the employee has received in cash. He does not go around and look under the plate to see if there is a dollar bill for the waiter. So, therefore, the burden is put on the employee to report cash tips to the employer and then the employer to report to us.

As to charged tips, the situation is entirely different. There a ready-made paper is created by the fact that a charge is made on the American Express card, or another card, or by simply writing on the bill if one is at a hotel. So the paper is already there.

Now we would be requiring—and we think this requirement is entirely reasonable in comparison with the tax avoidance problem that the American public has at present—the restaurant owner to keep track of these charged tips, and we don't think there is much of a burden. Then the restaurant owner would report that to us at the end of the year on the W-2, a form already there, in box 7, a space already there, and we don't think that is much of a burden.

Looking at it from the standpoint of the paperwork burden, it is necessary to see whether the addition of a paperwork requirement is offset by substantial advantages in tax administration. We think this particular burden is small and fully meets that test.

Senator NELSON. Then what do you do with the waiter or the waitress who receives the tip on the credit card, one in a day and five in another day and the rest of the time is by cash? IRS gets this information and a daily computerization or something has to be made by the restaurant owner, identifying the individual, and then it goes to IRS and then the IRS does what?

Mr. ALEXANDER. The IRS—if we are given the funds—would match or attempt to match the paper, the W-2 document, against what is reported on the individual's income tax return. As I mentioned in previous testimony before this committee, we match about 40 percent of this paper document universe at this time. We would like to match more than that and we intend to do it if we have the resources.

Senator NELSON. Then what about the complication of the waiter or waitress sharing *x* percent, 15 percent for the busboy? What do you do about that?

Mr. ALEXANDER. We provide in this ruling that I mentioned, revenue rule 76-231, that the waiter or waitress should explain that on his or her tax return.

Senator NELSON. I am not clear on this. On cash tips does the IRS make some kind of an assumption about how much the employee received?

Mr. ALEXANDER. When we conduct an audit—the results of some of these audits are discussed on page 12 of my statement—we go through an elaborate and highly developed technique of checking in depth to see what percentage of the gross receipts of the particular enterprise is properly representative of the tip universe.

Now, we know that the tip universe is divided and the waiters and the waitresses pay the busboy, some of it goes to the wine steward, some of it goes to the maitre d', but we know much of it is not reported for tax purposes; and, for the integrity of the tax system as a whole, we think it should be.

After going through this particular technique, we then apply the results, discounting the results to arrive at a conservative figure that we are reasonably sure will be upheld, which we apply to those that we think have not fully reported.

Senator NELSON. What do you do if some people say that the tips that they show on their W-2 form—that they received x dollars to charge accounts, then they simply say, we have received on an average only 6-percent tips; that is all I got; people didn't like this. What do you do about that?

Mr. ALEXANDER. Well, we are frequently told about that and most of the time nothing is done about it because most of the time we don't audit most of this population or even a substantial percentage of this population; but, in cases where we do audit, we correct.

Senator NELSON. What do you do about the vast amount of recreation industry in the country where the students work in the summertime or at the ski resorts in winter, people who do 3 months of waiter and waitress? Do you get all those people that work too and then discover that they don't attach themselves to that obligation because they only work almost? I see in the resort industry most of these people and busboys, busgirls working there a 3-month period, they are back in school or something. What do you do with those?

Mr. ALEXANDER. Well, in these situations it would not make sense to use our resources because these people probably are exempt from the filing requirement in the first place, and exempt from tax liability, they probably filed W-4E's and frequently they don't file returns.

Senator NELSON. One more question. On the paperwork side have you requested in your agency run throughout the real paperwork? Take a restaurant that may have five waitresses and waiters and not one that has a busboy, waiters and waitresses, another one has some big resorts and have a hundred and go through the motions of having somebody fill out the form and inform you as to really how many hours additional work you are adding to the present paperwork burden. Have you done that?

Mr. ALEXANDER. We have not run such a test, Senator Nelson. We have reviewed this new requirement from the standpoint of the paperwork burden. We think it fully measures up to the test that I described. The advantages to tax administration far outweigh the additional paperwork burden, which we believe would be minor and which we think has not been correctly represented to this committee.

Senator NELSON. I know nothing about it. I know my mail has bills from small restaurant tours. This is just going to be another large amount of people working and they don't want to see the Government imposed on them and now this committee has forms which I might say are horrendous. Every time you tell me you are going to give me some more paperwork I am negative on it.

By the way, you promised us some time back that you were going to submit to the committee specific provisions on the format which were obligatory by the Congress which I think ought to be modified. We have not received that.

Mr. ALEXANDER. I sent that to Senator Bentsen—he specifically asked for it, Senator Nelson. I did send that letter to him which I promised at a prior session of this committee.

Senator NELSON. In any event everybody around here are very sensitive about the paperwork. I look at the paperwork and I must say it is irrational the number of questions that are asked and the impositions that are made on business people, particularly small business people. I would have to have a whole lot more convincing cases than I have heard that IRS could require.

You came in here and said you got a cross section of 50 employers of all sizes and here is the way they work it out and here is the hours it cost and here is what it means to a restaurant with two or three people and uses high school kids in little towns. I might look at it favorably but I am going to be hard to swing on any additional paperwork as far as I am concerned.

Senator BROCK. Would the Senator yield?

Senator NELSON. Yes.

Senator BROCK. I just ask with all this revenue out there and all the revenue to be gained, would you be willing for us to recompense the small businesses for the expenses actually incurred?

Mr. ALEXANDER. This committee can, if it chooses, adopt that principle. We don't think it is very good principle. We think that it might encourage agencies to be wasteful and to impose paperwork burdens on the public, rather than discourage agencies I am getting a strong feeling of discouragement on the paperwork issue from Senator Nelson—I like that because that encourages me to go back and give further encouragement to the people at Internal Revenue. Why do we need that? I ask, why on earth do we ask this question on this form? If it is not mandated by law or necessary to tax administration, out it goes.

That is what the bureaucrats need and that is what the agencies need to do. That is the way to do the job rather than impose the cost of excessive paperwork on the public. If the entire public picks up the tab to reimburse a particular part of the public, the agency won't be discouraged from imposing excessive requirements.

Senator BROCK. I agree with you but it does not work that way and if it did we would not have a problem. It won't be a cash drain on you. The whole argument is out of balance.

The question the Senator is addressing, whether or not this is going to so burden small people that they cannot comply, some of them will be put out of business. I know the answer. I know what they fear and I know what you are doing. You are telling the small restaurants out here in my State and throughout the country you enforce the tax code for us because we don't have people or don't have the ability, one or the other, but they are carrying the load and it is not their income. We do that already.

How much of a burden are you going to put on the small business people?

Mr. ALEXANDER. They already have to compute the amount of the tip income because they have to pay it over to the employee. They already have a paper record. This would require the employer to add some figures together and subtract a figure from that. Now I question whether that is a burden. Again, we think any burden is small in comparison to the benefit to tax administration if we are not prevented from obtaining information, which we think we need to administer your tax laws.

You discussed making a payment to the restaurant owner. We think attaching this was not the best way to get rid of the paperwork burden on the American public.

Senator BROCK. I don't think we are getting away from paperwork, I think we are adding to it. In your little local food store you may pay by cash; in east Tennessee in the Smokies it is almost all credit card and you are really putting the burden of these people.

Mr. ALEXANDER. We are quite concerned about restaurants out in Nevada and the compliance problems there, for example, the maitre d's in some of these expensive restaurants.

Senator BROCK. You say if you eliminate the place that only had three employees or four employees we might solve the problem.

Mr. ALEXANDER. That is not where our compliance problem is. The problem is with the big establishment and the highly paid people in the big establishments.

Senator BROCK. But they have got the income, they can handle it. It is the small businesses you are going to kill. You are not going to get any income.

Senator NELSON. May I ask one more question. I must be missing something.

If you have a waiter or waitress which is widely honored in the minimum wage, the W-2 form is fine, isn't it?

Mr. ALEXANDER. Yes.

Senator NELSON. Since you have the W-2 form and three-quarters of all the income is paid in cash, you have their name—why don't you just go on that basis? What does it add to have tip income? I mean the charge tip.

Mr. ALEXANDER. Because what is reported in the W-2 form does not in any way approximate the aggregate tip income, Senator Nelson.

Senator NELSON. I understand that but you say the tip was only 25 percent paid by charge, therefore three-quarters of it you don't have any way so if you are going to check on it you have the W-2 form and if they work the year around and then charge them that much on their income tax——

Mr. ALEXANDER. To perform that task you need to have an intensive audit. We do not have the resources, nor are we asking for these resources, to try to do that in every case. The W-2 form with the present Form 4070 is simply inadequate to give us what we need. If we can take advantage of the paper record that is already there, a little additional paperwork with, perhaps, exempting small entities of the kind that Senator Brock is talking about, we think we will then not only have a good record of what is charged but we will also have a standard of comparison for what is not charged, which we don't have now.

Senator NELSON. I might say my staff reminded me of a little case that came into our office of four waitresses who were assessed 10-percent gross receipts at a buffet, arbitrary assessment, saying that was their tips. The waitresses said the two owners worked a substantial part of the time working on the table themselves and made the complaint to the IRS and the IRS refused to review the case. I think you are getting into a whole big muddle of stuff that is going to cost you more than you are going to get unless if the big resorts, the big hotels sets the standard like that. If you start tackling it in little restaurants and in little places, I can't see it.

Senator HASKELL. If the Senator would yield.

If you amended your ruling, Commissioner, you might pick up a couple of votes.

Mr. ALEXANDER. It seems to be that way. I got some very helpful suggestions this morning and perhaps in order for us to have any ruling at all it might be advisable to amend section 1312 to permit us to do that. We also need to supply to Senator Nelson a detailed analysis of this paperwork burden and I intend to do that. I would like to be permitted to do these two things.

Senator NELSON. I think it would be helpful for the whole committee.

Senator BROCK. If you will draw up some language, I would be delighted to offer it.

[The material referred to above follows:]

Internal Revenue Service | **Department of the Treasury**

Commissioner | Washington, DC 20224

JUL 2 C 1976

Honorable Russell B. Long
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

When I testified before the Senate Finance Committee on January 20 concerning section 1312 (relating to reporting of tip income) of H.R. 10612 there were a number of questions regarding the scope of the record keeping burden that would be imposed upon employers as a result of the procedures required by Revenue Ruling 76-231. Questions from various Senators also indicated interest in the possibility of the Service revising its procedures to exempt certain small businesses from the proposed reporting requirement. It is to these two aspects that I wish to address myself in this letter.

As a prelude to describing the really very small additional computation which our procedures would impose upon restaurant owners and operators let me discuss, briefly, the existing requirements which are imposed upon both employers and employees. The Service's Form 4070A is provided for the use of employees to keep a record for themselves of their tip receipts on a daily basis. This form, a copy of which is attached, contains a column for recording cash tips received directly from customers and a column for recording tips received on charge receipts.

Form 4070, a copy of which is also attached, is presently used by employees to report, on a monthly basis, to their employers the amount of tips received. As you can see, this Form also provides for separate reporting of cash tips and charged tips. The amounts reported on the monthly Form 4070 by the employee to the employer are, along with regular wages, subject to income tax and FICA tax withholding by the employer.

These are the procedures that are now required. As I indicated in my testimony on July 20, there is considerable noncompliance in the tip income area at the present time. This manifests itself in employees not reporting, on the monthly Form 4070, the full amount of their tip income--whether it be charged tip income or cash tip income. In order to improve compliance in this area the Service seeks to take advantage of the paper record which exists, via the customer's charge account slip, of the amount of charged tips paid to restaurant employees. This would simply involve requiring the restaurant owner to determine the excess of the aggregate amount of charged tips paid to an employee over the amount of charged tips reported by an employee on the Form 4070. It is this excess which the Service's recent Revenue Ruling would require the employers to enter on Box 7 of the Form W-2—a Form (copy attached) which the employer already uses and with which he is familiar. It is the determination and the entry of this figure, and only this figure, that would be additionally required of employers.

In a typical restaurant operation a petty cash slip, or some other form of recordation is prepared showing the charged tips which are paid over, generally on a daily basis, by the employer to the employee, and for which the employee signs a receipt. The petty charge slips or other forms of record are then totalled and the aggregate posted to the appropriate account in the employer's books. (This procedure is set out and recommended in the Uniform System of Accounts for Restaurants, published by the National Restaurant Association, see attached). To comply with the Service proposal, an employer would simply be required to periodically, e.g., weekly or monthly, total the petty cash slips, or other record, for each individual employee for charged tips, and subtract from this the total of the amount of charged tips reported by the employee on Form 4070.

The key point in this discussion is that while some minimum amount of additional record keeping would be required, no new forms or records would be required. The determination of the amount of charged tips actually paid by the restaurant to the employee is presently determinable--all that would be required is that the excess of that amount over the amount reported by the employee be entered on records or forms already used or required.

Let me turn now to the second point I wish to discuss—the exemption of certain small businesses from this reporting requirement. Pursuant to the suggestions made by Senator Nelson and Senator Brock, and perhaps others, the Service will in its revision of the Revenue Ruling, exempt certain small businesses from the charged tip reporting requirement contained in the present Revenue Ruling. Under the revised Revenue Ruling an employer will be required to comply with these reporting requirements only if, at anytime during the preceding calendar year, it had more than ten employees.

The Service contemplates that it would revise the Ruling to include the exception for small businesses and to restate the procedures involved in a manner in which they would be more capable of easy understanding.

As I stated in my letter to you of March 1, 1976, it was certainly never the Service's intention to impose undue or impossible burdens on employers in requiring the reporting of charged tips on each employee's Form W-2. In considering the provisions of section 1312 of H.R. 10612, I respectfully request that you and the other members of the committee weigh, against the minimal additional burden imposed on the employer, the undisputed fact that there is significant noncompliance in the tip income area and the increase in compliance which would result if restaurant employers undergo this minor modification in their bookkeeping procedures.

With kind regards,

Sincerely,

Donald C. Alexander

Enclosures

Employee's Daily Record of Tips (Form 4070A) and Employee's Report of Tips to Employer (Form 4070)

For the period beginning ...., 19 ....

and ending ...., 19 ....

Name and address of employee

Department of the Treasury
Internal Revenue Service

Document 5635 (Rev. March 1975)

Employee's Daily Record of Tips

Employer's name

Month		Year
Date	Tips received directly from customers	Tips received on charge receipts
1	$	$
2		
3		
4		
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
Sub-totals	$	$

(Continued on back) Form 4070A (Rev. 3-75)

Employee's Daily Record of Tips (Continued)

Date	Tips received directly from customers	Tips received on charge receipts
17	$	$
18		
19		
20		
21		
22		
23		
24		
25		
26		
27		
28		
29		
30		
31		
Sub-totals	$	$
Sub-totals from front	$	$
Totals	$	$

Form 4070 (Rev. March 1975) Department of the Treasury Internal Revenue Service	Employee's Report of Tips to Employer	Social Security Number
Employee's name and address		Tips received directly from customers . $
Employer's name and address		Tips received on charge receipts . . $
Month or shorter period in which tips were received from , 19 , to , 19		Total tips . $
Signature		Date

For Official Use Only

Wage and Tax Statement 1976

Type or print EMPLOYER'S name, address, ZIP code and Federal identifying number.

Copy A
For Internal Revenue Service Center

Employee's social security number	1 Federal income tax withheld	2 Wages, tips, and other compensation	3 FICA employee tax withheld	4 Total FICA wages

Type or print Employee's name, address, and ZIP code below (Name must align with arrow)	5 Was employee covered by a qualified pension plan, etc.?	6 *	7 *

* See instructions on back of Copy D.

Form W-2 See instructions on Form W-3 and back of Copy D Department of the Treasury—Internal Revenue Service

UNIFORM SYSTEM
OF
ACCOUNTS FOR RESTAURANTS

Fourth Revised Edition
1968

ADOPTED AND RECOMMENDED BY
THE NATIONAL RESTAURANT ASSOCIATION

Prepared by
LAVENTHOL KREKSTEIN HORWATH & HORWATH

Including
RECORD KEEPING FOR THE SMALL RESTAURANT

sales separately from food and beverage sales and a separate column is provided on this form to record them.

COLUMN 4—SALES TAXES

In many states and municipalities sales taxes are collected from the customer and are accounted for separately, and for this reason a separate column is provided for the taxes that are a part of daily sales.

If tax collections are kept separately, the total will be credited to a sales tax account in the general ledger and amounts paid to the government will be charged to this same clearing account.

Smaller restaurants, and some of the larger ones, often find it more practical to include these sales tax collections with sales and to charge the payments to the government to "administrative and general expense." Although in exact accounting the inclusion of sales taxes in the sales may affect the food cost and expense ratios, it is a matter of judgment and practical application whether the distortion is significant enough to warrant a separate accounting for these taxes collected.

CREDIT EXTENSION AND TIPS CHARGED

Restaurants are feeling the pressure of the demand for credit accounts, and this type of sale has expanded widely in all lines of retail and consumer sales in the past few years. The tremendous growth in popularity of the many credit card agencies is good evidence of this trend.

Although sales of most smaller restaurants are on a cash basis, there has been a trend toward some charge sales and for that reason Form No. 1 includes one column (12) for the recording of the charge sales for the day and one column (6), for recording the collections on charge sales previously made. It is advisable, in the event the proprietor adopts the policy of extending credit to his customers, that the details of these transactions should be noted in a separate book or record.

The details of the charges and collections on charge accounts can then be totaled daily for entry in the Sales and Cash Receipts Record—Form No. 1.

An example of this type of record is included on the reverse side of the Daily Report—Form No. 4, included as an exhibit later in this section. The record should at least include the date, the amount charged and the customer's name. In a small restaurant it may not be necessary to send out bills for the few charges made, but in the event it is necessary to do so there should be a record of the customer's address and credit card number, if any.

The policy of allowing the customer to obtain meals on credit by signing his check also poses the problem of what to do when he adds the amount of a tip to the check, which has become the prevailing procedure. Usually these tips are paid out of the cash drawer to the waiter or waitress, who signs a tip voucher as a receipt. This also makes it necessary in the daily records to provide separate columns in which to record the amount of tips charged and the tips paid. Form No. 1, therefore, provides columns (5) and (10), respectively, for this purpose. These two columns should balance daily unless one of the servers forgets to collect. Since the cashier will ordinarily keep all charge checks separate from the cash sales, the total amount of tips charged can be transcribed from them as the charges are listed. In many of the larger restaurants the cashier's sheets provide the data for compiling these records.

Mr. ALEXANDER. Thank you. We don't want to impose an additional burden on the small business but we do want to administer the tax laws effectively and also responsibly.

Senator HARTKE [presiding]. Any further questions?

The next witness is Mr. Fred Wertheimer, vice president-operations, Common Cause. Jack Moskowitz is appearing with him as a lobbyist.

STATEMENT OF FRED WERTHEIMER, VICE PRESIDENT—OPERATIONS, COMMON CAUSE, ACCOMPANIED BY JACK MOSKOWITZ, LOBBYIST

Mr. WERTHEIMER. Thank you, Mr. Chairman.

I am accompanied by Jack Moskowitz who is Common Cause's principal lobbyist on tax issues. This committee occupies a unique position of public trust because of its jurisdiction and power over matters that deeply affect the pocketbooks of every American. This trust places on the committee a heavy responsibility to the Nation's taxpayers. This responsibility is not being met.

For our tax system to work, taxpayers must believe it is fair and equitable. Overwhelming voluntary compliance has been the hallmark of the faith of American taxpayers in the fairness of the system. It has distinguished Americans from taxpayers in other countries.

But in recent years there has been a dramatic change in attitude. Many taxpayers no longer believe in the fairness of our tax system. They view it instead as a vehicle for providing special advantages for the wealthy and the influential. Every time a new tax reform bill passes Congress it is enacted at the cost of public cynicism and public disillusionment.

The American people today perceive a fundamental lack of integrity in our taxing system, a grave danger for any democracy. This perception is well founded. There is a basic lack of integrity in the political process that determines our tax system. The adding of dozens of special interest amendments to the pending Senate tax bill—in the evening after 2 weeks of exhausting markup session—without following even the most elementary legislative procedures reinforced this perception. So did the infamous Ross Perot case documented last year through the investigative reporting of the Wall Street Journal.

We wish to discuss today some of the steps that can be taken to correct the widespread view that the average taxpayer perpetually stands at the end of the line, while special interests perpetually stand first in line in determining this Nation's tax policies. These steps deal with the role of money in politics; with undisclosed lobbying activities; with secrecy and the unavailibity of relevant information, with inadequate committee procedures for making public policy; and, with potential conflicts of interest by public officials.

We recognize and applaud the central role played by the chairman of this committee in the creation of the new public financing system for our Presidential elections. But the same evils and dangers that led to this historic Presidential reform apply at the congressional level as well.

Ask American citizens if they believe that private campaign contributions buy political influence and affect congressional decisions in this country and they will respond with a resounding yes. Chairman Long has described the dangers of money in politics as aptly as anyone.

Ten years ago he said:

When you are talking in terms of large campaign contributions . . . the distinction between a campaign contribution and a bribe is almost a hair's line difference.

Hearings on S. 3496, Amendment No. 732, S. 2006, S. 2965 and S. 3014 before the Senate Committee on Finance, 90th Cong., 2d sess. 78 (1966).

Nine years ago he said:

Insofar as—public financing—would result in long-term economies in Government it is the one approach that the favored few would want the least. Of all expenditures by Government, this is the one which the robber barons will oppose the most. The cost of financing a Presidential campaign is one expense that they welcome. Investments in this area can often be viewed as monetary bread cast upon the water to be returned 1,000 fold.

S. 4586 Cong. Rec., April 4, 1967.

The absence of congressional public financing and the need to raise large private sums to finance political campaigns has left its mark—a large mark—on the Internal Revenue Code. It has also left an indelible black mark on Congress in the eyes of the public—a public which believes that political favors are up for sale. Erasing this black mark will only occur when we take Congress off the auction block by providing for public financing of congressional elections.

In order to give some sense of the potential effect campaign contributions could have on this powerful committee, as well as the potential appearance of influence they may have to the general public, I would like to introduce into the record an exhibit which accompanies my testimony and which the committee has before it.

Senator HARTKE. That will be included in the record.

[The exhibit follows:]

APPENDIX A

CAMPAIGN CONTRIBUTIONS TO THE SEVEN MEMBERS OF THE SENATE FINANCE COMMITTEE WHO RAN FOR REELECTION IN 1974

Prepared by:

Common Cause Campaign Finance Monitoring Project

ELECTION CANDIDATES	TALMADGE,HERMAN E DEM/INCUMBENT GENERAL ELECTION INFO: WON/OPPOSED 627,376 VOTES (71.7%) PRIMARY ELECTION INFO: WON/OPPOSED				JOHNSON,JERRY E REP/CHALLENGER GENERAL ELECTION INFO: LOST/OPPOSED 246,866 VOTES (28.2%) PRIMARY ELECTION INFO: WON/UNOPPOSED			
	-NMBR-	$-AMOUNT	AVER	--%--	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		254,870				12,640		
CASH ON HAND - BEGINNING		75,829				0		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	68	65,965	970	25.9	0	0	0	.0
IN STATE	56	45,465	812	17.8	0	0	0	.0
OUT OF STATE	12	20,500	1,708	8.0	0	0	0	.0
COMMITTEE CONTRIBUTIONS:	33	59,705	1,809	23.4	0	0	0	.0
INTEREST COMMITTEES	32	57,705	1,803	22.6	0	0	0	.0
POLITICAL PARTY COMMITTEES	1	2,000	2,000	.8	0	0	0	.0
LOANS RECEIVED	0	0	0	.0	1	6,000	6,000	47.5
LOANS REPAID	0	0	0	.0	0	0	0	.0
NET LOANS OUTSTANDING	0	0	0	.0	1	6,000	6,000	47.5
TOTAL EXPENDITURES		65,207				12,856		
CASH ON HAND - ENDING		183,668				204		

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST AC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
GA 55 DEM	*TALMADGE,HERMAN E	ADAIR,JACK	ATLANTA	GA	RETIRED MORTGAGE BANKER	1,000
		ADAMS,L CLIFFORD JR	ELBERTON	GA	ATTY HEARD,LEVERETT&ADAMS	500
		ALSTON,PHILIP JR	ATLANTA	GA	ATTY ALSTON,MILLER & GAINES	500
		BAIZE,E P	ATLANTA	GA	PRES BAIZE BROS TRUCKING CO	1,200
		BEEBE,W T	ATLANTA	GA	CHM DELTA AIR LINES	500
		BIRD,F M	ATLANTA	GA	ATTY JONES,BIRD & HOWELL	500
		BROOKS,D W	ATLANTA	GA	CH BD GOLDKIST INC	1,000
		CALHOUN,LAWTON M	SAVANNAH	GA	PRES ATLANTIC TOWING CO	500
		CALLAWAY,CASON	COLUMBUS	GA	PRES DIXIE SIZE & CHEMICAL CO	2,500
		DAVIS,A C	JACKSONVILLE	FL	EXEC WINN-DIXIE INC	3,250
		DAVIS,JAMES E	JACKSONVILLE	FL	EXEC WINN-DIXIE INC	3,250
		DEWBERRY,L GLENN JR	DECATUR	GA	PRES ATLANTIC STEEL CO	500
		DRAKE,HENRY C	PEACHTREE CTY	GA	PHYSIC	600
		DUKE,PAUL A	ATLANTA	GA	PRES DUKE ENTERPRISES	1,000
		DUNCAN,JOHN P JR	ALEXANDRIA	VA	RAILRD EXEC	1,000
		DUVALL,W C	ATLANTA	GA	CH BD ATLANTA FED SVNGS & LN	1,000
		ELSAS,HERBERT	ATLANTA	GA	ATTY SUTHERLAND,ASBILL,BRENNAN	500
		ELSON,ED	ATLANTA	GA	PRES THE HEALEY BLDG CO	1,140
		ENGELHARD,MRS CHARLES W JR	FAR HILLS	NJ	HSWF PHILANTHR	500
		FLOWERS,W H	THOMASVILLE	GA	EXEC FARMER FLOWER INDUSTRIES	1,000
		GARRETT,DAVID C JR	ATLANTA	GA	PRES DELTA AIR LINES	500
		GOODLOE,JOHN D JR	ATLANTA	GA	ADAMS CATES CO	500
		GRIFFIN,WARREN S	ATLANTA	GA	WARREN S GRIFFIN INS AGENCY	1,000
		HALL,J A III	ATLANTA	GA	1ST VP THE C&S ATL BK	500
		HARRINGTON,JAMES C JR	CUMMINGS	GA	PRES FORSYTH INDUSTRIES	500
		HAYMAN & SIZEMORE	ATLANTA	GA	PARTNERSHIP	1,000
		HEARD,ROBERT M	ELBERTON	GA	ATTY	1,000
		HOFMANN,PHILIP B	ANNANDALE	NJ	RETIRED	500
		HOLMAN,W J JR	PLAINFIELD	NJ	RETIRED	1,000
		HULSE,FRANK W	BIRMINGHAM	AL	PRES SOUTHERN AIRWAYS	500
		ISON,ROBERT L	ATLANTA	GA	PRES ISON FURNITURE CO	500
		JALIL,A	ELBERTON	GA	PRES GA SYNTHETICS INC	2,500
		JOHNSON,J SEWARD	SKILLMAN	NY	RETIRED	1,000
		JONES,CHARLIE W	ALEX	VA	EXEC	500
		KATTEL,RICHARD L	ATLANTA	GA	PRES C&S NATL BK	1,000
		KAUFMAN,DR JAMES A	ATLANTA	GA	PHYSICIAN	500
		KENNEDY,A T	ATLANTA	GA	DAVIDSON KENNEDY CO	500
		LANDERS,DR R RANDAL	COLLEGE PARK	GA	DOCTOR OF DENTAL SURGERY	500
		LEVERETT,E FREEMAN	ELBERTON	GA	ATTY HEARD,LEVERETT&ADAMS	500
		LOONEY,WILTON	ATLANTA	GA	CH BD GENUINE PARTS CO	1,000
		LOUDERMILK,ROBERT C	ATLANTA	GA	BUS MN AARON RENTS INC	1,000
		MCCLELLAND,JOHN E	ATLANTA	GA	PRES BACHE & CO	500
		MCNEIL,HENRY S	PLYMOUTH MTNG	PA	BD MEM JOHNSON & JOHNSON INC	1,000
		METTS,J C SR	SAVANNAH	GA	M D	500
		MOUNTCASTLE,PAUL	ALBANY	GA	BLUE SPGS PLANTATION	500
		MUNFORD,DILLARD	ATLANTA	GA	PRES MUNFORD INC	500
		MYRICK,RICHARD S	ATLANTA	GA	PRES THE MYRICK CO	500
		NESMITH,BUDDY M	HAWKINSVILLE	GA	BUS EXEC BUDDY NESMITH OIL CO	500

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CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

A-3

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
GA 55 DEM	*TALMADGE,HERMAN E	OLIN,JOHN M	ST LOUIS	MO	RETIRED EXEC OLIN CO	3,000
		PEROT,H R	DALLAS	TX	CH EDS	5,000
		POOLE,JAMES P	ATLANTA	GA	JAMES P POOLE & CO INC INS	1,000
		POST,ALLEN	ATLANTA	GA	ATTY HANSELL,POST,DORSEY	500
		PRINCE,JOHN III	TIFTON	GA	PRES PRINCE RETAIL & LSNG	975
		REDWINE,H R	FAYETTEVILLE	GA	PRES FARMERS & MERCHANTS BK	1,000
		RICHARDS,ROY	CARROLLTON	GA	PRES SOUTHWIRE CORP	1,000
		ROLLINS,O WAYNE	ATLANTA	GA	PRES ROLLINS INC	1,000
		RUTLAND,GUY W III	DECATUR	GA	EXEC TRUCKING INDUS	1,000
		SCOTT,WALTER C	SAVANNAH	GA	SR VP SAVANNAH FOODS & INDUST	500
		SIBLEY,JOHN A	ATLANTA	GA	RETIRED ATTY KING & SPALDING	1,000
		SINGLETARY,L H	THOMASVILLE	GA	BUSMAN	500
		SPRAGUE,R C	SAVANNAH	GA	CH BD SAVANNAH FOODS & INDUS	500
		SPRAGUE,W W JR	SAVANNAH	GA	PRES SAVANNAH FOODS & INDUST	500
		STRICKLAND,LOYD	CHESTNUT MT	GA	CHBD CRYSTAL FARMS	500
		THARPE,ROBERT	ATLANTA	GA	CHAIRMAN THARPE & BROOKS	[illegible]
		TOPPLE,JAMES A	DECATUR	GA	CONSTR PATTILLO CONSTR CO	500
		TROUTMAN,SANDERS	ATLANTA	GA	ATTY	1,000
		VEREEN,W C	MOULTRIE	GA	RIVERSIDE MFG CO	500
		WATKINS,BILL	ATLANTA	GA	WATKINS CAROLINA EXP INC	3,000
TOTAL FOR CANDIDATE ---						65,965

ST RC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
GA 55 DEM	*TALMADGE,HERMAN E	DAIRYMEN INC	SPACE (TRUST FOR SPEC AGRI COMMUNITY ED)	5,000
		MID AMERICA DAIRYMEN INC	ADEPT (AGRI & DAIRY EDUC POL TRUST)	5,000
		AM RICE GROWERS COOP ASSN	RICE PRODUCERS PEC LAKE CHARLES LA	1,000
		FLORIDA AGRICULTURE	FLORIDA AGRICULTURAL EDUCATION COMM	500
		NATL COUNCIL OF FARMER COOPS	PACE (POL ACTION FOR COOP EFFECTIVENESS	500
	SUB-TOTAL FOR ALL AGRICULTURAL COMM.	---		12,000
		HUGHES AIRCRAFT CO	HUGHES ACTIVE CITIZENSHIP FUND	5
		NATL TELEPHONE CO-OP ASSN	TELEPHONE EDUCATION COMM ORGANIZATION	200
		US INDEPENDENT TELEPHONE ASSN	COMPAC (COMMUNICATIONS PAC)	1,650
		GENERAL ELECTRIC CO	NON PARTISAN POL COMM (NEW YORK)	1,000
		AMERICAN BANKING	BANKPAC (BANKING PROFESSION PAC)	1,000
		TRUST CO OF GEORGIA	GOOD GOVT GROUP (GEORGIA)	1,000
		SECURITIES INDUSTRY	SECURTIES INDUSTRY CAMPAIGN COMM	3,000
		COCA COLA COMPANY	NON-PARTISAN COMM FOR GOOD GOVT (GA)	5,000
		FOOD INDUSTRY	FOOD INDUSTRY GOOD GOVT COMM	500
		KRAUSE MILLING COMPANY	EAST WISCONSIN CLUB (MILWAUKEE)	100
		NATL CONFECTIONERS ASSN OF US	GOVT IMPROVEMENT GROUP	3,000
		FOREST PRODUCTS INDUSTRY	FOREST PRODUCTS POL COMM	1,000
		NATL RESTAURANT ASSN	RESTAURATEURS PAC	1,000
		N A OF LIFE UNDERWRITERS	LIFE UNDERWRITERS PAC (LUPAC)	1,500
		SOUTHERN RAILWAY SYSTEM	SOUTHERN RAILWAY TAX ELIGIBLE GGF	2,000
		N A OF REALTORS	REAL ESTATE PAC	2,000
		AM COTTON SHIPPERS ASSN	COMM ORGANIZED FOR TRADING OF COTTON	250
	SUB-TOTAL FOR ALL BUSINESS COMM.	---		24,205
		AM DENTAL ASSN (NATL)	AMERICAN DENTAL PAC (ADPAC)	2,000
		AM MEDICAL ASSN (NATL)	AMERICAN MEDICAL PAC (AMPAC)	2,500
		AM NURSING HOME ASSN	AMHEPAC AMERICAN NURSING HOME ED & PAC	500
		AM PHYSICAL THERAPY ASSN	AMERICAN PHYS THERAPY CONG ACTION COMM	100
		AM PODIATRY ASSN	PODIATRY PAC	5,000
		AM SOCIETY OF ORAL SURGEONS	ORAL SURGERY PAC (OSPAC)	5,000
	SUB-TOTAL FOR ALL HEALTH COMM.	---		15,100
		MARINE ENGINEERS	MEBA POL ACTION FUND	2,500
		SEAFARERS	SEAFARERS POL ACTIVITY DONATION	2,500
		MEATCUTTERS	AMCOPE	400
	SUB-TOTAL FOR ALL LABOR COMM.	---		5,400
		NATL RURAL ELECTR COOP ASSN	ACRE (ACTION COMM FOR RURAL ELECTRIFICAT)	1,000
	SUB-TOTAL FOR ALL MISCELLANEOUS COMM.	---		1,000
		NATIONAL CONGRESSIONAL LEVEL	DEMOCRATIC SENATORIAL CAMPAIGN COMM	2,000-
	SUB-TOTAL FOR ALL DEMOCRATIC COMM.	---		2,000
	TOTAL FOR CANDIDATE IS ---			59,705

ELECTION CANDIDATES	RIBICOFF, ABRAHAM A DEM/INCUMBENT GENERAL ELECTION INFO: WON/OPPOSED 690,820 VOTES (63.7%) PRIMARY ELECTION INFO: WON/CONVENTION				BRANNEN, JAMES H (III) REP/CHALLENGER GENERAL ELECTION INFO: LOST/OPPOSED 372,055 VOTES (34.3%) PRIMARY ELECTION INFO: WON/CONVENTION			A-5
	-NMBR-	$-AMOUNT	AVER	--%--	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		454,027				67,893		
CASH ON HAND - BEGINNING		16,463				0		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	223	244,255	1,095	53.8	7	5,000	714	7.4
IN STATE	89	90,097	1,012	19.8	6	3,000	500	4.4
OUT OF STATE	134	154,158	1,150	34.0	1	2,000	2,000	2.9
COMMITTEE CONTRIBUTIONS:	17	14,800	871	3.3	4	5,740	1,435	8.5
INTEREST COMMITTEES	16	7,800	488	1.7	3	740	247	1.1
POLITICAL PARTY COMMITTEES	1	7,000	7,000	1.5	1	5,000	5,000	7.4
LOANS RECEIVED	0	0	0	.0	1	1,500	1,500	2.2
LOANS REPAID	1	250	250	.1	1	1,500	1,500	2.2
NET LOANS OUTSTANDING	1	250	0	.0	0	0	0	.0
TOTAL EXPENDITURES		435,985				66,162		
CASH ON HAND - ENDING		18,042				1,732		

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST	RC	PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT	T
CT	55	DEM	*RIBICOFF,ABRAHAM A	ABRAHMS,JOHN	W HARTFORD	CT	INS ABRAHMS AGY	767	
				ABRAMS,MR&MRS DAVID	W HARTFORD	CT	PRES PIONEER SYS	500	
				ABRAMSON,ALBERT	BETHESDA	MD	PRTNR TOWER CONST CO	2,000	
				ABUZA,HENRY	ROCKVILLE	CT	BUILDER	500	
				AMPER,ALAN	PITTSBURGH	PA	CH BD & PRES STEELMET INC	500	
				APPLEMAN,NATHAN	PALM BEACH	FL	N APPLEMAN CO	1,500	
				ARNHOLD,HENRY H	N Y	NY	PRTNR ARNHOLD & BLEICHROEDER	500	
				ARONS,HUBERTON	W HARTFORD	CT	EXEC HTFD FREEZER CORP	500	
				BANK,MERRILL L	BALTIMORE	MD	V CHMN MD CUP CORP	1,000	
				BASKIN,PHILIP	PITTSBURGH	PA	ATTY	1,000	
				BELFER,ARTHUR B	N Y	NY	CHBD BELCO PETROLEUM CORP	2,000	
				BENJAMIN,ROBERT S	N Y	NY	CO CH BD UNITED ARTISTS	500	
				BERGIN JR,EDWARD D	WATERBURY	CT	ADMIN GOLDEN HILL NURSING HOME	250-	3
				BERNSTEIN,HYMAN S	WASH	DC	CH BD MODERN ELEC CORP	1,000	
				BERNSTEIN,NORMAN	WASH	DC	PRES N BERNSTEIN MGMT INC	1,500	
				BISHOP,EDWARD	N Y	NY	PRES BISHOP ROSEN INC	2,[illegible]	
				BISHOP,WARREN	N ROCHELLE	NY	MEM NY STOCK EXCH	[illegible]	
				BLACK,ELI M	WESTPORT	CT	CH BD UNITED BRANDS CO	2,[illegible]	
				BLACK,SHIRLEY L	WESTPORT	CT	HSWF	2,000	
				BLANC,CHESTER	W HARTFORD	CT	RET	1,000	
				BLANK,JEROME	MIAMI BCH	FL	PRES NATL BRANDS	500	
				BORWICK,CHARLES M	RANCHO MIRAGE	CA	RETIRED	1,000	
				BROAD,ELI	LOS ANGELES	CA	CH BD KAUFMAN & BROAD	500	
				BURKE,DOMINICK	RIDGEFIELD	CT	LAWYER	500	
				BURROWS,SELIG S	N Y	NY	CH BD CELLUCRAFT INC	1,000	
				CALDER,ALEXANDER	ROXBURY	CT	ARTIST	4,500	
				CANTOR,ARMAND	BROOKLYN	NY	NATL COLD STORAGE CO	500	
				CARTER,VICTOR M	LOS ANGELES	CA	RET EXEC	500	
				CHASE,DAVID	W HARTFORD	CT	DEV	1,000	
				CLARK,GEORGE L	SOUTHPORT	CT	CONSULTANT SANITAS CORP	1,500	
				COHEN,EMMANUEL	WASH	DC	VP GIANT FOOD INC	1,000	
				COHEN,A M	WASH	DC	CH BD GIANT FOOD INC	2,000	
				COHEN,RUBY	COLCHESTER	CT	REST	500	
				COHEN,WILFRED P	BOCA RATON	FL	CHMN JOS M COHEN & SONS	500	
				COHON,J DONALD	W HARTFORD	CT	EXEC STERN & CO INC	500	
				COUMANTAROS,GEORGE	GREENWICH	CT	SHIPOWNER	500	
				COWAN,IRVING	HOLLYWOOD	FL	PRES DIPLOMAT HTL	1,000	
				COYNE,MARSHALL B	WASH	DC	PRES MADISON HOTEL	1,000	
				DANE,MAXWELL	N Y	NY	RET	500	
				DANZANSKY,JOSEPH B	WASH	DC	PRES GIANT FOOD INC	1,500	
				DARSKY,JULIUS	MIAMI BCH	FL	RET	500	
				DAVID,MR&MRS ROY C	SIMSBURY	CT	EXEC CENTRAL METAL CO	500	
				DAVIDSON,DONALD	W HARTFORD	CT	EXEC DAVIDSON & LEVENTHAL	600	
				DAVIS,JACK	PALM BCH	FL	CH BD METROPOLITAN NATL BK	500	
				DAVIS,JEROME	BEDFORD	NY	PRES CONSOL DIESEL ELEC CO	750	
				DAVIS,LEONARD MR&MRS	N Y	NY	DIR COLONIAL PENN	5,000	
				DEF LORO,MR&MRS GEORGE	NEW HAVEN	CT	PROF YALE UNIV	500	
				DEITCH,ALEON,MR&MRS	PITTSBURGH	PA	PRES DEITCH & CO	5,000	

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST	RC	PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
CT	55	DEM	*RIBICOFF,ABRAHAM A	DEKELBOUM,MARVIN	BETHESDA	MD	EXEC VP C E SMITH BLDG	1,500
				DEVOL,GEORGE	WILTON	CT	ENG	500
				DIBNER,BERN	WILTON	CT	ENG BURNDY LIBRARY	500
				EDELL,MORTON	BOCA RATON	FL	PRES BISHOP INDUSTRIES	500
				ENGELBERGER,JOSEPH F	NEWTOWN	CT	PRES CONSOLIDATED CONTROLS	1,000
				FACTOR,JOHN	BEVERLY HILLS	CA	INVESTOR	1,000
				FARKAS,GEORGE	PALM BEACH	FL	RETIRED	5,000
				FIERMAN,HAROLD L	N Y	NY	ATTY	1,500
				FISCHBACH,HENRY F	WESTPORT	CT	ENGINEERING	2,000
				FREEMAN,CARL M	GAITHERSBURG	MD	CH BD C FREEMAN ASSN	1,000
				FUNGER,MORTON	CHEVY CHASE	MD	PRES COMM RLTY OFC CO	1,000
				GAMPEL,HARRY	W HARTFORD	CT	PRES GAMPEL REALTY	500
				GEWIRZ,CARL S	BETHESDA	MD	INVESTOR GEWIRZ,MORRIS&BERNARD	1,000
				GIMBEL,MRS BERNARD F	GREENWICH	CT	HSEWF	500
				GLADSTEIN,ANSEL	FAIRFIELD	CT	BLDR	1,000
				GLADSTONE,HERBERT	STAMFORD	CT	VP TREAS CONDEC CORP	500
				GOLDBERG,HENRY L	N Y	NY	BRKR GOLDBERG & CO	500
				GOLDFARB,J A	N Y	NY	RETIRED	2,000
				GOLDMAN,NATHAN	N Y	NY	PRES SONNENBLICK GOLDMAN CORP	500
				GOLDSTEIN,COL JULIUS	WASH	DC	INVESTOR	500
				GOODMAN,ABRAHAM	ESSEX FALLS	NJ	EXEC H GOODMAN & SONS	500
				GRADMAN,DAVID J	PALM BCH	FL	RETIRED CONSULT	1,000
				GREENBERG,ARNOLD C	W HARTFORD	CT	PRES COLECO INC	1,000
				GREENBERG,LEONARD E	W HARTFORD	CT	EXEC COLECO IND	500
				GREENBERG,SANFORD D	WASH	DC	V CH KMS IND INC	1,000
				GREENE,JEROME L	NEW YORK	NY	ATTY	500
				GRIMSON,BETTINA	NEW YORK	NY	DOCTOR	500
				HARITON,MORRIS B	WASH	DC	FOUNDER M B HARITON & CO	500
				HARRIS,J E	SHORT HILLS	NJ	HARRIS & SONS STEEL CO	1,000
				HAUSSAMEN,CAROLYN	NEW YORK	NY	REAL ESTATE	1,000
				HERSHMAN,DR&MRS HARRY	BRISTOL	CT	PHYSICIAN	500
				HILL,MORTON	MIAMI BCH	FL	RET	1,000
				HILL,RAYMOND	KENSINGTON	CT	PRES NRTHRN PETRO	1,000
				HOFFMAN,MR&MRS BURTON	W HARTFORD	CT	HOFFMAN OLDS	500
				HOFFMAN,SAMUEL K	W HARTFORD	CT	PRES HOFFMAN PAINT & WALLPAPER	500
				HOKIN,MR&MRS EDWIN E	HGHLAND PK	IL	EXEC UNARCO INDUS	2,000
				HORDESTY,C HOWARD	GREENWICH	CT	EXEC VP CONTINENTAL OIL	500
				HORNSTEIN,BENJAMIN S	N Y	NY	RET INVESTMENTS	500
				HOROWITZ,ARTHUR R	MIAMI BCH	FL	PRES JUNIORS OF PLM BCH	1,250
				ISAACS,EDWARD	WESTPORT	CT	CPA	1,000
				ISAN,JERRY	CORAL GABLES	FL	FRANCH OWNER MCDONALDS	500
				ISENBERG,CHARLES	W HARTFORD	CT	EXEC L ISENBERG ASSOC	500
				KAISERMAN,HORTENSE M	WYNNEWOOD	PA	HOUSEWIFE	500
				KALMAN,HENRY	N Y	NY	INVESTOR	500
				KAPLAN,BERNARD B	W HARTFORD	CT	INS	500
				KAROSEN,LEON	KANSAS CTY	KS	PRES YOUTHCRAFT INC	2,000
				KARR,DAVID	PARIS FRANCE		INVESTMENTS	1,000
				KIMMEL,EDWARD A	N Y	NY	ATTY	1,000

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST	RC	PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT $
CT	55	DEM	*RIBICOFF,ABRAHAM A	KLEIN,SAM W	CLEVELAND	OH	DIR & TREAS BALLY MFG CO	500
				KOGOD,ROBERT P	BETHESDA	MD	PRES C E SMITH MGMT INC	3,000
				KOHN,BERNHARD L	W HARTFORD	CT	RET	500
				KORMAN,SAMUEL J	JENKINTOWN	PA	RL EST	1,000
				KRAMER,ARNOLD	N Y	NY	MFG DIST OF HOSIERY	500
				KRAMER,NORMAN M	STAMFORD	CT	BUS EXEC	500
				KRAUS,WILLIAM J	CLEVELAND	OH	ATTY	500
				KRAVIS,RAYMOND F	TULSA	OK	ENGINEER	1,000
				KRETSCH,HANS W	NEWTOWN	CT	VP CONSOLIDATED CONTROL	500
				KRIEGER,LEONARD H	RANCHO MIRAGE	CA	RETIRED	500
				KRONHEIM,MILTON S	WASH	DC	PRES M KRONHEIM & CO	500
				KUCHEL,THOMAS H	BEVERLY HILLS	CA	ATTY	1,000
				LANE,HAROLD M	BYRAM	CT	PRES LERNER SHOPS	1,000
				LEHRMAN,JACOB	WASH	DC	EXEC VP & SECY GIANT FOOD INC	1,000
				LENTZ,MERVYN D	W HARTFORD	CT	PRES BROSCOME DIS	500
				LEVESTON,SAMUEL	W HARTFORD	CT	INSUR	500
				LEVY,HARRY	MIAMI BCH	FL	LND DEVELOPER	500
				LEVY,SAMUEL J	WHITE PLAINS	NY	CHMN CELLU CRAFT INC	500
				LINOWES,ROBERT E	BETHESDA	MD	ATTY	1,000
				LIST,MR&MRS ALBERT A	BYRAM	CT	CH BD ALBERT LIST FOUNDATION	4,000
				LUBIN,CHARLES W	CHICAGO	IL	RETIRED	2,500
				MACK,H B	MASPETH	NY	BLDR INVESTOR	500
				MAILMAN,J L	N Y	NY	MAILMAN BROS PRIVATE INVEST	5,000
				MALKIN,PETER L	GRNWCH	CT	ATTY	500
				MASHKIN,JACK	W HARTFORD	CT	EXEC MASHKIN TRUCKING	500
				MASLOW,LESTER	GREAT NECK	NY	EXEC BEST MFG CO	500
				MATHES,PETER	NEW YORK	NY	PHOTOGRAPHER	1,100
				MCCOLOUGH,CHARLES P	GREENWICH	CT	EXEC XEROX CORP	2,000
				MCDONOUGH,E MERRITT	W HARTFORD	CT	INS C MCDONOUGH & SONS	1,000
				MELTZER,ABE	GREAT NECK	NY	EXEC TRIANGLE PAC FOREST PROD	2,500
				MERCEDE,NICHOLAS J	STAMFORD	CT	GEN CONTRACTOR	600
				MERKIN,MICHAEL J	NEW YORK	NY	V-CH BD FRANKLIN NATL BK	1,000
				MINSKOFF,HENRY H	N Y	NY	RL EST	500
				MOORE,HYMAN L	NEW BRITAIN	CT	EXEC MOORE DRUG EXCH	500
				MUGAR,STEPHEN P	BOSTON	MA	EXEC STAR MARKET CO	1,000
				NABOICHECK,M AARON	W HARTFORD	CT	EXEC STANDARD MATTRESS CO	500
				NEIDITZ,MOSES J	W HARTFORD	CT	PRES M J NEIDITZ & CO	500
				OCHSMAN,RALPH	WASH	DC	BUILDER O F C CO	1,000
				OURISMAN,FLORENZ R	WASH	DC	INVESTOR	500
				OURISMAN,MANDELL J	CHEVY CHASE	MD	OWNR OURISMAN CHEV	500
				PARKER,JACK	BOCA RATON	FL	RLTR	1,000
				PEDERSEN,WILLIAM F	NEW HAVEN	CT	ARCHITECT PLANNER	1,010
				PERRY,JACK A	FAIRFIELD	CT	BUS EXEC & ATTY PERRY OPTICAL	500
				PETRIE,MILTON J	N Y	NY	CHMN PETRIE STORES	1,000
				PISAR,SAMUEL	PARIS	FR	ATTY	500
				PLISHER,PAUL	NORWALK	CT	RADIO RESEARCH	500
				PLOTKIN,BENJAMIN L	FAIRFIELD	CT	PRES FAIRFIELD LUMBER	500
				POLLIN,ABE	WASH	DC	CH BD CAPITAL CENTRE	1,000

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
CT 55 DEM	*RIBICOFF,ABRAHAM A	POSES,JACK I	WESTPORT	CT	RET	1,700
		PRATT,GEORGE D JR	BRIDGEWATER	CT	AGRIC SUNNY VALLEY FARM	1,500
		PRESTON,MRS WILLIAM M	LINCOLN	MA	HOMEMAKER	500
		RAPKIN,JOSEPH E	MILWAUKEE	WI	ATTY	500
		RATNER,ALBERT B	CLEV HTS	OH	EXEC VP FOREST CITY MATERIALS	500
		RAVALESE,JOSEPH JR	W HARTFORD	CT	EXEC WOOSTEN EXP	600
		REYNOLDS,EILEEN	HIGHLAND PK	IL	HSWF	1,000
		RICH,ROBERT N	STAMFORD	CT	RL EST DEV	1,000
		RIFKIND,SIMON H	N Y	NY	ATTY PAUL WEISS RIFKIND GARRIS	500
		ROBINSON,D M	PITTSBURGH	PA	BUS CONS	500
		RODGERS,CHARLES H	NEW CANAAN	CT	VP CONDEC CORP	1,000
		ROGOW,LOUIS B	W HARTFORD	CT	EXEC BIRKIN MFG CO	500
		ROSE,DAVID	N Y	NY	RET	1,000
		ROSEN,JOHN N	BUCK COUNTY	PA	PHYSICIAN	500
		ROSENBERG,GERALD	WESTPORT	CT	EXEC VP CONDEC CORP	1,000
		ROSENSTEIN,MR&MRS A J	CANAAN	CT	MGNG DIR CAMDON RLTY	500
		ROSS,DANIEL M	WASH	DC	ATTY	1,000
		RUBENSTEIN,CHARLES	W HARTFORD	CT	METAL SCRAP DLR CNTR MTL CO	500
		RUDIN,HENRY	SCARSDALE	NY	RET	1,000
		RUDIN,SAMUEL	N Y	NY	CH BD RUDIN MGT CO	1,000
		RYAN,MARTIN J	BRIDGEPORT	CT	RET	1,000
		SAGARIN,J DANIEL	WOODBRIDGE	CT	ATTY	500
		SAGRIN,PHILIP H	BRIDGEPORT	CT	CH VCA GREENWICH	1,200
		SALESKY,CHARLES	E NORWALK	CT	PRES KDCC DIV/HCA	1,100
		SALOMON,EDNA	STAMFORD	CT	HSELF	1,000
		SALOMON,JEAN K	ST LOUIS	MO	HSWF	2,000
		SALOMON,SIDNEY JR	ST LOUIS	MO	INS EXEC	2,000
		SAVITT,A D	NORWALK	CT	LAWYER	1,000
		SCHAFLER,NORMAN I	N Y	NY	PRES CONDEC CORP	2,000
		SCHEUER,S H	N Y	NY	INVEST	2,000
		SCHINE,LEONARD	WESTPORT	CT	ATTY	1,000
		SCHNIER,CHARLES	SIMSBURY	CT	PRES C SCHNIER ENTP	[illegible]
		SEIDEMAN,EMANUEL	JAMAICA EST	NY	SEIBOW INC	[illegible]
		SELTZER,NATHAN R	MELROSE PK	PA	RL EST SELTZER ORG	[illegible]
		SHEKETOFF,LEWIS S	W HARTFORD	CT	PRES A C CORP	2,000
		SHIPLEY,WILLIAM M	CLEVELAND	OH	CH BD MAIN LINE CLEVELAND INC	1,000
		SIEGELAUB,DONALD	WESTPORT	CT	PRIVATE INVESTMENTS	[illegible]
		SILVER,JULIUS	BYRAM	CT	ATTY SAPERSTEIN BARNETT SOLOMO	3,000
		SILVER,ROSLYN	BYRAM	CT	HSWF	2,000
		SILVERMAN,HERBERT R	RED BANK	NJ	CH FNC COMM HELMSLEY SPEAR INC	500
		SILVERMAN,LAWRENCE	BETHESDA	MD	RL EST SLS LEWIS&SILVERMAN INC	1,000
		SIMON,JACK L	PLM BCH	FL	RET	500
		SINGER,HERBERT	STAMFORD	CT	ATTY	500
		SLAVITT,A D	NORWALK	CT	LAWYER	1,000
		SMITH,CHARLES E	WASH	DC	CH BD CHAS SMITH BLDG CORP	3,000
		SMITH,ROBERT H	BETHESDA	MD	PRES C SMITH BLDG CORP	3,000
		SOFFER,JOSEPH	BOCA RATON	FL	RL EST	1,000
		SOMMER,SIGMUND	GREAT NECK	NY	INVEST BLDR	5,000

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CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
CT 55 DEM	*RIBICOFF,ABRAHAM A	SONNENBERG,BENJAMIN	NEW YORK	NY	RET	500
		SPANIER,MAURY L	HARTSDALE	NY	ATTY	1,000
		STEINBERG,AL A	LONG ISLAND	NY	CONVERTER ACKER & JABLOW INC	1,000
		STERLING,AUDREY M	MALIBU	CA	DIR CORP SEC AQUARIAS TRAVEL	2,000
		STERN,MAX	N Y	NY	EXEC HARTZ MOUNTAIN PET FOODS	2,500
		STICH,IRVING R	W HARTFORD	CT	BUILDER DEVELOPER	2,500
		SUISMAN,EDWARD	W HARTFORD	CT	EXEC SUISMAN & BLUMENTHAL	2,000
		SUISMAN,JOHN R	W HARTFORD	CT	EXEC SUISMAN BLUMENTHAL	1,000
		SUISMAN,MICHAEL	W HARTFORD	CT	PRES SUISMAN & BLUMENTHAL	1,000
		SUISMAN,RICHARD	HARTFORD	CT	EXEC SUISMAN & BLUMENTHAL	1,000
		SULLIVAN,JOHN L	NEW BRITAIN	CT	RETIRED	500
		SULZBERGER,MRS ARTHUR H	STAMFORD	CT	RETIRED	500
		SWEIG,MORTON	N Y	NY	V CHM NATL KINNEY CORP	500
		TIMONER,ELI	CORAL GABLE	FL	CH AIR FLORIDA INC	500
		TITLE,MELVIN W	W HARTFORD	CT	INS	500
		TOLL,ALBERT A	BOCA RATON	FL	RL EST	1,000
		UBERMAN,CHAIM M	BETHESDA	MD	PRES NATL SOUVENIR CNTR	1,000
		VAN SINDEREN,ALFRED W	WOODBRIDGE	CT	PRES S N ENG TEL CO	1,000
		WARSHAW,ELMER C	SADDLE RIVER	NJ	EXEC TENNECO	500
		WASSERMAN,LEW R	BEVERLY HILLS	CA	EXEC MCA	1,000
		WEIL,FRANK A	MT KISCO	NY	CH FIN COM PAINE WEBBER INC	500
		WEINBERG,LAWRENCE	BEVERLY HILLS	CA	CH BD LARWIN GROUP	1,000
		WEISSMAN,GEORGE MRS	RYE	NY	HSEWF	500
		WELLS,JAY	SCARSDALE	NY	PRES WELLS NATL SERV CORP	1,000
		WETZLER,BENJAMIN	N Y	NY	STKBKR HARDY & COE	500
		WIEN,LAWRENCE A	WESTPORT	CT	ATTY	3,000
		WIEN,MAE L	WESTPORT	CT	HSEWF	3,000
		WILLIAMS,HAROLD M	BEVERLY HILLS	CA	DEAN GRAD SCH MGMT UCLA	3,000
		WOLFSON,FRANCES	MIAMI BCH	FL	HSWF	1,000
		WOLFSON,LYNN MRS	MIAMI BEACH	FL	HSWF	500
		YOUMANS,MR&MRS BERTRAM	W HARTFORD	CT	CH BD CONN SPRING CO	500
		ZIRINSKY,MR&MRS RICHARD	LAWRENCE	NY	OWNER GRACIE SQ HOSP	1,000
TOTAL FOR CANDIDATE ---						244,035

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

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ST AC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
CT SS DEM	RIBICOFF,ABRAHAM A	SAVINGS BANKERS	SAVINGS BANKERS NON-PARTISAN PAC	100
		CNA FINANCIAL CORP	CNA EMPLOYEES CIVIC RESPONSIBILITY COMM	100
	SUB-TOTAL FOR ALL BUSINESS COMM.	---		200
		AM NURSING HOME ASSN	AHHEPAC AMERICAN NURSING HOME ED & PAC	500
	SUB-TOTAL FOR ALL HEALTH COMM.	---		500
		BRICKLAYERS	BRICKLAYERS ACTION COMM	200
		ELECTRICAL WORKERS (IBEW)	IBEW COPE	1,000
		LABORERS	LABORERS POL LEAGUE	500
		OPERATING ENGINEERS	ENGINEERS PEC	500
		PAINTERS	POLITICAL ACTION TOGETHER POL COM (PAT)	200
		STEELWORKERS (NATL)	UNITED STEELWORKERS OF AMERICA PAF (PA)	2,200
		SERVICE EMPLOYEES	SEIU COPE POL CONTRIBUTIONS COMM	500
		RAILWAY CLERKS	RAILWAY CLERKS POL LEAGUE	2,000
	SUB-TOTAL FOR ALL LABOR COMM.	---		7,100
	SUB-TOTAL FOR ALL MISCELLANEOUS COMM.	---		0
		NATIONAL CONGRESSIONAL LEVEL	DEMOCRATIC SENATORIAL CAMPAIGN COMM	7,000
	SUB-TOTAL FOR ALL DEMOCRATIC COMM.	---		7,000
	TOTAL FOR CANDIDATE IS ---			14,800

ELECTION CANDIDATES	NELSON,GAYLORD DEM/INCUMBENT GENERAL ELECTION INFO: WON/OPPOSED 740,700 VOTES (61.8%) PRIMARY ELECTION INFO: WON/UNOPPOSED				PETRI,THOMAS E REP/CHALLENGER GENERAL ELECTION INFO: A-12 LOST/OPPOSED 429,327 VOTES (35.8%) PRIMARY ELECTION INFO: WON/OPPOSED			
	-NMBR-	$-AMOUNT	AVER	--%--	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		254,702				83,430		
CASH ON HAND - BEGINNING		38,746				0		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	25	15,995	640	6.3	20	18,151	906	21.8
IN STATE	17	11,000	647	4.3	9	9,132	1,015	10.9
OUT OF STATE	8	4,995	624	2.0	11	9,019	820	10.8
COMMITTEE CONTRIBUTIONS:	51	73,622	1,444	28.9	3	5,570	1,857	6.7
INTEREST COMMITTEES	50	65,372	1,307	25.7	3	5,570	1,857	6.7
POLITICAL PARTY COMMITTEES	1	8,250	8,250	3.2	0	0	0	.0
LOANS RECEIVED	0	0	0	.0	0	0	0	.0
LOANS REPAID	0	0	0	.0	0	0	0	.0
NET LOANS OUTSTANDING	0	0	0	.0	0	0	0	.0
TOTAL EXPENDITURES		247,551				80,590		
CASH ON HAND - ENDING		7,150				3,589		

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
WI 55 DEM	*NELSON,GAYLORD	BARTELL,GERALD A	MADISON	WI	EXEC AM MED BLDG	500
		BERNSTEIN,JOSEPH M	MILWAUKEE	WI	ATTY	500
		BLOCK,ROBERT S	MILWAUKEE	WI	EXEC R S BLOCK ADV INC	500
		BRENNAN,ROBERT	CHICAGO	IL	VP CHICAGO & NW RAILROAD	500
		BROGAN,GISELA M	GREEN BAY	WI	TRAVEL AGT KELLOGG TRAVEL AGCY	1,000
		BROGAN,JOHN	GREEN BAY	WI	EXEC CITIZENS SECURITIES	1,000
		CARLEY,DAVID	MADISON	WI	EXEC INLAND STEEL	500
		COLBURN,GERALD	MILWAUKEE	WI	PRES JAK-PAK CO	500
		FERGUSON,FRANCIS E	MILWAUKEE	WI	PRES NORTHWESTERN MUTUAL LIFE	500
		FERRY,CAROL B	SCARSDALE	NY	PHILANTHR	500
		FERRY,W H	SCARSDALE	NY	FOUNDATION DIR WB FOUNDATION	1,000
		GECHT,DAVID	MILWAUKEE	WI	PROP WHITE MANOR LIQUOR STORE	1,000
		HANSON,J LOUIS	MELLEN	WI	PT HOME SECY U S SENATE	500
		HOVING,JOHN	CINCINNATI	OH	EXEC FEDERATED DEPT STORES	500
		KARL,MAX	MILWAUKEE	WI	EXEC MGIC	1,000
		KOHL,HERBERT H	MILWAUKEE	WI	PRES KOHL FOOD STORES	500
		KOPS,FLOYD	WASH	DC	ATTY	995
		LEPPIN,RICHARD D	MILWAUKEE	WI	EXEC LEPPIN ELECTRIC CO	500
		MARK,WILLIAM B	WAUSAU	WI	WILLIAM B MARK & ASSOC	1,000
		MURPHY,CHARLES H JR	EL DORADO	AR	PRES MURPHY OIL CO	500
		NASH,HAROLD	MILWAUKEE	WI	ATTY	500
		PUTZER,RAYMOND	RACINE	WI	EXEC PRECISION FLEXMOLD INC	500
		WERNER,A MATT	SHEBOYGAN	WI	PUBLISHER SHEBOYGAN PRESS	500
		WILLIAMS,J D	WASH	DC	ATTY	500
		WINDHAP,JAMES C	MACON	MS	EXEC PABST BREWING CO	500
TOTAL FOR CANDIDATE ---						15,995

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST AC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
WI 55 SEN	NELSON,GAYLORD	CALIFORNIA AGRICULTURE	COMM ON AGRICULTURAL POLICY (CA)	1,150
	SUB-TOTAL FOR ALL AGRICULTURAL COMM.	---		1,150
		CREDIT UNION NATL ASSN (CUNA)	CREDIT UNION LEGISLATIVE ACTION COUNCIL	450
		MORTGAGE BANKERS	MORPAC (MORTGAGE BANKERS PAC)	800
		CANNING INDUSTRY	CANNERS PUBLIC AFFAIRS COMM	100
		KRAUSE MILLING COMPANY	EAST WISCONSIN CLUB (MILWAUKEE)	500
		BURLINGTON NORTHERN INC -RR	BURLINGTON NORTHERN OFF VOL GOOD GOVT	500
		CHICAGO & NORTHWESTERN RR CO	NORTH WESTERN OFFICERS TRUST ACCOUNT	1,500
		CHICAGO, MILWAUK & ST PAUL RR	MILWAUKEE OFFICERS TRUST ACCOUNT	250
		BOATING INFORMATION COUNCIL	BOATING INFORMATION COUNCIL PAC	500
		TOBACCO PRODUCTS MFRS	TOBACCO PEOPLES PUBLIC AFFAIRS COMM	500
	SUB-TOTAL FOR ALL BUSINESS COMM.	---		5,100
		AM MEDICAL ASSN-EC EXEC	PHYSICIANS COMM FOR GOOD GOVT (DC)	100
		AM MEDICAL ASSN WISCONSIN	WISCONSIN PHYSICIANS PAC (WISPAC)	700
		AM OPTOMETRIC ASSN	OPTOMETRIC PAC	500
		AM PHYSICAL THERAPY ASSN	AMERICAN PHYS THERAPY CONG ACTION COMM	100
		AM PODIATRY ASSN	PODIATRY PAC	1,500
	SUB-TOTAL FOR ALL HEALTH COMM.	---		2,900
		AFL CIO (NATL)	AFL CIO COPE POL CONTRIBUTIONS COMM	10,000-
		AFL CIO WISCONSIN	WISCONSIN STATE AFL CIO COPE	6,722
		BUILDING & CONSTRUCTION DEPT	PEF OF THE BUILDING & CONSTRUCTION TRAD	500
		CARPENTERS	CARPENTERS LEGISLATIVE IMPROVEMENT COMM	1,000
		ELECTRICAL WORKERS (IBEW)	IBEW COPE	2,000
		LABORERS	LABORERS POL LEAGUE	2,000
		OPERATING ENGINEERS	ENGINEERS PEC	500
		POSTAL WORKERS	POLITICAL FUND COMM OF AM POSTAL WORKER	100
		STATE COUNTY & MUN EMPLOYEES	PEOPLE (PUBLIC EMPLOYEES ORGANIZED)	1,000
		CLOTHING WORKERS (NATL)	AMALGAMATED POLITICAL EDUCATION COMM	2,000-
		GARMENT WORKERS LADIES	ILGWU CAMPAIGN COMM	550
		MACHINISTS	MACHINISTS NON PARTISAN POL LEAGUE(MNPL	3,000-
		STEELWORKERS (NATL)	UNITED STEELWORKERS OF AMERICA PAF (PA)	3,000
		UNITED AUTO WORKERS IND	UAW V-CAP	7,100
		HOTEL & RESTAURANT EMPLOYEES	H & RE & BIU COPE	1,000
		MEATCUTTERS	AMCOPE	1,000
		RETAIL CLERKS	ACTIVE BALLOT CLUB	4,000
		SERVICE EMPLOYEES	SEIU COPE POL CONTRIBUTIONS COMM	500
		RAILWAY CLERKS	RAILWAY CLERKS POL LEAGUE	2,500
		RAILWAY LABOR EXECUTIVES ASSN	RAILWAY LABOR EXECUTIVES ASSN POL LEAGU	200
		TRANSPORTATION UNION (UTU)	TRANSPORTATION POL EDUC LEAGUE	4,000
		TEAMSTERS INDEPENDENT UNION	DRIVE (DEMOCRATIC REPUBLICAN INDEPEND)	2,000
		COMMUNICATION WORKERS	CWA COPE	200-
		GRAPHIC ARTS UNION	GRAPHIC ARTS INTL UNION COPE	500
	SUB-TOTAL FOR ALL LABOR COMM.	---		55,372
		NATL RURAL ELECTR COOP ASSN	ACRE(ACTION COMM FOR RURAL ELECTRIFICAT)	750
		NATL RURAL ELECTR COOP WISC	WISCONSIN ACRE	100
	SUB-TOTAL FOR ALL MISCELLANEOUS COMM.	---		850
		NATIONAL CONGRESSIONAL LEVEL	DEMOCRATIC SENATORIAL CAMPAIGN COMM	8,250
	SUB-TOTAL FOR ALL DEMOCRATIC COMM.	---		8,250
	TOTAL FOR CANDIDATE IS ---			73,622

ELECTION CANDIDATES	GRAVEL, MIKE DEM/INCUMBENT GENERAL ELECTION INFO: WON/OPPOSED 54,361 VOTES (58.3%) PRIMARY ELECTION INFO: WON/OPPOSED				LEWIS, C R REP/CHALLENGER GENERAL ELECTION INFO: LOST/OPPOSED 38,914 VOTES (41.7%) PRIMARY ELECTION INFO: WON/OPPOSED			
	-NMBR-	$-AMOUNT	AVER	--%--	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		465,441				310,274		
CASH ON HAND - BEGINNING		2,806				0		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	122	157,996	1,295	32.5	86	133,295	1,550	43.0
IN STATE	19	24,616	1,296	5.1	48	80,065	1,668	25.8
OUT OF STATE	103	133,380	1,295	27.5	38	53,230	1,401	17.2
COMMITTEE CONTRIBUTIONS:	74	152,624	2,062	31.4	17	61,560	3,622	19.8
INTEREST COMMITTEES	73	147,524	2,021	30.4	13	26,580	2,045	8.6
POLITICAL PARTY COMMITTEES	1	5,100	5,100	1.1	4	35,000	8,750	11.3
LOANS RECEIVED	1	1,000	1,000	.2	3	6,900	2,300	2.2
LOANS REPAID	0	0	0	.0	1	1,400	1,400	.5
NET LOANS OUTSTANDING	1	1,000	1,000	.2	2	5,500	2,750	1.8
TOTAL EXPENDITURES		465,300				353,701		
CASH ON HAND - ENDING		33,000				525		

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT	T
AK 55 DEM	*GRAVEL,MIKE	ARNOLD,JAMES R	LA JOLLA	CA	PROF UNIV OF CALIF	600	
		BALDWIN,BOB	HOUSTON	TX	CH BD ALASKA INTERSTATE	2,441	
		BAMBIE,EUGENE A	LOS ANGELES	CA	ATTY	500	
		BASS,PERRY R	FT WORTH	TX	OIL OPER	3,000	
		BECK,KENNETH	SEATTLE	WA	PRES CENTRAL CONST CO	1,000	
		BELFER,ARTHUR B	NEW YORK	NY	CH BD BELCO PETRO CORP	1,000	
		BERGER,LEO V	OLD WESTBURY	NY		3,000	
		BERGT,NEIL	FAIRBANKS	AK	PRES ALASKA INTL AIRLINES	500	
		BERNSTEIN,JOSEPH M	PROVIDENCE	RI	ADVERTISING EXEC	1,000	
		BIRCH,EVERETT B	ST THOMAS	VI	ATTY BIRCH DE JONGH & FARRELLY	9,000	
		BOND,ROLAND	DALLAS	TX	INDEP OPER	500	
		BURNS,RICHARD L	SN BERNARDINO	CA	INDEP OPER	2,000	
		CARSON JR,PAUL	HINSDALE	IL	EXEC ADV CONST CO	500	
		CLIFFORD,PATRICK J	NEW YORK	NY	BANKER	500	
		DANE,MAXWELL	NY	NY	RET	500	
		DAVIS,LOUIS F	LA	CA	EXEC ARCO	1,[illegible]	
		DOWNS,J A	DOWNERS GROVE	IL	PRES GREAT LAKES DREDGE & DOCK	500	
		EKNESS,CHALMERS O	SEATTLE	WA	DUDLEY & EKNESS ARCHITECTS	1,000	2
		ELLIS,ELI	NEW YORK	NY		3,000	
		ERICSON,GALORIS A	SCOTTSDALE	AZ	RL EST	500	
		FERRY,W H	SCARSDALE	NY	EXEC DIR DJB FOUNDATION	700	
		FISCHER,RICHARD	ANCHORAGE	AK	CO OWNER R/E	[illegible]	
		FISCHER,RICHARD W	ANCHORAGE	AK	OWNER DICK FISCHER SREA	1,538	
		FLEMING,BOB	ANCHORAGE	AK	EXEC VP KYAK RADIO	500	
		FOSTER,WILLIAM C	WASH	DC	PATTON BOGGS & BLOW,ATTYS	2,[illegible]	
		FULLER,M C	BEND	OR	RET	500	
		GAGE,COKE L	DECATUR	TX	INDEP OPER	1,000	
		GAUTREAUX,O M	METAIRIE	LA	PRES WILLIAMS MC WILLIAMS	500	
		GEZON,DAVID M	GRAND RAPIDS	MI	AUTO DEALER	500	
		GLASSELL,ALFRED C JR	HOUSTON	TX	PTNR GLASSELL PRODUCING CO	6,100	
		GOTTSTEIN,BARNEY J	ANCHORAGE	AK	J B GOTTSTEIN & CO	1,200	
		GRIFFIN,W A	HOUSTON	TX	PRES DANIEL INDUSTRIES	[illegible]	
		GROSSMAN,SAM	PHOENIX	AZ	PRES THE GROSSMAN CO	500	
		GUFFEY,ROY	DALLAS	TX	EXEC DRILLING CO	500	
		GUNDERSON,LESLIE R	FAIRBANKS	AK	OWNER POLARIS INST	3,000	
		HAINES,ROBERT E	GARY	IN	EXEC J M FOSTER INC	500	
		HAMON,JAKE L	DALLAS	TX	INDEP OPER	3,000	
		HARDESTY,C HOWARD	GREENWICH	CT	EXEC VP OIL CO CONTNL OIL	500	
		HEARIN,ROBERT M	JACKSON	MS	CH CO EXEC 1ST NATL BK	3,000	
		HENNELLY,EDMUND P	MANHASSET	NY	ATTY MOBILE OIL CO	500	
		HESS,LEON	NEW YORK	NY	PRES HESS OIL CO	9,000	
		HEYSER,ESTILL JR	DALLAS	TX	INDEP OPER	500	
		HINCHEY,KEN	ANCHORAGE	AK	MGR ALASKA AGGREGATE CO	500	
		HITCHCOCK,ALFRED	LOS ANGELES	CA	MOTION PICTURE PROD	500	
		HUMPHREY,JOE A	DALLAS	TX	INDEP OPER	500	
		IVIE,ROBERT M	SAN FRANCISCO	CA	PRES GUILD WINERIES & DIST	500	
		JANSEN,HENRY	LYNDEN	WA	PRES LYNDEN TRANSPORT CO INC	500	
		JONES,A V	ALBANY	TX	INDEP OPER	500	

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST	RC	PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
AK	55	DEM	*GRAVEL,MIKE	KAZIS,EARL	NY	NY	EARL KAZIS ASSOC	1,000
				KENNY,JOHN E	NORTHBROOK	IL	CONTR KENNY CONST CO	[illegible]
				KRAMER,CLARENCE F	SITKA	AK	EXEC AK LUMBER & PULP	500
				LOITZ,LAWRENCE	GRANT PK	IL	EXEC LOITZ BROS CONST CO	[illegible]
				LUCAS,PHILIP B	HOUSTON	TX		1,000
				LYNCH,JOSEPH A	LIVONIA	MI	EXEC J D CONTR INC	[illegible]
				MAGUIRE,CARY	DALLAS	TX	PRES MAGUIRE OIL CO	500
				MARR,M M	DALLAS	TX	INDEP OPER MARR CO	[illegible]
				MARTIN,ALVIN R MRGMRS	HOUSTON	TX	CORP EXEC	[illegible]
				MCCOLLUM,H W	HOUSTON	TX	VP TENNECO	3,000
				MCEACHERN,ROBERT D	SEATTLE	WA	PRES GENERAL CONST CO	[illegible]
				MCKAY,ROY	ANCHORAGE	AK	OWNERS MERCHANT	[illegible]
				MERRIGAN,EDWARD L	WASH	DC	ATTY SMATHERS MERRIGAN & HERLO	[illegible]
				MIKLAUTSCH,THOMAS J	FAIRBANKS	AK	PHARMACIST & LAND DEV	3,000
				MITCHELL,GEORGE P	HOUSTON	TX	PRES MITCHELL ENERGY & DEV COR	3,000
				MITCHELL,JOHNNY	HOUSTON	TX	PRES OIL&GAS INVESTMENTS INC	[illegible]
				MONCRIEF,W A	FT WORTH	TX	INDEP OPER	[illegible]
				MOORE,POLLY L	DALLAS	TX	INDEP OPER	[illegible]
				MURRELL,JOHN	DALLAS	TX	INDEP OPER	[illegible]
				PARKS,NEIL	HOUSTON	TX	INDEP OPER	[illegible]
				PARTEN,J R	HOUSTON	TX	OIL OPERATOR	[illegible]
				PASCHEN,JACK H	NORTHBROOK	IL	EXEC PASCHEN CONTR	[illegible]
				PAULEY,EDWIN W	LA	CA	PRES PAULEY PETR CO	500
				PAULUCCI,JENO F	DULUTH	MN	CH BD JENO INC	[illegible]
				PEROT,H R	DALLAS	TX	CHMN ELECTRONIC DATA SYSTEMS	[illegible]
				PICKENS,JOHN T	DALLAS	TX	INDEP OPER	[illegible]
				PICKENS,R H	DALLAS	TX	INDEP OPER	[illegible]
				PICKENS,W C	DALLAS	TX	INDEP OPER	[illegible]
				PICKENS,W L	DALLAS	TX	INDEP OPER	500
				PITTS,L FRANK	DALLAS	TX	INDEP OPER/PITTS ENERGY	2,000
				PITTS,SHELBY D	DALLAS	TX	INDEP OPER	[illegible]
				POLLARD,ERIC W	NEW YORK	NY	CONSULT	2,000
				PONTARELLI,MICHAEL E	GLENVIEW	IL	CONTR PONTARELLI & SONS INC	[illegible]
				RAGAN,WILLIAM F	POTOMAC	MD	ATTY RAGAN & MASON	[illegible]
				RAYMOND,DAN	HOLLAND	IL	CONTR DAN RAYMOND CONST CO	[illegible]
				RIFE,M O	FT WORTH	TX	INDEP OPER	[illegible]
				ROSEN,ROBERT A	JAMAICA EST	NY	INVEST	[illegible]
				ROSS,LEONARD	LOS ANGELES	CA	PRES ROSSCO INC	[illegible]
				ROSSETTI,ANTHONY J	NORTHBROOK	IL	CONTR ROSSETTI CONTRACTING CO	500
				RUDIN,LEWIS	N Y	NY	VP RUDIN MNG	1,000
				RUDMAN,M B	DALLAS	TX	INDEP OPER	[illegible]
				RUSSELL,MADELINE	S FRAN	CA	HWF	[illegible]
				SANTUCCI,CARLO V	NORTHFIELD	IL	EXEC SANTUCCI CONST CO	500
				SCHLENSKER,JOHN A	RICHARDSON	TX	DRILLING CONTRACTOR	500
				SCHNITZER,KENNETH	HOUSTON	TX	PRES CENTARY DEV CO	2,500
				SHEINBAUM,STANLEY K	LOS ANGELES	CA	INVEST BROKER	1,000
				SHUSHAN,LOUIS G	NEW ORLEANS	LA	ATTY SHUSHAN MEYER JACOBSON	500
				SINTON,ROBERT	SAN FRANCISCO	CA	STOCKBROKER DEAN WITTER CO	500

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
AK 55 DEM	*GRAVEL,MIKE	SLAYMAKER,RONALD	ANCHORAGE	AK	CONTRACTOR VGR GEN CONTR	1,200
		SMITH,FELIX T	PALO ALTO	CA		950
		STAIR,RICHARD	ANCHORAGE	AK	PACIFIC INC	700
		STEPHENS,JOHN A	SANTA BARBARA	CA	PRES EXCEL MINERAL CORP	1,500
		SWANK,RUSSELL	ANCHORAGE	AK	OWNER TOPPERS OIL CORP	1,973
		TAMPKE,FRED	ANCHORAGE	AK	VP MODERN CONSTR	500
		THOMAS,E C	ELSA	TX	RANCHER	2,500
		THOMAS,MAX L	DALLAS	TX	INDEP OPER OIL	2,000
		TOWNSEND,CHARLES W	FAIRBANKS	AK	PHYSICIAN	500
		VANCE DAVIES & ROBERTS	SEATTLE	WA	ATTYS AT LAW	500
		VANCE,J DUANE	SEATTLE	WA	ATTY DAVIES & ROBERTS	500
		WAKEFIELD,GRAY MRCHRS	HOUSTON	TX	ACCTS	500
		WALLACE,WALLY D	JUNEAU	AK	SWITZER CRK MOBILE HOMES	500
		WALLERSTEIN,GEORGE	SEATTLE	WA		500
		WARD,DELBERT	HOUSTON	TX	SR VP BROWN & RGOT	500
		WARD,JERRY J	ANCHORAGE	AK	PRES K & W CO	6,000
		WASSERMAN,LEW R	BEVERLY HILLS	CA	CH BD MCA UNIVERSAL CITY	1,000
		WEBSTER,WM C	ANCHORAGE	AK	WM WEBSTER INC	712
		WEINBERG,LAWRENCE	BEVERLY HILLS	CA	CH LARWIN REALTY	1,000
		WEINGARTEN,JOAN	HOUSTON	TX	HSWF	2,500
		WERBY,DONALD	HILLSBOROUGH	CA	WERBER REALTY	500
		WHITE,JOHN S	WASH	DC	ATTY	500
		WHITMORE,RALPH E JR	ANCHORAGE	AK	BANKER AK STATE BANK	600
		WILENTZ,DAVID T	PERTH AMBOY	NJ	PRTNR WILENTZ GOLDMAN SPITZER	4,000
		WILLIAMS,J D	WASHINGTON	DC	ATTY,WILLIAMS & KING	1,000
		YARMOLINSKY,MICHAEL	PARIS FRANCE		BIOLOGIST	500
		ZEIR,D J	DOWNERS GROVE	IL	CONTR S A HEALY CO	500
TOTAL FOR CANDIDATE ---						158,[illegible]6

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ST RC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
AK 55 DEM	*GRAVEL,MIKE	ASSOC MILK PRODUCERS INC	TAPE (COMM FOR THOROUGH AGRI POL EDUC)	100
	SUB-TOTAL FOR ALL AGRICULTURAL COMM.	---		100
		KENNECOTT COPPER CORP	KENNECOTT EXECUTIVES CITIZENSHIP ASSN	500
		CONSOLIDATED NATURAL GAS (WV)	CONSOLIDATED EXEC VOL NON-PART POL FUND	100
		EAST OHIO GAS CO	EAST OHIO GAS EMP VOL GOOD GOVT ASSN	100
		HOUSTON NATURAL GAS CORP	POLITICAL SUPPORT ASSN (TX)	750
		NATURAL GAS RETAILERS	GAS EMPLOYEES PEC	400
		N A OF BROADCASTERS	NATL CONFERENCE FOR SUPPORT OF FREE BRO	700
		N A OF HOME BUILDERS	BUILDERS POL CAMPAIGN COMM	300
		GENERAL ELECTRIC CO	NON PARTISAN POL COMM (NEW YORK)	500
		SEATTLE FIRST NATL BANK	FIRST ASSOCIATES NATIONAL (WASHINGTON)	400
		SAVINGS & LOAN LEAGUE	SAVINGS ASSN POL ELECTIONS COMM (SAPEC)	5,100
		SAVINGS & LOAN LEAGUE CALIF	CENTURY CLUB (PASADENA)	250
		MORTGAGE BANKERS	MORPAC (MORTGAGE BANKERS PAC)	500
		SAVINGS BANKERS	SAVINGS BANKERS NON-PARTISAN PAC	250
		SECURITIES INDUSTRY	SECURTIES INDUSTRY CAMPAIGN COMM	3,000
		PAINE WEBBER	PAINE WEBBER FUND FOR BETTER GOVT	100
		CANNING INDUSTRY	CANNERS PUBLIC AFFAIRS COMM	100
		DEL MONTE CORP	DEL MONTE VOL NON-PART GOOD GOVT COMM	500
		FOOD INDUSTRY	FOOD INDUSTRY GOOD GOVT COMM	500
		FOREST PRODUCTS INDUSTRY	FOREST PRODUCTS POL COMM	1,700
		WEYERHAEUSER CO INTERESTS	HANSON FUND	2,500
		N A OF LIFE UNDERWRITERS	LIFE UNDERWRITERS PAC (LUPAC)	1,000
		BURLINGTON NORTHERN INC -RR	BURLINGTON NORTHERN OFF VOL GOOD GOVT	200
		SOUTHERN RAILWAY SYSTEM	SOUTHERN RAILWAY GOOD GOVT FUND	600
		SOUTHERN RAILWAY SYSTEM	SOUTHERN RAILWAY TAX ELIGIBLE GGF	1,000
		N A OF REALTORS	REAL ESTATE PAC	2,000
		TRUCKING INDUSTRY	TRUCK OPERATORS NON-PARTISAN COMM	5,000
		BOATING INFORMATION COUNCIL	BOATING INFORMATION COUNCIL PAC	150
	SUB-TOTAL FOR ALL BUSINESS COMM.	---		28,200
		AM MEDICAL ASSN-DC EXEC	PHYSICIANS COMM FOR GOOD GOVT (DC)	100
		AM NURSING HOME ASSN	ANHEPAC AMERICAN NURSING HOME ED & PAC	500
		AM OPTOMETRIC ASSN	OPTOMETRIC PAC	250
		AM PHYSICAL THERAPY ASSN	AMERICAN PHYS THERAPY CONG ACTION COMM	100
		AM PODIATRY ASSN	PODIATRY PAC	500
		FEDERATION OF AM HOSPITALS	FED PAC	750
	SUB-TOTAL FOR ALL HEALTH COMM.	---		2,200
		AFL CIO (NATL)	AFL CIO COPE POL CONTRIBUTIONS COMM	12,200
		AFL CIO WASHINGTON	WASHINGTON STATE COPE	200
		BOILERMAKERS	LEGISLATIVE EDUC ACTION PROGRAM (LEAP)	2,000
		BUILDING & CONSTRUCTION DEPT	PEF OF THE BUILDING & CONSTRUCTION TRAD	1,000
		CARPENTERS	CARPENTERS LEGISLATIVE IMPROVEMENT COMM	1,000
		ELECTRICAL WORKERS (IBEW)	IBEW COPE	1,000
		IRON WORKERS	IRON WORKERS POL ACTION LEAGUE	1,000
		LABORERS	LABORERS POL LEAGUE	2,500
		OPERATING ENGINEERS	ENGINEERS PEC	1,000
		OPERATING ENGINEERS WASH	LOCAL 302 VOL POL FUND (SEATTLE)	2,500

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
AK SS DEM	*GRAVEL,MIKE	PAINTERS	POLITICAL ACTION TOGETHER POL COM (PAT)	350
		PLUMBERS & PIPEFITTERS	U A POLITICAL EDUCATION COMM	1,000
		FIRE FIGHTERS	FIRE FIGHTERS COPE	100
		GOVERNMENT EMPLOYEES (AFGE)	COMM ON FEDERAL EMPLOYEE POL EDUCATION	200
		POSTAL WORKERS	POLITICAL FUND COMM OF AM POSTAL WORKER	400
		STATE COUNTY & MUN EMPLOYEES	PEOPLE (PUBLIC EMPLOYEES ORGANIZED)	1,000
		GARMENT WORKERS LADIES	ILGWU CAMPAIGN COMM	500
		MACHINISTS	MACHINISTS NON PARTISAN POL LEAGUE(MNPL	16,700
		PULP & PAPERMILL WORKERS	UNITED PAPER WORKERS INTL UNION	174
		SHEET METAL WORKERS	POLITICAL ACTION LEAGUE SHEET METAL	400
		STEELWORKERS (NATL)	UNITED STEELWORKERS OF AMERICA PAF (PA)	8,000
		UNITED AUTO WORKERS IND	UAW V-CAP	6,200
		MARINE ENGINEERS	MEBA POL ACTION FUND	31,000
		SEAFARERS	SEAFARERS POL ACTIVITY DONATION	15,500
		HOTEL & RESTAURANT EMPLOYEES	H & RE & BIU COPE	2,000
		MEATCUTTERS	AMCOPE	700
		RETAIL CLERKS	ACTIVE BALLOT CLUB	15,000
		FIREMEN & OILERS	FIREMEN & OILER POL LEAGUE	200
		MAINTENANCE OF WAY EMPLOYEES	MAINTENANCE OF WAY POL LEAGUE	200
		RAILWAY CLERKS	RAILWAY CLERKS POL LEAGUE	4,000
		TRANSPORT WORKERS (TWU)	TRANSPORT WORKERS UNION POL CONTRIB COM	700
		TRANSPORTATION UNION (UTU)	TRANSPORTATION POL EDUC LEAGUE	1,000
		TEAMSTERS INDEPENDENT UNION	DRIVE (DEMOCRATIC REPUBLICAN INDEPEND)	2,000
		TEAMSTERS IND ALASKA	ALASKA DRIVE VOLUNTARY COMM	9,100
		COMMUNICATION WORKERS	CWA COPE	1,000
		GRAPHIC ARTS UNION	GRAPHIC ARTS INTL UNION COPE	500
SUB-TOTAL FOR ALL LABOR COMM.		—		142,324
		NATL EDUCATION ASSN	NATL EDUCATION ASSN PAC (NEA PAC)	3,200
		NATL RURAL ELECTR COOP ASSN	ACRE(ACTION COMM FOR RURAL ELECTRIFICAT)	2,000
			PATTON BOGGS & BLOW (LAWYERS)NNNNNNNNNNN	1,000
SUB-TOTAL FOR ALL MISCELLANEOUS COMM.. —				6,200
		NATIONAL CONGRESSIONAL LEVEL	DEMOCRATIC SENATORIAL CAMPAIGN COMM	5,100
SUB-TOTAL FOR ALL DEMOCRATIC COMM.		—		5,100
TOTAL FOR CANDIDATE IS —				184,124

ELECTION CANDIDATES	ROY, WILLIAM R DEM/CHALLENGER GENERAL ELECTION INFO: LOST/OPPOSED 390,451 VOTES (49.1%) PRIMARY ELECTION INFO: WON/OPPOSED				COLE, BOB REP/INCUMBENT GENERAL ELECTION INFO: WON/OPPOSED 403,983 VOTES (50.9%) PRIMARY ELECTION INFO: WON/UNOPPOSED			
	-NMBR-	$-AMOUNT	AVER	--%--	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		789,534				1,104,672		
CASH ON HAND - BEGINNING		0				110,646		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	125	143,329	1,147	18.2	264	258,214	969	22.6
IN STATE	104	126,029	1,212	16.0	172	175,078	1,024	15.5
OUT OF STATE	21	17,300	824	2.2	92	83,136	919	7.1
COMMITTEE CONTRIBUTIONS:	76	156,914	2,065	19.9	91	152,655	1,612	13.3
INTEREST COMMITTEES	75	143,914	1,919	18.2	88	82,555	870	6.9
POLITICAL PARTY COMMITTEES	1	13,000	13,000	1.6	3	70,100	23,372	6.3
LOANS RECEIVED	1	110,000	10,000	13.9	1	10,000	10,000	.9
LOANS REPAID	0	0	0	.0	1	10,000	10,000	.9
NET LOANS OUTSTANDING	1	110,000	10,000	13.9	0	0	0	.0
TOTAL EXPENDITURES		636,927				1,110,024		
CASH ON HAND - ENDING		10,794				0		

ST	RC	PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
KS	55	REP	*DOLE,BOB	ABERCROMBIE,A L	WICHITA	KS	A L ABERCROMBIE INC	500
				ABLAH,GEORGE J	WICHITA	KS	OWNER REALTOR	1,500
				ADAIR,JOHN A	ATCHISON	KS	PRES XCHANGE NATL BK & TST CO	750
				ADAMS,CR ANDREW S	ARLINGTON	VA	DEPUTY DIR EDUC & REHAn SER VA	500
				ADAMS,CREMRS C C	MCLEAN	VA	OWNER ILIFF NURSING MC.IE	750
				ADAMS,EDWARD C	TOPEKA	KS	CO OWNER ADAMS BUSINESS FORMS	500
				ADAMS,JOHN P	TOPEKA	KS	CO OWNER ADAMS BUSINESS FORMS	500
				ADDIS,ICER	WICHITA	KS	OIL PRODUCER	500
				ANDERSEN,RONALC C	TOPEKA	KS	CONTRACTOR B B ANDERSON CO	500
				ANSCHUTZ,PHILIP F	DENVER	CO	PRES THE ANSCHUTZ CORP	500
				ANTONELLI,C F JR	WASHINGTON	DC	PRES PARKING MGMT INC	500
				ARBUTHNOT,MR&MRS JAMES C	BELLEVILLE	KS	OWNERS ARBUTHNOT DRUG CO	650
				ATHA,MARVIN E	SHAWNEE MISS	KS	RET	500
				AUSTIN,MR&MRS IRA W	ESKRIDGE	KS	OWNER AUSTIN FUNERAL HOME	500
				BABBITT,J F JOS & HELEN	TULSA	OK	AGNEW CHEMICAL	500
				BALES,DANE	LOGAN	KS	MGR HANSEN TRUST FUND	1,000

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT	T
KS 55 REP	*DOLE,BOB	BARCUS,GRANT	KANSAS CITY	KS	PARTNER LG BARCUSAND SONS	1,000	
		BARRINGER,L T	MEMPHIS	TN	PRES L T BARRINGER & CO	500	
		BAUER,MRCMRS LYLE	HARPER	KS	FARMER	500	
		BEACH,MARIANNA	HAYS	KS	HOUSEWIFE	1,000	
		BEACH,ROSS	HAYS	KS	PRES PRODUCERS GAS EQUITIES	1,000	
		BEACHNER,JERRY	ST PAUL	KS	PRTNR NEOSHO VLY ELECTRIC CO	500	
		BEARDMORE,HEBER JR	WICHITA	KS	INV	500	
		BECKER,LAVERN	RUSSELL	KS	FARMER	605	
		BEECH,MRS OLIVE A	WICHITA	KS	CHMN BRD BEECH AIRCRAFT CORP	1,050	
		BELL,S W	KANSAS CITY	MO	COMPTRLR RISS INTERNL CORP	1,000	
		BENES,HELEN	BERWYN	IL		500	
		BEREN,ROBERT M	WICHITA	KS	PRTNR OKMAR OIL CO	1,050	
		BERRY,LOREN M	DAYTON	OH	V CHM L M BERRY & CO	500	
		BICKNELL,GENE	PITTSBURG	KS	SELF EMPLOYED	500	
		BIGLER,DRCMRS F CALVIN	GARDEN CITY	KS	PHYSICIAN	500	
		BLAKEMORE,MILTON M	LIBERAL	KS	PRES 1ST NATL BANK	1,000	
		BLOCK,HENRY W	KANSAS CITY	MO	PRES H & R BLOCK	1,000	
		BLODGETT,JOHN W JR	GRAND RAPIDS	MI	RET	500	
		BOYD,FRANK JR	MORAN	KS	FARMER	600	
		BOYD,MCGILL	PHILLIPSBURG	KS	PUBLISHER	1,510	
		BOYER,MRCMRS EUGENE	TOPEKA	KS	CONSULTANT QUALITY OIL CO	500	
		BRAMLAGE,FRED	JUNCTION CITY	KS	INVESTS JUNCTION CITY	500	
		BRANDT,MRCMRS LLOYD C	PRAIRIE VLGE	KS	VP YELLOW FREIGHT SYSTEMS INC	500	
		BROWN,GARY L MRCMRS	SALINA	KS	CONTRACTOR	500	
		BROWN,THOMAS C	KANSAS CITY	MO	GEN COUN MAURICE L BROWN TRUST	1,000	
		BRUCE,GEORGE M	WICHITA	KS	PRES ALADDIN PETROLEUM CO	1,400	
		BUBB,HENRY A	TOPEKA	KS	CH BD CAPITOL FED SAVINGS&LOAN	500	
		BURDEN,I TOWNSEND	WASHINGTON	DC	VP CAPCO INC	1,000	
		BURTON,CECIL	GREAT BEND	KS	OIL PRODUCER PICKRELL DRILLING	500	
		BUTCHER,HOWARD III	PHILADELPHIA	PA	INVESTOR BUTCHER & SINGER	500	
		BUTCHER,W W KEEN	PHILADELPHIA	PA	INVESTOR BUTCHER & SINGER	500	
		CADY,MRCMRS WINSLOW	SHAWNEE MISS	KS	PRES WIND STATIONS INC	500	
		CAMP,JOHN C	LAKE CHARLES	LA	ATTY	500	
		CARLSON,LEROY T	EVANSTON	IL	PRES TEL & DATA SYS INC	500	
		CARPENTER,EDMUND N	WILMINGTON	DE	ATTY	1,000	
		CARSON,DAVID W	KANSAS CITY	KS	ATTY	500	
		CASSON,DAN L	TOPEKA	KS	SEC TREAS CASSON CONST CO INC	500	
		CLARK,CHARLEY K	OVERLAND PARK	KS	MGR COMMER DEPT OWEN REALTY CO	500	
		CLARK,PRESTON M MRS	WICHITA	KS	HSWF	500	
		CLEVENGER,THOMAS R	TOPEKA	KS	PRES 1ST NATL BK OF TOPEKA	600	
		CLINTON,ELEANOR F	WICHITA	KS	HSWF	2,000	
		CLINTON,R P	WICHITA	KS	OIL OPER SUTTON PL	1,000	
		COFFEY,JOHN M	ALEXANDRIA	VA	ATT HALL,ESTILL,HARDWICK,ETAL	700	
		COHEN,RICHARD S	ROCKVILLE	MD	PRES WILLCO	500	
		COLE,EVERETT S	WICHITA	KS	V CH BRD UNION NATL BANK	2,400	
		COLEMAN,CLARENCE	WICHITA	KS	V CHMN BD UNION NATL BANK	2,000	
		COLEMAN,SHELDON	WICHITA	KS	CHRMN OF BRD COLEMAN CO	1,000	
		COLLET,JOHN C	BLUE SPRINGS	MO	PRES RUPERT MFG CO	500	

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
KS 55 REP	*DOLE,BOB	COLMERY,HARRY W	TOPEKA	KS	LAWYER COLMERY MCCLURE FUNK	500
		COMMERC,CARSON E	KANSAS CTY	MO	REALTOR	500
		CRAWFORD,HOWARD E	ATCHISON	KS	RET	500
		CRAY,CLOUD L	ATCHISON	KS	CH BD MIDWEST SOLVENTS CO	500
		CRAY,CLOUD L JR	ATCHISON	KS	PRES MIDWST SOLVENTS CO	500
		CULP,C M	MEMPHIS	TN	MGR FERT MKTG W R GRACE & CO	500
		CUSHING,NED	DOWNS	KS	OWNER CUSHING INS AGENCY	1,250
		DARBY,HARRY	KANSAS CITY	KS	CH BD THE DARBY CORP	1,000
		DAY,JOHN F	SHAWNEE MISS	KS	SALESMAN THRIFTWAY MARKETS	500
		DIBBLE,STEPHEN	TOPEKA	KS	REALTOR	1,200
		DUPONT,REYNOLDS	WILMINGTON	DE	EXEC DUPONT INDUST	500
		EBY,MARTIN K JR	WICHITA	KS	PRES M K EBY CONST CO INC	600
		EDMISTON,MR&MRS E K	WICHITA	KS	OWNER E K EDMISTON OIL CO	500
		EISELE,JOHN C	OVERLAND PK	KS	LAWYER	1,000
		ELLSWORTH,ROBERT F	NEW YORK	NY	INVEST BKR GEN PARTNER	500
		EVANS,S DEAN SR	SALINA	KS	OWNER EVANS GRAIN CO	4,[illegible]
		EVERLY,JOE R	WINFIELD	KS	EVERLY CO INC	525
		FAIR,DALE JR	WICHITA	KS	ATTY MARTIN,PRINGLE,SCHALLEFAI	500
		FAIR,F DOYLE	WICHITA	KS	PETROLEUM ENG	500
		FAIRLEIGH,FLOYD L	SCOTT CITY	KS	OWNER & FARMER FAIRLEIGH FEED	600
		FALLEY,MR&MRS L C	TOPEKA	KS	CH BD FALLEYS INC	500
		FALSTAC,WILLIAM	FREDONIA	KS	PRES KANSAS BK NOTE CO INC	500
		FARHA,S JIM MD	WICHITA	KS	PHYSICIAN	500
		FASKE,PAUL	MIAMI	FL	EXEC BONDING CORP OF AMER	500
		FEGAN,ROBERT J	JUNCTION CITY	KS	RET	700
		FERRELL,JAMES E	PLATTE CITY	MO	PRES FERRELLGAS INC	500
		FINK,MR&MRS H BERNARD	TOPEKA	KS	CH BD C G F GRAIN CO INC	1,[illegible]
		FIRST NATIONAL BANK	SHAWNEE MSSN	OK		10,000 2
		FIRST NATIONAL BANK	SHAWNEE MSSN	OK		10,000- 3
		FOGARTY,JOSEPH F JR	MIAMI	FL	INSURANCE	1,000
		FRANK,R W	KANSAS CITY	KS	PRES CUMMINS MID AMER INC	1,000
		FREE,BENJAMIN J	MILWAUKEE	WI	PRES BADGER BY-PRODUCTS	500
		FRIDOVICH,MARTIN	FT LAUDERDALE	FL	OWNER FRIDOVICH INVESTMENT CO	500
		FRISBIE,GEORGE L	GYPSUM	KS	PRES FRISBIE CONST CO	1,000
		FYFE,ERNEST R	CONCORDIA	KS	OWNER FYFE SAND & GRAVEL	500
		GARVEY,MR&MRS JAMES S	FORT WORTH	TX	FARMER RANCHER GRAIN	1,005
		GARVEY,OLIVE W MRS	WICHITA	KS	CHMN BRD GARVEY PROPERTIES	3,[illegible]
		GARVEY,WILLIAM W	WICHITA	KS	CHMN OF BRD GARVEY IND	800
		GILPIN,GLEN E	EMPORIA	KS	OWNER BLACKTOP CONSTR CO	500
		GORE,THEODORE	WICHITA	KS	OIL PROD OWNER	1,000
		GOULD G JAMES	WICHITA	KS	PRES BARNETT OIL CO INC	955
		GRAHAM,KENNETH L	LEAVENWORTH	KS	MD PHYSICIAN	500
		GRANT,WILLIAM D	KANSAS CITY	MO	CH BD BUSINESS MENS ASSURANCE	1,000
		GRAVES,JOHN C	EL DORADO	KS	PRES GRAVES DRLG CO	500
		GRAVES,WILLIAM H	SALINA	KS	EXEC NELSON TRUCK LINE INC	605
		HAGMAN,WILLIAM R	PITTSBURG	KS	PRES HAGMANS INC	500
		HAINES,JORDAN L	WICHITA	KS	PRES THE FOURTH NATL BK&TRST	600
		HALE,H D	LEAWOOD	KS	PRES ADM MILLING CO	500

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CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST	RC	PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
KS	55	REP	DOLE,BOB	HAM,J R	GARDEN CITY	KS	MGR MASTER FEEDERS NO 2 INC	1,000
				HAMPTON,E S	SALINA	KS	ATTY HAMPTON ROYCE ENGLEMAN	500
				HAMPTON,TOM W	SALINA	KS	ATTY HAMPTON ROYCE ENGLEMAN	500
				HANKAMER,JOHN L	TOPEKA	KS	HANKAMER READY MIX OWNER	500
				HARDAGE,SAMUEL A	WICHITA	KS	PRES US COMMUNITIES INC	1,000
				HAUSSERMANN,C L JR	OAK BROOK	IL	SALESMAN DARLING & CO	500
				HENDEL,MURRAY M	OVERLAND PK	KS	VP FELD LEASING CO INC	500
				HILL,AL G	DALLAS	TX	OIL PRODUCER	500
				HOLLAND,GEORGE W	RUSSELL	KS	CATTLE RANCHER	500
				HOOVER,V RICHARD	WICHITA	KS	PRES CHIEF DRILLING CO	1,200
				HOUGLAND,WM	WICHITA	KS	V PRES KOCH OIL CO	2,000
				HOUSTON,W M III	MEMPHIS	TN	PRES OWNER W M HOUSTONGSON	500
				HSU,DR&MRS F RICHARD	WESTFIELD	NJ	PRES CHINA INST AMER	2,000
				HUDSON,DALE & LARRY	THAYER	KS	HUDSON BROTHERS	700
				HUTTON,WILLIAM W	LENEXA	KS	MNGR ASSOCIATED GNRL CONTRCTRS	1,000
				INGRAM,ROBERT P	KANSAS CITY	MO	PRES KBEA BROADCASTING CO	2,000
				JACOBSON,JOHN	LIBERAL	KS	PRES NATL BEEF PACKING CC	2,000
				JOHNSON,DONALD E	FLINT	MI	RET	500
				JOHNSON,E R FENIMORE	ARDMORE	PA		1,000
				JOHNSON,SAMUEL C	RACINE	WI	CHMN JOHNSON WAX CORP	500
				JOHNSTON,PROF FRANCIS A	ITHACA	NY	RET	500
				KALIVAS,WILLIAM	KANSAS CITY	MO	BUILDER DEVELOPER	500
				KATZ,MARVIN	ROELAND PARK	KS	MGR BUDDY FOODS	500
				KAUFFMAN,EWING M	SHAWNEE MISSI	KS	PRES MARION LABRATORIES INC	1,2[illegible]
				KECK,ELIZABETH A	LOS ANGELES	CA	HOUSEWIFE	1,000
				KECK,H B	LOS ANGELES	CA	PRES SUPERIOR OIL CO	1,000
				KEMPER JR,R CROSBY	KANSAS CTY	MO	CH BD UNITED MISSOURI BANK	500
				LAUNOFF,HOWARD J	DANVILLE	IL	PRES LAUNOFF GRAIN CO	2,000
				LAW,E B	WICHITA	KS	PRES THE LAW CC INC	700
				LEVENS,VREN D	PRAIRIE VLG	KS	PARTNER LORI ENTERPRISES	500
				LIGHTNER,ROBERT S	WICHITA	KS	HOLIDAY INN PLZ	1,000
				LITWIN,HARRY	WICHITA	KS	PRIVATE INVESTOR	1,200
				LOCKE,MRS ROBERT W	OVERLAND PARK	KS	HSWF	600
				LOCKTON,JOHN T III	PRAIRIE VILL	KS	LOCKTON INS AGCY	1,376
				LUNDBERG,K F	TULSA	OK	CH BD AGRICO CHEMICAL CO	500
				MAGUIRE,CARY M	DALLAS	TX	OWNER MAGUIRE OIL CO	700
				MARCUS,S H	WICHITA	KS	CH BD KANSAS BEEF INDUSTRIES	500
				MARQUA,M T	INDEPENDENCE	MO	PRES CARLAND LEASING INC	500
				MARTIN,ROBERT	WICHITA	KS	ATTY MARTIN,PRINGLE,SCHELL,FAI	1,200
				MAXFIELD,MORGAN	KANSAS CITY	MO	PRES GREAT MIDWT CORP	500
				MCGLYNN,L D	GREAT FALLS	MT	HOUSEWIFE	500
				MCKEVITT,JAMES D	WASHINGTON	DC	ATTY OCONNOR & HANNAN	500
				MCMORRIS,DONALD L	LEAWOOD	KS	YELLOW FREIGHT SYS LINES	500
				MELCHER,HAROLD S	SHAWNEE MSSN	KS	PRES TRENTON FOODS INC	700
				MICHAELIS,W A JR	WICHITA	KS	PRES GRAHAM MICHAELIS DRILLING	1,200
				MILLAND,FRANCES	MCPHERSON	KS	PRES M-E PETRO CO INC	1,223
				MILLER,KENNETH E MR&MRS	WESTWOOD	NJ	ACCT UNITED MARITIME	1,000
				MILLIKEN,ROGER	SPARTANBURG	SC	PRES DEERING MILLIKEN	1,000

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
KS SS REP	DOLE,BOB	MOORHEAD,MR&MRS THOMAS A	ATCHISON	KS	SELF EMPLOYED	500
		MORRISON,LLOYD	SALINA	KS	PRTNR MORRISON GRAIN CO	2,900
		MORRISON,MILTON L	SALINA	KS	PRES MORRISON GRAIN CO INC	2,635
		MOSS,ROBERT W MR&MRS	SALINA	KS	VP ZOCO DISTRIBUTING INC	500
		MUDRICK,STEVEN M	MISSION	KS	ARMY CORP OF ENGINEERS	500
		MULL,J A JR	WICHITA	KS	PRES MULL DRILLING CO INC	3,600
		MYERS,RICHARD G	SHAWNEE MSN	KS	EXEC VP SEABD ALLIED MILLING	500
		NETTELS JR,GEORGE E	PITTSBURGH	KS	CH BD MCNALLY PITTSBURGH CO	1,000
		NIELSEN,ARTHUR C SR	WINNETKA	IL	CH & CHF EXEC OFF NIELSON CO	3,000
		NORMENT,ELIZABETH D	PALM BCH	FL	HSWF	500
		ODONNELL,PETER JR	DALLAS	TX	OWNER PETER ODONNELL JR INVTMT	1,000
		OLIN,JOHN M	ST LOUIS	MO	RETIRED	2,000
		OLIVER,WILLIAM L JR MRS	WICHITA	KS	HSWF	500
		OWEN,DAVE	FAIRWAY	KS	PRES 1ST NATL BANK	1,200
		PACKARD,DAVID	PALO ALTO	CA	CHMN BD HEWLETT PACKARD CO	500
		PERELMAN,DR MEL	CARMEL	IN	PHYSICIAN	500
		PEROT,H ROSS	DALLAS	TX	CH ELEC DATA SYS	5,000
		PETERS,MR&MRS RICHARD C	LAWRENCE	KS	ARCH ROBERTSON,PETERS,WILLIAMS	500
		PETTY,J L	MEMPHIS	TN	SLSMN MID CENTRAL MILLING CO.	500
		PHILLIPS,L E JR	WICHITA	KS	LEE PHILLIPS OIL CO	750
		PHILLIPS,L E MR&MRS	WICHITA	KS	OIL OPER LEE PHILLIPS OIL CO	1,900
		PINNICK,MR&MRS FLOYD V	ULYSSES	KS	PRES GRANT CNTY STATE BK	1,000
		POISY,JOHN J	CLYDE	OH	PARTNER FORMULATED FEEDS	500
		POLLOCK,K W	FT SCOTT	KS	PRES KEY INDUSTRIES INC	5,000
		POPEJOY,DONALD	ULYSSES	KS	GNRL MNGR POPEJOY CONSTR CO IN	500
		PORTER,LOUIS	TULSA	OK	VP DALCO PETROLEUM INC	1,217
		QUINN,ARTHUR L	WASH	DC	ATTY DAWSON,QUINN,RIDDELL	500
		RAGAN,WILLIAM F	WASHINGTON	DC	ATTY RAGAN & MASON	500
		RAINS,MR&MRS WILSON	WICHITA	KS	OWNER RAINS & WILLIAMSON OIL	750
		RANSON,JACK	WICHITA	KS	INVESTOR	700
		REID,ROYAL D	GOODLAND	KS	REID GRAIN INC OWNER	1,000
		RICE,W RAY	WICHITA	KS	PRES BELTONE HEARING AID SERV	500
		RICHARDSON,JACK MR&MRS	LAWRENCE	KS	U S MARSHAL	500
		RITCHIE,H D	WICHITA	KS	OWNER VP RITCHIE ENTEPPRISES	600
		ROEMER,ALAN	TEANECK	NJ	OWNER ROEMER TRADING CO	500
		ROSKAM,MR&MRS DEL	WICHITA	KS	PRES CESSNA AIRCRAFT CO	500
		ROSS,DON C	WICHITA	KS	OIL INVESTOR	550
		ROUNDS,RALPH C	WICHITA	KS	PRES ROUNDS & PORTER CO	1,300
		RUPPENTHAL,L H	MCPHERSON	KS	LAWYER	500
		SALISBURY,PHYLLIS F	KANSAS CITY	MO	KS FARM OWNER HSEWF	500
		SAMARRAI,S H	MANHATTAN	KS	REAL EST SALESMAN	500
		SANDERS,W D	KANSAS CTY	MO	PRES SANDERS CO	500
		SCAIFE,RICHARD M	PITTSBURGH	PA	BKG	4,000
		SCOTT,JEROME H JR	SHAWNEE MSN	KS	BANKER UNITED MO BK OF KS	500
		SEBITS,CARL W	CHENEY	KS	PRTNR PICKRELL DRILLING CO	2,000
		SHARP,BAYARD	WILMINGTON	DE	PRIV INVESTOR	1,000
		SHARP,C E	KANSAS CTY	MO	PRES SHARP BROS CONST CO	2,750
		SHAWVER,E B	WICHITA	KS	OWNER CH BD STELBAR OIL CORP	2,500

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ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
KS SS REP	*DOLE,BOB	SHEARS,WILL H JR	HUTCHINSON	KS	CONTRACTOR	500
		SHEPARD,RAY	PORT SCOTT	KS	RAY SHEPARD MOTORS	613
		SHULTZ,MR&MRS REYNOLDS	LAWRENCE	KS	FARMER	500
		SIEBERT,MR&MRS RONALD C	NESS CITY	KS	PRES SIEBERT SAND CO INC	1,000
		SIMPSON,JOHN H	SALINA	KS	ATTY	500
		SLAWSON,CHARLES J	WICHITA	KS	INVESTOR OIL INVESTMENTS	2,200
		SLAWSON,DONALD C	WICHITA	KS	PRES SLAWSON DRILLING CO INC	2,400
		SMITH,B ALDEN	SHAWNEE MISS	KS	MFG ALDCOMP INC	1,000
		SOSLAND,SAMUEL	KANSAS CITY	MO	MGRING EDITOR SOSLAND PRESS	500
		STEWART,JOHN F III	WELLINGTON	KS	CH WELCO AEROSPACE CORP	2,000
		STOUT,WILLIS E	GOODLAND	KS	PRES 1ST NAT BANK	1,025
		SUNDERLAND,JAMES P	LEAWOOD	KS	PRES ASH GROVE CEMENT CO	1,000
		SUTHERLAND,DWIGHT D	KANSAS CITY	MO	OWNER SUTHERLAND LUMBER CO	1,000
		TAYLOR,THOMAS F	SALINA	KS	PHYSICIAN	700
		TIMKEN,W R	CANTON	OH	THE TIMKEN CO	500
		TODD,C H	WICHITA	KS	PRES INV R W RINE DRILLING CO	500
		TOMLINSON,WARREN E	WICHITA	KS	OIL PRODUCER TOMLINSON OIL CO	500
		TRAVIS,JOHN W DR&MRS	TOPEKA	KS	PHYSICIAN	500
		TURNER,COL COURTNEY S	ATCHISON	KS	RET	500
		UHL,MR&MRS PERRY	TOPEKA	KS	RETIRED	500
		UHLMANN,R HUGH	SHAWNEE MISS	KS	PRES STANDARD MILLING CO	2,000
		VAN HANFORD,JOHN JR	CHARLOTTE	NC	WHOLESALE FLORIST	500
		VANDEGRIFT,FRANK B	SHAWNEE MSN	KS	PRES HUDSON VAN OIL CO	3,000
		VANDEGRIFT,FRANK B MRS	SHAWNEE MSN	KS	OWNER HUDSON OIL CO	3,000
		VANIER,JOHN J	SALINA	KS	OWNER STAR GRAIN & INV INC	500
		VARNER,S V	WICHITA	KS	V PRES KOCH IND INC	3,000
		VICKERS,ROBERT F	WICHITA	KS	ADM INV MGR VICKERS TRUST	600
		WAGSTAFF,ROBERT W	SHAWNEE MSN	KS	HSEWF	500
		WALKER, LOUIS	TULSA	OK	VP DALCO PETROL INC	1,217
		WALKER,C A	PITTSBURG	KS	PRES VINYLPLEX INC	500
		WALKER,DAVID	TULSA	OK	PRES DALCO PETROLEUM INC	1,217
		WALKER,RALPH D	SHARON SPRING	KS	FARMER	500
		WALLACE,DUANE L	WICHITA	KS	CH BD CESSNA AIRCRAFT CO	2,000
		WALTON,HANK	OLATHE	KS	PRTNR MIDWEST CATTLE CO	1,557
		WARD,LOUIS L	KANSAS CITY	MO	PRES CHMN RUSSELL STOVER CANDY	2,000
		WEARY,ROBERT K	JUNCTION CITY	KS	ATTY AT LAW	500
		WEIR,GLENN A	ARLINGTON	VA	ASSOC ADM AG STAB&CONSERV SERV	500
		WHEELER,EDWIN H	CHEVY CHASE	MD	PRES THE FERTILIZER INS	500
		WILKINS,C HOWARD JR	WICHITA	KS	PRES PIZZA CORP OF AMER	2,100
		WILLIAMS,J D	WASHINGTON	DC	ATTY WILLIAMS & JENSEN	2,200
		WILLIAMS,JAMES D JR	WASHINGTON	DC	ATTY	1,000
		WILLIAMS,R C	RUSSELL	KS	OWNER R C WILLIAMS INC	1,000
		WILSON,DAVID K	NASHVILLE	TN	CHEROKEE EQUITY CORP PRES	1,000
		WINSOR,CURTIN JR	WASHINGTON	DC	BKR CHASE MANHATTAN BANK	1,000
		YEAGER,R W	NORTON	KS	PRES SHARP CONST CO INC	500
		YOST,LYLE E	HESSTON	KS	PRES HESSTON MANUFACT	500

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

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ST AC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
KS 55 REP	DOLE,BOB	ANSCHUTZ,FRED	DENVER	CO	OWNER, ANSCHULTZ CORP	500
		BLANCHARD,HENRY	S. MISSION	KA	CHM COM'L NATIONAL BANK	500
		CHAFFEE,TOM	NORTH TOPEKA	KS	FARMER	1,000
		ELLIS,D	FT. SCOTT	KS	OWNER, TRUCKING OPERATION	1,100
		GARABEDIAN,JOHN	FRESNO	CA	FARMER	500
		GOLDEN,JOHN H	GOODLAND	KS	FARMER	500
		HUSSEY,ED	GOSHEN	IN	PRES. LIBERTY HOMES INC	500
		MAYOR,H A	WICHITA	KS	PRES. SOUTHWEST GREASE&OIL CO	1,000
		NELSON,ROLLAND	WEST DESMOINES	IA	PRES. KEMIN INDUSTRIES, INC	500
		PENN, ETHEL	BRYN MAWR	PA	RETIRED	2,000
		RUAN, JOHN	DESMOINES	IA	PRES. RUAN TRANSPORT CORP	500
		UIHLEIN, J	GRAFTON	WI	CHM. TAMARACK PETROLEUM CO. INC	500
TOTAL FOR CANDIDATE---						258,226

ST	RC	PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
KS	55	REP	*DOLE,BOB			
				NATL MILK PRODUCERS INC	AGRICULTURAL COOPERATIVE TRUST (ACT)	100
				AM NATL CATTLEMEN'S ASSN	CATTLEMENS ACTION LEGISLATIVE FUND(CALF)	400
				AM RICE GROWERS COOP ASSN	RICE PRODUCERS PEC LAKE CHARLES LA	500
				CALIFORNIA AGRICULTURE	COMM ON AGRICULTURAL POLICY (CA)	200
				FLORIDA AGRICULTURE	FLORIDA AGRICULTURAL EDUCATION COMM	900
				NATL COUNCIL OF FARMER COOPS	PACE (POL ACTION FOR COOP EFFECTIVENESS	750
			SUB-TOTAL FOR ALL AGRICULTURAL COMM.	---		2,850
				HUGHES AIRCRAFT CO	HUGHES ACTIVE CITIZENSHIP FUND	1,150
				LTV CORP LTV AEROSPACE CORP	LTV CORP ACTIVE CITIZENSHIP CAMP FUND	100
				AM APPAREL MFRS ASSN	AMERICAN APPAREL MFRS ASSN PAC	200
				N A OF MANUFACTURERS (NAM)	BUSINESS INDUSTRY PAC (BIPAC)	2,500
				KENNECOTT COPPER CORP	KENNECOTT EXECUTIVES CITIZENSHIP ASSN	1,000
				OLIN CORP	OLIN EXECUTIVES VOL NON-PART POL FUND	100
				BITUMINOUS COAL INDUSTRY	COMM ON AMERICAN LEADERSHIP (COAL)	500
				CONSOLIDATED NATURAL GAS (PA)	CONPAC (PA)	200
				CONSOLIDATED NATURAL GAS (WV)	CONSOLIDATED EXEC VOL NON-PART POL FUND	100
				EAST OHIO GAS CO	EAST OHIO GAS EMP VOL GOOD GOVT ASSN	100
				NATURAL GAS RETAILERS	GAS EMPLOYEES PEC	200
				UNION OIL CO OF CALIFORNIA	POLITICAL AWARENESS FUND	1,000
				N A OF BROADCASTERS	NATL CONFERENCE FOR SUPPORT OF FREE BRO	1,500
				NATL CABLE TELEVISION ASSN	NATL CABLE TELEVISION ASSN PAC	500
				NATL TELEPHONE CO-OP ASSN	TELEPHONE EDUCATION COMM ORGANIZATION	200
				US INDEPENDENT TELEPHONE ASSN	COMPAC (COMMUNICATIONS PAC)	600
				ASSOC GENERAL CONTRACTORS	COMM FOR ACTION (BELLEVUE WASH)	2,000
				BLACK & VEATCH	BLACK & VEATCH GOOD GOVT FUND	800
				CONSTRUCTION EQUIPMENT INDUS	CONSTRUCTION EQUIPMENT PAC	300
				HOME BUILDERS MISSOURI	HOME BUILDERS ORG FOR POL ED (HOPE)	200
				SMCAC CONTRACTORS ASSN	SMACPAC (SHEET METAL & AIR CONDITIONI)	500
				GENERAL ELECTRIC CO	NON PARTISAN POL COMM (NEW YORK)	500
				AMERICAN BANKING	BANKPAC (BANKING PROFESSION PAC)	1,200
				KANSAS BANKERS	KANSAS BANKERS PAC	100
				FIRST NATL BANK OF TOPEKA	CITIZENS FOR GOOD GOVT (KANSAS)	100
				SAVINGS & LOAN LEAGUE	SAVINGS ASSN POL ELECTIONS COMM (SAPEC)	2,100
				MORTGAGE BANKERS	MORPAC (MORTGAGE BANKERS PAC)	500
				SECURITIES INDUSTRY	SECURTIES INDUSTRY CAMPAIGN COMM	1,100
				AM FROZEN FOOD INSTITUTE	FREEZERS PAC	100
				CANNING INDUSTRY	CANNERS PUBLIC AFFAIRS COMM	1,000
				COCA COLA COMPANY	NON-PARTISAN COMM FOR GOOD GOVT (GA)	550
				DEL MONTE CORP	DEL MONTE VOL NON-PART GOOD GOVT COMM	350
				FOOD INDUSTRY	FOOD INDUSTRY GOOD GOVT COMM	1,000
				NATL CONFECTIONERS ASSN OF US	GOVT IMPROVEMENT GROUP	1,000
				WILSON & CO INC (SUB OF LTV)	WILSON & CO ACTIVE CITIZENSHIP CAMPAIGN	105
				FOREST PRODUCTS INDUSTRY	FOREST PRODUCTS POL COMM	1,000
				GEORGIA-PACIFIC CORP	G-P EMPLOYEES FUND (OREGON)	500
				WEYERHAEUSER CO	TACOMA FUND	500
				NATL RESTAURANT ASSN	RESTAURATEURS PAC	1,750

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST AC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
KS 55 REP	DOLE,BOB	INDEPENDENT INSURANCE AGENTS	AMERICAN INSURANCE MENS PAC (AIMPAC)	400
		N A OF LIFE UNDERWRITERS	LIFE UNDERWRITERS PAC (LUPAC)	2,650
		KEMPER INSURANCE CO	KEMPER MANAGEMENT CAMPAIGN FUND	500
		PHARMACEUTICAL MFRS ASSN	PHARMACEUTICAL MFRS ASSN BETTER GOVT COM	100
		MARION LABORATORIES INC	MID-AMERICA COMM FOR SOUND GOVT	400
		SMITH KLINE & FRENCH	SKF VOLUNTARY NON-PARTISON POL FUND	300
		ATCHISON, TOPEKA & SANTA FE	CIVIC TRUST OU SANTA FE EMP FR GOOD GOV	200
		BURLINGTON NORTHERN INC -RR	BURLINGTON NORTHERN OMF VOL GOOD GOVT	650
		SOUTHERN RAILWAY SYSTEM	SOUTHERN RAILWAY TAX ELIGIBLE GGF	600
		UNION PACIFIC CORP	FUND FOR EFFECTIVE GOVT (NEW YORK)	700
		SAINT LOUIS SAN FRANCISCO RR	FRISCO EMPLOYEES COMM FOR GOOD GOVT	1,150
		N A OF REALTORS	REAL ESTATE PAC	3,200
		N A OF REALTORS-MINNESOTA	MINNESOTA REAL ESTATE PAC	200
		AM IMPORTED AUTO DEALERS ASSN	AIADA PAC	500
		N A OF MOTOR BUS OWNERS	BUS INDUSTRY PUBLIC AFFAIRS COMM BUSPAC	100
		NATL AUTO DEALERS ASSN	COMM OF AUTO RETAILERS (CAR)	400
		TRUCKING INDUSTRY	TRUCK OPERATORS NON-PARTISAN COMM	2,500
		AM ASSN OF NURSERYMAN	NURSERY INDUSTRY PAC	100
		AM COTTON SHIPPERS ASSN	COMM ORGANIZED FOR TRADING OF COTTON	400
		AM SOCIETY OF EXECUTIVES	EFFECTIVE GOVT GROUP (WASHINGTON DC)	250
		BOATING INFORMATION COUNCIL	BOATING INFORMATION COUNCIL PAC	250
		COTTON WAREHOUSE ASSN OF AM	COMM OF ONE HUNDRED (MEMPHIS)	100
		GENERAL AVIATION MFRS ASSN	GENERAL AVIATION PUB AFF COMM (GENAVPAC)	500
		TOBACCO PRODUCTS MFRS	TOBACCO PEOPLES PUBLIC AFFAIRS COMM	650
	SUB-TOTAL FOR ALL BUSINESS COMM.	——		44,205
		AM DENTAL ASSN (NATL)	AMERICAN DENTAL PAC (ADPAC)	5,000
		AM MEDICAL ASSN (NATL)	AMERICAN MEDICAL PAC (AMPAC)	10,000
		AM MEDICAL ASSN-CC EXEC	PHYSICIANS COMM FOR GOOD GOVT (DC)	100
		AM MEDICAL ASSN KANSAS	KANSAS MEDICAL PAC (KANPAC)	3,000
		AM NURSING HOME ASSN	AMHEPAC AMERICAN NURSING HOME ED & PAC	1,200
		AM OPTOMETRIC ASSN	OPTOMETRIC PAC	3,000
		AM PHYSICAL THERAPY ASSN	AMERICAN PHYS THERAPY CONG ACTION COMM	100
		AM PODIATRY ASSN	PODIATRY PAC	2,000
		AM SOCIETY OF ORAL SURGEONS	ORAL SURGERY PAC (OSPAC)	5,000
		FEDERATION OF AM HOSPITALS	FED PAC	2,000
		OPTICIANS ASSN OF AM	OPTICIANS COMM ON POL EDUCATION	700
	SUB-TOTAL FOR ALL HEALTH COMM.	——		32,100
		GOVERNMENT EMPLOYEES (AFGE)	COMM ON FEDERAL EMPLOYEE POL EDUCATION	600
	SUB-TOTAL FOR ALL LABOR COMM.	——		600
		NATL EDUCATION ASSN LOUSIANA	LOUISIANA EDUCATIONAL GROUP	300
		NATL RURAL ELECTR COOP ASSN	ACRE(ACTION COMM FOR RURAL ELECTRIFICAT)	500
		NATL RURAL ELECTR COOP KS	KANSAS ACRE	1,000
	SUB-TOTAL FOR ALL MISCELLANEOUS COMM.	——		1,800
		YOUNG AMERICANS FOR FREEDOM	CONSERVATIVE GROUP	1,000
	SUB-TOTAL FOR ALL IDEOLOGICAL COMM.	——		1,000
		NATIONAL CONGRESSIONAL LEVEL	NATL REPUBLICAN SENATORIAL COMM	60,100
		NATIONAL CONGRESSIONAL LEVEL	REPUBLICAN CAMPAIGN COMM	10,000
	SUB-TOTAL FOR ALL REPUBLICAN COMM.	——		70,100
	TOTAL FOR CANDIDATE IS ——			[illegible]

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ELECTION CANDIDATES	ROBERTS, BETTY DEM/CHALLENGER GENERAL ELECTION INFO: LOST/OPPOSED 338,551 VOTES (44.2%) PRIMARY ELECTION INFO: /OTHER				PACKWOOD, ROBERT W REP/INCUMBENT GENERAL ELECTION INFO: WON/OPPOSED 420,984 VOTES (54.9%) PRIMARY ELECTION INFO: WON/UNOPPOSED			
	-NMBR-	$-AMOUNT	AVER	--%--	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		82,403				345,485		
CASH ON HAND - BEGINNING		0				21,276		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	4	8,413	2,103	10.2	68	56,800	835	16.4
IN STATE	1	3,813	3,813	4.6	37	28,300	765	8.2
OUT OF STATE	3	4,600	1,533	5.6	31	28,500	919	8.2
COMMITTEE CONTRIBUTIONS:	28	50,027	1,787	60.7	63	99,032	1,572	28.7
INTEREST COMMITTEES	27	42,527	1,575	51.6	62	68,032	1,097	19.7
POLITICAL PARTY COMMITTEES	1	7,500	7,500	9.1	1	31,000	31,000	9.0
LOANS RECEIVED	0	0	0	.0	0	0	0	.0
LOANS REPAID	0	0	0	.0	0	0	0	.0
NET LOANS OUTSTANDING	0	0	0	.0	0	0	0	.0
TOTAL EXPENDITURES		80,153				333,004		
CASH ON HAND - ENDING		2,210				12,480		

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
OR 55 REP	*PACKWOOD,ROBERT W	ADAMS,CHARLES F	PORTLAND	OR	RET	500
		BENNING,A E	OGDEN	UT	PRES AMALGAMATED SUGAR CO	500
		BEYERS,ANNA	PHILMATH	OR	SAMUEL OPERATOR	500
		BONEBAKE,A C	VANCOUVER	WA	RET	1,000
		COLLINS,MARIBETH W	PORTLAND	OR	RET	500
		COUGLIN,ROBERT A	COOS BAY	OR	SAWMILL OPERATOR	1,000
		DUPONT,REYNOLDS	WILMINGTON	DE	CONSULTANT DUPONT INDUST	500
		ELLIS,DON A	PORTLAND	OR	TREAS TEKTRONIX INC STOCK	500
		FAUST,JOHN R JR	PORTLAND	OR	ATTY	550
		FINKELSTEIN,JAMES	NEW YORK	NY	NY LAW JOURNAL	500
		FOGELSON,JAMES H	N Y	NY	ATTY WACHTELL,LIPTON,ROSENKAT	5,000
		FORD,BENSON	DEARBORN	MI	CHM DLR POLICY BD FORD MTR CO	500
		FORD,HENRY II	DEARBORN	MI	CHMN BD FORD MOTOR CO	500
		FRONK,WILLIAM J	PORTLAND	OR	EXEC HYSTER CO	500
		GILMORE,ROBERT W	NEW YORK	NY	PRES CNTR FOR WAR-PEACE STUDIE	1,000
		GRAY,JOHN D	PORTLAND	OR	EXEC OMARK IND	1,000
		HAWES,PEYTON	PORTLAND	OR	EXEC PAYLESS DRUG CO	600
		HAYES,EDMUND	PORTLAND	OR	RET	500
		HELLER,HAROLD W	MCMINNVILLE	OR	REGIONAL REP OF AAU	750
		HILL,PHILIP S	LAKE OSWAGO	OR	EXEC HYSTER CO	510
		HOFFMAN,C W	LA GRANDE	OR	SAWMILL OPERATOR	500
		HOFFMAN,W BURNS	PORTLAND	OR	EXEC FOREST SAND CO	1,000
		HULT,NILS	EUGENE	OR	PROPERTY EVELOPMENT	500
		HUNT,WP W	PORTLAND	OR	CH BD LA PACIF CORP	500
		JACOBS,ELI S	N Y	NY	PRI INV	500
		JOHNSON,EVERETT P	RIDDLE	OR	OWNER C & D LUMBER CO	500
		JOHNSON,R LEE	PORTLAND	OR	ATTY GENRL ST OF OREGON	500
		JOHNSON,SAMUEL S	REDMOND	OR	LUMBERMAN	1,000
		KELLER,IRA C	PORTLAND	OR	CHBD WESTERN SALES CO	1,000
		KILKENNY,WILLIAM H	PORTLAND	OR	EXEC HYSTER CO	500
		KOGOD,ROBERT P	WASH	DC	RL EST EXEC	500
		LUFKIN,DAN W	PRAIRIE CITY	OR	CHM DONALDSON LUFKIN JENRETTE	1,000
		MALARKEY,HERBERT	PORTLAND	OR	LUMBER BUS OWNER	600
		MAYER,JANET C	SEATTLE	WA	HSWF	500
		MCCALL,W C	PORTLAND	OR	CHMN MCCALL OIL CO	500
		MCCLINTOCK,BEATRICE	LONG ISLAND	NY		500
		MCDONALD JR,ELLICE	GREENVLE	DE	RET PERSONAL INVESTMENTS	3,000
		MCDONALD,ROSA H	GREENVLE	DE	RET PERSONAL INVESTMENTS	3,000
		MCGAW,FOSTER G	EVANSTON	IL	HON CHMN AMER HOSP SUPP CORP	500
		MINDICH,BERNARD	BRONX	NY	ATTY WACHTELL,LIPTON,ROSENKAT	500
		MONETTE,V H	SMITHFIELD	VA	V H MONETTE CO	1,000
		NEWBEGIN,WADE	PORTLAND	OR	PRES R M WADE & CO	600
		OLIN,JOHN M	ST LOUIS	MO	RET EXEC	500
		PEROT,H ROSS	DALLAS	TX	CH BD ELECTRONIC DATA SYSTEMS	5,000
		POLLACK,LESTER	NEW YORK	NY	VP LOEWS CORP	500
		RABB,MAXWELL M	N Y	NY	ATTY	500
		ROCKEFELLER,DAVID MRS	N Y	NY	HSEWF	500
		ROCKEFELLER,JOHN D III	NEW YORK CITY	NY	INVESTOR	1,000

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CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT T
OR 55 REP	PACKWOOD,ROBERT W	SELIGSON,CHARLES	NEW YORK	NY		500
		SMITH,CHARLES E	WASH	DC	RL EST EXEC C E SMITH CO	1,000
		SMITH,DELFORD M	MCMINNVILLE	OR	REAL ESTATE	1,000
		SMITH,ROBERT H	WASH	DC	RL EST EXEC	500
		SOHN,FRED	ROSEBURG	OR	SAWMILL OPERATOR	1,000
		SOUTHER,CALVIN N	PORTLAND	OR	ATTY	1,000
		SOUTHER,SPAULDING,KINSEY	PORTLAND	OR	ATTY FIRM	1,500
		STONE,DONALD & B LASKER	NEW YORK	NY	NY STOCK EXCH STOCK BROKER	1,000
		SWIGERT,CHRISTINE	PORTLAND	OR	HSWF	500
		SWIGERT,ERNEST G	PORTLAND	OR	CH BD HYSTER CO	1,000
		TANKERSLEY,BEZY	TUSCON	AZ	HSWF	500
		THIEDE,CLIFFORD S	LK OSWEGO	OR	CORP PERS MGR WSTRN KRAFT CORP	600
		TISCH,LAURENCE A	N Y	NY	PRES LOEWS CORP	500
		TISCH,PRESTON R	N Y	NY	CH BD LOEWS CORP	500
		VINCENT,DAVE	PHILOMATH	OR	LUMBER CO	500
		WALKER,CYRUS	PORTLAND	OR	ADVISOR POPE & TALBOT CORP	1,000
		WALKER,GEORGE	NORTH BEND	OR	LOGGING CONTRACTOR	1,000
		WALLACE,DEWITT	MT KISCO	NY	RET PUB	500
		WEYERHAEUSER,FRED K	ST PAUL	MN	RET	1,000
		WILEY,STAN	PORTLAND	OR	REALTOR	500
		WILLIAMS,RALPH E	PORTLAND	OR	INVESTMENTS	500
TOTAL FOR CANDIDATE ---						57,100

