1981–82 MISCELLANEOUS TAX BILLS II

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 352

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 WITH RESPECT TO THE DEFINITION OF POLITICAL CONTRIBUTION

S. 483

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE THAT THE OCCUPATIONAL TAX ON WAGERING SHALL NOT APPLY IN ANY STATE IN WHICH WAGERING IS PERMITTED BY LAW

S. 502

A BILL TO AMEND THE INTERNAL REVENUE CODE TO PERMIT FOREIGN PENSION PLANS TO INVEST IN THE UNITED STATES ON A NONTAXABLE BASIS

S. 565

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO INCREASE THE AMOUNT OF THE DEDUCTION ALLOWABLE FOR CERTAIN MOVING EXPENSES

MARCH 16, 1981

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1981-82 MISCELLANEOUS TAX BILLS II

MONDAY, MARCH 16, 1981

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

The subcommittee met, pursuant to notice, at 10 a.m., in room 2221, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the subcommittee) presiding.

Present: Senators Packwood, Long, Byrd, and Moynihan.

[Press release; tax bills S. 352, S. 483, S. 502, and S. 565; and the joint committee print follow:]

[Press Release No. 81-109]

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

Senator 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 March 16, 1981 on miscellaneous tax bills.

The hearing will begin at 10:00 a.m. in Room 2221 of the Dirksen Senate Office Building.

The following pieces of legislation of general application will be considered:

S. 352—Introduced by Senator Packwood. Would amend I.R.C. Section 41(c) to permit a credit to be taken for otherwise qualifying political contributions to organizations seeking to influence the nomination or election of candidates for elective office.

S. 483—Introduced by Senator Cannon for himself and Senator Laxalt. Would provide that the occupational tax on wagering shall not apply in any State in which wagering is permitted by law.

S. 502—Introduced by Senator Moynihan for himself and Senator Wallop. Would extend the income tax exemption for domestic pension plans to foreign pension plans.

S. 565—Introduced by Senator Stevens. This bill would increase the limitations on the amounts deductible as certain moving expenses and replace the current fixed statutory amounts with limits determined by regulation.

Witnesses who desire to testify at the hearing on March 16, 1981 must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, to be received by no later than noon on March 11, 1981. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony.

Legislative Reorganization Act.—Senator Packwood stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon on Friday, March 13, 1981.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by noon on Friday, March 13, 1981.

(4) Witnesses should not read their written statements to the Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

Written statements.—Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record on the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Monday, March 30, 1981.

II

97TH CONGRESS
1ST SESSION

S. 352

To amend the Internal Revenue Code of 1954 with respect to the definition of political contribution.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 3 (legislative day, JANUARY 5), 1981

Mr. PACKWOOD 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 with respect to the definition of political contribution.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That subparagraph (B) of section 41(c)(1) of the Internal
4 Revenue Code of 1954 (defining political contribution) is
5 amended by striking out "to further the candidacy of such
6 individual or individuals for nomination or election to such
7 office" and inserting in lieu thereof "for such purpose".

1 SEC. 2. The amendment made by the first section of this
2 Act shall apply with respect to taxable years ending after
3 December 31, 1971.

II

97TH CONGRESS
1ST SESSION

S. 483

To amend the Internal Revenue Code of 1954 to provide that the occupational tax on wagering shall not apply in any State in which wagering is permitted by law.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 17 (legislative day, FEBRUARY 16), 1981

Mr. CANNON (for himself and Mr. LAXALT) 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 provide that the occupational tax on wagering shall not apply in any State in which wagering is permitted by law.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) section 4402 of the Internal Revenue Code of 1954
4 (relating to exemptions) is amended—
5 (1) by striking "or" at the end of paragraph (2),
6 (2) by striking out the period at the end of para-
7 graph (3) and inserting in lieu thereof a comma and
8 "or", and

1 (3) by adding at the end thereof the following new
2 paragraph:
3 "(4) STATE-AUTHORIZED WAGERS.—On any
4 wager authorized under State law.".
5 (b) Subchapter B of chapter 35 of the Internal Revenue
6 Code of 1954 (relating to occupational tax) is amended by
7 redesignating section 4414 as 4415, and by inserting after
8 section 4413 the following new section:
9 **"SEC. 4414. TAX NOT TO APPLY TO WAGERING AUTHORIZED**
10 **UNDER STATE LAW.**
11 "The tax imposed by section 4411 shall not apply in the
12 case of a person authorized under the law of any State or
13 political subdivision thereof to engage in the business of ac-
14 cepting wagers or to receive wagers for or on behalf of any
15 such person.".
16 (b) The table of sections for such subchapter is amended
17 by striking out the last item and inserting in lieu thereof the
18 following items:

"Sec. 4414. Tax not to apply to wagering authorized under State law.
"Sec. 4415. Cross references.".

19 SEC. 2. The amendments made by the first section of
20 this Act shall apply with respect to taxable periods beginning
21 after June 30, 1981.

II

97TH CONGRESS
1ST SESSION

S. 502

To amend the Internal Revenue Code to permit foreign pension plans to invest in the United States on a nontaxable basis.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 19 (legislative day, FEBRUARY 16), 1981

Mr. MOYNIHAN (for himself and Mr. WALLOP) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code to permit foreign pension plans to invest in the United States on a nontaxable basis.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) section 501(c) (relating to organizations exempt from
4 tax under section 501(a)) is amended by adding the following
5 new paragraph:
6 "(22) A trust, corporation or fund which is formed
7 pursuant to, or as part of, a foreign pension plan which
8 satisfies the following requirements—

1 "(A) the plan is maintained primarily to pro-
2 vide retirement or similar benefits to employees
3 who are primarily nonresident alien individuals;
4 "(B) the assets of the plan are segregated
5 from the assets of the employer or employers
6 maintaining the plan pursuant to the laws of the
7 foreign country in which such plan is maintained;
8 and
9 "(C) under the laws of the foreign country in
10 which the plan is maintained, the income of the
11 plan is exempt from tax or is subject to a lower
12 rate of taxation than is generally imposed on
13 other residents of such foreign country.
14 The exemption provided by this paragraph shall be
15 subject to adjustment under section 896 (relating to the
16 adjustment of tax of nationals of foreign countries), and
17 no later than January 1, 1984, the President shall
18 report to Congress on the extent to which he has exer-
19 cised the authority under that section with respect to
20 relief from foreign income taxes for plans described in
21 section 401(a). If all of the assets of a trust, corpora-
22 tion or fund are held for the benefit of one or more for-
23 eign pension plans described in this paragraph, such
24 trust, corporation or fund shall itself be considered to
25 satisfy the requirements of this paragraph.".

1 (b) Section 512(a)(2) (relating to the unrelated business
2 taxable income of certain foreign organizations) is amended
3 by inserting "or section 501(c)(22)" immediately after "sec-
4 tion 511".
5 (c) Section 805(d) (relating to pension plan reserves of
6 life insurance companies) is amended by adding the following
7 new paragraph:
8 "(7) purchased by foreign pension plan (within the
9 meaning of section 501(c)(22)).".
10 (d) The amendments made by this Act shall become ef-
11 fective on January 1, 1981.

II

97TH CONGRESS
1ST SESSION

S. 565

To amend the Internal Revenue Code of 1954 to increase the amount of the deduction allowable for certain moving expenses.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 24 (legislative day, FEBRUARY 16), 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 increase the amount of the deduction allowable for certain moving expenses.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) subparagraph (A) of section 217(b)(3) of the Internal
4 Revenue Code of 1954 (relating to dollar limits) is amended
5 to read as follows:
6 "(A) DOLLAR LIMITS.—
7 "(i) EXPENSES DESCRIBED IN SUBPAR-
8 AGRAPH (C) OR (D) OF PARAGRAPH (1).—

BEST COPY AVAILABLE

1 The aggregate amount allowable as a deduc-
2 tion under subsection (a) in connection with a
3 commencement of work which is attributable
4 to expenses described in subparagraph (C) or
5 (D) of paragraph (1) shall not exceed $1,500.
6 "(ii) EXPENSES OF SALE OR PUR-
7 CHASE OF RESIDENCE.—The aggregate
8 amount allowable as a deduction under sub-
9 section (a) in connection with a commence-
10 ment of work which is attributable to ex-
11 penses described in subparagraph (A) or (B)
12 of paragraph (2) shall not exceed the
13 applicable Federal maximum reimbursement.
14 "(iii) LEASE EXPENSES.—The aggre-
15 gate amount allowable as a deduction under
16 subsection (a) in connection with a com-
17 mencement of work which is attributable to
18 expenses described in subparagraph (C) or
19 (D) of paragraph (2) shall not exceed $2,500
20 reduced by the aggregate amount so allow-
21 able which is attributable to expenses de-
22 scribed in subparagraph (B) of paragraph (2).
23 "(iv) APPLICABLE FEDERAL MAXIMUM
24 REIMBURSEMENT.—For purposes of clause

1 (ii), the term 'applicable Federal maximum
2 reimbursement' means—
3 "(I) in the case of expenses de-
4 scribed in subparagraph (A) of para-
5 graph (2), the overall limitation on re-
6 imbursement for expenses for the pur-
7 chase of a home established pursuant to
8 such regulations.
9 Determinations under the preceding sentence
10 shall be made under the regulations as in
11 effect on the date of the sale of the former
12 residence or the purchase of the new resi-
13 dence (as the case may be).".
14 (b)(1) Subparagraph (B) of section 217(b)(3) of such
15 Code (relating to dollar limitations with respect to husband
16 and wife) is amended by striking out the last sentence and
17 inserting in lieu thereof the following: "In the case of a hus-
18 band and wife filing separate returns, subparagraph (A) shall
19 be applied by substituting '$750' for '$1,500', 'one-half of
20 the applicable Federal maximum reimbursement' for 'the ap-
21 plicable Federal maximum reimbursement', and '$1,250' for
22 '$2,500'.".
23 (2) Subparagraph (B) of section 217(h)(1) of such Code
24 (relating to increase in limitations in case of foreign moves) is

1 amended by striking out "and by substituting '$6,000' for
2 '$3,000'.".
3 (3) Subparagraph (C) of section 217(h)(1) of such Code
4 is amended to read as follows:
5 "(C) subsection (b)(3)(B) shall be applied as if
6 the last sentence of such subsection read as fol-
7 lows: 'In the case of a husband and wife filing
8 separate returns, subparagraph (A) shall be ap-
9 plied by substituting "$2,250" for "$4,500",
10 "one-half of the applicable Federal maximum re-
11 imbursement" for "applicable Federal maximum
12 reimbursement", and "$1,250" for "$2,500".'".
13 (c) The amendments made by this section shall apply to
14 taxable years beginning after December 31, 1981.

77-444 O - 81 - 2

DESCRIPTION OF TAX BILLS
(S. 352, S. 483, S. 502, and S. 565)

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 March 16, 1981, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are four bills scheduled for the hearing: S. 352 (relating to the political contributions credit), S. 483 (relating to the excise tax on wagers and the occupational tax on wagering), S. 502 (relating to exemption for foreign pension plans), and S. 565 (relating to the deduction for moving expenses).

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

I. SUMMARY

1. S. 352—Senator Packwood

Political Contributions Credit

Present law (Code sec. 41) allows individual taxpayers an income tax credit equal to one-half the amount of the taxpayer's political contributions during the year, but not in excess of $50 ($100 in the case of a joint return).

Contributions eligible for the credit include contributions made to organizations operated to influence the nomination or election of candidates for public office, for use by the organization to further the candidacy of such candidates. In "letter rulings" issued in February 1980, the Internal Revenue Service ruled that the credit was not available for contributions made to certain organizations described as carrying on activities to oppose the nomination or election of particular candidates for public office.

Under the bill, the credit would be available for contributions made to campaign organizations operated to influence the nomination or election of candidates for public office, for use by the organization for such purpose. Thus under the bill, the credit would be available for contributions made to campaign organizations which either support or oppose particular candidates for office.

The provisions of the bill would be effective with respect to taxable years ending after December 31, 1971 (the effective date of the political contributions credit provisions as enacted in the Revenue Act of 1971).

2. S. 483—Senators Cannon and Laxalt

Exemption From Excise Tax on Wagers and Occupational Tax on Wagering in States Authorizing Wagering

Under present law, a two-percent excise tax is imposed on the amount of certain wagers. In addition, an annual $500 occupational tax is imposed on a person who is liable for the excise tax or who receives wagers subject to the tax. These taxes do not apply with respect to parimutuel wagering, a wager placed in a coin-operated device, or a wager in a State-conducted lottery (Code secs. 4401–4405, 4411–4414).

The bill would exempt from the two-percent excise tax any wager authorized under State law, and would exempt from the annual $500 occupational tax any person authorized by State or local law to engage in the business of accepting wagers or to receive wagers on behalf of any such person.

The bill would apply to taxable periods beginning after June 30, 1981.

4

3. S. 502—Senators Moynihan and Wallop

Exemption for Foreign Pension Plans

Under present law, income earned by a qualified U.S. pension plan, or income earned by life insurance companies on behalf of qualified plans, generally is not subject to income tax until distributed as benefits (Code sec. 501). In many instances, foreign pension plans fail to satisfy the requirements under U.S. tax law for qualified status. Accordingly, U.S.-source investment income of foreign pension plans is subject to U.S. tax pursuant to the income tax rules generally applicable to foreign investors. Also, income earned by life insurance companies on behalf of foreign pension plans is taxable to the insurance company as well as to the pension plan when the income is distributed to the plan.

The bill would exempt certain foreign pension plans from tax on U.S.-source income and would also exempt U.S.-source income when earned on behalf of such foreign plans through pooled asset accounts managed by U.S. insurance companies. A foreign pension plan would qualify for this exemption if (1) the plan is maintained primarily to provide retirement or similar benefits to employees who are primarily nonresident alien individuals; (2) the assets of the plan must, pursuant to foreign law, be segregated from the employer's assets; and (3) the income of the plan is exempt from foreign tax or is subject to a rate lower than the generally applicable rate of foreign tax.

The provisions of the bill would be effective on January 1, 1981.

4. S. 565—Senator Stevens

Increased Dollar Limitations on Moving Expense Deduction

Present law provides a deduction from gross income for certain expenses of job-related moves, including expenses related to the sale of, or settlement of a lease on, the old residence and the purchase of, or acquisition of a lease on, a new residence at the new job location (Code sec. 217). The maximum amount deductible for qualified sale, purchase, or lease expenses is $3,000 ($6,000 in the case of foreign moves), reduced by any moving expense deduction amount allowed for premove house-hunting trips or temporary living expenses.

The bill generally would increase the amount of qualified sale or purchase expenses deductible as moving expenses to the maximum reimbursement allowed to a Federal employee for such expenses (currently $12,000). This limitation on sale or purchase expenses under the bill would not be reduced by any amount deducted for premove house-hunting trips or temporary living expenses. Qualified lease expenses would be deductible up to a maximum of $2,500, reduced by expenses attributable to the purchase of a new residence at the new job location.

The new limitations under the bill would apply to both foreign and domestic moves and would be applicable for taxable years beginning after December 31, 1981.

II. DESCRIPTION OF BILLS

1. S. 352—Senator Packwood

Political Contributions Credit

Present law

Present law (Code sec. 41) allows individual taxpayers a nonrefundable income tax credit equal to one-half the amount of the taxpayer's contributions during the year to candidates for elective public office, but not in excess of $50 ($100 in the case of a joint return).

The credit generally is available for contributions made to: (1) a candidate for nomination or election to Federal, State, or local public office in general, primary, or special elections, for use by the candidate to further his or her candidacy; (2) certain campaign organizations formed and operated with respect to the nomination or election of candidates for public office; (3) national, State, or local committees of a national political party; and (4) newsletter funds of an elected public official or candidate for elective public office. With respect to campaign organizations, Code section 41(c)(1)(B) provides that the credit is available for contributions to any committee, association, or organization which is "organized and operated exclusively for the purpose of influencing, or attempting to influence, the nomination or election of one or more individuals who are candidates for nomination or election to any Federal, State, or local elective public office, for use by such committee, association, or organization to further the candidacy of such individual or individuals for nomination or election to such office * * *."

In several "letter rulings" issued in February 1980,[1] the Internal Revenue Service ruled that the political contributions credit was not available for contributions made to certain organizations described as carrying on activities to oppose the nomination or election of particular candidates for public office. In these rulings, the Revenue Service took the position that because the organizations at issue directed their activities at opposing the election of targeted candidates, the organizations did not use their funds to further the candidacy of one or more candidates, within the meaning of Code section 41(c)(1)(B).

Issue

The issue is whether the political contributions credit should be available for contributions made to a campaign organization organized and operated exclusively for the purpose of influencing, or attempting to influence, the nomination or election of one or more individuals who

[1] IRS Letter Rulings 8019024 (February 12, 1980), 8019056 (February 13, 1980), and 8019057 (February 13, 1980).

are candidates for nomination or election to any Federal, State, or local elective public office, whether by directly supporting particular candidates for office or by opposing particular candidates for office.

Explanation of the bill

The bill would modify the provisions of present law with respect to the credit for contributions made to campaign organizations, by deleting the specific language in Code section 41(c)(1)(B) referring to use of contributions by the organization "to further the candidacy of such individual or individuals for nomination or election to such office." Under the bill, the political contributions credit would be available for contributions made to a campaign organization formed and operated exclusively to influence the nomination or election of candidates for public office, for use by the organization for such purpose.

Thus under the bill, the credit would be available for contributions made to such campaign organizations, whether the funds are used by the organization directly to support particular candidates for office or are used by the organization in activities to oppose particular candidates for office. For example, the credit would be available for contributions made to a political campaign organization which expends its funds to oppose a particular public officeholder who is a candidate for reelection,[2] whether or not an opposing candidate for the office has announced his or her candidacy for such office at the time such funds are so expended.

Effective date

The amendment made by the bill would be effective with respect to taxable years ending after December 31, 1971 (the effective date of the political contributions credit provisions as enacted in the Revenue Act of 1971).

Revenue effect

It is estimated that the bill would reduce budget receipts by approximately $1 million annually.

---

[2] Code sec. 41(c)(2) defines a "candidate" as an individual who "publicly announces before the close of the calendar year following the calendar year in which the contribution or gift is made that he is a candidate for nomination or election to such office * * *."

2. S. 483—Senators Cannon and Laxalt

Exemption from Excise Tax on Wagers and Occupational Tax on Wagering in States Authorizing Wagering

Present law

Under present law, a two-percent excise tax is imposed on the amount of certain wagers. For this purpose, a wager means (1) a wager placed with a person who is in the business of accepting wagers on the outcome of a sports event or contest, (2) a wager with respect to a sporting event or contest placed in a wagering pool conducted for profit, and (3) a wager placed in a lottery conducted for profit (including the numbers game, policy, and similar types of wagering). However, this excise tax is not imposed on (1) wagers placed with a parimutuel wagering enterprise licensed under State law, (2) wagers placed in coin-operated gaming devices, such as slot machines, and (3) State-conducted wagering, such as sweepstakes and lotteries (Code secs. 4401–4405, 4421–4424). Under present law, the two-percent excise tax is imposed on so-called off-track betting authorized by State law.

Every person engaged in the business of accepting wagers is liable for the tax with respect to wagers which are placed with such person and which are subject to the tax.

Under present law, an occupational tax of $500 per year is imposed on each person who is liable for the two-percent excise tax on wagers and on each person who is engaged in receiving wagers for or on behalf of such person (Code secs. 4411–4414).

Issues

The issues are whether the two-percent excise tax should be imposed on wagers which are authorized by State law and whether a person authorized under State or local law to receive wagers should be subject to the occupational tax on wagering.

Explanation of the bill

Under the bill, the two-percent excise tax on certain wagers would not apply to wagers authorized by State law. Also under the bill, the occupational tax would not apply to a person authorized by State or local law to engage in the business of accepting wagers. The exemption from the occupational tax would be intended to apply only with respect to the wagering business authorized under State or local law.

Effective date

The provisions of the bill would apply to taxable periods beginning after June 30, 1981.

Revenue effect

It is estimated that this bill would reduce budget receipts by $8 million in fiscal year 1981; $14 million in fiscal year 1982; $15 million in fiscal year 1983; $17 million in fiscal year 1984; $18 million in fiscal year 1985; and $20 million in fiscal year 1986.

Prior Congressional consideration

On February 29, 1980, the Committee on Finance held a hearing on a bill (S. 485, 96th Cong.) which was identical in substance to the present bill. No further action was taken on S. 485.

Later during the 96th Congress, the Committee on Finance twice approved provisions to repeal the excise tax on wagering and the $500 occupational tax (H.R. 3755, Sen. Rpt. 96-912, and H.R. 7171, Sen. Rpt. 96-1032). No further action was taken on H.R. 3755. The provisions in H.R. 7171 repealing the wagering tax and occupational tax were deleted, by Senate floor amendment, prior to passage of that bill by the Senate on December 13, 1980 (and subsequent enactment of that bill as P.L. 96-613).

3. S. 502—Senators Moynihan and Wallop

Exemption for Foreign Pension Plans

Present law

Foreign pension plans

Under present law income earned by a qualified U.S. pension plan generally is not subject to tax until distributed as benefits (Code sec. 501). However, as discussed below, foreign pension plans generally do not satisfy the requirements for qualified pension plans, so that U.S.-source income earned by such a foreign plan is subject to U.S. tax under the rules generally applicable to foreign investors.

In general, a pension plan is treated as qualified if it is a U.S. trust and if (1) the plan does not discriminate in favor of certain employees, (2) the plan meets certain minimum standards designed to protect employee benefits, and (3) benefits or contributions under the plan are within prescribed limits (Code secs. 401-415). In many instances, foreign pension plans fail to satisfy the requirements under U.S. tax law for qualified status because of differences in the tax and pension laws between the United States and foreign countries. For example, the foreign country may require the plan assets to be held in a trust organized outside the United States, or the foreign country's rules on nondiscrimination or benefit security may not satisfy U.S. requirements.

Accordingly, nonqualified foreign pension plans are subject to tax on U.S.-source investment income on the same basis as other foreign investors. In general, this means that U.S.-source investment income is subject to a 30 percent withholding tax or, where applicable, a lower rate (e.g., as low as 5 percent on dividends and elimination of the tax on interest) provided for in a U.S. income tax treaty. Most foreign pension plans investing in the United States are residents of countries with which the United States has an income tax treaty and, thus, pay a reduced rate of U.S. tax on their U.S.-source income.

Although the United States taxes the U.S. source income of a nonqualified foreign pension plan and exempts the income of a U.S. qualified pension plan, the U.S. taxation of the income of both plans is similar in that the income from both plans is taxed only once by the United States. The income of a qualified U.S. plan is not taxed when it is earned by the plan, but it is taxed to the pensioner when it is paid out as a pension. Conversely, the U.S.-source income of a nonqualified foreign pension plan is taxed when it is earned by the plan, but there is no U.S. tax on the income when it is paid to the foreign pensioner.

Although the U.S. income of a foreign pension plan is only taxed once by the United States, the fact that a tax is imposed by the United States at the plan level is nevertheless a disadvantage to the foreign

pension plan for two reasons. First, the foreign pension plan does not have the advantage that a qualified U.S. plan has of deferring the payment of the tax until some future date when the pension to which the income relates is paid. Second, unless the foreign pensioner's country of residence allows a credit for the U.S. tax paid by the foreign pension plan, the plan's U.S. source income is taxed twice, that is, once by the United States at the plan level, and again by the foreign country at the pensioner level.

This system of taxation is not dissimilar from the system of foreign taxation experienced by U.S. pension plans investing in foreign countries. Generally, foreign pension plans are exempt from tax in their home countries, but the pensioner pays a tax to the foreign country on receipt of the pension. U.S. pension plans, on the other hand, are taxed on their income from that country, but there generally is no foreign tax on the pension when it is paid to the U.S. pensioner. However, the pension is subject to U.S. tax when it is paid to the U.S. pensioner.

Life insurance companies

Currently, some pension plans use life insurance companies to invest all or a portion of the plan funds. If the pension plan is qualified, income earned by the life insurance company on behalf of the plan is not taxable either to the insurance company or to the plan. However, if the pension plan is not qualified, some or all of the income earned by the life insurance company on behalf of the pension plan may be taxable to the insurance company. The income is also taxed under the foreign investor rules when it is paid to the foreign pension plan.

Issues

The issues are whether foreign pension plans which do not meet the U.S. tax law requirements for status as qualified pension plans should be exempt from U.S. taxation on U.S.-source income, and whether U.S.-source income earned by U.S. insurance companies on behalf of such foreign plans should be exempt from U.S. taxation.

Explanation of the bill

Under the bill, a trust or corporation formed pursuant to a foreign pension plan would be exempt from U.S. tax if it satisfies three requirements. First, the plan must be maintained primarily to provide retirement or similar benefits to employees who are primarily nonresident alien individuals. Second, the assets of the plan must, pursuant to foreign law, be segregated from the employer's assets. Third, the income of the plan must be exempt from foreign tax or be subject to a rate lower than the generally applicable rate of foreign tax. Under the bill, the President would have authority under current Code section 896 to eliminate the tax exemption with respect to pension plans of a particular foreign country if that country does not extend a reciprocal exemption for U.S. plans investing in that country.

In addition, the bill would exempt foreign pension funds which invest in the United States through pooled asset accounts managed by U.S. insurance companies.

Effective date

The provisions of the bill would be effective on January 1, 1981.

Revenue effect

There is not at present sufficient information available to estimate how much U.S. tax is currently collected on U.S.-source income earned by foreign pension trusts. In addition to the revenue loss attributable to the tax presently collected on existing investments, it is estimated that this proposal would result in a revenue loss of approximately $10 million a year for each $1 billion net increase in foreign pension investments in the United States resulting from the exemption.

4. S. 565—Senator Stevens

Increased Dollar Limitations on Moving Expense Deduction

Present law

Under present law, employees and self-employed individuals are allowed a deduction from gross income for certain expenses of moving to a new residence in connection with beginning work at a new location (Code sec. 217).

Expenses of moving eligible for the deduction include reasonable expenses of transporting the taxpayer and members of the household, as well as household goods and personal effects, from the old to the new residence; the cost of meals and lodging en route; expenses for premove house-hunting trips; temporary living expenses for up to 30 days (90 days in the case of foreign moves) at the new job location; and certain expenses related to the sale of, or settlement of a lease on, the old residence and the purchase of, or acquisition of a lease on, a new residence at the new job location.

The moving expense deduction is subject to a number of dollar limitations. The maximum aggregate deduction for premove house-hunting trips and temporary living expenses at the new job location is $1,500. A maximum deduction of $3,000 (reduced by any deduction allowed for premove house-hunting trips or temporary living expenses) is allowed for qualified sale, purchase, or lease expenses. If a husband and wife file separate returns, these maximum deductible amounts are halved.

In the case of foreign moves, the maximum aggregate deduction for premove house-hunting trips and temporary living expenses is $4,500. The maximum deduction for qualified sale, purchase, or lease expenses is $6,000 (reduced by any deduction allowed for premove house-hunting trips or temporary living expenses).

The moving expense deduction is available only if the taxpayer's new principal place of work is at least 35 miles farther from the former residence than is the former principal place of work (or the former residence, if the taxpayer has no former place of work). During the 12-month period following the move, the taxpayer generally must be a full-time employee in the new general location for at least 39 weeks during the next 12-month period. A self-employed person, during the 24-month period following arrival at the new work location, generally must perform services on a full-time basis for at least 78 weeks, with at least 39 weeks of full-time work falling within the first 12 months. In general, members of the Armed Forces are exempt from these mileage and full-time work requirements.

Issue

The issue is whether the limitation on the amount of qualified sale, purchase, or lease expenses which may be taken into account for purposes of the moving expense deduction should be increased.

Explanation of the bill

Under the bill, the limitation on the moving expense deduction for amounts attributable to qualified sale or purchase expenses would be equal to the maximum reimbursement allowed to a Federal employee for such expenses. At present, this maximum reimbursement amount is $12,000.[1] (Unlike present law, the limitation on sale or purchase expenses under the bill would not be reduced by any deduction allowed for premove house-hunting trips or temporary living expenses.) In the case of qualified lease expenses, the limitation under the bill would be $2,500, reduced by expenses attributable to the purchase of a new residence at a new job location.

The new limitations would apply to both domestic and foreign moves. As under present law, if a husband and wife file separate returns, these maximum deductible amounts would be halved.

Effective date

The amendments made by the bill would apply to taxable years beginning after December 31, 1981.

Revenue effect

It is estimated that this provision would reduce budget receipts by $272 million in fiscal year 1982, by $940 million in fiscal year 1983, by $1,057 million in fiscal year 1984 and $1,189 million in fiscal year 1985.

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[1] Federal Property Management Reg. sec. 101-7.

Senator PACKWOOD. The subcommittee will come to order.
Our first witness will be the Honorable John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

Mr. CHAPOTON. Thank you, Mr. Chairman.

First we will discuss whether a foreign pension plan should be exempt from tax on U.S.-source income. The Treasury Department does oppose that exemption.

The second is whether a life insurance company should be able to invest on behalf of foreign pension plans without themselves incurring any U.S. tax liability. We believe that such an amendment would not be appropriate unless the exemption for foreign pension plans were to be enacted.

Let me go through a little background here.

Under present law, unless a lower treaty rate applies, foreign pension plans, like other foreign investors, are subject to the 30-percent U.S. withholding tax on all fixed and determinable U.S.-source income.

Capital gains may also be subject to tax from investments made in this country.

S. 502 would exempt foreign pension plans from such tax in order to attract investment by foreign pension plans in this country.

While we certainly strongly favor increasing capital formation in the United States, we think that if tax incentives are to be used for this purpose, they must not make arbitrary distinctions among categories of investors.

It is not clear to us why foreign pension plans should alone receive tax exemption. The purpose of the proposed tax exemption in this bill appears to suggest its extension to all foreign investors.

The real question is whether foreign pension plans should be treated more favorably than other foreign investors.

It is argued that foreign pension funds, which are tax exempt in their home countries should receive special U.S. tax treatment, because that treatment is enjoyed by their U.S. counterparts, but domestic qualified plans are tax exempt because they provide a valuable social purpose here. They take pressure off the social security system and they provide higher retirement benefits for U.S. residents.

In the case of a foreign pension plan, this benefit would adhere to the foreign governments and to nonresident alien employees.

There is no reason for the United States to provide a tax incentive or subsidize foreign social policy objectives.

Moreover, while domestic pension plans enjoy a tax-exempt status, the U.S. employee, upon retirement, receives income from the domestic pension plan, and is taxed on that income.

Foreign employees receiving benefits on retirement from foreign pension plans, would not be subject to U.S. tax on the previously untaxed U.S.-source income. Such a tax would be collected only by the foreign government. So there is not similarity of treatment with respect to the taxation of the employees upon retirement.

I should also mention that we have technical problems with S. 502. IRS would have to determine whether such a foreign plan meets the

primary purpose, the assets segregation, and reduced rate of tax test, provided in subsection A of the bill.

In addition, it has a reciprocity provision. The President would have the power to revoke the exemption of a foreign pension plan if the foreign plan home country doesn't grant favored tax treatment to U.S. companies' plans.

While we would support a reciprocity agreement, even if it does run counter to the overall purpose of the legislation to encourage investment in the United States, we think that the reciprocity provision in S. 502 is unworkable, because it would require the IRS to study the comparability of foreign laws and benefits and the provisions of plans abroad with the laws of the United States.

Our experience, under section 883, which provides for a similar reciprocity for foreign shipping and air transport, is that the reciprocal exemption mechanism has been a source of constant problems. We would hesitate to see that mechanism applied in the very complex area of qualified pension plans.

I should also mention that last December, the Congress passed a bill taxing nonresident aliens and foreign corporations on their gains delivered from investments in U.S. real estate. This bill would run counter to that policy, because it would exempt foreign investment, investment in real estate by foreign pension plans, from tax and would give rise to the possibility of abuse by small foreign concerns setting up pension plans for the purpose of investing in U.S. real estate and thereby avoiding the tax recently enacted by Congress.

The second issue in S. 502 is the treatment of life insurance companies in their capacity as managers of U.S. investment by foreign pension plans.

In general, life insurance companies are not taxed on income from the investment of assets on behalf of qualified domestic pension plans, instead the income is passed through to the pension trust, which by definition is tax exempt, and the tax falls only on the planned beneficiaries following retirement.

Subsection C of S. 502 would bring the treatment of life insurance companies when managing assets of foreign pension plans into line with the treatment that they enjoy when managing domestic qualified plan assets.

In our view, the appropriateness of this subsection C depends upon whether the foreign pension plan is accorded a blanket exemption from tax. Because we have opposed the exemption, we think that subsection C is unnecessary and inappropriate.

We have attempted to do some revenue estimating under this bill, Mr. Chairman. It is difficult to do. We come up with a very rough figure of approximately $90 million loss in fiscal 1982, but I must say that this does not take into account any increased foreign investment as a result of passage of the bill.

As stated, the Treasury Department does oppose enactment of S. 502.

I will turn now to S. 565, the deduction for moving expenses.

It would increase the maximum amount allowed as a tax deduction for certain employee moving expenses.

It would set the limit on the deduction of expenses from selling and purchasing a new home or breaking a lease at a dollar level equal to the overall maximum amount which the Federal Government would

reimburse its employees for a similar move under Federal regulations in effect at the time of the move.

Present law, section 217 of the code, permits a deduction for expenses of individuals attributable to moving to a new place of permanent employment, provided it meets certain requirements; that is, the move has to be at least 35 miles and the employee must work at the new location at least 39 weeks in the year following the move.

The deduction for moving household goods and for personal expenses of traveling to the new location is allowed without a dollar limit under present law, but indirect expenses, those for house-hunting trips and temporary living expenses, are limited to $1,500; and the deduction for qualified residential expenses, that is, expenses of selling the new home, expenses of breaking a lease, et cetera, and expenses at the other end, of buying a new home, are limited to $3,000 less any amount claimed with respect to house-hunting trips and temporary living expenses.

So, the effect is that if you have an employee who claims the full $1,500 deduction for house-hunting trips and temporary living expenses, then the qualified housing expense deduction is limited to $1,500. The total expense cannot exceed $3,000.

If an employer reimburses an employee for moving expenses, the amount of reimbursement is included in taxable income offset by the deduction subject to these limits. Any excess reimbursement is included in the employee's taxable income.

Moving expense allowances were last liberalized in 1976 in the Tax Reform Act of 1976. Prior to 1977, the $3,000 limit was $2,500, and the $1,500 limit was $1,000.

S. 565 would liberalize the current limits on deductibility significantly. It would allow a taxpayer to deduct the expenses up to the amount of the overall limitation on reimbursement under regulations in effect at the time of the move with respect to Federal employees who move at the Government's request. This would allow, at the present time, a deduction up to $12,000.

The bill would also allow up to $2,500 for expenses of breaking or entering into a lease, but this amount would be offset by any deduction claimed with respect to the cost of buying or selling a house. The limit for house hunting and temporary expenses would remain at the present law level of $1,500.

Mr. Chairman, we recognize that the current limit on deductibility of moving expenses has not kept pace with inflation since 1976, but the liberalization of the deduction limit would be extremely costly. S. 565 would cause a static revenue loss of $91 million in fiscal year 1982 and $917 million in fiscal year 1983.

We do not believe that increasing the deduction limits has a high enough priority to warrant enactment at this time, in light of the spending cuts the administration is proposing and the danger of large budget deficits.

Therefore, we are opposing S. 565 or any increase in the deductible limits at this time.

We would point out that when deduction limits are liberalized, we do not believe that the approach taken in S. 565 is the best means of achieving that goal. Instead, we would propose that the present dollar limits on deductibility should be increased to a specific level, and it

may be appropriate, we think, to provide authority in regulations for Treasury to raise the dollar limits with inflation or some standard set out in the statute.

We do not think that the amount the Federal Government will reimburse its employees for moving expenses is necessarily the correct limit. The determination of limits on reimbursement of Federal employees does not take into account all factors relevant to setting the deduction limit of similar expenses for tax purposes. For example, the tax limits have a much more significant revenue effect than the reimbursement of Federal employees.

We think that limits should be established for tax purposes in light of overall tax considerations, and not on considerations of what you are going to reimburse the Federal employee for his move.

If changes are to be made though, we would suggest three changes might warrant consideration.

First, we might consider raising the current $1,500 and $3,000 limits on deductions for indirect moving expenses.

Second, Congress could consider separating the two current limits; one for house hunting and temporary living expenses, and the other for expenses of home purchases and sales, so that the amounts deductible in one category do not offset the other.

And third, if periodic adjustment of moving expense limits is desired, we would suggest that it be considered a matter for Treasury in regulation.

We have set forth, in our testimony, revenue estimates on three alternatives to give the committee an idea of the amounts we are talking about.

