1981–82 MISCELLANEOUS TAX BILLS XIII

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 696, S. 1757, and S. 1883

DECEMBER 11, 1981

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

90-975 O WASHINGTON: 1982 HG 97-68

COMMITTEE ON FINANCE

ROBERT J. DOLE, Kansas, *Chairman*

BOB PACKWOOD, Oregon
WILLIAM V. ROTH, JR., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
JOHN HEINZ, Pennsylvania
MALCOLM WALLOP, Wyoming
DAVID DURENBERGER, Minnesota
WILLIAM L. ARMSTRONG, Colorado
STEVEN D. SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa

RUSSELL B. LONG, Louisiana
HARRY F. BYRD, JR., Virginia
LLOYD BENTSEN, Texas
SPARK M. MATSUNAGA, Hawaii
DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey
GEORGE J. MITCHELL, Maine

ROBERT E. LIGHTHIZER, *Chief Counsel*
MICHAEL STERN, *Minority Staff Director*

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

BOB PACKWOOD, Oregon, *Chairman*

JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
MALCOLM WALLOP, Wyoming
WILLIAM L. ARMSTRONG, Colorado

HARRY F. BYRD, JR., Virginia
LLOYD BENTSEN, Texas
SPARK M. MATSUNAGA, Hawaii
RUSSELL B. LONG, Louisiana

CONTENTS

1981-82 MISCELLANEOUS TAX BILLS XIII

FRIDAY, DECEMBER 11, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
Washington, D.C.

The hearing was convened, pursuant to notice, at 10:18 a.m., in room 2221, Hon. Bob Packwood (chairman) presiding.

Present: Senators Packwood, Wallop, and Danforth.

[The press release announcing this hearing the Joint Committee on Taxation's description, the text of bills S. 696, S. 1757, S. 1883, and the prepared statement of Senator Danforth follow:]

[Press Release]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT SETS HEARING ON TWO MISCELLANEOUS TAX BILLS

The Honorable Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, announced today that the Subcommittee will hold a hearing on Friday, December 11, 1981, on two miscellaneous tax bills.

The hearing will begin at 10:15 a.m. in Room 2221 of the Dirksen Senate Office Building.

The following proposals will be considered:

S. 696—Introduced by Senator Danforth. S. 696 would provide that certain organizations, whose activities are devoted to the operation of a library that serves the public, be treated as a tax-exempt public charity.

S. 1883—Introduced by Senator Packwood for himself and others. S. 1883 would conform the net operating loss carryback and carryforward treatment of the Federal National Mortgage Association to that of other financial institutions.

DESCRIPTION OF TAX BILLS

(S. 696, S. 1757, and S. 1883)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on December 11, 1981, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are three bills scheduled for the hearing: (1) S. 696 (relating to private foundations status of certain library organizations); (2) S. 1757 (relating to tax-exempt status of certain amateur athletic organizations); and (3) S. 1883 (relating to net operating loss treatment of the Federal National Mortgage Association).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, explanation of provisions, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 696—Senator Danforth

Exclusion from Private Foundation Status of Certain Library Organizations

Under present law, the term "private foundation" means any tax-exempt charitable, religious, scientific, public safety, literary or educational organizations, other than certain specified types of organizations that could be described as "public charities." "Public charities" include (1) certain organizations defined principally in terms of their function (churches, schools, hospitals, certain medical research organizations, and governmental units), (2) certain organizations that receive specified amounts of "public" support, and (3) organizations that are "supporting" organizations to other public charities.

Under the bill, an organization that operates a qualified library would be excluded from private foundation status. A qualified library would be one that was established as a library by a law of a State, of the United States, of a possession of the United States, of the District of Columbia, or, before 1789, in the geographic area now comprising the United States, and that is operated by the organization as a permanent and principal part of its public services. Alternatively, a qualified library would be any library that is open and available to the general public, does not charge a fee for admission or for use of the library collection on its premises, and is operated by an organization, none of whose income is expended for purposes other than the construction, maintenance, expansion, operation, or management of such library and its premises.

The bill is intended to benefit principally two libraries, the St. Louis Mercantile Library, located in St. Louis, Missouri, and the Linda Hall Library, located in Kansas City, Missouri.

The provisions of the bill would be effective on the date of enactment.

2. S. 1757—Senator Stevens

Tax-Exempt Status of Certain Amateur Athletic Organizations

Under present law, athletic organizations which teach youth or which are affiliated with charitable organizations have been able to qualify for exemption under section 501(c)(3) of the Code and have been eligible to receive tax-deductible contributions. In addition, the Tax Reform Act of 1976 provided that certain athletic organizations also could be eligible for exemption and could receive tax-deductible contributions. In order for this group of athletic organizations to qualify, the organization must be organized and operated for the primary purpose of fostering national or international amateur sports competition, but only if no part of the organization's activities involves the provision of athletic facilities or equipment.

The bill would provide that certain athletic organizations would be exempt under section 501(c)(3) and could receive tax-deductible contributions despite the fact that the organization provides athletic facilities or equipment or that its membership is local or regional in nature where the organization was organized and operated to conduct national or international competition in certain sports or to support and develop amateur athletes for national or international competition in those sports. The bill would be effective as of October 5, 1976.

3. S. 1883—Senator Packwood, et al.

Net Operating Loss Treatment of the Federal National Mortgage Association

Under present law, taxpayers generally may carry back a net operating loss (NOL) for 3 years and carry forward an NOL for 15 years. Banks and certain other financial institutions are permitted a special 10-year carryback and a 5-year carryover. The Federal National Mortgage Association (FNMA) is not eligible for the special 10-year NOL carryback, and thus must use the 3-year carryback and 15-year carryover rule.

The bill would provide a 10-year carryback and a 5-year carryover for NOL's of the FNMA. Thus, the carryback period would be lengthened by 7 years and the carryover period would be shortened by 10 years. The bill would be effective for NOL's incurred in taxable years beginning after December 31, 1981.

II. DESCRIPTION OF THE BILLS

1. S. 696—Senator Danforth

Exclusion from Private Foundation Status of Certain Library Organizations

Present Law

Under section 509(a) of the Code, the term "private foundation" means any tax-exempt charitable, religious, educational, or other organization described in section 501(c)(3), *other than* certain specified types of organizations. These excluded organizations, which could be called "public charities," include (1) certain organizations defined principally in terms of their function, such as churches, schools, hospitals, certain medical and research organizations, and governmental units; (2) certain organizations that receive specified amounts of "public" support, such as grants, contributions membership fees, admission fees and fees for performance of services not unrelated to their tax-exempt purpose; (3) organizations that are "supporting" organizations to other public charities; and (4) organizations operated exclusively for the testing for public safety.

A private foundation is subject to an annual two-percent excise tax on its net investment income (sec. 4940). Generally, a private foundation also is subject to excise taxes if it fails to make specified annual distributions for exempt purposes, violates prohibitions against acquiring or holding "excess" business interests, makes investments deemed to jeopardize its exempt purposes, or makes certain "taxable expenditures" (secs. 4942–4945). In addition, excise taxes are imposed on any act of self-dealing between a disqualified person and a private foundation; such taxes are to be paid by the disqualified person and any foundation manager participating in the act of self-dealing (sec. 4941).

Under section 170 of the Code individuals generally may deduct gifts of cash to public charities or to private operating foundations [1] to the extent of 50 percent of their adjusted gross income in the year of contribution with a five-year carryforward of any excess. In contrast, gifts of cash to nonoperating private foundations generally are deductible to the extent of 20 percent of adjusted gross income, with no carryforward. Also, a donor of long-term capital gain property to a public charity or private operating foundation generally can deduct

[1] In general, a private foundation is an "operating foundation" if it spends substantially all of its adjusted net income or its minimum investment return, whichever is less, directly for the conduct of its exempt purpose, and if it meets one of three other tests (sec. 4942(j)(3)).

the property's fair market value up to 30 percent of the individual's adjusted gross income (with a 5-year carryforward), whereas with contributions of such property to nonoperating private foundations, the deductible amount generally equals fair market value less 40 percent of the gain that would have been recognized if the property had been sold, is limited to 20 percent of the individual's adjusted gross income, and has no available carryforward.

Issue

The issue is whether the categories of charitable organizations excluded from private foundation status should be expanded to include certain organizations that operate either (1) libraries that were established by State or Federal statute, or (2) libraries that are open to the public free of charge.

Explanation of the Bill

The bill would exclude from private foundation status an organization that operates a qualified library by amending section 170(b)(1)(A)(ii) of the Code (relating to percentage of income limitations on deductions to charitable organizations), which describes educational organizations, to include any organization that operates a qualified library. Organizations described in that section are already excluded, by cross reference, from private foundation status.

To be treated as a qualified library under the bill, such library (a) must have been established as a library by a law of a State, a law of the United States, a law of a possession of the United States, a law of the District of Columbia, or, before 1789, in the geographic area now comprising the United States, and (b) must be operated by an organization as a permanent and principal part of its public services.

Alternatively, a library will be treated as a qualified library if it (a) is open and available to the general public, (b) does not charge a fee for admission or use of its collection on the premises, and (c) is operated by an organization, none of whose income is expended for purposes other than the construction, maintenance, expansion, operation, or management of the library, its collection, and the premises on which it is located.

An organization that, for its first taxable year beginning after the date of enactment, is an "organization which operates a qualified library" under the bill would be treated as not having been a private foundation at any time before the first day of such first taxable year.

The bill is intended to benefit principally two libraries, the St. Louis Mercantile Library, located in St. Louis, Missouri, and the Linda Hall Library, located in Kansas City, Missouri.

Effective Date

The provisions of the bill would be effective on enactment.

Revenue Effect

It is estimated that this bill would reduce fiscal year budget receipts by less than $1 million annually.

2. S. 1757—Senator Stevens

Tax-Exempt Status of Certain Amateur Athletic Organizations

Present Law

Under present law, athletic organizations which teach youth or which are affiliated with charitable organizations have been able to qualify for exemption under section 501(c)(3) of the Code and have been eligible to receive tax-deductible contributions. In addition, the Tax Reform Act of 1976 provided that certain athletic organizations also could be eligible for exemption under section 501(c)(3) and could receive tax-deductible contributions. In order for this latter group of athletic organizations to qualify for exemption under section 501 (c)(3), the organization must be organized and operated for the primary purpose of fostering national or international amateur sports competition, but only if no part of the organization's activities involves the provision of athletic facilities or equipment. The purpose of the restriction of athletic facilities and equipment was to prevent the allowance of tax benefits, including deductible contributions, for organizations which, like social clubs, provide facilities and equipment for their members.

Because of these restrictions, the Internal Revenue Service has not granted favorable rulings to a number of athletic organizations, including the national governing boards of several sports, because those organizations provided athletic facilities or equipment or because the membership of those organizations is local or regional in nature.

Issues

The issues are whether tax exemption under section 501(c)(3) and tax-deductible contributions should be allowed to an athletic organization which provides athletic facilities and equipment or which has a membership which is local or regional in nature so long as the organization is organized and operated primarily (1) to conduct national or international competition in sports played in the Olympic or Pan-American games or (2) to support and develop amateur athletes for national or international competition in such sports.

Explanation of the Bill

The bill would provide that certain athletic organizations organized and operated exclusively to foster national or international sports competition would be exempt under section 501(c)(3) and could receive tax-deductible contributions despite the fact that the organization provides athletic facilities or equipment or that its membership is local or regional in nature. Organizations qualifying for this treat-

ment under the bill would be those organizations which are organized and operated primarily (1) to conduct national or international competition in sports included on the program of the Olympic games or the Pan-American games or (2) to support and develop amateur athletes for national or international competition in such sports.

Effective Date

The provisions of the bill would be effective on October 5, 1976.

Revenue Effect

It is estimated that this bill would reduce fiscal year budget receipts by less than $5 million per year.

3. S. 1883—Senator Packwood, et al.*

Net Operating Loss Treatment of the Federal National Mortgage Association

Present Law

Prior to enactment of the Economic Recovery Tax Act of 1981 (ERTA), taxpayers could carry back a business net operating loss (NOL) against income for the 3 taxable years preceding the loss year and carry forward any remaining unused losses to the 7 years following the loss year (sec. 172). ERTA generally increased the carryover period to 15 years and retained the 3-year carryback.

There are a number of exceptions to the general 3-year carryback and 15-year carryover rule for certain industries or categories of taxpayers. One exception allows a 10-year carryback and a 5-year carryover for NOLs of financial institutions to which section 585, 586, or 593 (relating to the bad debt treatment of commercial banks, small business investment corporations, and savings and loan associations, and certain other thrift institutions respectively) applies (sec. 172(b)(1)(F)). In the Tax Reform Act of 1969, which added the special NOL rule applicable to financial institutions, Congress generally reduced the allowable deductions for additions to bad debt reserves for those financial institutions. Section 172(b)(1)(F) was added to ensure that, after reduction of the bad debt deduction, there would be adequate protection against substantial losses due to any future downtrends in the economy.[1]

Since the Federal National Mortgage Association (FNMA) is not described in sections 585, 586, or 593, it is not eligible for the 10-year carryover treatment, and thus must use a 3-year carryback and a 15-year carryover. FNMA is a corporation chartered by Congress to provide assistance, liquidity, and stability to the home mortgage market.[2]

---

*Cosponsors are Senators Moynihan, Roth, Danforth, Symms, Chafee, Durenberger, Long, Bentsen, Baucus, Matsunaga, Mitchell, Garn, and Lugar.

[1] The 10-year carryback provided by the Tax Reform Act of 1969 was effective for financial institutions other than cooperative banks for losses incurred in taxable years beginning after December 31, 1975, and for cooperative banks for losses incurred in taxable years beginning after December 31, 1969.

[2] FNMA serves two related functions. First, it helps housing by providing a secondary market for mortgages. Also, with respect to mortgage bankers. FNMA generally functions as a primary source of financing, since mortgage bankers are not depository institutions and generally make loans only if they have commitments from FNMA to buy them.

FNMA also offers mortgage lenders a way to hedge against changes in interest rates. It does this by making commitments to buy mortgages at a fixed price 4 months in the future.

Issue

The FNMA typically provides a secondary market for mortgages by borrowing on a short-term basis and investing in long-term mortgages. In this respect, the FNMA operates similarly to certain of the financial institutions which are eligible for the 10-year carryback of net operating losses.

The issue is whether the FNMA should have 10-year carryback and 5-year carryover periods similar to the rule applicable to certain other financial institutions.

Explanation of the Bill

The bill would amend section 172(b) to provide a 10-year carryback and a 5-year carryover of NOL's of the FNMA. Thus, the carryback period would be lengthened by 7 years, and the carryover period would be shortened by 10 years.

Effective Date

The bill would be effective for NOL's for taxable years of the FNMA beginning after December 31, 1981. Thus, for example, a net operating loss for calendar 1982 could be carried back as far as 1972.

Revenue Effect

It is estimated that this bill would reduce fiscal year receipts by $14 million in 1983 and increase fiscal year receipts by $14 million in 1984.

○

97TH CONGRESS
1ST SESSION

S. 696

To amend the Internal Revenue Code of 1954 to treat as public charities certain organizations which operate libraries.

IN THE SENATE OF THE UNITED STATES

MARCH 12 (legislative day, FEBRUARY 16), 1981

Mr. DANFORTH introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to treat as public charities certain organizations which operate libraries.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) clause (ii) of section 170(b)(1)(A) of the Internal Revenue Code of 1954 (relating to charitable, etc. contributions and gifts) is amended by adding at the end thereof: "or any organization which operates a qualified library within the meaning of subparagraph (F).".

(b) Paragraph (1) of section 170(b) of such Code is amended by adding at the end thereof the following new subparagraph:

"(F) QUALIFIED LIBRARIES.—For purposes of subparagraph (A)(ii), a library shall be treated as a qualified library if—

"(i) such library was established as a library by a law of a State, a law of the United States, a law of a possession of the United States, a law of the District of Columbia, or, before 1789, in the geographic area now comprising the United States and such library is operated by an organization as a permanent and principal part of the public services of such organization; or

"(ii) such library is open and available to the general public, does not charge a fee for admission to its premises or use on the premises of the library collection, and is operated by an organization, none of whose income is expended for purposes other than the construction, maintenance, expansion, operation, or management of such library, its collection and the premises on which such library is located.".

(c) For purposes of sections 509(b) and 507 of such Code, an organization which for its first taxable year beginning after the date of the enactment of this Act is described in the amendment made by subsection (a) shall be treated as not having been a private foundation at any time before the first day of such first taxable year.

O

90-975 O - 82 - 2

II

97TH CONGRESS
1ST SESSION

S. 1757

To amend the Internal Revenue Code of 1954 to clarify the tax-exempt status of certain amateur sports organizations.

IN THE SENATE OF THE UNITED STATES

OCTOBER 21 (legislative day, OCTOBER 14), 1981

Mr. STEVENS introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to clarify the tax-exempt status of certain amateur sports organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 501 of the Internal Revenue Code of 1954 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) SPECIAL RULES FOR CERTAIN AMATEUR SPORTS ORGANIZATIONS.—

"(1) IN GENERAL.—In the case of a qualified amateur sports organization—

"(A) the requirement of subsection (c)(3) that no part of its activities involve the provision of athletic facilities or equipment shall not apply, and

"(B) such organization shall not fail to meet the requirements of subsection (c)(3) merely because its membership is local or regional in nature.

"(2) QUALIFIED AMATEUR SPORTS ORGANIZATION DEFINED.—For purposes of this subsection, the term 'qualified amateur sports organization' means any organization organized and operated exclusively to foster national or international amateur sports competition if such organization is also organized and operated primarily to conduct national or international competition in sports included on the program of the Olympic games or the pan-American games or to support and develop amateur athletes for national or international competition in such sports.".

(b)(1) Subsection (c) of section 170 of such Code (defining charitable contribution) is amended by adding at the end of paragraph (2) the following new sentence: "Rules similar to the rules of section 501(j) shall apply for purposes of this paragraph.".

(2) Subsection (a) of section 2055 of such Code (relating to transfers for public, charitable, and religious uses) is amended by adding at the end thereof the following new sentence: "Rules similar to the rules of section 501(j) shall apply for purposes of paragraph (2).".

(3) Subsection (a) of section 2522 of such Code (relating to charitable and similar gifts) is amended by adding at the end thereof the following new sentence: "Rules similar to the rules of section 501(j) shall apply for purposes of paragraph (2).".

(c) The amendments made by this section shall take effect on October 5, 1976.

O

II

97TH CONGRESS
1ST SESSION

S. 1883

To amend the Internal Revenue Code of 1954 to conform the net operating loss carryback and carryforward treatment of the Federal National Mortgage Association to that of other financial institutions.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 22 (legislative day, NOVEMBER 2), 1981

Mr. PACKWOOD (for himself, Mr. MOYNIHAN, Mr. ROTH, Mr. DANFORTH, Mr. SYMMS, Mr. CHAFEE, Mr. DURENBERGER, Mr. LONG, Mr. BENTSEN, Mr. BAUCUS, Mr. MATSUNAGA, Mr. MITCHELL, Mr. GARN, and Mr. LUGAR) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to conform the net operating loss carryback and carryforward treatment of the Federal National Mortgage Association to that of other financial institutions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That—

(a) 10-YEAR CARRYBACK AND 5-YEAR CARRYFORWARD.—Paragraph (1) of section 172(b) of the Internal Revenue Code of 1954 (relating to net operating loss carrybacks

and carryovers) is amended by redesignating subparagraphs (H) and (I) as subparagraphs (I) and (J), respectively, and by inserting after subparagraph (G) the following new subparagraph:

"(H) In the case of the Federal National Mortgage Association, a net operating loss for any taxable year beginning after December 31, 1981, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.".

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (A) of section 172(b)(1) of such Code is amended by striking out "(H), and (I)" and inserting in lieu thereof "(H), (I), and (J)".

(2) Subparagraph (B) of section 172(b)(1) of such Code is amended by striking out "and (I)" in the second sentence and inserting in lieu thereof ", (H), and (J)".

(3) Paragraph (3) of section 172(i) of such Code is amended by striking out "subsection (b)(1)(H)" each place it appears and inserting in lieu thereof "subsection (b)(1)(I)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to net operating losses for taxable years beginning after December 31, 1981.

O

PREPARED STATEMENT OF SENATOR JOHN C. DANFORTH

Mr. Chairman, on March 12th of this year, I introduced S. 696 which provides that a tax exempt organization operating a library as a permanent and principal part of its tax-exempt activities is, under certain circumstances, to be treated as a public charity for tax purposes.