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CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST AC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
OR 55 REP	*PACKWOOD,ROBERT W	MID AMERICA DAIRYMEN INC	ADEPT (AGRI & DAIRY EDUC POL TRUST)	200
		AM NATL CATTLEMEN'S ASSN	CATTLEMENS ACTION LEGISLATIVE FUND(CALF)	100
		NATL COUNCIL OF FARMER COOPS	PACE (POL ACTION FOR COOP EFFECTIVENESS	500
	SUB-TOTAL FOR ALL AGRICULTURAL COMM.	---		800
		HUGHES AIRCRAFT CO	HUGHES ACTIVE CITIZENSHIP FUND	220
		N A OF MANUFACTURERS (NAM)	BUSINESS INDUSTRY PAC (BIPAC)	3,500
		KENNECOTT COPPER CORP	KENNECOTT EXECUTIVES CITIZENSHIP ASSN	750
		OLIN CORP	OLIN EXECUTIVES VOL NON-PART POL FUND	500
		NATURAL GAS RETAILERS	GAS EMPLOYEES PEC	200
		N A OF BROADCASTERS	NATL CONFERENCE FOR SUPPORT OF FREE BRO	300
		NATL CABLE TELEVISION ASSN	NATL CABLE TELEVISION ASSN PAC	100
		US INDEPENDENT TELEPHONE ASSN	COMPAC (COMMUNICATIONS PAC)	200
		ASSOC GENERAL CONTRACTORS	COMM FOR ACTION (BELLEVUE WASH)	1,000
		CONSTRUCTION EQUIPMENT INDUS	CONSTRUCTION EQUIPMENT PAC	300
		N A OF HOME BUILDERS	BUILDERS POL CAMPAIGN COMM	200
		UTAH INTERNATIONAL INC	1974 COMM FOR RESPONSIBLE GOVT (NON-PAR)	500
		GENERAL ELECTRIC CO	NON PARTISAN POL COMM (NEW YORK)	500
		AMERICAN BANKING	BANKPAC (BANKING PROFESSION PAC)	2,000
		SAVINGS & LOAN LEAGUE	SAVINGS ASSN POL ELECTIONS COMM (SAPEC)	5,000
		N LGE OF INSURED SAVINGS ASSN	NATL LEAGUE PAC	100
		MORTGAGE BANKERS	MORPAC (MORTGAGE BANKERS PAC)	500
		SAVINGS BANKERS	SAVINGS BANKERS NON-PARTISAN PAC	200
		MERRILL LYNCH	EFFECTIVE GOVT ASSN	250
		CANNING INDUSTRY	CANNERS PUBLIC AFFAIRS COMM	100
		COCA COLA COMPANY	NON-PARTISAN COMM FOR GOOD GOVT (GA)	350
		DEL MONTE CORP	DEL MONTE VOL NON-PART GOOD GOVT COMM	500
		FOOD INDUSTRY	FOOD INDUSTRY GOOD GOVT COMM	500
		ROSARIC FUNC	FOREST PRODUCTS	50
		FOREST PRODUCTS INDUSTRY	FOREST PRODUCTS POL COMM	200
		GEORGIA-PACIFIC CORP	G-P EMPLOYEES FUND (OREGON)	800
		MOUNTAIN FIR LUMBER CO	MOUNTAIN FIR POL COMP	1,500
		WEYERHAEUSER CO INTERESTS	HANSON FUND	1,700
		AM HOTEL & MOTEL ASSN	AMERICAN HOTEL MOTEL PAC (AHMPAC)	500
		NATL RESTAURANT ASSN	RESTAURATEURS PAC	1,000
		INDEPENDENT INSURANCE AGENTS	AMERICAN INSURANCE MENS PAC (AIMPAC)	100
		N A OF LIFE UNDERWRITERS	LIFE UNDERWRITERS PAC (LUPAC)	200
		SMITH KLINE & FRENCH	SKF VOLUNTARY NON-PARTISON POL FUND	100
		BURLINGTON NORTHERN INC -RR	BURLINGTON NORTHERN EFF VOL GOOD GOVT	500
		SOUTHERN PACIFIC CO	SUNSET ACTION COMM	400
		SOUTHERN RAILWAY SYSTEM	SOUTHERN RAILWAY TAX ELIGIBLE GGF	100
		UNION PACIFIC CORP	FUND FOR EFFECTIVE GOVT (NEW YORK)	300
		N A OF REALTORS	REAL ESTATE PAC	1,000
		NATL AUTO DEALERS ASSN	COMM OF AUTO RETAILERS (CAR)	100
		TRUCKING INDUSTRY	TRUCK OPERATORS NON-PARTISAN COMM	100
		AM COTTON SHIPPERS ASSN	COMM ORGANIZED FOR TRADING OF COTTON	100
		AM SOCIETY OF EXECUTIVES	EFFECTIVE GOVT GROUP (WASHINGTON DC)	250
		TOBACCO PRODUCTS MFRS	TOBACCO PEOPLES PUBLIC AFFAIRS COMM	200
	SUB-TOTAL FOR ALL BUSINESS COMM.	---		26,970

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CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
OR 55 REP	*PACKWOOD,ROBERT *	AM DENTAL ASSN (NATL)	AMERICAN DENTAL PAC (ADPAC)	2,500
		AM MEDICAL ASSN (NATL)	AMERICAN MEDICAL PAC (AMPAC)	8,000
		AM MEDICAL ASSN-DC EXEC	PHYSICIANS COMM FOR GOOD GOVT (DC)	100
		AM MEDICAL ASSN OREGON	OREGON MEDICAL PAC	437
		AM NURSING HOME ASSN	ANHEPAC AMERICAN NURSING HOME ED & PAC	500
		AM OPTOMETRIC ASSN	OPTOMETRIC PAC	500
		AM PHYSICAL THERAPY ASSN	AMERICAN PHYS THERAPY CONG ACTION COMM	100
		AM PODIATRY ASSN	PODIATRY PAC	5,000
		AM SOCIETY OF ORAL SURGEONS	ORAL SURGERY PAC (OSPAC)	5,000
		FEDERATION OF AM HOSPITALS	FED PAC	2,100
		OPTICIANS ASSN OF AM	OPTICIANS COMM ON POL EDUCATION	500
	SUB-TOTAL FOR ALL HEALTH COMM.	---		24,737
		OPERATING ENGINEERS	ENGINEERS PEC	1,325
		MARINE ENGINEERS	MEBA POL ACTION FUND	10,000
		SEAFARERS	SEAFARERS POL ACTIVITY DONATION	3,000
	SUB-TOTAL FOR ALL LABOR COMM.	---		14,325
		NATL EDUCATION ASSN OREGON	PEOPLE FOR IMPROVEMENT OF EDUCATION(PIE)	200
		ENVIRONMENTAL/CONSERVATION	LEAGUE OF CONSERVATION VOTERS	1,000
	SUB-TOTAL FOR ALL MISCELLANEOUS COMM.	---		1,200
		NATIONAL CONGRESSIONAL LEVEL	NATL REPUBLICAN SENATORIAL COMM	31,000
	SUB-TOTAL FOR ALL REPUBLICAN COMM.	---		31,000
	TOTAL FOR CANDIDATE IS ---			99,032

ELECTION CANDIDATES	LONG, RUSSELL B DEM/INCUMBENT GENERAL ELECTION INFO: WON/UNOPPOSED 434,643 VOTES (95.5%) PRIMARY ELECTION INFO: WON/OPPOSED			
	-NMBR-	$-AMOUNT	AVER	--%--
TOTAL FUNDS AVAILABLE		556,661		
CASH ON HAND - BEGINNING		60,587		
INDIVIDUAL CONTRIBUTIONS-$500 AND OVER:	90	91,024	1,011	16.4
IN STATE	69	70,599	1,023	12.7
OUT OF STATE	21	20,425	973	3.7
COMMITTEE CONTRIBUTIONS:	49	75,900	1,549	13.6
INTEREST COMMITTEES	48	70,900	1,477	12.7
POLITICAL PARTY COMMITTEES	1	5,000	5,000	.9
LOANS RECEIVED	1	75,000	75,000	13.5
LOANS REPAID	1	75,000	75,000	13.5
NET LOANS OUTSTANDING	0	0	0	.0
TOTAL EXPENDITURES		498,774		
CASH ON HAND - ENDING		57,886		

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT	T
LA 55 DEM	*LONG,RUSSELL B	ALBRITTON,WM LOUIS	BATON ROUGE	LA	RETIRED-ATTY	500	
		AMER BANK & TRUST CO	BATON ROUGE	LA	BANK	75,000	2
		AMER BK & TRST CO	BATON ROUGE	LA		75,000-	3
		ANDERSON,MRS G M	SHREVEPORT	LA	ANDERSON OIL & GAS	700	
		ASH,HARRY A	SURFSIDE	FL	ATTY	1,000	
		ASHY,M N	EUNICE	LA	PRESIDENT	600	
		BARTON,CHARLES A SR	LAFAYETTE	LA	OIL & GAS OPERATOR	500	
		BLAKEMORE WILLIAM B II	MIDLAND	TX	INDEPENDENT OIL OPERATOR	1,000	
		BOLES,WILLIAM R	RAYVILLE	LA	ATTYBOKR HOLES YOUNGER MALLACK	1,100	
		BOSSIER,ALBERT L JR	METAIRIE	LA	AVONDALE SHIPYARDS INC	600	
		BRADY,PATRICK H	HOUSTON	TX	BRADCO OIL & GAS CO	1,000	
		BROWN,GEORGE R	HOUSTON	TX	CH BD BROWN & ROOT INC	500	
		BURKHALTER,D F JR	MONROE	LA	INDEP CONSULTING ENGR	500	
		BUTCHER,ROBERT K	SHREVEPORT	LA	PRES R K BUTCHER & ASSOC INC	600	
		CAMP,JOHN C	LAKE CHARLES	LA	ATTY	1,200	
		CANDIES,OTTO	DES ALLEMANDS	LA	OTTO CANDIES INC	1,200	
		CANIZARO,JOSEPH C	METAIRIE	LA	JOS CANIZARO INTEREST	2,200	
		CANN,W DERWOOD JR	MONROE	LA	EXEC VP BANCROFT BAG CO	1,200	
		CORCORAN,THOMAS G	WASHINGTON	DC	ATTY	1,000	
		CUSIMANO,CHARLES V	METAIRIE	LA	EQUITABLE PETRO CORP	500	
		DANGELO,SALVATORE J	METAIRIE	LA	ALBERT & WEGMANN INC PRES	2,000	
		DAVIS,CHARLES W	WINNETKA	IL	ATTY HOPKINS,SUTTER,OWEN,MULRO	1,000	
		DAY,DR JAMES D	NEW ORLEANS	LA	MD	500	
		DELANEY,J B III	NEW ORLEANS	LA	J B DELANEY CO INC	600	
		DENTON,B J	BATON ROUGE	LA	DIV COMPT SOUTHLAND CORP	700	
		DIEFENTHAL,EDWARD L	NEW ORLEANS	LA	VP SOUTHERN SCRAP MATERIAL	700	
		DIEFENTHAL,JAMES R	NEW ORLEANS	LA	SOUTHERN SCRAP MATERIAL	700	
		DUFRENE,BRANDT J	METAIRIE	LA	CONSULTANT	500	
		EATON,L W JR	BATON ROUGE	LA	PRES L W EATON CO	500	
		FERGUSON,J V II	NEW ORLEANS	LA	ATTY	1,000	
		FORT,CHARLES F	BATON ROUGE	LA	SIEGEN DEVEL INC PRES	1,200	
		FOURNET,MARILYN R	MORGAN CITY	LA	HOUSEWIFE	600	
		FOWLER,J E JR	SHREVEPORT	LA	PRES FALCO INC	500	
		FRANKS,JOHN	SHREVEPORT	LA	PRES FRANKS PETROLEUM CO	[illegible]	
		FREEMAN,R W SR	NEW ORLEANS	LA	CH BD LA COCA COLA BOTTLING CO	500	
		FRENSLEY,HERBERT J	HOUSTON	TX	PRES BROWN & ROOT INC	700	
		GAUTREAUX,C M	METAIRIE	LA	PRES WILLIAMS MCWILLIAMS CO	1,[illegible]00	
		GUZZINO,GERALD	MORGAN CITY	LA	AGENT NY LIFE INSURANCE CO	1,200	
		HARTZMAN,EDWIN	NEW ORLEANS	LA	AVONDALE SHIPYARDS INC	600	
		HENDRY,WILLIAM O	CHICAGO	IL	SR VP HOUSEHOLD FINANCE CORP	1,000	
		JAMES,T D	RUSTON	LA	VP T L JAMES & CO	1,000	
		JOHNSEN,E F	NEW ORLEANS	LA	PRES CENTRAL GULF LINES INC	600	
		JONES,JAMES H	NEW ORLEANS	LA	1ST NATL BK OF COMMERCE	1,200	
		JONES,THEODORE L	BATON ROUGE	LA	ATTY	1,200	
		KYLE,J E	BERWICK	LA	J E KYLE JR & ASSOC	1,000	
		LA VIGNE,KIRK R	SHREVEPORT	LA	KLM CORP	500	
		LANDRY,JULES F	BATON ROUGE	LA	ATTY	1,400	
		LAWTON,J E	SULPHUR	LA	FARMER & RANCHER	700	

CONTRIBUTIONS FROM INDIVIDUAL CONTRIBUTORS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	CONTRIBUTOR	ADDRESS		OCCUPATION	AMOUNT
LA 55 DEM	*LONG,RUSSELL B	LAWTON,W B	SULPHUR	LA	FARMER & RANCHER	700
		LEBLANC,JULES B III	BATON ROUGE	LA	ATTY CORPORATE ONE	5,200
		LEBLANC,ROGER J	BATON ROUGE	LA	ATTY	5,200
		LEHLEITNER,GEO H	COVINGTON	LA	RETIRED	600
		LEVY,ARTHUR SR	METAIRIE	LA	PRES ARTHUR LEVY BOAT SERV INC	1,200
		LLOYD,W R JR	HOUSTON	TX	OIL & GAS REAL ESTATE	1,000
		LONG,MEREDITH J	HOUSTON	TX	INVESTMENTS	1,000
		LONG,RUSSELL B	BATON ROUGE	LA	U S SENATOR	600
		MARSH,JOHN D	GAINESVILLE	VA	LIVESTOCK BREEDER RL EST	500
		MENDOZA,RAY	BERWICK	LA	J E KYLE JR & ASSOC	1,000
		MERRIGAN,EDWARD L	CHEVY CHASE	MD	ATTY	2,000
		MERRIGAN,LAWRENCE A	NEW ORLEANS	LA	BK OF NEW ORLEANS & TRUST CO	1,000
		MIJALIS,GUS S	SHREVEPORT	LA	FARMERS SEAFOOD	1,000
		MOSES,WARREN G	NEW ORLEANS	LA	CONS ENG & OWNER W G MOSES&CO	[illegible]
		NOLAND,WILLIS W	LK CHARLES	LA	VP POWELL LUMBER CO	1,000
		OURSO,J CLIFFORD	BATON ROUGE	LA	PRES & CH BD AMER BK&TRUST CO	1,000
		PATOUT,CHARLES A	LAFAYETTE	LA	GULF COAST BANK CH BD	1,200
		PELTIER,HARVEY	THIBODAUX	LA	ATTY	1,000
		PENNIMAN,G ALLEN JR	BATON ROUGE	LA	DIV MGR SOUTHLAND CORP	700
		PEREZ,AUGUST JR	NEW ORLEANS	LA	ARCHITECT	1,000
		PEROT,H R	DALLAS	TX	ELECTRONIC DATA SYSTEMS CORP	1,000
		PITTMAN,CHARLES R	NEW ORLEANS	LA	PITTMAN CONST CO	700
		PLAISANCE,KIP	GOLDEN MEADOW	LA	KIP PLAISANCE CONTRACTORS	500
		POWELL,THOMAS E	EUNICE	LA	PRES POWELL OIL CO	1,000
		RAGAN,WILLIAM F	POTOMAC	MD	RAGAN & MASON ATTY	1,000
		RAULT,JOSEPH M JR	NEW ORLEANS	LA	PRES & OWNER RAULT CENTER	1,200
		REID,JOSEPH E	HOUSTON	TX	THE SUPERIOR OIL CO	1,000
		ROBERTSON,AUSTIN G	SHREVEPORT	LA	SEC TREAS CROW INDUSTRIES	500
		ROBERTSON,CORBIN J	HOUSTON	TX	QUINTANA PETRO CO	1,000
		ROUSSEL,LOUIS J	NEW ORLEANS	LA	REP PETRO CORP	1,700
		SAIA,FRANK T	BATON ROUGE	LA	EXEC ELECTRICAL CONT CO	1,200
		SCHWARTZ,CARL J	HOUSTON	TX	INEXCO OIL CO	1,000
		SEHRT,C TRICON	NEW ORLEANS	LA	ATTY	500
		SIBLEY,W HUGH	GREENSBURG	LA	ATTY	1,000
		STONE,JAMES H	CINCINNATI	OH	PRES STONE OIL CORP	1,125
		STREAM,HAROLD H	LAKE CHARLES	LA	GRAY ESTATE	500
		STREAM,MRS H G	NEW ORLEANS	LA	OWNR MATHILDA STREAM INTER INC	500
		THERIOT,NOLTY J	GOLDEN MEADOW	LA	NOLTY J THERIOT INC	1,000
		THOMPSON,W H JR	HOUSTON	TX	PRES&CH EXEC BUFMAN OIL&GAS CO	600
		WALKER,H W	ALEXANDRIA	LA	WALKER ROEMER DAIRIES	600
		WALSH,ALBERT A	YONKERS	NY	NATL RLTY COMM INC	1,000
		WESTBROOK,D D	MONROE	LA	OWNER STANDARD ENTERP INC	700
		WHITEHEAD,JOHN C	ESSEX FELLS	NJ	GOLDMAN SACHS & CO	1,000
		WOODS,VERNON W	METAIRIE	LA	MID-LA GAS CO	1,000
TOTAL FOR CANDIDATE ---						91,024

120

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST AC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
LA 55 DEM	*LONG,RUSSELL B	NATL COUNCIL OF FARMER COOPS	PACE (POL ACTION FOR COOP EFFECTIVENESS	500
	SUB-TOTAL FOR ALL AGRICULTURAL COMM.	---		500
		OLIN CORP	OLIN EXECUTIVES VOL NON-PART POL FUND	1,200
		NATURAL GAS RETAILERS	GAS EMPLOYEES PEC	200
		N A OF BROADCASTERS	NATL CONFERENCE FOR SUPPORT OF FREE BRO	1,500
		NATL CABLE TELEVISION ASSN	NATL CABLE TELEVISION ASSN PAC	100
		N A OF HOME BUILDERS	BUILDERS POL CAMPAIGN COMM	500
		GENERAL ELECTRIC CO	NON PARTISAN POL COMM (NEW YORK)	1,000
		AMERICAN BANKING	BANKPAC (BANKING PROFESSION PAC)	1,000
		SAVINGS & LOAN LEAGUE	SAVINGS ASSN POL ELECTIONS COMM (SAPEC)	1,000
		MORTGAGE BANKERS	MORPAC (MORTGAGE BANKERS PAC)	500
		SECURITIES INDUSTRY	SECURTIES INDUSTRY CAMPAIGN COMM	1,000
		PAINE WEBBER	PAINE WEBBER FUND FOR BETTER GOVT	200
		COCA COLA COMPANY	NON-PARTISAN COMM FOR GOOD GOVT (GA)	1,000
		FOREST PRODUCTS INDUSTRY	FOREST PRODUCTS POL COMM	1,000
		GEORGIA-PACIFIC CORP	G-P EMPLOYEES FUND (OREGON)	1,000
		AM HOTEL & MOTEL ASSN	AMERICAN HOTEL MOTEL PAC (AHMPAC)	5,000
		NATL RESTAURANT ASSN	RESTAURATEURS PAC	1,000
		N A OF LIFE UNDERWRITERS	LIFE UNDERWRITERS PAC (LUPAC)	1,000
		NACSAPAC (CASUALTY & SURETY A	N A OF CASUALTY & SURETY AGNT	200
		ATCHISON, TOPEKA & SANTA FE	CIVIC TRUST 80 SANTA FE EMP FR GOOD GOV	100
		BURLINGTON NORTHERN INC -RR	BURLINGTON NORTHERN OFF VOL GOOD GOVT	200
		SEABOARD COASTLINE RR	SPECIAL PROJECTS GROUP	200
		SOUTHERN PACIFIC CO	SUNSET ACTION COMM	200
		SOUTHERN RAILWAY SYSTEM	SOUTHERN RAILWAY GOOD GOVT FUND	2,000
		UNION PACIFIC CORP	FUND FOR EFFECTIVE GOVT (NEW YORK)	600
		N A OF REALTORS	REAL ESTATE PAC	2,000
		AM WATERWAYS OPERATORS INC	BARGE & TOWING COMM FOR POLITICAL ACTION	100
		NATL AUTO DEALERS ASSN	COMM OF AUTO RETAILERS (CAR)	1,000
		TRUCKING INDUSTRY	TRUCK OPERATORS NON-PARTISAN COMM	3,000
		AM SOCIETY OF EXECUTIVES	EFFECTIVE GOVT GROUP (WASHINGTON DC)	500
		BOATING INFORMATION COUNCIL	BOATING INFORMATION COUNCIL PAC	500
		TOBACCO PRODUCTS MFRS	TOBACCO PEOPLES PUBLIC AFFAIRS COMM	500
	SUB-TOTAL FOR ALL BUSINESS COMM.	---		29,900
		AM DENTAL ASSN (NATL)	AMERICAN DENTAL PAC (ADPAC)	2,000
		AM MEDICAL ASSN-DC EXEC	PHYSICIANS COMM FOR GOGO GOVT (DC)	300
		AM NURSING HOME ASSN	AMHEPAC AMERICAN NURSING HOME ED & PAC	200
		AM PHYSICAL THERAPY ASSN	AMERICAN PHYS THERAPY CONG ACTION COMM	100
		AM SOCIETY OF ORAL SURGEONS	ORAL SURGERY PAC (OSPAC)	5,000
		FEDERATION OF AM HOSPITALS	FED PAC	2,000
		OPTICIANS ASSN OF AM	OPTICIANS COMM ON POL EDUCATION	500
	SUB-TOTAL FOR ALL HEALTH COMM.	---		10,100
		LABORERS	LABORERS POL LEAGUE	3,000
		SHEET METAL WORKERS	POLITICAL ACTION LEAGUE SHEET METAL	800
		MARINE ENGINEERS	MEBA POL ACTION FUND	12,000
		SEAFARERS	SEAFARERS POL ACTIVITY DONATION	10,000
		MEATCUTTERS	AMCOPE	500

CONTRIBUTIONS FROM SPECIAL INTEREST GROUPS
CONTRIBUTOR WITHIN CANDIDATE

ST RC PTY	CANDIDATE	AFFILIATION/INTEREST	REGISTERED NAME	AMOUNT
LA 55 DEM	*LONG,RUSSELL B	TRANSPORTATION UNION (UTU)	TRANSPORTATION POL EDUC LEAGUE	2,000
	SUB-TOTAL FOR ALL LABOR COMM.	---		28,300
		NATL EDUCATION ASSN LOUSIANA	LOUISIANA EDUCATIONAL GROUP	1,000
		NATL RURAL ELECTR COOP ASSN	ACRE(ACTION COMM FOR RURAL ELECTRIFICAT)	500
			PATTON BOGGS & BLOW (LAWYERS)NNNNNNNNNNN	600
	SUB-TOTAL FOR ALL MISCELLANEOUS COMM.	---		2,100
		NATIONAL CONGRESSIONAL LEVEL	DEMOCRATIC SENATORIAL CAMPAIGN COMM	5,000
	SUB-TOTAL FOR ALL DEMOCRATIC COMM.	---		5,000
	TOTAL FOR CANDIDATE IS ---			75,900

Mr. WERTHEIMER. The exhibit sets forth campaign finance information, derived from the Federal campaign finance disclosure reports, for the seven members of this committee who raised money and ran for election in 1974. The exhibit provides for each Senator summary financial information regarding campaign contributions and expenditures, a list of each individual contributor who gave $500 or more, including the contributor's indentification as listed on the Federal reports, and a list of each special interest group contribution to the candidate.

A review of these documents reveals that individuals and groups with substantial economic interests have provided the political lifeline for the various members of this committee. While similar findings no doubt hold true for other Senate committees, the fact remains that this committee has an almost unmatched congressional power to grant or withhold direct economic benefits to private interests.

We have only been able to do a limited analysis in the time available to prepare for this hearing and would like to give a few examples of how this political money might impact.

The seven members of the committee who ran in 1974 received approximately $3,129,000 during the period from September 1, 1973, to December 31, 1974. Approximately 45 percent of that total came in contributions from larger individual givers—$500 or more—and interest groups. Listed below are the figures for each Senator:

Candidate	Receipts (Sept. 1, 1973 through Dec. 31, 1974)	Percent of receipts (individual contributions, $500 or more, and interest group contributions)	Individual contributions ($500 and over)	Interest group contributions
Talmadge	$179,041	69.07	$65,965	$57,705
Gravel	482,635	63.30	157,986	147,524
Ribicoff	437,564	57.60	244,255	7,800
Packwood	324,207	38.50	56,800	68,032
Nelson	215,956	37.68	15,986	65,372
Dole	993,826	34.28	258,214	82,555
Long	496,074	32.64	91,024	70,900
Total receipts	3,129,303		890,249	499,888

During the 1974 elections Common Cause categorized individual givers of $500 or more by economic background, based on the information set forth on the Federal disclosure reports. Looking at these categories, as well as the affiliation of 1974 interest group givers, we have come up with the following overall analysis for the seven Senators involved in 1974 races.

Economic identifications for individuals were based solely on the information revealed by the Federal disclosure reports and were made only on the basis of an interest clearly identified on the report. Further research would no doubt result in substantial increases in the amounts stated.

Interest:	Amount
Labor	$253,501
Oil	[1] 211,492
Medical	95,987
Real estate	64,698
Financial institutions	57,465
Forest products	30,800
Insurance	27,595
Securities	27,450
Ross Perot	21,000
Washington, D.C., attorneys	20,174

[1] In addition, Senator Bentsen, who also raised substantial funds in 1974, received $184,954 from oil-related donors.

The seven Senators analyzed included Senators Dole, Gravel, Long, Nelson, Packwood, Ribicoff, and Talmadge. Not each Senator received contributions from all of these interests nor were the contributions evenly divided among the Senators. This analysis is not intended to do more than provide one example of the way in which economic pressures can build upon members of this committee.

Of course, we realize that a number of these contributions may have been made without regard to any interest in the legislative activities of the Senate Finance Committee or of its members. However, it is only rational to assume that many large contributions are made because of the financial interest the contributors have in the committee's work.

An analysis of names of the District of Columbia attorneys who contributed, for example, revealed such Washington lawyer-lobbyists as J. D. Williams, William C. Foster, and Edward L. Merrigan. Mr. Foster is himself a member of the only Washington law firm with its own political action committee—Patton, Boggs & Blow. The firm's committee has also made a series of contributions to members of the Senate Finance Committee. These lawyers are regularly in contact with committee members on tax matters and have been identified as representing interests that benefit from amendments to the tax bill. We would like to insert in the record at this point, Mr. Chairman, a copy of articles that appeared in the New York Times on today and Monday, July 19, 1976, that deals with this matter.

[The articles follow:]

[From the New York Times, July 20, 1976]

Tax Bills Pass in Senate With Contents Unknown

(By Eileen Shanahan and based on reporting by her and David E. Rosenbaum)

Washington, July 19—Senator Lloyd Bentsen is responsible for inserting into the current tax bill at least 10 provisions that benefit just a few companies each. Precisely how many Bentsen proposals the bill contains in not easily determined.

The Senator, a Texas Democrat, would not say, when asked, for fear he would forget one.

Further the Senate Finance Committee does not have useable records. Although a relatively new Senate rule requires committees to keep minutes of all their meetings, it says nothing about having the minutes transcribed—and the Finance Committee's have not been.

Senator Bentsen's activities in connection with the current tax bill are not strikingly different from those of many other Finance Committee members. But what is known about them illustrates a couple of key points about the way the nation's tax laws are written.

The first is that tax bills have become so massive, the procedures under which they are written are so haphazard and the safeguards surrounding the process are so few and ineffective that no one, not even the senators most responsible, knows what is in them.

The second point is that those with a tax problem they want solved by legislation have a tremendous advantage if they are constituents of a member of the Finance Committee or can find a way to present themselves as constituents.

For example, Senator Bentsen was the sponsor of a provision in the tax bill that is generally known around the Finance Committee as the "Britannica Amendment" because the Encyclopedia Britannica is thought to be the largest beneficiary. The provision would overturn, by legislation, a recent unfavorable ruling by the Internal Revenue Service dealing with the way book publishers deduct some of their costs on their tax returns.

Senator Bentsen does not call the provision the "Britannica Amendment," however. He said he first heard about the desire of some book publishers for legislation overturning the ruling from Frank Bennack, executive vice president of the Hearst Corporation, who works and lives in New York City.

From 1967 to 1974, Mr. Bennack was the publisher of the San Antonio Light, a Hearst newspaper. Thus, according to Mr. Bennack, when a Hearst corporation tax lawyer discovered that the adverse I.R.S. ruling would apply to Hearst's Popular Mechanics Encyclopedia, he went to Mr. Bennack and asked if he knew Senator Bentsen.

Mr. Bennack did, and although he described the impact of the ruling on the Hearst organization's taxes as "not a big thing," he want to Washington and explained the problem to the Senator.

Representatives of the Encyclopedia Britannica came to see him only after he had already talked to Mr. Bennack, according to Senator Bentsen. He said his memory was "hazy" as to whether he had actually put the amendment before the committee before seeing the Britannica people.

HOSPITALS PRESENT CASE

Present and potential operators of the nation's hospitals that operate for profit also had the good fortune, or possibly the foresightedness, to have a basis for claiming they were constituents of Senator Bentsen.

They wanted a change in the tax law that would increase the maximum amount of taxfree bonds that could be issued to finance hospital construction.

They made their case to Senator Bentsen, he said, through Dr. John Bradley, of San Antonio, the president of their trade association, the Federation of American Hospitals, and the Senator sponsored their proposal. The federation also contributed at least $1,050 to the Senator's Presidential and senatorial compaigns.

So it goes, too, through the long list of narrow-interest provisions sponsored by other senators. Many can claim that those they were helping were in one way or another, constituents. For example, the bill contains a provision sponsored by Senator Vance Hartke, Democrat of Indiana, which would overturn by legislation a Tax Court case that was lost by the H. R. Robertson Company, which has a branch in Indiana.

Defenders of narrow-interest tax legislation make several arguments in its defense.

First, they say, much of it is justified to aid companies and occasionally individuals who get caught in the complexities of the tax laws in freakish ways and suffer hardships that no one intended. This argument is widely accepted.

In addition, advocates of narrow interest legislation say that ample safeguards exist in the Congressional procedures to prohibit the enactment of unjust and unwise legislation. Principally, they argue that narrow-interest provisions receive ample examination in either the House Ways and Means Committee or the Senate Finance Committee, or both.

They argue further that narrow-interest provisions can seldom attain enactment if they are opposed either by the Administration or by the staff of the Congressional Joint Committee on Internal Revenue Taxation, which is widely credited with competence and integrity.

REBUTTALS TO ASSERTIONS

These latter arguments are disputed by a great many people familar with the processes of tax legislation. There are a number of specific case histories of narrow-interest provisions in the current tax bill that rebut one or more of these assertions.

There are, for example, several dozen provisions in the Finance Committee bill that have no counterpart in the House Bill and most were not even carefully described, let alone debated, before they were approved by the committee. When there was any debate, it was often confined to one or two questions by a single senator.

There is no other area of legislation in which Congress deals with so many different issues in a single bill.

What distinguishes the narrow-interest provisions from other, broader provisions that are also in the bill, such as an extension of the 1975 tax cut, is that they were adopted not only without discussion but also without most Finance Committee members even knowing what they were voting for.

There is some indication that the senators themselves cannot always hear what little is being said. In the few seats in the committee room that are reserved for the public, and at the press table, it is impossible more often than not to hear enough to understand what is going on.

Ralph Nader's Tax Reform Research Group and Tax Analysts and Advocates, the two tax-reform organizations that separately monitored every minute of the Finance Committee's proceedings on the current bill are still unable, weeks after the end of the committee's deliberations, to answer such basic questions as who sponsored each provision of the bill. The reason was that they could not hear and there were no available committee records.

Nor, despite weeks of effort by reform-minded members of the Senate, the outside reform groups, the press and others, have all the beneficiaries of the narrow-interest provisions of the bill been identified.

HEARINGS THIS WEEK

In the face of criticism of the narrow-interest provisions, the Finance Committee chairman, Senator Russell B. Long of Louisiana, has scheduled some additional hearings for this week. But fewer than half the provisions of the bill are to be covered by the hearings and they are exclusively the ones that have been denounced by two Democratic Senators, Edward M. Kennedy of Massachusetts and William Proxmire of Wisconsin, and ones in which the beneficiaries have been publicly identified.

Administration opposition, a supposed barrier to enactment of unwise narrow-interest legislation, does not always work. Both the Treasury Department and the Federal Energy Administration fought a special tax credit for recyclers of used materials on the ground that it would cost the Government considerable revenue and do little to conserve either raw materials or energy.

But the committee chose to believe the contrary assertions of the recyclers and their supporters, which included some city government officials who are worried about solid-waste disposal, and the provision wound up in the bill.

The Treasury is also vigorously opposed to a provision in the bill, sponsored by Mr. Long, that would extend the investment tax credit to shipbuilders who are already paying no taxes on profits that they plow back into ship construction.

The history of this provision in the Finance Committee illustrates something else about the safeguards that are supposed to surround the process of tax legislation.

Although Laurence N. Woodworth, the staff director of the joint committee, was asked to describe the provision to the committee, he was not asked his opinion of it by any member. There is reason, based on opinions he has given in the past on analogous legislation, to think that he might have opposed the new tax benefit for shipbuilders, but he almost never volunteers opinions.

No one can remember his having volunteered an adverse opinion on a provision sponsored by the committee chairman.

In this instance, Senator Long was a passionate advocate of the provision, because, he said, large tax subsidies are necessary if the United States is to have a strong merchant marine. Shipbuilding is also a big business in Louisiana.

Dr. Woodworth's opinions on tax legislation, when sought, are given so much weight by the committee that both senators and lobbyists typically try to get clearance from him and his staff before offering their proposals.

But sometimes senators or lobbyists, inadvertently or otherwise, clear one version of a proposal with the joint committee staff and then offer a somewhat different one.

An extreme case of this type occurred this year, which involved one of Washington's most successful tax lobbyists and most open-handed campaign contributors, J. D. Williams, and Senator Mike Gravel, Democrat of Alaska.

Mr. Williams went to Senator Gravel with a proposal for legislation that would overturn a revenue service ruling that the nonrefundable hookup charges imposed by some water and sewer utilities constituted regular income to the companies and was taxable as such.

According to Senator Gravel, he told Mr. Williams to check with some utility companies in Alaska and find out whether they had any interest in the provision, and Mr. Williams reported back that "it benefited my people in Alaska."

Senator Gravel then decided that Mr. Williams' proposal "was eminently proper."

Mr. Williams next cleared the proposal with the joint committee staff, which offered no objection because the I.R.S. ruling had, in fact, disallowed a long-established (though not very logically defensible) practice of some water and sewer utilities of recording the one-time hookup charges as a non-taxable return of capital, rather than as income.

Between the time that Dr. Woodworth approved the proposal and the time it was actually presented in committee, electric and telephone utilities that had always reported hookup charges as taxable income got wind of the amendment, and, working through another committee member, Herman E. Talmadge of Georgia, asked to be included.

They were added to the Gravel proposal—but no one told Dr. Woodworth or any member of his staff.

As Senator Gravel presented the proposal to the committee, it sounded to Dr. Woodworth just like the original proposal, limited to water and sewer companies, that he had approved.

So he told the committee that the revenue loss to the Treasury would be no more than $10 million a year and that he had no objection. The Committee voted to include the provision in the tax bill.

It was only later, back in his office, that Dr. Woodworth read the exact words of the amendment Senator Gravel had submitted and saw that telephone and electric utilities had been added.

That meant an annual revenue loss to the Treasury estimated at $100 million, and the difference was so great that Dr. Woodworth went back to the committee the next morning, said he had misunderstood the proposal, and suggested that the committee reconsider and limit the change to water and sewer companies. It did so.

CHANGES AFTER APPROVAL

Dr. Woodworth will not confirm it, but others familiar with tax legislation say it is not unusual for tax lobbyists to make changes in their proposals after they have been cleared by the joint committee staff. If the differences are not too great, the staff may accept them without complaint—or it may change them back. It all depends on how bad they think the changes are, how much is in writing, whether they think the sponsoring senator will notice, and other factors.

Those who view themselves as tax reformers, and who view their task as one of making the nation's tax laws fairer, are discouraged over the contents of the current bill, even though it does contain some provisions they regard as good. One reason for the discouragement the number of provisions it contains that partly undo recent tax reform achievements.

The current tax bill contains a large number of exceptions to these tightenings of the law, all of which, according to their sponsors, cover operations that were not really meant to be covered by the 1975 changes. Some of the exceptions are quite broad, potentially affecting many American companies with overseas subsidiaries.

Others, such as the proposal sponsored by Senator Bentsen to make an exception for shipping companies whose sole business is servicing offshore oil-drilling rigs in foreign waters, potentially affect only a handful of companies.

DONORS TO LONG AIDED

Senator Long, as he readily concedes, also had some constituents who were interested in this provision. He said, "I don't want to call their names," but one company that appears certain to benefit is Arthur Levy Boat Service of Morgan City, La. Levy family members and employees of the company gave at least one of the largest such group contributions for a campaign in which Senator Long had no serious opposition.

Finally, there is the case of an exception to the foreign tax provisions sponsored by Senator Long that apparently will benefit no one—a case of where the haphazard procedures of the Senate Finance Committee simply misfired.

The intended beneficiary was a company called Southern Scrap Material, headed by Stanley Diefenthal, an old friend of Senator Long's whom he described, when asked about the case as "a nice fella, a very successful businessman in New Orleans." Members of the Diefenthal family and employees of the company contributed $2,400 to Senator Long's 1974 campaign.

The exception was drafted by the joint committee staff in the most detailed possible way so that it would fit no company except Southern Scrap Materials.

Unfortunately, in describing his company's operations to Senator Long, Mr. Diefenthal left out a key fact, and the exception, as drafted, does not except him—or any other company as far as anyone knows.

Senator Long said he would move to drop the amendment, unless some other company turns up that would be affected by it. In such a case, he said, he would keep the amendment, "because the principle is right."

DIFFERENCE IN HOUSE

Such a blunder probably could not have occurred in the House Ways and Means Committee, which used to write narrow-interest legislation the same way as the Senate Finance Committee but this year adopted more careful procedures.

First, of all, the measures can never be scribbled on the back of an envelope, introduced and approved all in the same day, as they are in Senate Finance. They must be presented sufficiently in advance so that the joint committee staff can prepare a written description, identify the beneficiaries, if possible, and make an estimate of the potential revenue loss to the Treasury. Then, hearings must be called on the specific proposals, at which outside parties can testify.

The House procedure does not mean that none of the narrow-interest bills get through.

This past year, for example, 22 such bills reached the hearing stage. The tax reform research group opposed six of them. The committee refused to approve only four.

It is not clear whether the Finance Committee will adopt similar procedures.

[From the New York Times, July 19, 1976]

TAX BREAKS FOR THE FEW HINGE ON ACCESS TO POWER

Knowing Someone in Key Post or Hiring Influential Lawyer or Lobbyist Helps With Preferential Legislation

(By David E. Rosenbaum and based on reporting by him and Eileen Shanahan)

WASHINGTON, July 18—This year, four well-to-do California business executives wanted a special provision in the tax law, one that would apparently benefit no one but them.

They retained a Los Angeles lawyer, John H. Hall, who, as Deputy Assistant Secretary of the Treasury for Tax Policy from 1972 to 1974, had worked closely with Congress in drafing tax measures.

Using the Washington connections he had made as a Government official, Mr. Hall went to Senator Carl T. Curtis of Nebraska, the ranking Republican of the Senate Finance Committee, which has jurisdiction over tax legislation in the Senate.

Senator Curtis arranged for the preferential language the businessman wanted to be written into the tax bill that is pending before the Senate.

Although the entire Finance Committee adopted the Curtis amendment, no other senator knew the identities of the beneficiaries or understood the details of the amendment.

The incident illustrates two important points about the way Congress writes the nation's tax laws.

The first is that every big tax bill contains a number of narrowly drawn provisions such as the Curtis amendment that are designed to benefit a small number of people or companies. Senator Edward M. Kennedy, Democrat of Massachusetts, calls them "one-eyed, bearded, man-with-a-limp" provisions.

The second point is that the ability of people to have such preferential language written into a tax bill depends largely on their knowing someone in an influential position or being able to hire a lawyer or lobbyists who have access to power.

Although there is no evidence that campaign contributors influenced the Curtis amendment, an examination of public records shows that large campaign contributors and constituents of well-placed senators frequently have a sizable advantage in obtaining the necessary access.

The Tax Reform Research Group, a public affairs lobby associated with Ralph Nader, has identified more than three dozen narrow-interest sectors in the 1,536-page tax bill approved last month by the Finance Committee.

The measure was debated for two weeks by the full Senate before Congress recessed for the Fourth of July and the Democratic National Convention. It will be taken up again when the Senate reconvenes tomorrow.

The special preference sections are only part of an important bill that, among its many broadly applicable provisions, would extend the 1975 antirecession tax cuts, liberalize estate tax laws and place limitations in the use of some tax shelters.

Defenders of narrowly drawn tax legislation argue that such provisions are necessary to rectify hardships in the law that were not intended. They contend that there are safeguards to prevent enactment of unjustified legislation.

But the procedure by which such special preferences are written into tax bills by the committee—which means more often than not that they become law—has been sharply challenged this year by Congressional critics and some senators who do not serve on the committee.

SCANDAL AND DISGRACE

Senator Kennedy declared on the Senate floor late last month, "The method by which these special interest provisions make their way into tax legislation is a scandal and a disgrace, an embarrassment to the Finance Committee and every member of the Senate."

Stung by such criticism, Senator Russell B. Long, Democrat of Louisiana, who is the Finance Committee chairman, took the extraordinary step of calling three days of special public hearings on the narrow provisions in the bill, beginning Tuesday.

It is highly unusual for a committee to reopen its hearing on a bill after floor debate has begun.

The official announcement of the new hearings said Senator Long has "noted that concern has been expressed as to whether certain of the provisions approved by the committee were the subject of sufficient public hearings and discussion."

Experts who have followed the work of Congress for years believe that the hearings will be little more than cosmetic. They expect that most of the narrow provisions in the bill will be retained, passed by the Senate and eventually enacted, and that many will not even be reconsidered.

Some of the preferential sections are arguably meritorious. They would provide relief for persons and companies that would otherwise be unfairly damaged by quirks in the tax law.

Other special preferences have been questioned by tax analysts on the ground that they cost the Treasury revenue while serving no worthy purpose.

Justifiable or not, the special provisions have much in common. Nearly all of them benefit well-connected persons, companies or industries. The causes are pressed with members of the Finance Committee by influential lobbyists or lawyers. Most were not challenged by anyone within the Finance Committee.

The provision involving the four California business executives, Mr. Hall and Senator Curtis found its way into the bill in the followng manner.

HOUSE PANEL VOTE

The businessmen—James L. Walker, Stanley L. Timmins, William B. Rapien and Russell A. Kendall, all officers in the Davis Walker Corporation of Los Angeles—learned sometime in early 1974 that they could save taxes by creating foreign trusts for their children. By May 1974, the paper work necessary to create the trusts was well under way.

Coincidentally, on May 21, 1974, the House Ways and Means Committee voted to plug the particular section involving foreign trusts that they were using.

The House committee decided to make the effective date of the change that very day to prevent people from rushing in under the wire, as they might have done if the effective date were set in the future.

According to Mr. Hall, the former Treasury official, word of the Ways and Means Committee action did not reach California for more than a week. He said that was because the daily tax report of the Bureau of National Affairs, on which lawyers rely for developments in tax law, did not report the action until May 29.

Some time between May 21 and May 29, work on the trusts for the four businessmen was completed, but, under the House bill, the men would not have been eligible for the tax break that was the reason for setting up the trusts.

The 1974 tax bill died at the end of the 93d Congress without becoming law. It was revived last year, however, and the bill passed then by the House retained the May 21 deadline for its change in the foreign trust rule.

EMPLOYED HALL

The businessmen then employed Mr. Hall to try to straighten the matter out before the measure cleared the Senate.

Mr. Hall said that he came to Washington and talked with Howard J. Silverstone, the staff member of the Joint Committee on Internal Revenue Taxation who was handling that particular aspect of the bill. Mr. Hall acknowledged that his Washington connections enabled him to determine the right staff member to see.

Mr. Silverstone, according to Mr. Hall, said it would be reasonable to push the effective date back eight days to May 29 in view of the delay in reporting.

Mr. Hall said that he then talked to Senator Curtis and Donald Moorehead, chief minority counsel of the Senate Finance Committee. Asked why he chose Mr. Curtis rather than some other senator, Mr. Hall replied:

"I knew Senator Curtis from when I was in Washington. I could have chosen any senator, I suppose, but I'd worked with Senator Curtis on the pension reform bill and other matters. I would have gone to a California senator if there'd been one on the Finance Committee, but there wasn't one."

NO ONE ASKED

In any event, Mr. Curtis arranged for the date to be changed to May 29 in the Finance Committee bill. No one on the committee asked Mr. Curtis who the beneficiaries were or why he wanted the change.

There is no evidence that campaign contributions influenced Mr. Curtis. Records for 1972, the last time he ran for office, are incomplete.

But The New York Times turned up a number of instances in which members of the Finance Committee sponsored special privilege tax provisions in which large contributors had an interest.

To take one example, Senator Mike Gravel, Democrat of Alaska, is the chief sponsor of language that would give special tax advantages to the recycling industry. The members of two trade associations—the Institute of Scrap Iron and Steel and the National Association of Recycling Industries—would be the principal beneficiaries of the provision.

The Washington lobbyist for the Institute of Scrap Iron and Steel is Thomas H. Boggs, Jr. He has contributed at least $1,150 to Mr. Gravel since 1973. His law partner, William C. Foster, donated at least $2,050 during that time.

Edward J. Merrigan is the lobbyist for the National Association of Recycling Industries and has been the most active lobbyist for the cause of recyclers. He gave at least $3,500 to Mr. Gravel's 1974 Senate campaign, some of which was donated after the election.

Mr. Gravel, in an interview, said that he had not been influenced by the contributions. Rather, he said, his interest in giving an advantage to recycling "predated" that of Mr. Boggs and Mr. Merrigan and was founded on his desire as a conservationist to preserve virgin timber in Alaska.

The Treasury Department opposes the amendment on the ground that it could eventually cost the Government as much as $300 million a year in tax revenue. Environmentalist organizations also oppose the amendment, saying that it would be useless for conservation purposes.

Mr. Gravel said that both the Treasury and the professional environmentalists were "misguided."

The Alaska Senator acknowledged, however, that he was often swayed by lobbyists in his work on the Finance Committee.

"Usually, I first meet lobbyists at social functions," he said. "Then, you meet them too at fund-raisers. My relationship with Merrigan is close as can be.

You get guys like that whom you trust and who never come around with dogs, and you generally help them."

CLIENTS NOT NAMED

Mr. Gravel said that he often did not even ask lobbyists to identify their clients.

"If the issue is a broad one, I don't care who their clients are if it is a good cause," he said. "If the issue is very esoteric and would benefit only one group or a few people, then I would turn around and say, 'Whom are you working for?'"

Campaign contributions, he said were a way a lobbyist could assure "contact" with him. He explained:

"All campaign support guarantees is access. I would pick up the telephone for a supporter before I would pick it up for someone else. But that's the end of my commitment. I have no obligation to help them, but I feel I have an obligation to listen to their problems."

Most members of the Finance Committee who were interviewed said that they saw their work on the committee as providing one more way they could be of special service to their constituents.

LIKE OTHER HELP

Senator Gravel said that helping a constituent obtain legitimate relief was "little different from helping someone get their Social Security check or V.A. payment."

Senator Robert Dole, Republican of Kansas, offered nine amendments to the tax bill in the Finance Committee. All would help constituents or special friends.

For example, Mr. Dole proposed a section that would give a tax advantage to private railroads that used concrete ties. There are only two such lines in the country, the Kansas City Southern Railroad and the Florida East Coast Railroad.

The Florida line is represented by Mr. Merrigan's law firm, of which former Senator George A. Smathers of Florida is senior partner.

With no Florida Senator on the Finance Committee, the firm appealed to the Kansas City Southern, which, according to Mr. Dole, operates in his state and persuaded him to offer the amendment that would help the two lines.

Senator Dole and his legislative aide, Kim Wells, were extraordinary open in explaining to The Times their procedure for dealing with requests for special interest tax relief.

They estimated that more than 30 interests approached them this year seeking special tax legislation. Normally, they said, if no constituent interest was involved, they turned down the request. If a constituent was involved, they said, they checked with the staff experts of the Joint Committee on Internal Revenue Taxation and with the Treasury. If there were no objections from either, they agreed to introduce the requested amendment.

Mr. Wells recalled one instance this year in which "a friend and a campaign contributor" went to the office with a proposal.

"We wrote Treasury. We got through the motions for a constitutent. But when Treasury opposed it, we dropped it," he said.

Asked whether contributors received special attention, Mr. Dole replied, "You have to be honest and say, 'Sure.' If some guy has helped you in a campaign, it doesn't hurt him at all."

PROCEDURE DEFENDED

Some members of the Finance Committee, including Senator Long, the chairman, defended the procedures for including special preference legislation in tax bills.

Mr. Long said that he was "not the least bit embarrassed to support anything for my constituents if I think it's right."

As for the influence of lobbyists and contributors, he declared, "The Constitution protects the right of citizens to petition the Government for redress of grievances."

Other committee members, including Senators Dole and Lloyd Bentsen, Democrat of Texas, said they hoped to alter the committee's procedures so that narrow provisions would receive more scrutiny.

Senator Robert W. Packwood, Republican of Oregon, counted himself in the latter group. Most of the provisions that are adopted by the Finance Committee are justifiable, he said. What worried him, he added, was that "there may be 1,000 others that are meritorious that nobody ever hears about" because the potential beneficiaries do not have the right connections or the money to hire a well-connected lobbyist.

Mr. WERTHEIMER. We have a series of recommendations which we believe would improve the process by which the committee conducts its affairs and set the stage for the American public being willing to accept the results regardless of who benefits much more because they will have an understanding that the process is taking place out in the open and that everyone has had an opportunity to get their viewpoint across and everyone has been able to know what is going on.

Let me just summarize some of our recommendations.

We recommend that this committee immediately initiate a system to require members of the committee and the committee staff to log all communications concerning matters pending before the committee and to make these logs available to the public on a timely basis.

There is a series of rules that can be adopted, to greatly improve the process. Some of which have already been mentioned today: (a) full and timely disclosure of the Senate sponsors, beneficiaries, projected revenue loss or gain, and justification for each tax amendment or special tax bill; (b) record votes by individual member on bills and on each substantive amendment; (c) open conference meetings on all tax and other legislative matters within the committee's jurisdiction; (d) transcripts of open meetings being made available to the public on a timely basis; (e) all amended bills to show clearly the matters added since the previous print; and (f) advance notices and the opportunity for public hearings on all private or special tax bills and amendments.

The jurisdiction of the Senate Finance Committee covers the entire economic landscape, not just with regard to tax matters, but also in dealing with health, welfare, trade, and other issues. The existing provisions to protect against potential conflicts of interest by Members of the Senate and their staffs are totally inadequate. A system of public disclosure by Government officials of sources of income, assets, and other holdings as well as gifts is the key to dealing with potential conflict-of-interest problems. The Senate has recognized this by passing comprehensive public financial disclosure legislation three times in the last 4 years. The House has been a bottleneck on this.

We urge the committee to implement the basic provisions of S. 495 immediately by adopting the rules which would require comprehensive disclosure. We also believe the committee should establish procedures from members and staff to refrain from voting or taking part in deliberations on matters in which they have a personal interest of more than a de minimis amount.

We believe that adoption of the proposals we have recommended would start the committee on the path to restoring public trust in the integrity of the tax system. It would assure that a comprehensive record is developed for Senators, the media, and the public to make judgments regarding tax proposals and preferences considered and recommended by the Senate Finance Committee. It would also begin the process of convincing the American people that the tax system is designed to serve the public interest, not the various special interests who can exercise the most pressure and undue influence over legislators.

Thank you very much, Mr. Chairman.

Mr. MOSKOWITZ. I have no comments.

Senator HARTKE. Thank you, Mr. Wertheimer.

Senator Nelson.

Senator NELSON. No.

Senator HARTKE. Senator Hansen.

Senator HANSEN. No questions.

Senator HASKELL. You refrain from working on anything you have other than the de minimis interest. I don't think I agree with that. In the first place, what is de minimis? In the second place, it is awfully subjective.

If you have your financial statement out in the open, it seems to me people can draw their own conclusion? Do you think that might be a better way of going about it?

Mr. WERTHEIMER. I think putting a financial statement out in the open certainly does create the opportunity for the public to make a judgment and draw their own conclusions. We think in a case of a committee such as this which exercises such enormous influence over the tax system and in view of the public perception of the state of the tax system in this country and the public's distrust of the methods by which decisions are made and in the light of the need to really take steps to do something about it, that this committee could go further.

Senator HASKELL. I would hate to have to judge when I had a de minimis financial interest.

Mr. WERTHEIMER. Our ultimate view is, Senator, that we would like to see increased salaries of both the Senate and the House Members in conjunction with the barring of any outside income or any outside holdings; then I think we could basically eliminate the conflict of intent.

Senator BROCK. Could you bar income?

Mr. WERTHEIMER. Outside earned income.

Senator BROCK. How about interest, dividends?

Mr. WERTHEIMER. That would be more difficult, Senator Brock [laughter]. I suppose that might be asking too much. You could certainly ask elected officials to take that step particularly if you were prepared to compensate them in a manner that fully justified the lack of any need for outside sources but it might be that this kind of approach would have to be limited to——

Senator HASKELL. Would the gentleman yield?

You are not seriously considering anybody to be elected giving away anything they own, are you?

Mr. WERTHEIMER. No; I am not, Senator, but I am proposing that they take every possible step to assure the American people that they are not involved or that there is not any appearance of involvement of outside personal interest affecting the decisions they make for the American people.

Senator NELSON. I don't happen to own any stocks or bonds or any interest in any business, anything like that. Everything I own is a house and a piece of property. You suggested that beyond the Finance Committee you should not vote on something if you have interest that is more than de minimis. Mine would always be de minimis.

Mr. WERTHEIMER. You should not have any problem supporting this.

Senator NELSON. Well, I do have a problem supporting it. Why would you say that the vote of the Finance Committee member was more important than the vote of some of those multimillionaires out on the floor of the Senate whose holdings are vast enough so that they have interest through stock in all kinds of businesses? Are you going to say that they should not vote either?

Mr. WERTHEIMER. Well, if the concept spread following the adoption of the Finance Committee, we are for it.

Senator NELSON. You say an elected official who is well heeled and has stock in rails and anything—you name a wealthy family and report you have got something, $100 million or more. If they have more than a de minimus interest, they should not vote?

Mr. WERTHEIMER. Yes. If they have specific interests and specific legislative matters on the floor, we think they should disqualify themselves.

The House has a rule now which requires any Member of the House in theory to disqualify themselves from voting on the floor on matters that they have a personal or pecuniary interest in. That rule in practice has not had much application because the interpretation of it has been that the ultimate decision is up to the Member of the body.

Senator NELSON. I just think that that position is so indefensible that I would like to pursue it and maybe I can understand it a little more.

Are you saying that if a wealthy person had, say, $20 million and, let's say, he didn't invest it in stocks, he put it in mutuals and mutual now is investing data so that we have investments in every economic interest in the country and he has $20 million worth it is more than de minimis, that he should not vote on an issue that comes up? Are you presuming that he is going to be dishonest because he is a multimillionaire who has stock in the corporation affected or are you going to say his constituents are deprived of his vote or are you going to say he is not allowed to serve because he is a man of means?

Mr. WERTHEIMER. I am arguing that a system should be devised which, in effect, eliminates Members of the Congress from voting on matters in which they have a significant personal interest.

If, for example, a Member of the Congress owns millions of dollars of stock in an automobile company——

Senator NELSON. Let's backup. Take my case. He has $50 million in mutual stocks. Mutual is investing without him making the decision in every major industry in this country.

You eliminate him from voting on the tax bill on any issue that affects him?

Senator BROCK. He would have no vote.

Senator NELSON. Of course he would not.

Mr. WERTHEIMER. It might also be that he should——

Senator NELSON. Isn't it adequate for public officials to disclose what they own? People don't live in a vacuum. I wish I had something substantial to disclose but I don't.

Isn't it adequate that they disclose to their constituents whether they are adequately representing them? I don't see how you can do it any other way.

Mr. WERTHEIMER. I don't want to understate the importance of disclosure because we as an organization have argued that that is an important reform.

Senator NELSON. I am conceding that, but isn't that adequate?

Mr. WERTHEIMER. I do not think so, Senator. I think the rules could be devised to go further and to eliminate the opportunity for voting on matters that the Member of the body had a specific interest in.

Senator HASKELL. Would the Senator yield?

Senator NELSON. Yes.

Senator HASKELL. I am having the same difficulty Senator Nelson is. Everything we vote on we have an interest in. We own a house, mortgage rates. If this is an official position of your organization, well, all I can say is you have a lot of missionary work to do. [Laughter.]

Mr. WERTHEIMER. We will take another look at it, Senator.

Senator HASKELL. How can you figure out what is de minimus or maybe, as the Senator from Tennessee says, maybe just not vote?

Mr. WERTHEIMER. I do believe de minimus is not a concept we invented, it is a concept that is fairly well-known in the law.

Senator HASKELL. But every time we go over to vote we do not try a lawsuit.

Mr. WERTHEIMER. I do believe that ground rules can be established which would not prohibit or not restrict Members of the body from representing their constituency while at the same time take them out of a position on voting for things which provide them with direct specific benefit.

As I say, the House has had rules along these lines, although they have not been implemented for many years.

Senator HASKELL. That may be so.

Mr. WERTHEIMER. There has not been too much desire to implement.

Senator NELSON. I come from the largest dairy State in the Union. Let's suppose we elect—and we have historically—a dairy farmer with 100 cows and we have got a dairy support program and 90 percent parity. Do you think he ought to have 100 and can't get above 80 but in fact that dairy support program would be of substantial benefit to this elected official, this Congressman?

He believes in it. Are you going to say that he can't represent his constituents and vote for it?

Mr. WERTHEIMER. If the result would be to provide him with a direct financial benefit.

Senator NELSON. Of course, that is what it is. He gets a higher price for his milk. You are going to say then the dairy farmers are deprived of their representation even though it is considered by them and their majority in Congress to be meritorious. You are going to deprive him of his vote. That is a silly position, I think you ought to review it.

Mr. WERTHEIMER. Senator, I will review it. [Laughter.] I will review it but I would not want to leave a wrong impression here regarding our position. It is possible to establish rules which will eliminate the impression that Members of the Congress are voting to benefit themselves in specific matters. Issues of this kind are pending before the House Ethics Committee today.

The difference between de minimus and totality leaves plenty of room for negotiation and consideration. There are clearcut cases. Hard cases always make difficult law.

I do believe, and I believe the committee should be cognizant of the effect that it has on the public. When people who hold public office are in a position of voting for legislation, particularly in the tax area, which also has the result of giving them personal financial benefits——

Senator BROCK. I understand what you are saying. If I may interject. Let me just ask you a question.

There are some Members of the House and I think some who have taken whatever incentives there are, whether large or small, and put them in a trust. Does that eliminate the potential conflict?

Mr. WERTHEIMER. That is a difficult question, Senator Brock.

Senator BROCK. Why?

Mr. WERTHEIMER. Because the question facing the Senate today in S. 495 is whether or not a blind trust should be considered an adequate safeguard for purposes of public financial disclosure legislation. It would seem to me that for purposes of the question you raise—disqualification from voting—if there was a blind trust protection could exist. But if in fact in order to achieve an adequate financial disclosure law, you believe that blind trusts should not be allowed, then the blind trust concept cannot be used as a means of dealing with disqualification from voting.

Senator BROCK. But you know, the way the blind trust is drawn, if it is drawn legally, it must in fact be blind and it must be totally supervised without any knowledge or consent of the basic element.

Now I don't see how in that circumstance you can——

Mr. WERTHEIMER. One question really depends on what went into the blind trust. If the blind trust consisted of a substantial share, most of the blind trust was placed in holdings of one company, then you would have a fairly good sense of what was in it.

Senator BROCK. You would have to make an assumption.

Mr. WERTHEIMER. Yes. If you had a much broader portfolio, then the description you describe would be more appropriate.

Senator HARTKE. Senator Fannin, any questions?

Senator FANNIN. Senator, I am sorry. I was not here but from what I heard I just wondered if you would like to have the Congress a body of have-nots or both in means as well as expertise? Is that the idea that you have?

Mr. WERTHEIMER. No, Senator.

Senator FANNIN. Do you feel that because a man was an expert, for instance, in the petroleum field that he should not be qualified to vote on any measures pertaining to the petroleum industry?

Mr. WERTHEIMER. No, I didn't say that, Senator.

Senator FANNIN. Well, if he has interest in the petroleum industry, should he be disqualified to vote?

Mr. WERTHEIMER. I think as we have stated here in terms of tax matters and the matters that come before this committee that a Senator should disqualify himself from voting on a matter that would be of specific benefit to that Senator.

Senator BROCK. Maybe we should call Kennedy and give him equal time.

Senator FANNIN. If that theory is carried through, then many of the Members could not vote on certain measures. But aren't we accountable to our constituency? Aren't they the ones that make that determination of whether or not we are handling their business properly?

Mr. WERTHEIMER. In part, yes. They are the ones that make the decision, but in terms of your question of accountability I don't think you are presently accountable under the rules that have been operating today. That is one of the reasons that we think steps have to be taken to provide much more of a public record so that we can judge what precisely is going on.

If people don't know, then the concept of accountability is a shallow one.

Senator FANNIN. I am often referred to by the press as an oil State Senator but we don't have any oil in my State. I wish I could fall into that qualification, I wish they could discover some oil in Arizona. My constituency knows how I vote as far as the measure is concerned, they return me to the Congress after knowing that because that was an issue in the campaign that I had last time and I don't hestiate at all to speak out on this issue.

I have a great interest in the petroleum industry but I don't hesitate at all to vote. I feel I have more knowledge about it. I vote more intelligently and I feel it is a great attribute to have men in the Congress that are qualified. I can't understand how Common Cause can criticize a person because of his expertise.

Mr. WERTHEIMER. Senator, we are not talking about expertise, we are talking about the capacity for personal financial benefit.

Senator FANNIN. It has been brought out by Senator Nelson that anything we do would affect us one way or another. I think you are describing some impractical solutions to what I would not consider, but I just think it would be very narrow and impractical to abide by your request.

Senator BROCK. You have been pretty well picked on, Mr. Wertheimer.

Let me ask a question. Senator Nelson was saying, I think, what he would do. If the people know what you do, then we achieve that basis and that is what I think we are reaching for.

Mr. WERTHEIMER. Thank you, Senator.

Senator NELSON. If you are talking about financial disclosure, when you have a dairy farmer who can't be down here voting for his dairy farmers on a support program I think you have a standard that cannot be conceivably complied within a democratic country.

Senator HARTKE. Mr. Wertheimer, isn't the fundamental problem rally—that you are groping with here—the question that you really would prefer public financing, as contrasted to private financing, for political campaigns for Members of Congress?

Mr. Wertheimer. That is one part of it, Senator Hartke.

Senator HARTKE. And practically all of this discussion would become a non sequitur if you had public financing?

Mr. WERTHEIMER. Well, a substantial part of it would. That would still leave questions dealing with procedures that take place and the manner in which the public and other Senators and the media can determine what decisions are being made and what is involved in those decisions with respect in this case to tax matters.

So there are a series of suggestions we have made and that others have made this morning which we think would improve the capacity for this committee and for the Congress to start to convince the American people that they have a fair tax system. The American people certainly, to my view, do not seem to believe that today.

Senator HARTKE. Thank you.

Senator Hansen.

Senator HANSEN. Mr. Wertheimer, you said earlier you thought one of the ways to do away with some of the evils in the present system would be to raise the salaries of Members of the Congress. Where do you think those salaries should be?

Mr. WERTHEIMER. Two points, Senator. I don't have a specific figure but my statement about increased salaries of Congress went hand-in-hand with the capacity to bar and eliminate outside income and outside holdings in a sufficient fashion so that the public could accept, as they don't accept today, salaries commensurate with the job that Members of Congress have to do.

Senator HANSEN. Well, you have been critical of the way things are running now. Is that as specific as you can be on that point, that this simply should be raised?

Mr. WERTHEIMER. Yes, that is as specific as I can be. I would like to point out that we are not talking about raises in the abstract, it is in the context of dealing with the other kinds of problems that we have described today.

Senator HANSEN. I suspect a good many people in this country have voted for a particular candidate in public office because he may have been in the business they were in. I would think that you could think of any number of Members of Congress who would identify with one group or another and if your concept were to be implemented and on those issues which might directly benefit that Member of Congress, he would be required to withhold his vote.

Would you not then be denying his constituents who happened to be associated with him in the same line of endeavor or business the right to be represented on that issue?

Mr. WERTHEIMER. I think it would be the Member of Congress who would be denying the constituents in light of those holdings, but if the Member of Congress decided he would want to have those holdings, then it would be the decision of the Member of Congress.

Senator HANSEN. I happen to be a cattleman which in these past few years has not been a particularly lucrative form of business to be in. I one time was president of the State livestock association. I am certain that some of my constituents found some reason to support me based upon their belief that if I were acting in my own self-interest I would be at the same time taking steps which might be protective of their interests.

That would violate the concept that you think I should employ in voting, if I understood you correctly.

Mr. WERTHEIMER. No. What is at stake here, Senator, is the question of the capacity for personal gain out of public and professional duties. That is the problem that is trying to be dealt with. Your expertise or knowledge is not a problem, it is your financial holdings as a rancher or as a cattleman that becomes a problem.

Senator HANSEN. Let's say I am voting on a tariff. Or it happens that the cattle industry has been damaged with price supports and I have been one who believes we ought not to have our product price supported. That is, to take the dairy business which I don't happen to be in, it at various times, as you know, has been price supported—supports on milk and cheese.

Two ways: one, tariffs against the importation of cheese. Say if I were in the dairy business, should I not vote on an issue that would involve those two areas?

Mr. WERTHEIMER. It would depend, as we state here, on the size of your holdings and the amount of benefit that the vote would be to you, Senator.

Senator HANSEN. You are really not answering my question excepting to say that unless I were to determine that it was greater than a de minimus interest then I should not vote.

Mr. WERTHEIMER. As I say, I think ground rules could be set. If this body was interested in doing it—which would provide guidelines, to answer your question—if you were a dairyman or a cattleman who had a cattle farm worth $5 million and you were involved in a vote——

Senator HANSEN. Say it was worth $500,000. Now go ahead with your statement.

Mr. WERTHEIMER. Worth $500,000 and you were involved in a vote which would double the value of your property, then I think the concept we are talking about would be very valid.

Senator HANSEN. I would say that if there was a way to double the value of my property on one vote, I would have to admit that I would likely vote aye. (Laughter)

Mr. WERTHEIMER. Thank you, Senator.

Senator HARTKE. Thank you, Mr. Wertheimer.

The situation is this. We have heard eight witnesses, there are 12 more to be heard. I am prepared to go ahead and do my part. The Republican policy committee started at 12:30 p.m. And the tax bill goes on the floor at 1 p.m. Do you object to me continuing hearing some of these people?

Mr. Thomas J. Reese, legislative director, Taxation With Representation, accompanied by Mr. Michael McIntyre.

STATEMENT OF THOMAS J. REESE, LEGISLATIVE DIRECTOR, TAXATION WITH REPRESENTATION, ACCOMPANIED BY THOMAS F. FIELD, EXECUTIVE DIRECTOR

Mr. REESE. Senator Hartke, I would like to thank you for being the only Senator to stay here to hear the testimony of one of the two public interest taxpayers' lobbies that has been involved in this legislation.

My name is Thomas Reese and I am legislative director of Taxation With Representation, a public interest taxpayers' lobby with more than 14,000 members throughout the United States.

My testimony will be organized around four points: (1) Obstacles to public interest testimony at hearings; (2) the need for analysis of narrow interest provisions by the staffs of the Treasury and the Joint Committee on Internal Revenue Taxation which would include public disclosure of the beneficiaries and the dollar amount which the provision is worth to the intended beneficiary; (3) the need for revenue raising reforms to balance the revenue loss of the provisions; and (4) an analysis of some of the provisions.

One of the Taxation With Representation's principal purposes is to sponsor public interest testimony regarding ending tax legislation. Public interest testimony is inherently more difficult to produce than is special interest testimony. Special interests in many cases are the actual draftsmen of the bills or amendments on which the committee is holding hearings, so those special interests are intimately familiar with very nuance of the proposed legislation, long before hearings are announced.

In contrast, public interest groups face a series of obstacles in preparing themselves to present helpful testimony to the tax writing committees of Congress.

First, public interest witnesses are forced to play detective in ferreting out the special interest measures that are buried in the technical language of a tax bill. These measures are hidden in narrowly defined exemptions, exceptions, changes in effective dates, transition periods and overrulings of IRS and Tax Court decisions.

The job of preparing public interest testimony also includes obtaining copies of the pertinent legislation, committee reports, Treasury bill reports, and other documents; locating competent experts who are willing to speak out in the public interest; contacting them by mail or phone; and subsequently printing and distributing their testimony. All of these steps are time consuming.

In addition, since public interest groups must rely primarily on unpaid experts, the witnesses testifying under their auspices must set aside time from teaching or other duties to do the research needed to present testimony that is professionally sound. Again, time is needed, since the demands of one's normal job cannot always be set aside on short notice.

For all these reasons, the time schedule set forth in the committee's July 8 press announcement is completely unrealistic, at least as far as public interest groups are concerned. Only the special interests already familiar with their own proposals can prepare testimony on such short notice.

These hearings must necessarily be viewed as a one-sided opportunity—which grants special interests a further chance to rehearse prepared arguments without granting a realistic hearing to individuals and groups seeking to represent the public interest.

The need for ample time for the preparation of testimony is especially important when large numbers of provisions are considered simultaneously. It is simply unrealistic to expect professional public interest testimony to be forthcoming on short notice with respect to 73 amendments.

Under these circumstances, public interest groups will be justified in regarding the committee's announcement of July 9 as simply "window dressing."

Is this merely a hearing to give the opportunity to stand up on the floor of the Senate and say we have held hearings?

The obstacles to public interest testimony require the adoption of procedures similar to those adopted by the Ways and Means Committee for dealing with miscellaneous bills.

The criteria used by the screening committee in determining whether a bill should be included in the special hearings on miscellaneous bills are outlined on page 4 of my testimony. I will note two of the points which they considered.

First of all, the bill must not involve a significant revenue loss. Generally that meant not more than $5 million per year.

Secondly, the bill must not involve a broad structural or major administrative change in the tax laws.

In addition, an important part of the Ways and Means Committee procedure is an analysis of the miscellaneous tax bills by the staff of the Joint Committee on Internal Revenue Taxation. This analysis described current law, the problem the bill was trying to solve, an explanation of the bill, the effective date, especially pointing out when it was retroactive legislation, the revenue effect, the beneficiaries, and the position of the executive departments.

The joint committee analysis of miscellaneous bills was made available prior to the public hearings. The analysis that has just been done by the joint committee is still not available to the public, although I believe it was just handed out to members of the committee and the staff just an hour ago.

Unless such analysis and similar analysis by the Treasury is available prior to the public hearings, there is no way that serious public interest testimony can be offered.

Public interest groups are forced to spend most of their time trying to find special provisions in the tax bill rather than in preparing testimony. Even now we fear that we have not uncovered half of the special interest positions in the bill.

Under such circumstances, we are frequently forced to oppose narrow interest provisions because sufficient evidence is not available to show that they are benign.

I strongly recommend that the Finance Committee adopt procedures similar to the Ways and Means Committee's procedures for dealing with miscellaneous and technical tax matters.

I also urge that the committee give serious consideration to adoption of the practice of the Judiciary Committee and naming the title of the bill, the person or firm being granted relief. Casting special relief in this form would also promote simplification of the Internal Revenue Code since it would no longer be necessary to disguise special relief bills as amendments to that code. There are enough special interest provisions in this tax reform bill to make it necessary for Congress 10 years from now to pass another deadwood bill repealing them all.

Most of the provisions before the committee lose revenue. That loss will have to be made up by ordinary taxpayers or by increased deficits unless the committee recommends reforms which will raise an equal amount of revenue.

In keeping with the spirit of the budget resolution, the committee should recommend revenue raising reforms to balance the revenue loss from these provisions. Unless there is tax reform to offset the revenue loss of narrow interest legislation, it is difficult to justify such legislation to the American taxpayer because their taxes will be higher as a result of this legislation. The American taxpayer will have to pick up the tab for the benefits given to a very few.

Furthermore, these tax matters should not be included in a tax-reform bill, they should be dealt with separately when there is time to give them the attention they deserve. In fact, many of the provisions under consideration today do not become effective until after December 31, 1976. There is no reason to enact these measures now.

If the committee adopts the procedures similar to the procedures adopted by the Ways and Means Committee, it will protect itself from being accused of slipping through tax provisions without adequate consideration.

Finally, Mr. Chairman, I have attached to my testimony 12 more pages of analysis of the provisions set forth in the July 8 press release. I ask that this material and other written material I have submitted be printed in the record following my testimony but I will not take the committee's time, since there are only two Senators here, to go through all of this material.

If anyone on the committee has any questions on this, I or Mr. Field will be happy to try and answer your questions.

Thank you.

[The material referred to follows:]

TESTIMONY BY THOMAS J. REESE, LEGISLATIVE DIRECTOR, TAXATION WITH REPRESENTATION

Mr. Chairman and members of the committee, my name is Thomas J. Reese, and I am legislative director of Taxation With Representation, a public interest taxpayers' lobby with more than 14,000 members throughout the United States. My testimony will be organized around four points:

1. Obstacles to public interest testimony at hearings.
2. The need for analysis of narrow interest provisions by the staffs of the Treasury and the Joint Committee on Internal Revenue Taxation which would include public disclosure of the beneficiaries and the dollar amount which the provision is worth to the intended beneficiary.
3. The need for revenue raising reforms to balance the revenue loss of the provisions, and
4. An analysis of some of the provisions.

Obstacles to public interest testimony

One of Taxation With Representation's principal purposes is to sponsor public interest testimony regarding pending tax legislation. Public interest testimony is inherently more difficult to produce than is special interest testimony. Special interests in many cases are the actual draftsmen of the bills or amendments on which the Committee is holding hearings, so those special interests are intimately familiar with every nuance of the proposed legislation, long before hearings are announced.

In contrast, public interest groups face a series of obstacles in preparing themselves to present helpful testimony to the tax writing committees of Congress. First, public interest witnesses are forced to play detective in ferreting out the special interest measures that are buried in the technical language of a tax bill. These measures are hidden in narrowly defined exemptions, exceptions, changes in effective dates, transition periods and overrulings of IRS and Tax Court decisions.

The job of preparing public interest testimony also includes obtaining copies of the pertinent legislation, committee reports, Treasury bill reports, and other documents; locating competent experts who are willing to speak out in the public interest; contacting them by mail or phone; and subsequently printing and distributing their testimony. All of these steps are time consuming.

In addition, since public interest groups must rely primarily on unpaid experts, the witnesses testifying under their auspices must set aside time from teaching or other duties to do the research needed to present testimony that is professionally sound. Again, time is needed, since the demands of one's normal job cannot always be set aside on short notice.

For all these reasons, the time schedule set forth in the Committee's July 9th press announcement is completely unrealistic, at least as far as public interest groups are concerned. Only the special interests already familiar with their own proposals can prepare testimony on such short notice. These hearings must necessarily be viewed as a one-sided opportunity—which grants special interests a further opportunity to rehearse prepared arguments without granting a realistic hearing to individuals and groups seeking to represent the public interest.

The need for ample time for the preparation of testimony is especially important when large numbers of provisions are considered simultaneously. It is simply unrealistic to expect professional public interest testimony to be forthcoming on short notice with respect to 62 amendments. Under these circumstances public interest groups will be justified in regarding the Committee's announcement of July 9th as simply "window dressing."

Need for analysis by the Joint Committee and Treasury

The obstacles to public interest testimony require the adoption of procedures similar to those adopted by the Ways and Means Committee for dealing with miscellaneous bills. (See Ways and Means Committee Public Hearing on Miscellaneous Minor Tax Bills, December 10, 1975.) An important part of the Ways and Means procedure is an analysis of the miscellaneous tax bills by the staff of the Joint Committee on Internal Revenue Taxation. This analysis described current law, the problem the bill was trying to solve, an explanation of the bill, the effective date, the revenue effect, the beneficiaries, and the position of the executive departments.

The Joint Committee pamphlets analyzing the miscellaneous bills were made available prior to the public hearings. The Treasury Department analysis of similar provisions should also be made available prior to the hearings. Unless such analysis by the Treasury and the Joint Committee is available prior to the public hearings, there is no way that serious public interest testimony can be offered. Public interest groups are forced to spend most of their time trying to find the special interest provisions in the tax bill rather than in preparing testimony. Under such circumstances we are sometimes forced to oppose narrow interest provisions because sufficient evidence is not available to show that they are benign. Even now we suspect that we have not uncovered half of the special interest provisions in H.R. 10612.

Besides providing Joint Committee analysis of the legislation prior to the hearings, I also urge the committee to give serious consideration to adoption of the practice of the Judiciary Committee in naming in the title of the bill the person or firm being granted relief. Casting special relief in this form would also promote simplification of the Internal Revenue Code, since it would no longer be necessary to disguise special relief bills as amendments to that Code. There are enough special interest provisions in this tax bill to make it necessary for Congress 10 years from now to pass another deadwood bill.

Revenue gains to balance revenue losses

Most of the provisions before the committee lose revenue. That loss will have to be made up by ordinary taxpayers unless the committee recommends reforms which will raise an equal amount of money. In keeping with the spirit of the budget resolution, the committee should recommend revenue raising reforms to balance the revenue losses from these provisions. Unless there is tax reform to offset the revenue loss of narrow interest legislation, it is difficult to justify such legislation to the American taxpayer whose taxes will be higher, because he must pick up the tab for benefits given to a few.

Recommended procedures

Earlier this year the Ways and Means Committee adopted procedures for dealing with miscellaneous bills. The bills submitted by members of the committee were reviewed by a special screening committee of committee members in order to determine whether the bills met the criteria of being technical or minor bills. The criteria used by the screening committee in determining whether a bill should be included in the special hearing on miscellaneous bills were:

1. The bill must not involve a significant revenue loss (generally, not more than $5 million full year effect; outside limit would be $15 to $20 million).
2. The bill must not involve a broad structural or major administrative change in the tax laws.
3. The bill must not have been included as a provision in the Tax Reform Bill (H.R. 10612).
4. The bill must not have been referred to a study committee during the consideration of the Tax Reform Bill (H.R. 10612).
5. The bill must not deal with an area specifically listed for consideration in phase II.

In connection with the hearing, the staff of the Joint Committee on Internal Revenue Taxation was directed to prepare a description of the bills, to indicate whether any of the bills are retroactive, and to name any particular taxpayer to which the bill might be directed to the extent of the staff's information. (Ways and Means Committee Public Hearing on Miscellaneous Minor Tax Bills, December 10, 1975, page vii.)

I strongly recommend that the Finance Committee adopt similar procedures for dealing with miscellaneous and technical tax matters. In addition, revenue raising measures should be adopted simultaneously so that the cost is not borne by the average taxpayer, nor cause an increase in the deficit. These tax matters should not be included in a tax reform bill. They should be dealt with separately when there is time to give them the attention they deserve.

Furthermore, many of the provisions under consideration today do not become effective until after December 31, 1976. There is no reason to enact these measures now. If such procedures are adopted by the Finance Committee, it will protect itself from being accused of slipping through tax provisions without adequate consideration.

ANALYSIS OF PROVISIONS

Refundable investment credits

Beginning in 1984, the Treasury Department will pay companies an amount equal to the value of unused investment credits. Unused credits are those which cannot be exhausted under the current provision for carrying them three years backward or seven years forward. The provision, which has general applicability, was sought mainly by the airlines and the utilities. The amendment will cost between $300 million and $500 million in 1984. We oppose this provision unless the revenue loss is recouped by reducing the investment tax credit or by closing some corporate tax loopholes. (Section 802 of the bill; page 177 of the report.)

Expiring credits

Investment and foreign tax credits which would otherwise expire at the end of 1976 would be extended for another two years. The amendment, sponsored by Vance Hartke, D-Ind., would aid the airline industry (investment tax credits) and Chrysler Corp. (foreign tax credits). The Treasury Department opposes the amendment, on the ground it disproportionately favors transportation. The provision would cost $14 million in fiscal 1977 and $30 million in fiscal 1978. (Section 803 of the bill; page 196 of the report). Currently the investment credit can be carried backward three years or carried forward seven years. If a company cannot make enough profits during this time to use its credits, it is not the responsibility of the Federal Government to bail them out.

Shipbuilding credit

This amendment, added at the request of Finance Committee Chairman Russell B. Long, D-La., would permit the investment tax credit for spending on ships built with tax-deferred funds. The Treasury Department, which opposes the amendment, estimates that the tax deferral currently available is equivalent to an investment tax credit of 17% and the 10% investment tax credit would be added to that. The revenue loss is estimated at $21 million in fiscal 1977, rising to $45 million by 1981.

Among the beneficiaries would be oil companies, which have extensive shipping fleets; banks, which can build ships and lease them; and steel companies, which use the ships for the movement of ore on the Great Lakes. In the case of the oil companies and the steel firms, the sabotage laws already require that American-built ships be used on the principal routes involved, so the additional incentive of the investment tax credit is totally unnecessary as a spur to ship construction. Furthermore, the provision would, in effect, grant the investment credit for the investment of tax money owed to the U.S. government. (Section 806 of the bill; page 196 of the report). For more information see testimony of Thomas F. Field on this issue which follows my testimony.

Investments in U.S. property

Under present law, when a United States corporation reinvests the earnings of a foreign subsidiary in property located in the U.S., this is considered a repatriation of foreign earnings and triggers the U.S. corporate income tax. The bill redefines what will be considered investment in U.S. property to allow a special retroactive exception for Superior Oil Co., which invested earnings in an oil rig on the U.S. continental shelf. Congress in 1960 had defined U.S. investment to include the continental shelf. In addition, there is another special exemption designed to aid Pyramid Ventures Corp. of Louisiana. (Section 1021 of the bill; page 225 of the report). We see no reason to make it easier to defer paying taxes on earnings of foreign subsidiaries.

Shipping profits

The Finance Committee tightened up the taxation of shipping profits but made four exclusions: two would aid the Hall Corp. Shipping Ltd., owned by the Frank A. Augsbury Jr. family of Ogdensburg, N.Y.

The first exception to aid Hall would exempt from the tightening provision income from shipping between two or more points within the country in which a foreign shipping subsidiary is incorporated and registered. The second exception favoring Hall is that, if a company has virtually all its assets in foreign shipping operations, repayments of unsecured loans would be treated as reinvestment in shipping operations and, thus, exempt from taxation.

Another exception is for two unidentified small corporations from Louisiana and Texas that registered their oil rig servicing vessels under the Panamanian flag. The Tax Reduction Act of 1975 would tax such operations.

A final exception is for the Diefenthal Corp., a Louisiana scrap company, which ships scrap to Japan and uses a Panamanian charter to avoid U.S. taxes. The exception includes a corporation which owns no vessel and doesn't manufacture, grow or mine any commodity. (Section 1025 of the bill; page 230 of the report). Since we do not support deferral, we see no reason to allow it in these special cases.

Agricultural products

The provision would exclude from the tax haven rules income from all farm products grown outside the U.S. This would give such goods a competitive price advantage and benefits such major agricultural exporters as Continental Grain. Bunge, Cook, Garnac and Louis Dreyfus. The revenue loss is estimated at $17 million in fiscal 1977 and $15 million a year after that. (Section 1205 of the bill; page 232 of the report). Again, since we do not support deferral, we see no reason to allow it in these cases.

Per country repeal exemption

The Finance Committee agreed with the House to repeal the per country limitation and place all taxpayers on the overall method of calculating the foreign tax credit. The effective date was for all tax years beginning after December 31, 1975. The committee approved a three-year transition rule that specifically benefits, among others, Freeport Sulphur Corp.

A similar postponement of per country limitation repeal and new loss recapture rules was included at the request of PPG Industries, though the amendment was tighter than the House version. The House bill also had the Freeport Sulphur provision. (Section 1031 of the bill; page 238 of the report.) We prefer putting all taxpayers on the per country method of calculating the foreign tax credit but if Congress wants everyone on the overall basis, then it should apply to everyone without exception.

Foreign oil and gas income

The bill provided a special carryback rule to permit oil companies to use excess foreign tax credits that could not be used because of limitations contained in the Tax Reduction Act of 1975. The proposal included in the House bill, was designed to benefit Natomas Corp., a San Francisco-based oil company, and would cost an estimated $8 million in fiscal 1977 and $10 million in fiscal 1978. (Section 1035(a) of the bill; page 246 of the report.) There is no justification for these excess foreign tax credits in the first place and therefore no need to allow a carryback.

The bill also provided a special transitional rule for recapture of losses to benefit the Sun Oil Co. This will cost $21 million in fiscal 1977 and $6 million in fiscal 1978. The tax money would be recouped in later years. (Section 1035(b) of the bill; page 247 of the report.) There is no reason to give Sun Oil a special break unavailable to others.

Oil related income

Special definitions of oil-related income were approved to benefit Tenneco, Inc., in its liquidation of a Canadian subsidiary and I. U. International, a Philadelphia conglomerate which apparently wants to consolidate certain gas utility income with its non-oil income so that foreign tax credits may be applied to such income. The cost would be about $5 million or less in each case. (Section 1035(c) of the bill; page 250 of the report). This will allow Tenneco to use excess oil tax credits to shelter from taxes income from non oil sources and I. U. International.

Iranian consortium

An amendment by Sen. Clifford P. Hansen, R-Wyo., at the request of Mobil Oil Corp., would grant a blanket 10-year exemption to Mobil and other members of the Iranian consortium from the provisions of the law which bar the use of the foreign tax credit on income from oil properties in which the companies do not have an "economic interest." The amendment, opposed by Treasury, would cost an estimated $40 million a year or a total of $400 million over the entire period of the exemption. (For discussion of the question, see article by Michael McIntyre.) (Section 1035(e) of the bill; page 251 of the report). The payments to foreign countries are really royalties not income taxes. They should therefore be deductible not creditable.

Oil production sharing

An amendment by Sen. Lloyd Bentsen, D-Texas, would reverse for five years an Internal Revenue Service ruling (Rev. Rul. 76-215) which denied the foreign tax credit in the case of certain production sharing agreements. The amendment, designed to benefit primarily Natomas Co., a San Francisco-based oil firm, would cost about $25 million a year for five years. (For analysis of the issue, see article by Michael McIntyre.) (Section 1035(f) of the bill; page 253 of the report)

The oil firms have been busy trying to persuade Indonesia, the principal oil producing country making use of production sharing agreements, to renegotiate them in a form that would pass muster with the IRS. The Service July 14 issued a press release setting the criteria that would have to be met in order to qualify for the foreign tax credit when the foreign government owns the minerals being extracted. The IRS has determined that these payments do not qualify for foreign tax credits. There is no reason to overrule the IRS determination.

H. H. Robertson Co.

The Finance Committee approved an amendment by Sen. Vance Hartke, D-Ind., to reverse a Tax Court decision (59 T.C. 53) against H. H. Robertson Co., a Pittsburgh-based multinational building products firm with a plant in Indiana. The amendment would change the law for all taxpayers but it provides retroactive relief for Robertson. At issue in the Robertson case is whether or not the company owes tax on about $1.5 million of income. (Section 1042(c)(3) of the bill; page 270 of the report)

The Robertson amendment is a private relief bill because it is intentionally designed to retroactively change the tax effect of a liquidating dividend received by H. H. Robertson Co. in 1965. The bill would also change the method of computing earnings and profits for other companies in subsequent years.

Whether the correct method of computing earnings and profits ought to be changed is a complex tax question. Under current law, a dividend of appreciated property from a foreign subsidiary is taxable in full to the recipient, but it reduces the earnings and profits of the foreign corporation by the company's basis in the assets. This rule is generally necessary to prevent repatriation of corporate profits tax-free or at capital gains rates.

The alleged defect in the rule—the subject of the Robertson amendment—occurs when a company which has paid a dividend in appreciated property subsequently liquidates. On liquidation, the domestic parent company is taxable on the fair market value of the liquidating dividend, to the extent of the earnings and profits of the company. Since the earnings and profits account was not reduced by the fair market value of the prior dividend, the sum of the portion of the liquidating distribution treated as a dividend and the prior dividend can exceed the historical earnings and profits of the foreign subsidiary.

That is what happened to Robertson. Its U.K. subsidiary paid a dividend in 1964 of appreciated property valued at $1.9 million and then liquidated in 1965. The subsidiary's cost basis in the distributed stock was relatively small ($250,000), making for only a small reduction in historical earnings and profits.

The liquidating distribution was held taxable by IRS up to the balance in the earnings and profits account ($2.9 million). That determination was upheld by the Tax Court (59 T.C. 53) and the U.S. Court of Appeals for the Third Circuit. Robertson was thus taxed on all of its subsidiary's earnings and profits plus an increment representing unrealized capital appreciation. This total, nevertheless, was less than the fair market value of the distributions.

Counsel for Robertson characterizes the above treatment as "double taxation." That characterization is misleading, since Robertson was taxed only once on the receipt of property from its subsidiary. All that occurred was that Robertson was denied the privilege of deferring tax on its unrealized gains.

The best argument for changing the current computation of earnings and profits is that the Robertson-type situation is unusual. In most situations, the sum of the distributions treated as a dividend will not exceed the sum of the historical earnings and profits. However, the Robertson treatment is correct in theory, and if the law is to be changed, it should be done so as to make the Robertson result the general rule. Since the objective of the Robertson amendment is to provide special relief to a single company, however, it seems proper to focus on the retroactive aspects of the bill and not become enmeshed in the merits or demerits of particular methods of computing earnings and profits.

Canadian mining subsidiaries

The Finance Committee approved an amendment permitting consolidation of Western Hemisphere Trade Corporations with non-WHTCs, a move prohibited by the new foreign tax credit rules in the bill. The amendment was designed specifically to aid the Hanna Mining Co. in merging two Canadian mining subsidiaries. Such a merger would be permitted only if 95% of the gross income is derived from mining in a country contiguous to the United States. (Section 1052 (b) of the bill; page 284 of the report). Such exceptions to the general tax credit rules are unjustified.

Political party debts

The Finance Committee narrowed an amendment contained in the House version which permits business deductions for bona fide bad debts to political parties. The committee version is effective for debts incurred after December 31, 1975, whereas the House version permitted deductions for bad debts incurred after January 1, 1975, and for years before that for which either an assessment or refund would still be possible. The Finance Committee version would eliminate the individual who sought the change in the first place, Charles Guggenheim, who incurred bad debts during some recent Democratic campaigns. It would benefit a major Republican campaign official, Henry Deirdorf. (Section 1304 of the bill; page 401 of the report). Since in general we do not support retroactive relief, we support the Finance Committee changes.

Prepublication costs

The Finance Committee approved an amendment in the House version which would reverse an Internal Revenue Service ruling (Rev. Rul. 73-395) that required publishers to capitalize over the life of a book the expenses relating to research. The publishers have been seeking to deduct the expenses over one year. Treasury opposes the amendment, which was designed primarily to benefit Encylopaedia Britannica, which incurs most of its revision cost in research. (Section 1305 of the bill; page 403 of the report). We support the Treasury in opposing this provision. Exceptions should not be made to general accounting principles.

Face amount certificates

The Finance Committee approved an amendment by Sen. Walter F. Mondale, D-Minn., to aid Minnesota-based Investors Diversified Services. The amendment would specify that, contrary to Internal Revenue Service regulations, it is not required that holders of face amount certificates include in their gross income the value of the discount on a ratable basis over the life of the certificate. An identical measure was defeated by the House Ways and Means Committee in March. The amendment, opposed by the Treasury, would cost about $5 million annually in lost revenue. (Section 1307 of the bill; page 407 of the report). Tax deferral is the main advantage of face amount certificates. Investment decisions should be guided by the market and not tax gimmicks.

Coca-Cola franchise

An amendment by Sen. Herman E. Talmadge, D-Ga., would exempt income from a Coca-Cola franchise from being treated as personal holding company income. This means it will be taxed at the 48% corporate rate instead of 70%. The amendment is retroactive to 1964. (Section 1308 of the bill; page 409 of the report). There is no good reason for such an exemption.

Texas Optical Co.

The Finance Committee approved a retroactive transitional rule to permit capital gains treatment in the case of the transfer of a professional practice.

The amendment, offered on behalf of the Texas Optical Co., is an exception to the committee's action extending the general rule denying capital gains treatment to the transfer of a franchise to situations involving a partnership. (Section 1311 or the bill; page 414 of the report). There is no legitimate reason for this retroactive exemption.

Tip income

The Finance Committee approved an amendment by Sen. Paul J. Fannin, R-Ariz., to ease reporting requirements for tip income. The amendment was sought by American Express, Marriott Corp. and restaurant workers unions. The change would cost less than $5 million annually in lost taxes due to unreported income. (Section 1312 of the bill; page 416 of the report). We support the IRS in opposing this amendment.

Percentage depletion

The Finance Committee approved several changes in the rules relating to repeal of percentage depletion on oil and gas, enacted in the Tax Reduction Act of 1975. The basic amendment was offered by Sen. Bob Dole, R-Kans. The committee restored the percentage depletion allowance for integrated companies if their retail sales are $5 million a year or less. Another provision restored the allowance for an independent oil producer who owns six gas stations in Israel. Another provision would retain percentage depletion in the case of certain trusts. The amendment would cost $18 million in fiscal 1977. (Section 1317 of the bill; page 424 of the report). Since we support complete repeal of percentage depletion on oil and gas, we see no reason to make it easier for companies to retain it.

State barge taxation

The Finance Committee approved an amendment by Chairman Russell B. Long, D-La., that would reverse a Louisiana district court decision and prohibit the state to levy an ad valorem property tax on vessels using navigable waters in interstate commerce. The Supreme Court of both Louisiana and the United States refused to review the case. The amendment was introduced at the request of Sen. James Eastland, D-Miss. A major campaign contributor of Eastland owns a shipping company in Greenville, Miss., that would benefit from the amendment. Some experts believe the Louisiana action to tax the out-of-state vessels is illegal under federal law. (Section 1321 of the bill; page 433 of the report). At present we have no position on this amendment.

Utilities charge

The Finance Committee approved an amendment by Sen. Mike Gravel, D-Alaska, that would reverse an Internal Revenue Service ruling (Rev. Rul. 75-557) and permit sewer and water utilities to exclude from gross income payments in cash or material made by customers in return for utility hookups. An earlier version would have included all utilities and we fear that these taxpayers will lobby in the future to widen the scope of the amendment. The amendment would cost $13 million in fiscal 1977 and could rise to $100 million if all utilities are included. Treasury is opposed to the change. (Section 1322 of the bill; page 434 of the report). This provision would be a bad precedent and provide a way of making payments to utilities that would not be taxed.

Life and casualty consolidation

A Finance Committee amendment to permit consolidated returns for life and casualty operations has sparked considerable controversy among technical experts. The amendment will permit tax savings from a property company's losses to be taken into account earlier by the affiliated group in computing its statutory surplus and this should increase the capacity of those companies to write insurance.

Proponents, including the Treasury Department, believe it will give uniform treatment to life and non-life companies who have casualty affiliates. They argue that the amendment preserves the procedures for determining taxable income used by each type of insurance company but permits life insurance companies to enjoy the same loss offset advantages enjoyed by non-life parents of casualty companies. Since the amount of loss which can be taken into effect in any one year is limited to the lesser of 50% of the taxable income of the life company or 50% of the sum of losses for the current year and prior years, there will be little opportunity for excessive tax reductions.

Opponents, including the American Mutual Insurance Alliance, a trade association of more than 100 mutual fire and casualty insurers, contend the change will further reduce life insurers' taxable income which, under current law, is only 50% of actual taxable income. That taxable income is still usually greater then 50% of the casualty losses, so under the limitations, life companies will most probably be limited to deducting 50% of the casualty losses. This limitation, opponents claim, will not limit a life company's advantage, however, because a carry-over provision in the amendment would, in effect, allow absorption of 97% of the casualty company's losses at the end of five years. They argue that the change will hurt independent casualty insurers who don't have large parents to absorb their losses. The provision will cost $25 million in fiscal 1978, and $40 million by 1981. (Section 1508 of the bill; page 454 of the report). Since the provision will not be effective until 1978, there is no reason to rush it through without more study.

Pollution control equipment

Sen. Clifford P. Hansen, R-Wyo., sponsored an amendment to make new pollution control equipment installed in facilities eligible for five-year amortization. In addition, it will be eligible for two-thirds of the 10% investment tax credit. This amendment continues a trend toward more generous treatment of companies forced by federal laws and regulations to install pollution control equipment, particularly in the extraction and paper industries. There is no reason why taxpayers should subsidize polluters. The cost of pollution control should be borne by the polluters and those who buy their products. (Section 1313 of the bill, page 417 in the Committee Report).

Private hospital bonds

Sen. Lloyd Bentsen, D-Texas, sponsored a provision to raise the small issue exemption on industrial revenue bonds to $20 million from $5 million if the bonds are issued by state or local governments for the construction of hospitals. Generally, revenue bonds are prohibited by the tax laws, but there are exemptions for certain purposes (not including hospitals) and for issues of less than $5 million. The amendment was sought by the Federation of American Hospitals which includes the Humana Corp. of Louisville, Ky., owner of 60 hospitals throughout the United States. We oppose industrial development bonds because they compete with municipalities in the tax exempt market and because they provide a method of escaping taxes for the very rich.

Amortization of track accounts

Currently, original track and ties are capitalized and no depreciation is allowed. When the original track and ties are replaced with track and ties of like quality, the cost (material and labor) can be deducted as current expense. If the replacement is made with material of a higher quality, for example cement ties, the increased value (betterment) must be capitalized.

The House version of the Tax Reform Act permitted current expensing of all replacements of existing ties (not track). The Finance Committee voted to retain current treatment of ties but to make track replacement eligible for 10-year amortization, compared with a normal life of about 40 years. We oppose both the House and Senate provisions giving further tax breaks to railroads. (Section 1701 of the bill, page 480–485 of the Committee Report).

Subchapter S corporations

An amendment offered by Sen. Harry F. Byrd, D-Ind-Va., would encourage regular corporations to become Subchapter S corporations to secure substantial tax savings for their shareholders.

Under present law, all corporations are allowed accelerated depreciation deductions. But, cash distributions in excess of the corporation's taxable income may result in ordinary income treatment to the shareholders because a double benefit of accelerated depreciation is disallowed. The Byrd proposal would mean that if a Subchapter S Corporation has a reserve of previously taxed income, certain cash distributions that exceed taxable income would be tax free.

The proposed amendment would encourage regular corporations which have a deficit of accumulated earnings and profits and which have large amounts of accelerated depreciation, to become Subchapter S Corporations. The Subchapter S corporations would then make cash distributions in their first year of operation which would be tax free to the shareholders. We oppose this amendment.

Effective date on new grantor trust rule

People presently put their investments in foreign trusts because such trusts do not pay any United States income taxes. The bill would remedy this by taxing the grantor on the income of the trust. The effective date of the House bill is May 21, 1974, in order to catch eleventh hour tax avoiders who rushed to set up such trusts once they heard that the House Ways and Means Committee was considering this provision. The Senate Committee changed the effective date to May 29, 1974, despite the fact that the Ways and Means Committee decision was made during an open hearing. There is no reason to allow this loophole to exist one hour more than necessary. (Section 1013 of the bill, page 215 of the Committee Report).

Tax-haven insurance earnings

The American International Group Inc., a U.S. insurance corporation, sought this exclusion for its Bermuda operation. Cost: $11 million in fiscal year 1977; $10 million yearly thereafter. The excluded earnings are those which must be set aside and reinvested to meet capital and legal reserve requirements *as if* (hypothetically) the more stringent U.S. requirements applied in the foreign country. We do not support any exceptions to tax haven rules since we support complete elimination of deferral. (Section 1023 of the bill, page 229 of the Committee Report).

Portfolio investments in U.S. of foreigners

General principles of international taxation give the first right to tax to the country where the income is generated. American investments abroad are taxed, foreign investments in the U.S. should also be taxed unless treaty agreements provide otherwise. (Section 1041, page 258 of the Committee Report). (See testimony of Professor Peggy Musgrave attached).

Contiguous country branches of domestic insurance companies

Under present law a domestic mutual life insurance company pays taxes on its worldwide taxable income, receiving a credit for foreign taxes paid. Because taxes imposed by the United States exceed those of Canada, the insurance industry has tried to get a special exception for their Canadian branches. This amendment frees profits of Canadian branches from United States taxes, as long as the profits are not repatriated to the United States. Mutual insurance companies use the separate branch accounting system whereby premiums and policyholder dividend rates are based upon the separate mortality and earnings experience of the Canadian branch. Therefore, these specially treated profits benefit only Canadian policyholders and may not be used to provide benefits for U.S. policyholders. The major insurance companies requested this tax preference. The revenue losses will be $4 million in 1977 and $8 million annually thereafter. (Section 1048 of the bill and page 271 of the Committee Report). Since we do not support deferral, we do not support this provision making it easier for a company to defer its taxes.

Amortization of railroad grading and tunnel bores

Railroads since 1969 have been allowed to amortize railroad grading and tunnel bores. They now want to be allowed to write off pre-1969 investments. This is retroactive legislation which will have no incentive effect. Railroads have received almost every conceivable tax break and Congress should not give them another which will not solve the fundamental problems of the railroads.

Energy-related provisions

I testified earlier on the energy bill, H.R. 6860, from which some of the energy-related provisions were taken. I have attached to my testimony a copy of my earlier statement. In general we opposed all of the energy related provisions. A tax reform bill is not a place for new inefficient and ineffective subsidies. In connection with these provisions, we suggest more reliance on the free market mechanism and less government interference in the form of price controls, quotas, and tax gimmicks. We strongly support the testimony of Environmental Action in opposing the recycling tax credit. We also strongly oppose the residential insulation credit which will cost $320 million per year and only save about 6.38 million barrels of oil a year.

Swap funds

Taxation With Representation supports repeal of the swap fund loophole, but we oppose grandfathering in any existing funds. Those who go out of their way to find loopholes in the Tax Code should not be protected from remedial legislation. (See my testimony before the Ways and Means Committee, March 29, 1976, attached).

Other provisions

In the time available to prepare testimony for this hearing, it was impossible to analyze all the provisions. Nor could we do an adequate job on those we did analyze, especially with the limited information available. While the bill language and the bill report were available for most of the provisions, they frequently hid rather than revealed what was happening and who would benefit. For the amendments adopted on June 4 and June 11 there was no bill report or language. As a result, the analysis given in this testimony is not definitive. It is subject to modification when additional information becomes available.

Additional material for the record

Mr. Chairman, I also request that the following material be printed following my statement in the record:

(1) Testimony by Thomas F. Field on Untaxed Maritime Construction Funds and the Investment Credit.

(2) Testimony of Thomas J. Resse on Exchange Funds, H.R. 11920.

(3) Letter of Thomas J. Resse of June 9, 1976 on Withholding Tax on Foreign Investors together with testimony of Professor Musgrave.

(4) Statement by Taxation With Representation on Provisions Which Should Be Deleted from the Tax Reform Bill, H.R. 10612.

(5) Statement of Thomas J. Reese on the Energy Bill, H.R. 6860.

(6) Article by Michael J. McIntyre on Taxing International Oil Profits.

Testimony by Thomas F. Field, Executive Director, Taxation With Representation

Summary of Statement

The Ways and Means Committee is considering whether to extend the 10 percent investment tax credit to ships built with so-called "tax deferred capital construction funds." These funds, which are authorized by the Merchant Marine Act of 1970, permit merchant shippers to postpone indefinitely any payment of federal tax on their earnings. The result is substantially similar, in most cases, to outright tax exemption.

The proposal now before Ways and Means would enlarge the tax shelter possibilities inherent in existing law, by granting the investment credit to firms making use of tax deferred reserve funds. The principal beneficiaries of the proposal will be the U.S. oil firms now preparing to produce oil in Alaska, major U.S. banks, and the larger U.S. steel producers.

Significantly, most of the beneficiaries of the investment credit proposal are already protected from foreign competition by the "cabotage laws" which require that the Alaska, Great Lakes, and coastwise trades be conducted in U.S. vessels manned by U.S. crews. Accordingly, the investment credit proposal will not result in any significant amount of additional ship construction in U.S. yards, or additional employment in the maritime trades. And since foreign competition is already excluded by law, there are no balance of payments arguments in favor of the proposal.

The attached analysis indicates that the tax deferred capital construction fund mechanism, as presently constituted, already provides substantial opportunities for tax avoidance. The figures set forth in the statement's appendix indicate that use of the construction fund mechanism in connection with a single $50 million tanker for the Alaska trade can result in undiscounted revenue losses over the life of the ship that come to more than $78 million. The analysis argues that further increases in these revenue losses, through allowance of the investment credit, are unjustified.

The analysis also argues that the proposal to grant the investment credit to ships built with untaxed funds violates basic tax law principles, and will encourage tax shelter operations. The analysis concludes that the pending investment credit proposal constitutes "thoroughly bad legislation" which should be rejected by the Ways and Means Committee.

UNTAXED CAPITAL CONSTRUCTION FUNDS AND THE INVESTMENT CREDIT

Mr. Chairman and members of the committee, thank you for this opportunity to testify on the eligibility of maritime capital construction fund withdrawals for the investment tax credit. For many years, the Internal Revenue Service has ruled that no investment credit could be claimed with respect to withdrawals of these tax deferred funds.[1] This rule results from the sound Congressional decision to compute the investment credit in terms of an asset's cost basis for depreciation purposes. Ships built with untaxed construction fund withdrawals lack a basis for depreciation, and as a consequence they are not eligible for the investment credit. The question before this Committee is whether the existing Congressional decision with respect to computation of the investment credit should now be changed.

Who will benefit?

As I will outline in a moment, I think that the proposal to grant an investment credit to untaxed construction fund withdrawals is wrong in principle. But before getting into the merits of this proposal, the Committee should first examine very carefully who the major beneficiaries of this proposal will be. In order of apparent importance, they are (a) the U.S. oil firms now preparing to produce oil in Alaska, (b) major banks, which have invested the so-called "black box technique of financing" to take advantage of tax deferred maritime funds, and (c) the major steel companies, which operate large fleets on the Great Lakes to transport their iron ore, coal, and limestone. These industries are not now paying federal corporate taxes at anything like the statutory 48% rate. Indeed, the effective rate of tax for the nation's commercial banks last year was only 2%. The basic question before this Committee is whether the already low effective rates for these firms will be reduced still further.

A parade of witnesses before this and other Congressional committees has repeatedly trumpeted the claimed need for extension of the investment credit to ships built with tax deferred reserve funds. It has been argued that jobs are at stake, that national security is involved, and that the U.S. balance of payments will be affected by this decision. I want to tell you, as unequivocally as I know how, that these are *not* the central issues, and that those who advance these arguments are being used as mere cat paws by the oil and banking interests that will be the real beneficiaries of the investment credit proposal now before you.

Background: The 1970 Merchant Marine Act Amendments

A word of background is needed to see why this is so. When the Ways and Means Committee failed in 1970 to review the tax provisions of the Merchant Marine Act that became law in that year, tax benefits were distributed by the maritime committees with wild abandon, and with little consideration of the possible consequences. Perhaps the most important change was to extend to a far more numerous class of shipowners the tax deferral benefits that had previously been available to only a handful of directly subsidized firms engaged in foreign trade. Among the new beneficiaries were oil firms preparing to move petroleum from Alaska to the West Coast, and steel producers operating ships on the Great Lakes. The extent to which they and their financial backers have taken advantage of these new privileges is indicated by the Maritime Administration's list of holders of capital construction fund accounts, which I request be inserted in the record following this testimony.

The principal new benefit granted to these firms by the 1970 legislation was the privilege of depositing shipping earnings, without payment of U.S. tax, in a so-called capital construction fund. So long as those earnings remain in the fund, or are invested in ships, no federal tax is due. In practice, this amounts to long-term deferral of tax, and simple arithmetic shows that long-term deferral comes very close to outright tax exemption.[2]

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[1] Revenue Ruling 67-395, 1967-2 Cum. Bull. 11, is declaratory of prior IRS practice as set forth in closing agreements between the IRS and U.S. flag shippers.

[2] For example, if we assume twenty year deferral and a 10% discount rate—both reasonable assumptions in light of business practice and the known behavior of those shippers who have had tax-deferred funds since 1938—the cost of tax deferral on earnings of $16 million comes to $4.1 million at present rates of tax. This is just $700,000 less than the cost of outright tax exemption for those earnings.

Big oil and the new tax benefits

For example, thanks to the 1970 legislation, oil firms may now avoid payment of any tax on the earnings of their coastwise tankers, and as you know, a substantial amount of petroleum is transported in tankers from the Gulf Coast to Middle Atlantic ports. Similarly, they can avoid payment of U.S. tax on what they earn transporting oil in the noncontiguous trade with Alaska, Hawaii, Puerto Rico, and other U.S. territories and possessions. Similarly, they can avoid payment of tax on their earnings in the foreign trade. And they can avoid payment of tax on the dividends and interest earned by the tax deferred earnings in their construction funds.

Furthermore, they can nicely regulate just how much in "earnings" their shipping operations realize, since there are substantial opportunities to shift income and deductions between shipping operations and other segments of an integrated business. Theoretically, the Internal Revenue Service could restrict these opportunities through use of the powers granted by Section 482 of the Internal Revenue Code, but it has been notably unsuccessful in applying that Code section to shipping income.

The extraordinary tax benefits just described are obviously of interest to petroleum firms that are contemplating major investments in tanker fleets designed to move petroleum from Valdez, Alaska, where the Alaska Pipeline ends, to the West Coast of the United States and to Hawaii. As things now stand, those tanker fleets will be built with money that has never paid tax, and the earnings from the ocean transport of Alaskan oil will not result in any U.S. tax for decades to come, if ever.

Long-term tax deferral amounting to virtual tax exemption is not the end of the story, however. Ships are depreciable assets, and by using accelerated depreciation and the Asset Depreciation Range (ADR) System introduced in 1971, it is now possible to bunch most of the depreciation deductions for ships into the first few years of a vessel's life. As a result, new capital investments in shipping can now generate tax free income on the one hand, if ship earnings are deposited in a capital construction fund, and large depreciation deductions on the other. The opportunity for tax avoidance and tax minimization operations under these circumstances is obvious. These opportunities are spelled out in more detail in Appendix A, attached, and in Tables 1–4 that are part of that Appendix. As that Appendix indicates, a single $50 million tanker can produce more than $78 million in revenue losses.

Now the Ways and Means Committee is being asked to put the icing on this already richly decorated cake by granting the investment credit to ships built with earnings withdrawn, tax free, from tax-deferred construction funds. Since the earnings of these tax free investments will themselves be tax free, at the option of the shipper, the opportunities to shelter oil company refining and marketing income from tax will be even further increased, since the investment credit can be used to reduce the taxes otherwise payable on those non-shipping operations.

What I have just said about the ability of large oil firms to take advantage of tax deferred construction funds, thanks to the 1970 tax amendments to the Merchant Marine Act, also applies to the case of banks, public utilities, and others who engage in "leasing operations" for tax shelter purposes. It also applies to a somewhat lesser extent to steel producers that can use tax benefits earned with respect to their Great Lakes fleets to shelter from tax the income from the production and marketing of steel products. It applies to wallboard and plaster producers who use ships to transport gypsum from mine to plant. This list of tax avoiders could be extended considerably, as is shown by the Maritime Administration roster that I am submitting for the record.

Cabotage and tax benefits: A rich brew

The list of public subsidies for the maritime industry seems almost endless, and this is not the place to discuss them all.[3] But one other major benefit must be mentioned: the protection given to our "coasting trade" and "noncontiguous trade" by the cabotage laws.[4] As things stand, no foreign vessel may transport

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[3] For an excellent comprehensive discussion of these benefits, see *Bread Upon the Waters: Federal Aids to the Maritime Industries*, Gerald R. Jantscher, The Brookings Institution, Washington, D.C. 1975.

[4] See 46 U.S.C. (1970 edition) Secs. 883 and 887. Additional cabotage restrictions are contained in 46 U.S.C. (1970 edition) Secs. 11, 251, 289, 292, and 316.

oil from Alaska to the West Coast of the U.S. That "noncontiguous trade" is reserved exclusively for U.S. vessels and U.S. crews. Nor may any but a U.S. vessel transport iron ore, coal, or limestone from one U.S. port to another on the Great Lakes. Again, foreign competition is absolutely excluded.

What this means is that the investment credit proposal now before this Committee will not result in any significant additional employment of U.S. sailors, or in the construction of additional U.S. ships for use in transporting oil from Alaska to the West Coast. The capacity of the Alaska Pipeline is largely fixed by the diameter of the pipe now being laid. Tax subsidies will not increase the size of that pipe, and without such an increase the number of ships and sailors needed to lift Alaskan oil from Valdez will necessarily remain relatively fixed. Similarly, the likelihood that tax subsidies will increase the amount of iron ore, coal, and limestone shipped in the Great Lakes is slight. The volume of such shipments is fixed by industrial requirements and by the general level of the economy, and so the investment credit proposal is not going to have any significant effect on the numbers of U.S. ships and sailors employed in moving iron ore from Duluth to ports such as Cleveland and Chicago.

The cabotage laws and the existing tax benefits for merchant shippers, taken together, are already a rich brew. If this Committee now decides to add the investment credit to the list of available tax benefits, the overall effect will be intoxicating indeed, especially for those who are well positioned to engage in tax shelter operations. Unfortunately, ordinary taxpayers will have to pay the bill.

What in the world are we trying to accomplish?

As with any proposal to grant new tax benefits, responsible legislators should ask what we are seeking to achieve through enactment of the proposed subsidy. Unfortunately, our goals in the case of tax subsidies for the merchant marine are almost totally muddled. At most, we hear vague talk about the need for jobs in the merchant marine, about national defense, and about our balance of payments.

These considerations are totally inapplicable in the principal situations in which the proposed investment credit legislation would apply. As outlined above, the cabotage laws already reserve our coasting trade, our noncontiguous trade, and most of the Great Lakes trade for U.S. built vessels manned by U.S. citizens. Nothing that you can do through the tax system will significantly increase employment or ship construction for those trades.

As for national defense, I think it is sufficient to point out that this question was thoroughly debated during the discussion of the merits of a trans-Canada pipeline, as opposed to a trans-Alaska pipeline. The possibility that tankers plying the West Coast might be attacked in wartime was not thought important enough to warrant selection of the trans-Canada route. As for the Great Lakes trade, I think it is sufficient to point out that those lakes have been demilitarized for more than a century, and that war with Canada does not seem imminent.

Finally, balance of payments considerations obviously have no applicability when we are dealing with a situation in which the earnings are exclusively domestic—as is the case with our coasting, noncontiguous, and Great Lakes trades, which involve the great bulk of the earnings and taxes here at stake.

Even when we turn to the world scene, and consider the relatively few U.S. vessels that engage in foreign trade, our goals are muddled. The Department of Defense has repeatedly pointed out that it expects to have little use for these vessels in the event of a major war—when large troop transport aircraft and vessels capable of unloading over the beach will probably be needed—or even in a limited war such as Vietnam. And the best that can be said for the shippers' balance of payments argument is that the leading expert in this field concludes "that balance of payments considerations do not argue forcefully for public assistance to the merchant marine." [8]

One is therefore forced to conclude, first, that rational support for granting the investment credit to U.S. shippers engaged in foreign trade (who are also the recipients of massive direct operating subsidies) is tenuous at best, and, second, that there is *no* rational support at all for the proposal to grant the investment credit to vessels engaged in the domestic commerce protected by the cabotage laws.

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[8] Jantscher, *Op. Cit.*, p. 109.

The data blackout and the effects of the proposed subsidy

Responsible consideration of the investment tax credit proposal also requires us to ask whether the credit will be an efficient means of producing added jobs, more ships, or some other desired goal. The muddle surrounding our goals in granting maritime subsidies obviously makes consideration of this question difficult.

But an even more serious problem relates to the data blackout imposed by the Maritime Administration on information needed to evaluate the efficiency of existing or proposed tax subsidies. To illustrate what I am talking about, I would like to insert in the record at the conclusion of my testimony an article and chart appearing in this week's *Tax Notes* magazine. That article chronicles the efforts made by *Tax Notes* to obtain tax data with respect to 12 U.S. shipping firms—data of the sort that is filed with the Securities and Exchange Commission as a matter of routine by substantially all other major U.S. firms. As you will see, the article concludes that the Maritime Administration, the Commerce Department, and the Interstate Commerce Commission "care little if at all about the public's right to information about firms supported with the public's money."

Under these circumstances, it is obviously impossible to evaluate whether the proposed investment credit for merchant shippers is an efficient way of achieving some unspecified goal, or a boondoggle designed to help oil firms and bankers to shelter their profits from tax. I strongly recommend that this Committee refuse to consider further tax benefits for shippers unless and until the Maritime Administration establishes a system of public access to tax data with respect to shippers and holders of tax-deferred construction funds that is at least as comprehensive as that established by the Securities and Exchange Commission with respect to tax data filed by most other major firms.

Under present circumstances, the most that can be said about the effects of our maritime tax subsidies is that "No empirical studies have been made that disclose what the effect [of tax subsidies on maritime investment] has actually been . . ."[6] In short, we have no idea what we have or have not accomplished through these subsidies. The goals of these tax subsidy programs are unclear, and their effects are unknown. That, in my view, is a very strong argument for ending them.

A response to claims of supporters of the credit

In addition to policy claims relating to jobs, national defense and our balance of payments, supporters of the investment credit proposal have also advanced three other arguments, to which some response should be made.

The first of these is the claim that extension of the investment credit to ships financed through capital construction funds would stimulate the construction of ships in U.S. yards. But, as pointed out above, the principal beneficiaries of the investment credit proposal are already required by the cabotage laws to construct their vessels in U.S. yards and to man them with U.S. citizens. The proposal will do virtually nothing to stimulate increased construction in their case. And in the case of U.S. ships on foreign routes, the number of ships built is almost totally dependent on the level of direct construction and operating subsidies that Congress authorizes, since such ships typically cost twice as much to build in the U.S. as in foreign yards, and twice as much to operate as their foreign competitors. Under these circumstances, it is the massive existing program of direct federal subsidies that will determine the level of ship construction, not a marginal tax subsidy.

Second, the shippers contend that Congress did not have an opportunity to consider investment credit questions when it enacted the Merchant Marine Act amendments of 1970, because the credit had been temporarily repealed the prior year, and that the failure to allow the credit to shippers was therefore mere inadvertence. But I specifically pointed out the investment credit matter to both the House Merchant Marine and Fisheries Committee and the Senate Subcommittee on Merchant Marine during my 1970 testimony before both those committees regarding the tax aspects of the Merchant Marine Act amendments, as is indicated by my written statement at that time, a copy of which I would like to submit for publication in the record following this testimony.

Finally, it is claimed that foreign governments give tax concessions to their shippers, and that we should do the same. This Gresham's law of taxation

[6] Jantscher, *Op. Cit.*, p. 67.

obviously has no applicability to the principal beneficiaries of the investment credit proposal, who are protected from foreign competition by our cabotage laws. And in the case of U.S. flag shippers who do engage in foreign trade, this argument overlooks the hundreds of millions of dollars of direct subsidies that they receive each year, to make up the difference between their operating costs and those of foreign ships. In any event, this argument really proves too much, since the major flag of convenience countries do not impose a corporate income tax. Hence, if this argument were to be accepted, the logical consequence would be complete abolition of the U.S. corporate income tax, at least as it applies to shipping firms. Deferral comes close to abolition already, but I see no reason for outright forgiveness, just because that is what the Panamanians or Hondurans do.

Tax law objections to the investment credit proposal

What I have said up to this point relates to policy matters. I would now like to mention the legal objections, inherent in the tax law, to the proposal to grant the invesment credit to ships built with tax deferred money.

First, this proposal would violate the basic tax principle that a receipt is not to be recognized for tax purposes until it has first been taken into income.[7] That is why tax exempt organizations may not claim the investment credit; since they pay no tax, they do not get the benefits accorded to those who do. Capital construction funds are tax exempt for as long as they choose to be. For that reason alone, they should be denied the investment tax credit.

Second, this proposal would break the highly important link between the tax "basis" for an asset computed for depreciation purposes and the investment credit that can be claimed with respect to that asset. Once this tie is broken, major revenue losses must be expected, since there will then be no principle by which to resist demands from pipeline firms, railroads, barge operators, and others who compete with coastal shippers, and who will similarly want to claim tax credits with respect to costs that are not part of an asset's tax basis. This is why Congress has always resisted demands to "unhitch" the investment credit from the tax basis for an asset, because that step would make all sorts of non-depreciable property potentially eligible for the tax credit, and there would be no principle on which to resist those demands.

Furthermore, breaking the link between the investment credit and basis for depreciation purposes will make the audit problems of the Internal Revenue Service even more formidable than at present. For the first time, an asset will have two different tax bases: one for depreciation purposes and the other for investment credit purposes. That will make an already difficult audit job even harder.

Encouraging tax shelter operations

As outlined above, existing law is already encouraging banks and other tax shelter operators to move into the maritime area. The prospect of realizing tax free income, on the one hand, while harvesting depreciation deductions and an investment credit to shelter income earned elsewhere is always enticing, as this Committee well knows. If the investment credit proposal becomes law, some firms will use the credit to shelter non-shipping income, such as the profits from oil refining and marketing, and some will shelter shipping income that they decide not to plow back into new vessels. Due to this second factor, allowance of the proposed investment credit to shippers may actually result in less, not more, investment in vessels, because a given amount of shipping investment will result in a larger tax shelter than is now the case under existing law. Thus a smaller investment will be needed to eliminate any given amount of income tax.

As I mentioned earlier, banks seem likely to enter these tax shelter operations in a more and more substantial way, through use of the "black box technique of financing". In substance, this involves placement of a fixed amount of capital in a construction fund, use of that capitial to build a ship which is then chartered (i.e. leased) to an operator, use of the investment credit and accelerated depreciation deductions on the leased vessel to shelter other bank income, and deferral of tax on vessel earnings through use of the capital construction fund mechanism. At the conclusion of the vessel's useful life, or before, the bank withdraws its capital contribution to the construction fund, which it can do tax free, since returns of capital are not taxable. It then uses the tax free earnings in the construction fund to build its next ship, and the earnings of that new ship can also be tax deferred. Since ships frequently last as long as 20 years, the net

[7] See, for example, Section 362 of the Internal Revenue Code.

result is such long term deferral of tax that there is little practical difference between this system of tax deferral and outright tax exemption.[8]

The proposed "compromise"

Supporters of the investment credit proposal, perhaps sensing the weakness of their case for additional tax subsidies, have recently begun to advance a proposed "compromise", under which the investment credit could be claimed with respect to that portion of a tax-deferred construction fund withdrawal that would have remained in the shipper's hands if he had chosen to pay tax on that sum. I oppose this compromise as strongly as I do the basic investment credit proposal, for several reasons.

First, this so-called compromise violates basic tax law principles just as clearly as does the broader investment credit proposal. Second, and even more important, this compromise is just as open to manipulation by tax shelter operators as is the basic proposal. The magnitude of their manipulations will perhaps be smaller if the so-called "compromise" is adopted, but the basic problem of tax avoidance will be the same. Finally, the policy arguments for permitting the investment credit under the compromise proposal are just as baseless as in the case of the broader proposal.

In short, both the proposed "compromise" and the basic investment credit proposal are bad, and for the same reasons. Surely this Committee has recently learned how hard it is to restrict tax shelters, once they are opened. That is why I urge you not to permit a compromise that is so loaded with possibilities for tax avoidance.

Conclusion

The investment credit proposal now under consideration by this Committee will confer its principal benefits on oil producers, banks, and steel firms, which are already paying federal tax at low effective rates. The proposal is not structured to encourage ship construction or the creation of additional jobs. Instead, the goals of the proposed subsidy are undefined, and its effects are unkown. It is clear, however, that the proposal will substantially encourage the formation of tax shelters based on the capital construction fund mechanism. In addition, the proposal violates basic principles of tax law, and is likely to lead to large and increasing revenue losses.

If the U.S. merchant marine actually needs more government help, the way to provide it is through direct appropriations, which can be reviewed annually by the Executive Branch and Congress to insure that the direct subsidy's benefits are commensurate with its costs. In contrast, tax subsidies go on and on, without effective review, long after any need for them has disappeared. Moreover, the use of tax subsidies will necessarily confer special benefits on selected individuals and firms, thus decreasing both tax equity and public confidence in the fairness of the tax system. This is why the tax system should be used primarily to raise revenue; we should rely on direct appropriations when public subsidies seem justified.

For all these reasons, I regard the pending investment credit proposal as thoroughly bad legislation, and I urge this Committee to reject it.

Appendix: "Use of Capital Construction Funds for Tax Avoidance Purposes"

Submissions for the record:

1. Maritime Administration's "List of Companies with a Capital Construction Fund"
2. "Shipper's Tax Burden: A Sea of Doubt", *Tax Notes*, December 15, 1975 (with appended chart)
3. "Why Tax Deferred Reserve Funds Are the Wrong Solution to the Problems Facing the United States Merchant Marine" by Thomas F. Field (testimony regarding S. 3287, 91st Congress)

APPENDIX A

USE OF CAPITAL CONSTRUCTION FUNDS FOR TAX AVOIDANCE PURPOSES

Analysis of the capital construction fund mechanism, as presently constituted, indicates substantial opportunities for tax avoidance. These opportunities are

[8] For further information on tax shelter operations under the Merchant Marine Act of 1970 see W. E. Seago, "Investing in Ships: Amendments to Merchant Marine Act Open up New Tax Shelter", 37 Journal of Taxation 306 (November 1972) and Gordon T. Stine, "Ship and Equipment Leasing as a Tax Shelter", 31 N.Y.U. Inst. Fed. Tax. 755, at 770–775.

summarized in Tables 1–4. As they indicate, use of the construction fund mechanism in connection with a single $50 million tanker can result in undiscounted revenue losses over the life of the ship that come to more than $78 million.

Because these tax avoidance techniques are so attractive, it is likely that they will be used by substantially all the banks, oil companies, and other firms that are now preparing to build tankers for use in the Alaska oil trade. Most of these firms have both liquid corporate assets that are now yielding taxable income and a need to build ships to move oil from Valdez, Alaska, where the Alaska pipeline ends, to the West Coast of the United States. The capital construction fund mechanism enables them to shelter from tax the income on substantial amounts of corporate assets, and thus permits them to build their tanker fleets with essentially tax exempt income.

Similar tax avoidance techniques are also available in the case of ore carriers engaged in the Great Lakes trade. As in the Alaska trade, ships operating between U.S. ports on the Great Lakes must be built in U.S. yards and manned by U.S. sailors. Accordingly, these ships are also eligible to make use of tax-deferred capital construction funds.

The three principal tax avoidance techniques available to shippers are detailed in Tables 2 through 4. Table 2 shows how the excess depreciation charges generated in the early years of a vessel's life can be used to reduce nonshipping income.

Table 3 shows how the technique of depositing income producing assets in a capital construction fund can be used to shield from tax the income produced by those assets. Table 3 involves deposits in a capital construction fund of assets equal to the depreciation charges on a vessel. The earnings on those assets are then redeposited tax free in the fund for use in building future ships, and the assets themselves are eventually withdrawn, tax free, to discharge the ship mortgage on the vessel in question.

Finally, Table 4 shows the revenue losses that result when shipping income that would otherwise be subject to tax is deposited in a capital construction fund.

Conservative assumptions used

Tables 1 through 4 have been constructed on the basis of conservative assumptions about vessel earnings, depreciation charges, asset earnings, and interest rates. Less conservative assumptions would have produced substantially larger revenue losses. Hence, the $78.7 million loss shown in Table 1 must be regarded as a minimum figure.

Tables 1 through 4 are particularly designed to sketch the situation of a typical oil firm or bank holding subsidiary which has income producing assets and which wishes to build a tanker to serve the Alaska oil trade. The assets in question are assumed to be yielding a return of 10 percent before tax (i.e. about the current rate for corporate bonds). If higher yield assets are deposited, the revenue loss would be correspondingly larger.

Tables 1–4 also assume that the tanker in question will cost $50 million, substantially all of which is to be borrowed at 10 percent interest, giving a ship mortgage in return. In addition, they assume that the ship's annual net earnings before depreciation and interest charges will be $7.5 million (i.e. a 15 percent rate of return on investment), that depreciation will be calculated by the double declining balance method, (leaving an unrecovered basis of $6.5 million at the end of 20 years), and that the corporate tax rate is 50 percent.

Finally, the tables assume that the investor is determined by the Maritime Administration to be otherwise qualified to open a capital construction fund.

Basic construction fund rules

Two basic Merchant Marine Act rules are crucial to the operation of the proposed tax avoidance mechanism. The first rule limits the amount of the deposits that a shipper can make in a tax-deferred capital construction fund. These deposits are limited to: (a) taxable vessel earnings, if any, (b) depreciation on the agreement vessel, (c) net proceeds, if any, from the sale of the vessel, and (d) earnings on the reserve fund itself. The second rule relates to the order or priority in which withdrawals may be made from the reserve fund, and provides that withdrawals must come first from "capital account"—e.g. from deposits of capital assets equivalent to the depreciation charges on an agreement vessel.

These two rules, taken together, mean that substantial amounts of income producing assets can be put into a capital construction fund, that the subsequent earnings on those assets can be allowed to accumulate tax free, and that the original capital investment can later be withdrawn tax free, to pay off the ship mortgage relating to an agreement vessel. The earnings produced by those assets will then remain untaxed in the fund to build additional ships.

The operation of these basic rules is illustrated in Table 3. Column 2 of that Table shows the deposit in a construction fund of income producing assets equivalent to the depreciation charges on an agreement vessel, and column 3 shows the deposit in that fund of the earnings on those assets and on previously deposited earnings. In obedience to the ordering or priority rule, column 4 of Table 3 shows the withdrawal of capital from the construction fund, tax free, to discharge the ship mortgage used to finance the tanker in question. Finally, column 6 of that Table shows the revenue losses as earnings build up, tax free, in the capital construction fund.

Table 4 illustrates in column 3 the way in which net shipping earnings can be deposited, tax free, in a construction reserve fund. Column 4 of that Table illustrates the resulting revenue losses.

Effect of relationship of borrower and lender

One important aspect of Table 3 is contrary to usual business practice relating to ship mortgages. In the typical case in which lender and shipowner are unrelated, the lender will demand prompt repayment of principal. But Table 1 assumes that the lender is another division of the same oil firm, or the bank owned by the holding company whose subsidiary is building the tanker, and that rapid repayment of principal is less important in a case in which the "lender" and "borrower" are really the left and right hands of the same corporate entity. Under these circumstances, tax minimization and tax avoidance motives argue for *postponement* of repayment of the principal of a ship mortgage for as long as possible, so that income producing assets can remain, tax free, in a capital construction fund as long as possible. Deferral of repayment of debt is an important key to making fullest possible use of the tax deferral opportunities provided by construction funds. In Table 3, payment of the ship mortgage in question is postponed until the last five years of the useful life of the vessel. Theoretically, of course, payment could be postponed until the very last year of a vessel's life, and under those circumstances the tax losses shown in Table 1 would be even greater.

Summary of tax avoidance possibilities

In brief summary, the tax avoidance possibilities shown in the attached tables involve:

a. *Excess Depreciation.* Interest charges combined with excess depreciation generated in the early years of a vessel's useful life by use of accelerated depreciation methods can produce artificial losses which, in turn, can be used to offset nonshipping income from refining, marketing, banking, or other activities. Table 2 shows how this process works in the case of a typical tanker costing $50 million. The revenue loss as shown in Table 2 comes to $4.3 million, all of it in the first seven years of the vessel's life.

b. *Tax Deferral on Asset Earnings.* As shown in Table 3, income producing assets can be deposited in tax deferred reserve funds in amounts equivalent to the depreciation charges on the vessel in question. Column 2 of Table 3 shows these annual deposits. Thereafter, the earnings on these assets and previously deposited earnings can be redeposited, tax free, as shown in Column 3 of that Table. Later, the original capital contributions can be withdrawn, without tax, to pay off the ship mortgage, as shown in Column 4. The remaining earnings shown in Column 5 are then available to build new ships. Note that these tax deferred earnings are more than twice as large as the $50 million originally invested. The revenue losses resulting from long-term deferral of tax on these funds are shown in Column 6. Those losses total $54.3 million.

c. *Tax Deferral on Ship Earnings.* Table 4 shows the revenue losses resulting from deferral of tax on net vessel earnings after payment of interest and depreciation charges. As shown in Column 2, net earnings are negative in the first seven years of the life of the vessel in question, thus producing the tax shelters possibilities detailed earlier in Table 2. But starting in the eighth year, earnings appear that would normally be subject to income tax. If these earnings are placed in a capital construction fund as shown in Column 3 of Table 4, tax will be deferred indefinitely, thus producing the revenue losses shown in Column 4 of Table 4.

d. *Investment Credit.* If the investment credit were to be granted to ships built with tax deferred reserve funds, an additional $5 million would have to be added to the other revenue losses shown in Table 1, thus raising the total revenue loss to $78.7 million.

TABLE 1.—*Summary of revenue losses on a tanker costing $50 million, where a capital construction fund mechanism is utilized to defer tax payments*

	Millions
1. Decrease in federal revenue caused by application of artificial losses to reduce nonshipping income [1]	$4.30
2. Decrease in federal revenue caused by deferral of tax on earnings of income producing assets which are deposited in a capital construction fund in an amount equal to depreciation charges on an agreement vessel [2]	54.35
3. Decrease in federal revenue caused by deferral of tax on net shipping earnings, after interest and depreciation, through deposit in a capital construction fund [3]	15.05
4. Decrease in federal revenue attributable to proposed investment credit	5.00
Total revenue losses	78.70

[1] See table 2 for details.
[2] See table 3 for details.
[3] See table 4 for details.

TABLE 2.—COMPUTATION OF REVENUE LOSS RESULTING FROM ATTRIBUTION TO NONSHIPPING INCOME OF ARTIFICIAL LOSSES CREATED BY ACCELERATED DEPRECIATION

Year	Gross vessel earnings	Interest on construction loan	Depreciation charges	Artificial loss	Tax loss attributable to use of artificial loss to reduce nonshipping income
(1)	(2)	(3)	(4)	(5)	(6)
1	7.5	5	5.0	2.5	1.25
2	7.5	5	4.5	2.0	1.00
3	7.5	5	4.1	1.6	.80
4	7.5	5	3.6	1.1	.55
5	7.5	5	3.3	.8	.40
6	7.5	5	2.9	.4	.20
7	7.5	5	2.7	.2	.10
8	7.5	5	2.3		
9	7.5	5	2.2		
10	7.5	5	1.9		
11	7.5	5	1.7		
12	7.5	5	1.5		
13	7.5	5	1.4		
14	7.5	5	1.3		
15	7.5	5	1.1		
16	7.5	4	1.0		
17	7.5	3	.9		
18	7.5	2	.8		
19	7.5	1	.7		
20	7.5		.6		
Total	150.0	85	43.5	8.6	4.30

TABLE 3.—COMPUTATION OF REVENUE LOSS CAUSED BY DEPOSIT IN CAPITAL CONSTRUCTION FUND OF (A) INCOME PRODUCING ASSETS EQUIVALENT TO DEPRECIATION CHARGES ON AGREEMENT VESSEL, AND (B) THE EARNINGS PRODUCED BY SUCH ASSETS

Year	CCF deposits of income producing assets equal to depreciation charges on agreement vessel	Redeposit of prior year earning on total previous deposit assets and earnings, as shown in col. 5	Nontaxable payments out of capital accounts to discharge ship mortgage	Total previous deposit assets and redeposit earnings thereon, i.e. earnings 2 + 3, less 4	Tax loss attributable to deferral of tax on redeposit prior year earnings
(1)	(2)	(3)	(4)	(5)	(6)
1	5.0			5.0	
2	4.5	0.5		10.0	0.25
3	4.1	1.0		15.1	.50
4	3.6	1.5		20.2	.75
5	3.3	2.0		25.5	1.00
6	2.9	2.5		30.9	1.25
7	2.7	3.0		36.6	1.50
8	2.3	3.6		42.5	1.80
9	2.2	4.2		48.9	2.10
10	1.9	4.9		55.7	2.45
11	1.7	5.6		63.0	2.80
12	1.5	6.3		70.8	3.15
13	1.4	7.1		79.3	3.55
14	1.3	7.9		88.5	3.95
15	1.1	8.8		98.4	4.40
16	1.0	9.8	(10.0)	99.2	4.90
17	.9	9.9	(10.0)	100.6	4.95
18	.8	10.0	(10.0)	100.8	5.00
19	.7	10.0	(10.0)	101.5	5.00
20	.6	10.1	(3.5)	112.2	5.05
Total	43.5	108.7	(43.5)	112.2	54.35

TABLE 4.—COMPUTATION OF REVENUE LOSS CAUSED BY DEPOSIT IN CAPITAL CONSTRUCTION FUND OF NET VESSEL EARNINGS AFTER INTEREST AND DEPRECIATION

Year	Net vessel earnings after interest and depreciation	Deposited net vessel earnings after interest and depreciation	Tax loss attributable to deferral of tax on deposited net earnings
(1)	(2)	(3)	(4)
1	(2.5)		
2	(2.0)		
3	(1.6)		
4	(1.1)		
5	(.8)		
6	(.4)		
7	(.2)		
8	.2	0.2	0.10
9	.3	.3	.15
10	.6	.6	.30
11	.8	.8	.20
12	1.0	1.0	.50
13	1.1	1.1	.55
14	1.2	1.2	.60
15	1.4	1.4	.70
16	2.5	2.5	1.25
17	3.6	3.6	1.80
18	4.7	4.7	2.35
19	5.8	5.8	2.90
20	6.9	6.9	3.45
Total	21.5	30.1	15.05

STATEMENT OF THOMAS J. REESE, LEGISLATIVE DIRECTOR, BEFORE THE WAYS AND MEANS COMMITTEE, REGARDING EXCHANGE FUNDS, H.R. 11920, MARCH 29, 1976

Mr. Chairman and members of the committee, my name is Thomas J. Reese, and I am legislative director of Taxation With Representation, a public interest taxpayers' lobby.