The first alternative would double the current limits to $3,000 for house hunting and temporary living expenses, to $6,000 for selling or purchasing a home, and would retain the current provision, reducing the $6,000 limit for amounts claimed for house hunting and temporary living expenses. In other words, it would retain the offset. The revenue cost on that would be $37 million in fiscal 1982; $370 million in fiscal 1983.

Alternative B would be the same as alternative A. You would raise the limits to $3,000 and $6,000, but you would eliminate the offset provision. This substantially increases the revenue loss to $56 million in fiscal 1982 and $569 million in fiscal 1983.

Alternative C would raise the limits to $5,000 and $10,000 respectively, and would eliminate the offset. That would be an $82 million cost in fiscal 1982 and an $826 million cost in fiscal 1983. As you can see in alternative C, the $5,000 and $10,000 limits would be closest to S. 565 in terms of revenue cost, but would still be slightly lower than the revenue cost of the proposed bill.

The next bill is S. 352, which would expand the availability of the income tax credit under section 41 of the Code for contributions to candidates for public office. The credit under the current law is one-half of the amount of an individual's political contributions limited to $100 on a joint return.

Credit is generally available for contributions made to candidates; to certain campaign organizations; national, State or local committees of national political parties; and to newsletter funds of incumbents or candidates.

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Under the statutory language of existing law, contributions to a campaign organization must be for use of the organization to further the candidacy of one or more candidates.

In a private revenue ruling released in early 1980, the IRS took the position that the requirement of "furthering the candidacy" precluded a credit for contributions to so-called negative campaign committees; that is, organizations which oppose incumbents but do not directly support a challenge.

S. 352 would simply remove the language "furthering the candidacy" and remove that test and thus make the credit available to contributions to negative campaign organizations.

The Department neither favors nor opposes this expansion of existing law. Once Congress determines, as it has, that tax credits for political campaigns are appropriate, it can properly determine what types of campaigns qualify for the rule. But, we also believe that the IRS must be kept out of the political arena to every extent possible and, thus, the determination of the eligibility of negative campaigns should be made by the Congress, one way or the other, and as clearly as possible.

Senator BYRD. Mr. Chairman, may I interrupt?

I think that's a fine statement you made that the IRS must be kept out of the political arena to the highest degree possible. I think that's very important and I think that you say that this decision should be made by the Congress.

Senator PACKWOOD. Let me ask you a quick question.

If Congress insures that organizations conducting so-called negative campaigns continue to receive the tax credit, do you have any estimate on revenue loss?

Mr. CHAPOTON. No, sir, we do not. Frankly, we have not even tried to develop that. It doesn't seem that—I feel confident the loss would be minimal overall.

Senator PACKWOOD. My hunch is that it would be minimal. I want to make sure that if Congress changes it, or at least Congress position is to change it, the administration doesn't decide to oppose the change because of the revenue loss.

As I understand your position now, you are going to go along with whatever Congress chooses to do on this.

Mr. CHAPOTON. That is correct.

Senator PACKWOOD. Fine.

Mr. CHAPOTON. Mr. Chairman, we will do further work on that, and if there is any problem there at all, we'll get back to you.

Senator PACKWOOD. Thank you.

Mr. CHAPOTON. The final bill before the subcommittee this morning is S. 483, which would grant exemption from the excise tax on wagers and the occupational tax on wagering for legal wagering activities.

Under curent law, there is a 2-percent tax on wagering transactions; basically, bets on sporting events and lotteries, other than State-operated lotteries. The 2-percent tax is not imposed on State-licensed parimutuel betting or slot machines, and basically the tax now is imposed on sporting events and on the numbers games.

The current law also imposes a $500 per year occupational tax on persons who are liable for the 2-percent excise tax.

S. 483, under this bill, neither the 2-percent wagering tax nor the $500 occupational tax would apply to any wager which is authorized under State law.

We would urge this subcommittee to consider modifying S. 483 to repeal the 2-percent wagering tax and the $500 occupational tax altogether. Most excise taxes can be justified on the basis of revenues they raise. These taxes do not raise a significant amount of revenues.

Approximately $11 million was collected under the 2-percent wagering tax and $1 million on the occupational tax in fiscal 1980. In fiscal 1979, it was only $9.1 million and $0.9 million.

We also do not believe that judgments as to the social utility of an activity are properly a matter of Federal concern.

Finally, a perceived justification for these taxes may be that they operate as an aid to the fight against illegal gambling activities and the collection of income taxes from persons engaged in such activities.

We do not believe that these arguments are justification for retention of the taxes. The amount of excise taxes collected from illegal, as opposed to legal gambling activities, has been minimal, and the commitment of Federal resources to maintain this taxing structure for such a limited purpose is, we think, wasteful and inefficient.

The Federal Government possesses a much more direct tool which can be used against significant illegal gambling operations. Public Law 91-452, enacted in 1970, makes it a Federal crime to engage in gambling business if certain magnitude tests are met. The Commission on the Review of the National Policy Toward Gambling, in a recent report, have concluded that the wagering tax had not been an effective deterrent to illegal gambling.

Moreover, IRS experience with the tax on wagers, and with the since repealed tax on coin-operated gambling devices, does not indicate any substantial benefits to enforcement of the income tax as a result of the existence of these excise taxes.

If the committee does not approve the total repeal of these taxes, we would urge that the current law be retained, without change, so that the imposition of the gambling taxes does not depend on whether a particular act is legal or illegal under State law. We think that the imposition of Federal taxes should be uniform throughout the United States, should not depend on legality or illegality under State or local law. To provide otherwise would require the IRS to determine that question, which we think is an undesirable function for the IRS to be—to be thrust on the IRS.

Mr. Chairman, that concludes our initial statement.

Senator PACKWOOD. Regarding the last two bills, on the tax credit for political contributions and the wagering, that when Congress acted, we did not foresee some of the problems that would come up. The legislation creating tax credit for political contributions was enacted before campaign financing laws were passed, before the days of independent expenditure committees and so, contributions were made to a political party or to a political action committee which, in turn, gave to a candidate.

If Congress had any intent, my hunch is the record would be pretty bare on this. I know what I personally intended, but it was not an issue that we foresaw.

On the wagering, I remember we hoped that it would help in tracing illegal gambling. It obviously has not turned out to be the most effective way of accomplishing that goal.

Mr. CHAPOTON. Yes, sir.

Senator PACKWOOD. Senator Byrd?

Senator BYRD. I think this committee, last year, approved repeal of that legislation; did it not?

Mr. CHAPOTON. It, I believe, approved the wagering tax, the change in the wagering tax.

Senator BYRD. S. 483, yes.

I think that this committee approved the repeal and the Senate approved the repeal. That's my recollection.

Anyway, I think it should be repealed, and the Internal Revenue Service recommended repeal; is that correct?

Mr. CHAPOTON. Yes, sir.

Senator BYRD. Thank you.

Senator PACKWOOD. I have no other questions.

Thank you very much.

Mr. CHAPOTON. Thank you, Mr. Chairman.

[The prepared statement of Hon. John E. Chapoton and a letter to Senator Packwood follow:]

DEPARTMENT OF THE TREASURY,
Washington, D.C., April 28, 1981.

Hon. ROBERT PACKWOOD,
United States Senate,
Washington, D.C.

DEAR SENATOR PACKWOOD: On March 16, 1981 I testified before the Subcommittee on Taxation and Debt Management with regard to S. 502 which would exempt certain foreign pension plans from tax on their U.S. source investment income. During the hearing the Treasury suggested that the revenue cost of the proposal appeared to be about $90 million in Calendar 1982. This rough estimate was based on the percentage of total equity assets held by pension funds in the major OECD countries.

Subsequent to the testimony, the Treasury found that additional data was available on the holdings of foreign pension funds. For example, the OECD publishes data on the *foreign* shares held by pension funds in certain major countries, including the United Kingdom and the Netherlands. On the basis of this data, we have revised the revenue cost downward from $90 million to $30 million. The Joint Committee Staff estimate of $10 million cost *per billion* dollars of investment in the United States is compatible with this figure.

We regret that the information did not come to light before the testimony and hope that this change has not overly complicated the evaluation of S. 502.

Sincerely,

JOHN E. CHAPOTON,
Assistant Secretary for Tax Policy.

STATEMENT OF THE HONORABLE JOHN E. CHAPOTON, ASSISTANT SECRETARY (TAX POLICY)

Mr. Chairman and Members of the Subcommittee: I am pleased to appear before you today to present the Treasury Department's views on four tax bills. The Treasury Department's primary focus at this time must be the tax proposals that are part of the President's economic program, and our comments on the four bills under consideration today must be understood in the light of the overriding need for swift action first on the proposals in the economic program. As you know, we are requesting that Congressional action with respect to all other tax measures, however meritorious, be deferred until completion of legislative action on the President's economic program.

SUMMARY

S. 502 would exempt certain foreign pension plans from tax on their U.S. source investment income and would also exempt such income when earned by a life insurance company on behalf of the foreign pension plan. The Treasury Department opposes S. 502.

S. 565 would increase the maximum amount allowed as a tax deduction for certain employee moving expenses. Because any expansion of deductions would involve substantial loss of revenue, the Treasury Department opposes at this time any change in the moving expense deduction.

S. 352 would expand the availability of the income tax credit for contributions to so-called "negative campaigns." The Treasury Department neither supports nor opposes S. 352.

S. 483 would exempt legal wagering activities from the federal wagering tax and the occupational tax on certain persons engaged in wagering activities. The Treasury Department believes the Subcommittee should consider repealing both the wagering tax and the occupational tax in their entirety.

S. 502—EXEMPTION OF FOREIGN PENSION PLANS

S. 502 would exempt certain foreign pension plans from tax on their U.S. source investment income and would also exempt such income when earned by a life insurance company on behalf of the foreign pension plan. S. 502 thus presents two separate issues. The first issue is whether foreign pension plans should be exempt from tax on their U.S. source income. Treasury opposes the exemption provided by S. 502. The second issue is whether life insurance companies should be able to invest on behalf of foreign pension plans without themselves incurring any United States tax liability. Treasury believes that such an amendment should be considered only if the exemption for foreign pension plans were to be enacted.

Presently, unless a lower treaty rate applies, foreign pension plans, like other foreign investors, are subject to a 30 percent United States withholding tax on all fixed or determinable U.S. source income which is not effectively connected with a United States trade or business. Foreign pension plans, depending on their investment vehicle and on the type of investment, may also be subject to capital gains tax.

S. 502 would exempt foreign pension plans from such tax in order to attract investment by foreign pension plans to this country and thereby increase capital formation in the United States. The Treasury Department is strongly in favor of increasing capital formation in the United States. If, however, tax incentives are to be used for this purpose, they must not make arbitrary distinctions among categories of investors and must be carefully tailored to minimize the conflict with other policy objectives.

It is not clear to us why foreign pension plans alone should receive tax exemption; the purpose of the proposed tax incentive appears to suggest its extension to all foreign investors.

Furthermore, S. 502 conflicts directly with the policy embodied in the Foreign Investment in Real Property Tax Act, passed by Congress just this past December. That Act generally subjects non-resident aliens and foreign corporations to a tax on their gains derived from the disposition of U.S. real property. S. 502, on the other hand, would exempt foreign pension plans from tax on their gains derived from the disposition of U.S. real property. Not only would S. 502 conflict with the policy object of the 1980 legislation, it would create the potential for avoidance of the new rules applicable to real property by the use of questionable pension plans set up by closely held corporations in tax haven jurisdictions. More fundamentally, however, S. 502 raises the question of why foreign pension plans should be treated more favorably than other foreign investors.

It is argued that foreign pension funds which are tax exempt in their home countries should receive special U.S. tax treatment because such treatment is enjoyed by their United States counterparts. Qualified domestic pension funds, however, are tax exempt because of the Congressional judgment that they provide valuable social benefits to both the United States government and to participating U.S. employees. The benefit of foreign pension plans, on the other hand, inures to foreign governments and to non-resident alien employees. There is no occasion for the United States to provide a tax incentive to subsidize foreign social policy objectives. Moreover, while domestic pension plans enjoy a tax exempt status, the

employee upon retirement is taxed on the previously untaxed investment gains of the pension plan. Foreign employees receiving distributions from foreign pension plans will not similarly be subject to United States tax on the previously untaxed United States source income derived by the plan. Instead tax on such gains will be collected by the foreign country in which the employee is resident at the time of distribution. At least in part, therefore, S. 502, by relieving foreign pension plans of U.S. tax, would cause a transfer of tax dollars from the U.S. Treasury to the treasury of a foreign country.

Even if some exemption for foreign pension plans were appropriate, Treasury would oppose S. 502 as written because of the technical problems that it would create. S. 502 would impose a severe administrative burden on the Internal Revenue Service, which would have to ascertain with respect to every foreign pension plan whether it meets the primary purpose, asset segregation and reduced rate of tax tests provided in section (a) of S. 502. IRS personnel would be forced to become experts in the pension laws of every foreign country which has a pension plan investing in the United States.

In an effort to assure that a U.S. pension plan receives reciprocal benefits, S. 502 provides that the President shall have the power under Section 896 of the Internal Revenue Code to revoke the tax exemption of a foreign pension plan if a United States pension plan is subject to a more burdensome or discriminatory tax in the foreign plan's home country. While Treasury would support a reciprocity requirement—even though it does run somewhat counter to the basic purpose of encouraging investment in the United States—we believe that the mechanism provided by S. 502 is unworkable. The Treasury Department and the IRS would be required to study all foreign tax laws to determine whether foreign countries provide relief equivalent to that provided by the United States. Since some countries might exempt some types of income and not others, or impose qualification requirements different from those in the United States, difficult questions of comparability would inevitably arise. It has been our experience under Section 883, which provides for a similar reciprocal exemption for foreign shipping and air transport, that the reciprocal exemption mechanism has been a source of constant problems. We would hesitate to see use of this mechanism expanded into the very complex area of qualified pension plans.

If any exemption is to be granted foreign pension plans on their U.S. source investment income, we believe that it should not be granted unilaterally but rather through bilateral agreement. Tax treaties provide a vehicle for granting the U.S. tax benefit in exchange for carefully tailored reciprocal treatment by the other country, perhaps in exchange for other concessions which would be of even greater benefit to the United States. It is our understanding that there are now pension plans from three countries (Japan, the United Kingdom and the Netherlands) which have expressed interest in investing in the United States. It would be far preferable to consider reciprocal treaty amendments with these three countries, rather than to exempt statutorily all foreign pension plans investing in the United States.

The second issue raised by S. 502 is the treatment of life insurance companies in their capacity as managers of United States investments by foreign pension plans. In general, a life insurance company is not taxed no income from the investment of assets on behalf of "qualified" domestic pension plans. Instead the income is passed through to the pension trust, which by definition is tax exempt, and the tax falls only on the plan beneficiaries. Section (c) of S. 502 would effectively bring the treatment of life insurance companies, when managing assets of foreign pension plans, into line with the treatment they enjoy when managing domestic qualified plan assets.

The appropriateness of section (c) depends on whether foreign pension plans are accorded a blanket exemption from tax. Because the Treasury opposes the exemption of such plans we think that section (c) is unnecessary to the extent it is intended as a companion to section (a) of S. 502. Absent section (a), on the other hand, we do not think any legislation is necessary or appropriate. Under current law, life insurance companies may make investments on behalf of persons who enjoy no particular tax-qualified status, including foreign pension trusts, through the use of contracts similar to variable annuity contracts. Except for capital gains, investment income earned under such contracts is not taxed to the life insurance company. Instead, it is taxed to the contract holder as payments under the contract are made. Presumably arrangements of this general sort can now be used by a life insurance company to make investments on behalf of nonexempt foreign pension trusts. We see no reason to depart from existing law with

respect to non-exempt foreign pension plans with which a life insurance company may deal on the same basis as it now acts for other non-qualified investors. Thus assuming section (a) of S. 502 is not adopted, we would oppose any change in existing law.

For the above reasons the Treasury Department opposes S. 502.

S. 565—DEDUCTION FOR MOVING EXPENSES

S. 565 would increase the maximum amount allowed as a tax deduction for certain employee moving expenses. Generally, the bill would set the limit on the deduction of expenses of selling and purchasing a home (or breaking a lease) equal to the "overall maximum" amount which the Federal government would reimburse its own employee for a similar move, under federal regulations in effect at that time.

Background

Section 217 of the Internal Revenue Code currently permits a deduction for expenses of individuals attributable to moving to a new principal place of work. Generally, the new place of work must be at least 35 miles farther from the old residence than was the former place of work, and the taxpayer must be employed at the new location for at least 39 weeks in the year following the move. A deduction is allowed for "direct" moving expenses, i.e., the reasonable expenses of moving household goods and for personal expenses of traveling to the new location without any dollar limit.

Section 217 also permits a limited deduction for certain indirect moving expenses. Expenses of traveling to search for a new residence ("house hunting") and temporary living expenses for up to 30 days may be deducted, up to a limit of $1,500. A deduction is also allowed for qualified expenses of selling an old home or purchasing a new home (such as real estate commissions and transfer taxes) and expenses of breaking, or entering into, a lease. The deduction for this category of items is limited to $3,000, less any deduction taken for temporary living expenses and house hunting. Thus, for a taxpayer claiming the maximum amount of house hunting and temporary living expenses, the deduction for the cost of selling or buying a home or for breaking, or entering into, a lease is effectively limited to $1,500.

Employer reimbursement for various moving expenses generally is includible in the employee's income, and the employee may deduct eligible expenses up to the above-mentioned limits. Any reimbursements in excess of the limits are taxable as income to the employee.

Moving expense allowances were last liberalized in the Tax Reform Act of 1976. Prior to 1977, the $3,000 limit was $2,500 and the $1,500 limit was $1,000.

S. 565 would liberalize the current limits on the deductibility of expenses related to the sale and purchase of a residence. The bill would allow a taxpayer to deduct such expenses up to the amount of the overall limitation on reimbursement under regulations in effect at the time of the taxpayer's move with respect to Federal employees who move at the government's request. At the present time, this would allow up to $12,000 of deductions. The bill would also allow up to $2,500 of deductions for expenses related to breaking, or entering into, a lease. This amount would be reduced by any expenses deducted for the purchase or sale of a home. The limit for house hunting and temporary living expenses would remain at $1,500.

Treasury position

The Treasury Department recognizes that the current limits on the deductibility of moving expenses have not been increased since 1976 despite the effects of inflation in that period. However, liberalization of the deduction limits would be extremely costly. S. 565 would cause a static revenue loss of $91 million in fiscal year 1982 and $917 million in fiscal year 1983. The Treasury Department does not believe that increasing the deduction limits has a high enough priority to warrant enactment, in light of the spending cuts the Administration has recommended and the danger of large budget deficits. Therefore, the Treasury Department opposes enactment of S. 565 or any increase in the deduction limits at this time.

When the deduction limits are liberalized, the Treasury Department does not believe that the approach of S. 565 should be followed. Instead, the present dollar limits on deductibility should be increased to a specific level. Provision for periodic review, either by Congress or through Treasury regulation, also may be appropriate at that time.

The determination of the overall limit on the reimbursement of Federal employees does not take into account all factors relevant to setting the deduction limits of similar expenditures for tax purposes. For example, the tax limits have a much more significant revenue effect. Further, under S. 565, any future change in the regulations governing reimbursement limits for Federal employees would be incorporated automatically into the tax law. The Treasury Department believes that limits established for tax purposes should be set in the light of overall tax considerations and changes made should be based upon the same considerations.

Finally, since inflation has affected all price levels, we do not believe that the approach of S. 565, which would raise only the limits applicable to selling and purchasing a home (or lease expenses), is appropriate. If changes are to be made, we believe that three changes warrant consideration. First, the current $1,500 and $3,000 limits on deductions for indirect moving expenses could be increased. Second, Congress should consider separating the two current limits, one for house hunting and living expenses, the other for expenses of home purchases and sales, so that amounts deductible under one limit would not reduce the deduction limit for the other. Third, we believe that if periodic adjustment of moving expense limits is desired, the appropriate means is by Treasury regulation, reflecting actual moving expenditures by middle level employees.

Revenue estimates

The static revenue loss from S. 565 is estimated to be $91 million in fiscal year 1982 and $917 million in fiscal year 1983. The Treasury Department also has estimated the static revenue loss for three alternative proposals. Each alternative is assumed to become effective for taxable years beginning after December 31, 1981, the effective date of S. 565.

Alternative A.—Double the current limits to $3,000 for house hunting and temporary living expenses and $6,000 for selling or purchasing a home, retaining the current provision reducing the $6,000 limit for amounts claimed for house hunting and temporary living expenses.

Fiscal years:	*Millions*
1982	$37
1983	370

Alternative B.—Double the current limits to $3,000 and $6,000 and make the limits for the two types of indirect expenses separate, so that expenditures under the first category would not reduce the limit under the second category.

Fiscal years:	*Millions*
1982	$56
1983	569

Alternative C.—Raise the limits to $5,000 and $10,000 and make the two limits separate as in Alternative B.

Fiscal years:	*Millions*
1982	$82
1983	826

Of the three alternatives, Alternative C most closely approximates the static revenue loss from S. 565.

S. 352—NEGATIVE CAMPAIGN CONTRIBUTIONS

S. 352 should expand the availability of the income tax credit under Code section 41 for contributions to candidates for public office. Existing law allows individual taxpayers a nonrefundable credit equal to one-half the amount of their political contributions, but limited to $50 ($100 on a joint return). The credit is generally available for contributions made to: (1) a candidate for nomination or election to Federal, state or local public office; (2) certain campaign organizations; (3) national, State or local committees of a national political party and (4) newsletter funds of an incumbent or candidate.

Under the statute, contributions to a campaign organization must be made to an organization which is organized and operated exclusively for the purpose of influencing or attempting to influence the nomination or election of one or more candidates, and must be for use by the organization "to further the candidacy" of such individuals. In private letter rulings issued early in 1980, the Internal Revenue Service took the position that the requirement of "furthering the candidacy" precluded a credit for contributions to certain so-called negative

campaign committees—i.e., organizations which oppose incumbents but do not directly support a challenger.

S. 352 would remove the "furthering the candidacy" test, with the intent of expanding the credit to apply to contributions to negative campaign organizations.

The Treasury Department neither favors nor opposes this expansion of existing law. Once Congress determines, as it has, that tax credits for political campaigns are appropriate, it can properly determine what types of campaigns qualify for that rule. Most importantly, we believe that the Internal Revenue Service must be kept out of the political arena. Thus, the determination of the eligibility of "negative campaigns" should be made by Congress—one way or the other—in as clear and unambiguous a manner as possible.

S. 483—EXEMPTION FROM EXCISE TAX ON WAGERS AND OCCUPATIONAL TAX ON WAGERING

Under current law, an excise tax of 2 percent is imposed on certain wagering transactions. These wagering transactions include only bets on sports events, and lotteries, other than state operated lotteries, conducted for profit. The 2 percent excise tax on wagers is not imposed with respect to wagers placed in a parimutuel pool licensed under state law or any wager placed in coin operated devices (slot machines). All persons who are in the business of accepting such wagers are made liable to pay this tax. Because state operated lotteries are exempted, the tax is limited largely to bets on sports events and the "numbers."

Current law also imposes a $500 per year occupational tax on persons who are liable for the 2 percent excise tax on wagers and on any person who receives wagers on behalf of such a person. Persons liable for the occupational tax are also required to register their occupation with the internal revenue district where they are located and supply such additional information as may be required.

Under S. 483, the 2 percent wagering tax would not apply to any wager authorized under state law. In addition, S. 483 would exempt from the $500 occupational tax any person authorized by state or local law either to engage in the business of accepting wagers or to receive wagers on behalf of another person.

We would urge this Subcommittee to consider modifying S. 483 to repeal the 2 percent wagering tax and $500 occupational tax in their entirety. Although most excise taxes can be justified on the basis of the revenue they raise, these taxes do not raise a significant amount of revenue. Approximately $11 million was collected under the 2 percent wagering tax and $1 million was collected under the occupational tax for fiscal year 1980. In fiscal year 1979, collections for these taxes totaled $9.1 million and $0.9 million respectively.

Although not significant for their revenue effect, some might argue that these taxes are justified as a means of raising revenue from an activity perceived to be socially undesirable. We believe that judgments as to the social utility of an activity are not properly a matter of federal tax concern. Thus, we reject the notion that the excise taxes can be justified on this basis.

A final justification for this tax structure may be that it operates as an aid to the fight against illegal gambling activities and the collection of income taxes from persons engaged in such activities. We do not believe that this justifies retention of these taxes. The amount of excise tax collections from illegal, as opposed to legal, gambling activities has been minimal. We view the commitment of Federal resources to maintain this taxing structure for such a limited purpose to be wasteful and inefficient. The Federal government possesses a more direct tool which can be used against significant illegal gambling operations. Public Law 91-452, enacted in 1970, makes it a Federal criminal offense to engage in a gambling business in violation of state or local law if the operation involves 5 or more principals or managers and continues in operation for more than 30 days, or has gross receipts of $2,000 in any single day. The Commission on the Review of the National Policy Toward Gambling, in its final report, reached the conclusion that the wagering tax had not been an effective deterrent to illegal gambling. Moreover, experience with the tax on wagers, and with the since repealed tax on coin operated gambling devices, does not indicate any substantial benefits to enforcement of the income tax as a result of the existence of these excise taxes.

If the Subcommittee does not approve the total repeal of these taxes at this time, Treasury urges that the provisions of current law be retained so that

imposition of these taxes will not depend on the extent to which wagering activity is authorized under state or local law. As a matter of sensible tax policy, the incidence of taxation should be uniform throughout the United States, and should not be a function of the legality of certain activities under state or local law. To provide otherwise would require the IRS to determine the legality of an activity under state or local law before imposing the Federal tax, an undesirable mixing of Federal and state functions that should be avoided where possible.

Senator PACKWOOD. Next, we will start our testimony on S. 352, relating to tax credits for political contributions.

I have had a chance to read all of the statements, except for that of Mr. Kamenar of the Washington Legal Foundation, which wasn't available until today. I ask that the witnesses not dwell heavily on the unconstitutionality of the IRS private letter ruling.

I don't mind the witnesses touching on that subject, but I would very much appreciate them also touching on whether or not, assuming that the IRS ruling is right, this committee ought to change it and say that you should be allowed political tax credits for negative campaigning or you shouldn't, depending upon what your position is. I believe that if we simply leave the law the way it is, we're asking it to go to the court and eventually for the IRS to decide it. Congress should clear it up one way or the other as to what we intended.

Senator BYRD. I think so.

Senator PACKWOOD. We'll start out with Mr. Terry Dolan, the chairman of the National Conservative Political Action Committee.

Is there any other television monitor for the audience? If not, Senator Byrd and I could go down there and watch the audiovisual presentation that is planned. That way, the audience can see it as well. If you want to turn it around so they can see it when you're ready, we'll go down and take a look.

STATEMENT OF JOHN T. DOLAN, CHAIRMAN OF THE NATIONAL CONSERVATIVE POLITICAL ACTION COMMITTEE

Mr. DOLAN. Thank you very much, Senator Packwood, for this opportunity to testify. With your comments, you seriously shortened my presentation, so I guess all should be grateful for that.

We support S. 352 for a number of reasons. First of all, we believe that it honors the intent of the organized tax credit bill of 1971 by encouraging grassroots political contributions. That is, I think, pointed out in my written testimony. I won't go any further on that.

I think, very briefly, touching on the constitutional questions, which I think are in fact the whole nub of this question, is that we don't really understand what the IRS is saying. It seems to me that they are, in fact, basing their discrimination on the content of the speech supposedly protected by the first amendment.

I think there are numerous cases which point out that the Government has no right, and no ability under the first amendment, to make such a discrimination on content. All speech, regardless of its content, is protected.

Second, it seems to be saying that there are certain classes of individuals or groups who get better protection from the first amendment, through the tax credit, than others.

As we read the statute, it seems fairly clear that both the Republican National Committee and the Democratic National Committee could do

exactly what we do, and contributions to them would get a tax credit; at the same time contributions to our committee would not get a tax credit. I think those two areas are clearly cases of invidious discrimination which are not allowed by the first amendment.

As a caveat, I think it's very strange that we are permitting the Internal Revenue Service, or anyone else, to come in and define what is "positive" or what is "negative" campaign activity.

What I would like to do at this time is show a couple of the commercials that were fairly typical, I think, of campaign activity in 1980.

One is produced by our political action committee; the other is produced by a candidate for office.

[Whereupon, a TV presentation was made.]

Mr. DOLAN. I think it's safe to say we could have brought many other commercials produced by our committee, produced by the Republican National Committee, or produced by any number of candidates for office.

Parenthetically, I might point out that Senator McGovern spent a fairly sizable sum of his media campaign attacking our committee. I don't know what the Internal Revenue Service would say about that. I think it's fair to say that much of what he said was vastly more "negative" than some of the things you saw on these commercials.

As a matter of fact, most people I've talked to have indicated they thought our first Eagleton commercial you just saw is a fairly accurate statement of a Senator's record. It was less "negative" than the second commercial which, among other things, attacked Senator Javits, based on his age.

I'm neither approving nor disapproving of that commercial, but what I'm saying is that no one has the right to go in and make that determination.

There are some other items which I would just like to point to in the testimony I have submitted. One is a letter that you, Senator Packwood, signed to the inner circle of the Senate campaign committee. It talks about things like the big liberal power brokers and the armada of ultraliberal pressure groups, and the Democratic political operators who will steal every campaign program we worked so hard to pioneer. [Laughter.]

And then I'd also like to point to a letter by Congressman Morris Udall, who talks about the shoulder-to-shoulder parade down Pennsylvania Avenue, organized by rightwing Republicans swaggering to the drumbeat of radical conservatists, and so on and so forth. He accuses them of doing a lot of things which I think you might object to.

The last item I would point to is a number of commercials that we simply reprinted the text, and we changed the names to protect the innocent, I guess, or the guilty. One was done by our committee, and the others were done by candidates.

Once again, I think it's fair to say that, if you look at them, I think you would be surprised by who did what, and it seems to be a fairly arbitrary notion to imply that we have no right to say what anyone else has a right to say.

The last item is simply a graph, which I have submitted in the text here, which talks about who has the right or who does not have the right to make contributions. Candidates can attack each other; political

parties and committees can attack candidates of an opposing committee. The only group as far as we can understand, which does not have that right, is an independent committee allegedly "making a negative campaign."

Senator PACKWOOD. As I understand it, they could claim the tax credit if they were making a "positive" contribution, that is, in favor of some candidate. That would apparently be furthering the candidate.

Mr. DOLAN. Well, we put that down as the case, but if you are going to have the Internal Revenue Service deciding what is furthering a candidacy and what is not, maybe not.

Senator PACKWOOD. Well, in these two ads that you show, the one that was attacking Senator Javits would be eligible for a tax credit because, apparently, it was furthering Senator D'Amato's campaign. I assume that would be the case.

Mr. DOLAN. I believe they said it was furthering Senator D'Amato's campaign because it was produced by Senator D'Amato's committee.

Senator PACKWOOD. That's fine.

In any event, it would have been eligible. The NCPAC attack on Senator Eagleton, however, would not be eligible because it's not considered to be furthering the candidacy of any particular person. It's simply pointing out his record.

Mr. DOLAN. So they say.

One last point, we don't view these campaigns as negative, at least in the sense that the IRS believes they are. We view them as informational. I don't think anyone would challenge the factual statement of anything we made in any of our commercials, much to the disbelief of a number of people whom we oppose. But, we have not been able to find, with the exception of one case where we immediately apologized for a false statement we made, any case where we simply made a factual mistake.

So, I think it comes down to the question of which side of the fence you are on. If you like what a Senator did, it's positive; if you don't like it, it's negative. So, I guess it also points to the value of the first amendment.

Senator PACKWOOD. Senator Byrd?

Senator BYRD. I don't think I have any questions either. Your two commercials make a very telling point. It's the old "picture in a thousand words" bit.

I appreciate your coming.

Mr. DOLAN. I'd like to make one last point.

Senator PACKWOOD. Yes.

Mr. DOLAN. This certainly will go to a lawsuit if it is not settled here in the Congress, and I would encourage the Senators to avoid a lot of litigation which I don't think any of us need any more in this country.

Thank you.

Senator BYRD. Thank you.

Senator PACKWOOD. Thank you very much.

Senator BYRD. Your feeling is that it should be—the determination should be made by the Congress?

Mr. DOLAN. Absolutely. I think for the Congress to ignore the position would invite a lawsuit that would cost several hundred thousand dollars, no doubt.

Senator PACKWOOD. Thank you very much.
[The prepared statement of John T. Dolan follows:]

WRITTEN STATEMENT OF JOHN T. (TERRY) DOLAN, CHAIRMAN OF THE NATIONAL CONSERVATIVE POLITICAL ACTION COMMITTEE

Thank you, Senator Packwood and the Members of the Finance Subcommittee on Taxation and Debt Management, for allowing me this opportunity to express unqualified support for S. 352 to "amend the Internal Revenue Code of 1954 with respect to the definition of political contribution."

I am here today as Chairman of the National Conservative Political Action Committee (NCPAC). According to the Federal Election's Commission, NCPAC is the country's largest, independent political action committee. In 1980, NCPAC spent $3,216,015.00 as direct cash contributions to candidates, in-kind contributions, or Independent Expenditures.

The procedures utilized by NCPAC in soliciting and spending its funds are similar to the procedures used by candidates and their committees. The funds are raised, deposited and expended in a manner in which NCPAC believes will most effectively and efficiently advance the election of the candidates it supports.

As I mentioned, one of the many projects NCPAC undertook in 1980 was an Independent Expenditure program we called, "Target '80." This program consisted of advertising programs exposing the records of liberal incumbent Senators. The statements are widely perceived by our opponents as "negative" and by our friends as "positive." We believe that these expenditures are neither negative or positive, they are simply informational in that they discuss the records of incumbent U.S. Senators.

Apparently, the Internal Revenue Service disagrees with our position. On February 13, 1980, the IRS decided that contributions made to NCPAC for the purposes of assisting our "Target'80" program did not qualify for a tax credit. The Internal Revenue Service said, "Contributions made to NCPAC for use in its "Target '80" program are not used to further the candidacy of any candidate within the mention of § 41(c)1(b) of the Code." It is with this backdrop that I am pleased to be permitted to testify on S. 352.

There are a number of reasons why we support Senator Packwood's bill.

THE IRS RULING WOULD PROVIDE DISINCENTIVES TO SMALL CONTRIBUTORS

First of all, we believe that Senator Packwood's amendment would support the congressional intent of the tax credit bill originally articulated in the Revenue Act of 1971, in that it would overturn the IRS's revenue ruling and NCPAC.

When the U.S. Senate passed, by a vote of 82–17 on November 17, 1971, Senator John O. Pastore's amendment to H.R. 109472 to provide a tax credit for political contributions, Senator Pastore said it was his intent to "Provide an incentive to the small contributor" and his amendment provided "an opportunity for the ordinary citizen to work his will in an area that all too often has been a special province of the large contributor or the vested interest." Senator Packwood accurately noted that because Congress accepts "the usefulness of tax credits for political contributions in promoting greater (political) participation . . . the House and the Senate in the Revenue Act of 1978 expanded the income tax credits for political contributions—the maximum amount was doubled.[1]" There can be little doubt of congressional determination to use tax credits to expand political participation.

There can be little doubt that Revenue rulings, like the one given, regarding "Target '80" contributions will do nothing but decrease grassroot's participation and contributions by ordinary citizens in political action committees or candidate committees. Financing informational or "negative" campaign statements is a form of political participation. It follows that a tax credit for contributions to finance these "negative" campaign statements would result in an expansion of political participation, the goal Senator Pastore espoused when he introduced his amendment to H.R. 10947. The Internal Revenue Service's interpretation, however, effectively diminishes political participation, for without the incentive of a tax credit, fewer people will be willing to sponsor "negative" campaigns. Such a result may please those who are the object of such campaigns, but it is not in keeping with the purpose of the tax credit.

[1] Congressional Record, Feb. 3, 1981.

The IRS has reported the results of the expended tax credit passed in 1978. In 1978, 3,560,384 people representing 3.9 percent of the persons who filed tax returns at the IRS utilized the tax credits and contributed $103,873,000 to political committees. In 1979, 4,060,824 people representing 4.4 percent of the persons who filed tax returns at the IRS utilize the tax credits and contributed $192,-893,000 to political committees.

The total $296,766,000 contributed to political campaigns by 7,621,208 individual contributions not exceeding $50 per person represents 30 percent of the total "$1 billion spent on behalf of candidates and political committees at all levels, Federal, State and local during the 1982 election cycle."

THE IRS RULING VIOLATES THE FIRST AMENDMENT

In its Revenue ruling, the IRS gives no rationale as to why contributions to NCPAC's "Target '80" project are not eligible to be claimed as credits. It merely cited section 1.41(1)(d) of the IRS regulations which provide that "Expenditures further a candidacy . . . if they are directly related to, and are intended to support, a candidate's campaign for elective public office."