Under S. 696, these organizations would be treated the same way that other educational organizations such as schools and universities are treated. In order to qualify for public charity treatment, the library operated by the organization would have to be operated as a permanent and principal part of the tax exempt activities of the organization and be organized by a public act of the United States, of any State, of the District of Columbia, or of any possession of the United States, or be in existence prior to 1789. Alternatively, if the library is open and available to the public at no charge and is operated as the sole activity of the organization in issue, public charity treatment would be extended. Libraries which meet either of these tests are not different in any material manner from other educational institutions that are already accorded public charity status under the Internal Revenue Code. In my opinion, the time has come to equalize the treatment of these similar institutions.

Under current law, some tax-exempt organizations that operate libraries of the type I have just described run the annual risk that they will fail to meet the Internal Revenue Service's guidelines to qualify as a "publicly supported organization" and that they will be classified as private foundations. For example, two libraries in Missouri that meet these tests, the St. Louis Mercantile Library in St. Louis and the Linda Hall Library in Kansas City, run the annual risk of being classified as private foundations because of investment income from their endowments. Once classified as a private foundation, an organization must pay an annual excise tax equal to 2 percent of its net investment income. In order to avoid this tax, libraries of the type that are the subject of my bill will often spend substantial amounts in legal and accounting fees trying to insure that they meet the "publicly supported organization test". Even then they may not meet the "publicly supported" test. Whether the organization spends its money paying the excise tax or in legal and accounting fees, I believe that as a matter of public policy, we would be better off it the money were spent acquiring books and other library materials.

There is another adverse aspect of being classified as a private foundation. A library that is classified as a private foundation has a more difficult task than an organization classified as a public charity in soliciting funds from potential contributors. A private foundation that is not an operating foundation may make contributions to public charities and private operating foundations, but generally may not make qualifying contributions to other private foundations that are not operating foundations. Because of the uncertainty as to whether a private operating foundation continues to qualify as an operating foundation—there are complex tests that must be satisfied annually—many individual contributors and other private foundations that are not operating foundations are hesitant to contribute funds to such an organization even though it clearly serves a public purpose. As a result, funds that would otherwise go to libraries described in the bill are diverted to other charitable organizations. This is not a hypothetical problem. I am aware of at least one situation where a private foundation that used to make a $10,000 a year grant to the St. Louis Mercantile Library has ceased making such grants *solely* becaue of the library's private foundation status.

Finally, libraries that are classified as private foundations must, in addition to the 2 percent excise tax, pay annual legal and accounting fees to insure that they comply with the private operating foundation rules set out in the Internal Revenue Code. Again, I believe these funds could be better spent on library activities.

I do not believe that enactment of my bill will open the floodgates to legislation exempting all sorts of organizations from the private foundation rules. My legislation is narrowly drawn and the organizations involved in S. 696 serve the pubic. No allegations have been made that these organizations have engaged in the types of activity which led to the enactment of the private foundation rules in 1969. These organizations serve the public exclusively and should be treated accordingly. They should be classified as public charities.

Since I know of only two libraries that would be affected by this legislation, I would like to describe briefly each of these institutions.

The Linda Hall Library was established in 1946. The instruments governing its establishment and operation specifically provide that the library shall be open and available to the public at no charge. These instruments also provide that none of the library's income shall be expended for purposes other than the construction, maintenance, expansion, operation or management of the library. The library is

maintained in its own buildings situated on a tract of land adjacent to the University of Missouri at Kansas City in Kansas City, Missouri.

Since its establishment, the library has assembled one of the nation's most extensive and notable collections devoted to science and technology including more than 460,000 volumes and over 620,000 microforms. Together with a distinguished retrospective collection, it also has very extensive holdings of current books and journals from all countries where publications at the research level in science and technology are available. Among those works especially valuable to research scientists throughout the United States, and not widely held by other institutions, are the library's comprehensive collections of current journals from the Soviet Union, Japan, and the People's Republic of China.

The Linda Hall Library maintains a program of providing photocopies of its materials to persons upon request, whenever requests for such services are consistent with copyright laws and with the Copyright Clearance Center procedures. It also maintains a program of lending portions of its collection from time to time to other libraries. Shortly after its establishment, the library purchased the entire collection of the American Academy of Arts and Sciences which had its principal offices in Boston, Mass. After the purchase, the Linda Hall Library agreed to act as the agent of the Academy in continuing its broad exchange program with libraries and learned societies located throughout the world.

In the early years of its existence, the Linda Hall Library was selected by the Atomic Energy Commission as one of 15 or 20 depositories throughout the United States for its literature, and the library continues to maintain a collection of material relating to the AEC's successor organization, the Energy Research and Development Administration. In the late 1950's, the National Aeronautics and Space Administration selected Linda Hall Library as a depository for the literature which it distributes in connection with its information program. Literature is still being sent by NASA to the library in connection with this program.

Linda Hall Library is a depository for all specifications and standards to be used by individuals and organizations when dealing with military and civilian projects of the federal government. The library also maintains the patent specifications for all patents issued by the U.S. government since July, 1946, and is a depository for all current maps issued by the U.S. Geological Survey.

Linda Hall Library maintains a very close relationship with the University of Missouri at Kansas City which is almost entirely dependent upon Linda Hall for library material in the areas of science and technology.

The St. Louis Mercantile Library Association was established in 1846 to form a well-rounded collection of books for the information and convenience of St. Louisans. The formation of the library was authorized and approved by a public act of the General Assembly of the State of Missouri. The library is maintained in its own building in downtown St. Louis.

Over the past 132 years the library has assembled a notable collection of books, now over 213.,000 volumes, comprising a general collection in the liberal arts area, with emphasis on history, biography, travel, philosophy, religion, and the arts. The library maintains one of the country's distinguished and most comprehensive collections of regional history pertaining to St. Louis and Western Americana.

The Western Americana Collection, with approximately 55,000 rare books, is probably the most comprehensive collection in that field in existence. The collection is frequently consulted and referred to by many historians in this field. In addition, the library has one of the most complete files available in the St. Louis area for 6 local papers, including some 500 bound volumes of St. Louis newspapers, beginning with 1812—a few of these cannot be obtained in any other library. The library has also been the recipient of many valuable gifts during its existence. These gifts include the fragmentary journal of Pierre Laclede's stepson, Auguste Chouteau, describing the founding of St. Louis, and the original manuscript, "Journal of the Proceedings of the First Legislative Council of the Territory of Louisiana, from June 3, 1806 to October 9, 1811."

For individuals researching the organization of the territorial government of the Louisiana Purchase or Missouri's first steps toward statehood, these documents are of extreme importance. Another notable possession is the four-volume elephant folio of Audubon's "Birds of America." The library is open to the public and currently maintains a broad-based membership of over 2,000. While membership is necessary to check out materials—membership dues are currently a nominal $10 per year—anyone can use the books and collection on the premises of the library. The library is also made available to students from Washington University to observe the library's unique cataloging systems, reference department and rare book room.

In my opinion, neither the St. Louis Mercantile Library nor the Linda Hall Library should be penalized by the private foundation rules and applicable excise taxes. These provisions were not intended to penalize organizations that clearly provide a public benefit such as these libraries do. I also believe that libraries such as these should not be burdened with the additional legal and accounting expenses incident to the private foundation rules.

Senator PACKWOOD. Senator Stevens has just arrived. Go right ahead, Ted.

STATEMENT OF HON. TED STEVENS, A U.S. SENATOR FROM THE STATE OF ALASKA

Senator STEVENS. Thank you very much, and I thank you for agreeing to put this bill on the agenda today. I would ask that my complete statement be placed in the record.

[The prepared statement follows:]

A BILL, S. 1757, CONCERNING A CLARIFICATION OF THE INTERNAL REVENUE CODE RELATING TO THE TAX EXEMPT STATUS OF CERTAIN AMATEUR SPORTS ORGANIZATIONS

Remarks of Senator Ted Stevens

before the

Committee on Finance

Subcommittee on Taxation and Debt Management

UNITED STATES SENATE

Washington, D.C.

December 11, 1981

Thank you Mr. Chairman. I am pleased to appear before the Committee today to discuss a problem relating to the tax exempt status of certain amateur sports organizations. Before I do that, I would like to especially thank my good friend from Oregon for setting up this hearing today. It is an important measure which can lift a tax barrier to our nation's efforts for the Olympics, and I thank him for his understanding in this matter.

Briefly, let me outline the problem to the committee. In 1976, the Congress amended section 501(c)(3) of the Revenue Code by section 2702 of the Tax Reform Act of 1976, which made it easier for certain amateur sports organizations to receive tax exempt status.

This amendment was the product of Senator Culver's efforts, and it was intended to help clear up the inconsistencies in the tax code and assist those organizations that were organized and operated to foster national and international sports competition.

During consideration of this amendment in conference committee, language was added excluding from consideration for tax exempt status those organizations which provided training facilities and equipment.

This was done, according to the conference committee report and statements on the Senate floor, to prevent health spas and social clubs from obtaining a tax windfall.

Unfortunately, Mr. Chairman, even though the clear intent of the Congress was not to deny tax exempt status to amateur sports organizations which foster competitive sports, and who provide training facilities and equipment, that is precisely what has happened.

The Internal Revenue Service, feeling that their hands are tied in this matter, has read the statute literally to mean that no tax-exempt organization may provide training facilities and equipment.

Mr. Chairman, for five years, and especially since the 1978 Amateur Sports Act spun off new national governing bodies for competitive sports, this statute has caused tremendous financial problems for the amateur sports world. Many of the development drives that assist and prepare our Olympic athletes are at a standstill simply because it is necessary for many of these organizations to provide training facilities and equipment.

Not only has this ambiguity in the tax code caused the sports organizations grief, but it has created an administrative headache to the Service as well. As I understand it, there are over 100 501(c)(3) applications pending at the Internal Revenue Service, on which no action can be realistically taken until this ambiguity is cleared up.

Other witnesses will go into greater depth on this matter, but I would like to share with the committee the progress that has been made so far in resolving this problem.

Shortly after I introduced S. 1757, staff from my office, the Treasury Department, House Ways and Means, the Joint Tax Committee and Senate Finance met. The product of their discussions is H.R. 4990, which was introduced in the House by Mr. Vander Jagt of Michigan, and is now pending before committee.

Mr. Chairman, the House version of S. 1757 is merely a technically different way of approaching this problem, and I would be happy to support it as well. It really doesn't matter how we technically resolve this problem, but we must take care of it soon, because many of these organizations simply cannot exist if donors are not able to make charitable contributions to them.

What this bill does, Mr. Chairman, is to restate, clarify and fully implement the intent of Congress that was expressed five years ago.

Thank you, Mr. Chairman, for the committee's consideration of this bill. I would be happy to answer questions that you might have.

Senator STEVENS. The problem is a simple one. In 1976 the Congress amended section 501(c)(3) of the Revenue Code, by section 2702 of the Tax Reform Act of 1976, which made it easier for certain amateur sports organizations to receive tax-exempt status. That amendment was the product of Senator Culver's efforts, and it was intended to clear up the inconsistencies in the Tax Code and assist those organizations that were organized and operated to foster national and international sports competition. During the consideration of the amendment in the conference committee, language was added excluding from consideration for tax-exempt status those organizations which provided training facilities and equipment. This was done, according to the conference committee report and statements on the floor, to prevent health spas and social clubs from attaining a tax windfall.

Unfortunately, even though the clear intent of Congress was not to deny tax-exempt status to those amateur sports organizations which foster competitive sports and who provide training facilities and equipment, that's precisely what happened. The Internal Revenue Service, feeling their hands are tied in the matter, has read the statute quite literally to mean that no tax-exempt organization may provide training facilities and equipment.

Now, the difficulty is for 5 years, and especially since the 1978 Amateur Sports Act spun off new national governing bodies for competitive sports, this statute has caused tremendous financial problems for the amateur sports world. Many development drives strive to assist and prepare our Olympic athletes. Many of those are at a standstill simply because it is necessary for many of the organizations to provide training facilities and equipment; that's their reason for being.

Not only has the ambiguity in the Tax Code caused sports organizations grief but it has caused and created an administrative headache for the IRS as well. As I understand it, there are over 100 501(c)(3) applications pending at the Internal Revenue Service, and that no action can realistically be taken until the ambiguity is cleared up.

I'm sure other witnesses will go into this in depth. I've introduced this bill, and there is also 4990 that has been introduced by Guy Vander Jagt in the House. My interest, frankly, stems from the time that I served as a member of the President's Olympic Sports Commission for President Ford, and I just think that this is a mistake and that we ought to clarify it, particularly for those bona fide organizations that are organized to assist in developing amateur athletes for the Olympics and the national sports competitions. They must have facilities in order to train their people. And that's their reason for being, to organize, to raise the money and provide the facilities so these athletes can train. I would hope the committee would help us by recommending that that ambiguity be rectified.

Senator PACKWOOD. Do you know anything about the hobgoblin the Treasury raises that somebody who is very wealthy is going to make a donation to one of these particular clubs and then that club is going to agree to take that person's son or daughter and train them, and basically it becomes a tax dodge for the wealthy

donor? That's as best I could understand the Treasury Secretary's argument.

Senator STEVENS. I understand that, and I think that can be made by fencing it in terms of the number of participants, that they have to provide facilities for more than x-number of people who are nonrelated to the donor.

I don't see anything wrong with the fact that a donor may be motivated by the fact that his or her son or daughter may have a great potential and they want to provide facilities that their children as well as many others may participate in. I can't see the personalized deduction for providing a jungle gym for your own son, but I do think that it ought to be possible to endow a swimming pool that your child or grandchild might use to compete with a lot of those people.

Senator PACKWOOD. I agree.

Senator STEVENS. I do think it's possible to create the circumstance that eliminates that fear that has been expressed to me, too.

I thank you very much, Bob.

Senator PACKWOOD. Ted, let me ask you just a quick question about the floor. What is our voting situation?

Senator STEVENS. We are now dealing with the Byrd amendment. There is a 40-minute time agreement on Byrd and Metzenbaum, and we still have the possibility that Bradley may raise one more question. There are three amendments, and then we will be finished with this bill. After that we will go to Treasury-Post Office.

Senator PACKWOOD. Thank you.

Senator STEVENS. Thank you.

Senator PACKWOOD. Let's take Mr. Lawrence A. Hough next. It's a panel: Mr. Hough, Mr. Counsil, and Mr. Wales.

STATEMENT OF LAWRENCE A. HOUGH, TREASURER OF U.S. OLYMPIC COMMITTEE

Mr. HOUGH. Thank you, Senator.

My name is Lawrence Hough. I'm treasurer of the U.S. Olympic Committee, in which capacity I serve as a volunteer. I competed in international rowing competition from 1966 to 1976. I was a member of the U.S. Olympic teams in 1968, 1972, and 1976. In 1968 I represented this country in Mexico City and won a silver medal, and I won the world champion title in competitions in France in 1967 and Austria in 1969. I call this record to your attention because I am keenly aware of the dramatic impact fundraising had in my own experience, and I attribute a lot of my success to the fact that the law at that time supported the kinds of monetary support I needed to have the equipment I used in my athletic competitions.

We are here, this panel, whom I would like to introduce to you, to urge the passage of S. 1757. On my right is John A. McCahill, special counsel to the U.S. Olympic Committee; on my immediate left is Roger Counsil, executive director of the U.S. Gymnastics Federation; and on my far left is Ross Wales, president of U.S. Swimming, Inc., and general counsel to the U.S. Diving Federation.

As Senator Stevens outlined, we are faced with a major problem in generating revenues to support our athletes. It is particularly significant at this time, in my judgment, because in 1984 we are

hosting the Olympic games in Los Angeles, the first time in many, many years in which this country has had this honor.

The programs that we need to have in place this winter and next summer in the year before the pan-American games and just 2 years before Los Angeles require funding, which in turn requires relief from the present problem, as Senator Stevens mentioned.

At issue is the need to simply clarify the law passed in 1976. At that time we attempted to insure the exempt status for any amateur sports organizations whose sole purpose is to support the best of our athletes training for national and international competition. Unfortunately, as you have heard first from Treasury and then from Senator Stevens, because of a technical issue we did not succeed in doing what we set out to do.

Indeed, the U.S. Olympic Committee's own programs, in addition to the national governing bodies and other primary sports development organizations, are threatened by the present 501(c)(3) interpretation by IRS. I think it would be appropriate for the committee to hear the remarks of Roger Counsil and Ross Wales, who speak on behalf of two of the national governing bodies and two organizations, in that they speak for diving, swimming, and gymnastics, whose record in international competition is of great significance to this country.

[The prepared statement follows:]

90-975 O - 82 - 3

Statement of

Lawrence A. Hough
Treasurer of the United States Olympic Committee

My name is Lawrence A. Hough and I am the Treasurer of the U.S. Olympic Committee. I competed in international rowing competition from 1966 through 1972 and was a member of the U.S. Olympic Teams in 1968, 1972, and 1976. In 1968, I won a silver medal in the pairs event and was world champion in that event in 1967 and 1969.

I am here today to urge the passage of S.1757.

In 1976, Congress amended the Internal Revenue Code in order to make it easier for amateur sports organizations to obtain tax-exempt status. From my own experience, I can assure you that this tax status is of critical importance to funding the development of world class amateur athletes. Unfortunately, as a result of the Internal Revenue Services' interpretation of the 1976 amendment, it is now more difficult for amateur sports organizations to obtain tax-exempt status than before the Tax Reform Act was passed. For example, several national governing bodies recognized by the United States Olympic Committee under the Amateur Sports Act of 1978 are unable to obtain 501(c)(3) status. Among them are the following national sports organizations: United States Diving, the Track Athletics Congress, the United States Volleyball Association, and the United States Amateur Confederation of Roller

Skating. I have also been informed that the American Horse Show Association, the national governing body for equestrian sports, as well as the national governing bodies for the sports of modern pentathlon and biathlon, have also been denied tax-exempt status on the basis of the 1976 amendment. It appears that all national governing bodies and similar organizations are in imminent danger of losing 501(c)(3) status. Unless this problem is resolved now, a substantial part of the programs which support our men and women athletes will go unfunded. I can say without reservation that our performance in the international sports arenas will suffer and the U.S. team at the XXIII Olympiad in Los Angeles will be inadequately prepared for competition.

The purpose of Congress is amending Section 501(c)(3) of the Internal Revenue Code by Section 1313 of the Tax Reform Act of 1976 was to clarify the law by eliminating the inconsistency which existed in the prior law and under which some amateur sports organizations were granted exempt status under Section 501(c)(3), while other apparently similar organizations were not. See, Conference Committee Report, 1976-3 (Vol. 3) C.B. 807, 946; 122 Cong. Rec. S. 13613 (1976). The change added to the organizations qualifying for exempt status those organizations which are established and operated ". . . to foster national and international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment). . ."

The difficulty we are having stems from the fact that the Internal Revenue Service interprets the "facilities or equipment" clause literally to mean that an amateur sports organization is ineligible for tax-exempt status if, for example, it provides uniforms, or a place to shower for its teams, or, in the instance of my sport, an expensive rowing shell. Clearly, this is unrealistic -- such a literal interpretation would eventually exclude all major amateur sports organizations in the United States, including the United States Olympic Committee and all national governing bodies recognized pursuant to the Amateur Sports Act of 1978. As the quality of competition has increased over the past years, more and more financial support has been required to keep U.S. athletes at the forefront of world competition. Much of the necessary funding has been created by the efforts of the Olympic Committee, the national governing bodies, and similar sports organizations. It is now common for the organizations responsible for this country's representation in international amateur athletic competition to equip and outfit national teams to compete abroad or in this country against teams from other countries. Such teams may train together at facilities owned or rented by the organization. In addition, training camps in nearly every sport are provided for the development of young athletes and for training of our top international caliber athletes. Each of these functions would appear to conflict with a strict interpretation of Section 501(c)(3).

To prepare this testimony today, I received a briefing on the underlying intent of the "facilities and equipment" exclusion. According to the Conference Committee Report, it was added to prevent organizations like "social clubs" from qualifying for the receipt of tax deductible contributions under the amendment made by Section 1313 of the 1976 act. 1976-3 (Vol. 3), C.B. 807, 946. Senator Culver of Iowa, during his testimony before the Senate, in introducing the original amendment, clearly stated that this phrase was intended to deal with such "social clubs," and not disqualify organizations which supported development of our Pan American and Olympic Team athletes.

> I would like to emphasize one point about this provision. It is not intended to make social clubs, or organizations of casual athletes, into tax-exempt charities. Only an organization whose primary purpose is the support and development of amateur athletes for participation in international competition in Olympic and Pan American sports will qualify under this amendment. Organizations whose primary purposes are the recreation of their members or whose facilities are used primarily by casual athletes will not qualify. (122 Cong. Rec. §13613 (1976)).