I wish to strongly support H.R. 11920, a bill to terminate the use of exchange funds as a means of escaping income taxes on realized capital gains. I wish to commend the chairman and the other cosponsors of the bill for their vigilance in quickly closing this loophole before it got out of control.

Exchange funds are not a new idea. They first came into existence in 1961 to provide a means whereby very wealthy investors could "swap" shares they held in individual companies for shares of an exchange fund without incurring a capital gains tax. Some investors have stocks which have greatly appreciated in value. If these stocks were sold, they would have to pay a capital gains tax. In order to avoid the capital gains tax, the investor could swap his stock for shares in an exchange fund which would have diversified holdings. For example, an individual who bought stock for $10,000 might now find that it is worth $110,000. If he sold this stock, he might have to pay a capital gains tax of over $25,000, depending on his tax bracket. An exchange fund would permit him to trade his stock for shares in a mutual fund and avoid paying the tax. He would thus have more money to invest in the fund than if he had sold his stock first.

In 1966, Congress quite properly closed this loophole by making such transactions a taxable event. Congress, however, closed this loophole only for corporate exchange funds, and not for partnerships. In 1966, no one thought it would be possible to set up an exchange fund as a partnership. We are currently faced with this problem again, thanks to the ingenuity of Vance, Sanders & Company, Inc., and changes in the California partnership laws. H.R. 11920 will close the exchange fund loophole for partnerships. The bill will also apply the same restrictions to certain reorganizations, such as where mutual funds issue their shares to acquire all of the stock or assets of family-held personal holding companies. We support these provisions.

No grandfathering.—Taxation With Representation opposes watering down this legislation by grandfathering in the Vance, Sanders Exchange Fund and any other funds. Grandfathering is not necessary. No investors will be subject to a retroactive tax as a result of this legislation. Although investors have deposited their stocks, no transfers have taken place. The investors can withdraw their stocks from deposit without any liability and without paying any tax. They will be no worse off after the withdrawl than they were before the deposit. In fact most of them will be better off since the stock market went up after they made their deposits. As a result, grandfathering is not necessary to protect the investors.

What about the costs of setting up the exchange fund? It has been argued that over $500,000 has been spent by Vance, Sanders, the broker-dealers, and the depositors in setting up their exchange fund. If the committee is sympathetic to their problem, I suggest it grant them and other funds assistance through a private relief bill. To grandfather in these funds would cost the Treasury many times the costs incurred by these people. Granfathering is, therefore, a highly inefficient form of relief, even if you think relief might be justified.

I would argue, however, that no relief is necessary. Many people make bad judgments every day about how to spend their money in order to make more money. When bad judgments are made money is lost. Such losses are deductible under the income tax laws. Vance, Sanders and others made a bad decision in thinking that Congress would let them get away with a new type of exchange fund. If Congress bailed out everyone who made a bad business decision, there would be no money left in the Treasury.

It has been further argued that these decisions were made in good faith. I do not contest that. But if I in good faith leave my house in the morning without an umbrella because the sky is blue and the weatherman says it is going to be clear, that does not mean that nature is bound not to rain on me on my way home in the evening. In good faith I made a mistake, in good faith I get wet.

Little Vance Sanders.—Perhaps I can make my point with a short story. Once upon a time there was a little boy named Vance Sanders. His mother used to bake cookies which she put in a jar on a high shelf where Vance could not reach it. One day Vance climbed up on a chair and ate all the cookies in the jar. His mother was very upset and told him never again to climb up on a chair to take cookies out of the jar.

Vance was very sad about this state of affairs because he loved cookies. He sat on the floor of the kitchen looking up at the cookie jar, day after day, trying to figure out how to get the cookies. Finally, he gave up and went next door and explained his problem to his friend, Johnny Tax Lawyer. Johnny told him that he would show him how to get the cookies if Vance would pay him with some candy. After Vance gave him the candy, Johnny explained that there was a difference between a chair and a ladder. Vance's mother had said that he could not use a chair to get at the cookies, but she had not said anything about a ladder. Vance knew, however, that his father, California, did not allow him to bring the ladder into the house. So he first went to his father and got permission to bring the ladder into the kitchen. Vance was a very careful boy, he also went to see his old soft hearted Uncle Sam to ask him if going after cookies with a ladder was different from going after cookies with a chair. Uncle Sam, who Vance's mother frequently accused of spoiling the child, said yes. Uncle Sam said his mother's instructions only applied to climbing up on chairs, and did not apply to climbing up on ladders.

So Vance got the ladder out of the garage and with much effort he hauled it into the kitchen. He climbed up on the ladder, put his hand in the cookie jar, grabbed a cookie, and guess who should walk in but mother. "Vance," she says, "You put that cookie back in the jar." And Vance replies, "But mother, you are changing the rules on me. You said I could not climb up on a *chair* to take cookies out of the jar. You did not say anything about using a ladder. Uncle Sam said it was alright. And besides, I already paid Johnny for telling me how to do it, and I spent so much time and energy bringing this ladder into the kitchen, so you should at least let me have the cookies this time. After all, I acted in good faith."

Now, how do you think the mother answered her son? Did she say, "O Vance, you are such an ingenious little devil. Since you learned the difference between a chair and a ladder, I guess I will let you have the cookies this time, but don't ever climb up on a chair *or* a ladder to get cookies." I think that if the mother said that, she would be considered rather permissive. In addition she would be unfair to her other children who stayed away from the cookie jar. She would also set a bad precedent. Vance and the other children would realize that if they could find a way around their mother's latest instructions they would be able to get the cookies. Johnny Tax Lawyer might, for example, suggest that next time they stand on a table to get at the cookie jar. And unless the mother takes a firm stand, this could go on forever.

The parable explained.—The exchange fund legislation puts the Ways and Means Committee in a position similar to the mother in my story. The hand is in the cookie jar, but the Treasury has not yet lost any money. If the Committee wishes to reward people who go out of their way to find loopholes in the tax code, then there should be a grandfather clause. If the Committee wishes to encourage people in the future to look for new loopholes, then there should be a grandfather clause. If the Committee wishes to reward those people who create extra work for this Committee, its staff, and the Congress, then there should be a grandfather clause. This Committee worked very hard last fall to close loopholes, and I do not think you want to reward the very people who create more work for you.

Advance public consultation.—Finally, this Committee like the mother in my story, needs to have a long talk with soft hearted Uncle Sam, who personifies the Treasury and the IRS in my saga about little Vance Sanders. Those who argue for grandfathering existing funds say that taxpayers would lose confidence in the IRS ruling process if Congress reverses a ruling issued to a particular firm. On the contrary, the confidence of the American taxpayer in the ruling process has already been compromised, as much as it can be, by the issuance of the Vance Sanders ruling. Corrective legislation will certainly not weaken public confidence further.

To overturn this IRS ruling will not destroy confidence in the rule making process; rather it will restore it. Since when is Congress bound by decisions of the executive which are made in secret without consultation with Congress or the public?

The ruling in this case is further evidence that secret rulings, issued without advance public consultation, can often set dangerous precedents. For who can argue that this ruling would have been issued in its present form if there had been an advance hearing on it? The same members of this Committee who have cosponsored this legislation could have objected in advance, if public comment on this ruling had been permitted, perhaps making legislation necessary—or at least giving adequate time for Congress to prepare corrective legislation if that were needed.

Conclusion.—Mr. Chairman, I hope that the Committee votes out this legislation in the same form in which you have proposed it. If this legislation is enacted as it stands, it will send a message to all the little boys, and big boys, in this country that they should not spend all of their time trying to figure out how to raid the federal cookie jar. And if they nevertheless are successful in finding a way to get at the cookies, this bill lets them know that this Committee will act with dispatch to make sure their cookie crumbles before it can be eaten.

Thank you, Mr. Chairman.

TAXATION WITH REPRESENTATION
AND THE TAX ACTION CAMPAIGN,
Washington, D.C., June 9, 1976.

Re keep the U.S. withholding tax on foreign investors

DEAR SENATOR: Existing U.S. law requires nonresident aliens and foreign corporations to pay a withholding tax of 30% on the dividends and interest they earn in the United States. In most cases, this is the only tax that foreigners pay on their U.S. earnings, since their home countries either levy no income tax on dividends and interest (in the case of most OPEC countries) or al'ow credits for the U.S. taxes already paid.

The Senate Finance Committee, as part of the tax "reform" bill, has voted to permanently exempt nonresident aliens and foreign corporations from the U.S. tax on bank interest payments, at a cost of $110 million annually, and to eliminate the U.S. tax on all other forms of interest payments, at a cost of $20 million more. The ostensible purpose is to attract foreign investment.

But foreign investment is already flooding into the United States. S[illegible] the recent press clippings on the other side of this sheet. Investment opportun'ties are good here, and foreigners know that this is one of the few countries in the world where their investments are safe from expropriation. If the Senate Finance Committee has its way, foreign investors will enjoy the blessings of t[illegible] American system without helping to pay for those benefits.

This may make foreign investors happy, but ordinary American ta[illegible]ayers will have to shoulder an additional $130 million tax burden each year, to make up for the taxes that Arab sheiks and others will escape under the Se[illegible]e Finance Committee proposal. That proposal amounts to a foreign aid progra[illegible] which will turn the U.S. into a haven for foreign tax avoiders. We see no reas[illegible] why ordinary Americans should shoulder a heavier tax burden for that pur[illegible].

Enclosed you will find a statement by Professor Peggy B. Musgrave which outlines why the existing 30% withholding tax should be retained. Professor Musgrave teaches economics at Northeastern University in Bosto[illegible], and is a leading authority on international tax matters.

I hope that you will find the enclosed statement to be interesting reading and that you will vote to retain the withholding tax on foreign investors.

Best regards,

THOMAS J. REESE,
Legislative Director.

[From the Wall Street Journal]

TREASURY FINDS FOREIGN HOLDINGS IN 1975 OF U.S. STOCKS AND BONDS INCREASED 28 PERCENT

(By a Wall Street Journal Staff Reporter)

WASHINGTON.—Foreign portfolio holdings of U.S. stocks an[illegible] totaled $86 billion at the end of last year, 28% higher than a year earlier a Treasury study said.

The rising stock market's inflating effect on the value of fore[illegible]n holdings caused a big part of the increase, but foreigners also had net purch[illegible]es of U.S. stocks amounting to $4.4 billion in 1975, the study concludes.

Gerald L. Parsky, assistant treasury secretary for internat[illegible] [illegible]airs, disclosed the new data in testimony before a Senate Commerce subcommittee. Mr. Parsky reiterated the Treasury's stance that the U.S. has little to fear and indeed much to gain from increased foreign portfolio investment here.

Portfolio investment includes holdings of stocks, corporate bonds, Treasury bonds and notes and certain other debt securities; it excludes such short-term investments as those in Treasury bills. However, purchases of stock by one who owns more than 10% of a company are considered "direct" rather than "portfolio" investments.

METHOD OF COMPUTATION

Congress ordered the Treasury's report in 1974. Although reports on foreign investment flows had been compiled regularly prior to then, there hadn't been a count of overall investment holdings since 1941. Estimates of holdings in the interim were computed using the data on investment flows and the 1941 figures on holdings.

The new study, Mr. Parsky disclosed yesterday, is based on questionnaires returned by 10,000 U.S. companies and gives holdings as of Dec. 31, 1974. The 1975 figure is computed from the 1974 data on holdings and the estimated 1975 investment flows.

According to the study, foreign portfolio holdings at the end of 1974 totaled $67.1 billion. The estimate from the 1941 data had put them at $56.6 billion. The $67.1 billion, however, was well below the $80 billion to $85 billion the Treasury estimated last October in a report to Congress based on a preliminary reading of the fresh numbers. At a news conference after his appearance before the committee, Mr. Parsky avoided explaining the discrepancy, but a Treasury official said later that "computer programing problems" were responsible.

Of the $67.1 billion, $24.7 billion was in stocks, Mr. Parsky said. A year later, foreigners held $37.2 billion of stocks in U.S. companies, with the increase reflecting $4.4 billion in net new purchases and an $8.1 billion jump in market value.

FIVE COUNTRIES DOMINATE

About 75% of the 1974 total of $24.7 billion was held in five countries—Switzerland, Great Britain, Canada, the Netherlands and France. Some of the Swiss holdings however, probably were in bank accounts for residents of other nations, the Treasury said. There were just 328 U.S. companies in which combined foreign holdings totaled more than 10% of the outstanding stock.

The Commerce Department, which was charged by Congress with conducting a companion study of foreign direct investment in the U.S., said its final report will be ready "in a few days." It will come in two volumes with seven volumes of appendices—2,500 pages in all, the department said.

Two Commerce Department officials appeared before the subcommittee to share a few tidbits from the report. They said that at the end of 1974 foreign direct investment here totaled $26.5 billion, and they estimated that by the end of 1975 the figure was $5.1 billion higher.

"Nearly 80% of the total investment position—$21 billion—consisted of foreign equity investment in incorporated U.S. affiliates," testified Milton Berger and George R. Kruer, the Commerce Department official. "Outstanding net loans to incorporated affiliates were $4.4 billion. The remaining $1.1 billion was investment in unincorporated affiliates."

[From the New York Times, May 3, 1976]

U.S. STOCK ABROAD TOTALS $37.2 BILLION

(By Edwin L. Dale, Jr.)

WASHINGTON, May 3.—Foreign holdings of United States stocks amounted to $37.2 billion at the end of last year, roughly 5 percent of the value of publicly traded stocks, a major new Treasury study disclosed today.

Of the total, $2.17 billion was owned by residents or governments of the Middle East oil exporting countries, held in diversified portfolios. New stocks purchases in the United States by these countries amounted to $1.44 billion last year, a big jump from the year before but only a small part of their total "investable surplus" from oil earnings of an estimated $42 billion in 1975.

The new survey of foreign stock ownership was the first since 1941. Based on some 10,000 reporting forms sent to United States corporations, brokerage firms, banks and others, it actually covered the year 1974, with the figures from 1975 estimated on the basis of regular reports on stock transactions and the rise in stock market prices.

The new survey put foreign stock ownership at the end of 1974 at $24.7 billion, well above the $18 billion figure estimated earlier. The increase to $37.2 billion at the end of 1975 reflected one-third new foreign stock purchases and two-thirds the rise in stock prices.

In addition to stocks, foreigners held Treasury securities, corporate bonds and other long-term private debt in their portfolios amounting to $48.8 billion at the end of last year. But the great bulk of this was in two categories—investment of monetary reserves held in dollars by foreign central banks and foreign holdings of "Eurobonds" issued by United States corporations under the now-defunct Government balance-of-payments programs of the 1960's and early 1970's.

The report says that apart from these categories, "foreign interest in United States corporate bonds has never been significant," though the Middle Eastern countries purchased about $1.4 billion of bonds last year in an effort to lengthen the maturity of their holdings.

INVESTMENT WELCOME

In presenting the results of the new survey to a Senate Commerce subcommittee, Gerald L. Parsky, Assistant Secretary of the Treasury, said, "The study has reinforced our view that foreign investment is beneficial to our economy and that we should continue to welcome it."

He added: "The more participation we have in our capital market, the more efficient it is in serving the needs of our economy for investment capital. The participation of foreign investors serves this purpose, just as that of American investors does, and distinctions made on the basis of the nationality of investors have no economic rationale."

As for the members of the Organization of Petroleum Exporting Countries, Mr. Parsky said that "they are cautious and conservative investors" and "they all are following diversified investment objectives similar to any institutional investor."

"They are almost entirely portfolio investors and none of them have a desire to acquire or control a major United States company," he said.

[From the Journal of Commerce]

Overseas Investment in U.S. Rises

FOREIGN PORTFOLIO HOLDINGS SOAR IN '75 TO OVER $100 BILLION

(Journal of Commerce staff)

Washington.—Foreign investment in the United States last year topped $100 billion for the first time, reports by the Treasury and Commerce Departments indicated Monday.

The two agencies told Congress that they favor changes in the law—particularly the removal of withholding taxes on dividend and interest payments to foreigners—that would further encourage foreign investors.

Testifying before a Senate commerce subcommittee, the two departments revealed that at the end of 1974 foreign portfolio investments in the U.S.—mainly securities holdings—totaled $67 billion, and foreign "direct" investment was $26.5 billion.

"Direct" investment refers to the ownership, indirect or direct, of 10 per cent or more of the voting securities of a corporation or an equivalent interest in an unincorporated business.

Treasury further disclosed that by the end of last year foreign portfolio holdings had soared to $86 billion, largely because of record foreign purchases of U.S. stocks and a sharp increase in stock values.

The Commerce Department did not provide a similar 1975 estimate for direct investment, but it was thought to be at least somewhat higher than the $26.5 billion of a year earlier.

Both the Commerce and Treasury investment reports followed comprehensive "benchmark" surveys of foreign investment in this country—the first since the 1940s. The new surveys were ordered by Congress in 1974, reflecting fears that foreigners "buy up" U.S. industry and real estate.

The two agencies, however, found that foreign investment is "beneficial" to the U.S. and that there is no reason for concern over Arab "takeovers" although

Treasury said, oil nation purchases of U.S. stocks rose markedly last year, to $1.5 billion.

Altogether, Treasury reported, members of the Organization of Petroleum Exporting Countries (OPEC) made $5.7 billion in U.S. portfolio investments last year, spread among government bonds and notes, corporate bonds and long-term certificates of deposits, besides stocks.

By the end of 1975, OPEC's portfolio of U.S. stocks and corporate bonds totaled $4.3 billion, against all such holdings by foreigners of $48.3 billion. West European nations still accounted for the great bulk of the foreign portfolio investment in U.S. companies— $33 billion, according to the Treasury.

OPEC Investments

"Direct" U.S. investments by OPEC nations, said the Commerce Department, totaled $1.8 billion at the end of 1974. The oil nations, particularly Venezuela, Iran, Kuwait and Suadi Arabia, are diretly invested in 83 U.S. affiliates, but the only large holding is by Saudi Arabia in the Arabian-American Oil Co. (Aramco), a Commerce official said.

Nearly two-thirds of all foreign direct investment apparently is in West European hands—particularly Britain, Netherlands, Switzerland and Germany—while Canada has 20 percent, Commerce disclosed. The $26.5 billion, it said, was distributed chiefly among manufacturing (31 percent), oil (24 percent), and finance, insurance and real estate (23 percent).

Foreign firms, Commerce said, own about 13 percent of total U.S. oil refinery capacity, but no more than 6 percent of the output of any broadly defined U.S. manufacturing industry. Foreign banks own about 7 percent of total U.S. commercial bank assets, while foreign-controlled insurance firms take in 5 percent of the premium income of all insurance companies in the U.S.

The Commerce Department indicated, however, that it was unable to get as clear a picture of foreign investment in U.S. farmland and other real estate. While it found that "for the nation as a whole" there is no "strong factual basis for concern," it urged that foreign real estate investments be probed further.

Foreign companies, through U.S. affiliates, employ over one million persons in this country and account for over one-fourth of U.S. foreign trade, Commerce revealed. Assets of the affiliate totaled $174 billion at year-end 1974.

The $26.5 billion in foreign investment Commerce reported was higher than what wouuld have been expected from past reports. That was partly due to Commerce for the first time including foreign ownership of less than 25 percent of a U.S. company as "direct" investment and a closer look at foreign subsidiary firms in the U.S.

Treasury's $67 billion portfolio investment total was about $12 billion lower than the estimate announced last October for year-end 1974, but still up sharply from figures of earlier years. The $67 billion included $25 billion in stocks, $16 billion in corporate bonds and other private debt and nearly $26 billion in U.S. Government bonds and notes.

By the end of 1975, the portfolio mix comprised $37 billion in stocks, $29 billion in treasury bonds and notes, $11 billion in corportae bonds, and $8.3 billion in other instruments, Treasury said.

About three-fourths of the stock holdings involved five countries—Switzerland, Britain, Canada, the Netherlands and France.. But, Treasury noted, more than half of the actual holders could not be identified, since the stocks were in the names of foreign brokers and nominees.

Still, said Treasury assistant Secretary Gerald Parsky, as long as U.S. security is protected and investors abide by U.S. laws, "we should not object to whether (the owner) is from the U.S., France or Abu Dhabi."

[From the Chicago Tribune]

Foreigners Find U.S. Fine for Investing

(By Bill Neikirk)

Washington.—Foreign investors, fearing political instability and economic crisis in their own countries, are turning to the United States in droves for a place to stash their money.

The U.S. stock market is the prime beneficiary of the rapidly growing shift of foreign capital, for it is increasingly being regarded worldwide as a safer place to invest, the Treasury Department said Monday.

The growth figures for foreign portfolio investments in the last year surprised even the Treasury's experts.

The department said foreign investment in the U.S. at the end of 1975 totaled $86 billion, with $17 billion of this invested in the stock market. The 1974 total was $67 billion. Most of the growth took place in foreign stock ownership.

Treasury officials gave a variety of reasons for the increase but ranked political troubles in many European countries as a major impetus.

Increased Communist influence in some European countries, mainly Italy, is a factor in the trend they said.

Many European investors see the United States as offering more profit potential and less risk of nationalization than other major countries. Gerald R. Parsky, Treasury assistant secretary for trade affairs said.

Parsky said foreign holdings in U.S. stocks in 1975 were heavily concentrated in a few countries—with Switzerland, the United Kingdom and Canada accounting for nearly 60 per cent of the total. These three countries, plus the Netherlands and France represented about 75 per cent.

But those figures are misleading. More than half of the holdings were in the names of intermediaries—brokers, banks, and individuals, holding them for someone else.

For example, nearly 90 per cent of the U.S. holdings in Switzerland, famed for its secret bank accounts, were on behalf of owners in other countries. Thus it is impossible to get a true picture of country-by-country ownership.

The figures showed that all the oil-producing nations, after having kept most of their newly won riches in bank accounts in 1974, put large amounts into the stock market and other investments in 1975.

Parsky said the oil producing countries made $5.7 billion in 1975 investments, then purchased $1 billion in portfolio investments in January and February of this year.

"We believe that the oil-producing countries will place an increasing proportion of their investments in longer-term debt and equity instruments," he said.

Parsky said the trend is nothing for Americans to worry about, for U.S. corporations need money to expand, and foreign investors represent a legitimate source.

"As long as our national security is protected, and as long as the company is willing to abide by our laws and compete in our marketplace, we should not object as to whether its owner is from the United States, or France, or Abu Dhabi," he said.

The value of foreign-held investments is equal to about 5 per cent of the value of all publicly-traded securities in the U.S., the Treasury said.

Other reasons foreign investors gave for putting their money in the U.S. were expectations of long-term capital gains; the large cash-flush money markets; close regulation and organization of U.S. stock markets; greater range of investment choices; sale-hustling by U.S. stock dealers; and greater efficiency of American markets.

Keep the Withholding Tax on Foreign Investors

(By Peggy B. Musgrave)

Last year, the Treasury Department proposed eliminating the withholding tax on dividends and interest paid to foreign investors. In my opinion, there are a number of reasons why the Treasury's proposal should be rejected:

1. It is a widely accepted principle in international taxation that the country of source of income should be allowed a reasonable tax share of income arising in its borders but accruing to foreign investors. In fairness to its own resident taxpayers who must ultimately make up the revenue loss, the United States should not surrender this legitimate claim. This is particularly the case for interest income on which the withholding tax is the only tax collected.

2. The withholding tax has customarily been modified under the terms of U.S. tax treaties with other countries and has proved to be a key factor in the U.S. treaty negotiating position. Without the tax, the position of the U.S. in bargaining for reciprocal tax concessions in future tax treaties is likely to be severely undermined and the incentive to conclude further tax treaties to be weakened.

3. The principal beneficiaries of the withholding exemption would be private portfolio investors from those countries with which the U.S. has no tax treaty,

such as the oil-producing countries and the less-developed countries of Latin America and elsewhere. The exemption would put the U.S. in a position of being a "tax haven" to these investors and of encouraging capital flight from the less-developed countries. In this connection, it is noteworthy that when the U.S. was recently in process of negotiating a tax treaty with one such developing country, the latter requested the U.S. not to reduce or eliminate its withholding tax for fear of encouraging capital outflow from its own borders.

4. Those portfolio investors resident in countries with well-developed income taxes are usually able to credit the U.S. withholding tax against the income tax in their own countries, thus completely or very largely offsetting any extra burden occasioned by the tax. In such cases, removal of the withholding tax would simply result in a transfer of revenue from the U.S. to foreign treasuries, without much effect on the investor's tax burden. It is only for investors from countries with weak or non-existent income taxes that removal of the withholding tax would represent a substantial reduction in their overall tax burden. But it is doubtful whether the U.S. taxpayer should be asked to assume the revenue cost of the withholding tax exemption for those foreign investors from countries which either do not tax them at all or, if they do so, do not provide the customary foreign tax credit.

5. Arguments made on behalf of the exemption largely run in terms of the need to make portfolio investment in the U.S. more attractive to foreigners, and particularly that financed by petro-dollars. As noted before, the withholding tax does not add to net liabilities and thus presents no deterrent where the investor receives a credit in his own country, but there are situations (e.g. with regard to petro-dollars) where such is not the case. While dropping the withholding tax might attract additional funds, there has been no solid evidence presented as to how much additional investment might be expected in return for a loss of nearly $2 billion in tax revenue over the next five years. Retaliation by other capital-importing countries via competing tax concessions must be allowed for, in which case the gains are likely to be modest. In view of the rapidly rising inflow of foreign capital to the United States in recent years, the withholding tax would not appear to have been a significant deterrent. Furthermore, the economic case for further increasing such an inflow of funds, much of which is potentially volatile in nature, is not a convincing one.

6. The Treasury has argued that a number of other countries now offer an exemption to interest payments made to non-resident investors and that the U.S. should therefore follow suit. It should be noted, however, that most of these countries are small countries with limited capital markets, investments in which can in no way compare in attractiveness with investment in the U.S. Furthermore, their interest exemptions are usually hedged with special conditions and are not extended to dividends as in the case with the Treasury proposal.

7. The United States removed the Interest Equalization Tax and other restraints on its own capital outflow on the ground that in a regime of flexible exchange rates such constraints were no longer needed for balance of payments reasons. Consistency requires similar reasoning to be applied to foreign portfolio inflow to the U.S., thus leading to the conclusion that tax concessions to attract such inflow are no longer required under a flexible exchange rate system. Furthermore, it would seem to be a misuse of the tax system to give tax concessions to capital inflow at the same time as tax preferences are available to U.S. investment made abroad.

8. Finally, and in my view most importantly, the exemption is likely to add further fuel to what is developing as a growing world-wide tax competition for international capital. In the process, the equity and integrity of income taxes in many countries of the world are being undermined and the tax collected on investment income (particularly the corporation tax) is undergoing rapid attrition. The United States played a large part in this tax competition when it introduced DISC, a tax concession which was followed by retaliatory tax incentives to domestic investment in a number of other countries. The United States should exert leadership in this area to head off what may prove to be a continuous and self-defeating cycle of tax concessions to international capital. Adoption of the withholding exemption cuts in the wrong direction and is likely to induce other capital-importing countries to tip in the same direction.

9. The Treasury has argued that the proposed withholding tax exemption is desirable because there already exist several other instances in which the withholding tax does not apply or can be avoided. The argument is not without

substance since equal treatment is desirable, but as in all matters of tax reform there are two directions in which the law can move. One is to aim at a more comprehensive tax base and to resist further exemptions, while the other is to equalize by abolishing taxation. In this case, it would seem that maintenance of the withholding tax and reconsideration of the other exemptions is the preferable and more responsible direction to take.

PROVISIONS WHICH SHOULD BE DELETED FROM THE TAX REFORM BILL, H.R. 10612

Taxation With Representation supports the tax reform package being offered by Senators Nelson, Kennedy, Haskell, Hathaway and others. In fact, we would prefer to go even farther, by ending the privilege of deferring U.S. tax on the earnings of wholly-owned foreign subsidiaries, and by repealing the domestic international sales corporation (DISC) tax subsidy for U.S. exports.

Taxation With Representation also opposes the very costly "committee amendments" proposed by the Senate Finance Committee.

In addition, there are numerous provisions in the tax "reform" bill which open up new loopholes in the tax code. We ask the Senate to strike these provisions from the bill. In particular, we urge that the following provisions be dropped from the bill:

302. Maximum tax rate. Revenue loss: $49 million in fiscal 1977, $333 million in 1978, and $577 million in 1981.

507. Moving expenses. Revenue loss: $10 million in fiscal 1977, $67 million in 1978, and $90 million in 1981.

604. Legislators travel expenses away from home. Revenue loss: In excess of $1 million annually.

802. Refunds of unutilized investment tax credits. Revenue loss: $300–$500 million in 1984 and following years.

803. Expiring investment and foreign tax credits. Revenue loss: $14 million in fiscal 1977 and $30 million in 1978.

804. Additional 2-percent investment tax credit for employee stock ownership plans (ESOPs) and other changes. Revenue loss: $235 million in fiscal 1977, $584 million in 1978, and $917 million in 1981.

805. Investment credit in the case of movies and television films. Revenue loss: $54 million in 1977, and $5 million a year thereafter.

806. Investment credit in the case of vessels constructed from funds withdrawn from the capital construction fund. Revenue loss: $21 million in fiscal 1977, $23 million in 1978, and $45 million in 1981. The Treasury Department has estimated that the revenue loss could be as high as $100 million a year.

807. Net operating loss carryover election. Revenue loss begins in 1982. It will be substantial.

901. Changes in the corporate tax rates and increases in the surtax exemption. Revenue loss: $1,676 million in fiscal 1977, $2,221 million in 1978, $2,771 in 1981.

1021. Investment in U.S. property by controlled foreign corporations. Revenue loss: small.

1023. Exclusion from subpart F of certain earnings of insurance companies. Revenue loss: $11 million in fiscal 1977, and $10 million per year thereafter.

1024. Shipping profits of foreign corporations. Revenue loss: less than $5 million annually, all going to a few firms.

1025. Limitation on definition of foreign base company sales income in the case of certian agricultural products. Revenue loss: $17 million in fiscal 1977, $15 million in 1978, and $15 million in fiscal 1981, all revenue going to a few firms.

1035. Foreign oil and gas extraction income. Revenue loss: $141 million in fiscal 1977, $188 million in 1978.

1037. Third tier foreign tax credit under subpart F. Revenue loss: $4 million in fiscal 1977, $10 million in fiscal 1978 and $10 million in fiscal 1981.

1041. Exclusion from gross income and from gross estate of portfolio investments in the U.S. of nonresident aliens and foreign corporations. Revenue loss: $73 million in fiscal 1977, $137 million in 1978, and $183 million in 1981.

1042(c)(3). H. H. Robertson amendment. Revenue loss: $800,000.

1043. Contiguous country branches of domestic insurance companies. Revenue loss: $4 million in fiscal 1977 and $8 million thereafter. Prudential Life, Metropolitan Life, and Occidental Insurance are the main beneficiaries.

1044. Transition rule for bond, etc. losses of foreign banks. Revenue loss: less than $5 million. Royal Bank of Canada is the beneficiary.

1305. Prepublication expenses. Revenue loss: unknown, but could be substantial.

1306. Exemption from taxation of interest on bonds issued to finance certain student loans. Revenue loss: less than $5 million annually.

1307. Treatment of face-amount certificates. Revenue loss: Up to $5 million a year, almost all to Investors Diversified Services.

1308. Income from lease of intangible property as personal holding company income. Small, but all to "incorporated pocketbooks".

1309. Work incentive (WIN) and federal welfare recipient employment incentive tax credits. Revenue loss: $3 million in fiscal 1977, $7 million in 1978, and $17 million in 1981.

1310. Excise tax on parts for light-duty trucks. Revenue loss: $3 million annually.

1311. Certain franchise transfers. Texas State Optical benefits.

1312. Clarification of an employer's duty to keep records and to report tips. Revenue loss: up to $5 million annually.

1313. Treatment of certain pollution control facilities. Revenue loss: $52 million in fiscal 1977, $75 million in 1978, $199 million in 1981.

1317. Rules relating to limitations on percentage depletion for oil and gas wells. $18 million in 1977: $10 million a year thereafter.

1319. Exclusion of income from certain cancellation of indebtedness under student loan programs. Revenue loss: small.

1320. Simultaneous liquidation of parent and subsidiary corporations. Revenue loss: small but concentrated on a few firms.

1322. Contributions to capital or regulated public utilities in aid of construction. Revenue loss: $13 million in FY 1977, $11 million in 1978 and thereafter.

1324. Deduction for cost of removing architectural and transportation barriers for handicapped and elderly persons. Revenue loss: $11 million in FY 1977, $10 million in 1978.

1325. Distortion of Statistics of Income to Benefit Tax Avoiders.

1401. Capital loss carryover for regulated investment companies. Revenue loss: $12 million in FY 1977, $21 million in 1978, and $51 million in 1981.

Title 15. Pension and Insurance Taxation. Revenue loss: $12 million in fiscal 1977, $51 million in 1978, $83 million in 1979.

Title 16. Real Estate Investment Trusts. Loss said to be small.

Title 17. Railroad provisions. These tax breaks will benefit profitable roads only. The firms most needing help will get none. Revenue loss: $56 million in fiscal 1977; $120 million in 1978; and $143 million in 1981.

Title 20. Energy related provisions. These are special interest provisions masquerading as conservation measures. Revenue loss: $268 million in fiscal 1977, $490 million in 1978; $565 million in 1979.

The fact that a provision is not mentioned above does not mean that it is supported by Taxation With Representation. The purpose of this document is to list the worst of the special interest provisions in the so-called tax reform bill, to assist in focusing attention on them.

If you wish, we will be glad to supply you with a more detailed explanation of the reasons for our opposition to the sections of the tax "reform" bill that are listed above. For further information, call Thomas J. Reese, TWR's legislative director at (202) 337-5530. We look forward to being of service to you.

Statement by Thomas J. Reese, Legislative Director, Taxation With Representation, Regarding the Energy Bill, H.R. 6860

Mr. Chairman, and members of the committee. My name is Thomas J. Reese, and I am Legislative Director of Taxation With Representation, a public interest taxpayers' lobby with almost 18,000 members.

The Senate Finance Committee plans to take up the Energy Bill (H.R. 6860) at the same time as the tax reform bill. We have already furnished our comments on the reform bill to the Committee. The following additional comments relate to the Energy Bill.

I. Thoroughly Bad Legislation

As it stands, the Energy Bill contains two main sets of proposals. First, there are energy conservation measures that are, in themselves, of dubious worth. In connection with these provisions, we suggest more reliance on the free market mechanism and less government interference in the form of price controls, quotas, and tax gimmicks.

Second, the Energy Bill contains a hodgepodge of thoroughly ill advised and highly objectionable tax provisions, some of which are more or less thinly disguised as energy conservation measures. Included in this objectionable category are:

1. The repeal of the exise tax on radial tires (Section 222).
2. The proposed tax credit for insulation of residences (Section 231).
3. The proposed tax credit for solar energy equipment (Section 232).
4. The proposed tax credit for the purchase of electric cars (Section 233).
5. The five-year amortization for railroad equipment (Section 422).
6. The five-year amortization for railroad rolling stock (Section 423).
7. The special investment credit for solar energy equipment and insulation (Section 431).

In short, whether the Energy Bill is looked at from the standpoint of energy conservation, or as a tax measure, it constitutes thoroughly bad legislation. We recommend that it be set aside, and that it be allowed to die a quiet death at the end of this Congress.

II. A DISCUSSION OF THE BILL'S TAX PROVISIONS

Set forth below are the reasons for our objections to each of the listed tax provisions of the Energy Bill:

1. *Excise Tax on Radial Tires* (*Sec. 222*).—This provision would give a special tax advantage to one segment of the tire industry at the expense of others. Discrimination of this sort between one firm and another is hard to justify. Furthermore, the revenue cost of the radial tire proposal—which is estimated at $75 million annually—seems far greater than the possible energy savings can justify. Finally, it is important to remember that the excise tax on tires is intended as a user charge to defray the cost of building the nation's highways. The radial tire proposal would breach that principle by allowing radial tire owners to use the highways even though they have not paid their fair share of the cost.

2. *Insulation of Residences* (*Sec. 231*).—This is a politically appealing but utterly misguided attempt to encourage individuals to insulate their homes. It is structured so that those who least need help will get government aid, and those who most need assistance in installing insulation will get no government help at all. This upside-down irrationality results from use of the tax system, rather than direct appropriations, to achieve an important national goal.

The persons who most need help in insulating their homes are those too poor to pay income tax. Moreover, they are the individuals who suffer most from the effects of high energy prices. This proposal will give them no help at all, while conferring substantial help on wealthier individuals earning large incomes. At a minimum, the credit should be made refundable, so that the poor will benefit too.

In general, however, we feel that direct appropriations are a far better means of encouraging home insulation, if government intervention is felt to be necessary. When direct appropriations are used, the costs of a program can be carefully controlled, unlike the costs of a tax credit, and aid can be directed to the areas of greatest need. Moreover, use of the appropriations route will encourage more careful scrutiny of both costs and likely benefits. At present, it seems that the possible benefits of this proposal, estimated at a saving of 100,000 barrels per day of oil in 1977, does not justify the huge revenue loss which is involved: $260 million annually.

3. *Solar Energy Credit* (*Sec. 232*).—This provision is a woolly-minded attempt to "do good" by providing encouragement for the development of solar energy. The revenue loss through 1978 is expected to be minimal, only because no one expects this provision to have any effect before that date. From 1979 on, however, the revenue loss will grow, because more solar energy equipment is expected to come into use at that time.

Thus, the proposed credit will be useless during the important developmental stages of solar energy technology, but it will constitute a fiscal time bomb with respect to future tax revenues. A direct appropriation for controlled funding of solar energy research makes far more sense than providing open-ended tax credits which can cause serious trouble in the future, but which will be of little or no immediate help in solving our energy problems.

4. *Electric Car Credit* (*Sec. 233*).—A tax credit for electric cars makes about as much sense as a tax credit for breathing. Electric cars are being sold as fast

as they can be built. A tax credit will simply allow the producers and sellers of these vehciles to raise their prices by approximately the amount of the credit. Moreover, these cars are less energy efficient than cars powered by internal combustion. This provision is therefore a recipe for energy waste and tax windfalls.

5. *Five Year Amortization of Railroad Signals, Yards, etc.* (*Sec. 422*).—This provision has nothing to do with energy conservation. It grants further tax breaks to profitable banks and railroads that don't need help, while doing nothing for bankrupt railroads that do. Under the proposal, new signals, traffic controls, classification yards, loading and unloading facilities, and tracks will become eligible for rapid amortization. The firms that would benefit from this provision already enjoy both accelerated depreciation and the 10 percent investment credit; that should be enough. Those railroads that need help to stay in operation would not be aided by this provision. Only banks—which pay almost no federal taxes now—will be able to take real advantage of this provision through their leasing operations. At a minimum, we recommend that the benefits of this provision be denied to corporate lessors, including banks and other financial institutions.

6. *Five Year Amortization of Railroad Rolling Stock* (*Sec. 423*).—As with Section 422, poverty-stricken railroads, which pay no taxes because they have no profits, will not benefit from the provision. Instead, the beneficiaries will be banks and financial institutions, which have enough tax loopholes already—so many, in fact, that the largest commercial banks now pay federal tax at an effective rate of only 2%, far below the tax rates paid by ordinary wage earners. If Congress wishes to aid railroads, it should do so through the appropriations process, not through new tax loopholes.

7. *Investment Credit for Solar Energy Structures and Insulation* (*Sec. 431.*)—Buildings and similar structures already get favorable treatment under the tax code, in the form of accelerated depreciation and other benefits. For that reason, Congress has not extended the 10 percent investment credit to buildings. This proposal would breach that precedent, and thereby open the way to huge potential revenue losses. But there is no need to incur this serious risk, because the high price of fuel will encourage all the business use of insulation that is needed. Creating tax breaks will only lead to installation of more insulation and solar energy equipment than can be justified economically.

III. ENERGY CONSERVATION AND CONVERSION—TITLES III AND IV

In general, Taxation With Representation opposes trust funds, including trust funds for energy purposes, such as the fund that would be established by Section 311–314 of the Energy Bill. Trust funds tend to lock Congress and the government into supporting programs that no longer have high priority. If a program is important, Congress should appropriate money for it annually out of general revenues. Tying money up in trust funds is an admission that Congress cannot be trusted to make intelligent decisions about national priorities. We believe that Congress should be free to determine how federal revenues should be spent, and that it should not tie its hands through use of a trust fund for energy purposes.

Taxation With Representation does not support the proposed excise tax on business use of petroleum and petroleum products as set forth in Section 411 of the bill. This provision might have made sense when the bill also included a gasoline tax, but it makes no sense to discriminate against the use of petroleum for business as opposed to non-business purposes.

We also oppose rapid amortization of certain energy use property, as proposed in Section 421 of the bill. In opposing this section, the Treasury Department has testified that the provision will encourage only an insignificant amount of conversion to coal of facilities that currently use oil or gas. To waste taxpayers' money on ineffective tax incentives is just as bad as wasting money on planes that don't fly or public assistance programs that fail to serve real needs.

IV. SUMMARY

In summary, if energy conservation and development measures are needed, they should be funded through direct appropriations, not tax gimmicks, so that the costs and results of the programs can be regularly reviewed. As the Manhattan Project and the Moon Program demonstrate, research projects funded through direct appropriations show results, and outlays are promptly cut when the project has achieved its objectives. In contrast, programs funded through the tax system go on and on, and there is never any review of the results or any end to the costs.

In general, we believe that the Congress should leave incentive and subsidy programs to those committees of the House that are in a position to authorize and appropriate funds for those programs. Expenditures authorized in that way will be automatically reviewed each year to evaluate their effectiveness; there is no corresponding review of tax incentives. That is one reason why tax incentives are inherently wasteful.

Taxing International Oil Profits: Tinkering Versus Basic Change

(By Michael J. McIntyre)

Debate over the proper treatment of the oil industry has accompanied every major tax bill enacted over the past 60 years. Several proposed Senate amendments to the Tax Reform Act (H.R. 10612) have received that debate for 1976.

The current debate centers on the effect on the foreign tax credit of the new relationships developing between the oil rich states and the international oil companies. Historically, most payments by the oil companies to the foreign governments have been cast in the form of income tax payments. This characterization of the payments has been challenged by public interest advocates but has been acceded to generally by the Internal Revenue Service and Congress.

Two recent events, however, have signaled a change in position by the IRS and Congress. As part of the Tax Reduction Act of 1975, Congress eliminated the credit for certain payments made in respect to oil in which the producing company had no "economic interest." The second event was the publishing this spring by the IRS of a revenue ruling (Rev. Rul. 76-215) holding that a contractor under a production sharing contract with Indonesia could not take a foreign tax credit with respect to oil retained by the Indonesian government. Amendments proposed by the Senate Finance Committee would at least temporarily reverse these decisions.

Indonesian Production Sharing Ruling

The amendment to reverse Revenue Ruling 76-215 is narrowly drawn to cover production sharing contracts entered into before April 8, 1976, the day the Service first announced its intention to deny foreign tax credits in the Indonesian case. (See Tax Notes, April 19, page 9.) The credit, moreover, will only be allowed for the next five years and will not be allowed to generate excess tax credits to offset taxes on other income.

The economic impact of the amendment is uncertian. If the IRS is correct in its legal analysis supporting the ruling, the impact of the amendment would be great, reversing current law to provide a retroactive tax break for Natomas Co. and other companies directly affected by the ruling.

If the IRS is incorrect in its analysis, the amendment serves no purpose and its impact therefore, would be minimal. Tax experts, however, believe that the IRS can present a substantial case in support of its position.

The long-term impact of the amendment, though, depends on how vigorously IRS would pursue new forms of production contracts which would be developed by the oil companies if Rev. Rul. 76-215 is allowed to stand. If IRS blocks the credit for all reasonable alternatives to production sharing agreements the economic impact will be very substantial—perhaps involving hundred of millions of dollars. No reliable estimates of the revenue possibilities have been prepared.

A fear of tax reform groups is that approval of the production sharing amendment will discourage IRS from issuing rulings in clearly analogous situations. Because of the willingness of many foreign governments to cooperate with the oil companies in shifting the burden of payments to the U.S. Treasury, the oil companies have considerable flexibility in redesigning the form of their contracts.

Iranian "Economic Interest" Amendment

The second amendment would postpone for 10 years the impact of Section 901(f) of the Internal Revenue code on certain oil leases in effect as of March 29, 1975. Section 901(f) prohibits a foreign tax credit with respect to taxes paid in connection with the purchase or sale of oil if (1) the purchase or sale price is artificial and (2) the taxpayer had no "economic interest" in the oil purchased or sold.

No one is clear what the term "economic interest" means in this context. The language was introduced into the Tax Reduction Act of 1975 by the conferees without substantial debate or analysis. It was intended to prevent, among other possible abuses, an oil company from purchasing oil nominally at a discount and then returning that discount by way of a nominal "income" tax. An oil company with a significant equity interest in the oil purchased or sold would clearly have an economic interest. A company whose first contact with the oil was at the time of purchase or sale would not have an economic interest. The status of the many complex relationships between the foreign governments and the oil companies which fall between these poles is unsettled.

The amendment was pushed vigorously by Mobil Oil Co. in order to save the credit for payments made by a consortium of American companies under a contract with Iran. Treasury and the Joint Committee on Internal Revenue Taxation estimate the revenue loss from the amendment at $40 million annually. The estimate assumes that the consortium does not have an "economic interest" in the Iranian oil. (The revenue effect is zero for companies with an economic interest.) The estimate also assumes that no other major contracts are, or will be, affected by the amendment. If future contract renegotiations among foreign governments and oil companies compel the companies to accept changes which deprive them of an economic interest in the oil, then the current estimate may be substantially low. No evidence has been produced, however, to suggest that such changes are in the offing. (See Tax Notes, June 21, page 6; June 14, page 5.)

POLICY CHOICES

The Finance Committee report (S. Rept. 94-938) characterizes the production sharing amendment and the economic interest amendments as mere transitional rules to prevent undue hardship to particular companies. The report, and the supporters of the amendments, argue that the changes do not raise basic questions about the proper treatment of the oil industry. They contend that little revenue is involved and that the major impact of the amendments is to clarify the law and prevent litigation of issues which would ultimately be resolved in favor of the oil industry.

Opponents of the amendments argue that substantial tax policy issues are involved. They contend that the IRS ruling and the economic interest test are both designed to prevent the oil companies from taking a tax credit for the cost of goods sold. They claim that payments made for oil owned by foreign governments are no different than payments made to the U.S. government for timber on public lands or for stamps at the post office. Only the strange history of the oil companies' relationships with foreign governments distinguishes these payments. The critics concede, nevertheless, that this argument is equally applicable to many other payments which are currently accepted by IRS as creditable taxes.

In addition, opponents are unhappy with (1) the retroactive feature of the amendments, (2) their intrusion into the proper functioning of the IRS and (3) their narrow, special interest character. They fear, moreover, that the revenue estimates may be wildly low, due to the unstable character of present oil concession agreements.

CONCLUSIONS

The difficulty in fashioning sensible rules for the taxation of the international oil companies stems from the flexibility of the companies to adjust the form of their legal relationships without significant change in economic substance. The chief interest of the foreign governments is in receiving a fixed amount on the sale of their oil. They do have some interest in form—nationalistic impulses have recently required that the government be cast as the "owners" of the oil and perhaps also of the major production facilities. But they have consistently shown a willingness, within limits, to cast the payments made to them in a way most likely to result in a foreign tax credit for the international oil companies. Only a comprehensive set of new tax rules approved by Congress is likely to have a long term impact on the U.S. tax liability of the oil companies.

Most observers assume that Congress is unwilling and unable at this time to seriously reevaluate the basic tax rules affecting the oil industry. The choice, therefore, is between a change which gives retroactive, relief to a few companies and postponement of any action until Congress is ready to carefully reconsider the ground rules for taxing international oil companies.

Senator HARTKE. I don't have any questions.

The chairman has returned. I would observe, Mr. Chairman, that the Republicans are having their Policy Committee meeting. My understanding is that the tax bill is supposed to be on the floor. I would think that most of the witnesses would not prefer to just submit their testimony to one or two of us. I am prepared to stay if you want to go ahead, whatever you want to do, but I think it would be better to try to figure out something else—I don't know what that is.

The CHAIRMAN. We have to meet when the Senate is in session, and there is nothing new about having a small number of Senators to take testimony.

I can only tell a witness what Lyndon Johnson once said to me. He said, "Well, I can get somebody to come and answer when his name is called but I can't make him stay here to hear your speech."

If people have some good information, we have able staff assistants who hear it as well as the Senators. We have a room full of people, many of whom come from Senators' offices and explain to their bosses what they hear. We have this testimoney we want to take down in writing, every word that is said, so that everybody who wants to can know what is said inside this room. I think that is fine, and we will do the best we can.

I will do the best I can to make myself available to help hear people and I will do the best I can to see that the views conveyed inside this room are made available and considered by everybody else. But I cannot make them be present to hear the statement.

Senator HARTKE. Whatever you want to do. You are the Chairman. [Laughter.] I am just here.

The CHAIRMAN. Does that complete your statement, sir?

Mr. REESE. I would appreciate, Mr. Chairman, if you could clarify something for me on the purpose of these hearings. Is there going to be a markup following them? It is unclear to me why these hearings are being called.

The CHAIRMAN. I would propose that the committee should consider everything that has been said at these hearings. Frankly, there is an amendment or two that we agreed to that I would like to ask be reconsidered. I voted against some of these amendments the way it is now. We will see what the Senate wants to do.

My impression is that right here on this committee you would be surprised how much unanimity we reach when we communicate. When each man understands the other's argument, usually we manage to have the best of both.

Have you completed your statement?

Mr. REESE. So there is going to be a markup after this hearing?

The CHAIRMAN. What I would propose to do is consider every Senator's suggestion. We can vote on them. If we think it is a good idea, we will keep it; if not, we will drop it.

Senator HARTKE. Mr. Robert M. Brandon, director, Public Citizen Tax Reform Research Group, accompanied by Mr. William Pietz.

Mr. BRANDON. Let me say at the outset, Senator Hartke, that I agree with your suggestion that the hearings adjourn temporarily. We would like to express our disagreement with what was just said by the Chairman.

It is difficult for me to understand how the committee can function taking testimony from witnesses when the tax bill is about to come up on the floor. We think the problem here is the fact that this committee is trying to jam what should be several weeks of hearings on numerous pieces of legislation into 3 days.

That is really the basic problem.

The CHAIRMAN. I will be willing to consider your view on taxes and I will do the best I can to see that your views are considered. Now I regret that I cannot be you. If I could be you, I might consider doing that but there are a lot of good people I would like to be if I could. I find the good Lord made me to be me. I do the job the best way I see it.

Now I want your views available. You asked to be heard, didn't you?

Mr. PIETZ. We would like the committee to hear our views.

The CHAIRMAN. I will tell you what Lyndon Johnson said. "I could get somebody to come into this room but I cannot make them stay here."

I will do the best I can to see to it that everything you say is considered. That is the best I can do for you.

Mr. BRANDON. We just don't feel with all the testimony that is going to be taken—the reason that we are all here today is that too much of what went into this tax bill has not been considered carefully and we are here today to try to make some suggestions as to how it can be considered carefully and then some suggestions on specific provisions and we don't feel we can do that adequately with members and other sponsors of these provisions not here.

I think we would just as soon submit our statement for the record and assume it will not be read, which it will not be by most people——

The CHAIRMAN. Well, I think a lot more of you than that. I believe that the Senators, especially those who tend to agree with you, will read your statement.

Mr. BRANDON. That will not help. I think we need to talk to the members of this committee who probably do not agree with our general criticism about procedures, and the procedures are what is really important here.

I think this really points out the problem.

We have hearings now where a pamphlet describing what is going on has just been distributed. Before we have had an opportunity we are being asked to comment on provisions when we don't know all the facts and circumstances. We are being asked to address the committee when most of the Senators are not here, and not because they don't choose to be here but because there is a specific obligation for them to be somewhere else.

I wish the scheduling could be arranged——

The CHAIRMAN. I tell you often in the conduct of hearings we have only a few Senators present.

Mr. PIETZ. But none of those hearings were conducted during the very debate on the tax bill itself. I personally attended all those hearings and I know the schedule that was followed.

The CHAIRMAN. Well, what difference does it make where a fellow is if he is not here to hear you? What difference does it make whether he is making a speech back in his home State or talking to somebody in the State Department or talking to the President in the White House?

Mr. PIETZ. By definition he can't be here to hear. Now in the other hearings that was not the case.

The CHAIRMAN. Other commitments are not keeping me away. Anyone that wants to be here can be here.

Mr. PIETZ. The very thrust of the objections raised by Proxmire, Kennedy, and other members of the public was the procedures, and one of the aspects of the procedures found glaringly deficient was the haste of those procedures and we are now typifying that haste.

The CHAIRMAN. Well, it seems to me that you have had plenty of time to talk about everything except what you want to talk about.

Mr. PIETZ. What we came to talk about is the process, we did not come to discuss the merits of the specific items of legislation since we happen to be one of the few groups in the country that is in any position to know even what those items were.

The committee disseminated a press release that named certain sections of the bill and gave no clue whatever as to what was under discussion. We have been contacted repeatedly by dozens of the public interest groups across the country and by the news media around the country begging us to tell them what was the subject of these hearings.

In fact, many private business interests have asked us to tell them what was the subject of these hearings. The public just has not had adequate notice of the agenda of these hearings.

Mr. BRANDON. We don't feel the burden should be placed on us to try to ferret out what sections of the bill are being referred to.

Now we are in a position to do some of that because we followed these markups closely but there are people all over the country that have not been able to do that.

The CHAIRMAN. Well, now if you want to come back at the end of the hearing, I will try to schedule you again. Would you like to do that?

Mr. BRANDON. Well, we would appreciate not having to testify at a time when we know members of the committee necessarily have to be absent. We ourselves have been interested in the tax reform bill that is up on the floor now.

The CHAIRMAN. Then why don't you go over there? [Laughter.] I will try to schedule you again when we get to the end of the hearings. Does that make you happier?

Mr. PIETZ. There are numerous other glaring deficiencies in the procedure, Mr. Chairman, that prevent——

The CHAIRMAN. Do you want to be heard now or some other time? That is all I want to know.

Mr. BRANDON. If we could be rescheduled at the end of the hearings that would be fine because we feel we have something important to say to the committee.

The CHAIRMAN. I am sure you have. Then come back at the end of the hearings. We will let you know and we will schedule you at a subsequent date. I hope we have a better crowd. Those are influential people back there.

Mr. BRANDON. We know that.

Mr. PIETZ. May I make a statement, Mr. Chairman? We believe there may be some hope by holding this type of hearing without adequate notice or this type of booklet prior thereto, that it may be possible to disseminate a statement that the bill has thus been the subject of proper deliberation and when objections are raised to these narrow special interest amendments on the floor it might be contended that this hearing has cured any deficiencies and we would like to state for the record our contrary points.

The CHAIRMAN. I don't know of anything perfect on this side of heaven but we will schedule you to come back and make your statement at the end of the hearing. OK?

Mr. PIETZ. Thank you.

Mr. BRANDON. Fine.

The CHAIRMAN. We will hear Mr. A. Blakeman Early, Environmental Action Group, accompanied by Mr. Leonard Lee Lane, Public Interest Economic Center.

Mr. EARLY. Good afternoon.

Mr. Lane was unable to come so I will make the presentation.

I would like to say that I share the sentiments of Mr. Brandon in terms of engaging in any kind of dialog with the committee.

The CHAIRMAN. Would you like to come back some other time?

Mr. EARLY. I would appreciate that.

The CHAIRMAN. Fine. We will schedule you later on and we will excuse you now.

Now Mr. K. Martin Worthy, Hamel, Park, McCable & Saunders.

STATEMENT OF K. MARTIN WORTHY, HAMEL, PARK, McCABE & SAUNDERS

Mr. WORTHY. Thank you, Mr. Chairman.

I am K. Martin Worthy with the law firm of Hamel, Park, McCabe & Saunders, Washington, D.C. I appear on behalf of Freda R. Caspersen in opposition to part of the foreign trust provisions of H.R. 10612.

These provisions would, first of all, eliminate an advantage now enjoyed by U.S. benefiiciaries of foreign trusts over beneficiaries of domestic trusts with respect to capital gains, and, by adding an interest charge to the tax imposed under the throwback rules, eliminate any advantage that such beneficiaries may presently enjoy from any deferral of tax on accumulated income of a foreign trust.

We have no objection to these changes in existing law.

Second, in addition, as a substitute for a tax on beneficiaries, the bill would tax every U.S. grantor hereafter on the income of any foreign situs trust having any U.S. beneficiary, even though the grantor has retained no control or possible interest in the trust. It is to this latter proposal, and specifically the effective date thereof, that we take strong exception.

Under present law, as described in the committee report, if property is transferred into trust, foreign or domestic, the grantor will continue to be taxed on the income of such trust if—but only if—he has retained some income or reversionary interest, some degree of control, or some power of revocation over the trust.

Section 1013(a) would, however, as previously noted, tax every U.S. grantor on any income of a foreign situs trust having any U.S. beneficiary, even though the settlor has retained no such control or possible interest in the trust. It would tax the grantor on any income earned after December 31, 1976, by such a foreign trust created at any time after May 29, 1974.

May 29, 1974, is the date in the 93d Congress on which the House Ways and Means Committee announced that the committee had arrived at a "tentative decision" to make a similar change in the law. A recommendation to that effect was subsequently made by the committee, but no action was taken thereon thereafter by either House of such 93d Congress.

More than 18 months ago, in December 1974, Mrs. Caspersen made an irrevocable transfer of what had been her property to a foreign situs trust with U.S. beneficiaries. Under that trust she transferred such property for all time, beyond recall, reserving to herself no control, dominion or right of direction whatsoever, and retaining no interest, present or future, vested or contingent, in the property transferred or in the income therefrom.

A significant U.S. gift tax was paid in 1974 on account of such transfer and a 30-percent withholding tax on dividends paid to the trust by U.S. corporations is currently being withheld.

I believe that the attempt in section 1013(a) to tax income earned in the future from property in which the grantor has retained no interest or control whatever is patently unconstitutional.

In *Hoeper* v. *Tax Commission of Wisconsin*, 284 U.S. 206, 52 S. Ct. 120, 76 L. ed. 248 (1931), the State of Wisconsin attempted to fix the rate of tax on a husband by reference to the separate income of his wife. In overturning such tax, the U.S. Supreme Court stated the legal principle involved very succinctly:

> We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the 14th Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income.

In later overturning a Federal tax on property which had formerly belonged to a decedent, in *Heiner* v. *Donnan*, 285 U.S. 312, 52 S. Ct. 358, 76 L. ed. 772 (1932), the Court said, at page 327:

> * * * there is imposed the burden of a tax, measured in part by property which comprises no part of the estate, to which the estate is in no way related, and from which the estate now derives no benefit of any description. Plainly, this is to measure the tax on A's property by imputing to it in part the value of the property of B, a result which both the Schlesinger and Hoeper Cases condemn as arbitrary and a denial of due process of law.

Mrs. Caspersen is now powerless either to revoke the trust or to require that any of the trust income be used to discharge the tax liability which would be imposed on her under section 1013(a).

The revenue should in any event be fully protected by the provisions of the bill, to which I have previously referred, in sections 1013(c) and 1014 requiring the U.S. income tax ultimately be paid, together with interest, by the beneficiaries on the full amount of income of a foreign trust.

And by applying such provisions of sections 1013(c) and 1014 instead of 1013(a), the burden of the tax would then be borne by those who receive the benefit of such income, which seems only fair.

It seems to me to be fundamental that every citizen in arranging his affairs should be able to rely on the law as it exists at the time and not on what some few Members of Congress, however able or well intentioned, believe the law ultimately should be.

See note, 84 Harvard Law Review 436, 1970, at p. 443, and New York State Bar Association, Report of the Committee on Tax Policy and Retroactivity of Tax Legislation, July 31, 1975, at p. 10.

Congress sometimes makes a tax "retroactive" to the beginning of the year, see *Cooper* v. *United States*, 280 U.S. 409, 50 S. Ct. 164, 74 L. ed. 516 (1929), but rarely if ever does it make a tax retroactive to a prior Congress. Even when it makes a tax retroactive to the beginning of the year, I know of no instance where it has successfully made a tax applicable to someone other than the taxpayer who earned the income subject to the tax.

As said by Judge Learned Hand in *Frew* v. *Bowers*, 12 F. 2d 625 (2d Cir. 1926), and repeated by the Supreme Court in the *Donnan* case:

> Such a law [would be] far more capricious than merely retroactive taxes. Those do indeed impose unexpected burdens, but at least they distribute them in accordance with the taxpayer's wealth. But this section distributes them in accordance with another's wealth; that is a far more grievous injustice.

Senator TALMADGE [presiding]. I hate to interrupt you. Your time is up. Your entire statement will be inserted in the record. You made a very able statement. I regret I didn't get to hear it all but the portion that you made was very able and I compliment you, sir.

Thank you very much.

Mr. WORTHY. Thank you.

[The statement referred to follows:]

STATEMENT OF K. MARTIN WORTHY

My name is K. Martin Worthy. I am a member of the law firm of Hamel, Park, McCabe and Saunders of Washington, D.C.

I appear here today on behalf of Freda R. Caspersen in opposition to part of the foreign trust provisions (Sections 1013–1015) of H.R. 10612.

These provisions would basically do two things: (1) They would eliminate an advantage now enjoyed by U.S. beneficiaries of foreign trusts over beneficiaries of domestic trusts with respect to capital gains, and, by adding an interest charge to the tax imposed under the throwback rules, eliminate any advantage that such beneficiaries may presently enjoy from any deferral of tax on accumulated income of a foreign trust. We have no objection to these changes in existing law. (2) In addition, as a substitute for a tax on the beneficiaries, the bill would tax every United States grantor hereafter on the income of any foreign situs trust having any United States beneficiary, even though the grantor has retained no dominion, control or possible interest in the trust. It is to this latter proposal, and specifically the effective date thereof, that we take strong exception.

Under present law, as described in the Committee report, if property is transferred into trust (foreign or domestic), the grantor will continue to be taxed on the income of such trust if—but only if—he has retained some income or reversionary interest, some degree of control, or some power of revocation over the trust.

Section 1013(a) would, however, as previously noted, tax every United States grantor on the income of a foreign situs trust having any United States beneficiary, even though the settlor has retained no such dominion, control or possible interest in the trust. It would tax the grantor on any income earned after December 31, 1976, by such a foreign trust created at any time after May 29, 1974. May 29, 1974, is the date in the 93d Congress on which the House Ways and Means Committee announced that the Committee had arrived at a "tentative decision" to make a similar change in the law. A recommendation to that effect was subsequently made by the Committee, but no action was taken thereon thereafter by either House of such 93d Congress.

More than eighteen months ago, in December 1974, Mrs. Caspersen made an irrevocable transfer of what had been her property to a foreign situs trust with United States beneficiaries. Under that trust she transferred such property for all time, beyond recall, reserving to herself no control, dominion, or right of direction whatsoever, and retaining no interest, present or future, vested or contingent, in the property transferred or in the income therefrom. A significant U.S. Gift Tax was paid in 1974 on account of such tansfer and a 30% withholding tax on dividends paid to the trust by U.S. corporations is currently being withheld.

I believe that the attempt in Section 1013(a) to tax income earned in the future from property in which the grantor has retained no interest or control whatever is patently unconstitutional.

In *Hoeper* v. *Tax Commission of Wisconsin*, 284 U.S. 206, 52 S. Ct. 120, 76 L. ed. 248 (1931), the State of Wisconsin attempted to fix the rate of tax on a husband by reference to the separate income of his wife. In overturning such tax, the United States Supreme Court stated the legal principle involved very succinctly:

> We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the 14th Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income.

The Supreme Court later said that what is prohibited to the State by the Fourteenth Amendment is prohibited to the Federal Government by the Fifth Amendment. In overturning a Federal tax on property which had formerly belonged to a decedent, in *Heiner* v. *Donnan*, 285 U.S. 12 52 S.Ct. 358, 76 L. ed. 772 (1932), the Court said (at page 327):

> . . . there is imposed the burden of tax, measured in part by property which comprises no part of the estate, to which the estate is in no way related, and from which the estate derives no benefit of any description. Plainly, this is to measure the tax on A's property by imputing to it in part the value of the property of B, a result which both the Schlesinger and Hoeper cases condemn as arbitrary and a denial of due process of law. Such an exaction is not taxation but spoliation. "It is not taxation that government should take from one the profits and gains of another. That is taxation which compels one to pay for the support of the government from his own gains and of his own property." *United States* v. *Baltimore & O. R. Co.*, 17 Wall. 322, 326, 21 L. ed. 597, 599.

Mrs. Caspersen is now powerless either to revoke the trust or to require that any of the trust income be used to discharge the tax liability which would be imposed on her under Section 1013(a). The trust property and income are forever beyond her reach. She has no way of even compelling the trustee to provide her with information as to the amount of the income on which Section 1013(a) would require her to pay tax.

The revenue would in any event be fully protected by the provisions of the Bill, to which I have previously referred, in Sections 1013(c) and 1014 requiring the United States Income Tax ultimately be paid, together with interest, by the beneficiaries on the full amount of income of a foreign trust. And by applying such provisions of Sections 1013(c) and 1014 instead of 1013(a), the burden of the tax would then be borne by those who receive the benefit of such income and not by one who has completely deprived herself of any interest or control therein.

It seems to me to be fundamental that every citizen in arranging his affairs should be able to rely on the law as it exists at the time and not on what some few members of Congress, however able or well intentioned believe the law should be. See Note, 84 Harvard Law Review 436 (1970) at p. 443, and New York State Bar Association, Report of the Committee on Tax Policy and Retroactivity of Tax Legislation (July 31, 1975) at p. 10. Congress sometimes makes a tax "retroactive" to the beginning of the year (see *Cooper* v. *U.S.*, 280 U.S. 409, 50 S. Ct. 164, 74 L. ed. 516 (1929)), but rarely if ever does it make a tax retroactive to a prior Congress. Even when it makes a tax retroactive to the beginning of the year, I know of no instance where it has successfully made a tax applicable to someone other than the taxpayer who earned the income subject to the tax. As said by Judge Learned Hand in *Frew* v. *Bowers*, 12 F. 2d 625 (2d Cir 1926), and repeated by the Supreme Court in the *Donnan* case "such a law [would be] far more capricious than merely retroactive taxes. Those do indeed impose unexpected burdens, but at least they distribute them in accordance with the taxpayer's wealth. But this section distributes them in accordance with another's wealth; that is a far more grievous injustice."

If a tax can be imposed *now* on income earned in 1977 and later years from property completely given away by the taxpayer in 1974, then there is no reason why a tax cannot be imposed for the first time in 1976 or 1977 on the income of property which a taxpayer transferred to a grandchild in 1964, gave to a sick brother for his support in 1944, or even donated to charity in 1924. I find that unthinkable, and surely not only the constitutional principles to which I have referred but the basic sense of fairness of the Congress will prevent it from doing so.

I submit that § 1013(a) should be eliminated, or that, at the very least, it should be made inapplicable to income from property transferred into trust long before the current legislation.

Senator TALMADGE. Thank you very much.

The next witness is Mr. Robert Lee, president, Bellefonte Insurance Co.

Mr. Lee had to leave the committee room. His entire statement will be inserted in the record.

[The statement referred to follows:]

STATEMENT OF ROBERT C. LEE, PRESIDENT, BELLEFONTE INSURANCE COMPANY, RELATING TO SOURCE OF UNDERWRITING INCOME

Bellefonte Insurance Company is a corporation chartered in the State of Kentucky licensed to underwrite multiple lines of insurance and reinsurance in that state as well as various other states. It is a wholly-owned subsidiary of Armco Steel Corporation with principal offices in Middletown, Ohio.

Bellefonte is opposed to the amendments to Sec. 1036 underwriting income which amend sections 861(a) and 862(a) relating to the source of income rules. These amendments would change an established position of the Internal Revenue Service that the source of income is to be determined on the basis of where the incidents of the transaction which produce the income occur, and substitute therefore a new provision which would determine the source of income on the basis of whether it was derived from the insurance of U.S. risks or non-U.S. risks.

The statement of the reasons for change outlined in the Senate Committee report refer to a limited situation in which such an amendment may be desirable. However, the amendment would have other, more far-reaching effects which were apparently not contemplated in the formulation of the amendment.

In the case of Bellefonte Insurance Company, it would impose double taxation on a sizeable portion of its business. This is because Bellefonte is, in addition to its operations in the United States, licensed to operate in the United Kingdom, Belgium, Holland, Spain and Greece. In the case of its underwriting operations in London, which are primarily reinsurance, it writes a sizeable volume of business in which about 65% of the premiums are paid in U.S. dollars and 35% in non-U.S. dollars.

This branch operation, which permits Bellefonte to participate in the large international insurance and reinsurance market centered in London, is conducted entirely in London where the incidents of the transaction which produce the income occur. Under these circumstances, Bellefonte's operation in London are subject to United Kingdom income tax. While Bellefonte, as a U.S. corporation is also subject to U.S. taxation on the whole of its operation, as respects that portion of its business carried on in London which is considered by the Internal Revenue Service to be foreign source income, it can take credit against its U.S. tax liability for the taxes paid to the United Kingdom (up to a maximum of 48%).

If the source of income rule is amended, Bellefonte would then be denied credit for the taxes it must pay to the United Kingdom with the result that it would pay 100% tax on this business (52% to the United Kingdom and 48% to the United States), which would destroy the branch operation in London.

The amendment would also provide a perplexing problem in that it is often difficult, if not impossible, to identify where the specific risk is located, particularly in the cases of marine and aviation business or whole account reinsurance of a company's total book of business.

Because of the necessity of spreading the huge risks associated with commerce and catastrophes among a broad cross-section of insurers or reinsurers as possible, insurance is an international business. Even the eastern countries find it necessary to participate in the international reinsurance market. It is a complex business that has been developing for a large number of years with much tradition attached to it. Under these circumstances, Bellefonte urges that any amendment to the source of income rule as affects underwriting be eliminated from this current legislation and considered for future legislation at a date when it can be considered in more detail and with participation of a larger cross-section of the industry.

SUMMARY OF PRINCIPAL POINTS IN THE STATEMENT OF ROBERT C. LEE, PRESIDENT OF BELLEFONTE INSURANCE COMPANY, BEFORE THE SENATE FINANCE COMMITTEE JULY 20, 1976

1. The proposed change in the source of underwriting income (Bill Section 1036) would have far reaching effects that were not previously contemplated.
2. If the proposed source rules are adopted, it could result in double taxation of a sizable portion of Bellefonte Insurance Company's business.
3. The location of specific risks can be difficult to determine, particularly in the case of marine, aviation and reinsurance business.
4. Bill Section 1036 should be eliminated from the pending Tax Reform Act and deferred until such time that it can be studied by a larger cross-section of the industry.

Senator TALMADGE. Next, Daniel M. Moenich, president, Apex International Alloys, Inc., on behalf of the Aluminum Recycling Association.

Ms. LIPSON. Mr. Chairman, Mr. Moenich, due to unforeseen circumstances, could not be here this morning I am Janice Lipson, assistant director of the Aluminum Recycling Association, and with your permission I will proceed.

Senator TALMADGE. Yes.

STATEMENT OF JANICE LIPSON, ASSISTANT DIRECTOR, ALUMINUM RECYCLING ASSOCIATION

Ms. LIPSON. We are opposed to the tax credit to our industry and, therefore, we support Amendment No. 1931 of Senator Taft to exclude aluminum base wrap from the credit.

I know you are very short on time and, therefore, I will read a brief executive summary and submit our full statement for the record.

Senator TALMADGE. Without objection, that will be done.

[The statement referred to follows:]

TESTIMONY OF ALUMINUM RECYCLING ASSOCIATION BY DANIEL M. MOENICH, PRESIDENT

EXECUTIVE SUMMARY

The proposed recycling tax credit does not expand the aluminum recycling industry's market for its product and, therefore, does not expand the need for additional aluminum scrap.

There is excess aluminum recycling capacity to produce to meet the demand for product.

There is capacity to process all aluminum scrap generated by municipal waste systems.

Should the proposed aluminum recycling tax credit induce primary aluminum producers to enter the recycling industry, they would have the dual advantage of the tax credit and depletion allowances thereby defeating one of the bill's major objectives, i.e., to equalize the benefits to primary and secondary industries.

In the fourth year of the tax credit—after the base period phase out—the aluminum recycling industry at present levels of scrap consumption and average scrap prices would receive a tax credit equal to 7% of its gross annual sales dollars.

Primary aluminum alloy is neither the equivalent of, nor substitutable for, nor interchangeable with recycled aluminum alloy.

Current demand for aluminum scrap by primary, recycling and fabricating (self-recyclers) plants applies the greatest possible pressure upon scrap collectors and brokers to bring available scrap back into the industrial stream.

The demand of the aluminum recyclers' customers—the casting industry—dictates the amount of aluminum scrap required by our industry each year. Monies made available through a tax credit result only in enabling aluminum recyclers to bid increasingly higher prices for scrap thereby inflating the price of recycled ingot.

The aluminum recycling industry has demonstrated a constant capability, willingness and motivation to expand scrap producing capacity without government incentive. Within the past eight months, aluminum recycling production capacity has increased 8% including the entrance of twelve new companies into the industry.

For all the foregoing reasons, the proposed recycling tax credit will not result in either the use of more aluminum scrap or the development of additional net scrap recycling capacity.

My name is Daniel M. Moenich. I am President of Apex International Alloys, Inc., Des Plaines, Illinois and I am President of the Aluminum Recycling Association.

By its title and by its long history of operation in recycling aluminum, obviously ARA is strongly in favor of the concept of recycling. We are, however, opposed to the application of a recycling tax credit to our industry as proposed in H.R. 10612 and therefore support Amendment No. 1931 of Senator Taft to exclude aluminum base scrap from the tax credit.

In a finite world concerned about steadily diminishing mineral reserves, there is great value in prolonging the useful life of materials. Minerals, and much of the energy used to refine them, can often be preserved for reuse by recycling. This process, the major concern of the member companies of the Aluminum Recycling Association, has been practiced by some of them for over seventy years.

Aluminum is too useful and too valuable not to be kept in use. Aluminum recycling today is an international industry, with metal and scrap traded daily in world markets. Recycled aluminum produced by U.S. firms to strict specifications for the castings processes goes into automobiles, heavy equipment, photo and optical equipment, electrical devices, major home appliances, and hundreds of other products for consumer or industrial use.

The first company to recycle aluminum was founded in 1904, a scant 16 years after the first commercial production of primary aluminum in 1888. Today there are almost 100 aluminum recycling plants spread through the country in virtually every industrial center dedicated to reusing aluminum scrap in producing metal for further use in commercial, industrial and consumer products.

Annual sales of the industry are between $600,000,000 and $700,000,00. Aluminum recycling is recognized as an important source of metal and metal technology separate and distinct from the primary aluminum industry. The aluminum recycling industry has steadily increased capacity and production since it began.

To emphasize the long history of the industry we have attached as Exhibit A a year-by-year list of aluminum recycled from scrap from 1913 (the year records were first kept for our industry) through 1975. In those 62 years, more than 42 billion six hundred ninety thousand pounds of recycled aluminum have been produced from scrap.

Our industry was begun 71 years ago by men of vision who found a market for a product made from aluminum scrap.

Over the past seven decades, the aluminum recycling industry has become highly sophisticated in its production processes and in the methods by which it has utilized scrap purchased from primary producers, other fabricating processes, and from scrap yards and brokers. During all these many years we have provided specification aluminum alloy for the castings industry. With very minor exceptions, primary aluminum producers do not provide alloy for the castings industry. Indeed aluminum alloy is not substitutable for nor interchangable with recycled aluminum alloy because primary alloy is not made to meet castings specifications. There is little product or market competition between the primary and the recycling aluminum industries. Therefore, the proposed amendment cannot provide tax equity between the two industries.

It has been stated that a goal of the recycling tax credit is to "create a situation of equity between virgin natural resources and recyclable material" by granting users of recyclable material a tax credit equal to one half of the percentage of depletion allowances given to competing virgin natural resources. We find a great fallacy and a great contradiction in this proposition as it applies to aluminum base scrap because it would enable primary producers who today use increasing amounts of scrap for their operations to avail themselves not only of depletion allowances but also of a recycling tax credit.

It has been said by the President's Council on Environmental Quality in its 1975 report to Congress at page 93: "In the long run, increased recycling will depend upon a committment by the major firms in the paper industry, for example, to use wastepaper day to day rather than only when virgin fiber is unavailable. For them to do so, a fundamental shift in the economics of recycling is necessary."

Mr. Chairman, members of the Senate Finance Committee, this may well be true for the paper industry and we have no base of knowledge from which to challenge it, nor do we wish to challenge it. However, it is not true of aluminum recycling. The existing fundamentals in the economics of recycling aluminum for the past seven decades has resulted in a strong, healthy and growing recycling industry that provides over 20 percent of this country's aluminum each year.

If it is the intent of the tax credit to encourage recycling and conserve energy and natural resources, as applied to aluminum it is simply throwing tax money at a problem that does not exist in our industry. It is a costly and misdirected approach.

The demand for aluminum scrap for our industry is based entirely upon demand placed upon us by the casting industry for specification alloy to produce consumer components. The casting industry in turn responds to demand from the automobile, heavy equipment, home appliance, photo and electrical and many other industries.

When the economy is strong, this demand is high and so are our requirements for scrap. When the economy weakens, the reverse is true and we use less scrap. Unwanted monies freed by tax credits are a disruptive intrusion into the economics of an established industry. We believe government should not force an industry to deal with an external infusion of money it neither wants nor can readily absorb within the framework of its demand-supply cycles.

For example, at our current rate of production and scrap usage and using current average scrap prices, the recycling tax credit for our industry in the year following phase out of the base period could amount to $49,500,000. (Over 7 percent of the industry's gross sales income). Pumping this kind of money into the scrap stream, demand for which is defined by customer needs, can result only in increased prices for scrap as recycling companies bid against each other to obtain scrap for their furnaces.

Within the past 18 months the capacity of our industry to recycle aluminum has grown from an annual capability of 1.9 billion pounds to over 2.25 billion pounds. This has come about without a tax incentive and because of the strength of the economics of our industry. And from our knowledge of the industry, there are companies today expanding capacity of existing plants and planning to construct plants as new entrants to the industry. This is a natural, normal and thoroughly acceptable phenomenon of our competitive industrial society.

It has been said: "The cities and States must find ready stable markets for all the recyclable metals, paper and glass they will be recovering from garbage." With this we agree and we are a part of that stable market for aluminum base scrap today, and we need no tax incentive readily and economically to process such scrap. Perhaps it is the requirement of cities and States to be helped to generate usable scrap or perhaps it is the need of the scrap gatherers and distributors for an incentive to obtain more scrap. It is not our need and without reservation we reject a recycling tax credit as misplaced in its application to recycling companies that produce specification ~~aluminum ingot~~ from aluminum base scrap and alloying materials.

Mr. Chairman, members of the Committee, our Association represents over 80% of this country's capacity to produce recycled ingot sold in the marketplace. We do not beg the questions either of the conservation of increasingly scarce raw materials nor the conservation of diminishing energy. We have practiced the conservation and reuse of commodities and energy since the beginning of this century. We have heard no arguments, seen no figures, no mathematical nor economic formula that convinces us that a recycling tax credit as it is proposed in H.R. 10612 either will expand the amount of aluminum base scrap available or increase the use of aluminum base scrap and we strongly urge the Senate Finance Committee and the Senate to exempt aluminum base scrap from the proposed tax credit by supporting Mr. Taft's amendment.

Thank you for this opportunity to present our arguments.

Recycled aluminum from scrap

Year:	*Pounds*	Year:	*Pounds*
1913	9, 308, 000	1946	556, 000, 000
1914	9, 044, 000	1947	690, 000, 000
1915	17, 000, 000	1948	574, 000, 000
1916	30, 600, 000	1949	362, 000, 000
1917	32, 200, 000	1950	486, 000, 000
1918	30, 100, 000	1951	594, 000, 000
1919	37, 382, 000	1952	608, 000, 000
1920	31, 000, 000	1953	736, 000, 000
1921	17, 800, 000	1954	626, 000, 000
1922	32, 580, 000	1955	828, 000, 000
1923	42, 600, 000	1956	856, 000, 000
1924	54, 000, 000	1957	880, 000, 000
1925	88, 000, 000	1958	708, 000, 000
1926	88, 400, 000	1959	898, 000, 000
1927	92, 400, 000	1960	876, 000, 000
1928	95, 600, 000	1961	970, 000, 000
1929	98, 800, 000	1962	1, 164, 000, 000
1930	77, 200, 000	1963	1, 308, 000, 000
1931	60, 600, 000	1964	1, 414, 000, 000
1932	48, 000, 000	1965	1, 658, 000, 000
1933	67, 000, 000	1966	1, 774, 000, 000
1934	92, 800, 000	1967	1, 756, 000, 000
1935	102, 800, 000	1968	1, 944, 000, 000
1936	103, 000, 000	1969	2, 300, 000, 000
1937	125, 120, 000	1970	2, 000, 000, 000
1938	77, 600, 000	1971	2, 100, 000, 000
1939	107, 894, 000	1972	2, 252, 000, 000
1940	160, 724, 000	1973	2, 470, 000, 000
1941	213, 714, 000	1974	2, 564, 000, 000
1942	392, 000, 000	1975	2, 364, 000, 000
1943	628, 000, 000		
1944	650, 000, 000	Total	42, 692, 466, 000
1945	596, 000, 000		

Sources: "Secondary Aluminum," R. J. Anderson (1931), Bureau of Mines, Aluminum Association BDC, Department of Commerce.

Ms. Lipson. The proposed recycling tax credit does not expand the aluminum recycling industry's market for its product and, therefore, does not expand the need for additional aluminum scrap.

There is excess aluminum recycling capacity to produce to meet the demand for product.

There is capacity to process all aluminum scrap generated by municipal waste systems.

Should the proposed aluminum recycling tax credit induce primary aluminum producers to enter the recycling industry, they would have the dual advantage of the tax credit and the depletion allowances thereby defeating one of the bill's major objectives, i.e., to equalize the benefits to primary and secondary industries.

In the fourth year of the tax credit—after the base period phase-out—the aluminum recycling industry at present levels of scrap consumption and average scrap prices would receive a tax credit equal to 7 percent of its gross annual sales dollars.

Primary aluminum alloy is neither the equivalent of, nor substitutable for, nor interchangeable with recycled aluminum alloy.

Current demand for aluminum scrap by primary, recycling and fabricating (self-recyclers) plants applies the greatest possible pressure upon scrap collectors and brokers to bring available scrap back into the industrial stream.

The demand of the aluminum recyclers' customers—the casting industry—dictates the amount of aluminum scrap required by our industry each year. Moneys made available through a tax credit result only in enabling aluminum recyclers to bid increasingly higher prices for scrap thereby inflating the price of recycled ingot.

The aluminum recycling industry has demonstrated a constant capability, willingness and motivation to expand scrap producing capacity without Government incentives. Within the past 8 months, aluminum recycling production capacity has increased 8 percent including the entrance of 12 new companies into the industry.

For all the foregoing reasons, the proposed recycling tax credit will not result in either the use of more aluminum scrap or the development of additional net scrap recycling capacity.

Mr. Chairman, our association represents over 80 percent of this country's capacity to produce recycled ingots sold in the marketplace. We do not beg the question, either the conservation of increasingly scarce raw materials nor the conservation of diminishing energy.

We have practiced the conservation and reuse of commodities and energy since the beginning of this century. We have heard no argument and have seen no figures, no economic formula that convinces us that a recycling tax credit either will expand the amount of aluminum-base scrap available or increase the use of aluminum-base scrap.

We strongly urge the Senate Finance Committee and the Senate to exempt aluminum-base scrap from the proposed tax credit by supporting Mr. Taft's amendment.

I thank you for the opportunity to present our arguments.

Senator TALMADGE. Thank you very much for the lucidity of your remarks and brevity.

Mr. J. Scribner Allen, assistant vice president, National Oil Jobbers Council.

Your full statement will be inserted in the record and you may summarize.

STATEMENT OF J. SCRIBNER ALLEN, ASSISTANT VICE PRESIDENT, NATIONAL OIL JOBBERS COUNCIL

Mr. ALLEN. Thank you, Senator.

I am Scribner Allen and I represent the National Oil Jobbers Council.

Since our affiliation and membership are outlined in the statement which we have submitted for the record, I will not repeat it here.

Our purpose in testifying is to recommend striking the provision for a heat pump tax credit contained in title 20 because it will be an incentive for much greater energy demand rather than a conservation measure.

Our reasons can be summarized as follows: A heat pump is also an air-conditioner which will increase energy use. A tax incentive is superfluous because the heat pump is already less expensive than a conventional heating-cooling system.

Since the heat pump is currently selling at an annual rate of 175,000 units, there is absolutely no need for such an incentive. The claimed deficiencies of the heat pump are more than defeated by the production and distribution losses of electric utility systems. This provision would also increase energy consumption in the summer by subsidizing a device with cooling capability. This increase is coincident with most utility summer peak which raises the specter of brown-outs or black-outs.

The increased capacity necessary to accommodate the increased peak will aggravate the capital requirements with which electric utilities already have problems.

The most conservative data we have accumulated indicates a revenue loss the first year of more than $19 million. The Joint Committee on Internal Revenue Taxation has estimated a revenue loss of $70 million. For that reason it is impossible to understand the committee report which estimated only $3 million.

The reliability record of the heat pump since the mid-1950s does not instill confidence. The effect of the problems encountered is to raise its operating costs appreciably.

The low-income consumer derives little, if any, benefit both because of his low tax bracket and because the cost of a heat pump even after the tax credit is generally beyond his means.

The provision is discriminatory, it provides a subsidy for heat pumps to the exclusion of presently available competing and more efficient heating systems.

Thank you for the opportunity to testify. I would be happy to answer any questions you may have.

Senator TALMADGE. Thank you very much for your testimony, sir.

[The statement of Mr. Allen follows:]

TESTIMONY BY J. S. ALLEN, NATIONAL OIL JOBBERS COUNCIL

My name is Scribner Allen, I am representing the National Oil Jobbers Council. Since our affiliation and membership are outlined in the statement which we have submitted for the record, I will not repeat it here.

Our purpose in testifying is to recommend striking the provision for a heat pump tax credit because it will be an incentive for much greater energy demand rather than a conservation measure.

Our reasons can be summarized as follows:

(1) A heat pump is also an air-conditioner which will increase energy use.

(2) A tax incentive is superfluous because it is already less expensive than a conventional heating/cooling system. Since the heat pump is currently selling at an annual rate of 175,000 units, there is absolutely no need for such an incentive.

(3) The claimed efficiencies of the heat pump are more than negated by the production and distribution losses of electric utility systems.

(4) This provision would also increase energy consumption in the summer by subsidizing a device with cooling capability. This increase is coincident

with most electric utility's summer peak which raises the specter of brown-outs or blackouts.

(5) The increased capacity necessary to accommodate the increased peak will aggravate the capital requiremenst with which electric utilities already have problems.

(6) The most conservative data we have accumulated indicates a revenue loss the first year of more than $19 million. The Joint Committee on Internal Revenue Taxation has estimated a revenue loss of $70 million. For that reason, it is impossible to understand the Committee report which estimated $3 million.

(7) The reliability record of the heat pump since the mid-1950's does not instill confidence. The effect of the problems encountered is to raise its operating cost appreciably.

(8) The low-income consumer derives little if any benefit both because of his low tax bracket and because the cost of a heat pump, even after the tax credit, is generally beyond his means.

(9) The provision is discriminatory. It provides a subsidy for heat pumps to the exclusion of presently available, competing and more efficient heating systems.

Thank you for the opportunity to testify. I will be glad to answer any questions my remarks may have raised.

STATEMENT OF THE NATIONAL OIL JOBBERS COUNCIL

The National Oil Jobbers Council is a federation of 42 state and regional trade associations representing thousands of independent small business petroleum markets. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residuel fuel oil. Together our members market approximately 75 percent of the home heating oils and 25 percent of the gasoline sold in America under either their own private brand or the trademark of their supplier.

The Tax Reform Act of 1975 (H.R. 10612) contains a provision for a refundable tax credit on a portion of the cost of installing a Heat Pump in existing residences. NOJC believes that this provision will not only fail to encourage energy conservation, it will actually become an incentive for much greater energy demand. For this reason and those listed below, we therefore respectfully request that this provision be striken from the Act.

The Heat Pump mandates the use of air-conditioning since it is an inherent capability of the equipment. This provision, therefore, instead of its avowed purpose, conservation, is actually promoting the additional use of energy for cooling.

An incentive already exists for the Heat Pump since it is less expensive than a combined air-conditioning and oil or gas heat system. The heat pump is not a new or inovative device and since they are being sold at an annual rate of 175,000 units, a tax incentive is superfluous.

The high losses (frequently acknowledged by Edison Electric Institute) inherent in the generation, transmission and distribution of electricity more than use up the energy conserved by the claimed efficiencies of the Heat Pump. Consequently *only* when compared to electric resistance heat, can a Heat Pump be a viable conservation alternative. *But*, when compared to oil or gas heat, a heat pump uses more of our resource energy.

The promotion of a system with cooling capability will add to electric utilities' summer load. Since most electric utilities now have a summer peak, additional generating capacity will be required. Once installed, the utility has an economic necessity to promote the use of the added capacity; i.e., more energy consumed, not conserved.

The result of this provision not only increases demands on our energy resources, but also increases the electric utilities' capital requirements with which they already have problems.

The Heat Pump tax refund represents an appreciable revenue loss to the Federal Treasury. It was reported by the Bureau of National Affairs (BNA) that the staff of the Joint Committee on Internal Revenue Taxation has estimated this to be $70 million the first year and ultimately $200 million annually. An analysis accompanying our written statement indicates that the most conservative estimate would be $19 million the first year. We find it, therefore, difficult to understand why the Committee report only anticipates a $3 million revenue loss the first year.

By subsidizing the installation of the Heat Pump, the consumer is ill-advisedly being encouraged to invest in a system which has historically high operating and maintenance costs and unproven reliability. Both the National Bureau of Standards and the Oak Ridge National Laboratory have issued reports supporting this reservation. Actual experience indicates that the problems encountered increase energy use to a startling degree.

The benefits of this provision do not accrue to low-income tax-payers. The installation cost of a Heat Pump dictates that even with the tax incentive, only high-middle income taxpayers can afford to consider such an installation.

The provision is discriminatory since it subsidizes the installation of Heat Pumps to the exclusion of presently available competing heating systems or equipment with greater conservation potential. This appears to be a return to the all-electric economy, a Project Independence philosophy which has been examined and found wanting.

Thank you for the opportunity to offer this statement to the Committee.

Attachments.

Annalysis of heat pump revenue loss

Replacement market:	
Oil fired residential furance (NOFI) [1]	400,000
Gas fired residential furnaces (AGA) [2]	500,000
Electric fired residential furnaces (Clark) [3]	250,000
Total, residential furances	1,150,000
Heat pump replacement installation cost:	
Minimum	$2,130
Maximum	6,400

[1] NOFI—National Oil Fuel Institute.
[2] AGA—American Gas Association.
[3] Clark—Authored article, "Heat Pumps . . ." March 1976, Air-conditioning and Refrigeration Business, Page 34.

Tax credit equals 20 percent times $1,000 plus 12.5 percent times $1,130 equals $341.

$3 million (Committee Report) divided by $341 equals 8,797 units. A market penetration of less than 1 percent which is patently ridiculous with a tax credit incentive.

Also, the 8,797 units represents only 5 percent of the 175,000 Heat Pumps which were installed in 1975 without a tax credit.

If penetration were only 5 percent of replacement market it would represent revenue loss of $19 plus million (@ $341/unit) in 1977 alone.

If penetration reaches 50 percent the revenue loss would reach $175 million annually, and with a tax credit, 50 percent penetration is not unlikely in the second or third year.

If the above "maximum" cost is used, a revenue loss as high as $503 million could be reached.

TAXATION AND FINANCE

TAX REFORM: INCREASE INSURANCE OF DEPOSITS, REDUCE INCENTIVES FOR DEBT FINANCING, WALLICH SAYS

Tax legislation should try to remove the tax bias toward debt and against equity, Federal Reserve Board Member Henry C. Wallich told a conference in New York City last week.

Another needed reform is a substantial increase in deposit insurance, Wallich told the "Conference on Financial Crises" of the Salomon Brothers Center for the Study of Financial Institutions of New York University.

Interest should be taxed at the same rate as dividends, and the total revenue from the corporate income tax should be held steady, he said.

Insurance of deposits should be increased, probably not to 100 percent, but far beyond the present $40,000 limit, he also said.

"The historical loss experience, even including U.S. National Bank in San Diego and Franklin (National Bank), indicates that it would cost little to raise the level of insurance even up to 100 percent," Wallich said. "Doing so, in addition to providing insurance, would also help minimize liquidity problems such as arose in the case of the Franklin National Bank, where a rapid runoff of CDs forced the Federal Reserve to substitute its credit for that of large depositors."

Wallich added that full deposit insurance could eliminate the discipline now exerted over banks by the market place. He said insurance should not substitute for a continued effort by banks to improve their capital positions.

TAX REFORM: SENATE FINANCE VOTES $225 TAX CREDIT FOR INSULATING HOMES

The Senate Finance Committee voted today to give taxpayers a tax credit of up to $225 for the cost of insulating their homes.

It also agreed to provide a tax break on purchases of a host of energy-related equipment, including solar and geothermal units and heat pumps installed in homes. In addition, the panel voted to repeal the excise tax on buses and bus parts—a levy which now raises $12 million a year for the Highway Trust Fund.

The proposals, which would cost the Treasury about $410 million next year and increasingly more thereafter, were added to a House-passed tax reform bill (H.R. 10612) which the committee is rewriting. They were previously approved by Finance during considerations of a now-obsolete energy tax bill (HR 6860).

The committee rejected, almost without debate, provisions of the House tax revision bill to change treatment of gains from the sale of stock and other capital investments. These would have permitted an individual to deduct more capital losses against ordinary income, but doubled the period an asset must be held to qualify for long-term capital gains treatment. Chairman Russell B. Long (D-La) suggested that the proposals be dropped to give the Senate more "bargaining chips" in a later conference with the House.

The panel agreed to a $10 million House plan to give mutual funds the three-year carryback, five-year carryforward now allowed corporations. Regulated investment companies are not currently permitted any carryback.

It added a provision to give businesses the option of an eight-year carryforward in lieu of the present three-year carryback and five-year carryforward. There would be no revenue loss to the Treasury until 1982, when staff estimates a $175 million decline.

In other action, the committee agreed to give utilities a 12-percent investment tax credit provided they pass on the extra tax benefits to workers. The plan, pushed by Long, would allow a 2-percent investment credit in addition to the 10-percent write-off normally permitted on purchases of plant and equipment if a utility makes certain contributions to an Employee Stock Ownership Plan (ESOP).

The panel voted last week to make an 11-percent investment tax credit available to any firm which contributes an amount equal to the extra percentage point to an ESOP period. The special break for utilities would bring to $280 million the cost next year of using a bigger investment credit to entice corporations to set up ESOPs—Long's pet project.

Also adopted was an amendment by Sen. Harry Byrd (I-Va) to deny foreign tax breaks to corporations which bribe foreign officials.

Insulation Tax Credit

A homeowner would be allowed a 30-percent tax credit on the first $750 he spends to insulate his home. To help persons too poor to owe any income tax, the credit would be refundable. Staff estimates this would reduce tax revenues $300 million a year.

Businesses would be provided a 10-percent investment credit on insulation installed in existing structures at an annual cost to the Treasury of $20–$25 million.

The House, in its energy tax bill, approved a 30-percent credit on up to $500 in home insulating expenses. But this break would be reduced by the cost of any insulation improvements made by a prior owner.

As another incentive to geothermal energy, the panel voted to make development costs eligible for the intangible drilling write-off and percentage depletion allowance now provided for oil and gas. Staff estimates the revenue loss at $15 million. In addition, a 20-percent investment credit would be allowed on solar and geothermal equipment through 1980, and a 10-percent break through 1985.

Also voted by the panel was a 12-percent investment credit for energy-related equipment, most of which is involved in coal mining. This would cost $30 million next year, but increase to $100 million annually.

Utility ESOP's

Under present law, which the committee already voted to make permament, any firm can take an extra 1 percent tax credit provided it contributes an amount equal to the additional benefits to an ESOP. The committee agreed today to provide another 1 percentage point credit to an electric utility or local gas distribution firm if the company and its workers each agree to contribute additional amounts equal to the 1 percent.

The extra 1-percent tax credit for utilities would cost the Treasury $80 million next year and $270 million after five years.

The additional two percentage points of credit would not be subject to the 50-percent-of-income-tax limit of the investment credit, but the total 12-percent credit could not exceed 100 percent of income tax.

JULY 19, 1976.

Re The Tax Reform Act 1975 (H.R. 10612).
Bulletin: 281.
Subject: Heat pump.

The attached contains a description of the heat pump and how it operates in simple terms.

More importantly—beginning on Page 3 it points out the reservations, cautions, and special service considerations which the owner/operators have found necessary to produce in a manual for their industry.

HEAT PUMP PERFORMANCE

Over the past several years much discussion has surrounded the use of the heat pump. Its promotion and use has had its ups and downs as witnesed by the actions of major manufacturers, utility companies, and builders. The following analysis treats the development of the heat pump, its operation and associated problems, maintenance tips, and what the property manager should look for when assuming properties that utilize heat pumps.

THE HEAT PUMP—AN OVERVIEW

A heat pump provides both heating and cooling from one basic machine. It has been called a "reverse-cycle" air conditioner in that the flow of refrigerant is reversed in winter to add heat to the room, instead of extracting heat as is done in summer. The key advantage is that it *transfers* some of the heat instead of generating it, thereby reducing the cost of energy required during the winter. For summer operation it operates similarly to an ordinary direct-expansion (DX) air conditioner.

The most common type of heat pump is the "air-to-air," in which the refrigerant in a heat exchanger absorbs heat from one body of air and, after being processed through the system, ejects it to another body of air. (Less common types use water as a heat-transfer medium instead of air, but these are restricted geographically by the availability of suitable well water or are used in very large specially designed systems.) A brief review of the air conditioning cycle (Fig. 1) and an explanation of the "reverse cycle" follows.

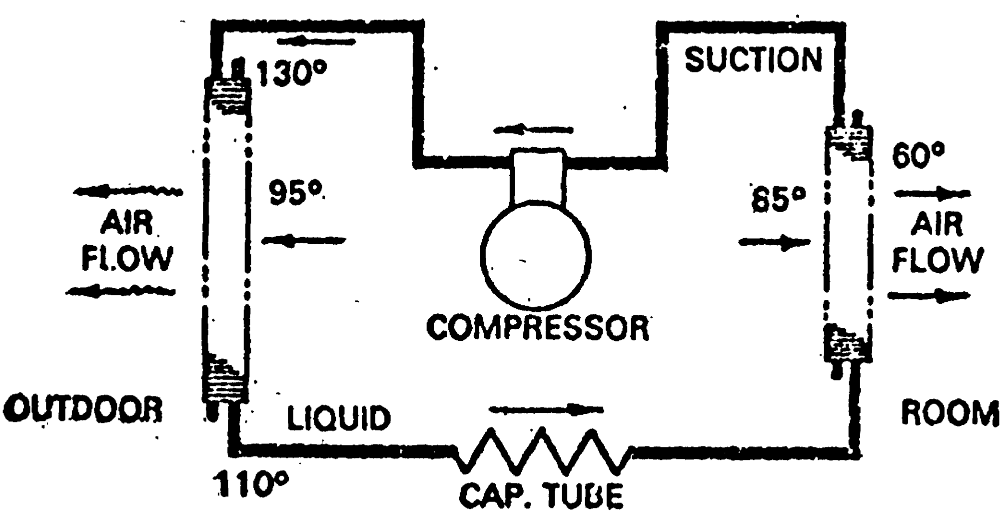

FIGURE 1.—Air conditioner

When a liquid refrigerant changes to a gas (evaporates), it must absorb heat from the air, and this is what happens in the room coil of an air conditioner. Liquid refrigerant passes through a thin capillary tube (or an expansion valve) into the room coil; in entering this larger area a sharp reduction of pressure permits the liquid to expand quickly, thereby evaporating into a gas. As it does, it requires heat, and that heat is taken from the room air which is passing over the outside of the coil.

The compressor creates suction, drawing in the warmed gas; at this point pressure is added to help the refrigerant continue on its cycle. The compressed gas, containing heat from the room and from the compressor, goes through the outdoor coil where it is chilled by the outside air and condenses again into a liquid.

Heat Pump Operation

During the summer the heat pump operates like an air conditioner, but in winter, by reversing the flow of refrigerant, heat can be absorbed from outdoors and sent into the occupied space (Fig. 2). The essential concept is the the refrigerant evaporating in the outdoor coil can absorb heat from the cold outside air, if the refrigerant is colder than the air. The amount of heat the refrigerant can absorb will depend of course on the temperature difference while it is being evaporated in the outdoor coil. That heat, plus the heat added by the compressor, is then sent to the indoor coil where it is picked up by the room air.

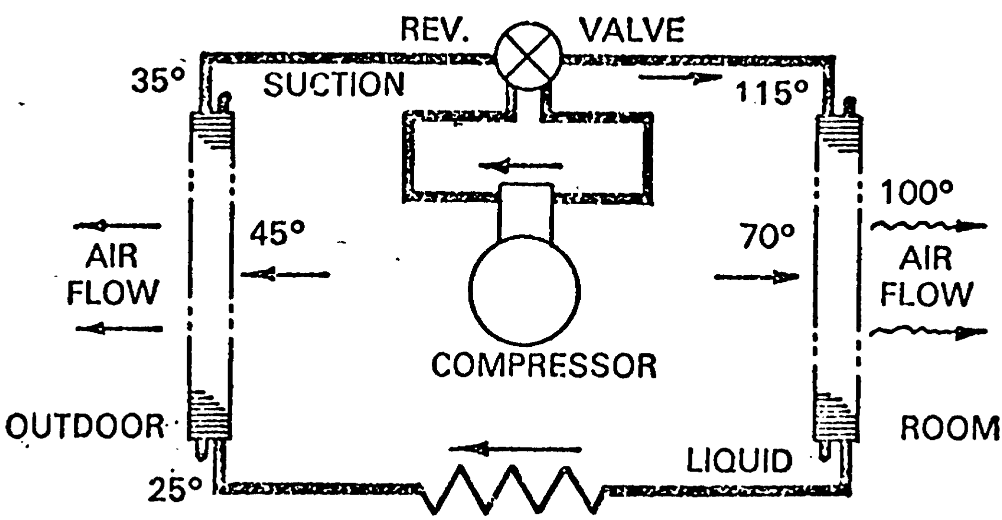

FIGURE 2.—Heat pump—Winter cycle

A basic measure of operating economy is the amount of watts required to produce the necessary Btu's of heating or cooling, called the "energy efficiency ratio." During the summer a heat pump has a slightly lower EER than its equivalent air conditioner because of the additional components involved, but there can be appreciable savings during the winter if a substantial amount of heat can be picked up from outdoors. It is for this reason that standard output ratings of the Air-Conditioning and Refrigeration Institute are based on 45-degree outside air temperature.

A random check of 60 unitary heat pumps, both self-contained and "split" types, shows coefficients of performance for winter ranging from 1.7 to 3.1, with most of them in the 2.2 to 2.6 range. This indicates that a heat pump will provide about 2½ Btu's of heat for each Btu of electricity purchased, or about 8½ Btu's for each watt, at 45 degrees outside temperature. This compares with 3.4 Btu's per watt obtained with ordinary electric resistance heating. Electric utility companies are often eager to promote heat pumps in order to avoid complaints of high heating bills during winter.

This advantage in efficiency can best be appreciated by examining the table below, abstracted from a report of the Western Massachusetts Electric Company.

Type of electric heating system utilization residential and small commercial: Efficiency (percent)[1]

	Utilization efficiency[1] (percent)
Electric heat pumps	148–158
Electric resistance baseboard	90–100
Electric furnace	74– 84
Electric glass panels	68– 79
Electric heating wires	79– 90

[1] These efficiency factors are being applied by several utility companies in estimating operating costs, and the accuracy of their equation has been reported to be within 3 percent.

"Applications" Ratings

Since the 45-degree base is not widely applicable, the manufacturers of heat pumps are permitted to list reduced output ratings down to 20 degrees outside temperature. However, this shows a disproportionate drop in operating efficiency, the coefficient of performance dropping as low at 1.1, and the modal value dropping from 2.5 at 45 degrees to 1.4 at 20 degrees. Thus, for one unit having a standard heating rating of 48,000 Btu's, the "applications" rating at 20 degrees drops down to 27,000. This reduction of efficiency is by no means a constant, varying with the manufacturer and model.

The essential disadvantage of the heat pump in winter is its inverse output to the heating requirements: the colder the outside temperature and the more heating required, the lower the capability and efficiency of the heat pump. To overcome this deficiency heat pumps with an auxiliary electric resistance coil (strip heater) can be provided to operate at predetermined outside temperatures and provide the necessary additional heat. This, however, defeats part of the advantage of the heat pump cycle and increases the cost of operation. It is therefore advisable for the specifier to determine the output of the refrigerant cycle at the winer temperature for the area, to ensure that at least 60% of the design requirements will be met without the operation of the strip heater.

Reliability

Much excitement was generated by the introduction in the early 1950's of the heat pump, and it seemed to be the answer for low-cost electric heat. In fact, in 1960 a key utility company spokesman announced at a national convention that "The electric utilities are committed to heat pumps." Yet it was just the previous year, in September 1959, that the United States Air Force announced it was halting purchases of heat pumps for government-owned housing. This decision was based on the excessive failures encountered with 9,000 heat pumps installed in homes at three bases in Mississippi, Arkansas, and North Carolina. In addition to finding that operating costs for energy were excessively high (in one area exactly double the cost predicted by the utility company) it was found that compressors were failing and being replaced at the rate of 2,500 per year, with each replacement costing the government $200 to $400.

With similar difficulties arising in Navy housing as well, the U.S. Department of Defense in March 1965 banned such equipment and issued the following directive: "Packaged air to-air heat pumps shall not be used in any personnel living space, and no heat pump of any type shall be used in family quarters." When pressured by industry representatives about this order, Defense officials assured them it was intended as a "moratorium" until the industry had eliminated the problems.

The essential problem was that the equipment required excessive maintenance—"almost could not be maintained"—and suitable training programs for service men were not available. Manufacturers reported that maintenance costs should normally not exceed $12 per year per unit; however, when bids were requested for such service, the lowest bid was $85.

Failure Causes

Compressor failures were repeatedly cited, and knowledgeable engineers felt the compressor was being assigned a function for which it was not suited. One of the serious causes of compressor failure is the lack of lubrication occurring when slugs of liquid refrigerant return to the compressor and "degrease" its moving parts. This can happen in winter when the outdoor evaporator coil is unable to extract sufficient heat from the air to effect full evaporation of the refrigerant.

A recent solution is the use of oversized "cans" which house the hermetic compressor. This would permit excess refrigerant to be stored, with little chance for the liquid to reach the suction outlet at the top. It is claimed that this design would eliminate the need for "crankcase heaters" which many other manufacturers now feel are essential.

Another problem, which may have been solved, is that of the high-temperature cut-off for the compressor motor. Instead of depending on one surface-mounted thermostat, there is a trend toward more positive motor protection by increasing the number of internal thermostats and applying them at critical locations.

Another problem aspect is the defrost cycle. During winter the low temperatures at the outdoor evaporator coil cause frost to form which reduces its capacity or actually prevents the unit from functioning. After a review of field tests of 400 heat pumps for at least three years, a report in April 1972 stated that "a dependable defrosting system is vital to heat pump operation."

To overcome this problem, it is essential that the unit be defrosted automatically several times each day, but this in itself creates a shock to the system. Not only does the reversing valve turn around, but most of the components suddenly change their function from hot to cold and vice versa, setting up temperature and pressure stresses which are not easily avoidable in moderate-cost equipment.

The defrost controller itself is sometimes at fault, both in accuracy of performance and in reliability. A timer is usually incorporated for this purpose, recycling the equipment at preset intervals. But considering the varying indoor and outdoor conditions which the equipment must satisfy, there is now some sentiment in the industry in favor of devices reacting to the actual surface temperatures of the outdoor coil. Putting such a thermostat in series with the timer can prevent unnecessary recycling, while putting it in parallel will ensure defrosting should the thermostate element or location prove unreliable.

Working Under Stress

Diagramatically the heat pump may resemble an ordinary room air conditioner, but the operation of the former is much more demanding. The ASHRAE Guide (handbook for comfort engineers) points out that heat pumps operate up to five times more hours than an air conditioner and urges engineers to take special care in selecting the proper components. Proper installation also plays a major role in system reliability. In addition to the stresses of the defrosting cycle and the additional burden of longer operation, there are further stress problems related to climate conditions. One study found that the stresses on the heat pump in northern climates were seven times as great as those in southern areas. However, there is a converse to the problem when outdoor temperatures exceed 65 degrees and some heating is desired (such as in motels). Having excessive capacity under this condition, the compressor pumps the refrigerant at a much higher rate, thereby increasing the stresses on the motor. Other factors which normally cause high stress conditions are contaminants in the refrigerant, voltage fluctuations, and cold starts of equipment when outdoor temperatures are low.

Supplementary Heaters

It is generally felt that the heat pump cycle should satisfy at least 60% of the design winter load with the remaining 40% provided by supplementary strip heaters. However, the division point is necessarily determined by the temperature zone. For colder areas the Electric Comfort Conditioning Journal recommends that strip heaters be sized for 100% of the heating load, plus a 15% safety factor, as a precaution against heat pump failure. This can, however, result in excessive operating costs. Unless reliable indoor-outdoor thermostats are used, with a manually adjustable two-stage indoor control, straight resistance heating is being used too frequently with resultant higher costs. In some instances, the refrigeration cycle had cut out on safety control and all heat was being furnished by the resistance heaters, which no one was aware of until the electric bills came in.

The outdoor thermostat should be set to cut out above 35 degrees to prevent the strip heater from operating unnecessarily, except during the defrost cycle. (During defrost, while hot refrigerant goes to the outdoor coil, the strip heater must take over to provide room heating.) A high limit device for sensing the outlet supply air to the duct system should be set at less than 200 degrees. Mechanical clock sequencers have been employed in some makes to perform these functions, but itt is now felt they should only be used in conjunction with thermostats. It is possible that new solid-state controls will overcome the reliabiliy gap.

Installation and Maintenance

Accurate sizing of equipment and ducts can be critical in a heat pump installation. Insufficient return of room air can put a heavier burden on the equipment and detract from its performance. Oversizing the cooling capacity in order to provide additional heating capacity will result in short cycling during summer, causing inadequate humidity control and spotty cooling temperatures; it will also result in discomfort and higher operating costs.

Even the location of the air ducts in the house can have a major effect on operating costs. In six identical houses adjacent to each other, it was found that three with ducts in the attic used 37% more electricity than the three with ducts in the crawl space.

Routine maintenance and trouble-shooting become more complicated with this type of equipment, and recharging the refrigerant can be critical. While recharging of ordinary air conditioners can be controlled through use of pressure gauges, the amount of refrigerant used in a heat pump must be carefully weighed. Otherwise the accumulator can be over-filled and will almost certainly send a slug of liquid refrigerant to the compressor.

Accurate control of temperature in all phases of operation is essential; all controls should be checked out before physically installing the heat pump. In one instance, an engineer discovered a motel installation in which controls were uniformly erratic from room to room, indicating a basic factory fault rather than mishandling by guests.

Service Training

Utility companies have strongly urged increased training for installers and service men. Poor system layout or installation often results in continuing service problems. Installers have been urged to provide five-year service contracts. Such service contracts can be quite beneficial to the owner, especially if priced at the time installation bids are being made.

The installing contractor should visit the customer after the installation has been completed and explain all phases of the heat pump's operation. Unfortunately, such communication often does not get down to the operating personnel and does not take the place of specially trained service mechanics who understand the nature of heat pumps.

Operating Costs

Many users of heat pumps are well pleased with their performance, both in comfort and cost. An installing contractor in Georgia, who specializes in this work and services his installations, has found that service costs for residential and small commercial equipment between two and five years old average about $47 per unit per year. Equipment over five years old shows an average service cost of $170 per unit annually, with some units running as high as $226.

Although such increases in service problems should be expected as the unit becomes older, it may be surprising that the energy usage also increases as the years go by. This was highlighted in a study made by a consulting engineer who for ten years carefully observed and recorded the performance of the heat pump in his own home in Gainesville, Florida. He is favorable towards the use of heat pumps, but the accurate metering he performed on his own unit revealed a 50% increase in electrical usage as indicated by the historical comparison below:

Kilowatt-hours per square feet per 1,000 degree days

	Kilowatt-hours
1960 to 1961	2.69
1969 to 1970	3.90

Maintenance costs have averaged $100 per year during this ten-year period in addition to initial warranty service. Three compressors, the fan motor, and a variety of controls and accessories have had to be replaced.

New Improvements

The Edison Electric Institute, representing the major electric utility companies, felt that the heat pump represented a major potential outlet for electric heat at moderate cost. However, when it became aware of the multitudinous problems, it commissioned two leading manufacturers to develop a more reliable product. In 1963 Westinghouse initiated work to develop a three-ton prototype for residential use, which was successfully completed in 1966.

Two hundred of the "second generation" heat pumps have been field-tested in 57 utility territories, thoroughly observed and instrumented, and by the end of 1971 the operating statistics were published. These statistics indicated significant gains had been made in reliability and performance.

Much knowledge has been gained concerning the causes of earlier failures, and many improvements have been incorporated in the new designs. However, the inherent problems of internal stress related to high or low outdoor temperature still have not been thoroughly satisfied. according to the Better Heating-Cooling Council. Typical air conditioners are designed to work within a low-stress range of internal pressure ratios, but this has not yet been fully worked out for the heat pump.

A recent innovation, the use of a different refrigerant, seems to have ameliorated some of the problems, and a favorable report has been issued concerning its advantages in reducing compressor failures. However, among those who cooperated in the study, there are differences of opinion as to the benefits of the refrigerant (R-502).

Builder's Experience

Based on the testimony of builders it appears that problems with the heat pump cannot be limited only to the north.

Statistics from the Dallas area tend to confirm this specific reaction. During the ten-year period of 1957–1966 heat pumps accounted for 60% of the electric heat sales in that area according to the electric utility company. They now report that heat pumps accounted for less than 1% of their sales in 1971.

It is also interesting to compare that local trend with the national picture, as revealed by data of the Edison Electric Institute which are based on reports from utility companies on apartment house installations. There were 175 electric heat installations in apartment houses nationwide during the 1966–1968 interval and only 12 or about 7% of these projects used heat pumps. These data seem to indicate a greater reluctance on the part of apartment house builders to use heat pumps as opposed to builders of single family units.

MAINTENANCE TIPS FOR HEAT PUMP SYSTEMS

When contrast servicing is required, qualifications and references must be carefully checked. When staff mechanics are used, they should be given specialized training for the particular brand. Service manuals should be obtained for all new mechanics, and they should be specifically cautioned about potential damages.

Trouble-shooting and repairs should follow procedures outlined by the Refrigeration Service Engineers Society. When motor burnout occurs, the procedures listed in the ASHRAE Guide should followed scrupulously.

Air Flow

Reduced flow of the inside air over the coil in winter increases system operating pressure and temperature and may lead to burnout of the compressor.

Reduced flow of air over the outside coil in winter will increase frequency of defrost cycles. Reduced flow of inside air in summer can cause the humidity from the room to freeze on the surfaces of the cooling coil, quickly accelerating further freeze-up and eventually causing damage to the compressor.

Tip.—Coils should be inspected frequently to ensure they are not clogged with lint or dirt. Air filters should be cleaned or replaced at regular intervals to provide protection for the coils.

Stress and Vibration

A quick stop-start operation can cause great stress internally, particularly during repeated defrost cycles several times a day. It can also create excessive intermittent vibration of the compressor, straining the tubing connections.

Tip.—A 3-to-5 minute time delay control should be installed after consultation with the manufacturer. Supporting mounts and springs can be replaced with stronger ones if necessary.

Moisture in System

Slight amounts of water vapor entrained in the refrigerant can freeze up at certain critical points, causing blockage throughout the system and severe, permanent damage. As little as 25 parts per million of moisture in the refrigerant can cause trouble.

Tip.—Use "super-sensitive" moisture indicators for testing heat pumps. Repairs to refrigerant tubing should be made only with sealed tubing, preferably filled with nitrogen. Dessicant driers, usually combined with the line filter, should be replaced every time the tubing is opened. In addition to normal dehydration procedures, it is good practice, after several weeks of operation, to replace the drier with a new one to ensure moisture-free operation.

Overheated Motors

Excessive temperatures in the motor windings may not harm the motor immediately, but frequently they can cause a chemical breakdown of refrigerant and oil, creating sludge and acids. These in turn gum up and corrode the compressor's pistons and valves.

Tip.—A variety of operating conditions can cause the motor to overheat. It is therefore essential that thermostat cutouts, preferably placed in the motor windings and other sensitive spots, be included in the hermetically-sealed unit. Check with the manufacturer to determine if such protection has been installed.

ROLE OF THE PROPERTY MANAGER

A review of the efficiency advantages of heat pumps, and an evaluation of their potential operating problems would indicate to the property manager that special attention should be devoted to such equipment when taking over a new property. A factual, above-board discussion should be held with the manufacturer's engineer to determine the specifics of potential service problems. The manufacturer should recommend suitable local service organizations, and bids should be taken for full service. This should initially be arranged for a one-year period until conclusions can be drawn on the competence of the service people, after which a five-year contract may perhaps be in order.

Arrangements should be made with the product manufacturer for a planned training program with operating personnel, covering normal operation and minor trouble-shooting, with particular emphasis on detecting abnormal conditions. In addition, accurate records should be kept on service calls and costs relating to individual units, and any substantial drains in cash flow should be brought to the attention of owners.

Senator TALMADGE. The next witness is Mr. John J. Contney, Linen Supply Association of America.

You may insert your full statement in the record and summarize it.

STATEMENT OF JOHN J. CONTNEY, EXECUTIVE DIRECTOR, LINEN SUPPLY ASSOCIATION OF AMERICA, ACCOMPANIED BY JOHN J. CONNORS, FEDERAL NATIONAL LINEN SERVICE, BOSTON, MASS.; ELLEN V. SANGER; AND STEVEN JOHN FELLMAN, LEGAL COUNSEL, WASHINGTON

Mr. CONTNEY. Thank you, Mr. Chairman.

This afternoon I am accompanied by three others: the president of our association, John J. Connors from Federal National Linen Service in Boston, Mass.; Ellen V. Sanger, our paralegal; and Steven John Fellman, our legal counsel for our office here in Washington, D.C.

Senator TALMADGE. Delighted to have all of you appear.

Mr. CONTNEY. Thank you, Senator.

We sincerely appreciate this opportunity to give public comment on section 2509 of the bill which would give special tax treatment to hospital cooperative laundries under section 510(e) of the Internal Revenue Code.

We are opposed to this amendment. The Senate rejected a similar amendment in 1967 and again in 1969.

We represent linen supply companies—that is, laundries who rent linens to a wide variety of independent users. We represent 90 percent of the volume done in the U.S. industry. Many of our companies seek the hospital linen as a significant growth industry. We are concerned with this amendment because this is a special interest amendment which is unjustified. It would give special tax treatment to central laundries who cannot compete in the marketplace without it.

Full details of comparative existing costs between hospital cooperative laundries and linen supply services and commercial laundry services are available in our written comments which accompanies our statement.

Central laundry costs are higher than the charges our members make to hospitals for the same services. We do laundry and linen supply service for hospitals and we service more hospitals and central laundries.

We, as an industry, are an energy efficient cycling industry in the major and many minor communities in the United States.

We have 15 laundry plants that operate, for example, in the State of Georgia and Atlanta, Ga., is the head of our main largest member, National Linen Service.

We offer exactly the same service to hospitals as central laundries do but tax exemption should not be given to a group of central laundries when they would use this exemption in direct competition with our member companies who offer the same service at less money and still pay taxes.

We are not asking for a special tax treatment. All we want is equal treatment so that we can compete in the marketplace on an equitable basis. There simply is no economic justification for this amendment. In fact, if enacted, it would increase health care costs.

We have been successful as an industry in reducing health care costs by reducing laundry costs. We do a better and a lower cost job than do central laundries. All we want is to retain the right to compete fairly in the marketplace, to give our hospital customers the best service and to offer them the very lowest possible costs.

We thank you very much for this opportunity to appear before you and hear our testimony.

Senator TALMADGE. Thank you very much for a lucid and precise statement. I know the Atlanta linen people extremely well. They are long-time friends of mine and they do an outstanding job.

[The statement of Mr. Contney follows:]

(STATEMENT OF THE LINEN SUPPLY ASSOCIATION OF AMERICA)

SUMMARY

1. The proposed amendment was rejected by the Senate before because less expensive commercial services were available. These services are still available.
2. Members of Linen Supply Association of America presently serve more than 10% of hospitals.
3. Entities serving tax exempt institutions do not themselves necessarily deserve tax exempt status.
4. Clear benefits accrue from central laundry services as provided by commercial linen suppliers:
   - A. No Federal funding;
   - B. No long term contracts;
   - C. Hospitals may change suppliers if needs not fulfilled;
   - D. Linen suppliers pay taxes—hospitals do not; and
   - E. Prices lower than most central hospital laundries.
5. Proposed amendment would delete tax revenue and increase health care costs.

STATEMENT

The Linen Supply Association of America strongly opposes the shared services for hospitals amendment reported by the Senate Finance Committee to H.R. 10612 as this amendment applies to laundry services. The proposed amendment will permit hospitals to obtain tax exempt status for cooperative laundries. This amendment sponsored by the American Hospital Association was rejected by the Senate the last time this issue was raised on the basis of clear and substantial evidence indicating that commercial textile laundry services provided cheaper and more efficient services than can be obtained from cooperative laundries and that commercial services are available in all areas of the country.

The Linen Supply Association of America is a trade association consisting of over 1,000 plants in the United States. It is estimated that members of LSAA account for a sales volume of over $1 billion annually and employ over 60,000 persons. At the present time according to the 1975 "Special Survey on Selected Hospital Topics" prepared by the American Hospital Association, over 10 percent of the hospitals reported are served by linen rental service.

The American Hospital Association wishes to establish tax exempt status for shared services as applied to cooperative hospital laundries. It has long been a well established principle that entities providing services to tax exempt organizations do not therefore necessarily qualify as tax exempt. The amendment concerning shared services of hospital laundries is a case of a special interest group asking for a tax preference when none is justified. As consumers the members of the Linen Supply Association of America are well aware of the fact that hospital and health care costs are rising and we are more than sympathetic to any argument that justifies the needs to keep these costs down. However, in the case of the amendment with which we are concerned, we can show that an increase in the number of cooperative hospital laundries will increase the cost of health care to our nation by not only increasing the cost of laundry services but by also depriving the government of the taxes paid by linen supply companies and their employees. Cooperative hospital laundries will require federal capital funding. Private linen supply companies provide their own capital funding. The American Hospital Association recognizes the concept of the efficiencies of large laundry facilities serving more than one institution. In its statement to the Committee on Finance, the American Hospital Association said "The benefits health care institutions derive from an efficiently managed central laundry include the avoidance of capital expenditures for unnecessary duplication of facilities, the freeing of space for other use in each hospital that does not have to maintain its own laundry, reduced operating costs through the greater efficiency of a large laundry as compared to smaller individual hospital laundries, and improved sanitation and quality control. Relieving hospital officials from responsibility for operation of a laundry, which is a job more appropriate to business trained personnel that large central laundries can afford to employ also leave hospital officials more time to devote to patient care."

Although the above quotation was offered in support of the shared services concept for central laundries, it applies even more aptly to the type of service that members of LSAA can offer and do offer to such hospitals. We offer the exact same benefits that cooperative hospitals laundries do, and at the same time provide our own capital for investment. We permit hospitals to leave and switch services from one supplier to another in the event service does not meet their needs. We pay taxes but hospitals do not. Last and perhaps most significant, we offer all this at a price that is substantially below the price at which most central hospital laundries have been able to provide service in the past.

We have provided the Committee with full details as to cost as included in our position paper of June 17, 1976, a copy of which is attached.

The last time the Senate considered this issue, it was decided not to include laundry services under the shared services for hospitals concept. To change position now, in light of the evidence presented by LSAA and without the opportunity for a full hearing in this issue is a travesty on justice. As our federal budget continues to increase and the costs of health care services become astronomical, it is the job of the Congress to avoid unwarranted and unjustified deletions from the tax base and to avoid further increasing hospital costs. We have clearly shown that the proposed amendment is unwarranted and unjustified on both the above bases. We ask that the shared service amendment as applying to laundry services and on textile rental services be deleted from the all-inclusive Committee amendments.

JOHN J. CONTNEY,
Executive Director, Linen Supply Association of America.

COUNIHAN, CASEY & LOOMIS,
June 17, 1976.

LINEN SUPPLY ASSOCIATION OF AMERICA—POSITION PAPER IN OPPOSITION TO SENATE FINANCE COMMITTEE

Committee Amendment to the Tax Reform Act (H.R. 10612) relating to tax treatment of laundry services by hospitals under Section 501(e) of the Internal Revenue Code.

In 1968 Congress enacted legislation that gave tax exempt status to certain cooperative hospital service organizations. This concept was incorporated into the Internal Revenue Code as Section 501(e). At that time, the Congress specifically determined that it was in the best interests of the Nation to exclude cooperative laundry ventures from the 501(e) exemption. (Conference Committee Report No. 1533, 90th Congress, 2nd Session, Section 109 (1968)).

The Senate Finance Committee has reported a Committee Amendment, which would now include laundry services under Section 501(e). This amendment covers an issue which was publicly debated in 1968 and has not been raised publicly at any time in the consideration of the present tax legislation.

The attached position paper clearly shows that there is no justification in changing Section 501(e) with regard to laundry services. It is inconceivable that the Senate would determine to reverse its previous opinion without giving interested parties an opportunity to present testimony at a hearing open to the public. The amendment contained in the Senate Finance Committee Amendments is the direct result of lobbying activities of the American Hospital Association which provided the Committee incorrect factual data. We urge that you oppose the amendments to broaden Section 501(e) with regard to laundry services.

For more information contact Ellen Saenger, Legal Assistant, Counihan, Casey & Loomis, or Steven J. Fellman, Counihan, Casey & Loomis, 1000 Connecticut Avenue, Washington, D.C. 20036. (202) 296-5680.

LINEN SUPPLY ASSOCIATION OF AMERICA,
Miami Beach, June 17, 1976.

LINEN SUPPLY ASSOCIATION OF AMERICA—POSITION ON TAX REFORM ACT OF 1976 SUPPLEMENTAL COMMITTEE AMENDMENTS

The Linen Supply Association of America is opposed to the Senate Finance Committee amendment to the Tax Reform Act of 1976 (H.R. 10612) which would allow hospital laundries to be considered "shared services" and exempt from payment of income taxes under Section 501(e) of the Internal Revenue Code.

WHY has Congress not invited the linen supply and laundry industries to appear at public hearings and present testimony on the joint hospital laundry issue? Why does Congress now consider an issue twice before defeated without holding hearings? With hospital cost rising, WHY does Congress want to create joint hospital laundries, constructed from Federal funds and operated with tax exempt dollars when utilization of linen supply or commercial laundry services would be more economical?

We ask the Senate to delete this amendment in the bill as passed by the Senate Finance Committee. This same solution was adopted by the Senate Committee on Labor and Public Welfare in rejecting a similar proposed amendment to the Partnership for Health Amendments of 1967 (Senate Report No. 724, 90th Congress, First Session, p. 19; November 4, 1967) and again in the Revenue and Expenditure Control Act of 1968.

Our specific reasons for requesting the deletion of the proposed amendment follows:

1. Existing cooperative laundry services have been shown to be more expensive when compared with the cost of outside-the-hospital laundry and linen services provided by linen supply companies.

2. The intent of the Congress should not be to continue to sponsor these institutions whose activities result in higher costs for hospital care when the same services can be provided at less cost by tax-paying, for-profit commercial companies.

3. The hospital community itself recognizes this and criticizes hospital management in general to be inadequate as regards productivity when compared to private industry. They also criticize hospital cooperative laundries, in particular, for poor service and high costs, especially the high cost of debt service because of high central laundry construction costs.

4. For-profit linen supply companies who pay taxes offer lower total per patient day costs for laundry and linen services than existing central hospital cooperative laundry establishments.

5. Linen supply companies and other outside-the-hospital commercial laundries have served a substantial percentage of hospitals economically and well for many years in a very stable customer/supplier relationship.

6. Combined use of linen supply services when compared with existing hospital central cooperative laundry establishments could save hospitals and their health care customers an estimated additional 5 to 10% of their present laundry/linen service costs, resulting in an annual savings of from $42,500,000 to $85,000,000 per year in medical expenses.

1. Existing cooperative laundry services have been shown to be more expensive when compared with the cost of outside-the-hospital laundry and linen services provided by linen supply companies

A survey conducted in 1975 of sixteen hospital laundry cooperatives by Michael Broadbent, a hospital laundry consultant, revealed that linen service costs per patient day in these cooperatives ranged up to $4.45 and averaged $2.91. The same survey noted that linen suppliers majoring in hospital rental averaged a per patient day linen service cost of $2.13. More significantly, the costliest linen supplier was $2.28 per patient day, a far cry from the high $4.45 cost of one cooperative laundry.

2. The intent of the Congress should not be to continue to sponsor these institutions whose activities result in higher costs for hospital care when the same services can be provided at less cost by taxpaying, for-profit commercial companies

The proposed Senate bill which would exempt hospital cooperatives from federal taxes is inimical to both hospitals and linen suppliers of the United States. It would act contrary to the very purpose for which the bill is intended—that of reducing the cost per patient day which is so necessary for the health care industry in the United States.

The Linen Supply Association of America and its member companies feel that the proposed tax examption will allow an unfair advantage to accrue to cooperative laundries and severely hamper the efforts of linen suppliers to provide a more efficient and economical alternative linen service.

3. The hospital community itself recognizes and criticizes hospital management in general to be inadequate as regards productivity when compared to private industry. They also criticize hospital cooperative laundries, in particular, for poor service and high costs, especially the high cost of debt service because of high central laundry construction costs

Mr. Allen G. Herkimer, Jr., Co-Chairman of the Hospital Financial Management Panel in its 1973 report to the National Commission on Productivity said that the first external problem of hospitals is the "general lack of competitive, risk-oriented atmosphere created by the marketplace." The statistical devices for measuring hospital productivity are not always adequate, as the Hospital Financial Management Panel noted. Yet it is essential that this vital industry knows what results it is producing and continually seeks ways to improve its productivity. But to further reduce the competition by encouraging the use of hospital laundry cooperatives which have not proved to lessen costs would be a severe blow to the attempt to increase hospital productivity in this most vital area.

Although there has been a certain trend towards creating or joining central laundries, there has been a parallel growth of complaints and dissatisfaction with their operations and service. Hospital administrators wavering on laundry decisions are justifiably concerned. According to Wilbur Stevens, Director of Central Services, Mercy Hospital, Pittsburgh, Pennsylvania, writing in the December 1975 issue of Hospital Financial Management.

> The tendency to consider and document laundry and linen service as one function and the resulting tendency to blame all problems relating to linen on the laundry are at the root of the dissatisfaction with central laundries . . . these ideas tend to obscure the real problem—usage.

This is the heart of the real problem with cooperative laundries. It is the internal savings effected by proper use of textiles which is the second half of the laundry system providing lower costs per patient day.

Linen suppliers, constantly pressured by the free enterprise system of competition and cost savings requirements, have developed and refined the system in order to provide the most economical laundry processing and linen service costs to hospitals throughout the United States.

It is the position of the Linen Supply Association of America that the growth of the central or cooperative laundry has also been slowed by its inability to provide this dual service—linen service as well as laundry service. The processing of laundry is relatively routine, while the management of the linen service within the hospital is a more complex and sophisticated affair.

The hospital served by a linen supplier has, in effect, an additional expert on the hospital staff. The linen supplier has a vested interest in assisting the hospital administrator to effect internal savings.

A typical central laundry makes the mistake of contracting with member hospitals to provide a specified quantity of linen at a specified price per pound. Central laundries, however, only control the cost of processing. The cost of replacing linen is out of their control. This results in inadequate budgets to replace linen, complaints and general dissatisfaction. According to Mr. Stevens and, again, quoting from the December 1975 issue of Hospital Financial Management:

> The central laundry has no control over how linen is used in a hospital. It may provide linen service as well as laundry service. It may have the responsibility for purchasing linen in volume for its members. But it can do nothing to control how that linen is used (or abused) after it is delivered to the member institution.

Another major item of significance contributing to the skyrocketing cost of cooperative laundries is the cost of debt service. In an address before the American Hospital Association Convention in August of 1975, another well-known hospital consultant, David Giancola, reported that "a major cost of centrals is debt service, which in some centrals can run as high as 6 to 8¢ a pound. At this rate it actually exceeds labor costs."

Clearly, the central hospital cooperative laundry concept has not proven to be cost effective. Rather, it is extremely costly when compared with the same or better service provided by taxpaying, private enterprise linen supply companies.

In an article entitled, "Priorities for a National Health Policy," written in the May 29, 1976 issue of the National Journal, Nelson A. Rockefeller, Vice President of the United States wrote:

> A major contributor to the rising cost of heatlh care has been the construction of unnecessary facilities, and the purchase of expensive equipment which duplicates that already available in a community. I recommend strict application of the provisions of the Health Planning Act, aimed at reducing the construction of unnecessary health facilities and the duplication of expensive equipment.

Extending tax exempt status to hospital laundry operations would further encourage unnecessary and uneconomical hospital laundry construction under the mistaken belief that they would save money. In fact, this construction would duplicate existing commercial laundry and linen supply facilities available in the community.

4. For-profit linen supply companies who pay taxes offer lower total per patient day costs for laundry and linen services than existing central hospital cooperative laundry establishments

The Broadbent survey previously mentioned sampled linen suppliers as well as the sixteen hospital cooperative laundries and reported significantly lower per patient day costs when compared with those same hospital cooperative laundries.

LSAA surveyed member companies in 1975 to determine among other facts, cost per patient day. All costs reported range from 55¢ to $3.30 per patient day. The middle 50% of members reporting reported costs ranging from $1.23 to $2.64 per patient day with a median of $1.75 per patient day.

In contrast, a recent survey of hospital cooperative laundries conducted for Community Hospital Services by Ken Davis in May, 1975, of 27 central laundries, showed a cost per pound range of from 10.21¢ to 26.40¢. At an average usage of from 12.27 to 17.09 pounds per patient day (as reported by the American Hospital Association in its 1975 survey of 1,831 hospitals), per patient day costs of the reporting hospitals served by these cooperative laundries could range from $1.25 to $4.51 per patient day. The middle 50% of the hospital cooperative laundries' reported costs are from 15.50¢ to 19.41¢ per pound. Again, at an average usage of 12.27 to 17.09 pounds, costs to serve member hospitals could range for $1.90 to $3.32 per patient day. With an average cost of 17.59 per pound and an average usage of 14.68 pounds per patient day, estimated average costs to hospitals served by cooperative laundries could be $2.58 per patient day compared with a median cost of $1.75 per patient day for linen supply.

5. Linen supply companies and other outside-the-hospital commercial laundries have served a substantial percentage of hospitals economically and well for many years in a very stable customer/supplier relationship

At the present time, according to the American Hospital Association 1975 survey of hospitals in the United States, only 10% of 6,223 hospitals reporting were served by laundry cooperatives while 40.6% were served by outside-the-hospital commercial and linen supply sources. The balance of hospitals were served by hospital in-house laundries or a combination of the above services.

A removal of taxable status from the 10% of cooperatives and the ability to solicit and serve other facilities, many of whom may be present customers of linen suppliers, would be a substantial detriment to our industry. More than 200 of the plants operated by members of the Linen Supply Association of America are in hospital rental and many have been engaged in this field for forty years or more. They have had remarkably stable relationships with their hospital customers over the years because of the fine service and the lower costs offered to these hospital customers.

6. Combined use of linen supply services when compared with existing hospital central cooperative laundry establishments could save hospitals and their health care customers an estimated additional 5 to 10 percent of their present laundry/linen service costs, resulting in an annual savings of from $42,500,000 to $85,000,000 per year in medical expenses

According to the American Hospital Association 1975 edition of Hospital Statistics, hospital expenditures in 1974 totaled $41,406,000,000 or 2.96% of the Gross National Product. In 1974, the 7,174 hospitals in the United States had 1,513,000 beds with an average daily census of $1,107,000 patients. Using a conservative figure of $2 a day for laundry and linen expense, the annual cost of laundry and linen expense for all hospitals in 1974 was $851,000,000.

Studies have been made of the cost of laundry and linen per patient day in central laundries as compared to linen rental. It appears that a savings of 5 to 10% of the $851,000,000 can be achieved annually where linen rental is used. This is a savings of $42,500,000 to $85,000,000 a year—a major item of significance, especially at a time of soaring medical costs.

For lowest possible patient costs, it is essential that laundries for hospital linen services function in a free enterprise environment. It is only in that competitive environment that internal barriers to low productivity will be dissolved and that pressures for profit and performance will result in the best patient care at the most reasonable per patient day cost.

Background

As background, the Linen Supply Association of America is a voluntary trade association with 1,053 member plants in the United States.

According to the U.S. Census of Business in 1972, the linen supply industry consisted of 1,314 establishments, employing 65,622 people.

Members of our association account for more than 90% of the one billion-plus dollars annual sales of our industry; and employ over 60,000 persons. In 1975, linen suppliers had an estimated sales volume of over one billion dollars, processed over 4 billion pounds of textiles, paid employees about $480 million in wages, used about $44 million in laundering supplies, purchased about $250 million of new textiles, spent about $37 million on machinery, equipment, and buildings, supplied customers with over 7 billion pieces of linen and operated over 22,000 vehicles. All segments of the textile rental industry have a total sales volume of about 1.9 billion dollars a year.