We can only presume from the IRS's position that "Target '80" contributions do not qualify because they are either "negative" and do not support a candidate, or not sufficiently direct since they are not made by a candidate "to support a candidate." In light of established constitutional doctrines, both interpretations qualify as invidious violations of the first amendment.

(a) *IRS discrimination based on the "content" of speech*

The Supreme Court has ruled over and over again that Government officials may not provide incentives or disincentives in any form based on the content of an individual's speech. The IRS has left a clear implication in its ruling that "Target '80" contributions are not eligible for tax credits because the message of "Target '80" is "negative."

As I mentioned earlier in my testimony, I reject the notion that "Target '80" expenditures were in fact negative, but even if we assumed that they are, the Internal Revenue Service has no right to determine that negative statements are any less protected by the first amendment than are positive statements. We concur with Justice Harlan in *Cohen* v. *California* when he said of attempts to categorize speech: "Government officials cannot make principled distinctions (because) . . . one man's vulgarity is another man's lyric . . ."

(b) *IRS discrimination based on who is the speaker*

There is also the implication made by the IRS that our expenditures are not direct enough to qualify for tax expenditure. They seem to be saying that it is acceptable for candidate A to attack candidate B, but not for NCPAC to attack candidate B. This distinction, as to the sources of a statement, qualifies as the most invidious violation of the First Amendment condemned by the U.S. Supreme Court for decades. In *Buckley* v. *Valeo*, the Supreme Court said: "The concept that the Government may restrict the speech of some elements of our society in order to enhance the relative voices of others is wholly foreign to the First Amendment which was designed to secure the widest possible dissemination from diverse and antagonistic sources." Definitionally arbitrary decisions by the Internal Revenue Service concerning who shall and who shall not be encouraged to express their political positions through a contribution to a political committee falls squarely upon the Court's prohibition against the Government enhancing the relative voice of others.

So, it is clear from a constitutional point of view, the IRS cannot deny a tax credit basis to our committee either because *they* perceive our activities as negative, or because they don't like who is making a political statement.

(c) *Procedural safeguard*

Under the First Amendment, procedural safeguards are required whenever the government regulates or burdens potentially protected expression. See, *Speiser* v. *Randall*, 357 U.S. 513, 520–21, 525–26 (1958). Because of the high value placed on freedom of expression, these requirements are more stringent than conventional Fifth and Fourteenth Amendment due process guarantees for civil proceedings. See, *Marcus* v. *Search Warrent*, 367 U.S. 717, 730–31 (1961). The Internal Revenue Service, by attempting through its interpretation of 41 I.R.C. to regulate contributions that are indispensable to political communication, is interfering in "an area of the most fundamental First Amendment activities." *Buckley* v. *Valeo*, 424 U.S. 1, 14 (1976). As a result, the Internal Revenue Service

cannot interpret 41 in a manner that will create undue likelihood that protected expression will be penalized, *Speiser* v. *Randall*, 357 U.S. 525-26 (1958), or in a manner that will raise the prospect of a protracted, costly defense which might induce self-censorship and thus chill protected speech. *First National Bank of Boston* v. *Bellotti*, 435 U.S. 765, 786, n. 21 (1978).

THE IRS RULING IS IMPRACTICAL AND IMPOSSIBLE TO ADMINISTER

We have shown that the Internal Revenue Service cannot say Candidate A has a right to attack Candidate B, but independent groups or individuals such as NCPAC do not have the same right to attack Candidate B. Therefore the IRS seems to be saying contributions to Candidate A for the purposes of attacking Candidate B also do not qualify for a tax credit.

First of all, to say that Candidate A's attack on Candidate B does not further A's candidacy defies logic. What else can it do? Is the IRS proposing that it go in and study every single expenditure by every single political committee in America to determine which they feel furthers a candidacy and which does not? Can they honestly say that a purchase of a paper clip is considered more "direct" in furthering a candidacy than the purchase of media time attacking candidate's opponent?

To date, the Internal Revenue Service has not questioned how the operating expenditures of a political party "furthers a candidacy." But I can assure you that most political experts would agree a television commercial attacking the record of Candidate B more directly advances Candidate A than does the purchase of a paper clip for a bureaucrat who resides in the bowels of the Republican National Committee in Washington, D.C.

I am submitting for testimony two fund-raising letters produced by the Democratic Congressional Campaign Committee and the National Republican Senatorial Campaign Committee. Congressman Morris Udall signed the letter for the DCCC in which he complains about "Right-wing Republican" and "fanatics" swaggering to the beat of radical conservatism.

Senator Robert Packwood signed the fund-raising letter for the N.R.S.C. In his letter he talks about the "Big liberal power brokers" and the "armada of ultra-liberal pressure groups." He also discusses the "Democratic political operatives" who will "copy or steal every campaign program we have worked so hard to pioneer."

The Democrats are suggesting that the Republicans are Nazi-like fanatics prepared to crush poor people and get the United States into war. The Republicans on the other hand are suggesting that the Democrats are owned lock-stock-and-barrel by some un-named group of communistic power brokers who are prepared to break the law in order to accomplish their goals. This seems to be the stuff of which "negativism" is made.

I certainly hope that Senator Packwood and Congressman Udall are prepared for the band of IRS auditors and agents who will come in and decide whether their speech is sufficiently positive so that contributions to their committees will qualify as tax credits.

Attached to this testimony as Appendix B are four samples of political advertising used in 1980 elections. We have removed the names of candidates involved in the ads. Two of the samples were used by NCPAC in its "Target '80" program and have been determined by the Internal Revenue Service to lack the requirement of "furthering" a candidacy. Of the other two samples, one was used by a Republican candidate's campaign committee and the other was used by a Democratic candidate's campaign committee. I defy anyone to distinguish between the four samples on the basis that they are "negative" or positive" in nature; yet, taxpayers whose contributions paid for the Republican and Democratic advertisements were entitled to the tax credit allowed under 41 I.R.C., while taxpayers whose contributions paid for the NCPAC advertisements were denied a tax credit. Surely Congress could not have intended such an absurd result when it enacted 41.

One final demonstration of the absurdity of the IRS is given by the attached chart. We have listed seven possible cases of expenditures relating to a hypothetical Candidate B. In most cases contributions would qualify for a tax credit as we understand.

To recapitulate, the Congress has overwhelmingly endorsed the plan to allow tax credits to encourage smaller contributors to participate in the electoral process. The IRS has directly thwarted this effort and created serious practical and constitutional problems by arbitrarily deciding that some types of advertisements

do not sufficiently further a candidacy. The IRS fails to explain how or why this type of advertisement does not allegedly further a candidacy, and thus qualify for a valid tax credit for those financing it.

Consequently, the IRS blatantly undermines the credibility of the tax code. The only solution congruent with the congressional mandate is to eliminate the artificial distinctions between categories of speech imposed upon election committees by the IRS by pasisng Senator Packwood's legislative proposal S. 352.

REPUBLIOAN SENATORIAL INNER CIRCLE,
Washington, D.C., March 9, 1981.

Mr. SPITZ CHANNELL,
Nat'L Conservative Pac.,
Arlington, Va.

DEAR MR. CHANNELL: Some very important people have been talking to me about you.

President Reagan, John Heinz, Barry Goldwater, Howard Baker and other leaders who've become involved with the Inner Circle, tell me they're convinced you already understand the crucial importance of continuing your participation in the Republican Senatorial Inner Circle.

For the sake of our Party and our country, I pray they're right.

I'm Bob Packwood, and in a moment, I'll introduce myself more completely.

First, please think about this:

It took 26 years and an incredible 16-seat switch in the United States Senate to put us where we are today.

But it will take only a four seat switch for the Democrats to regain control in 1982!

And they're not wasting a day.

Please read the enclosed newspaper material on "Leadership Circle".

No . . . it's not one of our programs.

It's a Democrat group modeled on us that formed this January!

However, in the so-called "Party of the little man", it costs $15,000 to join this Democrat circle!

And the big liberal power brokers will soon kick in their added millions. And the armada of ultra-liberal pressure groups . . . with their backs against the wall . . . will give as they've given before. And the Democrat political operatives will copy or steal every campaign program we've worked so hard to pioneer.

We're not going to catch them asleep . . . ever again.

They're not going to underestimate us . . . ever again.

In the 1981–82 election cycle, we're facing the full potential of dangerous, powerful and aroused adversaries . . . coming after us with everything they've got!

So if we fail to keep our Inner Circle intact this year . . . if we can't even hold on to the support of our most committed core of Republicans . . . our Senate Majority will be lost almost as quickly as it was won.

But if President Reagan and the others have judged you correctly . . . if our Inner Circle does not break ranks . . . then we will meet the challenge.

More than that . . . we'll hand the Democrats another stunning defeat!

Consider this:

In 1982, there are 33 Senate seats at risk. Only 12 of them are Republicans!

The same statistical opportunity we enjoyed in 1980 is with us in 1982!

However, this may be the last time in the decade we have this advantage. By 1984, 1986 and beyond, the balance of risk will shift.

We dare not miss this final chance!

We can actually gain ground in 1982!

We've got a crack at some of the most powerful liberal Democrats left in the Senate.

Let's not be timid about our chances against big names. We handled George McGovern, Frank Church, Birch Bayh, John Culver and more in 1980.

There's no such thing as an "unbeatable" Democrat if we match bold thinking with bold action!

It'll take the full two years (as the Democrats themselves realized when they studied the 1979–80 achievements of the Inner Circle). And we'll continue the guarantee that every Inner Circle dollar will go to the Senate campaigns!

I want very much to discuss our plans with you in person at our Spring Inner Circle meeting for renewing members on Monday, April 27, in Washington, D.C.

This will be a great meeting to attend! We'll share ideas about how we should fulfill our Senate Majority responsibility, how we can maintain our majority status and (frankly) we'll take a little time to offer you some deserved celebration for a job well done!

The meeting became my pleasant responsibility when my fellow Senators elected me Chairman of the National Republican Senatorial Committee. (Since our by-laws require a Chairman who is not, himself, standing for Senate reelection, John Heinz, who runs in 1982, ended his tenure as Chairman.) The Committee Chairmanship carries with it the additional privilege of chairing the Inner Circle.

I'm one of Oregon's two Republican Senators. My family was among the first pioneers in Oregon.

I'm Chairman of the United States Senate Committee on Commerce, Science and Transportation. I'll welcome the input of Inner Circle members on that score. (Send any thoughts on the Inner Circle itself and they'll reach me.)

My election to the United States Senate required the defeat of liberal Democrat Senator Wayne Morse . . . a figure of national reputation.

I was a relatively unknown state legislator at the time, but hard work, a lot of people and a handful of votes made the difference.

I think that's why I've never been afraid to ask others to dream boldly and fight hard for those dreams. The formula has worked in my own life.

Which brings me back to my reason for writing my first and most important letter to the Inner Circle.

On behalf of all 53 Republicans who comprise the Majority you helped so much to form in the United States Senate, I'm deeply honored to invite you, Mr. Channell, to remain with us in the Inner Circle as a respected and valued Charter Member.

The financial commitment to Inner Circle remains $1,000 to $5,000 (it has not increased since the Inner Circle started in 1979); moreover, your 1981 membership will extend to March of 1982.

Mr. Channell, your continued financial support is indispensable. But the spirit behind that support is even more important to building a wonderful new America . . . I want you to know how much we cherish that spirit.

If you step out of the Inner Circle . . . we cannot hold on.

If you remain with us . . . I'm convinced we cannot fail!

Mr. Channell, please let this moment be the start of an ever-deepening personal friendship between us.

Welcome back to the Inner Circle.

Cordially,

Bob Packwood,
Chairman.

Democratic Congressional Campaign Committee,
Washington, D.C.

Dear Friend: As methodical as a shoulder to shoulder parade down Pennsylvania Avenue, right-wing Republicans are marching into Congress.

Swaggering to the drumbeat of radical conservatism, they're challenging Congress to about-face, to dismantle the progressive gains of the past 40 years.

"Just give us 25 more votes on the Republican side of the aisle," says arch-conservative freshman Dan Lungren of California, "and we'll really have a tremendous impact around here."

The 38 bloc-voting Republicans in the Class of '78 spent an average of $192,000 on their campaigns—and they never stopped campaigning. They're committed to hard-line conservative posturing while expectantly awaiting right-wing reinforcements from the 1980 election.

We Democrats in Congress need your help now—whatever you can afford—to offset the massive arch-conservative treasury.

Listen to Carroll Campbell, a South Carolina freshman Republican: "Republicans have a chance to take over Congress in the next few years if we put our minds to it. And I don't look to spending my lifetime in the minority."

New Republican aspirants, dollar signs gleaming in their eyes, are already lining up to cash in on 1980.

The GOP bankroll almost rivals the oil companies'—with money pouring in from radical right-wing organizations, single-issue fanatics, well-heeled Big Busi-

ness political action committees, fat-cat lobbyists and the traditionally prosperous Republican Party Committees.

All those dollars can't buy good candidates or good ideas—but they might buy the election.

That's the Democratic challenge today. That's why I ask you to help us even the odds by contributing now to the Democratic campaign.

Let me remind you of another group of freshmen Congressmen—the "Watergate Class" of 76 Democrats elected in 1974.

Like their '78 Republican counterparts, these men and women came to Washington with fire and fervor. But the resemblance ends there.

The '74 Democratic class sought positive change—and many senior members were ready to go along with them.

The result was the most profound upheaval ever in Congressional procedures:

Three Committee chairmen were ousted.

The seniority system was abolished.

Closed-door meetings were opened.

For the first time new members got key jobs.

Working with veteran members, the Class of '74 helped establsh a revolutionary new budget process.

The Democratic Class of '74 then set to work to combat pollution, lower taxes, eliminate worthless federal programs, expose corruption, find jobs for people who wanted them, find help for people who couldn't help themselves.

In the wake of Vietnam and Watergate, these Congressmen and Congresswomen joined their senior colleagues to restore some confidence in the government of America, and in America itself.

These two Congressional classes symbolize the '70s:

The Democrats of '74 looking forward to reasonable, responsible change, searching for ideas to lift America from its knees.

The Republicans of '78 looking backward in a naive nostalgia, attacking their own leaders as nonmilitant, waiting for the problems of inflation and energy to vanish through neglect—and confidently marking time until 1980's reinforcements arrive.

I can think of no better examples of the contending forces in Congress than the Classes of '74 and '78.

And I can think of nothing more ominous than for the Republican forces of 1978 to prevail.

To prevent that—and to prevent a reversion to reactionary right-wing government—we need your help now.

In 1978, Republican candidates for Congress spent more than $41 million.

Here's a summary of the four-to-one odds Democrats fought in 1978:

	Democrats	Republicans
Gross national party receipts	$24,420,000	$84,840,000
Congressional Committee Disbursements	2,500,000	15,700,000
Total	26,920,000	100,540,000

This year the Republicans will spend another fortune.

Since January 1979, they have been recruiting ideologically "pure" conservative candidates, grooming them in image schools and concocting super-slick television and radio commercials to distort the Democratic record.

The Republican goals are clear enough:

Buy the Senate in 1980.

Buy the House in 1980 and 1982.

If they succeed, the bloated military establishment will get almost everything it wants.

America's deserving citizens—the poor, the old, the handicapped—will get almost nothing they need.

Of course, Presidential politics dominate this election year. But the real battle for America will take place in the 435 Congressional Districts.

I want you to help the Democrats in the battle.

I ask you to contribute now to the Democratic Congressional Campaign Committee—our official fundraising arm. Send $25, $50, $100—whatever you can.

We know we'll never match the Republicans in money.

But they'll never match us in good candidates—and these candidates need our help now!

The Democratic Congressional Campaign Committee helps plan our campaigns and pay for them—by monitoring Republican strategy, recruiting the

best candidates and carefully spending our limited funds where they'll do the most good.

In 1978, after 17½ years in Congress, I was almost defeated by a classic right-winger spouting the arch-conservative litany.

In the same election, despite heroic efforts by the Democratic Congressional Campaign Committee, heavily-financed right-wingers unseated 22 Democratic incumbents.

They defeated another 20 progressive—but underfinanced—challengers.

The Democratic Congressional Campaign Committee simply didn't have the resources to compete.

These setbacks have damaged our party and our legislative program. We cannot afford such losses in 1980—but we may not be able to afford to win.

Unless you help.

Help stop the right-wing takeover.

Help bar the radicals from Congress.

Contribute to the Democratic Congressional Campaign Committee today.

Sincerely,

MORRIS K. UDALL,
Member, Democratic Congressional Campaign Committee.

Senator PACKWOOD. Our next witness is Mr. John Kochevar, director of public affairs and manager of the public affairs department of the Chamber of Commerce of the United States, accompanied by Christine Vaughn, the director of tax policy center for the Chamber of Commerce.

STATEMENT OF JOHN KOCHEVAR, DIRECTOR OF POLITICAL AFFAIRS AND MANAGER OF THE PUBLIC AFFAIRS DEPARTMENT OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY CHRISTINE VAUGHN, DIRECTOR OF TAX POLICY CENTER FOR THE CHAMBER OF COMMERCE

Mr. KOCHEVAR. Thank you.

The chamber is the largest business federation, comprised of over 100,000 business firms and 2,700 chambers of commerce and 1,300 trade and professional associations.

Of the trade and professional associations that operate political action committees, approximately 80 percent are chamber members.

On behalf of these members, I welcome the opportunity to comment on S. 352, which proposes to clarify the ability of individuals to obtain tax credits for contributions to political campaigns.

I prefer not to read our entire statement, but ask that it be included as part of the record.

Senator PACKWOOD. It will be included in the record.

Mr. KOCHEVAR. I would like to say, at this point, that we are fully in favor of S. 352 and urge that Congress, not the IRS, make these kinds of determinations for a number of reasons. I would like to cite a couple of them, if I might.

First of all, there is the chilling effect that the kinds of regulations as proposed in the letter ruling would have on the individual participation in politics. The second point is its rather narrow interpretation of what is admittedly somewhat ambiguous statutory language, which will seriously violate the freedom of speech.

Unless clarified by Congress, I think we will see some very detrimental effects to the political process.

First, the chilling effect. Historically, we, as American people, have always had the opportunity and in fact the right, if not the responsibility, of being involved in the political process, whether it be in opposition or not. In fact, if we don't like the way someone dresses or if we don't like the way someone wears their hair, or, in fact, if we don't like the way someone votes, we have the opportunity to oppose that person.

The negative campaign has some very useful values in this country, it seems to me. One of those values is to bring out candidates who might not otherwise be obvious and may not see the possibility of running for office. So, when you come out in opposition to someone, it seems it opens that door.

From a purely political, strategic standpoint, it is inadvisable for candidates to come out in opposition to a candidate. They may be there, and they may be waiting. But, from a strategic standpoint, it might not be wise to do so.

If you say that you cannot get involved in opposition to a candidate, then it seems to me you are forcing candidates to voice their candidacy at a much earlier time than what might strategically be useful.

The result of this ruling would, in effect, for ourselves and groups like us, limit our ability to try to foster these two kinds of political activities.

I might point out, also, that it seems fairly clear to us that Congress intent back in 1978, when you expanded the tax credit, was clearly in favor of more participation in the political process. This kind of ruling from the IRS would certainly fly in the face of that.

Concerning the freedom-of-speech question, it's clear that campaigns in opposition to a candidate do have an influence on the political process. I think no one would deny that.

By disfavoring that kind of a campaign, however, it seems to me you tend to favor the person against whom that negative campaign would have been waged.

At the very best, and that is not to say it is good, you would bring equity between the two candidates. Let's say there are just two.

In the worst possible case, you would actually favor the candidate against whom such a campaign would be waged. That's totally outside of the purview of Government, as we see it.

This IRS letter ruling, if it were let stand, would raise an entirely new area of ambiguity. Not only would the IRS, or some other agency absent congressional action, be asked to make determinations of what is negative and what is positive, but additionally would start having to make definitions between various kinds of negative thought. We find this to be absolutely abhorrent.

So, if it were left to stand, we would enter an era where we would have the determination of the content of a political speech by an administrative agency. This is something that should be avoided and can, in fact, be avoided by positive action by this committee.

Again, we support S. 352. It would reverse the administrative action taken by the IRS in clarifying which political contributions can achieve a tax credit.

Senator PACKWOOD. Can you give us a rough idea of how you feel the IRS' letter ruling would affect the chamber's political program,

in particular, in your Political Action Committee Administration, in general?

Mr. KOCHEVAR. I also administer our Political Action Committee, so I can answer that question quite easily.

We begin our political year, basically, the December after the preceding election. In other words, we have begun already now to take a look at every congressional race and every Senate seat that will be up in the 1982 election.

We make our determinations based on such things as perceived vulnerability. Vulnerability, I suggest to you, is not based solely on whether or not there is an opposing candidate available at the moment. Vulnerability can be based on an entire raft of things, including someone simply voting outside of the mainstream of their constituents, which is frequently one of the areas with which we involve ourselves.

We like to think that by pointing out those vulnerabilities, we can provide a forum whereby good, strong candidates will then say, "OK, why don't we get involved in this race? Perhaps I will run for it."

By saying that we cannot make the determination that a candidate should be defeated. Let's say an incumbent should be defeated, which could very well be interpreted as a negative campaign, we would be seriously limited in our ability to do this.

I am thinking particularly of trade associations. For example, you don't just wait until there is a candidate running against a particular incumbent before you make a determination of whether or not you are going to get into that kind of a race.

Senator PACKWOOD. Senator Byrd?

Senator BYRD. This is a little off the subject, but driving from Richmond to Washington yesterday, the executive director of the Virginia State Chamber of Commerce, Dick Gillis, made what I think is a fine comment in urging the members of the Virginia Chamber of Commerce and business as a whole to support President Reagan's effort to control Federal spending.

I called Dick Gillis on the phone today and commended him for that.

Incidentally, the chamber of commerce has a topnotch guy in Dick Gillis. I've known him many years, long before I became a State Senator. I think that he and the State chamber—the national chamber, too, for that matter, does a fine, fine job. I'm pleased with my close association with the Virginia chamber and, indeed, with the national chamber.

I think you made good points this morning in regard to this legislation and I think it is a matter that Congress should address. It should not be something in which Internal Revenue interprets the intent of the Congress. I think Congress ought to make clear its own intent.

Senator PACKWOOD. I agree.

I have no other questions. Thank you very much.

Mr. KOCHEVAR. I might just point out that absent positive action, I don't think it's only the IRS that might find an interest in this; it might be any other of a number of agencies.

Mr. PACKWOOD. I think you're right and I think Mr. Dolan is right. If this is not corrected, the issue is going to court, whether the suit is

brought by Mr. Dolan's group, by the American Civil Liberties Union or by another party, there is going to be a lawsuit. It's likely to go all the way to the Supreme Court anyway. This is an issue that should properly be determined by Congress.

Mr. KOCHEVAR. We agree.

Senator PACKWOOD. Senator Long, any questions?

Senator LONG. Pass.

Senator PACKWOOD. In that case, thank you very much, Mr. Kochevar.

Mr. KOCHEVAR. Thank you.

[The prepared statement of John A. Kochevar follows:]

STATEMENT BY JOHN A. KOCHEVAR, FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES

I am John Kochevar, Director of Political Affairs and Manager of the Public Affairs Department of the Chamber of Commerce of the United States. With me is Christine Vaughn, Director of the Tax Policy Center of the Chamber.

The Chamber is the world's largest business federation, comprised of over 100,000 business firms, 2,700 chambers of commerce in the United States and abroad and 1,300 trade and professional associations. Of the trade and professional associations that operate political action committees, approximaely 80 percent are Chamber members. On behalf of these members, I welcome the opportunity to comment on S. 352, which proposes to clarify the ability of individuals to obtain tax credits for contributions to political campaigns.

SUMMARY

In February 1980, the Internal Revenue Service (IRS) issued several private letter rulings that would disallow the existing tax credit for political contributions to what the agency refers to as "negative campaigns." [1]

The Chamber is concerned that the IRS position could have a chilling effect on voluntary participation in, and financing of, political campaigns. Congress intended tax credits for contributions by individuals to campaigns to be widely available. The phrase "political contributions," as used in the Internal Revenue Code, should be interpreted to cover contributions to campaigns in opposition to, as well as in support of, candidates.

We believe the IRS action, based on a very narrow interpretation of ambiguous statutory language, is contrary to congressional intent and may violate the protection of free political speech provided by the First Amendment.

The Chamber has consistently supported the efforts of Congress in encouraging more citizens to become active in the public arena and to participate in the political process. We support reasonable limitations on campaign expenditures and contributions, favor disclosure of the source and recipient of contributions, and limitations on the use of cash.

Further, to encourage the broadest base of individual giving, and to encourage small contributors, we favor the use of tax credits for these contributors.

PARTICIPATION IN THE POLITICAL PROCESS

In 1971, in an effort to "clean up" our election system, Congress passed the Federal Election Campaign Act Amendments. These sweeping reforms were intended to prevent improper use of money in elections, while at the same time insuring that people were able to continue to participate in the political arena.

To further expand such participation, Congress included in the 1978 Revenue Act a provision to double the amount of the tax credit available for political contributions.

Defining a contribution

Present tax law allows individuals a tax credit for certain contributions to candidates for public office or to committees organized to influence their election. The IRS interprets this section of the tax code to require that these contributions be used to "further the candidacy" of such office seekers.

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[1] Private Rulings 8019056, 8019024 and 8019064.

The private letter ruling, by its interpretation of "contribution," now poses a clear threat to the continuing allowance of tax credits in certain situations. The letter ruling states that a contribution to a political action committee which engages in so-called "negative campaigns," that is, campaigns advocating the defeat of a specific candidate, will not qualify for a credit.

Even though private letter rulings apply only to the person requesting the ruling and have no precedential value, they can serve as the basis for revenue rulings which do have general application when published by the IRS. More troubling, they indicate in general how the Service interprets a particular section of the tax code.

THE INTENT OF CONGRESS

By making tax credits available for political contributions, the intent of Congress clearly was to encourage greater participation in the electoral process and public discussion of the issues.

The IRS letter ruling disallowing the use of the tax credits could discourage such participation, certainly contrary to the intent of Congress.

The IRS has failed to recognize the role and the value of the "negative campaign" as a legitimate part of the political system. Such a campaign could activate citizens not previously reached by the more traditional campaigns, and so directly influence the outcome of an election.

The "negative campaign" can also serve as a first step in coalescing political opposition to a candidate or a set of ideas. Historically, politics is being "against" as well as "for." "Negative campaigns" and movements are an important part of our nation's history. In every election or referendum, there exist people who vote against rather than for a candidate or set of proposals.

THE IRS ROLE IN ELECTIONS

A narrow interpretion of Section 41, such as that contained in the private letter rulings, could force the IRS continually to specify what constitutes a "negative campaign." This could cause a large volume of requests to the IRS for clarifications and rulings and would rule on political speech based on the content of that speech.

Would the election be over before the IRS ever rules? This would, it seems, confuse and make more complex a system that is intended to broaden participation, not narrow it. Worse, it could inhibit a good deal of participation in the political process.

FIRST AMENDMENT RIGHTS

We agree with the Supreme Court in *Buckley* v. *Valeo*, where the Court stated:

"The concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment." 424 U.A. 1 (1976).

The Court also noted in *Buckley* that previous Court decisions have held that:

"Legislative restrictions on advocacy of the election or defeat of candidates are wholly at odds with the guarantees of the First Amendment."

Our First Amendment tradition is built on the proposition that all citizens are guaranteed the right of free speech, whatever expressive form that may take. To insure such free speech, the government cannot interfere or favor one form of political expression over another.

The IRS private letter ruling restricting the use of tax credits for political contributions to "negative campaigns" run contrary to basic First Amendment principles. If a tax credit is provided to an individual who contributes to a campaign that is "for" a candidate, then the same right must be granted to individuals who contribute to a campaign that is "against."

CONCLUSION

We have spoken here today in opposition to the administrative action taken by the IRS. We support Senator Packwood's bill, S. 352, which would in effect, reverse that ruling by clarifying the definition of "political contributions" in section 41 of the Internal Revenue Code.

The IRS letter ruling effectively denies access to part of this process. The function of the IRS should not be to involve itself in election-related activities. Rather, the agency should avoid interpreting the tax law way that would com-

plicate or make more difficult a provision that should be kept simple, and widely available, so as to encourage citizen participation. If a statutory change is necessary to insure this, we urge this Subcommittee to move promptly to correct the Service's misinterpretation of congressional intent.

Senator PACKWOOD. The next witness is Mr. Arthur Eisenberg of the American Civil Liberties Union.

I understand that you are speaking this morning on behalf of both the American Civil Liberties Union and the New York Civil Liberties Union.

Mr. EISENBERG. That's correct.

STATEMENT OF ARTHUR EISENBERG, STAFF ATTORNEY, NEW YORK CIVIL LIBERTIES UNION, SUBMITTED ON BEHALF OF THE AMERICAN CIVIL LIBERTIES UNION

Mr. EISENBERG. Good morning.

I want to thank the subcommittee for the opportunity to speak this morning in support of S. 352. As the committee is aware, S. 352 has been made necessary by an IRS letter ruling of February 1980. The American Civil Liberties Union and its New York State affiliate, the New York State Civil Liberties Union, believe that this IRS ruling renders section 41 of the Code unconstitutional, with respect to two discrete constitutional first amendment principles.

First, we believe that the IRS ruling violates the first amendment principles of neutrality, principles that prohibit Government from making content-based judgments about what may be said, and that similarly prohibit Government from favoring certain political organizations over others.

Second, we believe that there is so uncertain a line distinguishing between affirmative and negative campaigning, that the IRS attempt to fashion such a distinction violates first amendment principles of vagueness.

With respect to the chairman's suggestion that we not dwell on the constitutional matters, and because we have submitted a more lengthy written statement this morning, I will rely upon written statements with respect to our discussion of the vagueness principles.

Senator PACKWOOD. The only reason I suggest that, is having been through a dozen years of constitutional arguments here, by and large, if Congress feels like changing something, they will, and if they won't, they won't, and the constitutional argument is one that both proponents and opponents will use when they have other reasons, quite frequently, for supporting or opposing the bill, and it ends up going to court anyway.

Mr. EISENBERG. But, I do feel it's important to recognize that, in the first instance, Congress has an obligation to inquire into the constitutionality of its own enactments. It may very well be the case that ultimately this matter will have to be resolved by the court, but I do think, as the earlier speakers have suggested, that it is important for Congress to resolve the matter at this time.

In that regard, I would like to focus my remarks upon the first amendment neutrality principles that I suggested.

Before doing so, perhaps I ought to briefly—and it might be helpful to briefly sketch the statutory scheme contemplated by section 41.

Section 41 of the code provides that tax credits may be granted in three general circumstances.

First, for a direct contribution to a candidate; second, for contributions made to the national, State, or local committees of a national political party; and third, under 41(c) (1) (b), for contributions given to organizations operating exclusively for the purpose of influencing the election of one or more candidates where the contribution is given to further the candidate or candidates.

In interpreting the phrase "to further a candidacy," the IRS, in its letter ruling, concluded that contributions to an organization that merely opposes a candidate, are not entitled to the tax credit.

This IRS ruling, as Mr. Dolan has suggested, combines with the original statutory formulation to set up various categories of contributions that will or will not be entitled to tax credits.

For example, a contribution to an independent political action committee, such as NCPAC, that engages in negative campaigning, will not be entitled to a tax credit. A contribution made to a local committee of the Democratic or national political parties, will be entitled to a tax credit, even if it engages in precisely the same sort of negative campaigning as that undertaken by NCPAC.

Similarly, contributions to small political parties will not be entitled to tax credits, even if they were to engage in precisely the same sort of political campaigning as that undertaken by the major political parties.

We think, therefore, that the IRS ruling, which rewards electoral advocacy of some political organizations and not others, and which create incentives and disincentives for electoral speech, depending upon the contents of the speech, violates first amendment neutrality principles.

What do I mean by the "first amendment neutrality principles?" There is an equality component to the first amendment. It essentially holds that when Government is regulating the speechmaking activities of citizens, it must remain neutral. Government can't favor what it believes to be good ideas over bad ideas. It can't favor certain political groups over other groups.

This equality rests in large measure upon the marketplace of ideas approach for its constitutional first amendment doctrine, originally introduced by Justice Holmes in *Abrams* v. *United States.*

Under this marketplace metaphor that Holmes borrowed actually from John Milton, it is believed that truth and wisdom are best achieved in an environment where ideas compete for acceptance within a society, but without governmental interference.

We think the constitutional advice of section 41 is twofold: It intrudes—first, it intrudes governmental officials deeply into the process of evaluating the content of speech; and second, it favors certain political organizations over others.

I'd simply like to conclude, Mr. Chairman, with perhaps a personal remark. When I was a little bit younger, my mother used to tell me that if I didn't have anything nice to say, I ought not to say anything.

Now, that may be perfectly appropriate as a parental admonition, but we submit that when Government enacts that form of social behavior into law, as it has done in section 41 as now interpreted by the IRS, the matter becomes one of serious constitutional concern; so seri-

ous that we believe that the section 41, at this point, is unconstitutional and we urge the enactment of S. 352.

Senator PACKWOOD. Senator Byrd?

Senator BYRD. It seems to me that you sum up the case pretty well on page 4 when you say:

Thus, the IRS ruling would base the availability of a tax credit for political contributions on two highly questionable criteria. One, the content of the speech and the popularity of the political organization engaging in the speech.

Then you go on to say:

For example, under the specific circumstances of the IRS ruling, contributions to a political action committee, such as the National Conservative Political Action Committee, engaged in negative political campaigning, would not be entitled to a tax credit. Yet, the tax credits would be available for contributions to the national committee of the Republican or Democratic Party, even if the Republican or Democratic national committees were to engage in precisely the same sort of negative political campaigning as that undertaken by the National Conservative Political Action Committee.

It has passed through my mind that the situation to which you refer could happen—one example of that might be, in 1964, in the advertisement that President Johnson used so effectively against Senator Barry Goldwater, if anything was negative, that was certainly a negative one. But, I wouldn't want to see the Government deciding on the nature of a political campaign as you bring out later on in your comments.

It's very difficult to know just what is negative and what is positive.

Also, on page 5 you say, "Similarly, in some years, contributions to the national committees of the Socialist Party might not be eligible."

I have seldom been accused of being a Socialist, but as a long-time newspaper editor, I shall quote Voltaire—"I disagree with everything you say, but will defend to the death your right to say it." So, I think that's what you are trying to indicate here. You don't necessarily agree with, and probably disagree, with many of these advertisements that were run in the last campaign, but you feel, and your organization feels, that a person or a group should have the right to express his views, whether it be positive or negative in regard to candidates. Is that basically what you are saying?

Mr. EISENBERG. That's a fair and more articulate statement than I was able to submit this morning. Thank you.

Senator BYRD. Thank you.

Senator PACKWOOD. Senator Long?

Senator LONG. I have no questions.

Senator PACKWOOD. Thank you very much for taking the time to testify here today.

[The prepared statement of Arthur Eisenberg follows:]

SUMMARY OF TESTIMONY OF ARTHUR EISENBERG, STAFF ATTORNEY, NEW YORK CIVIL LIBERTIES UNION, SUBMITTED ON BEHALF OF THE AMERICAN CIVIL LIBERTIES UNION AND NEW YORK CIVIL LIBERTIES UNION

The American Civil Liberties Union and New York Civil Liberties Union support the enactment of S. 352. This legislation has been made necessary by an Internal Revenue Service letter ruling issued in February 1980. In the letter ruling, IRS took the position that, under Section 41 of the Code, tax credits would be denied for political contributions to those organizations that merely oppose candidates for public office, where such organizations do not also affirmatively promote rival candidates.

This letter ruling effectively invites governmental inquiry into the content of electoral advocacy, and, indeed rewards certain kinds of political statements while penalizing other attempts at political expression. In addition to dispensing the rewards of Section 41 of the Code on the basis of the content of political statements, the ruling also effectively favors the most popular political parties at the expense of the smaller parties. In these respects, Section 41, as now interpreted by the IRS, plainly conflicts with our First Amendment tradition, a tradition that is built upon the proposition that government cannot disfavor electoral speech or political organizations that it deems unworthy but must, instead, remain neutral with respect to the expressive or speechmaking activities of all its citizens. The February 1980 IRS ruling, to the extent that it attempts to distinguish between "affirmative" and "negative" electoral advocacy, also renders Section 41 excessively vague and imprecise in violation of First Amendment "vagueness" principles.

S. 352 represents an appropriate effort to rectify the constitutional infirmities created by the IRS letter ruling and we urge its enactment.