Throughout the Senate debate, it was also clear that the amateur sports organizations I have mentioned would qualify for exemption even if they provided facilities or equipment. For example, Senator Culver further stated:

> Mr. President, the purpose of this other amendment is to insure that amateur sports organizations are eligible for tax-exempt status under Section 501(c)(3) and to make contributions to such organizations deductible if the organizations' primary purpose is the support and development of amateur athletes for participation in national and international competition. The activities involved include, but are not limited to, administration, competition, training, coaching, medical care and insurance, maintenance of sports facilities and equipment research, financial assistance, and dissemination of information. (Emphasis added.)

Senator Long stated:

> As I understand the explanation of the Senator from Iowa, this amendment will provide charitable tax-exempt status and qualification to receive tax deductible contributions for two types of amateur sports organizations. The first type consists of national organizations which are responsible for the conduct of national and international competition, including the conducting of national championships and the selection of national teams in Olympic and Pan American sports. The second type of organization includes national, local and regional organizations whose primary purpose is supporting and developing amateur athletes for participation in national and international competition in Olympic and Pan American sports. These organizations provide coaching and training facilities for amateur athletes. (Emphasis added.)

It should be noted that the amendment to Section 501(c)(3) was not intended to deny exemption to those organizations which would have qualified (or which did so qualify) under Section 501(c)(3) under the law prior to such amendment. (Sec. 1313 (c) of the 1976 Act.) Furthermore, as noted above in the record of

Senators Culver and Long, many amateur athletic organizations which were qualified for exemption under Section 501(c)(3) under the law prior to the 1976 amendment were known to provide "facilities" as part of their activities. The ownership, use, leasing, or providing of facilities was an acknowledged part of their activities and had not been a deterrent to their receiving an exemption under Section 501(c)(3), as it existed prior to the amendment. However, the unexpected effect of the parenthetical phrase appearing in Section 1313 of the 1976 Act has been to create a new inconsistency by denying exemption to those organizations which were intended to be benefited by the amendment and which, like the organizations exempt under prior law, owned, leased, or furnished facilities or equipment.

Therefore, the United States Olympic Committee believes it would be desirable to amend the language of Section 501(c)(3) so that it more properly reflects the concern of Congress with respect to the type of amateur sports organizations which should, or should not, receive tax-exempt status.

Passage of S.1757 would permit not only the United States Olympic Committee and national sports governing bodies but other organizations which nevertheless operate <u>exclusively</u> to foster national or international amateur sports competition (such as track clubs, swim clubs, and the like) to qualify for tax

exemption. The S.1757 language would continue to exclude from tax-exempt status any social club which does not primarily foster such competition. This was the intent of the amendment originally proposed by Senator Culver in 1976.

Let me emphasize in closing that for many of our nation's athletes in sports which are already underfinanced, the situation has become intolerable. For some, contributions are falling off since donors cannot deduct their donations from Federal Income Tax. These contributions are the base of support to send our most promising athletes to competitions this winter and next summer and to provide them with the best available equipment. In other more affluent sports, the effects are building more gradually, but the result will be no different. Their programs will certainly erode and future teams will be selected from a smaller base of athletes who will not be as well prepared.

I believe it is critical that we pass corrective legislation before Congress adjourns. This will ensure a strong sports program in 1982, a critical year for our athletes in that it is the next to the last year before we play host to the nations of the world in Los Angeles at the XXIII Olympic Games.

Mr. HOUGH. I would like to introduce at this time Mr. Ross Wales.

Senator PACKWOOD. Mr. Wales.

STATEMENT OF ROSS E. WALES, PRESIDENT OF U.S. SWIMMING, INC., AND GENERAL COUNSEL FOR U.S. DIVING, INC.

Mr. WALES. Mr. Chairman, Senator Danforth.

I would like to take this opportunity to thank Senator Stevens who, as you know, has been a great friend of amateur sports in this country, for recognizing and responding to a problem that was created under the 1976 amendment to 501(c)(3). I think it is ironic that that amendment which was intended to help amateur athletic organizations has done just the opposite.

I believe that the idea was to recognize that certain types of athletic organizations were charitable. They wouldn't have to claim that they were educational institutions, which so many of them did in order to obtain tax exemption prior to 1976. But at least before 1976 they could make a good argument for exemption. Presently if the national governing body wants to do its job as it perceives its job to be under the Amateur Sports Act of 1978 it has to forgo tax exemption. If it wants to be tax exempt, it has to let other organizations develop its athletes, and it must send its national team in competition against the rest of the world based upon the equipment that the athletes themselves must provide and can afford.

I do not think it was the intent of the Congress when they passed the legislation to send our teams into international competition in cutoffs or anything of the like.

Fortunately, in my sport, the only real equipment we are talking about is swimwear, swimsuits, a very reasonably afforded item. The U.S. Luge Association doesn't have that luxury. They decided to forgo tax exemption because the way they build their sport is to provide athletic equipment and facilities for a sport that is not very well known throughout the country.

Senator PACKWOOD. Which sport is that, sir?

Mr. WALES. U.S. luge, which is sliding down a hill, iced, on a luge sled. It is very expensive equipment, very difficult to find the facilities in which to do that.

Senator PACKWOOD. Is that an Olympic sport?

Mr. WALES. Yes; it is. Part of the reason you don't hear more about it is because of the expense of the facilities.

U.S. diving, like swimming, just requires a swimming suit. It has sought tax exemption, but it has not been able to get it. It did, prior to 1976, but it can't anymore. As a result, it cannot solicit contributions and its volunteers cannot deduct their out-of-pocket expenses.

I do not believe that the bill that is presently before this committee is a substantive tax bill. I think it's technical legislation needed in accomplishing what the Congress originally intended to do in 1976. And I would urge the Congress to pass this legislation as soon as possible.

Thank you.

[The prepared statement follows:]

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

Statement of

Ross E. Wales
President of United States Swimming Inc.,
and General Counsel for United States Diving, Inc.

on

S.1757 - A Bill to amend the Internal Revenue Code of 1954 to clarify the tax-exempt status of certain amateur sports organizations.

Presented December 11, 1981

Mr. Chairman, Senators, my name is Ross E. Wales; I am President of one National Governing Body ("NGB"), United States Swimming, Inc., and general counsel for another, United States Diving, Inc. My firm has assisted in the applications for tax-exemption of another half-dozen organizations which foster national or international amateur sports competition. All of them have had problems resulting form the unfortunate language of section 501(c)(3) of the Internal Revenue Code. I do not believe these problems were contemplated by the Congress when it added the language regarding such organizations in 1976. Public Law 94-455, Section 2702.

The intent of the added language was to equalize the treatment of organizations that fostered national and international sports competition, regardless of whether they were "educational," the term which some athletic organizations relied upon for exemption prior to the amendment. The legislative history stated that the restriction regarding the provision of athletic equipment or facilities

> is intended to prevent the allowance of these benefits for organizations which, like social clubs, provide facilities and equipment for their members. This provisions is not intended to adversely affect the qualification for charitable tax-exempt status or tax deductible contributions of any organization which would qualify under the standards of existing law.

While I agree that social clubs should not be able to obtain exemption just because they may be athletic, I believe the 1976 proviso painted with far too broad a brush and makes life

unnecessarily difficult for organizations which are not social clubs.

The proviso added in 1976 has placed NGBs on the horns of a dilemma: either they forgo tax-exemption or they fall short of their responsibilities under the Amateur Sports Act of 1978. That Act gave to each NGB the authority and responsibility to serve as the coordinating body for its respective sport, including the development of interest and participation and the selection and supervision of a national team. To fulfill their obligations, most NGBs would like to provide training facilities and quality equipment for their National Teams, as well as providing facilities and equipment to developing athletes. Unfortunately, whenever an NGB takes youngsters to a training camp and lets them use its facilities or whenever it sends a team into international competition with the best equipment available, the IRS interprets it as the providing of athletic facilities and equipment.

We have obtained within the last two years tax exemption for the NGBs for the sports of Swimming, Water Polo, and Synchronized Swimming, but only after those NGBs agreed with the IRS that they would not provide ahtletic equipment or facilities to their member athletes. This means that the U.S. Swimming Team that competed against the Russians in August could not wear a team suit, and the U.S. Water Polo Team members that competed in the World Cup in Long Beach last spring had to bring their own balls to practice. I can

assure the Committee that an inordinate amount of lawyers' time has gone into the issue of what these NGBs can do to produce a first-rate program and national team without exceeding the limitation of section 501(c)(3).

United States Diving applied for tax-exemption in June of 1980, but its application was placed in suspense because of confusion created by the language of the 1976 amendment. It presently equips its national team with diving suits, but is unable to accept tax-deductible contributions, or to advise its officials and administrators that their out-of-pocket expenditures for the sport can be deducted. In addition, Diving has commitments from at least six individuals who wish to become life members of the organization, as soon as their $1000 contribution can be tax deductible. While this sum may be quite small with the regard to the federal treasury, it is very significant to an NGB that captures a disproportionately large number of medals for the United States at the international level.

Another example is the United States Luge Association, which has chosen not to apply for tax exemption at this time because it would create more hardship than it is worth. Few people are aware of Luge in the United States, and few people have even seen a luge run or a luge sled. The equipment in this sport is very expensive, and if the NGB continues to rely upon the finances made available to it in the past to develop the sport, we will continue to take no medals in

international competition in Luge. The best way to develop a broad participation in the sport is to introduce youngsters to the sport at schools and recreational facilities. In fact this is what the organization does; by taking equipment to schools and allowing children to see and to use the equipment, the sport can attract interested participants, some of whom may later go on to become Olympians. Moreover, the National Luge Team trains at facilities provided by the NGB in Lake Placid. Obviously this provision of athletic equipment and facilities means that the U.S. Luge Association cannot presently obtain tax exemption. As a consequence it is no doubt losing contributions, and its volunteers are losing a benefit that other sports have.

All of the NGBs that I have mentioned were, prior to the Amateur Sports Act of 1978, governed by committees of the old Amateur Athletic Union. The AAU was determined in the early 1950's to be an educational institution, and therfore exempt under 501(c)(3). Contributions to the sports were deductible, as were officials' expenses in support of the sports, and the sports themselves did not worry about having to file tax returns if their revenues exceeded their expenses in any particular year.

Senate Bill 1757 would eliminate the dilemma for NGBs, but I do not believe that the definition of "qualified amateur sports organization" makes a clear distinction between a national governing body and a social club that may

have an interest in Olympic sports. Clearly national governing bodies would be included, but other organizations would be left to argue whether they were organized primarily to conduct a competition, or to support and develop athletes, as opposed to some other effort.

I would direct the Committee's attention to House Bill 4990, which would accomplish the same goals as would Senate Bill 1757, but would take into specific account differences between various sports organizations. It would remove all reference to the provision of athletic equipment and facilities with regard to tax exemption of an organization organized to foster national and international athletic competition under section 501(c)(3), but it would disallow any deduction for contributions made under section 170(c) to any such organization that provided athletic facilities or equipment to the contributors's family members. Excepted from this general rule would be contributions to the United States Olympic Committee and NGBs, contributions of less than $500 per year, and out-of-pocket expenses incurred by a non-athlete who renders service to such an organization.

Every NGB has among its membership clubs which really perform an educational service, by teaching youngsters the fundamentals of sport, as well as discipline and sportmanship. There are many such member-clubs of United States Swimming that received their tax exemption prior to the 1976 amendment; every club which has applied since that time has been denied.

tax-exempt status. I believe that Senate Bill 1757 would permit these organizations to qualify for tax-exemption, but I believe House bill 4990 more clearly accomplishes this objective.

I agree with the intent of the Congress in passing the 1976 amendment to section 501(c)(3). I do not believe, however, that Congress' intent has been served. I believe that Senate bill 1757 more effectively achieves that intent than did the original amendment, but I also believe that House Bill 4990 provides an even better resolution to the problems I have discussed. I would strongly urge that legislation be passed as soon as possible so that Congress' original intent can be satisfied.

Senator PACKWOOD. Mr. Counsil.

STATEMENT OF ROGER COUNSIL, EXECUTIVE DIRECTOR OF THE U.S. GYMNASTICS FEDERATION, FORT WORTH, TEX.

Mr. COUNSIL. Mr. Chairman and Senator Danforth, the U.S. Gymnastics Federation is the sole national governing body for the sport of gymnastics in the United States, as mandated by the U.S. Olympic Committee and the Federation of International Gymnastics, which is the international governing body. We are a true federation, with representatives on our board from the university community, high schools, YMCA's, privately owned clubs, and other organizations that sponsor the sport of gymnastics.

We perform a diversity of services, which I mention only to highlight the financial activities that occur, from assembling teams for Olympic games, pan-American games, world championships, as well as many other foreign and domestic competitions. We conduct an annual coaches congress, we manage State and regional competitions, coordinate rulesmaking on other committees of our board, publish two bimonthly magazines, and conduct many training camps for senior and junior male and female athletes.

As we attempt to improve athletic excellence, a more concentrated, more intensive program is necessary. And of course, concomitant to this, the costs also escalate. Our concern for a needed change in the 501(c)(3) wording as it relates to the national governing bodies for amateur sports is keenly felt. Specifically, in our case we are existing at the present time without tax-exempt status.

When we moved to Texas 1½ years ago we applied for tax-exempt status as a Texas corporation and have been put on hold until the wording of the legislation has changed. As a consequence, we have had to bypass one potential sizable donation which ultimately went to another organization, the Boy Scouts, a notable cause, to be sure, but so is ours. At the present time we cannot compete with groups such as the Boy Scouts under our present tax structure.

We now have an offer of land and an administrative office building which will be built by a donor, which is an industry, as soon as that donation can be claimed as a donation to a tax-exempt organization. And, of course, that project is also awaiting clarification of our status.

We cannot approach foundations for financial support through grants for projects that we need to undertake, an example being sports medicine research into chronic injuries common to gymnastics. We find in most cases that the moneys earmarked to be given by foundations, industries, and individuals will ultimately be given to some organization. We are caught in a dilemma in that many other nations' amateur sports governing bodies receive ongoing Federal support. Canada, for instance, receives 70 percent of its support from its Government. The Eastern-bloc nations, of course, are quite supportive. I am not advocating this, because it violates our ideals, quite obviously. But we need to be able to function efficiently within our present system; consequently, I urge modification of the present 501(c)(3) language.

Thank you.

[The prepared statement follows:]

90-975 O - 82 - 4

Statement of

Roger Counsil
Executive Director for United States Gymnastics Federation

The United States Gymnastics Federation (USGF) is the National Governing Body (NGB) in the United States recognized by the U.S. Olympic Committee pursuant to the Amateur Sports Act of 1978. The International Gymnastics Federation, which is the international governing body for Gymnastics also recognizes us as the NGB for our sport in the United States. The USGF is solely responsible for assembling U.S.A. Gymnastics teams for such international competition as the Olympic Games, the Pan-American Games, and the World Championship of Gymnastics. Additionally, the USGF conducts separate annual national championships for men and for women and separate Junior Olympic Championships for boys and girls. There are many additional competitions on both the national and international levels. A recent survey indicates that there are 10.8 million young people participating in some gymnastics activity.

Besides competitions at the national and international levels, the USGF has developed a complete network of state and regional competitions throughout the U.S.A., including Hawaii and Alaska. Within the Committee structure of the USGF Board of Directors, the organization concerns itself with making and enforcing rules, protecting athletes' rights, and communication with the American Gymnastics community through the media of two magazines and an annual coaches' congress.

The annual budget of the USGF in 1981 was $1,930,926.00, an increase of approximately $500,000 over 1980. Our financial picture has improved in recent years, but it has barely kept

pace with the increasing demands of assembling, training, and providing competition for our teams. Also, a growing demand for more workshops and clinics and a more complete system of information dissemination is straining our limited resources.

Historically, the United States Gymnastics Federation has received some donations from individual donors, along with some minimal donations from foundations. However, since the USGF moved its administrative offices in 1980 from Tucson, Arizona, to Fort Worth, Texas, we have been in a frustrating position. When we filed for incorporation in Texas, we were required to re-apply for 501(c)(3) status, even though we had 501(c)(3) status when we were not a corporation. Our application for recognition as a 501(c)(3) tax exempt organization was submitted to the regional IRS office about a year and half ago but the IRS informed us that we cannot regain our tax exempt status until the wording of the existing 501(c)(3) tax law is modified since we occasionally provide our athletes with modest equipment and facilities such as uniforms and a place to compete.

During our time in Forth Worth, we have been conducting business from a temporary office building. We have been offered the use of a new administrative office building and the land to build it on by a potential donor. However, he is unable to make the donation until he can claim it as a donation to a 501(c)(3) tax-exempt organization. We have been unable to accept cash donations or to approach foundations, seriously narrowing our financial base. Our volunteer officials who pay their own travel expenses, are unable to deduct these expenses because of our status. In fact, our counsel has advised us

to engage in no fund-raising until we receive 501(c)(3) status again.

We find that the U.S.A. Gymnastics Team and all U.S.A. teams, for that matter, are usually in the unenviable position of competing against nations that receive direct governmental subsidy. Sports programs in Canada receive about 70% of their expenses from the government. The stories are almost legendary regarding the extent of govenmental support received by athletes and sports programs in Eastern Bloc nations. In China, and even in West Germany, for example the governments subsidize most of their sports programs.

We do not resent the fact that we don't receive federal support of our programs--it is the American way. We do ask, however, that we be allowed to function in the American system without handicaps so that we can effectively fulfill our mandate--the development of our youth through the sports experience.

I urge the prompt passage of this corrective legislation.

Senator PACKWOOD. Any one of you who knows the answer can answer this question: Is there any merit to Treasury's argument about their fear of a rich person's money going to any of your organizations, almost earmarked to train their son or daughter?

Mr. WALES. I think that could be termed an abuse, as I understood the Secretary to say.

Senator PACKWOOD. Is this likely to happen?

Mr. WALES. It may. There are abuses of that kind everywhere, and that's why the IRS does such a good job in auditing everybody's returns. That's obviously a sham situation, if that is the case. Someone who is going to make a contribution of a few thousand dollars to a program that has hundreds of children benefiting from it, I don't think that's the kind of situation that legislation should prevent. I think the determination can be made by the IRS on a case-by-case basis, Mr. Chairman, as it does in just about every other area of contributions.

Senator PACKWOOD. Well, it would almost have to be a bogus organization to have any extraordinary tax benefit to the donor if they are going to give that son or daughter extended attention as opposed to a hundred others.

Mr. WALES. I have been familiar with sports organizations that claim to be such, where one athlete was the only member of that tax-exempt organization.

Senator PACKWOOD. Oh, is that right?

Mr. WALES. Now, I think that is a bogus situation. But to try to draft legislation to prevent that, I think you are going to end up with the same problem you had in 1976 where you threw the baby out with the bath, in far too broad an effort to try to prevent that.

Senator PACKWOOD. Well, as you heard me comment to Treasury Secretary Glickman, I've been here now a dozen years, and almost every time we attempt to correct a miniscule abuse, we end up causing more problems than we cure. And you almost might be better off to allow the abuse to go on—of course, you hate to say that—rather than trying to draw regulations that all of you have to adhere to. For 99 percent of you they are moot, anyway, because you are not going to do anything, whether the regulations exist or not, that would violate anybody's sense of propriety.

Mr. WALES. I agree wholeheartedly with the chairman in your use of the term "regulation." If there is a problem, I think it can be best addressed by the IRS in regulation rather than trying to etch it in stone in Federal enactment.

Senator PACKWOOD. Well, let me congratulate you. A group of Olympic athletes and others made an excellent presentation earlier on Senator Stevens' bill about contributions to the Olympic Committee, and you have followed well in this case. You make a very fine case. You did a good job. Thank you.

Mr. HOUGH. Thank you, Mr. Chairman.

Senator PACKWOOD. I am going to have to take a recess and go vote. Senator Danforth may be back before I get back. I told him to go early. He will go on to S. 1883 and conclude with S. 696.

I might say to Mr. Maxwell, you are not going to have to oversell your case. You are in a unique position. The Treasury Department supports you. That doesn't happen very often on these bills that come before us.

So I will ask Senator Danforth to start the hearing, and I will be back in about 10 minutes.

[Whereupon, at 10:43 a.m., the hearing was recessed.]

AFTER RECESS

Senator DANFORTH. Mr. Maxwell, as a lawyer, I was told that after you've won your arguments, don't say anything more. I think you've won and you have the administration supporting you, but if you would like to proceed at your risk, go ahead.

STATEMENT OF DAVID O. MAXWELL, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, FEDERAL NATIONAL MORTGAGE ASSOCIATION

Mr. MAXWELL. Senator Danforth, thank you. I will be very brief, bearing in mind that adage.