Member companies rent hygienically cleaned textile items to millions of customers in commerce, industry and the professions. Hospitals, nursing homes, doctors' and dentists' offices, medical and dental clinics, schools and other important human needs institutions as well as restaurants, hotels, food processing companies, retail stores, etc., are major customers of most linen supply companies.

The Linen Supply industry (SIC 7213):

Has great value to the economy as is clearly evidenced by its record of continuous growth.

Recycles its products thereby helping to maintain a proper ecological balance.

Is energy efficient. Use of our industry's services helps reduce our nation's energy expenditures.

Senator TALMADGE. Next is Mr. Thomas A. Melfe, executive vice president, U.S. Trust Co., and chairman, Taxation Committee of the Trust Division of the American Bankers Association.

Your full statement will be inserted in the record and you may summarize.

STATEMENT OF THOMAS A. MELFE, EXECUTIVE VICE PRESIDENT, U.S. TRUST CO., AND CHAIRMAN, TAXATION COMMITTEE OF THE TRUST DIVISION OF THE AMERICAN BANKERS ASSOCIATION

Mr. MELFE. I am accompanied by a former chairman of our committee and a tax lawyer expert.

I restrict my comments to the subject of generation-skipping trusts. The American Bankers Association believes the treatment of generation-skipping trusts cannot be considered separately.

On June 11, 1976, your committee with little discussion, decided to recommend an amendment to H.R. 10612 adopting the policy embodied in section 7 of H.R. 12966, which is entitled "The Estate and Gift Tax Reform Act of 1976."

That section 7 would add a new chapter 13 to the 1954 Internal Revenue Code captioned "Tax on Certain Generation-Skipping Transfers." Chapter 13 would tax transfers from trusts to grandchildren of the grantor or persons in the same generation as such grandchildren and after a 10-year period the tax would also be applied to preexisting trusts; that is to say, trusts created prior to April 30, 1976.

The ABA believes that this action by your committee was ill-advised. Highly controversial and complex subjects should not be dealt with in this manner without adequate hearings.

Since the Finance Committee decision, the Committee on Ways and Means has modified and restricted its original section 7 in significant respects. The two most important changes have been to exclude from the application of chapter 13 transfers to grandchildren of the grantor and trusts created before April 30, 1976.

Now why should a transfer to a grandchild be exempt from the chapter 13 tax? Because the law should not interfere with normal patterns of disposing of property among a person's family, these patterns having been developed over a period of several years.

These patterns include the use of a family trust or trusts which provide flexibility and enable the disposition of property to be altered to accommodate changes in circumstances.

It is unwise to penalize the trust disposition to a person's family in the form of a chapter 13 tax when outright distributions to the family would escape this tax.

To aid your committee in reviewing its action, we have prepared a memorandum analyzing section 7 of the Ullman bill with particular attention to the policy issues and to technical problems which it presents. A copy of the memorandum is filed with my statement.

Senator TALMADGE. Without objection, it will be inserted in the record.

Mr. MELFE. Thank you, Senator.

The major policy decisions discussed in our memorandum are as follows:

Should chapter 13 tax have a more significant impact on the moderately wealthy than it does on the very wealthy? And should it encourage unnatural estate plans to avoid the tax?

Second: Should it apply to preexisting trusts?

Third: Should it create a penalty for a trust disposition in the sense that property tax under that chapter is treated unfavorably for income tax purposes, estate tax deductions and other purposes when compared with property subject to it?

Senator TALMADGE. I regret to interrupt you, but your time has expired. Your entire statement will be inserted in the record.

This is something I have heard about from my people in Georgia, and it is hoped the committee would look into that.

Thank you.

Mr. MELFE. Thank you, Senator. We appreciate the opportunity to present our views.

[The prepared statement of Mr. Melfe follows:]

STATEMENT OF THOMAS A. MELFE ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and Members of the Committee:

My name is Thomas A. Melfe. I am the Chairman of the Taxation Committee of the Tust Division of the American Bankers Association and an Executive Vice President of United States Trust Company of New York. I am accompanied by J. H. Butala, Jr., Senior Vice President of Cleveland Trust Company, a former Chairman of the Taxation Committee.

The American Bankers Association is an association composed of about 14,000 banks or some 96% of the banks in the country. Approximately 4,000 of the banks exercise fiduciary powers serving their customers as trustees and executors. Thus, the Association is keenly interested in any changes in the tax laws affecting trusts and estates.

The list of the subjects to be considered at these hearings include generation-skipping trusts. The ABA believes the treatment of generation-skipping trusts cannot be considered separately from the treatment of generation-skipping transfers which are not in trust. This point is most important in developing an approach to the taxation of trusts which is sensible and does not encourage unnatural estate plans for reasons which will be discussed. The action which your Committee has taken on generation-skipping deals only with generation-skipping trusts.

The taxation of trusts is a technical and complex matter and geneation-skipping is the most difficult of all trust subjects. The ABA, in its 1973 testimony before the House Committee on Ways and Means, suggested what was then a new approach to the problem of generation-skipping transfers. During the hearings before the same Committee earlier this year, the ABA renewed its earlier recommendation which is discussed at pages 19–22 and 28 in a Commentary on

Proposed Tax Reform Affecting Trusts and Estates filed with this statement. The theory underlying the ABA approach is that it is not necessary to determine at the time of a transfer to a trust that a particular generation may be skipped. It is only necessary to apply the tax when the generation is actually skipped. This approach is desirable because it does not conflict with the trend towards flexible trust dispositions.

On May 24, 1976, Al Ullman, Chairman of the Committee on Ways and Means, introduced H.R. 13966 titled the "Estate and Gift Tax Reform Act of 1976" and shortly thereafter the Committee commenced mark-up on this bill. Section 7 of the bill would add a new Chapter 13 captioned "Tax on Certain Generation-Skipping Transfers" to the 1954 Code. The Chapter 13 tax is patterned after the approach suggested by the ABA, but with two important exceptions—transfers from trusts to grandchildren of the grantor or persons in the same generation as such grandchildren would be subject to tax and, after a ten year period, the tax would be applicable to "pre-existing" trusts, trusts created prior to April 30, 1976. These two changes are highly controversial. Section 7 contains other controversial provisions. For example, if a trust were created for a grandchild of the grantor and the grantor's attorney who was 13 years younger than the grantor acted as trustee and had discretionary powers over either income or principal, the trust property would be subjected to tax when the attorney ceased to act as trustee. This result goes far beyond what is commonly considered as a generation-skipping transfer.

On June 11, 1976 your Committee, with little discussion, decided to recommend an amendment to H.R. 10612 adopting the policy embodied in section 7 of the Ullman bill. The ABA believes that this action was ill-advised. Highly controversial and complex subjects should not be dealt with in this manner without adequate hearings.

Since the Finance Committee decision, the Committee on Ways and Means has modified and restricted section 7 in significant respects. The two most important changes have been to exclude from the application of Chapter 13 (1) transfers to grandchildren of the grantor and (2) trusts created before April 30, 1976. Why should a transfer to a grandchild be exempt from the Chapter 13 tax? Because the law should not interfere with normal patterns of disposing of property among a person's "family" which have developed. These patterns include the use of a family trust or trusts which provide flexibility and enable the disposition of property to accommodate changes in circumstances. A trust is no more than a single fund in which beneficiaries have interests which relate to their requirements. It is unwise to penalize a trust disposition to a person's "family" in the form of a Chapter 13 tax when outright dispositions to the "family" escape this tax.

To aid your Committee in reviewing its action we have prepared a memorandum analyzing section 7 of the Ullman bill, with particular attention to the policy issues and technical problems which it presents. A copy of the memorandum is filed with this statement.

The major policy decisions in the memorandum are:

1. Should the Chapter 13 tax have a more significant impact on the moderately wealthy than it does on the very wealthy and should it encourage unnatural estate plans to avoid the tax?

2. Should Chapter 13 apply to "pre-existing" trusts?

3. Should the Chapter 13 tax create a "penalty" for a trust disposition in the sense that property taxed under that Chapter is treated unfavorably for basis, estate deductions and other purposes when compared with property subjected to the estate tax?

4. Should Chapter 13 impose a tax upon the death of a trustee who happens to be in a generation below the grantor and has no beneficial interest in the trust?

5. Should Chapter 13 apply to "transfers" by non-resident aliens, thus discouraging the use of U.S. trustees?

6. Should Chapter 13 apply when there is an unusual order of deaths, viz., a child predeceases a parent or a grandchild predeceases a child?

7. Should the amount of the Chapter 13 tax have no relationship to the extent of a beneficiary's interest in the trust?

8. Should the purchase of an annuity for a child be made more advantageous than the creation of a trust for a child in terms of the Chapter 13 tax?

Section 7 answers each of these questions in the affirmative. We believe each of these questions in the affirmative. We believe each should be answered in the negative.

We feel confident that after you have read the memorandum your Committee will agree that it cannot support section 7 of the Ullman bill in the form it was in at the time you decided to approve it. We also believe that after careful consideration your Committee will not agree with the manner in which major policy issues are resolved in the section.

The ABA urges your Committee to modify its approval of section 7 of the Ullman bill. As previously mentioned, we suggested a generation-skipping approach to the Committee on Ways and Means. This approach reflected more than five years of careful consideration of a complex subject. Our approach is preferable to any other one that has been suggested. Its impact would not be so hard as section 7 of the Ullman bill, but would be broader than the approach recommended by the American Law Institute after years of study by a group headed by Professor A. James Casner of Harvard Law School, who acted as reporter. There are those who say that the impact of our proposal is not substantial. We disagree. Where the wealth involved is considerable, the impact will not be minor. The effect of the ABA approach, in the context of a trust for descendants of the grantor, would be to shorten the period during which trust property may be kept outside of the transfer tax base from as much as 100 years to a period not to exceed the life or lives of children of the grantor.

One of the concerns expressed by interested individuals and groups is that the complexity of the proposed legislation is such that it will not be understood or be able to be applied by general practitioners. We have revised our draft statute in an effort to shorten the language and simplify the concept. In doing so, we have adopted material from section 7 of the Ullman bill. The revision of our "estate tax" generation-skipping provision to be inserted in Chapter 11 is filed with this statement. The result is a draft statute with the operative provisions expressed in only 5 pages. The revision is much easier to understand than section 7 of the Ullman bill. Simplicity is a virtue. The "gift tax" generation-skipping provision to be inserted in Chapter 12 is essentially the same as our estate tax provision, except for a reference to taxable distributions as well as to taxable terminations. The location of these provisions in Chapters 11 and 12 rather than in a new Chapter 13 eliminates many of the problems of section 7.

In conclusion, we recommend to your Committee the approach contained in the revision of our "estate tax" generation-skipping provision filed with this statement. If your Committee does not approve this approach, we urge changes be made in section 7 of the Ullman Bill which would (1) create an exception for a distribution to a grandchild of the grantor, (2) make Chapter 13 inapplicable to all pre-existing trusts and (3) change other parts of section 7 as suggested in our memorandum to reverse its policy and cure its technical defects. If your Committee rejects the ABA approach and modification of section 7 in the manner indicated, we believe the section should be eliminated from your Committee's amendments because the problems involved with it are serious and make its enactment undesirable.

Senator TALMADGE. The next witness is Arthur Peter, Jr., on behalf of the American College of Probate Counsel.

Mr. Peter, you may insert your full statement in the record and summarize it, sir.

STATEMENT OF ARTHUR PETER, JR., AMERICAN COLLEGE OF PROBATE COUNSEL

Mr. PETER. Thank you, Senator.

I appreciate the opportunity to appear for the American College of Probate Counsel, a group of more than 1,700 probate lawyers from every State of the Union.

We have appended to our statement a technical commentary on the generation-skipping provisions and the Ullman bill and I will not go over them at this time.

I have several points I would like to make. We in the college field feel it is very important to defer action on the skipping until hearings can be held on the technical language involved.

As an example, Senator, the Ullman bill contains 17 pages and the clean bill, H.R. 14571, contains 21 pages to put into legislative language the concept of a generation-skipping tax on generation-skipping trusts.

We fear that if this is enacted in its present form without adequate hearings we may have some of the very same problems that have occurred in the past when Congress has acted hastily on very technical tax legislation, and one illustration of that would be the trust on the format of 1969.

Another reason we would seek deferral of the consideration of generation skipping at this time until there are hearings is that many of us in American College seriously question whether there is a need for this legislation. It has been our experience that most clients do not want a long-term trust that goes out to the length to rule against perpetuities but are only interested in their children and grandchildren.

So we don't think there has been the burden. We feel the burden is on the proponents of this to show the clear abuse of the statute, the revenue laws, and we don't feel that abuse has been shown.

If there is to be such legislation in this session then we certainly feel it is very important to have an exception on the generation-skipping provisions for a distribution from a trust to a grandchild because this is certainly part of the normal family disposition.

We note that the American Law Institute, the American Bankers Association and our group, all of which deal in an extended manner with the establishment of trusts and their operation, all would approve of this exception.

Turning to the effective date provision, we feel it is very important to exclude from the operation of this legislation irrevocable trusts in existence before April 30, 1976, and we note that the House Ways and Means Committee did amend the Ullman bill to provide for this. We think it is also important that a person under a small disability have an opportunity to amend the trust executed by him when he does recover his mental compentency.

This again was put in by the Ways and Means Committee which provided for this by an amendment to the Ullman bill.

Finally, we come to a point that we think is very significant, that there should be an exception for an irrevocable trust and 1976 in the case of before January 1, 1972, where there has been no subsequent revocation or amendment affecting the generation skipping trust.

Unfortunately, the Ways and Means Committee amendment would not allow this exception if there was any kind of amendment of the will or trust.

Now the trouble with that, Senator, is the practical problem. If there is an executor who has died or a trustee or an individual is no longer qualified or a bank has merged or a bank is disqualified or thrown out of existence, any of those require just out of good housekeeping the opportunty to amend the will or trust as the case may be. This is the housekeeping thing as it should be allowed.

We feel in the case of the generation-skipping trust there is no reason not to allow a codicil of the will to change a bequest or a legacy that has no effect on the generation-skipping trust division.

Suppose the dependent wants to have a legacy for some relative. Why should he not have the opportunity to do that and not give up the protection that would otherwise be afforded to him.

That concludes our testimony and I would like to have our testimony made part of the record.

Senator TALMADGE. Without objection, the entire statement will be inserted.

Thank you for your contribution.

[The full statement of Mr. Peter follows:]

STATEMENT OF ARTHUR PETER, JR., ON BEHALF OF THE AMERICAN COLLEGE OF PROBATE COUNSEL

This Statement has been prepared by a duly constituted Committee[1] of the American College of Probate Counsel, a group of more than 1,700 probate lawyers from all over the United States, and is being made under the direction of its President (William P. Cantwell, Esquire) and its President-Elect (J. Nicholas Shriver, Esquire).

There is appended to this Statement copies of pages 30–37 of the technical commentary on H.R. 13966 (the Ullman bill revising estate and gift tax laws) which this Committee of the American College of Probate Counsel submitted to Dr. Laurence N. Woodworth and Mr. John M. Martin by letter dated June 1, 1976. Such pages contain our Committee's comments on Section 7 of H.R. 13966, providing for a tax on generation-skipping trusts.

SUMMARY OF PRINCIPAL POINTS IN STATEMENT

1. Many in the American College of Probate Counsel are opposed to a transfer tax on generation-skipping trusts on the ground that the avowed abuse requiring such legislation, namely, the avoidance of a transfer tax for a hundred years or more by means of a long-term trust extending over many generations, does not in fact occur frequently enough to justify burdening the Internal Revenue Code with the necessarily extremely complicated legislation required to impose such a tax.

2. If there is to be a transfer tax on generation-skipping trusts, a substantial majority of the American College of Probate Counsel strongly believe there should be:

(a) an exception for a distribution from such a trust to a grandchild of the Grantor, so that this normal type of family trust disposition, providing for life estates for the children and remainder to the grandchildren of the Grantor, is not discouraged.

(b) the holder of only a "naked" (non-beneficial) power to control the disposition of trust income or corpus should not come within the definition of a "beneficiary", for the effect of such a provision is to repeal that portion of Sections 2041 and 2514 exempting such powers of appointment from estate and gift tax, and to treat most powers as taxable general powers of appointment.

(c) The effective date provisions should:

(i) except all irrevocable trusts, whether inter vivos or testamentary, in existence on April 30, 1976, but only to the extent the transfer is not made out of corpus added to the trust after that date;

(ii) except revocable trusts and wills in existence on April 30, 1976, in the case of a decedent dying before January 1, 1982, where there has been no subsequent revocation or amendment affecting the generation-skipping trusts; and

(iii) in the case of a decedent who was under a mental disability to change the disposition of his property on April 30, 1976, except any

[1] The Committee members are listed on the last page of this Statement.

revocable trust or will executed by him on or before such date for a period of 2 years after the date on which he first regains his mental competency.

GENERAL DISCUSSION OF PRINCIPAL POINTS

1. Many in the American College of Probate Counsel are opposed to a transfer tax on generation-skipping trusts on the ground that the avowed abuse requiring such legislation, namely the avoidance of a transfer tax for a hundred years or more by means of a longe-term trust extending over many generations, does not in fact occur frequently enough to justify burdening the Internal Revenue Code with the necessarily extremely complicated legislation required to impose such a tax.

It has been the experience of most lawyers in the American College of Probate Counsel that their clients are very seldom interested in providing for an inter vivos or testamentary trust extending beyond their grandchildren even after they have been made aware of estate tax benefits arising from the extension of the period of the trust to the outer limits allowed by the Rule Against Perpetuities. Many of us feel that the proponents of a generation-skipping transfer tax have the burden of establishing the substantial usage of long-term trusts to avoid estate tax in order to justify insertion of the extremely complicated generation-skipping tax legislation into the Code, and that this burden has not been met. We note in this connection that the favorable estate tax treatment of generation-skipping trusts has been part of the fabric of our estate and gift tax laws for many years, and a reversal of such favorable treatment should not be undertaken in the absence of clear proof of abuse of such provisions.

2. If there is to be a transfer tax on generation-skipping trusts, a substantial majority of the American College of Probate Counsel strongly believe that there should be an exception for a distribution from a trust to a grandchild of the Grantor, so that the normal type of family trust disposition, providing for life estates for the children and remainder to the grandchildren of the Grantor, is not discouraged.

In this connection, it is significant that both the American Law Institute and the American Bankers Association are on record in support of either the same or a more liberal exception to the imposition of a tax on a generation-skipping trust. Thus, the 1968 recommendation of the American Law Institute states that no such tax should be imposed on a transfer under which final distribution by the trust is required to be made no later than the death of a person or persons one generation below the transferor, or in the same generation or in a higher generation than the transferor. This recommendation is more liberal than the 1972 American Bankers Association proposal, excepting trust distributions to grandchildren, which the American College of Probate Counsel here supports, since it would permit a distribution to be made to generations below the grandchildren of a Grantor or outside of the Grantor's family. Thus the three nationwide professional groups most clearly identified with the establishment and operation of trusts have unanimously supported this exception.

Two other reasons for supporting such an exception for trust distributions to grandchildren should be noted. It would seem grossly unfair to tax such a distribution so long as outright distributions to grandchildren are not subjected to a generation-skipping tax, and we are not aware that any major professional group has supported a transfer tax in the latter instance. Furthermore, it is notable that generation-skipping tax legislation which does not provide an exception for trust distributions to grandchildren in effect favors the family of more affluent Grantors who can afford to skip their children as life beneficiaries of a trust for their grandchildren or to provide a separate trust for each generation as compared with the less wealthy families whose Grantor must provide some financial support for his children, as well as his grandchildren, in the same trust.

Finally, it is notable that while H.R. 13966, the Ullman bill, did not provide for an exception for a trust distribution to a grandchild, yet in its final mark-up session on such bill, the House Ways and Means Committee voted favorably on an amendment providing such an exception.

3. If there is to be a transfer tax on generation-skipping trusts, a substantial majority of the American College of Probate Counsel strongly believe that the holder of only a "naked" (non-beneficial) power to control the disposition of

trust income or corpus should not come within the definition of a "beneficiary", for the effect of such a provision is to repeal that portion of Sections 2041 and 2514 exempting such powers of appointment from estate and gift tax, and to treat most powers as taxable general powers of appointment.

Pursuant to Section 2613(c)(3) and Section 2613(d) of H.R. 13966, a person who received no beneficial interest in the trust would be treated as a "beneficiary" for purposes of a generation-skipping tax if he had any control over the disposition of income or corpus. The effect of this "naked power" provision is that a generation-skipping tax would be imposed where a Grantor sets up a trust for his grandchildren and names one of his sons as trustees either in the event that the son should die while the trust is in existence or the trust terminates while such son is acting as trustee. Such a "naked power" provision would obviously discourage a Grantor from appointing members of his family as trustees of trusts for his descendants, and the American College of Probate Counsel feels that this would be a most unfortunate result.

We are glad to note that the House Ways and Means Committee adopted an amendment eliminating the "naked power" concept from H.R. 13966.

4. If there is to be a transfer tax on generation-skipping trusts, a clear majority of the American College of Probate Counsel believe that the effective date provisions should except all irrevocable trusts, whether inter vivos or testamentary, in existence on April 30, 1976, but only to the extent the transfer is not made out of corpus added to the trust after that date. It is too obvious to require extended discussion that it would be most inequitable to impose this tax on trusts which were established in the past without having to take into account such a tax and which are now incapable of amendment. While Section 7 of H.R. 13966 provided only a limited moratorium from the generation-skipping tax for such an irrevocable trust, the Ways and Means Committee has voted favorably on an amendment to such bill incorporating the effective date provision for irrevocable trusts which the American College supports.

5. The American College of Probate Counsel further believes that the effective date provision for a tax on generation-skipping trusts should make an exception for revocable trusts and wills in existence on April 30, 1976, in the case of a decedent dying before January 1, 1982, where there has been no subsequent revocation or amendment affecting the generation-skipping trusts. Thus, we feel that it is imperative that such an exception permit mere procedural, "housekeeping" modifications in wills and trusts such as may be required for the substitution of executors or trustees caused by the death of an individual or the failure of a bank or the merger of a bank named as fiduciaries in the original trust instrument. It should also permit substantive amendments of such a will which do not affect the generation-skipping trusts. Unfortunately, the House Ways and Means Committee amendment of H.R. 13966, while containing most of the provisions desired by the American College of Probate Counsel with respect to revocable trusts and wills existing on April 30, 1976, does not permit any kind of modification in such trust instrument, and such failure will lead to most unfortunate results in some instances. It would be hoped that this glaring omission could be rectified either in Committee or on the floor of the House or Senate in the event that a tax on generation-skipping trusts is enacted into law.

6. The American College of Probate Counsel further favored an effective date provision which would make an exception for a revocable trust or will in existence on April 30, 1976 in the event that the decedent was under a mental disability to change the disposition of his property on such date. Fortunately, the House Ways and Means Committee amendment of H.R. 13966 does provide for such an exception for a period of two years after the date on which such a decedent first regains his mental competency.

The American College of Probate Counsel appreciates the opportunity to appear before the Senate Finance Committee and make known its views on the taxation of generation-skipping trusts, and it offers its services in any way it may be helpful to such Committee.

The Estate and Gift Tax Reform Committee of the American College of Probate Counsel consists of the following lawyers:

Frank S. Berall, Chairman, of Hartford, Connecticut; Luther J. Avery, of San Francisco, California; Joseph Kartiganer, of New York, New York; Arthur Peter, Jr., of Washington, D.C.; Raymond A. Reister, of Minneapolis, Minnesota; and E. Frederick Velikanje, of Yakima, Washington.

TAX ON CERTAIN GENERATION-SKIPPING TRANSFERS

Section 2602(c)(2), page 97

The exception for the unused portion of basic credit refers just to the unified credit under section 2010(a)(1) which is only allowable against the estate tax. The exception must be expanded to provide the credit under section 2505(a) against the gift tax in the case of an inter vivos transfer.

Section 2603(a)(1)(A), page 98

The statutory language states in part "the trustee shall be personally liable for such tax."

Such language leaves it ambiguous as to whether a trustee in office before or after the taxable transfer would be personally liable for the tax even though it is presumably intended only that the trustee in office at the time of the taxable transfer be personally liable for the tax.

While such ambiguity could be cured by the Regulations, it would be better to modify the statutory language to read "each trustee in office at the time of the transfer shall be personally liable for such tax."

There would seem to be no counterpart to a "trustee" which could be inserted in the statutory language to cover personal liability in the situation of a "generation-skipping trust equivalent".

Section 2603(a)(2), page 98

While this subparagraph provides for the Secretary or his delegate to supply rates of tax to the trustee, there are no statutory provisions with respect to the mechanics of obtaining such information. While such mechanics can certainly be worked out under the Regulations, there may be a real virtue in providing by statute both a procedure and a time frame for the Secretary or his delegate to supply such rates to the trustee rather than leaving this entirely to the Regulations. Section 2204 provides a good precedent for setting forth such procedure and time frame by statutory language.

Section 2603(b), page 99

This paragraph which provides a lien on transferred property for the amount of the Section 2601 tax, should be enlarged to provide for the divestment of such lien in the case of a purchaser or holder of a security interest. See Section 6324 (a)(2) of the Code.

Section 2611(c), pages 99–101

Under the statutory language it would appear that a person who is a successor to a lineal descendant by virtue of the assignment to him of such a descendant's interest would fall under subparagraph (5). It would seem desirable to insert a new subparagraph prior to (5) to assign to such a person the generation of the lineal descendant from whom he received his interest.

Subparagraph (7) provides in substance that if "another entity" is a beneficiary of the trust, then each individual having a beneficial interest in such other entity is to be treated as a beneficiary of the trust. Such a far-reaching provision adds a great deal of complexity and uncertainty to the record-keeping of the trustee, since the individuals holding these indirect beneficial interests in the trust will be constantly changing.

Section 2612(a), page 102

Paragraph (a) deals with the "deemed transferor" with respect to a transfer to "*any individual*". It is unclear who would be the "deemed transferor" with respect to a transfer to a trust, partnership, corporation or other entity, unless it is intended that the word "individual" include an individual having a beneficial interest in such entity at the time of transfers. The meaning of the term "individual" for the purposes of Section 2612(a) should be clarified by the statute to avoid confusion.

Subparagraph (1) refers to a parent having a closer "*affinity*" to the grantor. The word "affinity" is so broad and amorphous that in many instances each parent may be said to have a closer affinity to the grantor than the other parent depending on the criteria which are used. This term needs further refinement.

Subparagraph (2) provides that under a specified circumstance the youngest of the ancestors of the transferee is to be treated as the "deemed transferor". It would seem more logical to refer to the eldest of such ancestors.

Section 2613(a)(1), page 103

This statutory provision refers to "distributable net income". Since such term is indigenous to a trust, it makes it uncertain what comparable term should be applied for purposes of a generation-skipping trust equivalent. Therefore it would be better to use a general accounting term such as "current income" which may be applied to both trusts and other entities. In any event, the phrase "of that trust" should be inserted at the close of Section 2613(a)(1), as was done in Section 2613(b)(1).

Section 2613(b)(4), page 105

This subparagraph provides in substance that on the termination of a power the property transferred is to be determined immediately before the termination of the power even though this date may be many years before the date when the termination of several powers is deemed to occur pursuant to paragraph (2), and on the latter date it may be difficult to determine and value the assets which were held immediately prior to the termination of each power. Under these circumstances it may be far more practical to have the determination of both the property subject to the power and the time of the termination of the power on the same date (when the last termination occurs) where paragraph (2) is applicable.

It may be advisable to insert a new subparagraph after subparagraph (5), to provide that the value of property passing on a taxable termination is to be reduced by an amount equal to the value of any consideration received by the beneficiary by reason of any assignment causing the termination. This is to take care of the situation where a beneficiary sells his income interest for cash. There should also be a reduction for the value at time of termination of any income interest then outstanding in such property of any person other than the descendant of the beneficiary. The American Bankers Association proposal contains both of these provisions.

Section 2613(c)(3), page 107

This provision defines "beneficiary" to mean any person who has an interest or power in the trust. It would appear desirable to exclude from such definition a person who is a successor to a beneficiary by means of an assignment, whether for a consideration or not. This point was also made in the American Bankers Association proposal.

Section 2614(a), page 108

This provision in substance allows a disclaimer of an interest or a power in a trust 12 months after the date the trust becomes irrevocable where there has been no distribution from the trust or the exercise of a power. It would appear essential to also allow a disclaimer by beneficiaries of irrevocable trusts which were in existence on the date when H.R. 13966 becomes law if such disclaimer is made within 12 months after the issuance of final Regulations under H.R. 13966. An extended period of time will be necessary since our experience with the Tax Reform Act of 1969 provisions relating to charitable remainder trusts shows that it takes a long time for word of the new law to become known and for state legislatures and courts to act once the Regulations are issued which may take several years.

Section 2621(a)(1), page 109

This subparagraph in effect provides that if the deemed transferor is dead, then all provisions of the Code applicable to the estate tax except Section 6166 and Section 2032 A are applicable to the tax under Section 2601. This "blanket application" of provisions to Chapter 13 and Section 2601 appears far too broad. Thus, for example, it is notable that this would seem to allow an extension of time to pay this tax under Section 6161 where there is undue hardship (reasonable cause under H.R. 13966). Such provision would presumably also allow for an election by the executor to obtain a quick audit of the estate tax return and a discharge from personal liability under Section 2204 since such Section relates to the tax under Section 2001. Accordingly, Section 2621(a)(1) should be amended to make clear that Chapter 11 is applicable except to the extent inconsistent with the provisions of Chapter 13.

Section 2621(a)(2) presumably faces the same kind of problem.

Section 7(c)(2), page 112

A very strong argument can be made that the Section 2601 tax should not be applied to any transfer from the pre-May 1, 1976 corpus of any irrevocable trust existing on that date. (The Tax Reform Act of 1969 provides a precedent for including in the definition of an "irrevocable trust" either a revocable inter vivos trust or a trust under a will where the grantor is mentally incompetent.) At a minimum, the 10 year moratorium in subparagraph (2) of the bill should be extended to 25 years, constituting one generation, for such a transfer.

In view of our experience under the Tax Reform Act of 1969 as to charitable trusts, the effective date for application of the generation-skipping provisions of H.R. 13966 to all transfers should be deferred for at least two years to allow time for the amendment of outstanding wills and revocable trusts, and there should be a 10 year moratorium for transfers from trusts under such wills and trusts where the grantor died during the two year period.

In any event, there should be a liberalization of the bill's exception in the case of a decedent dying before January 1, 1977 with respect to a will or revocable trust in existence on May 1, 1976, which was not amended or revoked at any time after that date. A codicil to the will or an amendment to the revocable trust which merely changes the fiduciaries (as, for instance, required by death or merger) or makes some minor clerical change should be permitted. Therefore, we suggest that the statutory language be changed to provide "and was not amended by a dispositive provision or revoked at any time after that date."

It is very difficult to know what exceptions to the April 30, 1976 effective date in paragraph (c) are intended to apply in the case of a trust equivalent pursuant to the statutory language in the last paragraph of (c) on page 112 of the bill, but it probably is very difficult to draft meaningful language. This is another reason to exempt all pre-existing arrangements from the Section 2601 tax.

The above technical comments with respect to Chapter 13 are not to be considered as an approval of its provisions by the American College of Probate Counsel. The College is opposed to generation-skipping trust legislation because the remedy is far worse than the problem, and it takes the position that if there is such legislation, then it should except a transfer in trust which vests absolutely in a grandchild of the grantor no later than the death of his last living child. Such an exception would permit the usual type of family trust to continue to exist without the penalty of a generation-skipping tax.

Senator TALMADGE. The next witness is Mr. Peter L. Faber, chairman of the tax section, New York State Bar Association. Mr. Faber, your entire statement will be inserted in the record. You may summarize it, sir.

[The statement follows:]

STATEMENT OF TAX SECTION OF THE NEW YORK STATE BAR ASSOCIATION

This Statement is submitted to the Senate Finance Committee pursuant to the opportunity afforded in its Press Release dated July 8, 1976.

On June 11, 1976, the Senate Finance Committee tentatively approved a proposal to tax certain so-called generation-skipping trust transfers. The announcement of the proposal described it only in very general terms. It appears to be consistent with Section 7 of H.R. 14115, introduced on June 1, 1976 by Hon. Al Ullman, Chairman of the House Ways and Means Committee ("Ullman Bill"). Since June 11, however, the Ullman Bill has been extensively and fundamentally revised in mark-up sessions by the Ways and Means Committee.

Because the text of a Senate Finance Committee bill on generation-skipping is not available, this Statement cannot deal with specific, concrete problems thereunder. On the other hand, we see no useful purpose in discussing provision by provision the text of Ways and Means Committee Print dated June 26, 1976, which, with the addition of the so-called Landrum amendment exempting transfers to grandchildren from the tax, purports to contain all the mark-up session amendments. We feel that the fundamental revisions made by the mark-up changes necessitate rethinking of the Ullman Bill's entire approach to generation-skipping and that the Bill must be rewritten rather than simply marked up.

We respectfully urge the Senate Finance Committee in the strongest terms to do the necessary rethinking, to come to grips with the difficult and competing policy problems involved, and to define carefully the objectives it would seek to attain through generation-skipping tax legislation. The following specific questions need answering:

1. Should the generation-skipping tax be limited in application to skipping through trusts and like arrangements?
2. Should generation-skipping to grandchildren through trusts and like arrangements be permitted without tax?
3. Do the complexities involved warrant imposition of the tax at the skipped generation level?

We find the complexity of the Ullman Bill to be its most distressing feature. We members of this Subcommittee who have assumed primary responsibility for preparing this Statement have spent many hours separately and in concert studying the Ullman Bill's generation-skipping provisions. We have scores of years of combined experience dealing with trust, estate and tax matters. Despite our long experience and diligent study, we can only say that we think the language of the Bill accomplishes most of what we think its draftsmen intended but we are not sure. The terms used in the Bill are unfamiliar in trust and tax law and stand for concepts that are highly complex and difficult to grasp fully. A "deemed transferor" need have no interest whatever in the trust property. Yet the trust property will be subjected to tax as if he had complete dominion of it. The "transfer" to be taxed as if the deemed transferor transferred the trust property is usually not a transfer at all but a termination of some interest or power (which may be insignificant) in the trust property of a person who may be unrelated to the creator of the trust, the deemed transferor or the ultimate transferee. Some terminations are taxable, some are not, and some of the taxable ones are deemed to occur at other times than they actually do occur. There are also deemed transfers and deemed transferees. The term "transferee" is, in fact, nowhere defined. Understanding these concepts and how they would operate in a myriad of possible trust settings requires a thorough and detailed familiarity with trust and property law, particularly future interests, and an unusual degree of expertise in gift and estate taxation and the income taxation of trusts.

While we admire the erudition, ingenuity and drafting skill of the writers of the Ullman Bill, we are appalled by the amount of study that would be required of the bar throughout the United States and of the Internal Revenue Service to comprehend it. Indeed, so complex and intricate is the Bill that we doubt whether it could generally be understood and enforced, if enacted. Experience since 1948 and 1969 with the far simpler marital deduction and charitable remainder provisions demonstrates the injustices and administrative difficulties that result from legislating above the heads of the average testator and his counsel.

The undue specificity of the mark-up exceptions to the general application of the generation-skipping tax provisions of the Ullman Bill is also most disturbing. The italicized words in the two following provisions are pure tax traps:

Section 2613. . . . (b) . . . (1) . . . Such term ["taxable termination"] does not include a termination of the interest or power of any person who *at no time has had anything other than* a future interest or future power (or both) in the trust. . . .

Section 2613. . . . (e) Limited Power to Appoint Among Lineal Descendants of Grantor Not Taken Into Account in Certain Cases.—For purposes of this chapter, if any individual—

(1) does not have *any* present or future interest in the trust, and
(2) does not have *any* present or future power in the trust other than a power to dispose of the corpus of the trust or the income therefrom to a beneficiary or a class of beneficiaries who are lineal descendants of the grantor assigned to a generation younger than the generation assignment of such individual,

then such individual shall be treated as not having any power in the trust.

The entire exception contained in Section 2613(b)(7) is far too narrowly drawn. Its purpose is to exempt from tax the death of a child of the grantor before the grantor's widow's death, but the draft touches only a handful of such cases:

(7) Certain discretionary trusts to distribute income to spouse and children of grantor.—The term "available termination" does not include the termination of an interest of a child of the grantor where—

(A) the only interest of the child in the trust is as a permissible recipient of income under a power exercisable by an unrelated party,

(B) the spouse of the grantor of the trust is a permissible recipient of income under the same power,

(C) during the life of the grantor's spouse and children, only these individuals are permissible recipients of income from the trust, and

(D) all children of the grantor who were permissible recipients of income under the power predeceased the grantor's spouse.

The specificity or the mark-up exceptions makes them inoperative if powers exercisable in favor of charity are present.

The "qualified disclaimer" concept in Section 2518 is also so limited as to be entirely inadequate. It requires that the disclaimer be made within nine months after the day on which the transfer creating the interest in the disclaiming person is created. It thereby requires that interests be disclaimed while they are remotely and improbably contingent. It does not even provide for lack of knowledge of the transfer in question by the person entitled to disclaim or for his infancy or incompetency. Current case law holding that a reasonable time for disclaiming starts to run when prior interests terminate is practical and fair and should be retained. We see no justification for a "qualified disclaimer" definition in the Bill.

The failure of the Bill after mark-up sessions to specify what property is to bear the burden of the new tax must be rectified. We believe that many existing wills contain allocation provisions that might cause the proposed tax to be paid from the testator's personal estate rather than from the trust property.

On the positive side, we particularly commend the removal in the mark-up sessions of all retroactive features of the Ullman Bill's generation-skipping tax provisions. Applying this new tax to existing dispositions which may not now be changed would contravene basic principles of fairness.

Relationship of this Statement to House of Delegates' Resolution Calling for Reasonable Time to Study and Report Back to Congress concerning Generation-Shipping Provisions.

On June 19, 1976, the House of Delegates of the New York State Bar Association, representing its 23,000 members, unanimously urged the Congress to take final action respecting the Ullman Bill, and particularly its generation-skipping provisions, without affording to the organized bar of the United States, and in particular, the New York State Bar Association and its Sections having special competence in the fields of law affected thereby, reasonable time to study and report back to the Congress concerning them. (Copy of Resolution annexed). The House of Delegates is justly concerned that the impact of this complex and revolutionary legislation on New York property dispositions, for which the New York bar is responsible, be made clear and precise.

This Statement has necessarily been prepared in great haste. It is not exhaustive but summary in nature, and has not had the benefit of the detailed study, consideration and endorsement normally given by the entire 50 member Executive Committee of the Tax Section to its work products. Not only for this reason, but also and particularly because the text of a Senate Finance Committee bill is not yet available, the opportunity to submit this Statement should not be deemed to satisfy the House of Delegates' request for reasonable time to study and report back concerning the entire subject matter of the Ullman Bill prior to final action thereon.

Respectfully submitted,

HEWITT A. CONWAY,
Chairman,
MARY-KATHERINE BELL,
CHRISTINE BESHAR,
PAUL MEADERS,
ALLAN METRICK,
NATHANIEL WINTHROP,
Generation-Skipping Subcommittee of Committee on Estate and Gift Taxes.

NEW YORK STATE BAR ASSOCIATION RESOLUTION ADOPTED UNANIMOUSLY BY HOUSE OF DELEGATES, JUNE 19, 1976

Whereas "The Estate and Gift Tax Reform Bill of 1976" (H.R. 13966) was introduced in the House of Representatives by Chairman Al Ullman of the Ways and Means Committee on May 24, 1976; and

Whereas (1) the provisions of H.R. 13966 are detailed and complex; (2) they would effect revolutionary changes in the estate and gift tax law, treating of such diverse subjects as a unified transfer tax system, unrealized appreciation at death and new taxes on generation-skipping transfers; and (3) they make the new generation-skipping taxes applicable at progressive rates reaching 70% not only to existing wills and future transfers but also to many thousands of presently effective property dispositions governed by the laws of the State of New York; and

Whereas the New York bar is responsible to the public for the proper preparation of wills and other instruments disposing of property under New York law and is justly concerned that the impact on New York property dispositions of federal tax legislation having such far reaching effects as H.R. 13966 be clear and precise; and

Whereas the text of H.R. 13966 did not become generally available for study by members of this Association until early in June 1976, and the Sections of this Association having particular competence in the areas of law affected by it have not had sufficient time to study its provisions in depth and consider and report their conclusions and recommendations to the Congress; and

Whereas this House of Delegates, representing the 25,000 members of the New York State Bar Association, is deeply concerned at the precipitous and unwarranted haste with which H.R. 13966 is being considered by Congress, and by the failure of either the House Ways and Means Committee or the Senate Finance Committee to hold public hearings with respect to its provisions or otherwise afford the public an opportunity to be heard concerning them; be it

Resolved, therefore, That the New York State Bar Association hereby calls upon the House of Representatives and the Senate to take no final action approving H.R. 13966, and particularly the so-called generation-skipping tax provisions contained in section 7 thereof, without due deliberation after affording to the organized bar of the United States, and this Association and its Sections in particular, and other segments of the public affected thereby, reasonable time to study and report back to the Congress concerning it; and be it further

Resolved, That the Executive Director of this Association is hereby directed to send a copy of this Resolution to each member of the Congress of the United States.

NEW YORK STATE BAR ASSOCIATION TAX SECTION

COMMENTS ON H.R. 10612 AS REPORTED TO THE SENATE, SECTION 701
ACCUMULATION TRUSTS

A. Problem Addressed by the Bill

The stated objectives of the amendment are to simplify the complicated provisions requiring the throwback of distributions of accumulated trust income to the years of accumulation, to make them more equitable, and to circumscribe certain areas of tax avoidance. S. Rep. No. 94–938, 94th Cong., 2d Sess. 5, 15, 170–1.

B. Provisions unchanged in Senate Finance Committee bill

The following provisions in the Bill as reported to the Senate are identical to those in the bill as passed by the House:

(1) Changing the base to which throwback income is added from the beneficiary's gross income to his taxable income.

(2) Eliminating, except as to tax-exempt interest, the treatment of throwback income as having the same character in the hands of the beneficiary as in the hands of the trust.

(3) Eliminating the so-called exact method as one of two alternative methods of making throwback computations.

(4) Revising the remaining method, the so-called shortcut method, by taking as the base for a 3-year average not the 3 preceding years, but the 3 out of the 5 preceding years left after eliminating the 2 years in which the beneficiary had the highest and lowest taxable income.

(5) Abolishing the refund, or credit against other taxes, which a beneficiary is entitled to receive under present law when his tax on an accumulation distribution is less than the tax previously paid by the trust.

(6) Providing that a beneficiary receiving accumulation distributions from three or more trusts attributable to the same taxable year loses any credit against his tax on the throwbacks for taxes paid by the "third" trust, except where the aggregate accumulation distributions from the "third" trust for such year are less than $1,000.

(7) Eliminating application of the unlimited throwback rule to distributions of income accumulated before the beneficiary attains age 21, except for distributions from more than two trusts attributable to the same year.

(8) Repealing the capital gains throwback rule.

(9) Eliminating treatment as accumulation distributions of distributions which do not exceed trust accounting income.

C. Provision changed in Senate Finance Committee bill

The House bill enacted a new § 644 of the Internal Revenue Code converting any gain realized on unrealized appreciation in property transferred to the trust into short-term gain if the property is sold within two years after transfer to the trust. The Senate bill substitutes a revised § 644 under which the trust's tax on such gain will equal the additional tax the transferor would have paid had the gain been included in his gross income for his taxable year in which the trust sold the property, if he is alive at the time of such sale. An interest factor is added to the trust's tax if the sale takes place in a trust taxable year ending before that of the transferor, requiring a one-year postponement of the reporting of the gain by the trust. The Senate bill also solves a number of technical problems present in the House bill, but it fails to close a significant loophole arising from the availability of put options.

D. Tax section comments

(1) The Tax Section approves the changes described in B(1), (3), (4), (8), and (9) above as consistent with the stated objectives of the bill.

(2) The Section approves the elimination of throwback treatment of pre-age 21 accumulations described in B(7) above. However, the Section disapproves as without rational basis the exception for distributions from more than two trusts. No justification appears in the Committee Report. Once the principle is accepted that accumulations during minority do not represent an abuse requiring application of the throwback rule, it is arbitrary and discriminatory to subject a beneficiary to throwback treatment merely because income was accumulated during his minority in more than two trusts (all of which may have been created by different grantors for legitimate non-tax reasons). Accordingly, the Section recommends that the words "(other than subsection (c) thereof, relating to multiple trusts)" be stricken from § 701(b) of the bill.

(3) The Section believes that the multiple trust rule described in B(6) above is unduly broad in the light of its objectives, and should be limited to trusts created by the same person for the same beneficiary, treating husband and wife as one grantor. The Section also recommends that the de minimis amount be increased to $2,000 per annum as providing more realistic relief to beneficiaries of smaller trusts. Accordingly, the Section recommends the following amendments to § 667 of the Code as amended by § 701(a)(1) of the bill:

(a) In § 667(c)(1), insert the following words after the word "trusts": "created by the same grantor (treating husband and wife as one grantor)".

(b) In § 667(c)(2), change the figure $1,000" to "$2,000".

(4) The Section disapproves the changes described in B(2) and (5) above as contrary to the stated objective of making the income tax more equitable.

(a) The bill's elimination of the character rules (except for tax-exempt interest) means that all throwback income will be treated as undifferentiated ordinary income even though the income accumulated by the trust was of a type subject to special treatment, such as capital gains (when classified as trust accounting income), or foreign source income eligible for a foreign tax credit. This change will produce highly inequitable results not justified by the simplification sought to be accomplished. In no event should the change be applied retroactively to income accumulated before enactment of the new law in good faith reliance on its retention of the same character when later distributed to beneficiaries. Accordingly, the Section recommends that the words ", with respect to any tax-exempt interest to which section 103 applies," be stricken from § 667(a) of the Code as amended by § 701(a)(1) of the bill. In the alternative, § 667(a) should be amended to add the following provision:

"At the election of the beneficiary, the limitation to tax-exempt interest of the application of section 662(b) shall not apply to amounts attributable to undistributed net income for taxable years of the trust ending on or prior to the date of enactment of the Tax Reform Act of 1976."

(b) The Section believes that it is inequitable to deny a beneficiary a refund, or credit against other taxes, if his computations on an accumulation distribution in a particular year produce a lower tax than the tax paid previously by the trust, given that in most years the beneficiary will have to pay taxes on accumulation distributions in addition to those previously paid by the trust. Accordingly, the Section recommends that the words "or a beneficiary of such trust" be stricken from § 666(e), as added by § 701(a) (2) of the bill.

(5) The Section regards the Senate Finance Committee version of § 644 as a significant improvement over the corresponding provision in the bill as passed by the House. Imposing a tax on sales by the trust within two years of transfer at the transferor's bracket directly counteracts the abuse perceived in a transferor's effort to benefit from the difference in the tax brackets between the trust and himself, as compared with the House bill's arbitrary doubling of the rate of tax payable by the trust. The Senate version also solves the problems of transfers from trust to trust, of limitation of the special treatment to unrealized appreciation existing at the time of transfer to the trust, and of effective date which were present in the House bill. The Senate bill contains a provision extending the two-year period to the closing of a short sale in order to prevent circumvention of the two-year period through short sales during such period. However, the bill leaves a significant loophole by failing to apply a similar rule to put options acquired by the trust during the two-year period, since they have the same economic effect as short sales. Accordingly, the Section recommends that § 644(d), as added by § 701(e) (1) of the bill, be amended to add the same wording as now appears in the last sentence of § 1233(b) of the Code.

The Senate version of § 644 will create difficult administrative problems where tre trustee does not have sufficient information about the transferor to compute the tax at his bracket, as the Committee report recognizes. S.Rep. No. 94–938 at 174. The Section remains doubtful that the magnitude of the alleged abuse § 644 seeks to counteract justifies the additional complexity introduced by the new provision. Nevertheless, if the Congress is convinced that there is sufficiently widespread abuse in transfers in trust of appreciated property in order to shift the tax on the gain to the trust's lower rate structure, the Section believes that the legislative solution of the Senate bill is far more consistent with the bill's basic objective of improving the equity of the income tax than the House version.

COMMENTS ON H.R. 10612, SECTIONS 1501, 1503, IRA CONTRIBUTIONS BY PLAN PARTICIPANTS

Problem addressed by the bill

Employees participating in qualified plans may not make deductible contributions to an individual retirement account (IRA), even though the value of their contributions or benefits under the qualified plan may be nominal.

Approach of House bill

Section 1502 of the House bill permits such employees to deduct contributions to an IRA in an amount equal to the difference between the $1,500—15 percent of compensation limitation on IRA deductions, and the value of their contributions or benefits under the qualified plan. This privilege is not extended to participants in government plans. The House bill also partially ameliorates the impact of IRA penalty taxes which in many cases operate as traps for the unwary.

Approach of Senate bill

Section 1503 of the Senate bill rejects the House proposal for budgetary reasons but provides that the House proposal, if adopted, is to be extended to government plan participants. Section 1501 of the Senate bill proposes to permit an employee to make contributions to an IRA on behalf of a non-working spouse, subject to a $2,000 ceiling for all IRA contributions.

Tax section comments

The Section believes that the proposal to permit contributions on behalf of a non-working spouse is sensible. The Committee also approves the principle of the original House proposal (and its extension to government plan participants), although it finds the mechanics of that proposal unduly complicated in requiring an individual computation of the value of each employee's participation in a defined benefit plan, and in gearing the deduction to the current year's contributions under a qualified plan, rather than to a prior year. The Committee believes that a simplified approach to valuing participation in a defined benefit plan is desirable, and that the "contribution period" in teh Senate bill should be lengthened. Finally, the Committee believes that the elimination of the traps for the unwary contained in the present IRA provisions is desirable, irrespective of what other changes may be made. Section 1502 of the House bill has been discussed in more detail in a report prepared by the Section's Committee on Employee Benefits, a copy of which can be obtained from Peter L. Faber, 700 Midtown Tower, Rochester, New York 14604.

COMMENTS ON H.R. 10612, SECTION 1502, MINIMUM KEOGH PLANS

Problem addressed by the bill

ERISA amended the Internal Revenue Code to waive the usual Keogh plan deduction limitation (15% of earned income) for contributions of up to $750 of earned income. However, section 415 of the Code makes the benefits of this waiver not fully available to employees earning less than $3,000 a year, while the benefit of the waiver is available to highly compensated employees (such as corporate directors without limitation.

Approach of House bill

The House bill contained no provision on this subject.

Approach of Senate bill

Section 1502 of the Senate bill allows a deduction for contributions to a Keogh plan of up to $750 a year of earned income, without regard to the limitations of Code section 415. However, this provision is not available to employees with adjusted gross income in excess of $15,000.

Tax section comments

The Section believes that § 1502 carries out the intent of the original provision authorizing small Keogh plans, both in eliminating the present restriction on its use by individuals earning less than $3,000, and by restricting availability of the device to individuals whose adjusted gross income does not exceed $15,000.

STATEMENT OF PETER L. FABER, CHAIRMAN, TAX SECTION, NEW YORK STATE BAR ASSOCIATION

Mr. FABER. Thank you, Mr. Chairman. My name is Peter L. Faber. I am a partner in the Rochester law firm of Harter, Secrest and Emery in New York. I am the chairman of the tax section of the New York State Bar Association.

I too am going to speak on the imposition of tax on generation-skipping transfers. Let me begin by stating the tax section's strong objection to the failure to place the other estate and gift tax proposals on the agenda for these hearings. Mr. Chairman, these proposals would stand the existing estate and gift tax on its ear, they would completely restructure it and would have a revolutionary impact on the process by which property is transferred from generation to generation. They would have social and economic implications going far beyond those of most tax bills, and the suggestion that they are less deserving of the committee's time available for public hearings than the proposal to allow an investment credit for solar-powered windmills just boggles the mind.

Mr. Chairman, the section is deeply concerned that the Senate may act on estate and generation-skipping transfer proposal without having an adequate opportunity to consider its policy implications and study specific statutory language. The concepts involved in generation skipping are complex and the language in which they must necessarily be expressed is more complex still. For the Senate to enact legislation on this important subject without studying it carefully beforehand would be irresponsible and unworthy of such a distinguished body.

Unfortunately, you have just received a generation skipping bill. It was handed out in this room an hour or so ago. My written statement illustrates some of the problems in the area by referring to the Ullman bill as originally presented to the House Ways and Means Committee.

Although we have not had much time to study this bill, our review has disclosed serious technical problems. While it is not my purpose today to present a comprehensive technical analysis of the bill, my written statement, and my supplementary statement delivered this morning, point out a number of technical difficulties and illustrate the generation skipping as a complex area.

I might add that I have reviewed briefly the committee print of the Senate version of generation skipping, and the same difficulties as pointed out in my written statement appear to be in this version.

For example, the bill nowhere states who pays the generation-skipping tax, nor does it state who signs the tax return, nor for that matter what kind of tax return is required. In fact, a possible interpretation is that a parent of the younger generation beneficiary would have to pay the tax out of his own assets, even though he himself is not a beneficiary of the trust. The application to second life estates or terms of years is unclear. The tax paid on generation skipping transfer is a self-skipping generation-skipping transfer under the bill, and this could lead to indefinite tax and transfers extending ad infinitum.

There are more problems we have detected, and evidently more we have not. Although we bring many years of experience to the problem, the bill contains new concepts and terminology that are not easily mastered. There is a new language in this bill that is unfamiliar to us, and that would be unfamiliar to you when you first study it. These are not mere technical difficulties, they give rise to a basic concern on our part as to whether this legislation will work. Will it do what it intends to do? If it does, will it nevertheless have undesirable side effects? We don't know the answers to these questions, Mr. Chairman; do you? And will you have time to find out?

Additionally, there are many important policy decisions that have to be made.

The CHAIRMAN. Unfortunately, time has expired, Mr. Faber. Your entire statement will be inserted in the record, and I compliment you on your expertise in this area.

Mr. FABER. Thank you, Mr. Chairman.

The CHAIRMAN. Your expertise in this very complex subject.

Mr. FABER. Thank you. We hope you will go slow and consider this subject.

The CHAIRMAN. Thank you. The next witness is Mr. George Hatch, KUTV, Salt Lake City, Utah.

STATEMENT OF GEORGE C. HATCH, VICE PRESIDENT, THE STANDARD CORP., OGDEN, UTAH

Mr. HATCH. Mr. Chairman, I have prepared a statement which I have submitted for the record.

The CHAIRMAN. Without objection, it will be inserted in the record in full, Mr. Hatch, and you may summarize it, sir.

[The statement follows:]

TESTIMONY OF GEORGE C. HATCH, VICE-PRESIDENT, THE STANDARD CORP., OGDEN, UTAH

My name is George C. Hatch. I am Vice-President of The Standard Corporation of Ogden, Utah, which has operated the Ogden Standard Examiner newspaper since 1892, and KUTV television station, Salt Lake City, Utah, since 1956.

The Standard Corporation was founded by my wife's grandfather, and, today, the stock of the corporation is owned entirely by lineal descendants of the founder. The stock is owned by or for the benefit of twelve grandchildren of the founder (the third generation) and some thirty-five great-grandchildren (the fourth generation). Of the voting stock, 43% is owned by individuals and 57% is owned by irrevocable trusts—some under wills and some created during life for the benefit of the third and subsequent generations. These trusts bear dates such as 1953, 1954, 1955, 1963, 1965, etc.—all the way to 1976. These trusts were created for the purpose of preserving the local family ownership of the newspaper and broadcasting station and preventing diffusion of control as succeeding generations increase in numbers. The family desired to preserve the local editorial voice of the newspaper and television station and prevent their sale to a national chain with overwhelming emphasis on a bottom-line net income and bland editorial policy.

I am here today to express deep concern that the worthy objectives of preservation of family farms and businesses in other sections of the bill may be defeated by the provisions proposed for a tax on generation-skipping transfers. The trusts that hold a majority of the stock in our family corporations, like many others across the country, made no provision for accumulating income to pay a transfer tax when a beneficiary's interest terminates. The beneficiaries of the income from the trusts are not the ultimate beneficiaries in the distribution of the corpus.

I understand that the House Ways & Means Committee has reconsidered the original provisions of HR–13966 and voted to exempt from its provisions previously-created irrevocable trusts. I strongly urge this exemption that would preserve the purposes of trusts previously established. If the transfer tax were passed in its original form, a trustee of an established trust directed by the grantor to preserve the family business and stock, and instructed to distribute all income as earned, would be in a hopeless dilemma. He would have to seek relief from his state legislature to change the law of trusts of his state; or he would have to seek relief from Congress, to repeal the tax you are now considering enacting.

In addition to supporting the amendment to exempt prior established trusts, I would support the proposal of the Ways & Means Committee to provide a one-generation exemption in future irrevocable trusts to permit a grantor giving a spouse or children lifetime income and to exempt the application of the transfer tax in the distribution of the corpus to the grandchildren. This proposal would permit the founding grantor to provide for the payment of gift or estate tax on the family farm or business and to leave the property to his grandchildren intact. If the trust transfer tax is not so amended, a family business or farm would be subject in a trust to a transfer tax on the death of the children of the grantor, and this would require the sale of the family business or farm in one generation.

There is a strong increase in the percentage of newspapers and television stations owned by national chains directly attributable to the inability of founders of these local communications media to pass on local ownership to their heirs, and still pay large estate taxes. The family trust is the last means of preservation of such local ownership and control.

Either the legislation should be amended with a one generation-skipping exemption, as proposed by the House Ways & Means Committee, or an exemption from a tax on generation-skipping transfers should be made for family farms and family corporations that will preserve local ownership. These are the categories that you recognize as worthy of consideration for relief in the proposal for favorable valuation, additional credit against the estate tax, and extensions of time for payment of estate tax. My suggestion for an exemption from a tax on generation-skipping transfers for trusts that own family farms and family operating businesses recognizes that the trusts holding these assets have a non-tax social purpose that trusts holding diversified liquid assets do not. Strengthening of antitrust laws and regulation of large national and international conglomerates will be of no avail if family enterprises cannot afford transfer taxes without the sale of family businesses and farms to such large corporations. Concentration of economic power is a serious long-range problem in our society.

At the very least, in considering radical changes in estate and gift tax laws, the effective date should be well in advance of the date of enactment, so that the professional people and businessmen who must deal with the new law have time to adjust to it. For example, millions of wills drafted over the last twenty years will require review and amendment if some of the proposed changes become law.

There is presently a trend in state legislatures for streamlining probate procedures through adoption of the Uniform Probate Code. The trend has been promoted by consumer groups. Utah enacted the Uniform Probate Code in early 1975, but used an effective date of July 1, 1977. By this means, the people who deal with the new law—lawyers, accountants, trust officers, businessmen—have time to adjust to the new procedures in an orderly fashion. Another example of advance effective dates and time to adjust was the adoption by forty-nine states of the Uniform Commercial Code, which provided for various advance effective dates from about six months to about two years.

I contrast this to what has been proposed here in the Congress—radical changes in the estate and gift tax laws with retroactive effective dates in some important instances. I contrast also the gains in simplification and savings in cost that the Uniform Probate Code is designed to accomplish with the losses in simplification and increased costs that the proposed legisltaion, if not designed to invoke, will inevitably cause.

If, ultimately, you decide that a tax on generation-skipping transfers serves a valid purpose and is worth the complexity, costs, and delay in administering estates that will accompany it, I would, in summary, urge consideration of two limitations:

1. The proposed transfer tax should not be retroactive. Application of the tax to presently-existing irrevocable trusts would upset bona fide plans long ago embarked on, and would encourage the concentration of property in large publicly-traded corporations. Certainly, the tax laws of the nation should not encourage bigness when the antitrust laws discourage it.

2. As to future generation-skipping trusts, I would propose permitting the skipping of one generation or, in the alternative, exempting those trusts which hold as their principal asset family farms and family-held operating businesses. Without such an exemption in the generation-skipping trust transfer tax legislation, the relief given to farmers and closely-held businesses in one area of the new legislation is dissipated in another area.

I thank you for the opportunity to testify.

Mr. HATCH. Our concern is the family-operated business, majority stock of which is owned by irrevocable trust. It has been the effect on the business of the proposed generation-skipping transfer tax. Since the original bill which I commented on in my testimony on arrival here today, I received a copy of the committee's report on the amendments that have been proposed as to existing irrevocable trusts and future trusts. I certainly agree that modification is necessary so that transfers can be made to grandchildren, and so that existing trusts can comply with the new law.

After reviewing the proposed amendments, my remaining concern would be whether under State law and under the terms of trusts, the provisions proposed covering existing irrevocable trusts actually could be carried out, because trustees do not presently have the power to change the beneficiaries and to pay the transfer taxes. So I would recommend that the language which the Ways and Means Committee has adopted as to existing irrevocable trusts be considered, and I have prepared a summary of how that language would amend the proposed language.

The CHAIRMAN. That is included in the record.

Mr. HATCH. Similarly, the Senate language states that it was intended to exempt the trust that went directly to grandchildren, and that there would be no gift tax in such an event. In the same case, we believe that the language of the amendment considered and passed by the House Ways and Means Committee is clearer in those provisions and there is some doubt in the proposed Senate amendment whether it would in fact exempt such grants from a gift tax. So I have also prepared proposed language to conform——

The CHAIRMAN. Without objection, that will be inserted in the record and made available to the staff.

[The document referred to follows:]

Amendment of Committee Print of July 20, 1976 2202 dealing with certain generation skipping; transfer as follows:

1. Page 36, line 14, after the words "such transfer" add "is to a granchild of the grantor of the trust or"

2. Page 48, line 14, after the words "such transfer" add "is to a grandchild of the grantor of the trust or"

3. Beginning at page 54, line 15, delete lines 15 through 24 on Page 54 and lines 1 through 17 on page 55, and substitute in lieu thereof the following:

"(2) EXCEPTIONS.—The amendments made by this section shall not apply to any generation-skipping transfer—

(A) Under a trust which was irrevocable on April 30, 1976, but only to the extent that the transfer is not made out of corpus added to the trust after April 30, 1976, or

(B) In the case of a decedent dying before January 1, 1982, pursuant to a will (or revocable trust) which was in existence on May 1, 1976, and was not amended or revoked at any time after that date.

For purposes of subparagraph (B), if the decedent on April 30, 1976, was under a mental disability to change the disposition of his property, the period set forth in such subparagraph shall not expire before the date which is 2 years after the date on which he first regains his competence to dispose of such property."

Mr. HATCH. Thank you very much.

The CHAIRMAN. Thank you, Mr. Hatch.

The Chair recognizes the distinguished Senator from Utah.

Senator MOSS. Thank you, Mr. Chairman. I had hoped to come here in time to introduce Mr. Hatch who has just testified briefly. I simply wanted to identify him as one of our outstanding citizens of the State, not only the identification that appears in the statement, but he is chairman of the board of the University of Utah, and has filled many positions in an amount of substance, and I might add is a good Democrat, which pleases my heart and I therefore would ask the committee to give great attention to the point that he brings up. But he has explained it to me, and it seems to me to be very reasonable, one that certainly I would like to adopt as far as my position as Senator is concerned.

The CHAIRMAN. He made an outstanding statement. I might say to the Senator from Utah, and I am sure the committee will give thorough consideration to his recommendation. It does affect the trust retroactively, and that is something the committee tries to avoid doing. Thank you, Mr. Hatch, and thank you Senator Moss.

This completes the list of witnesses scheduled for today. The committee will stand in recess until 8 a.m. tomorrow morning.

[Whereupon, at 2:53 p.m. the committee adjourned, to reconvene at 8 a.m. on July 21, 1976.]

CERTAIN COMMITTEE AMENDMENTS TO H.R. 10612

WEDNESDAY JULY 21, 1976

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met at 8 a.m., pursuant to recess, in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Talmadge, Hartke, Harry F. Byrd, Jr., Nelson, Gravel, Bentsen, Hathaway, Haskell, Curtis, Fannin, Hansen, Dole, and Packwood.

The Chairman. The hearing will come to order.

I want to announce for the benefit of Mr. Brandon and Mr. Early, who indicated they would like to testify when we had more Senators present, that I am going to call them when we have more Senators in the room. It is now 2 hours earlier than we usually call our committee meeting, and there will be other Senators showing up as we go along. I will seek to accommodate those two fine gentlemen by calling them when we have as much attendance as I think we are likely to have here today.

I will call the first witness, Mr. Howard M. Benedict of Arent, Fox, Kintner, Plotkin and Kahn, special tax counsel.

We are happy to have you. We will be pleased to know your views.

STATEMENT OF HOWARD M. BENEDICT, CHAIRMAN OF THE NATIONAL ASSOCIATION OF REALTORS ECONOMICS AND RESEARCH COMMITTEE

Mr. BENEDICT. Mr. Chairman, my name is Howard M. Benedict. I have been in real estate business in general active practice in New Haven, Conn., for over 28 years. I serve as real estate commissioner in the State of Connecticut. I have served as vice chairman of the Federal Taxation Subcommittee of the National Association of Realtors and chairman of the Associations' Mortgage and Finance Subcommittee. I serve presently as chairman of the Economics and Research Committee of the National Association of Realtors.

I am accompanied this morning by Gil Thurm, our staff legislative counsel and Mr. Stephen Bodzin of the firm of Arent, Fox, Kintner, Plotkin and Kahn and Kem Karin who directs our department of economy and research.

We represent 700 real estate boards throughout the United States, 50 State associations and approximately 500,000 people actively engaged in the real estate business throughout the United States. The

National Association of Realtors is the largest trade association involved in real estate; it includes persons involved in mortgage banking, home building, and commercial and industrial real estate as well. We appear today to urge you to reconsider and hopefully to reject the Haskell-Kennedy amendment which was approved by the Senate on June 22. This amendment places an "at risk" limitation on real estate limited partnerships.

This provision, if allowed to become part of the law, will have a very severe adverse effect on the already depressed real estate industry. Our industry, Mr. Chairman, right now has over 17 percent unemployment throughout the United States against 7.2 percent for the country as a whole.

In previous testimony before the committee we have tried to explain that real estate development, including multifamily construction, was the first segment of our national economy——

The CHAIRMAN. Would you mind repeating how much unemployment you have in the industry?

Mr. BENEDICT. Seventeen percent unemployment in the construction industry and 7.2 percent is the overall United States.

The CHAIRMAN. So there is 2½ times as much unemployment in your industry as there is in others?

Mr. BENEDICT. There is indeed.

The CHAIRMAN. Thank you.

Mr. BENEDICT. As a matter of fact, in my area, New Haven, Conn., seven out of the nine major contracting firms in the last 5 years are either bankrupt or out of business and no longer available in case we have to have an expanding business.

The CHAIRMAN. I hope you will look Senator Ribicoff up. I know he is busy elsewhere, but I hope you look him up and explain that to him.

Mr. BENEDICT. Mr. Ribicoff was in Connecticut last week, and I am sorry he is not here this morning.

The CHAIRMAN. He is in town.

Mr. BENEDICT. His legislative aide will do nicely.

The CHAIRMAN. For the benefit of all the people who testify before a committee and complain that all the Senators are not there, I suggest you track them down, just pad on down the hall and rap on everybody's door, or call them off the Senate floor. If I was not satisfied with a provision, that is what I would do, and I would urge you to do likewise, to look at who is not there to hear your statement and to look him up. If Muhammad won't come to the mountain, the mountain may have to go to Muhammad. [Laughter.]

Mr. BENEDICT. Senator, I appreciate your advice and I will look up Senator Ribicoff during the day while I am here.

In previous testimony before the committee we have tried to explain that real estate development, including family construction, was the first segment of our national economy to enter the recession and it is one of the last to come out of it.

It is difficult to talk about economic recovery for the country without regard to the severe economic problems that beset the real estate industry today.

We appreciate the wisdom of your committee in rejecting the House limitation on artificial loss provisions. It indicates the Senate's awareness of the many problems which beset the real estate industry.

However, there are significant numbers of other negative, adverse provisions which are in H.R. 10612, including investment interest expense, particularly the long-term interest expense of a limited partnership in the add-on minimum tax which will have an adverse effect on our industry.

Although this committee rejected the "at risk" provision for the real estate industry, the Senate made the tax bill even more complicated and financially destructive by adopting a general provision, the Haskell-Kennedy amendment, which is, in fact, an "at risk" limitation on real estate limited partnerships, and this should be reconsidered and rejected.

The limited partnership is one of the major competitive uses that we have of competing for equity funds to build real estate and to build housing in the United States. If this is denied to us we will be at a severe competitive disadvantage.

The rule is so harmful to the real estate industry that the House Ways and Means Committee rejected it, the House of Representatives rejected it, this committee rejected it, the Treasury and the administration are opposed to it. We believe that it is a serious mistake for the Senate to so drastically change the current tax law by imposing this discriminatory limitation on real estate investment.

We respectfully request that the committee take all appropriate action to cause the Senate to reverse its action on this provision and to reject the "at risk" rule for real estate.

[Mr. Benedict's prepared statement follows:]

SUMMARY OF STATEMENT OF HOWARD M. BENEDICT ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS

A more adequate supply of housing plus needed balance of commercial and industrial real estate is vital to the social and economic health of our country. Investment in real estate is an important part of our competitive economy. Recent changes in the tax law, in addition to the threat of certain current tax revision proposals, have adversely affected the real estate industry and the nation's economy.

The amendment offered by Senators Haskell and Kennedy which applies an "at risk" limitation to limited partnerships, including real estatae limited partnerships, has made the Tax Reform Act of 1976, H.R. 10612, extremely complicated and financially destructive to the real estate industry. This amendment will eliminate an important source of equity capital—particularly for new rental housing projects which rely heavily on limited partnerships for equity financing.

We respectfully request the members of this distinguished Committee on Finance to urge their fellow Senators to reconsider and reject this drastic "at risk" limitation.

INTRODUCTION

Mr. Chairman, members of this distinguished Committee, my name is Howard M. Benedict and I am engaged in the real estate business in New Haven, Connecticut. I have previously served as Real Estate Commissioner of the State of Connecticut, Vice Chairman of the Federal Taxation Subcommittee of the National Association of Realtors, and Chairman of the Realtors Mortgage Finance Subcommittee. I presently serve as Chairman of the Economics and Research Committee of the National Association of Realtors. I am accompanied by Albert E. Abrahams, Staff Vice President, Government Affairs, National Association of Realtors and by Gil Thurm, Staff Legislative Counsel and Director of Tax Programs for the National Association of Realtors Government Affairs Department. We appreciate this opportunity to testify on behalf of the Association.

The National Association of Realtors is comprised of more than 1,700 local boards of Realtors and 50 State Associations. The combined membership of the Association is approximately 500,000 persons actively engaged in sales, brokerage, management and appraisal of residential, commercial, industrial, and farm real estate. The activities of our membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and industrial real estate development. The National Association of Realtors has the largest membership of any association in the United States concerned with all facets of the real estate industry.

THE COMPETITIVE NATURE OF AN INVESTMENT IN BUILDINGS AND OTHER IMPROVED REAL ESTATE

Investors in real estate recognize that their capital investment is materially less liquid than most other investments. The sale of real estate at a fair price usually requires negotiation over an extended time period. This factor, when added to such other factors as local taxes, increasingly stringent environmental considerations, local zoning regulation, and maintenance, financing and carrying costs, and escalating utility costs, usually makes real estate competitive with other investments only when the return on the real estate invesment, if it is successful, can be anticipated to be larger than a successful investment in other, more liquid investment activities.

The traditional Federal tax provisions applicable to real estate have had the effect of permitting real estate investment to remain competitive despite the inherent risks and costs in real estate investments. Unfortunately, adverse tax treatment during the past decade, especially in the Tax Reform Act of 1969, greatly reduced the competitive position of the real estate industry at a time when private sector investment in real estate was of crucial importance to the welfare of the country as a whole. Further, persistent threats of imposition of drastic and discriminatory adverse tax provisions such as the limitation on accounting losses (LAL) has had and continues to have, a dampening effect on real estate investment.

We appreciate the wisdom of the members of the Senate Finance Committee and the Senate as a whole in rejecting the LAL proposal. This indicates the Senate's awareness of the many problems which beset the real estate industry. However, there are a significant number of other negative and adverse provisions already in the proposed Tax Reform Act of 1976, H.R. 10612. For example, inclusion of investment interest expenses and, particularly, long-term interest expenses of a limited partner, in the add-on minimum tax no doubt will have an adverse impact on the already depressed real estate industry. Further, although this Committee rejected an "at risk" provision for the real estate industry, the Senate has made the tax bill even more complicated and financially destructive by adopting a general provision (the so-called Haskell-Kennedy amendment) which is in fact an "at risk" limitation on real estate limited partnerships. This drastic "at risk" limitation is more fully discussed below.

The real estate industry needs strong private sector investment in order to continue to provide the single and multi-family housing, commercial buildings, industrial complexes, and shopping center complexes that are required for the continued growth and maintenance of our high standard of living.

The adverse actions mentioned above already have reduced the competitive position of real estate. If the Federal tax system is again changed to adversely affect the capital requirements of the real estate industry, the consequent discouragement to new real estate investment will inevitably cause a decrease in the supply of improved real property, an increase in rental rates, and a deferral of proper timely maintenance of our country's buildings. This conclusion is inescapable—for if real estate is to lose investment capital to other segments of the economy, it must either decrease the supply of houses and buildings or must regain its flow of capital through an increased rate of return from higher rents, thereby hurting the very people who can afford it least.

"AT RISK" LIMITATION ON REAL ESTATE LIMITED PARTNERSHIPS

On June 22, 1976, the Senate adopted an amendment by Senators Haskell and Kennedy to apply an "at risk" rule to limited partnerships, including real estate limited partnerships. For all practical purposes, this harsh amendment would substantially reduce (and perhaps even eliminate) the use of limited partnerships as an investment vehicle for real estate projects. The consequence of this would be the elimination of an important source of equity capital—particularly for new rental housing projects which rely heavily on limited partnerships for equity financing.

The "at risk" rule is so harmful for the real estate industry that the House Ways and Means Committee rejected it. The House of Representatives rejected it. The Senate Finance Committee rejected it. The Treasury Department and the Administration are opposed to it. We believe it is a serious mistake for the Senate to so drastically change the current tax law by imposing this discriminatory limitation on real estate investment. We respectfully request this Committee to take all appropriate action to cause the Senate to reverse its action on this provision and to reject this "at risk" rule for real estate.

Under current law, when none of the partners of a limited partnership is personally obligated on a partnership debt, a limited partner is allowed to include a portion of the nonrecourse (non-personal) liabilities of a limited partnership in the basis of his limited partnership interest. This places the limited partner in the same position as a joint owner of property not held in partnership form, and enables the limited partner to deduct the amount of his distributive share of partnership expenses in the same manner as the joint owner of property may deduct his share of the expenses of operating a property. Like individual owners, many limited partnerships hold and operate depreciable real estate constructed or purchased with nonrecourse loans secured by the depreciable property.

This partnership basis rule (which the Haskell-Kennedy amendment would revoke) is derived from Code Section 752(c) and the Income Tax Regulations promulgated thereunder. These provisions reflect the basic principle of *Crane* v. *Commissioner*, 331 U.S. 1 (1947) where the U.S. Supreme Court stated: "We are no more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that an owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were his personal obligations (331 U.S. 14)."

To the same effect is Treasury Regulations Section 1. 163–1(b) which holds that the owner of property is entitled to an interest deduction on a mortgage on his property, even though he is not personally liable for the mortgage, since in reality the mortgage on his property is his debt.

Whether a mortgage is recourse or nonrecourse, that is, with or without personal liability on the mortgagor, the owner of the property (including a limited partnership) has a continuing obligation to make payments on the mortgage. Failure to do this will certainly cause his equity to be foreclosed upon and lost. This is what the Supreme Court was talking about when it stated in the *Crane* case that as long as the value of the property exceeds the related debt, the owner "will treat the conditions of the mortgage exactly as if they were his personal obligations". That is, he will pay the mortgage to preserve his equity (cash investment) in the property, and this will be done regardless of whether or not he is personally liable on the mortgage.

The proposed change in the basis rule for limited partners would discriminate against real estate as an investment for the general public. It would provide a greater tax benefit for the wealthy, who can invest directly, and thereby discriminate against the small investor who must invest through some form of group ownership because he lacks the resources to buy the property directly.

Aside from the effect of not permitting a limited partner to deduct his full share of partnership losses, the "at risk" rule for limited partnerships will have another serious unintended adverse tax effect. That is, to the extent that a limited partner receives partnership cash flow, even though there is no limited partnership taxable income, any such partnership cash distributions will be fully taxable to the limited partner if they exceed his equity investment in the partnership. This effect doesn't even occur in the Committee's "at risk" provisions found in Section 202 of the Bill. For this reason alone, the "at risk" rule should be reversed.

In terms of financing, investment real estate is significantly different from investment in other areas of the economy. In a real estate investment there is a large tangible value to the real estate property supporting the amount of the mortgage. Further, the investor will have placed perhaps 20% down in hard cash, which is a sizable outlay and which provides the impetus to avoid foreclosure. These factors are not as significant in non-real estate investments where nonrecourse financing is usually found and often not supported by real value. Therefore, there is an appropriate distinction between other investments and real estate for purposes of this "at risk" rule.

Furthermore, since the taxpayer who purchases property by obtaining a mortgage secured by that property can normally be expected to satisfy the payments on the mortgage (whether or not the taxpayer is personally liable for the mortgage), he will have the same equity cost for the property as the taxpayer who does not finance the property. Financing property (whether on a recourse or nonrecourse basis) does not create a loophole but is merely one of the many factors which an owner may use in causing construction and improving the value of a community. It should not be the subject of adverse tax legislation. Indeed, as noted above, the "at risk" provision would tend to force out of the real estate industry the thousands of small and middle-income property owners who must rely on mortgage financing. The long-term result would be to place real estate ownership in the hands of a relatively few large corporations and wealthy families who can make direct cash investments.

This Committee may be concerned with so-called shelter or gimmick arrangements where investments are sought on the basis of quick tax benefits rather than the basic economic feasibility of the project. The Committee should take into account the fact that the economics of the marketplace—even without the usual administrative action of the Internal Revenue Service—has significantly curtailed and will ultimately eliminate most of the "gimmick" arrangements. Additionally, so far as the unsophisticated investor is concerned, the danger of his being enticed into these losing situations has been and is being met by regulatory authorities, such as the Securities and Exchange Commission (SEC) and state security commissioners, who have more effective means of affording such protection than can be found in the tax system.

Again, we seriously question the need for any further adverse tax treatment, such as the "at risk" rule, for the real estate industry. Present law imposes the minimum tax on real estate excess accelerated depreciation. Also, in some cases, under present law there are significant limitations on the deduction of interest expense. The Committee's proposals (which have already been accepted by the Senate) would include construction period interest as a new item of tax preference, as well as investment interest and all interested allocated to a limited partner even though the partnership activity might otherwise be treated as a trade or business and not as an investment. To further add to this "at risk" provision would in substance be a triple attack on the real estate industry; this Committee and the Senate should not have a part in hitting an industry already down.

In sum, we respectfully request that the members of this distinguished Committee urge their fellow Senators to reconsider and reject the drastic "at risk" limitation on real estate limited partnerships.

Thank you for this opportunity to present our views.

The CHAIRMAN. Thank you very much, gentlemen.

I know you people have been criticized when you go out and talk to Senators, and you are accused of lobbying. But the Bill of Rights does more than protect the right of the freedom of the press; it protects the right of freedom of religion, freedom of speech, and it specifically says that the Congress shall pass no law to prevent citizens from organizing and seeking redress of their grievances. That is what the Boston Tea Party was all about—people were being treated unfairly and the Parliament turned a deaf ear to them and it called on America to be a free country.

Now, your people are provided under the Constitution with the right to go tell people when you think you are being treated unfairly. I don't care whether the Evening Star likes it or not or the New York Times likes it or not; you are protected under the Constitution and have every right to talk to the people who represent you.

The Senators who voted to clobber your industry have told me that they have not heard from a single person in their States. If you have some people in those States who are involved and who are getting the worst of it because of this, they better talk to their Senators.

Somebody called me and told me that this just absolutely destroys the equipment leasing industry. I said:

Well, I feel sorry for you people. You must have corns on the seat of your pants from just sitting there while somebody else tries to look after your business for you.

Now, if your people talk to those Senators, especially from their States, I think you are going to see a different result.

Mr. BENEDICT. Senator, we are very anxious to talk to them, because I was always taught as a youngster you don't hit a man when he is down. This "at risk" rule at the moment is absolutely going to devastate an industry that is down on its knees right now. It cannot absorb any more of this threat of legislation.

The CHAIRMAN. I don't know of a single Senator—I guess I know of one or two—whose principles go so far that he won't even talk to his own constituents, but those people have a high political mortality rate. [Laughter.]

I urge you, both for their good as well as for yours, to talk to those people who are supposed to be representing you here because I believe that they would be more considerate of your problem if they heard from you.

Are there any further questions, gentlemen? Senator Packwood.

Senator PACKWOOD. No questions.

The CHAIRMAN. Senator Talmadge.

Senator TALMADGE. No questions.

The CHAIRMAN. Senator Curtis.

Senator CURTIS. I will be very brief. You ask us to reconsider. You were satisfied with what the Finance Committee did on this, were you not?

Mr. BENEDICT. You rejected LAL and we were pleased at that.

Senator CURTIS. But what you are complaining about is the Kennedy amendment on the floor?

Mr. BENEDICT. The Haskell-Kennedy amendment.

Senator CURTIS. The Haskell-Kennedy amendment. The rollcall on that is found on page S. 10110——

Mr. BENEDICT. Forty-eight to forty-four.

Senator CURTIS. — of the Congressional Record of June 22, 1976.

Now, if you want a reconsideration of this, your forum is these 48 Senators who voted against you. How many have you called on?

Mr. BENEDICT. Mr. Curtis, we have written to all of them and we have asked our people throughout the United States to write them in quantity over this amendment and to visit with them also.

Senator CURTIS. I never want to judge what is in anybody's mind and heart but I am sure that there are many Senators who vote against jobs, vote against the interests of our economy, because they are misled by a lot of this demagoguery and falsehood and one-third lies that are published about the actions of this committee and about our tax law, and it takes someone who is involved, who knows what the facts are, to set them straight.

That is all, Mr. Chairman.

Senator HANSEN. Mr. Chairman.

The CHAIRMAN. Go ahead.

Senator HANSEN. Mr. Benedict, there has been a proposal before the Congress, an earlier one, that was vetoed that would provide some $6 billion for public works jobs. That has been cut back to about $4 billion. Would that be a better way of providing jobs for people in the

State of Connecticut than to have the private sector be able to expand and provide these jobs?

Mr. BENEDICT. Senator Hansen, I am a firm believer that the private sector is a more efficient way of doing it and any time we can give some form of help and get the private sector to do it, it will put people back to work faster and more efficiently than the public sector.

Senator HANSEN. Thank you. I have no more questions.

Mr. BENEDICT. This particular provision will do nothing but lower housing production. It will raise unemployment and it will increase rents. I should have all the members of the trade union sitting with me here today because they are the ones who will be hurt the most when there is no equity capital to build and all of the people are continuing to be laid off and then they stand in unemployment compensation lines and then the public sector has to pay for that.

Senator HANSEN. Do you think they would rather be working building homes than to take that course?

Mr. BENEDICT. People would always be rather gainfully occupied in the private sector than be on the public dole, yes, sir.

Senator HANSEN. Thank you, Mr. Chairman.

The CHAIRMAN. I want to just tell you that I am pleased to have your statement and I am pleased that the committee at this early hour is well represented. I regret that although the TV cameras were here representing all three networks and the press table was so crowded with standing room only yesterday, we have only one person representing the whole press to hear you people testify on behalf of the National Association of Realtors. That is too bad but it may be that that one soul, one little lady, can get the word to the rest of them [laughter]. That would seem to indicate how little interest there is on behalf of our fine liberal fraternity in the press when someone comes up to plead the cause of American business.

Thank you very much.

Mr. BENEDICT. Mr. Chairman, my problem is——

The CHAIRMAN. And American jobs for that matter.

Thank you.

Senator HATHAWAY. Mr. Chairman.

I am glad to hear you say you are all in favor of the private sector creating the jobs and not the public sector but it is a little bit contradictory because you are all in favor of getting all the tax breaks you can from the public sector in order to create these jobs. I was one of the sponsors of the amendment that you are criticizing and this amendment would not have been necessary if it were not for these artificial front-end deductions that you are able to get for your industry which the other taxpayers have to pay for. If you want to eliminate all of those, I will be glad to sponsor that amendment for you and really make this a private sector without any public help in the economy.

Mr. BENEDICT. Senator, I can live a lot better with that than I can with what I am getting. The reason we have the public focus on tax shelters right now is because we failed to build enough good housing for your central city people and they burned the cities. We had to have the 236 program and the FHA low-cost housing.

The 236 program was never real estate, it was a financing vehicle. It provided income limited to 6 percent, certainly no appreciation and so it passed through tremendous amounts of tax shelter to encourage the private sector to come in. When the private sector came in it got its hands slapped and was accused of using the public dole. Sir, I submit that that was a Government program designed by the Government and it was not an economic real estate program.

Senator HATHAWAY. I don't know of any real estate people who are complaining about the housing program. Maybe they are complaining about some details that they are not getting enough public money for their public housing programs. I never heard of knocking down a farmer's home because of a few other very heavy Government subsidies for your industry.

Mr. BENEDICT. I think there are areas where the public and private sector responsibly can cooperate. I think to the extent that the private sector is able to produce housing it will produce it substantially at less cost than when the public sector is asked to do this.

When I testified before the House Ways and Means Committee in 1969 it was pointed out that the cost of a 236 project was about $12,000 a unit and yet the cost to the Government was $18,000. Martha Griffiths asked me specifically why a 50-percent increase had to be because the public sector was involved in the building. I think this is the area that if private enterprise can be freed up from any of the restrictions and artificial loss we can do the job, but the constant threat of tax reform, which is a sword over our head all the time, forces us to build into rental rates enough extra margin to take care of the worst things that can happen.

If we were not threatened with tax reform all the time and could make business decisions which often have to be made 5, 6, 7 years in advance, we will lower the rates to homeowners and we will produce better housing at lower cost. Just give us a chance.

Senator HATHAWAY. Are you saying we can take all the public money out of the housing industry?

Mr. BENEDICT. No, sir.

Senator HATHAWAY. Including the tax breaks, you would be better off?

Mr. BENEDICT. I don't know what all these big tax breaks are.

Senator HATHAWAY. Well, if it were not for the front-end deduction, you would not have the shelter.

Mr. BENEDICT. We do not have the reduction. I have a copy of Economic Indicators which is prepared for the Joint Economic Committee by the Council of Economic Advisors. That is the Bible, so to speak, on what is happening in indicators and housing has had the outstanding record because these very tax breaks that you referred to are passed through directly in the forms of lower rent.

A specific example is between 1967 and 1969. The inflation rate in the United States was 9.8 percent. On average, rents only went up 5.7—only 58 percent of the overall cost. When the tax bill was passed in 1969 and became effective in 1970 and we reduced accelerated depreciation sharply, our rental rates went up 13 percent versus the economy of 17 percent which meant we went from 58 percent up to almost 80 percent because these benefits were taken away and then after we had some stability in the market in the last 3 years we have had an average of 10.5 percent increase in rents which was only 50 percent of the CPI increase.

I submit to you, Senator, that these tax benefits that are believed to inure to the developer's back pocket gets passed on through to the renter. In his competitive position the real estate owner passes them through in lower rent increases and the public is indeed the beneficiary of these tax benefits. They don't rest in these developments. They enable him to have a home and have lower rents and your statistics here will prove that point very clearly.

Senator HATHAWAY. I would rather delete the tax break and let the chips fall where they may and we will have taxpayers who might pay more rent but less taxes. I am not so sure that your figures are exactly right because we have had testimony indicating that it has increased as a result of these tax breaks with people who are in these developments selling their tax break to somebody who is not in the business so that he could make the deduction or the deferral deduction against his income and deferral of taxes.

Mr. BENEDICT. Senator, that is exactly what is referred to in the FHA 236 program. There was a public sale of tax shelters. There was not an economic piece of real estate. There is no way the private sector built that. That was built with the tax shelter in mind and we got blamed for it. I wish we honestly had never heard of the program other than for the poor people who are entitled to decent housing in the country because the people who bought the program and built the housing so that we eliminated the problems are now being blamed for the very good they did for our economy.

You sacrificed very little in giving them some tax breaks but you stopped the burning of our cities because of the terrible conditions that people lived under because they were not getting decent housing. I think that is a terribly small price to pay to eliminate the unrest that we had on all the television for almost 5 years.

Senator HATHAWAY. Well, it was the price we have to pay to do it. I would rather see it done by a direct appropriation rather than through the back door because in certain instances people do need to be subsidized in almost every industry that you can think of but we are much better off if they are on top of the table where we can see them and we know how much money is being spent rather than across the board and giving it to people who don't need it, and that is the biggest amount—coming in the back door expenditures.

Mr. BENEDICT. But when we kill our incentive to build and we don't have the housing, it is the poor people that need jobs, they need factories to work in, they need new machinery, they need decent housing. They are the ones that are hurt, not the wealthy people.

Senator HATHAWAY. We can provide that by direct appropriation rather than through the tax shelter.

The CHAIRMAN. Senator Dole.

Senator DOLE. No questions.

The CHAIRMAN. I would like you to expand upon your answer to Senator Hathaway's question and the Senator might want to provide some rebuttal information but I think the record ought to show both. Obviously from all that wealth of information you have there you can better document your argument and he can better document his and the record will show both and I will see that the record contains that information.

Mr. BENEDICT. Senator, I can document it with your statistics.

The CHAIRMAN. Well, I just suggest because of our limited time you expand on your answer and the Senator can supplement his statement. I would like him to expand on his, too, so that both sides can be presented and people can have both sides and decide for themselves with whom they agree.

Mr. BENEDICT. I appreciate your offer and I will supply that for the record.

The CHAIRMAN. Thank you very much, gentlemen, for a fine statement.

As much as I enjoy participating in this, I am going to limit myself hereafter and try to limit everybody else.

Mr. BENEDICT. Thank you.

[Material supplied by Senator Hathaway and supplemental statement of Mr. Benedict follows:]

DEPARTMENT OF THE TREASURY,
Washington, D.C., August 10, 1976.

Hon. WILLIAM D. HATHAWAY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR HATHAWAY: In response to your request, I am providing a summary of our analysis of the change in rental housing prices which would result from application of the House version of LAL.

When fully phased in, LAL would apply directly to only about 7 percent of total private construction, including about 28 percent of multifamily residential construction. No more than 15 percent of presently allowable deductions for these properties would be deferred in any one year, even if all present financing and accounting practices were continued.

Treasury staff estimates that deferral of these deductions would increase the cost of providing private rental housing by less than one-half of one percent. Average rentals would eventually rise to cover this increased cost, and the total amount of housing demanded would be smaller by about the same proportion.

These market adjustments would take place over several years and imply no necessary change in overall employment, since an unchanging monetary and fiscal policy is assumed.

Sincerely yours,

CHARLES M. WALKER.

[1973 Ways and Means hearings.]

DEVELOPER ATTACKS LOOPHOLES FOR BUILDING INDUSTRY

Amid the stream of special interest representatives who appeared before the Ways and Means Committee to argue for the continuation of their own loopholes, there was one unanticipated and very significant appearance by a wealthy real estate developer from Columbus, Ohio. George H. Deffet is president of the Deffet Companies, one of the fifty largest apartment builders in the country, with operations in six states. His testimony caused quite a stir in the committee room when he denounced the real estate loopholes as unfair, wasteful and inefficient.

The fact is that the tax subsidies that pervade the Internal Revenue Code are usually unfair, wasteful and inefficient. They encourage investment in industries not because they are the most productive but because they offer the best tax shelters. The use of the tax code to provide incentives to industry results in a misallocation of resources and encouragement of a flabby economy. Mr. Deffet explained this effect on the housing industry but the argument could be made in other areas as well. Excerpts from his testimony follow:

It is my personal opinion that present real estate tax incentives—I really prefer to call them tax shelter loopholes—perpetuate a totally unfair form of taxation. Indeed, they are perversions of the progressive tax system.

The shelter gimmicks related to our industry promote, in my judgement, waste and inefficiency. They do not add measurably to the stock of low and moderate income housing—an explicit social goal of Congress when it passed the Tax Reform Act of 1969.

Rapid depreciation and favorable capital gains are, as you know, the major elements of real estate "tax shelter." I believe these elements are not necessary for sustained, high levels of construction activity. I am convinced these tax loopholes indirectly aid fragmentation and irrationality in our industry. I contend they stimulate and support artificial competition while inhibiting technological advancement. These effects, ultimately, deny consumers superior housing products at lowest possible costs.

Let me describe for this committee just how some of this waste occurs. If builders are to produce low and moderate income rental housing through presently suspended 236 programs, one must obtain his profit through a syndication of wealthy investors. Their goals are to avoid payment of income tax—not the goals of creating better housing. The developer receives his profit by selling "tax losses" to others. The wealthy investors, who can certainly use the tax write offs, purchase the "losses." In this sense, the syndication vehicle and investor limited partners are totally superfluous, parasitic participants in the development process.

In addition, use of the tax system means a developer must absorb a substantial "selling" expense—often many thousands of dollars—in order to realize his compensation. These costs have nothing to do with creation of housing. But tax shelter dynamics also spur incentives in another way; to build expensively.

This follows simply because amounts a developer can earn are, primarily, a function of tax benefits converted to cash through syndication. The most important factors in such arrangements are deductions for depreciation. In turn, the size of depreciation deductions are governed by the total amount spent in constructing the units.

Accordingly, it's to the developer's advantage to build the most expensive structures he can . . ."

This entire concept was well summarized in a study of tax incentives for 236 rehab programs. The study indicated that: "Tax shelters typically related to some form of accelerated depreciation concentrates benefits to investors in early years of ownership. This way of making available subsidies, does not provide an incentive for the supply of adequate housing services over the long term . . . our overall conclusion is that rehabilitation incentives operating as an independent program, will generally be elected by taxpayers only under circumstances that will benefit relatively few tenants, living in better neighborhoods, within a narrow range of incomes, close to the maximum eligible under the incentive."

SUPPLEMENTAL STATEMENT OF HOWARD M. BENEDICT, REALTOR FROM NEW HAVEN, CONNECTICUT, ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS

The notion that real estate tax incentives belong to developers and investors is not evidenced by available economic statistics. These statistics indicate that to a great extent real estate tax benefits are passed on to the renters of apartments in the form of lower rents. This is easily seen by simply reviewing the government publication, Economic Indicators, prepared for the Joint Economic Committee by the Council of Economic Advisers, January, 1976.[1]

If the rental index is calculated in the three-year period from 1967 to 1969 (before the Tax Reform Act of 1969), it only increased 58 percent as much as

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[1] See the following table:

CONSUMER PRICE INDEX—PERCENT INCREASES

	All items	Rent	Rental increase as a percent of increase in all items
1967–69	9.8	5.7	58
1970–72	7.7	8.3	108
1973–75	21.1	10.5	50

the increase in the consumer price index for that same period. During the 1970 to 1972 period, following the reduction in tax incentives for real estate made by the Tax Reform of 1969, rents rose 8 percent faster than the price index. Then, during the 1973 to 1975 period of double-digit inflation, the real estate rental index increased only half as fast as the rise in the consumer price index. Rents during this period helped reduce inflation by dramatically resisting the national trend. Indeed, the Federal tax incentives passed on to the renter in the form of lower rental increases have had a dampening effect on the inflation spiral. Attached is a graph indicating the relationship of the rental index to the total consumer price index.

Unemployment in the construction industry nationally is 17 percent—about two and one-half times the U.S. average. Instead of the construction industry being productively employed and paying its fair share of the Federal income tax burden, it is drawing unemployment compensation at public expense.

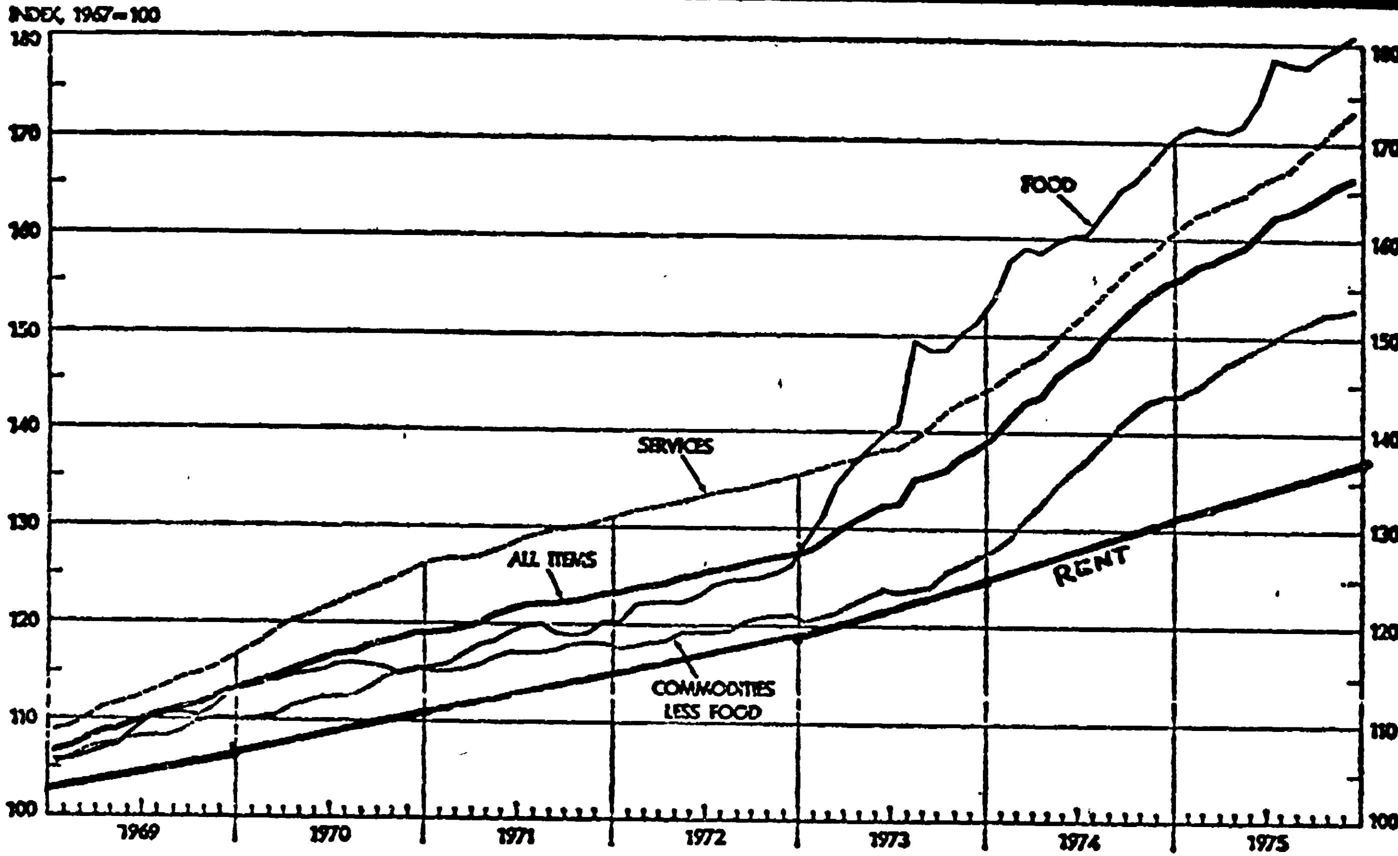
The ill-considered Haskell-Kennedy amendment which imposes an "at risk" rule on capital attraction for housing and related construction built by persons operating in limited partnership form will lower housing production, raise still further our present construction unemployment above 17% and, just as in the 1970 to 1972 period, raise the housing cost for millions of Americans who can least afford higher rents.

When an industry has been so badly battered and hurt as construction has in the last two years, it needs help, not another cruel blow and most unemployment.

PRICES

CONSUMER PRICES

In December, the consumer price index rose 0.4 percent (0.5 percent seasonally adjusted). Food prices rose 0.5 percent (0.3 percent seasonally adjusted). Nonfood commodity prices increased 0.1 percent (0.3 percent seasonally adjusted) and services prices rose 0.6 percent.



SOURCE: DEPARTMENT OF LABOR

COUNCIL OF ECONOMIC ADVISERS

[1967=100]

Period	All items	All commodities	Food	Commodities less food: All	Commodities less food: Durable	Commodities less food: Non-durable	Services: All services	Services: Rent	Services: Services less rent
1967	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1968	104.2	103.7	103.6	103.7	103.1	104.1	105.2	102.4	105.7
1969	109.8	108.4	108.9	108.1	107.0	108.8	112.5	105.7	113.8
1970	116.3	113.5	114.9	112.5	111.8	113.1	121.6	110.1	123.7
1971	121.3	117.4	118.4	116.8	116.5	117.0	128.4	115.2	130.8
1972	125.3	120.9	123.5	119.4	118.9	119.8	133.3	119.2	135.9
1973	133.1	129.9	141.4	123.5	121.9	124.8	139.1	124.3	141.8
1974	147.7	145.5	161.7	136.6	130.6	140.9	152.1	130.6	156.0
1975	161.2	158.4	175.4	149.1	145.5	151.7	166.6	137.3	171.9
1974:									
November	154.3	152.0	167.8	143.3	138.0	147.2	158.7	133.1	163.3
December	155.4	153.0	169.7	143.9	138.8	147.7	160.1	133.7	164.8
1975:									
January	156.1	153.4	170.9	143.9	130.3	147.2	161.3	134.5	166.2
February	157.2	154.4	171.6	144.9	140.3	148.2	102.6	135.1	167.5
March	157.8	155.0	171.3	146.0	142.1	148.8	163.2	135.5	168.3
April	158.6	155.7	171.2	147.2	143.6	149.8	164.1	135.9	169.2
May	159.3	156.5	171.8	148.1	144.8	150.5	164.5	136.4	169.6
June	160.6	157.9	174.4	148.9	145.8	151.2	165.7	136.9	170.9
July	162.3	160.1	178.6	149.9	146.9	152.2	166.6	137.3	171.9
August	162.8	160.4	178.1	150.7	147.5	153.0	167.4	138.0	172.7
September	163.6	160.8	177.8	151.4	148.2	153.8	169.1	138.4	174.6
October	164.6	161.7	179.0	152.2	148.9	154.6	170.1	139.3	175.7
November	165.6	162.2	179.8	152.6	149.2	155.1	172.0	139.9	177.7
December	166.3	162.7	108.7	152.8	149.3	155.4	173.1	140.6	179.0

Source: Department of Labor, Bureau of Labor Statistics.

The CHAIRMAN. Next we will hear from a very fine public-spirited citizen who impressed me some years ago as the king of the Louisiana Mardi Gras ball here in Washington. He is better known for his activity in the housing area. He is Mr. George W. DeFranceaux, chairman of the National Corporation for Housing Partnerships. He is one of our Louisiana boys who made good and I would like to say I am sorry we had to lose him.

We are happy to have you here, Mr. DeFranceaux.

STATEMENT OF GEORGE W. DEFRANCEAUX, CHAIRMAN, NATIONAL CORPORATION FOR HOUSING PARTNERSHIPS

Mr. DEFRANCEAUX. Thank you. I appreciate your getting up so early this morning.

Mr. Chairman, I am George W. DeFranceaux, chairman of the board of the National Corporation for Housing Partnerships. I am appearing today on behalf of the Ad Hoc Coalition for Low and Moderate Income Housing. With me is Bruce S. Lane, counsel to the coalition.

The Ad Hoc Coalition represents individuals and organizations from all parts of the country who are engaged in providing decent housing for low and moderate income families. The coalition includes the Council of State Housing Agencies, which represents nearly all of the 35 States that have enacted State housing programs, the National Leased Housing Association, and the National Housing Rehabilitation Association. The National Corporation for Housing Partnerships is also a member. This organization is a private corporation established, at the direction of Congress in the Housing and Urban Development Act of 1968, "to encourage maximum participation by private investors in programs and projects to provide low and moderate income housing."

Pursuant to Section 236 of the National Housing Act, Section 8 of the United States Housing Act of 1937, as amended in 1974, the Section 515 Farmers Home Loan program, and similar State housing legislation, over 650,000 multifamily dwelling units have been built since 1968 for low and moderate income American families. As we have stated in previous testimony before this committee, tax benefits, by design of Congress, are the essential means of encouraging the private sector to develop, construct, and market this housing.

The Department of Housing and Urban Development stated in a recent memorandum by Secretary Carla Hills to the House Ways and Means Committee: "The fact is that builders will not build subsidized projects unless they are able to sell the project to investors. And the fact is that investors will not purchase subsidized apartment projects unless their investment produces the substantial tax advantage available under current law."

In other words, without tax incentives it would be impossible to raise the equity capital necessary to produce low and moderate income housing.

Today, I would like to express our objection to the Haskell-Kennedy amendment which was adopted by the Senate on June 22, 1976. That amendment would limit the deductions of a limited partner to the amount that he has invested in a limited partnership, plus any amount that he is obligated to invest under the partnership agreement.

The Haskell-Kennedy amendment does not contain an exemption for limited partnerships which are formed prior to January 1, 1982 and which construct or rehabilitate low income housing. However, the definition of low income housing in the amendment is based on Section 1039(b) of the Internal Revenue Code. That definition fails to include section 8 housing, any State assisted housing programs, or the Section 515 Farmers Home Loan program. At the present time, these are the principal operating programs. Thus, the exemption is meaningless for most practical purposes.

This is inconsistent with the action that the Senate has taken with respect to the minimum tax provisions. There the Senate has voted to exempt as tax preference items construction period interest and excess investment interest attributable to all low income housing, including section 8, State assisted housing, and section 515 farmers home loan program housing, if such housing is underway by January 1, 1982. In so doing, the Senate recognized that, for better or worse, the present tax benefits are necessary until Congress can establish substitute incentive programs for low income housing. The Haskell-Kennedy amendment would nearly eliminate the tax benefits produced for investors by those low and moderate income housing programs which are presently operational. Consequently, if Haskell-Kennedy is adopted in its present form, virtually no one will invest insection 8, State assisted and other low and moderate income housing, and little or no such housing will be built.

Accordingly, we urge the Senate to amend the Haskell-Kennedy provision to bring section 8, State assisted housing and section 515 farmers home loan projects within the exemption. That would be consistent with the exemption presently provided under the minimum tax. It is our understanding that Senator Haskell would agree to such an amendment.

Even if the exemption is amended to include all low income housing projects, we respectfully submit that the Haskell-Kennedy amendment is nonetheless ill-advised and unnecessary. This is true first because the amendment would still not exempt moderate income housing and second because the producers of low income housing and of other residential real estate do not exist in separate worlds.

Housing financed with a mortgage insured under Section 221(d)(4) of the National Housing Act is one example of the type of moderate income housing that would be adversely affected by the Haskell-Kennedy amendment if it were to become law. Assuming that the low income housing exemption in the Haskell-Kennedy provision is amended to be consistent with the exemption under the minimum tax provisions, section 221(d)(4) housing and other moderate income housing would still be fully subject to the limitations on deductions by limited partners. If so, it will no doubt significantly curtail building activity financed under section 221(d)(4), a program which, on the other hand, Congress and HUD have strongly encouraged through the recently concluded $3 billion GNMA tandem program, which, in effect, provides the builder with a 7½ percent mortgage.

Moreover, the Haskell-Kennedy amendment will seriously affect and reduce the production of all residential housing, and it is often the producers of non-low income residential housing who build the best low income housing. We do not want to see them out of business. The Senate has already adopted significant changes affecting real estate. The effect of these changes with respect to the minimum tax provisions and depreciation recapture may be to seriously wound the industry, and in any event they are more than adequate to deal with any abuses that may now exist in the real estate area of the tax law.

We strongly urge the Senate to reconsider and reverse its prior decision adopting the Haskell-Kennedy amendment. However, if the Senate fails to take that action, we urge that the provision be amended to exempt section 8 housing, State assisted housing and the section 515 farmers home loan program.

Thank you.

The CHAIRMAN. Mr. DeFranceaux, I am going to defer my questions. I hope I have a chance to ask them of you personally before the day is out. I hope to move the hearing along.

Any questions?

Thank you very much. I would like to ask you about some aspects of this matter later today, after the hearing is concluded.

Mr. DEFRANCEAUX. Thank you.

The CHAIRMAN. Let me call the next witness, Mr. Al Walsh, president of the National Realty Committee.

STATEMENT OF ALBERT A. WALSH, PRESIDENT, NATIONAL REALTY COMMITTEE

Mr. WALSH. Thank you very much, Mr. Chairman.

My name is Albert A. Walsh. I am appearing today as president of the National Realty Committee, a nonprofit business league of owners and developers of all types of real estate throughout the United States. I am accompanied by Alan J. B. Aronsohn, Esq., our tax counsel.

At the outset, Mr. Chairman, I would like to commend your statement at the opening of these hearings yesterday, particularly——

The CHAIRMAN. Let me ask all of you, because we are going to start calling time at 5 minutes on witnesses, not to bother telling us who you are and what your background is or even to commend the committee. [Laughter] Just get right down to summarizing your statement. We will read the statement.

Mr. WALSH. Well, let me just say it simply. I agree with your statement of yesterday, Senator.

The real problem, Mr. Chairman, with the Haskell-Kennedy amendment is not in the amendment alone, it is the combination of this proposed change in the tax law together with other changes which have already been adopted by the Senate which produces extraordinarily severe consequences for the real estate industry. As all the members of this committee know, the Senate has already determined to treat construction period interest as a tax preference item, both for purposes of a substantially more onerous add-on minimum tax and for purposes of the preference offset in determining income subjet to the benefits of the maximum tax on earned income.

In addition, the Senate has adopted a proposed rule treating a limited partner's interest in a partnership trade or business as an investment for purposes of the excess investment interest preference. Thus, long term mortgage interest becomes potentially a tax preference item which has the effect of converting all losses incurred by a limited partner, including even losses resulting from straight line depreciation, into tax preference items; again for purposes of both the new, more severe minimum tax and the minimum tax on earned income.

What is the practical result of these changes, particularly after the Haskell-Kennedy amendment is added as an additional disincentive to construction?

A taxpayer willing to risk money in a speculative construction project is first told that he will probably be subject to an extra 15 percent tax on any deduction for interest during the construction period and that he will lose any benefits he might otherwise be entitled to under the maximum tax on earned income to the extent of such interest deductions. The total tax impact of such deductions could therefore be an additional 35 percent tax.

If he is still willing to invest in a speculative venture despite these tax detriments, he must then be advised that if he attempts to limit his liability by investing as a limited partner, any loss incurred by the partnership after completion of the construction of the building attributable to the payment of interest on the permanent mortgage may be excess investment subject to another 15 percent tax and a similar adverse effect on the taxpayer's right to secure the benefits of the maximum tax on earned income.

The Haskell-Kennedy amendment, by imposing a further overall limit on the deductions to which a limited partner will be entitled, without regard to the legitimacy of those deductions or whether or not they are already "tax preferencee items" subject to the minimum tax, simply adds a final, compelling disincentive to investment in speculative construction projects by limited partners.

I might point out, Mr. Chairman, that the combination of the Haskell-Kennedy amendment which puts a limit on all limited partner deductions and the excess investment interest, be it long term mortgage interest tax preference, is the particularly onerous part. First you have a limit on how many deductions you can take, and if you are allowed to take any deductions under that limit, mortgage interest is going to be one of those deductions, a very substantial deduction in most real estate ventures, and you are going to get your minimum tax on that. So it is the combination of those two which I think was not intended by the Senate.

These two things happened at two different times which is particularly devastating and I think illogical and unnecessary. I might also point out, as the Chairman knows, one of the problems with that excess interest tax preference is that it applies to mortgage interest on a transaction that may have been consummated 2 or 3 or 5 years ago and so it has a punitive retroactive effect.

I might also point out, Mr. Chairman, that the Haskell-Kennedy amendment, per se, affects very much more than so-called tax shelter vehicles. It affects most specifically the small builder trying to get in to attract a few investors into a small development project.

It is clear that eventually the real estate market will adjust to any level of new rents required to accommodate tax disincentives to real estate construction. However, it is also clear that current rental markets in the United States will not presently absorb the substantial rental increases which will be required to attract investment capital into new construction under the tax burdens imposed upon such activity by the Senate bill.

It is also true that in time corporate investment in real estate would probably replace the private investment lost under the Haskell-Kennedy amendment, but experience has shown that it will do so less efficiently at higher cost, and I for one at least believe that that is not a desirable change for this country.

During any period in which the cost of new construction increases more rapidly than the ability of the market to absorb the rental premium such new construction requires, there will be a substantial reduction in construction activity and a substantial increase in construction industry unemployment.

We are currently witnessing such a period, the effects of which will be substantially exacerbated if the Senate bill, with the Haskell-Kennedy amendment, becomes law. Across the Nation, construction trades unemployment is currently running 17 to 27 percent, with as much as 40 percent unemployment in some of our older urban areas.

Using the "Tax Impact Model" which he created for the National Realty Committee, Dr. Norman B. Ture, a well-regarded Washington economist, estimates that the Senate bill with the Haskell-Kennedy amendment would actually increase unemployment within the construction and real estate industries by 540,000 to 890,000 jobs. Furthermore, instead of raising $50 million in additional Federal tax revenues, the amendment would actually reduce Federal tax revenues from the real estate industry by $6–$9 billion.

Now perhaps over time some of these losses will be offset elsewhere in the economy as the "reformers" claim; but this hardly seems the time to take this kind of a gamble with an industry that is just beginning to recover from the throes of its biggest slump since the thirties.

The CHAIRMAN. I have to call time on you, Mr. Walsh. I have read your statement and I think the other Senators have read your statement. It is a good statement and I will try to see to it that all Senators do consider it.

[The written statement of Albert A. Walsh follows:]

SUMMARY OF NATIONAL REALTY COMMITTEE, INC. STATEMENT

The National Realty Committee, Inc. opposes the Haskell-Kennedy Amendment which would add a new subsection (e) to Interal Revenue Code Section 752 on the following grounds:

(1) During the current period of declining real estate construction and substantial unemployment among construction workers, increasing tax disincentives to real estate investment is unwise and counterproductive.

(2) In today's market, the real estate industry requires increasing amounts of equity capital investment, much of which is reasonably obtainable only from limited partner investors.

(3) Limiting a limited partner's right to currently deduct partnership losses will substantially deter limited partnership investments in real estate, particularly in view of the treatment of both construction period interest and a limited partner's share of post-construction period "excess investment interest" as tax preference items.

(4) The Haskell-Kennedy Amendment, together with the other investment disincentives in the Senate bill, will increase real estate unemployment by at least 540,000 jobs.

(5) The Haskell-Kennedy Amendment is unnecessary to deter large scale syndication of "tax shelter" investments. A logical solution would be to limit the eligible number of participants in such a partnership.

(6) At the very least, Congress should give serious consideration to "phasing in" the various tax changes affecting real estate investment in order to minimize immediate adverse economic effects.

STATEMENT OF NATIONAL REALTY COMMITTEE, INC.

Mr. Chairman and members of the Committee.

My name is Albert A. Walsh and I am appearing today as President of the National Realty Committee, Inc., a non-profit business league of owners and developers of all types of real estate throughout the United States. I am accompanied by Alan J. B. Aronsohn, Esq., NRC's tax counsel.

We appreciate this opportunity to testify in opposition to the Haskell-Kennedy Amendment to HR 10612 which would, for all practical purposes, eliminate the use of limited partnerships as an investment vehicle for real estate projects and, thus, cut off an important source of equity capital, particularly for new rental housing which relies heavily on limited partnerships for equity financing. This, in turn, would have the effect of substantially exacerbating the current depressed condition of the construction industry, would delay economic recovery and re-employment in that industry and, in fact, would create further construction industry unemployment and a concomitant reduction in Federal tax revenues from the real estate industry.

The full impact of the Haskell-Kennedy Amendment cannot be ascertained by viewing this proposed change alone. It is the combination of this proposed change togeter with others already adopted by the Senate which produces extraordinarily severe consequences.

The Senate has already determined to treat construction period interest as a tax preference item, both for purposes of a substantially more onerous add-on minimum tax and for purposes of the preference offset in determining income subject to the benefits of the maximum tax on earned income.

In addition, the Senate has adopted a proposed rule treating a limited partner's interest in a partnership trade or business as an investment for purposes of the excess investment interest preference. Thus, long term mortgage interest becomes potentially a tax preference item, which has the effect of converting all losses incurred by a limited partner, including even losses resulting from straight line depreciation, into tax preference items; again for purposes of both the new, more severe minimum tax and the maximum tax on earned income.

What is the practical result of these changes, particularly after the Haskell-Kennedy Amendment is added as an additional disincentive to construction?

A taxpayer willing to risk money in a speculative construction project is first told that he will probably be subject to an extra 15% tax on any deduction for interest during the construction period and that he will lose any benefits he might otherwise be entitled to under the maximum tax on earned income to the extent of such interest deductions. The total tax impact of such deductions could therefore be an additional 35% tax.

If he is still willing to invest in a speculative venture despite these tax detriments, he must then be advised that if he attempts to limit his liability by investing as a limited partner, any loss incurred by the partnership after completion of the construction of the building attributable to the payment of interest on the permanent mortgage may be excess investment interest subject to another 15% tax and a similar adverse effect on the taxpayer's right to secure the benefits of the maximum tax on earned income.

The severity of these results is accentuated by the fact that the taxpayer has absolutely no control over them. While a taxpayer does have the option to capitalize construction period interest rather than deduct it immediately, no such option is granted with respect to interest payable under a permanent mortgage. Therefore, where, for example, a taxpayer invests in a new project which produces losses after completion of construction as a result of rental receipts being insufficient to cover mortgage interest, taxes, operating expenses and straight-line depreciation, such losses, when incurred by a limited partner, may be treated as tax preference items and the taxpayer will not have the option to defer the deduction of such losses in lieu of paying the 15% tax. In addition, if a taxpayer exercises the option to capitalize construction interest, capitalization of such interest will create potentially greater future operating losses subject to treatment as tax preferences under the "excess investment interest" rules applicable to limited partners under the Senate Bill.

The combination of adverse treatment of construction period interest and adverse treatment of post-construction period losses will obviously deter investment in any construction projects other than those involving minimum risk and exceptionally high rewards.

The Haskell-Kennedy Amendment, by imposing a further overall limit on the deductions to which a limited partner will be entitled, without regard to the legitimacy of those deductions or whether or not they are already "tax preference items" subject to the minimum tax, simply adds a final, compelling disincentive to investment in speculative construction projects by limited partners. Under the Haskell-Kennedy Amendment, an investing limited partner will be denied the current deductibility of certain losses which, under present law, cushion the risks of speculative investment, particularly when projects are less successful than anticipated. Many real estate projects currently in financial trouble, and the subject of "work outs" with banks and REITs, will not be able to successfully reorganize if the Haskell-Kennedy Amendment is retained.

It is clear that eventually the real estate market will adjust to any level of new rents to accommodate tax disincentives to real estate construction. However, it is also clear that current rental markets in the United States will not presently absorb the substantial rental increases which will be required to attract investment capital into new construction under the tax burdens imposed upon such activity by the Senate Bill. Unlike many other short-lived commodities traded in the economic market-place, new rental buildings, whether residential, commercial or industrial, must compete with available space in older structures. New buildings can command a premium rental rate by virtue of newness but there are limits on the size of such premium which cannot be effectively exceeded. During any period in which the cost of new construction increases more rapidly than the ability of the market to absorb the rental premium such new construction requires, there will be a substantial reduction in construction activity and a substantial increase in construction industry unemployment.

We are currently witnessing such a period, the effects of which will be substantally exacerbated if the Senate Bill, with the Haskell-Kennedy Amendment, becomes law. Across the nation, construction trades unemployment is currently running 19–20 percent, with as much as 40 percent unemployment in some of our older, urban areas.

Using the "Tax Impact Model" which he created for the National Realty Committee, Dr. Norman B. Ture, a well-regarded Washington economist, estimates that the Senate bill with the Haskell-Kennedy Amendment would actually increase unemployment within the construction and real estate industries by 540,000 to 890,000 jobs. Furthermore, instead of raising $50 million in additional federal tax revenues, the Amendment would actually reduce federal tax revenues from the real estate industry by $6–9 billion.

Admittedly, Dr. Ture's estimates are not infallible; but they are based on three years of research, the most reliable and up-to-date data available and the use of extremely conservative assumptions. For example, in estimating the effect of the Haskell-Kennedy Amendment Dr. Ture assumed that limited partnerships account for only 15–33⅓ percent of all real estate partnerships.

Perhaps, over time, some of these losses will be offset elsewhere in the economy as the "reformers" claim; but this hardly seems the time to take this kind of a gamble with an industry that is just beginning to remove from the throes of its biggest slump since the '30's.

The real estate industry requires outside investment from limited partners particularly during periods, such as the present, when lending institutions are decreasing the proportion of debt capital which is available for construction projects and increasing the rates of interest charged. At the very moment when the economy requires additional equity investment in the real estate industry in order to make up for declining debt investment and to reduce unemployment, the Senate is proposing a Bill which contains tax credits for recycling waste paper but offers the real estate industry a package of substantial tax disincentives.

We respectfully submit that this is a most inappropriate time for adoption of tax legislation which would further discourage real estate investment. We believe that the Haskell-Kennedy Amendment is an unnecessary addition to the Senate Bill. If, as Senator Kennedy stated during the debate on the Senate floor on June 22nd, "what we are really interested in is the large syndication which may involve twelve hundred to fifteen hundred limited partners" it surely is not necessary to throw the baby out with the bath water. If sound tax policy requires that use of the limited partnership entity be curtailed, the logical solution would be reasonably to circumscribe the eligible number of participants in such a partnership.

In any event, we believe that Congress should give serious consideration to phasing in the changes reflected in the various proposals discussed in this statement over a period of time so that the economics of the industry can adjust to the new rules with less detrimental effects upon overall activity and employment.

The CHAIRMAN. Any questions?

Thank you very much, sir. I want the gentleman to know that sometimes you may not think you got your point across but occasionally people will get the point when it is read to them on the Senate floor. Thank you.

Mr. WALSH. Thank you very much.

The CHAIRMAN. Next we call Mr. Leonard Silverstein, tax counsel, National Association of Home Builders.

STATEMENT OF LEONARD L. SILVERSTEIN, TAX COUNSEL, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. SILVERSTEIN. Thank you, Mr. Chairman, and members of the committee.

I am accompanied today by Nathaniel H. Rogg on behalf of the National Association of Home Builders. Dr. Rogg, as you well know, is the executive vice president and Dennis O'Toole is the associate legislative counsel.

NAHB is the trade association of the homebuilding industry with a membership of over 79,000 firms and individuals engaged in the construction of homes, apartments, and commercial properties throughout the United States.

We are here today to express unequivocal opposition to the homebuilding industry's "at risk" limitation of the Haskell-Kennedy amendment.

Now the opposition of NAHB is not based on the view that the tax laws as applied to real estate work perfectly. We appreciate, and I do especially, that some anomalies do exist and that correction as part of a tax reform program which deals comprehensively with partnerships may well be in order.

NAHB also has consistently and today continues to support the principle that every American should pay his fair share of taxes, either directly as a percentage of taxable income or through the application of the minimum tax rules.

Our opposition notwithstanding the Haskell amendment is based on these two factors. From an economic standpoint—you heard about this earlier and Dr. Rogg is fully equipped to discuss this—the amendment will severely retard the housing industry's beginning recovery from the 1975 recession.

From a tax structural standpoint, the Haskell amendment we believe to be a patchwork approach to the very complex problem of the proper measurement of taxable income from real estate construction and operation.

Now consider first the Haskell amendment in light of the severe recession facing the housing industry. This subject has been developed today. I would point out simply that our national survey indicates the national vacancy rate of only 5.4 percent attributable principally to the lack of new rental housing units. Among the resources to meet that vacancy and to meet the needs are the tax laws, whether or not they are perfect.

Housing is the country's largest user of borrowed funds. On the other hand, it is the one industry which is most vulnerable to cyclical economic fluctuations and it has the greatest difficulty in meeting competition in the financial marketplace.

The housing industry is always severely limited. Unlike the stock market, there is no stock exchange for the small volume homebuilder who makes up the great bulk not only of our membership but the housing industry in the country today. Tax inducements, provided by realty partnerships, contribute materially to equity capital. If this resource is stripped away, favorable alternatives from the private sector must not only be available but in place and functioning. This is not the case today and the Haskell amendment in conjunction with the other provisions of the tax bill which other witnesses have alluded to would eradicate the industry's access to noninstitutional private equity investors. The amendment, therefore, comes at precisely the wrong time in housing history.

Consider the specifics of the amendment. By eliminating deductions to the aggregate of cash and recourse obligations, depreciation, and other deductions attributable to borrowed funds in excess of that amount are precluded. Such deductions are available, if at all, at some later date in the partnership history: for example, if and when the property is sold. The economic inducement to a potential investor is severely and perhaps, we believe, fatally reduced.

At the same time, no comparable constraints are placed upon a sole proprietor who acquires the building, nor upon a general partnership. The exception to the Haskell amendment for subsidized housing before 1982 is internally inconsistent. If the objective of the legislation is to eliminate structural aberrations in the tax law affecting real estate, the amendment should be applied to all categories of real estate—reaching a result which would be even more devastating economically. Under the Haskell amendment, however, all that occurs is that tax shelter inducements are skewed in the direction of subsidized housing, thus depriving other forms of housing from this equity capital resource. If deductions in excess of investment are an improper application of the tax laws, then from the standpoint of the investor, that impropriety is, in fact, still available. To the extent that the Haskell amendment is directed at large heavily promoted real estate syndications, remedies already exist under the code—taxing such entities as corporations, for example.

NAHB therefore suggests that the real estate taxation problem—traditionally at least—be approached through the minimum tax. All taxpayers should have opportunity and inducements to invest in any form of real estate—with the tax laws available to cushion both the economic risk and the lack of liquidity—as a recognized tax expenditure—until such time as more adequate equity and debt support of the housing market appears.

[The written statement of Leonard L. Silverstein follows:]

Statement of the National Association of Home Builders

Summary

NAHB opposes the At Risk Limitation for Limited Partners Amendment based upon two factors: (1) From an economic standpoint, it will severely retard the housing industry's recovery from the 1975 recession; and (2) From a tax structural standpoint, the Amendment is a patchwork approach to the complex problem of the proper measurement of taxable income from real estate construction and operation.

My name is Leonard L. Silverstein. I am a partner in the firm of Silverstein and Mullens in Washington, D.C. and appear this morning in my capacity as Tax Counsel to the National Association of Home Builders. I am accompanied by Nathaniel H. Rogg, Executive Vice President of the NAHB.

The National Association of Home Builders is the trade association of the home building industry with a membership totaling over 79,000 firms and individuals engaged in the construction of homes, apartments and commercial properties throughout the United States.

We appear today to express the home building industry's unequivocal opposition to the At Risk Limitation for Limited Partners adopted as a floor amendment to H.R. 10612.

Our opposition is not based upon the view that the tax laws as applied to real estate work perfectly. We appreciate that some anomalies do exist and that correction as part of a tax reform program which deals comprehensively with partnerships may well be in order.

NAHB has consistently, and today continues to support the principle that every American should pay his fair share of taxes—either directly as a percentage of taxable income or through the application of the minimum tax rules.

Our opposition to the Haskell amendment is based upon two factors:

(1) From an economic standpoint, it will severely retard the housing industry's recovery from the 1975 recession.

(2) From a tax structural standpoint, the Haskell amendment is a patchwork approach to the complex problem of the proper measurement of taxable income from real estate construction and operation.

First, consider the Haskell amendment in light of the very severe economics which continue to face the housing industry. In 1975, housing production was at the country's lowest level since the conclusion of World War II. Today, although single family housing starts have moderately increased, multiple housing starts remain, on a national basis, at unacceptably low levels. This occurs at a time when household formations are at record levels due both to the arrival of the postwar baby population and the swelling ranks of the elderly. Both categories of persons, together with the general population, need—but are not receiving—adequate housing accommodations.

Today there is a national vacancy rate of only 5.4 percent, attributable to the lack of new rental units. Thus, national needs for housing exceed current resources to satisfy those needs. Among those resources are inducements, whether or not technically perfect, which are currently provided by the tax laws.

Housing is the country's largest user of borrowed funds. It is, on the other hand, the one industry which is most vulnerable to cyclical economic fluctuations. It has the greatest difficulty in meeting competition in the financial marketplace for available debt[1] and equal capital. The industry's access to the private equity marketplace has always been severely limited. Unlike the stock market, there is no stock exchange for the small volume builder, who makes up the great bulk. not only of the NAHB membership, but of the housing industry in the country today. Tax inducements, provided by realty partnerships, contribute materially to their equity capital. If this resource is stripped away, favorable alternatives must not only be available, but in place and functioning. This is not the case today, and the Haskell amendment, in conjunction with other provisions of the tax bill, would therefore eradicate the housing industry's access to non-institutional private equity investors. The amendment, therefore, comes at precisely the wrong time in housing history.

The Committee's attention is next directed to the specifics of the amendment. By limiting deductions to the aggregate of cash and recourse obligations, depreciation and other deductions attributable to borrowed funds in excess of that amount are precluded. Such deductions are available, if at all, at some later date in the partnership history; for example, if and when the property is sold. The economic inducement to a potential investor is, therefore, severely, if not fatally, reduced. At the same time, no comparable constraints are placed upon a sole proprietor who acquires the building, nor upon a general partnership. Additionally, the exception to the Haskell amendment for subsidized housing in tax policy terms is internally inconsistent. If the objective of the legislation is to eliminate structural aberrations in the tax law affecting real estate, the amendment should be applied to all categories of real estate—reaching a result which would be even more devastating economically. Under the Haskell amendment, however, all that occurs is that tax shelter inducements are skewed in the direction of subsidized housing, thus depriving other forms of housing from this equity capital resource. If deductions in excess of investment are an improper application of the tax laws, then from the standpoint of the investor, that impropriety is, in fact, still available. To the extent that the Haskell amendment is directed at large heavily promoted real estate syndications, remedies already exist under the Code—taxing such entities as corporations, for example.

NAHB suggests that the real estate taxation problem—transitionally at least—be approached through the minimum tax. All taxpayers should have opportunity and inducements to invest in any form of real estate—with the tax laws available to cushion both the economic risk and the lack of liquidity—as a recognized tax expenditure—until such time as more adequate equity and debt support of the housing market appears.

The CHAIRMAN. Thank you very much.

Any questions?

Thank you very much, sir.

Mr. SILVERSTEIN. Thank you.

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[1] Since the end of World War II, the housing market has been one of the largest users of borrowed funds in the American economy. Between 1947 and 1971 the total net public and private debt outstanding in the United States rose from $415.7 billion to $1,996.4 billion—an increase of $1,580.7 billion, or 380 percent. During this same period, residential mortgage debt outstanding on nonfarm properties rose from $34.8 billion to $374.6 billion—an increase of $330.8 billion, or 976 percent. By comparison, private corporate debt outstanding increased by 660 percent during this same period as it rose from $108.9 billion to $827.3 billion. Overall, the increase in nonfarm residential mortgage debt accounted for 21 percent of the increase in total outstanding net debt.

The CHAIRMAN. Next we will call Mr. Paul Ignatius, president, Air Transport Association of America.

STATEMENT OF PAUL R. IGNATIUS, PRESIDENT, AIR TRANSPORT ASSOCIATION OF AMERICA

Mr. IGNATIUS. Mr. Chairman and members of the committee, I want to discuss four provisions of the pending tax bill which make the investment tax credit more effective for capital formation. I am accompanied by Dr. Charls Walker, president of Charls Walker Associates and former Deputy Secretary of the Treasury, who has had a great deal of experience with the investment tax credit.

The airline industry is a capital-intensive industry which over the period of the next several years I estimate that more than $20 billion will be needed to meet increasing transportation demands with quieter, more fuel efficient aircraft. The ability of the airlines to raise the necessary capital is limited because of generally inadequate earnings in recent years. These poor earnings were principally caused by fuel, labor, and other costs which rose more rapidly than compensating air adjustments and by turn arounds in the Nation's economy in 1970 and 1974.

As a result it is very difficult for the airlines to raise equity capital. Banks and other lending institutions are increasingly reluctant to lend money for aircraft purchases if perceived earnings fall far short of the needed amount. Accordingly, the airlines have tightened their belts to reduce costs in every appropriate way. In addition, they have advocated changes in the investment credit law that would help them get on with the job of providing what I think is universally conceded to be the world's best air transportation system, but more is at stake.

U.S. leadership in the world of aviation is in jeopardy because of the limited ability of the U.S. airlines to initiate programs for new technology aircraft. These programs physically begin with orders from U.S. airlines with substantial follow on orders from foreign airlines. In terms of U.S. export sales, commercial aircraft have traditionally ranked in the top categories. It would be a tragedy, I think, if we lost our world leadership in this important area. Changes in the investment credit law will help to prevent this from occurring.

Now the four things I want to talk about begin with refundability. During hearings in both the House and the Senate the airlines recommended full refundability of earnings by expiring tax credits as provided by Senator Stevenson's bill, S. 3080.

The committee decided, after hearing witnesses from government and industry, to limit the refundability concept to future investments only with refundability at the end of the 7-year carryover period. Treasury Secretary Simon, for example, advocated this approach.

The main points I want to make at this time are:

First: The provision was included in the tax bill after extensive testimony.

Second: It would be available to all qualifying taxpayers, large or small, and not just the one group such as the airlines.

Third: There would be no revenue impact for 7 years—that is, not until 1984.

The committee staff has estimated that the total revenue impact in 1984 for all taxpayers would be in the range of from $300 million to

$500 million. We estimate that the airline portion of this total would not exceed $25 million.

Section 803 of the bill provides for a 2-year extension of the carry-over period for credits which would otherwise expire in 1976. This provision would apply to all businesses supported by the airlines but we recommend that it be broadened to extend to 1978 credits that would otherwise expire in 1977.

The two other changes we want to talk about—first there is a provision for the railroads that would permit first-in-first-out application of investment credits and increased utilization of investment credits in a single tax year. The committee adopted these provisions in view of the investment needs of the railroad industry and its generally poor earnings record.

For similar reasons the Congress in 1975 authorized increased investment credit utilization for the public utility industry. The railroad problem is described on page 486 of the committee report and it is almost identical to the airline problem. Accordingly, the airlines strongly support amendment 1906 offered by Senator Curtis that would extend to the airlines the two provisions provided by the railroads.

Thank you, Mr. Chairman.

[The written statement of Paul R. Ignatius follows:]

SUMMARY OF STATEMENT OF PAUL R. IGNATIUS, PRESIDENT, AIR TRANSPORT ASSOCIATION OF AMERICA

1. This statement supplements our testimony of March 31, 1976, concerning airline industry capital formation problems. We support Sections 802 and 803, which apply to all taxpayers, large or small, and not to any single industry or group. We also urge approval of Amendment No. 1906.

2. A combination of large investments and low earnings have resulted in airline inability to utilize substantial amounts of investment credits.

3. Airlines earlier advocated refundability of previously earned, but unused and expiring credits as provided for in S. 3080 (Senator Stevenson).

4. After extensive public hearings, the Committee, however, approved in Section 802 refundability of future generated credits for all taxpayers beginning in 1984. Revenue impact attributable to the airlines in 1984 would not exceed $25 million.

5. Section 802 assures that every taxpayer making qualified investment will receive credit and provides greater incentive for future investment.

6. Section 803 provides two-year general extension of credits which otherwise would expire in 1976. Credits which otherwise might expire in 1977 also should be extended.

7. Airline capital formation problems are similar to those of public utilities and railroads (as described on page 486 of Committee Report). The FIFO and credit utilization provisions of Section 1701 applicable to the railroads should be extended to the airlines as provided for in Amendment No. 1906, offered by Senator Curtis.

8. U.S. world leadership in commercial aircraft sales is threatened by inability of U.S. airlines to order new technology aircraft because of capital formation difficulty.

My name is Paul R. Ignatius. I am President of the Air Transport Association of America which represents virtually all of the scheduled airlines of the United States. We appreciate this opportunity to comment further on certain provisions of H.R. 10612 on which the Committee has invited testimony, particularly those relating to capital formation and the utilization of investment credit.

We strongly support Sections 802 and 803 of the Committee reported tax bill, which provide for a refundable investment credit and a two-year extension of the carry-over period for investment credits which otherwise would expire in 1976. We also urge approval of Amendment No. 1906, which extends to the airlines the first-in-first-out and increased credit utilization provisions contained in Section 1701 of the bill.

The hearing record on capital formation and the utilization of investment tax credit in both the Senate and the House is very extensive. We, among others, testified in public hearings before both the Ways and Means Committee and the Senate Finance Committee concerning the serious capital formation problems of the airline industry, and how those problems could be alleviated through changes to the investment tax credit law. Specifically, we advocated adoption of pending bills providing for the refundability of investment credits which may expire because of the inability of the taxpayer to utilize them.

REFUNDABLE INVESTMENT CREDIT

In our appearance before this Committee on March 31, 1976, we urged your favorable consideration of the provisions of Senator Stevenson's bill, S. 3080, which provided for the refundability to any taxpayer of previously earned, but unused and expiring investment credits. This proposal would have provided capital for necessary investments in new technology aircraft. The Committee, however, adopted provisions for the refundability of future earned credits, a principle endorsed by Treasury Secretary Simon when he appeared before the Committee on April 13, 1976.

As approved by the Committee, Section 802 of H.R. 10612 provides for the future refundability of credits, beginning 7 years hence, if earnings do not permit their full utilization before that time. The airlines fully support this provision of the bill. It provides an incentive for future investment and assures equitable treatment for all investors in new plant and equipment, since they would receive the benefit of the investment credit through tax off-sets or refundability. The benefits of this provision would be available to all taxpayers, large or small, corporate, partnership, or individual proprietorship, who make investments which qualify.

The Committee Report accompanying H.R. 10612 points out that the provision in Section 802 would have no revenue impact for the next 7 years. Whether it would have any revenue impact after that period would depend on a multitude of events and circumstances over the next 7 years which no one, of course, can now foresee with precision. For example, in making an estimate, assumptions have to be made as to the level of qualified investment in 1976, as well as corporate profits and taxes for each of the next 7 years. Based upon such assumptions, the Committee report estimates on page 178 that the revenue impact of Section 802 for all taxpayers would be $300–$500 million.