TESTIMONY OF THE AMERICAN CIVIL LIBERTIES UNION AND THE NEW YORK CIVIL LIBERTIES UNION

Mr. Chairman and members of the Senate Finance Subcommittee on Taxation and Debt Management:

My name is Arthur Eisenberg. I am a staff attorney with the New York Civil Liberties Union and the co-author of the American Civil Liberties Union handbook, entitled "The Rights of Candidates and Voters" (Avon Books, 1980). I wish to thank the subcommittee for the opportunity to testify with respect to Section 41 of the Internal Revenue Code and the proposed amendment of that section contemplated by S. 352.

As Senator Packwood has made clear, upon introducing S. 352, this bill has been made necessary by an Internal Revenue Service letter ruling issued on February 12, 1980. In the letter ruling I.R.S. took the position that, under Section 41 of the Internal Revenue Code, tax credits would be denied for political contributions to those organizations that merely oppose candidates for public office where such organizations do not also affirmatively promote rival candidates. In essence, the IRS ruling rewards electoral advocacy where the political speech promotes the election of candidates and it penalizes political statements that exclusively oppose the election of candidates.

I appear here this morning on behalf of the American Civil Liberties Union (A.C.L.U.) and its New York affiliate, the New York Civil Liberties Union (N.Y.C.L.U.) to express our deep concern with this I.R.S. ruling and to support S. 352 in its effort to rectify the constitutional infirmities posed by the February, 1980 I.R.S. decision.

The A.C.L.U. and N.Y.C.L.U. are nonpartisan organizations devoted to the protection of individual rights and freedoms under the Constitution. Within the pantheon of constitutional rights, perhaps none are more cherished and fundamental to our democratic system than are the First Amendment freedoms of political speech and participation. These basic First Amendment freedoms lie at the heart of our objection to the February 1980 I.R.S. ruling. For reasons which will be more fully set forth below, the A.C.L.U. and N.Y.C.L.U. believe that the February 1980 I.R.S. ruling serves to further a statutory regime, under Section 41, in which the federal government is penalizing and, in effect, censoring political speech based upon the content of the speech and the political affiliation of the speakers. Thus, as we shall demonstrate, Section 41, as interpreted by the I.R.S., plainly conflicts with our First Amendment tradition—a tradition that is built upon the proposition that government cannot disfavor political speech or organizations that it deems unworthy, but must, instead, remain neutral with respect to the expressive or speech-making activity of all its citizens. In addition, we believe that the February 12 ruling renders Section 411 excessively vague and therefore, violates First Amendment "vagueness" principles. We, therefore, support S. 352 in its attempt to correct these constitutional problems.

Each of these concerns will be amplified below.

THE STATUTORY SCHEME SET FORTH IN SECTION 41

In order to fully demonstrate the constitutional difficulties presented by the February, 1980 I.R.S. ruling, it may be useful, at the outset, to briefly sketch the

statutory formulation set forth in Section 41 of the Code, and to identify how Section 41 will apply in a variety of situations.

Under Section 41 of the Code, tax credits may be taken for political contributions in three general circumstances: First, for direct contributions to "a candidate for nomination of election to any Federal, State, or local elective . . . office." 26 U.S.C. 41(c)(1)(A); Second, for contributions to national, state, or local committees of a national political party.[1] 26 U.S.C. 41(c)(1)(C), (D), (E); Third, where a contribution is given to any "organization . . . operated exclusively for the purpose of influencing . . . the election of one or more candidates . . . [where the contribution is given] for use by such . . . organization to further the candidacy of such individual or individuals." 26 U.S.C. 41(c)(1)(B).

It was subsection 41(c)(1)(B) that was the subject of the February, 1980 I.R.S. ruling. In interpreting this subsection, I.R.S. emphasized the language of the provision which suggests that, in order to qualify for a tax credit, the contribution must be made "to *further* [a] candidacy. . . ." (emphasis supplied). In seizing upon the requirement that contributions under 41(c)(1)(B) must be made in "furtherance" of a candidate's election, the I.R.S. ruling combines with the statutory language of 41(c)(1)(C), (D), and (E) to establish various categories of political speech, some of which will be favored with a tax credit, others of which will not.

Thus, the I.R.S. ruling would base the availability of a tax credit for political contributions on two highly questionable criteria: the content of the speech and the popularity of the political organizations engaging in the speech.

For example, under the specific circumstance of the I.R.S. ruling, contributions to a political action committee such as the National Conservative Political Action Committee (NCPAC) that engaged in negative political campaigning would not be entitled to the tax credit.[2] Yet tax credits would be available for contributions to the national committee of the Republican or Democratic Party, even if the Republican or Democratic national committees were to engage in precisely the same sort of negative political campaigning as that undertaken by NCPAC. Similarly, in some years contributions to the national committees of the Socialist Party, U.S.A.[3] might not be eligible for a tax credit where the Socialist Party engaged in precisely the same sort of negative campaigning as that undertaken by the Republicans and Democrats—because that organization might not qualify as a committee of a national political party, as defined by 26 U.S.C. 41(c)(3).

The disparity in treatment under Section 41 is manifest. The Republican and Democratic political parties (and other major political parties) can engage in both affirmative and negative political campaigning; smaller or less popular political parties are penalized for engaging in negative political campaigning, as are all political action committees not organized as political parties. This disparity—based as it is both upon the content of the political speech and the popularity of the political parties undertaking to speak—clearly violates the First Amendment.

THE FIRST AMENDMENT'S COMMAND OF GOVERNMENTAL NEUTRALITY

The Supreme Court has repeatedly insisted that "[a]bove all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter or its content." *Police Depart-*

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[1] A national political party is defined as a political party whose presidential candidate appears on the ballot in ten states. Where the contribution is made during a presidential election year, the determination of whether a party qualifies as a national political party is made by examining the election ballots in that presidential year. Where the contribution is made during a nonpresidential election year, the determination of whether a party qualifies as a national political party is made by examining the election ballots in the preceding presidential election.

[2] Negative political campaigning was described in the I.R.S. letter ruling as "an independent expenditure program directed in opposition to the nomination and election of several identified . . . candidates for elective public offices." I.R.S. letter of Feb. 12, 1980, Index No. 0041.00–00 at p. 1.

[3] The Socialist Party, U.S.A., with a political tradition dating back to the presidential candidacies of Eugene Debs, would not have qualified as a national political party under 26 U.S.C. 41(c)(3) between 1976 and 1979 because its presidential candidate appeared on the ballot in only seven states during the 1976 election. The presidential candidate of the Socialist Party, U.S.A. appeared on the ballot in ten states during the 1980 presidential election. Therefore, the contributions to the Socialist Party, U.S.A. would now qualify for a tax credit. However, in light of the 1980 election the Socialist Labor Party might not qualify for tax credits.

ment v. *Mosely* 408 U.S. 92, 95 (1972). Moreover, the First Amendment is offended as much by statutory disincentives as by direct prohibitions based upon content or subject matter. As Justice Douglas pointed out in *Speiser* v. *Randall* 357 U.S. 513,536 (1958) (concurring opinion):

"Plainly a community may not suppress, or the state tax, the dissemination of views because they are unpopular, annoying or distasteful. [citations omitted] If the Government may not impose a tax upon the expression of ideas in order to discourage them, it may not achieve the same end by reducing the individual who expresses his views to second-class citizenship by withholding tax benefits granted others. When government denies a tax exemption because of a citizen's belief, it penalizes that belief. That is different only in form, not substance, from the 'taxes on knowledge' which have had a notorious history in the English-speaking world . . . ."

The First Amendment's prohibition against governmental favoritism regarding the content of speech extends to a prohibition against the state favoring or disfavoring certain speechmakers because of their political affiliation or favoring others because of the popularity or social utility of their ideas. This basic theme has been consistently articulated by the Supreme Court. Thus, in *NAACP* v. *Button* 371 U.S. 415, 445 (1963), the Court observed:

"the Constitution protects expression and association without regard to the race, creed or political or religious affiliation of the members of the group which invokes its shield, or to the truth, popularity or social utility of the ideas and beliefs which are offered."

This theme has been most frequently invoked where the state has either created a public forum or where a governmental entity is supervising First Amendment access to a public facility. For example, when a municipality regulates speechmaking access to the streets, sidewalks, parks, or a public auditorium, it cannot make content-based judgments about who may or may not speak or what may or may not be said. It is axiomatic that in such circumstances the First Amendment's command of governmental neutrality limits the municipality to judgments based only upon "time, place, or manner." *Cox* v. *Louisiana* 379 U.S. 536, 558 (1965); *Niemotko* v. *Maryland* 340 U.S. 268 (1950); *Fowler* v. *Rhode Island* 345 U.S. 67 (1953).

The constitutional requirement of governmental neutrality has also been applied to the imposition of tax exemptions. For example, California enacted a statute requiring that any person seeking a property tax exemption must sign a statement on the tax return declaring that such person does not advocate the unlawful overthrow of government. Persons refusing to subscribe to such a statement were denied tax exemptions. In *Speiser* v. *Randall*, *supra*, the Supreme Court invalidated the California enactment. The *Speiser* decision, is most often cited, for the proposition that vague statutes and procedures affecting First Amendment freedoms are suspect because they force persons to "steer far wider of the unlawful zone" than is necessary. Id. at 526. In fact, at the heart of the *Speiser* decision is the notion that government may not use its tax laws to favor certain political positions and disfavor others.

In *Police Department* v. *Mosley* 408 U.S. 92 (1972) the Supreme Court held a Chicago ordinance unconstitutional where the ordinance prohibited all forms of peaceful picketing within 150 feet of a public school except for picketing arising out of a labor dispute. The *Mosley* decision rested upon the observation that the Chicago ordinance selectively granted the right to picket based upon the content of the speech and the labor affiliation of the speakers. In this regard, the Court declared supra, at 96:

"[U]nder the Equal Protection clause, not to mention the First Amendment itself, government may not select which issues are worth discussing or debating in public facilities. . . . There is an 'equality of status in the field of ideas,' and government must afford all points of view an equal opportunity to be heard. . . ."

Section 41, as presently interpreted by the I.R.S., thus, violates the neutrality principles underlying the Supreme Court decision in *Speiser* and articulated by the Court in *Mosley*. Section 41 invites governmental inquiry into the content of political statements and, indeed, rewards certain kinds of statements while penalizing other attempts at electoral advocacy. It dispenses these rewards and punishments on the basis of the content of the statements and the popularity of the political parties engaging in the electoral advocacy. Section 41, as presently interpreted, thus favors the most popular political parties over the smaller parties. And it deeply intrudes public officials into the process of making content-based judgments about electoral advocacy.

THE CONSTITUTIONAL PROHIBITION AGAINST VAGUE STATUTES

While the primary thrust of our concern is with the violation of First Amendment "neutrality" principles presented by the February, 1980 I.R.S. ruling, we are also concerned that the ruling raises First Amendment "vagueness" and "overbreadth" problems. The First Amendment is not only offended by governmental favoritism. It is also violated by laws that are imprecise and that, therefore, sweep too broadly with respect to expressive activity.

The dangers inherent in vague or overly broad statutes that affect speech are threefold: First, the individual who is subject to the statute will be uncertain as to that speech which is proscribed and that which is not; Second, public officials who must enforce the laws will be similarly confused about the reach of the statute; Third, vague and overly broad statutes will confer excessive discretion upon public officials who may wish to use the statutes to single out unpopular views for discriminatory enforcement. See *Gooding* v. *Wilson* 405 U.S. 518 (1972).

The I.R.S. attempt to distinguish "affirmative" from "negative" electoral advocacy suffers from all of the vices inherent in a vague and overly broad statute. It is entirely unclear how and where one would draw the line between an "affirmative" and "negative" political campaign. Was an advertisement critical of President Carter's management of the Iranian crisis or of the economy a "negative" advertisement if it failed to urge support for any of candidate Reagan's programmatic positions? Would that very same advertisement criticizing Carter become miraculously transformed into "affirmative" electoral advocacy if it concluded with the statement: "Paid for by the Ronald Reagan Campaign Committee?"

In truth, there appears to be no clear distinction between "affirmative" and "negative" campaigning. And the inability to clearly distinglush between "affirmative" and "negative" campaigning renders the I.R.S. February 12 interpretation of Section 41 violative of First Amendment vagueness principles.

CONCLUSION

S. 352 appropriately rectifies the constitutional infirmities created by the February 1980 letter ruling. The bill accomplishes this result, quite simply, by eliminating language of 41(c)(1)(B) upon which the I.R.S. relied when it concluded that contributions must be made in "furtherance" of the election of a particular candidate in order to qualify for a tax credit. S. 352 thus eliminates the constitutionally impermissible and realistically unfeasible distinction between "affirmative" and "negative" electoral advocacy.[4] For these reasons, we urge the enactment of S. 352.

In closing, I simply want to again thank the subcommittee for extending to the A.C.L.U. and the N.Y.C.L.U. the opportunity to testify about the constitutional dimensions of Section 41 and its impact upon First Amendment freedoms of electoral advocacy and political participation.

Senator PACKWOOD. Next we'll take Mr. Paul Kamenar, the director of litigation for the Washington Legal Foundation.

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[4] There may, however, by one respect in which S. 352 does not go far enough in its effort to cure the constitutional deficiencies inherent in Section 41. As suggested above, Section 417(c)(1) (C), (D), (E) permits tax credits for contributions to national, state, or local committees of a national political party. However, a national political party is defined as a political party whose presidential candidate appears on the ballot in ten states (26 U.S.C. 41(c)(3)). In this respect, Section 41 continues to discriminate against small political parties. There would seem to be no compelling governmental justification for failing to extend the benefits of Section 41 to, at least, any political party whose presidential candidate secures a place on the ballot in any one state. Accordingly, Section 41's discrimination against small political parties is itself a violation of First Amendment equality principles. See *Greenberg* v. *Bolger* 497 F. Supp. 756 (E.D.N.Y. 1980).

Because of the availability of tax credits for contributions directly to the candidates (25 U.S.C. 41(c)(1)(A)) or to political action committees (25 U.S.C. 41(c)(1)(B)), we are uncertain as to the practical consequences that flow from Section 41's discrimination against small parties. And because this issue is somewhat beyond the intended scope of today's testimony, the contours of this problem are not fully explored here. Nevertheless, we raise this issue simply to suggest that even if S. 352 succeeds in remedying the most egregious constitutional violations resulting from the February 1980 I.R.S. letter ruling, constitutional problems may yet remain.

STATEMENT OF PAUL D. KAMENAR, DIRECTOR OF LITIGATION WASHINGTON LEGAL FOUNDATION

Mr. KAMENAR. Thank you, Senator.

I apologize for my statements getting up here a little late. I think they were here about 8 o'clock this morning.

They are very brief and I will not go into them since, basically, they follow the constitutional arguments that were made by Mr. Dolan and Mr. Eisenberg.

Just to briefly point out about the fundation, the Washington Legal Foundation is a nonprofit public interest law firm. They have about 80,000 members nationwide, and we get involved in litigation, in fact, representing many Members of the Senate and the U.S. Congress.

We do not advocate the passage of any particular bill. We like to present the public interest viewpoints on particular bills and we believe this particular bill would be clearly in the public interest because it would lay to rest, basically, the confusion and the uncertainty about whether or not a tax credit may be taken for certain political contributions.

In that respect, in terms of the Senator's earlier request on whether or not Congress should do this through legislation, it is my understanding right now that the particular private letter ruling has not been finally ruled on by the Commission of the IRS to basically put it in concrete.

So, theoretically, there is still a possibility open that the private letter ruling will not achieve the final status of a revenue ruling.

I do not understand, fully, what the position of the Secretary of the Treasury's position would be with this, but obviously it would be in the hands of the Commissioner of the IRS.

Nevertheless, I think that the time is now right for this body to clear the air, so-to-speak, once and for all and rule in a way that, I think, is clearly one that is in the public interest and is clearly designed to correct a constitutional flaw in the interpretation by the Internal Revenue Service.

I have no doubt, in my mind, that should NCPAC or another organization or, in fact, should a contributor whose tax credit was disallowed for contributing to NCPAC, would fight that through the Tax Court up to the Supreme Court. I have no doubt, in my mind, that a court would quickly strike it down as being unconstitutional since it does discriminate between NCPAC as an organization, for example, as well as the national parties.

It is clear, from the legislation, that Congress is giving a blanket exemption to the national parties, State parties, local parties of a political committee, and treating other organizations which operate the same way, differently.

In fact, in the recent case in New York, *Greenberg* v. *Bolger*, the District Court in the Eastern District of New York in an opinion on June 30, 1980, struck down Congress' Postal Appropriate Act whereby they were giving a postal subsidy for the major political parties. In effect, they were allowing them to mail at 3.1 cents per letter, but requiring other political parties, such as the Conservative Party of New York, the Libertarian Party, the Socialist Party, et cetera, they were requiring them to mail at the 8.4 cents rate.

In a very recent opinion, the district court clearly said that this is unconstitutional. You cannot say that the national parties can be treated one way under the postal laws and by Congress, and the other parties be treated a different way. They struck down that act as clearly unconstitutional and allowed, in fact, affirmative relief to the parties by giving them an opportunity to mail at a reduced rate.

The final point I'd like to just simply address is, the administration of this revenue ruling as it now stands would be horrendous. We would basically have to track an individual's contributions to the political committee, such as NCPAC, and then track where that money went, and vis-a-vis, a particular advertisement. NCPAC and other committees, as I understand it, do not necessarily advertise only so-called negative campaigns or attack an incumbent's record; they also do positive campaigns.

So, you might have a problem where it's hard to track which money is going where and, indeed, a taxpayer could give money to NCPAC, and if he was obeying revenue ruling, he would disallow his tax credit. But, lo and behold, it could be that NCPAC actually used that money for a positive campaign and here the taxpayer would not receive the benefit of the tax credit.

So, we think that it's most appropriate for the Congress to correct this legislation and to make clear its intent without having it be resolved through the courts.

Thank you.

Senator PACKWOOD. Senator Byrd?

Senator BYRD. No questions.

Senator PACKWOOD. Senator Long?

Senator LONG. No questions.

Senator PACKWOOD. I have none either. Thank you very much. I think your closing comments about independent groups that make positive ads and negative ads are interesting. Do contributions leading to expenditures in favor of a candidate count toward a tax credit, and the ones that are negative don't count? Or, do you claim 50 percent of the tax credit? Do you divide up the time that you spend on television proportionately, or do you say if you do any negative ad there is no tax credit? I'm not sure Solomon could decide that.

Mr. KAMENAR. You would get into all kinds of accounting problems. You would have to look at, for example, the administrative expenses of that committee. Obviously, every committee has to pay its staff and salaries. Then you are going to find out what proportion of the money ultimately was transmitted to the campaign, and the IRS would have to get into that, and it just would not be in the public interest to get into that kind of interpretation of the tax bill. Plus, it would probably cost more than the credits that would be lost from disallowance.

Senator LONG. Mr. Chairman, is there going to be anybody up here to testify on the other side of the argument?

Senator PACKWOOD. Yes; the next witness.

Senator LONG. Fine.

Senator PACKWOOD. Thank you very much.

Mr. KAMENAR. Thank you.

[The prepared statement of Paul Kamenar follows:]

TESTIMONY OF PAUL D. KAMENAR, DIRECTOR OF LITIGATION, WASHINGON LEGAL FOUNDATION

On behalf of the Washington Legal Foundation, let me express my appreciation to Senator Packwood and the distinguished members of the Senate Finance Subcommittee on Taxation and Debt Management for this invitation to testify on Senator Packwood's bill, S. 352, which would amend the Internal Revenue Code of 1954 to permit a tax credit to be taken for otherwise qualifying political contributions to organizations seeking to influence nomination or election of candidates for elective office.

In accordance with the Subcommittee's Press Release of March 3, 1981, I am providing a brief summary of my testimony on the following page.

SUMMARY OF TESTIMONY

1. The Washington Legal Foundation (WLF) does not advocate the passage or defeat of any legislation. As a non-profit public interest law firm, we do, however, give our views as to the public interest aspects of measures or proposals being considered by regulatory agencies and other public policy decisionmakers such as committees of the Congress.

2. In that regard, WLF believes that S. 352 is in the public interest by providing equal tax treatment to those individuals who decide to make political contributions to political committees which in turn make expenditures that either expressly advocate the defeat of political candidates, or those expenditures which, while not expressly advocating the defeat of a candidate, nevertheless tend to further the defeat of a candidate.

3. We believe that the current tax law provision, section 41(c), would allow such equal tax treatment, notwithstanding the Internal Revenue Service private letter ruling to the contrary. However, because that letter ruling remains extant, S. 352 is designed to clarify the issue and thus leave no misunderstanding as to the will and intent of the Congress.

4. Indeed, in some respects, the IRS is currently allowing tax credits for political contributions which, although on the surface are given to further the election of a candidate, are, in fact, used to further the defeat of a candidate. Such disparate treatment is unconstitutional and not in the public interest.

TESTIMONY ON S. 352

I. Interests of the Washington Legal Foundation

The Washington Legal Foundation (WLF) is a non-profit, public interest law firm, organized in 1977 with a nationwide membership of some 80,000 members, contributors, and supporters. The Foundation seeks to provide a balance before the federal regulatory agencies and the courts where an imbalance exists on those issues which have a broad impact on the public interest.

The Foundation believes in limited government intervention in the lives of individuals and small businesses, advocates a free market approach to our economy, supports a strong national defense, and protects the rights of crime victims. WLF regularly participates before federal regulatory agencies opposing unnecessary regulations as well as litigating public interest issues in the courts. WLF has represented over 100 Members of Congress and the Senate before the Courts. More importantly, WLF prepared and filed comments last year before the FEC opposing the rulemaking petition designed to give legitimacy to the IRS letter ruling.

II. Criticism of IRS private letter ruling of February 12, 1980

The proposed bill, S. 352, is designed to counteract the private letter ruling issued by the IRS on February 12, 1980 which apparently was requested by the Democratic National Committee (DNC) and the Democratic Senatorial Campaign Committee (DSCC). That ruling would not allow citizens to take as a tax credit contributions given to political committees, such as the National Conservative Political Action Committee (NCPAC), which make expenditures that tend to defeat certain candidates.

The DNC and DSCC filed with the Federal Election Commission on April 8, 1980, a Petition for Rulemaking urging the FEC to adopt the IRS rule and to

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require committees such as NCPAC to place notices on its solicitation material that contributions to it are not deductible. The FEC, in one of its rare wise moves, decided to drop the rulemaking proceeding.

The Washington Legal Foundation believes that the IRS ruling is a narrow interpretation of the Code and one that is clearly unconstitutional on First and Fifth Amendment grounds, and thus not in the public interest. See *Speiser* v. *Randall*, 357 U.S. 513 (1958); *Police Department* v. *Mosley*, 408 U.S. 92 (1972).

Under the current tax law, section 41(c) would allow tax credits for contributions made directly to the "national committee of a national political party" as well as to local and State committees of such parties without regard to the use of the contribution. IRC § 41(c)(1) (C)-(E). Why should the national parties and their committees be given special treatment in this respect? Committees such as NCPAC and others operate in much the same way as do political party committees. Such disparate treatment violates fundamental notions of equal protection of the laws and is not countenanced by the Courts.

For example, last year WLF supported litigation which attempted to strike down as unconstitutional the postal subsidy provisions which allowed major rather than minor or new parties to take advantage of reduced postal rates for political mailings. The U.S. District Court ruled that such treatment is unconstitutional. *Greenberg* v. *Bolger*, No. 80 Civ. 0340 (E.D.N.Y., decided June 20, 1980). In that case, the court reiterated long-standing judicial principles that government regulation of speech and related activities be content neutral.

Under the IRS ruling, however, the government is discriminating between various political organizations because of the content of their speech in the form of political advertisements. Indeed, not only are all party committees automatically exempt, but also sections 41(a) and 41(c)(5) allow automatic credits for contributions made to a "newsletter fund" maintained by a candidate or an incumbent, regardless of the content of the newsletter, i.e., whether it furthers or opposes a candidate.

As Senator Packwood correctly points out in his statement in the Congressional Record, February 3, 1981. "as a matter of commonsense, it seems that any expenditure against one candidate does, in fact, further the candidacy of that candidate's opponent." And even if it does not, the Constitution does not sanction the disparate treatment.

In short, it seems to us that a proper court would strike down any attempt by the IRS to apply this discriminatory private letter ruling. However, the chilling effect that its existence has on contributions to political committees cannot be fully measured and thus this legislation would dispel any uncertainties.

Furthermore, if the IRS were serious about enforcing its ruling, the administrative enforcement costs would be burdensome and would no doubt cost the taxpayers more for IRS salaries than to allow the credits in the first place. The IRS would have an enormous task in tracking down the political contribution from the taxpayer, to the political committee, and to match it up with the ultimate political advertisement actually used.

Indeed, the ruling may even have the effect of preventing tax credits where the contribution was in fact used "to further" the candidacy of an individual. For example, money may be contributed to support a so-called "negative" campaign and the taxpayer would not get the credit. But, by the time the contribution is received and deposited into the committee's account, the committee might decide to launch a series of "positive" ads in support of the candidate who is the opponent of target of the "negative" ads. Thus, the taxpayer's contribution was actually used "to further" a campaign although not so originally intended.

III. Conclusion

The Washington Legal Foundation strongly believes that the current IRS ruling violates fundamental constitutional principles. S. 352 is designed to correct the fatal flaws of that ruling and to allow equal tax treatment for all citizens and all political committees. Such result is clearly in the public interest.

Thank you for this opportunity to present these comments.

Senator PACKWOOD. The next witness is Mr. Robert Bauer, the general counsel of the Democratic Senatorial Campaign Committee.

Mr. Bauer?

STATEMENT OF ROBERT F. BAUER, GENERAL COUNSEL OF THE DEMOCRATIC SENATORIAL CAMPAIGN COMMITTEE

Mr. BAUER. Thank you, Senator. Senator Long's remarks suggest that when you're in the minority, you're really in the minority, and I'll make my remarks brief and humble in light of the parade of witnesses which have already testified the other way.

I'll begin by stating that I'm not going to delve into the constitutional matters. I think you have made it very clear that that's unnecessary here, and I think that the Assistant Secretary for Tax Policy also made it clear that this is a matter that Congress is going to have to decide, and there is not a compelling issue that the courts won't decide the other way.

The testimony that I would give is, in the main, contained in the written statements, and I assume they will be printed in the record as part of the hearing record.

Senator PACKWOOD. All of the statements will be included in the record.

Mr. BAUER. I would like to go beyond the arguments that I think have all been conceded here, that the statute does appear to refer only to the furtherance of candidacy; that the congressional intent is, at best, ambiguous.

I would like to go beyond that and address myself to your question, "Right or wrong, what should we do?"

The position that the DSCC takes is not content based. It is not content based. We are not suggesting that only conservative negative campaigns should have a tax credit disallowed.

We think that negative campaigns are an ugly new phenomenon in American politics. I don't believe, as interesting as they were, that the advertisements shown here by Mr. Dolan constitute the full range of advertisements that were seen by the voting public in 1980. There were gross references to baby killers pinned on U.S. Senators. There were ugly advertisements suggesting the U.S. Senators were unfit to serve because they were suffering from degenerative diseases.

There were, it seems to me, negative campaigns which suggested a very unattractive new trend in American politics and one which, in our judgment, contributed nothing to the quality of political debate and which, while it is certainly constitutionally protected in the main, does not necessarily qualify or should require or be rewarded with Federal subsidy.

Now, some points, some very practical points were made that I think we ought to address, the DSCC ought to address, because we don't want to be positioned as opponents of free speech in any way.

One was that a chilling effect would occur here, that people who would otherwise like to participate would be dissuaded from doing so. We have not heard any hard data on this point at all. Our judgment, in 1980, was that tax credit or no tax credit, there were many people who were prepared to contribute to negative campaigns, and I have heard no data suggested here that the IRS rulings had any deterrent effect, whatever. No dollar figures, no other data to suggest that people were turned away from their otherwise negative activities, by these IRS rulings.

Second, we have heard the argument that there is an ambiguity here which is going to pose serious administrative problems for the Internal Revenue Service. Here again, I don't know the evidence for this. We haven't heard of any controversies bubbling to the surface, any questionable rulings by the IRS which are being challenged over whether an advertisement was negative or positive.

Quite frankly, the advertisement shown this morning could very easily be characterized. One was an advertisement to defeat Senator Eagleton, and only that, and would not have qualified for the tax credit. The other was an advertisement to elect Senator D'Amato by attacking Senator Javitz, but the pro-D'Amato content was clear.

I might add that Mr. Kamenar's closing remarks referred to the difficulties of deciding how a committee was spending its money. But, in fact, NCPAC had a target 1980 program, which consisted entirely of a fund, if you will, or a set of solicited contributions, for the purpose of running negative ads on U.S. Senators running for reelection.

So, I'm not sure that the administrative problems that were cited here today are as awesome as they were portrayed to be.

I suppose I will conclude by saying that the ACLU representative here quoted his mother as saying, "If you don't have anything nice to say, don't say anything." Obviously, that's not a principle of constitutional law.

But, the questions before this committee is not whether people should or should not be able to say such and such a thing. The question is, as a matter of policy, do we want to encourage or ratify or otherwise endorse this wave of ugly talk which substitutes for quality political debate in our system?

I don't think that there are any reasons why the IRS ruling, as it stands, is an unjust interpretation of section 41, and I don't think that section 41, as it stands now on behalf of the DSCC, I must say, should be changed.

That's my statement.

Senator PACKWOOD. Let me say to Senator Long, we invited all the opponents of the bill we were aware of. There are only two that I could find: the Democratic National Committee and the Democratic Senatorial Campaign Committee. The Democratic National Committee chose not to testify. The Democratic Senatorial Committee did, but I cannot find any other opponents of the bill.

The fact is that there were a number of proponents. We could have had, I suppose, 15 or 20 witnesses that would have testified in favor of it.

Let me ask you a question. I'm curious about the ad that NCPAC showed. I didn't find the ad against Senator Eagleton any more negative than those most challengers use against incumbents. If that is a negative ad, then almost all candidates who are challenging incumbents engage in negative campaigning.

Mr. BAUER. Well, I think that's correct, Senator. I think there is a continuum of negative advertisements, and I think Mr. Dolan wisely chose to select an advertisement which was sort of on the more generous side of this continuum.

Apart from the fact that it made no reference to his opposition, that advertisement might very well have had a closing like the D'Amato ad; that is, elect his opponents.

But I don't think that that is primarily what we're concerned with here, and while it is true that there will be times when advertisements will be shown which you and I could agree are very close to the line I think by and large that's not going to be a serious problem. I think that negative campaigns are easily and quickly identified. We saw them in 1980. We saw what they were like. We saw how much press attention they drew and what an impression of our political process they gave.

That would be my response.

Senator PACKWOOD. Let me ask you this. You made reference to single issue groups and attacks on Senators as "baby killers." That's a reference, of course, to the political action committees involved with the Human Life Amendment. I am one of those that they targeted in the last campaign. I'm very familiar with the ads.

But let's say it's 1979 or 1985 when I'll be running again, and I have no opponent at the time. There are two groups very deeply interested in the subject of abortion: one being the Life Amendment Political Action Committee and the other being the National Abortion Rights Action League, and its political action committee.

If I have no opponent, and the Life Amendment Political Action Committee puts on negative political advertising and says, "Defeat Packwood because he's pro choice on abortion and he's a 'baby killer,'" you're saying that contributions to that group should not be entitled to a tax credit.

Mr. BAUER. As I gather, Senator, you are suggesting that at no point do you draw an opponent. In other words, those advertisements are run to the general election?

Senator PACKWOOD. No. They are run, let's say, a year and a half ahead of time or 1 year ahead of time, when nobody has yet been selected as my opponent.

Mr. BAUER. Yes, I'm very comfortable saying that they should not be entitled for the tax credit.

Senator PACKWOOD. Now, at the same time the National Abortion Rights Action League is running advertisements, or sending out mail on my behalf saying, "Reelect Senator Packwood, no matter who his opponent may be, because he's been a great supporter of our cause." They would be eligible for the political tax credit.

Mr. BAUER. That's correct. That's correct, and I understand the anomaly that you're driving at and I think that, in the abstract, it strikes us as unjust, but we have to remember that we're dealing here, not with an entitlement, but with a credit, a tax credit.

Senator PACKWOOD. I understand that.

Mr. BAUER. My judgment is that there are very good public policy reasons, which I think, were they implemented now, we would see the fruits of 5 or 6 years from now, to try to channel political energies in more positive directions in this country.

Senator PACKWOOD. Now, let's take it a step further. I'm also a supporter of tuition tax credits, which kind of twists some of my supporters and opponents into a reverse position.

Assume that NCPAC, which supports my position on tuition tax credits says, even though I have no opponent, "Reelect Senator Packwood. We like his position on tuition tax credits." That would be considered positive campaigning, fur[illegible]ing my reelection.

Therefore, a tax credit could be claimed.

Mr. BAUER. That's correct.

Senator PACKWOOD. And, if the National Education Association Political Action Committee says, "Defeat him, he supports tuition tax credits and that's going to finish public education," then they don't get a tax credit.

Mr. BAUER. That's correct.

Senator PACKWOOD. So, would your standard be this then: If any organization engages in any negative advertising, they should have no credit at all. We shouldn't try to prorate what the credit might be between the number of negative and the number of positive ads they have.

Mr. BAUER. Well, what I'm suggesting, Senator, on the basis of our experience in 1980 is that committees, by in large, segregate their programs fairly carefully and they allocate funds to one account and to the other. I think, without any great administrative inconvenience, if there is a substantial campaign being waged on behalf of the U.S. Senator and funds are being solicited for that purpose, taxpayers responding to those solicitations would be entitled to the credit; whereas, if taxpayers are responding to the target 1980 solicitation, which was clearly segregated for negative campaigning purposes, no, the tax credit would not be available.

My judgment is that, while this may impose some inconvenience on the administration of the IRS, it's workable.

Senator PACKWOOD. One further question. You would leave the law the way it is, basically?

Mr. BAUER. That's correct.

Senator PACKWOOD. OK. Now, that does mean then, that if NCPAC chooses to oppose me in the next election with these kind of ads, they get no tax credit, but if the Democratic Party did identically the same thing, they would get the tax credit.

Mr. BAUER. If they conducted a campaign against you which was entirely negative in nature?

Senator PACKWOOD. Yes. If they did exactly the same thing NCPAC did, but they would get the tax credit.

Mr. BAUER. I'm somewhat uncertain about my response to that question and I wonder, especially, if the campaigns waged by political parties for this purpose were as organized and dedicated as those conducted by so-called negative committees, I wonder whether that isn't an issue that we should address at some length. Because, I don't know if I want to start drawing those sorts of distinctions.

We are concerned here with negative campaigning as a phenomenon of media politics now, and I do not want to discriminate between source.

Now, the letters that Mr. Kamenar included in his testimony—excuse me, Mr. Dolan put in his testimony, were not negative campaign expenditures, as we understand them, because they were not candidate based. They were written by senatorial committees alleging outrageous conduct on the part of the other party, but in very general terms. I don't regard that as negative campaigning. Democrats and Republicans have been firing shots at each other like——

Senator PACKWOOD. I remember one night, in 1976, when I was campaigning for President Ford in Ohio. I spent an evening in Cin-

cinnati and I turned on the television. I saw some of the political advertisements going on. I saw two of the most negative campaigns against an incumbent Member of Congress, who was a Republican, that I've ever seen.

In the first, a group of cowboys rides into town, shooting their guns in the air and driving cattle down the street, and whooping it up. Then a deep voice comes on and says, "Texas has 26 Congressmen; 25 are from Texas. The other is—" and it mentions the name of who this fellow is from Ohio. And, it gives the impression that he's in the oil companies' pocket. This is totally negative campaigning.

Keep in mind that the ads I speak of were done by the local Democratic Party. The second starts out with Hawaiian music playing and a picture of the beach at Waikiki and a voice said, "Have you had a chance to vacation overseas lately, at taxpayers' expense?" Congressman X says, "Is that your idea of positive campaigning?"

Mr. BAUER. No; that's not my idea of positive campaigning. I might add, I think especially to your question about the party—the party negative campaigning triggers this in my mind, I don't know any precedent for what you're suggesting, large-scale negative campaigning by a political party, but I recall, for example, the very effective "Vote Republican for a Change" advertisement, one of which included an implicit attack on the wisdom of the policies superintended by the Speaker of the House. It was identified in the ad very clearly and it made him out to be somewhat of a culprit in our current energy crisis, and at the end it stated, "Vote Republican for a Change."

I don't regard that as a negative campaign. I think it's clearly a positive campaign. "Vote for such as a change" is a standard line that parties use to suggest that the other party simply hasn't performed to par.

Senator PACKWOOD. Senator Byrd?

Senator BYRD. I might say that I've never been involved in a campaign where my opponent was positive in his campaign tactics.

[Laughter.]

Senator BYRD. Every one of our opponents have been negative right down the line in every statement they have made, all of them.