I appreciate the opportunity to testify in support of S. 1883, which has been introduced by you and other Senators. This bill would accord to Fannie Mae the same income and loss-averaging treatment for tax purposes as is currently afforded other financial institutions.

I might say, Senator Danforth, that this bill in the Ways and Means Committee has been amended to reflect some concern that Fannie Mae not sell mortgages in order to recapture taxes paid in the years covered by this bill.

I testified in the Ways and Means Committee 2 days ago to the effect that we had no intention of doing that, and in fact there would be sound business reasons why we would not. I haven't seen the precise language of that amendment yet, but in concept we have no problem with it. And if it is worded to reflect the actual concern of the Ways and Means Committee, as I understand it, we wouldn't have any problem with it at all.

As you know, Fannie Mae is a private corporation chartered by Congress for only one purpose, and that's to provide assistance, liquidity and stability to the home mortgage market. As such, it has been a key to maintaining a stable flow of money into the mortgage sector. This has been the case particularly in past occasions of credit shortage and indeed this year as well, Senator Danforth. Even though we have had our problems this year, we have purchased more than 98,000 home mortgages for a total value of about $5 billion. Indeed, it has been said that in the secondary market this year Fannie Mae has often been the only game in town.

Over the years Fannie Mae has operated by borrowing in the short or intermediate term to buy mortgages which were, of course, long term. Since 1978, generally speaking, short-term rates have been higher than long-term rates and interest rates in the economy have moved steadily upward.

We now hold $60 billion in mortgages, which is 1 in every 20 home mortgages in America, and they yield us an average rate of 9.7 percent. But during this year and particularly at one point this summer we have had to borrow at rates of up to 18 percent to finance the debt that we incurred to buy these mortgages.

S. 1883 as amended, if it is amended, would permit us to carry operating losses generated by our long-term investments in mort-

gage loans back 10 years and forward 5 years, as do other financial institutions. At present we carry our losses back 3 years and forward 15, like manufacturing companies and commercial enterprises.

We support this amendment on the basis of tax equity and parity and our comparability to financial institutions that were given the 10-year carryback in 1969 when Fannie Mae was still in the process of coming out of the Federal Government.

We are essentially a bank chartered by Congress to invest in mortgages and, like thrift institutions, our business is to acquire home mortgages, albeit we do it at the secondary market level. We have no business other than that.

So the same economic conditions that have affected the profits and losses of thrift institutions have affected us. Our cycles are tied closely to theirs.

The legislation would be applicable to losses beginning with 1982, so the carryback would be to years commencing in 1972. There have been various figures as to the revenue effect on the Federal budget cited in the joint committee print and by the Treasury Department. These simply reflect differences in forecasts about interest rates. I think that I could invite you to accompany me to talk to 10 economists, and you would get 10 different forecasts of interest rates for 1982. That accounts for the difference in these forecasts. But with the decline recently in interest rate levels, we believe that the effect in the 1983 fiscal year will be less than originally had been supposed. And, of course, the net effect overall will be of no cost to the taxpayers because we could carry the losses forward if we couldn't carry them back.

This bill is supported by all of the major groups involved in residential housing. They are the American Bankers Association, the American Savings & Loan League, the Mortgage Bankers Association of America, the Mortgage Insurance Companies of America, the National Association of Home Builders, the National Association of Mutual Savings Banks, the National Association of Realtors, the National Savings & Loan League, and the U.S. League of Savings Associations. And, Mr. Chairman, I have with me letters from these organizations which, with your permission, I would like to enter in the record.

[The letters follow:]

USL
UNITED STATES LEAGUE of SAVINGS ASSOCIATIONS 111 EAST WACKER DR./CHICAGO, ILLINOIS 60601/TEL. (312) 644-3100

WILLIAM B. O'CONNELL
President

'81 DEC -7 AM 2

December 3, 1981

The Honorable Bob Packwood
Chairman, Subcommittee on Taxation
and Debt Management
Committee on Finance
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

The U.S. League of Savings Associations* wishes to express support for S. 1883. This legislation would conform the net operating loss (NOL) carryback and carryforward treatment of the Federal National Mortgage Association (FNMA) to that of the other financial institutions serving the important housing industry.

The importance of FNMA to the housing and finance industries is unquestionable. Throughout the past three years of rising interest rates and declines in the housing market, FNMA has continued to borrow money to provide liquidity to the home mortgage market. It buys mortgages from primary lending institutions so that they can restructure their portfolios and lend more money to home buyers. So far in 1981, some 93,000 home mortgage loans were purchased by FNMA with a total value of about $5 billion. FNMA now holds $60 billion in mortgages -- one of every 20 home mortgages in America.

FNMA continues its strong commitment to housing in the midst of the worst housing year since 1946. The home building industry is now in its 34th consecutive month of decline with housing starts down from 2,020,000 units in 1978 to a seasonally adjusted annual rate of 937,000 units for the first eight months of this year. With the volume of housing sales down 45% since 1978, the entire housing industry, including those who finance it, are in serious trouble.

---

*The U.S. League of Savings Associations has a membership of 4,400 savings and loan associations representing over 99% of the assets of the $625 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, stock and mutual. The principal officers are: Roy Green, Chairman, Jacksonville, FL; Leonard Shane, Vice Chairman, Huntington Beach, CA; Stuart Davis, Legislative Chairman, Beverly Hills, CA; William B. O'Connell, President, Chicago, IL; Arthur Edgeworth, Director, Washington Operations; Glen Troop, Legislative Director; and Phil Gasteyer, Associate Director, Washington Operations. League headquarters are at 111 East Wacker Drive, Chicago, IL 60601. The Washington Office is lcoated at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

A principal cause of our disastrous housing situation is the difficulty of our traditional housing lenders to operate in a high interest rate environment. Indeed, the financial institutions, which have long provided mortgage credit for our nation's home builders and owners, have suddenly become the innocent victims of rising costs and low-mortgage portfolio yields. Spurred initially by inflation and then by the government's tight monetary policy to fight inflation, interest rates have continued to remain inordinately high causing great economic dislocation and hardship. High interest rates have crippled FNMA in the same way as our nation's primary mortgage financing institutions, i.e., FNMA's money costs exceed their fixed, low-mortgage portfolio income. With continued instability in the financial marketplace and inevitable high interest periods in the future, FNMA will face additional unrefunded operating losses unless the NOL tax law oversight is corrected.

In recognition of the significant risks and potential losses borne by long-term residential lenders, Congress provided them with a special net operating loss treatment in the Tax Reform Act of 1969. The loss provision was described in the words of the House Ways and Means Committee as "proper protection of the institution and its savers in light of the peculiar risks of long-term lending on residential real estate...". This NOL provision (10 years carryback, 5 years carryforward) adopted in section 172 of the I.R. Code provided this Congressionally intended protection to long-term mortgage lenders until intervention by the IRS some 10 years later. Then, in 1978, the IRS -- without any Congressional or judicial approval -- issued a regulation (1.593-6A(b)(5)(vi)) requiring that when a NOL is carried back, the tax base for computation of the savings and loan associations' bad debt reserve allowance in the prior profitable year must be recomputed by the amount of the carryback loss. This change effectively diminishes our tax refund benefit by 40%.

Additionally, in 1979, the IRS accelerated the change by providing that recomputation would be required for losses carried back from taxable years beginning in 1979 rather than starting in 1988 as originally proposed. Consequently, at a time when real protection for long-term residential lenders was needed, the IRS substantially undermind by regulation the net operating loss carryback benefits for savings and loan institutions. In view of increasing operating losses by our institutions, the savings and loan business requests your assistance and that of Congress in rescinding this overreaching IRS regulation and restoring our institutions' full NOL as originally intended by the 1969 Tax Reform Act.

However, Mr. Chairman, we want to make it very clear that we fully support FNMA participation in our net operating loss carryback and carryforward treatment, in spite of the fact they will enjoy greater loss carryback benefit (FNMA 100% vs. savings and loans 60%) than savings and loan institutions.

FNMA is important to the stability and future success of the housing industry and the benefits of IRC section 172 should not be denied or diminished for them or any long-term residential lenders facing their "peculiar", but very real market risks. Therefore, we strongly support the efforts of FNMA to secure as quickly as possible the more favorable loss carryback treatment outlined in S. 1883. This action will not only strengthen FNMA's own financial position but will better enable it to survive the up-and-down swings of today's financial cycles.

Sincerely,

William B. O'Connell

William B. O'Connell

MORTGAGE INSURANCE COMPANIES OF AMERICA
1725 K STREET, N. W., SUITE 1402 - WASHINGTON, D. C. 20006 - (202) 785-0787

JOHN C. WILLIAMSON
EXECUTIVE VICE PRESIDENT

STEVEN P. DOBKLER
DIRECTOR OF RESEARCH AND ECONOMICS

December 3, 1981

The Honorable Robert J. Dole
Chairman, Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, DC 20510

Re: S. 1883
Federal National Mortgage Association

Dear Mr. Chairman:

This Association strongly supports the subject bill and urges early and favorable action by the Senate Financing Committee.

The depressed state of the housing industry has generated increased dependence on the secondary market for residental mortgages. Originators of home mortgages experiencing repeated net outflows of savings have sought liquidity by increased reliance on the secondary markets. In the panorama of secondary market entities, the Federal National Mortgage Association stands out as the most significant; and recovery of the housing industry depends to a great extent on FNMA's continued effectiveness.

FNMA's experience during the last three years with an inverted yield curve has focused attention on an inequity in the Internal Revenue Code. This inequity penalizes FNMA as the only financial institution in the country that is unable to take advantage of the same carryback and carryforward treatment accorded financial institutions under section 172 IRC. At present FNMA may carry losses back three years and forward fifteen years, the tax treatment accorded business generally. However, Congress has accorded financial institutions a ten year carryback and a five year carryforward. This 10 year-5 year formula was accorded financial institutions in 1969 to insure against substantial losses resulting from a downturn in the economy. At that time-1969-FNMA was in a transition status to a wholly owned private corporation. We believe, therefore, that the failure to include FNMA in the legislation affecting other financial institutions was an oversight.

We strongly urge your Committee's early approval of the subject bill so that FNMA will be permited a needed planning and management tool in 1982 and subsequent years. The recovery of the housing industry in 1982 depends to a great extent on this action by the Congress.

We respectfully request that this letter be incorporated in the record of the hearings on this legislation.

Sincerely,

John C. Williamson
John C. Williamson

National Association of Mutual Savings Banks

NEW YORK, N.Y. 10166

Cable Address: Savings, New York

WASHINGTON OFFICE
FRANKLIN L. WRIGHT, JR.
ASSISTANT DIRECTOR—HOUSING COUNSEL
SUITE 300
1709 NEW YORK AVENUE, N.W.
WASHINGTON, D.C. 20006
TEL. 202: 783-6144

December 10, 1981

The Honorable Bob Packwood
Chairman
Subcommittee on Taxation and Debt Management
Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Subcommittee Hearings on Two Miscellaneous Tax Bills, December 11, 1981

Dear Mr. Chairman:

The National Association of Mutual Savings Banks takes this opportunity to express its support for S. 1883, legislation which would conform the net operating loss (NOL) carryback and carryforward treatment of the Federal National Mortgage Association to that of other financial institutions. Specifically, the legislation would extend FNMA's net operating loss carryback to 10 years and reduce its net operating loss carryforward from 15 to 5 years. We would also, respectfully, request that this letter be included in the printed record of the subcommittee's hearings on S. 1883.

The Federal National Mortgage Association, like most thrift institutions is encountering difficulty in coping with the tremendous volatility that characterizes financial markets today. FNMA plays an extremely critical role in the mortgage market and the passage of S. 1883 would enhance the ability of FNMA to provide much needed home mortgage credit.

While we strongly favor early action on S. 1883, we would also call to your attention the fact that the Internal Revenue Service has promulgated regulations which seriously undermine the benefit for thrift institutions of the net operating loss (NOL) provisions. As you know, the Tax Reform Act of 1969 granted thrift institutions a special method for treating net operating losses which would provide, in the words of the House Ways and Means Committee, "proper protection of the institution and its savers in light of the peculiar risks of long-term lending on residential real estate...". In 1978, the IRS -- without Congressional or judicial approval -- issued a regulation requiring that when a NOL is carried back, the tax base for computation of the thrift institution's bad debt reserve allowance in the prior profitable year must be recomputed by the amount of the carryback loss. This change effectively diminishes the tax refund benefit by 40 percent. Additionally, in 1979 the IRS accelerated the change by providing that

recomputation would be required for losses carried back from taxable years beginning in 1979, rather than phased through 1988 as was originally proposed. These administrative actions have substantially diminished the benefits of the NOL for savings banks at a time when real protection for long-term residential lenders is needed and we thus request the subcommittee schedule an early review of the entire NOL issue.

In closing, we wish to reiterate our strong support for S. 1883 and go on record as fully supporting its immediate passage.

Sincerely,

Franklin L. Wright, Jr.

Franklin L. Wright, Jr.
Assistant Director-Housing Counsel

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

James F. Aylward, CMB
President
Mortgage Bankers
Association of America
202-861-6501

December 8, 1981

The Honorable Robert J. Dole
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the Mortgage Bankers Association of America*, I would like to express our strong support for urgent action on S 1883. We believe that this amendment to conform the net operating loss carryback and carryforward treatment of the Federal National Mortgage Association (FNMA) to that of other financial institutions is important for the housing industry and the financial institutions which serve it.

---

*The Mortgage Bankers Assocation of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- o Mortgage Banking Companies
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Pension Funds
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D,C. 20005; Telephone: (202) 861-6500

S 1883 would amend Section 172 of the Internal Revenue Code to permit FNMA to carry back its losses ten years, as other financial institutions are permitted to do, rather than for three years as provided in current law. Congress enacted the ten year carryback provision for financial institutions in 1969 particularly in order to safeguard those financial institutions that invest in residential real estate.

It appears that failure to include FNMA in this provision at the time was an oversight. FNMA's present charter was enacted in 1968, but its transition to private status was not complete until 1970. Until now, this oversight has not been detrimental to FNMA's ability to provide additional capital for residential mortgage lending. However, both the housing and home mortgage finance industries are reeling from the effects of extremely high interest rates and continued inflation. The combination of these factors has foreclosed the opportunity of homeownership for millions of American families, particularly young and moderate-income families.

The grim statistics of the housing slump are clearly illustrated by the statistics of the home building industry.

The level of home construction is now in its 34th consecutive month of decline. The prospects are that 1981 will be the worst year for housing since 1946. The issuance of building permits has fallen from 1,801,000 in 1978 to a seasonally adjusted annual rate for the first eight months of this year of only 863,000 units. Permits for single-family homes have declined 41.5 percent from last year's level. Housing starts have also dropped precipitously from 2,020,000 units in 1978 to a seasonally adjusted annual rate of only 937,000 units for the first eight months of this year. And housing sales volume has dropped about 45 percent from 1978. Clearly, the housing industry is in serious trouble.

FNMA is an important link between the housing and finance industries. Throughout the past three years of rising interest rates and declines in the housing market, FNMA has continued to borrow money to provide liquidity to the home mortgage market. It has bought mortgages from lenders so that they can lend more money to homebuyers.

So far, in 1981, FNMA has purchased some 93,000 home mortgage loans with a total value of about $5 billion. FNMA now holds $60 billion in mortgages—one of every 20 home mortgages in America. To maintain and continue to add to this portfolio of mortgages, however, FNMA has been forced to absorb losses during this period.

In order that FNMA can continue to operate as effectively and efficiently as possible, it is vital that a significant oversight in the tax laws be corrected. FNMA must be permitted to average its losses and gains for tax purposes in the same manner as banks, savings and loans, and other financial institutions, rather than as if they were a manufacturing or retailing company, as is the case at present. Economic conditions affect the profits and losses of FNMA and other financial institutions in the same way. It is thus not only equitable, but important, to the stability of the industry to allow FNMA to cope with lengthening periods of high interest rates and inflation in the same way as other financial institutions.

In closing, we want to emphasize that it is important to act on S 1883 now. FNMA's new management is taking a number of steps to strengthen the corporation's financial position and channel more money into housing. This amendment will enable FNMA to do so from a tax posture that most reasonably fits the business and financial cycles it faces and strengthens FNMA's arsenal of financial and management weapons in the struggle to improve our current disastrous situation in housing.

Please accept our appreciation for your favorable consideration of this matter.

Sincerely,

James F. Aylward

James F. Aylward
President

National Association of Home Builders
15th and M Streets, N.W., Washington, D.C. 20005
Telex 89-2600 (202) 452-0400

Herman J. Smith
1981 President

December 8, 1981

The Honorable Robert Dole
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the more than 123,000 members of the National Association of Home Builders (NAHB), I offer our support for S. 1883 which would provide the Federal National Mortgage Association (FNMA) the same carryback and carryforward treatment of its losses that are allowed other financial institutions.

The housing industry and the institutions which supply its credit, including FNMA, are enduring a prolonged economic crisis. While during the past three years of rising interest rates FNMA has continued to borrow money to provide liquidity to the home mortgage market, FNMA has now been forced to absorb losses as it adds to its portfolio. In 1969, financial institutions other than FNMA were given a ten year carryback and five year carryforward provision to help them against losses occuring during economic downturns. The legislative history of the 1969 law indicates a desire by Congress to safeguard those institutions which invest in residential real estate. The exclusion of FNMA at that time appears to have been an oversight. The bill presently before your Committee, S. 1883 would provide FNMA the same opportunities to carryback losses as are afforded other financial institutions. This legislation which would have a modest revenue impact, would help FNMA through its present crisis and would help ensure the continuation of FNMA's positive and progressive role in the secondary mortgage market. I would greatly appreciate it if you would include this letter in the hearing record for S. 1883.

Sincerely,

Herman J. Smith
President

HJS:dag

NATIONAL ASSOCIATION OF REALTORS
Julio S. Laguarta, President
Jack Carlson, Executive Vice President

Albert E. Abrahams, Senior Vice President, Government Affairs
Gil Thurm, Vice President & Legislative Counsel, Government Affairs

Government Affairs Division
777 14th Street, N.W., Washington, D.C. 20005
Telephone 202 383 1000

December 5, 1981

The Honorable Robert Dole
Chairman, Senate Finance Committee
Dirkson Senate Office Building
1st & C Streets, N.E.
Washington, D. C. 20510

Dear Chairman Dole:

On behalf of the NATIONAL ASSOCIATION OF REALTORS®, I would like to urge your support for passage of H.R. 5013. This legislation will conform the tax treatment of the Federal National Mortgage Association to that of other financial institutions.

FNMA is an important link between the housing and finance industries. Throughout the past three years of rising interest rates and declines in the housing market, FNMA has continued to borrow money to provide liquidity to the home mortgage market. It has bought mortgages from primary lending institutions so that they can restructure their portfolios and lend more money to homebuyers.

FNMA, like many of the nation's thrift institutions, has been severely battered by this country's recent experience with high and volatile interest rates. The erosion of long-term capital markets has also increased the problems confronting FNMA. Since the asset and debt structure of FNMA is similar to that of thrift institutions, we believe that it is wise policy to tax FNMA as thrift institutions are taxed.

So that FNMA can continue to operate as effectively and efficiently as possible, it is vital that this significant oversight in the tax laws be corrected. FNMA must be permitted to average its losses and gains for tax purposes in the same manner as banks, savings and loans, and other financial institutions, rather than as if they were a manufacturing or retailing company, as is the case at present.

In closing, we want to emphasize that it is not only equitable, but important to the stability of the housing industry to allow FNMA to cope with lengthening periods of high interest rates and inflation in the same way as other financial institutions.

Thank you for your consideration of this matter.

Sincerely,

Julio S. Laguarta as

Julio Laguarta, President

cc: The Honorable Russell B. Long
The Honorable Robert Packwood

National Savings and Loan League

1101 Fifteenth Street NW
Washington, DC 20005
202 331-0270 Cable: NATLISA

Jonathan Lindley
Executive Vice President

December 7, 1981

The Honorable Bob Packwood
Committee on Finance
145 RSOB
Washington, D.C. 20510

Dear Senator Packwood:

The National Savings and Loan League would like to express our support of S. 1883, a bill to conform the tax treatment of the Federal National Mortgage Association (FNMA) to that of other financial institutions. We are pleased that you have introduced this important legislation and have scheduled hearings in such a timely fashion.

FNMA is an integral part of the housing finance delivery system in this country. The role of FNMA in housing will grow even greater in the economic environment of the future. It is critical that FNMA be given this tax parity if it is to be able to continue to assist the savings and loan industry and other mortgage finance entities in providing homeownership opportunities.

We urge you and other Members of the Finance Committee to approve this legislation as soon as possible.

Thank you for your consideration of our views.