It has been suggested in several recent statements that Section 802 would primarily benefit the airlines. This is not the case. As stated earlier, this Section would apply to all taxpayers, and the Committee's $300–$500 million revenue impact estimate was based in the availability of this provision to all such taxpayers. As a matter of fact, we estimate that the maximum amount that would be refunded to the airlines in 1984 will not exceed $25 million.

The Committee decided, after hearing several witnesses on the subject, to provide for future refundability in order to equalize the incentives for investment by both profitable and unprofitable companies. It was recognized that unprofitable companies needed this incentive more than profitable companies. It was also recognized that present law is inequitable since it has the effect of requiring unprofitable companies to pay more than a profitable company does for the same piece of equipment.

The airlines are faced with the need to replace their aircraft with less noisy, more fuel-efficient planes. They have very heavy capital requirements. However, because of their generally poor earnings record, the airlines are limited in their ability to raise new outside capital. Many representatives of the investment community have stated that they will not lend the airline industry substantial amounts of long-term capital. With the current earnings record, equity capital is not available. Yet, there exists an urgent need for capital to accomplish essential fleet modernization and expansion to meet the accelerating demand for air transportation.

It is for these reasons that we have advocated the principle of refundability. Section 802 would help assure that the investment incentive, which formed the basis of the credit, will not be lost. Only in this way can the investment credit law assure equal treatment to all who make new investments.

TWO-YEAR EXTENSION

We also fully support Section 803 of H.R. 10612, which provides for a two-year extension of the carryover period for credits which otherwise would expire in 1976. This provision would apply to all businesses, not just the airlines. It would provide a temporary solution to the problem of expiring investment tax credits, and is similar to the three-year extension of the carryover period enacted in 1971 (P.L. 92-178) with respect to investment tax credits earned prior to 1971.

The Committee's report on H.R. 10612 stated that this two-year extension would ". . . make it possible to use these credits against income generated in these two additional years. In addition, this will provide time in the next two years to see whether any other relief needs to be provided in these cases."

We support Section 803 and urge that credits otherwise expiring in 1977 also be extended to 1978.

AMENDMENT NO. 1906

Amendment No. 1906, offered by Senator Curtis, recognizes that the serious problems facing the railroads and public utilities also confront the airlines. This amendment would extend to the airlines two provisions which the Committee has approved for the railroads in Section 1701 of H.R. 10612 to meet a virtually identical problem. These provisions relate to (1) first-in-first-out utilization of the credit, and (2) a temporary increase in the utilization of credits against tax liability.

The Committee described the railroad problem necessitating the change contemplated by Section 1701 on page 486 of its report as follows:

"Railroads have been investing heavily in equipment and facilities during the past several years in order to expand the ability of the railroad system to handle an increasing volume of traffic and to modernize the system through replacement of obsolete and obsolescent equipment and facilities. Additional expansion of the railroad system also is needed to connect new and reopened coal mines with principal railroad routes as reliance on coal as a fuel and energy source increases relative to other sources, Railroad equipment and facilities tend to be capital intensive and long-lived.

"In contrast with the growth in investment requirements, earnings of railroad companies have been relatively small. Because the limitations on the amount of investment credit that may be claimed in a given year are expressed in terms of a percentage of tax liability, the low earnings has left railroad companies with substantial amounts of unused investment credits which soon will expire. The railroads also face the prospect that future investment credits earned on the installation of new equipment and facilities will accrue faster than profits and tax liabilities grow. As a result, railroads may continue to lose unused investment credits at the end of the carryforward period even though the investment was undertaken in anticipation of reducing future tax liabilities to the full extent of the credits they earned.

"The Committee's decision to relieve all taxpayers of the problem of unused credits by making them refundable in the future does not provide any taxpayer relief currently or in the future before 1984. The decision to allow two additional years (1977 and 1978) to carryforward for credits that expire at the end of 1976 would not be helpful to the railroads because present investment plans through 1978 will generate enough credits for most railroads to virtually use up the full amount of the limitation against current tax liability."

The airline situation is substantially the same as that described in the above quotation from the Committee Report. In short, the airlines:

1. Have heavy investment in essential equipment;
2. Face additional expansion to meet growth;
3. Have relatively low earnings;
4. Have substantial amounts of unused credits which will expire soon;
5. Will have future investment credits accruing faster than growth in profits and tax liabilities;
6. Anticipate continued losses of credits; and
7. Believe that relief offered by Sections 802 and 803 may be of minimum help in the near-term future.

Accordingly, like the railroads, the airlines need the additional measures contained in Section 1701 to more fully utilize the investment credit. Sound public policy and simple tax equity would suggest that these two essential, regulated transportation industries be treated similarly.

The investment credit law originally required that a taxpayer utilize his currently generated credits before any credit carryover could be used. This requirement resulted in large accumulations of unused credits. Because of the problem, in 1971, Congress provided *first-in-first-out* utilization of credits generated *prior* to 1971. The Senate Finance Committee, as well as the House Ways and Means Committee, in proposing this provision, stated:

"The desire of taxpayers to use these credit carryovers as quickly as possible (to avoid losing them) could significantly dampen the stimulative effect of restoring the investment credit."

However, Congress left unchanged the requirement that credits generated *after 1970* be used *after* currently generated credits. Unless this requirement is changed, the airlines will be faced in future years with the potential situation where, by making an investment and generating additional credits, they will lose previously generated credits which expire. Unless a taxpayer has some assurance that he will ultimately receive a benefit from both his existing and new investment credits, he is unlikely to make the investment that will generate new credits. Application of the *first-in-first-out* provision to the airlines will provide increased assurance that the credits they have earned can be utilized without destroying their incentive for future investment.

Moreover, under present law, a taxpayer is allowed to offset a maximum of 50 percent of his tax liability with investment credit. In 1975, because of an anticipated problem with investment stimulus in the regulated public utility industry, Congress authorized the utilities to increase their utilization of credit to 100 percent of tax liability for two years, declining gradually to 50 percent at the end of 5 years.

Section 1701 extends this investment stimulus to the railroads, and Amendment No. 1906 would extend it to the airlines. Extension to the airlines of the increased utilization provision would provide the airlines with resources to assist in acquiring new aircraft. The stimulative effect of this additional capital investment, and the jobs created, would be felt throughout the economy. Accordingly, we strongly urge approval of Amendment No. 1906.

U.S. LEADERSHIP IN WORLD AIR TRANSPORT SALES IS THREATENED

There is more at stake in the capital formation issue than the immediate needs of the U.S. airlines. U.S. leadership in the world of aviation is in jeopardy because of the limited ability of the U.S. airlines to place orders for new technology aircraft. U.S. aircraft manufacturers have consistently obtained over 90 percent of the total free world commercial airplane market. U.S. aircraft sales have traditionally been among the leading exports of the United States. However, other nations now seek a major share of the world's commercial airplane market. Recent European aircraft manufacturer successes, encouraged by aggressive government assistance, are beginning to erode the U.S. position. It would be a tragedy if the U.S. lost its world leadership in this important area.

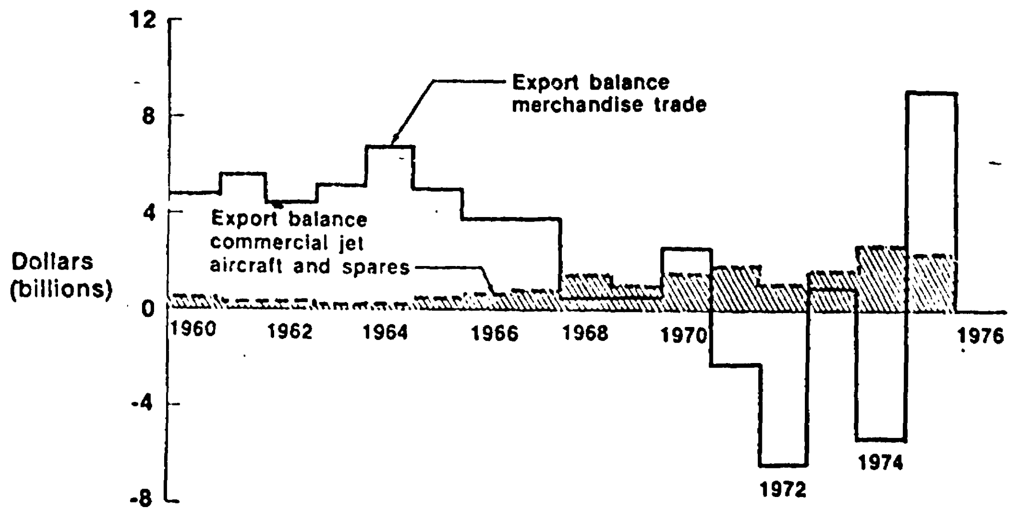
Historically, it has been the initial orders of one or more U.S. airlines which have launched new airplane manufacturing programs in this country. Orders from other U.S. airlines and from foreign airlines have then followed. But, while the ailines of the United States face the need in the next decade to acquire more than $20 billion worth of new aircraft, they simply do not have the financial resources to place these essential initial orders. Attached to my statement (Attachment A) are charts and tables prepared by The Boeing Company which illustrate this serious threat to U.S. aircraft manufacturing leadership.

For all of these reasons, we reaffirm our support of Sections 802 and 803 of H.R. 10612, and urge approval of Amendment No. 1906.

ATTACHMENT A

TABLES FROM THE BOEING COMPANY PRESENTATION ON "IMPORTANCE OF ADEQUATE U.S. AIRLINE EARNINGS TO CONTINUED WORLD LEADERSHIP BY U.S. COMMERCIAL AIRCRAFT MANUFACTURERS"

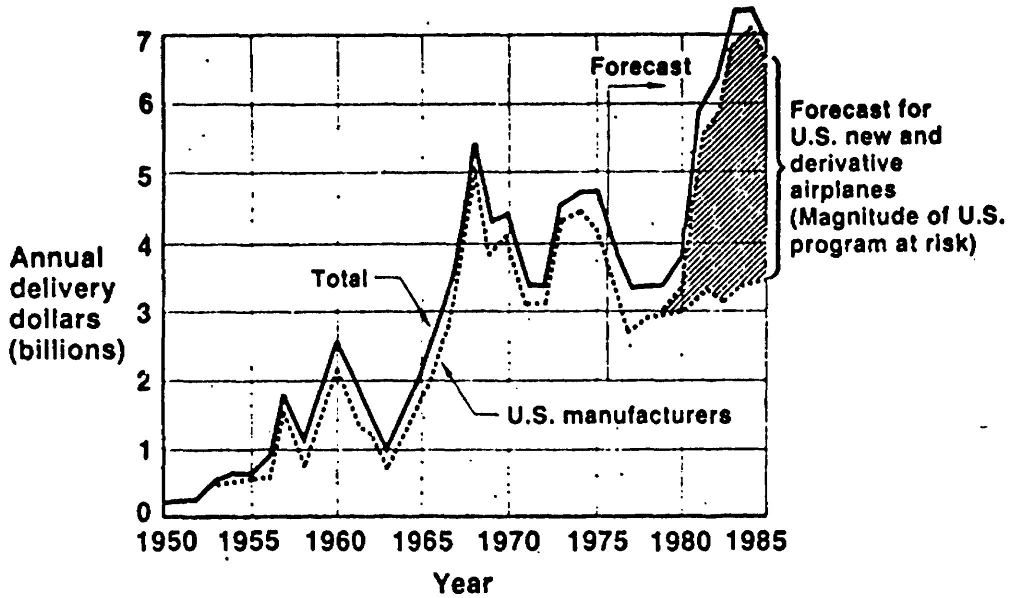
Commercial Aircraft Contribution to the Balance of Trade



Source: Department of Commerce and AIA

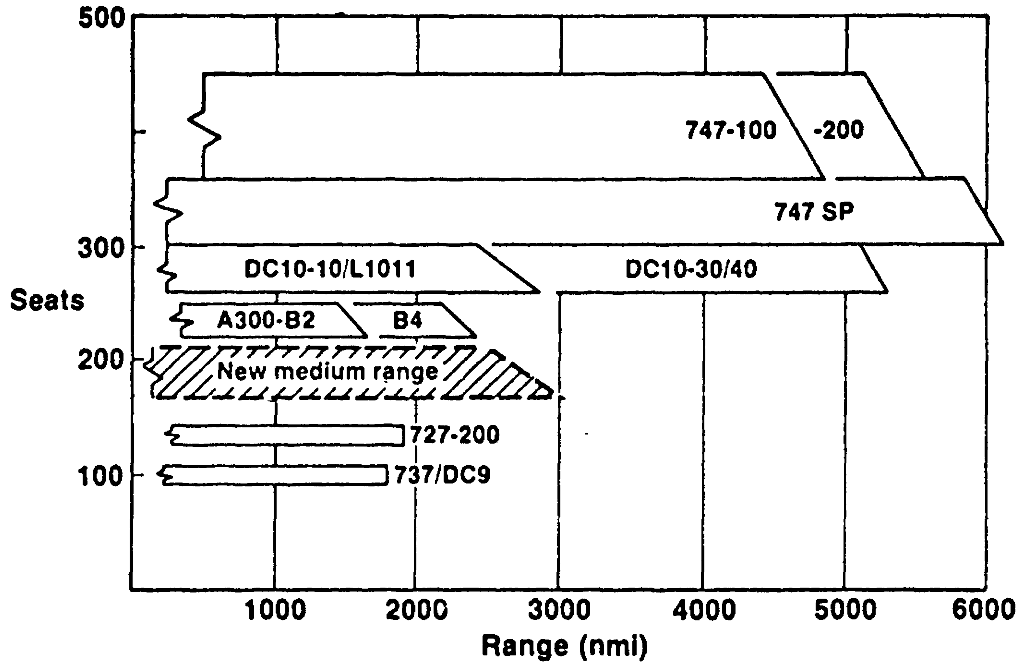
World Commercial Aircraft Annual Deliveries

(1975 Constant Dollars)



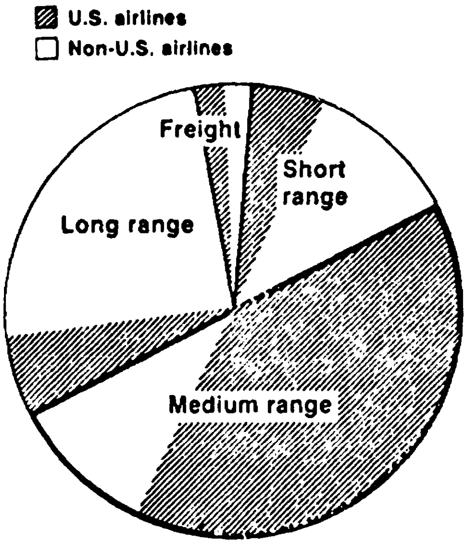
Note: Excludes USSR, Peoples Republic of China, and non-ICAO countries

Major Product Offerings



World Commercial Jet Transport Market

($46 Billion Total Open Market Through 1985 In Constant 1975 Dollars)



Product assumption			
Category	Market	Current	Future
Short range	$7 3 billion	737-200 DC-9-30 50 747SR BAC III	737 derivative DC-9 derivative 7X7 Mercure 200
Medium range	$23 1 billion	727-200 A300 DC-10-10 L-1011 747	7X7 DC-X-200 A300B-10
Long range	$13 6 billion	707 DC-10-30 40 747-100 200 747SP Concorde	707 derivative 7X7 747 derivative A300 derivative
Freighter	$2 0 billion	747 F C DC-10C F	
	$46 0 billion Total		

Role of U.S. Carriers in Kicking Off New Airplane and Derivative Programs

Boeing products		
Type	Model	Initial customers
707	-120 -320 -720	Pan Am Pan Am/Air France/Sabena United
727	-100 -200	Eastern/United American/Northeast
737	-100 -200	Lufthansa United
747	-100 -200 SP	Pan Am Northwest Pan Am

Other U.S. manufacturers		
Type	Model	Initial customers
DC-8	Std -61 -63	United/Pan Am Eastern/United KLM
DC-9	-10 -30 -50	Delta Delta Swissair
DC-10	-10 -30 -40	American/United KSSU Northwest
L-1011	-1	Eastern/TWA

Impact of Current Market Situation

Who is going to provide new medium range aircraft for U.S. and world market for next 20 years?

Primary considerations

- Foreign airlines will continue to provide major portion of all sales opportunities for several years.
- Continued access to major foreign markets probably requires U.S. manufacturers' involvement with foreign industry.
  - Many foreign carriers are partially or wholly owned by governments.
  - Government policies transcend airline interests.
- Lack of U.S. sales also causing U.S. manufacturers to seek foreign industry involvement to bear some portion of new aircraft development risks.
- French/German A-300 program represents major threat to U.S. manufacturers' dominance of medium range market.

Conclusions

- U.S. Trunk earnings are key to continued U.S. dominance of world commercial aircraft market.
- U.S. Trunks unable to undertake required replacement program or kick-off new airplane program.
- Continued operation of older, inefficient aircraft will delay public environmental improvement and seriously impact airline efficiency.
- Lack of U.S. sales will erode U.S. manufacturing leadership and capability, decreasing employment base and positive balance of payments contribution.

The CHAIRMAN. I want to address a question to Mr. Charles Walker. You served as the man under the previous administration who would sit in this room and tell us what you thought, whether tax provisions could be afforded or whether they could not be afforded or what you thought about their merits, so you ought to be an expert on this.

The refundable tax credit proposed by this committee, everyone agrees, cannot cost the Treasury 1 red copper cent for 7 years because it would be 7 years before anybody could claim a benefit under it, is that correct?

Mr. WALKER. That is correct, sir.

The CHAIRMAN. All right. Now is it not likely that during this 7 years it will make the Government a great deal of money because it improves the ability of every company to borrow money because as it stands now you don't know whether you are going to get the investment tax credit or not? If you know you can rely on getting it, you can borrow money from a bank or an insurance company against something that is due to you in the future. Is that correct or not?

Mr. WALKER. That is correct, sir.

The CHAIRMAN. Now let me ask you. Is is likely then that as a result of doing this we will improve the capacity of companies who are having a hard time making it to borrow money and do the essential things that those companies are expected to do with the result that we can put more people to work, generate more income and in doing so generate more assets for the Government?

Mr. WALKER. I don't think there is any doubt about it, Mr. Chairman. It would create jobs, it would create economic growth, it would generate income and profits and in return that will come back to the Government. Nothing would suit the companies better than to earn enough money in this period so that there would not be any refunding of credits on down the road.

The CHAIRMAN. So during the next 7 years it can't do anything but make money for the Government, is that correct?

Mr. WALKER. That is my theory.

The CHAIRMAN. Thank you very much.

Any further questions?

Thank you very much for your fine statement.

Mr. IGNATIUS. Thank you.

Senator HATHAWAY. Mr. Chairman, before the witness leaves I would like to state that I have an amendment pending on the floor to remove both 802 and 803 because I think the extensions are justified. I don't see any sense in rewarding the companies that can't make a profit over that period of time.

The CHAIRMAN. Well, we are certainly happy to have the Senator's view for the record. I would never want the record to fail to reflect the views of the junior Senator from Maine who is one of the valued members of our committee and who is as right as he can be when it gets down to fishing boats. [Laughter.]

Senator HATHAWAY. As long as they help Louisiana fishing boats as well as Maine.

The CHAIRMAN. We will next hear from Mr. Brian O'Keefe, assistant corporate comptroller, Chrysler Corp.

STATEMENT OF BRIAN T. O'KEEFE, ASSISTANT CORPORATE COMPTROLLER, CHRYSLER CORP.

Mr. O'KEEFE. At the outset I would like to clear up some of the confusion which has been created about any so-called benefit to Chrysler through a provision which has been approved by this committee. It has been reported that Chrysler will benefit from the committee's expiring investment tax credit provision, which, if adopted, will cost the Treasury $44 million in 1977 and 1978.

This is not true. Chrysler has no unused investment tax credits which expire before 1980. Not one dime of this $44 million will benefit Chrysler Corp.

Chrysler does support a technical change which would apply to an amendment to the tax law which has been approved by the committee extending the period of use for certain foreign tax credits. Specifically, Chrysler has sought an amendment to H.R. 10612 which would extend the period in which 1972 foreign tax credits may be utilized and would make possible the use of such carry-forward credits before any new credits generated in 1976 through 1978.

The facts in support of the proposed amendment are as follows:

First, in a period in which the creation of jobs is of paramount importance to the Nation, this amendment represents a jobs bill in the best sense. To remain fully competitive in the U.S. automotive market, Chrysler has begun a multi-billion-dollar investment in new, more-fuel-efficient models for introduction over the next several years. Those investments create jobs for American workers.

If this amendment becomes law, Chrysler will initate plans immediately to repatriate up to $100 million of foreign-source income as a vital part of that new investment.

Second, this amendment creates equity out of inequity. Because of the severe economic recession which the Nation has just endured, Chrysler was unable to claim foreign-tax credits in the same manner as companies which were less seriously hurt. This amendment would correct that discriminatory situation.

Briefly stated, Chrysler generated foreign-tax credits in 1972 from repatriated foreign earnings. Subsequent recession losses in 1974 and 1975 were required to be carried back to 1972, thereby displacing the 1972 foreign-tax credits and forcing them to be carried forward. Unless utilized, these displaced credits will expire at the end of 1977.

Under current law these older credits can be used in later years only if substantial amounts of new foreign-source income are repatriated. Even then any new credits which are generated must be used first, thereby again displacing the older credits.

The proposed amendment would enable us to use these 1972 credits prior to any new credits in the next few years. This would equalize the treatment of foreign-tax credits with that of expiring investment-tax credits.

Third, while this amendment would result in the immediate repatriation of foreign-source income, the current drain on the United States Treasury insofar as Chrysler is concerned would be zero. Any cost to the Treasury would come after 1978 and would be more than offset by the jobs created as a result of the earlier repatriation.

Finally, the proposed amendment provides a needed stimulus to U.S. employment through investment from credits already earned by the taxpaying company. Favorable action by the Senate will insure that foreign-source income is made available as soon as possible to finance investment in new jobs for American workers.

The committee has already recognized these facts in its own report accompanying the tax reform bill:

> During 1970–71 and 1974–75 the economy suffered two serious recessions * * * Nonetheless, is order to remain competitive domestically and internationally, many firms in these industries have continued to invest in new plant and equipment in the U.S. and maintain their overseas business operations. In some cases, funds have been brought back from overseas to support domestic operations. However, where domestic operations have subsequently worsened and created net operating losses, these losses have often eliminated the domestic income in the earlier years and resulted in carry-forwards previously absorbed tax credits. The committee is concerned that the expiration of the carry-forward period for both of these credits may adversely affect the domestic investment programs of U.S. firms, and, as such, impact adversely on the long run structure of capital formation in the economy.

The CHAIRMAN. Any questions, gentlemen?

Thank you very much, sir.

Mr. O'KEEFE. Thank you.

The CHAIRMAN. Incidentally, the staff in its pamphlet prepared for the committee has stated, as did the witness:

> While representatives of that company have indicated interest in this provision, it is not clear that in its present form this provision would benefit this company."

So whoever apparently found out Chrysler was going to get a big windfall out of the amendment is badly in error.

Next we will call Mr. Ernest S. Christian, Jr., special tax counsel, American Maritime Association, accompanied by Mr. James J. Reynolds, president, American Institute of Merchant Shipping. I am pleased to see you gentlemen before our committee. I thought that in 1970 we had made a fine contribution toward the reestablishment of the American merchant marine and I regret that through unintended error in drafting other tax laws all the advantage of that was neutralized by subsequent legislation so it didn't work out the way it was intended.

I am happy to have your statement, gentlemen.

STATEMENT OF ERNEST S. CHRISTIAN, JR., SPECIAL TAX COUNSEL, AMERICAN MARITIME ASSOCIATION, ACCOMPANIED BY JAMES J. REYNOLDS, PRESIDENT, AMERICAN INSTITUTE OF MERCHANT SHIPPING

Mr. CHRISTIAN. Thank you, Mr. Chairman.

I am appearing on behalf of the American Maritime Administration and Mr. Reynolds who is accompanying me is the president of the American Institute of Merchant Shipping.

We are here to strongly support section 806 of the committee's bill which clarifies that the investment tax credit is indeed applicable to U.S. merchant ships that are constructed with capital construction funds under the Merchant Marine Act of 1970 which I think is clearly the intention of the Congress.

There are 20 organizations representing all segments of labor and management in the shipbuilding and ship operating industries in the fishing trades and the ocean trades.

This is not a new matter. There has been public testimony previously this year before this committee. There has been public testimony before the Ways and Means Committee late last year. Indeed, this same amendment to clarify as to the investment tax credit as applies to these ships was adopted by the Senate Commerce Committee last year and in fact passed by the Senate.

U.S.-flag merchant ships should not be the only item of machinery or equipment for transportation facilities that is excluded from investment credit. Congress clearly did not intend that they be excluded. Congress in fact never considered excluding these ships from the investment tax credit.

The purpose of section 806 in the committee's bill is merely to clarify that they, like all other equipment, are eligible for the credit. The application of the credit has been frustrated over the last 5 years by dispute involving a statutory interpretation between the Treasury Department and the Commerce Department. The effect on the industry has been substantial both in terms of frustrating the policy and purpose of the Merchant Marine Act and indeed of frustrating the purpose of the investment-tax credit.

The U.S. merchant fleet faces tremendous capital requirements over the next several years which are estimated by the Government to be in the area of $7.5 billion. A 10-year shipbuilding program was initiated in 1970 and set forth certain incentives to help accomplish that result. One of those was the capital construction fund under the Merchant Marine Act. That is simply another way of taking accelerated depreciation or recovering the cost of capital investment in ships which is directly comparable to other methods of depreciation which are available by definition for every other kind of property that receives investment credit.

There is no more reason for excluding these ship. Mr. Chairman, from the investment tax credit than there is for excluding railroad cars, airplanes, trucks or any of the many, many thousands of other items of property that are——

The CHAIRMAN. I am sorry, your time has expired. Let me just assure you that I understand this problem.

Mr. CHRISTIAN. I know you do.

The CHAIRMAN. And the staff understands this problem. Warren Magnuson, the chairman of the Commerce Committee, understands this problem and you can be sure that the people who understand what you are saying here are the people who are going to explain this. I am confident we are going to win because we are right about this and you are going to win because you are right.

Mr. CHRISTIAN. Thank you, Mr. Chairman.

The CHAIRMAN. Any further questions, gentlemen?

[The written statement of Ernest S. Christian follows:]

STATEMENT OF ERNEST S. CHRISTIAN, JR., ON BEHALF OF THE AMERICAN MARITIME ASSOCIATION

SUMMARY OF STATEMENT

Twenty organizations representing all segments of labor and management in the shipbuilding and ship operating industries in the ocean trades, Great Lakes and the fisheries strongly support section 806 of the Committee's Bill to eliminate an unintendel obstacle to investment in U.S. flag vessels. Section 806 clarifies that the investment tax credit is available for vessels built in the United States with withdrawals from capital construction funds established under the Merchant Marine Act of 1970.

This same matter was earlier the subject of public testimony before the Senate Committee on Finance on March 31, 1976, and before the House Ways and Means Committee on December 15, 1975. It was also earlier unanimously approved by the Senate Commerce-Committee (S. 1542) and passed by the Senate on April 25, 1975.

I. SUPPORT OF ELIGIBILITY OF SHIPS BUILT OR PURCHASED WITH CAPITAL CONSTRUCTION FUNDS FOR THE INVESTMENT TAX CREDIT

1. U.S. flag merchant ships constructed in U.S. shipyards should not be singled out as the only item of machinery, equipment and transportation facilities excluded from the investment tax credit: a reduction in capital cost designed to apply across the broad spectrum of the economy.

2. In fact, such ships properly are eligible for the credit the same as aircraft and railroad cars. Congress never even considered excluding them and did not intend that they be denied the credit. Thus, section 806 is not some new or special extension of the basic investment tax credit.

3. Indeed, the purpose of section 806 is to clarify present law and settle a longstanding dispute between the Departments of Treasury and Commerce over the interpretation of a statutory technicality which has frustrated the availability of the credit for ships.

4. The U.S. merchant fleet faces tremendous capital requirements over the next several years, estimated by the Government to total $7.6 billion.

5. A 10-year shipbuilding program initiated in 1970 set forth certain incentives to encourage investment because the Congress recognized that a viable U.S. merchant fleet is essential to meet national defense and economic needs, and that incentives for a private fleet are far less costly than maintaining a government-owned fleet.

6. One of the primary incentives enacted in 1970 was the Capital Construction Fund (CCF). The CCF is a form of cost recovery, much like depreciation, pursuant to which the vessel owner or operator enters into an agreement with the Secretary of Commerce to establish reserve funds out of shipping income to build or purchase agreed-upon ships. The CCF does not provide a double cost recovery since it is in lieu of, and a substitute for, depreciation.

7. The investment tax credit was intended to be a 10 percent reduction in capital cost. It applies to the full cost of property even through accelerated depreciation that cost is also fully deducted against income (and the tax basis of property reduced to zero) within a relatively short time.

8. Since the capital construction fund is merely another method of accelerated depreciation and since the investment tax credit applies to all other machinery, equipment and transportation facilities subject to accelerated depreciation, there is no reason why it should not be equally applicable to U.S. flag merchant ships.

9. Uncertainty about the availability of the investment credit for CCF-built ships discourages investment in U.S. ships and puts U.S. flag merchant ships at a relative disadvantage compared with other capital goods. This clearly frustrates the national policy of encouraging investment in U.S. ships and negates the CCF incentive which was passed by the Senate in 1970 by a record vote of 68 to 1.

10. Denial of the credit has the additional effect of exporting jobs. CCF-built ships discourages investment in U.S. ships and puts U.S. flag merchant ships 44-man-years per $1 million of contracts, one of the highests in all manufacturing, and also employs a very high percentage of minority workers. Further, seven out of ten major shipyards are located in chronically high unemployment areas and provide jobs where most needed.

11. Earlier in this Congress, the Senate passed maritime legislation (S. 1542) amending the CCF to clarify that the investment credit is not to be denied. Because of a jurisdictional question in the House, the matter was deleted in conference, although the House conferees unanimously stated they supported the provision on the merits. The Conference Report (H. Rept. No. 94–529) on the Maritime Appropriation Authorization Act of 1975, adopted by the House and Senate, makes clear that these U.S. flag merchant ships were not intended to lose the benefits of the investment tax credit. The Chairman and other members of the House Committee on Merchant Marine and Fisheries introduced H.R. 10551 which would clarify that the credit should be allowed for taxable years beginning after 1969 which coincides with the effective date of the Merchant Marine Act of 1970.

II. REBUTTAL OF ARGUMENTS THAT MAY BE MADE AGAINST ALLOWING THE INVESTMENT TAX CREDIT

Thomas F. Field, Executive Director, Taxation With Representation, has circulated arguments and testified against allowing the investment tax credit for these ships.

1. The arguments basically are arguments against the CCF under the 1970 Act, but that is not the subject of debate. The arguments now being used against the capital construction fund were raised by the identical witness in 1970, carefully considered, and overwhelmingly rejected.

"This authority [capital construction fund] will do more than any other provision of this bill to build ships in United States shipyards to be operated under the American flag." (S. Rept. No. 91–1080).

2. The example (likely to be used) of a $78 million "revenue loss" from a single $50 million tanker is wrong. In fact, there is ultimately a $69 million tax liability in the transaction described which fails to take account of amendments in the 1970 Act.

3. The principal beneficiaries are not banks, oil companies and integrated steel companies. Of 96 capital construction funds, only 10 have been established by such companies.

4. Moreover, no matter who owns them, the CCF and the credit would be available only for U.S. flag merchant ships constructed in U.S. shipyards.

5. Arguments that the "cabotage" laws protect certain U.S. shipping trades from foreign competition is irrelevant. The question is whether the capital costs of U.S. ships are to be increased relative to other transportation equipment and capital goods. Vast amounts of other property receive similar benefits or protection from tariffs, licenses, etc., but all that property is also eligible for the investment tax credit.

6. The argument that the CCF is a substitute and that ships do not need the credit is wrong. The pre-credit after tax cost of a ship under CCF using a typical financing pattern is about 60 percent compared to a pre-credit after-tax cost of a railroad car of 65 percent under ADR depreciation. In addition, until 1982 a railroad car gets a 12 percent credit under provisions of the Bill. There is a 10 percent credit under present law for railroad cars. Since railroad cars get a 10 to 12 percent credit, why should U.S. flag merchant ships constructed in U.S. shipyards get a zero investment tax credit.

7. The argument that the CCF is a "tax exemption" is wrong. All property eligible for the investment tax credit is depreciable which means the full cost is deducted against income. Deduction of the cost under the CCF method of depreciation is no more a "tax exemption" than deduction of the cost of an airplane under another method of depreciation.

STATEMENT OF ERNEST S. CHRISTIAN, JR., ON BEHALF OF THE AMERICAN MARITIME ASSOCIATION

This statement is submitted on behalf of the American Maritime Association for which I am special tax counsel.

The American Maritime Association consists of 37 companies operating 104 American flag ships in the foreign and domestic commerce of the United States.

We strongly support section 806 of H.R. 10612 as added by the Senate Committee on Finance to clarify that the investment tax credit is allowed for investments in U.S. flag fishing and merchant ships constructed or acquired with withdrawals from capital construction funds under the Merchant Marine Act of 1970.

This legislation is broadly supported throughout the fishing and merchant shipping industries, including employee unions. Specifically supporting the legislation are the following groups: American Institute of Merchant Shipping; American Maritime Association; International Longshoremen's Association; International Protein Corporation; Labor-Management Maritime Committee; Lake Carriers Association; Marine Engineers Beneficial Association, AFL–CIO; Maritime Trades Department, AFL–CIO; Matson Navigation Company; Moore-McCormack Resources, Inc.; National Fish Meal and Oil Association; National Ocean Industries Association; Offshore Marine Services Association; Seacoast Product, Inc.; Seafarer's International Union; Sea-Land Service, Inc.; Shipbuilders Council of America; Standard Products Company, Inc.; Transportation Institute; Wallace Menhaden Products, Inc.; and Zapata Corp.

In order to avoid unduly enlarging an already extended record, this statement will partly incorporate by reference previous testimony which explains the policy of the Merchant Marine Act of 1970 to encourage private investment in the American merchant marine, and which explains why allowing the investment tax credit for the ships is not only fully consistent with, but required by, the policy of the investment tax credit in the Internal Revenue Code. See statements of James R. Barker before the Senate Committee on Finance on March 31, 1976, and before the House Committee on Ways and Means on December 15, 1975. See also, statements of Ernest S. Christian, Jr., before the Senate Committee on Finance on March 31, 1976, and before the House Committee on Ways and Means on December 15, 1975.

Thus, this statement will first merely summarize the maritime and tax policies supporting allowance of the investment credit. Secondly, this statement rebuts in detail arguments that have been made by an opponent of allowing the investment tax credit for U.S. flag merchant ships. These arguments that are rebutted are contained in testimony before the House Committee on Ways and Means, December 15, 1975, by Mr. Thomas F. Field, Executive Director, Taxation With Representation, which included an Appendix consisting of Tables 1–4 entitled "Use of Capital Construction Funds for Tax Avoidance Purposes". Copies of this testimony were submitted to members of the Senate with a letter from Mr. Thomas Reese, Legislative Director, Taxation With Representation, dated June 21, 1976, and it is understood that the substance of this prior testimony also will be submitted for the record of these hearings of the Senate Committee on Finance.

The following summation of the reasons for allowing the investment tax credit for ships and the following clear rebuttal of all arguments against allowing the investment tax credit, lead inescapably to the conclusion that the Committee's decision as reflected in section 806 of H.R. 10612 is correct.

GENERAL POLICY IN SUPPORT OF ALLOWING THE CREDIT

A viable U.S. flag merchant fleet is essential to meet national defense needs, and incentives for a private fleet are far less costly than maintaining a government-owned fleet. This is the only case where the commercial market is expected to provide the capital, and to construct and operate the defense facility.

The U.S. merchant fleet faces tremendous capital requirements over the next several years, estimated by the government to total $7.6 billion. A 10-year shipbuilding program was initiated in 1970 and set forth certain incentives to encourage investment.

One of the primary incentives enacted in 1970 was the Capital Construction Fund. The capital construction fund is a form of cost recovery, much like depreciation, pursuant to which the vessel owner or operator enters into an agreement with the Secretary of Commerce to establish reserve funds out of shipping income to build or purchase agreed-upon ships. The capital construction fund was adopted in 1970 with only two dissenting votes and is recognized by Congress as essential to shipbuilding in the United States: "This authority [capital construction fund] will do more than any other provision of this bill to build ships in United States shipyards to be operated under the American flag". (S. Rept. No. 91–1080).

The investment tax credit is another incentive for high-cost U.S. shipbuilding which is relatively modest compared to tax and other incentives provided by most other maritime nations.[1]

[1] Sweden (depreciation deductions in excess of cost, and tax-deferred reserves); United Kingdom (immediate write-off of cost of new ship); West Germany (30 percent first-year depreciation, progress payments, tax-deferred reserve and 50 percent credit against tax on income from foreign trade); Japan (25 percent first-year depreciation of new ships, tax deferred reserves, and credit against tax from foreign trade). S. Rept. No. 94–96, 94th Cong. 1st Sess.

The capital construction fund was not intended to be, and should not be, a substitute for the investment tax credit which is available for all other machinery, equipment and transportation facilities and is designed to be applied as broadly as possible throughout the economy to have its intended effect. U.S. flag merchant ships constructed in U.S. shipyards should not be the only significant items of machinery, equipment and transportation facilities excluded from the investment credit. Denial of the investment tax credit puts these ships at a relative disadvantage in attracting investment capital.

Denial of the investment tax credit also negates the intended effect of the capital construction fund which was passed by the Senate in 1970 by a record vote of 68 to 1.

Denial of the credit has the additional effect of exporting jobs. The shipbuilding industry employs 44 man-years per $1 million of contracts, one of the highest levels in all manufacturing, and also employs a very high percentage of minority workers. Further, seven out of ten major shipyards are located in chronically high unemployment areas and provide jobs where most needed.

Allowance of the investment tax credit for ships constructed with capital construction funds is not a new or a novel idea. It is in fact fundamental to both the Merchant Marine Act of 1970 and the Internal Revenue Code. Likewise, arguments that are made against allowing the investment tax credit are not new or different arguments that require special consideration again. All such arguments are in fact arguments against the capital construction fund, were made by the same witnesses in 1970, and were overwhelmingly rejected by the Congress.

It is also clear that Congress did not even consider excluding ships from the investment tax credit and did not intend that such ships be excluded from the investment tax credit, although for the last 5 years the allowance of the credit has been frustrated by a dispute between the Departments of Commerce and Treasury over a technical interpretation of statutory language. The Conference Report (H. Rept. No. 94–529) on the Maritime Appropriation Authorization Act of 1975, adopted by the House and Senate, makes clear that these U.S. flag merchant ships were not intended to lose the benefits of the investment tax credit.

Indeed, the Internal Revenue Service has settled at least one case in litigation and allowed the investment tax credit on a 50/50 basis. Properly interpreted, the credit is allowed under present law and the amendment in section 806 should be considered as a clarification of present law. It was for that reason that H.R. 10551 introduced by the Chairman and other members of the House Committee on Merchant Marine and Fisheries would provide that the credit should be allowed for taxable years beginning after 1969 which coincides with the effective date of the Merchant Marine Act of 1970. The investment tax credit was not reinstated until 1971 which would, of course, be the first year of application. Section 806 of H.R. 10612 only applies to taxable years after 1975 and does not provide clarification for prior years.

TAX ANALYSIS AND POLICY IN SUPPORT OF ALLOWING THE CREDIT

A. Operation of capital construction fund

The capital construction fund is a method of cost recovery for U.S. merchant ships constructed in U.S. shipyards that is similar to accelerated methods of depreciation in the Code. A shipowner may either deduct the cost in accordance with an accelerated depreciation schedule or make a tax-deductible deposit of income from ships in a capital construction fund under the supervision of the Secretary of Commerce.

These deposits provide a cash reserve with which to replace the ship or acquire an additional ship. When the accumulated funds are withdrawn and invested in a replacement ship, the "tax basis" of that ship is reduced to the extent paid for out of the capital construction fund. As a result of that reduction in tax basis, depreciation deductions on the ship in the future are smaller, just as depreciation deductions are smaller after accelerated depreciation is taken and the tax basis is reduced.

In both cases, the result is a deferral of tax that must be repaid by smaller deductions and greater tax payments in the future. The major differences are as follows:

(*a*) The amount taken as a deduction under the capital construction fund method must actually be set aside in a fund for a replacement vessel; whereas in the case of depreciation deductions there is no such requirement.

(b) Capital construction fund deductions may be taken only against shipping income.

(c) The rate of cost recovery may in some cases be more rapid under the capital construction fund method, but the rate of cost recovery is generally irrelevant to the application of the investment tax credit. Larger differences in the rate of cost recovery may result by application of the ADR sysetm of depreciation.

B. The investment tax credit

The investment tax credit was intended to be a 10 percent reduction in capital cost. It applies to the full cost of property even though through accelerated depreciation that cost is also fully deducted against income (and the tax basis of property reduced to zero) within a relatively short time.

Since the capital construction fund is merely another method of accelerated depreciation and since the investment tax credit applies to all other machinery, equipment and transportation facilities subject to accelerated depreciation, there is no reason why it should not be equally applicable to U.S. flag merchant ships.

Clearly, these ships are property of the category to which the investment tax credit was intended to apply. Ships constructed in the U.S. meet the policy criteria underlying the credit: to offset higher capital costs and thereby help redress competitive advantages of foreign trading partners; and to stimulate employment in this country. In addition, merchant ships have declined in number to the point of causing the Department of Defense, "the greatest concern". See testimony of Deputy Assistant Secretary, John J. Bennett, before the House Committee on Merchant Marine and Fisheries, June 5, 1975.

The revenue cost is small and ships are the only property ever singled out and required particularly to justify receiving the credit: a reduction in capital cost designed to apply across the broad spectrum of the economy and which is available to all other property without such particular justification. Vast amounts of property eligible for the credit also receive other governmental benefits—through tariffs, licenses, etc.—but those benefits have never been sought to be negated by denying the investment tax credit. Obviously, that would be illogical and self defeating. Only in the case of ships has this occurred.

C. Comparison of relative capital costs

Having in mind that all property eligible for the investment credit is allowed accelerated depreciation and that ships are merely allowed the similar CCF deduction in lieu of depreciation, comparisons of pre-credit "after tax" costs are instructive. The full cost is deducted in all cases (by depreciation or by CCF deposits in the case of ships).

Comparative pre-credit after-tax costs of railroad cars under ADR accelerated depreciation and of a ship financed under a typical pattern using a capital construction fund are as follows: Expressed as[3] percentage of actual cost—Railroad car, 65 percent and Ship, 60 percent.

The railroad car is allowed an additional 10 percent investment credit; and under section 703 of H.R. 10612 the railroad car would until 1982 be allowed a 12 percent investment credit.

If ships constructed with capital construction funds are denied the investment tax credit, the after-tax cost will be substantially greater than for railroad cars. If, as provided in section 806 of H.R. 10612, the credit is not denied to ships, their after-tax costs would be about the same as railroad cars.

Certainly no bias should be created against construction of U.S. flag merchant ships in U.S. shipyards. If any basis is created, it should be in favor of, not against, the vital U.S. flag merchant fleet.

REBUTTAL OF ARGUMENTS AGAINST ALLOWING THE CREDIT

This rebuttal is addressed to testimony by one witness, Mr. Thomas F. Field, Executive Director, Taxation With Representation, before the House Committee on Ways and Means which included an Appendix consisting of Tables 1-4 entitled "Use of Capital Construction Funds for Tax Avoidance".

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[3] The ship is assumed to be puchased for a 25 percent down payment and financed under a 20-year mortgage with level annual principal payments, and the entire cost is paid for by capital construction funds that are deposited in the same year that each of the payments are made. If the ship were paid for in a lump sum with an amount deposited in a fund the pre-credit after-tax cost would be 52 percent, but this is not a realistic assumption or representative of the manner in which the CCF is permitted to operate under the supervision of the Secretary of Commerce.

A. Summary

The principal points sought to be made by the witness are (i) to try to illustrate by Tables 1–4 of the Appendix that investment of $50 million in a tanker results in a $78.70 million "revenue loss", (ii) that the principal beneficiaries of capital construction funds are banks and integrated oil and steel companies, and (iii) that the credit is not needed since "cabotage" laws protect some shipping trades from foreign competition.

All these assertions are patently incorrect.

First, the witness' Appendix entitled "Use of Capital Construction Funds for Tax Avoidance Purposes", is devoted entirely to analyzing a situation in which the eligibility of capital construction fund-built ships for the investment tax credit is not even an issue. The ship was not acquired with capital construction funds and the investment tax credit clearly is applicable even without clarification of existing law.

The example in the witness' Appendix also misrepresents the application of the capital construction fund. It fails to take into account amendments in the Merchant Marine Act of 1970 and is wrong in its assertion that purchase of a $50 million tanker results in a "revenue loss" of $78.70 million. In fact, at the end of the transaction described, there is a tax liability of at least $69.4 million payable immediately along with interest upon a non-qualified withdrawal from the fund or thereafter upon reduction in the basis of ships.[3]

Second, it is argued that the principal beneficiaries of the capital construction fund—and the investment tax credit—would be banks and integrated steel and oil companies that also own ships. These repeated claims remain unsubstantiated. Of the 96 existing funds, only 10 have been established by such companies. The overwhelming percentage of capital construction funds are established by shipping companies and shipping companies are the primary beneficiaries of the program. Furthermore, the purpose of the capital construction fund is to encourage private investment in U.S. shipbuilding to modernize and revitalize the American merchant fleet to serve our national needs. The benefit to the nation from such investment exists regardless of the identity of the investor.

Deposits in a capital construction fund can only be made to purchase or construct ships and the tax deduction can be taken only against income from ships. The investment tax credit also would be allowed for investment in ships. The credit could be taken against income either from ships or from some other source, but the effect is only to reduce the capital cost of ships, not some other property.

Third, the argument that the "cabotage" laws protect certain U.S. ships from foreign competition in some trades is irrelevant. The question is whether the capital costs of U.S. ships are to be increased relative to other transportation equipment and capital goods. Other types of capital investment are protected by tariffs and otherwise, but all these other investments are eligible for the investment tax credit.

Such extraneous and incorrect arguments should not divert attention from the fact that allowance of the investment tax credit for U.S. flag merchant ships at modest revenue cost is not only consistent with existing law, it is compelled by basic principles of tax and maritime policy.

The attached Exhibit to this statement reviews and rebuts in detail all the general arguments as well as the examples in Tables 1–4 of the Appendix to the witness' testimony before the House Committee on Ways and Means.

EXHIBIT TO STATEMENT OF ERNEST S. CHRISTIAN, JR.

This Exhibit consists of a detailed rebuttal of arguments made against allowing the investment tax credit in testimony on December 15, 1975, before the House Committee on Ways and Means, by Mr. Thomas F. Field, Executive Director, Taxation With Representation.

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[3] This basic error is in addition to others. The most serious are (i) that accumulated deposits of the magnitude indicated would not be permitted for a one-ship fleet; and (ii) that both the interest and principal schedules are distorted and do not reflect the liability of the related lender on the interest income (actual and imputed). It should also be understood that depreciation of capital investment is characterized as an "artificial loss" and that $5 million of the "revenue loss" is the investment tax credit. All these errors are discussed in detail hereinafter in this statement.

I. REBUTTAL OF GENERAL OBJECTIONS TO ALLOWING THE CREDIT

The witness' asserted that the capital construction fund is an indefinite deferral of tax amounting to a tax "exemption"; that because of the capital construction fund the investment tax credit is an unneeded additional benefit; that integrated companies that also own ships would somehow avoid section 482 and other fundamental principles of the Internal Revenue Code and "convert" their other income into shipping income eligible for deposit; that allowance of the credit is conceptually inconsistent because there would be a break in "the highly important link" between "basis" for depreciation and "basis" for investment credit; and that there would be formidable administrative difficulties.

None of thes objections is correct or warrants denial of the investment tax credit.

1. Deferral of tax is fundamental to both accelerated depreciation and the capital construction fund method of cost recovery. In reality, there is in every industry (not just merchant shipping) some limited degree of continuing deferral depending on the rate of growth in capital investment, but that is inherent in all forms of cost recovery and cannot in any case be considered inconsistent with the investment tax credit.

A ship is no more "tax-exempt" because its cost is deducted through the capital construction fund, than a railroad car is "tax-exempt" because its cost is deducted through depreciation. In fact, taking into account the discount rate and the respective rates of cost recovery for each, the "after-tax" cost of a railroad car under ADR is 65 percent and the "after-tax" cost of a ship (with a 20-year mortgage) under the capital construction fund is typically in the range of about 60 percent.

2. The investment tax credit was enacted as an additional reduction in capital costs, thereby to increase investment in productive capacity, create jobs, and enhance the economic growth overall. It is vital to maintenance of a U.S. merchant fleet and to employment in U.S. shipyards. Accordingly, the legislation is supported by both labor and management throughout the merchant shipping industry.

It is well know that the U.S. fleet, built in U.S. shipyards and operated under U.S. flag with American seamen, must compete with lower construction costs in foreign shipyards, with other investment incentives for foreign construction, and with substantial income tax advantages offered by other countries to ships of their registry.[1]

It cannot be denied that the allowance of the investment tax credit will reduce the impact of such foreign competitive advantages and increase construction of U.S. merchant ships in American shipyards.

3. The assertion that section 482 of the Code is ineffective and integrated companies convert manufacturing, etc. income into shipping income eligible for deposit in a fund, simply has no foundation in fact.

4. Regs. § 1.46–3(c) expressly provides that for purposes of the investment tax credit "the basis of property would generally be its cost (see section 1012), unreduced by . . . any other adjustment to basis, such as that for depreciation." The cost of these merchant ships includes the amount paid for out of the capital construction fund. Certainly the part of the cost paid with a deductible deposit in a capital construction fund (accompanied by an offsetting reduction in basis) is no less a part of the ship's cost than the amount deducted as depreciation (also with a offsetting reduction in basis). The full amount of cost is the ship's basis for investment tax credit purposes "unreduced by . . . any other adjustment to basis" (such as the reduction required by the Merchant Marine Act of 1970).

Moreover, pursuant to the provision of section 48(d) of the Code where the lessor of the new section 38 property elects to treat the lessee as the purchaser, the lessee is entitled to the investment tax credit which is based not on the tax basis of the asset, but on the fair market value of the property.

5. The Code already embodies the concept of basis and adjusted basis. The adjusted basis (which is basis reduced by depreciation) and the basis for investment tax credit purposes are never the same after the date the property is placed in service. The additional 20 percent first-year depreciation allowance under section 179 of the Code reduces the basis of property for depreciation

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[1] Nearly all other maritime nations provide substantial incentives for shipping: Sweden (depreciation deductions in excess of cost, and tax-deferred reserves); United Kingdom (immediate write-off of cost of new ship); West Germany (30 percent first-year depreciation, progress payments, tax-deferred reserve and 50 percent against tax on income for foreign trade); Japan (25 percent first-year depreciation of new ships, tax deferred reserves, and credit against tax from foreign trade).

purposes as of the date placed in service, but not for investment tax credit purposes. Also, the Treasury has urged that legislation be adopted to allow the investment tax credit on the full basis of property, but to reduce the basis of the property for depreciation purposes by the amount of the investment tax credit. No administrative problems result.

II. REBUTTAL OF TABLES AND ANALYSIS IN APPENDIX

A. Fundamental error in appendix

The Appendix to the witness' testimony entitled "Use of Capital Construction Funds for Tax Avoidance Purposes", purports to show a revenue loss of $78.70 million from investment in a single $50 million tanker and attributes that effect primarily to the capital construction fund under the Merchant Marine Act of 1970. In fact, at the end of the transaction described there is a tax liability of at least $69.4 million.

The false proposition is sought to be illustrated by three Tables (Tables 2, 3 and 4) which taken together (i) present an unrealistic picture of the way in which ships are financed and the way the capital construction fund operates; and (ii) ignore the effect of amendments in the Merchant Marine Act of 1970 that designated the statutory "order" of withdrawals from the fund.

The basic structure and operative principle of the capital construction fund method of cost recovery is as follows: a tax deduction is taken when income is deposited in the fund, but that deduction is later recaptured either by (i) reducing the basis and future depreciation of a ship when a qualified withdrawal is later made for further investment in shipping; or by (ii) taxing as ordinary income (with interest) a nonqualified withdrawal.

There is only a deferral of tax and by the time the cycle is complete, the total tax paid is the same whether cost is recovered by the capital construction fund method, by accelerated depreciation or by straightline depreciation. (See Tables 2(a) and 2(b))

Typically—having in mind the way ships are financed—deposits of income are made in the fund and then withdrawn to pay the mortgage on that ship or to make the downpayment and mortgage payments on some other ship; so that subsequent to each deductible deposit there is one or a series of reductions in basis of ships that result in lesser depreciation deductions.

The examples in Tables 2-4 of the Appendix reverse this typical pattern, in an attempt to show extreme tax results. First, Table 2 shows a ship purchased with borrowed funds not withdrawn from a capital construction fund. Accelerated depreciation is taken which produces losses through the seventh year where the Table stops, although positive taxable income in produced beginning in the eighth year. Then, Table 3 shows that the annual depreciation charges are deposited in the "capital account" of a fund and that the income of the capital account is also redeposited. Thereafter, Tables 4 and 3, respectively, show that (i) beginning in the eighth year when positive taxable income is produced, that income is deposited in the fund and deducted; and (ii) beginning in the sixteenth year amounts are withdrawn from the "capital account" to pay off the mortgage.

The point of the illustration is supposed to be that the taxpayer has "beat the system" first by taking large accelerated depreciation deductions through the seventh year, and then when the ship starts to produce positive taxable income in the eighth year, by making offsetting deductible deposits of that income in a fund. Tables 2 and 4. (The mortgage is paid beginning in the sixteenth year by withdrawals from the capital account which do not reduce basis or otherwise result in taxable income. Table 3.)

The fundamental error in the illustration is that in the Merchant Marine Act of 1970 it was expressly provided that withdrawals would be deemed first to be made out of the capital account. This was done to assure recapture into ordinary income of the income previously deposited into the fund. It might otherwise be possible first to withdraw from the ordinary income and pay the mortgage in years 16-20 after the basis of the ship had already been reduced nearly to zero by depreciation.

Under the Merchant Marine Act of 1970, since the mortgage was deemed paid out of the capital account, the taxpayer, in the example set forth in the Tables 2-4, is left with $138.8 million (i.e. $108.7 of earnings on total previously deposited assets and redeposited earnings thereon, and $30.1 of deposited net ship earnings after interest and depreciation) in the ordinary income account which under the agreement with the Secretary of Commerce would either have to be withdrawn and taxed or withdrawn and applied to reduce the basis of a ship which will have the same effect. The tax liability is $69.4 million.

The example in the Appendix is simply wrong.

B. Specific deficiencies and errors in tables

1. The situation described where an investor would keep $142.3 million "tied up" in a capital construction fund is unrealistic. Section 607(a) provides that the Secretary of Commerce may enter into a capital construction fund agreement which will provide for deposits into the fund of amounts agreed upon as necessary and appropriate to provide funds for a specific shipbuilding program.

2. The regulations require that the program specify the types and number of vessels to be constructed, the estimated costs, the estimated completion dates, where the vessels will be constructed, and other such data. Regulation 390.7(e)(2) provides a maximum level of deposit. Deposits are permitted only to the extent necessary to accomplish the approved shipbuilding program, and deposits in excess of what is necessary to complete the approved program are not permitted. Accordingly, if the example assumes a one vessel fleet, deposits in excess of $50 million would be prohibited. If additional vessels are assumed, the example is wrong in that it does not take into account the reductions in tax basis which will result from subsequent required withdrawals.

3. Even if a taxpayer were permitted to accumulate in the capital construction fund $142.3 million, which is the accumulation in the example, there would be no incentive to do so. Section 607(c) and Regulation 390.8 regulate the investments permitted with fund assets. Since safety of investments is essential, the investments are required to be conservative in nature.

4. No lender would allow the borrower to defer for 16 years the repayment of the principal on the debt as the example assumes. Interest, paid to the related lender, as the example assumes, would be taxable income to the related lender (the parent corporation) thus offsetting any benefit.

5. In a real situation where (i) the cash deposited in the capital construction fund for any given year is the cash flow generated from the taxpayer's operations which is equal to the gross ship earnings less the interest on mortgage, (ii) the ship mortgage is paid in 10 annual payments, and (iii) interest on borrowings and available funds accrues and is paid at 10 percent rate, there would be no tax-free accumulation related to deposit deductions. Deposits and interest earned thereon are insufficient to meet debt payments.

C. Correct tax result of purchase of $50 million tanker using the capital construction fund

In reality the cash that a taxpayer deposits in the capital construction fund for any given year is the cash flow generated from the taxpayer's operations which is equal to the gross ship earnings less the interest on the mortgage. This is because the cash flow is less than the amount of depreciation charges that could be deposited in the fund. The ship mortgage is paid in ten annual payments and interest on borrowings and available funds accrues and is paid at 10 percent rate. The following illustration is predicated upon these realistic premises and shows that there would be no tax-free accumulations related to deposit deductions, since deposits and interest earned thereon are insufficient to meet debt payments.

Table 2.—Appendix illustrates depreciation. It also alleges that interest charges combined with depreciation in the early years of a vessel's useful life create an "artificial loss".

These deductions are no more artificial with a ship than with all other property which receives the investment tax credit.

The Table, however, is predicated upon the assumption that the firm using such system of accelerated depreciation has non-shipping income. Tax losses derived from the use of this method of depreciation would then be used to offset such income. However, if the interest paid on the construction funds borrowed is artificially inflated by a delay in the payment of the principal, such interest would be taxable income in the hands of the lenders. Thus, it will offset the benefits derived by the parent from the use of such method of accelerated depreciation.

ILLUSTRATION OF CORRECT TAX RESULT OF PURCHASE OF $50,000,000 TANKER

Year	Deposit ceiling for deprecia-tion charges	Revenue from operation	Interest on mortgage	Cash flow from opera-tions (3−4)	Deposit in year (lesser of 2 or 5)	Redeposit of prior years' earnings	Payments on ship mortgage	Balance in fund	Tax deferral attribut-able to deposit
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1	5.0	7.5	5.00	2.50	2.50		2.50	0	0
2	4.5	7.5	4.75	2.75	2.75		2.50	.25	0
3	4.1	7.5	4.50	3.00	3.00	0.02	2.50	.77	.03
4	3.6	7.5	4.25	3.25	3.25	.08	2.50	1.6	.04
5	3.3	7.5	4.00	3.50	3.30	.36	2.50	2.56	.08
6	2.9	7.5	3.75	3.75	2.90	.26	2.50	3.22	.33
7	2.7	7.5	3.50	4.00	2.70	.52	2.50	3.74	.35
8	2.3	7.5	3.25	4.25	2.30	.58	2.50	3.32	.39
9	2.2	7.5	3.00	4.50	2.20	.40	2.50	4.02	.20
10	2.0	7.5	2.75	4.75	2.00	.41	2.50	3.93	.20
11	2.7	7.5	2.50	6.00	3.70	.40	2.50	3.53	.20
12	3.5	7.5	2.25	3.25	3.50	.36	2.50	3.15	.18
13	1.4	7.5	2.00	5.50	2.40	.32	2.54	2.31	.16
14	1.3	7.5	1.75	5.75	1.30	.24	2.50	1.25	.12
15	1.1	7.5	1.50	6.00	1.10	.13	2.45		.07
16	1.0	7.5	1.25	6.25	1.00		1.00		
17	.9	7.5	1.60	6.50	.90		.90		
18	.8	7.5	.75	6.75	.80		.80		
19	.7	7.5	.50	7.00	.70		.70		
20	.6	7.5	.25	7.25	.60		.60		
Total	43.5	150.0	52.5	97.5	30.0	3.48	41.48		

D. Analysis of table 2

TABLE 2.—APPENDIX

Year	Gross vessel earnings	Interest on construction loan	Depreciation charges	Artificial loss	Tax loss attributable to use of artificial loss to reduce nonshipping income
(1)	(2)	(3)	(4)	(5)	(6)
1	7.5	5.0	5.0	2.5	1.25
2	7.5	5.0	4.5	2.0	1.00
3	7.5	5.0	4.1	1.6	.80
4	7.5	5.0	3.6	1.1	.55
5	7.5	5.0	3.3	.8	.40
6	7.5	5.0	2.9	.4	.20
7	7.5	5.0	2.7	.2	.10
8	7.5	5.0	2.3		
9	7.5	5.0	2.2		
10	7.5	5.0	1.9		
11	7.5	5.0	1.7		
12	7.5	5.0	1.5		
13	7.5	5.0	1.4		
14	7.5	5.0	1.3		
15	7.5	5.0	1.1		
16	7.5	4.0	1.0		
17	7.5	3.0	.9		
18	7.5	2.0	.8		
19	7.5	1.0	.7		
20	7.5		.6		
Total	150.0	85.0	43.5	8.6	4.30

Table 2 shows depreciation deduction taken without the use of the capital construction fund method of tax recovery. The effect of the use of accelerated depreciation is that any acceleration of depreciation reduces the basis of an asset. Beginning in the eighth year that additional deduction is recaptured.

Early accelerated depreciation increases taxable income after the eighth year. Thus, income, as shown on column (5) of Table 2(a) and taxes, as shown on column (6) of Table 2(a), are increased as a result of prior depreciation.

In fact, all Table 2 shows is that the same deferral of tax achieved by the capital construction fund method of cost recovery is inherent in all accelerated depreciation.

TABLE 2(a).—TAX CONSEQUENCES AFTER 8TH YEAR OF ACCELERATED DEPRECIATION

Year (1)	Gross vessel earnings (2)	Interest on construction loan (3)	Depreciation charges (4)	Income which is increased by prior depreciation (5)	Taxes (6)
8	7.5	5	2.3	.02	0.1
9	7.5	5	2.2	.3	.15
10	7.5	5	1.9	.6	.3
11	7.5	5	1.7	.8	.4
12	7.5	5	1.5	1.0	.5
13	7.5	5	1.4	1.1	.55
14	7.5	5	1.3	1.2	.6
15	7.5	5	1.1	1.4	.8
16	7.5	4	1.0	2.5	1.25
17	7.5	3	.9	3.6	1.8
18	7.5	2	.8	4.7	2.3
19	7.5	1	.7	5.8	2.9
20	7.5		.6	6.9	3.4
Total	150.0	85	43.5	29.1	15.05

The purpose of Table 2(b) is to show that in a 20 year period the tax result of using early accelerated depreciation or straight line depreciation is the same.

TABLE 2(b).—TAX RESULT IN CASE OF STRAIGHT LINE DEPRECIATION

Year (1)	Gross vessel earnings (2)	Interest (3)	Depreciation charges (4)	Income (5)	Taxes (6)
1	7.5	5	2.5		
2	7.5	5	2.5		
3	7.5	5	2.5		
4	7.5	5	2.5		
5	7.5	5	2.5		
6	7.5	5	2.5		
7	7.5	5	2.5		
8	7.5	5	2.5		
9	7.5	5	2.5		
10	7.5	5	2.5		
11	7.5	5	2.5		
12	7.5	5	2.5		
13	7.5	5	2.5		
14	7.5	5	2.5		
15	7.5	5	2.5		
16	7.0	4	2.0	1.5	0.75
17	7.0	3	1.0	3.5	1.75
18	7.0	2	1.0	4.5	2.25
19	7.0	1	1.0	5.5	2.75
20	7.0		1.0	6.5	3.25
Total		85	43.5	21.5	10.75

E. Analysis of table 4

Table 4 is combined in the Appendix with Table 2 in an attempt to show that an indefinite tax deferral is created when net earnings which are negative in the first seven years because of the use of accelerated depreciation, at the beginning of the eighth year are placed in a capital construction fund.

TABLE 4.—APPENDIX

Year (1)	Net vessel earnings after interest and depreciation (2)	Deposited net vessel earnings after interest and depreciation (3)	Tax loss attributable to deferral of tax on deposited net earnings (4)
1	(2.5)		
2	(2.0)		
3	(1.6)		
4	(1.1)		
5	(.8)		
6	(.4)		
7	(.2)		
8	.2	0.2	0.10
9	.3	.3	.15
10	.6	.6	.30
11	.8	.8	.40
12	1.0	1.0	.50
13	1.1	1.1	.55
14	1.2	1.2	.60
15	1.4	1.4	.70
16	2.5	2.5	1.25
17	3.6	3.6	1.80
18	4.7	4.7	2.35
19	5.8	5.8	2.90
20	6.9	6.9	3.45
Total	21.5	30.1	15.05

However, the $30.1 million of ordinary income previously deducted when deposited in the capital construction fund will be taxed when withdrawn or after investment in a ship the tax basis of which is reduced by $30.1 million.

F. Analysis of table 3

TABLE 3.—APPENDIX

Year (1)	CCF deposits of income producing assets equal to depreciation charges on agreement vessel (2)	Redeposit of prior year earnings on total previous deposits, assets, and earnings, as shown in col. 5 (3)	Nontaxable payments out of capital accounts to discharge ship mortgage (4)	Total previous deposits, assets, and redeposits, earnings thereon, i.e. 2+3, less 4 (5)	Tax loss attributable to deferral of tax on redeposits, prior year earnings (6)
1	5.0			5.0	
2	4.5	0.5		10.0	0.25
3	4.1	1.0		15.1	.50
4	3.6	1.5		20.2	.75
5	3.3	2.0		25.5	1.00
6	2.9	2.5		30.9	1.25
7	2.7	3.0		36.6	1.50
8	2.3	3.6		42.5	1.80
9	2.2	4.2		48.9	2.10
10	1.0	4.0		55.7	2.45
11	1.7	5.6		63.0	2.80
12	1.5	6.3		70.8	3.15
13	1.4	7.1		79.3	3.55
14	1.3	7.9		88.5	3.95
15	1.1	8.8		98.4	4.40
16	1.0	9.8	(10.0)	99.2	4.90
17	.9	9.9	(10.0)	100.0	4.90
18	.8	10.0	(10.0)	100.8	5.00
19	.7	10.0	(10.0)	101.5	5.00
20	.6	10.1	(3.5)	112.2	5.05
Total	43.5	108.7	(43.5)	112.2	54.35

Table 3 ignores the real effect of the amendments introduced by the Merchant Marine Act of 1970 providing that withdrawals are deemed first to be made out of the capital account. Since the mortgage would be paid out of the capital account, the taxpayer would then be left with $108.7 million in his ordinary income account which, together with the $30.1 million of operating earnings (See Table 4), would either have to be withdrawn and taxed (with interest) or applied to reduce the basis of a ship which will have the same effect.

Table 3 also overlooks a cash flow problem. Column (2) of the Table is based upon the assumption that "the capital construction fund deposit of income-producing assets equal to depreciation charges on agreement vessel" is equal, in the first year, to $50.0 million, however, in Table 2 the amount of cash in the hands of the taxpayer is only $2.5, *i.e.*, the difference between the gross vessel earnings and the interest on construction costs. As shown in the Illustration of Correct Tax Result of Purchase of $50 Million Tanker, *supra*, in a real situation a taxpayer would deposit in the capital construction fund only the cash generated from its shipping operations.

APPENDIX A.—USE OF CAPITAL CONSTRUCTION FUNDS FOR TAX AVOIDANCE PURPOSES

Analysis of the capital construction fund mechanism, as presently constituted, indicates substantial opportunities for tax avoidance. These opportunities are summarized in Tables 1–4. As they indicate, use of the construction fund mechanism in connection with a single $50 million tanker can result in undiscounted revenue losses over the life of the ship that come to more than $78 million.

Because these tax avoidance techniques are so attractive, it is likely that they will be used by substantially all the banks, oil companies, and other firms that are now preparing to build tankers for use in the Alaska oil trade. Most of these firms have both liquid corporate assets that are now yielding taxable income and a need to build ships to move oil from Valdez, Alaska, where the Alaska pipeline ends, to the West Coast of the United States. The capital construction fund mechanism enables them to shelter from tax the income on substantial amounts of corporate assets, and thus permits them to build their tanker fleets with essentially tax exempt income.

Similar tax avoidance techniques are also available in the case of ore carriers engaged in the Great Lakes trade. As in the Alaska trade, ships operating between U.S. ports on the Great Lakes must be built in U.S. yards and manned by U.S. sailors. Accordingly, these ships are also eligible to make use of tax-deferred capital construction funds.

The three principal tax avoidance techniques available to shippers are detailed in Tables 2 through 4. Table 2 shows how the excess depreciation charges generated in the early years of a vessel's life can be used to reduce nonshipping income.

Table 3 shows how the technique of depositing income producing assets in a capital construction fund can be used to shield from tax the income produced by those assets. Table 3 involves deposits in a capital construction fund of assets equal to the depreciation charges on a vessel. The earnings on those assets are then redeposited tax free in the fund for use in building future ships, and the assets themselves are eventually withdrawn, tax free, to discharge the ship mortgage on the vessel in question.

Finally, Table 4 shows the revenue losses that result when shipping income that would otherwise be subject to tax is deposited in a capital construction fund.

CONSERVATIVE ASSUMPTIONS USED

Tables 1 through 4 have been constructed on the basis of conservative assumptions about vessel earnings, depreciation charges, asset earnings, and interest rates. Less conservative assumptions would have produced substantially larger revenue losses. Hence, the $78.7 million loss shown in Table 1 must be regarded as a minimum figure.

Tables 1 through 4 are particularly designed to sketch the situation of a typical oil firm or bank holding subsidiary which has income producing assets and which wishes to build a tanker to serve the Alaska oil trade. The assets in question are assumed to be yielding a return of 10 percent before tax (i.e. about the current rate for corporate bonds). If higher yield assets are deposited, the revenue loss would be correspondingly larger.

Tables 1–4 also assume that the tanker in question will cost $50 million, substantially all of which is to be borrowed at 10 percent interest, giving a ship mortgage in return. In addition, they assume that the ship's annual net earnings before depreciation and interest charges will be $7.5 million (i.e. a 15 percent rate of return on investment), that depreciation will be calculated by the double declining balance method, (leaving an unrecovered basis of $6.5 million at the end of 20 years), and that the corporate tax rate is 50 percent.

Finally, the tables assume that the investor is determined by the Maritime Administration to be otherwise qualified to open a capital construction fund.

BASIC CONSTRUCTION FUND RULES

Two basic Merchant Marine Act rules are crucial to the operation of the proposed tax avoidance mechanism. The first rule limits the amount of the deposits that a shipper can make in a tax-deferred capital construction fund. Those deposits are limited to: (a) taxable vessel earnings, if any, (b) depreciation on the agreement vessel, (c) net proceeds, if any, from the sale of the vessel, and (d) earnings on the reserve fund itself. The second rule relates to the order or priority in which withdrawals may be made from the reserve fund, and provides that withdrawals must come first from "capital account"—e.g., from deposits of capital assets equivalent to the depreciation charges on an agreement vessel. These two rules, taken together, mean that substantial amounts of income producing assets can be put into a capital construction fund, that the subsequent earnings on those assets can be allowed to accumulate tax free, and that the original capital investment can later be withdrawn tax free, to pay off the ship mortgage relating to an agreement vessel. The earnings produced by those assets will then remain untaxed in the fund to build additional ships.

The operation of these basic rules is illustrated in Table 3. Column 2 of that Table shows the deposit in a construction fund of income producing assets equivalent to the depreciation charges on an agreement vessel, and column 3 shows the deposit in that fund of the earnings on those assets and on previously deposited earnings.

TABLE 1.—*Summary of revenue losses on a tanker costing $50 million, where a capital construction fund mechanism is utilized to defer tax payments*

	Millions
1. Decrease in federal revenue caused by application of artificial losses to reduce nonshipping income (See Table 2 for details)	$4.30
2. Decrease in federal revenue caused by deferral of tax on earnings of income producing assets which are deposited in a capital construction fund in an amount equal to depreciation charges on an agreement vessel (See Table 3 for details)	54.35
3. Decrease in federal revenue caused by deferral of tax on net shipping earnings, after interest and depreciation, through deposit in a capital construction fund (See Table 4 for details)	15.05
4. Decrease in federal revenue attributable to proposed investment credit	5.00
Total revenue losses	78.70

TABLE 2.—COMPUTATION OF REVENUE LOSS RESULTING FROM ATTRIBUTION TO NONSHIPPING INCOME OF ARTIFICIAL LOSSES CREATED BY ACCELERATED DEPRECIATION

Year (1)	Gross vessel earnings (2)	Interest on construction loan (3)	Depreciation charges (4)	Artificial loss (5)	Tax loss attributable to use of artificial loss to reduce nonshipping income (6)
1	7.5	5	5.0	2.5	1.25
2	7.5	5	4.5	2.0	1.00
3	7.5	5	4.1	1.6	.80
4	7.5	5	3.6	1.1	.55
5	7.5	5	3.3	.8	.40
6	7.5	5	2.9	.4	.20
7	7.5	5	2.7	.2	.10
8	7.5	5	2.3		
9	7.5	5	2.2		
10	7.5	5	1.9		
11	7.5	5	1.7		
12	7.5	5	1.5		
13	7.5	5	1.4		
14	7.5	5	1.3		
15	7.5	5	1.1		
16	7.5	4	1.0		
17	7.5	3	.9		
18	7.5	2	.8		
19	7.5	1	.7		
20	7.5		.6		
Total	150.0	85.0	43.5	8.6	4.30

TABLE 3.—COMPUTATION OF REVENUE LOSS CAUSED BY DEPOSIT IN CAPITAL CONSTRUCTION FUND OF (A) INCOME PRODUCING ASSETS EQUIVALENT TO DEPRECIATION CHARGES ON AGREEMENT VESSEL, AND (B) THE EARNINGS PRODUCED BY SUCH ASSETS

Year	CCF deposits of income producing assets equal to depreciation charges on agreement vessel	Redeposit of prior year earnings on total previous deposits, assets, and earnings, as shown in col. 5	Nontaxable payments out of capital accounts to discharge ship mortgage	Total previous deposits, assets, and redeposits, earnings thereon, i.e. 2+3, less 4	Tax loss attributable to deferral of tax on redeposits, prior year earnings
(1)	(2)	(3)	(4)	(5)	(6)
1	5.0			5.0	
2	4.5	0.5		10.0	0.25
3	4.1	1.0		15.1	.50
4	3.6	1.5		20.2	.75
5	3.3	2.0		25.5	1.00
6	2.9	2.5		30.9	1.25
7	2.7	3.0		36.6	1.50
8	2.3	3.6		42.5	1.80
9	2.2	4.2		48.9	2.10
10	1.9	4.9		55.7	2.45
11	1.7	5.6		63.0	2.80
12	1.5	6.3		70.8	3.15
13	1.4	7.1		79.3	3.55
14	1.3	7.9		88.5	3.95
15	1.1	8.8		98.4	4.40
16	1.0	9.8	(10.0)	99.2	4.90
17	.9	9.9	(10.0)	100.0	4.95
18	.8	10.0	(10.0)	100.8	5.00
19	.7	10.0	(10.0)	101.5	5.00
20	.6	10.1	(3.5)	112.3	5.05
Total	43.5	108.7	(43.5)	112.2	54.35

TABLE 4.—COMPUTATION OF REVENUE LOSS CAUSED BY DEPOSIT IN CAPITAL CONSTRUCTION FUND OF NET VESSEL EARNINGS AFTER INTEREST AND DEPRECIATION

Year	Net vessel earnings after interest and depreciation	Deposited net vessel earnings after interest and depreciation	Tax loss attributable to deferral of tax on deposited net earnings
(1)	(2)	(3)	(4)
1	(2.5)		
2	(2.0)		
3	(1.6)		
4	(1.1)		
5	(.8)		
6	(.4)		
7	(.2)		
8	.2	0.2	0.10
9	.3	.3	.15
10	.6	.6	.30
11	.8	.8	.40
12	1.0	1.0	.50
13	1.1	1.1	.55
14	1.2	1.2	.60
15	1.4	1.4	.70
16	2.5	2.5	1.25
17	3.6	3.6	1.80
18	4.7	4.7	2.35
19	5.8	5.8	2.90
20	6.9	6.9	3.45
Total	21.5	30.1	15.05

The CHAIRMAN. Next we will call Mr. John H. Hall of Latham & Watkins.

STATEMENT OF JOHN H. HALL, LATHAM & WATKINS

Mr. HALL. Mr. Chairman, I much appreciate the opportunity to speak very briefly here today for individuals James L. Walker, Stanley L. Timmins, William B. Rapien, and Russell A. Kendall who established a foreign trust in 1974 for the benefit of their children. Section 1013 of H.R. 10612 for the first time taxes grantors of irrevocable foreign trusts on the trusts' income as long as the grantors are alive.

I don't quarrel with the legislative decision to take this step. However, the effective date of this decision—this section was passed by the House, was made retroactive to trusts created on or after May 21, 1974. That was the day on which the Ways and Means Committee made its tentative decision on the subject.

To our knowledge until May 29, 1974, there was no generally published announcement indicating that the Ways and Means Committee proposed to change the taxation on foreign trusts in this manner. Prior press coverage of the May 21, Ways and Means Committee action did not refer to the U.S. action nor was this proposed change referred to in the Ways and Means Committee agenda for 1974, tax reform agenda as reported in the BNA Daily Tax Report. The Daily Tax Report, generally the most current publication for practitioners, carried the story on May 29, 1974.

Now without knowledge of this proposed change, our clients took the irrevocable action of establishing the foreign trust for the benefit of their children on May 28, 1974. As evidenced by the British Consulate General's stamp dated May 8, 1974, on the trust instrument they had begun execution of the trust well before the tentative decision had been made by the Ways and Means Committee but did not obtain the signature of the foreign trustee until May 28. We believe, therefore, that the committee acted properly when it decided to make the effective date of the bill the earliest date on which the bar could reasonably have learned of the House Ways and Means Committee's tentative decision.

Criticism that the change of the effective date would set a precedent allowing persons to take advantage of the inherent timelag between announcement of a tentative decision and publication of that decision in the media is without merit. First, the committee decision here has no weight as a precedent unless future cases arise under identical circumstances which is unlikely. In this case there was an unusually long delay in publicizing the announcement, the taxpayer consummated an irrevocable act during the period of delay, and the period of retroactivity of the proposed legislation reaches back very, very far—to the trust created in 1974.

There is no indication at all here that anybody rushed in between May 21 and May 29 to try to get in under the wire. In fact, as a practical matter, you could not setup a foreign trust that fast if you wanted to.

Furthermore, no action by Congress is binding as a precedent unless in future cases Congress determines that the public interest would be served by reaching the same result. The only precedent that could be established by leaving May 29 as the effective date of this legislation would be a recognition that at least under some circumstances any social utility of changing the tax laws on the very day of the decision might be outweighed by the undesirability of defeating reasonable expectations that lawful actions may be taken in reliance upon existing tax laws which have been in effect for many years.

In this case the provision would have taxed my clients for the rest of their natural lives without regard to how much other income they would have on the income of this trust. Now that might be perfectly all right if they had gone into this with their eyes open and full knowledge of the Ways and Means Committee tentative decision, but they had no way of knowing what the Ways and Means Committee had decided at the moment that this trust was executed. Under the particular circumstances here I believe that no fair-minded person should disagree with the Senate Finance Committee's action.

Thank you very much.

[The written statement of John H. Hall follows:]

STATEMENT OF JOHN H. HALL

SUMMARY

A. The effective date of Section 1013 of H.R. 10612, 94th Cong., as reported by the House Ways and Means Committee was May 21, 1974, the date on which the Committee's tentative decision was announced.

B. There was no generally published announcement of this decision until May 29, 1974.

C. On or before May 8, 1974, our clients commenced execution of instruments creating a foreign trust. On May 28, 1974 execution was completed in reliance on existing law and without knowledge of the then unpublicized proposed change in law.

D. The Senate Committee on Finance acted properly in changing the effective date of the legislation to May 29, 1974, the date on which the bar could reasonably have been aware of the proposed change.

STATEMENT

Section 1013 of H.R. 10612, 94th Cong., for the first time taxes grantors of irrevocable foreign trusts. We do not quarrel with the legislative decision to take this step. However, the effective date of this Section, as reported by the House Ways and Means Committee, was retroactive to May 21, 1974. This was the date on which the Ways and Means Committee announced its tentative decision on the subject. To our knowledge there was no generally published announcement indicating that the Ways and Means Committee proposed to change the taxation of foreign trusts in this manner until May 29, 1974 when the Committee's tentative decision was disclosed in a BNA Daily Tax Report. Prior press coverage of the May 21 Ways and Means Committee action did not refer to the taxation of U.S. grantors of foreign trusts, nor was this proposed change referred to in the Ways and Means Committee's tax reform agenda for 1974, as reported in the BNA Daily Tax Report. The Daily Tax Report, generally the most current publication for tax practitioners, carried the story on May 29, 1974.

Without knowledge of the proposed change our clients took the irrevocable action of establishing a foreign trust for the benefit of their children on May 28, 1974. As evidenced by the British Consolate General's stamp dated May 8, 1974 on the trust instrument, our client had begun execution of the trust well before the tentative decision but did not obtain signatures of the foreign trustees until May 28. We believe therefore that the Senate Committee on Finance acted properly when it decided to make the effective date of the Bill the earliest date on which the tax bar could reasonably have learned of the House Ways and Means Committee's tentative decision.

Criticism that the change of the effective date would set a precedent allowing persons to take advantage of the inherent time lag between announcement of a tentative decision and publication of that decision in the media is without merit. First, this decision has no weight as precedent unless future cases arise under the same circumstances. In this case there was an unusually long delay in the public announcement, the taxpayer consummated an irrevocable act during the period of delay, and the period of retroactivity of the proposed legislation reaches back unusually far, to 1974.

Furthermore, no action by Congress is binding as precedent unless in future cases Congress determines that the public interest is served by reaching the same result. The only precedent which could be established by a delay in the effective date of this legislation would be a recognition that under some circumstances the social utility of changing the tax laws on the very day of decision may be outweighed by the undesirability of defeating reasonable expectations that actions may be taken in reliance upon existing tax laws in effect for many years. Under the particular circumstances here, we submit that no fair minded person should disagree with the Senate Finance Committees action.

STATEMENT BY JOHN H. HALL

Section 1013 of H.R. 10612, 94th Cong., as reported by the House Ways and Means Committee and the Senate Committee on Finance would tax currently to a United States grantor the income of a foreign trust with United States beneficiaries. The effective date of the version of this Bill reported by the House Ways and Means Committee was retroactive to May 21, 1974. This date was selected because on May 21, 1974 the House Ways and Means Committee announced its tentative decision on this subject. However, there was, to our knowledge, no generally published anouncement indicating that the House Ways and Means Committee proposed to change the taxation of foreign trusts in this manner until May 29, 1974 when the Committee's tentative decision was first publicized in the BNA Daily Tax Report. Press coverage concerning changes affecting foreign income appeared in the May 22, 1974 issue of the Wall Street Journal, the New York Times and the BNA Tax-Report, but none of these articles referred to the taxation of United States grantors of foreign trusts. Furthermore, the House Ways and Means Committee's tax reform agenda for 1974 as reported in the BNA Daily Tax Report of April 30 did not refer to proposals regarding the taxation of foreign trusts.

Having no notice or knowledge of the proposed change, our clients established on May 28, 1974 a foreign trust which would be treated as a grantor trust under H.R. 10612. The trust was created for the benefit of their children. The trust instrument bears the stamp of the British Consulate General in Los Angeles dated May 8, 1974, evidencing that our clients had commenced execution of the trust instrument prior to any decision by the House Ways and Means Committee. However, the signature of the foreign trustee was not obtained until May 28, 1974, and the irrevocable transfer of the assets was completed on that date.

Prior to May 29, 1974, the first date on which the BNA Tax Report carried news of the decision, neither our clients nor their trust counsel had actual knowledge of the proposed legislation. By the time the tentative decision was reported, our clients had taken irrevocable action by funding the trust. We believe, therefore, that the Senate Finance Committee acted correctly when it decided to make the effective date of the Bill the first date on which the bar could reasonably have been expected to know of the House Ways and Means Committee's tentative decision.

Criticism that the change of the effective date would set a precedent allowing persons to take advantage of the inherent time lag betwen announcement of a tentative decision and publication of that decision in tax journals or the media is without merit. First, this decision has no weight as precedent unless future cases arise under the same circumstances or involve the same set of facts. In this case there was an unusally long delay in publication of the House Ways and Means Committee's tentative decision. Such reports are usually carried the next day by the press. Under normal circumstances it would be virtually impossible to set up a foreign trust betwen the decision date and the date on which the announcement would be carried by the reporting services. Moreover, in this case the action taken in reliance on the continuance of existing law was irrevocable and the effective date of the proposed legislation was retroactive for an unusually long period. There are few instances in which the effective date of legislation adversely affecting a taxpayer reaches back over a period in which two tax returns would have been filed. Therefore, this case can easily be distinguished from different cases which may follow where a taxpayer happened to get word of a proposed action and moved quickly to "get in under the wire."

Furthermore, no action by Congress is binding as precedent unless in future cases Congress determines that the public interest would be served by reaching the same result. In any event the only precedent which could be established by the Senate Finance Committee's decision would be a recognition that under some circumstances the social utility of establishing an early cut-off date may be outweighed by the undesirability of defeating the reasonable expectation that irrevocable action may be taken in reliance upon existing laws in effect for many years. It would be difficult to say that there are no circumstances in which it would be appropriate to defer the effective date of new legislation until persons acting in reliance upon existing law could reasonably have become aware of the proposed change, even if a delay in the effective date permitted the continuation for one or two more days of an activity which had been permitted for many years. We submit that this is a case where such delay in the effective date is appropriate and that the Senate Finance Committee's decision to move the effective date of the Bill to May 29, 1974 was entirely proper and fair.

Dated: July 16, 1976.

Respectfully submitted,

JOHN H. HALL.

The CHAIRMAN. Thank you, sir.

Any questions?

Senator CURTIS. I just would like to note that in the reading from the Finance Committee report, page 7 discusses this problem and the dates and then it says:

> Explanation of the Provision. This provision was suggested by the staff as an alternative to the date in the * * * the provision delays the date for which the new grantor trust rules apply from transfer of the property the foreign trust made after May 21, 1974, to transfers made after May 29, 1975.

Above that it carries this report:

> The House provision is after May 21, 1975, the date of the initial Ways and Means Committee decision. However, no news report of the Committee decision was made until May 29, 1974. Thus, taxpayers who did not have access to individuals physically present at the Ways and Means Committee markup could not know the Committee's decision. The issue is whether the date would apply to grantor rules which should be made May 29, 1975.

Do you agree with that explanation that is in the committee report?

Mr. HALL. Yes, I do, Senator Curtis. That is perfectly accurate.

Senator CURTIS. That is all.

Senator BENTSEN. You say as an irrevocable trust. Is it irrevocable under our law or the law under which the trust is now operating?

Mr. HALL. Senator Bentsen, it is irrevocable under the law of the country in which the trust is operating.

Senator BENTSEN. Which country is that?

Mr. HALL. It is Cayman Islands.

The CHAIRMAN. Thank you very much.

Mr. HALL. Thank you.

The CHAIRMAN. Next we will hear Mr. Edwin S. Cohen on behalf of Superior Oil Co.

STATEMENT OF EDWIN S. COHEN ON BEHALF OF SUPERIOR OIL CO.

Mr. COHEN. My name is Edwin S. Cohen.

Section 956 of the Internal Revenue Code now provides in general that if a U.S. corporation owns more than 50 percent of the stock of a foreign corporation and the foreign corporation makes certain investments in U.S. property, the amount so invested is to be treated as a dividend to the U.S. corporation.

The Superior Oil Co. is a U.S. corporation which owns about 53 percent of the stock of Canadian Superior Oil Ltd., a Canadian corporation that is engaged in exploration for oil and gas in Canada and throughout the world.

The remaining 47 percent of Canadian Superior's stock is publicly held and the majority of its directors are Canadian residents.

Canadian Superior since 1964 has advanced substantial funds for the acquisition of the exploration and development of interests in Federal oil and gas leases off the Outer Continental Shelf more than 12 miles beyond the U.S. coastline.

The amounts advanced by Canadian Superior for these leases has been paid into the U.S. Treasury. Any oil or gas discovered on these leasehold interests is sold by Canadian Superior to unrelated U.S. companies and has benefited the energy needs of the United States.

Superior, the American company, could not properly prevent Canadian Superior, with 47 percent of its stock publicly held, from using Canadian Superior's own funds to acquire oil and gas leases on the Outer Continental Shelf or elsewhere in the world if Canadian Superior considered it desirable to do so.

Superior believes it was not the intent of section 956 to cause expenditures made by Canadian Superior under these circumstances on the Outer Continental Shelf in the ordinary course of its business of exploring for oil and gas to be taxable as dividends to Superior.

If Canadian Superior's expenditures in past years were taxable to Superior when made, then under section 959 of the present law, dividends in corresponding amounts paid by Canadian Superior to Superior in future years would be tax-free. Thus the uncertainty of the status of past expenditures also produces uncertainty as to the tax status of future distributions.

The 1969 Tax Reform Act added section 638 to the Internal Revenue Code to provide that for certain purposes the Outer Continental Shelf, even though outside the 12-mile limit, should be treated as being within the United States.

It does not appear that the Congress, in enacting that provision in 1969, contemplated the effect this amendment might have in broadening the scope of section 956. Accordingly, section 1021(d)(2) of the present bill provides that investments on the Outer Continental Shelf made by foreign corporations after the 1969 act and before 1977 will not be treated as dividends to their U.S. shareholders.

This provision was approved by the Ways and Means Committee last October after discussion in public markup session, where the companies involved were disclosed and the problem fully discussed, and it was contained in the bill passed by the House of Representatives. It was approved by the Finance Committee subject to the limitation that it not apply to investments made after 1976.

Superior believes that this provision, previously approved by both committees, is fair and reasonable and we respectfully urge its enactment.

[Mr. Cohen's prepared statement on behalf of Superior Oil Co. follows:]

SUMMARY OF PRINCIPAL POINTS IN STATEMENT OF THE SUPERIOR OIL CO., IN SUPPORT OF SECTION 1021 OF H.R. 10612

1. The Superior Oil Company ("Superior") owns 53 percent of the stock of Canadian Superior Oil, Ltd. ("Canadian Superior"); the remaining stock is publicly owned. Canadian Superior explores for oil and gas throughout the world, and since 1964 has made investments in oil and gas leases on the Outer Continental Shelf in the Gulf of Mexico, more than 12 miles beyond the U.S.

coastline. The amounts paid for these leases were paid to the U.S. Treasury and the wellhead oil and gas have been sold to unrelated U.S. companies.

2. The Tax Reform Act of 1969 added Section 638 to the Internal Revenue Code to provide that the Outer Continental Shelf, even though outside the 12-mile limit, should be treated for certain purposes as being within the United States.

3. Section 1021(d)(2) of H.R. 10612 provides that investment in property situated on or used exclusively in connection with the Outer Continental Shelf made by foreign corporations subsequent to the Tax Reform Act of 1969 will not be treated under Section 956 as dividends to their U.S. shareholders.

4. This provision was approved by the Ways and Means Committee after discussion in public mark-up session, where the companies involved were disclosed and the problem fully discussed, and was included in the bill as passed by the House of Representatives.

STATEMENT OF THE SUPERIOR OIL CO., IN SUPPORT OF SECTION 1021 OF H.R. 10612

My name is Edwin S. Cohen. I am of counsel to the law firm of Covington & Burling, Washington, D.C. I appreciate the opportunity to appear before the Committee this morning on behalf of The Superior Oil Company in support of the provisions of Section 1021 of H.R. 10612, modifying Section 956 of the Internal Revenue Code.

Section 956 of the Code now provides that if a United States corporation owns more than 50 percent of the stock of a foreign corporation and the foreign corporation makes certain investments in United States property, the amount so invested is to be treated as a dividend to the U.S. corporation.

The Superior Oil Company ("Superior") is a U.S. corporation which owns about 53 percent of the stock of Canadian Superior Oil, Ltd. ("Canadian Superior"), a Canadian corporation that is engaged in the exploration for oil and gas in Canada and throughout the world. Canadian Superior's remaining stock is publicly held, and a majority of Canadian Superior's directors are Canadian residents. Canadian Superior has explored for oil and gas off the Outer Continental Shelf of the United States, as well as elsewhere throughout the world.

Since 1964, Canadian Superior has advanced substantial funds to Canadian Superior's wholly-owned U.S. subsidiary for use in the acquisition, exploration and development of interests in Federal oil and gas leases on the Outer Continental Shelf in the Gulf of Mexico, more than 12 miles beyond the coastline of the United States. The U.S. subsidiary was organized because Federal leasing regulations require that such leases be held by a U.S. corporation.

The amounts paid for these leases have been paid into the United States Treasury. Any oil or gas discovered on these leasehold interests is sold by Canadian Superior to unrelated U.S. companies.

Superior has derived no tax or other benefit from the expenditures made by Canadian Superior. Indeed, since Canadian Superior and its U.S. subsidiary do not have U.S. income from other sources, the usual tax deductions for the oil and gas exploration and development expenditures by Canadian Superior's U.S. subsidiary in excess of its income therefrom have produced no tax benefit. Superior could not properly prevent Canadian Superior, with 47 percent of its stock publicly held, from using Canadian Superior's own funds to acquire oil and gas leases on the Outer Continental Shelf or elsewhere in the world if Canadian Superior considered it desirable to do so.

Superior believes that it was not the intent of Section 956 to cause the expenditures made by Canadian Superior on the Outer Continental Shelf in the ordinary course of its business of exploring for oil and gas to be taxable as dividends to Superior. If Canadian Superior's expenditures in past years were taxable to Superior when made, then under Section 959 of the present law dividends in corresponding amounts paid by Canadian Superior to Superior in future years would be tax-free. The uncertainty of the status of the past expenditures also produces uncertainty as to the tax status of future distributions.

The Tax Reform Act of 1969 added Section 638 to the Internal Revenue Code to provide that for certain purposes the Outer Continental Shelf, even though outside the 12-mile limit, should be treated as being within the United States. It does not appear that Congress contemplated the effect this amendment might have in broadening the scope of Section 956 when the amendment was enacted in 1969. Accordingly, Section 1021(d)(2) of H.R. 10612 provides that investments in property situated on or used exclusively in connection with the Outer Continental Shelf made by foreign corporations subsequent to the Tax Reform Act of 1969 and prior to January 1, 1977 will not be treated as dividends to their U.S. shareholders.

This provision was approved by the Ways and Means Committee after discussion in public mark-up session, where the companies involved were disclosed and the problem fully discussed, and it was contained in the bill passed by the House of Representatives. It was approved by the Finance Committee subject to the limitation that it apply only to investments prior to January 1, 1977.

We believe that this provision, previously approved by both Committees, is fair and reasonable and we respectfully urge its enactment.

Mr. COHEN. Mr. Chairman, I appear as a witness, as the list indicates, also on behalf of Pyramid Ventures, Inc., which is a completely unrelated company, which supports another part of this same provision. If I may, I will just continue.

The CHAIRMAN. Go ahead.

STATEMENT OF EDWIN S. COHEN ON BEHALF OF PYRAMID VENTURES, INC.

Mr. COHEN. Pyramid Ventures, Inc., a U.S. company, organized two foreign subsidiaries in 1970 and 1972 to carry on a shipping business by time-chartering vessels to transport bulk cargo. The charters expired in mid-1974 and neither subsidiary has engaged in the shipping business since then.

Both foreign subsidiaries then invested the funds remaining after cessation of the shipping business in publicly traded shares of unrelated U.S. companies. These investments were made between August 15, 1974, and January 30, 1975.

Under the present law, as I understand it, the amount of these U.S. investments is technically treated as dividends taxable to the U.S. parent, Pyramid, simply because the investments were made in U.S. property—that is, the shares of U.S. corporations rather than foreign property—even though those corporations in which the investments were made were unrelated to Pyramid.

On May 21, 1974, some 3 months before the first of these investments was made, the House Ways and Means Committee issued a press release announcing a tentative decision to amend section 956 to allow such investments without dividend treatment to U.S. shareholders. I may say that parenthetically that I do not know whether the actual date of that release was May 29 or May 21; that was discussed earlier by another witness but it would be immaterial to this case.

H.R. 10612, passed by the House, ultimately contained this provision.

In a written statement filed with the Finance Committee on April 23, 1975, Pyramid requested that the revision of section 956 be applicable to investments made after May 21, 1974, when the Ways and Means Committee first announced its intention to exclude these types of investments from section 956. The Finance Committee so desired.

Mr. Chairman, this is remedial legislation that eliminates a trap for those not familiar with the technicalities of section 956 and it encourages investment in the U.S. economy. The investments do not, in fact, resemble dividends; they do not represent funds furnished to parent stockholders or affiliates.

Other remedial provisions designed to stimulate U.S. investment, such as the investment credit, have been made effective when announced, prior to the date of their enactment.

Pyramid respectfully submits that the committee should affirm its earlier decision and make the new amendment effective at the taxpayers' election for investments made after May 21, 1974, when the Ways and Means Committee first announced its decision. Thank you, Mr. Chairman.

[Mr. Cohen's prepared statement on behalf of Pyramid Ventures, Inc., follows:]

SUMMARY OF PRINCIPAL POINTS IN STATEMENT OF PYRAMID VENTURES, INC., IN SUPPORT OF SECTION 1021 OF H.R. 10612

Pyramid Ventures, Inc. is a United States corporation with two wholly-owned foreign subsidiaries which made portfolio investments in stocks of unrelated publicly-owned United States corporations between August 15, 1974 and January 30, 1975.

On May 21, 1974 the Ways and Means Committee issued a press release announcing a tentative decision to amend Section 956 to permit such portfolio investments without dividend tax to the U.S. shareholders of the foreign corporation. The amendment was contained in the bill as passed by the House.

Pyramid supported the provision in a written statement filed with the Finance Committee on April 23, 1976, and asked that it be made effective at the election of the taxpayers for investments made after May 21, 1974, the date of the Ways and Means Committee announcement. The bill reported by the Finance Committee makes this change in the effective date.

Since the provision is remedial legislation that eliminates a trap and is desirable for the U.S. economy, it seems entirely fair and reasonable to make it effective from the date it was first publicly announced by the Ways and Means Committee, and Pyramid urges that this provision be retained in the bill.

STATEMENT OF PYRAMID VENTURES, INC., IN SUPPORT OF SECTION 1021 OF H.R. 10612

My name is Edwin S. Cohen. I am of counsel to the law firm of Covington & Burling, Washington, D.C. I appreciate the opportunity to appear before the Committee this morning on behalf of Pyramid Ventures, Inc., in support of Section 1021 of H.R. 10612.

Pyramid Ventures, Inc., a U.S. corporation, urges the enactment of Section 1021, which would amend Section 956 of the Internal Revenue Code to permit controlled foreign corporations to make certain investments in United States property without adverse tax consequences so long as the investment is not in a related United States person. Pyramid also urges that the Committee retain Section 1021(d)(2), allowing taxpayers to elect to apply Section 1021 to investments in United States property made after May 21, 1974, the date on which the Ways and Means Committee first announced its tentative decision in favor of amending Code Section 956.

Pyramid publicly supported this provision in a written statement filed with the Finance Committee on April 23, 1976. That statement disclosed that in 1974 Pyramid was caught in a "trap for the unwary" created by Section 956 when its foreign subsidiaries invested in stocks of publicly-held, unrelated U.S. corporations. Pyramid requested that the revision of Section 956 be applicable to investments made after May 21, 1974, when the Ways and Means Committee first announced its intention to exclude these types of investments from Code Section 956.

Pyramid's position was summarized on page 29 of the Joint Committee Staff's "Summary of Statements Submitted to the Finance Committee on Tax Revision and Extension of Tax Reductions" dated April 30, 1976.

Pyramid organized two foreign subsidiaries in 1970 and 1972, respectively, to carry on a shipping business by time-chartering vessels to transport bulk cargo between U.S. Gulf Coast ports and foreign ports. The charters expired in mid-1974 and neither subsidiary has engaged in the shipping business since then.

Both foreign subsidiaries then invested the funds remaining after cessation of the shipping business in publicly-traded shares of unrelated U.S. companies. These investments were made between August 15, 1974 and January 30, 1975.

Under present law (Int. Rev. Code Sec. 956) the amount of these U.S. investments is technically treated as dividends taxable to the U.S. parent, Pyramid, simply because the investments were made in United States property (the shares of U.S. corporations) rather than foreign property, even though the corporations were unrelated to Pyramid.

On May 21, 1974, some three months before Pyramid's foreign subsidiaries made their first investments in U.S. securities, the House Ways and Means Committee issued a press release announcing a tentative decision to amend Section 956 to allow controlled foreign corporations to invest in United States property without dividend treatment to their U.S. shareholders so long as the investment is not in a related U.S. person. H.R. 10612, as passed by the House, ultimately contained a provision reflecting this decision. The change was made because Section 956 has been a trap for those not familiar with its existence; it has encouraged foreign investment rather than U.S. investment to the detriment of the U.S. economy; and the investment does not, in fact, resemble a dividend if it does not represent funds furnished to the parent stockholder or its affiliates.

The Finance Committee agreed that Section 956 should be amended so that portfolio investments by foreign corporations in unrelated U.S. corporations do not give rise to dividend consequences to the U.S. shareholders of the foreign corporations. It made the new rule effective with respect to investments made after May 21, 1974, the date when the Ways and Means Committee announced the change without specifying an effective date.

This is remedial legislation that eliminates a trap and encourages investment in the U.S. economy. Other remedial provisions designed to stimulate U.S. investment, such as the investment credit, have been made effective when anounced, prior to the date of enactment. Pyramid respectfully submits that the Committee should affirm its earlier decision to allow controlled foreign corporations to make portfolio investments in the U.S. economy without dividend treatment to their shareholders, effective at their election from May 21, 1974, when the amendment was first announced by the Ways and Means Committee.

The CHAIRMAN. Mr. Cohen, you have done more to advocate specific tax reforms than anybody else in this room. You were the Treasury expert who sat in the committee room day in and day out and who participated in conferences. Many times you stood up and spoke out vehemently against the suggestions that Senators made that might help some of their constituents where you thought that relief was not justified. Now you are testifying with regard to provisions that can be regarded as narrowly drafted amendments.

Would you explain, from a purely philosophical point of view—and I would like you to relate this to your experience in the Treasury—why, if at all, it is necessary to draft amendments limited to a single taxpayer or to a small number of taxpayers?

Mr. COHEN. Well, there are various reasons, Mr. Chairman. As I think is obvious, the Internal Revenue Code itself is divided into various sections or parts that apply to specific industries, and that fact in itself causes need for amendments that affect particular industries.

As an illustration, we have sections or parts of the code with series of provisions that apply to banks, to life insurance companies, to regulated investment companies, to real estate investment trusts, provisions relating to the extractive industries, provisions in this bill that apply to professional sports; so there is no way to avoid having many provisions apply to specific industries and that, of itself, results in application of provisions to a limited number of persons. The code is constructed that way because industries differ.

Second, when you have provisions that deal with one specific set of facts that are not going to recur, I think the draftsmen, both in the Treasury and on your staff—not only the draftsmen but those who make the policy decisions—see the merits and the equity of a particular provision but are concerned, in view of the speed with which they have to act, whether the provision should be made broadly applicable without knowing all the facts that might exist nationwide, and time does not permit obtaining all of those facts.

You cannot have a set of special hearings on each provision in a large bill, so I think the natural tendency of those who are convinced of the equity of a particular provision is to say: "Yes, that is all right, but let's limit it for the present purpose and then we will look at it later when someone else requests a change." I think that is the way it comes about.

I might say that where there are specific statutory revisions in particular cases, the procedures the House has followed in the last year seems to have satisfied a lot of criticism; and, while I don't see the need for it to be done in both branches of the Congress on the same provision if there have not been objections on the House side, it is a model with which one can start.

The CHAIRMAN. In other words, when you were with the Treasury, someone could come in and show where he was being treated unfairly and that it was a situation that deserved remedial legislation?

Mr. COHEN. Yes.

The CHAIRMAN. Now sitting there as a representative of the administration, you would, then, find yourself inclined to say: "Well, applied to this situation, I agree that is not fair and something should be done about it; but if we are too broad in what we do, we might find that we created a loophole for a lot of people that was never intended, and so we will draw this narrowly."

Now, also is it not true that in some cases in seeking to close a tax loophole, you might have done something more than necessary and fair; you might have clobbered somebody you didn't intend to and that would require legislation to reduce the burden that you might have placed on a person that went beyond what you had in mind?

Mr. COHEN. This is frequently a problem. I think this is one of the reasons why, from the standpoint of drawing regulations under the Administrative Procedure Act, since 1946 we have had provisions for notice of proposed rulemaking so that people can come in and say, "Well, you have hit me unintentionally," and very often you acknowledge that you have done that and you make the correction.

Even then, you have a problem, that, in making the correction, the very act of making the correction may hit someone else who was not hit before; and so you never know whether you should have the regulation republished for further comment.

There comes a time when you have to act, but you do find that in some cases in good faith you thought a generalized provision was warranted, without knowing of circumstances that are later called to your attention that merit a correction, and you then take action to correct it. I think that you do the best you can with the problem in good faith.

The CHAIRMAN. Now with regard to the theoretical problem, suppose you find that an injustice exists, but it involves only a single taxpayer. Should the Congress or the administration act to recommend something or not if it involves only a single taxpayer where there is a patent injustice?

Mr. COHEN. I must say, Mr. Chairman, that injustices should be corrected and the mere fact that it involves a single taxpayer does not seem to me to be a bar to the correction of an injustice. If everybody is agreed that it is an injustice and people on both sides have an opportunity to be heard, I do not see why an injustice should not be corrected.

The CHAIRMAN. The courts would do it, wouldn't they? You have a right to go to court on behalf of a single client.

Mr. COHEN. There are occasions, Mr. Chairman, in which the court gets the problem of whether the provision can possibly be construed in a way which would eliminate the injustice, or whether the language is so specific and so tight that the court feels powerless to do so; in that event, there is no place to go except to the Congress for the correction of the injustice.

The CHAIRMAN. Now I have one further point that I think you might want to comment on.

Mr. COHEN. Yes, sir.

The CHAIRMAN. It was suggested yesterday that taxpayers should exhaust all of their remedies before we consider providing relief in legislation. Now, there is a type of thing that I know has happened and the people on this technical staff would be the first to agree that is the case.

In some cases, doing the best they can, the staff has failed to draft the amendment so it does precisely what they have in mind. Then an aggrieved taxpayer goes to court seeking redress of his grievance and he finds that the unfortunate part about it is that the language drafted in error by the committee staff or even by a Senator fails to say what that person had in mind, and the only way to get that corrected is not to pursue judicial review but to go back to Congress and ask the Congress to draft it the way it should have been to begin with. Are you familiar with that problem?

Mr. COHEN. I am indeed, Mr. Chairman, because I have made those mistakes myself; I think we all do. With the speed at which one has to work in Government, there is no way to avoid such a problem and, if you have made an error, it seems to me the proper thing to do is to acknowledge it and correct it.

The CHAIRMAN. Thank you very much, sir.

Are there any further questions, gentlemen?

Thank you very much, Mr. Cohen.

Mr. COHEN. Thank you.

The CHAIRMAN. Next we will call Mr. John S. Nolan on behalf of American International Group, Inc.

STATEMENT OF JOHN S. NOLAN ON BEHALF OF AMERICAN INTERNATIONAL GROUP, INC.

Mr. NOLAN. Mr. Chairman and members of the committee, I appear here on behalf of the American International Group, Inc. I am accompanied by Mr. Meed who is general counsel to the American International Group. He is an expert in the regulation of insurance companies by the States and by foreign countries.

I appear in support of section 1023 of the bill which is entitled "Exclusion From Subpart F of Certain Earnings of Insurance Companies."

This section is merely an adoption by this committee of a provision which was included in the House bill as reported by the Ways and Means Committee and it simply extends a long standing exclusion from subpart F which has been in the Internal Revenue Code since 1962 in order to prevent the unintended application of subpart F to certain income earned in the ordinary course of business by a foreign casualty insurance company. This has become necessary because of certain subpart F changes which were enacted in the Tax Reduction Act of 1975 and which could inadvertently result in treating this income as a constructive dividend to U.S. shareholders even though it in fact cannot be paid to them. This result was clearly not intended by Congress.

Now subpart F has always been inapplicable to income from investment of the insurance reserves and unearned premiums of foreign insurance companies just as it has been inapplicable to interest earned by foreign banks in their banking business and in each case this is income earned in the ordinary course of business and is not tax payment income. In actual practice, however, foreign casualty insurance companies are also required to maintain intact an amount of their surplus equal to one-third of the premiums written. These earnings cannot be distributed in dividends and they, therefore, serve as additional protection to the policyholders.

This requirement is imposed by the State insurance authorities in the United States and by foreign insurance regulatory authorities to meet certain solvency requirements.

Now, prior to the Tax Reduction Act of 1975, these earnings were effectively protected from subpart F treatment by the so-called 70–30 rule. That rule was changed to a 70–10 rule in the 1975 act and that in turn created for the first time a serious risk of taxing these earnings which may not, as I have said, be actually distributed.

Section 1023 has been included in the bill to prevent this unintended result. I might add that it contains appropriate safeguards to prevent its application to income received from related persons and also to prevent its application to earnings attributable to premiums from insuring risks of related persons so as to limit the purpose and the effect of this provision to earnings which are in fact realized in the ordinary course of business by a foreign casualty insurance company.

This provision is not drafted narrowly to apply to any one company and in fact it will apply to all for even casualty insurance companies which are otherwise subject to our subpart F provisions.

I have been authorized by at least one other foreign casualty insurance company, the Continental Corp., which is unrelated to the American International Group, to advise that they also support this provision.

Now I might add that this provision was fully explained by letter to the staff of the Joint Committee on Internal Revenue Taxation and to the Treasury Department well before its consideration by the Ways and Means Committee and was reviewed by me personally with both of those staffs. It was in turn carefully considered by the Ways and Means Committee and the provision was included in the Ways and Means Committee bill as reported and as finally passed by the House.

As I have said, the Senate Finance Committee has done no more than approve the House action. Finally, I would observe that the Treasury Department in its report to this committee yesterday indicated that they have no objection to this provision. Accordingly, I urge that section 1023 in all events be continued in the Senate Finance Committee bill.

[Mr. Nolan's prepared statement on behalf of American International Group, Inc., follows:]

SUMMARY OF STATEMENT IN SUPPORT OF SECTION 1023, H.R. 10612, TAX REFORM ACT OF 1976

Section 1023 of H.R. 10612, the Tax Reform Act of 1976, as reported by the Senate Finance Committee, adopts § 1023 of the House bill, as reported by the Ways and Means Committee and passed by the House. It extends a long-standing exclusion from Subpart F (in the Internal Revenue Code since 1962) in order to prevent the unintended application of Subpart F to certain income earned in the ordinary course of business of a foreign casualty insurance company. This is necessary because Subpart F changes enacted in the Tax Reduction Act of 1975 could inadvertently result in treating such income as a constructive dividend to U.S. shareholders even though it cannot in fact be paid to them. This result clearly is not intended.

Subpart F has always been inapplicable to income from investment of the insurance reserves and unearned premiums of foreign insurance companies. In actual practice, however, foreign casualty insurance companies are also required to maintain intact an amount of their surplus equal to one-third of premiums earned. Such earnings cannot be distributed in dividends and serve as additional protection to policyholders. This requirement is imposed by U.S. and foreign insurance regulatory authorities to meet certain solvency requirements.

Prior to the Tax Reduction Act of 1975, these earnings were effectively protected from Subpart F treatment by the so-called 70–30 rule. That rule was changed to 70–10, posing a serious risk of taxing such earnings which may not in fact be distributed. Section 1023, with appropriate safeguards to prevent its application to income received from related persons and earnings attributable to premiums from insuring risks of related persons, would prevent the unintended application of Subpart F to such earnings realized in the ordinary course of business of a foreign insurance company.

Section 1023 clearly does not "exclude Bermuda operations of American Investors Group, Inc." or any other corporation from U.S. tax.

This problem was fully explained by letter to the Staff of the Joint Committee on Internal Revenue Taxation and to the Treasury Department well before its consideration by the House Ways and Means Committee. It was carefully considered by that Committee, and section 1023 was included in the Ways and Means Committee bill and was passed by the House. The Senate Finance Committee has done no more than approve the House action. Section 1023 should in all events be continued in the Senate Finance Committee bill.

STATEMENT IN SUPPORT OF SECTION 1023 OF H.R. 10612, TAX REFORM ACT OF 1976

Section 1023 of H.R. 10612, the Tax Reform Act of 1976, as reported by the Senate Finance Committee would, in effect, extend the existing exclusion from Subpart F of certain income from investments by an insurance company of its insurance reserves. This existing exclusion would be extended to income from investments of assets of a foreign casualty insurance company equal to one-third of premiums earned by such a company. This is designed to recognize the fact that insurance regulatory authorities within the United States and some foreign jurisdictions require that surplus to this extent be maintained as additional protection to policyholders of casualty insurance companies. Thus, such income is earned in the ordinary course of business of a foreign casualty insurance company, just as in the case of investment of insurance reserves as such, and U.S. shareholders of such a foreign insurance company should not be treated as receiving a constructive dividend of income which cannot in fact be distributed to them.

This same provision was contained in the House bill after being approved by the House Ways and Means Committee. The necessity of such a provision arose because in the Tax Reduction Act of 1975, the so-called 70–30 rule in Subpart F was amended, creating a much greater likelihood of Subpart F treatment of such income.

Under the prior 70–30 rule, none of the income of a "controlled foreign corporation" was treated as Subpart F income if less than 30 percent of gross income consisted of such amounts. The rule excluding from Subpart F income the investment of reserves and unearned premiums, previously described, prevented Subpart F treatment of income from investment of surplus required by insurance regulatory authorities to be maintained to meet insurance solvency requirements. In the Tax Reduction Act of 1975, however, this 30 percent test was reduced to 10 percent, so that Subpart F income was treated as such, and became a constructive dividend, unless it was less than 10 percent of total gross income. This created, for this first time, the very serious risk of applying Subpart F to a foreign casualty insurance company which is a "controlled foreign corporation" under our Subpart F provisions with respect to income which cannot in fact be distributed. This is clearly beyond the purpose of Subpart F, and section 1023 of H.R. 10612 is designed to prevent this unintended and unfair result.

The provision is explained fully at pages 219–220 of the House Ways and Means Committee report (H.R. Rep. 94–658, 94th Cong., 1st Sess.) and pages 229–230 of the Senate Finance Committee report (Sen. Rep. 94–938, 94th Cong., 2d Sess.). The provision is succinctly explained in both reports as follows:

Those assets maintained by these insurance companies in order to meet this ratio test are necessarily in the form of investments, which, in turn, generate passive income such as dividend and interest income. Just as in the case of the maintenance and investment of unearned premiums or reserves, these insurance companies, in compliance with the high ratio requirement, must maintain and invest a certain portion of their assets in connection with the active conduct of their trade or business. The committee believes that it is appropriate to provide the same type of exception from subpart F for surplus which is required to be retained as is provided for unearned premiums or reserves.

This problem had been presented to the Staff of the Joint Committee on Internal Revenue Taxation by letter dated July 8, 1975, and by an identical letter of that date to the Assistant Secretary for Tax Policy, U.S. Treasury Department. The latter letter was available for inspection by any interested person. The problem was considered and acted upon by the House Ways and Means Committee in open mark-up session, and until reference was made to it by Senator William Proxmire on June 28, 1976, on the Senate floor, it has never been criticized by anyone.

Senator Proxmire erroneously described the provision as designed to exclude Bermuda operations of American Investors Group, Inc. from U.S. tax. American International Group,-Inc. (not American Investors Group, Inc.) is a U.S. corporation controlled by American International Reinsurance Company, Inc., the parent company of a worldwide group of insurance companies with principal offices in Bermuda. This AIRCO group is one of several well-known and highly-respected groups of insurance companies doing business throughout the world. Section 1023 clearly is not designed to exempt Bermuda operations of American International Group, Inc., or the AIRCO group, from U.S. tax. As previously stated, it does no more than extend, in effect, a well-established principle that income from operations which are ordinary and necessary in the conduct of a foreign insurance business are not to be subject to Subpart F. This extension has become necessary only because of an unintended effect of the change in the 70–30 rule to a 70–10 rule in the Tax Reduction Act of 1975.

Section 1023 will in fact apply to the operations of many foreign casualty insurance companies which are "controlled foreign corporations" under our Subpart F provisions. Continental Corporation, unrelated to the AIRCO group, joins in this Statement to emphasize that fact.

The rule in Subpart F that an insurance company is not subject to Subpart F treatment with respect to income from investment of insurance reserves and unearned premiums has existed ever since Subpart F was first enacted in 1962. It exists *because* such income is ordinary and necessary for the proper conduct of the insurance business, and it is so described in § 954(c)(3)(B) itself. Section 1023 is an implementation of the same policy underlying that provision. Similar rules render Subpart F inapplicable to dividends and interest in the conduct of a banking, finance, or similar business (§ 954(c)(3)(B)) and rents and royalties derived in the active conduct of a trade or business (§ 954(c)(3)(A)).

Section 1023 contains important safeguards to limit its effect to proper cases. It does not apply with respect to income received from a related person. It does not apply with respect to premiums attributable to the insurance or reinsurance of related persons; thus, it cannot apply to so-called captive insurance companies. It also applies, in effect, with respect to surplus maintained with respect to casualty insurance, not life insurance, where different considerations are involved.

Section 1023 is clearly sound on its own merits. It is not designed to benefit only one company; it will protect all foreign casualty insurance companies which are controlled foreign corporations from an unintended application of Subpart F. It was contained in the House bill, and it has been carefully considered over a period of time by the Staff of the Joint Committee on Internal Revenue Taxation and the Treasury Department, without objection. It should be retained in the Tax Reform Act of 1976.

The CHAIRMAN. Mr. Nolan, I can recall the days when you were invited to be the only outside person—that is, the only person who was not either a member of the committee or the staff—to sit in the committee room while we explained and discussed amendments to major tax measures. Many times I have invited you and others have asked you to explain the view of the U.S. Treasury on some legislation. So, many times you fought a lonely battle all by yourself to explain why something that a Senator thought should be done should not be done and I felt great sympathy for you many times when you were trying to fight a battle against something that the committee seemed to want to do when you didn't have a vote and didn't have the right even to speak unless invited to do so.

Now, you certainly understand the procedure and the proper way to go about amending the tax law. Would you mind explaining to us how you look at the same problem I asked Mr. Cohen about? You had a similar responsibility and did similar work for the President and the Treasury Department. How do these problems involving a single taxpayer or a single company or a few companies arise and why is it necessary to draft limited amendments which we are now criticized for as having approved special interest amendments to meet specific problems.

Mr. NOLAN. Mr. Chairman, we have a tremendously complex economy in this country. We have over a long course of years attempted to build an equitable tax system which takes into account all of those complexities. That in turn has led to a complex tax law, but it is complex because it is basically designed to be an equitable tax law and to take into account the special circumstances of each industry, each type of business, each particular taxpayer group.

Now when you build that kind of tax law you build an extremely complex and difficult set of provisions, and nobody can foresee all of the possible ramifications of a provision. Furthermore, the committee and the Treasury Department are, in tax legislation, always working under the most extreme kind of deadlines so that the result, as Mr. Cohen said, has been that you try to draw the provisions of in any particular area to solve only the particular problem but not any broader than is necessary—in other words, restrict their application as much as you can so as to solve the particular problem that Congress wants to deal with.

When you do that, not being clairvoyant on everything, you necessarily are going to inadvertently overlook some circumstances. There will be companies that are inadvertently benefited and there will be companies that are inadvertently hurt by the provision.

Now those matters are brought to the attention of these committees, this committee and the Ways and Means Committee, and they are brought to the attention of the Treasury Department from time to time. It is the job of the Joint Committee staff and the staff of this committee, the staff of the Ways and Means Committee and the Treasury Department, to make decisions whether those are appropriate changes or not and report to this committee.

They do that, and they do it very well. These matters are very carefully considered by those staffs. It is absolutely inevitable that in these circumstances there will be cases that arise that are not properly dealt with by the legislation, where the congressional intent is not carried out, where there are unintended benefits on the one hand or unintended burdens on the other hand. It is absolutely necessary in my judgment that the commitee periodically hear from the taxpayers who are affected, deal with these problems, and solicit the views of the Treasury Department. The committee has always taken into account the views of their own staff and acted to achieve the right result irrespective of how many taxpayers a particular provision applies to.

The CHAIRMAN. I am happy Senator Haskell is here, I want him to hear what I have to say.

Let us talk about a problem of drafting the amendment more broadly. I would like to refer you to a situation which you are familiar with where a lady in Philadelphia decided to join a religious order. She became a nun. She was an heir to a large amount of wealth. Someone on her behalf sought an amendment to the tax law to say that all the income which had been left to her could be given to a religious charity and that she would not be taxed on that income because she had renounced all wordly gains and donated it to charity.

Having drafted this for the benefit of this lovely Philadelphia nun we go down the road 10 years and we find that 23 percent of the people who are reporting adjusted gross income of $5 million or more per year are paying no Federal income tax because they are taking advantage of this law that was drafted for this lady that became a Catholic nun and renounced all earthly wealth by taking a vow of poverty. That was the biggest loophole in the entire tax law done for one single person who wanted to take a vow of poverty and devote her life to religion.

That is what you get by drafting amendments broadly. If that provision had been drafted narrowly, you would have saved what subsequently became the biggest avenue of tax avoidance by millionaires in the entire tax code. Are you familiar with that?

Mr. NOLAN. Yes, Mr. Chairman I certainly am. I completely agree with you that in the long run in these areas it is much preferable to draw these provisions as narrowly as possible to solve the problem that Congress has in mind and then if it turns out that there are inadvertent burdens or benefits created which come to light subsequently, to deal with those when they do come to light.

The CHAIRMAN. That is the No. 1 loophole that was approved while I have been a member of this committee, and that has been a long time—24 years—and I have attempted to close that loophole.

Sometimes by not drafting provisions narrowly in seeking to do justice for someone you can provide a very big tax loophole. You had to study that problem when you were with the Treasury?

Mr. NOLAN. Yes, Mr. Chairman, we have many times.

The CHAIRMAN. Thank you very much.

Any further questions?

Senator CURTIS. Mr. Chairman.

The CHAIRMAN. Senator Curtis.

Senator CURTIS. In reference to this insurance proposal that you have just testified about, you say that has been approved by the Ways and Means Committee, by the House of Representatives, and approved by this committee?

Mr. NOLAN. Yes, Senator Curtis.

Senator CURTIS. The Treasury is not objecting?

Mr. NOLAN. That is correct.

Senator CURTIS. Do you feel that the failure to enact it would create an injustice?

Mr. NOLAN. I very much feel that way and I think it is a product of something that could not have been foreseen as I have tried to indicate. Last year when Congress changed subpart F to broaden its application, that in turn created a problem for foreign casualty insurance companies which could not have been foreseen at that time and all this does is to put subpart F back where it is supposed to operate.

Senator CURTIS. I understand, but it is your opinion that by not enacting this provision would create an injustice? I wanted to ask in another way.

To enact this provision, will that give an unconscionable and unfair advantage to the taxpayers in question?

Mr. NOLAN. No; it will not because the income in question is income earned in the ordinary course of business of these companies and subpart F is not supposed to apply to that.

Senator CURTIS. Do you know anyone who is knowledgeable of tax law that disagrees with you?

Mr. NOLAN. No.

Senator CURTIS. I think we are facing a rather dangerous thing for our economy and jobs and our whole economic system. Matters of this kind have to be reheard the second time because irresponsible demagogues misstate to the public and irresponsible publishers present erroneous pictures to the American public. This assumes that we are not correcting an injustice but that we are creating an injustice and that members of the committee or the committee as a whole are not individuals of character but deliberately granting special favors here. This is just not so and anyone who investigates it and who is knowledgeable of the law involved will agree. We can get our story across. Anybody here is pretty well able to take care of themselves back in their own constituency.

What these irresponsible people are doing and these publishers who have no regard for truth or right and wrong, they are seriously damaging the tax code and the economy of the country.

Thank you for your appearance.

Senator FANNIN. Mr. Chairman.

The CHAIRMAN. Excuse me.

Senator Hansen.

Senator HANSEN. No.

Senator FANNIN. I had a question.

The CHAIRMAN. Senator Haskell.

Senator HASKELL. Go ahead. No questions.
The CHAIRMAN. Senator Dole.
Senator DOLE. No questions.
The CHAIRMAN. Senator Fannin.
Senator FANNIN. All I wanted to say is that this did come over as a House provision, is that correct?
Mr. NOLAN. That is correct. There is no change from the House provision.
Senator FANNIN. The press gave me credit, if you can call it credit, for this special interest amendment. I don't know whether you noticed it or not but in the listing of the special interest items they listed your amendment as my brainchild. I want to bring out specifically that this was in the House bill and was therefore considered by the committee in the regular course.
Mr. NOLAN. That is correct. I never even discussed this with you because it was not necessary to do so. It was part of the House bill and it was considered by the committee in the regular course.
Senator FANNIN. I just wanted that to be part of the record, Mr. Chairman.
Thank you.
The CHAIRMAN. Thank you.
Senator CURTIS. Any similarity of what you read and what happens is purely coincidental.
[Laughter.]
The CHAIRMAN. Senator Gravel.
Senator GRAVEL. No questions.
The CHAIRMAN. Senator Hartke.
Senator HARTKE. No questions.
The CHAIRMAN. Senator Haskell.
Senator HASKELL. Mr. Nolan, your organization is the American International Group?
Mr. NOLAN. That is correct.
Senator HASKELL. Now let us assume, as I am sure you do and I am sure is the case——
Senator HANSEN. Is your mike on?
Senator HASKELL. Maybe I just better talk loud.
Let us make the assumption, as I am sure is the case, whether it is a meritorious amendment nevertheless it is for one company. Now we are faced in this committee, at least as I view it, with what I suppose maybe Ceasar's wife was faced with. We are certainly faced with appearances as well as fact so there has got to be not only the fact but there is no special biases, no special deals. There has got to be the appearance, at least in my view, if we are going to maintain respect in the country.
So we deal with a provision that in your instance we are making the assumption—I am sure it is the case if it is going through all this legislative process—that is entirely meritorious. However, it deals with one company. Now what, if anything, would you suggest as a procedure to insure that integrity of performance of the committee system and the appearance of integrity of performance? What kind of procedures would you suggest we adopt, because for my money that is the whole purpose of this hearing, is trying to find out what procedures would be the best procedures. You are on the receiving end

of a special provision of the tax code. I am making the assumption that it is meritorious, and I am sure it is, but nevertheless it is for a special company. Now what would you suggest this committee do so that it does not get the type of publicity we have gotten recently?

Mr. NOLAN. In the first place, I would like to clear that up. It is not really for one company. I appear for one company because the company has hired me and asked me to deal with the problem but it applies to all foreign casualty and insurance companies which otherwise would be subject to subpart F and, in fact, the problem is a generic one for all those companies.

Senator HASKELL. How many foreign casualty companies are there?

Mr. NOLAN. Subject to public support there must be, I would say, 100.

Senator HASKELL. Then you do have a class situation? Very often we don't have a class situation. Let us make the assumption that it just did favor your company. Let us make that assumption and let us make the assumption it is meritorious. Then what would you recommend?

Mr. NOLAN. I think that it is perfectly appropriate for the committee, and should be, that the practice for the committee staff here—the way the Joint Committee staff and the way this committee make it clear in their committee prints that they provide to the committee members, and which are now available to the public, to indicate who is a proponent of this provision, what affect it will have on this company or on companies that are in a small class, what the revenue impact is. The Ways and Means Committee has instituted some procedures which are designed to provide information to the public on this score and I think it is perfectly appropriate or ought to be done.

In fact, when the Treasury Department reports on these matters to the committee, as it does, those things are generally fully discussed and available to the public for comment. The important point is that the system is just too complex, not to correct the things that dvelop and which can't be foreseen.

Senator HASKELL. Mr. Nolan, I have said yesterday and today that this is a relief provision in taxation like anything else. We were just talking about a procedure. You would subscribe then to the procedures of publishing the code's name, submitting it to Treasury, having it analyzed by staff so that if anybody thinks that there is a fast one going on they can request a hearing? Would that be a possibility?

Mr. NOLAN. That certainly is a possibility. Now to a large extent that already occurs. Sometimes it does not occur as well as we would like it to because of the time pressures that this committee and occasionally the Ways and Means Committee are subjected to but there is a process whereby the Treasury Department analyzes and reports on these matters to the committee.

I was in the Treasury Department for many years and filed literally hundreds of reports with this committee and the Ways and Means Committee on these matters and that is a very important and useful process of filtering the good from the bad.

Senator HASKELL. Would you also suggest that these reports be public for some limited period of time so that if there are interested members of the public to speak up they can have an opportunity to do so?

Mr. NOLAN. I certainly would be in favor of that.
Senator HASKELL. Thank you, sir.
The CHAIRMAN. Thank you very much.
Mr. NOLAN. Mr. Chairman, I am sorry but I do appear separately on the list for one other matter and I will try to keep my remarks very brief on that.
The CHAIRMAN. We did have you scheduled to appear for the American International Group, Inc., and also for Clara Miller Trust. You have been listed twice for that reason and there are two items in the bill. We will permit you to appear twice and allow you 5 minutes. Go ahead.
Mr. NOLAN. I won't take 5 minutes.

STATEMENT OF JOHN S. NOLAN ON BEHALF OF CLARA MILLER TRUST

Mr. NOLAN. I appear on behalf of Clara Miller Trust in support of section 1035(d) of the bill, which is entitled "Foreign Oil Related Income Earned by Individuals." Now, section 1035(d) relates again to a provision which was enacted in the Tax Reduction Act of 1975 and which limits the foreign tax credit with respect of foreign oil related income.

Section 1035(d) of this bill is really only designed to make that limitation that was enacted in 1975 work as was intended by Congress at that time but with respect to individual taxpayers as well as corporate taxpayers.

The Tax Reduction Act of 1975, as I have said, imposed a special limitation on the foreign tax credit for foreign taxes paid in connection with foreign oil and gas extraction income. Now, the congressional purpose in 1975 was to prevent any foreign taxes on such oil income from being used to offset U.S. taxes on other nonoil foreign source income.

The foreign tax credit was accordingly limited to 2 percentage points above the U.S. corporate rate with certain transitional provisions, and that, of course, after the transitional period, will limit the credit for such taxes to 50 percent.

The limitation is, however, also applicable to individuals as well as to corporations, and individuals may be subject to U.S. tax on such income at a rate which is well above 50 percent—in fact, up to 70 percent—or, alternatively, they may be subject to U.S. tax at a much lower rate, down to 14 percent.

Now, this effect of the limitation on individuals was apparently not fully considered in developing the 1975 act. As a result, the 50-percent limit that was adopted can either work unfairly to individuals by denying them a credit with respect to foreign oil income which they are intended to have even under the purpose of the limitation; or, alternatively, it can provide an unintended benefit to these people where they are in a low U.S. tax-effective rate and thus permit them to use those credits against other nonoil income and thereby frustrate the congressional purpose.

The limitation with respect to individuals should not be based on the corporate rate but should be based on the effective U.S. rate applicable to such foreign oil income in the individual's return.

Section 1035(d) of the bill would cure this deficiency by allowing a foreign tax credit for foreign taxes paid on foreign oil and gas extraction income up to but not in excess of the effective U.S. rate on that income. That will, in turn, prevent any excess credits from offsetting U.S. tax on other foreign source income of individuals and thus will carry out the congressional purpose as applied to individuals; but similarly it will not deny individuals a credit for foreign taxes paid on foreign oil income against their U.S. tax on that same income.

I think that this provision should in all events be continued in the bill because it really does no more than insure that the purpose of the Tax Reduction Act of 1975 in limiting the foreign tax credit with respect to foreign oil income—that that purpose is carried out fully and fairly.

If the provision is not drafted too narrowly it will apply to all individual taxpayers who have foreign oil-related income; and the Treasury Department has advised this committee that it affirmatively supports this provision as carrying out the intent of the 1975 act. Thank you.

[Mr. Nolan's prepared statement on behalf of Clara Miller Trust follows:]

Summary of Statement in Support of Section 1035(d) of H.R. 10612 as Amended by Senate Finance Committee

The Tax Reduction Act of 1975 imposed a special limitation on the foreign tax credit for foreign taxes paid in connection with foreign oil and gas extraction income. The Congressional purpose was to prevent high foreign taxes on such income from being used to offset U.S. taxes on *other* foreign source income. The foreign tax credit was accordingly limited to 2 percentage points above the U.S. *corporate* rate. This will limit the credit for such taxes to 50 percent.

This limitation is also applicable to individuals, however, who may be subject to U.S. tax on such income at a rate well above 50 percent—up to 70 percent, or at a much lower rate—down to 14 percent. This was apparently overlooked in drafting the 1975 Act. The limitation with respect to *individuals* should be the effective U.S. rate applicable to such foreign oil and gas extraction income.

Secion 1035(d) of H.R. 10612 would cure this deficiency, allowing a foreign tax credit for foreign taxes paid on foreign oil and gas extraction income up to, *but not in excess of*, the effective U.S. rate on such income. This will prevent any excess credits from offsetting U.S. tax on *other* foreign source income. Sen. Rep. 94-938, 94th Cong., 2d Sess. 250-251 (1976).

This provision should in all events be continued in the bill; it does no more than insure that the purpose of the Tax Reduction Act of 1975 is carried out fully and fairly.

Statement in Support of § 1035(d) of H.R. 10612, as Amended by Senate Finance Committee

Under present law, § 907 imposes certain limitations upon the foreign tax credit with respect to foreign oil and gas extraction income and also with respect to foreign oil-related income. Foreign oil-related income includes, in addition to foreign oil and gas extraction income, income from the processing, transporting, and distributing of foreign oil and gas. Section 907 was added to the Code by the Tax Reduction Act of 1975.

Since the enactment of § 907, certain unfair and unintended consequences to individual taxpayers have been discovered. The results were not intended and were probably the result of a drafting oversight. Section 1035(d) of H.R. 10612, added by the Committee to the House bill, is designed to correct this unintended oversight. The Committee is strongly urged to continue § 1035(d).

Section 907(a) of the Code imposes a limit upon the foreign tax credit with respect to foreign oil and gas extraction income. The purpose of this provision is to prevent high foreign taxes on this income from being used to offset U.S. taxes on other foreign source income. See Conference Report on Tax Reduction

Act of 1975, House Rep. 94–120, 94th Cong., 1st Sess. 69 (1975). For taxable years ending in 1975, this limit is expressed interms of 110 percent of the regular corporate tax; for taxable years ending in 1976, 105 percent; and for taxable years thereafter, 2 percentage points above the regular corporate rate. This translates, for both corporate and individual taxpayers, into a 52.8 percent limit for 1975, a 50.4 percent limit for 1976, and a 50 percent limit thereafter.

Unlike corporations, however, individual taxpayers are taxed at progressive rates ranging from 14 percent to 70 percent. The limitation imposed by § 907 (a) therefore can be unduly generous to individual taxpayers in brackets below the corporate tax rate and unfair to individual taxpayers in brackets above the corporate tax rate. The Senate Finance Committee Report on the Tax Reform Act of 1976, Sen. Rep. 94–938, 94th Cong., 2d Sess. (1976), illustrates this point with the following example at 251:

* * * For example, if an individual has a high effective rate of tax (in excess of the corporate rate), his disallowed foreign tax credit will cause him to pay U.S. tax on his foreign extraction income, while a corporation would owe no U.S. tax.

Section 1035(d) would amend § 907(b) of the Code in case of individual taxpayers to provide that the above-described limits in § 907(a) would not apply and a new limitation would apply. As explained at 251 of the Committee Report—

The committee amendment provides that the allowable foreign tax credit on foreign oil and gas extraction income is to equal the average U.S. effective rate of tax on that income. Thus, in any case there will be sufficient tax credits to offset the U.S. tax on the foreign oil and gas extraction income but no excess credits to offset U.S. tax on other foreign source income. The committee amendment achieves this result by limiting the taxpayer to a separate overall foreign tax credit limitation for foreign oil and gas extraction income. . . . [Sen. Rep. 94–938, 94th Cong., 2d Sess. (1976)]

Section 1035(d) therefore is designed to fully and fairly accomplish the purpose of § 907 when it was added to the Code by the 1975 Tax Reduction Act. The § 907 rules with respect to corporations would not be changed.

The CHAIRMAN. Thank you very much. Senator Hartke.

Senator HARTKE. This measure, which I was responsible for including originally in the tax law, didn't go as far as I wanted it to go. Let me ask you, in the case of the Clara Miller Trust, what is the appropriate tax rate?

Mr. NOLAN. The Clara Miller Trust had an interest in the Canadian oilfield which was sold outright and which was therefore subject to treatment as long-term capital gain in her return. Now she is subject to the minimum tax on trusts, so she is effectively subject to a U.S. tax rate on this in the amount of about 36½ percent.

The Canadian tax rate, however, is far above that on this sale; it is over 50 percent. And if this is the only income and return, which it effectively is, the result will be that she will be denied a foreign tax credit with respect to a substantial part of the Canadian taxes on this income even though she is not using those taxes to offset any other U.S. tax on other kinds of income; it is using it only to offset U.S. tax on this income.

So this provision would prevent that and would really carry out the purpose of what I believe you had in mind and the committee had in mind in 1975.

Senator HARTKE. Now let me ask you, just as a matter of record: What this does is apply to individuals at the equivalent rate; isn't that right?

Mr. NOLAN. It applies it at the effective U.S. rate on that income.

Senator HARTKE. Effective equivalent rate on U.S. tax?

Mr. NOLAN. Yes.

Senator HARTKE. Whereas on the corporate structure it still applies on the 50-percent level vis-a-vis a 48-percent rate?

Mr. NOLAN. Right.

Senator HARTKE. In other words, under this amendment, and under this provision, the effective rate would be more stringent than it is on corporations?

Mr. NOLAN. That is correct. There is still a 2-percent leeway for corporations and there is none for individuals.

Senator HARTKE. I might say it is my intention, in defending business on the floor of the Senate, to correct that situation as far as corporations by helping them along to make them on the same basis of this amendment. Now we will use this amendment to say that the corporations have a benefit today which an individual, even under this amendment, would not have. Is that correct, Mr. Nolan?