As I understand it, you would have the IRS determine whether an advertisement is positive or negative.

Mr. BAUER. If the statute stood as it did now, the IRS would have the threshold administrative determination to make, that's correct, Senator.

Senator BYRD. So an organization would need to submit, I assume, all of its advertisements to the IRS and let the determination be made at that point; is that the way you feel?

Mr. BAUER. I would assume that the determination would have to be made only if a question were raised about the credit and whether it was allowable. I haven't heard, in all of 1980, beyond the question that was first presented before this letter ruling was issued, I have not heard of one challenged tax credit in all of 1980, and 1980 was virtually crammed with negative campaigning, and I have not understood that it generated any special controversy or question that the Internal Revenue——

Senator BYRD. But your recommendation to this committee is that the IRS make the determination as to whether the campaign is negative or positive?

Mr. BAUER. That's correct.

Senator BYRD. Thank you.

Senator PACKWOOD. Senator Long?

Senator LONG. First, let me commend you for intellectual fortitude, coming up here to explain your position on this matter, in view of the parade of witnesses on the other side of the issue.

My mind is open. I hadn't heard the issue discussed and I wasn't even familiar with it until I came into the committee room, but I do want to explore this matter and I appreciate the Chair permitting me to ask about this matter. I haven't interrogated the other witnesses.

We are not talking here about the right of somebody to express himself, as I understand it. We are talking about what it is that the Government might want to subsidize by way of a campaign expenditure; is that correct?

Mr. BAUER. That's correct.

Senator LONG. We are recognizing that someone who is against candidate Y, for example, has every right to say every scurrilous thing he can tie his tongue to, and he can publish pamphlets and buy newspaper ads and even ads on television. He can even put out material that is libelous and subject to litigation. He can take his chances on publishing stuff like that.

Now, in my State, we had a lot of experience with people publishing pamphlets, or at least pieces of information, that were absolutely scurrilous, and for years they would do that kind of thing but they wouldn't sign it. We passed a law that said that when you publish political information of a scurrilous nature, political information, you have got to identify who it was that published that.

Under the Federal Communications Commission, that's true, too, and under our campaign laws, you have to at least identify who you are when you say these things. There are many times that you have to tell the public who you are. The impact isn't one fraction of what it would be if you didn't have to expose who you are; isn't that right?

Mr. BAUER. That's correct.

Senator LONG. For these kinds of people, who engage in this negativism, they have got to identify themselves and make themselves known. And really that is why we did that, because in a great number of cases people who engaged in these negative tactics were known for who they are and what they are?

It has much less impact than if they're not identified.

Mr. BAUER. That's correct.

Senator LONG. Now, the moral majority makes a point of this, and I suspect that they're right. The moral majority group is beginning a fight against pornography and what they believe is stuff that's contrary to good morals being shown on television. They are arguing against those who say that this violates somebody's free speech rights and first amendment rights, and saying that when they look at that TV program where that program is portraying smut, that they are helping to pay that advertiser's way.

They're not saying that the stations don't have a right to put smut on the air. What they're saying is that they don't have to pay for it.

Mr. BAUER. That's correct.

Senator LONG. I personally think they're right. I think they have a right to refuse to trade with people who put something on the air

that they think is immoral and that they think undermines good conscience.

If you can't do anything else about purveyors of smut, you could refuse to look at their programs. Which means that you are not paying for it.

I am inclined to think with regard to the constitutional argument, when we start subsidizing, we do have a right to say who it is we are going to subsidize.

Mr. BAUER. That's correct in this instance, definitely.

Senator LONG. In other words, we are willing to subsidize each candidate to make his argument. But when someone comes in to deal himself a hand, you have a right to take a look and say, "Who is this now, that we are going to subsidize? What is his claim? What type of thing did he have in mind?"

I am inclined to think that you are right on the constitutional issue, for that reason. That is, one who purveys smut, one who engages in venal and dirty campaigning, for whatever purpose, is not entitled to claim a public subsidy, even though a candidate would be.

Where I have my difficulty is finding how you are going to draw a line between one who is using what you believe to be meritorious campaign tactics and one who you believe is using campaign tactics that are not meritorious.

Suppose the same organization, confronted with such a law, did a little affirmative campaigning to go along with their negative campaigning.

How would you handle that? How would you draw the line?

Mr. BAUER. Senator, as I suggested to Senator Packwood, I don't think, given our experience in 1980, that that would be a problem.

For example, the National Conservative Political Action Committee had a clearly identified program of negative expenditures for which they specifically solicited.

Now, perhaps the answer to your question is: Once we find out there are administrative problems and they are real administrative problems, maybe then the time has come to reassess this legislation as the IRS has interpreted it.

But, to date, with any hard data that there is that administrative problem. With every suggestion that there is not, why should we send out a clear signal that we favor, ratify, endorse the kind of campaigning that was unfortunately so prevalent in 1980.

Senator LONG. You see, if the Democratic Committee engages in scurrilous campaigning, that tends to hurt the Democrats, especially when the public may tend to disprove that kind of a thing.

When the Republican Committee does that, that tends to brand that party as well.

But, when some outfit that does not go by the name of the Democratic Committee or the Republican Committee, avails themselves of the opportunity to do this—let's not say it is NCPAC, just say it is an organization that is engaged in scurrilous, dirty, filthy campaigning—that offends the conscience of sensible people. It offends the conscience of rank and file people who understand it.

Let's assume there is a group who will take wide latitude with the truth, put just enough truth in something to try to make all the falsehoods stick and engage in the most scurrilous type of a campaign.

There is a law that we passed to try to provide people an equal opportunity to tell their story to the public, but not to help them engage in something which we believe is venal and corrupt.

This is why I was impressed that perhaps the others were right on the constitutional point, until I heard your statement. I am inclined to think this does not have anything to do with constitutionality. It has to do with a Federal subsidy and our right to subsidize one type of activity without subsidizing another.

Now you call both activities political, but within the area of a political activity, it seems to me you do have a right to talk about the kind of politics that offends conscience and good morals and the kind that does not.

You are saying you are sure you would have difficulty drawing the line in the future, but where you don't need to worry about that line, where it is very clear, maybe you have a case.

Mr. BAUER. I guess my feeling is, Senator, if it is not broken, why fix it? We haven't had any problems in the past, so why should we anticipate and attempt to address them? If the problems arise, if the IRS is bogged down with determinations which appear to be constitutionally dangerous, then I think that this committee and this Congress can act to rectify the matter and would do so speedily.

Senator LONG. Well, you are saying that when NCPAC comes in seeking a Federal subsidy, your argument is, "Why?"

Mr. BAUER. That's correct. My argument is: Why do we want——

Senator LONG. If they don't have it, why should they have it? Why should we convey it to them?

Mr. BAUER. Precisely, and give a signal that this is the kind of campaigning that the Congress now believes should be given some form of ratification.

Senator BYRD. Are you contending that the Republican Senatorial Campaign Committee and the Democratic Senatorial Campaign Committee are always positive and excellent and fine in everything they do?

Mr. BAUER. Well, I can't say that we are entirely quiet when we don't have anything nice to say. But, I am not aware in the years that I have been general counsel, for 3 years now, that I have ever seen any communication financed by my committee, which is on a par with the material that I have seen in 1980, suggesting that U.S. Senators, and I will be happy to provide examples of this for the record, kill babies; are allied with the Communists; would like to bring homosexual teachers into the schools; and otherwise contribute to this poisoning of the political atmosphere.

I am not aware that my committee has ever done so.

Senator BYRD. I am not defending any of those advertisements. What I am saying is: We are getting on very dangerous ground when we permit an agency of the Government to make a determination as to what is positive and what is negative in the political field.

I have been a politician all my life, but I don't claim that politicians have the greatest regard for facts and truth as does anybody else in the country. [Laughter.]

I think that applies to the political committees, Democratic Committee or Republican Committee. Committees can be equally as good

or equally as bad. We were not necessarily associated with either the Republican or Democratic Committees.

I think the danger of what you are advocating is that you get Government in determining what should be said and what should not be said in a political campaign.

Now, concerning those very scurrilous ads you are mentioning, whatever candidate they may oppose or back, I have great confidence in the elective judgment of the American people. They can read these scurrilous ads and they don't pay any attention to them, in my opinion.

Now, where ads are well done, I happen to think that Tom Eagleton is a good Senator. That ad, I didn't think was as bad as many of the things that have been said about me. Many worse things have been said about me than that. I would have been well pleased to have an ad like that run. [Laughter.]

Doing away with the negative campaigns would appeal to me. I have been on the ballot 10 times, and fortunately, knock on wood, I have been successful 10 times. But I have never mentioned my opponent. I have never attacked my opponent. I never used his name.

One opponent, I haven't yet met, and that was 12 or 15 years ago he ran against me. I am not defending these negative campaigns. All I am saying is that I don't like to see the Government start drawing the line as to what campaign is negative and what campaign is not negative.

Mr. BAUER. Senator, may I just respectfully add one thing? The IRS would never be in a position of suggesting what someone should or should not say, specifically, whether it is the National Conservative Political Action Committee or the Washington Legal Foundation or any other organization.

Senator BYRD. But it makes the determination as to whether someone who contributes to that can take a tax deduction for that contribution, just as they can take a tax deduction for contribution to your organization.

Mr. BAUER. That is correct, Senator, but I somehow—my committee views that as a considerably lower order of concern so long as the rights of speech of those who engage in negative campaigning are fully protected, and they are.

Senator PACKWOOD. Thank you very much. We appreciate it.

Mr. BAUER. Thank you.

[The prepared statement of Robert F. Bauer follows:]

SUMMARY OF TESTIMONY OF ROBERT F. BAUER, GENERAL COUNSEL OF THE DEMOCRATIC SENATORIAL CAMPAIGN COMMITTEE

I. INTRODUCTION

A. DSCC shares the concerns with "opening up" the political process expressed in S. 352.

B. DSCC does not concur, however, with the view that those concerns mandate reversal of the IRS disallowing tax credits on contributions to "negative" campaigns.

II. DSCC RESPONSE TO ARGUMENTS MADE IN SUPPORT OF S. 352

A. Section 41(c)(1)(B) is not ambiguous. The provision clearly covers only those contributions made to "further," i.e., support, a candidacy.

B. Nor is the Congressional intent ambiguous. The legislative history indicates that Congress intended political contributions to encompass traditional, time-honored donations to the candidate or party of the contributor's choice.

C. Finally, the DSCC does not believe that the IRS letter ruling poses constitutional problems. So long as tax benefits are not granted or withheld to encourage or discourage particular political beliefs, Congress is not prohibited from encouraging one form of protected activity over another. The effect of the IRS ruling is not to distinguish between the kind of negative campaigns waged—Democratic or Republican, liberal or conservative—but instead to encourage contributions to the positive campaigns which are at the heart of our political process at its best. This is sound public policy, as well as an interpretation consistent with the language of § 41(c)(1)(B) and its Congressional intent.

III. CONCLUSION

The DSCC does not support enactment of S. 352, but instead believes that the IRS construction of § 41(c)(1)(B) is supported by the plain language, the legislative history, and sound policy rooted in the best political traditions of the country.

STATEMENT OF ROBERT F. BAUER, GENERAL COUNSEL OF THE DEMOCRATIC SENATORIAL CAMPAIGN COMMITTEE

On behalf of the Democratic Senatorial Campaign Committee, I am pleased to testify today on S. 352, a bill to amend the definition of "political contribution" in § 41 of the Internal Revenue Code.

INTRODUCTION

Section 41 currently provides for a tax credit on any "political contribution" of $50, or $100 in the case of a joint return. Under a current IRS ruling, the term "political contribution" does not include contributions to "negative campaigns," i.e., campaigns waged to defeat a candidate, not to support one. It is this IRS ruling that S. 352 is designed to reverse, with the result that tax credits would be freely available for contributions for such "negative" campaigning.

The DSCC has reviewed S. 352 and the statements introduced by Senator Packwood, in support of that measure, in the Congressional Record of February 3, 1981.

While the DSCC respects and shares the genuine concern, expressed in S. 352, with the free and unfettered operation of our political process, the Committee believes that those concerns have been misapplied in this instance. I should like to briefly review, and to answer, each of the grounds asserted against the current IRS interpretation of § 41's definition of "political contribution."

1. The Meaning of the Statute

Senator Packwood has stated, first, that 26 U.S. 41(c)(1)(B) is "ambiguous," and that it supports the IRS position no more than the contrary conclusion that negative contributions qualify for credit. Upon close examination, DSCC fails to find any such ambiguity in § 41(c)(1)(B). That section states, simply, that the credit is available to contributions made to committees:

". . . influencing, or attempting to influence, the nomination or election of one or more individuals who are candidates for nomination or election to any federal, state or local elective public office, for use by such committee . . . to further the candidacy of such individual or individuals . . ."

The meaning of the provision could hardly be clearer. The contributions must be used to further, not damage or derogate, a candidacy for public office. Moreover, there is no ambiguity in the phrase "influencing or attempting to influence;" it is expressly defined by the provision as including only attempts to influence in furtherance of a candidacy. Specifically, the plain language of the section states that if a contribution is to qualify for the credit, a committee seeking to "influence the nomination or election of one or more individuals" must use that contribution to "further the candidacy of such individual or individuals. . . ." There is simply no room in the language of the provision for a contribution made and used to harm or undermine a candidate's prospects for election.

The Senator counters, however, with the assertion that any expenditure against a candidate must, "as a matter of common sense," further the candidacy of another candidate. As an empirical matter, this assertion would not appear to hold up under close scrutiny. There have been numerous press reports over the last

two election years, during which negative campaigns have grown ever more prominent, that negative campaigns frequently help the candidate under attack—and hurt his or her opponent. In fact, there have been instances when, in recognition of the harm done to his or her candidacy, the opponent of the candidate under attack has publicly disavowed the activities of the "negative" committee, and has asked that committee to remove itself from the campaign altogether. Moreover, since these negative campaigns are built around hate for a candidate, and not around any program or set of coherent ideas, it is not correct to state that no committee would engage in negative expenditures unless it hoped to assist someone with election to office. Negative organizations don't operate that way; they simply hope to inflict injury to reputation, to smear and slander, often without regard for the practical politics of who might hold the office in the alternative.

2. The Congressional Intent Behind 26 U.S. 41

In his remarks of February 3, 1981, Senator Packwood also maintains that the IRS ruling stands "in direct conflict" with Congressional intent. He correctly views § 41 as a vehicle for broadened citizen participation in the political process. Negative campaigns, he insists, contribute to such broad participaton no less than the standard "positive" campaign organized around support for a candidate and his or her positions. On this basis, the Senator concludes that while Congress "did not intend 'negative' campaigning to dominate or be favored," it also did not seek to discourage or abolish such activity.

DSCC reads the "Congressional intent" behind § 41 very differently. It is highly unlikely that Congress, in enacting these tax credits, intended anything other than encouragement of contributions as we generally and traditionally understand them. Highly organized, "negative" campaigns are a relatively recent phenomenon; they have only surfaced as a prominent feature of our political life in the last couple of years. There is no evidence that Congress considered this phenomenon in enacting § 41; there is every evidence that it had in mind contributions, in the traditional sense, in support of a candidate. Thus, in the Senate Finance Committee report on its amendment to double the maximum tax credit, it is stated:

"The Commitee believes that the credit for political contributions can be an effective means of encouraging individuals to participate actively in the electoral process by donating to the candidate or party of their choice."

Thus, Congress had in mind donations ". . . to the candidate or party of [the individual donor's] choice. . . ." This is a donation clearly distinguishable from one made to a committee seeking exclusively to "bring down" a candidate. So, to the degree that Congress considered at all the nature of the contribution qualifying for the credit, it's clear that only contributions in the traditional and time-honored sense—that is, contributions in support of a candidate—were contemplated.

3. The Constitutionality of the IRS Action

Finally, Senator Packwood has raised concerns about the constitutionality of the IRS ruling, and more specifically, about the ruling's infringement of protected free speech. The ACLU has expressed similar concerns which have been printed in the Record as an appendix to the Senator's own remarks.

There is no question that whenever the government involves itself in any way in our political process, we must be alert to any resulting dangers to our First Amendment rights of free speech and association. It is the DSCC's judgment, however, that no such dangers are presented by the IRS action on "negative" campaign contributions.

Nothing in the IRS ruling would prohibit, limit, or otherwise prevent citizens from exercising their First Amendment rights through contributons to negative campaigns. Citizens may continue now, as before, to contribute their money and volunteer their time to such campaigns. The IRS ruling simply disallowed federal subsidization of this activity. The Supreme Court has held clearly that even if citizens have a constitutional right to engage in certain activity, it does not follow that the federal government is constitutionally bound to subsidize or finance that activity. The language from the Supreme Court's decision in *Harris* v. *McRae*, 100 S. Ct. 2671 (1980), decided only last year, leaves no doubt on this point:

"Whether freedom of choice that is constitutionally protected warrants federal subsidization is a question for Congress to answer, not a matter of constitutional entitlement." Supra, at 2689.

In other words, committees conducting negative campaigns have no claim on federal resources to support their activity, regardless of the fact that that activity is fully protected by the First Amendment.

Moreover, and no less important, Congress is not obliged to subsidize that activity even if, as is currently the case, it provides a subsidy, through the credit, for other contributions to "positive" or "affirmative" campaigns in support of a candidate or party. *Harris* v. *McRae* restates the long standing constitutional rule on this point:

". . . the court [has] cited the basic difference between direct state interference with a protected activity and state encouragement of an alternative activity consonant with legislative policy. Constitutional concerns are greatest when the state attempts to impose its will by force of law; the state's power to encourage actions deemed to be in the public interest is necessarily far broader." Supra, at 2687.

Thus, Congress is entitled to favor, with subsidization, one form of protected activity over another. It is the DSCC's position that for the purpose of awarding a subsidy, a distinction should be made. as a matter of policy, between the time-honored support of a candidate and his or her party, on the one hand, and the new wave of hate campaigns, or "negative campaigns," which poison our process with personal invective, smear tactics and slander. It would hardly be irrational for the Congress, in the best traditions of our country, to favor the former, "positive" activity over the latter, "negative" one.

I might add, in closing, two additional points in response to the statements made by Senator Packwood and the ACLU.

First, the case of *Speiser* v. *Randall*, 357 U.S. 513 (1958), which is cited both by the Senator and ACLU, does not seem to support the point they are making. In *Speiser*, the court addressed the constitutionality of a state statute which conditioned the availability of a property tax exemption on the taxpayer's rejection of a particular political belief. The court rightly struck down this governmental attempt to effectively "bribe" citizens into adopting specific political beliefs. The IRS ruling does no such thing. That ruling applies to all negative campaigns, whether waged against Democrats or Republicans, liberals or conservatives, against the left or the right. The ruling simply bears no relation to, and will have no inhibitive impact on, any belief or set of beliefs.

Second, the ACLU has alleged, as an additional ground of constitutional infirmity, that the IRS ruling is "vague" and "overbroad." It is that organization's contention that the ruling sets forth little basis for distinguishing between "negative" and non-negative political activity, with the result that citizens "must constantly seek to appraise the 'negativeness' of their actions." In the DSCC's view, there is hardly anything "vague" about the phase "negative campaigns," and therefore about the reach of the IRS ruling. Such campaigns are precisely what they purport to be, namely, campaigns conducted against the election of a specific candidate, with all the emphasis placed on the liabilities, faults, and vices of that candidate without any reference whatever to the virtues of his or her opponent. It would certainly seem that, for First Amendment purposes, the identification of "negative" campaigns should be no less difficult than, for example, the assessment of what constitutes "obscenity" outside the scope of existing First Amendment protections.

4. Conclusion

While DSCC has the utmost respect for Senator Packwood's concerns in S. 352, the Committee cannot agree that the IRS ruling represents either misconstructions of the applicable law, or infringements of constitutional rights of free speech and association. Indeed, in the DSCC's view, the IRS ruling correctly states the law on the tax credit as it is now written.

The IRS ruling will not prevent negative campaigns from being waged against any candidate on any issue. These campaigns will surely continue to be waged. The government is not bound, however, constitutionally or otherwise, to support with tax dollars scurrilous campaigns of this kind which are totally at odds with the best political traditions of our country.

Senator PACKWOOD. Next we will hear S. 483.

Our first witness is the Honorable Howard W. Cannon, U.S. Senator.

Thank you, Howard, for being patient while we finished up.

STATEMENT OF HON. HOWARD W. CANNON, U.S. SENATOR

Senator CANNON. Thank you, Mr. Chairman.

Senator PACKWOOD. I might say to the official reporter, I have a statement from Senator Laxalt. I would like to have it placed in the record, after Senator Cannon's statement.

Senator CANNON. I enjoyed listening to the previous discussion, I might say.

Thank you, Chairman Packwood, and members of the subcommittee. I am pleased to have this opportunity to discuss the wagering tax bill.

As you know, this measure would amend the Internal Revenue Code to provide that the 2-percent excise tax on wagers and the $500 occupational tax on wagering shall not apply in any State in which wagering is permitted by law.

You may recall that this legislation was favorably considered by this subcommittee and the full committee, last session.

Let me take a few minutes to stress several factors that I believe are important arguments in favor of passage of this measure.

First, the original purpose of enacting these taxes was to raise revenue and curb illegal wagering activities. Clearly, however, the impact of these taxes over the years has been just the reverse.

Gaming establishments are hampered by the 2 percent and occupational taxes in their efforts to comply with the regulation.

Further, their ability to compete effectively with illegal counterparts has been severely restricted. The result is that illegal operations are actually benefited. In fact, the Finance Committee's report last session speaks to this very issue, and I quote: "The imposition of taxes subjects legal wagering to an unnecessary economic burden not borne by illegal wagering for which such liabilities are generally evaded."

The legal bookmaker is really placed between the proverbial "rock and a hard place" in this situation. If he passes the tax on to his customers, they will more than likely take their business to an illegal bookmaker who simply ignores the tax.

On the other hand, if the legal operator absorbs the tax, he is likely to drive himself out of business. This is particularly evident with the smaller volume bookmakers who have difficulty paying the tax.

Contrary to some misconceptions, the majority of bookmakers in Nevada are not the large casinos, but small businesses whose primary and oftentimes only operation is sports and racebooks.

For example, most of these operations employ very few employees, the average number of employees being only 12.

I it interesting to note that the Commission on the Review of the National Policy Toward Gambling, on which I served, in its 1976 report to the Congress, pointed out that many licensed bookmaking operations in Nevada are only marginally profitable.

Besides benefiting illegal bookmakers, these taxes also subject legal bookmakers to discriminatory tax treatment. These taxes apply solely to legal sports and horse bookmaking and do not apply to parimutuel wagering, coin-operated devices, State lotteries that base winnings on horserace results, or casino games.

Nevada is the only State which conducts this regulated and fully policed activity which is affected by these taxes. States that conduct

horseracing, dogracing, or jai alai games are not subjected to a special Federal tax nor are States that conduct legalized offtrack betting.

Nevada has longstanding experience in legalized wagering. This year marks the 50th year for Nevada's legal wagering operations. That experience has shown us that the effect of the excise and occupational taxes is discriminatory among the States and within the industry. These taxes should not apply to wagering operations which are legal and regulated by the States.

Now, I wish to emphasize that the State of Nevada, in its own revenue-raising capacity, already imposes a tax of 5.5 percent on licensed bookmaking operations. A strong element of inconsistency and inequity exists in imposing Federal taxes on select gaming activities.

Gaming, which is Nevada's largest industry, is highly regulated and licensed in the State. Let me assure you that elimination of illegal gaming activities is a goal shared by both State and Federal officials.

I would now like to focus on the revenue aspects of these taxes. These taxes were originally adopted in 1951, and Congress was advised that the estimated gain in revenue from these taxes was $400 million per year.

By reviewing the attached breakdown [exhibit A], for the past 5 fiscal years, taken from the IRS Commissioner's annual report, you will see that this estimate was completely in error.

For example, the total revenues from these taxes in fiscal year 1980 amounted to only $11 million, and for the past 2 years, the total cumulative figure is only $21 million.

Furthermore, the Department of Treasury, in 1978, acknowledged that the revenues from these taxes are "extremely minor," and that "experience with the several taxes on gambling does not support the conclusion—there have been any substantial direct benefits in income tax enforcement arising from the existence of the gambling taxes."

I quote from a letter from Donald C. Lubick, Assistant Secretary-designate, Department of the Treasury, dated June 8, 1978.

A copy of Mr. Lubick's letter is attached for the record as exhibit B.

In the 94th Congress, I introduced an amendment to eliminate the excise tax for legal gaming operations.

When the amendment went to conference, the tax, which at that time was 10 percent, was reduced to 2 percent, and the occupational tax, which was at that time $50 was increased to $500.

Certainly, the reduction of the wagering tax was a step in the right direction.

However, it has proven itself to penalize the legal operators just as much as the 10-percent tax. Where the 10-percent tax was passed on to the customer, the 2-percent tax is absorbed by the operator.

The margin of profit in these wagering operations is approximately 2 percent and the effect of the tax is to remove that profit for the legal operator.

Quite simply, the 2-percent tax is a disincentive to legal bookmaking businesses, while illegal bookmakers continue to profit. I would like to bring to your attention a recent Las Vegas Sun article in which the IRS estimated that illegal bookmakers gross $8 billion to $10 billion annually in untaxed profits from illegal horse and sporting bets and evade as much as $3.6 billion a year in Federal taxes.

The $500 occupational tax is yet another penalty. Each ticket-writing employee of a wagering operation is subject to this tax.

As a practical matter, most employers pass it on to their workers. In some cases, the ticket-writer, who is only a salaried employee, pays it outright.

In other cases, the tax is taken directly from the employee's paycheck. I am sure it was never the intention of the Congress to apply a special tax on the right to work.

One of the original purposes of the occupational stamp was to serve as a law enforcement tool by identifying bookmakers. That purpose, however, is already served since these individuals are either licensed by the State of Nevada, pursuant to a rather demanding inquiry and hearing or are registered with law enforcement officials.

I can see no reason why there should be a duplication of effort when this very same information is already available from the State.

In conclusion, Mr. Chairman, these taxes are not effective as revenue raising measures; nor are they effective as tools for enforcement of gaming laws. They are discriminatory taxes borne by the small business person who complies with the law, while illegal bookmakers continue to benefit.

For these reasons, I urge that this committee reaffirm its action of last year and act favorably and expeditiously on this legislation.

As you know, Treasury does support our position on this matter.

Thank you very much. I am available for any questions.

Senator PACKWOOD. Treasury was here this morning and said we should get rid of both the wagering tax and the occupational tax, that the taxes did not serve the end we hoped it would serve at the time it was passed.

Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

The committee, last year, approved Senator Cannon's bill. I hope it will approve it quickly this year.

Senator CANNON. Thank you very much, Senator Byrd.

It is true that the bill came up as an amendment, with a number of other tax measures at the close of the session. There was the threat of a filibuster. We didn't want to block action on several other important tax matters. So, we acceded to having the matter passed over in order to present it separately.

Senator BYRD. Every comment made to this committee last year and the same way this year has been favorable to the legislation.

Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Long.

Senator LONG. It seems to me that much of your problem has to do with confusion in the minds of people between legal gambling and illegal gambling. In my State, we have both. I guess you have both in Nevada. We have horseracing. That is legalized gambling. You can go out to the racetrack, bet your money, and the track takes out about 15 percent to help pay expenses and pay the expense of putting the events on—or maybe it is 17 percent, something like that.

But, anyway, they take something out to pay the expense of putting on the events, so if you are just the ordinary bettor out there at the track, you have to lose money if you keep betting, because the track is taking out about 17 percent to pay expenses.

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At the same time it is entertainment. You are paying for the entertainment of going out there to watch the horses run. A lot of people enjoy doing that.

Now, one can engage in gambling, find himself a bookie, which is an illegal operation since off-track handbook is not legal in Louisiana. Those people are not paying that 15 or 17 percent to support the State government or the city government; they are just keeping the whole thing.

Once they start that type of operation, then they start getting themselves involved in betting on college sports, then on high school sports, and then that leads to an effort to corrupt those sports, to try to fix the games or pay somebody to shave the points and similar things.

It also leads to corruption in Government. Illegal operators spend money, either in campaigns, bribes, or whatever, to try to keep those who have the responsibility of passing laws and enforcing those laws from enforcing the laws against them.

All that is bad, in my judgment. I take it you are not seeking to defend any of that. In fact, I would ask you affirmatively, do you favor strict law enforcement against illegal gambling?

Senator CANNON. Absolutely. Those same illegal gamblers that you refer to, who take the off-track bets are likewise evading this Federal tax of 2 percent. In our State, wagering is highly regulated. Wagering operations also pay a 5.5-percent tax to the State. We are just as anxious as anyone else to put the illegal bookmakers out of business.

As I said, the revenue that they receive, from $8 to $10 billion a year in illegal betting, is a tremendous source of revenue that ought not be available to them.

Senator LONG. Well, I agree with you on that. I think it is mainly confusion about that type of thing that causes some people to be timid to be supporting what you are asking us to do here.

I voted for this measure when it first became law, the measure you seek to repeal. My impression at that time was that it was easier to vote for it than to explain why I didn't vote for it, because Senator Kefauver was recommending it and his committee had done some investigating into organized crime.

But the studies that have occurred since that time, as well as the information available to the Treasury, clearly show that if we are seeking to deal with corruption and in upholding the law, the tax does not achieve that result and we would be better off without it.

That is basically what the Treasury has determined. And that is the position you are contending here.

Senator CANNON. The Treasury Department has determined that, as did the Commission on the Review of the National Policy toward gambling.

Senator LONG. So that the legal, law-abiding operator is punished by this and it does not punish the corruptionist or the illegal operators.

Senator CANNON. That is correct.

Senator LONG. Thank you.

Senator PACKWOOD. We have no other questions. Senator Cannon, we thank you very much for coming.

Senator CANNON. Thank you very much.

[The prepared statements of Senators Cannon and Laxalt follow:]

STATEMENT OF SENATOR HOWARD W. CANNON

Chairman Packwood and members of the subcommittee, I am pleased to have this opportunity to discuss the wagering tax bill. As you know, this measure would amend the Internal Revenue Code to provide that the two percent excise tax on wagers and the $500 occupational tax on wagering shall not apply in any state in which wagering is permitted by law.

You may recall that this legislation was favorably considered by this subcommittee and the full committee last session. Let me take a few minutes to stress several factors which I believe are important arguments in favor of passage of this measure.

First, the original purpose of enacting these taxes was to raise revenue and curb illegal wagering activities. Clearly, however, the impact of these taxes over the years has been just the reverse.

Gaming establishments are hampered by the two percent and occupational taxes in their efforts to comply with the regulation. Further, their ability to compete effectively with illegal counterparts has been severely restricted. The result is that illegal operations are actually benefitted. In fact, the Finance Committee's report last session speaks to this very issue:

". . . the imposition of taxes subjects legal wagering to an unnecessary economic burden not borne by illegal wagering for which such liabilities are generally evaded."

The legal bookmaker is really placed between the proverbial "rock and a hard place" in this situation. If he passes the tax on to his customers, they will more than likely take their business to an illegal bookmaker who simply ignores the tax. On the other hand, if the legal operator absorbs the tax, he is likely to drive himself out of business. This is particularly evident with the smaller volume bookmakers who have difficulty paying the tax. And, contrary to some misconceptions, the majority of bookmakers in Nevada are not the large casinos, but small businesses whose primary and oftentimes only operation is sports and racebooks. For example, most of these operators employ very few employees, the average number of employees being only 12.

It is interesting to note that the Commission on the Review of the National Policy Toward Gambling, on which I served, in its 1976 Report to the Congress, pointed out that many licensed bookmaking operations in Nevada are only marginally profitable.

Besides benefitting illegal bookmakers, these taxes also subject legal bookmakers to discriminatory tax treatment. These taxes apply solely to legal sports and horse bookmaking and do not apply to parimutuel wagering, coin-operated devices, state lotteries that base winnings on horserace results, or casino games. Nevada is the only state which conducts this regulated and fully-policed activity which is affected by these taxes. States that conduct horse racing, dog racing, or j'ai lai games are not subjected to a special federal tax nor are states that conduct legalized offtrack betting.

Nevada has long-standing experience in legalized wagering. This year marks the 50th year for Nevada's legal wagering operations. That experience has shown us that the effect of the excise and occupational taxes is discriminatory among the states and within the industry. These taxes should not apply to wagering operations which are legal and regulated by the state.

I wish to emphasize that the State of Nevada, in its own revenue-raising capacity, already imposes a tax of 5.5 percent on licensed bookmaking operations. A strong element of inconsistency and inequity exists in imposing federal taxes on select gaming activities.

Gaming, which is Nevada's largest industry, is highly regulated and licensed in the State. Let me assure you that elimination of illegal gaming activities is a goal shared by both state and federal officials.

I would now like to focus on the revenue aspects of these taxes. These taxes were originally adopted in 1951, and Congress was advised that the estimated gain in revenue from these taxes was $400 million per year. By reviewing the attached breakdown (exhibit a) for the past five fiscal years, taken from the IRS Commissioner's annual report, you will see that this estimate was completely in error. For example, the total revenues from these taxes in Fiscal Year 1980 amounted to only $11 million, and for the past two years, the total cumulative figure is only $21 million.

Furthermore, the Department of the Treasury, in 1978, acknowledged that the revenues from these taxes are "extremely minor," and that "experience with the

several taxes on gambling does not support the conclusion that . . . there have been any substantial direct benefits in income tax enforcement arising from the existence of the gambling taxes." Letter from Donald C. Lubick, Assistant Secretary-Designate, Department of the Treasury, June 8, 1978.

A copy of Mr. Lubick's letter is attached for the record (exhibit B).

In the 94th Congress, I introduced an amendment to eliminate the excise wagering tax for legal gaming operations. When the amendment went to conference, the tax, which at that time was ten percent, was reduced to two percent, and the occupational tax, which was at that time $50 was increased to $500. Certainly, the reduction of the wagering tax was a step in the right direction. However, it has proven itself to penalize the legal operators just as much as the ten percent tax. Where the ten percent tax was passed on to the customer, the two percent tax is absorbed by the operator. The margin of profit in these wagering operations is approximately two percent and the effect of the tax is to remove that profit for the legal operator. Quite simply, the two percent tax is a disincentive to legal bookmaking businesses, while illegal bookmakers continue to profit. I would like to bring to your attention a recent Las Vegas Sun article in which the IRS estimated that illegal bookmakers gross $8 billion to $10 billion annually in untaxed profits from illegal horse and sporting bets and evade as much as $3.6 billion a year in federal taxes.

The $500 occupational tax is yet another penalty. Each ticket-writing employee of a wagering operation is subject to this tax. As a practical matter, most employers pass it on to their workers. In some cases, the ticket-writer, who is only a salaried employee, pays it outright. In other cases, the tax is taken directly from the employee's paycheck. I am sure it was never the intention of the Congress to apply a special tax on the right to work.

One of the original purposes of the occupational stamp was to serve as a law enforcement tool by identifying bookmakers. That purpose, however, is already served since these individuals are either licensed by the State of Nevada, pursuant to a rather demanding inquiry and hearing or are registered with law enforcement officials. I can see no reason why there should be a duplication of effort when this very same information is already available from the State.

In conclusion, Mr. Chairman, these taxes are not effective as revenue raising measures; nor are they effective as tools for the enforcement of gaming laws. They are discriminatory taxes, borne by the small business person who complies with the law, while illegal bookmakers continue to benefit.

For these reasons, I urge that this committee reaffirm its action of last year and act favorably and expeditiously on this legislation.

Thank you.

EXHIBIT A

COLLECTIONS NATIONWIDE FROM THE 2-PERCENT WAGERING TAX AND THE $500 OCCUPATIONAL TAX, AS SHOWN IN THE INTERNAL REVENUE SERVICE COMMISSIONER'S ANNUAL REPORTS FOR FISCAL YEARS 1976, 1977, 1978, 1979, AND 1980

Tax	1976	1977	1978	1979	1980
Wagering tax	$4,962,000	$6,632,000	$6,637,000	$9,124,000	$10,972,000
Occupational tax	900,065	776,000	1,048,000	908,000	1,079,000
Total	5,862,065	7,408,000	7,685,000	10,032,000	12,051,000
Cumulative yearly total	5,862,065	13,270,065	20,955,065	30,987,065	43,038,065

EXHIBIT B

DEPARTMENT OF THE TREASURY,
Washington, D.C., June 8, 1978.

DEAR SENATOR CANNON: This is in reply to your letters of March 16 to Secretary Blumenthal requesting his comments on S. 98 and S. 1411. S. 98 would increase the maximum credit for a State tax imposed on coin operated gaming devices from 80 percent to 95 percent of the $250 per year Federal tax. S. 1411 would repeal the 2 percent tax on wagers and the $500 per year occupational tax levied on all persons accepting taxable wagers or engaged in receiving wagers for any person liable for the tax on wagers.