Sincerely,

Jonathan Lindley

:bc

AMERICAN SAVINGS AND LOAN LEAGUE, INC.
SUITE 1019 ● 1499 G STREET, N. W. ● WASHINGTON, D. C. 20005
(202) 628-6624

December 9, 1981

The Honorable Bob Packwood
Chairman
Subcommittee on Taxation and
Debt Management
U. S. Senate
145 Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The American Savings and Loan League, a national trade association composed of 75 savings and loan associations in 25 states and the District of Columbia that are owned or controlled by Blacks, Hispanics, Asian-Americans and members of other minority groups, strongly supports and urges prompt action on S. 1883, a bill to amend the 1954 Internal Revenue Code to conform the net operating loss carryback and carryforward treatment of the Federal National Mortgage Association (FNMA) to that of other financial institutions. Our members view this legislation as most important for the housing industry and for the financial institutions which serve it.

It is no secret that the financial institutions which lend money to those purchasing homes have been hurt. Even at current high mortgage interest rates, the mortgages they hold provide a return far below the sums needed to refund their debt.

FNMA continues to serve as an important link between the housing and finance industries. Throughout the past three years of rising interest rates and declines in the housing market, FNMA has continued to provide liquidity to the home mortgage market by buying mortgages from primary lending institutions so that these institutions can restructure their portfolios and continue to lend money to homebuyers.

So that FNMA can continue to operate effectively and efficiently, it must be permitted to average its losses and gains for tax purposes in the same manner as banks, savings and loan associations, and other financial institutions, rather than as a manufacturing or retailing company, as is presently the case.

Economic conditions affect FNMA profits and losses and other financial institutions in the same way. It is therefore not only equitable, but important to the stability of the home financing industry to allow FNMA to cope with lengthening periods of high interest rates and inflation in the same way as other financial institutions.

The recovery of the housing industry in 1982 can be helped by the early enactment of this legislation.

Sincerely,

Theresa L. Watson

Theresa L. Watson
Executive Vice President

AMERICAN
BANKERS
ASSOCIATION

1120 Connecticut Avenue, N.W.
Washington, D.C.
20036

EXECUTIVE DIRECTOR
GOVERNMENT RELATIONS

Gerald M. Lowrie
202/467-4097

December 1, 1981

The Honorable Robert Dole
Chairman
Committee on Finance
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The American Bankers Association, with a membership of more than 90 percent of the country's 14,500 full service banks, is writing in support of S. 1883 and to urge its enactment at the earliest possible date.

Commercial banks and bank affiliated mortgage banking companies represent the second largest source of mortgage originations for single-family homes. Traditionally, banks and other depository institutions have relied on individual savings as their main source of funds. But, in recent years, the deposit base for all depository institutions has shifted away from traditional passbook accounts to short-term time deposits, which pay higher rates but are subject to greater interest rate fluctuations.

Because of the enormous capital required for mortgage lending exceeds the liability base of depository institutions, mortgage lenders have developed an active secondary mortgage market as a source of funds. Institutions whose actual deposits have not been keeping pace with the demand for mortgage loans have been able to maintain loan activity by reselling their loans in the secondary market, thus raising the funds for further lending. Operating nationwide, FNMA helps to redistribute mortgage funds from capital-surplus to capital-short areas.

The Federal National Mortgage Association (FNMA) created by Congress in 1968 as a stockholder-owned corporation, operates in the secondary mortgage market as the largest investor in residential mortgage funds, with a portfolio of more than $59 billion of mortgage loans. The 1968 legislation also made FNMA a for-profit, tax paying corporation.

Because FNMA converts funds borrowed in the money and capital markets into residential mortgage loans, its activities and earnings are influenced primarily by the level of interest rates and the availability of alternative sources of mortgage credit. Recent inflation has thrown financial markets and financial intermediaries into disarray. Inflation and gyrating

interest rates have generally affected home mortgage financing institutions more than other economic institutions, enforcing on them major institutional changes. FNMA has been forced to borrow in the volatile capital markets of the past year at rates up to 18 percent, increasing FNMA's cost of borrowing to 11.52 percent, while the return on their portfolio was 9.62 percent at September 30, 1981.

FNMA management has responsibly reacted to recent economic conditions by attempting to build greater flexibility into its asset management by increasing the yield on the corporation's assets and lengthening the term of its debt. However, its asset management has been made difficult because of FNMA's present tax treatment for operating losses.

Our understanding is that FNMA's present loss averaging treatment is unlike the carryback and carryforward treatment provided for other financial institutions. Instead, FNMA can presently carry losses back three years and forward fifteen years. Our Association, Mr. Chairman, supports S. 1883 extending FNMA's net operating loss carryback to ten years and reducing its net operating loss carryforward to five years, thus conforming the tax treatment of FNMA to that of other financial institutions.

Sincerely,

Gerald M. Lowrie

Mr. MAXWELL. I also have a copy of a letter which has been given to Senator Packwood's staff from members of the Senate Committee on Banking, Housing, and Urban Affairs, supporting S. 1883.

Senator DANFORTH. Thank you very much, Mr. Maxwell. I think that you have clear sailing.

Mr. MAXWELL. Thank you, Senator.

[The prepared statement of David Maxwell and the above mentioned letter follow:]

Statement of Mr. David O. Maxwell
Chairman of the Board and Chief Executive Officer
Federal National Mortgage Association
Before the
Subcommittee on Taxation and Management of the
Finance Committee
U.S. Senate
December 11, 1981

Mr. Chairman and Members of the Committee:

I am David Maxwell. Since May of this year I have been Chairman of the Board and Chief Executive Officer of the Federal National Mortgage Association, usually called Fannie Mae. I am pleased to be here today to testify in support of S. 1883, introduced by Senator Packwood for himself and Senators Moynihan, Roth, Danforth, Symms, Chafee, Durenberger, Long, Bentsen, Baucus, Matsunaga, Mitchell, Garn, and Lugar. Identical companion legislation was introduced in the House by Ways and Means Chairman Rostenkowski and Representative Conable. This bill would accord the Federal National Mortgage Association the same income and loss averaging treatment for tax purposes currently accorded other financial institutions.

The Federal National Mortgage Association began in 1938 as part of the federal government. After several reorganizations, in 1968 the Congress enacted legislation to charter Fannie Mae as a private corporation, with a statutory mandate to provide assistance, liquidity, and stability to the home mortgage market. In accordance with that legislation, Fannie Mae became private in 1970. Fannie Mae has a fifteen person Board of Directors, ten elected by the holders of its 59,000,000 shares of stock and five appointed by the President of the United States. It is subject to a certain degree of regulation by

the Secretary of Housing and Urban Development and the Secretary of the Treasury.

Today Fannie Mae holds $60 billion in mortgages -- one of every 20 home mortgages in America. It purchases these mortgages from originators, such as mortgage bankers, savings and loan associations, and commercial and savings banks, to provide them money to lend more people to buy homes.

Fannie Mae has obtained the money to purchase these mortgages largely through short or medium term borrowing in the credit markets. Fannie Mae's debt -- about $58 billion -- is held by banks, savings and loan associations, state governments, foreign central banks, and other investors. Fannie Mae's obligations constitute a significant portion of the portfolios of many of these institutions.

Fannie Mae is a financial intermediary, spanning the gap between the real estate and finance markets. It improves the efficiency of the housing finance market, thus permitting housing to compete for investment dollars. Fannie Mae's operations transform mortgages from small, illiquid, and local investments into blue-chip corporate paper which attracts needed money to housing. Given Fannie Mae's national scope, it also channels mortgage funds from regions of greatest availability to regions of greatest need. And Fannie Mae has worked with Ginnie Mae -- the Government National Mortgage Association -- to use the market mechanism to increase the availability of low and moderate income housing. (GNMA was established in 1968 as part of the Department of

Housing and Urban Development to carry out government-subsidized mortgage programs and help provide financing for FHA and VA mortgages.)

Fannie Mae is a key to maintaining a stable flow of money into the mortgage sector. During past periods of credit shortages and high interest rates, Fannie Mae has responded with extensive mortgage purchases to help prevent even more severe disruptions in housing. This year has been no exception. Indeed, there have been several periods this year when Fannie Mae has been described as "the only game in town" in the secondary market. So far in 1981, Fannie Mae has purchased some 93,000 home mortgage loans with a total value of about $5 billion.

For years, Fannie Mae was able to borrow short term at interest rates that were traditionally lower than the long term mortgage rates. Since 1978, this relationship between short and long term rates has changed: generally short term interest rates have been higher than long term interest rates. In addition, the general upward movement of all interest rates has left Fannie Mae locked into a portfolio of long term assets that yields less than it must pay to turn over its debt. As a result, Fannie Mae's $60 billion in mortgages yield today an average rate of return of 9.7 percent. But we have borrowed money at rates up to 18 percent in 1981 to finance this portfolio and to continue to carry out our Congressional mandate to provide funds for housing.

S. 1883 would accord Fannie Mae the same tax treatment other financial institutions receive with regard to the

losses generated by long term investment in mortgage loans. The present tax code permits businesses generally, such as retailing and manufacturing companies, to average income by permitting them to carry net operating losses back for three years and forward for fifteen years. Fannie Mae is treated like such a company. On the other hand, other financial institutions, such as commercial and savings banks and savings and loan associations, are allowed a ten year carryback and a five year carryforward. As a matter of tax equity and parity, Fannie Mae should be treated like these financial institutions, rather than like retailers and manufacturers.

The special loss carryback provision for financial institutions was enacted by the Congress in 1969, at a time when businesses generally were permitted to carry losses back only three years and forward only five. The Congress gave this special treatment to financial institutions for a number of reasons.

In 1969, the Congress was beginning to trim back special bad debt deductions for financial institutions. At the same time, it recognized the desirability of protecting such institutions from substantial losses brought about by future downturns in the economy. The Joint Committee on Taxation's General Explanation of the Tax Reform Act of 1969 states that a reason for the ten year carryback was to provide such protection. */

---

*/ Staff of the Joint Committee on Taxation, 91st Cong., 2nd Sess., General Explanation of the Tax Reform Act of 1969 at 147 (Comm. Print 1970) (discussing section 431 of the Act and section 172(b)(1)(F) of the IRC)

Fannie Mae has never had any exceptional bad debt treatment to help it during extended cyclical downturns. Moreover, its Congressional charter restricts it to a business that is particularly susceptible to large market swings. The Senate Report on the Tax Reform Act of 1969 specifically noted "the peculiar risks of long-term lending on residential real estate," and added that such lending was "an activity which Congress has indicated it desires to encourage."*/ Long term home mortgage loans have been the mainstay of the business of both the thrift institutions and Fannie Mae.

It is important to note that the 1969 amendments did not limit the ten year carryback treatment to institutions relinquishing a part of their special bad debt treatment. The amendments also applied the carryback to banks for cooperatives. Like Fannie Mae, banks for cooperatives had no special bad debt treatment.

Fannie Mae is comparable to the financial institutions given the ten year carryback in 1969. It is essentially a bank chartered by the Congress to invest in mortgages. Like the thrift institutions, Fannie Mae's business is to raise money which it uses to acquire residential mortgages, albeit at the secondary level. The same economic conditions affect

---

*/ 1969-3 C.B. 526, from S. Rep. No. 91-552, 91st Cong., 1st Sess. 162 (1969).

the profits and losses of Fannie Mae and the thrift institutions in the same way. Our common experience has made it apparent that Fannie Mae has business and financial cycles which are tied tightly to those of the thrifts and other financial institutions, and both logic and equity argue that Fannie Mae should have the same carryback and carryforward treatment.

However, it is easy to see how Fannie Mae was apparently overlooked when the 1969 tax amendments were adopted. Although the Congress passed the law to charter Fannie Mae as a private institution in 1968, Fannie Mae was widely regarded as a part of the federal government during 1969. The law scheduled Fannie Mae's transition to private status for sometime between 1970 and 1973.

I strongly support the amendment, and urge that the Congress expeditiously enact ~~H.R. 5013~~, and grant Fannie Mae the same income averaging treatment enjoyed by other financial institutions.

The effective date for the proposed amendment would be for losses for years beginning with 1982. The carryback would be to years commencing in 1972.

Although this amendment will provide Fannie Mae with a needed planning and management tool in 1982, it will have no budgetary impact until fiscal 1983. The Joint Committee on Taxation has estimated that there would be a $14 million revenue loss in fiscal 1983, and a $14 million revenue gain in fiscal 1984. Revenue would be gained in fiscal 1984 because under current law FNMA could carry its losses forward in that year to offset taxable income. S. 1883 simply permits Fannie Mae to carry its losses back now instead of forward in the future. Thus, the amendment's real revenue impact is to shift the revenue loss to a more propitious time for the nation's housing and lending institutions.

In closing, let me reiterate my appreciation for this opportunity to testify.

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

December 10, 1981

The Honorable Robert Dole
Chairman
Committee on Finance
United States Senate
Washington, D. C. 20510

Dear Bob:

The purpose of this letter is to express our strong support for S. 1883, a bill to provide the Federal National Mortgage Association (Fannie Mae) with the same net operating loss carryforward and carryback as that of other, similarly situated financial institutions.

As you are well aware, housing is one of the hardest hit industries in our nation's current economic slump. One of the major factors affecting the industry in this period has been the availability and cost of home mortgages. Fannie Mae is in the business of funding mortgage loans in the secondary market and at times during the last 18 months it has been the only major institution to do so. That performance must be sustained. It is thus imperative that Fannie Mae be accorded treatment consistent with equity and parity under our nation's tax laws so that its operations may continue as efficiently and effectively as possible.

S. 1883 contributes significantly to that objective by making treatment of Fannie Mae's net losses consistent with that accorded banks, savings and loans and other similar financial institutions. This is a simple but rational change, which will bolster Fannie Mae -- and thus the housing industry -- at a crucial time for both. We are appreciative that the Committee on Finance has moved expeditiously to hold hearings on this legislation. We urge you to bring S. 1883 to the floor of the Senate so that this vital bill can be enacted as quickly as possible.

Sincerely,

Jake Garn
Chairman

Harrison A. Williams, Jr.
Ranking Minority Member

John Heinz

Christopher J. Dodd

Richard G. Lugar

Alan J. Dixon

John H. Chafee

Alfonse M. D'Amato

Harrison Schmitt

Senator DANFORTH. The next bill is S. 696, and the witnesses are Thomas D. Gillies, director of the Linda Hall Library, and Michael Newmark of Lewis, Rice, Tucker, Allen & Chubb in St. Louis representing the St. Louis Mercantile Library.

Gentlemen, welcome, and please proceed in any order you would like.

STATEMENT OF THOMAS D. GILLIES, DIRECTOR, LINDA HALL LIBRARY, KANSAS CITY, MO.

Mr. GILLIES. Thank you, Senator.

I am Thomas Gillies of the Linda Hall Library. It is my firm conviction that the Tax Reform Act of 1969 omitted institutions such as libraries simply by overlooking them; not purposefully, but rather by inadvertence. We are in fact public institutions, just as schools, churches, hospitals, whatever. Our services are entirely to the public. They must be so by terms of our founding documents. And, as I say, I think we were simply overlooked in the exemptions that would otherwise have occurred in the Tax Reform Act of 1969.

I assume from Treasury's statement that there is no question about the national significance of our library holdings or of the services that we render to the public at large. In our own case, the Linda Hall Library extends those services to all the public, to many governmental agencies which depend upon us for little-held scientific and technical materials from abroad, particularly. We also extend services to the academic communities from the University of Missouri across the street from us, and to the entire State of Kansas' higher educational system by courier loans which are made there.

This bill would affect not only the Linda Hall Library but other independent research libraries as well, in areas of the necessity for complying with certain aspects of the foundation rules. Such libraries as the Pierpont Morgan in New York, the New York Public Library itself through the Astor, Lenox & Tilden Foundation, the Huntington Library in San Marino, and several others; although we are a relatively small group and, as I say, suffer in this particular instance from low visibility.

I would point out also that because of our founding documents there is virtually no way that we could abuse those five rules which we must meet under the Tax Code as publicly supported organizations.

Thank you.

[The prepared statement of Thomas D. Gillis follows:]

LINDA HALL LIBRARY
science and technology
5109 CHERRY STREET
KANSAS CITY, MISSOURI 64110
U.S.A.

Statement of Thomas D. Gillies

Director of Linda Hall Library

before the

Subcommittee on Taxation and Debt Management

of the

Senate Committee on Finance

on S.696

December 11, 1981

The independent research libraries which would be classified as public charities by passage of S.696 are all major national resources for study and scholarship. The Independent Research Libraries Association is made up of such libraries as The Folger Shakespeare Library, The Pierpont Morgan Library, The American Antiquarian Society, The Huntington Library, The New York Public Library - Astor, Lenox and Tilden Foundations, and several others. They are open to the public; they support and provide public programs and exhibitions; they have notable, and often unique, research collections for the use of students, scholars, and other researchers. They are, in fact, educational institutions, for they provide learning materials as do academic libraries and tax-supported public libraries. The independent research libraries differ in that they are supported, either in

whole or in part, by endowment income.

A few of these libraries are still able to fund their programs from endowment income. Many of them, however, must supplement that income by efforts to receive substantial contributions from the public or from governmental foundations and endowments. It seems clearly inconsistent, as tax policy, that institutions which must solicit tax-deductible contributions must, in turn, pay excise taxes and incur fees of legal and accounting firms to assure themselves of maintaining an appropriate tax status. Passage of S.696 would resolve this inconsistency.

Because of the investment income from their endowments these libraries run the annual risk that they may fail to meet Internal Revenue Service guidelines to qualify as "publicly supported organizations" or "private operating foundations". If they fail to meet those guidelines and are thus classified as private foundations their income would be so eroded as to restrict severely their services to the public. As each of these libraries clearly serves a public function, and thus both supplements and complements the services of other public and academic libraries, their services are clearly in the public interest. Thus, they should in fact be classified as public charities.

Specifically, in the case of Linda Hall Library which I represent, the instruments governing its establishment and operation provide that the library shall be open and available to the public at no charge. These instruments also provide that no part of the library's income may be

expended for purposes other than its collections, operation, appropriate construction, and maintenance for the purpose of serving the public. The library is adjacent to University of Missouri at Kansas City, and is heavily depended upon by the university community. The library's major services are heavily used by governmental research agencies, independent research scientists and engineers, industrial research agencies, and the lay public as well. Because of the library's extensive holdings in scientific journals, monographs, proceedings of scientific symposia, and the like, its collections are widely used through interlibrary loan and copying services throughout the nation. Because of its extensive holdings of current journals from the Soviet Union, Japan, People's Republic of China, Eastern as well as Western European countries, the library can provide the public and the research community with materials that are not readily available elsewhere.

Endowment funds of the foundations which maintain research libraries like the Linda Hall Library, are so structured as to make impossible the kind of tax abuses which the private foundation rules were enacted to prevent. Their financial resources are, and must be, fully committed to maintenance of these libraries, and their charters or founding documents prevent use of their funds for any other purpose. It is our genuine belief that the Tax Reform Act of 1969 was a sound and necessary

effort to correct shortcomings in tax law. However these independent public libraries were included in that law by oversight rather than by design. The fees and taxes which must be paid by these institutions under their present classifications could otherwise be made available for library acquisitions and public services. Moreover, no tax loss should result so far as the Internal Revenue Service is concerned, as the 2% excise tax is intended only to reimburse the Internal Revenue Service for monitoring these organizations. If there were no need to monitor them, the Internal Revenue Service workload should decrease accordingly. The other fees incurred by these institutions to assure themselves of maintaining a tax exempt status provide no income to the Internal Revenue Service in any event.

The great merit of S.696 is that its passage would correct an inadvertent inclusion in the Tax Reform Act of 1969, and would allow these specific cultural institutions to make appropriate use of all their endowment income to further enhance their collections for public use.

Summary

Independent research libraries which are open to the public are essentially educational institutions, making a unique contribution to scholars, students, researchers, and the public at large. They depend, either in part or in whole, on income from their endowments for operating costs. Some of them must supplement that income with contributions from the public and with grants from private and governmental foundations or governmental endowments.

Although their entire income is committed to maintaining their collections and their services to the public, some of them still are subject to an excise tax and all of them incur the additional expenses of legal and accounting fees to assure themselves of compliance with the IRS foundation rules. Their role as public educational institutions appears to have been overlooked in the Tax Reform Act of 1969, and they were thus included where they should not have been.

By the nature of their founding documents, these libraries cannot act in such a fashion as to be guilty of the tax abuses which the private foundation rules were enacted to prevent.

S.696 would, without reduction of any meaningful tax revenue, classify these libraries as public charities, and would thus allow them to make use of their endowment income for public services.

Senator DANFORTH. Mr. Newmark.

STATEMENT OF MICHAEL N. NEWMARK, LEWIS, RICE, TUCKER, ALLEN & CHUBB, ST. LOUIS, MO.