Mr. NOLAN. There is still a 2-percent leeway for corporations.

Senator HARTKE. Two-percent difference and leeway for corporations which, even under this amendment, is no longer available to an individual?

Mr. NOLAN. That is correct.

Senator HARTKE. All right.

The CHAIRMAN. Thank you very much. Are there any further questions of the witness?

Thank you very much for your testimony, Mr. Nolan.

I am going to ask that the reporter undertake to transcribe immediately and make available to us before the close of the day what you said with regard to the problem of a narrowly drafted amendment compared to a broadly drafted amendment and what Mr. Cohen said with regard to the same problem.

Both of you had to struggle with that and I want to make it available to some of our reporters who seem to be unable to show up here before 10 o'clock in the morning, because they need to know that information to be fully informed and I would like to educate some of those people. [Laughter.] If they cannot come in time to hear the witnesses, we will try to take it to them and I will shove it in their pockets just as I do with some Senators. Thank you very much.

Senator HASKELL. Mr. Chairman, I wonder if I could ask a question.

The CHAIRMAN. Yes.

Senator HASKELL. You mentioned, Mr. Nolan, that actually the Canadian tax exceeds the U.S. tax and this proposed provision works a hardship on your client?

Mr. NOLAN. Yes.

Senator HASKELL. Why in the world would your client ask it?

Mr. NOLAN. The provision that works the hardship on us is the one that was enacted in 1975 because it limits the effective foreign-tax credit in terms of the corporate rate whereas my client is a trust and is taxed as an individual and——

Senator HASKELL. I thought you said that the capital gain and the Canadian tax exceeded the U.S. tax and therefore, without the proposed amendment, you would be better off than you would be with the proposed amendment.

Mr. NOLAN. No; the amendment is necessary in order to make the foreign-tax credit limitation work properly in our case.

Senator HASKELL. In other words, if you take the foreign-tax credit, you need this amendment?

Mr. NOLAN. That is correct.

Senator HASKELL. The Treasury has commented on this provision?

Mr. NOLAN. Yes, and they have said they support this provision.

Senator HASKELL. As far as you know, there are no staff or outside people who criticize this?

Mr. NOLAN. I am not aware of any criticism of this.

Senator HASKELL. Thank you.

The CHAIRMAN. Let me try to get this a little more specific just so we understand. The corporate-tax rate is 48 percent, right?

Mr. NOLAN. Right.

The CHAIRMAN. So the foreign-tax credit is geared to the 48-percent corporate-tax rate, is that right?

Mr. NOLAN. The limitation on the credit that was enacted in 1975 was geared to that 48-percent rate and it limits the credit to 2 percentage points above that corporate rate of 50 percent.

The CHAIRMAN. But you are saying that if the taxpayer is taxed at a 70-percent rate, for example, which is the top individual rate and is higher than the corporate rate, he ought to be permitted to take the credit to the same extent that he could take the credit against the corporate rate—that is, to at least the maximum individual rate?

Mr. NOLAN. Yes. The purpose of the limitation is to prevent you from using the credit against any part of your U.S. tax except that part of your U.S. tax which is applicable to this foreign-oil income. And so it works OK to use the corporate rate for corporations because they have a proportional rate; but in the case of individuals, they are subject to progressive rates and, if you want to limit the credit so that it can offset only the portion of the U.S. tax that is applicable to the foreign-oil income, you have got to gear it to the effective U.S. individual rate on that income.

The CHAIRMAN. Let me just get one more thing straight which I think you understand but I fear some well-informed others don't understand. They don't need to agree but they ought to understand the argument and the facts. The general rule of U.S. taxation is as between steps of government you get a deduction at one level for the tax paid at another; but, as between equal sovereigns, you get a credit.

For example, if you are talking about a sales tax paid in one State, you give a credit for the sales tax paid in the other State; or, if you are talking about an income tax paid in one State, generally a credit for the income tax paid in the other State is provided if you are doing business in more than one State. The whole thrust of tax justice and uniformity is that between the two it should not be taxed twice between equal sovereigns.

Mr. NOLAN. Right.

The CHAIRMAN. As between steps of government, the way we do business here—and, I would assume, elsewhere—is that a deduction is allowed for what is paid to the local government against what is owed in our Federal income tax; but, so far as I know, the general rule as between equal sovereigns, whether you are talking about a sales tax or an income tax, is to get a credit for what is paid to the equal sovereigns.

Mr. NOLAN. No; we give a credit for income tax paid to another sovereign because the same income should not be subject to two income taxes.

The CHAIRMAN. How about the sales tax? If you pay a sales tax on something that you buy in Mississippi and there is a similar sales tax in the adjoining State, is there not a tendency to give a credit if it has already been paid in the other State? Is that right or wrong?

Mr. NOLAN. As between those two States, they are going to give a credit ordinarily for the sales tax paid to the other State; but, in dealing with the U.S. Federal Government, we do not give a foreign tax credit for sales taxes paid to a foreign government; we give a deduction; but we do give a credit for income taxes paid to the foreign government because the same income should not be subject to two income taxes.

The CHAIRMAN. Thank you very much.

Senator HASKELL. I think I am a little confused now. The problem, as you express it, is that individual rates go up to 70 percent, at least as I understand it; and I think that is what bothered me before because I thought you said it was a capital gain income.

As we all know, capital gain income is at a fixed rate and it is under 70 percent—in fact, it is under 50 percent—and I think that is where I am confused as to why you need this provision.

Mr. NOLAN. Let me explain exactly what happens here. With respect to individuals, the technique for taxing capital gains separately is to exclude 50 percent of the income from tax. Now, in 1975, when you adopted this limitation on the credit, the way it was drafted was to take that proportion of your tax which the income bears to your total income.

Now, in this case that meant that we are taking 50 percent of our income into account and, if the limitation on the credit is 50 percent, that cuts our effective credit rate to 25 percent.

Senator HASKELL. All right.

Mr. NOLAN. And, therefore, we can get a credit for only 25 percent whereas we are actually paying to the United States 36½ percent; so we are losing 11½ percent of our credit, and I am sure that was never intended in 1975.

Senator HASKELL. Thank you.

The CHAIRMAN. In other words, that is one more example of an unintended hardship that nobody anticipated when it happened; is that your impression of this?

Mr. NOLAN. Yes.

The CHAIRMAN. Thank you.

Senator HARTKE. Mr. Chairman, I am not really questioning the amendment before us at the moment. I do want to make it clear because the amendment that is pending on the floor of the Senate and is pending business, would provide for the same type of treatment of corporation that this amendment now, under the way it has been drafted, would apply to an individual, is that not right, Mr. Nolan?

Mr. NOLAN. That is the effect.

Senator HARTKE. In other words, the 2 percent differential—in other words, at the present time, with the corporate tax rate of 48 percent, this provides still for an excess rate of 2 percent?

Mr. NOLAN. Yes.

Senator HARTKE. Just for the information of the chairman, while I have this expert in front of me, I just want to say that what I intend to do on the floor of the Senate is to eliminate that 2 percent to bring that back to 4 percent, then the law will be treating the corporation and the individual on the same basis, is that not right?

Mr. NOLAN. Yes.

The CHAIRMAN. I will pose it right here in the committee, Mr. Senator. Maybe we ought to——

Senator HARTKE. I am sorry, we wanted to see if we could get it adopted.

The CHAIRMAN. I think if you want to do it, you ought to propose it as a committee member.

Senator HARTKE. It is pending business right now before the Senate. I just wanted to make clear that what Mr. Nolan is talking about here still provides a more stringent tax liability than is applied to the corporate tax rate, is that not correct?

Mr. NOLAN. That is correct.

The CHAIRMAN. Let me further complete the record on how this inequity arose. I just was informed by Mr. Woodworth, who is our expert on taxes in this room, that the reason this occurred was that at the time this was drafted, the Joint Committee staff was just not aware of the fact that there were individuals participating in some of these foreign oil ventures.

They knew that corporations were involved but they were just not aware that people were doing it as individuals. Apparently your client was?

Mr. NOLAN. Yes, there were quite a few individuals who invested in oil exploration in Canada, for example. That is where my client is involved.

The CHAIRMAN. Thank you. Next we will call Mr. William Mayberry, executive director, Offshore Marine Services Association.

STATEMENT OF WILLIAM A. MAYBERRY, EXECUTIVE DIRECTOR, OFFSHORE MARINE SERVICE ASSOCIATION

Mr. MAYBERRY. Thank you, Mr. Chairman. My name is William Mayberry, director of the Offshore Marine Service Association. The association was founded in 1957 and today has a membership of 70 U.S. vessel owning companies located in several States throughout the United States.

On behalf of OMSA I urge the adoption of that portion of the section 1024(a) of H.R. 10612, which exempts the U.S. shareholders of controlled foreign corporations for current U.S. taxation from the transportation of men and supplies from a point onshore to offshore locations on the Continental Shelf from the subpart F provisions of the code.

In its statement issued June 15, 1976, the Treasury Department did not oppose this amendment, however in its statement issued July 20, 1976, the Treasury opposed this amendment on the grounds that income derived by the offshore supply vessels is traditional base company income which is not true.

Traditional base company income requires two elements: The corporation's business must be conducted outside the country of incorporation; and two: Sales and purchases must be to a related party or services must be rendered on behalf of a related party.

The Treasury's opposition to this amendment is solely on the first criterion and the translation is simply incorrect.

A controlled foreign corporation which renders services other than shipping to unrelated parties outside its country of incorporation does not have subpart F and such income is not base company income because there is no related party involved.

Vessel-owning members of the Offshore Marine Service Association do not render services to related parties. Their services are related to oil companies, contractors, and are completely unrelated to the vessel-owning and operating countries and consequently their income is not traditional base company income.

Moreover, the Treasury Department used an unfair and inaccurate example to buttress its position by claiming that the exclusion would permit foreign supply vessels to service rigs located on the Continental Shelf of the United States without paying U.S. tax.

In the first place, supplying the offshore drilling rigs on the U.S. Continental Shelf of a port in the United States is closed to trade under the Jones Act and foreign vessels may not perform such services.

Although it is theoretically possible for a foreign-flag vessel to supply a location on the U.S. Continental Shelf from a foreign port, as a practical matter, such operation is unfeasible.

To the best of my knowledge, there are no continuous operations of this type. Unless the Treasury Department is describing a factual situation which simply does not exist, more importantly if a foreign vessel could supply offshore locations on the U.S. Continental Shelf under current law, only the U.S. shareholder of the foreign corporation will be taxed.

The United States would not tax that foreign corporation but only the vessel or the foreign shareholder of such corporation.

It is precisely this competitive disadvantage created by current law which would be corrected by this amendment. For the Treasury Department to say this example, in order to deny relief to the U.S. owners of foreign corporations engaged in servicing offshore installations is completely misleading.

Actually the Treasury's example demonstrates that this amendment is necessary to allow American firms to compete with foreign-owned firms on an equal basis. I respectifully submit, very simply, the transportation amendment applies from a point onshore to a point in the Continental Shelf or an adjacent continental shelf from the definition of foreign commerce.

Under subpart F, shipping provisions are necessary to permit American-owned offshore service companies to compete abroad. It is only the U.S. owners of foreign ships that will be taxed, it will be uneconomic for the U.S. firms to own such vessels.

Foreigners will be able to continue to operate their vessels and pay only current taxes to the local country in which the operations are conducted. Consequently the foreigners will be able to realize greater after-tax profit for identical operations, and would eventually become the owners and operators of all vessels engaged in this industry.

The change in ownership, gentlemen, I submit will benefit neither the U.S. Treasury nor our American industry.

[The prepared statement of Mr. Mayberry follows:]

OUTLINE OF MAJOR POINTS, TESTIMONY OF WILLIAM MAYBERRY, EXECUTIVE DIRECTOR OF THE OFFSHORE MARINE SERVICE ASSOCIATION—SECTION 1024(a) OF H.R. 10612

I urge the adoption of that portion of section 1024(a) of H.R. 10612, which exempts income derived overseas from the transportation of men and supplies from a point onshore to offshore locations on the continental shelf from the Subpart F provisions of the Code for the following reasons:

1. The members of the Offshore Marine Service Association (OMSA) are not "tax exempt". They pay income taxes to virtually every foreign country which they operate.
2. OMSA members do not generally transport persons or property from a port in one country to a port in a different country. Thus, such operations do not constitute "foreign commerce" as that term is generally understood.
3. The vessel-owning members of OMSA provide their services to unrelated parties. The rendition of services to unrelated persons does not constitute a "base company" operation of the type at which the Subpart F provisions of the Code are directed.
4. Exempting the foreign affiliates of OMSA members from current taxation under Subpart F is necessary to allow the United States vessel-owning members of OMSA to compete on an equal basis with foreign-owned operations which provide similar services throughout the world.

WRITTEN SUBMISSION OF WILLIAM MAYBERRY, EXECUTIVE DIRECTOR OF OFFSHORE MARINE SERVICE ASSOCIATION, SECTION 1024(a)—FOREIGN BASE COMPANY SHIPPING INCOME CONTINENTAL SHELF EXCEPTION

My name is William Mayberry and I am the Executive Director of the Offshore Marine Service Association (OMSA). This association was founded in 1957 and today has a membership of seventy United States vessel-owning companies located in several states throughout the United States. These member companies of OMSA own and operate approximately 1,500 vessels providing support services to the offshore exploration industry domestically as well as overseas. The majority of OMSA's vessel-owning membership comes from the states of California, Texas, Louisiana, Mississippi, Alabama, Florida and Massachusetts. These member companies currently have under construction some 124 new vessels costing hundreds of millions of dollars which are being built throughout the United States, including the states named above and the State of Washington. Equipment to construct these vessels is manufactured in many states, notably Wisconsin and Illinois. Our member companies, both large and small, have a vital interest in the Tax Reform Act of 1976 which is presently before your Committee.

Specifically, we urge the adoption of the special exclusion, contained in section 1024(a) of H.R. 10612 as reported by this Committee, for foreign base company shipping income:

". . . derived from the transportation of men and supplies from a point in a foreign country to a point on the continental shelf of such country or the continental shelf adjacent to the continental shelf of such country."

This exclusion would relieve the offshore vessel service industry from current taxation by the United States under Subpart F of the Code of certain undistributed income of foreign affiliates. This provision is necessary to allow the United States-owned companies engaged in this industry to continue to compete abroad.

The vessel-owning members of our Association furnish transportation and supply services to unrelated oil companies and drilling contractors engaged in exploring for, developing and producing oil or gas in offshore locations throughout the world. We are in direct competition with a growing number of foreign-owned companies which stand ready to perform these functions if American firms are no longer able to compete with them on an equal basis.

As I will explain in greater detail later, the foreign subsidiaries of the members of our industry, should not be categorized as "tax-haven" operations and subjected to current United States tax under the Subpart F provisions. The members of our Association pay foreign income taxes to virtually every foreign country in which we operate. Moreover, the vessel-owning members of OMSA render their services to unrelated parties, and, therefore, their foreign subsidiaries are not "base companies" (which deal with related entities) of the type at which the Subpart F "sales" and "services" provisions are directed.

The Tax Reduction Act of 1975 imposed a current tax on United States shareholders of foreign subsidiaries deriving income from the use of any aircraft or vessel in "foreign commerce." Prior to that legislation, all shipping income of controlled foreign corporations was specifically exempted from current taxation under the Subpart F provisions of the Code. Whether this change is in the best long-term interest of the United States is certainly debatable, since it applies only to the United States owners of foreign flag vessels, thereby making them noncompetitive with foreign-owned shipping companies. Whatever the merits of that provision, it is clear that the offshore exploration vessel support industry was accidentally "caught" in the legislative net.

The "shipping income" amendment to the Subpart F provisions in the Tax Reduction Act of 1975 was obviously aimed at "shipping corporations, operating on the high seas" which paid little or no tax to any country. As described in the House Ways and Means Committee Report accompanying H.R. 17488 (which was the first bill in which that provision appeared), this total exemption from tax "results because most countries (including the United States) do not tax the profits from shipping into and out of their ports, and most shipping corporations are based and incorporated in countries which do not tax foreign shipping operations." This is simply not the case in our industry. American-owned offshore service companies are not exempt from foreign tax. Affiliates and subsidiaries of our members pay foreign tax in virtually every foreign country in which they operate.

Allow me to describe briefly the general organization of the members of our Association and the manner in which their operations in foreign countries are conducted. Vessels utilized by our offshore service companies are generally based in a specific foreign area for a period of years. The vessels are usually operated out of foreign countries on the continental shelves off which the offshore installations are located. The vessels are operated by controlled foreign subsidiaries incorporated under the laws of or registered to do business in those foreign countries. Indeed such local incorporation or registration of the operating entities is generally a condition precedent to being permitted to operate there. The operating companies are thus subject to the laws of the foreign countries including their tax laws. In order to permit these vessels to be transferred from one area to another and to avoid the practical and legal problems which would be involved in registering the vessels locally, such vessels are usually chartered by another foreign affiliate of the offshore service company to the ultimate customers (e.g., the oil company or the drilling contractor). A separate contract is entered into simultaneously with the "local" subsidiary of the offshore service company to operate the vessel.

The members of our association are United States-owned companies who must compete with foreign-owned counterparts. Prior to the adoption of the Tax Reduction Act of 1975, United States tax was deferred with respect to shipping income (both charter income and operating income of foreign subsidiaries) of foreign affiliates. Those provisions permitted the United States-owned offshore service companies to compete with foreign-owned vessels and foreign-owned operators throughout the world because the tax burden on the foreign-owned companies and the American-owned companies was the same. I submit that without reinstituting the deferral of United States tax for this industry, United States-owned offshore service companies will no longer be able to compete abroad because of the increased burden.

This industry is extremely competitive and investment decisions will be responsive to the increased United States tax burden. Since only United States owners of foreign flag ships will be taxed it will be uneconomic for United States firms to own such vessels. Foreigners will be able to continue to operate their vessels and only pay current taxes to the local country in which the operations are conducted. Consequently, the foreigners will be able to realize a greater after-tax profit on identical operations. Obviously, they can and would underbid the American-owned companies and would eventually become the owners and operators of all the vessels engaged in this industry. This change in ownership will benefit neither the United States Treasury nor American industry.

As generally understood, "foreign commerce" involves the transportation of persons and property between ports in different countries. This is not the function of the vessel-owning member companies of this Association. Normally, OMSA members transport men and materials only from a point onshore to a drilling rig or production platform located on the continental shelf of the same country. Occasionally, there will be transportation of materials and supplies to a location on the same geographic shelf which may be legally a part of the territory of an adjacent country. This is certainly not the type of "foreign commerce" at which the foreign base company shipping income provisions of the Tax Reduction Act of 1975 were directed.

In its statement issued on June 15, 1976, the Treasury Department did not oppose this amendment. However, in its statement issued on July 20, 1976, the Treasury opposed this amendment on the grounds that the income derived by offshore supply vessels is "traditional base company income." This is not true. Traditional base company income requires *two* elements:

(1) The corporation's business must be conducted outside the country of incorporation *and*

(2) Sales or purchases must be to or from *a related party* or services must be rendered for on or behalf of *a related party*.

The Treasury's opposition to this amendment is based solely on the first criterion. Their position is simply incorrect. A controlled foreign corporation which renders services (other than shipping) to unrelated parties outside its country of incorporation *does not have "Subpart F" income*. Such income is not "base company" income because there is no related party involved. The vessel-owning members of the Offshore Marine Service Association do not render services to related parties. Their services are rendered to oil companies and drilling contractors who are completely unrelated to the vessel-owning and operating companies, and, consequently, their income is not "traditional base company income."

Moreover, the Treasury Department has used an unfair and inaccurate example to buttress its position by claiming that:

"the exclusion would permit foreign supply vessels to service rigs located on the continental shelf of the U.S. without paying U.S. tax."

In the first place, supplying an offshore drilling rig on the U.S. continental shelf from a port in the United States is "coastwise trade" under the Jones Act, and, consequently, foreign flag vessels may not perform such services. Although it is theoretically possible for a foreign flag vessel to supply a location on the U.S. continental shelf from a foreign port, as a practical matter, such operations are unfeasible. To the best of my knowledge there are no continuous operations of this type. Thus, the Treasury Department is describing a factual situation which simply does not exist.

More importantly, even if a foreign flag vessel could supply offshore locations on the U.S. continental shelf, under current law only a United States shareholder of a foreign corporation owning the vessel would be taxed. The United States would not tax either the foreign corporation owning the vessel or a foreign shareholder of such a corporation. It is precisely this competitive disadvantage created by current law which would be corrected by this amendment. For the Treasury Department to cite this example in order to deny relief to United States owners of foreign corporations engaged in servicing offshore installations is completely misleading. Actually, the Treasury's example demonstrates that this amendment is necessary to allow American firms to compete with foreign-owned firms on an equal basis.

I respectfully submit that exempting the transportation of men and supplies from a point onshore to a point on the continental shelf or adjacent continental shelf from the definition of "foreign commerce" in the Subpart F shipping provisions is necessary to permit American-owned offshore service companies to continue to compete abroad. Normally, the foreign affiliates of our vessel-owning members render services only to unrelated persons and, therefore, are not subject to tax under the "foreign base company services income" provisions of Subpart F. Our operations are not tax exempt abroad. Therefore, our operations are not of the type at which any of the Subpart F provisions were directed. This amendment is necessary to allow American-owned firms to continue to participate in this vital industry which is of growing importance in connection with supplying the energy needs of the United States.

The CHAIRMAN. Let me just say this about your testimony. I would like to call attention to the Treasury witness in this room—the Treasury has waived their supposition on this matter, have they not?

Mr. MAYBERRY. Yes, sir.

The CHAIRMAN. It is my impression that what you are saying is correct and the Treasury knew it was correct and Treasury chickened out on you when someone raised a voice of protest.

Now it sounds to me as though you are right. I think the Treasury ought to study what you have to say. They apparently have reversed themselves. I think they ought to study what you have to say with regard to your reversal and consider your position.

Let me tell you good men of the Treasury, you do the best you can and so do we. We make mistakes, so does everyone and no one is perfect.

People should not be afraid to do what they think is right just because they have opposition. They ought to go ahead and recommend what they think is right, even though they might be misunderstood.

I would say that the Treasury, having taken an earlier position, ought to consider what has been said because it has been suggested they were not right in changing their position. I hope they will give us their honest judgment.

Mr. GOLDSTEIN. In our statement, Senator Long, you will find numerous provisions that are on the list—I will tell you tomorrow if we made a mistake and will change our position. I will also tell you what is right.

The CHAIRMAN. That is all I ask you to do and frankly I expect to change my mind about some things when I ask you for more information but all we can ask of anybody is their honest, best judgment.

I would hope that everybody has the courage to give us that because we are going to have difficulty doing a good job if people fail to do that. Are there any further questions of the witness?

Senator HASKELL. I would like to make an observation. It seemed to me, listening to you very briefly and not fully understanding the problem, this is a perfect example of where we ought to have an adversary hearing.

The CHAIRMAN. We have the adversaries right in the room.

Senator HASKELL. I do not see them.

The CHAIRMAN. Senator?

Senator HASKELL. I see a fellow at the back of the room.

The CHAIRMAN. I have been holding two adversaries waiting for a quorum, waiting for you to show up.

Senator HASKELL. Where are the adversaries today? Where is the fellow who has analyzed this and may take an opposite viewpoint? That is what I mean by an adversary hearing, Mr. Chairman.

The CHAIRMAN. I have been waiting for you to show up so that I can call him.

Senator HASKELL. I am not the adversary.

The CHAIRMAN. Senator if you had shown up at 8 you would have known the adversaries.

Senator HASKELL. You mean we have an adversary in this particular thing?

The CHAIRMAN. I hope so; I hope there is another side in addition to the Treasury, for example.

Senator HASKELL. If we are going to comment, how will we see the other side?

The CHAIRMAN. Are there any further questions of this witness?

Senator HASKELL. I am just making an observation.

The CHAIRMAN. Any further questions of this witness?

Senator HASKELL. No further questions.

The CHAIRMAN. Now I want to call Mr. Robert M. Brandon, director, Public Citizen Tax Reform Research Group, accompanied by Mr. William Pietz. Senator Haskell, I want you to know that these two gentlemen appeared here yesterday and objected to testifying because you were not here and so I said I would try to get them a better audience to hear them. [Laughter.] They wanted you to hear them and wanted a substantial number of people. I am happy to tell these gentlemen they have a quorum of the committee to hear their statement. Gentlemen, proceed.

Senator HATHAWAY. The Committee on Committees is meeting the same 3 days. I am a member of the Committee on Committees. We are considering a number of matters, including expanding the jurisdiction of the Finance Committee.

Part of the time between now and the end of the hearings, I will need to be there because we have some remarks—if I must be absent, just consider the fact I am over there defending the jurisdiction of this committee.

The CHAIRMAN. Senator, I will excuse you, if that is what you have in mind. [Laughter.]

I will represent you myself, if I have to. I want to tell you that if need be, we can stand even more members. I think we have a great committee. I think all points of view are represented on this committee, but you tell those people, if need be, we will take some more good people, even if we are limited only to liberal Senators to be added to the committee to see that everyone's point of view is represented on the committee.

Senator HANSEN. Before you leave that point, if the Senator from Wisconsin will yield, let me observe there are three of us on this side also on the Committee on Committees of which I am one, Senator Packwood, and Senator Brock.

I have been here since 8 o'clock this morning, just as has been Senator Packwood. I do not think Senator Brock has been there, but this is one of the real problems. It occurs because there has been such a proliferation of subcommittees in this Congress.

I think it is absolutely ridiculous. I believe there are 17-some such committees that deal with energy alone. I do not think there is any reason or rhyme to it at all but it is a fact.

Senator Fannin happens to be the ranking member on the Interior Committee and as Senator Haskell knows, a committee that has dealt with a great many energy problems and by virtue of that fact, he has been forced as have I, and Senator Haskell often has to be gone from this committee. It is a tough deal.

I hope that the chairman, in his great mercy and kindness will also excuse some others of us who are not able to be here when we would like very much to be here.

The CHAIRMAN. I hope you will stay around long enough to hear this witness.

Senator HANSEN. I am going to.

STATEMENT OF ROBERT M. BRANDON, DIRECTOR, PUBLIC CITIZEN TAX REFORM RESEARCH GROUP, ACCOMPANIED BY WILLIAM PIETZ

Mr. BRANDON. Thank you, Mr. Chairman. I appreciate the opportunity to be rescheduled. We are here to oppose some of these provisions. First, I would like to make a few comments on the process generally.

My name is Robert Brandon and I am director of the Public Citizen Tax Reform Research Group. With me is Mr. William Pietz, attorney. We have a full statement which we would like included in the record.

[The statement follows:]

STATEMENT OF ROBERT M. BRANDON AND WILLIAM PIETZ

Mr. Chairman and Members of the Committee: Ordinarily we would welcome an opportunity to appear before this Committee to testify on tax legislation. Today, this is not the case. We are not happy to be here. Our appearance is not an endorsement of these procedures nor should it be construed in any way to rehabilitate or legitimize the numerous ill-considered and secretive special relief provisions which are the subject of these hearings. We are here because we are concerned about the integrity of the tax legislative process, the tax system, and the public's loss of confidence in that system.

Let us say at the outset that these hearings can be a sham unless there is some procedural consequence flowing from them. We would call on the Committee, therefore, to consider in a subsequent mark-up session all the legislation under discussion as well as other legislation not fully considered by the Committee. Without a procedure for the Committee to reconsider after full discussion and full disclosure of all the facts relating to this legislation and other parts of the Committee's tax reform bill, hese hearings become a meaningless *ex-post facto* exercise concerning legislation already approved.

Secondly, even if the Committee re-convenes to consider these and other provisions, these hearings will be of limited use in that process. The burden should not be on public witnesses such as ourselves to evaluate a series of narrow interest amendments where there has been far less than full disclosure of the effects of that legislation or who its beneficiaries are. We should be testifying today not on a list of bill sections but on specific provisions fully disclosed and explained by the staff. Our analysis should be based on public facts about these bills, not on what we can ascertain about them in spite of the lack of public information or obscure references in the bill or its report. Indeed, these hearings are a consequence of some groups digging out information on these provisions that the Committee refused to reveal or chose not to reveal in its Report. It is a dangerous and ludicrous process that produces public laws that the public does not know about—tax laws that benefit narrow classes of taxpayers known only to the beneficiaries of those laws, a select group of staff, and indeed, only some members of the Committee and fewer members of the Congress that passes them. In fact, without a public disclosure of all the relevant facts, it is difficult to see how the members of this Committee could evaluate the testimony they are about to receive on the more than eighty (80) technical provisions which are the subject of these hearings.

The fact that we can ultimately decipher the real effect of some of these tax provisions and have an opportunity to comment on them gives us little cause for cheer. It must give less to the other members of the taxpaying public who will also be affected in varying degrees by such legislation. How can a taxpayer or group learn enough about a narrow interest provision from a one sentence description in a Committee press release to formulate a position on it.

It is not enough to say, as the press release announcing these hearings said, that many of these provisions have been the subject of testimony. The hearings on H.R. 10612 drew a great deal of testimony on general tax reform or specific areas dealt with by the House-passed bill. A company or group of taxpayers might testify on a special measure for their own benefit, but it is impossible for members of the public to comment on legislation they do not know exists. Any such narrow interest legislation should be fully disclosed and explained beforehand so that testimony on both sides of the issue can be elicited. The burden should not be on the taxpaying public, but on the proponents of these bills, to fully explain the provision and to show why they should receive special treatment.

We do not oppose this type of legislation simply because it benefits narrow interest groups. We oppose the secretive process by which these provisions were written. In fact, under the full disclosure procedures recently adopted by the House Ways and Means Committee, we opposed only six of thirty bills subject to full public hearings in December. All twenty-four of the "non-objectionable" provisions were approved while four of the six others were rejected by the Committee. Nor do we oppose this type of legislation because it involves revenue loss to the Treasury. We want to ensure only that the lost revenue is money well spent—achieving proper and well thought-out policy goals or achieving equity among taxpayers.

The Chairman of this Committee has taken the somewhat cynical view that tax reform is whatever fifty-one Senators will vote for. We don't agree with that. But more importantly, it cannot continue to be what one lobbyist can convince one member of this Committee to vote for. The process must be changed.

THE PROCESS

The major problem with these special relief measures is the lack of an explanation of what the legislation really does, who it benefits, and what its costs are. The public can only conclude from such non-disclosure that the proponents of such a bill have something to hide. Meritorious legislation should be able to withstand scrutiny in the light of day and not depend upon confusion, ignorance or improper influence to pass. Full disclosure would remove the cloud of secrecy from narrow interest legislation as well as guard against unworthy legislation.

Without full disclosure, campaign contributions from the beneficiaries of such special relief cast doubt on the motives of Congressional sponsors. As Appendix B indicates, there is a great deal of overlap between campaign contributions to members of this Committee and the beneficiaries of the tax legislation this Committee has approved. We are not listing these contributions to necessarily imply any improprieties. The public can judge whether these provisions represent proper constituent services. If campaign finance reform is to mean anything it must require disclosure at both ends so constituents can fully evaluate the performance of their representatives.

The lack of full-disclosure of the purposes and effects of these provisions also often leads to a lack of any real debate or serious deliberation on them. With only the beneficiaries of a bill, a few staff, and one or two members of the Committee fully understanding the effects of legislation being considered, non-meritorious legislation is routinely approved.

Similar problems exist with the deliberations over a number of general interest provisions involving major policy questions. For instance, the Committee adopted after about thirty minutes discussion, a multi-billion dollar tuition tax credit. There were no hearings on this provision; there were no materials prepared by the staff discussing the effects of this provision on post-secondary education; there was no input from HEW, colleges and universities, education groups, or other committees in Congress knowledgeable in the area. In fact, there is no evidence that this multi-billion dollar program will send one more student to college. The only thing that is certain is that it will provide several billion dolars of tax relief for those who happen to send their children to college. Even if this provision were worthwhile, no one could possibly know that based on the deliberations of this Committee. Such processes do little to enhance the image of the Congress.

Similarly, the Committee enacted a billion dollar reduction in capital gains taxes. Senator Bentsen held some hearings on this provision a few years ago and proposed such a change to stimulate a slumping stock market. It is unclear what this provision will accomplish in 1977 when it would become effective.

Other major policy decisions involving hundreds of millions of dollars of new tax subsidy programs were made with little staff analysis, no real input from the public or other interested and knowledgeable groups, and in an atmosphere of confusion that often kept the press, the public and members of the Committee from participating fully. One of the most outrageous examples of this is the refusal of this Committee to make available to Senators or the public the "quasi-bill report" describing the Committee amendments, even though many are supposed to be the subject of comment at this hearing.

The first casualty of such a process is sound tax policy. Equally important is the loss of public confidence in a system that provides special tax relief for a select unnamed few. Finally, a wide range of legitimate tax problems can't be addressed because they become labelled as a part of this defective process.

If sensible procedures were established the Committee could guard against poor tax policy, pass needed reforms, and provide a method for legitimate narrow interest tax problems to be addressed.

PROPOSED REFORMS

Anyone who sat through the Finance Committee's recent mark-up is aware that many general reforms are needed in the process by which the Committee considers tax legislation. It is not our purpose today to focus on these general reforms. Clearly, changes need to be made. These include an agency with more notice for members on subjects under discussion, staff pamphlets with background information and proposed changes (including changes to be proposed by other members), the position of the Department of Treasury should be solicited and made public, a larger room to provide more access by personal staff to members and more access for the public to the mark-up sessions, a microphone system that allows everyone to know what is being said, voted upon, etc.

SPECIFIC PROPOSALS FOR CONSIDERING NARROW INTEREST LEGISLATION

Narrow interest legislation falls into several broad categories. First, there are technical changes in the law designed to correct an unintended and unanticipated result on a class of taxpayer. In this case legislation may be a proper remedy but the Congress must guard against technical changes in the law designed to reverse intended changes in the law. It is no accident that one year after reforms were passed in the area of shipping "tax haven" income and the foreign tax credit that a number of "transitional or permanent" provisions have been approved to make those reforms inapplicable to certain taxpayers. This is not a proper function of narrow interest legislation.

A second area involves legislation which reverses current administrative interpretation of the law. The Congress, of course, has the prerogative to overrule the IRS through legislation but must be very careful not to interfere with the fair and proper administration of the tax laws. It is also bad policy to change the rules that all taxpayers live under retroactively for the benefit of specific taxpayers.

A third area of narrow interest legislation might involve broad policy questions that involve narrow classes of taxpayers. The Congress must be very careful in these situations nor to compound the complexities and inequities of the current law by making distinctions for such taxpayers without strong policy reasons after all the facts and circumstances are known.

Many of these provisions, whatever form they take, are private relief bills. They should be treated as other private relief bills with the names of the beneficiaries disclosed. But there is a broader question involving these bills that the Committee should address.

In many respects, when this Committee considers legislation of this type it is really functioning in a judicial capacity; sitting as a court of tax equity. The Committee may want to think in the longer run about legislation to establish some sort of taxpayers' court of equity. Presently, only certain taxpayers with meritorious claims have the wherewithal, the connections or the influence to come to this Committee and have their claims considered. The merits of their claims have been less important than the financial resources to hire tax attorneys or lobbyists with Washington connections or the access to Committee members. We would suggest that Congress think about some kind of legislation that will allow all taxpayers, whether they have the financial resources to get to Washington or not, to have an opportunity to have the equities of their case adjudicated.

Specifically, we would recommend the following procedural reforms in considering narrow interest legislation:

1. Establishment of a subcommittee to screen narrow interest legislation brought to the Committee's attention. This first step would be designed to weed out obviously non-meritorious provisions or general policy issues properly the subject of general tax legislation.
2. The Treasury Department, the IRS and any other affected agency should prepare bill reports to accompany these provisions.
3. Staff pamphlets providing full disclosure of all relevant facts about each provision including beneficiaries and lobbyists, rationale for the provision, staff analysis, Treasury and IRS positions, and revenue effect.
4. Full public hearings conducted after the dissemination of the descriptive pamphlets and after sufficient time to evaluate the provisions. If the proponents of a provision are unwilling to testify on behalf of that provision at these hearings, the provision should be automatically dropped.

5. These bills should not be reported out as part of omnibus tax legislation, but rather should be reported separately as miscellaneous bills accompanied by full Committee reports.

CONCLUSION

In light of the foregoing, we would ask the Committee to split off from H.R. 10612 all these miscellaneous provisions and Committee amendments that by the Committee's own admission have received inadequate deliberation. Ironically, the only provisions listed in the notice of hearings are those which have already been uncovered and publicly criticized by parties other than the Committee. Yet we know there are several other narrow interest provisions in the bill.

Other provisions in the bill have had equally insufficient treatment. The Committee should not force the full Senate to vote on provisions that have not been fully considered. We would suggest instead that the Senate proceed on the major elements of H.R. 10612 and set aside these other provisions for consideration in this session under procedures consistent with our proposals.

COMMENTS ON SOME SPECIFIC PROVISIONS

The following comments are on some specific provisions mentioned in the Committee's press release. These comments and, therefore, our position are based on the sometimes limited information available on each provision.

SOME OBJECTIONABLE SECTIONS AND BRIEF ANALYSIS

Sections 802 and 803—*Refundability and extension of Investment Tax Credits.* Half of all utilities are already off the tax roles. The committee has not considered whether refund will be subtracted from the "hypothetical taxes paid" used in the utility rate base which would further compound the problem of customer overcharging. Encourages over-investment by airlines. Negative income tax for corporations.

Section 806—*Investment Tax Credit on ships.* Also eligible for tax free construction funds—See Appendix A.

Section 1021—*Investment in U.S. Property*—two separate retroactive changes to excuse any tax now owing. Benefits Superior Oil which invested in U.S. continental shelf drilling rigs and Pyramid Ventures which invested in U.S. stock market. Each claims not to have known this was a repatriation. Unfairly discriminates against others—who knew the law and paid the tax.

Section 1024—*Narrowing definition of shipping ("tax haven") income* to exclude, for several companies, the carrying of supplies from a country (Nigeria) to a drilling rig on its continental shelf. This might have been defensible had there been added the requirement that the carrier pay taxes in that country. But it is (in fact purposely broad) enough to cover companies chartered in Panama, Liberia or other tax haven countries.

Section 1024—*Narrowing definition of shipping ("tax haven") income* to exclude a Panamanian shipping company which charters ships to a related scrap dealer, Southern Scrap Co., of Louisiana, on other than a long term charter basis. There is no reason why such a shipping company should escape taxes even though they claim to have foreign competition. Ironically, the amendment was drawn so narrowly (to disqualify all other taxpayers) that it inadvertently disqualifies the intended beneficiary.

Section 1025—*Exclusion of agricultural products grown and sold outside the U.S. from U.S. taxation.* May perhaps give such goods a competitive advantage over goods grown in the U.S. and exported. Some tax experts are concerned that this will serve as a precedent for extending tax free treatment to sales of every other imaginable category of goods—any of which may presently be subject to the tax haven rules (as "foreign base company sales income.") This could significantly undermine present tax haven rules.

Section 1031—*Three year exclusion for mining and Puerto Rican operations from repeal of per country foreign tax credit methods for Freeport Minerals and Pittsburg Plate Glass Co.* Such exclusions have no valid rationale and reduce the erstwhile revenue impact of repeal ($50 million) so that it will be only $25 to $40 million.

Section 1031—*Special Carryback of denied excess 1978 foreign tax credits of oil companies.* An unjustified partial repeal of the 1975 reform (for Natomas Corp.) which will deny credits in excess of 50% of income. Designed narrowly to benefit a few companies who won't have large credits prior to 1978.

Section 1032—*Sun Oil Exclusion from Recapture of Foreign Losses.* The recapture rules enacted in 1975 are fair rules designed to prevent "having one's cake and eating it too." See attached write-up. Sun Oil found it economically desirable to contract to drill in the North Sea and it seems unlikely that this decision was made in reliance on the continuation of an overly generous tax law with respect to foreign losses.

Section 1035—*Expansion of "Oil Related Income" definition to include interest income.* See attached write-up. Gives multinational oil companies additional ways to use the extra 2 percentage points above 48 percent which the Hartke-Nelson et al. amendment would abolish.

Section 1035—*Narrowing of "Oil Related Income"* definition *to suit I.U. International.* See attached write-up. Seems to take income (income from transportation or distribution of gas by a utility) which would naturally be oil related income and classify it (perhaps illogically) as *non*-oil related income. This opportunistic definition contrasts with the preceding amendment and the Tenneco amendment which follows below.

Section 1035—*Expansion (Clarification) of "Oil Related Income" definition to include sale of stock.* This provision may be technically defensible as a mere clarification of existing law which expressly includes sale of assets. But contrasts with preceding amendment. It could apparently cover expropriations and this might have unexpectedly large revenue cost.

Section 1035—*Mobil-Iranian amendments*—This provision unjustifiably makes the 1975 reform (so recently agreed to by Congress) applicable only to newcomers having no economic interest on March 29, 1975 at estimated cost of $40 million yearly for at least 10 years. This estimate may prove very low if other countries expropriate properties thus depriving more companies of an "economic interest". Will make possible the labeling of royalties as taxes.

Section 1035—*Indonesian-Production sharing* unjustifiably overrules April 1976 IRS ruling. See attached write-up. The IRS ruling was believed to have been well-founded by many tax specialists. This amendment could have enormous revenue cost if it discourages the IRS from making similar rulings in other countries.

Section 1041—*Non-taxation of interest earned by foreigners on bonds and bank accounts.* On the House floor the non-taxation of *bond* interest and dividends was defeated. The Finance Committee also declined to make dividends tax free. See Appendix A.

Section 1042—*H. H. Robertson*—This provision reverses an IRS position upheld by the courts. It is strongly opposed by the Treasury staff, who were not consulted during mark-up. See Appendix A.

Section 1052—*Hanna Mining Co.*—Under present law a company computing its foreign tax credit on the overall method can't consolidate a Western Hemisphere Trade Corporation subsidiary with other subsidiaries. WHTC's are taxed at only 34 percent instead of 48 percent—which rate advantage is phased out by 1980 under the bill. (Companies using the per country method can consolidate but the committee bill repeals this method.) The existing non-consolidation rule was designed to prevent tax avoidance that will result from mixing income tax at 34 percent with income taxes at 48 percent when computing the credit. (If a foreign country levies a tax at $45 on WHTC income of $100 and the U.S. taxes it at 34 percent there will be excess credits of $11 available to shelter other income.) In any case the amendment is discriminatory in its narrow tailoring.

Section 1305—*Expensing of Pre-Publication Costs*—Overrules an apparently logical IRS ruling requiring the capitalization of large research and development costs incurred in publishing encyclopedias and text books over the life of that particular edition. The staff has estimated no revenue loss for this provision on the theory that the IRS ruling has not been enforced to date and its overruling produces no change. In fact, this provision will cost the Treasury several hundred million dollars, largely to Encyclopedia Britannica, otherwise collectable under the legal ruling.

Section 1307—*IDS Face Amount Certificates.* See Appendix A.

Section 1308—*Alabama Coca-Cola Franchise*—See Appendix A. Personal holding company rules apply a 70 percent penalty tax to closely held corporations (which are taxable at 48 percent) which earn passive types of income and pay no dividends to shareholders (who might be taxable at 70 percent). Royalties are regarded as "more passive" than rents. This amendment alters a logical 1971 IRS ruling that payments for a license to a secret process are royalties rather than rents. The amendment calls them rents. Lobbists argued that the corporation only held the license (and thus received the royalties) to protect the perpetual life of the license and not for tax avoidance. But if this were so it can avoid the holding company tax by paying out its profits as dividends.

Section 1311—*Texas Optical Co.*—See Appendix A. The 1969 Reform Act which repealed favorable capital gains treatment contained no exceptions for later sales under contracts binding in 1969. Such an exception may have been warranted and perhaps even a retroactive enactment of one six years later is defensible. But the draftsmen have seemingly bent over backwards to help one party by providing that the contract in existence in 1969 need not have been "binding: and that the rule (intended to cover a professional practice) also cover transfer of a related business. The rule narrowly excludes other taxpayers, who may have paid their tax without petitioning Congress.

Section 1312—*Reporting of Tip Income*—See Appendix A. Employers have always been required to report to the IRS the amounts of tips reported to them by the employee. It is not at all clear why employees cannot keep a running total of their charge account tips and report them to the employer just as they do on other tips. Failure to report tips is a frequent abuse which is hard to police.

Section 1322—*Contributions to Capital of Water Utilities.* The illogic of not treating these non-refundable payments by customers as income is revealed by the fact that the committee decided not to apply this same treatment to gas and phone utilities because it would then cost $100 million per year.

Section 1508—*Consolidation of casualty insurance losses against income from life or health insurance.* Such consolidation has never been permitted because (roughly speaking) only one half of life insurance income is subject to tax. (This is a special preference enjoyed because—arguably—taxable income may be overstated due to underestimation of future claims.) The amendment partially deals with this by allowing offset of only one half of the casualty losses but they can continually be carried over to future years.

Prudential, Metropolitan, and perhaps other large insurers have recently entered the casualty business and the Treasury will in effect subsidize their start-up losses and perhaps enable them to undercut smaller companies who have no other business against which to use casualty losses. Numerous casualty companies, e.g. Kemper, thus oppose this. Since it doesn't take effect until 1978 it is not urgent and should be preceded by a comprehensive study of insurance taxation.

Sections 1701 and 1702—*Railroad tax preferences*—Very few railroads pay any income taxes. Additional preferences will be used by some conglomerate holding companies to shelter income from other businesses. At a minimum, any new preferences would not be deductible against nonrailroad income—even if the committee believes that railroads need a subsidy and should therefore be allowed to depart from normal accounting rules in writing off rail and ties etc. The amortization of grading and tunnel bores undercuts the compromise worked out in the 1969 Reform Act. Until 1969 such costs were not deductible at all. It was then decided to allow such write-offs on post-1969 investments as an incentive. Now allowing write-offs on all pre-1969 investments is a giveaway which can have no incentive effect.

Partially Inclusive List of Some Sections Which Might Be Unobjectionable (Judged Solely Upon Inadequate Information Available to Date)

Section 1013 p. 215—Effective date on foreign trusts advanced a week.
Section 1023 p. 229—American International Group, Inc. Bermuda insurance earnings.
Section 1024 p. 230—Hall Corporation Shipping Ltd.
Section 1032 p. 240—Boise Cascade.
Section 1032 p. 240—Robert Hall.
Section 1035 p. 250—Section 907 limit on individuals.
Section 1036 p. 257—American International Group, Inc.—Reclassifying certain insurance income as foreign income.
Section 1043 p. 271—Contiguous Country Branches.
Section 1044 p. 276—Royal Bank of Canada.
Section 1304 p. 401—Political debts.
Section 1317 p. 424—Depletion amendments.
Section 1320 p. 431—Simultaneous liquidations.
Section 1321 p. 433—Local Taxation of Barges Prohibited.
Section 1509 p. 457—BMA—Inadvertent distribution.

Appendix A

The following pages contain a description of the amendments referred to in the preceding analysis together with names of beneficiaries where known.

Refundable Investment credit (sec. 802; pg. 177 of report). Primarily for airlines, such as United Airlines and utilities. Starting in 1984 companies will receive a check from the treasury in the amount of any post 1975 investment credits which go unused because future taxable income is too low. Cost in 1984: $300–500 million.

(Refunds don't start until 1984 because taxpayers must exhaust their existing right to carry forward unused credits for 7 years to offset taxable income in those years.) Overinvestment in aircraft has yielded excess accelerated depreciation and investment credits.

2-Year Extension of Existing Carryover Periods for Expiring Investment Credit and Foreign Tax Credits—(sec. 803; p. 178 of report) sought by airlines, such as United Airlines and Chrysler. Airlines sought to extend their ability to keep alive old (pre 1976) unused investment credits which can already be carried forward at least 7 years and often 10 years. They have been seeking to make these old credits refundable (just as post 1975 credits will be) and this gives them two more years in which to lobby. The committee later applied this to *foreign* tax credits apparently to benefit Chrysler. Cost: $14 million in FY 1977 and $30 million in FY 1978.

Allowing the Investment Tax Credit on Maritime Capital Construction Funds (sec. 806, p. 196 of report).

EXPLANATION OF THE AMENDMENT

A Finance Committee Amendment to the House Tax Reform Bill allows shipbuilders to take the 10% investment tax credit for money spent to build ships in the United States, even though the construction is financed with previously untaxed profits deposited in so-called "capital construction funds" (CCFs).

These CCFs are special accounts created by the Merchant Marine Act of 1970 to provide tax benefits to shipbuilders. Shipping earnings may be deposited tax free in these accounts and used to build additional vessels. The interest and dividends earned on fund deposits and all additional vessel earnings may also be redeposited, tax free, in these funds. This money is untaxed until it is withdrawn for non-shipping purposes.

The Finance Committee Report explains that "when these funds are used to finance ship construction, there is no tax cost, or basis" in order "to prevent a double allowance for these tax-deferred amounts." Because there is no tax cost, or "basis," sums expended out of these privileged accounts have not resulted in an investment tax credit or depreciation allowances. Not surprisingly, the shipping industry and its supporters have argued that the investment credit should be applied to these expenditures, but the IRS has resisted their efforts.

ANALYSIS

The Treasury Department strongly opposed this change in testimony before the Ways and Means Committee and under the present bill for four reasons—1) it is a dangerous attack on basic tax principles; 2) CCFs already provide a major tax break; 3) the extension of the direct subsidy program would be more efficient; and 4) there is no need for the subsidy and the revenue loss could be significant. Other testimony showed that the subsidy is wasteful and its chief beneficiaries may be oil companies, banks and steel companies.

THE PROVISION DOES VIOLENCE TO BASIC TAX PRINCIPLES

Basis. The Treasury Department was particularly concerned with the implications of "breaking the connection between 'basis' and other provisions of the law." As Assistant Treasury Secretary Walker explained: "The concept of 'basis' is central to the code. Once a taxpayer has freely disposable money or property which becomes freely disposable because he has paid the appropriate taxes in acquiring it, he gets at tax cost basis in any property the acquires with it."

Property acquired with money from already tax-free profits has no basis. The investment credit and depreciation allowances are predicated on the existence of a tax basis. Granting tax-free profits and then an investment credit for expenditures out of those untaxed profits provides an enormous double dip for one selective industry. If investors in shipbuilding are granted an investment tax credit in the absence of a legitimate tax basis, there is no persuasive argument against giving them depreciation without basis, or extending this benefit to other subsidized industries. The revenue implications would be phenomenal.

Income. This amendment violates the basic principle that a receipt is not to be recognized for tax purposes until it has first been taken into income. Persons and corporations who pay no tax should not get the benefits accorded to those who do.

Auditing. The existence of two different tax bases—one for depreciation purposes and the other for investment credit purposes—will significantly complicate an already difficult audit job for the IRS.

CCFS ALREADY PROVIDE A MAJOR TAX BREAK

Treasury testimony showed that the net tax benefit already provided by CCFs is equal to an investment tax credit of 17 percent.

THE WRONG CORPORATIONS WILL BENEFIT

Oil Companies. Seventeen oil companies have CCFs. They receive a tax break for building ships to transport Alaskan oil. However, this shipping is subject to the cabotage laws, so there is no foreign competition and the United States gets no benefit from this tax gift.

Banks. By building ships and *leasing* them to commercial shippers, banks are able to use these CCFs to shelter income completely unrelated to shipping.

Steel Companies. Ten steel companies have CCFs. They save tax dollars while building ships for the movement of ore on the Great Lakes. As with Alaskan oil, this ship construction is free from foreign competition by law, so the tax subsidy does not result in additional U.S. shipbuilding.

THE SUBSIDY SHOULD BE DIRECT

The best method of arriving at the proper level of subsidy and controlling who receives it is through the appropriation process, rather than the back-door technique of a "tax expenditure". Over half-a-billion dollars is already provided to the shipping industry this way under the Merchant Marine Act.

THERE WILL BE A SERIOUS REVENUE LOSS

The Senate Finance Committee estimates that in fiscal 1977 the amendment will cost $21 million and that by 1981 the annual cost will be $45 million. The projections of the Shipbuilders Council of America suggest an annual revenue loss of $75 million. Some analysts project that the incentive effects of the change could lead to revenue losses in excess of $100 million annually.

SHIPBUILDING DOES NOT NEED AN ADDITIONAL SUBSIDY

In addition to CCF's, shipbuilders are given $600 million in operating-differential and construction-differential subsidies under the Merchant Marine Act. They also receive loan guarantees of over $4 billion.

Private shipyard employment has increased every year since 1971 and as of the beginning of 1975 there was a *$4.2 billion backlog* of commercial ship construction contracts with U.S. yards.

Piggybacking the investment credit on CCFs gives shipbuilding an effective tax credit of 27 percent. There is no good reason to add this large subsidy.

A 1-Week Change in the Effective Date of the New Grantor Trust Rule (Sec. 1013, p. 215 of the Report)

People presently put their investments in foreign trusts because such trusts do not pay any United States income taxes. The bill would remedy this by taxing the grantor on the income of the trust. The effective date of the House bill is May 21, 1974, in order to catch eleventh hour tax avoiders who rushed to set up such trusts once they heard that the House Ways and Means Committee was considering this provision. The Senate Committee changed the effective date to May 29, 1974, purportedly because the wire services delayed reporting the House action for a week. It is not clear who is trying to beat the effective date with this amendment but apparently it is a client of John Hall, a California tax attorney.

Investments in U.S. Property (Sec. 1021; p. 225 of Report)

Under present law when a U.S. corporation reinvests the earnings of a foreign subsidiary in property located in the U.S. this is considered a repatriation of foreign earnings and triggers the U.S. corporate income tax. The bill redefines what will be considered investment in U.S. property to eliminate some hardships.

However, the bill contains a special retroactive exception for Superior Oil Co. Superior accidentally invested foreign earnings in a drilling rig on the U.S. continental shelf without being aware that in 1969 Congress defined U.S. investment as including the continental shelf.

There is another special exception to the definition designate to exclude Pyramid Ventures Corp. of Louisiana.

It is known that Pyramid Ventures Corp. invested in the U.S. stock market in 1975 without realizing that this triggered a tax. They still have not paid the tax. The bill's new definition of repatriation would result in such an investment (in stock of a party not related to the U.S. parent) not being considered a repatriation. The new definition has been made retroactive to 1975 to help this corporation.

Excluding Certain Insurance Earnings From the Rules Which Subject Tax-Haven Earnings of Foreign Operations to U.S. Tax (Sec. 1023; p. 229 of Report)

The American International Group Inc., a U.S. insurance corporation sought this exclusion for its Bermuda operation. Cost: $11 million in FY 1977; $10 million yearly thereafter.

The excluded earning are those which must be set aside and reinvested to meet capital and legal reserve requirements *as if* (hypothetically) the more stringent U.S. requirements applied in the foreign country.

Four Exclusions of Certain Shipping Profits From Rules Which Subject Tax Haven Earnings of Foreign Operations to U.S. Tax (Sec. 1024; p. 230)

Consists of technical amendments narrowing only slightly the definition of shipping income. (Shipping income is ineligible for deferral of tax on foreign earnings—unless promptly reinvested in shipping operations—because shipping income can be easily manipulated into tax haven countries.)

The first exception to the tax haven rules for foreign subsidiaries would be provided for income from shipping between two or more points within the country in which a foreign shipping subsidiary is incorporated (and in which the ship is registered). In addition, if a company has virtually all of its assets in foreign shipping operations, repayments of unsecured loans would be treated as reinvestment in shipping operations for purposes of the tax haven rules in the same manner as is treated the repayment of secured loans. (Fourth exception listed in the Report.) Both of these rules are for Hall Corporation Shipping Ltd. owned by Frank A. Augsbury Jr. and family.

The second exception listed in the Report is for two unidentified small corporations from Louisiana and Texas that have set up their oil rig servicing vessels under the Panamanian flag to avoid taxation. The 1975 Tax Reduction Act would generally tax such operations so these companies have sought a special exclusion.

The third listed exception in the Report (p. 232) is for a Louisiana scrap company (Diefenthal) which ships scrap to Japan and whose operations use a Panamanian charter to avoid U.S. taxes. It would narrow the definition of shipping (tax haven) income by excluding someone who owns no vessel and doesn't manufacture, grow or mine any commodity—which neatly excludes a scrap dealer.

Exclusion of Sales of Certain Agricultural Products Grown Outside the U.S. From the Rules Subjecting Tax Haven Income to U.S. Tax (Sec. 1025; p. 232 of Report)

Under present law foreign tax haven income is ineligible for deferral and therefore is immediately subject to U.S. tax. Profits from sales of foreign grown farm products which are of a type also grown in the U.S. are subject to tax under the tax haven rules. This bill would exclude from tax all farm products grown outside the U.S. It thus may give such goods a competitive price advantage. Primarily benefits Cargill and apparently the other five major grain and commodity exporters: Continental, Bunge, Cook, Garnac, Louis Dreyfus. Cost: $7 million in FY 1977; $15 million in each future year.

Three Year Transitional Exclusion of Certain Mining Companies and Puerto Rican Operations From This Bill's Repeal of the Per Country Method of Computing the Foreign Tax Credit (Sec. 1031(c)(2); p. 238 of Report)

Benefits among others, the Freeport Sulphur Co., and would cost the Treasury between $10 million and $25 million of the anticipated $50 million a year expected to come from the repeal. Would permit use of the per country limitation for three more years provided that: 80% of a company's foreign operations involved mining of hard minerals; there is a commitment to expand these operations; and the activities are carried out through a separate corporation which has been in existence for at least five years and has been operated at a loss for at least two years.

A similar three-year postponement was accorded Puerto Rican operations, apparently at the request of PPG Industries, Inc. (Pittsburgh Plate Glass).

Exception to Foreign Loss Recapture Rules of the Senate Bill for Some of Boise Cascade Corporation's Chilean Losses (Sec. 1032(c)(2); p. 284 of Report)

After 1975 the bill will curb the the advantages of deducting foreign start-up losses against U.S. income and then paying no U.S. tax on subsequent profitable foreign operations (due to the foreign tax credit). But it doesn't apply to losses from the future disposition of securities which were received before 1975 if they were received as compensation for an expropriation of property.

"The second exception" on p. 240 is designed for the Robert Hall Co. (the apparel retailer), and allows escape from recapture where the loss (although incurred after this bill's effective date) is from stock, indebtedness, or guarantees of a corporation in which the taxpayer owned at least 10% of the voting stock, if it has had losses in three of the last five years.

Special Carryback of Excess Foreign Tax Credits of Oil Companies (Sec. 1035(a); p. 246 of Report)

Amounts not allowed as foreign tax credits on foreign oil extraction income in 1978 and later years (because of the Tax Reduction Act of 1975) could be carried back (to taxable years ending in 1975 to 1977 only). The 1975 Act generally provides that oil company credits in excess of 50% of taxable income are not usable. A floor amendment proposed by Nelson, Hartke et al. would reduce this 50% limit to 48%.

Designed to benefit Natomas Corp. Cost: $8 million in FY 1977; $10 million in FY 1978.

Special Transitional Exclusion From the Recapture of Foreign Oil Related Losses (Sec. 1035(b); p. 247 of Report)

Existing law (enacted in 1975) curbs the practice of using foreign drilling losses to reduce U.S. taxable income and then paying no U.S. taxable income and then paying no U.S. taxes when operations become profitable (due to the foreign tax credit). Such losses are later "recaptured" by reducing the amount of foreign taxes allowed to offset U.S. tax on subsequent profits.

The committee approved a transition rule on foreign losses to aid the Sun Oil Co., presumably in its North Sea operations. The provision applies to losses incurred before July 1, 1979, under binding contracts entered into prior to July 1, 1974. The amount of the loss which could be recaptured in any year would be limited to 15% of the loss in each of the first four years in which oil-related income is earned. The remaining loss would be recaptured in the fifth year. Cost: $21 million in FY 1977; $6 million in FY 1978. Recouped in later years.

Expansion of the Definition of Oil Related Income (Against Which Foreign Tax Credits From Oil Extraction Operations Can Be Offset) by Including Certain Interest Income (Sec. 1035(c); p. 248 of Report)

Benefits most of the major oil companies. Most majors have branches which are organized as U.S. corporations but earned all of their income abroad. These branches are capitalized with both debt and equity; thus they pay dividends and interest to their parent company. The amendment provides that interest received from a domestic corporation which earned less than 20% of its income in the U.S. will qualify as "Oil Related Income". Foreign tax credits from extraction operations can only be offset against oil related income under present law (Tax Reduction Act of 1975).

Dividends already are included, as are both interest and dividends from *foreign chartered* corporations. There is no strong logic that dictates either exclusion or inclusion but inclusion will cost the Treasury $40 million in FY 1977 and $90 million yearly after that.

Moreover, inclusion simply gives oil companies another way to use their credits for foreign "taxes" in excess of 48% of extraction income, many of which "taxes" are actually royalties.

Special Definition of Oil Related Income To Exclude Income From Transportation or Distribution of Natural Gas by a Regulated Public Utility Which Meets Stock of a Foreign Corporation (Sec. 1035(c) (2) (b); p. 250 of Report)

Amendment benefits I.U. International Corporation, a Philadelphia based conglomerate. Under the 1975 Tax Reduction Act oil related income cannot be consolidated with non-oil income. I.U. International evidently desires to consolidate certain gas utility income with its non-oil income to use some foreign tax credits on such income. Cost: $5 million.

Clarification of Definition of Oil Related Income (Against Which Oil Extraction Foreign Tax Credits Can Be Offset) To Include Gain on Sale of Common Stock of a Foreign Corporation (Sec. 1035(c) (2) (B); p. 250 of Report)

Amendment is designed to benefit Tenneco on its liquidation of a Canadian subsidiary. The law already allows this favorable treatment on the sale of *assets*. Cost: less than $5 million annually.

Partial Repeal of 1975 Tax Reduction Act To Allow Mobil and Other Oil Companies to Iran to Claim Foreign Tax Credits Even Though They Have No "Economic Interest" in Properties After Expropriation (Sec. 1035(e); p. 251 of Report)

Amendment was sought by Mobil Oil Corporation. The 1975 Tax Reduction Act denies foreign tax credits when oil companies no longer own an "economic interest" in the wells (i.e. they own no mineral rights after expropriation) and they buy their crude oil from the host country at other than market prices. This prevents the disguising of part of the purchase price as a foreign tax.

Mobil hopes to quietly repeal the 1975 Act wherever a company had owned an interest on March 29, 1975. The 1975 Act thus would only apply to newcomers. Cost: $40 million yearly for at least 10 years.

Overruling of Recent (April, 1976) IRS Ruling Which Had Denied Foreign Tax Credits on Production Sharing Contracts in Indonesia (Sec. 1035(f); p. 253 of Report)

Amendment sought by Natomas Corporation and others who operate in two Indonesian consortiums. (Natomas also received another special interest amendment allowing Carryback of Excess Credits disallowed by the 1975 Tax Reduction Act.)

It is increasingly common for a corporation wholly owned by the host country to own all oil reserves, while the U.S. oil company acts as a service contractor and receives a share of the oil production as its compensation. The government-owned corporation pays over some of the oil revenues to the government and this is arbitrarily labelled an indirect payment of income taxes on behalf of the U.S. owned oil company.

The IRS denied the foreign tax credit in part because the foreign country already owns all the oil and thus there is really no payment by the contractor to the government and in any event, any such payment would be a royalty.

Amendment will overrule the IRS ruling for 5 years as to contracts entered into by April 8, 1976. To restrict benefits to small companies the benefits will be unavailable to the extent a company has excess credits available from other countries. Cost: $25 million yearly for five years.

Exclusion From Taxation of Interest Earned by Foreigners on U.S. Bank Accounts and Bonds (Sec. 1041; p. 258 of Report)

Amendment sought by Laredo National Bank (Texas), which holds large Mexican deposits, and many other banks.

The only U.S. tax that foreigners now pay on dividends or interest they make from investments in this country is a 30% withholding tax. (This is lowered by bilateral treaty with some countries.) H.R. 10612 would repeal this 30% tax supposedly to encourage more investment in U.S. corporations, bonds, and bank deposits.

Foreign investors who pay taxes on such interest in their country of residence receive a credit against their domestic tax to avoid double taxation. They would either pay the U.S. tax or the tax in their own country. Repeal of the U.S. tax thus amounts to "revenue sharing" with foreign treasuries. Therefore, the major benefactor of this provision will be foreign governments and foreigners who pay little or no tax to their home country and who will now pay no tax to the U.S. either.

Repealing the tax would create an unwarranted windfall for such investors, as well as treating them more generously than U.S. citizens who make the same investments, but who are required to pay regular U.S. taxes. Moreover, the U.S. has long encouraged other nations to maintain the integrity of their revenue base and has criticized nations which create tax havens to attract capital.

This tax holiday provision is costly because it will apply to all investors who already invest in the U.S. for non-tax reasons.

It is questionable how much new investment will be created or whether huge investment by foreigners in U.S. industry is in the national interest. Many countries (particularly the newly-enriched OPEC nations), have strict limits on the amount of capital they allow to be invested in other countries (fear of expropriation, outflows of capital, etc.). Because of OPEC hesitancy it appears that any capital inflows will come mostly from Western Europe. Of course, the banks and investment firms can only profit from whatever increase does result, but the Treasury will foot the bill. Even if bank profits are increased, the Treasury won't benefit much since banks pay taxes at an extremely low effective rate.

Technical Clarification of Rules for Determining the Source of Insurance Underwriting Income (Sec. 1036; p. 257 of Report)

Amendment is one of two special amendments sought by American International Group. At present insurance contracts negotiated in the U.S. covering overseas risks may be subject to foreign taxation, but classified as U.S. income under U.S. tax laws and therefore ineligible for the foreign tax credit. This amendment would classify such income as foreign income to prevent double taxation. Cost: less than $5 million annually.

Overruling Of Tax Court Decision (Affirmed by Court of Appeals) Which Had Required H. H. Robertson To Pay A Tax On A Liquidating Dividend (Sec. 1042; p. 270 of Report)

H. H. Robertson Co. liquidated a foreign subsidiary and as required by present law (Sec. 367) obtained an IRS ruling that it would pay ordinary income tax on its accumulated earnings and profits. Robertson miscalculated the tax owed because it had reduced its accumulated earnings by the fair market value of certain property it had earlier paid out as a dividend instead of by its cost basis. The courts held that its computation was clearly contrary to law.

The bill modifies the general requirement that an IRS ruling be obtained before a foreign liquidation. But it also includes a *retroactive* "special rule in the case of certain past liquidations: not withstanding that a refund would be barred by any court case." Cost: $2 million.

Contiguous Country Branches of Domestic Insurance Companies (sec. 1043, p. 271 of the report.)

Under present law a domestic mutual life insurance company pays taxes on its worldwide taxable income, receiving a credit for foreign taxes paid. Because taxes imposed by the United States exceed those of Canada, the insurance industry has tried to get a special exception for their Canadian branches.

This amendment frees profits of Canadian branches from United States taxes, as long as the profits are not repatriated to the United States. It takes effect December 31, 1975.

Mutual insurance companies use the separate branch accounting system whereby premiums and policyholder dividend rates are based upon the separate mortality and earnings experience of the Canadian branch. Therefore, these specially treated profits benefit only Canadian policyholders and may not be used to provide benefits for U.S. policyholders.

The major insurance companies requested this tax preference. The revenue loss will be $4 million in 1977 and $8 million annually thereafter.

Permitting Foreign Banks To Treat Gains on Debt Instruments After July 11, 1969 as Capital Gains to the Extent They Have Capital Losses Incurred Prior to July 11, 1969 (Sec. 1044; p. 276 of Report)

Amendment sought by Royal Bank of Canada. The 1969 Tax Reform Act changed the character of certain income from capital gains to ordinary income. This would accidentally prevent using capital loss carryforwards to reduce taxes on such income. Cost: Less than $5 million.

Permitting Consolidation of Canadian Mining Subsidiaries (Sec. 1052(b); p. 284 of Report)

Amendment tailored to a Canadian iron ore subsidiary of Hanna Mining Co. The bill repeals favorable treatment for Western Hemisphere Trade Cos. (WHTCs) and repeals the per-country method of computing foreign tax credits. The new foreign tax credit rules prohibit consolidation of WHTC's with non-WHTC's. The amendment would allow such consolidation if over 95% gross is derived from mining in a country contiguous to the U.S.

Tax Treatment of Certain Debts Owed By Political Parties (Sec. 1304, p. 401 of the Report)

The present law does not allow a tax deduction for bad debts of political parties. This law is an effort to avoid favorable tax treatment to individuals or corporations who would "donate" their services to political campaigns knowing they will not actually be paid for them. However, recently more and more professional services are provided to political campaigns by professionals who anticipate payment for those services (polling, direct mailing, media campaigns, etc.) Some of these people have been stuck with large debts after recent campaigns and while making good faith efforts to collect the debts, have been unable to. They are also denied a tax deduction. The amendment would grant a tax deduction to such *bona fide* bad debts.

Specifically, Charles Guggenheim has been seeking this change in the law because of bad debts incurred during past Democratic campaigns.

Ironically, the Senate Finance Committee has worded the prospective change in such a way that it could only be of help to a major Republican campaign professional, Henry Deirdorf, but could be of no help to Mr. Guggenheim.

Amendment Overruling the IRS On The Question of Expensing Pre-Publication Costs (Sec. 1305, p. 403 of the Report)

Explanation.—This amendment would allow past expensing (writing off in one year) of prepublication costs, overruling the IRS position relating to encyclopedia publishers and other technical and textbook publishers.

The IRS has published a revenue ruling (Rev. Rul. 73-395), that would require publishers to capitalize over the life of a book, expenses relating to research. Publishers have been expensing (writing off in one year) such costs. This primarily covers a situation such as the Britannica III where most of the cost of production is in research. The IRS has rules that such expenses should properly be deducted over the commercial life of the publication and not written off in the first year and has applied this ruling retroactively. The bill would make this ruling prospective only.

Revenue Effect.—This amendment could mean reductions in tax liabilities of several hundred million dollars for a narrow class of taxpayers, (mainly Encyclopedia Britannica) who have taken these fast writeoffs in the past.

Amendment Overruling IRS Regulations On The Tax Treatment Of Face-Amount Certificates (Bill 1307, p. 407 of the Report)

This amendment relates to the tax treatment of face amount certificates—an installment investment certificate promising a lump sum interest yield after 22 years. These certificates are sold almost exclusively (95%) by Investors Syndicate of America, a subsidiary of the Minneapolis-based mutual fund, Investor Diversified Services. The IRS has recently ruled that investors in these certificates must include in income a ratable portion of the interest payments deferred until maturity. (This treatment is the same as that applied to oher deposit arrangements that provide for interest to be paid in a lump sum at maturity—i.e. certificates of deposit).

In 1975, ISA filed suit to enjoin the IRS from enforcing its regulations. The U.S. Court of Appeals in the District of Columbia ruled against ISA.

The amendment would overturn the IRS regulations, giving interest on face amount certificates the favorable tax treatment accorded such investments before Congress cracked down on them in 1969.

The House Ways and Means Committee after hearings and several hours of debate defeated similar legislation earlier this year.

These certificates are notoriously bad investments yielding only 3% over the 22 year period. Furthermore, the investor will lose up to 20% of his money if he bows out of the deal within the first 8 years. (According to "Forbes," at least half of the investors do drop out early with an actual out of pocket loss.) After 10 years the average yield is 1.1%, after 15 years it is only 2.5%.

Tens of thousands of people buy these certificates ($320 million worth in 1974). "Forbes" notes "a person would be far better off putting his money in a bank or U.S. Savings Bonds, . . . or in whole life insurance," and asks: "Is it wrong to persuade people to invest their hard earned savings in so unprofitable a way?" As a practical matter—Congress ought not to lift a finger to grant ISA the legislation which it says it needs to continue marketing those unconscionable instruments to consumers (whose average annual income is between $12,000 and $14,000).

Amendment to Exempt From Personal Holding Company Income Rent From the Lease of Intangible Property (Sec. 1308; p. 409 of the Report)

This retroactive amendment would apparently exempt income received by a Coca-Cola Franchise (we believe in Alabama) from being treated as personal holding company income (taxed at 70% instead of the 48% corporate rate).

Presently, a corporation or partnership set up to collect primarily passive types of investment income for its shareholders or partners is treated as a personal holding company and taxed at the regular 70% individual tax rates. Exceptions are made for income where the corporation leases its tangible property to a 25% shareholder. The exception does not apply to intangible property such as trademarks or licenses. The amendment would change this rule to include certain intangible property within the exception.

In this case, apparently, a Coca-Cola bottling franchise owned by a corporation or partnership leases its license to one of its own shareholders or partners who operates the franchise in his own right. Without this section, the corporation or partnership, which is merely operating as a "corporate pocketbook" to shelter ordinary investment income, would be taxed as a personal holding company at 70%.

The amendment is retroactive for twelve years to 1964. Apparently, the individuals involved would qualify for cash refunds from the Treasury.

Reporting Tip Income—(sec. 1312; p. 416 of report)

This amendment was added at the behest of the Marriott Corporation and the restaurant workers unions. Under the amendment, an employer would not have to include any tip income on an employee's W-2 Form which was not reported to him by the employee pursuant to sec. 6053 of the Internal Revenue Code. The effect of the amendment is to free employers from the responsibility of reporting tip income from charge account receipts. Thus, if an employee fails to report charge account tip income to his employer, the employer is not required to report these tips to the IRS.

The amendment will result in tax savings for restaurant workers of less than $5 million.

Rules Relative to Limitations on Oil & Gas Percentage Depletion (Sec. 1317; p. 424 of the Report).

This section contains a series of amendments to help narrow classes of oil and gas operators.

The 1975 Tax Reduction Act repealed the oil and gas depletion allowance for integrated oil producers who own retail outlets. One part of this section *restores* the depletion allowance for all integrated companies with $5 million of sales or less. There are several large oil and gas companies who will benefit from this proposal (among the top 70 oil companies in the country).

Also a special provision restores depletion allowance for one independent oil producer who happens to own six gas stations in Israel but does not sell his U.S. production through those stations. Belco Petroleum Corporation was inadvertently hit by the integrated company rule.

Two sections modify the depletion repeal exception rules to benefit unnamed trusts that own oil properties and receive depletion.

Revenue Loss: This section loses $18 million in fiscal year 1977, $10 million in fiscal year 1981.

Technical Rules Relating to Simultaneous Liquidation of Parent and Subsidiary Corporations (Sec. 1320; p. 431 of the report)

Under present law a corporation which has adopted a plan of complete liquidation and sells or exchanges some or all of its assets within 12 months does not recognize a gain or loss from the sale or exchange. This is because the shareholders will be taxed on the proceeds after liquidation is completed. This rule does not apply to corporations which are 80% controlled by other corporations because the parent corporation (which is the shareholder in this instance) will not be taxed at the time of liquidation. Therefore, the subsidiary is taxed on the sale or exchange. When both the parent and subsidiary are liquidated this rule might result in inequity, (because the shareholders of the parent will be taxed) so the Internal Revenue Service has held, that so long as the subsidiary is liquidated before the parent, the assets can then be sold or exchanged as part of a general liquidation plan and neither the parent nor the subsidiary must recognize a gain or loss. (Upon liquidation the shareholders of the parent would recognize the gain or loss).

This amendment liberalizes the rules for sales of property by subsidiaries. Under the terms of the amendment the sale or exchange of the subsidiary's assets as part of a general liquidation plan does not result in the recognition of gain or loss regardless of whether the subsidiary or the parent is liquidated first.

This provision was supported by the American Bar Association. But it is also backed by an unidentified N.Y. city attorney on behalf of an identified client. It is effective January 1, 1976.

Prohibition of State-Local Taxation of Vessels Using Interstate Waterways (sec. 1321; p. 433 of the report)

At the request of Senator Eastland, Chairman Long included this limitation on the taxing powers of the states. The amendment would prohibit the taxation by a state of vessels of another state using the navigable waters of the United States in interstate commerce. Apparently this was passed because a political subdivision of Louisiana has levied a tax on barges. Brent Towing of Greenville, Miss., requested it. It overrules a court case upholding the right to tax.

Contributions to Capital of Regulated Public Utilities in Aid of Construction (sec. 1322; p. 434 of the report)

This provision allows regulated water and sewage disposal utilities to exclude from income amounts received as "contributions in aid of construction".

Utilities typically make a hookup charge for customers and the money is placed in escrow and is returned to the customer when service is stopped, usually because of a move to another locale by the customer. The funds placed in escrow are not required to be counted in gross income. In the case of some customers, however, usually businesses, the cost to the utility of initiating service is so high that the utility requires a special contribution, either in cash or material, before it will hook up the customer. The contribution is not refundable.

The IRS ruled that such a transaction resulted in income to the utility. This amendment by making such payments "contribuitons to capital" of the utility, would reverse this result.

This provision will be effective for "contributions" made on or after February 1, 1976. It will save the utilities $13 million in fiscal year 1977 and $11 million annually thereafter.

If this treatment were to be extended to gas and telephone companies it would cost $100 million a year.

Amendment To Allow Certain Franchise Transfers To Receive Capital Gains Treatment (Sec. 1411, p. 414 of the Report)

The first part of this section simply extends the 1969 Tax Reform Act general rule, denying capital gains treatment to the transfer of a franchise, to partnership situations.

But the retroactive transitional rule is a special rule to allow capital gains treatment to the transfer of a professional practice if a contract was in existence prior to January 1, 1970, and the transferor is an employee or partner of the transferee.

Such franchise transfers are typically franchise optical companies. The amendment was offered on behalf of the Texas State Optical Company.

Permitting Insurance Companies To Consolidate Their Life Insurance Operations With Casualty Insurance Operations (Sec. 1508; p. 454 of Report)

Amendment sought by a dozen major insurers. At present *non*-insurance companies (such as ITT) can file a consolidated return and thus offset casualty insurance losses against other business income. The amendment is a logical extension of this rule. Cost: $0 in FY 1977; $25 million in FY 1978; $50 million yearly thereafter.

Special Treatment of Certain Inadvertent Distributions of a Life Insurance Company (Sec. 1509; p. 457 of Report)

Amendment will apply only to Businessmen's Assurance Co. of America. It miscalculated the tax effect of a dividend which was inadvertently paid from a (taxable) surplus account. It discovered the error and had the dividend paid back before the end of the year. Amendment is retroactive to 1959 and applies only to dividends paid back before the end of the year.

This provision was enacted as the vehicle for September 1, 1976 tax-cut extension.

Special Treatment of Concrete Railroad Ties Replacing Wood Ties (sec. 1702, p. 482 of report)

This amendment was introduced for the benefit of Florida East Coast R.R. and Kansas City Southern R.R., the only privately-owned railroads using concrete ties. Contrary to principles of accounting and past tax rules, it allows the immediate deduction of the costs of installing concrete railroad ties, but not to exceed the replacement cost of wood ties. Because wood ties have become extremely expensive, this amendment allows these companies to deduct much of the installation cost immediately. Under normal business practice the cost of these ties would be capitalized over their useful life.

The bill grants this favored treatment for any expenses since December 31, 1975 and for the future. It will cost less than $5 million a year, but all benefits will go to these two companies.

Special Interest Energy Amendment (Sec. 2001 et seq.; p. 549 of Report)

The homeowner insulation credit, which will generally benefit Johns-Manville, Certain-Teed Products, etc., has appended to it a credit for automotive clock-timers (the so-called "Honeywell amendment") and a credit for heat pumps, pushed by GE and Westinghouse. The geothermal drilling and depletion deductions will probably primarily benefit Union Oil or Pacific Gas and Electric in their joint California Geyser operation. The "exemption from the retailer excise tax on special motor fuels (propane) for certain non-highway use" will simply equalize the treatment of propane and diesel fuel. It will benefit Eaton Corp., a maker of lift trucks.

Income from Fairs, Expositions and Trade Shows (Sec. 2107; p. 601 of Report)

This amendment provides that tax-exempt organizations will not be subject to as unrelated-business income tax on rental income from trade shows even though the exhibitors sell their products at the trade show. It also exempts income from entertainment activities at public fairs. Two IRS rulings had held that income from parimutuel betting on horse racing at a county fair and income received by an exempt business league from renting display space at a trade show, where selling was permitted are taxable as unrelated business income.

This provision was urged by the American Society of Association Executives and is retroactive to December 31, 1962 for public fairs and to December 31, 1969 for conventions and trade shows.

APPENDIX B: CAMPAIGN CONTRIBUTIONS

The following is a partial list of companies who appear to benefit from specific provisions in the Tax Reform Bill. Included is a separate compilation of contributions made by officers of those companies to the campaigns of members of the Senate Finance Committee. The information is necessarily incomplete because of difficulties both in identifying the beneficiaries of particular provisions in the bill, and ascertaining the corporate affiliations of many campaign contributors. In light of these difficulties, time has not permitted a check of all campaign finance records.

We suggest no impropriety with regard to the various campaign contributions. We feel, nevertheless, that it is important that this information be made available to the public.

1021, p. 225: Pyramid Ventures, Donald Scafidi, Pres., $400 to Long. Superior Oil Co., $1,000 to Long; $500 to Bentsen (pres.).

1024, p. 230: Jackson Marine Corp., $1,000 to Bentsen (pres.). Aransas Pass, Tex., $500 to Bentsen (sen.). Arthur Levy Boat Services, Morgan City, La., $2,300 to Long. Deutsch, Kerrigan and Stiles, lawyers for Arthur Levy, Inc., $1,000 to Long.

1025e, p. 232: Grain companies, Cook Industries, Memphis, $4,750 to Bentsen (pres.); $880 to Brock; $200 to Packwood.

1031c, p. 238: Freeport Minerals, $1,700 to Long; $400 to Bentsen (sen.).

1032, p. 240: Boise Cascade Corp. (officers are residents of Idaho), $250 to Long.

1035a, p. 246: Natomas Corp., $500 to Bentsen (pres.).

1035b, p. 247: Sun Oil Co. (officers and Pew Family), $2,200 to Hansen; $2,000 to Dole; $1,000 to Curtis. Pepper, Hamilton and Scheetz, lobbyists, $200 to Packwood.

1035c(2), p. 250: I.U. International, $550 to Bentsen (sen.); $500 to Bentsen (pres.); $100 to Long; $100 to Dole. Williams and Jensen, lobbyists, $2,700 to Dole; $2,100 to Long; $1,000 to Bentsen (sen.); $250 to Packwood; $200 to Hartke.

1035c, p. 248: All major oil companies.

1035e, p. 251: Contributions by those identifying themselves as officers of the major oil companies:

Gravel: Atlantic-Richfield, $2,500; Hess Oil, $2,000; Standard Oil of Ohio, $700; Continental Oil, $700.

Dole: Union Oil Calif., $1,000; Atlantic Richfield, $500; Citgo, $1,000.

Long: Continental Oil, $1,300; Citgo, $1,000; Exxon, $1,000; Shell, $900.

Bentsen: Moncrief Oil, Ft. Worth, $7,100; Continental, $2,000; Standard of Ohio, $800; Mobil, $600; Gulf, $400; Shell, $350.

Ragan and Mason, lobbyists for Gulf Oil: Gravel, $1,000; Bentsen, $550; Hartke, $500; Dole, $500; Haskell, $200.

Patton, Boggs & Blow, lobbyists for Atlantic-Richfield, Exxon and Sohio: Gravel, $2,050; Bentsen, $1,680; Haskell, $200; Packwood, $100.

Dawson, Riddell, etc., lobbyists for Standard Oil of Ohio: Hartke, $1,100; Bentsen, $750.

1035f, p. 253: Natomas Corp. (see above).

1041, p. 258: Laredo National Bank, J. C. Martin, Mayor of Laredo, and Radcliffe Killam, Directors of the bank, and Mr. Martin's wife gave $1000 each to Bentsen's senate campaign and $1000 each to Bentsen's presidential campaign.

1043, p. 262: All major insurance companies:

Long: Mutual of Omaha, $2,500; Pan American Life, $2,000; New York Life, $1,250; Continental Life, $200.

Bentsen: Prudential Life, $2,000 (sen.); Equitable Life, $500.

Ribicoff: $5,400 from Connecticut insurance agents.

Dole: Over $10,000 from various insurance agents whose company affiliations could not be identified.

1317, p. 424: Belco Petroleum Co., Arthur Bolfer, Pres. contributed: $2,000 to Ribicoff; $1,000 to Gravel; $500 to Hansen.

Registered Lobbyists: Vinson, Elkins, Searls, Connally and Smith of Houston, through John Chapoton.

The firm contributed $6,500 to Bentsen's senate campaign, $550 to his presidential campaign.

Maurice Rosenblatt, National Counsel Associates $100 to Bentsen (pres.)

1411, p. 1: Texas State Optical Co., Rogers Brothers Investments. Rogers Bros. makes optical equipment. Two of the four brothers are optometrists, and own a TSO franchise in Beaumont. The four brothers gave $2,200 to Bentsen (sen.); $1,000 to Bentsen (pres.).

1321, p. 433: Brent Towing, Greenville, Miss. Jesse Brent, $1,500[1] to Eastland (1972). Amendment proposed on behalf of Senator Eastland by Senator Long. (American Waterways Operators of Virginia, which donated $1,000 to Eastland, may also benefit.[1])

1508, p. 454: All casualty companies affiliated (see above) with life insurance companies.

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[1] Source: Tax Analysts and Advocates.

1509, p. 457: BMA Corp., $2,050 to Bentsen (pres.); $1,000 to Dole.
Committee amendment on use of IDB's for private hospital construction. FEDPAC, the political action committee of the Federation of American Hospitals and beneficiary of one of the Committee amendments, gave: $1,000 to Bentsen; $1,000 to Dole; $2,100 to Packwood.

Mr. BRANDON. Let me just say that we have some basic disagreements with the chairman's characterization of how the committee has proceeded in the past. We had tried to attend all of the markup sessions.

Let me say first, even where there have been hearings on some of these provisions, it is difficult when only the proponents know of the existence of the provisions involved, know there is going to be testimony on those provisions, or know anything about them.

Transcripts have not been made available generally during markup, no list of sponsors have been attainable from the committee, in fact we have been told that if you are not here in the room, that is too bad.

We have had no opportunity, nor have the members of this committee had an opportunity, to receive all of the facts and circumstances surrounding these various provisions. That is the reason I assume that these hearings are being reconvened.

In many cases you cannot hear what is going on during the markup even when you are in the room and I would also suggest the 50 or 100 or so who are standing outside the committee during markup obviously cannot know what is going on.

Finally, there really is no reconsideration on these provisions. There are too many. Most of the members of this committee, I am sure, rely on presentations offered by the proponents of the provisions.

We did not have an opportunity to look at a clean bill nor did members of this committee, so we do not know technically how some of these items were drafted. I know there is some unhappiness by the members themselves who proposed these provisions, that the drafts are not necessarily the way they expected them to be.

Finally, there is no automatic input from the Treasury and IRS. Mr. Nolan earlier talked about bill reports routinely prepared by the Treasury. This is not the case in the recent past.

Certainly bill reports have not been presented to this committee for full consideration while they were voting on these provisions. I think that generally speaking, we feel very concerned that the information involved in the narrow-interest provisions have remained the private domain of this committee and have not been generally available to other members of the public, so they can comment upon them.

We happen to have the luxury of being here, we are both tax attorneys who understand some of what goes on in the committee. There are many members of the public around the country and other businesses that may be affected by some of these provisions that do not know what transpires in this committee.

Let me say also that these hearings themselves are somewhat less useful than they would be because the descriptions of these provisions have only been available recently and not available in time to really have any impact on our evaluation.

Also the hearings are of limited value unless there are some procedural consequences that flow from them. The committee should reconvene to have a markup on these provisions and consider them again in their totality.

Let me also say that we are not opposed to narrow-interest provisions generally. There has been a lot said to the effect: "What is so wrong with narrow-interest provisions that affects one or two taxpayers?"

As far as we are concerned, there is nothing wrong with that in and of itself. It really is the process under which these provisions have arisen. It is a process which generally speaking has resulted in a number of poorly drafted and poorly considered provisions, bad tax policy enacted into the law in the past and we would say provisions along the same line enacted in this bill.

It is, I think, very important to know who is involved in these provisions in spite of some of the comments yesterday. It is important to know who benefits and not just what is the circumstance because oftentimes who benefits will determine what circumstances are involved.

If there are claims being made about employment or investment situations, it is very difficult to evaluate those claims unless there are some specific materials available to this committee based on specific corporate taxpayers who are interested in the provisions.

We would say that the process needs to be cleaned up and we hope that in the future it will be. The consequence of this process, unfortunately, is that there are many provisions that are meritorious, that as you have all been witnessing, get tarred with the same brush as some provisions that are not meritorious because there was no information available on any of them and every one of them is suspect in the eyes of the public and the press.

We feel that there needs to be some general reform in the area of the committee markup and specifically reforms addressing themselves to narrow interest legislation. We have no objection to narrow-interest legislation when it involves technical corrections of the law where they are designed to correct unintended inequities.

We do have objection, however, when these technical amendments are designed to get taxpayers out from under very much intended changes in the law. It is no accident that a year after the Tax Reform Reduction Act of 1975 was passed, and a number of major reforms in the areas of foreign taxation were adopted, many taxpayers are here now trying to get out from under those very reforms.

We would also like to say that we have objection to narrow-interest legislation when it overrules administrative practices that are consistent with current law. This committee obviously has the prerogative to overrule administrative practices if they feel they are not consistent with current law.

However, it is grossly unfair to all of those taxpayers that follow the rules as they understand them, and as the IRS understands them, to allow other taxpayers who do not follow the rules and are caught by the IRS or are ruled against by the IRS to get out from under those rules that everybody else plays by.

Let me finally say that in many cases we are probably talking much more of narrow-interest legislation in terms of equity and that this committee is really sitting much more in a semijudicial capacity than it is in a legislative capacity.

I would urge the committee to at least consider in the future legislation that would set up some sort of court of tax equity to hear these kinds of judicial, nonlegislative claims and not clutter up the tax law, the Tax Code, with such ad hoc relief.

It is unfortunate, we think, that many taxpayers who found that they have inequitable situations, cannot have access to this committee, do not have the wherewithal to hire Washington attorneys, do not have the access that is available as some of the members of this committee have admitted through campaign contributions.

We feel that all taxpayers have a right to have their equities adjudicated. We just urge that the committee consider at least this kind of process in the future.

Let me finally say that we would suggest in the interest of passing a tax reform bill this year, and also in upholding the integrity of the tax system, that many of the controversial provisions that have been approved by this committee be split off in the bill, the noncontroversial provisions to stay in the bill and for the Senate to proceed with its consideration of the overall bill absent of those controversial provisions that either have a great deal of controversy from various members of the public or are opposed by the Treasury.

Let me also say, in terms of the committee amendments which we have not really commented on in our testimony because they were unavailable until yesterday, that those amendments be put over also for a separate proceeding consistent with our recommendations this session.

Let me turn now to some specifics. We have several reforms listed specifically on page 9 of my testimony. Let me just quickly run through them. We think that there should be some kind of task force or some committee set up by this committee to screen our interest legislation, to weed out those obviously nonmeritorious, and the committee does not have to waste its time with those provisions.

We feel also that the Treasury Department, the IRS or any other affected agency should prepare reports to accompany all of these provisions, that staff pamphlets, well in advance, be provided with full disclosure of all relevant facts about each provision, including beneficiaries and interest groups lobbying on behalf of the provisions.

The rationale of the provisions, and not just simply the stated rationale by the proponents of the provisions, but a rationale and an analysis by the staff and comment by the IRS on the provisions should also be included.

A number of these are also listed as having not much of a revenue effect. They are based on some assumptions that we feel are incorrect: assumptions that while taxes so far have been suspended, they are never collected and, therefore, there is no revenue effect.

I think it is important to at least know the amount of revenue loss involved potentially by passing the particular provision involved. We then feel that we should follow up by full public hearings, after dissemination of these pamphlets, so that everyone can analyze the provisions and comment on them intelligently. Finally, this should be followed by a markup where the members are given an opportunity to understand fully all the provisions involved, with record votes on each provision. These provisions should be kept off omnibus tax-legislation and passed, instead, separately as the House of Representatives is beginning to do with such provisions.

I would like to turn to the specifics of some of the objectionable provisions that we would oppose in this legislation.

First of all, section 802 and 803, having to do with the refundability of investment tax credit and the extension of the 2-year, self-expiring investment tax credits, we are particularly opposed to the extension of the expiring investment tax credits which we feel are unwarranted.

They are also opposed by the Treasury. Section 806, the investment tax credit on shipbuilding from capital construction funds, we have a detailed analysis, we think it is bad tax policy.

We think there is no need for this. It is a double dip in that we are talking about funds invested from already tax-free profits that receive, according to the Treasury, their benefit equal to a 17 percent investment tax credit. On top of that, we are going to give them another 10 percent investment tax credit.

Section 1021, investments in U.S. property: We feel that the two retroactive changes in this area are bad tax policy. They give unfairly to two specific taxpayers an advantage unavailable to other taxpayers that know the law, complied with and paid any tax they owed.

The Treasury also was opposed to that. Section 1024, narrowing the definition of tax haven income, the Treasury is opposed and I understand this is the one about which there is some question.

Let me just say in this area, that it makes sense, perhaps, to exclude offshore shipping having to do with oil rigs, if, in fact, the operations involved are paying taxes to the countries in which they are operating.

In these situations, what we are talking about is certainly many of the specific companies that have favored this provision and certainly companies the committee may not know about are offshore rig servicing operations that may operate in one country but are registered in a tax-haven country like Panama, or Liberia.

They are paying no taxes whatever. The whole purpose of the change in subpart F is to see that those companies who pay no taxes whatever because they are incorporated and registered in a tax haven pay some taxes to the United States.

We feel strongly that this provision should be knocked out. The same is true in other sections of 1024, one designed to help a scrap dealer, which we understand is now too narrowly drawn to derive any benefit at all.

We would hope that would be knocked out just in case there is somebody around. Again we are talking about companies, while they may be operating in offshore, in a taxpaying country, they are not paying taxes in those countries; they are registered in Panama or Liberia and are paying no taxes there and there are no taxes to the United States as well.

Section 1025 we are strongly opposed to. Again a significant undermining of the present tax haven rules would simply say the taxpayers who locate in tax-haven countries ought to pay taxes they are not paying to Panama or whatever to the United States.

In the situation, exclusion is for agricultural products from outside the United States, but again, if those agricultural products are grown and sold in Europe and taxes are paid on those, there is a full tax credit available. We are not talking about those situations.

This provision is designed for those companies operating and taking advantage of tax haven income that is movable from one country to another. We would strongly oppose that provision as well.

Section 1031, 3-year exclusion of mining and Puerto Rican mining and operations from the repeal of per country farm tax credit. This is really designed to give taxpayers a chance to have it both ways because the whole idea of time to repeal the per country limitation is to get at the problem of huge startup losses being used to offset U.S. taxes directly against U.S. income—pardon—foreign losses against U.S. income.

In this case, this provision allows for a mining company, for instance, in this case Freeport Minerals, who is operating with huge startup losses, to take advantage of the overall limitation, take advantage of the per country limitation and then spinoff as it becomes profitmaking as a subsidiary.

We feel these are unwarranted exclusions. The Treasury again here is opposed to these provisions for the same reason.

Section 1052, again another exclusion for the recapture of foreign losses, which we feel the same as about section 1031. In section 1035, let me say that Senator Hartke's amendment would cure many of the problems in section 1035 by eliminating the excess tax credits available to the oil companies on their overseas operations.

Let me further say that just as the reform that it went through in 1975 brought back all of these provisions out of those reforms. I imagine that we will be here again a year from now if the Hartke amendment passes with the special provision to allow exclusions from that 48 percent rule.

We feel that just the excess credits in that area should be done away with and we feel that all of the areas in 1035 are poor. The Treasury is opposed to those. We are also not opposed to the provision that Mr. Nolan testified to involving individuals.

We feel it was unwarranted and unintended by the Congress and it was one of those areas where legislation is intended to correct an unintended technical mistake. Also strongly in 1035, two provisions which basically overrule newly enacted reforms and IRS regulations which say companies who have operations in the OPEC countries and who no longer have any economic interest in those operations, but are simply purchasing barrels of oil, the IRS ruling and reform act was designed to keep them from obscuring those payments simply of purchasing as taxes and also making them creditable.

We feel these provisions are totally unwarranted interference with the administration of the tax laws.

Section 1042, we oppose this provision as a retroactive change in the law for a company that had its position adjudicated by the courts and lost.

We feel it is unfair to other taxpayers to get this kind of special relief. Section 1052, we oppose this as well as does the Treasury in terms of the transitional rules in this section.

Section 1305, the expensing of prepublication costs. We oppose this provision. We feel that this does violence to normal accounting procedures and procedures that allow encyclopedia companies who otherwise under the law now would have to capitalize their huge front-end cost on research and development over the life of the addition.

It certainly does violence to normal accounting procedures and tax laws to allow those huge otherwise capitalized expenses to be expensed all at once in the first year. Apparently this is an area where the revenue cost here was originally listed as zero.

We understand this involves several hundred millions of dollars to the taxpayers involved. The Treasury is also opposed to that provision.

Section 1307, face amounts of certificates, we opposed this provision. We have a lengthy discussion of why in our statement. We feel that from a tax point-of-view, it is a bad policy to change the IRS ruling which we feel is sound.

In addition to that, we feel that this committee should not be changing the tax laws to benefit a company that is selling what we consider unconscionable investment opportunities.

Section 1308, we oppose as does the Treasury. We see no reason for this as stated in our testimony. Section 1311, we oppose the retroactive grandfathering clause in here for the benefit of Texas Optical Co. and the Treasury also is opposed to that provision.

Section 1312. You heard from Commissioner Alexander yesterday on reporting of tips. We are opposed to this provision. We feel that failure to report tips is a frequent abuse.

We feel the IRS deserves every available opportunity to police it. In section 1322, contributions to capital of water utilities, again completely illogical treatment in this case with nonrefundable payments made by customers, that are not going to be refunded ever, should not be treated as income.

We do not understand why that should be the case. The IRS has ruled it should not be the case. The Treasury opposes overruling the IRS position and we would, too. More importantly, this may very well set a precedent to extend this kind of treatment to utilities generally at the cost of many, many hundreds of millions of dollars.

We are opposed to section 1508, the consolidation of casualty insurance losses. In this case, it is primarily because we feel that there has not been a careful enough study in this area as we would like to see, since it does not affect until 1978 anyway, that the committee look at this a little more carefully.

We are not sure that we are totally against this provision but we would like the committee to take a further look. We are opposed to the railroad writeoff section. We feel that any kind of relief for the railroads ought to apply to all of the railroads, the taxpaying railroads, as well as the nontaxpaying railroads and it could be done through direct subsidies.

Providing tax preference to the railroads at this point is only giving advantages to those very few railroads that are making money these days and paying taxes.

The Treasury is also opposed to these provisions except for as I understand the tunnel borés provision. I would just like to comment briefly on this.

Here is a perfect example of bootstrapping on tax preferences. In 1969, the railroad industry tried to get a 50-year amortization on tunnel bores which after all do not wear hardly. I do not know of any that have worn out or closed up in any mountains that I have seen but are written off when the track is abandoned.

The railroad wanted to be able to write these off, the House refused to go along with them. I understand the Senate did go along and the compromise was that future railroad tunnel bores which involved future investments would be able to be written off over 50 years.

Curiously enough in 1975 the railroad industry came back to the House and argued that it is illogical and unfair for tunnel bores post 1969 to receive this treatment when tunnel bores prior to 1969 do not receive it.

That is why it is in here now and we would oppose that provision.

We also have some other problems with the bill. We talk about it a little in our testimony, primarily because the energy sections—we are against the energy sections as is the Treasury, except I understand they support the home insulation credit.

We feel the home insulation is going to provide very little new insulation and provide simply some tax relief to those people that cannot afford to put insulation into their homes.

We would much rather see this committee—take a much closer look at the conservation legislation in the Interior and Commerce Committees. That provides for low interest loans and grants, et cetera, for this kind of purchase.

When you understand that close to 50 percent of the subinsulated homes in this country are owned by poverty class individuals, or lived in by poverty class individuals, it does not do them any good to tell them they can go out and buy $500 worth of insulation and you are going to give them a tax credit.

Also I am not sure how many members of the committee are aware of the fact that in the ESOP legislation which also is one which should be looked at much more closely because all of its broad implications—there is a provision in there which will allow retroactively a company like A.T. & T. with $10 billion of investments, approximately, in 1975, to with the stroke of a pen opt to receive Government funds to the tune of $100 million for past investments for 1975 and 1976.

We feel that that is totally unwarranted. If the Senate is going to adopt the ESOP provisions, we feel they should be adopted in the future; we frankly think they should not be adopted at all.

However, we would like some further debate and discussion on that. We also feel the recycling tax credits, do no good in terms of adding any measure of recycling to the—to our Nation that, in, fact, most of the cost associated with recycling have to do with things like transportation and gathering and are not cured by this kind of legislation with a modest investment tax credit.

The next witness I am sure is going to elaborate much more on the objections for recycling credit. We strongly oppose that and we feel it is a total waste of money. There are much better programs.

You can talk to your colleagues serving on the committees involved in solid waste management. I think they will tell you there are other programs around that would make much more sense.

I would also like to mention the trade fairs. We would oppose the treatment there. We feel that there is a reason for the unrelated business tax in the first place, to guard against unwarranted competition from tax free organizations and we just do not feel it is fair to those people that are not tax free organizations that, in fact, engage in these kinds of opportunities.

We think that in the area of hospital bonds, which as a committee amendment, is the only one I am prepared to make mention of at all, that it is a dangerous precedent to begin to expand once again the industrial development bond concept which is—has soared.

The municipalities in recent years, because their market was squeezed out for tax free bonds, we have a list on page 17 also. It is admittedly a little shorter than the list I just went through, provisions we feel are not objectionable.

I would be happy to discuss any of those if you want to do so. These are based on some fairly inadequate information that we have but we feel that at this point, based on what we know, that they are not objectionable.

I will be happy to submit answers to any questions.

The CHAIRMAN. Let me just get one thing straight between the two of us. How long has your organization been in existence?

Mr. BRANDON. Since 1972.

The CHAIRMAN. This committee has been around here for the better part of 200 years and you could not very well expect us to gear the committee to your operation until you existed, could you?

Mr. BRANDON. That is true.

The CHAIRMAN. So that since you started your organization you have advocated that this type of thing should be done in the Ways and Means Committee and they have adjusted their way of doing business to accommodate you and those who share your views, have they not?

Mr. BRANDON. To some extent, that is correct, but let me just say that we would not like to think that it is simply the existence of an organization such as ours that would make the Senate Finance Committee consider these kinds of provisions in the open and more deliberate manner than they have in the past.

The CHAIRMAN. Let us understand this. I am chairman of the committee and that is all right, I do not mind being held up to ridicule and scorn, it has happened many times before and it is all right with me.

I would like to have it understood that this country managed to survive for 200 years without proceeding as you advocate and it managed to survive long enough for me to become a Member of this Senate and chairman of the committee.

Mr. BRANDON. The result is the present tax law which is not exactly perfect.

The CHAIRMAN. Our tax laws are not perfect but they are better than others. I was talking to an Englishman who was telling me that their law was far more complicated than ours. I said how can that possibly be?

He says it is because we have been at it longer than you have. When I became chairman of the committee I started trying to make a couple of changes. I am not the man that closed the committee sessions, I am the fellow who opened them up.

As a Democrat, I led the charge to put as many on this committee so it can reflect the same balance that exists in the Senate.

We have not had an opportunity to act on one major revenue bill in this Congress and this is the second year. If I were a Senator, not on the Finance Committee and I had an amendment to correct an injustice, then I would just get my amendment and every time someone came up with some revenue bill that was headed for the President's desk, I would offer my amendment on there, especially if I thought I could get a majority of the votes.

We must have at least 30 or 40 Senators standing in line that way because one of our able colleagues who appeared yesterday, Senator Proxmire, as well as others, are standing right there in the gate, blocking Senate consideration.

Anytime you bring up a revenue bill and someone wants to offer an amendment to it, Senator Proxmire is going to stop the bill.

Mr. BRANDON. Senator Long, if the system was set up to consider these provisions, first of all, we do not like the idea of ill-considered provisions whether they are passed by the Finance Committee or on the floor of the Senate.

If there is a procedure set up where such provisions are fully aired, input is made on them and the members of this committee and the Senate could deliberate on them with all of the facts known, then I would say that you would not have this bottleneck problem, legislation would be able to proceed in a much more orderly fashion.

The Ways and Means Committee, when it brings legislation out now in a now-interest area, nobody gets up and screams this is a special-interest provision because they know it is not through the process of being analyzed carefully by the staff, the Treasury, the public and committee.

It is fully explained to the House of Representatives before they vote on it.

The CHAIRMAN. Please understand——

Mr. PIETZ. May I say that the Ways and Means Committee in its recent so-called Christmas tree markup considered 2½ dozen bills, our organization opposed 6 of them, 4 of them failed to pass, the remainder of them sailed right through without criticism, objection, publicity, controversy, et cetera.

The CHAIRMAN. Please understand that you cannot expect anyone to gear his operation to your operation before your operation existed. That is point one. The Ways and Means Committee has not sent us a major revenue bill in a long time.

They have been working on this bill for 3 years and they got it to us right at the close of the session and there was so much legislation backed up that people wanted to offer as amendments, that about the best we could do was try to take a few things we thought would pass by unanimous consent, without objection, and get that much done.

I cannot make changes before the thought occurs to me, because the thought even occurs to me or because some committee member suggests it or because someone, even you, comes before us and says "Gee, I wish you could change the procedures so that we can make a better contribution ourselves."

Mr. BRANDON. Senator, we would hope the changes that are made are made not in response to us but in response to the needs of the members of this committee. Anyone that sat through the markup that just took place will know that many provisions considered were considered without adequate facts and circumstances.

Senator Nelson raised the point a couple of times that there was not sufficient notice and preparation for the members to intelligently vote on things and those are the kinds of reforms that I think generally are needed.

The very fact that nobody knows what went on one day, it is almost a joke with the people back there that nobody can understand what is going on and if they cannot understand what is going on, it is possible that some of the members of the staff are not aware of what is going on.

The CHAIRMAN. Please understand that I will do what I can to accommodate you and everybody who agrees with you, but understand this; it is only recently that you have begun to be in the room.

I cannot gear this committee to your operation prior to the time that we started doing business in such a way that we have a broad audience participation program. We do the best we can to try to improve things for the better.

I would like you to understand that neither I nor any member of this committee has been in charge of what has been happening in this country before we even got to the Congress. Since we got here, people have been making suggestions, you and a lot of others, about how we can do things better.

I like to make changes, I like to try new ideas, I like to see if they work. If they work, let us implement them, continue to do them, but if they do not work, let us dump them, get rid of them.

It seems to me that no one should be condemned because it has not been that way in the past. Let me make one more point.

You have undertaken to identify everybody here——

Mr. PIETZ. Mr. Chairman, can I just respond to the question of gearing this to our organization? I would like to note in the past year, and particularly in recent weeks, we have gotten numerable phone calls from around the country from various individuals, various social groups and organizations and from various newspaper editors.

All of them have asked us exactly what is under consideration here, what is meant by the single-line items on the committee press release, how can we evaluate it, how can we comment on it.

The CHAIRMAN. Your type of activity is a relatively new thing in the history of this country and we will do what we can to accommodate you.

Mr. PIETZ. Can I just say it is not our activity, it is the members of the public, throughout the country, you just have no way of knowing, unless the usual concepts of legal notice are adhered to.

The CHAIRMAN. I understand that. I can recall some years ago when I was fighting very strenuously to try to stop the practice of someone taking out a private patent on research paid for by the United States Government, I think it is outrageous and I do not like it.

You should not have some fellow charging a royalty fee or denying the public use of something that the public paid for to begin with. I fought very hard on that.

In the course of that debate, especially feeling the frustration that I was not having it my way, I was not winning, I made a number of statements that indicated that people who did not agree with me were likely taking after us because so many interests in this country were benefiting from the other side, and those who supported the existing established procedure were receiving contributions for it.

One or two people felt that was intended for their ears in particular. I felt it my duty just as a human being to go to those people and offer apologies for saying something like that.

You have a list identifying people's campaign contributions. For example, you say—you mention the name of a corporation and you say so much to this person, including numbers.

Those contributions were not made by corporations—that is against the law. You find people who are workers, employees, or officers of those corporations who made contributions. Some of those, for example, are $200 to Long or maybe two or three people contributed $200 or $300.

I notice you have here, as though to suggest that this lawyer made a contribution to me and therefore, that is why I supported an amendment; that is the inference of it.

Mr. PIETZ. We expressly disclaimed any such suggestion. It is up to the public to judge that.

Mr. BRANDON. Senator Long, it is very curious that many times the only way we could identify companies involved with this legislation was that they happened to show up on people's contributions.

Our only point is that I think your constituents have a right to know, as they do, who contributes to you. They also have a right to know whether or not legislation you sponsor helps those people and let them decide whether you are fairly representing your constituents.

I am not arguing that you are not.

The CHAIRMAN. It may well be, but I would not like to claim it to be true if it is not. If you read the list of people who contributed to my last campaign, it would read like the Who's Who of Louisiana, whoever could afford to contribute, more than 1,000 people.

Mr. PIETZ. That is correct. We have the list.

The CHAIRMAN. I notice on this list—did you know that Mr. Deutsch was my lawyer. I just got through paying him $5,000 for representing me so in a way we were sort of taking in each other's wash.

Mr. BRANDON. Let me say that employees of Arthur Levy also contributed as well.

The CHAIRMAN. And Arthur Levy is a personal friend that I have known for many years, my father was a good friend of Arthur Levy's. You did not know that, did you?

Mr. BRANDON. Senator Long, the problem is I think it is possible for people to know that Arthur Levy can stand to gain by one of the provisions in this bill, that people wanted to know who was involved.

The CHAIRMAN. If there is any way Arthur Levy could have done it, in view of the background and the personal friendship with that man, if the law would let him do it, and I needed it, he would put up $10,000, not $300.

I assume that was made in successive contributions. Incidentally, are you aware of the fact that I have more scars to show from the fight to finance campaigns publicly than anybody in Congress?

Mr. BRANDON. I can agree on the need for public financing.

The CHAIRMAN. As long as we are going to finance campaigns, as long as the law stands as it is now, you have two choices, you can either seek some campaign contributions or write a book or something rather than serve in public office because it takes money to run for the job.

It just seems frankly——

Mr. PIETZ. I would like to comment——

Mr. BRANDON. We feel there should be full public disclosure. Obviously that is the purpose of the disclosures.

Senator HANSEN. Would you yield on that point for just a moment?

The CHAIRMAN. Go ahead.

Senator HANSEN. I would like to ask one question, if I may, Mr. Chairman. You gentlemen are associated with Ralph Nader?

Mr. BRANDON. Yes, we are associated with Public Citizen which is a part of Ralph Nader's organization.

Senator HANSEN. What is the reason Ralph Nader does not want to make the same kind of disclosure that is spread out here?

Mr. BRANDON. I cannot answer for Ralph Nader but I think the clear distinction is that public servants should in fact disclose their campaign contributions.

Senator HANSEN. I do not know how much money Ralph Nader gets and I must say either he has some people willing to work for peanuts, which is a popular thing to eat these days—or he certainly gets a lot of dough.

It occurs to me that if this is such a holy concept to embrace, I cannot see for a single moment why Ralph Nader is not perfectly willing to abide by the same rules that he is asking public servants to abide by.

Mr. BRANDON. Let me say, and furthermore, I would be happy to give to you and provide to you a complete annual report of the Public Citizen organization that has been available every year.

Senator HANSEN. Would that include all of the contributors?

Mr. BRANDON. It is not itemized in contributors.

Senator HANSEN. I am talking about itemized contributors and are you willing to do that, are you willing, yes or no? It is a simple answer.

Mr. BRANDON. I have no control over that. Let me say there is a clear distinction between contributors who are——

Senator HANSEN. Now you are avoiding my question.

Mr. BRANDON. I am trying to answer it.

Senator HANSEN. No, you are not. My question is would you be willing to provide the same amount of detail—the same detailed type of information you believe every member of this committee ought to provide insofar as Ralph Nader's group is concerned?

Mr. BRANDON. Senator Hansen, we are not submitting that this committee should provide anything other than what is required under the law. We do not collect the identities of the hundreds of thousands that contribute, it is not required under the law, and we feel it is not relevant. Frankly I do not feel it is relevant to this discussion.

We would be happy, as a personal favor, I would be happy to supply to you all of the public records for Public Citizens and the annual report.

Senator GRAVEL. On that point, we do not have to give anything under $100?

Senator HANSEN. That is exactly the point of my question.

Senator GRAVEL. Would the Senator yield?

Senator HANSEN. Yes.

Senator GRAVEL. We do not have to provide the names under $100.

Mr. BRANDON. As I said, I cannot answer for Mr. Nader and I can only say that there are no requirements on that score for that kind of disclosure. We do file forms with the IRS.

Senator GRAVEL. Do you think that there should be some requirements for that to equate with what we have to do?

Mr. BRANDON. Not if there is no public trust involved. As far as I am concerned, as a private organization and a private citizen, we are distinctly different than public officials who are paid—who are on the public payroll and who represent the public and are elected officials.

The requirements of the Campaign Finance Disclosure Act recognizes that distinction.

Senator GRAVEL. You are not making a distinction. If an oil company comes in and does make a contribution, they are public about it. Why would you not want to be public about it?

Mr. BRANDON. If we contribute to Members of Congress, we will disclose it any time that we do that.

[Senator Talmadge acting as chairman.]

Senator TALMADGE. Senator Hansen?

Senator HANSEN. A further point that I think ought to be understood is that the organization of which I suspect these two gentlemen are a part is a tax exempt organization. It is entitled to certain privileges and it is exempt from the normal application of the law.

It would seem to me that the answer that has not yet been given is very much in the public interest and I am disappointed that the gentlemen before us are not willing to comply with my request.

I am disappointed that the gentlemen are not willing to comply with my request that they make the same kind of information available, given their tax exempt status, and the degree of public trust that they would presume to speak for as they appeared before various Members of the Congress, and various committees before the Congress.

I am frankly very disappointed. Thank you, Mr. Chairman.

Senator CURTIS. Would you yield there?

Senator HANSEN. I would be happy to.

Senator CURTIS. I concur with Senator Hansen. As a matter of fact, your whole organization spends its time trying to influence legislation and public policy and for you to fail to make a full disclosure is not excusable on the grounds that you are not public officials.

Mr. BRANDON. May I respond to that?

Senator CURTIS. No, not until I get through. I am not impressed by your appearance here. Lots of time I have had constituents at home who were taxpayers working to pay their bills and so on and pay their taxes who wanted to appear before this committee and sometimes could never be heard at all.

Once in a while they ~~have been~~ here and heard very early that they have to take their turn about 5:30 or 6 at night. I was astounded to learn that you refused to testify yesterday because you wanted a big crowd here.

You people are engaged in trying to influence legislation, trying to form public policy. The public has a right to know who is paying and who is backing you and that you have not made public, you have not made——

Mr. BRANDON. Senator Curtis, we are are a 501(c)(4) organization, that is correct. We are lobbying, a registered lobby. If anyone on this committee would like to introduce legislation which requires all 501(c)(4) and 501(c)(3) organizations, churches, hospitals, and everyone else to provide more disclosure than is now required under the forms that they file within IRS as tax exempt organizations, I think that is perfectly proper and we could have a hearing and discuss the merits of that, at that point.

I do not think that is relevant at this point, to what we are talking about at this hearing. I also again would like to draw the distinction between our organization and public servants.

When it comes to disclosure, if you would like to change the law, that is fine, I think we should have a hearing on that and you can propose some legislation and the relevant committees can have hearings on it.

Senator CURTIS. How many different organizations do you have?

Mr. BRANDON. I am an employee of Public Citizen which has several groups within that context. Our annual report details all of our activities in various groups.

Senator CURTIS. How many different organized groups do you have? Does the Nader organization——

Mr. BRANDON. There are two essentially different organizations.

Senator CURTIS. Just who?

Mr. BRANDON. The Public Citizen Organization and the Center for Study of Responsive Law which is a 501(c)(3) organization that publishes reports, study reports, and so on, and Public Citizen is a 501(c)(4) organization supported primarily by individual contributions of $15 from direct mail solicitation.

Senator CURTIS. Is there ever any transfer of funds between those two groups?

Mr. BRANDON. Absolutely not, there cannot be.

Senator CURTIS. Are you sure about that, never?

Mr. BRANDON. They are not inconsistent with the law.

Senator CURTIS. I did not ask you that. I said are there any transfer of funds between those two groups?

Mr. BRANDON. I do not think there can be, Senator, under the law and I am sure that we are very careful to follow the requirements of the law.

Senator CURTIS. Are you sure that it is only two organizations?

Mr. BRANDON. That is correct.

Senator CURTIS. You are real sure?

Mr. BRANDON. Oh, yes.

Senator CURTIS. Nader has an operation with only two organizations?

Mr. BRANDON. That is why, those are the two organizations.

Senator CURTIS. Has he ever had more than that?

Mr. BRANDON. I do not know. I would suggest you write him a letter and you will get an answer from him.

Senator CURTIS. Nobody can find him, he has no address listed or telephone number.

Mr. BRANDON. You can write to the Center for the Study of Responsive Law, 1910 K Street, the number is 833-3400. I am sure somebody there will answer your questions or have an answer prepared for you.

Senator TALMADGE. Mr. Brandon, is your organization financed by contribution?

Mr. BRANDON. By contributions?

Senator TALMADGE. Is your organization financed by contributions?

Mr. BRANDON. Yes, non-tax-deductible contributions, that is correct.

Senator TALMADGE. Not tax deductible? In other words, they cannot take a deduction for contribution to your organization.

Mr. BRANDON. That is correct.

Senator TALMADGE. That is the reason you can engage in lobbying, otherwise you could not?

Mr. BRANDON. That is correct.

Senator TALMADGE. Any further questions?

Senator GRAVEL. Let me first of all say you perform a very fine service. I think the recommendations made for committee procedures are excellent recommendations. I feel so strongly about the adversary principle, I would pay for your activity with taxes.

Let me give you an example of disagreement of policy. You talked of insulation and the fact that we do not give enough to the poor people and that the tax credit would only permit those who can afford to buy insulation to enjoy the tax credit. That is so.

You offer as an alternative the fact that we should have grants and loans. Can you imagine the bureaucracy, the size the Government would have to grow to start handing out those sums or grants or loans and the processing thereof in order to get insulation effective in this country?

It would be something that I would not choose to accept.

Mr. BRANDON. Senator Gravel, I think the Senate just several weeks ago passed legislation which will establish this kind of low interest loan program for insulation. There did not seem to be too much debate at that time about the bureaucracy.

It fits right into the other existing HUD programs, as well as I know, but I am not an expert.

Mr. PIETZ. We would admit that this is one on which there is a difference of opinion and widespread popular support for it, perhaps.

Senator GRAVEL. Very well.

Mr. BRANDON. We made recommendations in that area and just cut down on the size of the subsidy.

Senator GRAVEL. But when it is loophole legislation——

Mr. BRANDON. This one, I do not think that.

Senator GRAVEL. This is one that—here is legislation we pay now, as taxpayers, you and I, in a community for the removal of trash. If we could find some way within our system to have that trash removed without having to use tax dollars, then I would say that the beneficiaries of that device would not be what you consider a loophole. This would be broad impact legislation.

Mr. PIETZ. Let me say, Senator, that there is a substantial question as to whether the provision as drafted does accomplish that purpose and as the Senator has mentioned, the committee procedures really did not allow even the Senators to know for sure the precise content of it because there was not a review of the bill once drafted.

I would like to say that, a fortiori, those of us in a less-preferred position have an even tougher position evaluating this piece of legislation and all other pieces.

Senator GRAVEL. I think the point is well taken and certainly more valid with others because this issue has been hanging around for several years and I fought it for several years.

This is the first time I have won to get it into the committee, committee approval.

Mr. BRANDON. We do have a strong policy disagreement on this one which I am sure we will outline later on by a later witness in the Treasury Department.

Senator GRAVEL. I have had occasion to go over that, but you give credits to it because when you give good judgment—testimony on some areas, obviously that reputation carries over into some areas.

Mr. PIETZ. I do understand the Public Works Committee does have other questions. I do believe that Senator Hart and others have been proposing them.

Senator GRAVEL. As a supporter to the solid waste legislation, I feel that——

Mr. BRANDON. We just feel that is a much more efficient way of subsidizing this activity.

Senator GRAVEL. Here again, I think we have a basic disagreement. The point I really want to make is that we can have this disagreement, but I would appreciate it if you realize that the beneficiaries of this legislation are not narrow and, therefore, it does not make it a loophole in that regard because this legislation, if it is successful, every citizen of the local government will have admonition to some degree of his tax burden.

Mr. BRANDON. Let me just say that the reason we request that this is narrow, the Treasury will have very little effect on recycling, then the chief beneficiary of this will be the companies that are already doing recycling who will get the benefit of the tax credit for what they are already doing profitably.

Senator GRAVEL. What we could do then is make a decision that we could try this and if you are right, we could appeal it, if I am right, we could add to it. Would not that be a legitimate way to do it?

Mr. BRANDON. We have some trouble with appealing tax credits in the past.

Mr. PIETZ. We would just like to say that there are so many worthy causes and every year there are a dozen new ones and that has been true for the last several decades. The result is today's tax law.

Maybe we had best start over.

Senator GRAVEL. Certainly this Nation is beginning to recycle its trash. It is not a new worthy cause. It is not something very insignificant and so I would submit that on that point——

Mr. PEITZ. Let me say that I know the preferences——

Senator TALMADGE. I am sorry, Senator Gravel, your 5 minutes of time has gone by. We have 21 or 22 witnesses remaining to be heard.

Senator HASKELL. Mr. Chairman?

Senator TALMADGE. It is the intention of the Chair to vigorously enforce the 5-minute rule. Any further questions? Senator Haskell.

Senator HASKELL. Mr. Brandon, I would agree with Senator Gravel, I think you and your colleagues performed a real service. I suspect that you and others have indicated a procedure on which my hunch is the majority of the committee is in sympathy, that is a screening of narrow legislation.

One of the real problems that goes through my mind is how you define narrow legislation. It is easy when you have to blow—it might be a little more difficult when you have Mr. Nolan who is listed as appearing for American International Grouping but on the other hand, this is merely one of a hundred casualty companies doing business overseas.

I would hope that some of you would give some thoughts to what kind of guidelines could be set up for the special screening procedure because, as I said earlier to another witness, I think it is important both for substance and form that we do this or perhaps you could respond in writing or maybe you have something off the top of your head.

Mr. PIETZ. Let me say that if several members of the committee did convene a session to consider the breadth of that legislation that would be quite in advance——

Senator HASKELL. That would not quite do it because you have to know—we can have a subcommittee to screen legislation but you have to know what legislation to refer to and it is that—those guidelines that I hope you would give some thought to.

Just one other question, if I have time, on your 1305, this prepublication cost for Encyclopedia Britannica, let me ask you this. These people came in to see me and told me they had no objection to capitalizing costs in the future but that if the Treasury changed the rules on them in midstream, all the expense of prepublication costs, and a ruling came out affecting past years, maybe you ought to ask Treasury this, that made them suddenly capitalize.

All they were asking for was relief from this rather arbitrary ruling. Do you have information that would dispute that set of facts?

Mr. PIETZ. No, we do not and that is a perfect illustration of our point that those are the types of factual allegations that the committee itself should evaluate and should be available in the course of comment from the Treasury.

We might have no objection.

Mr. BRANDON. The only thing I can say on that, Senator, is that I am not sure that simply because an industry or taxpayer follows a certain practice in the past, if it is at variance with the law and when the IRS catches up with them and changes it, I am not sure that past conduct alone is sufficient to change it.

Senator HASKELL. That is why this committee or a subcommittee of it could sit as you indicated as a court of equity because some of this is awfully unfair.

Mr. BRANDON. But I think in this case you would have to balance the equities. All I can say is that past practice alone should not be the criteria.

Senator HASKELL. I would agree with that.

Senator TALMADGE. Any further questions?

Senator DOLE. I find that somebody suggested that we at least have a transcript of markup sessions to enable us to protect ourselves from charges or to at least have information available. I think that is the first step.

I think the chairman has indicated he will take that step. I think we are all, and I have looked over some of your lists, you say they are not particularly objectionable and find that some of the amendments are on the list but none of mine are on the other list.

The point is that I think we are sensitive even though we disclose our contributions, there is that inference, whether intention or not, that only those seven Senators mentioned have received contributions from any of these groups.

Second, that we have some direct tie to that company or have offered an amendment for those companies, I cannot think of any of the companies for which I have offered amendments because of the political contribution.

It does tickle the imagination of the press when they see something like this even though it has been a matter of public record. They are cynical for the most part in any event. They like to attack public officials.

This does stir their imagination. Even though you indicate in your statement there is no impropriety suggested, I do not know why else you would attach the piece.

Mr. PIETZ. Can I say Senator that it is more the secrecy of the process that stirs their imagination. If in the future, you follow the procedure of getting full and adequate notice of who the beneficiary is, I think it would be very difficult to cast aspersions.

I would also suggest that we were very happy to find that there were numerous Members who apparently were very scrupulous about not having any overlap between amendments they sponsored or even any of the beneficiaries of the special interest amendments that someone may have sponsored about which they knew. There wasn't any overlap between that and their campaign contributions, we were very pleased to find both Republicans and Democrats—

Senator DOLE. I can give you names of contributors who came to me with amendments that I did not offer but you cannot just say that because someone offered a contribution, he cannot talk to the Senator.

Mr. PIETZ. That is right.

Mr. BRANDON. The only point is that the nondisclosure on the side of the beneficiaries of the provision is what gives rise to the inferences. That is the point that we are trying to make.

If all of this is out in the open and it does not look like there is something trying to be put over on the public—

Senator DOLE. Our contributions have been out in the open at least since the new law. They are a matter of record.

Mr. BRANDON. I do not suggest. I do not quarrel with that at all.

Senator DOLE. I think it would be helpful and I do not quarrel with the public citizens but we do not know who your contributors are. We may find in your contributors, competitors of some of these people who make big contributions to you to come up and attack their amendments. I do not know what the facts are, maybe that has never happened.

I would suggest that if we get a look at all of your contributors maybe we might find rather sizable contributors that Mr. Nader's group who have a direct interest in not seeing this legislation passed.

I think you have a million dollar reserve in Public Citizen, have you not?

Mr. BRANDON. I do not know what the latest report is. We do have a budget that runs in there.

Senator DOLE. You are a pretty big business and I do not quarrel with that.

Mr. BRANDON. I do not believe—I do not think we have that kind of portfolio.

Senator DOLE. I know that David Sanford is not one of Ralph Nader's favorite—he is the managing editor of the New Republic and at one time he wrote a book entitled, "Me and Ralph."

Mr. BRANDON. He never really had any close relationship but that is not the point.

Senator DOLE. You may not know that, no more than we had any relationship at all with any of these contributors. You inferred that, that definitely Sanford had no relationship with Nader.

Senator FANNIN. I do not like to disagree with some of my colleagues. They have their viewpoints and I have mine. I resent the almighty attitude that these gentlemen have taken, demanding special treatment, saying that they should have the audience here, they should have the Senators here, they want to be treated differently than others.

I just resent that very much. I also resent their rabble-rousing attitude and their feeling that they are to be given a preference above all others. I just feel that with the criticism that has been made by these gentlemen is misplaced. However, I do not want to take further time now to discuss their inaccurate statements, because I feel we have been very unfair to other people, that wanted to testify by giving these gentlemen the time we have.

It has been very, very unfair. I feel that some of the statements you have made here are terribly inaccurate and they are misleading, they are not founded on facts and I just do not feel that we benefit by having irresponsible people like you come into this chamber and try to dictate to us just what we should do.

Mr. PIETZ. May I say something?

Senator FANNIN. Now you can say what you want.

Mr. PIETZ. Let me just say that I—our statement yesterday, was that we are entitled to be heard with all the proper accoutrements of legal procedure and that all of the witnesses are.

We do not want any preferred status over any other witness.

Senator FANNIN. We have responsible and knowledgeable people who come in here to testify. We give them only a certain amount of time. We cut back on their testimony and sometimes cut them off. Yet we let you fellows, that I do not feel have the knowledge, the background and the expertise in the different tax fields who think you know it all, try to cover everything——

Mr. PIETZ. We sought no such preferential treatment.

Senator FANNIN. Let me finish my statement to the chairman. I think I have the floor. I just feel that with respect to our constituents, that we are responsible to them and to the people of America, not to Ralph Nader and his group.

I just do not feel that our time is well spent listening to people who do not have knowledge and expertise about what they are talking.

Senator TALMADGE. Any further questions?

Senator CURTIS. Are there any employees of these two Nader groups that work for both groups?

Mr. BRANDON. I do not believe so, if there are, they are on separate payrolls, maybe an accountant. I do not know but I could find out for you.

Senator CURTIS. Which do you work for?

Mr. BRANDON. Public Citizen.

Senator CURTIS. What is the other?

Mr. BRANDON. The Center for Study of Responsive Law.

Senator CURTIS. You do not do any work for them?

Mr. BRANDON. No.

Senator CURTIS. Have you ever?

Mr. BRANDON. No.

Senator CURTIS. You have no employees that are paid out of both funds?

Mr. BRANDON. I do not know of my own personal knowledge, but if there are, they are kept separately on two separate accounts. That is in the requirements of the law.

Senator CURTIS. How large an operation is the lobbying group? How many employees do you have?

Mr. BRANDON. I do not know the exact number. I could tell you who works in my group. We have eight people in my group but not all are salaried.

Senator CURTIS. You have no idea how many are in total?

Mr. BRANDON. I could supply that information to you. I am not quite sure I should supply it to the record here but I would be happy to supply it to you personally.

Senator CURTIS. Why do you not want to put it in the record?

Mr. BRANDON. It is not that I want not to, but I think it is irrelevant to the hearing.

Senator CURTIS. No, it is not. You are trying just like everybody back of this table to enact legislation and to prevent the enactment of legislation. You are trying to impose your beliefs on the public in the form of law.

Mr. BRANDON. We are just trying to make our beliefs known.

Senator CURTIS. No, you are not.

Mr. BRANDON. As are the other witnesses here, Senator.

Senator CURTIS. It is true that one of these organizations has a sizable reserve as referred to by Senator Dole?

Mr. BRANDON. I will get you the annual report which will tell you exactly how much money is spent.

Senator CURTIS. Is it in the neighborhood of a million dollars?

Mr. BRANDON. I frankly do not know. I will supply the information to you.

Senator CURTIS. You are a very good witness.

Mr. BRANDON. I did not come here today to discuss the intricacies of our organization. If you would like to discuss those privately, I would be happy to or even publicly.

Senator CURTIS. You came here to discuss the intricacies of this organization, to reform our procedures. We thought we would like to inquire about yours.

Mr. PIETZ. May I say that we as individuals feel that we have the same interests in the tax code as all of the other taxpayers who are similar witnesses. If everyone is curious as to their financial status, then perhaps we should all be treated equally but I do not feel that persons such as myself who feels himself ill used by the present tax code should be denied the chance to appear here.

Why should I be treated differently from the other witnesses in terms of whatever disclosure I am required to make?

Senator CURTIS. The other side of that coin is not to demand anything different than the other witnesses demanded, which you did not do yesterday. That is all, Mr. Chairman.

Senator TALMADGE. Any further questions?

[No response.]

Senator TALMADGE. Thank you very much, Mr. Brandon, for your contribution. The next witness is Mr. A. Blakeman Early, Environmental Action Group, accompanied by Mr. Leonard E. Lane, Public Interest Economic Center.

Mr. Early, you may insert your full statement in the record and summarize it.

[The statement follows:]

Good morning. My name is A. Blakeman Early, I am with Environmental Action, a national citizen's environmental lobbying organization. Environmental Action has been particularly active in promoting resource recovery legislation before the Congress. I am here to discuss section 2006 of H.R. 10612, the Tax Reform Act of 1976, the Recycling Tax Credit.

TAX EQUITY

As the Committee knows, many recycling tax credit proposals have been considered over the past several years and with each succeeding proposal the complexity of this subject area has become more apparent. While this proposal is distinguishable from others primarily by the addition of the base period which is designed to prevent windfall benefits, it still attempts to deal with a complex problem in the same fashion. It seeks to eliminate the effects of tax benefits to virgin materials users by creating a countervailing tax benefit to recyclable materials users across the board without regard to whether the benefits will achieve greater recycling of a given material. The benefits are extended without regard to whether the use of the recyclable material is even in competition with virgin materials which generate the original tax credits to be offset. Indeed, the benefits are extended without regard to whether there is any additional recyclable material which can be recycled. As the Aluminum Recycling Association has pointed out in its statement in opposition to this proposal, recycled aluminum alloy and primary aluminum alloy are used in wholly different products and so are not in competition. In addition, primary alloy manufacturers rely on foreign sources for their raw material, bauxite, and therefore cannot use the percentage depletion allowance to a great extent. Materials such as textiles and plastics qualify for the tax credit when no data has been developed indicating to what extent virgin material counterparts have achieved an unfair tax advantage. Clearly, then, if tax equity is the goal, the equity achieved by the subject proposal is a rough one, indeed. The only effective means of achieving tax equity, if that is the Committee's goal is to remove the benefits which accrue to virgin materials users, not to enact a countervailing benefit to recyclers which cannot even be shown to aproximate the virgin materials benefits.

INCREASED RECYCLING

The testimony and data provided to the Finance Committee in support of this proposal and past proposals is replete with the environmental, energy, materials, and balance of payment benefits which will accrue from the increased recycling promoted by the proposal. But will any appreciable increase in recycling result from the enactment of the subject provision? Proponents of this measure have presented no data to demonstrate its effectiveness in increasing the use of recyclable materials. Again, this is due in part to the failure of the measure to treat each material category on an individual basis. The lack of greater recycling of these materials is caused by a bewildering combination of technical, economic, and institutional barriers which vary depending upon which material is considered. Although it is difficult to generalize, many problems surround the impurities found in most recyclable materials which either require more processing than virgin materials need in order to remove them, or which simply are not removable using existing technology. (Attachment 1) The Committee cannot expect that a tax credit of the size proposed will be sufficient to overcome technological barriers requiring extensive research and development in each materials area, for the needs are different for each material. Section 2006 does not take into account that for some materials the technological barriers are too great. Therefore the use of that recyclable material should not qualify for the credit since no additional recycling will result and the only result would be that existing levels of recycling will receive windfall benefits.

The evidence we have examined indicates that the recycling tax credit proposal will also be ineffective in overcoming the economic factors which inhibit greater recycling. This data indicates that the factors limiting the use of secondary materials are not fundamentally altered by the minor adjustment in price enabled by this proposal. Attachment 2, taken from a study done for the U.S. Environmental Protection Agency, which compares subsidies to the product charge in the paper industry, illustrates that even when excessively large subsidies are introduced, demand for secondary material increases only slightly. This is because the subsidy would not be passed forward in the form of lower prices and stimulate demand.

The subsidy would be kept as "economic rent", or excess profit. Attachment 3 demonstrates that the cumulative tax subsidies available to virgin materials extraction industries, and to users of such materials because of the high degree of vertical integration, represent a small percentage of the total price of such materials. These findings indicate that the removal of these tax advantages would provide only a marginal increase to the cost of virgin materials in the form of higher prices. Consequently, the incentive to substitute post-consumer scrap would also be very low. A corresponding tax credit for secondary material suppliers would also represent a small percentage of post-consumer scrap price, since such prices are equal to or higher than competing virgin material prices. If the impact of such a tax credit on post-consumer scrap prices is small, then the corresponding incentive to suppliers to increase supply will also be small. Moreover, such a small reduction in post-consumer scrap prices would be unlikely to cause manufacturers to substitute such material for virgin materials.

Another study of the paper and steel industries found that demand and supply are inelastic and not responsive to price. The study found that subsidies of supply would have a reduced impact on the users since often half the cost of scrap materials is in transportation which would not be affected by a subsidy. (See Attachment 4.)

Therefore, the reduction of recyclable materials cost to the user through the proposed tax credit is unlikely to increase demand for such material significantly because the credit will lower the cost of such materials only slightly. To the extent that demand is marginally increased, suppliers will respond, in part, by raising prices and shifting more recyclable materials from the export market to the domestic market—not by obtaining more recyclables from the waste stream. This is why the proposal is opposed by the Association of Brass and Bronze Ingot Manufacturers and the Aluminum Recyclers Association as well as the Garden State Paper Company which provided much of the testimony in favor of the original proposal considered by the Finance Committee last summer. Indeed, we feel that the principal reason the measure is supported by recycled materials suppliers, who do not qualify for the credit, is that such suppliers will be able to increase the price of recyclable materials they sell users receiving the credit.

Finally, a major defect in the formulation of the provision is that the calculation of the credit is based on the price of the recycled material, which bears no relationship to the weight of the material—a more accurate measure of the burden such material places on the disposal system—and which also is no measure of the quantity of the materials available in the wastestream for recycling. Consequently, nonferrous metals such as aluminum would receive a disproportionately high part of the tax credit relative to the low tonnage of nonferrous which is presently recycled and relative to the additional tonnage which is available for recycling. In addition, basing the credit on the price will have a tendency to exacerbate the boom and bust pricing experienced in the recyclable materials markets. This is because when demand for recyclable material is low, prices are down too, and the tax benefit is at its lowest, since it is based on price. This is the time when the incentive is most needed. Conversely, when prices are high, due to high demand, the tax benefit is at its greatest during a period when it is least needed.

THE WINDFALL PROBLEM

The tax credit proposal will provide substantial "windfall" profits despite complex but ineffective provisions to prevent them. Manufacturers will receive a "windfall" by qualifying for the credit by recycling materials which they would have recycled without the tax credit. The provisions, by limiting accrual of the credit until purchases of recyclable material by the manufacturer exceed 75 percent of base period purchases, subsidize the manufacturer for increases in total production over previous levels even if he has not increased the actual percentage of recycled material in his product. Thus, manufacturers will be subsidized for using recycled material which they would have used simply to meet increases in production. Proponents of the recycling tax credit proposal claim that tax loss will be minimal because for each ton of recyclable material used, there will be a corresponding decrease in use of virgin material which would qualify for a tax credit. This assumes that there will be an increase in recycling, which we question. The assertion fails to account for the tax loss I have just described. The revenue loss would be much greater under Senator Gravel's amendment which I will discuss later.