Repeal of the 2 percent tax on wagers would reduce revenues by $7 million. The comparable revenue loss for the $500 occupational tax would be about

$1 million. Increasing the credit for State tax on coin operated gaming devices would reduce revenues by about $2 million.

Taxes on wagers and coin operated gaming devices reflect a public policy decision that gambling constitutes an expenditure that can reasonably be subject to taxation. In some cases this is a moral judgment. In others, an evaluation that such spending is discretionary spending. Others have advocated excise taxes on gambling as an aid to determining illegal gains which otherwise might escape income tax.

Our experience with the several taxes on gambling does not support the conclusion that in the aggregate there have been any substantial direct benefits in income tax enforcement arising from the existence of the gambling taxes. Cases of evasion schemes have been discovered as a result of gambling tax enforcement, but not enough for us to make a strong argument for retention of the tax on wagers or coin-operated gaming devices. Revenues from the taxes are extremely minor. Consequently, retention or repeal of these taxes should be determined by public opinion as to whether gambling activities should be taxed as a sign of social disapproval. We express no judgment on this.

STATEMENT OF SENATOR PAUL LAXALT

Mr. Chairman, today I wish to recommend the passage of S. 483, which would remove both a two-percent tax on the gross income of legalized bookmaking operations, and a $500 occupational tax on each person employed by these legal businesses to accept wagers.

These two taxes were originally enacted as weapons for law enforcement agencies in the fight against illegal bookmaking. Unfortunately, these taxes have instead encouraged the very activity they were designed to control. Legal, honest bookmakers are forced into bankruptcy by the punitive nature of the taxes, while illegal booking operations continue to ignore the tax and flourish. Rather than eliminating illegal operators, the taxes force legal establishments out of business, and encourage the growth of crime.

Allow me to explain exactly how this outrageous injustice comes about. First of all, sports wagering is the one and only legal business in this country which is taxed on gross, not net, income. This often exceeds the normal profit margins of the legal wagering business. Second, it is important to remember that sports wagering operations are very often small businesses, and are not necessarily associated with large, corporate casinos. In fact, most of these small businesses employ a few as a single person, and the average number of employees among all of these operations is only 12 people. Keeping this in mind, it is easy to see how a seemingly small two-percent tax, combined with a $500 occupational tax per employee, can take more than the net income of these small businesses, thereby forcing them out of operation.

What are the consequences of allowing legal operators to go bankrupt because of unjust taxes? The answer is that gamers are forced to go elsewhere in order to place their wagers. Some will go to the Caribbean or Europe in search of legal gaming, thereby worsening our already unfavorable balance-of-payments situation. But, it is likely that the vast majority of gamers will simply continue to wager in this country, turning instead to illegal bookmakers to provide for their demands.

When gamers turn to illegal bookmakers, our country once again loses out. The IRS estimates that illegal bookies gross between $8 and $10 billion per year, and evade more than $3.6 billion in personal income and business taxes. Not only does the state lose this revenue, but this lost money is in turn used to finance other illegal activities which benefit organized crime.

This problem is of grave concern to the nation, and especially to Nevada, where legalized gambling is a highly regulated industry, and an accepted leisure-time activity for millions of Americans. The matter becomes of greater national concern as we realize that forty-six of the fifty states currently allow some sort of gaming activity such as lottery, bingo, racing, and so forth. With highly regulated state and local legalized gaming, criminal elements have been largely thrown out of business. But punitive laws, such as the two-percent tax, threaten to eliminate legal elements and increase illegal operations throughout the nation.

This is why I ask today that S. 483 be passed. Repealing the two-percent tax on gross earnings and the $500 occupational tax will provide equity for sports wagering with other business. Passing this legislation will allow small businessmen to survive, and will keep criminal elements from taking their place. It will restore

untold millions in lost tax revenue, and keep this money from funding organized crime. For all of these reasons, the Treasury Department supports this legislation, and I call on my colleagues to do the same.

Senator PACKWOOD. Next, we will hear from Mr. Lee Walker, Santa Anita Race and Sports Book, Las Vegas, Nev.

Senator CANNON. May I say, Mr. Chairman, Mr. Walker is a lawyer and businessman in Las Vegas. I am very happy to introduce him to the committee.

Senator PACKWOOD. Thank you very much.

Welcome, Mr. Walker.

STATEMENT OF LEE WALKER, SANTA ANITA RACE AND SPORTS BOOK, LAS VEGAS, NEV.

Mr. WALKER. What we have done is arbitrarily taken a couple of baseball teams, and these designs reflect baseball which is about ready to begin the baseball season.

[Diagram shown.]

Mr. WALKER. Each morning, each book sets its opening line, and for the information of the committee, the negative implies the favorite and the positive implies the underdog, if you will.

The line here we have set is what we call the 15-cent line, 15 cents between $1.55 and $1.40.

In this illustration, the opening line would require that somebody betting on the favorite would have to post $1.55 to win $1.

If you wanted to bet on the underdog, you bet $1 to win $1.40.

Assuming that we establish that kind of a line and the bettor came in and bet with us $15,500 to win $10,000 on the favorite, at that point in time we would move our line a nickel, to $1.45 and $1.60, the idea being to try to induce bettors to come in and put money on the other side so they have a balance.

I indicated at the outset that I am not a gambler. We run books, not—we don't gamble; we try to establish sound business practices and follow those as we go through the day.

In any case, we move the line to attract wagering on the other side. At that point in time, bettors come in and bet $10,000 on the underdog to win $14,500.

Now, at that point in time, our liability, our exposure would be about the same. So, that is what we call a well-balanced line.

You will note that we have $15,500, plus $10,000 wagered. That is a total of $25,500. The 2-percent tax would be $510.

The effect of all of that, at the end of the day, is this: If the favorite wins, we pay out the $25,500, these two amounts, plus the tax, a total of $26,010. The net loss to the house is $510.

If the underdog wins, we pay out $24,500, these two amounts, plus the tax, or $25,010, which leaves us a profit of $490.

Now, during the season, assuming that prevails, this is what happens. There are 26 American League and National League teams playing a total of 162 games each, during the regular season, or a total of 2,106 games. If the favorites were to win half the games, the underdogs would win half the games, then we would lose $20 every two games throughout the season.

The fact is that the favorite wins three out of five games.

Now, with the favorite winning three out of five games, that is a total of 1,262 games won by the favorite, on which we would lose $510 per game, or a total loss of $644,130.

If the underdog wins, on that basis of three out of five, the underdog wins 842 of those games on which we win $490, and we win this, therefore, $490, and we win, therefore, $412,580 a season. We have a net loss for the season of $231,550.

Thank you.

Senator LONG. Is that your actual experience?

Mr. WALKER. That was our experience during the last football season, Senator Long.

Senator PACKWOOD. How do you stay in business? [Laughter.]

Mr. WALKER. Well, that is the reason we are here. We are at the point where we have to make a decision. If the tax stays on, then I have a couple of alternatives. One, I can lease out the book to somebody else who probably would operate it illegally in order to survive, or I can close the sports book and maintain the horsebook, the racebook.

The win in the racebook is better than in the sportsbook, and so we do have some profits there.

Senator PACKWOOD. It doesn't seem to me that with or without the tax, and I think we ought to get rid of it, but with or without it, you are not making money on the sports book.

Mr. WALKER. Without the tax, you make probably 2 percent, sometimes 5 percent, depending on how the games fall.

Senator PACKWOOD. Senator Long.

Senator LONG. Thank you, Mr. Chairman.

I see your point. I would think that the fact you are losing money would indicate you are running an honest book. [Laughter.]

You are saying that doing that, you can't stay in business with the tax on you.

Mr. WALKER. That is true. One of the reasons, I suppose, now first of all, the only gaming, as Senator Cannon indicated, to which this tax applies is racing sports books. We could have slot machines. They don't have to account for it.

I guess one of the reasons it was applied to racing sports books, there may be other reasons, but one of the reasons is that we do write a ticket on every bet that is made. So it is easy to trail it, follow it through.

If it were done illegally, obviously we would take bets without writing tickets on them and then not report them for tax purposes. We don't want to be put in that position.

Senator LONG. Thank you.

Senator PACKWOOD. Thank you very much for taking the time to come.

Mr. WALKER. Thank you for your time.

[The prepared statement of Lee E. Walker follows:]

STATEMENT OF MR. LEE E. WALKER, OWNER AND GENERAL MANAGER OF THE SANTA ANITA RACE AND SPORTS BOOK OF LAS VEGAS, NEVADA

Mr. Chairman and members of the Subcommittee: I am a lawyer by profession, and since April 1979, have been the owner and general manager of the Santa Anita Race and Sports Book in Las Vegas, Nevada. I am licensed by the Nevada Gaming Commission. Today I also speak on behalf of the licensed independent race and sports book owners in Nevada. In that capacity I ask for your favorable action on S. 483.

The 2% excise tax on wagering, which would be repealed by S. 483 and which was principally designed to control illegal bookmaking, has in its application had the reverse effect and does in fact foster illegal activity. It is so oppressive, particularly when applied to sports bookmaking, that licensed books must either refuse to accept such wagers, thereby diverting such wagering to the illegal bookmakers, or operate illegally themselves.

May I quickly illustrate the actual effect of the tax on my own sports operation.

During the final 3½ months of 1980, which covers most of the football season, which is generally the most profitable of sports activities Santa Anita received $11,403,250 in sports wagers. The excise tax on those wagers was $228,065. Our total win was $209,882, leaving a negative balance of $18,183. We were still responsible for a 5% state tax plus a county assessment, and, of course had to pay our regular overhead.

I also submit a chart to illustrate that if good bookmaking practices are followed in baseball, it is impossible to operate profitably if the 2% tax is applied. In the illustration, the opening line is set to reflect the Dodgers as the favorite. Once the wagers come in, the line is adjusted to attract wagers on the underdog (Cardinals) and to assure the proper wagering balance. You will note that the total amount bet is $25,500. The excise tax is $510. If the favorite wins, the amount paid out plus the tax results in a loss in the amount of the federal tax. If the underdog wins, the house realizes a net win of $490.

The effect of this illustration, over the season is as follows: If the underdog teams won one-half of the games the house would have a net loss of $20 every two games. In fact, however the favorite teams win approximately 3 of every 5 games. The result of that ratio of wins is as follows: There are 26 teams in the National and American Leagues. Each team plays 162 regular season games, for a total of 2,106 games. The favorite, winning three of five games, would win a total of 1,263 games on which the house would have a net loss of $510 per game, or $644,130 in total. Meanwhile the underdog would win only 842 games on which the house would win $490 per game, or $412,580 in total. The net loss to the house would be $231,550, which figure is exclusive of state and county taxes and other operating costs.

May I also point out that the tax is discriminatory in that it is only applied to wagering on sports and racing. We who operate independent books cannot absorb the burden in other gaming activities.

S. 483 also provides for repeal of a $500 annual occupational tax assessed against each employee who accepts wagers. That assessment is clearly discriminatory as a tax on the right to employment, in that it is only imposed on employees of race and sports books.

We are operating legal, licensed, small business activities. We have substantial investments in those activities. We ask your assistance in making that possible.

Thank you.

	OPENING LINE	ADJUSTED LINE
CARDINALS	+140	+145
DODGERS	-155	-160

				TOTAL WAGERED
BETTOR WAGERS →	$15,500	(ON DODGERS)	10,000 (ON CARDS)	$25,500
				~~.20~~ .02
TO WIN →	10,000		14,500	Excise tax ~~510~~

	PAYOUT TO BETTOR	+	TAX	=	TOTAL OUTLAY	NET TO HOUSE <LOSS>
DODGERS WIN	$25,500		510		26,010	<510>
CARDINALS WIN	24,500		510		25,010	490

THERE ARE 26 AMERICAN AND NATIONAL LEAGUE TEAMS PLAYING 162 GAMES PER SEASON OR 2106 TOTAL GAMES. FAVORITE TEAMS HISTORICALLY WIN 3 OF EVERY 5 GAMES:

FAVORITE WINS	1263 X <$510>	=	<$644,130>
UNDERDOG WINS	842 X 490		412,580
	NET LOSS FOR SEASON		<$231,550>

Senator PACKWOOD. Next, we will hear S. 502.

We will start out with a panel consisting of Malcolm MacKinnon, Harrison Givens, Theodore Groom, and Mr. Bernard F. Curry.

STATEMENT OF MALCOLM MacKINNON, VICE PRESIDENT, THE PRUDENTIAL INSURANCE CO. OF AMERICA; HARRISON GIVENS, SENIOR VICE PRESIDENT, EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES; AND THEODORE R. GROOM, ESQ.

Senator PACKWOOD. Gentlemen, go right ahead.

Mr. GIVENS. Thank you, Mr. Chairman.

I am Harrison Givens, Jr., senior vice president of the Equitable Life Assurance Society of the United States. I am accompanied by Malcolm MacKinnon, vice president and actuary of The Prudential Insurance Co. of America, and our tax counsel, Ted Groom, of Groom & Nordberg, Washington, D.C.

We are also appearing on behalf of six other major U.S. life insurance companies, Aetna Life & Casualty, Connecticut General Life Insurance Co., Metropolitan Life Insurance Co., John Hancock Mutual Life Insurance Co., Phoenix Mutual Life Insurance Co., and the Travelers.

Our eight companies offer pension funding facilities to U.S. pension plans that span nearly every major investment area including stocks, bonds, private placement loans, and real estate mortgages and equities.

We appreciate this opportunity to testify on S. 502. We strongly support the enactment of this legislation to amend the Internal Revenue Code to permit foreign pension plans to invest in the United States on the same nontaxable basis already available to domestic plans.

In the interest of time, Mr. MacKinnon and I will summarize our statement, but we ask that it be included in the record in full.

Mr. Chairman, there is widespread agreement, in the Congress, in the administration and, indeed, across the entire country, that a major challenge facing our economy is to promote more capital investment and to increase productivity.

We agree that the principal focus of the efforts to increase capital investment should be on incentives for Americans to save more. But our needs are great. The capital formation incentives that are currently being discussed mainly shift capital from one sector to another instead of adding to the overall supply of capital.

The legislation that we address today has the advantage of providing new capital for this country with little or no revenue loss. It identifies and combines two important sources of capital: foreign investment and retirement savings.

It would enable the U.S. economy to benefit from the savings of others by having that savings invested here. We believe this proposal will attract significant amounts of capital to the United States.

It will do so in a way that is consistent with sound tax policy. It has long been a principle of U.S. tax policy that the U.S. tax liability of a foreign taxpayer should be based on U.S. standards.

Current law exempts from U.S. tax the investment income and capital gains of tax qualified pension trusts of domestic employers.

However, for foreign plans to be treated equally, present law requires that pension plans meet detailed qualification requirements, which they rarely do because of differences between U.S. and foreign law and practice.

Many of the U.S. requirements reflect policies that are irrelevant to the foreign pension plans and some even conflict with the retirement plan laws of their home countries.

Consequently, the U.S. investment income of foreign pension plans is currently subject to U.S. tax—primarily withholding taxes, which may be as high as 30 percent—though the foreign pension plans are generally exempt from taxes in their home countries.

By contrast, foreign charitable and religious organizations do not have this U.S. tax problem. Foreign charitable and religious organizations may qualify under the general U.S. standards for such organizations and therefore would be able to invest on the nontaxable basis already available to domestic charitable or religious organizations.

Mr. Chairman, the current rules that tax the U.S. investment income of foreign pension plans are a disincentive to investment in the United States by these plans and have prevented the United States from tapping a significant potential market for additional capital.

It is on this point that we and the Treasury Department seem to disagree. Treasury fails to see a fundamental distinction between foreign pension plans and other foreign investors. A foreign taxable investor pays a tax whether he invests in his own country or in the United States.

A foreign pension plan, however, is tax exempt as to investments in his own country, but currently, is taxable as to U.S. investments.

Now there is general sensitivity to giving foreign investors greater advantages than their U.S. counterparts. S. 502 avoids this problem.

Several of our companies have been contacted by managers of foreign pension plans maintained by large employers in industrialized foreign countries such as the United Kingdom, the Netherlands, and Japan. Their desire to invest in the United States is generated by the desire to invest in our stable economy, to earn attractive returns, and to diversify their portfolios and lessen their dependence on the economic cycles of their home countries.

The potential sources of capital from foreign pension plans are substantial. For example, the total assets of pension plans maintained by employers in the United Kingdom, Netherlands, and Japan exceed $200 billion.

Senator PACKWOOD. May I ask you to summarize your statement.

Mr. GIVENS. Yes, sir.

If I may, I will ask Mr. MacKinnon to summarize the final points.

Mr. MACKINNON. Thank you.

S. 502 would allow foreign pension plans to make portfolio investments in the United States without the imposition of taxes on the investment income subsequently paid to such plans.

First, we expect the proposal to channel substantial amounts of foreign pension capital to the U.S. financial institutions that provide the principal source of financing for U.S. business.

Since pension plans traditionally invest on a long-term basis, we would also expect that most investments made by foreign pension plans under the proposal would be more stable—and would produce more long-term benefits—than other types of foreign investment.

Second, the proposal is limited to pension plan portfolio investments of the types which U.S. pension plans may make on a nontaxable basis.

It would not put foreign pension plan managers in a position of exercising control over U.S. business or to actively conduct a business in this country on a nontaxable basis.

Third, the proposal would extend to foreign pension plans the same tax treatment as their U.S. counterparts with respect to U.S. source investment income and gains.

Fourth, the proposal involves little or no revenue loss. To the extent that foreign pension plans have made significant U.S. investments in the absence of such legislation, it is likely that such investments have been or would be structured to involve minimal U.S. tax burdens.

Fifth, the proposal contains a technical amendment to remove an obstacle to foreign pension plan investment through insurance companies which does not exist for other financial institutions.

This change is needed because the life insurance company tax rules are structured to allow insurers to invest funds on a tax free basis only for specified, qualified retirement arrangements.

Finally, the proposal is tailored so that only those foreign pension plans that are comparable in structure to U.S. plans would be eligible for the favorable treatment.

Specifically, the foreign plan must be maintained primarily to provide retirement benefits for employees, be funded with assets which are segregated from those of the employer and be tax exempt, in whole or in part, under the laws of the foreign country.

Also, consistent with our traditional international tax objectives, the proposal would provide the executive branch with the authority to encourage foreign countries to extend a reciprocal exemption to investments by U.S. plans abroad if that were considered appropriate.

We strongly urge you to take prompt and favorable action on S. 502.

We appreciate this opportunity to appear before the subcommittee and we would be pleased to address any questions you may have.

We would also appreciate the opportunity to submit additional materials on the legislation at a later date if that is acceptable to the chairman.

Senator PACKWOOD. The record will be open 2 weeks for additional material.

Mr. MACKINNON. Thank you.

Senator PACKWOOD. Who is next?

Go ahead.

STATEMENT OF BERNARD F. CURRY, ON BEHALF OF AMERICAN BANKERS ASSOCIATION

Mr. CURRY. Good morning, Mr. Chairman and Senator Moynihan. I am Bernard F. Curry, a senior vice-president of Morgan Guaranty Trust Co., on behalf of the American Bankers Association. I serve as a member of the Government Relations Council of the American

Bankers Association. I am the immediate past president of the ABA's Trust Division. I am accompanied today by Mr. James D. McLaughlin, of the government relations staff, of the ABA.

It is hardly a secret to the members of the committee that the ABA is a national trade association composed of 13,000 odd banks, with 90 percent of the full-service banks in the United States included. More than 4,000 of these banks have trust powers.

I appear before you today to express the support of the ABA for S. 502, which would allow foreign pension plans to invest in the United States on a tax-free basis comparable to the treatment afforded domestic pension plans.

Currently, foreign pension plans are discouraged from investment in the United States because they would be taxed here even though they are generally exempt from taxation in their home countries.

S. 502 would remove this barrier and encourage bona fide pension plans to invest in the United States. To prevent potential abuses the proposal limits tax exemption to plans whose assets are segregated from employer assets, and whose beneficiaries include primarily nonresident alien individuals.

Finally, to be eligible a plan would have to qualify for tax exemption or a reduced rate of tax in its home country. Foreign countries are expected to reciprocate.

Foreign pension plans represent one potential source of new capital which American industry sorely needs. Pension funds invest for a long-term and so long as the investment outlook continues favorable these funds tend to be stable.

Government and business are searching for ways to generate new investment to build new factories and to modernize existing plants. The purpose is to make American industry more efficient and more competitive at home and in world markets, and finally, to create jobs for our workers.

The tables appended to my prepared statement illustrate the fact that of six major industrial nations, the U.S. ranks lowest in capital formation in the last decade.

As a direct consequence, our Nation ranked second lowest in manufacturing productivity increase and dead last in compensation growth for manufacturing workers.

Our industries need new capital, and foreign pension plans can help to provide some of that need. This bill will encourage foreign pension plans to consider U.S. business for a portion of their investment portfolio.

Under the bill investment would be possible either directly or through U.S. intermediaries.

It is important to note that, unlike many capital formation proposals which have been advanced, this proposal would result in little or no loss of revenue to the Treasury.

For the most part, because of the tax consequences, foreign pension funds have not made significant investment in the United States. Where they have invested in the United States they have done so through vehicles which serve to minimize the tax burden. Rather than cost our Government revenues, to the extent foreign pension investment results in the creation of more jobs, Treasury revenues will increase.

While we support the objective of S. 502 as being in the best long-term interests of our Nation, we must make one point very clear. The American Bankers Association has thrown its full support behind the goals expressed in the President's economic package of tax and spending cuts.

Our Nation must bring inflation under control, that is and will be our highest priority. Measures such as the one before us, or other proposals, no matter how meritorious they may be, should not distract us from the goal of prompt enactment of the President's economic package.

Foreign pension investments will come only if we can demonstrate our commitment as a nation to control inflation and make the investment climate an attractive one.

Thank you very much for permitting me to appear.

Senator PACKWOOD. Mr. Groom.

Mr. GROOM. Mr. Chairman, I would like to address just briefly, the objections that the Treasury Department raised earlier today that came, I might say, somewhat as a surprise to us.

Senator MOYNIHAN. Mr. Chairman, would Mr. Groom allow me to interrupt?

Mr. GROOM. Yes.

Senator MOYNIHAN. You may not be familiar enough with our environ here, the Treasury always objects, Mr. Groom. It doesn't matter. Answer them, but don't feel bad. [Laughter.]

Mr. GROOM. Well, I appreciate that, Senator Moynihan. I might say I was particularly surprised that they would object to a proposal to provide additional capital to the United States itself.

Senator MOYNIHAN. There is the inverse ratio rule, to the degree a proposal makes sense, their objections are all the more. [Laughter.]

Mr. GROOM. Well, I think that is illustrated by the comments I am about to make. The fundamental question the Treasury asked is: What is the difference between a foreign pension plan and any other foreign investor? If we are going to allow foreign pension plans to invest tax exempt in the United States, why shouldn't we allow any other foreign investor to do so?

There are many who believe that we should let other foreign investors invest broadly in the United States on a tax-favored basis. But I think the Treasury Department is missing a very basic and important difference here. If you have somebody in the United Kingdom that is taxable on the income that they receive from investments in the United Kingdom, when they look at an investment today, currently, they will say, what is the return on an investment in the United Kingdom versus what is the return on an investment in the United States.

In both cases, they will be taxable. So that the tax laws play no part in the investment decision.

On the other hand, if you have a U.K. pension fund that is tax exempt if it invests in the United Kingdom, but taxable if it invests in the United States, then the tax laws put up a block, an impediment, to that fund investing in the United States if it thinks the U.S. investment is otherwise a good investment.

Every time this type of proposal has been raised, one of the things that a number of Senators quite rightly have some concern about is: Do we want to have a situation which gives more preferable treatment to a foreigner than to a U.S. person?

That type of concern comes up also when you are talking about letting in foreign investment generally. But, when you have a situation involving foreign pension plans—when U.S. pension plans are already exempt from tax—you don't have that same concern, just like you don't with charities.

Now the Treasury recognizes that a foreign charity can invest in the United States without being subject to tax, even though the beneficiaries are foreigners.

But, here they don't seem to see the distinction. So they are missing what seems to me to be a very clear and easy to understand distinction.

Second, a second set of point of difference, the Treasury says that there is going to be some revenue loss from this proposal, although they apparently hedge as to exactly how much, but they made sort of a wild guess I understand, this morning, that it would be on the order of $90 million.

The Joint Committee tax staff said it would be something around $10 million in each new $1 billion investment approximately.

We think that since foreign pension plans are not currently investing here in a taxable way at all, there will be no direct revenue loss from our proposal.

Certainly the life insurance companies that we represent are not currently handling any foreign pension funds. So, any that we get in now will be a plus factor.

The Treasury also mentions incidental points such as: "Wouldn't the treaty process be a better process?" Well, as you know, the treaty process tends to skip the regular tax committees and it takes a very long time.

This is something that we think we want to do now rather than wait 15 years.

Essentially the rest of their problems are technical ones and we are certainly willing to work with them on the technical problems and to try and work out accommodations to those.

So, we think they really have no sound objections to our proposal.

Senator PACKWOOD. Senator Moynihan this is your bill; go ahead.

Senator MOYNIHAN. Well, thank you, Mr. Chairman.

This was a bill which Senator Wallop and I introduced this year. I introduced it last. The Treasury was against it last time, too. There comes a time when just recognize that institutional block and you go ahead.

Senator PACKWOOD. I might say one thing in Treasury's defense. In a bill relating to political tax credits this morning they were neither opposed nor in favor, they were neutral.

So, they are making progress.

Senator MOYNIHAN. Well, never underestimate the power of Don Regan.

Mr. Chairman, I would address these remarks as much to you as the distinguished panel. As Mr. Curry said, and as we know, capital for-

mation has got to be a central economic concern of this country. It is not just for the last decade, if I may expand on your remark. Mr. Curry, it is for the last quarter century we have had the lowest capital formation rates of any nation in OECD.

That can in part reflect a maturing economy in which service activities take up more of the work force than otherwise, but only in part. The fact is, our taxes have been too high.

We saw the impulse to invest when we reduced capital gains tax rates in 1978 from 49 to 28 percent for individuals and from 30 to 28 percent for corporations. Treasury solidly assured us it would take 5 years to recoup revenue. In point of fact, capital gains revenues increased by 15 percent in the following year.

When you can find a tax wherein you cut the tax you increase the revenue, find that tax.

We are very concerned with this and the tax bill we reported out last August 19 to 1, there is one fellow who didn't like the bill, I don't know his name. But the unanimous bipartisan judgment of this committee had a provision to cut capital gains to 20 percent, based upon this little experiment we ran. This idea we have here is very much in the same point.

If there is any revenue loss, it is minimal. I mean, $10 million as the Joint Tax Committee, when the Treasury can only summon itself to think of a $90 million loss, you may be sure there is no loss at all. And that will not show up in any statistics.

But the question I would like to address to Mr. Groom, which is a new thought to me, is that as a matter of fact there are a great many American organizations, insurance companies you say, who as managers would take over, would get business this way. You would have a correspondent pension fund over there and you will say, we will do it for you. It is not just bringing the capital in, it is giving Prudential and Equitable and other firms financial management employment which is a gain in its own right I would say.

Mr. GROOM. Yes; that is exactly why the insurance companies got interested in this proposition. I might say the two companies that the gentlemen sitting on my left represent Prudential and Equitable, between them, I don't know the exact figure, I am sure they do, but invest currently, manage currently well in excess of $30 billion of U.S. pension fund money; $45 billion, Mr. Givens corrects me.

So we want to essentially be able to perform the same type of roles with respect to these foreign pension funds that we are performing with respect to U.S. pension funds.

Senator MOYNIHAN. Mr. Chairman, I would just count that an additional attraction of this legislation. There are firms in this country whose work is the management of this kind of an investment, and it is work for them.

I might state, just as a New Yorker, one of the striking facts of the recovery of our city in the last 5 years has been the degree to which foreign capital has come in to the city, thinking for all the alarms we raise about the place, this is the safest place in the world to invest resources. Individuals will do it, and organizations with a trust responsibility will do it even more.

It seems to me it is just sitting there waiting for us. I hope we can persuade you to support us.

In any event, I thank you for the opportunity.

Senator PACKWOOD. I was the 1 in the 19 to 1 vote. [Laughter.] However, I might say that it was only the general idea of cutting taxes without cutting spending that bothered me. Now that we have an administration that is serious about cutting spending, Congress is over a barrel, because most of the spending cuts are in appropriated areas. If the President doesn't like what we pass, he can veto it and the votes are there to sustain the veto, and the issue then becomes his budget or no budget.

At that stage, I think many of those who are opposed to his budget, when given the alternative of no budget, may opt for his.

Any other questions?

Senator MOYNIHAN. No, thank you, Mr. Chairman.

Senator PACKWOOD. Gentlemen, thank you very much.

[The prepared statements of the preceding panel follow:]

SUMMARY OF TESTIMONY OF BERNARD F. CURRY ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

The bill will permit foreign pension plans to invest in the United States on the same tax-free basis as domestic pension plans. The American Bankers Association supports the proposal because by encouraging investment in the United States foreign pension plans will help to provide capital for business.

This proposal has particular merit because while it provides an incentive for additional capital investment, it will have little or no effect on revenues. The American Bankers Association urges that this proposal not divert efforts to achieve prompt enactment of the goals enunciated in the President's economic package.

TESTIMONY OF BERNARD F. CURRY ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Good morning Mr. Chairman and members of the subcommittee. My name is Bernard F. Curry. I am a Senior Vice President of Morgan Guaranty Trust Company in New York and serve as a member of the Government Relations Council of the American Bankers Association. I am also the immediate past president of ABA's Trust Division. The ABA is a national trade association composed of 13,100 banks, 90% of the full service banks in the United States. More than 4,000 of these banks have trust powers.

I appear before you today to express the support of the American Bankers Association for S. 502. This bill would allow foreign pension plans to invest in the United States on a tax-free basis comparable to the treatment offered domestic pension plans.

Currently, foreign pension plans are discouraged from investment in the United States because they would be taxed here even though they are generally exempt from taxation in their home countries.

S. 502 would remove this barrier and encourage bona fide pension plans to invest in the United States. To prevent potential abuses the proposal limits tax exemption to plans whose assets are segregated from employer assets, and whose beneficiaries include primarily nonresident alien individuals. Finally, to be eligible a plan would have to qualify for tax exemption or a reduced rate of tax in its home country. Foreign countries are expected to reciprocate.

Foreign pension plans represent one potential source of new capital which our industry sorely needs. Pension funds invest for the long-term and so long as the investment outlook continues favorable these funds tend to be stable. Government and business are searching for ways to generate new investment to build new factories and to modernize existing plants. The purpose is to make American industry more efficient and more competitive at home and in world markets, and finally, to create jobs for our workers.

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The tables appended to my prepared statement illustrate the fact that of six major industrial nations, the United States ranks lowest in capital formation in the last decade. As a direct consequence, our nation ranked second lowest in manufacturing productivity increase and dead last in compensation growth for manufacturing workers.

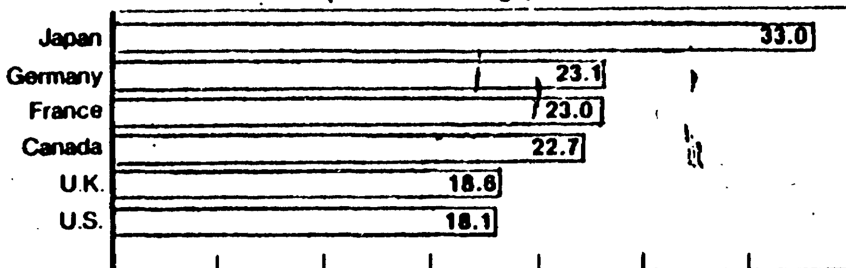
Our industries need new capital, and foreign pension plans can help to provide some of that need. This bill will encourage foreign pension plans to consider United States business for a portion of their investment portfolio. Under the bill investment would be possible either directly or through United States intermediaries.

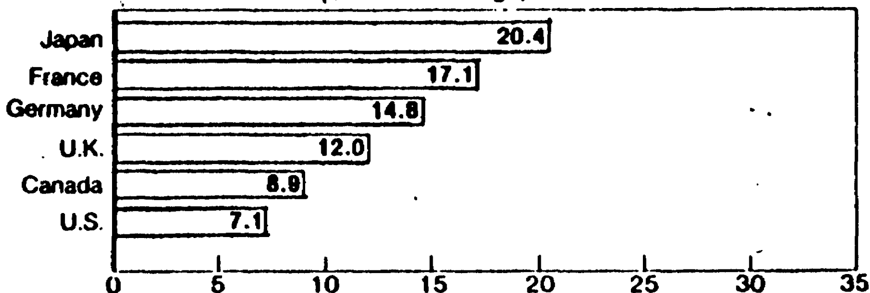
It is important to note that, unlike many capital formation proposals which have been advanced, this proposal would result in little or no loss of revenue to the Treasury. For the most part because of the tax consequences, foreign pension funds have not made significant investment in the United States. Where they have invested in the United States they have done so through vehicles which serve to minimize the tax burden. Rather than cost our government revenues, to the extent foreign pension investment results in the creation of more jobs, Treasury revenues will increase.

While we support this proposal as being in the best long-term interests of our nation we must make one point very clear. The American Bankers Association has thrown its full support behind the goals expressed in the President's economic package of tax and spending cuts. Our nation must bring inflation under control, that is and will be our highest priority. Measures such as the one before us, or other proposals no matter how meritorious they may be, should not detract us from the goal of prompt enactment of the President's economic package.

Foreign pension investment will come only if we can demonstrate our commitment as a nation to control inflation and make the investment climate an attractive one.

I will be pleased to answer any questions.



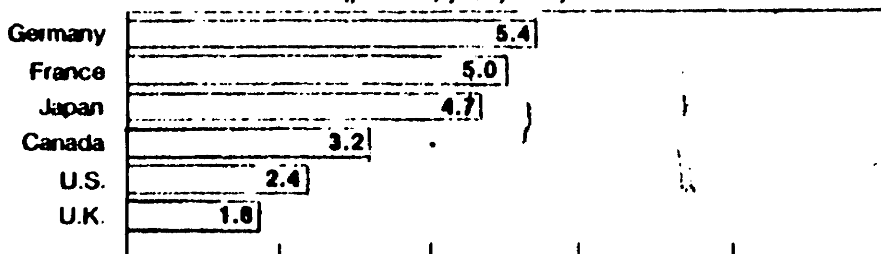


The U S rates of capital formation -- i e , total private fixed investment and nonmilitary government investment -- as well as household saving are much lower than in major foreign countries.

Source: U.S. Treasury.

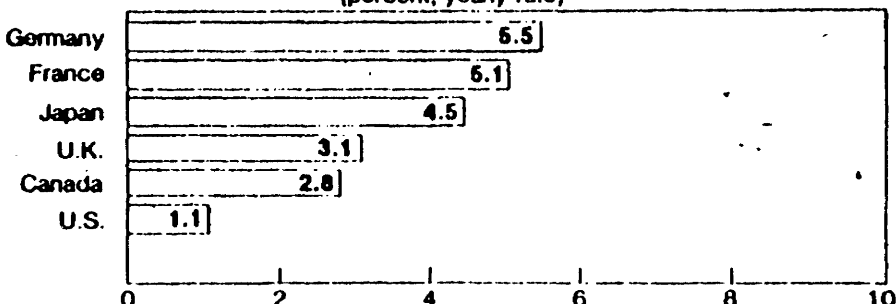
GROWTH OF PRODUCTIVITY IN MANUFACTURING, 1970-79

(percent, yearly rate)



GROWTH OF REAL COMPENSATION PER HOUR IN MANUFACTURING, 1970-79

(percent, yearly rate)



Because of relatively low rates of saving and capital formation, U.S. growth in productivity and real wages has been much less than in most major foreign countries.
Compensation may include employment taxes on employers.

Source: U.S. Treasury.

ORAL STATEMENT OF HARRISON GIVENS, JR., SENIOR VICE PRESIDENT, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES AND MALCOLM MACKINNON, VICE PRESIDENT, THE PRUDENTIAL INSURANCE CO. OF AMERICA

Thank you, Mr. Chairman. I am Harrison Givens, Jr., senior vice president of the Equitable Life Assurance Society of the United States. I am accompanied by Malcolm MacKinnon, vice president of the Prudential Insurance Co. of America, and our tax counsel, Theodore R. Groom of Groom and Nordberg, Washington, D.C. In addition to Equitable and Prudential, we are appearing on behalf of six other major U.S. life insurance companies—Aetna Life and Casualty, Connecticut General Life Insurance Co., John Hancock Mutual Life Insurance Co., Metropolitan Life Insurance Co., Phoenix Mutual Life Insurance Co., and the Travelers. Our eight companies offer pension funding facilities to U.S. pension plans that span nearly every major investment area including stocks, bonds, private placement loans, and real estate mortgages and equities.