Mr. NEWMARK. Good morning, Senator.

My name is Michael Newmark, and I am legal counsel to the St. Louis Mercantile Library, a library which was organized in 1846 by the Missouri Legislature. I speak this morning in support of Senate bill 696, and I wanted to briefly address four questions: One, the need for Senate bill 696; how Senate bill 696 meets that need; the question of the potential for abuse; and the question of the impact on Federal revenue.

During the Mercantile Library's existence, since 1846, it has built up a sizable endowment fund. It is because it has built up that endowment fund that it wasn't able to meet the publicly supported charity test that was incorporated into the 1969 private-foundation legislation in the Tax Reform Act of 1969.

If a library can be open to the public for free because it has accumulated this sizable endowment, it may very well not satisfy the test for a publicly supported charity. But if that same library were to charge a fee for the services that it renders, it may then satisfy the test because the proportion of its endowment income to its total income would then be small. And I would suggest that this really ought not be the test as to whether it's a publicly supported charity.

As has been indicated, a library like the Mercantile Library that falls into the classification of a private operating foundation, incurs reporting requirements, legal and accounting fees, exise taxes, and perhaps most importantly for a library like the Mercantile Library, it's not attracting some contributions that it believes that it would otherwise attract.

So we believe that there is a clear need for this legislation, and we believe that Senate bill 696 satisfies that need because it makes a library like the Mercantile Library entitled to public-charity status regardless of the size of its endowment fund.

Now, the proposed legislation in no way extends the category of exempt organizations. What it does do is it provides that an exempt library like the Mercantile, that services the public, qualifies for public-charity status. The bill only covers those few libraries that have a permanent facility and are either organized by public act or are open to the public for free.

So Senate bill 696 would meet the needs, because it changes the status of the Mercantile Library and, as Mr. Gillies indicated, it would also change the status of the Linda Hall Library in Kansas City. It is coincidental that both libraries happen to be in Missouri. And, as Mr. Gillies indicated, the bill would affect other libraries in the country who, although they are not directly affected, nonetheless, spend time and money to insure that they do not fall into the category of a private operating foundation.

Now, what is the potential for abuse? Senate bill 696 provides a very narrow classification for those libraries that qualify under its terms. We only know of two libraries in the country that would be covered. And since it's unlikely that there would be many others

that would qualify, we do not believe that this opens the door to abuse.

It also seems highly unlikely that passage of this legislation would open the door to other legislation that would cover other types of charities. Granted, Senate bill 696 does provide a specific classification for a particular type of a charity; but this doesn't imply that other types of organizations deserve specific classification. There may be others, and if there are others, they should have it. And if there are others that are not deserving of specific classification, I doubt that Congress would extend the laws to give them public-charity status.

It should be noted, of course, that section 170 of the code already makes specific references to certain kinds of charitable organizations, and, therefore, this does not set a precedent in singling out a particular type of a charity.

Since there will be so few libraries that would be covered by Senate bill 696, it is unlikely that the bill would have much of an impact on revenue.

In summary, the Mercantile Library is satisfying, we believe, a very important public function in the St. Louis metropolitan community. Classifying the library as a public charity would be very helpful to the library in permitting it to raise funds from others and in eliminating fees and expenses that would allow us to purchase books and supply other services to the St. Louis community. And, since the likelihood of abuse, we believe, is remote because the classification of libraries has been so narrowly drafted, and since it's unlikely that providing coverage for a worthwhile public library would cause Congress to broaden the statute to include other, undeserving charitable organizations, and since the loss of revenue has minimal impact, we would respectfully urge this committee to act favorably on Senate bill 696.

Thank you.

[The prepared statement of Michael N. Newmark follows:]

LEWIS, RICE, TUCKER, ALLEN AND CHUBB
ATTORNEYS AT LAW
SUITE 1400 RAILWAY EXCHANGE BUILDING
611 OLIVE STREET
ST. LOUIS, MISSOURI 63101
314/231-5833

MICHAEL N. NEWMARK

December 9, 1981

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Dirksen Senate Office Building-Room 2227
Washington, D.C. 20510

Re: S.696, a Bill that will provide that certain organizations whose activities are devoted to the operation of a Library that serves the public will be treated as a tax exempt public charity.

Subcommittee on Taxation and Debt Management Hearing - December 11, 1981.

Dear Mr. Lighthizer:

I am legal counsel to the St. Louis Mercantile Library Association ("Library") which operates a library open to the public in St. Louis, Missouri. We thank you for the opportunity to enter into the record our views on Senate Bill 696, which provides that certain organizations, whose activities are devoted to the operation of a library that serves the public, be treated as a tax-exempt public charity.

Summary of Statement

1. Senate Bill 696 will permit certain permanent libraries that are open to the public, including the St. Louis Mercantile Library Association, to be treated, like other educational institutions, as a public charity for federal income tax purposes without regard to the source of their funds. The Bill is limited to those libraries which are operated as a permanent and principal part of the tax-exempt activities of the organization and were organized by a public act of the United States, or any state, or the District of Columbia, or of any possession of the United States, or were in existence prior to 1789. In addition, the proposed legislation would extend to libraries which are open and available to the public at no charge and are operated as the sole activity of the organization.

2. The purpose of the legislation is to provide libraries that are clearly organized to serve the public with public charity status.

3. Some libraries, because of substantial investment income from their endowments, run the annual risk that they will fail to meet the Internal Revenue Service guidelines to qualify as a "publicly supported" organization and that therefore they will be classified as a private foundation.

4. These libraries incur significant expenditures for legal and accounting fees on an annual basis. Amounts that would otherwise go to the exempt purpose are therefore expended to determine and insure that the organization will meet the Internal Revenue Service guidelines.

5. A library that is classified as a private foundation has a more difficult task than an organization classified as a public charity in soliciting funds from potential contributors. There is no public purpose served by discriminating against libraries in this manner; to the contrary, libraries that serve the public deserve the same treatment as other public charities.

6. The purpose of the two percent excise tax on private foundations as well as other aspects of the 1969 private foundation legislation, as set out in the legislative history to the Tax Reform Act of 1969, is not to raise revenue for the government. The purpose of the excise tax is rather to cover the Internal Revenue Service expense in monitoring private foundations, principally to insure and guarantee that such organizations are properly and promptly using their funds for charitable purposes. The purpose behind the 1969 legislation is not applicable to the class of libraries which are the subject of Senate Bill 696.

7. Senate Bill 696 will have a minimal impact on government revenue. The Independent Libraries Association has advised us that to their knowlege the proposed legislation would directly affect only two libraries. However, Senate Bill 696 will have an indirect affect on many libraries, because the passage of such legislation would also relieve those libraries of the necessity of continuing to insure that they satisfy the "publicly supported" tests.

8. The likelihood of abuse from the proposed legislation is remote since only those libraries that satisfy the narrow requirements set forth in the Bill will qualify as a public charity. Therefore, only those libraries that clearly benefit the public will qualify under Senate Bill 696.

I. History of the St. Louis Mercantile Library Association.

The St. Louis Mercantile Library Association was established in 1846 to form a well-rounded collection of books for the information and convenience of St. Louisans. The formation of the Library was authorized and approved by a Public Act of the General Assembly of the State of Missouri. The Library is currently maintained in its own building in downtown St. Louis.

Over the past 135 years, the Library has assembled a notable collection of books, now over 215,000 volumes, comprising a general collection in the liberal arts area, with emphasis on history, biography, travel, philosophy, religion and the arts. The Library maintains one of the country's most distinguished and comprehensive collections of regional history pertaining to St. Louis and western Americana. These collections are frequently consulted and referred to by many students and historians in these fields.

The Library has also been the recipient of many valuable gifts during its existence. These gifts include the fragmentary journal of Pierre Laclede's stepson, Auguste Chouteau, describing the founding of St. Louis, the original manuscript "Journal of the Proceedings of the First Legislative Council of the Territory of Louisiana, from June 3, 1806 to October 9, 1811," and the four-volume Elephant Folio of Audubon's "Birds of America." In addition, the Library was the recipient of a comprehensive collection of George Caleb Bingham drawings.

During its existence, the Library was able to develop a substantial endowment fund. This endowment fund was substantially increased by the sale in the mid-1970s of the Bingham collection.

The Library is open to the public and currently maintains a broad-based membership of over 2,000 members. While membership is necessary to check out materials (membership dues are currently a nominal $25.00 per year), anyone can use the books and collections on the premises of the Library. In addition, the Library staff will also conduct research pursuant to telephone requests from both members and non-members. The Library is also made available to students from Washington University to observe the Library's unique cataloging system, reference department and rare book room.

II. Current Tax Status of the Library.

The Library is currently classified as a "private operating foundation" for Federal tax purposes. It is classified as a private foundation because, with its substantial endowment fund, the proportion of the receipts and gifts from the general public compared with the total sources of support do not satisfy the "publicly supported" tests to qualify as a public charity under the existing Internal Revenue Code and regulations. Because the Library is classified as a private foundation, it must pay a two percent excise tax on its net investment income. The Library must also incur annual legal and accounting expenses to make sure that it falls within the private operating foundation guidelines. In addition, the Library's private foundation status has an adverse impact on its fund raising activities, particularly with respect to obtaining grants from other private foundations.

III. Proposed Legislation.

Senate Bill 696 would provide that any tax-exempt organization that operates a bona fide library as a permanent and principal part of its tax-exempt activities, would be treated, for tax purposes, as a public charity in the same manner as other educational organizations such as schools and universities. The legislation would be limited to only those libraries which are operated as a permanent and principal part of the tax-exempt activities of the organization and were organized by a public act of the United States, of any state, of the District of Columbia, or of any possession of the United States, or were in existence prior to 1789. In addition, the proposed legislation would extend to libraries which are open and available to the public at no charge and are operated as the sole activity of the organization. The purpose of the legislation is to insure that only such libraries that are clearly organized to serve the public will benefit from this legislation.

IV. Reason for Legislation.

(a) Elimination of excise tax and annual accounting and legal fees.

Because of the investment income from their endowments, some tax-exempt organizations operating a library run the annual risk that they will fail to meet the Internal Revenue Service guidelines to qualify as a "publicly supported" organization and that, therefore, they will be classified as a private foundation. Under existing law, unless a library meets the "publicly supported" financial test, it will not qualify as a public charity

even though such library clearly serves a public purpose. Such libraries spend significant amounts in legal and accounting fees on an annual basis, funds that would otherwise go to the exempt purpose (for example, to purchase books and other library materials) to determine and insure that they will meet the Internal Revenue Service guidelines. A library that does not meet these tests is usually classified as a private operating foundation and is required to pay a two percent excise tax. The purpose of the excise tax, as set out in the legislative history to the Tax Reform Act of 1969, is not to raise revenue for the government, but to cover the Internal Revenue Service expense in monitoring private foundations, principally to insure that such organizations are properly and promptly using their funds for charitable purposes. The purpose behind this excise tax is not applicable to the class of libraries described above.

(b) Fund raising problem.

A library that is classified as a private foundation has a more difficult task than an organization classified as a public charity in soliciting funds from potential contributors. For example, a private foundation that is not an operating foundation may make contributions to public charities and private operating foundations, but generally may not make qualifying contributions to other private foundations that are not operating foundations. Because of the uncertainty as to whether a private operating foundation continues to qualify as an operating foundation (there are complex tests that must be satisfied annually), many individual contributors and other private foundations that are not operating foundations are hesitant to contribute funds to such an organization even though it clearly serves a public purpose. In addition, a private foundation making contributions to a private operating foundation is required to maintain certain reports and exercise "expenditure responsibility" with respect to such grants, while there is no reporting responsibility with respect to grants to public charities. As a result, funds that otherwise might be contributed to a library described above, are diverted to other charitable organizations. The St. Louis Mercantile Library Association is aware of at least one private foundation that previously made a $10,000.00 per year grant to the Library, but has since ceased to make such grants solely because of the Library's private foundation status.

While most libraries within the class of libraries described above are able to satisfy the "publicly supported" tests and qualify as public charities, there are a few libraries within that class, such as the St. Louis Mercantile Library Association, that because of their endowment funds are unable to satisfy these

tests, and therefore are classified as private operating foundations.

V. Revenue Effect.

The anticipated annual loss in Federal revenue if this bill is enacted would be less than $50,000 per year, as the proposed legislation would directly affect possibly only one other library, in addition to the St. Louis Mercantile Library Association. The Independent Research Libraries Association has advised that to their knowledge only the St. Louis Mercantile Library Association and Linda Hall Library, also located in Missouri, would be directly affected by this proposed legislation. The proposed legislation would indirectly affect many other libraries because the passage of such legislation would also relieve these libraries of the necessity of continuing to insure that they satisfy the "publicly supported" test. For this reason, the legislation has been supported by, among others, The Independent Research Libraries Association, whose members include the New York Public Library, The Henry E. Huntington Library, American Antiquarian Society and The Library Company of Philadelphia.

Respectfully submitted,

Michael N. Newmark

Senator DANFORTH. Senator Packwood.

Senator PACKWOOD. Speaking for myself, I can say that Senator Danforth has already well prepared me for this bill. I have no questions. I think it is justified and meritorious. I hope we can help.

Mr. NEWMARK. Thank you very much.

Senator DANFORTH. Mr. Chairman, I have a statement which I would like to put in the record.

I would like to just ask a few questions, if I could.

First, the Deputy Assistant Secretary testified this morning, Mr. Glickman, that the administration opposes this bill. In stating the basis of the opposition, the administration talked about the distinction between public charities and private foundations. However, in the footnote on page 4 of Mr. Glickman's testimony, he states as follows:

> There are certain types of organizations which may qualify as public charities regardless of whether they are publicly supported: basically, churches, schools, hospitals and medical research organizations and governmental units.

[The prepared statement of Hon. David G. Glickman follows:]

For Release Upon Delivery
Expected at 10:15 A.M. EST
December 11, 1981

STATEMENT OF DAVID G. GLICKMAN
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

Mr. Chairman and and Members of the Subcommittee:

I am pleased to have this opportunity to appear before you today to present the views of the Treasury Department on three bills: S. 696, which would exempt certain library organizations from the private foundation provisions, S. 1883, which would provide the Federal National Mortgage Association with a 10-year net operating loss carryback period, and S. 1757, relating to amateur sports organizations.

Summary

S. 696 would provide that organizations operating certain libraries would not be treated as private foundations without regard to whether they are publicly supported.

The Treasury Department opposes S. 696.

S. 1883 would extend to FNMA the special loss carryback rules that apply to banks, thrift institutions and certain other financial institutions. Under an amendment passed by the House Ways and Means Committee, this treatment would not apply to losses incurred in the sale of mortgages held by FNMA.

The Treasury Department supports S. 1883 and the concept of the Ways and Means Amendment.

S. 1757 would clarify the exempt status of certain amateur sports organizations.

The Treasury Department strongly supports legislation to clarify this area. From a technical standpoint, however, we believe that the approach taken by a bill similar in concept introduced in the House of Representatives (H.R. 4990) would accomplish the objectives in a more direct fashion. Additionally, certain issues remain under these bills and we would be pleased to assist in fashioning a solution which would balance the interests of all concerned.

S. 696: Exemption of Certain Libraries from Private Foundation Provisions

Under present law, in general, the rules applicable to tax-exempt religious, charitable, scientific, literary, educational, etc., organizations described in Code section 501(c)(3) differ depending on whether the organization is classified as a public charity or a private foundation. Moreover, the rules applicable to private foundations differ depending on whether or not the foundation is a "private operating foundation." Generally, the rules applicable to private operating foundations are more favorable than those applicable to private foundations generally but less favorable than those applicable to public charities. The principal differences between the rules applicable to private operating foundations and those applicable to public charities are:

(i) that private operating foundations (but not public charities) are subject to the provisions of Code sections 4941, 4943, 4944, and 4945, which place detailed restrictions on self dealing, excess business holdings, investments which jeopardize charitable purpose, and certain taxable expenditures; and

(ii) that private operating foundations (but not public charities) are subject to a 2-percent annual excise tax on net investment income to help pay for the cost to the Internal Revenue Service of auditing private foundations.

Private foundations are defined, in general, as organizations described in section 501(c)(3) other than

(i) a small number of enumerated types of organizations such as churches, schools, hospitals and medical research organizations, and governmental units;

(ii) publicly supported organizations;

(iii) certain supporting organizations which provide support for organizations described in (i) or (ii); and

(iv) organizations which test for public safety.

Public charity is a term sometimes used to describe a section 501(c)(3) organization which is not a private foundation.

S. 696 would treat an organization which operates a "qualified library" as a public charity (rather than as a private foundation) without regard to whether it was publicly supported. A "qualified library" is defined as:

(i) a library which was established as a library by a law of a state, of the United States, of a U.S. possession, of the District of Columbia, or (before 1789) in a geographic area now comprising the United States and which is operated by an organization as a permanent part of the public services of such organization; or

(ii) a library which is open to the general public, does not charge an admission fee, and is operated by an organization none of whose income is spent for purposes other than the construction, maintenance, expansion, operation or management of such library, its collection and the premises on which such library is located.

In addition, a library organization which satisfied these conditions for its first taxable year beginning after the bill's enactment would apparently be treated as <u>never</u> having been a private foundation.

In effect, S. 696, by treating an organization operating a qualified library as a public charity (without regard to whether it was publicly supported), would automatically exempt such an organization from the general private foundation restrictions (on

self dealing, excess business holdings, etc.) and would exempt it from the 2-percent excise tax on net investment income. We understand that S. 696 is intended to benefit two libraries -- the St. Louis Mercantile Library located in St. Louis, Missouri and the Linda Hall Library, located in Kansas City, Missouri -- although it may also apply to other libraries.

It is urged that these nonpublicly supported libraries bear an extra financial burden because of their classification as private operating foundations rather than public charities. The burden is argued to result from (i) the 2-percent excise tax on net investment income, (ii) legal and accounting expenses incurred to insure that the organizations continue to qualify as private operating foundations and (iii) some reluctance on the part of some potential contributors to make contributions to the organizations because of uncertainty about whether their private operating foundation status is continuing to be maintained.

The two libraries that this bill is intended to benefit have been described as possessing important collections of materials made available to a wide range of researchers and scholars. We do not doubt the uniqueness of these libraries' collections or the importance of the services they provide. Nevertheless, Treasury must oppose S. 696, for several reasons.

First, the general reason for the different treatment of private foundations as opposed to public charities relates to the role played by public support. For publicly supported organizations, it is thought that the presence of significant public funds helps to guard against actions by the organization or its managers in violation of the organization's public trust. In effect, the need to go to the public for funds insures a certain degree of public accountability with respect to the organization's activities and helps to limit domination by small groups of individuals. However, when an organization is not publicly supported, this source of public accountability is lacking and Congress decided it was appropriate to put in specific statutory provisions to deal with such potential abuses as self dealing, failure to make distributions for charitable purposes, excess business holdings, investments jeopardizing charitable purpose, and certain taxable expenditures.1/ As part of this statutory

1/There are certain types of organizations which may qualify as public charities regardless of whether they are publicly supported -- basically churches, schools, hospitals and medical research organizations, and governmental units. However, the special status of these organizations is a historical development which preceded the enactment of the major private foundation provisions as part of the Tax Reform Act of 1969. Also, these organizations may be considered different from other types of exempt organizations in that they are generally broad based organizations serving what are considered unusually important public interests.

framework, Congress decided that the costs to the Internal Revenue Service of monitoring these rules through audits of private foundations should be borne by the foundations rather than by the general taxpayer. This is the purpose of the 2-percent excise tax on net investment income of private foundations.

Viewed against this background, it is difficult to see why organizations operating qualified libraries should be treated differently from other operating foundations. Since the public accountability considered to result from public funding is absent, it would seem appropriate for the rules relating to the specific private foundation abuses -- self dealing, excess business holdings, etc. -- to apply.2/

Second, as a matter of tax policy, we are troubled by special exceptions of narrow application. These types of provisions tend to cause other taxpayers to seek similar exceptions. More important, they can easily result in similarly situated taxpayers being treated unequally. Additionally, they are a source of complexity for all taxpayers.

Finally, with respect to the arguments concerning financial burden, since Internal Revenue Service resources must be used to monitor these library organizations' compliance with the private foundation provisions just like any other private foundation, it would seem appropriate for these organizations to pay the 2 percent "user fee" for private foundations. As to the various legal and accounting fees and uncertainty about private operating foundation status, these are issues which relate to all operating foundations, not simply those described in the bill. We are always open to suggestions to improve the private foundation procedures, consistent with the purposes of the private foundation.