In addition, we note with dismay that provisions in previous recycling tax credit proposals designed to limit possible windfall have been eliminated in this proposal. The provisions make no attempt, as found in prior versions, to limit the credit to purchasers of post-consumer material and exclude purchases of industrial converting wastes, 90 percent of which are currently being recycled. Gone is the requirement that the tax credit can only be applied against new investment in recycling equipment. (Identified by EPA as the best means of assuring that long term substitution of recyclable material will take place.) Except for scrap paper, gone also is the ceiling provision which terminates the credit should the price of the recyclable material rise high enough to provide its own incentive to increase supply and to prevent excessive revenue loss. Finally, the requirement that the credit be terminated at such time as tax benefits for virgin materials users are removed by the Congress has also been eliminated.

A great deal of controversy surrounds the level of tax loss and windfall benefit which will result from the proposal. Although the Report on H.R. 10612 states that the tax loss in 1977 will be $9 million, the Association of Brass and Ingot Manufacturers calculates that the scrap copper processors it represents would be entitled to $6,913,012 in credits. Since copper represents less than 5 percent of the material recycled each year, the Committee's calculations may be in error. More importantly, the Committee calculation of the revenue loss when the proposal is in full effect in 1981 is $345 million. Attachment 5 provides the U.S. Treasury calculation of the cost-per-ton of additional recycling created by the proposal when in full effect. It shows that the Federal government will in effect be paying from 2.60 to 20.10 times the market price in the form of lost revenue for every ton of additional material recycled. We submit that these moneys would be far more effectively spent if used to ensure that the recently passed Solid Waste Utilization Act (S. 2150) were fully funded. This bill provides technical assistance, planning, grants, and loan guarantees to stimulate the supply and use of recyclable materials and the safe disposal of non-recoverable waste. We are far more optimistic about the prospect of success for such an approach.

Finally, I would like to address the amendments to section 2006 recently proposed by Senators Mike Gravel and John Tunney. In our view, both proposals would amplify the current problems with the measure which I have outlined.

Amendment number 2016, introduced by Senator Gravel would essentially eliminate the base period as established in H.R. 10612 over a three year period. Recyclers would therefore receive a credit for 100 percent of the base year plus 100 percent of any incremental increase in recyclables used. Therefore, barring any major economic decline the revenue loss in 1981 should be about four times the Committee's original estimate, or $1.380 billion. A staggering tax loss, yet the data we presented indicates that as a percentage of recyclable materials cost to the user, it will be small and thus have little effect.

Amendment number 2017 introduced by Senator Gravel and Senator Tunney is a clear example of the inappropriateness of trying to apply the recycling tax credit approach across the board without regard to the technological and economic realities of the materials involved. The major effect of the amendment is to extend the 5 percent recycling tax credit already provided to purchasers of recyclable glass and plastic to purchasers of energy and other products produced from garbage residues, after all recyclable materials have been removed.

First, the amendment can not be supported by a tax equity argument since the production of steam is not directly subsidized through tax benefits resembling the depletion allowance and such allowance has been largely removed for oil production. This is not to imply that other subsidies for fossil fuels producers do not exist. More important, is the fact that the overwhelming impediment to the purchase of energy products from these resource recovery facilities is caused by the newness and questionable reliability of the technology involved and the technological modifications users must make in order to accommodate these products. These technological risks could not be remotely affected by such a modest tax benefit. Although we support the concept of encouraging the development of energy recovery facilities we believe that such facilities must operate on a free market basis without depending on subsidies for support. Where financial encouragement is necessary, it is far more effective if provided directly to the energy developer, rather than indirectly through the energy user, which simultaneously has the effect of encouraging increased energy use caused by lower energy costs.

ALTERNATIVE PROPOSALS

Although we recognize that current tax policy encourages the excessive use of virgin materials and energy, there are several approaches to correcting such inequities and providing an incentive for increased recycling: (1) tax credits for users of recyclable material, (2) tax credits for suppliers of recyclable material, (3) severance taxes on virgin materials extractors, (4) disposal charges on producers of consumer products which do not contain recycled material, and (5) the removal of existing tax benefits available to virgin materials users. The best manner for Congress to rationally alter tax policy in this area so as to create an effective incentive for recycling which will minimize tax revenue loss is to consider such proposals concurrently, rather than consecutively. In this way, if the Congress chose to pass more than one proposal, the passage of one would not jeopardize valuable support for the other. The Senate passed the Solid Waste Utilization Act on June 30 which contains a comprehensive study provision requiring an examination of all the available proposals for creating an effective incentive to encourage greater recycling. We urge the Senate to defer passage of the recycling tax credit until the completion of such a study to enable an effective analysis of the options to be conducted. Given the importance and complexity of improving our national materials policy to increase recycling and the importance of reducing revenue loss to a minimum to achieve the budget ceiling established by the congressional budgeting process, a delay to ensure that such information is considered before legislation in this area is passed is a necessity. Make no mistake about it, we view this provision as a special interest tax loophole—not as a provision to save energy and improve the environment.

My testimony presented today has the support of the following organizations besides Environmental Action: Environmental Policy Center, Friends of the Earth, Taxation with Representation, Public Interest Economic Center, and Public Citizen—Tax Research Group.

Paper Recycling, the Impacts of Contaminants, 1973–1985

(A Report by the Midwest Research Institute and Franklin Associates for the Solid Waste Council of the Paper Industry)

From 1973 to 1985, the use of waste paper is forecast to grow from 22.3 percent in 1973 to 24.4 percent in 1985. In tonnage, this is a significant turnaround, and in fact, the actual waste paper fiber use will increase substantially as its use outpaces growth in total paper demand.

The trends in fiber sources are summarized in Table 2–1. Total waste paper use will increase from 14.3 million tons in 1973 to 23.0 million tons in 1985, or from 22.3 percent of total fiber to 24.8 percent of total fiber.

Thus waste paper will become a more important fiber source in the future. This means it will be used in more grades of paper and in higher percentages. As it becomes more important, the type of contaminants associated with paper recovered for recycling will be of interest to the companies that recycle post-consumer grades.

Some uncertainties occur today because the concentration of contaminants is rising and the types of substances encountered cannot be fully removed or dispersed in the paper mills. If this situation prevails, then recycling costs and recycled products could become noncompetitive with virgin fiber and recycling will not expand as rapidly as it would otherwise. In either case, the effect of rapidly increasing contaminants could be unfavorable to the industry as it shifts its raw materials base toward waste paper.

TABLE 2-1.—FIBROUS RAW MATERIALS USED IN PAPER MANUFACTURE, 1950–85

[In thousand tons]

Year	Roundwood		Wood residues		Total wood pulp		Wastepaper		Other fibers		
	Tons	Percent	Tons	Percent	Tons	Percent	Tons	Percent	Tons	Percent	Total
1950	15,518	59.9	991	3.8	16,509	63.7	7,456	30.7	1,439	5.6	25,404
1955	19,737	62.0	1,716	5.4	21,453	67.4	9,041	28.4	1,340	4.2	31,845
1960	21,331	59.8	4,369	12.2	25,700	72.0	9,032	25.3	971	2.7	35,703
1965	25,369	56.2	8,638	19.2	34,007	75.4	10,231	22.9	879	2.0	45,117
1970	30,710	54.8	12,482	22.3	43,192	77.1	12,021	21.5	828	1.5	56,041
1973	30,490	47.6	18,372	28.6	48,862	76.2	14,319	22.3	964	1.5	64,145
1980	34,010	44.2	24,130	31.3	58,140	75.5	17,860	23.2	1,000	1.3	77,000
1985	39,510	42.6	29,210	31.5	68,720	74.1	22,990	24.8	1,000	1.1	92,710

Source: American Pulpwood Association; American Paper Institute; Midwest Research Institute.

RESEARCH TRIANGLE INSTITUTE,
January 1976.

The statements, findings, and conclusions presented in this draft report are tentative and are not necessarily those that will be found in the final report. Therefore, please do not cite or quote this document.

DRAFT FINAL REPORT—THE CASE FOR VIRGIN MATERIAL CHARGES: A THEORETICAL AND EMPIRICAL EVALUATION IN THE PAPER INDUSTRY

(Prepared for Office of Solid Waste Management Programs Environmental Protection Agency by Allen K. Miedema, Bun Song Lee, Joanne T. Rogoff, Philip C. Cooley)

5.2 REUSE RATIO EFFECTS

Figure 5–1 arrays predicted virgin fiber shares in 1985 versus charge/subsidy rates. Under all three generic policy specifications the virgin fiber share will decline from the predicted baseline level of 82 percent in 1985, i.e. the predicted baseline wastepaper reuse rate of 18 percent in 1985. The rate of descent, however, differs considerably among the three policies. For example, at a $25 rate the virgin fiber shares are predicted at 64, 81.6, and 73.3 percent for the charge, subsidy, and mixed policies, respectively. These imply reuse rates of 36, 18.4, and 26.7 percent respectively. It is interesting to note that the predicted 36 percent reuse rate under the $25 charge policy is nearly identical to the reuse rates that were experienced in the U.S. during World War II. At the extreme rate of $50 per ton the virgin fiber shares would be 47, 79.2, and 65 percent under the charge, subsidy and mixed policies, respectively. Clearly, the subsidy policy appears completely ineffective. Furthermore the effectiveness that the mixed policy does have is associated with the increasing charge rate over the ten-year period.

Since the subsidy policy was found uniformly ineffective it may be useful, at this point, to mention the two main reasons for this observation First, the elasticity of secondary fiber supply is very low, .09. Therefore, virtually none of the subsidy would likely be passed forward. It would be absorbed as economic rent by paperstock suppliers and/or paper producers. Second, the subsidy has a perverse demand effect as noted in chapter 3. This results because the little subsidy that does get passed forward lowers overall fiber furnish costs and, hence, paper production costs. This, in turn, shifts the paper supply functions rightward and downward. Therefore, with small substitutiton effects this shifting paper supply function may actually serve to increase total virgin fiber consumption above what it would have been in the absence of any policy.

5.3 FIBER CONSUMPTION EFFECTS

Figure 5–2 shows projected secondary fiber tonnage consumption projections for 1985 under the three policies at the ten rates.

ATTACHMENT 2–2

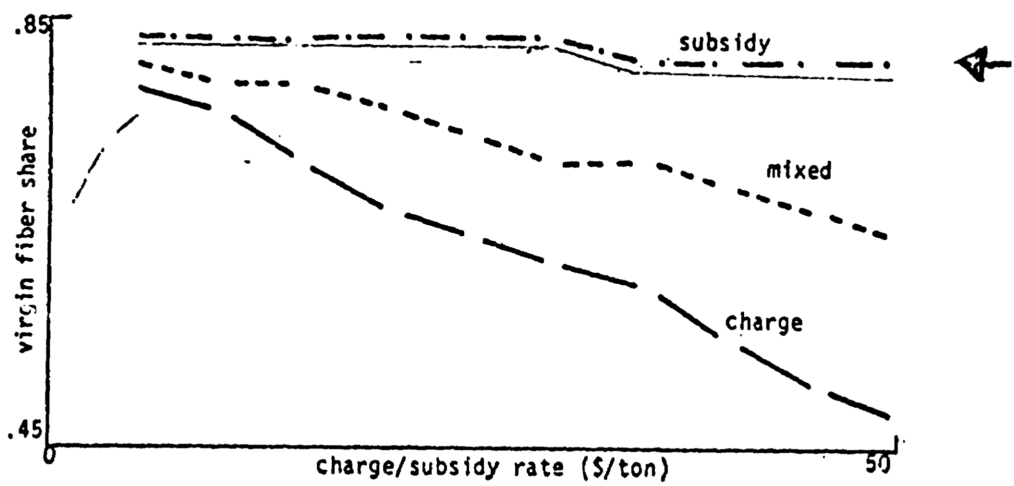

FIGURE 5–1.—Charge/subsidy effects on the virgin fiber share in 1985

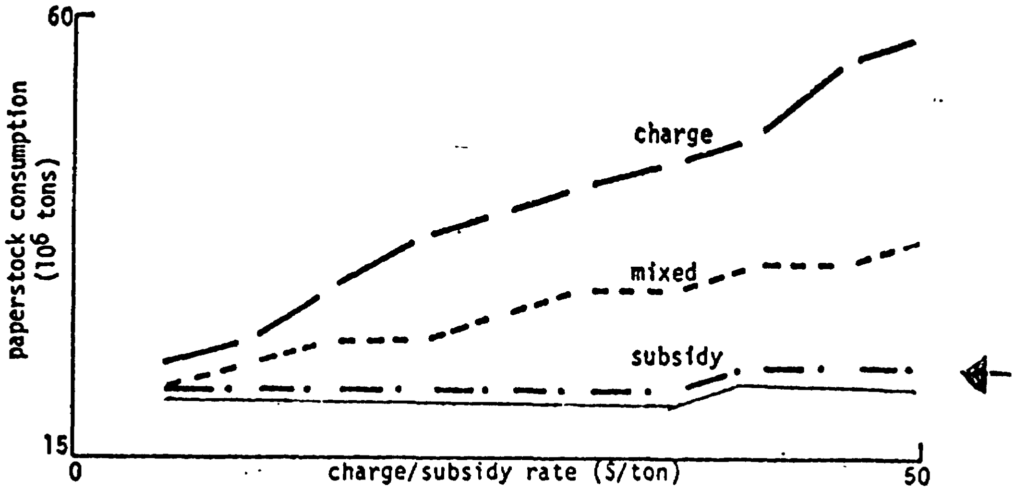

FIGURE 5-2.—Charge/subsidy effects on paperstock consumption in 1985

ATTACHMENT 3

MAXIMUM ESTIMATED IMPACT OF DISCRIMINATORY TAXES AND TAX BENEFITS ON THE COST OF SELECTED COMMODITIES, 19—

Tax element	Aluminum (per ingot ton)	Pulp and paper: Newsprint (per ton)	Pulp and paper: Paperboard (per ton)	Glass (per ton)	Steel (per ton of raw steel)	Petroleum (per barrel) for 1971	Natural gas (per thousand cubic feet) for 1971
Percentage depletion	$1.35			$0.20	$0.90	$0.25	$0.015
Foreign tax treatment	1.51				.27	.13	
Expensing of mine exploration and development expenditures	1.02				.27		
Expensing of intangible drilling and development costs						.01	.002
Capital gains treatment of income from timber sales		$1.14	$2.48				
Minimum tax on preferences						(.04)	(.002)
State and local resources taxes	(.08)				(.19)	(.06)	(.007)
Total (after tax)	3.80	1.14	2.48	.20	1.25	.29	.008
Percent of price	0.7	0.7	1.4-2.2	1.4	1.7	9.8	4.4
Total (before tax)	$7.92	$2.28	$4.96	$0.40	$2.60	$0.60	$0.017
Percent of price	1.5	1.4	2.8-4.3	2.7	[1] 3.5	20.2	9.3

[1] Percent of estimated average cost of producing raw steel at $75 (ton).
[2] Includes estimated percentage depletion for limestone, soda ash (a limestone derivative) and feldspar.

Note: Impacts are shown as tax savings associated with tax benefits (after tax basis). Before tax impacts represent the amount that prices would have to be increased to fully affect the effects of the removal of tax benefits.

THE FEDERAL TAX CODE AS A DETERRENT TO RECYCLING

(By Robert Anderson and Richard Spiegelman)

To the extent scrap supply and demand curves are inelastic, subsidies to either buyers or sellers have only a nominal impact upon quantities recycled. For example, a 10 percent ad valorem depletion allowance (or recycling tax credit as it was termed in pending energy conservation legislation) would, according to our estimated supply and demand elasticities, increase the quantity of wastepaper recycled by only 0.8 percent. A similar subsidy to the scrap steel industry would increase the quantity of steel recycled by 4.5 percent.

The equalization of effective tax rates in virgin and secondary materials industries achieved through the elimination of some of the income tax subsidies currently accorded the virgin material producers, would as we have seen in the econometric section, have a negligible impact on recycling over the short to intermediate term for which the elasticity estimate may be considered valid. The tax code may also be used to increase the final price of certain virgin based products so as to encourage greater recycling. HR 2172, for example, would tax beverage containers but would exempt all returnable containers from the tax.

The dilemma faced by those who would seek to increase recycling rates is that subsidization of either supply or demand fails to significantly increase recycling to the extent that production and consumption decisions are not responsive to price. In attempting to formulate a public policy which might have a greater impact one must first examine the underlying determinants of inelastic supply and demand curves. Inelasticity of demand with respect to the price asked by scrap dealers may be attributed to at least two factors. First, the full cost of scrap to a user includes transportation charges which occasionally exceed the dealer's price in magnitude. This means that though dealer prices are quite volatile, the price perceived by the user will fluctuate over a much narrower range. The inclusion of transportation charges in the price to users substantially reduces the elasticity of demand in response to a change in dealer prices. Second, many users perceive supply as being unresponsive to market signals and consequently may be reluctant to depend upon scrap supplies as a regular source of raw materials. These users purchase scrap only when other sources of supply are unavailable, and demand for their final outputs is strong. During these periods such users probably care little what they must pay for raw materials—availability counting far more than price in their purchase decisions.

Scrap supplies tend to be inelastic for two related reasons. First is the fact that over half of all scrap generated is of the home or prompt variety and is recycled automatically, or at least with little reference to prevailing prices for scrap. Of the post consumer sources most of the high quality, generator separated metals and paper are subject to disposal contracts with scrap dealers and will be recovered irrespective of current market conditions. Only the widely dispersed post consumer wastes are available as new supply sources when scrap demand rises, and the marginal costs of processing these supplies is high. The second, related factor leading to supply inelasticity is the volatile nature of demand which increase the risk of financial ruin.

ESTIMATED IMPACT OF FULLY EFFECTIVE RECYCLING CREDIT; 5 MAJOR RECYCLABLE MATERIALS [1]

Recyclable material	Typical market price per ton	Unsubsidized recycling volume	Incremental recycling due to credit [2]		Cost per ton of incremental recycling [3]	
			Amount (tons)	Percent	Amount	Ratio to market price
Paper (overall)	$45	16,000,000	120,000	0.75	$230	5.15
Scrap iron (overall)	75	40,000,000	190,000	.47	310	4.10
Copper	1,100	400,000	750	.19	11,100	10.10
Aluminum	300	350,000	3,900	1.10	785	2.60
Lead	220	560,000	500	.09	4,400	20.10

[1] These calculations are based on assumptions intended to overstate response to the subsidy, hence understate the cost per incremental ton of recycling: (1) Induced cyclable instability of the credit due to use of prior year bases is ignored. (2) No allowance provided for administratively uncontrollable fraud. (3) Estimates of market response rounded upward.

[2] This assumes that the base for the credit is purchases in excess of 75 percent of the taxpayer's base period quantity. If the base is redefined to be purchases in excess of 50 percent of the base period quantity, the numbers in this column would be doubled.

[3] Entries in this column are independent of the definition of the credit base, they depend only on price response of market demand and supply.

STATEMENT OF A. BLAKEMAN EARLY, ENVIRONMENTAL ACTION GROUP

Mr. EARLY. Good morning. Mr. Lane was not able to be with me today but his organization endorses my testimony. My name is A.

Blakeman Early and I am here to discuss section 2006 of H.R. 10612, the Tax Reform Act of 1976.

While this proposal is distinguishable from others of a similar nature that have been introduced in prior Congresses, primary by the additional base period, which is designed to prevent windfall benefits, it still attempts to deal with a complex problem in the same fashion.

It seeks to eliminate the effects of tax benefits to virgin material users by creating a countervailing tax benefit to recyclable materials users across the board without regard to whether the benefits will achieve greater recycling of a given material.

The benefits are extended without regard to whether the use of the recyclable material is even in competition with virgin materials which generate the original tax credits to be offset.

Indeed, the benefits are extended without regard to whether there is any additional recyclable material which can be recycled. As the Aluminum Recycling Association has pointed out in its statement in opposition to this proposal, recycled aluminum alloy and primary aluminum alloy are used in wholly different products and so are not in competition.

In addition, primary alloy manufacturers rely on foreign sources for their raw material, bauxite, and, therefore, cannot use the percentage depletion allowance to a great extent.

Materials such as textiles and plastics qualify for the tax credit when no data has been developed indicating to what extent virgin material counterparts have achieved an unfair tax advantage.

Clearly then, if tax equity is the goal, the equity achieved by the subject proposal is a rough one, indeed. The only effective means of achieving tax equity, if that is the committee's goal, is to remove the benefits which accrue to virgin materials users, not to enact a countervailing benefit to recyclers which cannot be shown to approximate the virgin materials benefits.

The testimony and data provided to the Finance Committee in support of this proposal and past proposals is replete with the environmental, energy, materials, and balance of payment benefits which will accrue from the increased recycling promoted by the proposal.

But, will any appreciable increase in recycling result from the enactment of the subject provision? Proponents of this measure have presented no data to demonstrate its effectiveness in increasing the use of recyclable materials.

Again, this is due in part to the failure of the measure to treat each material category on an individual basis. The lack of greater recycling of these materials is caused by a bewildering combination of technical, economic, and institutional barriers which vary depending upon which material is considered.

Although it is difficult to generalize, many problems surround the impurities found in most recyclable materials which either require more processing than virgin materials need in order to remove them, or which simply are not removable using existing technology.

The committee cannot expect that a tax credit of the size proposed will be sufficient to overcome technological barriers requiring extensive research and development in each materials area, for the needs are different for each material.

Section 2006 does not take into account that for some materials the technological barriers are too great. Therefore, the use of that recyclable material should not qualify for the credit since no additional recycling will result and the only result would be that existing levels of recycling will receive windfall benefits.

Senator TALMADGE. Sorry, Mr. Early. I am sorry to interrupt, we have 21 witnesses waiting to be heard. Any questions, Senator Gravel?

Senator GRAVEL. I have a question. On page 7 of your proposal, I think this essentially goes to the heart of the matter. I will read what you have here.

"Although we recognize that current tax policy encourages the excessive use of virgin materials and energy, there are several approaches to correcting such inequities and providing an incentive for increased recycling: One, tax credits for users of recyclable material, which is really what we have here; two, tax credits for suppliers of recyclable material."

My question then would be what additional credits—let me finish my question and then you can respond. Three is the severance taxes on virgin materials extractors, the repeal of that which of course was offered in committee and failed overwhelmingly, so that cannot be utilized; and four, disposal charges on producers of consumer products which do not contain recycled material.

That came up in the Senate not long ago and failed very strongly as did your last point, the removal of existing tax benefits available to virgin material users. The Senate already has essentially voted on two of these and they voted no, overwhelmingly.

That leaves the first proposal, which is the one we offer in this legislation, and the second proposal. Would you have any other constructive thought to give us as to what we ought to do to try to get this country fractured on what—on recycling some of its wastes?

Mr. EARLY. First of all, Mr. Gravel, I would not endorse either of the first two approaches.

Senator GRAVEL. But the others have failed.

Mr. EARLY. The others have not really been adequately considered by the Congress.

Senator GRAVEL. But if the Congress chooses not to take those, then you have no recommendation to make about this country?

Mr. EARLY. To my knowledge there has been consideration of the severance tax proposal by Congress.

Senator GRAVEL. We just had a vote in the Senate on adding the 5 cents or a source reduction tax. We had a vote on that. That was the Hatfield amendment that we had.

Mr. EARLY. That is not the proposal that I seek to describe.

Senator GRAVEL. It is simpler in concept?

Mr. EARLY. It is similar. It would be a tax on virgin materials and extractors, at the virgin extraction point in the production, consumption cycle, not at the consumer.

Senator GRAVEL. Essentially though if we do not adopt those provisions which you think are better, then your point is we should not do anything?

Mr. EARLY. My basic point is that the proposals have not been considered, as I pointed out—they have not been compared with each other.

Senator GRAVEL. Maybe they have not been considered adequately.

Mr. EARLY. I do not consider it a new idea for the Congress just to pass something to get through when it is going to cost $345 million in 1981.

Senator GRAVEL. Those figures are $325 million but I believe they are in error and the committee staff has already corrected it and we are talking about 200 and something at this point.

The first year is $9 million, the second is $39 million that it would cost?

Mr. EARLY. That is still open to question. As you know the witness on behalf of the element of recycling association intends that in the first year alone, the aluminum industry would qualify for over $6 million worth of tax credits.

Senator GRAVEL. I have had the aluminum people visit me, of course Alcoa and the other large companies and they find no problem with this. It is the smaller ones feeling that they will be disinfranchised.

Do you see—because the ones with which you lined up are not going to be enjoying that benefit of 75 percent of the profit. I tried to improve upon that but the committee was not willing to go.

You wind up with people who essentially have a sort of monopolistic position. I do not want to see an increase come in, which would change the market situation. I can understand that.

Mr. EARLY. There is certainly some truth to that. There are very much disturbed people about the so-called prejudice against the new entrance into the marketplace.

Senator GRAVEL. Do you not think that the fact that we only recycle 4 percent of all of the aluminum produced does not cry out for some change?

Senator TALMADGE. All right, Senator Gravel.

Senator GRAVEL. If I could have one brief statement?

Senator TALMADGE. Without objection, so ordered.

Senator GRAVEL. The New York Environmental Agency, and I do not want to let it be known to the committee that all of the environmentalists are on one side, which is like this organization, is for this amendment.

The National League of Cities is for this amendment, the U.S. Conference of Mayors is for this amendment and the National Governors' Conference is for this amendment so I do not feel it is special interest legislation.

I appreciate the views of the witness.

Senator TALMADGE. Thank you very much, Mr. Early. We appreciate your contribution and the next witness is Mr. Chase Troxell, on behalf of Mr. Frank A. Augsbury, III and Mr. Frank A. Augsbury, Jr. You may insert your full statement in the record and summarize.

[The statement follows:]

STATEMENT OF D. CHASE TROXELL ON BEHALF OF FRANK A. AUGSBURY, JR. AND FRANK A. AUGSBURY III

SUMMARY OF PRINCIPAL POINTS

1. Tax Reduction Act of 1975 contains a provision under which shipping income of a foreign corporation is taxed directly to its U.S. shareholders except to the extent plowed back into ships.

2. 1975 Act provision was aimed at tax haven, flag-of-convenience shipping controlled by U.S. corporations but also affects Hall Corporation Shipping Ltd., a Canadian company owned by U.S. individuals. Hall—

a. is incorporated in Canada because Canadian law requires local incorporation and registration of ships;
b. is subject to Canadian tax on worldwide income;
c. pays U.S.-scale wages to its crews, who are unionized; and
d. is not affiliated with any U.S. business organization.
3. If no relief is granted, this family business is likely to be destroyed.
4. Full disclosure of identities of interested parties was made to Ways and Means, Finance and Joint Committee staff.
5. Proposal was examined by Joint Committee and discussed by both Congressional Committees at some length in open executive sesions.

STATEMENT

This statement is made by Chase Troxell, a partner in the law firm of Burke & Burke, Daniels, Leighton & Reid, New York City, on behalf of Frank A. Augsbury, Jr. of Ogdensburg, New York, and his immediate family, who own all of the stock of Hall Corporation Shipping Ltd. of Montreal.

I. General Nature of Problem

Section 602 of the Tax Reduction Act of 1975 amended Subpart F of the Code in such a way as to cause shipping income earned by a controlled foreign corporation to be taxed currently to U.S. shareholders as if declared as a dividend, except to the extent that the foreign corporation spends the income for additional ships or repays mortgage loans on its existing fleet.

The Conference Committee Report [1] states that the intent was to repeal prior law "which permits a deferral of U.S. tax for shipping income received by a foreign subsidiary of a U.S. corporation." The provision was in fact aimed at "flag of convenience" fleets—ships owned by foreign subsidiaries of U.S. corporations incorporated in such tax haven countries as Bermuda and the Bahamas and registered in such countries as Liberia and Panama, ships that are operated as integral parts of U.S.-controlled international businesses, ships that could be operated by U.S. corporations, under U.S. flag and with U.S. seamen but are instead operated under foreign flag and ownership by low-wage foreign crews.

The provision was, however, written so broadly that it has exactly the same tax impact on Hall Corporation, a Canadian corporation which can only operate as a Canadian corporation with Canadian-flag ships; which is subject to tax by Canada on its world-wide income; which pays American-scale wages to its crews; and which is owned by U.S. individuals and is not part of a multinational combine in any sense.

II. Requirement of Canadian Incorporation and Registry

Few people outside the shipping industry have ever heard the term "cabotage." It means coasting, carrying passengers or goods between points within a single country.

Many countries have cabotage laws which restrict the coasting trade to vessels which are registered in that country and which are owned by citizens or corporations of that country.

The United States has had a cabotage law since 1920. No foreign ship can pick up goods in New Orleans and deliver them to Baltimore, for example.

Canada has a cabotage law too, forbidding, for example, an American ship from carrying goods between Montreal and Toronto. Only Canadian-flag ships owned by Canadian corporations or Canadian or other British Commonwealth citizens may do so. Consequently, if an American wants to engage in that trade he must do so through a Canadian corporation.

Hall Corporation Shipping Ltd. is a Canadian company headquartered in Montreal which ships grain, ore, coal and petroleum products on the St. Lawrence River and the Great Lakes. It is wholly owned by one American family, the Augsbury family who live in the small St. Lawrence valley city of Ogdensburg, New York, and who have owned the company since it was formed fifty years ago.

[1] The povision was not in either the House or Senate version of the Tax Reduction Act of 1975 but was added by the Conference Committee. Consequently no reference to it appears in either the House or Senate Committee Report. For fuller discussion please see Part VIII (G) below.

About 70 percent of Hall's income comes from coasting in Canada. The remaining 30 percent is from shipping goods—primarily Labrador iron ore—between Canada and the U.S. Since each of Hall's ships earns a significant part of its income from coasting, each must be registered in Canada and owned by a Canadian corporation.

III. Absence of Wage or Tax Avoidance Motivation

Hall is not avoiding high labor costs or taxes by being Canadian. Its crewmen are all members of the Seafarers International Union of Canada, AFL/CIO, whose wage rates are very comparable to U.S. union rates. Moreover, all of its worldwide income is subject to Canadian tax at rates comparable to ours.

IV. Independence of Operation

Hall is not part of a multinational group. It is owned by members of one family rather than by a U.S. corporation and all of its trade is with unrelated persons.

Hall is, therefore, not the sort of runaway operation which, we believe, the shipping income provision of the Tax Reduction Act of 1975 was aimed at. Nevertheless, under the Tax Reduction Act, Hall is treated no different from the offshore oil company subsidiary that runs Liberian-flag tankers from the Persian Gulf or the Caribbean to U.S. refineries—companies which could be incorporated in the U.S. and operate U.S.-flag ships with U.S. crews but choose not to.

V. Effect of Tax Reduction Act of 1975

The stockholders of Hall received a ruling from the Internal Revenue Service in December 1975 that any shipping income it earns in 1976 will not be Subpart F income because Hall was not formed or availed of to avoid tax. The ruling was issued under a general escape-valve section which was part of the original Subpart F when it was enacted in 1962.

If it were not for the ruling, the effect of the shipping income provision would be this: Hall would either have to pay out most of its income as dividends in order to enable the Augsburys to pay U.S. and State income taxes or purchase additional shipping, whether or not economic conditions justified such purchases.

The dividend alternative would strip the company of working capital.

The reinvestment alternative is impractical for two main reasons:

1. Strikes, collisions, weather along the St. Lawrence and in grain-growing areas of Canada and governmental actions, as well as rises and falls in the general economy, makes profits very unpredictable. An independent shipping company like Hall, which carries spot cargoes when and as available rather than operating ships under long-term charters to substantial shippers, cannot project profits at the beginning of a year with anything like the certainty of a manufacturing company, so it cannot hope to time ship purchases, which must be committed for long before delivery dates, in such a way as to match profits.

2. The purchase of shipping depends not only on the availability of current cash flow but also the availability of loans and shipyard berths and in many cases the concurrence of existing creditors and the host government.

As a practical matter, if not amended, the Tax Reduction Act would either force the sale of Hall to foreign interests or gradually drive the company out of business.

The ruling saves Hall from this result for 1976, and we would hope that the Service would renew the ruling from year to year. However, our situation is so completely free of tax-avoidance and fair wage-avoidance motives that we feel justified in asking Congress to exempt us by statute from Subpart F.

VI. Effect of Section 1024 of Tax Reform Act of 1976

Section 1024 of the Tax Reform Act[1] would give substantial relief since it provides that income from the coasting trade and, according to discussion on the floor of House when it debated the Act, also from the sale of ships to the extent that they have been engaged in that trade, is not "foreign base company shipping income." However, it does not remove from that category the income that Hall's

[1] Section 1024 of the House bill was directed at our situation alone. Section 1024 of the Senate bill covers three different situations, ours and two others which do not concern Hall.

ships derive from carrying goods between Canada and the U.S., and we feel that this income too should be exempt because:

1. No ship may operate in the U.S.-Canada trade under U.S. flag and ownership unless the ship is taken out of the Canadian coasting trade, since Canada bars the coasting trade to non-Canadian vessels.

2. Taking any ship out of the Canadian coasting trade would deprive it of such a large amount of business that it could not come close to operating profitably unless some new source of business were substituted.

3. None of Hall's ships could coast in the United States because coasting here is forbidden to foreign-built ships.

4. Ships such as Hall's fleet of dry-cargo vessels (called "lakers"), which are designed for the Great Lakes and the St. Lawrence River service, are shallow-draught and of reduced strength criteria and therefore cannot operate in the open ocean. Because of their small size (5,000 to 12,000 deadweight tons), its tankers are limited to distribution of refined products from local refineries on the lakes and river. They are not economically viable for ocean operation, where tankers ten or twenty times their size are commonplace and even larger tankers are not unusual.

5. There is not enough Canada-U.S. business available in the St. Lawrence-Great Lakes for an independent fleet to operate in that trade alone.

As a result, Hall can only operate as it now operates, and, if the present version of section 1024 is enacted, almost a third of Hall's income will be Subpart F income regardless of the fact that it must be Canadian and is not avoiding taxes or unionization by being so.

We feel that Congress did not have our type of business in mind when it passed the Tax Reduction Act and that the relief provided in H.R. 10612 does not up until this point protect us adequately from the unintended harm that the Tax Reduction Act will do to us.

VII. Relief Requested

It is requested that the present version of section 1024 be modified to exempt from "foreign base company shipping income" any income derived from the operation or sale of ships which engage, regularly and to a substantial extent, in the coasting trade within a foreign country if the laws of that country prohibit ships owned by U.S. corporations and citizens from engaging in that trade.

Not a single job which an American seaman could fill would be lost through such an exemption and any revenue loss would be temporary and miniscule. It would, on the other hand, avoid the needless and, we believe, unintended destruction of a major family business which has benefited people on both sides of our northern border for 50 years.

VIII. Procedure Followed in Requested Relief

Certain members of the Senate have objected to the fact that the Tax Reform Act contains many provisions, applicable to only one or a few taxpayers, which were slipped into the bill with little or no notice or opportunity for analysis and evaluation.

The relief provision Hall has asked for applies, we believe, to Hall and the Augsbury family only. We have never in any way attempted to make a secret of that fact but have, on the contrary, stated it orally and in writing to the House Ways and Means Committee, the Senate Finance Committee and the Staff of the Joint Committee on Internal Revenue Taxation. Moreover both Committees have discussed the provision at some length and the Staff of the Joint Committee has studied it in detail.

A summary of the procedural steps taken follows.

A. Ways and Means Committee hearings

On July 24, 1975, I made an oral statement before the Ways and Means Committee. In that statement, and in the written statement which I submitted at that time, I identified my clients by name and address and stated that the relief requested would probably affect only them.

The transcript of that hearing shows that the Acting Chairman proposed to the Committee that our request be refered to the Staff of the Joint Committee on Internal Revenue Taxation and that his recommendation was supported by Committee members from both parties.

B. Joint Committee inquiry

Our request was considered by the Staff of the Joint Committee during the summer of 1975. I had personal and telephone conversations with Staff members during that period and submitted data on Hall Corporation as well as proposals, ideas and arguments. There was no misapprehension on the Staff's part either as to whom I represented, what I sought or why I sought it.

The Staff made recommendations to the Ways and Means Committee when the Committee met in executive session in September and October 1975 to adopt the Tax Reform Bill.

C. Ways and Means Committee decisions

The Committee adopted the viewpoint recommended by the Staff of the Joint Committee, in effect approving our request in part but not in full, and the provision became Section 1024 of the Committee bill. The House passed the bill as proposed by the Committee.

D. House debate

The provision was the subject of a brief colloquy on the floor of the House between the Chairman of the Ways and Means Committee and a ranking minority member. The colloquy, which clarified an ambiguity in the provision, mentioned that the provision affected a particular Canadian corporation and its U.S. shareholders.

E. Finance Committee

When this Committee began consideration of the Tax Reform Act, I submitted a written statement to the Committee requesting the same relief that I had requested of the Ways and Means Committee. I also requested the opportunity to address the Committee, but that request was denied. In both the written statement and the request for leave to address the Committee, I identified my clients by name and address.

Our proposal was discussed by the Committee in executive session for perhaps 10 minutes, and the views of the Joint Committee Staff were requested and given. The Committee then approved the same partial relief as the House had and, though the wording of the applicable parts of Section 1024 of the Finance Committee bill differs from that of the House bill, to my mind the two bills mean exactly the same thing.

F. Conclusion

We believe that we have been completely candid and open with the Congress in requesting relief. We also believe that our proposal was thoroughly examined by an unbiased, expert body, the Staff of the Joint Committee. It was also discussed at some length by both the Ways and Means Committee and this Committee in executive sessions.

G. Postscript regarding congressional procedure in enacting the Tax Reduction Act of 1975

We would like to point out that the provision from which we have been seeking relief became part of the Tax Reduction Act of 1975 only in the Conference Committee. The concept was not considered by the Ways and Means Committee during its deliberations on the bill and was not part of the bill adopted by the House. Similarly, it was not considered by the Finance Committee.

On the floor of the Senate, an amendment to the Senate bill was adopted under which all net income of all controlled foreign corporations would be taxed as dividends to their U.S. sharholders; however, the amendment was a general one and did not apply particularly to the shipping industry. It applied to all business: finance, manufacturing, insurance, service, utilities, transportation, everything.

In the Conference Committee, the Senate floor amendment was eliminated and the particular provision involved here, that is, the provision applying to shipping alone, was adopted. The first notice to the public that there was a possibility that this provision would become part of the Tax Reduction Act of 1975 came after the Conference Committee had agreed on the provision and the House and Senate had by voice vote approved the Act and sent it to the President for signature.

The members who spoke on the floor on June 29 are unquestionably right in saying that special interest tax legislation should not be passed without adequate disclosure to and consideration by Congress, but at the same time we feel that Congress should not pass tax legislation without giving citizens any opportunity whatsoever to be heard and to demonstrate that a particular piece of legislation

is unfair and would have an unintended and disastrous effect on many of them, a few of them or even just one of them.

STATEMENT OF D. CHASE TROXELL ON BEHALF OF FRANK A. AUGSBURY, JR., AND FRANK A. AUGSBURY III

Mr. TROXELL. Gentlemen, I am listed as speaking on behalf of Frank A. Augsbury. In the newspapers, the provision on which I am speaking is listed as the Hall Corp. shipping provision.

I would like to say that the Public Citizen Tax Research Group according to its written statement finds that my client may be objectionable based on incomplete information. The Tax Reduction Act of 1975 contained a provision which provided that the shipping income realized by any foreign corporation, controlled by American citizens or American corporations will be taxed directly back to the U.S. shareholders, except to the extent that income is plowed back into ships for reinvestment.

The 1975 act's provision was aimed at tax haven flag of convenience shipping controlled by large west corporations particularly oil corporations which chose to have their foreign shipping handled through foreign subsidiaries which pay no U.S. tax to their jurisdictions of incorporation because they are low tax which register their ships in such countries as Liberia and Panama.

These companies pay no income taxes and they further benefit by the low rates that they are able to have because of their foreign crews. The provisions in the 1975 act, also affects our corporation, Hall Corp., Ltd., which is a Canadian, Montreal based corporation which separates the St. Lawrence River and the Great Lakes.

Hall Corp. is incorporated in Canada because under Canadian law it must be incorporated. The Canadian equivalent of the Jones Act was mentioned earlier this morning. Our corporation is subject to worldwide income tax by Canada at rates comparable to American rates.

Our corporations crews are all unionized AFL-CIO Canadian people to whom wages are comparable to U.S. wages, perhaps above them. Moreover the company is not affiliated with any U.S. business organizations. so that it is not comparable in any way to the situation which the Tax Reduction Act provision was aimed.

Quite simply if no relief is granted to our situation, our family business is likely to be destroyed through a forced sale or a destruction of business until it ultimately goes out of business.

We went to the Way and Means Committee for relief, disclosing who we were by name and address. We spoke at their hearings and they did in fact run—put into the Ways and Means Committee bill a partial means of relief.

They gave us an exemption from subpart F taxation for income realized on the traffic between Canadian ports and however, that covers 70 percent of our business and the other 30 percent is between the United States and Canada.

We are still asking for relief on our trade between the United States and Canada on grounds that we must be a Canadian corporation and cannot transfer our United States to Canada business anywhere else, the reason being that the ships engaged in this trade are also substantially engaged in the strictly Canada-to-Canada trade.

The CHAIRMAN. Your time has expired. Any questions? We appreciate very much your contribution to the committee's deliberations.

The next witness is Mr. William J. Byrne, Jr., vice president and treasurer, Freeport Minerals Co. You may insert your full statement in the record and summarize it.

[The statement follows:]

STATEMENT SUBMITTED ON SECTIONS 1031 AND 1032 BY FREEPORT MINERALS CO.

Repeal of Per Country Limitation and Recapture of Foreign Losses

Mining Company Transition Rule

SUMMARY OF PRINCIPAL POINTS CONTAINED IN STATEMENT

1. *Reliance of present rules justified.*—Per country limitation is more appropriate for "pure" mining companies than overall limitation. Mining companies must go where the minerals are.

2. *Stable tax climate important.*—Overseas mining projects of U.S. based companies have traditionally depended heavily on funds borrowed from consortiums of multi-national lenders; required long lead time, usually five years or more, from date of initial development until production at design rates is achieved and therefore need a stable tax climate in their early stages of life.

3. *Reason and fair play is basis for transition rule.*—A rule of reason and fair play suggests that a Mining Company Transition Rule of the type adopted by the Senate Finance Committee should be provided for newly established overseas mining ventures which have yet to demonstrate the ability to earn a profit on a consistent basis and have recently committed substantial additional capital (say in excess of $1,000,000) to reach design capacity.

4. *Revenue impact is minor.*—The revenue impact of this limited mining company transition rule should not exceed $2,500,000 per year during the three-year transition period (1976–1979) and a portion or all of this amount will in all likelihood be recovered in later years under the Committee's per country loss recapture provision which is applicable to these projects.

STATEMENT

My name is William J. Byrne, Jr. I am Vice President and Treasurer of Freeport Minerals Company, a domestic producer of fertilizer products and, through domestic subsidiaries, a producer of copper concentrates in Irian Jaya, Indonesia and a participant in a nickel and cobalt joint venture in Queensland, Australia.

I am pleased to have the opportunity to appear before your Committee to speak in favor of he Mining Company Transition Rule, which you have seen fit to include in Sections 1031 and 1032 of HR 10612. These Sections repeal the per country foreign tax credit limitation generally effective for taxable years beginning after December 31, 1975 and require the "recapture" of foreign losses again generally effective for taxable years beginning after December 31, 1975.

Accompanying me today is Mr. Dennis Bedell of the Washington Law firm of Miller & Chevalier.

HOUSE DECISION

Per country limitation

The House passed bill provides a transition rule whereby certain mining projects can continue to use the per country method of computing the foreign tax credit limitation for three years. Specifically the House passed bill permits certain recently-established mining projects, where substantial investments of capital had been committed under the assumption that the foreign tax credit could be computed under the per country limitation, to avail themselves of this transition rule.

A domestic corporation to be eligible to benefit from this transition rule would, as of October 1, 1975, have to meet all of the following conditions:

1. Been engaged in the active conduct of the mining of hard minerals for less than 5 years; and

2. Had losses from the mining activity in at least 2 of the 5 years; and

3. Deprived 80 percent or more if its gross receipts from the date of its incorporation from the sale of its mined minerals; and

4. Made commitments for substantial expansion of its mining activities.

Recapture of foreign losses

The House passed bill imposes, in the case of newly established mining ventures which qualify for the three year per country transition rule, a requirement that any foreign losses generated in taxable years beginning after December 31, 1975 be "recaptured". The "recapture" however was on a per country basis only during the three year transition period. However if these losses were not fully "recaptured" on a per country basis by the end of the three year transition period, all losses not so "recaptured" were to be immediately "recaptured" on an over-all foreign tax credit basis.

SENATE FINANCE COMMITTEE DECISION

Per country limitation

Agreed to House version.

Recapture of foreign losses

Agreed to House passed version except the Senate Finance Committee decision requires that foreign losses generated during the three year transition period be "recaptured" only on a per country foreign tax credit basis in future years.

DETAILED STATEMENT

Freeport Minerals respectfully submits that the transition rule for mining companeis provided by the Senate Finance Committee pursuant to its decision to repeal the per country foreign tax credit limitation is essential to assure equitable tax treatment for those mining companies which have relied in good faith on the present law and which have, as a result of that reliance, recently made substantial financial commitments to the development of new sources of minerals for our industrial society.

Basis for the per country method in the present law

The per country limitation has been a part of our tax laws since 1954. In 1960, when taxpayers were granted the ability to choose alternative limitations on the foreign tax credit, the pertinent committee reports recognized the appropriateness of the per country limitation for certain types of business operations by stating:

"On the other hand it is recognized that in some cases taxpayers may think of their businesses in various foreign countries as separate ventures. This, of course, is especially likely when a company begins in a different foreign country a business which is risky and which is likely to result in losses at least for an initial period of years. In such cases the company is more likely to think of such a business as being separate and apart from its other more stable operations in other foreign countries. It seems appropriate in such cases to permit taxpayers to use the per country limitation, thus for tax purposes treating each as a separate operation."

The per country method is particularly appropriate for mining companies

The foreign mineral operations of U.S. mining companies clearly fit the description of the types of business operations for which use of the per country limitation was deemed by Congress to be appropriate. The case of Freeport Minerals Company provides a specific illustration.

Freeport is presently involved in a nickel venture in Australia and a copper venture in Indonesia. Freeport's Australian nickel venture involves total capital costs in excess of $350,000,000 while the Indonesian venture has required a total capital cost in excess of $200,000,000. Both projects have been separately financed by international lending consortia. Each project is expected to service its debt from its own earnings, and the sales price of the output for each project is directly related to the world price of the particular mineral, and in the case of each venture, all sales are made to independent third parties.

With respect to the lead time required to bring these ventures into production, it should be noted that while the first development expenses for the Australian venture were incurred in 1969, sales of mineral products were not made until 1975. Although the Indonesian copper project was commenced in April 1967, first ore concentrate shipments did not begin until December, 1972.

As regards pre-production and operating losses, the Australian nickel project has recorded tax losses in all years to date, i.e., June 30, 1976, and expects to record a tax loss for its fiscal year ended June 30, 1977. In short, the tax losses from Freeport's Australian nickel venture, which at present substantially exceed its taxable income from its Indonesian copper mining project, can be expected to continue until the price of nickel rises from its current depressed level.

Furthermore, these operations were undertaken in a context of historical and continuing world-wide volatility of natural resources prices, recent and continuing world-wide violent currency fluctuations, and unprecedented recent and continuing high rates of inflation. As a result, the existence of the per country limitation, which would assure the stable tax climate necessary for bringing projects of this magnitude through the lengthy early stages of development, constituted a major factor in the decisions by both the company and the lenders to proceed with these projects. In view of the fact that the per country method has been available since 1954, and in view of the particular suitability of this foreign tax credit limitation to the practical realities of foreign mineral operations, there appeared to be little reason to expect that this limitation could not continue to be available. Freeport, therefore, moved forward with the large capital commitments required to secure the new reserves of industrial minerals which these projects could provide and included in the necessary preliminary feasibility studies the assumption that the per country method of computing the foreign tax credit would be available in determining the amount of funds available to repay borrowed capital.

Repeal of the per country method requires an equitable limited transition rule

The Senate Finance Committee has recognized that repeal of the per country limitation represents an abrupt change in long-standing tax policy which requires a degree of equitable relief for those most adversely affected by reliance on previous policy. While repeal of the per country limitation will undoubtedly inhibit prospective investment in foreign mineral ventures, the most severe impact will be felt by existing, newly established overseas mining ventures which have yet to demonstrate the ability to earn a profit on a consistent basis and which have recently committed substantial additional capital (i.e., in excess of $1,000,000) to reach design capacity and commercial viability. The Senate Finance Committee has therefore provided a limited and reasonable transition period in which companies with existing projects in this category can restructure their financial operations without placing such projects in undue jeopardy.

Revenue impact of the transition rule

The revenue impact of the limited mining companies transition rule provided by the Senate Finance Committee should not exceed $2,500,000 per year during the three-year transition period (1976–1979) and a portion or all of this amount will in all likelihood be recovered in later years under the Committee's per country loss recapture provision which is applicable to these projects.

The rationale supporting a limited transition rule for mining companies is not dependent upon or related to the Possessions exception which is also included in Sections 1031–1032 of the Bill. By far the major part of the revenue loss of $32 million reported in the press, if correct, is related to the Possessions exception.

STATEMENT OF WILLIAM J. BYRNE, JR., VICE PRESIDENT AND TREASURER, FREEPORT MINERALS CO.

Mr. BYRNE. I have with me today, our counsel, Mr. Dennis Beddell. In our opinion, the per country limitations are generally more appropriate today to mining income because mining companies must go where the minerals are.

As a rule, each overseas new venture is looked upon as a separate venture, hence heavily—requires long lead time and is by the nature a risky enterprise susceptible to losses in its early years.

It was this type of business operation to which the use of the per country limitation was deemed by Congress to be appropriate. It was introduced into law in 1954. In the case of Freeport Minerals Co., I think a specific illustration is provided.

Freeport is presently involved in a nickel venture in Australia. Freeport's Australian nickel venture involves total capital cost in excess of $350 million, of which over $250 million represents borrowed capital from outside sources including the U.S. Export-Import Bank. The Indonesia venture involves total capital costs in excess of $200 million.

Both projects have been separately financed by international lending consortia. Each project is expected to service its debt from its own earnings, and the sales price of the output for each project is directly related to the world price of the particular mineral.

The leadtime for the Australian project was 5 years between 1969 and sales in 1975 and the Indonesian project approximately the same has had tax losses in the 4 years to date.

These operations were undertaken in the context of historical and continuing worldwide volatility of natural resources prices and currency flutuations and high rates of inflation.

The existence of the per country limitation would assure the stable tax climate necessary for bringing projects of this magnitude through the lengthy early stages of development, constituted a major factor in the decisions by both the company and the lenders to proceed with these projects.

In view of the fact that the per country method has been in the loss in 1954, over 20 years now, there was little reason to expect that this limitation would not continue to be available.

We, therefore, moved forward with the necessary feasibility studies based on the assumption that the per country method would continue and large capital expenditures were made accordingly.

We brought to the attention of the Ways and Means Committee—the Ways and Means Committee staff, early last fall this problem and that may be why our name is so readily mentioned.

In all of the documents we have submitted over a long period of time, our name, of course, is quite evident. We feel that we have followed the regular procedure.

Senator TALMADGE. Thank you very much for your contribution, any questions?

The next witness is Mr. T. J. Shiel, director of taxes, PPG Industries, Inc. You may insert your full statement in the record.

[The statement follows:]

PPG INDUSTRIES,
Pittsburgh, Pa., July 19, 1976.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Dirksen Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: Attached is statement on behalf of PPG Industries, Inc. in connection with the pending Tax Reform Bill of 1976.

Following is a summary of the principal points raised in the statement:

1. Section 1031 of the Bill repeals the per-country limitation now contained in Section 904 of the Internal Revenue Code. With respect to Puerto Rico operations, it has a three year phase-in clause.
2. Per-country limitation is a valuable option, especially to those investing in Puerto Rico; it ought not to be repealed.
3. If it is repealed, then the repeal should not apply to investments already made; or, there should be an adequate phase-in period which will allow those taxpayers relying on the option, sufficient time within which to adjust to the change in the law.
4. Charges have appeared in the press to the effect that Section 1031 of the Bill was altered in Committee, at the request of Senator Mike Gravel, which granted special concessions to PPG Industries, Inc. This is just not so.

Yours very truly,

THEUS J. SHEIL,
Director of Taxes.

Attachment.

STATEMENT OF MR. T. J. SHEIL, DIRECTOR OF TAXES, PPG INDUSTRIES

My name is T. J. Sheil and I am Director of Taxes for PPG Industries, Inc. I am accompanied by John D. Luffe, Tax Manager for PPG Industries. Inc.

This statement is directed at Section 1031 of the Tax Reform Bill of 1976, as reported by the Senate Finance Committee. Section 1031 of the Bill provides for repeal of the "per-country limitation" which is now one of the two options contained in Section 904, IRC. The alternative option is the "overall limitation"; either option imposes a limit on the credit allowed against U.S. taxes for foreign taxes paid on foreign source income. Except for the special status of a corporation operating under Section 931, IRC, income and taxes emanating from U.S. possessions and Puerto Rico are governed by the foreign tax credit provisions of the code.

Section 1031 contains a phase-out of the impact of the repeal of the "per-country limitation" with respect to operations in U.S. possessions and Puerto Rico. It was reported in the press that one or more Senators alleged that Senator Mike Gravel introduced this part in the Senate Bill on behalf of PPG Industries, Inc. To set the record straight, Senator Gravel made no proposals relating to this subject and PPG had no part in the version of Section 1031 produced by the Senate Finance Committee. PPG has made representations to the U.S. Treasury Department and the Joint Committee on Taxation with respect to Section 1031 as it pertained to investment on the Island of Puerto Rico.

While the per-country limitation is not actually an incentive, it does provides a safety valve for industries investing in Puerto Rico should such investment result in losses. The valve isolates such losses, thus preventing mitigation or elimination of the foreign tax credit otherwise available to the taxpayer. Absent such relief, the price to be paid for an unprofitable investment in Puerto Rico is not only the normal business risk of operating at a loss but the additional penalty of the elimination of the foreign tax credit otherwise available when profits are brought home from foreign countries.

In the case of PPG Industries, Inc., the decision to invest $200 million in the Puerto Rican economy was made under the rules of the game which provided for the "per-country limitation" and thus protected PPG from the loss of its foreign tax credit should the investment not prove profitable. Statements from various sources, in addition to those noted above, have named PPG as seeking special treatment in this area. Nothing could be further from the truth. PPG went to Puerto Rico on the basis of the Code in existence at the time. Section 1031 would change the rules after PPG had invested a very substantial sum of money in Puerto Rico. If this is to be the case, PPG believes that a phase-in of the rule changes should be allowed in order that appropriate business decisions concerning existing Puerto Rico investment may be made without undue harm to the economy of Puerto Rico or the taxpayer.

If Congress should enact Section 1031, we believe that it should only apply to profits (and losses) derived from investments in Puerto Rico made subsequent to enactment. This would enable us to consider the jeopardy to our foreign tax credit when a business decision must be made as to future investment on the Island.

It is stated that the proposed changes in parts of the Code are designed to correct alleged abuses in foreign operations. What abuses exist in Puerto Rico? In fact, since 1898 Congress has attempted to encourage economic development in Puerto Rico. What person here considers Puerto Rico to be "foreign?" Earlier this year, this Committee heard testimony on the subject and concluded that the policy was still valid.

But what about losses? Of course, no companies are going to Puerto Rico, or anywhere else, to generate losses. Yet, as we know from our own experience, it can happen with capital intensive industries. If Section 1031 is to be enacted we urge the Committee to provide the safety valve of "per-country limitation," or at least a modest phase-out, with respect to operations in our possessions and territories.

Thank you.

Mr. SHEIL. In the interest of time, we will pass the opportunity to testify and let the record move on.

Senator TALMADGE. In that case, we will next hear from Mr. George W. Beatty, on behalf of Boise Cascade Corporation.

[The statement follows:]

Statement Submitted by Boise Cascade Corp.

SUMMARY

Boise Cascade Corporation ("BCC") holds foreign government bonds which were issued years ago when the foreign governments took over local operating companies owned by predecessors of BCC. The bonds are presently worth much less than their face value and tax basis.

If the loss recapture provisions of H.R. 10612 were enacted in the form approved by the House, and the bonds became worthless or were sold after the effective date of the new law, BCC's normal foreign tax credit would be severely reduced for a number of years thereafter.

It seems highly unlikely that the House actually intended such a result. As passed by the House, the loss recapture provisions have no application to certain involuntary losses including "foreign expropriation losses." Because it is clear that the potential losses in question here are closely akin to expropriation losses, it seems virtually certain that the House would have excluded such losses from the coverage of its bill if it had been aware of the problem when it passed the bill.

In an open mark-up session on May 14, 1976 Senator Packwood described the foregoing problem to the Finance Committee and identified BCC as the US corporation involved. In response to that public presentation, the Finance Committee added Section 1032(c)(2) to the House bill to make the loss recapture rules inapplicable to losses incurred on disposition of foreign government obligations issued before May 14, 1976, in payment for the stock, debt or assets of local operating companies taken over by the foreign governments. Because Section 1032 (c)(2) avoids a potential unintended hardship and implements the House's stated purpose of excluding expropriation-type losses, the amendment should be retained in the Senate bill.

Background Facts

In 1964 and 1970 agencies of the Chilean and Brazilian governments issued their bonds to corporate predecessors of BCC in payment for the stock and debt of foreign utility companies operating in Chile and Brazil. BCC's predecessors sold the stock and debt of the local utility companies to the Chilean and Brazilian governments under an implied or de facto threat of condemnation.

There is no public market for these foreign government bonds, but over a period of years, BCC has succeeded in selling some of them at a discount to third parties in private placement transactions. On July 2, 1976, BCC sold all of its remaining Chilean bonds, which had a face value and tax basis of approximately \$61 million, for a total price of approximately \$29.5 million. BCC still holds Brazilian bonds with a face value and tax basis of approximately \$79 million. If BCC is able to dispose of the bonds at a discount prior to maturity, or if the Brazilian government defaults on the bonds, the IRS will probably treat the resulting loss as a foreign source loss.

EFFECT OF H.R. 10612 WITHOUT A CORRECTIVE AMENDMENT

Section 1032 of H.R. 10612 as passed by the House provides that if a taxpayer has an "overall foreign loss" in a taxable year beginning after December 31, 1975, the amount of that loss will reduce the amount of the taxpayer's otherwise allowable foreign tax credit in subsequent years. The House bill does this in two ways. First, for purposes of calculating the § 904 foreign tax credit limitation, the amount of foreign source income realized by the taxpayer in subsequent years is reduced by 50% in each subsequent year until the aggregate reductions equal the amount of the original overall foreign loss. Second, the amount of creditable foreign tax paid or deemed paid in each such subsequent year is also reduced by 50%.[1]

On an average basis over the last three years, BCC has realized approximately \$16 million of net foreign source income each year (excluding extraordinary items), and has paid foreign taxes of approximately \$4 million each year. If these levels continue, enactment of H.R. 10612 without a corrective amendment would reduce BCC's allowable foreign tax credit by approximately \$1.1 million over a

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[1] The second adjustment contained in the House bill has been eliminated in the Finance Committee bill for reasons unrelated to BCC's submission.

seven year period if BCC's remaining Brazilian bonds were sold later this year at the same discount rate as the Chilean bonds and the losses on these sales were treated as foreign source losses.[3]

DISCUSSION

The basic concept of the loss recapture provisions is that "where a loss from foreign operations reduces U.S. tax on U.S. source income, the tax benefit derived from the deduction of these losses should, in effect, be recaptured by the United States when the company subsequently derives income from abroad." H. Rep. No. 94-658, 94th Cong. 1st Sess., p. 228. However, the concept is not intended to apply to involuntary foreign losses over which the taxpayer has no real control. Thus, H.R. 10612 as passed by the House already provides that foreign expropriation losses and casualty losses will not be taken into account in determining whether there is an "overall foreign loss". (See section 904(f)(2)(B) as added by section 1032(a) of H.R. 10612).

If the stock or assets of a foreign company are sold to a foreign government following express or implied threats of condemnation, and if the government issues its bonds in payment therefor, any loss realized on subsequent disposition or worthlessness of those bonds is clearly an involuntary loss, and it should be so treated for purposes of the new loss recapture rules. This is particularly true where the transaction with the foreign government occurred long before the new loss recapture rules were first proposed, with the result that the taxpayer will have a large "built-in" loss on the foreign government bonds when the new rules go into effect.

As previously stated, Senator Packwood described this problem and identified BCC's interest in it during a public Committee mark-up session on May 14, 1976. In resopnse, the Finance Committee decided to amend the bill by adding the provisions now contained in Section 1032(c)(2). The committee's decision—taken after full public discussion of the problem—was consistent with the real objectives of the House bill and should not now be reversed.

STATEMENT OF GEORGE W. BEATTY ON BEHALF OF BOISE CASCADE CORP.

Mr. BEATTY. I am appearing on behalf of Boise Cascade Corp., who we have represented concerning a variety of tax matters for some time. Boise Cascade strongly urges your support for the retention of section 1032(c)(2) in the bill dealing with a transitional exception to the so-called loss recapture roles dealing with the computation of the foreign tax credit.

The statement we have submitted for the record goes into the technical background. I certainly do not want to take your time to repeat it now, beyond very briefly pointing out how this problem arose and why we think the committee's solution is a perfect case study of how the process ought to work.

In 1964 and again in 1970, the Brazilian and Chilean Governments took over the stock of local utility companies operating there from predecessors of Boise; instead of totally exappropriating the foreign utilities, the foreign governments delivered to Boise predecessors Government bonds, Brazilian and Chilean agency Government bonds in purported payment of the assets.

Those bonds are now worth much less than their face value. Boise succeeded in getting rid of part of them at a substantial loss and antic-

[3] In 1976 there would be an overall foreign loss of $56 million ($31.5 million actual loss on sale of Chilean bonds plus $40.5 million assumed loss on sale of Brazilian bonds, less $16 million net foreign source income from other transactions). In each of the next seven years, foreign source income would be reduced by 50% from $16 to $8 million for purposes of calculating the section 904 limitation. The limitation would therefore be reduced by 50% each year to $3.84 million (50% of 48% of $16 million). Thus, in each year, $160,000 of foreign tax credit would be lost ($4 million tax paid less $3.84 million limitation). The total loss over seven years would be $1.12 million (7 x $160,000).

ipated that it will incur a greater loss when it disposes of the rest of them.

The question that presents is whether that loss which is now— should be taken into account under these new foreign tax credit rules.

When the House passed the bill late last year, it contained an exception in it, stating that the new loss recapture rates were not to apply to foreign expropriation losses. When Boise read the technical language, they realized that it would not cover their case as written, but clearly the intent was to prevent the new rules from applying to an expropriation type of loss which was essentially an involuntary one.

Boise then came to the staff of the joint committee and explained the situation. The staff immediately agreed that had they been aware of the situation when drafted, the House bill would have taken care of it at that time as part of that expropriation loss.

Boise in turn went to the staff of a Finance Committee member and explained the problem. It was taken up in markup session. Boise's involvement was made absolutely clear at that markup session.

Boise was named, their background facts all brought out. The committee decided to make an appropriate change, announced it in a press release, and it was done when the committee bill came out.

The Treasury has no objection to this provision. Taxation With Representation yesterday had not objection to this. Mr. Brandon has no objection to this, and it is, so far as I know, a totally unobjectionable amendment which we urge you to strongly retain in the bill.

Senator TALMADGE. Thank you. Any questions? We appreciate your contribution. The next witness is Mr. Ralph I. Petersberger on behalf of SCM Corp.

[The statement follows:]

STATEMENT SUBMITTED BY SCM CORP.

SUMMARY

SCM is a Fortune 500 U.S. company which is engaged in the production and sale of chemicals and coatings, paper, foods, and consumer and office products. It has some 45 foreign subsidiaries operating in 21 foreign countries throughout the world.

Because of declining demand resulting from the European economic recession, SCM was recently forced to sell its French paint business. The French subsidiary's operating assets were disposed of and the operations were terminated. SCM incurred a substantial loss on its investment. The Company is now faced with deciding whether it should continue certain of its foreign operations which have also been experiencing difficulties. As a result of operating losses which have not been deducted in SCM's U.S. tax returns, these foreign subsidiaries are now worth much less than the amount SCM has invested in them.

Under the loss recapture rules in Section 1032 of H.R. 10612 as passed by the House, SCM's regular foreign tax credit could be cut in half for several years as a result of losses realized on the disposition of foreign subsidiaries which became largely worthless before the new law went into effect. To avoid this undue hardship, the new loss recapture rules should be made inapplicable to "built-in" losses which were incurred in an economic sense prior to enactment of the new law.

The Finance Committee has previously approved two transitional rules designed to reach this result in certain situations. The first of these transitional rules is contained in section 1032(c)(3) of the bill reported out by the Committee; the other is described in the Committee's press release for June 11, 1976. SCM strongly urges the Committee to retain both of these provisions in the bill.

DISCUSSION

Section 1032 of H.R. 10612 as passed by the House provides that if a taxpayer has an "overall foreign loss" in a taxable year beginning after December 31, 1975, the amount of that loss will reduce the amount of the taxpayer's otherwise allowable foreign tax credit in subsequent years. The House bill does this in two ways. First, for purposes of calculating the § 904 foreign tax credit limitation, the amount of foreign source income realized by the taxpayer in subsequent years is reduced 50 percent in each subsequent year until the aggregate reductions equal the amount of the original overall foreign loss. Second, the amount of creditable foreign tax paid or deemed paid in each such subsequent year is also reduced by 50 percent.[1]

Under § 1032 as passed by the House, losses realized after the effective date are taken into account in full in computing the foreign tax credit reduction in future years, even though those losses are attributable in an economic sense to events occurring before the enactment of § 1032. Such losses are referred to as "built-in" losses.

For example, assume that a U.S. parent has invested $25 million in the stock of a foreign subsidiary. Over a period of many years, the subsidiary has incurred operating losses which have consumed most of its capital. Because the subsidiary is a foreign corporation, the U.S. parent has not been able to deduct or otherwise reflect any of these operating losses in its own U.S. return. In 1977, the subsidiary becomes insolvent. Under § 165(g)(3) of the Code, the parent is entitled to a $25 million ordinary deduction in its 1977 return for its worthless stock investment in the subsidiary.

If § 1032 were enacted without an exception to cover such cases, the entire $25 million deduction would be taken into account under the new foreign tax credit limitation rules, even though most of this amount was economically attributable to the operating losses incurred by the foreign subsidiary long before § 1032 was enacted. The results of applying § 1032 without an exception for built-in losses could be catastrophic. For example, if the U.S. parent normally received $10 million of foreign source income and normally paid $4 million of foreign tax each year, recognition of the entire $25 million built-in loss would mean that the U.S. parent's normal foreign tax credit would be reduced by almost $5 million during the three year period following the year of the loss.[2]

In recognition of the undue hardship that could result if § 1032 were applied to built-in losses, the Finance Committee has approved two transitional exceptions. As previously stated, the first is contained in § 1032(c)(3) of the bill reported out by the Committee; the other is described in the Committee's Statement of Actions taken on June 11, 1976. Since these provisions apply only to built-in losses that are realized in taxable years ending before January 1, 1979, they will not afford complete protection to SCM should it be forced to dispose of other subsidiaries currently operating at a loss. Indeed, it seems likely in some cases that four to five years will be required to make all of the studies and analyses, and to develop and implement programs designed to salvage these operations, before making the irrevocable decision to dispose of them. Nevertheless, SCM strongly urges the Committee to retain both provisions of the bill. Taken together, they should provide at least partial relief for SCM and numerous other similarly situated taxpayers that may be forced to shut down foreign operations in the immediate future as a result of the cumulative effect of pre-1976 operating losses for which no prior U.S. tax deduction has been taken.

STATEMENT OF RALPH I. PETERSBERGER ON BEHALF OF SCM CORP.

Mr. PETERSBERGER. I appear on behalf of SCM regarding foreign loss recapture provisions of section 1032(c)(3) of the bill. SCM is a

[1] The Finance Committee bill omits the second adjustment for reasons unrelated to this submission.

[2] 1977, the parent would have an "overall foreign loss" of $15 million ($25 million stock loss—$10 million foreign source income). For purposes of computing the § 904 limitation in each of the next three years, net foreign source income would be reduced by $5 million (50% of $10 million) for total reductions of $15 million (3 x $5 million). In each year, the revised § 904 limitation would be $2.4 million (48% of $5 million) and $1.6 million of foreign tax credit would be lost ($4 million tax less $2.4 limitation). Over the three year period, the total loss of credit would be $4.8 million (3 x $1.6 million).

widely diversified company which is engaged in the production and sale of chemicals, coatings, paper, and office products.

It has some 45 foreign subsidiaries operating in 21 foreign countries throughout the world. Because of declining demand resulting from the European economic recession, SCM was recently forced to sell its French paint business.

The French subsidiary's operating assets were disposed of and the operations were terminated. SCM incurred a substantial loss on its investment. The company is now faced with deciding whether it should continue certain of its foreign operations which have also been experiencing difficulties.

As a result of operating losses which have not been deducted in SCM's U.S. tax returns, these foreign subsidiaries are now worth much less than the amount SCM has invested in them.

Under the loss recapture rules in section 1032 of H.R. 10612 as passed by the House, SCM's regular foreign tax credit could be cut in half for several years as a result of losses realized on the disposition of foreign subsidiaries which became largely worthless before the new law went into effect.

To avoid this undue hardship, the new loss recapture rules should be inapplicable to "built-in" losses which were incurred in an economic sense prior to enactment of the new law.

The Finance Committee has previously approved two transitional rules designed to reach this result in certain situations.

The first of these transitional rules is contained in section 1032(c)(3) of the bill reported out by the committee; the other is described in the committee's press release for June 11, 1976.

SCM strongly urges the committee to retain both of these provisions in the bill. At this point, I would like to depart from my statement to make four additional points. This is not special- or narrow-interest legislation in any sense.

SCM had no part in the introduction of these provisions and it came forward to testify only when it was alleged that this was special interest legislation. It wanted to make clear that this is equitable relief in these transitional rules and that they apply to SCM and a substantial number of other similarly situated taxpayers who have conducted their foreign operations through foreign subsidiaries and where such subsidiaries have operated at a loss, have claimed no prior U.S. tax benefit with respect to such operating losses.

Furthermore, this is not special interest legislation in the sense that it is granting an extraordinary benefit to one or more taxpayers. On the contrary, it is attempting to remove a penalty which would have been inadvertently imposed on a large group of taxpayers.

These transitional rules are designed to protect taxpayers which incurred foreign losses through foreign subsidaries in an economic sense prior to enactment of the new law on a par with other U.S. taxpayers which incurred them through foreign ventures.

I would note that the Treasury, which was one of the original sponsors of the loss recapture rules, indicated in the statement filed yesterday with the committee, that it has no objection to those transitional provisions.

I note that these transitional rules as drafted apply only to built-in losses that are realized in taxable years, ending before January 1,

1979. SCM is a June 30 fiscal year taxpayer and, thus, the partial relief afforded by these provisions will apply to it only with regard to losses realized at the close of a tax year ending June 30, 1978.

We would urge that the transitional rule adopted by the committee on June 11 be applied to loss in factor, realized before January 1, 1979 with no regard to the taxable year involved.

In this way, all taxpayers will have the same target. I thank you.

Senator TALMADGE. Thank you. The next witness is Mr. Raphael Sherfy, on behalf of Nabisco, Inc.

[The statement follows:]

STATEMENT OF RAPHAEL SHERFY, MILLER & CHEVALIER, WASHINGTON, D.C. ON BEHALF OF NABISCO INC.

SUMMARY

(1) Recommends that Committee reaffirm its decision of June 11, 1976, regarding the recapture of foreign loses caused by worthless securities. That Committee decision would provide that in the event a worthless securities loss is claimed with respect to a foreign subsidiary prior to January 1, 1979, the U.S. taxpayer's loss would not be recaptured to the extent of the cumulative negative earnings and profits of such subsidiary on December 31, 1975.

(2) Nabisco believes that the loss recapture provisions of section 1032 apply inequitably in certain cases involving worthless securities.

(3) Losses of foreign subsidiaries which have been incurred before January 1, 1976 should be excluded from these provisions if claimed in connection with a worthless security loss prior to January 1, 1979.

STATEMENT

Mr. Chairman: My name is Raphael Sherfy and I am testifying on behalf of Nabisco, Inc., which believes that Sec. 1032 of the Senate Finance Committee version of H.R. 10612, dealing with recapture of foreign losses, in particular the treatment accorded worthless securities, discriminates against many corporations operating through foreign subsidiaries, including Nabisco.

Section 1032 position

Under Section 1032 any taxpayer who sustains an overall foreign loss for any taxable year which reduces the taxpayer's U.S. tax would be required to repay this tax benefit over future years by reducing the taxpayer's use of future available foreign tax credits.

Nabisco is not here to discuss the primary issue raised by Section 1032 of whether or not foreign tax credits should be restricted or eliminated in any way. Nabisco is here only to ask that tax legislation relating to loss recapture now being considered treat those corporate taxpayers who have operated overseas through foreign subsidiaries equally with corporations having operated overseas as branch operations of a U.S. corporation. Existing tax law allows corporations with branches abroad to reduce their U.S. taxable income by losses sustained in those branch operations in the year incurred. However, corporations operating through foreign subsidiaries may reduce their U.S. taxable income through foreign losses only if and when they go out of business and claim a worthless securities loss with respect to the foreign investment. We believe it is not the intention of the Committee to retroactively take away from U.S. corporations who have relied on the tax law in its present form, the tax benefits from a worthless securities deduction which stemmed from operating losses of those subsidiaries incurred in past years and for which no U.S. tax benefit has been claimed.

The outcome of any investment is never determinable at the outset. For those foreign investments of Nabisco which have negative earnings, the Company has not received a U.S. tax benefit because of the foreign subsidiary form of organization which was utilized. The Company has turned some of its past loss operations around. Nabisco has continued to operate abroad with the belief that if its efforts to remedy certain foreign problems ultimately prove to be unsuccessful, we would, under present law, eventually receive a U.S. tax benefit for prior years losses which were never taken previously if we terminate the operation and claim a worthless securities loss under Section 165(g) (3) of the Internal Revenue Code. Section 1032, in its present form would effectively negate this benefit.

In general, Section 1032 would be effective for taxable years beginning after December 31, 1975. We feel this rule is unreasonable and inequitable for the following reasons:

1. No prior US tax benefit could have been taken by Nabisco on foreign subsidiary loss operations.
2. Because of the effective date proposed in this section, an insufficient time period is given the taxpayer in which to evaluate the worthlessness of his investment and adopt appropriate action to continue operations or to claim a security loss without recapture
3. The Company relied on existing tax law when making past investment decisions, and now the rules are being changed in the middle of the game.

Recommendation

Nabisco recommends that the Committee reaffirm its decision of June 11, 1976, regarding the recapture of foreign losses caused by worthless securities. That action was an amendment which states that in the event a worthless securities loss is claimed with respect to a foreign subsidiary prior to January 1, 1979, the U.S. taxpayer's loss would not be recaptured to the extent of the accumulative negative earnings and profits of such subsidiary on December 31, 1975. This provides partial equity, since it puts the taxpayer who operated through a foreign subsidiary somewhat on a par with those who operated under the foreign branch concept. It also provides a reasonable period of time to continue to make the operation profitable before being forced to decide to accept the worthless nature of the investment.

STATEMENT OF RAPHAEL SHERFY ON BEHALF OF NABISCO, INC., ACCOMPANIED BY ED MATTHEWS, TREASURER OF THE COMPANY

Mr. SHERFY. I am testifying on behalf of Nabisco. Mr. Edward Matthews, treasurer, is with me. Nabisco is here to ask that any tax legislation relating to less recapture, now being considered, treat those corporate taxpayers who have operated overseas in foreign subsidiaries equally with corporations having operated overseas as branch operations.

Existing tax law allows corporations with branches abroad to reduce their U.S. tax liabilities by losses sustained from those branch operations. Our corporations operating through foreign subsidiaries may reduce their U.S. taxable income through foreign losses only if and when they go out of business and claim a worthless securities loss with respect to the foreign investment.

We believe it is not the intention of the committee to take away retroactively, from U.S. corporations, who have relied on the tax law in its present form, the tax benefits from a worthless securities deduction which stemmed from operating losses of those subsidaries incurred in past years and for which no U.S. tax benefit can be claimed.

Nabisco recommends that the committee reaffirm its decision of June 11, 1976, regarding the recapture of foreign losses caused by worthless securities. That action was an amendment which states that in the event a worthless securities loss is claimed with respect to a foreign subsidiary prior to January 1, 1979, the U.S. taxpayer's loss would not be recaptured to the extent of the accumulated negative earnings and profits of such subsidiary on December 31, 1975.

Let me point out that this recommendation is not a new one. In the Revenue Act of 1962, Congress decided that subpart F income should be reduced currently by any deficits for years prior to its effective date.

See Section 952(c)(1)(B). In other words, favorable treatment of deficits sustained in years prior to the effective date of Subpart F was adopted by the Congress. Our request is similar in purpose.

We would like to point out also that the basic recapture loss provision was originally conceived as being a provision to prevent double benefits. The first benefit being the allowance of deductions for foreign losses against U.S. source taxable income followed by the second benefit, which is the foreign tax credit when the operation becomes profitable. We would like to emphasize that in the case of worthless security losses, the operation will never prove profitable and therefore a main concern leading to the recapture proposal does not exist here. Thank you.

Senator TALMADGE. Thank you very much. The next witness is Mr. Felix B. Laughlin, on behalf of American Can Co.

[The statement follows:]

SUMMARY OF TESTIMONY OF FELIX B. LAUGHLIN FOR AMERICAN CAN CO.

1. On March 5 of this year, American Can Company recognized a loss of more than $10,000,000 upon the abandonment of stock and debt investments in a group of seven foreign corporations, referred to as the "Elegance Group", whose overall operations had resulted in substantial losses since the Group's acquisition in 1970.

2. Under section 1032 of the House-passed version of H.R. 10612 (which would be applicable to losses recognized in taxable years beginning after December 31, 1975), American Can's anticipated "overall foreign loss" for 1976 resulting from the termination of its interest in the Elegance Group would be subject to "recapture" for foreign tax credit purposes. This would mean that, to the extent of such overall foreign loss, American Can's foreign source income in subsequent years from operations wholly unrelated to such loss would be treated as United States source income so that foreign taxes paid with respect to such unrelated foreign source income may never be creditable by American Can for U.S. Federal income tax purposes.

3. American Can strongly urges that the retroactive application of section 1032 of the Bill to termination losses should be limited by an appropriate transitional rule, such as the one contained in paragraph (3) of section 1032(c) of your Committee's amendments to the Bill (which paragraph is entitled "Substantial worthlessness prior to enactment"). Although American Can would prefer a permanent exception for termination losses, this transitional rule recognizes the unfairness of applying the recapture provision to foreign losses like the Elegance loss which were sustained in a very real economic sense prior to the effective date of section 1032, even though such losses may be technically recognized for tax purposes after such effective date.

Mr. Chairman and members of the committee, my name is Felix B. Laughlin. I am a member of the law firm of Dewey, Ballantine, Bushby, Palmer & Wood. I am appearing today on behalf of American Can Company in support of limiting the retroactive application of section 1032 of H.R. 10612 (the tax Reform Bill of 1976), through provisions such as the one contained in paragraph (3) of section 1032(c) of your Committee's amendments to the Bill (which paragraph is entitled "Substantial worthlessness prior to enactment").

American Can Company is a New Jersey corporation having its principal office at American Lane, Greenwich, Connecticut 06830. American Can is a publicly-held company engaged primarily in the production of container and packing products, consumer products and chemicals and in providing printing, solid waste processing, patterns and information technology. Since 1968, American Can has conducted certain international financing operations through its wholly-owned subsidiary, American Can International Corporation ("International").

On March 5 of this year, American Can and International recognized a loss of more than $10,000,000 upon the abandonment of their stock and debt investments in a group of seven foreign corporations, referred to as the "Elegance Group," which were wholly-owned first- and second-tier subsidiaries of International. The companies in the Elegance Group were engaged in the international mail order merchandising of high-fashion dresses and fabrics.

International had purchased the stock of the Elegance companies on July 10, 1970 for a total purchase price of $3,360,000. As a result of subsequent stock investments in, and loans to, the companies in the Elegance Group by International and American Can, certain open-account sales by American Can to companies in the Elegance Group and payments with respect to a guaranty of bank debt, the total basis to American Can and International in the stock investments in, and notes and accounts receivable from, the Elegance Group as of March 5, 1976 (the date on which American Can and International terminated their interest in the Elegance Group) was approximately $10,208,000.

The overall operations of the Elegance Group were not successful and resulted in substantial losses subsequent to the acquisition by International.[1] Because of these substantial losses, in late 1975 American Can began making efforts to sell the stock of the Elegance companies, but these efforts proved unsuccessful. On March 5, 1976, International abandoned its stock in the Elegance Group, and American Can and International cancelled all outstanding indebtedness to them from the Elegance companies. On the same day, in order to give certain employees of the Elegance Group the opportunity to attempt to salvage the business, International transferred the stock of the companies in the Elegance Group to those employees. The resulting loss amounted to approximately $10,208,000, and is so large that it is anticipated that American Can will suffer an "overall foreign loss" under the proposed statute with respect to its foreign operations in 1976.

Under section 1032 of the House-passed version of H.R. 10612, which would be applicable to losses recognized in taxable years beginning after December 31, 1975, American Can's overall foreign loss for 1976 would be subject to "recapture" for foreign tax credit purposes. This would mean that, to the extent of such overall foreign loss, American Can's foreign source income in subsequent years from operations wholly unrelated to such loss would be treated as United States source income so that the foreign taxes paid with respect to such unrelated foreign source income may never be creditable by American Can for United States Federal income tax purposes.

This result seems to go well beyond the purpose of the recapture provision, which appears intended to prevent a taxpayer from deducting "start-up" losses incident to the commencement of a foreign business and later taking a credit for foreign taxes paid on income received in subsequent years from such foreign business. As stated by Secretary Simon in his testimony before your Committee on March 17, 1976:

"We view this [i.e., the recapture rule] as a technical change to eliminate an unintended benefit. Under present law, a U.S. taxpayer can use foreign start-up losses to reduce U.S. tax and then pay no U.S. tax on subsequent foreign gains because of the foreign tax credit. In such a case it is only fair for the U.S. to recapture the tax lost during the start-up period."[2]

Termination losses, i.e., losses incurred on the discontinuance or other disposition of a business enterprise, are not comparable to "start-up" losses; rather, they are economically similar to casualty and foreign expropriation losses which are excepted from the definition of "overall foreign loss" by proposed section 904(f)(2)(B) (contained in section 1032(a) of the Bill). As in the case of casualty and expropriation losses, such termination losses are unplanned, largely beyond the control of the taxpayer, and inherently unlikely to have offered any opportunity for the taxpayer to have obtained any unintended foreign tax credit advantage.

If, however, no permanent exception is to be provided for termination losses, we strongly urge that the retroactive impact of the recapture provision to such losses should be limited by an appropriate transitional rule. Such a transitional rule is presently contained in your Committee's amendments to the House-passed Bill. Although your Committee's modifications retain the general effective date of December 31, 1975, a transitional rule is provided in section 1032(c)(3) which excepts from the recapture provision all losses incurred by a taxpayer with respect to stock or indebtedness of a 10%-or-more owned corporation in which the taxpayer has terminated his interest by sale, liquidation or other disposition before January 1, 1977, where such stock or indebtedness is considered "substantially worthless prior to enactment." In order for the stock or indebtedness to be considered "substantially worthless", the issuing or obligor corporation (i)

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[1] A summary of the performance of each company in the Elegance Group, and the overall performance of the Elegance Group, during the past five fiscal years is shown in the attached schedule.

[2] Statement of the Honorable William E. Simon, Secretary of the Treasury, on Major Tax Revisions and Extension of Expiring Tax Cut Provisions, before the Senate Finance Committee, March 17, 1976, at page 89.

must have sustained losses in three out of the last five taxable years beginning before January 1, 1976, and (ii) must have sustained an overall loss for those five years.[3]

Although we would prefer a permanent exception for termination losses, this transitional rule would at least limit the retroactivity of the recapture provision in the case of termination losses. Where this exception applies (which requires satisfying the five-year "look-back" tests), it is clear that the foreign loss has been sustained in a very real economic sense prior to the effective date, and it seems unfair to apply the recapture provision to such loss simply because it is technically recognized for tax purposes after the effective date.

There are, of course, a number of other ways in which the retroactivity of the recapture provision could be limited. For example, your Committee could move the general effective date of the recapture provision to December 31, 1976, or to the date of enactment. Changing the effective date in this manner would be consistent not only with the traditional view of the Congress that retroactive tax legislation should be avoided,[4] but also with the "recapture of foreign oil related loss" provision contained in section 907(f) of the Internal Revenue Code (added as part of the Tax Reduction Act of 1975), which apparently served as a model for the more general recapture provision here in question and which was made applicable to taxable years beginning after the calendar year of enactment.

Another approach would be to adopt a transitional rule which would exempt from the recapture provision any termination loss resulting from investments made by the taxpayer prior to the effective date of the provision (or prior to the House Ways and Means Committee's announcement relating to this provision) and recognized for tax purposes prior to, say, January 1, 1981. This appproach would not result in a permanent "grandfather" rule, but would give taxpayers some period of time in which to decide either (i) to take their losses prior to the cut-off date with the tax consequences they could have expected when the investment was made or (ii) to continue the investment beyond the cut-off date having received adequate notice of the tax credit implications of the recapture provision.

I thank you for the opportunity to be here today and will be pleased to answer any questions you may have with respect to my testimony.

SCHEDULE SHOWING 5-YR PERFORMANCE OF ELEGANCE GROUP, AFTER TAX INCOME (OR LOSS) FOR FISCAL YEAR ENDED OCT. 31

Company	1971	1972	1973	1974	1975	Total
Elegance Rolf Offergelt GmbH	($285, 331)	($15, 790)	$332, 708	($1, 095, 524)	($1, 691, 232)	($2, 755, 169)
Elegance Publikations AG	8, 149	27, 791	52, 205	60, 126	7, 070	155, 341
Setalana Couture Stoffe AG	45, 534	49, 220	64, 093	33, 349	20, 748	212, 944
Goldfalter Modestoff Grosshandel GmbH	34, 189	35, 525	20, 150	(29, 156)	596	61, 304
Tissus Elegance S.A	6, 009	(60, 751)	(113, 004)	72, 406	(166, 635)	(261, 975)
Astor Modetvger AB	(20, 349)	(12, 011)	(38, 609)	(14, 504)	(22, 081)	(107, 554)
Elegance Tissus et Nouveautes SpA	(1)	(115, 225)	(448, 213)	($7, 663)	64, 343	(596, 758)
Consolidation adjustments	(2, 755)	20, 542	258, 723	637, 047	129, 326	1, 042, 883
Total	(214, 554)	(70, 699)	128, 053	(433, 919)	(1, 657, 865)	(2, 248, 934)

[1] Not in existence in fiscal 1971.

STATEMENT OF FELIX B. LAUGHLIN ON BEHALF OF AMERICAN CAN CO.

Mr. LAUGHLIN. I am appearing here today on behalf of American Can Co., in support of limiting the retroactive provision of section 1032 of the bill relating to the recapture of foreign losses.

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[3] Your Committee's Report on H.R. 10612 (S. Rep. No. 94-938, 94th Cong., 2d Sess., June 10, 1976), at page 241, notes that, in applying the five-year tests, a taxpayer should be permitted to aggregate the results of operations of all issuing or obligor corporations which are operated in the same line of business, where the taxpayer terminates its interest in all of the included corporations by January 1, 1977.

[4] See Statement of Senator Long and Senator Curtis, on Tax Revision Revenue Estimates, before the Senate Budget Committee, April 1, 1976.

More specifically, we support the transitional rule which is contained in section 1032(c)(3) of the committee's version of the bill which is entitled, "Substantial Work Business Prior to Enactment."

In the interest of saving this committee's time and in light of the prior testimony, I would like to submit my written statement.

Mr. LAUGHLIN. I thank you for the opportunity to be here.

Senator TALMADGE. Thank you very much for your brevity. The next witness is Mr. Cornelius C. Shields, accompanied by Mr. H. Lawrence Fox, on behalf of Sun Oil Co.

[The statement follows:]

WRITTEN TESTIMONY ON BEHALF OF SUN CO., INC.

(By Cornelius C. Shields, Chief Tax Counsel Sun Co., Inc. and H. Lawrence Fox, Pepper, Hamilton & Scheetz, Counsel)

SUMMARY

1. Section 907 of the present Code was added by the Tax Reduction Act of 1975. Subsection 907(f) provides rules for recapture of foreign oil-related losses. Although Congress intended that Section 907(f) operate prospectively, in its present form the Section can operate retroactively by requiring a taxpayer who relied upon prior law to recapture losses incurred pursuant to pre-existing contractual obligations even through such obligations were entered into well before the 1975 Tax Act.

2. Section 1035(b) of H.R. 10612 is a technical amendment which provides a deferral-type transition rule to the foreign loss recapture provision. It does not eliminate loss recapture in the case of pre-existing contracts, but only extends the time period over which recapture occurs. Specifically Section 1035(b) provides that foreign oil-related losses which are sustained in a taxable year ending before January 1, 1979, and which are incurred pursuant to a binding contract entered into on or before July 1, 1974, need not be recaptured in an amount exceeding 15 percent of such loss for the first four years after they become subject to recapture and are fully subject to recapture thereafter.

3. Sun is requesting relief from Congress because of an oversight contained in Section 907(f) when enacted. Classification of the Company's petition as special in nature and therefore questionable would be as unfair as the statute itself. The Company has not suggested eliminating the principle of law contained in Section 907(f) but merely reducing its inequitable application. Section 1035(b) of the Bill provides significantly less relief than most "grandfather" amendments and does not reduce Sun's ultimate tax burden.

4. Finally, in addition to filing testimony with this Committee on April 22, the Company has brought its position to the attention of one, the Treasury Department, two, the entire U.S. Senate, and three, many of the so-called public interest groups. Clearly, the Company has not sought this amendment without public scrutiny or a public hearing.

INTRODUCTION

Prior Testimony and Finance Committee Action

Sun Company filed testimony with the Committee on Finance on April 22, 1976, indicating its concern with the apparent but unintended requirement of present Code Section 907(f) that a taxpayer which relied upon existing law must recapture, to its detriment, losses incurred pursuant to binding contractual obligations entered into with foreign governments or their national oil companies well before the Tax Reduction Act of 1975.

Following this testimony, the Finance Committee adopted a deferral-type transition rule to redress this inequity. The technical amendment is in Section 1035(b) of H.R. 10612 as reported to the Senate.[1] Prior to the Committee's determination, Sun representatives met with each Senator on the Committee or his staff to ensure that the equities of this amendment were understood. Subsequent

[1] Present Code Section 907(f) is renumbered as Section 904(f) in the Bill as a consequence of other decisions made by the Finance Committee. References in this statement to present Code Section 907(f) should be understood as equally applicable to the proposed renumbered Section 904(f).

to the Committee's favorable decision, correspondence was sent to all other members of the Senate explaining the amendment, along with a copy of the testimony.

July 21, 1976 testimony

Due to concern expressed by several members of the Senate that this provision and numerous others contained in the Bill were not subject to sufficient public hearings, the Finance Committee issued a press release on July 8, 1976, announcing that additional hearings would be held on over 60 provisions of H.R. 10612 including Section 1035(b). On behalf of Sun Company, we are here to offer additional testimony.

EFFECTIVE DATE OF 907(f)

Statute to be prospective

The Tax Reduction Act of 1975 added Section 907 to the Code. In general, this Section applies a strict limitation on the use of foreign tax credits from foreign oil extraction income and foreign oil-related income. Section 907(f) provides rules for recapture of foreign oil-related losses. When enacted, Congress intended that it be prospective by providing an effective date after December 31, 1975, instead of the general effective date, December 31, 1974, for Section 907. However, in Sun's case it is unintentionally retroactive because it requires this taxpayer, who relied upon prior law, to recapture losses incurred pursuant to pre-existing contractual obligations, even though such obligations were entered into well before the 1975 Tax Reduction Act.

Application of 907(f) to Sun Co.

Before July 1, 1974, Sun entered into contracts with a number of foreign governments or their national oil companies pursuant to which Sun is required to expend over $100 million through 1978 in drilling and exploring new areas. This program was initiated a number of years ago in reliance on the tax law prior to the enactment of Section 907(f) in order to develop additional sources of crude oil for Sun's U.S. refineries.

It is anticipated that as a result of Sun's contractual foreign exploration effort, the Company will have net foreign losses totaling approximately $70 million over the next two to three years. As enacted, Section 907(f) would recapture these losses thereby requiring Sun to pay approximately $33 million in additional Federal income taxes. This retroactive tax increase is directly attributable to contracts entered into prior to the enactment of Section 907(f). It is a burden that the Company could not have anticipated in making its financial commitments. Notwithstanding the unfair windfall to the Federal Government, the amendment, contained in Section 1035(b) of the Bill will not relieve Sun of its obligation to pay these increased taxes. It will only provide a measure of relief by extending the time over which they must be paid.

EQUITABLE RELIEF

In general

As previously stated, Section 907(f) produces an inequitable and unintended tax burden on Sun. It is fair to assume that this would not have occurred if Congress were aware of Sun's facts at the time of enactment. For example, it probably would have provided a transition rule "grandfathering" binding contracts as it did in Section 604(b)(2), relating to the investment credit on drilling rigs used outside the northern part of North America. This would have been consistent with the historic policy of Congress in providing equitable transition rules in cases where tax law changes alter the economics of existing binding contracts.[2]

Deferral concept

When Senator Carl T. Curtis (R-Neb.) suggested a grandfather amendment to Section 907(f) last December, this Committee recognized the need for a technical amendment to Section 907(f) and directed the Joint Committee Staff to study an appropriate amendment.

From Sun's perspective, losses under binding contracts existing prior to the enactment of Section 907(f) should not be subject to recapture at all. From the Staff's view, that type of amendment might reopen the statute. Therefore, it suggested in the alternative a deferral transition rule.

[2] The Code is replete with examples (in particular, the investment tax credit).

Section 1035(b)

On May 18, 1976, this Committee unanimously adopted Senator Curtis' deferral amendment as Section 1035(b). This provision provides that foreign oil-related losses which are sustained in a taxable year ending before January 1, 1979, and which are incurred pursuant to a binding contract entered into on or before July 1, 1974, need not be recaptured in an amount exceeding 15 percent of such loss for the first four years after they become subject to recapture and are fully subject to recapture thereafter.[8] Accordingly, Sun continues to be subject to the full $33 million of tax under Section 907(f). However, the amendment provides Sun with some deserved relief by allowing the tax to be paid over a 5-year period. This means that the revenues to the Federal Government are not lost. Also, Sun's projections indicate that there would be no recapture under present Section 907(f) until 1978. Therefore, in Sun's case, this provision will have no effect on the Federal revenues in 1977.

SUMMARY

Sun is requesting relief from Congress because of an oversight contained in Section 907(f) when enacted. Classification of the Company's petition as special in nature and therefore questionable would be as unfair as the statute itself. The Company has not suggested eliminating the principle of law contained in Section 907(f) but merely reducing its inequitable application. Section 1035(b) of the Bill provides significantly less relief than most "grandfather" amendments and does not reduce Sun's ultimate tax burden.

Finally, in addition to filing testimony with this Committee on April 22, the Company has brought its position to the attention of one, the Treasury Department, two, the entire U.S. Senate, and three, many of the so-called public interest groups. Clearly, the Company has not sought this amendment without public scrutiny or a public hearing.

STATEMENT OF CORNELIUS C. SHIELDS, ACCOMPANIED BY H. LAWRENCE FOX, ON BEHALF OF THE SUN OIL CO.

Mr. SHIELDS. My testimony concerns section 1035(b) of the bill, the section containing the transition rule to eliminate an inequity contained in the Tax Reduction Act of 1975.

It does not reduce Federal tax liabilities but only provides a measure of relief by extending the time over which they must be paid. The Tax Act of 1975 added section 907 to the code.

Subsection 907(f) provides rules for recapture of foreign related oil losses. Although 907(f) was intended to be prospective in Sun's case, it is unintentionally retroactive because it requires recapture of losses incurred pursuant to existing contractual obligations even though these were entered into well before the 1975 act in reliance on prior law.

Specifically before July 1, 1974, Sun entered into contracts with a number of foreign governments or their national oil companies pursuant to which Sun is required to expend over $100 million through 1979 in drilling and exploring new areas.

This program was initiated a number of years ago in reliance on the tax law prior to the enactment of section 907(f). In order to develop additional sources of crude oil for Sun's U.S. refineries, it is anticipated that as a result of this contractual foreign exploration effort, Sun will have foreign losses totaling approximately $70 million over the next 2 to 3 years.

[8] The intent of this provision is to eliminate any unforeseen and inequitable application of the Code. Accordingly, it should be optional, as appears to be the intent of the Committee when Section 1035(b) of the Bill is read in conjunction with Section 1032(a) of the Bill.

As enacted, 907(f) recaptures these losses and thereby retroactively requires Sun to pay approximately $33 million in additional Federal income taxes. This retroactive increase is directly attributable to contracts entered into prior to the enactment of 907(f).

It is a burden that the company could not have anticipated in making its financial commitments, not withstanding the unfair windfall to the Federal Government, the amendment contained in section 1035 of the bill will not relieve Sun of its obligation to pay these increased taxes.

It will only provide a measure of relief by allowing taxes to be paid over a 5-year period. Sun's perspective losses and binding contracts existing prior to the enactment of 907(f) should not be subject to recapture at all.

This would be consistent with the historic policy of Congress in providing equitable transitional rules in cases where tax law changes alter the economics of existing binding contracts.

However Sun believes that this type of amendment conceivably might reopen the statute. Therefore, the committee unanimously passed in the alternative, a deferral transition rule which is section 1035(b).

I would like to add that Sun has consistently invited and sought the scrutiny of its efforts to obtain an equitable transition rule. We filed testimony with this committee on April 22.

We met with each Senator on the committee or his staff to insure that the equities of the amendment were understood. We corresponded with all of the Members of the Senate to explain section 1035(b) and supplied them a copy of Sun's April testimony.

I would like to state that any attempt to classify our petition in this amendment as special in nature and, therefore, questionable, would be unfair.

Senator TALMADGE. Thank you very much. Any questions?

Senator CURTIS. You testified that section 1035(b) has no ultimate revenue impact upon Sun Oil. Tuesday's Wall Street Journal indicates that it will give some $33 million tax—would you comment on that?

Mr. SHIELDS. The $33 million is not a tax break. That is the amount of an additional tax that we are going to have to pay as a result of 907(f). The amendment will in no way alleviate our burden to pay that $33 million of tax.

All it does is give us a 5-year period over which to make the payment so there is no $33 million tax break for Sun Oil Co.

Senator CURTIS. Thank you.

Senator TALMADGE. Thank you. The next witness is Mr. Robert H. Miller, vice president, Tenneco, Inc., accompanied by Mr. F. Cleveland Hedrick, Jr.

The entire statement will be inserted in the record and you may summarize please.

[The statement follows:]

STATEMENT BY ROBERT H. MILLER, VICE PRESIDENT, TENNECO, INC.

SUMMARY

Under the foreign tax credit limitations on oil and gas income imposed by the Tax Reduction Act of 1975, gain on the sale of assets used in a foreign oil and gas business is included in the definition of foreign oil related income. However, it is not clear whether this definition includes gain on the sale of stock of a foreign corporation included in an affiliated group filing a consolidated U.S. tax return to the extent the gain is attributable to assets used in the foreign oil and gas business. The gain from the sale or exchange of such foreign subsidiary's stock should be treated the same as gain from the sale or exchange of the subsidiary's oil and gas business assets. This is consistent with the purpose of the foreign tax credit limitations of section 907 which were intended to apply to all income arising from foreign oil and gas business activities, including the sale or exchange of the business assets.

STATEMENT

I am Robert H. Miller, Vice President of Tenneco, Inc. Tenneco is a Houston-based multi-industry company. I am accompanied by F. Cleveland Hedrick, Jr., of the Washington, D.C. law firm of Hedrick and Lane, tax counsel to the company.

On June 4, 1976 the Committee on Finance approved an amendment to the Tax Reform Act of 1976 (H.R. 10612) to clarify the definition of foreign oil related income and foreign oil and gas extraction income in the case of the sale of stock of a foreign subsidiary corporation included as a member of an affiliated group filing a consolidated tax return. In general terms the Committee's amendment provides that gain on the sale of such stock shall be treated as "foreign oil and gas extraction" or "foreign oil-related" income to the extent attributable to the foreign subsidiary's assets used for the production of either foreign oil related income or foreign oil and gas extraction income.

Pursuant to the Committee's July 9, 1976 announcement of hearings on this and other amendments to H.R. 10612, the following information is submitted for inclusion in the record in support of proposed section 1035(c)(2)(B) of H.R. 10612 as reported on June 10, 1976 by the Committee on Finance.

The Tax Reduction Act of 1975 imposed certain new foreign tax credit limitations for taxable years ending after December 31, 1974, in the case of foreign oil and gas income. For the purposes of these limitations, gain from the sale of a foreign oil and gas business by means of a sale or exchange of assets used by the taxpayer in that business is included in the definition of foreign oil and gas extraction income or foreign oil related income, as the case may be. However, it is not clear under present law how to treat gain from the sale of an oil and gas business in a foreign country by means of a sale of all of the stock of the foreign corporation conducting the business.

Since foreign oil related income of a taxpayer includes gain from the sale or exchange of the taxpayer's business assets giving rise to that income, gain from the sale of the foreign subsidiary's stock should be treated the same as gain from the disposition of the subsidiary's oil and gas business assets. This is consistent with the purpose of the foreign tax credit limitations of section 907 which were intended to apply to all income arising from foreign oil and gas business activities, including the sale or exchange of the business assets.

The need for a clarification of the definition contained in the Tax Reduction Act of 1975 with respect to foreign oil and gas income subject to the new foreign tax credit limitations became apparent in connection with Tenneco's 1975 sale of part of its foreign oil and gas business in Canada.

Under Canadian law, a United States corporation may operate certain Canadian federal oil and gas properties only through a Canadian subsidiary corporation. For about 50 years United States taxpayers have been permitted an election to include wholly-owned contiguous country foreign corporations (organized and maintained to comply with the foreign law) in an affiliated group filing a consolidated tax return.

For a number of years Tenneco operated a Canadian oil and gas exploration and production business through one of these contiguous country foreign corporations and included all of the taxable income of its Canadian subsidiary in its U.S. consolidated tax return. Tenneco also owned through two domestic subsidiaries certain oil and gas properties, related production facilities, and real estate in Canada which were not required to be held by a Canadian corporation.

During 1975, Tenneco determined that it no longer had the prospect of exporting Canadian oil for its United States refinery. Since Tenneco has no plans to enter refining and marketing operations in Canada, it decided to sell all of the Canadian oil and gas business assets of its two domestic subsidiaries and one-half of the oil and gas business of its Canadian subsidiary to Canada Development Corporation ("CDC"), a corporation owned in part by the Canadian government. The ale permitted Tenneco to retrieve and repatriate a significant part of its investment in Canada, while continuing to operate in Canada on a more limited scale.

Tenneco's initial negotiations with CDC called for the direct sale of all of the assets in Canada of the two domestic subsidiaries and approximately one-half of the assets of the Canadian subsidiary. In fact, all of the Canadian assets of Tenneco's two domestic subsidiaries were sold directly to CDC and the gain thereon attributable to assets used in Tenneco's oil and gas business was treated as foreign oil related income pursuant to section 907 of the Code. A substantial Canadian income tax was paid on the gain arising from this part of the transaction in addition to a Canadian withholding tax on the return of the proceeds to the United States. However, in the case of Tenneco's Canadian subsidiary, it was not feasible to make the sale by a direct disposition of the subsidiary's oil and gas assets because the large amount of Canadian tax which would have been incurred would have substantially reduced the amount that could be returned and reinvested in the United States. As a practical matter, this part of the transaction cold only be consummated as a stock sale.

In order to facilitate the transaction, Tenneco conducted a reorganization pursuant to favorable rulings by the Internal Revenue Service and the Canadian counterpart. All of the assets to be retained by Tenneco (approximately 50%) were transferred to a newly created Canadian subsidiary and all of the assets to be sold to CDC (and only those assets) remained in the original Canadian subsidiary. Tenneco then sold all of its stock in the original Canadian subsidiary as a means of disposing of the underlying oil and gas business assets.

If the disposition of Tenneco's Canadian subsidiary had been structured as an asset sale the gain from the sale of its business would have been foreign oil related income. Since the sale of stock in this case was essentially a disposition of oil and gas business assets described in section 907(c)(2), Tenneco assumed that the gain would be treated as foreign oil related income.

In order to confirm its interpretation of section 907 of the Code and to obtain some assurance that its treatment on its 1975 tax return of the gain on the sale of the stock of its Canadian subsidiary will be accepted, counsel for Tenneco met with the Treasury Department earlier this year to request administrative confirmation of its position with regard to the definition of foreign oil related income. Although Tenneco believed the required clarification could be accomplished administratively, the Treasury gave no assurance of its position on this question pending the promulgation of regulations under section 907, which may take several years. However, it is understood that the Administration does not object to legislation amending the definition of foreign oil related income to cover gain on the sale of stock in any foreign corporations which holds oil related assets.

STATEMENT OF ROBERT H. MILLER, VICE PRESIDENT, TENNECO, INC., ACCOMPANIED BY F. CLEVELAND HEDRICK, JR.

Mr. MILLER. I am vice president of Tenneco, Inc. I am accompanied today by Mr. Cleveland Hedrick.

I would like to address my remarks to an amendment adopted by the Committee on Finance during its consideration of H.R. 10612, which relates to foreign tax credit limitations which were adopted last year by the Congress.

The proposed amendment would make it clear that the definition of oil-related income includes gain on the sale of stock of a foreign corporation entitled to be included as a member of a consolidated group.

The need for a clarifying amendment became apparent as a result of Tenneco's 1975 position as part of its Canadian oil and gas business. Tenneco sold certain of its Canadian oil and gas properties and related production facilities to Canada Development Corp., partly owned by the Canadian Government, primarily because Tenneco determined that it would not be able to continue to export oil from Canada to Tenneco's U.S. refinery.

The sale permitted Tenneco to retrieve and repatriate a substantial part of its investment in Canadian oil and gas assets. A question arose because part of the disposition of Tenneco's oil and gas business in

Canada took the form of sale of stock instead of a direct sale of the underlying assets.

Tenneco's initial negotiations with Canada Development Corporation called for the direct sale of all of the assets in Canada held by domestic subsidiaries of Tenneco. In fact, all of the Canadian assets of Tenneco's two domestic subsidiaries were sold directly to Canada Development Company.

The gain on this part of the transaction was clearly foreign oil related and substantial related income tax was paid on this gain and a Canadian withholding tax was paid on the proceeds in the United States.

However, it was not feasible to dispose of the subsidiaries' oil and gas assets by a direct sale because of a large amount of Canadian taxes which would have been incurred.

As a practical matter, this part of the transaction can only be submitted by slot sale. Consequently Tenneco stripped from the Canadian subsidiary all of the assets to be retained. This left the Canadian subsidiary holding only the assets that Tenneco agreed to sell to Canada Development Corporation.

Tenneco then sold all of this stock of the Canadian subsidiary in order to dispose of the underlying gas and business assets. Substantially less of Tenneco's interests in Canada would have been returned to reinvest in the United States had not part of the transaction taken the form of a stock sale.

The gain on the stock of Tenneco's Canadian subsidiary should constitute foreign oil-related income no less than if the underlying oil and gas properties had been disposed of directly.

The committee's amendment would provide the same treatment for the gain of sale of stock of a foreign corporation engaged in oil and gas which is included as a member of the affiliated group following a consolidated U.S. tax return as gain on the direct sale of its assets.

This amendment is considered with the limitations which were intended to apply to all income derived from foreign and gas business activities.

I would like to submit a more detailed statement for the record.

Senator TALMADGE. Without objection the full statement will be inserted in the record. Thank you very much. The next witness is Mr. John T. Jackson, chairman of the executive committee, IU International Corporation.

You may insert your full statement in to the record and summarize.

[The statement follows:]

SUMMARY OF PRINCIPAL POINTS OF TESTIMONY OF JOHN T. JACKSON, CHAIRMAN OF THE EXECUTIVE COMMITTEE, IU INTERNATIONAL CORP.

1. IU International, an American Corporation, has operated gas utilities in Canada through subsidiaries for decades and has been authorized to explore for and produce gas in Canada for these utilities in order to insure sufficient supplies of gas for their customers.

2. The 1975 Tax Reduction Act limited foreign tax credits of large, multinational, integrated oil companies.

3. The Committee on Finance amendment exempted from this limitation regulated public utility income related to distribution and transportation of gas and we support this move.

4. Also, the Committee should consider that the limitation of tax creditable is 50%, designed to equal U.S. taxes, but fails to consider withholding taxes, which makes the effective rate in Canada over 57 percent.

TESTIMONY OF MR. JOHN T. JACKSON RELATING TO SECTION 1035 OF H.R. 10612

My name is John T. Jackson and I am Chairman of the Executive Committee of IU International Corporation. I would like to address my remarks to an amendment adopted by the Committee on Finance during its consideration of H.R. 10612 which relates to foreign tax credit limitations which were adopted last year by the Congress.

The Congress adopted, as part of the Tax Reduction Act of 1975, separate limitations on the use of foreign tax credits from foreign oil extraction and foreign oil related income (§ 907 of the tax law). These rules separately limit the amount of foreign tax on foreign oil related income which is treated as creditable for U.S. foreign tax credit purposes. The language from which these rules evolved was adopted on the Senate floor, and the debate clearly indicates that they were meant to apply to the foreign tax credits of large multinational-integrated oil companies. However, their scope goes far beyond this. For example, the 1975 limitations also cover the situation of a regulated public utility in a foreign country which distributes gas locally in that foreign country, and whose U.S. parent is not an oil or gas company. I understand that the sponsor of the 1975 legislation, Senator Hartke, has stated in response to a question during the recent committee markup on H.R. 10612 that it was not his intent to have regulated foreign public utilities included within the scope of § 907.

IU International Corporation was originally called International Utilities. 50 years ago we started operating in Canada through regulated public utility subsidiaries. Today, IU continues to operate these local gas distribution systems and electrical distribution systems through subsidiaries in Canada. Our gas utilities serve the same type of customers as any other local gas company does, homes, factories, offices, and the like. Under the 1975 legislation, we are subjected to the same limitations as is a multinational-integrated oil company. Additionally, a number of years ago the subsidiaries were granted permission by the Canadian regulatory body to invest in local gas fields in order to assure our utility customers of a continuing source of supply at a cost subject to regulatory rules. I should stress at this point that we would be treated the same way as a multinational-integrated oil company even if we had not discovered any gas to be used in our own system, simply because of the fact that gas is merely transported in our pipelines and distributed to our utility customers.

It is my understanding that this Committee decided to adopt a rule which would make this special foreign tax credit limitation not applicable to regulated public utility income. I applaud this action. This amendment also has the effect of treating in a parallel manner the foreign tax credits of competing regulated public utilities that produce energy; foreign electric and gas utilities will now be taxed alike on their transportation and distribution income.

Nevertheless, because we produce our own gas we would continue to be subject to the 1975 special foreign tax credit limitation on our extraction income even though our extraction income is derived by these same regulated public utilities. Under this special limitation, the maximum rate of tax which is authorized to be creditable with respect to oil/gas extraction income is approximately 50%. This figure is designed to approximate the U.S. rate of tax. However, it fails to take into consideration withholding taxes on this income which can, as in the case of Canada, drive up the effective rate of tax to over 57%. We request that consideration be given to this point, perhaps by arriving at an appropriate precentage limitation to which any legitimate withholding tax by the foreign government may be added.

Needless to say, any remaining allowable credits generated from IU's operations in Canada continue to be subject to all of the other rules and limitations normally applicable to foreign tax credits.

Thank you, Mr. Chairman, and members of the Committee, for giving me this opportunity to present our views. We feel that if the Committee is to properly discharge its duties, it must remedy inequities in the tax laws through the exercise of oversight jurisdiction. It is clear the provision we are supporting remedies an unintended and patently unfair application of a general provision to our particular situation. We believe we were inadvertently placed within this general provision and at the time the provision was passed there was no opportunity for a hearing. We respectfully suggest that there is nothing unfair, illegal, immoral, or inappropriate about seeking legislative relief.

STATEMENT OF JOHN T. JACKSON, CHAIRMAN, EXECUTIVE COMMITTEE, IU INTERNATIONAL CORP.

Mr. JACKSON. Dan Brennan, our vice president of taxes, is with me. I would like to comment on the unintended effects on my company of an amendment adopted by the Committee on Finance during its consideration of H.R. 10612, which relates to foreign tax credit limitations which were adopted last year by the Congress.

The Congress adopted, as part of the Tax Reduction Act of 1975, separate limitations on the use of foreign tax credits from foreign oil extraction and foreign oil-related income, section 907 of the tax law.

These rules separately limit the amount of foreign tax on foreign oil-related income which is treated as creditable for U.S. foreign tax credit purposes. The language from which these rules evolved was adopted on the Senate floor, and the debate clearly indicates that they were meant to apply to the foreign tax credits of large multinational-integrated oil companies.

However, their scope goes far beyond this. For example, the 1975 limitations also cover the situation of a regulated public utility in a foreign country which distributes gas locally in that foreign country, and whose U.S. parent is not an oil or gas company.

I understand that the sponsor of the 1975 legislation, Senator Hartke, has stated in response to a question during the recent committee markup on H.R. 10612 that was not his intention to have regulated foreign public utilities included within the scope of section 907.

IU International Corp. was originally called International Utilities. We started operation in Canada through regulated public utility subsidiaries 50 years ago.

Today, IU continues to operate these local gas distribution systems and electrical distribution systems through subsidiaries in Canada. Our gas utilities serve the same type of customers as any other local gas company does—homes, factories, offices, and the like.

Under the 1975 legislation, we are subjected to the same limitations as is a multinational-integrated oil company. Additionally, a number of years ago the subsidiaries were granted permission by the Canadian regulatory body to invest in local gasfields in order to assure our utility customers of a continuing source of supply at a cost subject to regulatory rules.

I should stress at this point that we would be treated the same way as a multinational-integrated oil company even if we had not discovered any gas to be used in our own system, simply because of the fact that gas is merely transported in our pipelines and distributed to our utility customers.

It is my understanding that this committee decided to adopt a rule which would make this special foreign tax credit limitation not applicable to regulated public utility income.

I applaud action. This amendment also has the effect of treating in a parallel manner the foreign tax credits of competing regulated public utilities that produce energy; foreign electric and gas utilities will now be taxed alike on their transportation and distribution income.

Nevertheless, because we produce our own gas we would continue to be subject to the 1975 special foreign tax credit limitation on our extraction income even though we—our extraction income is derived by these same regulated public utilities.

Under this special limitation, the maximum rate of tax which is authorized to be creditable with respect to oil/gas extraction income is approximately 50 percent. This figure is designed to approximate the U.S. rate of tax.

However, it fails to take into consideration withholding taxes on this income which can, as in the case of Canada, drive up the effective rate of tax to over 57 percent. We request that consideration be given to this point, perhaps by arriving at an appropriate percentage limitation to which any legitimate withholding tax by the foreign government may be added.

Needless to say, any remaining allowable credits generated from IU's operations in Canada continue to be subject to all of the other rules and limitations normally applicable to foreign tax credits.

Thank you, Mr. Chairman, and members of the committee, for giving me this opportunity to present our views. We feel that if the committee is to properly discharge its duties, it must remedy inequities in the tax laws through the exercise of oversight jurisdiction.

It is clear that the provision we are supporting remedies an unintended and patently unfair application of a general provision to our particular situation. We believe we were inadvertently placed within this general provision and at the time the provision was passed there was no opportunity for a hearing.

We respectfully suggest that there is nothing unfair, illegal, immoral, or inappropriate about seeking legislative relief.

Senator TALMADGE. We have more than 10 witnesses yet to be heard, any questions. The next witness is Mr. Donald P. Hertzog, general tax counsel, Texaco, Inc.

You may insert your full statement into the record and summarize.

[The statement follows:]

STATEMENT OF D. P. HERTZOG, GENERAL TAX COUNSEL, TEXACO, INC.

SUMMARY

Mr. Chairman, my name is Donald P. Hertzog. I am General Tax Counsel of Texaco Inc.

I strongly support that portion of the amendment of Section 1035 which would include interest received from domestic corporations (i.e. companies incorporated in the United States) within the definition of foreign oil-related income. The purpose of this provision is to correct a drafting error, which occurred in the Tax Reduction Act of 1975. This error was pointed out in testimony before this Committee on March 25, 1976, by Mr. W. R. Young appearing on behalf of the American Petroleum Institute as follows:

"TECHNICAL PROBLEMS OF 1975 TAX REDUCTION ACT

"In addition, perhaps due to the haste in which the 1975 changes were enacted, there are many technical questions of interpretation which make it difficult for tax payers to know the tax results of future activities. There are also several technical errors and apparent oversights. In the latter category is the apparent omission of interest income from U.S. incorporated oil companies operating abroad as oil-related income, whereas such income from foreign affiliates would be oil-related * * *" (Testimony of Mr. Wilford R. Young, Tax Reform Act of 1975, H.R. 10612, Senate Committee on Finance, Hearings, Part 2, p. 813, March 25, 1976.)

The Tax Reduction Act of 1975 created a new category of income known as foreign oil-related income. The purpose was to apply limitations to foreign tax credits which could be utilized by oil companies. These provisions apply to earnings of both foreign corporations (i.e. companies incorporated in foreign countries) and domestic corporations. Regardless of whether a company chose to operate in foreign areas through a foreign corporation or a domestic subsidiary restrictions were imposed on the amount of the foreign tax credits which could be used.

1. The amendment to Section 1035 of the Tax Reform Bill of 1976 which would include interest from domestic corporations within the definition of foreign oil-related income should be adopted.

2. This would correct a drafting error made in the Tax Reduction Act of 1975. See statement on House Floor on March 26, 1975 (Congressional Record, H. 2383).

3. Foreign earnings of both domestic and foreign subsidiaries are subject to foreign tax credit limitations based upon foreign oil-related income. Both dividends and interest from foreign subsidiaries are treated as foreign oil-related income. Dividends from domestic subsidiaries are treated as foreign oil-related income and it is inconsistent to treat interest from domestic subsidiaries as non-foreign oil-related income.

4. The error should be corrected retroactive to January 1, 1975, and not from January 1, 1977, as provided in the Tax Reform Bill.

Section 907(c) (3) created by the Tax Reduction Act included within the definition of foreign oil-related income dividends and interest received from a foreign corporation and dividends received from a domestic corporation. The statutory provision did not specifically refer to interest received from a domestic corporation.

The Tax Reform Bill of 1976 would correct the drafting error by including within the category of foreign oil-related income interest received from domestic subsidiaries. It is pointed out in the Report of the Senate Finance Committee (p. 249) that the change is being made in order to avoid discriminating between taxpayers who carry on foreign oil-related activities through foreign subsidiaries, and those who carry on such activities through branches of domestic subsidiaries.

It is clear for a number of reasons that the omission of interest from the Tax Reduction Act was not intended. First, since the earnings of both foreign subsidiaries and domestic subsidiaries are subject to foreign tax credit limitations based upon foreign oil-related income, there was no reason to penalize taxpayers who choose for business reasons to use domestic subsidiaries. Second, foreign income earned by a domestic subsidiary is foreign oil-related and interest paid out of such income should retain its character as foreign oil-related income. Third, there is no logical basis to distinguish between payments of interest and payments of dividends made by a domestic corporation.

The injustice resulting from not treating interest income from domestic corporations as foreign oil-related income is evident if we consider the situation where both parties are members of a consolidated group filing a consolidated U.S. income tax return. Assume that the corporation paying the interest is engaged solely in the oil business and that all of its income is oil-related income. The payment of the interest reduces the oil-related income of the paying corporation. Unless the receipt of the interest is treated as oil-related income by the receiving corporation, there will be a clear distortion of the amount of oil-related income of the consolidated group.

Moreover, the fact that the omission was unintentional is evident from statements made by Chairman Ullman on the House Floor in presenting the Conference Report. Mr. Ullman stated that both interest and dividends from domestic corporations engaged in foreign oil-related activities were to be characterized as foreign oil-related income (Congressional Record, March 26, 1975, H. 2383.)

For these reasons, we submit that the amendment of the Senate Finance Committee which corrects the error should be adopted.

We further submit that the error should be corrected from the effective date of the provision, namely January 1, 1975, and not from January 1, 1977, as provided in the Tax Reform Bill. It is manifestly unfair to subject taxpayers to the effects of the error for any period of time. We note that retroactive corrections have been proposed in the case of other unintentional errors.

STATEMENT OF DONALD P. HERTZOG, GENERAL TAX COUNSEL, TEXACO, INC.

Mr. HERTZOG. Thank you. I am here to support section 1035(c) of the tax reform bill which would amend section 907(3) of the Reduction Act. This amendment would specifically include interest for the subsidiaries and the definition of foreign-related oil income.

As the committee is aware, the 1969 Tax Reduction Act would place limitations on the use of foreign tax credits by oil companies. These limitations applied only to oil companies.

The concept of foreign-related oil income was applied to both domestic subsidiaries and foreign subsidiaries but the statute specifically provided that interest and dividends from foreign subsidiaries was oil-related income and that dividends from domestic subsidiaries was foreign related.

We submit that this omission was not intentional, that it was through a drafting error for three reasons. First, the foreign subsidiaries and domestic subsidiaries have foreign-related oil income and distribution from either type of company should be treated the same.

Second, foreign-related oil income is earned by domestic subsidiary and it should retain its character when paid out as dividends or interest.

Third, there is no logical basis for a distinction between dividends and domestic subsidiaries and interest of domestic subsidiaries in this context.

Further, the injustice is shown by the situation in the consolidated return where the subsidiary making the payment reduces his foreign oil-related income by such income unreceived by the parent not treated as oil-related income.

This produces a clear distortion of oil-related income in the consolidated group. I might note that the problem arises solely because of the selection of a domestic subsidiary to operate abroad.

The problem could have been avoided by having the parent company operate directly through a branch abroad or by switching to the use of a foreign corporation abroad. The one direction we would propose is that since this is a question of an error, which we believe is unintentional, the change should be made retroactive to January 1, 1975, the effective date of the bill and not from January 1, 1977, as provided in the tax reform bill.

Thank you.

Senator TALMADGE. Thank you. The next witness is Mr. F. L. Morefield, vice president, finance, American Independent Oil Co.

STATEMENT OF F. L. MOREFIELD, VICE PRESIDENT, FINANCE, AMERICAN INDEPENDENT OIL CO.

Mr. MOREFIELD. I am vice president of Finance of American Independent Oil Co. Our company is known as Amoil and we are a subsidiary of A. J. Reynolds Industries. I am accompanied by Mr. Clayton Turney, our outside tax counsel, and Mr. Arnold Sitman, the tax manager for Reynolds Industry.

We submitted a statement which I understand will be put into the record. I would like to summarize a few points, but first, would like to give a little background on our company.

Amoil was formed in 1947 in a search for oil in the Middle East. At that time of our acquisition by Reynolds, in 1970, we had operations in Kuwait and Iran. In Kuwait we produced 80,000 barrels a day of oil and in Iran we have an interest in the consortium of five-sixths of 1 percent which gives us a production of about 40,000 barrels a day.

Since acquisition by Reynolds, we have expanded our exploration into the United States. Last month we made a major expansion of this commitment into the United States for the purchase of the U.S. properties of Burma Oil Co., located primarily offshore Louisiana and Texas, also in California.

Basically we are in just one phase of the oil industry, in exploration and production. All of the production for Kuwait and Iran and our production of oil and gas moves to third parties.

We strongly urge the enactment of section 1035(e) of H.R. 10612 as reported to this committee. We believe this action will clarify the implication of section 907(f) consistent with the reported intention of section 907(f).

This clarification is necessary, we believe, for the effective negotiation of compensation arrangements with governments where American oil companies have had historic interest, including our companies.

The purpose of section 907(f) was really to deny credit or payments for normal purchases or oil for these—where these payments have been discussed as taxes. It could be argued, however, that 907(f) could also apply to deny credit for taxes on profits arising from compensation when takeover.

We do not believe this interpretation is correct. In section 1035(e), it is designed to clarify this matter. Typically in takeovers, partial compensation is given in the form of payment for assets taken, but this is very small and related to net book value and not the economic value of the assets or the properties that are taken.

A substantial part of compensation is generally given in the form of discounts on future prices. There is nothing inappropriate or artificial, we believe, in a foreign government taxing profits arising from these discounts.

Such profits are, in essence, a substitute for ongoing profits from the original arrangements or a substitute for partial compensation for the takeover.

Amoil's principal interest in the provision, section 1035(e) is with respect to its Iranian operations. We believe the agreements negotiated in 1973 continue to "economic interests" crucial for credit.

Senator TALMADGE. Sorry, I have to call time on you. Your time has expired and there are many other witnesses waiting to be heard. Questions?

Senator HANSEN. Early this morning Robert Brandon and William Pietz in testifying before this committee submitted a full statement in which they criticized this section 1035(e) and I would like to read, if I may what they have in their printed summary.

It says, and then I will hand it to you. "This provision unjustifiably makes the 1975 reform so recently agreed to by Congress applicable only to newcomers having no economic interest on March 29, 1975, as assuming the cost of nearly $40 million yearly for at least 10 years.

This estimate may prove very low if other countries expropriate properties thus depriving more companies of an economic interest will make possible the labeling of royalties as taxes.

I think you have addressed this issue but just for the record, would you care to respond? Would you like to have this before you?

Mr. MOREFIELD. Yes, I would. First of all, we are talking about a correction in something which is consistent with the original intent. We do not believe we are talking about something which is taking something out of the tax revenues with respect to our own company.

This matter will mean something to us, could mean something to us of less than $1 million per year and with respect to our Iranian operations. We do not necessarily understand the necessity to limit this provision to agreements or arrangements that were in existence at a given point in 1975.

We do feel that this is a matter which in a sense could arise at any time, and it is very important to not only insure the antiquity of our present arrangements, but also we believe provide flexibility with respect to the forum in which we achieve compensation in the future.

I think it is important to emphasize that the strictures of 901(f) really go to limiting us in the form in which we can deal with foreign governments, not in the substance. I think it is important if we are going to be competitive and be able to maintain a long-term interest such as in Iran which has served this company for many years.

I think it is important that we have the flexibility.

Senator CURTIS. Would you say then, that your continuing interest in exploring for, and developing fields in foreign lands may be tempered somewhat by the treatment that you get in this instance?

If it is unfavorable, you would be less inclined to go out and explore in other parts of the world than would be the case if this section would be adopted?

Mr. MOREFIELD. I think it increases the uncertainty and that is a key element in our business.

Senator HANSEN. Do you think that available sources of oil is in the interest of all Americans?

Mr. MOREFIELD. Yes, I do, and I think this has been proven through the last crisis we had.

Senator HANSEN. No further questions.

[The prepared statement of Mr. Morefield follows:]

STATEMENT BY AMERICAN INDEPENDENT OIL CO.

SUMMARY

The purpose of section 901(f) of the Internal Revenue Code, as stated in the report of the Committee on Finance on the pending Bill, was to deny foreign tax credits where payments for normal purchases of petroleum are disguised as payments of tax.

This purpose is not applicable to cases of discounts on purchases granted by a foreign government to an oil company in connection with nationalization by the foreign government of the properties and operations of the company. The discounts in such cases in substance amount to compensation granted by the government to the oil company for the takeover in addition to inadequate lump sum compensation based on book values.

In these takeover situations, there is nothing inappropriate or artificial in taxation by the foreign government of profits resulting from the discounts as a substitute for loss of the company's future operating profits or as gain to the company on the takeover.

Where such a takeover arrangement involving discounts on future purchases from the government was entered into before the enactment of the 1975 Act, there was no reason to anticipate that continuance of an economic interest was necessary to sustain credit for the tax. While it is believed that in the case of the agreement negotiated in Iran in 1973 an economic interest did continue, this is a technical question which is not altogether free from doubt, and section 901 (f) should be inapplicable to such cases in order to prevent the possibility of an inequitable retroactive effect.

Section 901(f) should be made inapplicable to any past or future takeover situations if the oil company had an economic interest on or before March 29, 1975, in order to make the use of discounts on purchases from the government clearly available as a method which can be used in future negotiations to obtain compensation for loss of the properties and future profits of the oil companies.

STATEMENT

My name is Fred. L. Morefield. I am Vice President-Finance of American Independent Oil Company ("Aminoil"), which is a wholly owned subsidiary of R. J. Reynolds Industries, Inc. ("Reynolds"). Aminoil is an independent oil company that was formed in 1947 to search for oil in the Middle East. Aminoil operated principally in Kuwait and Iran until 1970 when it was acquired by Reynolds. Since that time Aminoil has obtained exploration properties in the United States and last month Reynolds purchased all of the United States oil and gas properties of Burmah Oil Incorporated, including both producing and exploration ventures in the United States.

Aminoil produces about 80,000 barrels of oil per day in the Kuwait-Saudi Arabia Divided Zone and refines the oil in Kuwait. In Iran, Aminoil through a subsidiary holds a ⅝ of one per cent interest in the Consortium and its share of the available oil is approximately 40,000 barrels per day. Aminoil markets its Kuwait and Iranian production to third-party customers in the Far East and occasional sales are made to Europe and Brazil. Aminoil also holds interests in petroleum ventures in Paraguay and other foreign countries as to which no production has been obtained. Affiliates have interests in an oil field located in Argentina, in a gas field located in the Dutch sector of the North Sea and are developing a geothermal steam operation in California. Also, the affiliates engage in (i) retail and wholesale marketing of fuel oil, natural gas liquids and natural gas liquid products, principally in the United States Mid-West and North East, and (ii) the wholesale marketing of motor gasoline in the United States West Coast.

Aminoil urges the enactment of section 1035(e) of H.R. 10612 as reported to the Senate by the Committee on Finance. This provision would amend section 901(f) of the Internal Revenue Code, as added by the Tax Reduction Act of 1975, in order to prevent the inequitable operation of section 901(f) in certain cases where foreign countries nationalize the properties of United States companies.

Section 901(f) denies foreign tax credit for any foreign income taxes incurred in connection with the purchase and sale of oil or gas extracted in the taxing country if the taxpayer has no economic interest in the oil or gas and the purchase or sale is at a price which differs from the fair market value for such oil or gas at the time of such purchase or sale. As stated in the Committee's report on H.R. 10612 (pp. 251–253), the intent of section 901(f) was to deny foreign tax credits "where payments for the purchase of oil owned by the foreign country are disguised as the payment of a tax by casting normal crude purchase and sale arrangements in non-commercial formats" with the effect of creating an artificial profit on which a tax could be imposed, so that the net economic effect is the same, for the foreign government, as a simple purchase of the oil.

The amendment proposed to be made by section 1035(e) of the pending Bill to section 901(f) of the Code recognizes that the purpose of section 901(f) is not applicable to cases of discounts on purchases granted by foreign governments to oil companies in connection with nationalization by the foreign governments of the properties and operations of the companies. A number of the major oil-producing countries have taken over ownership and control of oil operations within their territories and others are preparing to do so. While recognizing an obligation to compensate the companies for the properties and the oil reserves which have been developed by the capital and expertise of the companies, the governments have refused to pay outright compensation beyond the "net book value" of the properties, which is far below the actual value of the properties, based on the profits which the oil companies would have derived. As noted in the Committee's report, in some cases the governments have been and may in the future be willing, in addition to payment of net book value, to allow the former owners to participate to some extent in the future profits of the operations by permitting them to purchase some of the oil or gas at a discount.

In 1973 the Government-owned National Iranian Oil Company took over from the Consortium of which Aminoil is a member, control of the operations and the right to the production. The compensation received by the Consortium members for this takeover consisted of the right to buy quantities of oil out of future production at a formula price which might be considered to be less than the fair market value of the oil, and the right to credit against the price of such purchases, in installments, 60% of the net book value of their investments, such net book value being extremely small in comparison with the value of the right of the companies to continue such operations under the former agreement.

Since the profits which may be realized by the Consortium members on purchases, in installments, 60% of the net book value of their investments, such net profits which would have been realized by them under continuance of the former agreement, and can be regarded as a profit to them from disposition of their former rights and interests for a total consideration in excess of the book value basis, there is nothing inappropriate of artificial in the imposition of income tax on those profits by Iran.

As pointed out in the Committee's report, it may not be clear that the oil companies' rights under new arrangements involving discounts on purchases of oil from the governments after nationalization will be recognized as falling within the limitations of the technical concept of an "economic interest." While it is believed that the Consortium members still have an economic interest in Iran, the question is not altogether free from doubt. However, such new arrangements, whether or not they continue the companies' economic interests, do not fall within the intent of section 901(f) as described in the Committee's report on H.R. 10612.

Until the enactment of section 901(f) in 1975, there was no reason, from the viewpoint either of law or fairness, to anticipate that the continuance of an economic interest would be requisite for the allowance of a foreign tax credit for Iranian taxes on profits from purchases of oil under the new agreement. Construction of section 901(f) in a manner which would deny such credits would retroactively and inequitably alter, to the disadvantage of the companies, the financial effect of the 1973 agreement which they entered into in good faith and in reliance on the existing U.S. tax law.

The Iranian government is now insisting on further revision of its agreement with the Consortium companies. The form of such new revision cannot yet be predicted. Other foreign governments are in the process of working out with the oil companies the terms of nationalization of existing concessions. There would seem to be no reason why section 901(f) should be continued in a form which hampers the companies in these negotiations by preventing, or at least casting a cloud on, the use of discounts on future purchases of oil or gas as a method by which the companies can obtain some measure of compensation for the loss of their properties and future profits.

American Independent Oil Company therefore urges the enactment of section 1035(e) of H.R. 10612 as reported to the Senate by the Committee on Finance, in order to make it clear that section 901(f) will not apply to any oil purchase arrangements made at any time in the past or in the future, in connection with nationalization or takeover of the purchaser's properties, provided that such purchaser had an economic interest in the property on or before March 29, 1975. In the interest of clarity, it is suggested that the words "if, on March 29, 1975, the taxpayer has made an investment" be changed to "if, on or before March 29, 1975, the taxpayer had made an investment."

We also suggest that the effectiveness of the amendment should not terminate in 1986. The length of time over which the discounts should be regarded as compensation to the companies for the taking of their rights depends on the per-unit amount of the discount and on other terms of the new agreements, and the period agreed on between the parties should speak for itself as the appropriate period.

Senator TALMADGE. Further questions? Thank you very much. We appreciate your contribution. The next witness is Mr. James Q. Riordan, senior vice president, Mobil Oil Corp. You may insert your full statement and summarize.

[The prepared statement of Mr. Riordan follows:]

MAJOR POINTS IN STATEMENT OF JAMES Q. RIORDAN, MOBIL OIL CORP.

1. At the time section 901(f) was drafted, it was widely assumed that the new foreign producing arrangements would follow the equity-buyback pattern in which companies would make a profit on the equity oil but not on the buyback oil. Under this pattern, the taxes paid by U.S. companies that had invested in foreign producing operations would clearly have been creditable, irrespective of section 901(f).

2. Instead of equity-buyback, however, some of the producing governments are moving toward 100 percent participation, while establishing a new structure for the companies to continue to render service, earn profits and acquire oil. The wording of section 901(f) now creates an additional question, albeit unintended, as to the creditability of all income taxes paid by U.S. companies under these new agreements.

3. Section 901(f) was designed to assure that taxpayers could not manipulate the purchase price of non-profit oil (buyback oil or oil simply purchased from a producing country by a company having no prior connection with the country) to convert a part of the purchase price into creditable taxes. It was not intended to create a problem for U.S. companies which have made prior substantial investments in foreign concessions.

4. It now seems likely that there will be cases where all of the legal title to an existing concession will be taken over by a foreign government and that government, to compensate the former concessionaire for the value of the concession taken, will grant the concessionaire the right to earn a profit by buying at a discount the oil produced from the concession. Although section 901(f) was not intended to deny foreign tax credits in this case, it is unclear whether the oil company has, technically speaking, retained an economic interest in the oil or gas. Also, the determination of whether or not a discount for prior investments is reasonable will usually be difficult.

5. The Finance Committee recognized these problems and resolved them by assuring that at least for a period of time there will be no unintended application of section 901(f).

STATEMENT

My name is Jim Riordan. I am Senior Vice-President Finance of Mobil Oil Corporation. I am pleased to have the opportunity to participate in today's hearing, and to discuss the Finance Committee's amendment to section 901(f) dealing with the foreign tax credit.

There are two basic principles which I feel should guide the Congress in taxing U.S. businesses operating abroad.

First, we should avoid double taxation. Second, U.S. companies operating abroad should be able to compete fairly with foreign companies. We should especially avoid double taxation of U.S. companies when competing French, German, English, Dutch and Japanese companies are not subject to double taxation. For reasons I will explain, there is a risk this will happen to U.S. oil companies as a result of the unanticipated operation of section 901(f). If the availability of the foreign tax credit to U.S. oil companies in impaired, foreign business opportunities will simply fall to our foreign competitors who will not be burdened by double taxation. America's economy will then be doubly dependent upon foreign oil controlled by foreign companies.

As you know, the international oil industry is going through a period of dramatic change. Foreign producing governments are revising drastically the historic relationships which exist with private companies in respect of both established and new exploration and producing operations. When making these revisions it seems clear that those governments assumed that income taxes payable to them under the new arrangements would continue to be creditable against the home country taxes in the U.S., Japan and the European countries.