We appreciate this opportunity to testify on S. 502. We strongly support the enactment of this legislation to amend the Internal Revenue Code to permit foreign pension plans to invest in the United States on a nontaxable basis. In the interest of time, Mr. MacKinnon and myself will summarize our statement but we ask that it be included in the record in full.

Mr. Chairman, there is widespread agreement—in the Congress, in the administration and, indeed, across the entire country—that a major challenge facing our economy is to promote more capital investment and to increase productivity. We agree that the principal focus of the efforts to increase capital investment should be on incentives for Americans to save more. But our needs are great. The capital formation incentives that are currently being discussed mainly shift capital from one sector to another instead of adding to the overall supply of capital.

The legislation that we address today has the advantage of providing new capital for this country with little or no revenue loss. It identifies and combines two important sources of capital—foreign investment and retirement savings.

It would enable the U.S. economy to benefit from the savings of others by having that savings invested here. We believe this proposal will attract significant amounts of capital to the United States.

It will do so in a way that is consistent with sound tax policy. It has long been a principle of U.S. tax policy that the U.S. tax liability of the foreign taxpayer should be based on U.S. standards. Current law exempts from U.S. tax the investment income and capital gains of "tax qualified" pension trusts of domestic employers. However, for foreign plans to be treated equally, present law requires that pension plans meet detailed "qualification" requirements, which they rarely do because of differences between U.S. and foreign law and practice. Many of the U.S. requirements reflect policies that are irrelevant to the foreign pension plans and some even conflict with the retirement plan laws of their home countries. Consequently, the U.S. investment income of foreign pension plans is currently subject to U.S. tax—primarily withholding taxes, which may be as high as 30 percent—though the foreign pension plans are generally exempt from taxes in their home countries. By contrast, foreign charitable and religious organizations do not have this U.S. tax problem. Foreign charitable and religious organizations may qualify under the general U.S. standards for such organizations and therefore would be able to invest on the nontaxable basis already available to domestic charitable or religious organizations.

Mr. Chairman, the current rules that tax the U.S. investment income of foreign pension plans are a disincentive to investment in the United States by the plans and have prevented the United States from tapping a significant potential market for additional capital.

Several of our companies have been contacted by managers of foreign pension plans maintained by large employers in industrialized foreign countries such as the United Kingdom, the Netherlands, and Japan. Their interest in investing in the United States is generated by the desire to invest in our stable economy, to earn attractive investment returns, and to diversify their portfolios and lessen their dependence on the economic cycles of their home countries.

The potential sources of capital from foreign pension plans are substantial. For example, we estimate that the total assets of pension plans maintained by employers in the United Kingdom, Netherlands, and Japan exceed $200 billion. Since these foreign pension plans are generally exempt from income taxes on investments in their home countries, the potential U.S. taxation does not produce significant revenues, but rather constitutes a significant deterrent to investing in our country.

The funds of foreign pension plans are a valuable source of additional capital for the U.S. economy, and their availability should not be impeded by our current tax laws. Mr. Chairman, the enactment of S. 502 will remove the current inequity in the tax treatment of U.S. vs. foreign pension plans and allow this country to receive additional capital without affecting revenues.

At this time, I would ask Mr. MacKinnon to summarize our final points.

Thank you, Mr. Chairman.

S. 502 would allow foreign pension plans to make portfolio investments in the United States without the imposition of taxes on the investment income subsequently paid to such plans.

First, we expect the proposal to channel substantial amounts of foreign pension capital to U.S. financial institutions that provide the principal source of financing for U.S. business. Since pension plans traditionally invest on a long-term basis, we would also expect that most investment made by foreign pension plans under the proposal would be more stable—and would produce more long-term benefits—than many other forms of foreign investment.

Second, the proposal is limited to pension plan portfolio investments of the types which U.S. pension plans may make on a non-taxable basis. It would not put foreign pension plan managers in a position to exercise control over U.S. business or to actively conduct a business in this country on a non-taxable basis.

Third, the proposal would extend to foreign pension plans the same tax treatment as their U.S. counterparts with respect to U.S. source investment income and gains.

Fourth, the proposal involves little or no revenue loss. To the extent that foreign pension plans have made U.S. investments so far, they have been structured to involve minimal U.S. tax burdens.

Fifth, the proposal contains a technical amendment to remove an obstacle to foreign pension plan investment through insurance companies which does not exist for other financial institutions. This change is needed because the life insur-

ance company tax rules are structured to allow insurers to invest funds on a tax-free basis only for specified qualified retirement arrangements.

Finally, the proposal is tailored so that only those foreign pension plans that are comparable in structure to U.S. plans would be eligible for favorable treatment. Specifically, the foreign pension plan must:

Be maintained primarily to provide retirement benefits for employees;

Be funded with assets which are segregated from those of the employer; and

Be tax exempt, in whole or in part, under the laws of the foreign country.

Also, consistent with our traditional international tax objectives, the proposal would provide the Executive Branch with the authority to encourage foreign countries to extend a reciprocal exemption to investments by U.S. plans abroad if that were considered appropriate.

We strongly urge you to take prompt and favorable action on S. 502. We appreciate this opportunity to appear before the Subcommittee and we would be pleased to address any questions you may have. We would also appreciate the opportunity to submit additional materials on the legislation at a later date if that is acceptable to the Chairman.

STATEMENT ON S. 502 BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

On Behalf of Aetna Life & Casualty, Connecticut General Life Insurance Company, The Equitable Life Assurance Society of the United States, John Hancock Mutual Life Insurance Company, Metropolitan Life Insurance Company, Phoenix Mutual Life Insurance Company, The Prudential Insurance Company of America, and The Travelers

SUMMARY OF THE STATEMENT OF HARRISON GIVENS, JR., SENIOR VICE PRESIDENT, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES AND MALCOLM MACKINNON, VICE PRESIDENT, THE PRUDENTIAL COMPANY OF AMERICA

Thank you, Mr. Chairman.

S. 502 would allow foreign pension plans to make portfolio investments in the U.S. without the imposition of taxes on the investment income subsequently paid to such plans. In addition, the bill would carry out this policy by amending the life insurance company tax rules to make it clear that U.S. tax would not be imposed on life insurance companies with respect to any amounts that they hold for U.S. investments by foreign pension plans.

The enactment of this proposed legislation should, consistent with sound tax policy considerations, help us meet our capital formation needs and produce significant benefits to our economy in the following ways:

First, we expect the proposal to channel substantial amounts of foreign pension capital to the U.S. financial institutions that provide the principal source of financing for U.S. business. Since pension plans traditionally invest on a long-term basis, we would also expect that most investments made by foreign pension plans under the proposal would be more stable—and would produce more long-term benefits—than many other forms of foreign investment.

Second, the proposal is limited to pension plan portfolio investments of the types which U.S. pension plans may make on a non-taxable basis. Consequently, the proposal would not put foreign pension plan managers in a position to exercise control over U.S. business or to actively conduct a business in this country on a non-taxable basis.

Third, the proposal would extend to foreign pension plans the same tax treatment as their U.S. counterparts with respect to U.S. source investment income and gains. In contrast to the rules of present law, the tax treatment of this income would be the same whether the foreign plan invests directly in the United States or whether it invests here through a U.S. financial institution.

Fourth, the proposal involves little or no revenue loss. To the extent that foreign pension plans have made significant U.S. investments in the absence of such legislation, it is likely that such investments have been or would be structured to involve minimal U.S. tax burdens.

Finally, the proposal is tailored so that only those foreign pension plans that are comparable in structure to U.S. plans would be eligible for the favorable treatment. Also, consistent with our traditional international tax objectives, the proposal would provide the Executive Branch with the authority to encourage

foreign countries to extend a reciprocal exemption to investments by U.S. plans abroad if that were considered appropriate.

We strongly urge you to take prompt and favorable action on S. 502. We appreciate this opportunity to appear before the Subcommittee and we would be pleased to address any questions you may have. We would also appreciate the opportunity to submit additional materials on the legislation at a later date if that is acceptable to the Chairman.

PREPARED STATEMENT OF HARRISON GIVENS, JR., SENIOR VICE PRESIDENT, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES AND MALCOLM MACKINNON, VICE PRESIDENT, THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

This statement is submitted on behalf of eight major U.S. life insurance companies: Aetna Life & Casualty, Connecticut General Life Insurance Company, The Equitable Life Assurance Society of the United States, John Hancock Mutual Life Insurance Company, Metropolitan Life Insurance Company, Phoenix Mutual Life Insurance Company, The Prudential Insurance Company of America, and The Travelers ("the Companies"). The Companies offer pension funding facilities to U.S. pension plans that span nearly every major investment area including stocks, bonds, private placement loans and real estate mortgages and equities.

The Companies strongly support the enactment of S. 502, co-sponsored by Senator Moynihan and Senator Wallop, to permit foreign pension plans to make investments in the United States on a non-taxable basis.

There is widespread agreement—in the Congress, in the Administration and, indeed, across the entire country—that a major challenge facing our economy is to promote more capital investment and increase productivity. We agree that the principal focus of the efforts to meet that challenge should be on U.S. business and incentives for Americans to save more. Our needs are great, however, and we should also recognize other sound approaches to meeting the capital formation challenge. The Moynihan-Wallop proposal is such a sound approach.

The Moynihan-Wallop proposal identifies and combines two important sources of capital—foreign investment and retirement savings. It would put the United States in a position to derive benefits from the savings of others by having that savings invested here. We believe this proposal will attract significant amounts of capital to the United States, and that it will do so in a way that is consistent with sound tax policy and that involves little or no cost to the Government.

In the remainder of this statement, we will discuss the nature of this capital pool, the current tax law impediments to its access to the United States and why S. 502 would properly remove impediments to foreign pension plan investments in this country.

FOREIGN PENSION PLANS ARE INTERESTED IN U.S. INVESTMENTS

In recent years, investment advisers to foreign pension plans maintained by large employers in industrialized foreign countries—including the United Kingdom, the Netherlands and Japan—have shown a strong interest in including securities of U.S. companies and U.S. real estate in their investment portfolios. The opportunity to earn attractive investment returns and the depth and stability of U.S. capital markets have been factors in this movement. In addition, these investment advisers consider U.S. investment as an important means of diversifying their plans' portfolios and lessening their dependence on the economic cycles of their home countries.

These foreign pension plans represent a potentially substantial source of additional capital for the United States. For example, it is estimated that the total assets of pension plans maintained by employers in the United Kingdom, the Netherlands, and Japan exceed $200 billion. The problem is that current U.S. tax laws and treaties do not encourage foreign pension plans to bring their funds here.

Foreign pension plans are currently subject to the same U.S. tax burdens as any other foreign portfolio investor, even though U.S. pension plans are themselves exempt from tax on their U.S. investment income. The tax burdens on foreign plans generally take the form of withholding taxes either at a statutory rate of 30 percent or at a reduced treaty rate of 10–15 percent and, under recently-enacted legislation, a capital gains tax on investments in U.S. real estate.

Since these foreign pension plans are generally exempt from income taxes on investments in their home countries, potential U.S. tax burdens have been a significant (and sometimes a decisive) factor against investing in our country. In addition, the structure of the Internal Revenue Code provisions for the taxation of life insurance companies particularly discourages foreign pension plans from using life insurance company pension funding arrangements to make their U.S. investments relative to direct investment or to the pension funding arrangements offered by certain other U.S. financial intermediaries.

PROBLEMS UNDER PRESENT LAW

Current law exempts the investment income and capital gains of "tax-qualified" pension trusts and similar retirement plans of domestic employers from U.S. tax. As a result, a U.S. bank or life insurance company may receive funds from a U.S. pension plan, invest them and ultimately repay the principal and accumulated investment income to the pension plan without the imposition of any U.S. tax. The U.S. life insurance industry currently holds more than $100 billion of the more than $300 billion of capital now held under such tax-favored retirement arrangements.

While a basic policy of U.S. tax law has been to provide for equal treatment of comparable types of U.S. and foreign investors, this policy has not been carried out in the case of pension plans. This is because the applicability of our statutory tax exemption for pension plans (secs. 401(a) and 501(a) of the Internal Revenue code) requires compliance with very detailed "qualification" retirements that largely reflect U.S. retirement income policies for U.S. workers. Foreign pension plans are rarely in a position to conform with these complex requirements, many of which reflect policies that are irrelevant to the foreign pension plans and may even conflict with the retirement plan laws of their home countries. Significantly, foreign charitable and religious organizations do not have these U.S. tax problems. Foreign charitable or religious organizations may qualify under the general U.S. standards for such organizations (sec. 501(c) (3)) without much difficulty. Thus, such organizations are exempt from U.S. income and withholding taxes on their passive investment income under present law.

Since foreign pension plans are generally unable to "qualify" under the U.S. standards, they are subject to the same tax rules that apply to foreign individual and corporate investors generally.[1] This means that (1) dividends, rents and most forms of interest and other investment income derived from the U.S. are subject to a 30 percent withholding tax or any lower rate that may apply under a tax treaty, and (2) capital gains from U.S. real estate are subject to U.S. tax under rules similar to those that apply to U.S. real estate investors. Moreover, if a foreign pension plan were to invest in the U.S. through a life insurance company, the plan would at least indirectly be subject to tax on all of its U.S. capital gains, and the payments it received from the life insurance company probably would not even qualify for the reduced treaty withholding rates on interest and dividends. This additional impediment to foreign pension plan investment in the United States generally does not affect banks, mutual funds and others. It occurs because the life insurance company tax rules are structured in such a way as to allow insurers to invest funds on a tax-free basis only for "qualified" retirement arrangements.

S. 502 WOULD BENEFIT THE U.S. ECONOMY AND REFLECTS SOUND TAX POLICY

The Moynihan-Wallop proposal would resolve the above problems by allowing foreign pension plans to make portfolio investments in the United States on a non-taxable basis and without the imposition of withholding taxes on the investment income subsequently paid to such plans. In addition, the bill would amend the life insurance company tax rules to eliminate the current competitive disadvantage of life insurance companies with respect to foreign pension plans.

The enactment of this proposed legislation should, consistent with sound tax policy considerations, help us meet our capital formation needs and produce significant benefits to our economy. Specifically:

1. We expect the proposal to channel substantial amounts of foreign pension capital to the U.S. financial institutions that provide the principal source of

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[1] A limited exception exists for pension plans maintained by foreign governments; such plans may generally invest in the U.S. on a tax-free basis under the statutory exemption (Code section 892) that applies to foreign governments and their instrumentalities.

financing for U.S. business. In this regard, since pension plans traditionally invest on a long-term basis, we would also expect that most investments made by foreign pension plans under the proposal would be more stable—and would produce more long-term benefits—than many other forms of foreign investment.

2. The proposal is limited to pension plan portfolio investments of the types which U.S. pension plans may make on a tax-free basis. Consequently, the proposal would not put foreign pension plan managers in a position to exercise control over U.S. business or to actively conduct a business in this country on a non-taxable basis.

3. The proposal would extend to foreign pension plans the same tax treatment as their U.S. counterparts with respect to the taxation of U.S. source investment income and gains. Also, in contrast to the rules of present law, the tax treatment of this income would be the same whether the foreign plan invests directly in the United States or whether it invests here through a U.S. financial institution such as a bank or a life insurance company.

4. The proposal involves little or no revenue loss. To the extent that foreign pension plans have made (or may make) significant U.S. investments in the absence of such legislation, it is likely that such investments have been or would be structured to minimize U.S. tax burdens (to the extent that existing tax treaties do not already reduce withholding taxes).

5. The proposal is tailored so that only those foreign pension plans that are comparable in structure to U.S. plans would be eligible for favorable treatment. Specifically, only those foreign pension plans which cover primarily nonresident individuals, which qualify for tax-favored treatment in their home countries and whose assets are separately held from the employer's, would be eligible. Also, consistent with our traditional international tax objectives, the proposal would provide the Executive Branch with the authority to encourage foreign countries to extend a reciprocal exemption to investments by U.S. plans abroad if that were considered appropriate.

We strongly urge the Subcommittee to take prompt and favorable action on the Moynihan-Wallop proposal. We appreciate this opportunity to present our views to the Subcommittee on this subject.

Senator PACKWOOD. We will conclude with our hearings on S. 565. We will start with a panel of Mr. Larry Powers, Ms. Karin Lamb, and Mr. Loren R. Schulenberg.

Go right ahead and speak in whatever order you prefer.

STATEMENT OF LARRY G. POWERS, CHAIRMAN OF THE BOARD, EMPLOYEE RELOCATION COUNCIL; KARIN LAMB, CORPORATE MANAGER, PERSONNEL PROGRAMS FOR BAXTER TRAVENOL LABORATORIES, INC., DEERFIELD, ILL., AND LOREN R. SCHULENBERG, RELOCATION MANAGER, 3M, ST. PAUL, MINN.

Mr. POWERS. My name is Larry G. Powers. I would like to thank the committee for this opportunity to appear before you today.

I am appearing as chairman of the board of directors of the Employee Relocation Council, in support of S. 565, a bill introduced by Senator Stevens to increase the amount of deductions allowable for certain job-related moves.

I am employed by American Airlines in Dallas-Fort Worth, Tex., as the director of benefits. Part of my responsibilities at American Airlines include the policy development, administration and management of American's employee relocation policy.

The Employee Relocation Council was founded in 1964. It is composed of 763 major corporations and governmental agencies that transfer employees among multiplant and office locations.

The aggregate number of job-related moves within our membership is approximately 300,000 employees annually. These 300,000 employee

moves make up approximately 25 percent of all individuals annually qualifying for the reporting of job-related moving expense deductions to the IRS.

Our demographic studies show that the typical person being relocated is in an early to midcareer stage. This person is between 31 and 35 years of age, and earns less than $35,000 per year.

So please bear in mind that the Stevens bill is not targeted to provide relief for executive levels of corporate management.

The Employee Relocation Council applauds Senator Stevens and the leadership role he has assumed with the introduction of S. 565. This bill recognizes the inadequacy of the current $3,000 deduction contained in section 217.

This $3,000 deduction is intended to cover the combined expenses of househunting; living in temporary quarters awaiting occupancy of the new home; and the expenses associated with selling the home at the old location and purchasing a replacement residence at the new location.

Just the selling—expenses of selling a home generally run about 10 percent of the selling price. With today's price of homes, these selling expenses almost always are substantially in excess of the present $3,000 limit, leaving no deduction for the other categories of expense.

In fact, when the ceiling on deductible moving expenses was first enacted in 1969, the average price of a home in this country was $27,000.

The most recent figures indicate that the average price of a house has increased to more than $76,000, 272 percent higher than in 1969.

Thus, if cost incident to the home had remained constant as a percentage of sales price during this period these costs would have risen more than 270 percent since 1969, to around $7,600 for the average home sale.

In large metropolitan areas and the entire Western region of the United States the increased cost of housing has been much more dramatic.

For example, the average price of all homes sold in the Census Bureau's western region is now $108,100, which represents more than a 400-percent increase since 1969.

The average sale price of a house in the Washington, D.C., area last fall was $117,500.

In the San Francisco region the average price was $128,400, the highest in the country.

The approach taken by Senator Stevens in S. 565 is to permit deductions of reasonable real estate related expenses. This is accomplished by providing a separate deduction equal to the reimbursement the U.S. Government provides for Federal civilian employees who move for the convenience of the Government.

At the present time the reimbursable amount on real estate sales expenses under the Federal Travel Regulations is 10 percent of the sale price of a home, not to exceed $8,000 and 5 percent of the purchase price of a new home with a $4,000 limit.

We believe these percentage and dollar limits more accurately reflect the actual cost incurred by the typical relocating employee in the middle-income brackets.

The Federal Government, through its Federal Trade Regulations has acknowledged these figures as reasonable levels of reimbursement. It would appear obvious that a corresponding deduction is entirely logical and appropriate.

The current deductible limits are unrealistic in light of——

Senator PACKWOOD. Please summarize your statement, since your time has elapsed.

Mr. POWERS. Mr. Chairman, in respect to the revenue estimate for S. 565, we have asked the Treasury and the joint committee staff for estimates for the last year and a half, formally and informally, to no avail.

We believe the estimates given by the joint committee staff and the Treasury Department are considerably on the high side.

We would hope to have the opportunity to review the assumptions used in making the estimates, since ERC has considerable experience and information on moving costs which may not have been available to the joint committee and Treasury's staffs when they made their estimates.

However, assuming the correctness of the estimates, they only demonstrate how serious the problem is with respect to the present unfair tax rules applicable to job related moves.

Thank you.

Senator PACKWOOD. Thank you.

I will ask the reporter to put a statement of Senator Stevens in the record.

[The prepared statement of Senator Stevens follows:]

STATEMENT BY U.S. SENATOR TED STEVENS

Mr. Chairman, I appreciate your holding a hearing so quickly on a problem that goes largely unnoticed but portends serious consequences. Unlike many nations, the citizens of this great country are highly transient. This mobility overtime helps level off economic scarcities and dislocations in various parts of the counrty. In the past, workers unsatisfied with their conditions risked their futures by moving to places of perceived opportunity. Beginning with the early settlements of the colonies to today's migration to the south and southwest, the people of this country venture into places where they can make a new living. In so doing, new industries springing up in often remote areas are given life by the supply of energetic and creative workers.

In recent years, however, the inflationary spiral, particularly in home sales and purchases, has forced individuals, who in other times would move, to stay where they are. Disenchanted workers, who want to make a new start, simply cannot afford substantially higher priced homes coupled with excessive mortgage rates in other parts of the country. Moving to a new job always involves risks. Compounding these risks with guaranteed financial losses inhibits those who help make our economy vibrant. Mr. Chairman, this is the underlying motive to S. 565.

S. 565 means that the disenchanted yet innovative worker can take a chance without enduring a loss of thousands of dollars in the first few years. It means small businesses that wish to expand or move into other parts of the country can reimburse relocated employees for costs only and not be forced to cover increased taxes. It means high level federal employees, who can be moved without appeal or a concommitant pay increase, will not go bankrupt nor be forced to leave government employment.

Mr. Chairman, the provisions of S. 565 fit neatly into the philosophy underlying the President's economic recovery plan. It removes the disincentive in the tax laws to moving to places of economic growth and opportunity and to moving out of depressed areas of the economy. For instance, my state of Alaska saw a great increase in population during the mid-1970's. In the past few years it grew more gradually with a net decline in the last year. However, the im-

minency of the gas pipeline construction will beg many to Alaska again. This volatile growth pattern necessitates the removal of disincentives to move, such as the cap on the moving expense deduction. Removing such artificial costs will indirectly hold down inflationary pressures around the pipeline while alleviating the depressed areas of the state.

Mr. Chairman, mobility is one of the cornerstones of this nation. Yet at this time, the tax laws are beginning to impede the movement of people. Such mobility is critical to the economic recovery of the nation. S. 565 will go a long way to remedying the situation. Thank you for your consideration.

Senator PACKWOOD. Ms. Lamb, are you next?

Ms. LAMB. Yes. I am the corporate relocation manager for Travenol Labs, Inc., the domestic operating subsidiary of Baxter-Travenol Laboratories.

Baxter-Travenol employs approximately 32,000 men and women worldwide. Within the United States, the company has 23,000 employees. Domestic sales are made in 50 States by a specialty sales force employed directly by the company. Other domestic employees are based at facilities in 15 States in 28 communities.

With the company's 1979 performance, Baxter-Travenol has achieved its 25th consecutive year of earnings-per-share increases and a compound growth rate of 21 percent.

Having the right person in the right place at the right time has been a key element in the success of the company. We are concerned about being able to maintain the mobility of management employees as well as employees with highly technical skills.

I have been involved with the relocation of company employees for 7 years. In 1979, relocation activities were centralized, and during the past 2 years I have been responsible for all domestic relocation, involving the relocation of over 2,300 families.

Our estimated cost to move an employee during 1981 reflects a 76 percent increase over the costs to move an employee in 1976.

In addition to this increase, the company estimates that new policy benefits implemented January 1, 1981, in reaction to the increased financial hardships for transferees, will raise our costs another 64 percent. This amounts to an increase of 140 percent in 6 years.

Despite the policy improvements we have made, many employees are faced with an economic loss due to their move. For example, an employee moving from our North Cove, N.C. plant to our facility in Los Angeles incurs additional annual expenses of $17,539 in transportation, taxes, and increased housing costs.

Working spouses of our employees often find that employment opportunities are unavailable or that their earning power is greatly reduced at their new location.

One such spouse had to settle for a job at $12,000 compared to $27,000 at the old location. And although Baxter-Travenol generally attempts to offset the added tax liability incurred in moving, the formula used does not always accomplish this.

Under our policy in 1980, one of our employees who moved from Atlanta, Ga., to Memphis, Tenn., had to pay an extra $5,225 out of his own pocket.

While Senate bill 565 will not alleviate the problems incurred in moving people to higher cost location, or make up for reduced earning capability of our employee spouse, it will assist those employees

who have to pay extra income taxes simply because they are transferred.

Finally, S. 565 will significantly help newly hired employees who must move to begin their careers.

The bill, of course, is of utmost importance to Federal employees who are presently reimbursed for their moves under Federal Travel Regulations, but are forced to pay taxes on all amounts in excess of $3,000 reimbursed for the selling and purchasing of a home.

The overall benefit to the economy of more reasonable tax rules applicable to job related moves is obviously hard to measure. However, we believe that elimination of the present unfair tax burden will promote labor mobility and increase employment opportunities in this country and thereby contribute to productive growth and efficiency.

Senator PACKWOOD. Thank you. Mr. Schulenberg.

Mr. SCHULENBERG. Thank you, Mr. Chairman.

My name is Loren R. Schulenberg. I am employed by the 3M Co. in St. Paul, Minn., as 3M's relocation manager, a position I have held for the last 8 years. I am appearing before you today in support of S. 565. Our position is further detailed in the written statement submitted for the record.

Since the founding of 3M Co. in 1902, we have grown to 85,000 employees, worldwide, of which more than 50,000 are in the United States. Our expansion beyond Minnesota includes manufacturing and marketing facilities in more than 100 communities located in 35 different States.

Much of our growth can be attributed to our ability to maintain a mobile work force. Annually 3M relocates approximately 1,000 employees. This mobility enables us to provide career opportunities for our employees as well as meet the productivity goals we have established. Most of our relocations provide increased responsibility, opportunity, and compensation for our employees.

The present law, section 217(b)(3), permits a transferred employee of 3M to deduct up to $3,000 for his costs associated with the sale of his old home, the purchase of a replacement home, living expenses for 30 days while occupying temporary quarters, and for a house hunting trip.

At 3M last year, it cost more than $7,900 just to sell the transferred employee's home.

3M reimburses its employees who are relocated for their actual cost in all four of the categories listed above. However, the amounts reimbursed in excess of $3,000 are fully subject to tax.

As a consequence, the average employee would lose thousands of dollars by reason of the move, unless 3M agreed to pay for his added tax burden.

As do most large corporate employers, 3M pays all or a substantial portion of the transferred employee's additional tax liability.

However, this heavy tax cost, coupled with the many other rapidly expanding costs associated with employee moves, increased the average total cost per move paid or reimbursed by 3M to approximately $30,000 in 1980.

Of this amount, approximately $4,000 is attributable to the additional taxes charged the transferred employee under present law,

because 3M has been willing to pay expenses connected with the house sold and the one bought in excess of the $3,000 limit.

Despite 3M's efforts to keep our employees financially whole when they are requested to transfer, it is difficult to completely offset the added tax liability our employees incur when we reimburse them for expenses beyond the current deductible limits. This can occur if the employee has income from sources other than 3M; and is especially true if the employee has a working spouse.

The increasing costs associated with moving employees from one job location to another is forcing companies such as 3M to reduce the number of employees transferred, the result that we may not be making the most productive or effective use of our employees.

Moreover, some of our employees may have more reluctance to move because our moving expense reimbursement procedures do not always cover all the additional tax bite put on the employee under existing law.

We strongly support S. 565 as a measure to remove an unfair tax on labor mobility. We believe the impact of this bill to be completely noninflationary in nature, and that the resulting improvement in flexibility in the economy will generate more in revenue than any estimated revenue loss the Treasury may calculate.

In summary, I understand this administration is dedicated to increasing job opportunity and productivity increases in industry. The adoption of S. 565 can only enhance this admirable objective.

Thank you.

Senator PACKWOOD. You will find that the Treasury's revenues are based on a static assumption, and maybe with some justification, on the theory that if they start trying to take a dynamic assumption and you have half a dozen different organizations telling you what to expect in terms of increased revenues if you undertake a certain course of action. The Treasury is pretty good about saying we know the static revenues are not accurate, but at least they are consistent and you have some base to go on.

I am inclined to agree with you. I think probably a good many people are deterred from moving because of this and the Treasury would actually generate revenues from it, but that is not something they will speculate on.

I have no questions. I appreciate your patience.

We have one other panel to follow you and you will be excused.

Thank you.

[The prepared statements of the preceding panel follow:]

SUMMARY OF STATEMENT OF EMPLOYEE RELOCATON COUNCIL (E-R-C)

1. E-R-C strongly supports S. 565 as a reasonable and much-needed liberalization of the moving expense deduction for job-related moves provided by § 217 of the Internal Revenue Code.

2. The present $3,000 limit on deductions is intended to cover the combined expenses of house-hunting, living in temporary quarters awaiting occupancy of the new home, and the expenses associated with selling the home at the old location and purchasing a replacement residence at the new location, which are usually the costliest expenses of a move. The expenses of selling a home generally run around 10 percent of the selling price of the home. At today's average home price of $76,300, this generates a cost of $7,630, which is more than two-and-one-half times the $3,000 limit.

3. The approach taken in S. 565 is to permit deductions for reasonable real estate related expenses by providing a separate deduction equal to the reimbursement the U.S. Government provides for Federal civilian employees who move for the convenience of the Government. As the Government has acknowledged a reasonable limit of reimbursement, it would appear obvious that a corresponding deduction is entirely logical and appropriate.

4. Legislation along the lines of S. 565 will permit corporations and the Government to deploy their most valuable asset—their human resources—to maximize productivity and reduce costs. In turn, workers in the middle income brackets, particularly Government workers, the self-employed and those who are unemployed, will not suffer inequitable tax hardships when they are forced to make job-related moves.

ORAL STATEMENT OF LOREN R. SCHULENBERG, RELOCATION MANAGER, 3M COMPANY

My name is Loren R. Schulenberg. I am employed by the 3M Company in St. Paul, Minnesota, as 3M's Relocation Manager, a position I have held for the last eight years. I am appearing before you today in support of S. 565. Our position is further detailed in the written statement submitted for the record.

Since the founding of the 3M Company in 1902, we have grown to 85,000 employees worldwide, of which more than 50,000 are in the United States. Our expansion beyond Minnesota includes manufacturing and marketing facilities in more than 100 communities located in 35 different states.

Much of our growth can be attributed to our ability to maintain a mobile workforce. 3M annually relocates approximately 1,000 employees. This mobility enables us to provide career opportunities for our employees as well as meet the productivity goals we have established. Most of our relocations provide increased responsibility, opportunity, and compensation for our employees.

The present law (Section 217(b) (3) permits a transferred employee of 3M to deduct up to $3,000 for his costs associated with the sale of his old home, the purchase of a replacement home, living expenses for 30 days while occupying temporary quarters and for a househunting trip. At 3M last year it cost more than $7,900 just to sell the transferred employee's home.

3M reimburses its employees who are relocated for their actual costs in all four of the categories listed above. However, the amounts reimbursed in excess of $3,000 are fully subject to tax. As a consequence, the average employee would lose thousands of dollars by reason of the move, unless 3M agreed to pay for his added tax burden. As do most large corporate employers, 3M does pay all or a substantial portion of the transferred employee's additional tax liability. However, this heavy tax cost, coupled with the many other rapidly expanding costs associated with employee moves, increased the average total cost per move paid or reimbursed by 3M to approximately $30,000 in 1980. Of this amount, approximately $4,000 is attributable to the additional taxes charged the transferred employee under present law because 3M has been willing to pay expenses connected with the house sold and the one bought in excess of the $3,000 limit.

Despite 3M's efforts to keep our employees financially whole when they are requested to transfer, it is difficult to completely offset the added tax liability our employees incur when we reimburse them for expenses beyond the current deductible limits. This can occur if the employee has income from sources other than 3M; and is especially true if the employee has a working spouse.

The increasing costs associated with moving employees from one job location to another is forcing companies such as 3M to reduce the number of employees transferred, the result that we may not be making the most productive or effective use of our employees. Moreover, some of our employees may have become more reluctant to move because our moving expense reimbursement procedures do not always cover all the additional tax bite put on the employee under existing law.

We strongly support S. 565 as a measure to remove an unfair tax on labor mobility. We believe the impact of this bill to be completely noninflationary in nature, and that the resulting improvement in flexibility in the economy will generate more in revenue than any estimated revenue loss the Treasury may calculate.

In summary, I understand this administration is dedicated to increasing job opportunity and productivity increases in industry. The adoption of S. 565 can only enhance this admirable objective.

ORAL STATEMENT OF KARIN LAMB, CORPORATE RELOCATION MANAGER, BAXTER-TRAVENOL LABORATORIES, INC.

My name is Karin Lamb. I am the Corporate Relocation Manager for Travenol Labs, Inc., the domestic operating subsidiary of Baxter-Travenol Laboratories, Inc. Baxter-Travenol employs approximately 32,000 men and women worldwide. Within the U.S. the company has 23,000 employees. Domestic sales are made in 50 states by a specialty sales force employed directly by the company. Other domestic employees are based at facilities in 15 states in 28 communities.

With the company's 1979 performance, Baxter-Travenol has achieved its 25th consecutive year of earnings per share increases and a compound growth rate of 21%. Having the right person in the right place at the right time has been a key element in the success of the company. We're concerned about being able to maintain the mobility of management employees as well as employees with highly technical skills.

I have been involved with the relocation of company employees for seven years. In 1979, relocation activities were centralized, and during the past two years I have been responsible for all domestic relocation, involving the relocation of over 2300 families.

Our estimated costs to move an employee during 1981 reflects a 76% increase over the costs to move an employee in 1976. In addition to this increase the company estimates new policy benefits implemented January 1, 1981, in reaction to the increased financial hardships for transferees, will raise our costs another 64%. This equals an increase of 140% in 6 years.

Despite the policy improvements we have made, many employees are faced with an economic loss due to their move. For example an employee moving from our North Cove, North Carolina plant to our facility in Los Angeles incurs additional annual expenses of $17,539 in transportation, taxes, and increased housing costs. Working spouses for our employees often find that employment opportunities are unavailable or that their earning power is greatly reduced. One such spouse had to settle for a job at $12,000 compared to $27,000 at the old location. And although Baxter-Travenol generally attempts to offset the added tax liability incurred in moving, the formula used does not always accomplish this. Under our policy in 1980 one of our employees who moved from Atlanta, Georgia to Memphis, Tennessee had to pay an extra $5,225 out of his own pocket.

While Senate Bill 565 will not alleviate the problems incurred in moving people to higher cost location, or make up for reduced earning capability of our employee spouse, it will assist those employees who have to pay extra income taxes simply because they are transferred. And finally, S. 565 will significantly help newly hired employees who must move to begin their careers. The bill, of course, is of utmost importance to Federal employees who are presently reimbursed for their moves under Federal Travel Regulations, but are forced to pay taxes on all amounts in excess of $3,000 reimbursed for the selling and purchasing of a house.

The overall benefit to the economy of more reasonable tax rules applicable to job related moves is obviously hard to measure. However, we believe that elimination of the present unfair tax burden will promote labor mobility and increase employment opportunities in this country and thereby contribute to productive growth and efficiency.

ORAL STATEMENTS OF LARRY G. POWERS, CHAIRMAN, BOARD OF DIRECTORS, EMPLOYEE RELOCATION COUNCIL

My name is Larry G. Powers and I am appearing before you today as Chairman of the Board of Directors of the Employee Relocation Council in support of S. 565, a bill introduced by Senator Stevens to increase the amount of deductions allowable for certain job-related moves. I am employed by American Airlines in Dallas/Fort Worth, Texas as the Director-Benefits. Part of my responsibilities at American include the development, administration, and management of American's employee relocation policy.

I have with me Cris Collie, Executive Vice President of the Employee Relocation Council, and Jay Glasmann, who serves as E-R-C's Tax Counsel. Also appearing with me today are representatives of two other member companies of E-R-C. They will discuss how the current tax treatment of moving expenses is impeding or detering their respective relocation programs. I assure you, Mr.

Chairman, that the three of us will be brief and concise, and that we will complete our prepared remarks within the time allotted for our testimony.