S. 1883 -- FNMA Tax Loss Carrybacks

S. 1883 would extend to the Federal National Mortgage Association (FNMA) the special loss carryback rules that apply under section 172(b)(1)(F) to certain financial institutions, such as commercial banks and savings and loan associations. Under existing law, these institutions have a ten year carryback

2/In this regard we note that the bill would apparently have retroactive effect; an organization operating a qualified library would be treated as never having been a private foundation, including, apparently for past years. It is possible that this would nullify any past violations of the restrictions on self-dealing, excess business holdings, etc. Even apart from the merits of the bill generally, we see no justification for this kind of retroactive provision.

and five year carryforward period, while FNMA and most other businesses have a three year carryback and fifteen year carryforward period. Under S. 1883, FNMA would have a ten year carryback and five year carryforward period, for losses incurred in taxable years beginning after 1981. Thus, this bill has only a prospective effect.

An amendment to the companion bill (H.R. 5013), adopted by the House Ways and Means Committee on December 9, would limit this treatment to operating losses. This amendment is designed to limit the carryback of losses from the sale or other disposition of portfolio mortgages. Thus, losses incurred in the sale of portfolio mortgages would continue to be governed by the general rules applicable to most businesses.

The Administration supports enactment of S. 1883 and supports the concept of the Ways and Means amendment.

Background. FNMA was organized in 1938 as a federal agency; it provided a secondary market for residential mortgages through the use of funds borrowed exclusively from the U.S. Treasury. In 1954 FNMA became a "mixed-ownership" corporation, with the federal government owning the preferred stock and private shareholders owning the common equity. In 1968 FNMA was rechartered as a privately owned and managed corporation, subject to limited federal supervision (both Treasury and HUD have certain supervisory powers). The President appoints five of its fifteen directors.

FNMA is a unique organization; it is a privately owned corporation with a Federal charter and public purpose. FNMA is the largest single source of residential mortgage credit in the United States, holding a sizeable portfolio of low-yielding, long term, fixed-rate mortgages funded with a large amount of short term debt, and is the largest private issuer of debt securities in the United States as well as one of the country's most highly leveraged corporation. Thus, the economic difficulties of most mortgage lenders -- a result of the risk inherent in borrowing short term and lending long term -- also afflict FNMA (although unlike savings and loans, FNMA is not required to borrow short term to hold mortgages).

According to earlier FNMA estimates, their operating losses for 1980 and 1981 are of such magnitude that there will not be sufficient remaining income against which 1982 losses can be carried back under the three year rule. However, recent changes in interest rates have led FNMA to predict much smaller 1982 losses.

Current Law. Sections 172(b)(1)(A) and (B) permit net operating losses to be carried back three years and forward fifteen. Certain financial institutions (commercial banks, mutual savings banks, savings and loans, cooperative banks, banks for cooperatives (chartered by the Governor of the Farm Credit Administration), small business investment companies and business development corporations) are permitted to carry losses back ten years and forward five years, under sections 172(b)(1)(F) and (G). Other financial institutions, such as insurance companies, are subject to the general rules.

The ten year loss carryback period provision was enacted as section 431 of the Tax Reform Act of 1969. Prior to that legislation, certain financial institutions were permitted to deduct additions to bad debt reserves on terms more generous than those applicable to taxpayers generally, to protect against potential catastrophic losses (according to the legislative history in the 1969 Act). The 1969 Act reduced the permitted deduction for additions to reserves. At the same time, the ten year carryback period was provided as "an extra margin of safety to protect against the possibility of unusally large bad debt losses...". H. Rep. No. 91-413, 91st Cong., 1st Sess., p. 121 (1969). The bad debt losses comtemplated by Congress apparently were those from failure to collect amounts due (in an economy like the Depression), rather than losses resulting from rising interest rates. FNMA was not covered by any of these provisions.

While FNMA is not a thrift institution, it does have certain similarities to these institutions. Most notably, FNMA, like a thrift, has incurred a great deal of short term debt to hold an asset portfolio consisting primarily of home mortgage instruments. Because of this similarity in debt and asset structure, the Administration supports S. 1883.

At the same time, however, we note that there are significant differences as well between FNMA and thrift institutions, especially the fact that while thrift institutions generally are required by law and charter to take deposits and hold mortgages (i.e., required to borrow short and lend long), FNMA is not. It is required to provide a secondary market for home mortgage instruments, but its recent practices of borrowing short term to hold long-term mortgages is the result of the judgment of its management. In light of the fact that FNMA is not a thrift institution, we believe that it would not be appropriate to extend other tax provisions applicable to thrifts to FNMA, such as the 40 percent bad debt deduction under section 593. We understand that FNMA will not seek such treatment.

Revenue Effect. Without an amendment limiting the carryback period for portfolio sale losses, enactment of S. 1883 would generate a revenue loss of $0.5 billion, since such sales are within the control of FNMA management.

Enactment of S. 1883 with such an amendment, under FNMA's earlier expected interest rate scenario, would have generated a revenue loss of approximately $200 million in FY 1983 from the carryback of losses from operations. If interest rates fall by 1 to 2 percentage points (as is now projected by FNMA), the proposal will generate a revenue loss of about $35 million.

The maximum potential revenue effect of the proposal would involve carrying back losses of $1.0 billion (the amount of FNMA prior year income not already offset by 1980 and 1981 losses) which would generate approximately $0.5 billion of refunds. Should interest rates remain high and FNMA remain unprofitable, additional refunds to FNMA under this proposal would represent a permanent loss to the Treasury. If interest rates decline and FNMA turns profitable, the Treasury would receive taxes from FNMA in excess of what will be received under present law, since net operating loss carryforwards will be eliminated or reduced by the proposal.

S. 1757 -- Amateur Sports Organizations

S. 1757 clarifies the tax exempt status of certain amateur sports organizations. Subsequent to the introduction of S. 1757, a bill similar in concept but taking a somewhat different approach, H.R. 4990, was introduced in the House of Representatives.

The Treasury Department strongly supports clarifying legislation in this area. While both S. 1757 and H.R. 4990 would provide this clarification, from a technical standpoint the latter would accomplish the objectives in a more direct manner, although there are still several provisions in H.R. 4990 which need further consideration and which we will address. We would be pleased to assist in fashioning a solution to these issues which would effectively balance the interests of all interested parties.

To put the issues raised by these bills in perspective, I believe that some background may be useful. Prior to 1976, organizations which were engaged in the teaching of sports or promoting sports for youth generally qualified for tax exemption as educational or charitable organizations under section 501(c)(3) of the Internal Revenue Code and were thereby eligible recipients of tax deductible contributions. However, organizations which were engaged in promoting, governing, and regulating amateur sports but not for youth were generally exempt under section 501(c)(4) or 501(c)(6) with the result that contributions were generally not eligible for tax deduction.

The Tax Reform Act of 1976 sought to provide clarification and uniformity in this area. Additionally, the Congress considered it appropriate to encourage organizations which contributed to developing athletes for competition in the Olympic games and other national or international competition. Accordingly, section 1313 of the Act created, as a separate category of exempt organization under section 501(c)(3), organizations organized and operated exclusively to foster national or international amateur sports competition. The provision was intended not to adversely affect the qualification of any organization which would qualify under the standards of prior law.

In the development of this provision there was substantial concern that organizations which foster amateur sports could prove to be vehicles through which individuals paid for private recreational activities with tax deductible dollars. Accordingly, the Conference Committee added as a condition to exemption the parenthetical phrase "(but only if no part of [the organization's] activities involve the provision of athletic facilities or equipment)." Although the legislative history of the 1976 Act indicates that the purpose of this limitation was to prevent qualification for organizations which, like social clubs, provide facilities or equipment to their members, the statute is absolute, providing that any provision of facilities bars exemption under the 1976 Act amendments. Thus, the effect of the clear provisions of the statute is to prevent exemption, not only for social clubs, but also for other amateur sports organizations.

The existence of this facilities-equipment limitation has created serious administrative problems. Compelled to follow the unambiguous language of the statute, the Internal Revenue Service and Treasury have determined that organizations providing facilities cannot be recognized as exempt, unless the organization could otherwise qualify under section 501(c)(3). As a complicating factor, the Congress in 1978 enacted the Amateur Sports Act, a purpose of which was to coordinate and reorganize amateur sports in this country. The Act requires that the national governing bodies for Olympic sports be incorporated as separate autonomous entities. As a result, a number of former components of the Amateur Athletic Union (AAU) have been spun off and have applied for exemption under the amateur sports provisions. However, as many of these organizations provide facilities and equipment, they could not qualify under the 1976 Act amendments. Further, it was not at all clear that they could qualify under the standards of prior law. This created the ironic situation where, while the AAU was an exempt section 501(c)(3) organization when the 1976 amendments were enacted, the national governing bodies might not qualify for exemption under present law.

The Service and Treasury have been reluctant to take the draconian measure of issuing adverse rulings to organizations providing facilities and equipment. At the same time, however, we have been unable to fashion an approach administratively which would appropriately draw the lines between qualified and nonqualified organizations. Only Congress can provide the solution to the dilemma. In the meantime, numerous applications for exemption are pending at the IRS and Treasury awaiting this solution.

We therefore appreciate Senator Stevens' leadership in attempting to solve this problem through introduction of S. 1757. However, as I stated earlier, from a technical standpoint, the House bill, H.R. 4990, solves the problem in a more direct fashion. S. 1757 makes certain changes to the exemption section, section 501(c)(3), which defines a qualified organization. The goal of these provisions, of course, is to differentiate organizations which truly foster national or international amateur sports competition from those which are merely for private recreation. This line, however, is a difficult, if not impossible, one to draw. Further, we do not believe it necessary to make the attempt in the exemption provisions. As we see it, the problem is not one of exemption per se but rather the deductibility of the contributions to the organization. We do not anticipate that these organizations will have substantial income. However, we are concerned that individuals will be able to pay for recreational activities with tax deductible contributions.

In this connection, I should note that some may argue that legislative changes are unnecessary in light of the principle that no charitable contribution deduction is allowed where the donor receives a benefit by reason of the contribution. While this quid pro quo doctrine is an important and long-standing principle of law, its reaches are uncertain and it is not easy to apply. While the quid pro quo doctrine should continue to apply in this, as well as in other, areas, we believe that certain specific rules, over and above quid pro quo, are necessary.

Thus, H.R. 4990 attacks the problem by focusing on the deduction rather than the exemption sections and by providing specific disallowance rules. Under that bill, the parenthetical to section 501(c)(3) would be eliminated, with the result that any otherwise eligible organization which fosters national or international amateur sports competition will be eligible for exemption without regard to its provision of athletic facilities or equipment. However, specific provisions would be added to the income, estate, and gift tax charitable contribution sections which will preclude deduction for contributions to

these organizations under certain circumstances. As a general matter, the provision disallows a deduction to the organization if the contribution is made by a person (or by a member of his or her family) who uses any athletic facility or equipment provided by the organization within a period beginning 12 months before and ending 12 months after the day the contribution is made.

The changes to the section 501(c)(3) rules would be retroactive to the effective date of the 1976 Act. The changes to the contribution rules would apply prospectively to contributions made after December 31, 1981. Thus, contributions made to these organizations in prior years would be allowed without regard to the specific disallowance rules.

H.R. 4990 provides three exceptions to the disallowance rule. The first, intended as a de minimis rule, provides that contributions up to $500 per year will be insulated from the specific disallowance provision. This exception highlights one of the problems in this area. We recognize that there will be cases where a person makes a very small contribution to an organization and he (or a member of his family) makes considerable use of the facilities. In this case, probably no deduction should be allowed. At the other extreme are cases where the donor makes a substantial contribution and uses the facilities to a relatively insignificant extent. In these cases, at least some portion of the contribution should be allowed as a deduction. In between are the vast majority of cases where there is some contribution and some use of facilities. In these cases, it is very difficult to determine the amount, if any, of the contribution which should be allowed. Compounding the problem are the administrative difficulties of measuring, under any of these scenarios, the extent and value of the use, and the limited audit resources of the Internal Revenue Service to make this measurement. While the quid pro quo doctrine is available to handle some of the clearer cases when selected for audit, we believe that a rule is necessary to facilitate administration in other instances.

The approach taken by the House bill is to provide a strict disallowance rule, barring all deduction when there is use of the facilities, and then providing the de minimis exception. We believe there is considerable merit to this approach. The strict disallowance rule will eliminate the requirement that the Service monitor in every case the extent and value of use, and the de minimis exception carves out those cases where the amounts are small and therefore not of substantial concern. In this connection, however, we question whether the $500 exception is too high. Inasmuch as the purpose of the disallowance rule in the first instance is to police the financing of private

recreation with deductible contributions, the exception should be limited to relatively small amounts (perhaps $100). Further, I must emphasize that if a de minimis exception is provided (whatever the amount), it should not in any way affect the quid pro quo principle. Thus, even contributions within the de minimis limit would be subject to disallowance if the link between the contribution and benefit to the contributor could be established.

We also recognize, however, that a different approach may be taken. Thus, it may be argued that, to the extent the contribution is paying for the use of facilities, it is the first rather than the last dollar which is providing the benefit. Accordingly, instead of a de minimis exception (which takes the form of a ceiling on allowable contributions), a rule may be fashioned which provides a floor amount of nonallowable deductions, amounts in excess of which would be allowed (subject to quid pro quo). A problem with this approach, however, is that it would disallow the vast majority of contributions which are relatively small in amount. Further, where contributions are large, heavy reliance would be placed on the quid pro quo doctrine to curb abuse. We are concerned that the administrative application of this doctrine may prove ineffective.

A second exception (also subject to quid pro quo) applies to contributions to the U.S. Olympic Committee or to a national governing body. We have no objection to this exception since contributions to these types of organizations were generally allowed under the law prior to 1976 without regard to the provision of facilities or equipment to the contributor or the contributor's family. We agree that a similar rule should now apply.

The third exception applies to non-reimbursed, out-of-pocket expenditures made incident to the rendering of services by a noncompetitor. We are troubled by this provision in that it may be subject to abuse. For example, a parent wanting to watch his or her child participate in an out-of-town athletic competition may arrange to render some nominal service to the sponsoring organization and thereby claim a deduction for the travel and lodging expenses incurred. While this abuse potential is not unique to amateur sports organizations, its impact becomes more acute given the nature of the organization involved and the likelihood of family members incurring the expenses described.

We believe, and we think supporters of the bill would agree, that charitable contribution deductions should not be allowed under these circumstances. Further, we believe that under current law such deductions would not be allowed. Under existing authority, if an out-of-pocket expenditure is made primarily for the personal benefit of the contributor, it is not a deductible contribution. Similarly, with respect to expenses which have a dual character (in that they benefit both the charity and the taxpayer), which are incurred incident to the rendering of services, the presence of a substantial direct personal benefit to the taxpayer or someone other than the charity is fatal to the claim for a charitable contribution. In this area also the legislative history should confirm that the exception is subject to this rule of existing law.

In this connection, I must add that we do not want to limit the deductibility of expenses incurred by the bona fide volunteers of amateur sports organizations. We understand that many organizations depend upon these volunteers as their life blood and we do not want to interfere with that relationship. Our concern is rather with the abusive cases where the service rendered is disproportionate in relation to the expenses claimed.

We strongly support an effort to reach a legislative solution to the problems raised in this area. Accordingly, we would be pleased to assist in fashioning a measure that is satisfactory for all concerned.

Senator DANFORTH. Now, it would be my position, and I take it that it is your position, that libraries such as the Linda Hall Library and the Mercantile Library are more like schools and medical research organizations than they are like the typical private foundation. Many private foundations are, in essence, let's face it, an extension of their founder, a kind of an organized and continuing pocketbook, and controlled by a very limited number of people who have broad discretion in utilizing funds and perhaps perpetuating some purpose of the original grantor.

By contrast, it is my understanding that with the Linda Hall Library and the St. Louis Mercantile Library the function of the library is the sole purpose of the organization, that the library is a major resource in the community and, indeed, well beyond the community; especially the Linda Hall Library, which is a major scientific library and certainly made available right across the street from the University of Missouri-Kansas City. For this reason, far from being an extension of the grantor or a kind of a private discretionary fund existing in perpetuity, these libraries have well established educational functions; they have been going on for some time; they will be going on for some time. They are open to the public, and, therefore, it would seem to me, meet the exception noted in the footnote of Mr. Glickman's testimony.

Would you agree with that statement?

Mr. GILLIES. I would certainly agree with it thoroughly, inasmuch as by the terms of Mr. Hall's will our funds can be used for nothing except the maintenance of a public library which is freely accessible to the public. So, by our own founding documents, we have no choice.

Mr. NEWMARK. I wish I could have said it as well. The John Doe kind of private foundation which, say, gives money to the poor is the kind of a foundation that could be subject to some abuse. But when you have a library that is either founded by an act of the State legislature or one that has to be open to the public for free and is providing a very important library service, it just doesn't seem to fall into that category.

Senator DANFORTH. I might say that it is my belief that these are the only two libraries of their kind that would be covered by this exception. There might be others, but they both happen to be in the State of Missouri. Both of them are exceedingly well-known institutions, well-known and well-recognized in the community. They are hardly some backroom operation. Everybody knows about the Linda Hall Library and everybody knows about the St. Louis Mercantile Library. As a matter of fact, when we had the reception for the three new Federal judges in Kansas City, it was held in the Linda Hall Library because it was an exceptionally commodious place to have such an affair. So they are highly public, highly visible, very well-respected institutions, and I think, clearly, far more like educational institutions that are covered in the exceptions recognized in Mr. Glickman's testimony than they are like some wealthy benefactor's continuing trust.

Mr. GILLIES. Perhaps, Senator, if I may, I should point out that although the reception was held in our premises we provided only the space. The law firms paid for it.

Senator DANFORTH. Good. Nail those law firms. [Laughter.]

Thank you very much.

Mr. GILLIES. Thank you very much.

Mr. NEWMARK. Thank you very much.

Senator PACKWOOD. Gentlemen, thank you. We appreciate your taking the time.

You are adjourned.

[Whereupon, at 11:10 a.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Special Libraries Association

235 Park Avenue South, New York, N.Y. 10003

212/477-9250

December 11, 1981
S. 696 - Senator Danforth
"Treatment as Public Charities of Certain Organizations Which Operate as Libraries"

Testimony Prepared by
the Special Libraries Association
for Senate Bill 696

The Special Libraries Association is an organization of more than 12,000 librarians and information managers. Special libraries serve industry, business, research, educational and technical agencies, government, special departments of public and university libraries, newspapers, museums and other organizations both in the for-profit and not-for-profit sectors, requiring specialized information. The Association and its members are concerned with the advancement and improvement of communication and the dissemination and ultimate use of information and knowledge for the general welfare of all users.

David R. Bender, Executive Director

Richard E. Griffin, Assistant Executive Director

Special Libraries Association

The special library community has long recognized the merits and needs for sharing informational resources. Special librarians have recognized their dependence on other collections for in-depth subject background and for materials peripheral to their major interests. Senator Danforth's bill (S.696) is aimed at assisting library and information users across this nation by ensuring that the resources of several tax-exempt organizations which operate libraries as permanent and principal parts of their tax-exempt activities are available for public use. This advances the Association's concern for access to information through cooperative arrangements.

Both the Linda Hall Library (Kansas City, Missouri) and the St. Louis Mercantile Library (St. Louis, Missouri) have opened their doors to persons throughout the United States. Their unique collections have contributed to the study and research efforts of scholars, researchers, scientists, historians, and other individuals who have interests in their extensive holdings.

In order to maintain their preeminence as research libraries, both institutions have continued to be responsive to their vast publics through the provision of appropriate materials for study and research. If the libraries were insensitive to user needs, the quality of their services would decline, they would lose their patronage, and their reputations would suffer. This is clearly not the case with either library. Both have established nationally known and respected collections, and they maintain

more

their prestige by being responsive - hence, accountable - to their users.

Senator Danforth has enumerated the merits of his bill as reported in the Congressional Record of March 12, 1981 (S-2133-36) and March 25, 1981 (E-1344-45). We do not support the opposition of the Department of the Treasury to S.696 because it appears that the 2% excise tax on net investment income collected by the I.R.S. serves little purpose with respect to the requirement that the libraries be accountable to the public. The funds collected through this means restrict the growth of the libraries' holdings by diverting revenues from their intended purpose, collection development, to the payment of governmental services.

The Association strongly urges the passage of S.696 as presented to this subcommittee. It is, therefore, the hope of the members of the Special Libraries Association that you, Senator Packwood, and your esteemed colleagues will support Senator Danforth's bill.