When the Congress undertook to revise the U.S. tax law in 1975 as it bore on foreign exploration and production operations, certain assumptions were obviously made about how the new foreign arrangements would evolve and how the U.S. law would be applied to those new arrangements. The U.S. Treasury Department and the Internal Revenue Service are reviewing the U.S. tax law implications of the diverse new arrangements that are now evolving. Furthermore, the Service has begun to re-examine a number of basic foreign tax credit principles that had been established in earlier years, and are beginning to consider the implications of the new provisions added to the law in 1975. It now appears that the U.S. tax assumptions made by the producing countries and the Congress are in doubt, and that certain parts of the 1975 legislation, namely section 901(f), which were drafted under difficult time deadlines, could have unintended application with disastrous and unfair results to U.S. oil companies.

At the time the Congressional draftsmen were working on section 901(f) it was widely assumed that the new foreign producing arrangements would follow the equity-buyback pattern that seemed to be emerging. Under that pattern, profits are made, taxes are paid and tax credits are available on equity oil, but it is assumed that profits are not made and taxes are not paid on buyback oil purchased from the government. Buyback oil was assumed to be purchased from the government and sold to customers at the same market price. In these circumstances, buyback oil gives rise to no tax credits, just as a purchase of a cargo of oil from the government at the market price by a customer with no prior connection with the country, would give rise to no tax credit. Had that happened, the taxes paid by the U.S. companies that had established foreign producing operations would have clearly been creditable under section 901(f). As I understand it, section 901(f) was designed to assure that there could be no manipulation of the purchase price of buyback oil or oil purchased by a company having no prior connection with the producing government by converting part of the purchase price into creditable taxes. It now appears, however, that the equity-buyback pattern will not be universally adopted. Instead, some of the producing governments are moving toward 100% participation, while establishing a new structure for the companies to continue to render service, earn profits and acquire oil. Unfortunately, the wording of section 901(f), designed for the equity-buyback situation, now creates, albeit unintentionally, an added question as to the credibility of all income taxes paid by U.S. companies under these new agreements.

Under section 901(f) no credit is allowed for foreign taxes paid with respect to purchases or sales of oil or gas where the taxpayer has no economic interest in the oil or gas and if the purchase or the sale is at a price other than fair market value. Some believe that section 901(f) is needed to deal with possible "gimmicky" arrangements where the taxpayer has never made a substantial investment in the oil and manipulates the purchase price by converting a part of the purchase price into an income tax. It is my understanding, however, that it was never intended to create a problem for United States companies which earn profits because they have actually made substantial investments in foreign concessions. In some countries that do not adopt the equity-buyback pattern but take over the entire legal title to the concession, the former concessionaire will continue to earn profits through the mechanism of a price discount on oil or gas as compensation for the value of the concession. Section 901(f) was not aimed at disallowing foreign tax credits in this situation since legitimate foreign taxes would be levied on the profit arising from these discounts. It is not clear, however, as the Senate Finance Committee Report points out, whether an oil company would be treated as continuing to have, as a technical matter, an economic interest in the oil or gas in this instance. Also, as the Report states, the determination of whether or not a discount for prior investments is reasonable will usually be difficult.

The amendment to section 901(f) made by the Senate Finance Committee recognized these problems and resolved them by not applying section 901(f) for ten years to transactions involving the purchase and sale of oil or gas from a field if the taxpayer had an economic interest in that field on March 29, 1975 (the date of enactment of the Tax Reduction Act of 1975). Thus, the amendment only protects taxpayers who actually had an economic interest in the oil or gas by virtue of investments made prior to the enactment of the provision and provides such relief for only ten years (through 1984).

On a broader basis the present confusion surrounding the creditability of all foreign taxes convinces me that what we really need is a comprehensive review of the U.S. tax rules relating to foreign income. This review should produce a simple set of rules that are fair and consistent with those established by other nations such as Britain, France, Germany, Japan and the Netherlands. I recognize that we have neither the time nor the facts available to do that review in the course of considering this legislation. We believe, therefore, that the approach adopted by the Finance Committee of assuring at least for a period of time that there will be no unintended application of section 901(f) to situations that were clearly not meant to be covered, is a practical and reasonable solution, albeit one that it is limited and temporary. It is in this context that I support the proposed amendments to section 901(f).

Finally, section 901(f) was added to the law in the 1975 conference. It was not subject to hearings. We understand that section 901(f) was prompted by suggestions made to the staff of the U.S. Treasury Department and Congress by representatives of European governments who were concerned that somehow U.S. companies were going to gain a competitive tax advantage by manipulating purchases of oil from foreign governments. The ultimate irony is that it now appears that section 901(f) may produce double taxation of U.S. companies that will not be borne by foreign companies. If it does so, there will be a competitive advantage for foreign oil companies. These potential foreign beneficiaries of section 901(f) were not publicly identified in 1975. As I understood the thrust of the testimony at the beginning of yesterday's session, under these procedural circumstances, section 901(f) should never have been enacted. For substantive reasons, I believe that it should never have been enacted.

Senator TALMADGE. You may proceed, Mr. Riordan.

STATEMENT OF JAMES Q. RIORDAN, SENIOR VICE PRESIDENT, MOBIL OIL CORP.

Mr. RIORDAN. My name is Jim Riordan. I work for Mobil Oil Corp. and I am here to support the Finance Committee's amendment to section 901(f) dealing with the foreign tax credit.

There are two basic principles which should guide the Congress in considering any tax provision relating to U.S. businesses operating abroad.

First, we should avoid double taxation. Second, companies operating abroad should be able to compete fairly with foreign companies.

Therefore, we should especially avoid the taxation of U.S. companies when competing with French, German, English, Dutch, and Japanese companies not subject to double taxation for reasons I will explain.

There is a risk that this can happen to U.S. oil companies as a result of the unanticipated operation of 901(f); 901(f) was added to the law in the 1975 conference. It was not subject to hearings.

We understand that 901(f) was prompted by some suggestions made to the staff of the U.S. Treasury Department and to the Congress by representatives of European governments who were concerned that somehow U.S. companies were going to gain a competitive tax advantage by manipulating purchases of oil from foreign governments.

The ultimate irony is that it now appears that section 901(f) may produce double taxation on U.S. companies that will not be borne by foreign companies.

If it does there will be a competitive advantage for foreign oil companies. These potential foreign beneficiaries of section 901(f) who were not publicly identified in 1975 of that meeting, not to be argumentative in any sense, as I understand the thrust of the testimony at the beginning of yesterday's session under these procedural circumstances, section 901(f) should never have been enacted in the first place.

The fact is, of course, that 901(f) was enacted in good faith by the Congress under difficult time pressures as events have transpired.

However, I believe that it is now clear that it would have been that if this section had never been enacted and at the time that Congress was working on 901(f), it was assumed that the new foreign producing arrangements would follow the so-called partial participation or equity buyback pattern.

Under that pattern, profits are made, taxes are paid, and tax credits are clearly available on equity oil but profits are not made, taxes are not paid on buyback oil purchased from the Government.

. Section 901(f) was designed out of an excess caution, I believe, to assure that there could be no manipulation of the purchase or selling price of oil purchased from the Government so as to convert a part of the purchase price of such oil into creditable taxes.

It now appears, however, that the equity buyback pattern is not going to be universally adopted by all of the producing companies; instead, some of them are going to go toward 100-percent participation but are establishing a new structure for the oil companies to continue to render service, get profits, and acquire oil.

Senator TALMADGE. Sorry to call time on you, Mr. Riordan. There are a number of other witnesses to be heard. Thank you for your contribution.

Senator HANSEN. I do have one question, Mr. Chairman, if I may?

Senator TALMADGE. Senator Hansen?

Senator HANSEN. Is it not true that this provision falls far short of correcting the deficiency enacted as part of the Tax Reduction Act of 1975 in that the relief granted is limited to 10 years rather than granted in perpetuity and also the relief is limited in respect to an actual field as distinguished from a concession discovered by the date of the enactment of that bill, March 29, 1975?

Mr. RIORDAN. We believe the section 901(f) is not needed and creates confusion and should be repealed. The Finance Committee has adopted a more limited approach and only relates to a certain field where you have a clear economic interest on a certain date, March 29, 1975, and it only applies for 10 years.

We think that that is the minimum that ought to be done in order to make sure that in no way in this provision which was designed to govern manipulation—now there is a danger that it is really going to put us at a disadvantage as a result of double taxation for what was obviously a basic commercial transaction.

I believe this is limited but we hope the language that is worked out by the Joint Committee will provide at least a practical and effective relief for the period of time until we can learn more.

Senator HANSEN. Thank you very much, Mr. Chairman.

Senator TALMADGE. Thank you very much, Mr. Riordan.

Chairman Long is enroute to the committee room right now. We have a vote going on on the Senate floor. I will let the committee stand in recess subject to the arrival of Senator Long which will be in about 4 or 5 minutes.

[Whereupon, a short recess was taken.]

The CHAIRMAN. Mr. Thomas Driscoll, on behalf of Roy M. Huffington, Inc., accompanied by Mr. C. W. Leisk, chairman and chief executive officer of Austral Oil Co., Inc.; Gen. A. A. Sproul, chairman and president of Virginia International Co.; and Mr. D. L. Commons, president of Natomas Co., and Mr. Miles of Trend Exploration.

STATEMENT OF THOMAS DRISCOLL ON BEHALF OF ROY M. HUFFINGTON, INC., ACCOMPANIED BY C. W. LEISK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AUSTRAL OIL CO., INC.; GEN. A. A. SPROUL, CHAIRMAN AND PRESIDENT OF VIRGINIA INTERNATIONAL CO.; AND D. L. COMMONS, PRESIDENT OF NATOMAS CO., AND MR. MILES OF TREND EXPLORATION, INC.

Mr. DRISCOLL. Thank you, sir. I am Tom Driscoll, chief financial officer of Roy M. Huffington, Inc. Also with me are the gentlemen you mentioned and Mr. Miles of Trend Exploration.

We all have one thing in common; our companies are operating under oil and gas production sharing contracts. Further, each of us is a small- or medium-sized independent oil company, operating overseas in competition with the largest oil companies in the world.

We appear here today in support of the Finance Committee amendment of May 27 which added section 1035(f) to the tax reform bill.

We are particularly pleased to be here in view of the newspaper stories, Senate floor statements, and testimony presented to this committee yesterday which have described this amendment as a "ripoff" and dismissed production-sharing contracts used to avoid the 1975 Tax Reduction Act Amendments.

Those responsible for these misrepresentations are completely uninformed as to the significance of the amendment and, a temporary problem and attempting to resolve, for example, Indonesian production-sharing contracts where first entered into in 1966 and in no way were designed to avoid the impact of the tax bill enacted last year.

I would like to try to set the record straight on the substance of the amendment. This amendment relates to the foreign tax credit in production-sharing contracts and it is a limited transactional rule which will provide time for the smaller and the medium-sized U.S. contractors who have invested hundreds of millions of dollars in Indonesia to renegotiate their contracts, so as to satisfy the requirements of the Internal Revenue Service.

A reasonable time to accomplish this task and clear the proposed changes with IRS is necessary in order to avoid the extreme financial hardships which we might otherwise face.

The amendment was drafted to assure that no benefits included larger multinational companies which have excess tax credits.

It was also drafted to assure that no provisions of the Tax Reduction Act of 1975 were nullified.

The problem that has arisen is that the IRS issued a public ruling on May 7 of this year which means the new position that the U.S. contractors operating certain production-sharing arrangements are not entitled to a foreign tax credit for payments made on their behalf to the host foreign government and treated by that government as income tax.

The IRS concluded that if a U.S. contractor is operating under this type of agreement that the entire amount paid to the foreign government, in that case, 50 percent to 70 percent is royalty and we pay no tax at all.

Existing production-sharing contracts of the smaller companies which benefit from this amendment were entered into with the reasonable expectation that the foreign tax credit would be allowed in the IRS ruling, reflects this understanding since the ruling is to apply only prospectively.

The chief problem with this ruling is the 6-month period is not enough to carry out the necessary complex negotiations with the Government of Indonesia to obtain the clearance of any new arrangement from the IRS.

It is important to note that section 1035(f) does not reverse the IRS ruling. The Finance Committee amendment and the committee report are silent as to whether the ruling is or is not correct.

The amendment merely defers implementation of the ruling with respect to existing contracts for a period of 5 years.

If, upon further consideration the committee should conclude that 5 years is too long a time to allow for renegotiation of production-sharing contracts under subsequent clearups with IRS, our companies can probably live with the shorter periods, such as 2 or 3 years; however, we would note that the IRS spent more than 2 or 3 years considering existing Indonesian arrangements before publishing its present position on the subject.

The question may be asked, why did we not appear before the Finance Committee on the production-sharing contract matter during the public hearings during April and March. The obvious answer is that we were not even sure that we had a problem until the IRS published its ruling on May 7, 1976.

Thereafter, we immediately brought this matter which is absolutely vital to our operations to the attention of the Finance Committee and its staff and worked with them in developing the very limited amendment that was set forth in 1035(f). Thank you, sir.

The CHAIRMAN. Thank you very much.

Senator BENTSEN. Mr. Chairman, if I may make a comment here. One of the reasons, as I understand, for the production-sharing contract is to try to let some of the smaller companies get in there and compete where they do not have big bonuses, that type of thing—that they frankly cannot afford.

That is one of the reasons I have always been sympathetic to the production-sharing contract, to try to bring more competition into the oil business. Does it not, in fact, work that way?

Mr. DRISCOLL. Yes, sir; that is precisely right. That is one of the reasons that this amendment does not benefit major oil companies hardly at all because they did not choose to operate under production-sharing contracts.

Senator BENTSEN. The amendment was specifically drawn on the carry-forward of tax credits with some limitations on them; is that correct?

Mr. DRISCOLL. That is correct.

Senator BENTSEN. What would be the result if you had too short of a period and too much pressure put on you through negotiations within a government?

Mr. DRISCOLL. If we are forced to make a bad and disadvantageous resolution to these resolutions such that we would be double taxed on this income we would have no choice but to sell our interests, probably to foreign companies or possibly to major oil companies.

Senator BENTSEN. You might sell to the major companies; is that not about what it would amount to?

Mr. DRISCOLL. That is correct.

Senator BENTSEN. And they would take over this business?

Mr. DRISCOLL. That is correct.

Senator BENTSEN. Thank you.

The CHAIRMAN. I understand there is another provision in the bill, section 1035(a) on which the Treasury has taken a position in opposition, in which your company has expressed an interest. Did you talk with Treasury before proposing your amendment and if so, what did they say at that time?

Mr. COMMONS. I think, Mr. Chairman; yes, sir, they did. This particular provision affects not only us but all of the other independent oil companies operating abroad under the production-sharing contracts and it was in the bill as passed by the House. It was fully discussed by the Ways and Means Committee prior to adoption and was not offered until this time and the Treasury Department had approved the amendment.

The purpose of the amendment is to correct an unintended injustice created by the 1975 act that results in double taxation.

The amendment insures that a corporation obtains a foreign tax credit at no more than the U.S. corporate rate of 48 percent over a period of years and it is simply an averaging provision recognizing that if Indonesia calculates income taxes somewhat differently than does the United States, to obtain this averaging by means of a carryback the taxpayer must suffer the 50-percent foreign tax limitation and accept a 48-percent tax limitation.

Yesterday, after affirming their support for this provision time and again the Treasury suddenly reversed their position.

They did so because they say that it is somewhat 1-year retroactive but I find it hard to understand why the sudden change in their position.

The CHAIRMAN. Thank you very much, gentlemen.

[The prepared statement of Mr. Driscoll follows:]

STATEMENT OF THOMAS C. DRISCOLL

SUMMARY

1. Section 1035(f) of H.R. 10612, dealing with oil and gas production-sharing contracts and the foreign tax credits, is needed to give relatively small and medium-sized independents operating in Indonesia a reasonable opportunity to renegotiate their contracts with Indonesia so as to satisfy IRS requirements for allowance of foreign tax credits.

2. The amendment does not reverse Rev. Rul. 76-215, issued on May 7, 1976, but merely postpones its effective date for five years in the case of small and medium-sized independent oil companies operating in Indonesia. The amendment was designed not to benefit the larger oil companies having world-wide operations. The affected companies can probably live with a shorter period of postponement than five years, but a reasonable period is needed so that negotiations with Indonesia do not have to be conducted on a crash basis. The short six-months' transition period given by the IRS in Rev. Rul. 76-215 is just not enough.

3. The affected companies have invested hundreds of millions of dollars in Indonesia on the reasonable assumption that foreign tax-credits were available. The IRS change in position could reduce after-tax profits of these concerns by as much as 50 percent, if the present contracts with Indonesia are not renegotiated in a manner satisfactory to the IRS.

4. Indonesian oil is of considerable strategic and economic importance to the United States. The financial wellbeing of the independent U.S. oil companies investing in Indonesia is properly a matter of concern to this country.

5. Rev. Proc. 76–215 was issued as the result of a ruling request filed by one of the major oil companies. The smaller companies affected by the postponement of the effective date of the ruling had no opportunity to participate in the development of the ruling, although they are the ones most adversely affected by it.

6. Rev. Rul. 72–215 was published on May 7, after the Finance Committee hearings on H.R. 10612 had been concluded. The smaller independents immediately brought their problem before the Finance Committee and its staff and assisted in the development of the limited amendment embodied in § 1035(f) of the bill as reported by the Committee.

7. The Committee' estimate of the decrease in budget receipts for fiscal years 1977 and 1978 resulting from the postponement of the effective date of Rev. Rul. 76–215 is a strong indication the revenue estimators believe it will take at least two years for the companies involved to work out their problems with Indonesia. There would be no pick up in revenue if new contracts with Indonesia could be negotiated before the end of the year which would meet IRS requirements for allowance of foreign tax credits.

8. Newspaper stories, Senate floor statements and testimony presented to this Committee yesterday have described this amendment as a rip-off and dismissed production-sharing contracts as a "gimmick" used to avoid the 1975 Tax Reduction Act amendments. Those responsible for these misrepresentations are completely uninformed as to the significance of the amendment and the temporary problem it is intended to resolve. For example, Indonesian production-sharing contracts were first entered into in 1966 and in no way were designed to avoid the impact of a tax bill enacted last year. It would be most distressing if the amendment should be stricken from the bill based on such false and misleading representations.

STATEMENT

My name is Thomas C. Driscoll. I am Chief Financial Officer of Roy M. Huffington, Inc., of Houston, Texas. I have with me Mr. C. W. Leisk, Chairman and Chief Executive Officer of Austral Oil Company, Incorporated, of Houston, General A. A. Sproul, Chairman and President of Virginia International Company of Staunton, Virginia, and Mr. D. L. Commons, President of Natomas Company of San Francisco. We all have one thing in common; our companies are operating in Indonesia under oil and gas production-sharing contracts. Further, each of us is a small or middle-sized independent oil company operating overseas in competition with the largest oil companies in the world, both domestic and foreign.

We appear today in support of the Finance Committee amendment of May 27, which added Sec. 1035(f) to the Tax Reform Bill of 1976 (Committee Report, pp. 253–255).

This amendment relates to the foreign tax credit and production-sharing contracts, and is a limited transitional rule which will provide time for the smaller and medium-sized U.S. contractors that have invested substantial amounts of capital in Indonesia to renegotiate their contracts with Indonesia so as to satisfy the requirements of the IRS. A reasonable time to accomplish this task and to clear the proposed changes with the IRS is essential in order to avoid extreme financial hardships which we must otherwise face. It should be emphasized at the outset that this amendment is drafted so that no benefit will inure to the major oil companies.

The problem that has arisen is that the IRS issued a published ruling on May 7 of this year (Rev. Rul. 76–215) which announced the position that U.S. contractors operating under certain production-sharing arrangements are not entitled to a foreign tax credit for payments made on their behalf to the host foreign government and treated by the foreign government as income taxes. The IRS concluded that if a U.S. contractor is operating under the type of agreement described in the ruling, the entire amount paid to the foreign government was a royalty. The effect of the IRS rule is that the U.S. contractor is treated as having paid a royalty to Indonesia ranging from 50 percent to 70 percent, but is regarded as having paid no income tax whatever to the foreign government.

It is important to have an understanding of how these smaller companies got into this problem with the IRS. In the late 1960's and early 1970's Indonesia refused to offer its natural resources for development under the normal type of concession arrangement. Rather, it developed the production-sharing concept. Under this new concept, Indonesia retained control over its natural resources while sharing the benefits of their development with the U.S. contractors which supplied all the capital and technology. This new concept was consistent with the nationalism of a developing country like Indonesia. In general, the major international oil companies rejected the production-sharing contracts and this provided smaller U.S. companies with the opportunity to enter these areas.

The smaller companies have been successful in Indonesia and have invested hundreds of millions of dollars in that country under production-sharing contracts. The joint undertakings of the smaller companies and Indonesia were proceeding in a satisfactory manner until the IRS problem arose in the Spring of this year. It is not our intention to criticize or complain about the actions of the major companies or any single major company. However, it is relevant to the consideration of the proposed amendment that the Committee clearly understand that the IRS developed its ruling as the result of a ruling request filed by one of the major companies and, under IRS procedures, the smaller independent companies, who were most significantly affected by the IRS action, were precluded from any meaningful participation in the process which developed the substantive IRS position. We blame no one for the fact that we were shut out of the IRS substantive considerations. The major company that sought the ruling owed us no duty of consultation and the IRS personnel would probably have acted improperly if they had invited our participation.

The existing production-sharing contracts of the smaller companies which benefit from this amendment were entered into with the reasonable expectation that the foreign tax credit would be allowed. Even the IRS ruling reflects this understanding since the ruling is to apply prospectively only to years beginning after June 30, 1976. The chief problem with this ruling is that the six months' turn-around time given to calendar year taxpayers is just not enough for us to carry out the necessarily protracted negotiations with the Government of Indonesia and to obtain the required clearance of any proposed new arrangement from the IRS.

What the IRS ruling has done is to substantially alter the economic consequences of these existing contracts after the companies have invested large amounts of capital in these operations. If the companies had known that the foreign tax credit was not to be available, the terms of these contracts governing the division of the recovered oil would have been negotiated on a vastly different basis. Primarily, the U.S. companies would have been forced to insist upon a much larger share of the oil and gas to make their operations economically feasible in the absence of a credit for Indonesian tax payments. Had we done so, we probably would not have received our contracts from the Indonesian Government, and the United States would probably not have available to it the substantial amounts of oil being supplied to it today from Indonesian sources.

It is important to note that Sec. 1035(f) does *not* reverse the IRS ruling. The Finance Committee amendment and the Committee Report are silent as to whether the ruling is or is not correct. The amendment merely defers implementation of the ruling with respect to existing contracts for a period of five years. If upon further consideration the Committee should conclude that five years is too long a time to allow for renegotiation of existing production-sharing contracts and their subsequent clearance with the IRS, our companies can probably live with a shorter period such as two or three years. However, we would note that the IRS spent more than two years considering the existing Indonesian production-sharing arrangements before publishing its present position on the subject. The U.S. companies and Indonesia are now engaged in the process of modifying the existing contracts. This is being undertaken because Indonesia is desirous of obtaining a large share of the profits from these operation and both Indonesia and the companies are hopeful of restructuring the contracts so as to resolve the IRS problem. These changes are of the greatest significance to the smaller companies and it is absolutely essential that the new agreements be mutually beneficial to the long-term interests of all involved, including, of course, the companies and Indonesia.

Without the Finance Committee amendment, the smaller U.S. companies will find themselves in a real time bind; we will be forced to strike a new arrangement with Indonesia prior to year-end in order to avoid harsh U.S. tax consequences that will reduce after-tax profits by up to one-half. Such an artificial time constraint severely diminishes the companies' bargaining position and it does so unnecessarily. It may well be that an agreement can be reached with Indonesia by a few companies in the next few months, but a longer period will be needed to complete the renegotiation of all existing contracts. Certainly everyone hopes that the current negotiations can be brought to a rapid and satisfactory conclusion. But it is clear that the prospects of a mutually beneficial agreement will be greatly enhanced if the time available for negotiation can be extended considerably beyond year-end.

If we smaller companies are forced to press for modifications of our contracts on a crash basis, the resulting arrangement may be so unfavorable to us as to make further oil and gas development activities in Indonesia uneconomic. If so, we may have no alternative but to sell our contracts to either the major companies or the oil companies of foreign countries. This can hardly be viewed as being in the best interests of the United States or the taxpaying public.

We note with concern that Senator Bumpers has had printed an amendment to H.R. 10612 (Amendment No. 1970) which would strike Section 1035(f) from the bill. The reason he gives for his proposed amendment is that it is a narrow, special interest provision which is not necessary because the IRS has given us six months to revise our contracts with Indonesia. Last Wednesday, the Service put out a Press Release (IRS Information Release 1638) in which it listed five characteristics that tax payments made to a foreign government by taxpayers engaged in extracting mineral resources owned by the foreign government must have in order to be eligible for the U.S. foreign tax credit. At least 3 and possibly 4 of the 5 factors listed by the IRS call for very basic changes in our production-sharing contracts with Indonesia. It is clearly unreasonable to expect that the necessary modifications to our contracts can be negotiated with Indonesia and approved by our Internal Revenue Service in the five months remaining in this year. All we seek is a reasonable time for negotiations to be carried on in an orderly manner without having a critical time factor as a millstone around our necks.

The question may be asked, why didn't we appear before the Finance Committee on the production-sharing contract matter during the public hearings on the tax bill last March and April? The obvious answer is that we were not sure we even had a problem until the IRS published its ruling on May 7, 1976 that no foreign tax credit would be allowable for Indonesian tax payments for years beginning after June 30, 1976. Thereafter, we immediately brought this matter, which is absolutely vital to our operations, to the attention of the Finance Committee and its staff, and worked with them in developing the very limited amendment set forth in § 1035(f) of the bill. This amendment simply postpones the effective date of the IRS production-sharing ruling for those smaller and middle-sized companies that would suffer most from the abrupt change of the IRS with respect to the allowance of foreign tax credit with respect to taxes paid to Indonesia.

A word about the estimated decrease in budget receipts in fiscal years 1977 and 1978 of $23 million and $27 million set forth at page 255 of the Committee Report. These estimates are based on the assumption, erroneous we hope, that the U.S. companies operating in Indonesia will not be able to reach agreement within this two-year period with the Government of Indonesia on new contracts which will clearly permit the allowance of foreign tax credits for Indonesian income tax imposed upon their oil and gas extraction income. As such, the revenue estimates themselves suggest that we should be given at least a two-year transition period to work out our problems with Indonesia.

Finally, I can't close without commenting on the newspaper stories, Senate floor statements and testimony presented to this Committee yesterday, which have described this amendment as a rip-off and dismissed production-sharing contracts as a "gimmick" used to avoid the 1975 Tax Reduction Act amendments. Those responsible for these misrepresentations are completely uninformed as to the significance of the amendment and the temporary problem it is intended to resolve. For example, Indonesian production-sharing contracts were first entered into in 1966 and in no way were designed to avoid the impact of a tax bill enacted last year. It would be most distressing if the amendment should be stricken from the bill based on such false and misleading representations.

The CHAIRMAN. Next we will call Mr. Joseph H. Guttentag on behalf of Continental Corp., Chubb Insurance Co., the American International Group, Inc., U.S. Fidelity and Guaranty Co., and Hanover Insurance Co.

[The document referred to follows:]

STATEMENT OF JOSEPH H. GUTTENTAG, ON BEHALF OF CONTINENTAL CORP., CHUBB INSURANCE CO., THE AMERICAN INTERNATIONAL GROUP, INC., U.S. FIDELITY & GUARANTY CO., AND HANOVER INSURANCE CO., ACCOMPANIED BY WILLIAM F. GLEASON, JR., VICE PRESIDENT AND ASSISTANT SECRETARY OF THE CONTINENTAL INSURANCE CORP.

Mr. GUTTENTAG. Thank you, Mr. Chairman. With me this afternoon is Mr. William F. Gleason, Jr., vice president and assistant secretary of the Continental Insurance Corp.

We are here to support the provisions of section 1036 of the bill which provides for the first time in the Code a rule for determining when insurance underwriting income has its source in the United States and when such income has its source overseas.

We are also here to challenge the representations which have been made just by the mere presence of these five companies that this is a bill of interest to and benefitting only one company.

The Internal Revenue Code now contains a variety of rules which determines where income has its source. There is no rule that either the Code or the regulations determines the rules for underwriting income.

Why are these rules important? They are important in determining when companies are subject to tax in some cases and in other cases for determining the amount of U.S. tax which can be offset by foreign tax credits.

There are some rules in the Code now with limited applicability which do define the source of underwriting income in terms of where the risk is located.

Section 1036 would extend that same rule, generally; this is the best rule as it cannot be manipulated as easily as all other rules.

Furthermore, if we were to adopt some other way we would end up with two different rules in the Code for no good reason.

There will be minimal revenue loss, some gain and some loss. This rule will prevent double taxation because most other countries have similar rules.

Of course, there can always be double taxation as the United States cannot, unilaterally, always avoid double taxation but we have avoided double taxation through tax treaty and, for example, there was a statement submitted before the committee yesterday indicating there could be double taxation involving United Kingdom operations or the United States company.

That problem is specifically solved by the provisions of the United States-United Kingdom treaty which is presently pending before this body.

Our support of this legislation has been on the table. There have been documents available for public inspection.

The proposal affects every insurer and foreign companies operating in the United States rather than a provision of limited application.

Adoption will mean that we will have a general rule regarding the source of income for all purposes in the Code which will affect all insurance companies.

As we indicated, there is no rule in the present Code now and we all agree that we should have one.

The pending proposal has been reviewed by the staff and the Joint Committee and determined to be the best available rule as it is not subject to manipulation.

The administration also supports this provision and even Mr. Nader's organization finds it nonobjectionable.

Adoption of this rule will simplify the Code and ease its administration. Thank you.

The CHAIRMAN. The Treasury is also for this?

Mr. GUTTENTAG. Yes, sir.

[The prepared statement of Mr. Guttentag follows:]

STATEMENT OF JOSEPH H. GUTTENTAG

SUMMARY OF STATEMENT

1. Determination of the source of underwriting income is important to all U.S. and foreign insurers.

2. The Internal Revenue Code contains no general rule for determining the source of underwriting income but certain rules of specific application provide that such income has its source where the risk is located.

3. The proposed legislation would extend these rules of limited application generally to define the source of underwriting income as the place of the location of the insured risk. Adoption of the proposal would provide a single rule applicable to all provisions of the Code.

4. The "location of the risk" rule eliminates the opportunity for manipulation of the source of underwriting income and helps avoid double taxation of such income. Adoption of any other rule would mean there would be two disparate rules under the Code for determining source of underwriting income—for no good reason.

5. Adoption of the proposed rule would have minimal adverse revenue consequences. It would result in revenue gain as well as some revenue loss. It would provide for the first time a specific nonmanipulative rule which would simplify the Code and the administration of the tax law.

STATEMENT

My name is Joseph H. Guttentag. I am a partner in the law firm of Surrey, Karasik and Morse. I appear here today on behalf of Continental Corporation, Chubb Insurance Company, American International Group, Inc., U.S. Fidelity & Guaranty Co., and the Hanover Insurance Company, in support of the provisions of H.R. 10612 contained in section 1036, dealing with the determination of the source of insurance underwriting income.

Summary

We urge the Committee to adopt this proposal which affects not only the companies for whom I appear, but taxation of all insurance companies, both U.S. and foreign, and, accordingly, has broad applicability. The proposal provides for the first time in the Internal Revenue Code a general rule for determining the source of insurance underwriting income. This rule would not apply to only one or two companies but to the entire international insurance industry. It would have the effect of in some cases increasing, and in some cases decreasing, U.S. revenue. The gross and net revenue effects will be negligible. There will be substantial benefits in the administration of the tax laws by having a definitive rule on this subject in the Code for the first time.

Source of income rules

Some rules for determining the source of income are set forth in the Code. For example, the Code provides specific rules governing the source of income of interest, dividends, the sale of goods, and the performance of personal services. The Code leaves open the determination of the source of other types of income including insurance underwriting income.

Reasons for source of income rule

The source of income rules are important for many reasons under the Code. The two principal purposes for these source rules are for determining income subject to tax, particularly in the case of foreign individuals and companies whose U.S. tax is measured in whole or in part by the amount of U.S. source income, and secondly, for determining income, the U.S. tax on which may be offset by foreign taxes. Under the foreign tax credit rules, foreign taxes may be credited only against U.S. taxes imposed with respect to foreign source income.

The proposed source rule would be of general application and would be used for determining income subject to U.S. tax, as well as entitlement to the foreign tax credit.

Current tax rules regarding insurance income

As explained above, under existing Internal Revenue Code provisions, there is no rule which sets forth the source of insurance underwriting income. Furthermore, there are no regulations which cover this issue. There are, however, other provisions of the Internal Revenue Code under which it is necessary to determine the source of insurance underwriting income. Under Subpart F of the Code, certain underwriting income of controlled foreign corporations is subject to tax. These provisions require a determination of the source of underwriting income, and the Code provides that for these purposes, insurance underwriting income has its source where the risk which is being insured is located. Regulations issued under these provisions of the Code set forth detailed rules for the purpose of determining where an insurance risk is located.

Additionally, the Code imposes an excise tax on insurance premiums paid to certain foreign insurers. While this is an excise tax, it is designed to replace the usually applicable withholding tax imposed by the United States on foreign individuals and companies not engaged in trade or business in the United States who receive U.S.-source income. For the purpose of the excise tax, U.S.-source insurance premium income is defined in terms of where the risk is located.

While the Internal Revenue Code does not contain the above rules which determine the source of underwriting income as the place where the risk is located, these rules are of limited application. The Internal Revenue Service has issued only one published ruling with respect to the general rule as the source of insurance underwriting income. This ruling was issued in 1922, and could be interpreted to mean that the place of negotiation of the insurance contract is determinative of the source of the income. The ruling, however, is over fifty years old, involves an unusual factual situation, and is of doubtful precedential value.

Avoidance of double taxation

If the current IRS position were to be followed, U.S. companies insuring foreign risks may be subjected to double taxation.

Many of the major general insurance companies incorporated in the United States receive a portion of their business from brokers or agents situated in the United States, covering risks which are located exclusively outside the United States (hereinafter referred to as "Home Foreign Accounts").

Typically, a United States corporation or broker representing such corporation will approach a U.S. incorporated insurance company or its agent to provide insurance for the corporation's worldwide (excluding the United States) operations. The insurance risks covered may be exclusively those situated outside the United States and frequently are the risks of the foreign subsidiaries of the insured U.S. companies. The insurance companies, under an overall binder issued on the Home Foreign Account may cover property and other risks of the U.S. corporation and/or its foreign subsidiaries, and the insurance losses may be payable either in U.S. dollars or the currency of the country which the foreign risk is situated.

Frequently, the foreign subsidiary insured (rather than its U.S. parent) will pay the premiums in order to obtain an income tax deduction in the jurisdiction in which such subsidiary is incorporated and doing business. Also, in many instances, a policy covering the Home Foreign Account risk must be issued in the foreign jurisdiction in which the insured's risk is located in order to comply with the local insurance laws of such country or the requirements of the insured. In both these instances, the underwriting income derived from the House Foreign Account would be subjected to foreign income taxation but would generate U.S. source income under the Internal Revenue Service's present position, thus prohibiting the utilization of foreign income taxes paid on such income as credits against the U.S. tax liability on such income. This results in double taxation. Adoption of the proposed rule would not affect the taxation by the U.S. of brokerage fees paid on such foreign risks. Such fees paid for services rendered in the U.S. would remain U.S. source income. Only the pure underwriting income would have its source where the risk is located.

Various underwriting income source rules considered

The Congress now has the opportunity to set forth a definitive rule of general application to resolve the issue once and for all, and to avoid further administrative problems of determining tax liability.

There are various rules which could be adopted for determining the source of insurance underwriting income. Some of these rules are as follows:

1. The location of the risk that is being insured.
2. The location of the headquarters of the taxpayer issuing the policy.
3. The domicile of the taxpayer issuing the policy.
4. The place where the contract is negotiated or executed, or where other activities with respect to the generation of the business take place.
5. The place where the premium is paid or received.

Reason for adopting situs of risk rule

It is our position that for the reasons set forth below Congress should adopt a rule, as presently set forth in section 1036 of the pending Bill, which would define the source of underwriting income as the place where the insured risk is located. We believe that this is the most appropriate rule for the following reasons:

1. Several of the other possible rules set forth above can with facility be manipulated by taxpayers to place the source of the income artificially in one jurisdiction or another. Included in this category would be the rules which define the source in terms of the place where the contract was negotiated or executed, or the place where the premiums were paid or received. For example, if a place of negotiation rule were adopted, the source of income could be manipulated to generate foreign income simply by negotiating and executing a policy outside the United States insuring a building *located* in the United States which is both owned and insured by U.S. companies and where payments of premium and losses were made in the United States in U.S. dollars.

2. Other alternative rules set forth above should have no bearing on the source of the underwriting income subjected to tax as there is little connection between the criteria suggested and the income generated.

3. The situs of the risk rule would be consistent with the rules of many foreign countries which, through a combination of laws, effectively tax insurance income based on the place where the insured risk is located.[1] In some cases, however, under this rule, an insurer could be subject to tax by its country of residence on a worldwide basis (as in the U.S.) and by a country in which it has an insurance writing office. This problem has been recognized and resolved by tax treaties, including the pending U.K. treaty and the model U.S. treaty prepared by the Treasury Department.

4. Adoption of the proposed rule would help to eliminate double taxation since, as explained above, a rule related to the situs of risk would be consistent with taxing rules of other jurisdictions. When such jurisdictions do tax insurance income, which is also subject to U.S. tax, the United States would grant a credit for such taxes. Conversely, when foreign companies are subject to tax on insurance income earned with respect to insurance U.S. risks, they would be more likely, under the terms of applicable tax treaties or their domestic law, to avoid double taxation.

5. Adoption of this rule would be consistent with existing provisions of the Internal Revenue Code under sections 953 and 4371. These existing sections

[1] Among these countries are Australia, Argentina, Brazil, Denmark, France, India, Jamaica, Japan, Pakistan, Spain, Sweden and Switzerland.

provide respectively that for purposes of Subpart F of the Code, and for purposes of the insurance premium excise tax, insurance underwriting income has its source where the risk is located.

6. As opposed to other rules which could be adopted, the location of the risk rule is also the most practical and realistic rule in that the location of the risk is also the place where ancillary services in connection with the placing of the insurance would be performed. For example, prior to the insurance contract being written, the insurer may inspect the property or hazard being insured to determine the risk involved. After the contract is written, the insurer may make periodic "onsite" inspections. Servicing of the insurance contract and claims adjustment in the event of loss would most likely take place at such location.

7. The situs of the risk rule would also substantially conform to rules adopted by the National Association of Insurance Commissioners. The rules are used for state regulatory purposes and for certain purposes under the Internal Revenue Code. See, e.g., *New Hampshire Fire Insurance Co.*, 2 T.C. 708 (1943), aff'd. 146 F.2d 697 (1st Cir., 1945); Section 832(b)(6), IRC.

Effect of adopting situs rule

Adoption of the proposed rule would have the following effect:

1. The rule is more likely to be internationally compatible than other rules which might be adopted.

2. Such a rule would tend to avoid double taxation.

3. For the first time, the Internal Revenue Code would contain a generally applicable rule with respect to insurance underwriting income which would apply both to United States and to foreign taxpayers.

The adoption of this rule would not have significant revenue impact. Based on a survey of over twenty United States companies, which are the major insurers of foreign risk, we estimate that the revenue loss with respect to such companies would not exceed $2.5 million. On the other hand, adoption of this rule would also serve to increase the U.S. tax on the income of foreign companies insuring U.S. risks. Furthermore, any income earned in the U.S. by brokers or agents for services in connection with the negotiation and execution of the contract would remain fully subject to U.S. tax as U.S. source income.

This estimate as well as a statement in support of the proposed legislation was originally presented to the Staff of the Joint Committee of Internal Revenue and U.S. Treasury Departments by letters dated May 6, 1976, by several insurance companies, and has been available for inspection by any interested person. The problem was considered and acted upon by the Senate Finance Committee. During the consideration of the proposal, Dr. Woodworth stated before the Committee that the proposal represented the better rule, as it avoided artificial manipulation by taxpayers. The proposal is a tax reform measure.

The CHAIRMAN. Any further questions?

[No response.]

The CHAIRMAN. Next, we will call Mr. William M. Horne, senior vice president and general tax counsel, First National City Bank, New York, N.Y., on behalf of American Bankers Association.

STATEMENT OF WILLIAM L. HORNE, SENIOR VICE PRESIDENT AND GENERAL TAX COUNSEL, CITIBANK, ON BEHALF OF AMERICAN BANKERS ASSOCIATION

Mr. HORNE. Mr. Chairman, we thank you for the opportunity to testify before your committee.

On behalf of the American Bankers Association we would like to support the committee's action with respect to continuing the exemption for the 30-percent withholding tax on deposits to the U.S. banks owned by foreign individuals and corporations.

We have a statement which will be submitted for the record. I would simply like to summarize it at this time, if I may.

I would like to clarify two misconceptions that I think may have occurred as to this committee's proposal.

The first is that it is a special interest provision. That is simply not true.

The exemption from withholding on foreign bank deposits in the United States owned by foreign corporations and individuals has been in our laws for more than 50 years and all that your committee has done is to continue that exemption to make it permanent.

The exemption has been temporary since 1966 but your action would make that exemption permanent.

Now, the second misconception relates to the amount of the revenue loss. In the committee's report it was stated that the potential revenue loss from this provision in 1977 would be $110 million.

We think those estimates are far overstated for the following reasons: In the first place, the estimate, of course, assumes that the exemption from withholding on the bank deposits would otherwise go into effect in 1977 and the exemption would be removed in 1977 at the time the bank deposits would be subject to a 30-percent withholding tax.

Of course, that assumes that these bank deposits would be continued by the owners of the deposits, the foreign owners, and not withdrawn if the withholding tax comes into play.

We think there is very ample evidence that once the withholding tax does come into play that most of these foreign deposits will, in fact, be withdrawn so the revenue estimates would not, in fact, occur.

There would actually not be any revenue loss; certainly to the extent that has been projected.

Just to look at what happens when a foreign individual or corporation invests in a U.S. bank deposit: You take funds, in effect, from the foreign country and convert those funds into U.S. dollars and put those dollars on deposit in a U.S. bank account.

These funds have a stimulated effect upon the U.S. economy and, in addition, they have a favorable impact on your balance of payments.

For these reasons we strongly urge the committee to support its action and continue this exemption.

Finally, I would like to point out, if I may have one minute more, that the fact the exemption is bound to expire at the end of this year has already caused a number of foreign depositors to raise questions about whether or not they will continue to keep their deposits in the United States and so it is necessary that the Congress take action fairly early if we are not to lose a substantial amount of foreign deposits.

The CHAIRMAN. Can you tell me, how does it serve this Nation's interest to have those deposits over here? You have to keep in mind that everybody is not a banker around here—you had better explain that to us.

Mr. HORNE. In effect, let us take a Venezuelan individual who would convert his bolivars into U.S. dollars and place them on deposit in a U.S. bank account.

That would add, in effect, then, to the amount of funds available for investment in the U.S. economy.

This is a desirable situation, one that we would hope the committee would approve by continuing to approve the exemption from the withholding tax.

The CHAIRMAN. Just to get all of this straight in my mind, does it not stand to reason that if all $36 billion were pulled out as you say might happen, that the Federal Reserve would just expand the amount of money and credit in the United States by using the powers that are vested in the Federal Reserve to expand the Federal money supply?

Mr. HORNE. The Federal Reserve, as you say, can take action to counter any substantial withdrawals; it certainly is true, Mr. Chairman, but what we are suggesting, though, is by the presentation of the United States exempting from the 30-percent withholding tax, the interest on these foreign bank deposits, we are, in fact, encouraging and have been encouraging for many years these deposits to be made in the United States.

If we take away that incentive I do not think we would have any new funds coming in.

It is just a problem—you are probably correct as to the fact that even if the funds should flow out from the United States to Europe, there are other dollar deposits in other foreign countries. The Federal Reserve could, of course, take action to counter that effect.

What they could not counter, though, would be the fact that the incentive impact of this amendment of the present exemption would, in fact, be eliminated by proposing a 30-percent withholding tax.

The CHAIRMAN. We do not have time to go into it now. I wish you would provide us with a follow-up statement, hopefully, by tomorrow, that would explain not from the point of view of your bank or any bank, but from the point of view of the national interest and maybe the Treasury can help you with this—just exactly how it advances the Nation's interest to have these funds on deposit here in the United States.

I am sure that a good argument can be made but I think it requires a little bit of thought and if you would provide it to us, would like to have it.

Mr. HORNE. Thank you, Mr. Chairman.

[The prepared statement of Mr. Horne follows:]

TESTIMONY OF WILLIAM M. HORNE, JR., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

SUMMARY

I. Between 1921 and 1966, the Congress provided a permanent exemption from withholding for interest on foreign-owned deposits in U.S. banks. Since 1966, the exemption has been extended twice. It now expires on December 31, 1976.

II. This longstanding exemption is not, in any sense, "special interest" legislation. It is of particular importance to banks in border states, regional banking states, and money center states which have substantial foreign deposits. It is of considerable importance to the U.S. economy.

III. At present, U.S. banks hold over $6 billion in foreign deposits subject to the exemption. If Congress does not soon act on the permanent exemption, because of the approaching expiration date a large volume of these deposits will flow out of the U.S. to other countries.

IV. The American Bankers Association disagrees with the conclusion in this Committee's Report that the foreign deposit interest exemption produces a decrease in tax revenues, for the following reasons:

(i) The U.S. has tax treaties with a large number of countries which specifically exempt all interest from withholding taxes. Treaties with other countries provide for withholding on interest at a rate of 15 percent or lower.

(ii) If the withholding exemption were repealed, those foreign deposits not subject to treaty exemptions would immediately flow out of the U.S. into other countries which do not tax foreign-owned deposits, with the result that he U.S. tax base for these deposits would disappear.

V. As a result of a "multiplier effect" the $6.1 billion in foreign deposits produces at a minimum between $15 and $18 billion in bank loans to business and individuals. This increased volume of loans generated by foreign deposits produces substantially increased tax payments to the Federal Government.

STATEMENT

I am William M. Horne, Jr., Chairman of the Taxation Committee of the American Bankers Association. I appreciate this opportunity to testify on behalf of the American Bankers Association before the Committee on Finance on the exemption from the 30 percent withholding tax for interest on deposits in U.S. banks owned by foreign individuals and corporations, which are unrelated to a trade or business in the U.S.

Section 861(c) of the Internal Revenue Code contains an exemption for this bank deposit interest, which expires on December 31, 1976. This exemption would be made permanent under § 1041(c) of the Tax Reform bill, as passed by the House and approved by this Committee. In our testimony before this Committee on March 26, 1976, the American Bankers Association urged the Senate to make the exemption permanent. Again, we urge the adoption of the permanent exemption, and we continue to stress the importance of this provision to the U.S. economy.

As we pointed out in our testimony before the Committee on March 26, 1976, the interest on foreign-owned deposits has been exempt from U.S. tax for more than half a century. For 45 years (1921 to 1966) the exemption was permanent. Beginning in 1966, the Congress made the exemption temporary by imposing a definite termination date. Since 1966, the Congress has reviewed the exemption several times, and has extended the termination date each time because of the impact on the balance of payments.

This longstanding exemption is not "special interest" legislation. Quite to the contrary, it is of importance to the economy. There are many banks and other financial institutions that are vitally interested in the continuance of the exemption for interest on foreign-owned depostis. Banks in states bordering Mexico, the Caribbean area, and Canada, and banks in regional banking states and money center states (i.e., NY, Ill., Mass., Cal., Penn., Ga., Tenn., NC, and Wash.) which have substantial foreign-owned deposits are vitally concerned with this issue.

Because the exemption expires in less than six months, banks with foreign-owned deposits have been receiving increasing numbers of inquiries from their foreign depositors concerning the tax status of their interest bearing time and savings accounts. Because of this uncertainty, these deposits are in danger of being withdrawn and deposited with foreign banks.

Foreign-owned deposits in U.S. banks take the form of time deposits, with maturities ranging from 30, 60, 90, 180 days to one year, and passbook savings accounts. Also involved in this issue is a probable loss of a substantial volume of non-interest bearing demand deposits owned by the same foreign individuals who maintain time and savings deposits in U.S. banks.

The average holdings of non-negotiable interest-bearing deposits in U.S. banks by foreigners other than official institutions was approximately $6.1 billion in 1975.

At the outset, we seriously question the accuracy of the Committee's statement that the continued exemption of these foreign-owned deposits will produce a decrease in tax liabilities and budget receipts. The Committee's Report on H.R. 10612, at page 261, states as follows:

"It is estimated that these provisions will result in a decrease in tax liability of $8 million for calendar year 1976, and $130 million for calendar year 1977. In 1977, $20 million is attributable to the exemption for nonbank account interest, *and $110 million is attributable to the exemption for bank account interest.*" (Emphasis added.)

"This provision will reduce budget receipts by $73 million in fiscal year 1977, $137 million in fiscal year 1978, and $188 million in fiscal year 1981."

Similarly, the Report of the House Ways & Means Committee on H.R. 10612, at page 239, estimates that the revenue loss attributable to the exemption of bank deposit interest would be $110 million for the taxable year 1977.

Our reason for taking issue with the estimated revenue impact of the bank interest exemption contained in the Senate and House Reports is based upon the following considerations.

A number of countries, such as Canada, the United Kingdom, Germany, the Scandanavian countries, Belgium, etc., have tax treaties with the U.S. which contain reciprocal provisions relating to withholding-at-source on interest. For a majority of these countries, all interest is exempt from withholding. The remainder of these treaties provide a lower withholding rate of 5, 10, or 15 percent on the interest paid to residents of the respective treaty country.

Some unknown but presumably significant portion of the non-governmental foreign deposits in U.S. banks are owned by residents of foreign jurisdictions with which the U.S. does not have any tax treaty provisions relating to interest. It is safe to predict that virtually all of these highly mobile short-term deposits, in absence of a withholding exemption, would flow out of the U.S. into investment in countries which do not tax foreign-owned short-term funds. Thus, if a U.S. withholding tax were imposed on foreign-owned deposits, the resulting outflow of these funds from U.S. domiciled banks would cause the projected source of revenue to largely disappear.

While the withdrawal of foreign deposits would add nothing to Treasury receipts, however, it could be positively detrimental to the U.S. economy. In a real sense, foreign nationals who deposit funds in U.S. financial institutions are investing in the United States. The institutions channel deposits into mortgages that support construction of new housing and the sale of existing homes, into loans to businesses for inventory accumulation and investments in modernized or expanded productive capacity and to the purchase of securities issued by both the federal government and the governments of states and localities. If these funds are deposited in foreign banks, they would be employed in the Eurdollar market.

The Federal Reserve controls the total amount of deposits in the nation's commercial banks through its open-market operations, changes in reserve requirements, and changes in discount rates and availability. But it cannot control the way the total amount of funds in the economy is employed. Inflows of foreign funds make a meaningful contribution to investment spending. It would be counterproductive to terminate this contribution by imposing a tax that would raise no revenue.

A permanent exemption, as provided by H.R. 10612 as it passed the House and was approved by the State Finance Committee, would remove the continuing uncertainty in U.S. tax policy—which has existed since 1966—for attracting foreign funds for investment in the U.S. through the bank deposit mechanism.

Accordingly, the American Bankers Association urges the Senate to approve the permanent withholding exemption for interest on foreign-owned bank deposits, as provided by Section 1041(c) of H.R. 10612.

AMERICAN BANKERS ASSOCIATION,
Washington, D.C. July 23, 1976.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance of the U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: At the Senate Finance Committee hearings on July 21, you requested that the American Bankers Association furnish you with a statement explaining why foreign-owned deposits in United States banks are beneficial to the U.S. economy.

As we indicated in our testimony, if the longstanding withholding tax exemption expires on December 31, 1976, there is every indication that a substantial portion of the foreign-owned deposits which would then be subject to the 30 percent withholding tax would, in fact, be withdrawn. We understand that the Treasury Department estimates that these potentially taxable bank deposits are in the area of $9 billion.

The loss of all or a substantial portion of these $9 billion of foreign-owned deposits would clearly have an adverse effect on the Nation's exchange rate to the extent these deposits are converted into foreign currencies. Intervention by the Federal Reserve System to prevent the deterioration of the exchange rate would lead to a loss of our reserves. To the extent that the funds move into dollar deposits in the Euro-currency markets, this business would be lost to foreign banks. More importantly, a change in withholding and the resultant movement of funds would work against the re-establishment of the United States as the world financial center now that the various capital controls have been removed. The loss of position by the U.S. as the world financial center has long-range employment implications for U.S. financial markets.

In addition, the loss of these deposits would be a factor which the Federal Reserve Board would have to take into account in its monetary policy. Since the timing of the loss of these deposits would not be within the control of the Federal Reserve Board, the outflow might occur at a time in which it would have an adverse impact on the Board's then monetary policy. Thus, if the outflow occurred at a time in which the Board was attempting to further stimulate the economy by making more credit available, the Board would have to take additional steps in order to counteract the adverse impact of these foreign deposits.

In the longer view, the repeal of the longstanding exemption from the withholding tax of foreign bank deposits is clearly a restrictive measure that impedes the free flow of capital in international financial markets, reducing the benefits of such flows to U.S. and foreign markets. In most major industrial countries, interest on bank deposits owned by foreigners is either exempt from withholding tax or is taxable at substantially lower rates than the U.S. withholding rate of 30 percent.

From a revenue standpoint, it is clear that the Treasury would obtain additional tax revenues if, and only if, these foreign-owned deposits, which would become taxable by reason of the repeal of the exemption, did, in fact, remain in U.S. banks. It is our considered judgment that a very large portion, if not substantially all, of these deposits would be withdrawn if they became subject to the 30 percent withholding tax; hence, the estimated revenues projected, if the withholding tax applies, would not materialize. In addition to the loss of interest-bearing deposits that would become subject to tax, the United States would also be adversely impacted by a loss of non-interest bearing demand deposits owned by the same foreign holders who maintain time and savings deposits in U.S. banks.

In effect, the withholding tax would act as a *in terrorem* measure. An applied proof of this result can be adduced from the relatively small amount of withholding taxes that would be lost if the Finance Committee's proposed exemption for nonbank account interest is enacted. Since the foreign bank accounts are much more volatile than foreign portfolio debt investments, it is evident that there would remain very few foreign deposits subject to the 30 percent withholding tax.

Accordingly, the American Bankers Association strongly urges your Committee and the Senate to approve the permanent withholding exemption for interest on foreign-owned bank deposits as provided by Sec. 1041(c) of H.R. 10612.

Sincerely,

WILLIAM M. HORNE, Jr.,
Chairman.

The CHAIRMAN. Any other questions?

[No response.]

The CHAIRMAN. Next we will hear Mr. Tom C. Frost, Jr., chairman of the board of the Frost National Bank.

STATEMENT OF TOM C. FROST, JR., CHAIRMAN OF THE BOARD, FROST NATIONAL BANK

Mr. FROST. Thank you, Mr. Chairman. I am here also to support section 1041(c) of the House bill amending the same part of 861(c) of the Revenue Code on the bank deposits for nonresident aliens not doing business in the United States.

I am here as a working banker who has had 26 years experience in this marketplace dealing with these individuals that have put this money in the United States.

I am also here as someone who can kind of explain it a little bit more simply, maybe.

It does not get into the theory of the Federal Reserve or anything else but I can say that if you do not extend this privilege this money will be lost to the economy because the deposits are going to go down and when banks do not have deposits they cannot make the same amount of loans.

I would like to make the point here that the benefits are to the borrowers, not to the banks or to any particular institution or to a full industry.

We can discuss a long time what the Federal Reserve could or could not do but I can tell you that from practical experience that if that money is just not here we cannot lend it out to somebody and they don't get the benefit from it.

I would like to take just one second to, since we have talked so much about how some of those proposals come about, I think there has been a little criticism that there has not been a proper public hearing.

It was mentioned that this has been in the law since 1921. It has been extended three times by Congress and in this particular session of Congress this proposal has been considered by the Ways and Means Committee and on the floor of the House.

This is the third time the committee or one of the committees has considered it so we cannot say that this has not had a good public airing.

We are supported by the Treasury, I understand, so they would not lose any revenue. They are not collecting any now.

And, I request that you affirm the House's action and your own previous action because if this is not extended, I think the money just will not be there and there will be hundreds of thousands of borrowers that just will not get their loans because of that. Thank you.

The CHAIRMAN. Thank you.

Senator BENTSEN. Would it also be true, sir, that in the area in which you operate that even though the amounts might not be as large as they are in the New York banks that proportionately it probably has an even greater impact on the economy at the local areas to provide funds for growth expansion and jobs in that area?

Mr. FROST. There is no question about it. Texas, Arizona and even Florida are capital short and we need to get funds from wherever we can and the State of Texas and the banks I have talked to—it is a very significant part of the deposits and they have been lending to local consumers, businessmen and individuals, for the benefit of the local economy.

Senator HANSEN. Mr. Chairman, this does mean a great deal to Arizona. You have that "black gold" in Texas—it is not as important there.

The CHAIRMAN. You have sunshine out in Arizona——

Senator FANNIN. Golden sunshine—but, certainly, it is tremendously important to capital formation which, I feel, is the greatest problem in this Nation today.

Certainly this would have an effect on the ability, as you have stated, to finance many programs that are very badly needed.

Mr. FROST. I agree.

The CHAIRMAN. Thank you very much, Mr. Frost.

[The prepared statement of Mr. Frost follows:]

Statement of Tom C. Frost, Jr., Chairman of the Board, Frost National Bank, July 21, 1976

SUMMARY

1. Section 1041(c) would extend permanently the exemption from U.S. tax on interest on bank deposits owned by foreign persons—a provision that has been part of U.S. tax law since 1921.
2. This legislation is fully supported by the Treasury Department. It was considered by the Ways and Means Committee, was passed by the House of Representatives, and testimony was received by the Senate Finance Committee.
3. It is estimated that about $6.5 billion of time deposits in U.S. banks are held by foreigners. This money is on deposit in banks throughout the country, and benefits the communities of all of those banks.
4. If present law is not extended, a large outflow of funds can be expected to the detriment of the nation and the communites in which the depository banks are located.

STATEMENT

My name is Tom C. Frost, Jr., and I am Chairman of the Board of Frost National Bank of San Antonio, Texas. I am appearing in support of Section 1041(c) of H.R. 10612, the Tax Reform Bill, which would amend Section 861(c) of the Internal Revenue Code. Section 1041(c) would extend permanently the exemption from U.S. tax on interest on bank deposits owned by foreign persons—a provision that has been part of U.S. tax law since 1921. This extension is supported by Treasury.

Mr. Chairman, I want to set the record straight, since some have charged that enactment of this provision would fall into the category of "special interest" legislation, and may not have been fully considered by the Congress prior to the time it appeared in the Senate Finance Committee bill dated June 10, 1976.

The record shows careful consideration of this issue by the House Ways and Means Committee, the full House, and this Committee. First, with respect to testimony, the American Bankers Association and Mr. Max Mandel, Chairman of the Executive Committee, Laredo National Bank of Laredo, Texas, appeared on this issue before the House Ways and Means Committee last year.[1] Second, I testified before the Subcommittee on International Finance and Resources of the Senate Finance Committee on March 1, 1976, on this same subject.[2] Third, on April 22, 1976, I submitted testimony on this issue to the Finance Committee during consideration of the Tax Reform Bill, H.R. 10612. Others, I am sure, also provided the Committee with comments on the issue.

Moreover, the issue came before this Committee after close scrutiny by the House of Representatives. An amendment adopted on the floor of the House struck part of Section 1041 of the Ways and Means bill, but left the permanent exemption relating to bank deposits (Sec. 861(c) of the Internal Revenue Code) intact.

I submit that the House Ways and Means Committee, the full House, and the Senate Finance Committee, have all recently discussed and debated this issue and concluded that permanent exemption is the best solution to the problems faced. This conclusion comes after repeated extensions of the law. I believe the exemption was a part of the Code from as far back as 1921, and when Congress in 1966 reviewed Sec. 861(c) in the Foreign Investors Tax Act of 1966, it extended the exemption through the end of 1972. The next review brought an extension through the end of 1975, and again in 1975 Congress extended the provision through the end of 1976. After repeated extensions of this statute, Mr. Chairman, I submit that the House and this Committee are correct in recommending that the exemption be made permanent.

Now let me dispel any thought that continuation of this provision would benefit a select few.

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[1] Public Hearings before the Committee on Ways and Means, House of Representatives, 94th Congress, on the subject of Tax Reform, Vol. 1, page 862, et seq., and Vol. 4, page 2571, et seq.

[2] Hearing before the Subcommittee on International Finance and Resources of the Committee on Finance, United States Senate, 94th Congress, March 1, 1976, page 38, et seq.

The ABA estimates that about $6.5 billion of time deposits in U.S. banks are held by foreign individuals or businesses. The totals are, of course, much smaller for the Southwestern banks, but I can personally testify to the tremendous significance of such funds, the biggest portion of which comes from citizens of Mexico and other Latin American countries. From my 25 years of banking experience in this market, I have concluded that the deposits provide a strong and stable base for extension of credit to domestic borrowers.

However, if the provision is not extended, a very large portion of these deposits will be shifted to banks in other countries—countries which require no payment of tax on the interest earned. Who will benefit? Banks and borrowers in those other countries. Who will suffer? Potential borrowers—business, consumer, and agricultural—from banks in the United States. For the simple fact is that we cannot lend what we do not have.

This is not simply theory. With the exemption due to expire next December 31, many foreign investors are carefully considering the redeposit of these funds. This has occurred in the past as the various temporary extensions have approached expiration. And it is a compelling reason why this most worthwhile and defensible provision of the tax law should be made permanent.

Mr. Chairman, the provision has great merit; it was drafted, debated and passed in full public view; and in no way can it be said to benefit "special" or "narrow" interests—unless indeed the millions of borrowing customers of the affected banks are so classified.

I shall be happy to respond to questions.

STATEMENT OF TOM C. FROST, JR., CHAIRMAN OF THE BOARD, FROST NATIONAL BANK, APRIL 23, 1976

I am Tom C. Frost, Jr., Chairman of the Board of Frost National Bank of San Antonio, Texas. I appreciate the opportunity to submit my statement to this Committee in support of Provisions 1041 of HR 10612 exempting from income tax the interest paid on deposits by commercial banks to non-resident aliens not doing business in the United States. This Provision also exempts these deposits from estate taxes.

This Legislation is important not only to the individual banks in the major money centers and in locations bordering Canada, Mexico, and the Caribbean who receive the deposits, but also to the economies served by these banks. As evidence of the significance of this, The American Bankers Association in testimony before the House Ways and Means Committee in support of this Legislation on July 9, 1975, estimated these deposits at approximately six and one-half billion dollars. I personally can testify to the significance of these deposits to the economy of San Antonio and South Texas. During my 26 years of banking experience in this market and through conversations with bankers in other areas such as Florida, Arizona, and other money centers, I have observed that these deposits have been a good stable base for the extension of credit to domestic customers.

This exemption from taxes has been in effect since 1921 and was on a permanent basis until 1966. For the last ten years Congress has recognized repeatedly the benefit of these funds to our domestic economy and the need to maintain this exemption to protect this source of deposits by several extensions of the law.

Previous Congressional action is consistent with the conclusion that these deposits would not remain deposited with domestic banks in the United States without this exemption since other countries whose banking systems and economies are attractive to the potential depositors do grant similar exemptions. I refer to the United Kingdom, Canada, the Bahamas, Switzerland, Belgium, Germany, and the Netherlands as examples. Legislative action has supported the position that if the normal withholding taxes are extended to the interest earned on these deposits and estate taxes are levied on them upon death of the depositor that a significant amount of these deposits would leave this country and their benefit would be lost to us. In considering the extension of this law on previous occasions, Congress has also concluded that the outflow of these funds would cause a significant adverse affect on the balance of payments.

Ten years of repeated extension have cause the depositors of these funds to be aware of these expiration dates. These deposits are now more sensitive than before to this exemption from taxes. Our bank has had direct experience with depositors who are carefully renewing their time deposits to mature within the present expiration date, December 31, 1976. In conversations with other bankers, similar experiences are occurring. It can be seen that a good and continuous stable deposit source has been affected adversely. Many depositors are carefully reconsidering the redeposit of these funds because of the expiration of this law. These monies then must be treated in a different light by the bankers who receive them. We in San Antonio and many banks in Texas have had a stable and normal source of funds from citizens in Mexico and have used these deposits to finance needs in the local economy. Under the present circumstances with the exemption from taxes on these deposits not on a continuous basis, we may have to look upon them as less permanent and stable. Thus they might not be used for the same long-term beneficial credit purposes if the exemption from taxes is not made permanent.

It is my opinion and the opinion of many other bankers involved in dealing with these funds that little additional revenue, or none at all, may be gained by taking this source. First, a significant amount of the deposits would leave and would not be subject to any tax whatsoever. Secondly, the banks which handle these deposits could not gain a profit on those deposits which were withdrawn thereby reducing the taxes which might be paid by the recipient bank.

Next, any jeopardy of these funds penalizes the smaller banks without offshore operations to a greater extent than those larger banks in the major money centers who could entice their depositors to transfer these funds to a foreign branch in a country which does grant the exemption on a continuous basis. Foreign branch funds currently are not recycled to the domestic economy but are lost to the United States. The result would be an inequity favoring the larger banks.

It is my understanding that this committee may be asked to consider a proposal to exempt from taxes the income from certain other portfolio investments such as stocks and bonds held by nonresident aliens. I would like to point out that my remarks are directed to the making permanent an exemption which has existed since 1921 on the passive and short-term vehicle of commercial bank deposits only.

I should like to submit to you for your records as additional information in support of Provision 1041 of HR 10612 a letter dated November 28, 1975, from Max Mandel, Chairman of the Executive Committee of the Laredo National Bank, Laredo, Texas, to Senator Russell B. Long, Chairman of the Finance Committee.

In conclusion, I ask that you agree that Provision 1041 of HR 10612 is beneficial to the general domestic economy of the United States and that this Provision be adopted by the Senate as passed by the House so that the exemption is on a permanent basis without an expiration date. I would also respectfully suggest that reasonably prompt action is needed since the present exemption expires December 31, 1976. At this time banks are experiencing a reluctance on the part of depositors to extend time deposits to mature after this date.

I will be happy to attempt to answer any questions or obtain any additional information which you might desire. Thank you for the privilege of appearing before you.

The CHAIRMAN. I call Mr. Michael Abrutyn, on behalf of H. H. Robertson Co.

STATEMENT OF MICHAEL ABRUTYN ON BEHALF OF H. H. ROBERTSON CO.

Mr. ABRUTYN. My name is Michael Abrutyn. I am with the Washington law firm of Cole, Corrett and Bradfield and I am here on behalf of H. H. Robertson and Co.

At the outset I would like to thank the committee for affording H. H. Robertson the opportunity to testify for a second time with respect to the provision in the bill which will afford it relief from double taxation.

The purpose of this testimony is to correct certain inequity descriptions of the provision which will afford Robertson relief from double taxation.

The previous testimony before this committee which took place on March 26 and the materials submitted with respect to that testimony fully sets forth the technical basis upon which we were subject to double taxation.

This matter was also considered by the Treasury Department and the staff of the Joint Committee on Internal Revenue and Taxation with full time for adequate consideration and at all times with the full disclosure that the amendment would benefit the H. H. Robertson Co. and the amount of revenue involved with respect thereto.

The two inaccuracies which I would like to correct—excuse me, I would like to add that the amendment is correctly summarized on page 270 of the Senate Finance Committee report.

The two inaccuracies which I would like to correct—excuse me, I with the idea that this will provide a totally tax-free liquidation for foreign subsidiaries, that is not correct.

Under the amendment, it will require Robertson to include an income of $1.3 million of earnings and have attacked as a dividend.

The second inaccuracy I would like to correct is that this will overturn a court decision. There was a court decision involved in these circumstances.

However, in no way will the amendment overturn this decision; although the cost result will be different; however, the reason is the circumstances in which the court decision arose.

The circumstances of this is that section 367 ruling determination by the Commission, the standard by which the Commissioner imposes the so-called 367 toll charge is not, and I repeat, is not subject to court review.

We acceded to the standard that the Commissioner imposed which was a standard of earnings and profits. We used those words.

Our disagreement with the Commission was as to the appropriate interpretation of the term "earnings and profits".

The court, ultimately, defined the term "earnings and profits" but—and I repeat—but the court did not, in no way consider, whether the Commissioner's judgment which is within his sole and absolute discretion could use the term "earnings and profits" was correct.

I might add, in fact, that the court decision went on to say that the theory—that is, that the double taxation we were subjected to, the court noted that in theory we were correct, however, it felt constrained by the words of the statute to produce the result that it produced—I think this is an important point because to some extent we complain about our retroactive relief—is that somehow, the court give us our justice and that now we are seeking specifically legislative action and that is not the case because what we are seeking relief from, the court did not review. I thank you.

Chairman LONG. Any questions?

[No response.]

[The prepared statement of Mr. Abrutyn follows:]

TESTIMONY ON BEHALF OF H. H. ROBERTSON CO. BY MICHAEL ABRUTYN, SPECIAL TAX COUNSEL TO H. H. ROBERTSON CO.

SUMMARY

1. This testimony supplements earlier testimony before this Committee in order to correct certain subsequent inaccurate descriptions of the effect of the amendment. The prior testimony fully analyzed the problem which was also carefully considered by the Staff of the Joint Committee on Internal Revenue

Taxation and the Treasury Department with adequate time for thorough study and full disclosure indicating that the proposal was being submitted on behalf of Robertson.

2. Congressional relief from double taxation is appropriate where it was inadvertently caused by the technical working of the tax law and the insistence of the Commissioner upon using inappropriate standards in circumstances where review of the Commissioner's judgment was prohibited.

3. The amendment does not provide for a totally tax-free liquidation of a foreign subsidiary, but limits the amount required to be included in income upon liquidation of a foreign subsidiary to historical earnngs minus declared dividends so that double taxation will not occur.

4. The Court decision defined the term earnings and profits. This amendment will not overturn the Court's definition of that term.

5. From its inception to its liquidation the foreign subsidiary earned $9.1 million and the total amount of its income which was included in Robertson's income as a dividend was $10.7 million. The amendment would limit the total amount to $9.1 million.

STATEMENT

We would like to thank the Finance Committee for affording the H. H. Robertson Company ("Robertson") the opportunity to submit additional material and to testify for a second time with respect to the Senate amendment to H.R. 10612 which relieves it from the harsh result of double taxation. The circumstance resulting in Robertson having $1.6 million of income being subject to double taxation, which circumstance is similar to a wage earner being taxed upon $10,700 of salary income where the actual salary is only $9,100, was previously fully, openly and publicly discussed in testimony before the Finance Committee on March 26, 1976, and was fully considered by both the staff of the Joint Committee on Internal Revenue Taxation and the Treasury Department with adequate time for a thorough analysis. The written statement of Mr. Robert E. Holmgren, Vice President, H. H. Robertson Company, and Robert T. Cole, counsel to Robertson, both dated March 26, 1976, submitted for the record in connection with their earlier oral testimony included an attachment of an extensive 57-page technical printed brief discussing the issue. All of the material clearly indicated that the proposed amendment was being submitted on behalf of Robertson. Since that material fully sets forth a technical explanation and analysis of the intermeshing of the complex rules which created this unwarranted double taxation, the explanation will not be repeated. Also, the reason for this amendment was correctly described on the top of page 270 of the Report of your Committee. The purpose of this supplemental testimony is to correct certain misleading descriptions of the effect of this amendment (section 1042 (c)(3)).

OVERRULING A COURT DECISION

The description of this amendment as overruling a court decision may lead to the erroneous implication that a court carefully considered the issue presented and that justice, which is generally provided by our court system, is now being overturned by precipitous legislative action. This is simply not the case. The court decision is not being overruled, although obviously the result will be altered.

The issue presented to the court arose in the following way: When Robertson liquidated its U. K. subsidiary and applied for a section 367 ruling from the Commissioner, the Commissioner, pursuant to his unilateral and absolute authority granted under section 367, extracted the so-called section 367 "toll-charge" in the form of a condition to the favorable issuance of the ruling. The condition was geared to the standard of "earnings and profits." The decision to use the standard of earnings and profits was totally and absolutely within the sole discretion of the Commissioner with no availability for court review. Although Robertson assented to the condition, it interpreted the term earnings and profits in a manner which was different than the interpretation of the Commissioner. Earnings and profits is a term of art used throughout the tax law. Ultimately, the issue as to the proper interpretation of that term was litigated and the government's interpretation prevailed. However, the litigation did not deal with, discuss or in any way involve the question as to whether the Commissioner's insistence upon using the standard of earnings and profits as the basis for the condition was appropriate. That question was not (and could not have been) litigated.

The provision in the bill merely provides that in the Robertson circumstances, earnings and profits is not the appropriate standard upon which to base the condition because it can produce an inequitable result. The bill in no way alters the definition of earnings and profits as clarified in the Robertson litigation.

Additionally, it is noted that unlike the circumstances that were presented to Robertson in that it could not dispute the use of the standard of earnings and profits, the present bill provides that taxpayers who feel the Commissioner is basing the toll charge condition on inappropriate standards can present the issue to a court for review.

NONTAXABLE LIQUIDATION OF FOREIGN SUBSIDIARY

The description of this amendment as resulting in an income tax refund to Robertson attributable to a tax-free liquidation could leave the erroneous implication that the amendment would improperly provide for a totally tax-free liquidation of a foreign subsidiary. Again, this is simply not the case.

The income earned by Robertson's U.K. subsidiary was not subject to tax in the United States on a current basis. Only declared dividends were subject to U.S. tax. When Robertson decided to liquidate its U.K. subsidiary, it recognized that this deferral would end and it would have to include an amount in its income attributable to the deferred earnings. As computed by the Internal Revenue Service under its toll-charge standard of earnings and profits (as defined by the court), the amount required to be included in Robertson's income was equal to approximately $2.9 million, whereas under the toll-charge standard of the bill, the amount required to be included in Robertson's income would be equal to approximately $1.3 million. From its inception to its liquidation the U.K. subsidiary earned $9.1 million and after the IRS toll-charge the total amount included in Robertson's income was $10.7 million. The inclusion of $1.3 million in income is certainly not a circumstance where the taxpayer was urging to have the liquidation on a totally tax-free basis. Since the difference between the two numbers is approximately $1.6 million of income, the tax effect of the amendment would result in a refund to Robertson of approximately $800,000 and not, as has been described, $1.6 million.

CONCLUSION

Since our tax system is complex and not a perfect mechanism, it can and often does operate inadvertently to produce an incorrect result in circumstances not foreseen when the specific statutory provisions were enacted. This is particularly the case when domestic principles are applied in the international area. A linchpin of our self-assessment tax system is the ability of Congress to provide specific relief where the technical operation of the tax law produces inequitable, inappropriate or unintended results, or when the Internal Revenue Service overreaches or applies inappropriate standards. This safeguard insures taxpayers that Congress will serve as a court of last resort when the tax system operates defectively.

The reasons Robertson was subject to double taxation, which is not sanctioned by our tax system, was because of (1) a technical intermeshing of several provisions of the tax law in the foreign area which were designed for other purposes, and (2) the insistence of the Commissioner on applying an inappropriate standard in a circumstance where the taxpayer had no opportunity for review. Under such circumstances, Congress is the only forum where relief can be provided. We respectfully suggest that the Senate amendment properly grants such relief.

Chairman LONG. Next we will call Mr. Ralph K. Smith, Jr. accompanied by John S. Nolan.

STATEMENT OF RALPH K. SMITH, JR., ACCOMPANIED BY JOHN S. NOLAN

Mr. SMITH. I am a member of the law firm of Sage, Gray, Todd and Sims in New York City.

I am appearing here today in support of section 1044 of the bill and my appearance is on behalf of the Royal Bank of Canada which is a foreign corporation.

In accordance with the Foreign Agents Registration Act of 1938 as amended, I wish to disclose that I appear as an agent for a foreign principal as defined in that act; that I am registered for that purpose with the Department of Justice.

I have with me a copy of my latest registration statement which I will furnish to the committee as required by law and, of course, neither the filing nor the submission of that statement is made to indicate any approval thereof by the Department of Justice.

In the interest of time I will dispense with the portion of my remarks which would have discussed, again, this section 1044.

I wish merely to point out that the Ways and Means Committee commenced consideration of this statute in 1973.

Ways and Means held two full public hearings on it in 1974 and received a very thorough Treasury Department report on it and it was only after all of that thorough consideration that it was included in the House bill which was passed last December.

In the words which were used recently on the Senate floor, Mr. Chairman, section 1024 did not "tiptoe" in on May 27 and it has been under serious consideration long before it could be considered part of anyone's Bicentennial birthday present.

I would like to conclude, Mr. Chairman, by reading into the record the brief conclusion in the Treasury Department memo delivered only yesterday:

> Section 1044 Administration position. The Administration does not object to this Amendment although the Administration generally opposes retroactive relief for particular taxpayers. The Administration recognizes that Congress has inadvertently failed to provide the proper rule in this case. No action of a taxpayer could have prevented the hardship.

If I may ask that my written statement be included in the record, I will conclude then, Mr. Chairman.

Chairman LONG. Thank you very much.

[The prepared statement of Mr. Smith follows:]

STATEMENT OF ROYAL BANK OF CANADA IN SUPPORT OF SECTION 1044 OF H.R. 10612

This material is presented by Sage Gray Todd & Sims, 140 Broadway, New York, New York, 10005, and Miller & Chevalier, 1700 Pennsylvania Avenue, N.W., Washington, D.C. 20006, which are registered under the Foreign Agents Registration Act of 1938, as amended, with the Department of Justice, Washington, D.C., as agents of a foreign principal, the Royal Bank of Canada, Montreal, Quebec, Canada. This material is filed with the Department of Justice, where it is available for inspection by the public. Registration by the above-named agents of a foreign principal, as required by the Foreign Agents Registration Act of 1938, as amended, does not indicate approval by the United States Government of the contents of this material.

SUMMARY

Section 1044 corrects an anomalous result inadvertently created by the Tax Reform Act of 1969. Prior to 1969, domestic banks were permitted to treat gains on the sales of debt instruments as capital gains, while treating losses on such sales as ordinary losses. In 1969, Congress sought to prevent abuse of that provision by requiring all such gains and losses to be treated as ordinary gains or losses.

The 1969 Act also applied to foreign banks, which had been recognizing capital gains and losses from such transactions, and which therefore, unlike domestic banks, had carryovers of capital losses from pre-1969 transactions. Because post-1969 ordinary gains on such transactions could not be offset by capital-gains carryovers, an unintended result of the 1969 Act was to prevent foreign banks from using those carryovers.

Section 1044 would correct this oversight by permitting foreign banks to treat gains on the sales of debt instruments as capital gains to the limited extent necessary to permit the normal five-year carryover of pre-1969 capital losses. Thus, enactment of section 1044 would vindicate the basic principle that a taxpayer is taxed only on net income, and would grant foreign banks the rights already enjoyed by domestic banks.

Section 1044 resolves an inequity that the Royal Bank of Canada presented to the House Ways and Means Committee in public hearings in 1973, and again in 1975. A House bill was introduced, and the Treasury Department issued a favorable bill report. The problem was carefully considered by the House Ways and Means Committee, and section 1044 was included in the Tax Reform Bill to correct the inequity. It should in all events be retained in H.R. 10612.

RALPH K. SMITH, Jr.
Sage Gray Todd & Sims
New York, N.Y.

JOHN S. NOLAN,
Miller & Chevalier,
Washington, D.C.

JULY 20, 1976.

STATEMENT

Prior to 1969, a domestic bank was permitted by section 582(c) to treat net losses on sales or exchanges of bonds and other debt instruments as ordinary loses, while treating net gains as capital gains. In its consideration of the Tax Reform Act of 1969, Congress found that this nonparallel treatment had encouraged banks to time their dispositions of debt instruments so as to time their dispositions of debt instruments so as to recognize gains (as capital gains) in selected years and losses (as ordinary losses) in other years, thereby circumventing the netting principles of the Internal Revenue Code and obtaining "preferential treatment over other taxpayers". H. Rep. No. 91-413 (Part 1), 91st Cong., 1st Sess. 129-30 (1969); S. Rep. No. 91-552, 91st Cong., 1st Sess. 167 (1969). Indeed, domestic banks had thus gained preferential treatment even over foreign banks, which were not covered by section 582(c) and which were thus required to treat both gains and losses as capital gains or losses.

Congress reacted to this abuse by amending section 582(c) to require both gains and losses on such transactions to be treated as ordinary gains or losses for taxable years beginning after July 11, 1969. P.L. 91-172, § 433(a), 83 Stat. 623 (1969). The impact on domestic banks, with respect to debt instruments held on July 11, 1969, was mitigated by the transitional rule of section 582(c)(2), which provided for capital gains treatment for a prorated portion of the excess of long-term gains over short-term losses.

Section 582(c), as amended, however, applied not only to domestic banks, as it had before 1969, but to "financial institutions," including foreign banks, small business investment companies, and business development corporations. Small business investment companies and business development corporations were provided a transitional rule, which made the application of section 582(c) optional for five years. In other words, such taxpayers were permitted to treat their gains and losses as either ordinary or capital, so long as gains and losses were treated alike.

Congress neglected, however, to provide any transitional rule for foreign banks. Those banks, which had never been guilty of the abuses that prompted the 1969 legislation, suddenly became subject to severe financial hardship. As required by law, the Royal Bank of Canada, before 1969, had consistently given parallel treatment to such gains and losses, treating them as capital gains or losses. During its fiscal year ending October 31, 1969, the Bank realized substantial losses from the sale of bonds, and reported a net capital loss. Principles of netting, reflected in section 1212, dictated that the Bank would have a capital-loss carryover to the succeeding five fiscal years. These, significantly, were the same principles of netting that guided the congressional committees in 1969 when they sought to prevent the abuses of the domestic banks. Indeed, in its fiscal year ending October 31, 1970, the Royal Bank of Canada did have substantial gains on the sale of bonds, against which it would normally have been entitled to apply its capital-loss carryover. Nevertheless, because those gains were treated as ordinary gains under the new rule, the capital-loss carryover could not be used.

This unfair result could have been avoided only if the Bank had realized sufficient capital gains from other sources within five years of October 31, 1969. But the Bank, being a foreign bank, holds very few other capital assets in the United States, and its capital gains during the five-year period therefore fell far short of its pre-1969 carryover, which therefore went largely unused.

It is essential that this problem be viewed in proper perspective. Domestic banks, whose abuses had given rise to the 1969 amendment, had no problems with pre-1969 capital-loss carryovers, because their pre-1969 losses had been recognized (or carried over) as ordinary losses. Small business investment companies and business development corporations could avoid losing the benefit of pre-1969 capital-loss carryovers, by electing during the five-year period to treat gains from the sale of bonds as capital gains. Significantly, this is the same five-year period as that prescribed for capital-loss carryovers under section 1212. Foreign banks, such as the Royal Bank of Canada, however, were given no option, but were required to treat post-1969 gains on bonds as ordinary income. Moreover, such foreign banks, simply because they were foreign banks, with limited domestic holdings, found themselves with very few other opportunities to use their pre-1969 capital-loss carryovers. In other words, the taxpayers most likely to have the problem of unused carryovers were the taxpayers that had been rendered incapable of solving the problem, because they had been overlooked in the mitigation and transition provisions of the 1969 amendment. Since it is a fundamental principle of United States income taxation that taxpayers should be taxed only on their net income, and since it was that same principle of netting which Congress actually sought to vindicate by amending section 582(c), it is most anomalous that the intended remedy should operate to prevent a foreign bank from offsetting its losses on the sale of securities against its gains on the sale of the same type of securities.

This anomaly is especially striking when it is considered that Congress chose to treat both gains and losses on debt instruments as ordinary gains and losses, rather than capital gains and losses, partly because such treatment "gives financial institutions more effective tax relief for their losses." S. Rept. No. 91-552, 91st Cong., 1st Sess. 167 (1969); cf. H. Rep. No. 91-148 (Part 1). 91st Cong., 1st Sess. 130 (1969). Surely, with a stated purpose of giving more effective tax relief for losses, Congress could not have intended foreign banks to be denied the use of losses altogether.

Section 1044 of H.R. 10612 would correct this unintended anomaly, by allowing a foreign bank to treat gains from post-1969 sales of debt instruments as capital gains, but only to the extent those gains would be offset by available capital-loss carryovers from pre-1969 transactions. The identical result would be achieved if pre-1969 capital-loss carryovers were deemed to be ordinary-loss carryovers, to the extent of post-1969 gains from such sales. The objective is simply to provide for parallel treatment, so as to permit proper offsetting of similar items.

Viewed against this background, it is clear that section 1044 would not convert ordinary income to capital gains, except for the very limited purpose of permitting the operation of the netting principles that underlie the 1969 amendment. When the distinguished senior Senator from Wisconsin attack section 1044 on the floor of the Senate, he simply misconstrued this purpose of the section. 122 Cong. Rec. S10814 (June 28, 1976). In contrast, the explanation inserted in the Record by the Senator stated: "The 1968 [sic] Tax Reform Act . . . would accidentally prevent using capital loss carry-forwards . . ." Id. at S10817. Section 1044 has been drafted to correct that "accident."

The Senator also misconstrued the circumstances when he implied that section 1044 was added to the bill by this Committee "at the last minute, without very much discussion." Id. at S10818. In fact, section 1044 is identical to H.R. 13009, 93d Cong., 2d Sess. (1974), which had received a favorable report from the Treasury Department. Letter from Acting Assistant Secretary Ernest S. Christian, Jr., to the Honorable Wilbur D. Mills, Aug. 30, 1974. The identical language appeared in H.R. 4998, 94th Cong., 1st Sess. (1975) and was supported in the House Ways and Means Committee's hearings on tax reform. Hearings on the Subject of Tax Reform Before the House Committee on Ways and Means, 94th Cong., 1st Sess., pt. 4, at 3280-83 (1975). The identical language again appeared as section 1044 of the first complete Ways and Means Committee print of the Tax Reform Bill (dated November 3, 1975), and as section 1044 of H.R. 10612 as introduced, as reported by the Ways and Means Committee, and as passed by the House last December. The unintended effect of the 1969 amendment and the remedial purpose of section 1044 were correctly described in both the Ways and Means Committee report and the report of this Committee. H. Rept. No. 94–658, 94th Cong., 1st Sess. 252–53 (1975); S. Rept. No. 94–938, 94th Cong., 2d Sess. 276 (1976). nI short, the thoughtful consideration of section 1044 by both Congress and the Administration is a matter of clear public record.

Because of the history of section 1044 as a separate House bill, however, it is respectfully pointed out that it will be necessary to correct one technical error which has persisted in the text. In section 1044(b)(2), page 541, line 7, the words "the first section of this Act" should be deleted and the words "subsection (a)" inserted in lieu thereof.

RALPH K. SMITH, Jr.,
Sage Gray Todd & Sims
New York, N.Y.

JOHN S. NOLAN,
Miller & Chevalier
Washington, D.C.

JULY 20, 1976.

FORM OBD-63
Budget Bureau No. 43-R208.6
Approval Expires Oct. 31, 1976

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D.C. 20530

REGISTRATION STATEMENT

Pursuant to Section 2 of the Foreign Agents Registration Act of 1938, as Amended

I - REGISTRANT

1. Name of the registrant.

SAGE GRAY TODD & SIMS

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2. Business address.

140 Broadway, New York, N.Y. 10005

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3. If the registrant is an individual, furnish the following information:

(a) Residence address.

(b) Date and place of birth.

(c) Present citizenship.

(d) If present citizenship not acquired by birth, state when, where and how acquired.

(e) Occupation.

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4. If the registrant is not an individual, furnish the following information:

(a) Type of organization: Committee ☐ Association ☐ Partnership ☒ Corporation ☐ Other (specify) __________

(b) Date and place of organization. 1842 - New York, N.Y.

(c) Address of principal office. 140 Broadway, New York, N.Y.

(d) Name of person in charge. Herschel E. Sparks, Jr., Managing Partner

(e) Locations of branch or local offices in United States. None

(f) If a membership organization, give number of members.

(g) List all partners, officers, directors or persons performing the functions of an officer or director of the registrant.

Name	Residence Address	Position	Citizenship

See Rider Attached

(h) Which of the above named persons renders services directly in furtherance of the interests of any of the foreign principals?

From time to time, each of the above has rendered legal services on behalf of The Royal Bank of Canada. None have heretofore rendered services requiring registration.

(i) Describe the nature of the registrant's regular business or activity.

Law practice

(j) Give a complete statement of the ownership and control of the registrant.

Wholly-owned by the partners listed in item (g).

5. List all employees who render services to the registrant directly in furtherance of the interests of any of the foreign principals in other than a clerical, secretarial, or in a related or similar capacity.

Name	Residence Address	Nature of Services
J. Reid Bingham	245 E. 87th Street New York, N.Y. 10028	Legal
John W. Reddy	304 Hyde Avenue Pelham, N.Y. 10803	"
Dean A. Stiffle	333 E. 30th Street New York, N.Y. 10016	"
John F. Walsh	122 Rutland Road Brooklyn, N.Y. 11225	"

Attachment to Form OBD-63

SAGE GRAY TODD & SIMS

I - 4.(g) List all partners, officers, directors or persons performing the functions of an officer or director of the registrant.

Name	Residence Address	Position	Citizenship
Edward H. Spencer	1 Red Oak Road Bronxville, N.Y. 10708	Partner	U.S.A.
William V. Keenan	47 Mayer Drive Suffern, New York 10901	"	"
George W. McGrath, Jr.	172 Flowerhill Road Huntington, N.Y. 11743	"	"
Ralph K. Smith, Jr.	Private Lane Locust Valley, N.Y. 11560	"	"
John F. Lawler	26 Larchmont Avenue Larchmont, New York 10538	"	"
Edward W. Forrester	65 Duck Pond Road Glen Cove, New York 11542	"	"
Richard M. Siegel	229 Golf Edge Westfield, N.J. 07090	"	"
Herschel E. Sparks, Jr.	86 Highland Circle Bronxville, N.Y. 10708	"	"
William J. Allingham	5 Jill Drive Holmdel, N.J. 07733	"	"
Paul H. Briger	850 Park Avenue New York, N.Y. 10021	"	"
William P. Mills, Jr.	3 Beverly Gardens Bronxville, N.Y. 10708	"	"
Lawrence J. Hohlt	47 Willow Place Brooklyn, N.Y. 11201	"	"
John F.X. Peloso	25 Whitfield Terrace New Rochelle, N.Y.	"	"
Robert W. Brundige, Jr.	360 Beechwood Road Ridgewood, N.J. 07450	"	"

II - FOREIGN PRINCIPAL

6. List every foreign principal[1] for whom the registrant is acting or has agreed to act.

Name of Foreign Principal	*Principal Address*
The Royal Bank of Canada	1 Place Ville Marie Montreal, P.Q. Canada H3C 3A9

III - ACTIVITIES

7. In addition to the activities described in any Exhibit B to this statement, will you engage or are you now engaging in activity on your own behalf which benefits any or all of your foreign principals? Yes ☐ No ☒

If yes, describe fully

IV - FINANCIAL INFORMATION

8. *(a)* RECEIPTS - MONIES

During the period beginning 60 days prior to the date of your obligation to register to the time of filing this statement, did you receive from any foreign principal named in Item 6 any contribution, income or money either as compensation or for disbursement or otherwise? Yes ☒ No ☐

If yes, set forth below in the required detail and separately for each such foreign principal an account of such monies.[2]

Name of Foreign Principal	*Date Received*	*Purpose*	*Amount*
The Royal Bank of Canada	6/30/76	Legal fees	$900.00
		Total	$900.00

[1] The term "foreign principal" includes a foreign government, foreign political party, foreign organization, foreign individual and, for the purpose of registration, an organization or an individual any of whose activities are directly or indirectly supervised, directed, controlled, financed or subsidized in whole or in major part by a foreign government, foreign political party, foreign organization or foreign individual.

[2] A registrant is required to file an Exhibit D if he collects or receives contributions, loans, money, or other things of value for a foreign principal, as part of a fund raising campaign. There is no printed form for this exhibit. See Rule 201(e).

(b) RECEIPTS - THINGS OF VALUE

During the period beginning 60 days prior to the date of your obligation to register to the time of filing this statement, did you receive from any foreign principal named in Item 6 any thing of value[3] other than money, either as compensation, or for disbursement, or otherwise? Yes ☐ No ☒

If yes, furnish the following information:

Name of Foreign Principal	Date Received	Description of thing of value	Purpose for which received

9. (a) DISBURSEMENTS - MONIES

During the period beginning 60 days prior to the date of your obligation to register to the time of filing this statement, did you spend or disburse any money in furtherance of or in connection with your activities on behalf of any foreign principal named in Item 6? Yes ☒ No ☐

If yes, set forth below in the required detail and separately for each such foreign principal an account of such monies, including monies transmitted, if any, to each foreign principal.

Date	To Whom	Purpose	Amount

Since March 15, 1976 (the date of the firm's latest general bill to The Royal Bank of Canada), the firm has incurred disbursements of $8,042.12, consisting of telephone tolls, postage charges, photocopies, secretarial overtime and travel expense on many matters, none requiring registration.

(b) DISBURSEMENTS - THINGS OF VALUE

During the period beginning 60 days prior to the date of your obligation to register to the time of filing this statement, did you dispose of any thing of value[3] other than money in furtherance of or in connection with your activities on behalf of any foreign principal named in Item 6? Yes ☐ No ☒

If yes, furnish the following information:

Date	Name of person to whom given	On behalf of what foreign principal	Description of thing of value	Purpose in giving

(c) DISBURSEMENTS - POLITICAL CONTRIBUTIONS

During the period beginning 60 days prior to the date of your obligation to register to the time of filing this statement, did you make any contribution of money or other thing of value from your own funds and on your own behalf in connection with an election to any political office or in connection with any primary election, convention, or caucus held to select candidates for political office? Yes ☐ No ☒

If yes, furnish the following information:

Date	Amount or thing of value	Party or Candidate	Identify location of election, convention, etc. if any

[3] Things of value include but are not limited to gifts, interest free loans, expense free travel, favored stock purchases, exclusive rights, favored treatment over competitors, "kickbacks," and the like.

V - POLITICAL PROPAGANDA

(Section 1 (j) of the Act defines "political propaganda" as including any oral, visual, graphic, written, pictorial, or other communication or expression by any person (1) which is reasonably adapted to, or which the person disseminating the same believes will, or which he intends to, prevail upon, indoctrinate, convert, induce, or in any other way influence a recipient or any section of the public within the United States with reference to the political or public interests, policies, or relations of a government of a foreign country or a foreign political party or with reference to the foreign policies of the United States or promote in the United States racial, religious, or social dissensions, or (2) which advocates, advises, instigates, or promotes any racial, social, political, or religious disorder, civil riot, or other conflict involving the use of force or violence in any other American republic or the overthrow of any government or political subdivision of any other American republic by any means involving the use of force or violence.)

10. Will the activities of the registrant on behalf of any foreign principal include the preparation or dissemination of political propaganda as defined above? Yes [x] No [ ]

IF YES, RESPOND TO THE REMAINING ITEMS IN THIS SECTION V.

11. Identify each such foreign principal.

The Royal Bank of Canada

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12. Has a budget been established or a specified sum of money allocated to finance your activities in preparing or disseminating political propaganda? Yes [ ] No [x]

If yes, identify each such foreign principal, specify amount and for what period of time.

---

13. Will any public relations firms or publicity agents participate in the preparation or dissemination of such political propaganda material? Yes [ ] No [x]

If yes, furnish the names and addresses of such persons or firms.

---

14. Will your activities in preparing or disseminating political propaganda include the use of any of the following:

- [ ] Radio or TV broadcasts
- [ ] Motion picture films
- [ ] Advertising campaigns
- [ ] Pamphlets or other publications
- [ ] Magazine or Newspaper articles
- [ ] Letters or telegrams
- [ ] Press releases
- [ ] Lectures or speeches
- [x] Other (specify) Written Statement to Senate Finance Committee

---

15. Will the political propaganda be disseminated among any of the following groups:

- [ ] Public Officials
- [ ] Civic groups or associations
- [x] Legislators
- [ ] Libraries
- [ ] Government agencies
- [ ] Educational institutions
- [ ] Newspapers
- [ ] Nationality groups
- [ ] Editors
- [ ] Other (specify) ________

---

16. Indicate language to be used in political propaganda:

- [x] English
- [ ] Other (specify) ________

VI - EXHIBITS AND ATTACHMENTS

17. (a) The following described exhibits shall be filed in duplicate with an initial registration statement:

Exhibit A - This exhibit, which is filed on Form DJ-306, sets forth the information required to be disclosed concerning each foreign principal named in Item 6.

Exhibit B - This exhibit, which is filed on Form DJ-304, sets forth the information concerning the agreement or understanding between the registrant and the foreign principal.

(b) An Exhibit C shall be filed when applicable. This exhibit for which no printed form is provided consists of a true copy of the charter, articles of incorporation, association, constitution, and bylaws of a registrant that is an organization. A waiver of the requirement to file an Exhibit C may be obtained for good cause shown upon written application to the Assistant Attorney General, Internal Security Division, Department of Justice, Washington, D.C. 20530. See Rule 201 (c) and (d).

(c) An Exhibit D shall be filed when applicable. This exhibit for which no printed form is provided sets forth an account of money collected or received as a result of a fund raising campaign and transmitted for a foreign principal. See Rule 201 (e).

(d) A Short Form Registration Statement shall be filed for each person named in Items 4 (h) and 5.

The undersigned swear(s) or affirm(s) that he has (they have) read the information set forth in this registration statement and the attached exhibits and that he is (they are) familiar with the contents thereof and that such contents are in their entirety true and accurate to the best of his (their) knowledge and belief, except that the undersigned make(s) no representation as to the truth or accuracy of the information contained in attached Short Form Registration Statement, if any, insofar as such information is not within his (their) personal knowledge.

(Type or print name under each signature)

Ralph K. Smith, Jr.

(Both copies of this statement shall be signed and sworn to before a notary public or other person authorized to administer oaths by the agent, if the registrant is an individual, or by a majority of those partners, officers, directors or persons performing similar functions who are in the United States, if the registrant is an organization.)

Subscribed and sworn to before me at New York, N.Y.

this 19th day of July, 1976

JOHN V. PROVENZ, Notary Public, State of New York
No. [illegible], Qualified in Westchester County
Cert. Filed in New York County
Commission Expires March 30, 19[illegible]

John V. Provenz
(Signature of notary or other officer)

My commission expires ______, 19____

Form DJ-306
(Ed. 11-10-66)

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D.C. 20530

Budget Bureau No. 43-R116.7
Approval expires Oct. 31, 1971

EXHIBIT A

TO REGISTRATION STATEMENT

Under the Foreign Agents Registration Act of 1938, as amended

Furnish this exhibit for EACH foreign principal listed in an initial statement and for EACH additional foreign principal acquired subsequently.

1. Name and address of registrant	2. Registration No.
Sage Gray Todd & Sims 140 Broadway New York, N.Y. 10005	

3. Name of foreign principal	4. Principal address of foreign principal
The Royal Bank of Canada	1 Place Ville Marie Montreal, P.Q., Canada

5. Indicate whether your foreign principal is one of the following type:

- [ ] Foreign government
- [ ] Foreign political party
- [x] Foreign or [ ] domestic organization: If either, check one of the following:
  - [ ] Partnership
  - [ ] Committee
  - [x] Corporation
  - [ ] Voluntary group
  - [ ] Association
  - [ ] Other (specify) ______
- [ ] Individual - State his nationality ______

6. If the foreign principal is a foreign government, state:

a) Branch or agency represented by the registrant.

b) Name and title of official with whom registrant deals.

7. If the foreign principal is a foreign political party, state:

a) Principal address

b) Name and title of official with whom the registrant deals.

c) Principal aim

8. If the foreign principal is not a foreign government or a foreign political party,

a) State the nature of the business or activity of this foreign principal

Commercial Banking

b) Is this foreign principal

Owned by a foreign government, foreign political party, or other foreign principal ..... Yes ☐ No ☒

Directed by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Controlled by a foreign government, foreign political party, or other foreign principal .. Yes ☐ No ☒

Financed by a foreign government, foreign political party, or other foreign principal ... Yes ☐ No ☒

Subsidized in whole by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

Subsidized in part by a foreign government, foreign political party, or other foreign principal .... Yes ☐ No ☒

9. Explain fully all items answered "Yes" in Item 8(b). (If additional space is needed, a full insert page may be used.)

10 If the foreign principal is an organization and is not owned or controlled by a foreign government, foreign political party or other foreign principal, state who owns and controls it.

Publicly held by approximately 32,000 stockholders

Date of Exhibit A July 19, 1976	Name and Title Ralph K. Smith, Jr. a Partner	Signature Ralph K. Smith

Form DJ-306
(Rev. 3-30-67)

Budget Bureau No. 43-R435
Approval Expires Oct. 31, 1971

UNITED STATES DEPARTMENT OF JUSTICE
Washington, D.C. 20530

EXHIBIT B

TO REGISTRATION STATEMENT
Under the Foreign Agents Registration Act
of 1938, as amended

INSTRUCTIONS: A registrant must furnish as an Exhibit B copies of each written agreement and the terms and conditions of each oral agreement with his foreign principal, including all modifications of such agreements; or, where no contract exists, a full statement of all the circumstances, by reason of which the registrant is acting as an agent of a foreign principal. This form shall be filed in duplicate for each foreign principal named in the registration statement and must be signed by or on behalf of the registrant.

Name of Registrant	Name of Foreign Principal
Sage Gray Todd & Sims	The Royal Bank of Canada

Check Appropriate Boxes:

1. [ ] The agreement between the registrant and the above-named foreign principal is a formal written contract. If this box is checked, attach two copies of the contract to this exhibit.

2. [ ] There is no formal written contract between the registrant and foreign principal. The agreement with the above-named foreign principal has resulted from an exchange of correspondence. If this box is checked, attach two copies of all pertinent correspondence, including a copy of any initial proposal which has been adopted by reference in such correspondence.

3. [X] The agreement or understanding between the registrant and foreign principal is the result of neither a formal written contract nor an exchange of correspondence between the parties. If this box is checked, give a complete description below of the terms and conditions of the oral agreement or understanding, its duration, the fees and the expenses, if any, to be received.

The Registrant performs legal services from time to time, upon request from The Royal Bank of Canada. There is no minimum retainer. Bills are based upon services performed. General bills are rendered semi-annually; bills for separate items are rendered when appropriate. There is no separate agreement as to the proposed services described herein.

4. Describe fully the nature and method of performance of the above indicated agreement or understanding.

See item 3.

5. Describe fully the activities the registrant engages in or proposes to engage in on behalf of the above foreign principal.

Proposed appearance before the Senate Finance Committee, in support of enactment of one provision of the Tax Reform Bill of 1976, at a public hearing scheduled for July 21, 1976.

6. Will the activities on behalf of the above foreign principal include political activities as defined in Section 1(o) of the Act?1/ Yes [X] No [ ]

If yes, describe all such political activities indicating, among other things, the relations, interests or policies to be influenced together with the means to be employed to achieve this purpose.

The registrant proposes to submit, on behalf of The Royal Bank of Canada, a written statement and an oral statement, in support of enactment of one provision of the Tax Reform Bill of 1976. The provision would provide relief to The Royal Bank of Canada from the effect of an omission, believed inadvertent, in the Tax Reform Act of 1969.

Date of Exhibit B	Name and Title	Signature
July 19, 1976	Sage Gray Todd & Sims by Ralph K. Smith, Jr., a partner	Ralph K. Smith Jr.

1/ Political activity as defined in Section 1(o) of the Act means the dissemination of political propaganda and any other activity which the person engaging therein believes will, or which he intends to, prevail upon, indoctrinate, convert, induce, persuade, or in any other way influence any agency or official of the Government of the United States or any section of the public within the United States with reference to formulating, adopting, or changing the domestic or foreign policies of the United States or with reference to the political or public interests, policies, or relations of a government of a foreign country or a foreign political party.

Budget Bureau No. 43-R215.7
Approval Expires Oct. 31, 1976

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D.C. 20530

SHORT-FORM REGISTRATION STATEMENT

Under the Foreign Agents Registration Act of 1938, as amended

Each partner, officer, director, associate, employee and agent of a registrant is required to file a short form registration statement unless he engages in no activities in furtherance of the interests of the registrant's foreign principal or unless the services he renders to the registrant are in a secretarial, clerical, or in a related or similar capacity.

1. Name: Ralph K. Smith, Jr.

Registration No.

2. Residence Address: Private Lane, Locust Valley, N.Y. 11560

3. Business Address: 140 Broadway, New York, N.Y. 10005

4. Date and Place of Birth: Nov. 6, 1925, Ambridge, Pennsylvania

Present Citizenship: U.S.A.

5. If present citizenship was not acquired by birth, indicate when, where, and how acquired.

6. Occupation: Lawyer

7. What is the name and address of the individual or organization whose registration made it necessary for you to file this statement?

Name: Sage Gray Todd & Sims Address: 140 Broadway, New York, N.Y. 1000[illegible]

8. List every foreign principal of the individual or organization named in item 7.

The Royal Bank of Canada

9. Indicate your connection with the individual or organization named in item 7:

- [x] partner
- [ ] director
- [ ] employee
- [ ] officer
- [ ] associate
- [ ] agent
- [ ] other (specify)__________

10. Describe in detail all services which you have rendered or will render to the individual or organization named in item 7. If you are no longer rendering such services, indicate period of past services. (If space is insufficient, a full insert page must be used.)

General legal services, including advice with respect to United States and New York law applicable to numerous transactions engaged in by the New York Agency of a foreign commercial bank, whenever requested.

11. Do any of the above described services include political activity as defined in the footnote below?
[X] Yes [ ] No

If yes, fully describe such political activity

I intend to appear before the Senate Finance Committee on or about July 21, 1976, in support of a provision of the Tax Reform Bill of 1976 which would be of benefit to The Royal Bank of Canada.

12. The services described in Item 10 are to be rendered on a

[ ] full time basis [ ] part time basis [X] special basis

13. What compensation are you receiving or will receive for above services?

[ ] Salary: Amount $________ per________ [ ] Commission at ________% of________

[X] Fee: Amount $ Unknown [ ] Other thing of value ____________

14. What compensation or thing of value have you received to date for above services?

Date	*From Whom Received*	*Amount*
	None	

15. During the period beginning 60 days prior to the date of your obligation to register to the time of filing this statement, did you make any contributions of money or other things of value from your own funds or possessions and on your own behalf in connection with an election to political office or in connection with any primary election, convention, or caucus held to select candidates for political office? Yes [ ] No [X]

If yes, furnish the following information:

Date	*Amount of thing of value*	*Name of political organization*	*Name of candidate*

July 19, 1976
Date of Signature

[illegible signature]
Signature

Subscribed and sworn to before me at New York, N.Y.

this 19th day of July, 1976

John V. Provens, Notary Public, State of New York
No. [illegible], Qualified in [illegible] County
Cert. Filed in New York County
Commission Expires March [illegible], [illegible]

John V. Provens
Signature of notary or other officer

My commission expires____________________, 19__

Footnote: Political activities as defined in Section 1(o) of the Act means the dissemination of political propaganda and any other activity which the person engaging therein believes will, or which he intends to, prevail upon, indoctrinate, convert, induce, persuade, or in any other way influence any agency or official of the Government of the United States or any section of the public within the United States with reference to formulating, adopting, or changing the domestic or foreign policies of the United States or with reference to political or public interests, policies, or relations of a government of a foreign country or a foreign political party.

The CHAIRMAN. Next we will hear from Mr. Raphael Sherfy, on behalf of Hanna Mining Co.

STATEMENT OF RAPHAEL SHERFY ON BEHALF OF HANNA MINING CO.

Mr. SHERFY. I would like to ask that my written statement be put into the record.

The CHAIRMAN. That will be done.

Mr. SHERFY. My name is Raphael Sherfy. I am appearing on behalf of Mr. Wilf Trembley of the Hanna Mining Co. who happens to have had an emergency and cannot appear.

Hanna engages, principally, in the production and sale of iron ore in the United States and abroad.

One of Hanna's principal sources of iron ore is through equity interest in Iron Ore Co. of Canada called IOC, and an integral segment of IOC operation is a railway system. In the ordinary development of such a mining operation, the railroad would have been an operating division of IOC.

However, the Canadian Government required that the railroad be a foreign corporation, a Canadian corporation and, as a result, the railroad was organized as the Quebec, North Shore, Labrador Railway. QNS&L.

The QNS&L qualifies as a Western Hempishere trading corporation, and that company and IOC filed consolidated returns and for past years. The foreign tax credits stemming from the Canadian income taxes were averaged because they were on a per country limitation.

Under present law, an affiliated group using the overall limitation which H.R. 10612 is requiring everybody to be on, and filing consolidated returns cannot average the railroad's Western Hemisphere's company's Canadian income taxes with its parents' taxes, a non-Western Hemisphere.

IOC, the parent, is a non-Western Hemisphere because of the requirements that the railroad be carried on in a separate entity so that dividends distributed up to the parent will disqualify IOC from Western Hemisphere treatment because they do not constitute business income.

We request that under the overall limitation those two companies' taxes can continue to be averaged.

IOC and QNS&L, whose operations are in Canada only, are intimately related. They are in essentially the same position as certain public utilities which presently can average their foreign income taxes.

Under today's law, public utilities carrying on business in the same country may average out their foreign taxes even though a Western Hemisphere and one not a Western Hemisphere trade corporation filing consolidated returns.

IOC is a mining company and QNS&L is a railroad company operating in the same country. We would like to have the same exemption that is applicable to the public utilities to be applicable to IOC and QNS&L. Thank you very much.

The CHAIRMAN. Questions, gentlemen?

[No response.]

The CHAIRMAN. Thank you very much, sir.

[The prepared statement of Mr. Trembley follows:]

Statement of Wilfred J. Trembley on Behalf of the Hanna Mining Co.

Summary

1. The Iron Ore Company of Canada (IOC) and Quebec North Shore and Labrador Railway Company (QNS&L) are parent and subsidiary corporations.
2. IOC and QNS&L operate solely in Canada in related activities (mining and transportation) and file consolidated returns.
3. QNS&L, a Canadian Corporation, is a WHTC but IOC is not a WHTC. Under present law, all Canadian income taxes paid by both can be averaged for foreign tax credit purposes under the per-country limitations.
4. With the elimination of the per-country limitation, income taxes paid by a WHTC will not be able to be averaged with the income taxes paid by non-WHTC under the present provisions of the overall limitation.
5. The Committee adopted an amendment as a transition rule which permits averaging under the overall limitation, so that IOC and QNS&L can continue its present treatment.
6. This amendment is exactly similar in principle to an exception already in present law which applies to public utilities operating in the same country.
7. It is urged that the Committee reaffirm its decision to extend this exception to the IOC and QNS&L situation in Canada.

Statement

Mr. Chairman, my name is Wilfred J. Trembley, and I am Director of Taxes of The Hanna Mining Company ("Hanna"). I am appearing before you today in support of the provision in § 1052(b) of the Committee bill.

Hanna is a publicly-held corporation, headquartered in Cleveland, Ohio, which engages principally in the production and sale of iron ore in the United States and abroad.

One of Hanna's principal sources of iron ore is through the equity interest in the Iron Ore Company of Canada ("IOC") for which Hanna has management responsibility. IOC is a U.S. corporation organized in 1949 to develop and operate large iron ore deposits which are located in remote sections of Quebec and Labrador. Its shareholders, in addition to Hanna, were five (now six) U.S. steel companies and three (now two) Canadian corporations; two of the latter were the original holders of the mining rights. Nearly $1 billion has been invested in the mining, concentrating, pelletizing, railroad, dock, townsite and related facilities of IOC.

An integral segment of the IOC operation is a railroad system. In the ordinary development of such a mining operation, the railroad would have been organized as an operating division of the mining company. In this case, however, since the railroad would be operating in both Quebec and Newfoundland, the Canadian government required that it be incorporated as a Canadian corporation and operated as a common carrier. As result, the railroad was organized as the Quebec North Shore and Labrador Railway Company ("QNS&L"), a wholly-owned Canadian subsidiary of IOC, QNS&L qualifies as a Western Hemisphere Trade Corporation ("WHTC") while IOC does not, solely because of the dividends it receives from QNS&L. QNS&L and IOC file a consolidated U.S. income tax return. This situation is unique and involves circumstances over which neither IOC nor its owners have any control whatever.

Up to the present time this consolidated group has elected to use the per-country limitation so that the Canadian taxes paid by each corporation were averaged together. The Tax Reform Act of 1976, H.R. 10612, which is presently under consideration by the Senate, provides for the repeal of the per-country foreign tax credit limitation for all industries. Thus, the overall limitation will, in the future, have to be used by IOC and QNS&L.

Under present law, an affiliated group using the overall limitation and filing a consolidated return which includes a WHTC may not average any excess foreign income taxes of the WHTC with the foreign income taxes of the non-WHTCs in the affiliated group for foreign tax credit purposes. However, a special exception makes this rule inapplicable in the case of certain public utilities on the overall limitation where the affiliated group includes non-WHTCs which have utility-type income from sources in the same foreign country.

IOC and QNS&L, whose operations are in the same foreign country and are integrally related, are in essentially the same position as the public utility WHTCs for which present law provides an exception to the non-averaging rule. Up until now, since IOC and QNS&L have used the per-country limitation, the non-averaging rule has not applied. Under the bill, however, IOC and QNS&L will be required to use the overall limitation. This would make the non-averaging rule applicable. Since IOC and QNS&L are in essentially the same position as the utilities for which present law provides an exception to the non-averaging rule, we believe that, during the phase-out of the Western Hemisphere Trade Corporation provisions, a similar exception should be provided for IOC and QNS&L.

An amendment was offered and approved by this Committee which can be found in section 1052(b) of the Committee Bill (H.R. 10612) which is intended to accord the benefits of the exception of present law to IOC and QNS&L's type of situation. It should be noted that, since the Committee Bill phases out the WHTC provisions by the end of 1979, the exception in reality is only a short-term, transition rule.

The amendment accomplishes this purpose by modifying Section 1503(b) of the Code to provide that no reduction shall occur in the amount of foreign income taxes paid to a contiguous foreign country (i.e., Canada) by a WHTC which is a corporation treated as a domestic company by reason of Section 1503(d) (i.e., QNS&L) to the extent that other domestic companies in the same affiliated group (i.e., IOC) have an unused foreign tax credit limitation. The rule contained in the amendment would apply only to taxes paid to a contiguous country by a corporation of that country and only insofar as the other affiliated corporations have an excess credit limitation with respect to taxes paid to, and income from, that contiguous country. It further provides that all corporations in the affiliated group must derive 95% or more of their gross income from sources within the contiguous country and must be primarily engaged in a mining or related transportation business within that contiguous country.

In brief, this amendment closely parallels the similar exception contained in present law and is necessitated solely because of an inadvertent and unintended side effect of the repeal of the per-country limitation on the foreign tax credit.

I trust that in the reconsideration of this amendment of Section 1503(b), the Committee will resolve this matter on the same equitable basis that it previously did.

Respectfully submitted,

THE HANNA MINING CO.,
W. J. TREMBLEY, *Director of Taxes.*

Chairman LONG. Mr. Stephen A. Nauheim of Surrey, Karasik & Morse.

STATEMENT OF STEPHEN A. NAUHEIM OF SURREY, KARASIK & MORSE

Mr. NAUHEIM. Mr. Chairman, in view of the hour, I would like to ask that my statement be submitted for the record, and I will only briefly——

The CHAIRMAN. You might summarize your statement for us.

Mr. NAUHEIM. There was a coloquy this morning between yourself, Mr. Chairman, and Mr. Nolan about legislation that is overly broad and clobbers some people not intended to be hurt.

This really goes to a lot of my testimony here today concerning income earned abroad. I think the modifications made by this committee will hurt people not intended to be hurt and the amendment subsequently offered by Senator Fannin will help ameliorate this.

But it will hurt a substantial number of people that I believe are not intended to be hurt.

The committee in its committee report rejected the repeal of section 911 and indicated that it did not favor the repeal of 911, but rather its retention to protect the competitiveness of the American companies abroad.

Yet, the modifications made by the committee in many cases will be tantamount to repeal; particularly in the case of taxpayers who are suffering high foreign tax burdens abroad; although the ones who will primarily benefit from the modifications made by the committee are the ones—you might say are least deserving of it, those that pay no foreign taxes.

I have included in my testimony an example of how the committee's modifications can, in many cases, result in taxes equal to the taxes that would have been paid in the case of repeal of section 911.

I would add one more point without going into further detail which is in my testimony. It goes to one other conversation that transpired this morning in which you noticed, Mr. Chairman, the tendency of government at the same level, nation to nation, to offset taxes, to allow a credit for an income tax of one nation against the income tax of another.

You raised the parallel of the States that allowed the credit of State income taxes against other State income taxes and State sales taxes against sales taxes of other States.

It was also noted as to foreign sales taxes there is no comparable credit in the United States.

The United States does not have comparable taxes, say, to the value-added tax which is probably the primary or largest indirect tax by foreign countries.

It really serves as a substitute to higher income taxation in many foreign countries.

Not only are these value added taxes and other foreign indirect taxes not allowed as a credit, they also are not allowed as a deduction even though comparable State sales taxes are allowed as deductions so that Americans living abroad often pay taxes already that are higher than the taxes their counterpart in the United States pays.

They also suffer additional complexities over those of their American counterparts and the modifications made by the committee, may, I am afraid, contribute to both of these categories of burdensomeness and complexity. Thank you.

The CHAIRMAN. Questions?

Senator FANNIN. Mr. Chairman, I would just like to ask one question.

Would not the option provision that I supported and offered, assist in meeting the objections that you have?

Mr. NAUHEIM. The option provision only makes sure that Americans working abroad are not subject to more burdensome taxes than they would be had the provision been repealed.

It allows them to compute their taxes as if section 911 were not in existence, in essence.

That relief is only directed to those few cases—the problem of those few cases in which the committee's modification would have created a greater burden than absolute repeal of section 911.

Senator FANNIN. The objection that the Senator from Arizona has is that in offering this election provision, it would assist in that regard.

It was certainly not intended in any way to place an additional burden on those who would be affected.

I will review very thoroughly the recommendations you have made.

The CHAIRMAN. Mr. Nauheim, I would like you to, at the conclusion of this hearing which will be immediately after you finish your testimony here today, to get together with Mr. Laurence Woodworth, the Chief of Staff of the Joint Committee on Internal Revenue and Taxation. I would like you to explain your views and let him ask you a few questions and see if your case is as good as you think it is.

It may be that you can provide information that will strengthen those views. Maybe you cannot, but I think you ought to do that.

That will conclude this meeting for today. I believe we are scheduled to meet tomorrow at 8 a.m.

I, for one, would like to say that I believe it has been a very useful hearing and we have obtained a lot of information and while I do not say much of it has changed my mind, much of it is very useful and very helpful and I believe it to be of use to the Senate.

I want to thank all of the witnesses who have testified here today. I particularly appreciate what has been said by Edwin Cohen in answer to questions and Mr. John S. Nolan and I want to say, again, that they testified here today with regard to narrowly drawn positions and I request that part of these hearings be transcribed as soon as possible and made available to me, for one; I would like to make that section available to some people who do not seem to know what these able men have learned down through the years. Thank you very much.

[The prepared statement and letter of Mr. Nauheim follows:]

STATEMENT OF STEPHEN A. NAUHEIM

SUMMARY

1. Contrary to popular belief, the tax treatment accorded to an American working abroad is less favorable than the tax treatment accorded to his counterpart in the United States.

2. The Committee's proposed revision to Section 911 would, in many cases, be tantamount to repeal, and, in some cases, worse than repeal.

3. Retention of present law is needed to maintain the competitiveness of U.S. companies abroad and to maintain the use of U.S. labor by these companies.

4. Provisions of the Code other than Section 911 operate inequitably with regard to Americans working abroad, particularly, the inclusion in income of cost of living allowances and the failure of the Code to take into account the value added tax, either as a deduction or credit.

5. Alleged "unintended benefits" of Section 911 (resulting in the Committee's amendments denying, in part, the foreign tax credit and taxing included income at higher brackets) are not caused by Section 911 but rather by the operation of other provisions of the Code which apply any time income is excluded from taxation; already over-burdened Americans working abroad should not be made the scapegoats for a problem of general applicability.

6. The Committee's Third amendment, making ineligible for exclusion certain income received outside the country in which earned adds considerable subjectivity, uncertainty and complexity in an area where complexity is already at a premium; the idea that a taxpayer who uses legitimate and accepted means to reduce the burden of foreign taxes should be penalized by the U.S. while others pay no foreign tax without penalty appears to make no sense.

7. The Committee should defer any action with respect to Section 911 until it has had an opportunity to consider the broader picture, including the tax inequities and complexities presently faced by Americans living abroad; Section 911 should be retained in its present form and the Committee should give consideration to more equitable tax treatment for Americans working abroad.

STATEMENT

I am pleased to have the opportunity to appear before you today to discuss United States tax policy with regard to American citizens working abroad. I am a member of the law firm of Surrey, Karasik and Morse. Surrey, Karasik and

Morse is a Washington based law firm with additional offices in New York and Paris. We have 12 American attorneys working in our Paris office and I appear before you today formally on their behalf. Their interests in this subject matter, however, coincide to a substantial extent with the interests of approximately 100,000 American citizens working abroad.

In Section 1011 of the Senate Bill, this Committee wisely rejected the House provision which would have repealed Section 911 of the Internal Revenue Code, the section which allows an exclusion from gross income of up to $20,000, or $25,000, of income earned abroad. This Committee has heard, on various occasions in the past, the reasons for retention of Section 911. It is not my purpose today to repeat those reasons, as it appears from the Committee's explanation of its decisions with regard to Section 911 you fully understand and accept the arguments in favor of retaining the basic approach of Section 911. This Committee, however, in its decisions, proposed three modifications to the present law which, ironically, for some American citizens, could result in more burdensome taxes than would have resulted had the House decision to repeal Section 911 been enacted and, for many others, will be tantamount to repeal. I am here to urge the deletion of the changes which this Committee has proposed to Section 911 and the retention of the provisions of present law.

I am submitting for the record an exhibit which compares the effect of present law with that of: the House proposal to repeal Section 911, the Senate Finance Committee modifications to Section 911, and present tax law as applied to a domestic taxpayer similarly situated to the foreign-based taxpayer used as a model in the exhibit. The exhibit illustrates two basic points: First, that this Committee's modifications to the present law would, in the typical case, have virtually the same effect as repeal of Section 911 and, second, contrary to popular belief, the typical American citizen working abroad does not enjoy an overall tax benefit over his counterpart in the United States. The exhibit uses as a model a taxpayer receiving a basic salary of $25,000 who is sent abroad by his employer and receives various allowances to compensate him for the increased out-of-pocket expenses he incurs as a result of living abroad. Under current law, this taxpayer would pay income taxes of $8,592 compared to his domestic counterpart who would pay income taxes of only $4,620. Both under the House proposal to repeal Section 911 and under this Committee's proposal to modify Section 911, our model taxpayer ends up paying total income taxes of $11,128. As a result the American who stays in the United States at a $25,000 salary nets $20,380 after taxes whereas his counterpart who is transferred abroad by his employer would, under either the House or Senate version of the Bill, end up with a net after taxes of $18,872. I would emphasize that the model we have used is not an exaggerated case; rather, I believe it most likely represents the fact pattern of a large portion of American citizens working abroad.[1]

FACTORS SUPPORTING THE RETENTION OF PRESENT LAW

1. Decline in Competitiveness of U.S. Companies and in the Use of U.S. Labor.

In its Committee Report, this Committee explained its rejection of the House proposal to repeal Section 911 on the basis that it was doing so so that the competitive position of American firms abroad would not be jeopardized. The exhibit amply illustrates that this Committee's modifications to Section 911 achieve virtually the same result as repeal in many cases. The resultant additional difficulty recruiting U.S. personnel for overseas assignments and the additional expense involved for those companies that reimburse their overseas personnel for increased tax burdens will quite obviously result in the decline in the use of U.S. labor replaced by local nationals and will lessen the ability of American companies to compete with foreign companies.

2. Present U.S. Taxation of Cost of Living Adjustments.

Retention of the current provisions of the law can be justified not only on the basis of maintaining the competitive position of American firms abroad but also as a matter of tax equity to balance against the tax detriments suffered by U.S. citizens working abroad. The high rate of inflation in most foreign countries, compared to that of the United States, results in a much higher cost of living in most foreign countries. (For example, the October 1975 cost of living index issued by the Bureau of Labor Standards reflects a cost of living index for Paris of 170

[1] The Compendium on Tax Expenditures published by the Senate Committee on the Budget March 17, 1976 tends to support this. The Compendium shows that 56.7% of the tax expenditure for Section 911 is derived from taxpayers with adjusted gross incomes (after the exclusion) of $15,000 or less (p. 14).

using a Washington, D.C. base of 100.) The cost of living and other allowances paid typically to Americans working abroad generally falls far short of meeting the full increase in the cost of living. Adding to the burden is the fact that any allowances paid to the employee to compensate him (in part) for this increased cost of living is included in full in the employee's income as additional earned income and no deduction is allowed for the expenses which these payments are intended to reimburse.[3] There are other similar inequities such as the combined effect of the inclusion of reimbursed or in kind moving expenses in the employee's income and a partial disallowance of deductions for these same moving expenses under section 911.

3. Failure of U.S. Tax Law to Take into account Value Added and Similar Taxes.

In addition, most foreign countries, particularly in Europe, rely more heavily on indirect taxation for sources of revenue than does the United States. Thus, for example, in France, the basic rate of the value added tax is 20% and rises to as high as 33%. As an alternative to direct income taxes as a source of revenue, this value added tax can be viewed as being similar in concept to the "in lieu of" taxes allowed as a foreign tax credit under Section 903 of the Code. However, Americans who pay these heavy value added taxes are not allowed to credit these alternative taxes against their U.S. income tax liability. Not only that, but they are not even allowed to deduct these and a variety of other indirect taxes, such as general sales taxes, gasoline taxes and personal property taxes, in computing their U.S. tax liability in spite of the fact that they are comparable in nature to (although significantly greater in amount than) state taxes which are deducible.

THE COMMITTEE'S MODIFICATIONS

The Committee Report suggests that the modifications proposed to Section 911 are intended to curtail unintended benefits under Section 911. Whether or not these benefits were intended, they would appear to be fully justifiable in equitable terms as offsetting, in part, the inequities of other provisions of the tax law. Further, these supposedly unintended benefits are not caused by, nor unique to, Section 911. Rather, they are benefits which result whenever income is excluded under *any* provision of the Code and arguably apply whenever income is indefinitely deferred from taxation under any provision of the Code.

One of these modifications would require income derived by individuals in excess of the excluded amount to be subject to U.S. tax at the higher rate brackets which would apply if the excluded income were not so excluded. The Committee Report notes that this additional income is now taxed at the marginal rate that would apply to an employee who had not earned the excluded amount. This same result occurs, however, any time income is excluded from taxation whether it be income from municipal bonds, the result of the capital gains deduction, possessions source income, social security payments, or any other of a long list of excluded income items.

Similarly, the Committee proposal denies a foreign tax credit for foreign taxes imposed on income which has been excluded from U.S. taxation under Section 911. However, again, this same result will occur any time a taxpayer earns income excluded from U.S. taxation but subject to foreign taxation.

One can legitimately question whether American citizens working abroad, who already suffer a greater tax burden than their counterparts in the United States, should be singled out for this special treatment which does not apply to other taxpayers who may have other forms of excluded income. If this Congress feels that our present tax structure with regard to the interaction of the multitude of provisions allowing for exclusion of amounts from gross income with the foreign tax credit and the progressive rate structure is unwarranted, the problem should be attacked directly and the one group of taxpayers that already suffer a heavier burden than other taxpayers similar situated should not be made to suffer alone for this alleged defect in our tax system.

I do not mean to suggest by this that these basic interrelationships should be adjusted. I believe that as long as our basic U.S. international tax policy allows for computation of the limitation on the foreign tax credit on an overall basis, the results criticized in the Committee Report can be fully justified. The overall

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[3] The Committee Report reflects that this Committee has decided to allow a limited exclusion for cost of living allowances. However, the Committee Report goes on to state that the amount excluded as housing allowance will reduce the amount of available exclusion under Section 911, thereby offsetting, in large part, the ameliorative nature of the proposed new exclusion for cost of living allowances. Report No. 94–938 at p. 212.

limitation on the foreign tax credit has the effect of limiting the amount of U.S. taxes which can be offset by foreign taxes under the foreign tax credit mechanism to those U.S. taxes attributable to all of the taxpayer's foreign source income and, under that limitation, the Congress has consciously allowed the averaging of income subject to high taxation, low taxation and *no* taxation. This can be fully justified both on the grounds of simplicity and equity.

Certainly, in the context of the limited amount of exclusion under Section 911, taxation of the remaining income at the highest brackets does not seem justifiable. While $20,000 (and in some cases $25,000) may not sound like a minimal amount, it really is when one considers the high cost of living adjustments that have to be taken into account when an American is transferred abroad. The dollar amounts of the exclusion were set at their present levels in 1964 and no adjustment has been made since that time to take into account the effects of inflation.

In addition to the equitable argument in support of not taxing included income at the highest brackets, the system proposed under the Bill adds significantly to the complexity of the tax law in this area. The complexity involved in the simple filing of a tax return for an American living abroad is significantly greater than the complexity involved for his counterpart living in the United States and, even in the pure domestic context, this complexity has risen to a level where it is bearly tolerable.

The third of the amendments made by this Committee to Section 911 would make ineligible for the exclusion any income earned abroad received outside of the country in which it was earned if one of the purposes of the receipt of that income outside the country was the avoidance of taxes. Obviously, this "one of the purposes" test is going to be a highly subjective test, difficult to administer. We already have in our law principal purpose tests, primary purpose tests, insubstantial purpose tests, etc., which have led to large volumes of administrative and judicial controversy. This proposal will not only add significantly to the complexities of preparing a tax return for an American living abroad but will also also add uncertainty. About the only certainty that will result is that, if the taxpayer attempts to exclude any income received outside the country in which it was earned, he will be challenged by the Internal Revenue Service, adding further to his already burdensome costs of living abroad. More importantly, why should a taxpayer be penalized for legitimate tax planning to minimize taxes? Why should the American working in a tax-free country, who obtains the maximum benefit under section 911, be treated more favorably than an American whose earning are subject to foreign income taxes, but who has used well-accepted means, specifically sanctioned by the foreign country's own law, to reduce the foreign tax burden?

It is also important to note in the context of this third proposed modification to Section 911 that the taxes which are being reduced are not United States taxes; rather, they are the taxes of the foreign country. This raises two further questions: Why should the United States encourage U.S. taxpayers to pay higher foreign income taxes with no benefit to the U.S. treasury? Also, if the taxpayer intentionally receives income in a manner so that it will be subject to the foreign tax where he could have received it in a manner that would have avoided the foreign tax, whatever foreign tax he may have left as eligible for the credit after this Committee's denial of a part of them may be lost. The Internal Revenue Service is increasingly taking the position that foreign taxes paid by a taxpayer which did not have to be paid do not qualify as creditable foreign income taxes. Thus, the American working abroad will be caught in the middle of two conflicting principles of tax law if this proposal is passed. He either avoids the foreign tax and loses the exclusion under Section 911 or he pays the foreign tax and loses a foreign tax credit under Section 901.

The Committee's proposal would place the Internal Revenue Service in the position of interpreting, analyzing and, in some cases, policing the tax laws of other countries, adding further to the complexities in this area.

Conclusion and Summary

I have in this testimony attempted to convey three basic points regarding this Committee's proposals with respect to Section 911. First, there is a basic misconception that American citizens working abroad receive tax treatment more than favorable than their counterparts working in the United States. The contrary is true. Second, the alleged unintended benefits of Section 911 attached in this Committee's proposals are not the result of Section 911 but are the result of other provisions within the basic U.S. tax structure which can be fully justified as applied to Americans working abroad. American citizens who are already faced with the more burdensome tax than others simililarly situated should not be the scape goats who are singled out for different treatment. Third, any unintended benefit which results by virtue of the interaction of Section 911 with other provisions of the Code are more than offset by the tax and non-tax detriments suffered by Americans working abroad and by the substantial increase in complexity which would be involved in administering and complying with the proposals which this Committee has made.

The Internal Revenue Service is now in the process of collecting and analyzing the 1975 income tax returns of Americans claiming the Section 911 exemption. The data base resulting from this analysis will provide a much sounder basis for consideration of revisions to Section 911 than the data resulting from the sampling of 1968 returns as reflected in the Treasury Department's position paper in this area. Section 911 should not be considered in isolation. This Committee should defer any changes in Section 911 until it has had an opportunity to both review the up-to-date data now being compiled and to consider, at the same time, the present tax inequities, outside of Section 911, and the complexities facing Americans living aboard.

If any change is to be made in the U.S. taxation of American citizens working abroad it should be to allievate the tax detriments suffered by these American citizens rather than increasing already disproportionate burdens suffered by them. This Committee should seriously consider, for example, treating the value added tax as a creditable tax and, at a minimum, if not as a creditable tax, the value added tax and other foreign indirect taxes should be deductible taxes as are similar state taxes in the United States. I urge the Committee, therefore, to delete the proposed modifications it has made in Section 911 and consider instead provisions which will provide more equitable tax treatment for Americans working abroad. I thank you for your time.

EXHIBIT

(Accompanying the Testimony of Stephen A. Nauheim, of Surrey, Karasik and Morse, before the Senate Finance Committee on H.R. 10612, July 21, 1976)

The following is a comparative analysis of the income tax burden suffered by an American citizen receiving a basic salary of $25,000 under the following four circumstances: (1) Employed in the United States; (2) Employed abroad (in France) under present law; (3) Employed abroad, under the Senate Finance Committee's proposed modifications to present law; and (4) Employed abroad, under the House's proposal for repeal of Section 911. The analysis makes certain assumptions as to how the Committee's proposals would be interpreted, in a manner which minimizes the increased tax burden and ignores the value added tax ("VAT"), both in terms of its effect as an increase in the tax burden and the failure of U.S. tax law to make any adjustment for the VAT in the computation of U.S. tax liability.

UNITED STATES CITIZEN WORKING IN FRANCE

	U.S. citizen working in the United States	Current law	Sec. 911 as modified	Complete repeal of sec. 911
Base salary	25,000	25,000	25,000	25,000
Cost-of-living and housing allowances		12,500	12,500	12,500
Child's education		1,500	1,500	1,500
Home leave		1,000	1,000	1,000
Total earned income	25,000	40,000	40,000	40,000
Sec. 911 exclusion		(20,000)	(20,000)	
Personal exemptions (3)	(2,250)	(2,250)	(2,250)	(2,250)
Standard deduction	(2,000)			
Taxable income	20,750	17,750	17,750	37,750
U.S. tax before credits	4,620	3,750	[1] 6,748	11,128
Foreign tax credit	0	(3,750)	[2] (4,212)	(8,592)
Total U.S. tax liability	4,620	0	2,536	2,536
French income tax	0	8,592	8,592	8,592
Total United States and French taxes	4,620	8,592	11,128	11,128
Cash flow:				
Salary	25,000	25,000	25,000	25,000
Less total taxes	(4,620)	(8,952)	(11,128)	(11,128)
Total	20,380	16,408	13,872	13,872

[1] Tax on net taxable income 11,128
Less tax on net excluded earned income ($20,000) .... (4,380)

Tax at higher rate on income exceeding sec. 911 income 6,748

[2] Disallowed French taxes on an accrued basis, using U.S. progressive rates, would be: $4,380 (U.S. tax on $20,000). The allowable portion would therefore be $8,592 less $4,380 ,or $4,212.

SURREY, KARASIK & MORSE,
Washington, D.C. July 21, 1976.

Senator RUSSELL B. LONG,
U.S. Senate,
271 Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: At the conclusion of my testimony of today regarding the Senate Finance Committee's modification to Section 911, the exclusion for income earned abroad, you suggested that I confer with Dr. Woodworth's staff concerning the example in my testimony and that, if my example were correct, you would look into the matter further. I therafter had a brief discussion with Howard Silverstone, Esq., the International Tax Counsel for the Joint Committee, regarding the example.

I believe the reason there was some question about my example was because we had submitted to Mr. Silverstone several weeks earlier a similar example without the benefit of Mr. Silverstone's knowledge of how the Committee's modifications to Section 911 were intended to operate and Mr. Silverstone was under the impression that the example contained in my testimony was that same example. Actually, the example in my testimony was a revised example based on my understanding of the operation of the Committee's modifications after my earlier discussion with Mr. Silverstone. Mr. Silverstone is now looking into the example and I will be talking to him regarding the correctness of the example.

Because of the shortness of time available with regard to options which are still available for revising the tax bill, I am writing this letter to you now to urge you to consider further the appropriateness of the Committee's modifications and to consider the recommendations I make at the end of my prepared testimony. I believe Mr. Silverstone will find that the example is now essentially accurate and that the principles illustrated by that example are sound. I would add that, in the event my example is inaccurate, this simply gives further weight to another reason why the modifications should not be enacted into law—that is, they would add substantially greater complexity to an already complex area. This is true whether or not my example is accurate.

For your convenience, I am attaching an extra copy of my prepared testimony. I have been most impressed with the careful attention and consideration you have given to each witness that appears before you and particularly appreciate the consideration you have given to my remarks and your concern over the problems I raised.

I believe the shortness of time, combined with the complex nature of the modifications, may have resulted in many effected taxpayers not yet realizing the impact of the Committee's actions in this area. Corrective action now will avoid what I believe will otherwise be an after-the-fact influx of requests for remedial legislation. My impression from today's hearing is that most of the Committee's previous actions have now been, if not previously, fully defended and justified and that any further changes by the Committee as a result of these hearings will be minimal. I would urge that one of those changes be the deletion of the Committee's changes to Section 911 in order to allow time for a more considered and balanced approach to modifying the taxation of Americans abroad.

Thank you.

Yours truly,

STEPHEN A. NAUHEIM.

Senator BYRD. Mr. Chairman, may I ask what is the hour we convene tomorrow?

Chairman LONG. At 8 o'clock. I am trying to give everyone a chance to be heard. The hearing is adjourned.

[Whereupon, the hearing was adjourned, to be reconvened at 8 a.m. on July 22, 1976, in room 2221, Dirksen Senate Office Building.]

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