TESTIMONY OF

THE MARINERS MUSEUM
THE STRONG MUSEUM
PHILADELPHIA MARITIME MUSEUM
MERRIMACK VALLEY TEXTILE MUSEUM
AMERICAN ASSOCIATION OF MUSEUMS

submitted to the

SENATE FINANCE SUBCOMMITTEE ON

TAXATION AND DEBT MANAGEMENT

at the

December 11, 1981

HEARING ON

S. 696

To provide that certain organizations, whose activities are devoted to the operation of a library that serves the public, be treated as a tax-exempt public charity.

Mr. Chairman, we are pleased to have the opportunity to submit our statement for the record. We are particularly interested in S.696 because we are affiliated with museums which, like the libraries, seek to expand the definition of a tax-exempt public charity.

Under present law, a museum which does not satisfy one of the tests for public charity status under section 170 of the Internal Revenue Code is presumed to be a private foundation. Section 170 classifies certain institutions as public charities based upon their function as a religious organization, educational institution or hospital. Each other type of charitable organization is deemed to be a public charity only if a substantial part of its financial support is from "public" sources.

Each charitable organization which fails to satisfy either the functional test or the public support test is classified as a private foundation and is subject to a set of requirements not imposed on public charities. These requirements include limitations on gifts, additional recordkeeping for donors as well as recipients, a two percent excise tax and a variety of practical limits on the operation of the institution.

We are directors of small museums with specialized collections that rely for their financial support on a limited universe of donors. This limited base of support is causing an increasing number of museums to fail to meet the public support test and to be classified as private foundations rather than as public charities. For example, a museum that has had the good fortune to be the beneficiary of a successful endowment may be classified as a

private foundation because it is the beneficiary of a trust with substantial income which reduces the relative support of other donors.

To avoid private foundation status, museums will be forced to seek public support thereby reducing the amount of charitable donations available to other worthy--and less financially secure--institutions. Thus, maldistribution of donations is encouraged at a time when the available amount of contributions is shrinking.

Mr. Chairman, we anticipate that legislation will be introduced in the Senate and House before the end of this session which will provide that museums which satisfy strict standards designed to assure public involvement and accountability--like the standards applicable to churches, schools and hospitals--be excluded from the private foundation rules. These standards include the following:

(1) The museum must be a permanent institution which is exempt from tax under IRC Section 501(c)(3);

(2) At least twenty-five percent of the governing body of the museum must consist of community leaders and/or local public officials;

(3) The museum must employ a professional staff and own, possess and care for tangible objects; and

(4) The museum must conduct regular exhibits which are open to the public.

Public charity status should not depend solely on sources of financial support. Equally important is the degree of public access to the tax exempt organization, the nature of the function

performed by the organization, and the extent of public participation in the operation of the organization. Congress's intent in enacting the private foundation legislation in 1969 was to apply the new rules to personal charitable funds and to exempt cultural institutions serving the public at large. Many museums as well as libraries meet the criteria for public operations and service listed above and should, in keeping with the spirit of the private foundation legislation, be classified as public charities.

The Mariners Museum
Newport News, Virginia 23606
William D. Wilkinson, Director

The Strong Museum
700 Allen Creek Road
Rochester, New York 14618
H.J. Swinney, Director

Philadelphia Maritime Museum
321 Chestnut Street
Philadelphia, Pennsylvania 19106
J. Welles Henderson, President

Merrimack Valley Textile Museum
800 Massachusetts Avenue
North Andover, Massachusetts 01845
Thomas W. Leavitt, Director

American Association of Museums
1055 Thomas Jefferson Street
Room 428
Washington, D.C. 20007
Lawrence Reger, Director

Statement for Hearing on December 11, 1981
on S.696, which provides that certain
organizations whose activities are devoted to
the operation of a library that serves the public
be treated as a tax-exempt public charity.

My name is Charles O'Halloran. I am State Librarian at the Missouri State Library. The Missouri State Library is responsible for and concerned with libraries of all kinds in the State of Missouri and in my capacity as State Librarian I have been very much aware of the Linda Hall Library for many years.

I have been State Librarian for seventeen years and prior to that I worked for five years as a librarian in Kansas City, Missouri.

Most of the great research libraries in the United States are the products of concern, attention, and expenditures extending over very many years. Most of these libraries were first established in the nineteenth century or even earlier and represent efforts and expenditures over a century or more.

By contrast, the Linda Hall Library was established after the Second World War and has developed its collection of materials and its service program over a relatively short period of time. The fact that after only thirty-five years of existence the Linda Hall Library has become a nationally, indeed internationally, important research library is, it seems to me, an indication of the care and devotion with which the board and

the administration of that library have carried out their mission of developing a research library. Had the board and the administration not been acutely and constantly aware of the needs of the public to be served by the library, this library would not, I think, have achieved such remarkable and rapid development.

In library circles it is frequently suggested that approximately two-thirds of a library's funds should be expended for employees' salaries, about twenty percent of its funds for books and library materials, and the balance for other operating costs. I was told by the founding director of Linda Hall Library that when he was charged with the creation of a major research library in the late 1940's, he concluded that this would be impossible if he adhered to this traditional pattern of library expenditures. He therefore, deliberately, he said, sought to reverse this formula and to expend as much as two-thirds of the library's funds for the purchase of books, etc., with very small portions expended for salaries and other operating costs. He indicated to me that the Linda Hall Library could legitimately use additional employees and that the library could expend more of its money for general operating costs. His determination and that of his board to build a substantial research library led to this "heresy," but also produced the library which Linda Hall is today. Once again, I believe that this is an indication of the determination of the library administration and of the board to create a research library responsive to the needs of

scientists and other researchers.

We in the State of Missouri are of course proud that one of the world's great research libraries is located in our state. I have seen statistics and have heard reports from the director of Linda Hall Library which indicate that usage of the library is much greater in states other than Missouri and that Linda Hall Library could, if geography were the only consideration, legitimately be located on either the East or the West Coast. I am sure that Linda Hall Library is and always has been concerned with the research needs of people living in the Midwest, but in its efforts to develop its library service program, it has been sensitive to the research needs of individuals living anywhere in the United States and indeed in the entire world. Once again, I think that Linda Hall has been acutely sensitive to its users' needs in the development of its program.

Finally, I should say, as one who is responsible for encouraging library cooperation and as one who has administered a federal grant program for libraries, that although the Linda Hall Library has been most cooperative and most interested in assisting other libraries, the Linda Hall Library has never sought to receive funds from the Missouri State Library. This lack of interest in outside funding may partly be caused by a concern that outside funding could result in outside control. I think, however, that the Linda Hall Library has avoided seeking this kind of funding because of its determination that it would continue single-mindedly to develop its collection of material in order

that it might be one of the premier libraries of the world; that it would not be diverted from this goal by any other consideration, even by money.

As a citizen and as a librarian who has known the Linda Hall Library for over thirty years, I regret very much that any of the funds available to the Linda Hall Library must be diverted for the payment of any kind of taxation. Faced as are all libraries with inflation and attempting as all libraries are to cope with the explosion of knowledge and printed information, and faced in a unique way with the responsibility for supplying highly sophisticated, complex and specialized material in a large number of languages, the Linda Hall Library is engaged in a monumental task requiring dedication and determination, and I believe that it is bad public policy for federal law and regulation to divert any of the funds available to Linda Hall to any other purpose.

Senate Bill 696 introduced by Senator John Danforth would provide relief to the Linda Hall Library and would in some small way permit that library to continue to develop as one of the nation's most important assets.

The nation is embarking, I believe, upon an era characterized by volunteerism and free choice rather than compulsion and regulation. Linda Hall Library has a history demonstrating how effective voluntary action can be in producing excellence. Linda Hall Library should not be inhibited in its further development by federal law which, a priori, suggests any lack of accountability for the use of its funds.

AMERICAN SAVINGS AND LOAN LEAGUE, INC.
SUITE 1019 ● 1436 G STREET, N. W. ● WASHINGTON, D. C. 20005
(202) 628-6624

1981 DEC -9 AM 11:

December 9, 1981

The Honorable Bob Packwood
Chairman
Subcommittee on Taxation and
Debt Management
U. S. Senate
145 Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The American Savings and Loan League, a national trade association composed of 75 savings and loan associations in 25 states and the District of Columbia that are owned or controlled by Blacks, Hispanics, Asian-Americans and members of other minority groups, strongly supports and urges prompt action on S. 1883, a bill to amend the 1954 Internal Revenue Code to conform the net operating loss carryback and carryforward treatment of the Federal National Mortgage Association (FNMA) to that of other financial institutions. Our members view this legislation as most important for the housing industry and for the financial institutions which serve it.

It is no secret that the financial institutions which lend money to those purchasing homes have been hurt. Even at current high mortgage interest rates, the mortgages they hold provide a return far below the sums needed to refund their debt.

FNMA continues to serve as an important link between the housing and finance industries. Throughout the past three years of rising interest rates and declines in the housing market, FNMA has continued to provide liquidity to the home mortgage market by buying mortgages from primary lending institutions so that these institutions can restructure their portfolios and continue to lend money to homebuyers.

So that FNMA can continue to operate effectively and efficiently, it must be permitted to average its losses and gains for tax purposes in the same manner as banks, savings and loan associations, and other financial institutions, rather than as a manufacturing or retailing company, as is presently the case.

Economic conditions affect FNMA profits and losses and other financial institutions in the same way. It is therefore not only equitable, but important to the stability of the home financing industry to allow FNMA to cope with lengthening periods of high interest rates and inflation in the same way as other financial institutions.

The recovery of the housing industry in 1982 can be helped by the early enactment of this legislation.

Sincerely,

Theresa L. Watson

Theresa L. Watson
Executive Vice President

UNIVERSITY OF MISSOURI

Office of the President

321 University Hall
Columbia, Missouri 65211
Telephone (314) 882-2011

January 6, 1982

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Rm. 2227, Dirksen Senate Office Bldg.
Washington, D. C. 20510

Dear Mr. Lighthizer:

This pertains to the Finance Subcommittee on Taxation and Debt Management Hearing on Two Miscellaneous Tax Bills on Friday, December 11, 1981.

The Linda Hall Library of Science and Technology of Kansas City, Missouri, has been of extraordinary benefit to the academic well-being of the University of Missouri. The benefit that the University of Missouri derives from this great scientific research library is not unique to our University. We are but one of many universities and other research institutions that turn to the collections of Linda Hall Library for titles not held in our libraries.

However, my statements will be confined to my experience as president of a public university with four campuses, over 53,000 students, and a teaching, research, and extension staff of over 5,000. We offer doctoral work in a wide spectrum of scientific and technological disciplines and we are proud of the contributions to scientific research made by our faculty and staff. Nevertheless, the University of Missouri libraries are unable to subscribe to as many scientific journals as Linda Hall Library does.

Our libraries turn to Linda Hall Library daily to borrow books not held in our libraries and to secure copies of articles from journals to which we cannot subscribe. This means that Linda Hall Library is always there as a back-up to what our own libraries do in serving the needs of our students and faculty.

Linda Hall Library is known internationally for its extensive subscriptions to scientific journals in such languages as Russian, Japanese, and Chinese. Significant research is being reported in these languages so that access to the journals is indispensable. The great contribution of Linda Hall Library in this respect is not just its expenditures to these subscriptions, but the expertise of its staff which has identified

these journals and has made the often complex arrangements necessary to receive these publications on a regular basis.

Linda Hall Library in its history of some 35 years has had but two directors, both of whom I have had the pleasure of knowing. I also know some of the members of its board. I know firsthand the careful planning of Linda Hall services and the management of its resources so as to insure that its great collections can be maintained and kept up-to-date in spite of the fiscal pressures brought about by the staggering increases in the prices of scientific materials. The history of that library is the history of a steadfast dedication to the purposes of the Hall bequest that a library be established to serve the public. The particular public Linda Hall serves is the public of scientific research.

Sincerely,

James C. Olson
President

JCO:mjs

cc: Senator John C. Danforth
Chancellor George A. Russell

Independent Research Libraries Association

AMERICAN ANTIQUARIAN SOCIETY • AMERICAN PHILOSOPHICAL SOCIETY • JOHN CARTER LIBRARY
FOLGER SHAKESPEARE LIBRARY • LINDA HALL LIBRARY • HISTORICAL SOCIETY OF PENNSYLVANIA
HUNTINGTON LIBRARY • LIBRARY COMPANY OF PHILADELPHIA • MASSACHUSETTS HISTORICAL SOCIETY
PIERPONT MORGAN LIBRARY • NEWBERRY LIBRARY • NEW YORK ACADEMY OF MEDICINE
NEW-YORK HISTORICAL SOCIETY • NEW YORK PUBLIC LIBRARY • VIRGINIA HISTORICAL SOCIETY

December 22, 1981

Dec. 11

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Dirksen Senate Office Building, Room 2227
Washington, D. C. 20510

Re: S. 696, a Bill that will provide that certain organizations whose activities are devoted to the operation of a Library that serves the public will be treated as a tax exempt public charity.

Dear Mr. Lighthizer:

I am chairman of the Independent Research Libraries Association (IRLA), a group of fifteen of the largest independent research institutions in the country. Although most of the IRLA member libraries are exempt from taxes under present legislation, we are collectively and independently in unanimious support of Senate Bill 696 which would give public charity status to all libraries that are clearly organized to serve the public. Senate Bill 696 will provide equal treatment under the tax law for libraries offering similar services to the public. It will also eliminate the annual risk faced by some libraries that they will fail to qualify as a "publicly supported" institution because they have successful and substantial endowment income. Such libraries (and there are several in this category in the IRLA membership) are threatened because they do not need as much public support and therefore risk being categorized as foundations. We feel strongly that libraries are among the basic resources of this country and that they should all be allowed to serve the public under a public charity status.

I appreciate the opportunity to place this statement before your Committee and to urge the passage of Senate Bill 696 on behalf of the millions of library users who will ultimately benefit from its passage.

Sincerely,

James Thorpe

James Thorpe

James Thorpe, Chairman
The Huntington Library, 1151 Oxford Road, San Marino, California 91108 (213) 792-6141

HUNTINGTON FREE LIBRARY AND READING ROOM
9 Westchester Square
Bronx, N. Y. 10461
(212) 829-7770

DEPOSITORY FOR THE LIBRARY OF:
MUSEUM OF THE AMERICAN INDIAN
HEYE FOUNDATION

STATEMENT ON S. 696 BY
EDWARD A. MORGAN, PRESIDENT
HUNTINGTON FREE LIBRARY AND READING ROOM
TO THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

December 24, 1981
(Hearing Date December 11, 1981)

I am Edward A. Morgan, President of the Huntington Free Library and Reading Room, Bronx, New York. Our Library was founded pursuant to a private trust deed in 1892 as a "free public library" and has so served, from the 1890s to the present. Since 1930, the Library has also been the holder of one of the great collections in the United States of library materials pertaining to the Native American peoples of North and South America. I am pleased to have this opportunity to state our Library's strong support for S. 696. S. 696, I believe, would correct an unintentional oversight in the Tax Reform Act of 1969 by properly classifying as a public charity any public library meeting the specific standards set out in the bill.

S. 696 would include as public charities (and thus exclude from the category of private foundations) any organizations operating either (1) libraries established pursuant to certain federal or state statutes, or (2) libraries open to the public free of charge. With respect to the latter, which is the more pertinent for the purposes of my remarks, S. 696 would define as a "qualified library" only an organization which (1) is open and available to the general public, (2) does not charge a fee for admission or use of its collection on the premises, and (3) is operated by an organization, none of whose income is expended for purposes other than the construction, maintenance, expansion, operation, or management of the library, its collection, and the premises on which it is located. We believe that these three tests -- all of which must be met in order to be a "qualified library" under the pertinent definition -- provide substantial safeguards of the public interest, and justify the classification of such libraries as public charities under the Internal Revenue Code.

Under present law, absent S. 696, such libraries are classified as private foundations, quite commonly (as in the case of the Huntington Free Library and Reading Room) private operating foundations. The "private" classification, among other things, subjects these institutions to a 2-percent excise tax on net investment income and regulates, generally within the confines of annual accounting periods, the type and level

of expenditures. Given the obvious public service rendered by libraries acting under the pertinent definition of S. 696, both of these burdens should be lifted so that these public libraries, like other educational institutions already listed in the public charity category, may operate as efficiently as possible in these difficult, inflationary times. Both the excise tax and the expenditure requirement keyed to yearly periods have the effect of diverting elsewhere limited funds which could best be spent in maintaining library buildings and in preserving (and building) library collections used by the public.

In wholeheartedly supporting S. 696, we would also like to take this opportunity to make a few suggestions as to specific bill language and as to other clarifications which we would think suitable for inclusion in the Committee's report.

First, the bill requires that "none" of the qualifying library's income be expended other than on its own collection and premises. As one who has worked as a lawyer and appeared before this Committee before on tax legislation, I know this is strong language. When such language has been used elsewhere in the Internal Revenue Code, it has often generated litigation and produced obviously unintended results, requiring further Congressional action to set straight. In order to give some protection with respect to small disbursements which might be misclassified or extraordinary events not controllable by the

library, we recommend that the relevant language be recast to read, ". . . substantially all of whose income is expended for the construction, maintenance, . . . [etc.] of such library . . . ." In this connection, we assume, although the bill does not literally so specify, that expenditures to preserve the library's endowment are intended to be permitted by S. 696.

Second, S. 696 requires that a qualified library not charge a fee for admission to the premises or use on the premises of the library collection. In the ordinary meaning of words, free admission and free use on the premises of the collection should be clear enough. To avoid misunderstandings, however, we suggest that some elaboration in the Committee's report could be helpful. For example, the right of a reader to obtain in the library a copy of a book so that he may study it freely should not include the right, free of charge, to obtain permissible photographic copies of pages from such book. Nor should a library be foreclosed from making a suitable charge to cover its costs when a reference request of the librarian goes beyond normal assistance in card catalog use, finding volumes, etc., and requires extensive, specialized assistance (in some instances perhaps over a period of weeks or months).

In conclusion, S. 696 is a sound proposal, and, having noted the testimony of the Treasury Department, we hope that the Department will reexamine its position and ultimately also support enactment of the bill. The specific tests required by

S. 696 to be a qualified library necessarily provide the public with full access to its activities and leave little opportunity for abuse. Accordingly, in this period when unnecessary federal regulatory processes are being reexamined, S. 696 would achieve the doubly constructive purpose of reducing regulatory burdens and freeing more private funds to preserve the heritage and activities of our country's public libraries. In addition, the excise tax level and number of institutions involved are such that no substantial federal revenues would be lost through enactment of S. 696. Finally, while there are probably relatively few institutions which would be shifted from private to public charity status by S. 696, the bill would not create special exceptions of narrow application. Rather, it would eliminate a narrow distinction created in 1969 -- without any known evidence of specific intention to do so -- and enable qualified libraries to rejoin the group of basic institutions in our society (including educational institutions, hospitals and churches) which most citizens generally would recognize as public charities.

THE UNIVERSITY OF KANSAS

Office of the Chancellor
223 Strong Hall, Lawrence, Kansas 66045
(913) 864-3131

January 4, 1981

Robert E. Lighthizer, Chief Counsel
Subcommittee on Taxation and Debt Management
Committee on Finance
2227 Dirksen Senate Office Building
United States Senate
Washington, D.C. 20510

Dear Mr. Lighthizer:

RE: S.696

It has been brought to my attention that Senate Bill 696, concerning the tax-exempt status of organizations devoted to the operation of a library that serves the public, is currently before the Finance Subcommittee on Taxation and Debt Management. The Linda Hall Library in Kansas City, Missouri, is an organization that would receive tax relief from the passage of this legislation. The University of Kansas endorses the provisions of S.696.

The importance of the Linda Hall Library to the nation, and especially to the central Midwest, cannot be overstated. In addition to being one of the richest resources for scientific and technical books, journals, and conference proceedings, the Linda Hall Library is also a valuable and generous organization that engages wholeheartedly in cooperative ventures with the University of Kansas Libraries and other libraries in the Midwest and throughout the nation. By free and generous loans of its materials, the Linda Hall Library serves a national constituency of students, scholars, and the general public. In the 1980 fiscal year, for example, nearly 1,000 items were borrowed from the Linda Hall Library for use at the University of Kansas (Lawrence). This represents approximately 25% of the interlibrary loan requests generated in the scientific and technical disciplines at the University of Kansas. In addition to generous interlibrary loan services, the professional staff at the Linda Hall Library also provides superb reference services by answering a multitude of questions raised by libraries nationwide.

In this time of escalating library costs, specialized organizations such as the Linda Hall Library provide a necessary and almost irreplaceable resource for other libraries. These organizations serve a broad clientele and attempt to meet the needs of the academic, business, and research communities far beyond local geographic limits. On behalf of the University of Kansas, I urge the Committee on Finance to consider favorably the provisions of S. 696.

Sincerely yours,

Gene A. Budig
Chancellor

GAB:dw

cc: The Honorable Bob Dole