The Employee Relocation Council, was founded in 1964. It is composed of 763 major corporations and governmental agencies that transfer employees among multi-plant and office locations. The aggregate number of job-related moves within our membership is approximately 300,000 employees annually. These 300,000 make up approximately 25 percent of all individuals annually qualifying for the reporting job-related moving expense deductions to the IRS. Our demographic studies show that the typical person being relocated is in an early to mid-career stage. This person is between 31 and 35 years of age and earns less than $35,000 per year. So please bear in mind that the Stevens bill is not targeted to provide relief for executive levels of corporate management.

The Employee Relocation Council applauds Senator Stevens and the leadership role he has assumed with the introduction of S. 565. This bill recognizes the inadequacy of the current $3,000 deduction contained in Section 217. This $3,000 deduction is intended to cover the combined expenses of househunting; living in temporary quarters awaiting occupancy of the new home; and the expenses associated with selling the home at the old location and purchasing a replacement residence at the new location which are usually the costliest expense of a move. The expenses of selling a home alone generally run around 10 percent of the selling price. With todays price of homes such expenses almost always are substantially in excess of the present $3,000 limit leaving no deduction for the other categories of expenses.

In fact, when the ceiling on deductible moving expenses was first enacted in 1969, the average price of a home in this country was $27,000. The most recent figures indicate that the average price for a house has increased to more than $76,000, 272 percent higher than in 1969. Thus, even if costs incident to the sale of a home such as brokerage commission, attorneys fees, and transfer taxes had remained constant as a percentage of sales price during this period, (unfortunately all have increased), these costs would have risen more than 270 percent since 1969, to around $7,600 for the average home sale.

In large metropolitan areas and the entire western region of the United States, the increased cost of housing has been much more dramatic. For example, the average price of all homes sold in Census Bureau's western region is now $108,100, which represents more than a 400 percent increase since 1969. Recent figures compiled for the major urban areas indicate, not surprisingly, much higher average prices. For example, the average sale price of a home in the Washington, D.C. area last fall was $117,500. In the San Francisco region, the average price was $128,400, the highest in the country.

The approach taken by Senator Stevens in S. 565 is to permit deductions of reasonable real estate related expenses. This is accomplished by providing a separate deduction equal to the reimbursement the U.S. Government provides for Federal civilian employees who move for the convenience of the government.

At the present time, the reimburseable amount on real estate sales expenses under the Federal Travel Regulations is 10 percent of the sale price of the home, not to exceed $8,000 and five percent of the purchase price of a new home with a $4,000 limit. We believe these percentage and dollar limits more accurately reflect the actual cost incurred by the typical relocating employee in the middle income brackets. Also, as the Federal Government, through its Federal Travel Regulations, has acknowledged these figures as reasonable levels of reimbursement, it would appear obvious that a corresponding deduction is entirely logical and appropriate.

The current deductible limits are unrealistic in light of present moving costs. Congress has often acknowledged the need for job mobility. In the Report on the Tax Reform Act of 1969, the Senate Finance Committee stated "the mobility of labor is an important and necessary part of a dynamic and full-employment economy, since it reduces unemployment and increases production capacity." Both the reduction of unemployment and the emphasis on increasing the productivity of American companies remain primary objectives of this Congress.

With the enactment of legislation along the lines of S. 565, corporations and the government will be able to deploy their most valuable asset, their human resources, to maximize productivity and reduce costs. In turn workers in the middle income brackets, particularly government workers, the self employed and those who are unemployed, will not suffer inequitable tax hardships when they are forced to make job-related moves.

STATEMENT OF EMPLOYEE RELOCATION COUNCIL (E-R-C) IN SUPPORT OF S. 565

E-R-C is pleased to participate in this hearing on S. 565 introduced recently by Senator Stevens of Alaska. The Employee Relocation Council and its approximately 750 member companies strongly supports the Stevens bill and urge that it be favorably considered by Congress this year.

E-R-C has long been of the view that job-related moving expenses for private and Governmental employees should be fully deductible, within reasonable limits. S. 565 would provide a long-needed liberalization of the present moving expense deduction rules set forth in § 217 of the Internal Revenue Code.

Since 1964, when § 217 was added to the Tax Code, mobile American families, and the businesses that relocate them, have faced significant and substantial Federal tax liabilities caused by the inadequate deductions allowed for reimbursed and non-reimbursed expenses.

This tax on mobility has been brought about by the restrictive limitations on deductions permitted under the current law which was amended in 1969 and slightly liberalized in 1976. The current law, in addition to allowing a full deduction for the costs of shipping household goods and personal effects and travel to the new location, allows only $3,000 deduction for the combined expenses of house-hunting, temporary living (at the new location for 30 consecutive days), and real estate sale and purchase expenses. House-hunting and temporary living are further subject to a $1,500 sub-limit.

These restrictive and unrealistic deductions are causing severe hardships for industry and its employees and within the Federal Government itself. Federal civilian employees requested to move for the convenience of the Government are reimbursed certain moving expenses but must pay Federal tax on most of these reasonable, actual and non-discretionary expenses.

The problem was recognized by the former Director of OPM, Alan Campbell, in a communication last year to the former Secretary of Treasury, G. William Miller:

"* * * Escalating moving costs, inadequate reimbursements and, for many senior executives, increased responsibility with no increase in pay, have combined to make relocation for the benefit of the Government an expensive proposition for the employee * * *. Tax policies are frequently cited as a disincentive to geographical mobility * * *."

In November 1979 members of a Federal agency task force recommended immediate action to increase or remove the limitations imposed by the present law.

"* * * One factor which immediately comes to mind as having a negative impact on our inability to successfully attract and retain the quality staff necessary to the effective functioning of the Service, is the statutory limitation on certain moving expenses. Section 217(b)(3) of the Internal Revenue Code limits the deduction for premove travel, temporary living expenses, and real estate expenses to $3,000.00. This limitation is in need of change to more adequately reflect the realities encountered by a mobile labor force. It is our recommendation that the Service and Treasury initiate immediate action to increase or remove the limitation imposed by Section 217(b)(3) of the Internal Revenue Code * * *."

This report, which is included in full with the communication to the former Secretary of Treasury in Attachment A, cited the substantial financial loss and sacrifices faced by civilian Government employees requested or required to relocate.

Because of this tax on and deterrent to mobility and because of its serious negative impact on the Federal Government and its employees, Senator Ted Stevens recently introduced a bill, S. 565, to bring much-needed reform to this area of the Tax Code. The example used in his introductory remarks (see Attachment B for the full text) highlights the inadequacies of the present law and system.

"* * * For example, recently a GS-15 employee with the IRS was asked to move from Tennessee to Washington, D.C., to take a Senior Executive position. Without a pay cap on top salaries this individual could have expected an $8,000 pay increase.

"Instead, he received a $2,500 pay increase which was totally wiped out by the higher State income taxes in Virginia where he moved. He sold his home in Tennessee for $87,500 and purchased one with comparable square footage in northern Virginia for $120,000. His monthly mortgage payment increased from $500 per month to $880 per month. His nonreimbursed moving expenses amounted to $1,650. The cost to this family for a move requested by the Federal Govern-

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ment after all tax deductions and credits were accounted for was a loss of over $5,000 in 1980. Because of the higher mortgage on his new home, he will effectively lose over $1,500 a year in the future.

"Mr. President, there is something seriously wrong with a system when a devoted and obviously hard-working Federal employee must pay $5,000 to take a promotion with increased responsibility. Enactment of the bill I am introducing would substantially reduce such costs to future relocated Federal and private sector employees. * * *."

S. 565 proposes retention of the full deduction for the costs of shipping household goods and travel to the new location, creates a separate deductible category for house-hunting and temporary living expenses with a retention of the present $1,500 limit on these expenses and, most importantly, ties a new limit for real estate sales and purchase expenses to the level of reimbursement provided by the Federal Government to its transferred civilian employees. The current Federal Travel Regulations administered by the General Services Administration provide for reimbursement of expenses incurred in connection with the sale of the old house and the purchase of a replacement home as follows:

"The aggregate amount of expenses which may be reimbursed is as follows:

(1) In connection with the sale of the residence at the old official station, reimbursement shall not exceed 10 percent of the actual sales price or $8,000, whichever is the lesser amount.

(2) In connection with the purchase of a residence at the new official station, reimbursement shall not exceed 5 percent of the purchase price or $4,000, whichever is the lesser amount."

The Employee Relocation Council (see Attachment C for a partial list of members) applauds Senator Stevens for his realistic solution to this problem and fully supports the modifications to § 217 of the Tax Code that are proposed in S. 565.

In addition to removing the present tax burden faced by all persons, including civilian Government employees, who are reimbursed reasonable job-related moving expenses, the provisions of S. 565 will assist business and labor in responding to the need for improved productivity in industry. Tying the deductible limit for real estate sales and purchase expenses to what the Government has determined to be a fair and equitable level of reimbursement is logical. E-R-C submits that the Government through the FTR's has determined fair and reasonable reimbursements for real estate expenses in connection with job-related moves and the limits provided in the Internal Revenue Code for the deduction of such real estate expenses should coincide with the reimbursable limits in the FTR's, otherwise the Government can fairly be accused of giving with one hand and taking away with the other.

The Congressional intent with respect to the tax treatment of Federal relocation allowances is clearly revealed by the House Floor Debate on March 23, 1966 on H.R. 10607 (which became P.L. 89-516) in the 89th Congress and by Senate Report No. 3583, 89th Cong., 2d Sess., on the same bill. (P.L. 89-516 is the legislation which first authorized the Federal Government to reimburse its transferred employees for house-hunting trips, temporary living expenses and real estate expenses.) Mr. Smith of California, speaking for the Rules Committee, stated: "The aim is to get this bill passed and try to remove such payments to employees, both Government and private, from ordinary income for tax purposes". Cong. Record, p. 6277, 89th Cong., 2d Sess. In like fashion, Mr. Byrnes of Wisconsin summarized the inequitable tax situation then existing as follows: "Mr. Chairman, it seems to me it is inconsistent to recognize that these expenses are a legitimate expense of the employer, that they are incurred for the convenience of the employer, and they say 'yes; but if we reimburse the out-of-pocket and the actual expenses of the employee, he has received income as a result and he must pay income taxes on these funds.'

"Mr. Chairman, if we take this attitude it just seems to me that we defeat the very purpose that we have in mind here." Finally, Mr. Erlenborn stated: "I think we have also made a good record here as to the fact that it is the intention of this Congress, although we cannot do it through this vehicle, to make those reimbursements of expenses non-taxable. Certainly this can be done only by the passage of another substantive piece of legislation, several of which have been discussed during the debate here today. I hope that the Committee on Ways and Means will act favorably on one of those bills so that this bill may reach its fullest meaning and these reimbursement expenses will not be counted as income

to the employees, which would mean they would in fact receive only a portion of the benefit that we intend to give them by the passage of this bill."

The following excerpt from Senate Report No. 3583 is also indicative of a Congressional intent *not* to tax relocation allowances paid to Federal employees:

"The committee considered a proposed amendment to H.R. 10607 which would specifically have exempted the allowances and benefits authorized by this bill from taxation, unless, of course, the taxpayer should realize a gain from such reimbursement.

"The committee endorses the intent of this proposed amendment. However, in view of the jurisdictional problems which might be raised as a result of adding such language to this bill and in view of the fact that general legislation similar to the proposed amendment is currently pending before the Ways and Means Committee of the House and the Finance Committee of the Senate, the amendment was not adopted.

"The committee is of the view, however, that the general purpose and effect of H.R. 10607 would be seriously diluted if the benefits and allowances authorized thereunder are deemed taxable as income. In this regard the committee is in full accord with the following testimony given on this matter by John W. Macy, Chairman of the Civil Service Commission before the House Committee:

"' * * * the basic philosophy behind this legislation would indicate that this is not compensation, this is not additional income. This is reimbursement, and therefore, should not be taxable.' "

Unfortunately, until the enactment of the Tax Reform Act of 1969, the Internal Revenue Code, as interpreted by the IRS and supported by a number of Court decisions in the sixties, treated as taxable income to the employee any amount reimbursed to him by his employer for the cost of his move, other than actual transportation costs and subsistence while en route.

The unfairness of this approach was obvious to anyone who had ever been moved from one city to another by his employer. A transferred employee can avoid a move suggested by his employer only by risking the loss of his job, and by jeopardizing possible promotions in the future. In any event, beginning about 1966, bipartisan groups in both Houses of Congress pressed for corrective legislation, which was finally enacted in compromise form as part of the Tax Reform Act of 1969. The deductible limits established in 1969 included an overall limit of $2,500 for house-hunting and temporary living (both of which were subject to a $1,000 sublimit) and real estate sale and purchase expense.

The Tax Reform Act of 1976 slightly liberalized these limits by increasing the overall limit to $3,000 with a corresponding increase to $1,500 of the sublimit for house-hunting and temporary living expenses.

HOW HAVE THE 1969 AND 1976 PROVISIONS WORKED?

The $2,500 limit (1969) which was increased to the present $3,000 limit (1976) was first suggested in 1967 by former Representative James Burke (D. Mass.) as a compromise measure in order to eliminate Treasury objection to his bill. That bill, H.R. 47, merely provided that to be deductible moving expenses had to be reasonable.

Fourteen years have passed since then and the token increase, in 1976, to the present rigid $3,000 ceiling for deductible items which was far from generous in 1967, barely touches the actual cost of moving faced by persons today. In fact, the costs of selling real estate alone usually far exceed the present $3,000 limit.

To illustrate: when the ceiling on deductible moving expenses was first enacted in 1969, the average price of a home was $27,900, according to the Department of Commerce's Census Bureau. With the average cost of selling a residence running about 10 percent of the sales price, the 1969 disposition costs of $2,790 were clearly in excess of the $2,500 limit. However, the most recent figures indicate the average price of a house has increased to $76,300, which, in turn, generates total costs of selling the average residence of around $7,630, a 273 percent increase over the 1969 level. At 1980 dollars the costs of selling the residence are now more than two-and-one-half times the overall deductible limit.

In large metropolitan areas, the increases have been more dramatic. According to the Federal Home Loan Bank Board, 1980 average home prices were $121,500 in Honolulu, Hawaii; $120,100 in San Francisco; $110,600 in Los Angeles, and $91,600 in Washington, D.C. Chicago housing costs of $77,700 were slightly under the 32-city average of $78,800, while Minneapolis-St. Paul was slightly over at $80,300.

At these average home prices, the $3,000 limit, intended to cover four different categories of expenses ((1) house-hunting, (2) temporary living, (3) selling the old residence, and (4) purchasing a new residence) now does not even come close to covering just one of those items—namely, the costs of selling the old residence.

PERSONS AFFECTED

The Stevens bill is, in E-R-C's opinion, designed for the typical, or average, person who moves for job-related reasons. Although the proposed limits will fail to cover all expenses for persons moving from large metropolitan areas, as illustrated in the preceding section dealing with home prices, it is a much-needed step in the right direction.

Demographic studies reveal that the majority of employees who are being relocated are in an early to mid career stage, generally earning less than $35,000 per year.

Age	Percent	Earned income before taxes [1]	Percent
30 or under	26	$15,000 or less	4
31 to 35	43	$16,000 to $20,000	20
36 to 40	17	$21,000 to $25,000	27
41 to 45	5	$26,000 to $30,000	19
46 to 50	7	$31,000 to $35,000	19
Over 50	1	$36,000 to $40,000	4
		Over $40,000	8

[1] Source: "The Effect of Job Transfers on Employees and their Families." November 1980, E-R-C.

These data clearly demonstrate that the typical relocated employee is not the wealthy executive but rather a person at middle management levels. The increased costs of moving these persons is indeed forcing some companies to reduce the number of employees transferred, with the result being that they may not be providing advancement opportunities or making the most productive and effective use of their employees. And some employees, who are provided with relocation opportunities are rejecting them because of the non-reimbursed, personal expenses of moving caused, in part, by the additional Federal and state tax burden.

Congress has often acknowledged the need for job mobility. In the Report on the Tax Reform Act of 1969, the Senate Finance Committee stated, "the mobility of labor is an important and necessary part of a dynamic and full employment economy, since it reduces unemployment and increases production capacity." In the Report on the Tax Reform Act of 1976, the House Ways and Means Committee stated:

"The mobility of labor continues to be important in the economy of the United States. Frequently, employers must transfer employees from one location to another and workers must change their residences in order to obtain better employment opportunities * * *."

The reduction of unemployment and the emphasis on increasing the productivity of American companies remain primary objectives of this Congress and the new Administration.

The present law, which is tantamount to imposing a tax on mobility, when coupled with other present barriers to mobility such as high mortgage rates, higher housing costs, etc., threatens the ability of our nation to achieve a full employment economy and to provide new job opportunities to our citizenry.

With the enactment of legislation along the lines of S. 565, corporations and the Government will be able to deploy their most valuable asset—their human resources—to maximize productivity and reduce costs. In turn, workers in the middle income brackets, particularly Government workers, the self-employed and unemployed, will not suffer inequitable tax hardships when they are forced to make job-related moves.

Attachment.

ATTACHMENT A

AUGUST 4, 1980.

HON. G. WILLIAM MILLER,
Secretary of Treasury,
Washington, D.C.

DEAR BILL: For some time we have been aware of inequities in Federal Employee Relocation policies. Escalating moving costs, inadequate reimbursements and for many senior executives, increased responsibility with no increased pay,

have combined to make relocation for the benefit of the Government an expensive proposition for the employee. These concerns were highlighted by a number of Federal managers at the recent Cherry Hill conference.

Top officials are concerned that relocation policies are having a negative impact on the efficiency and effectiveness of the Federal service. For this reason, I recently established an OPM task force which is working with GSA and OMB in examining relocation policies, documenting their impact and developing proposals for change.

Tax policies are frequently cited as a disincentive to geographic mobility. Section 217(b)(3) of the Internal Revenue Code limits deductions for premove travel, temporary living expenses and real estate expenses to $3,000. When an employer reimburses employees for such moving-related expenses, any reimbursements in excess of $3,000 must be declared as income. Since real estate costs alone normally exceed $3,000, employees who move for the benefit of the employer find that they have assumed a substantial tax burden.

The Internal Revenue Service is one of several Federal Agencies which has requested us to re-evaluate relocation policies. For your information, I have enclosed an IRS analysis on the tax implications for relocating.

In the past, Treasury officials have recognized the need for change, but were hesitant to introduce legislation for the sole purpose of revising relocation deductions. They suggested that such provisions be attached to other tax legislation which is broader in scope. Since the Department is in the process of designing 1981 tax reduction legislation, I suggest that this is a most appropriate time to consider tax adjustments related to relocation.

Members of the OPM task force are available to discuss this issue in more detail with Treasury officials. Your staff may contact Lee Hall *632-8742* or Gene Rummell FTS *729-8227*. I am hopeful that we can take advantage of this opportunity to correct inequities and manage the Federal workforce in a more productive, fair manner.

Please keep me advised of any actions you plan to take, also please call me if we may be of any assistance.

Sincerely yours,

ALAN K. CAMPBELL,
Director, Office of Personnel Management.

INTERNAL REVENUE SERVICE MEMORANDUM

Date: November 21, 1979.
To: Assistant Commissioner (Resources Management) RM.
From: Acting Assistant Commissioner (Compliance) CP.
Subject: Administrative Task Force.

We welcome the opportunity to address the issues to be considered by the task force. My staff will be available for assistance during this process.

One factor which immediately comes to mind as having a negative impact on our ability to successfully attract and retain the quality staff necessary to the effective functioning of the Service, is the statutory limitation on certain moving expenses. Section 217(b)(3) of the Internal Revenue Code limits the deduction for premove travel, temporary living expenses, and real estate expenses to $3,000.00. This limitation is in need of change to more adequately reflect the realities encountered by a mobile labor force. It is our recommendation that the Service and Treasury initiate immediate action to increase or remove the limitation imposed by Section 217(b)(3) of the Internal Revenue Code.

The initial legislation for Section 217 covered the expenses incurred for moving household goods and travel to the new location. There was no provision to cover expenses incurred in premove travel for househunting purposes, temporary living expenses or real estate expenses.

The committee reports address the same concerns we face, i.e., the importance of removing deterrents to the mobility of labor. Realizing that mobility is a result of competition for skilled employees and a necessary part of a dynamic economy, Congress expanded the expenses deductible as a consequence of an employment related move.

Amendments to Section 217 instituted the deduction for premove travel, temporary living expenses, and real estate expenses subject to an overall $1,500.00 limitation for years after 1969. In 1977, recognizing the impact inflation had upon

the general level of prices and the need to make mobility less costly to the public, Congress increased the limitation to the current $3,000.00.

Since the Government employee is reimbursed for these type expenses, the $3,000.00 limitation for tax purposes is a hardship. The excess reimbursement constitutes taxable income; thus, the mobile employee suffers an out pocket cost of some consequence.

This statutory limitation coupled with the inflationary impact on purchasing power increases this financial burden substantially. During a period of rising prices, more current dollars must be spent to purchase the same level of goods and services.

The inflationary impact alone on the $3,000.00 limitation is severe. However, we must also recognize that along with the erosion of spending power, the employee is moved steadily upward into a higher and higher marginal tax rate which further increases the financial hardship. As the cost of services rise, the moving expenses reimbursement rises generating increased taxable income with the obvious result of a higher and higher tax bracket.

So, combined with the reduced purchasing power of the $3,000.00, the employee is faced with increased income taxes on the excess reimbursement resulting in a higher "cost" to move and relocate. As this "cost" increases, the available pool of mobile employees diminishes. Competition is reduced and productivity and quality suffer.

Assuming a static taxable income figure as well as a static level of services purchases, these financial burdens can be readily identified through comparisons of situations over a period of time.

The attached examples bring this "cost" into a clear perspective which demonstrate a need to address this inequity through legislation to increase or remove the statutory limitation applicable to premove travel, temporary living expenses, and real estate expenses imposed by Section 217(b)(3) of the Internal Revenue Code.

These examples include comparisons for a joint return with a constant taxable income of $41,500.00. Computation includes the income tax liability if no move is made and the income tax liability with a move. In each example, the move is a constant level of services purchased.

The 1970 example covers a $4,000.00 expenditure for premove travel, temporary living expenses, and real estate expenses of a couple with taxable income of $41,500.00 exclusive of adjustments for the move. All subsequent examples assume the same taxable income before adjustments for the move and the same level of services purchased for the move. The $4,000.00 level of services is adjusted each year to reflect the increase in the expenditure necessary to purchase an equivalent level of services. The net consequence is identified as the economic loss suffered solely as a result of a move or the additional federal income tax liability due as a result of the move and the limitations imposed by Section 217(b)(3) of the Internal Revenue Code.

1970 economic loss	$738.00
A moving expense of $4,000.00 is incurred and fully reimbursed. The taxable income exclusive of the move is $41,500.00. The limitation of $2,500.00 results in $1,500.00 taxable income.	
Tax without a move: $41,500 taxable income	13,181.50
Tax with a move: $43,000 taxable income	13,919.50
Additional income tax payable due to the move or economic loss	738.00
1975 economic loss	1,480.00
The 1970 example converted to 1975 dollars to reflect the impact of inflation. A 1970 dollar compared to a 1975 requires an expenditure of $1.39.	
The 1970 move of $4,000 restated in 1975 dollars costs $5,560.00. Applying the $2,500.00 statutory limitation results in taxable income of $3,060.00.	
Tax without a move: $41,500 taxable income	12,860.00
Tax with a move: $44,560 taxable income	14,340.00
Additional income tax payable due to the move or economic loss	1,480.00
1976 economic loss	1,640.00

The 1970 example converted to 1976 dollars reflects the impact of inflation. An expenditure in 1970 of $1.00, requires an expenditure of $1.47 in 1976 to acquire comparable levels of service.
The 1970 move of $4,000.00 restated in 1976 dollars costs $5,880.00. Applying the $2,500.00 statutory limitation results in taxable income of $3,380.00.

Tax without a move: $41,500 taxable income	12,680.00
Tax with a move: $44,880 taxable income	14,320.00
Additional income tax payable due to the move or economic loss	1,640.00

1977 Economic Loss	1,504.20

An expenditure in 1970 of $1.00 requires an expenditure in 1977 of $1.56 to acquire comparable levels of service.
The 1970 move of $4,000.00 restated in 1977 dollars costs $6,240.00. Applying the increased statutory limitation of $3,000.00 results in taxable income of $3,240.00.

Tax without a move: $41,500 taxable income	11,195.00
Tax with a move: $44,740 taxable income	12,699.20
Additional income tax payable due to the move or economic loss	1,504.20

1978 Economic Loss	1,734.60

An expenditure in 1970 of $1.00 requires an expenditure of $1.68 to acquire comparable levels of service.
The 1970 move of $4,000.00 restated in 1977 dollars costs $6,720.00. Applying the $3,000.00 statutory limitation results in taxable income of $3,720.00.

Tax without a move: $41,500 taxable income	11,195.00
Tax with a move: $45,220 taxable income	12,929.60
Additional income tax payable due to the move or economic loss	1,734.60

1979 Economic Loss	2,118.60

An expenditure in 1970 of $1.00 requires an expenditure in 1979 of $1.88 to acquire comparable levels of service.
The 1970 move of $4,000.00 restated in 1979 dollars costs $7,520.00. Applying the $3,000.00 statutory limitation results in taxable income of $4,520.00.
The tax consequences are based on 7812 (sic) rates and law to maintain comparability.

Tax without a move: $41,500 taxable income	11,195.00
Tax with a move: $46,020 taxable income	13,313.60
Additional income tax payable due to the move or economic loss	2,118.60

Table I summarizes the examples previously addressed for comparative analysis. The economic loss suffered for 1977 dropped as a result of the general tax credit provisions. However, 1978 and 1979 losses increased dramatically despite the general tax credit provisions. As you can see, these costs are significant.

Table II points out the true reimbursement actually realized. The additional federal income tax liability dilutes the reimbursement substantially. Despite a full reimbursement by the Government for the expenses paid in column (1), the employee realized only the amount in column (4). The amount in column (3) must be paid out in additional federal income taxes.

TABLE I

Year:	*Economic loss*
1970	$738.00
1975	1,480.00
1976	1,640.00
1977	1,504.20
1978	1,734.60
1979	2,118.60

TABLE II

Year	Full reimbursement paid for premove travel, temporary living expenses, and real estate expenses	Additional taxes due to sec. 217 limitation or economic loss	Net reimbursement actually realized—col. (2) less col. (3)
1970	$4,000	$738.00	$3,262.00
1975	5,560	1,480.00	4,080.00
1976	5,880	1,640.00	4,240.00
1977	6,240	1,504.20	4,735.80
1978	6,720	1,734.60	4,985.40
1979	7,520	2,118.60	5,401.40

It should be emphasized that these examples do not include the additional state income tax liability which may arise. They deal strictly with one item—dilution of government reimbursements for moving expenses resulting from the limitation on income tax deductions for moving expenses pursuant to Section 217(b)(3) of the Internal Revenue Code.

Attachment B—Statement Made by Senator Ted Stevens When Introducing S-565

Mr. President, I am introducing a bill to allow employees who relocate for business reasons to take a more reasonable and flexible income tax deduction for expenses incurred in such a move. Existing law provides a maximum deduction of $3,000 for the costliest aspects of a move; that is, the expenses associated with the selling and purchasing of a home. This bill eliminates the cap and instead ties the deduction associated with home sales and purchases to the maximum reimbursement allowed for a Federal employee for such expenses, presently $12,000.

Mr. President, money is the big obstacle in moving these days. Many businesses offer raises and bonuses to those who relocate, but workers are rejecting seemingly profitable offers because relocation costs would cut into the gain. Many workers find that the cost of a new house and mortgage would wipe out any raise or bonus that the company might give. The resulting effect is that the people are not willing to move.

Moreover, simple reimbursement by an employer is insufficient in most cases to cover the employee's actual costs because reimbursements above $3,000 must be included in income. Hence, the employee loses money. In addition, instances where businesses are willing to pay for the added tax burden are significantly decreasing due to the exorbitant costs that must be borne by the employers.

Ironically, however, Federal employees who are eligible for sizable reimbursements experience some of the most serious problems. The Federal Government normally reimburses an employee who is asked to relocate. Relocation usually means increased responsibility and pay. However, pay caps over the years have eliminated any incentive for those employees who are most likely asked to move. With the existence of the Senior Executive Service, employees can be relocated at the drop of a hat. Without any hope for increased pay, a required move, regardless of reimbursement, means losses of thousands of dollars.

For example, recently a GS-15 employee with the IRS was asked to move from Tennessee to Washington, D.C., to take a Senior Executive position. Without a pay cap on top salaries this individual could have expected an $8,000 pay increase. Instead, he received a $2,500 pay increase which was totally wiped out by the higher State income taxes in Virginia where he moved. He sold his home in Tennessee for $87,500 and purchased one with comparable square footage in northern Virginia for $120,000. His monthly mortgage payment increased from $500 per month to $880 per month. His nonreimbursed moving expenses amounted to $1,650. The cost to this family for a move requested by the Federal Government after all tax deductions and credits were accounted for was a loss of over $5,000 in 1980. Because of the higher mortgage on his new house, he will effectively lose over $1,500 a year in the future.

Mr. President, there is something seriously wrong with a system when a devoted and obviously hard-working Federal employee must pay $5,000 to take a promotion with increased responsibility. Enactment of the bill which I am

introducing would substantially reduce such costs to future relocated Federal and private sector employees.

Finally, the problem with the system is especially evident in my home State of Alaska. Large distances between major population centers require a greater need for mobility. As a result of these large distances, Alaska has had volatile growth characteristics for many years. To adequately perform many aspects of businesses, our people need to have more mobility. Yet, the costs of moving in Alaska are prohibitive. Alaska's economic and employment conditions have worsened in the past 2 years. There are opportunities but people must be able to get to them. Without some form of relief, the depressed areas of the State will worsen, and the areas where opportunities do exist will increase in cost due to the low supply of workers.

Mr. President, this country was and is known as the land of opportunity. Its greatness is directly related to the ability of its people to move to places of opportunity. Prohibitive moving costs restrain mobility and indirectly foreclose opportunity. I urge early consideration of this bill which will remedy serious problems in the relocation of workers in this Nation.

ATTACHMENT C—E-R-C MEMBER COMPANIES

AMF, Inc.
AMP, Inc.
ARA Services, Inc.
Abbott Laboratories
ABEX Corp.
Adria/Warren-Teed Labs, Inc.
Aerojet-General Corp.
Aetna Insurance Co.
Aetna Life & Casualty Co.
Agway, Inc.
Air Canada
Airco, Inc.
Air Products & Chemicals
Albany International Corp.
Allen-Bradley Co.
Allendale Mutual Insurance
Allied Chemical Corp.
Allis-Chalmers Corp.
Alumax, Inc.
Aluminum Co. of America
AMAX, Inc.
Amdahl Corp.
Amerace Corp.
Amerada Hess Corp.
American Air Filter Co.
American Airlines, Inc.
American Bell International
American Broadcasting Cos.
American Bureau of Shipping
American Can Co.
American Cyanamid Co.
American Express Co.
American Hoechst Corp.
American Home Products Co.
American Honda Motor Co.
American Hospital Supply
American International Group
American Standard, Inc.
American Tele. & Tele. Co.
American Thread Co.
Amica Mutual Ins. Co.
Aminoil USA, Inc.
Andersen Corp.
Arthur Andersen & Co.
Anheuser-Busch, Inc.
ARINC Research Corp.
Armco, Inc.
Armour-Dial, Inc.
Armstrong Cork Co.
Arnold Bakers, Inc.
Ashland Oil, Inc.
Atlantic Richfield Co.
Atlas Powder Co.
Automobile Club of Southern California
Avis Rent-A-Car System, Inc.
Babcock & Wilcox Co.
Baker/Beech-Nut Corp.
Michael Baker, Jr., Inc.
Ball Corp.
The Bankers Life
C. R. Bard, Inc.
BASF Wyandotte Corp.
Bausch & Lomb, Inc.
Baxter-Travenol Labs, Inc.
Beatrice Foods Co.
Bechtel Corp.
Becton, Dickinson & Co.
Bell & Howell Co.
Bell System Center for Technical Education
Bell Telephone Co. of Pa.
Bell Telephone Labs, Inc.
Bemis, Co., Inc.
Bendix Corp.
L. M. Berry & Co.
Bethlehem Steel Corp.
Black & Decker Mfg. Co.
Blue Cross of Southern Ca.
Boeringer Ingelheim, Ltd.
The Boeing Co.
Boise Cascade Corp.
Borg-Warner Corp.
Bose Corp.
Boston Edison Co.
Boy Scouts of America
W. H. Brady Co.
Brockway Glass Co., Inc.
Brown Co.
Brown-Forman Distillers Corp.
Brown & Williamson Tobacco
Brunswick Corp.
Bundy Corp.
Bunker-Ramo Corp.
Burlington Northern, Inc.

ATTACHMENT C—E-R-C MEMBER COMPANIES—Continued

Leo Burnett U.S.A.
Burroughs Corp.
H. E. Butt Grocery Co.
CBS, Inc.
CF Industries, Inc.
CH2M Hill
CPC International, Inc.
Cabot Corp.
Calspan Corp.
Cameron Iron Works, Inc.
Campbell Soup Co.
Cargill, Inc.
Carnation Co.
Carter Hawley Hale Stores
Carter-Wallace, Inc.
J. I. Case Co.
Caterpillar Tractor Co.
The Ceco Corp.
Celanese Corp.
Central Soya Co., Inc.
CertainTeed Corp.
Cessna Aircraft Co.
Champion International Corp.
Champion Spark Plug Co.
Champlin Petroleum Co.
Chemetron Corp.
Chemplex Co.
The C & P Telephone Co.
Chesebrough-Pond's, Inc.
The Chessie System
Chicago Bridge & Iron Co.
Chicago & Northwestern Transportation Co.
Chicago Tribune Co.
Chrysler Corp.
Chubb & Son, Inc.
CIB A-GEIGY Corp.
Cincinnati, Inc.
Cities Service Co.
Clopay Corp.
Cobe Laboratories
The Coca-Cola Co.
College Entrance Examination Board
Colorado Interstate Gas Co.
Columbia Gas System Service
Columbus Line, Inc.
Combustion Engineering, Inc.
Commercial Union Assurance
Communications Satellite
Comptroller of the Currency, Administrator of National Banks
Computer Sciences Corp.
ConAgra, Inc.
Connecticut General Life Insurance Co.
Consolidated Natural Gas Service Co., Inc.
Consolidated Papers, Inc.
Consolidated Rail Corp.
Consumers Power Co.
Container Corp. of America
Continental Can Co., U.S.A.
Continental Casualty Co.
Continental Grain Co.
Continental Oil Co.
Control Data Corp.
Conwed Corp.
Cooper Laboratories, Inc.
Coopers & Lybrand
Adolph Coors Co.
Corning Glass Works
Council on Foundations, Inc.
Crown Zellerbach Corp.
Cummins Engine Co., Inc.
Curtiss-Wright Corp.
Cutler-Hammer, Inc.
Dames & Moore
Dane Corp.
Datapoint Corp.
Deere & Co.
Del Monte Corp.
Deloitte Haskins & Sells
Deluxe Check Printers, Inc.
Denny's, Inc.
Dentsply International, Inc.
Department of Housing & Urban Development
Desoto, Inc.
The Detroit Edison Co.
Diamond Shamrock Corp.
Dictaphone Corp.
Digital Equipment Corp.
Walt Disney World Co.
Dow Chemical Co.
Dow Corning Corp.
The Drackett Co.
Dravo Corp.
Dresser Industries, Inc.
Duplex Products Inc.
E. I. duPont de Nemours & Co.
EMI Technology
ESB Inc.
Eastern Airlines, Inc.
Eastman Kodak Co.
Eaton Corp.
Ebasco Services Inc.
Economics Laboratory, Inc.
Electric Power Research Institute
Electronic Data Systems Corp.
Elgin Leach Corp.
El Paso Natural Gas Building Co.
Emerson Electric Corp.
Emery Air Freight Corp.
Emery Industries
Emhart Corp.
Employers Insurance of Wausau
Envirotech Corp.
Equifax, Inc.
Ernst & Ernst
Esmark, Inc.
Ethyl Corp.
Exxon Corp.
FMC Corp.
Fatnir Bearing Div. of Textron, Inc.
Farmers Inurance Group
Federal Deposit Insurance Corp.
FedMart
Fiat-Allis Construction Machinery Inc.
Fieldcrest Mills, Inc.
Fireman's Fund Insurance Co.
Firestone Tire & Rubber Co.
Fleming Cos., Inc.
Flintkote Supply Co.

ATTACHMENT C—E-R-O MEMBER COMPANIES—Continued

Fluor Corp.
Ford Motor Co.
Foremost-McKesson, Inc.
Friendly Ice Cream Corp.
Fruin-Colnon Corp.
GAF Corp.
GTE Service Corp.
The Gates Rubber Co.
General Accident Group
General Battery Corp.
General Electric Co.
General Foods Corp.
General Mills, Inc.
General Motors Corp.
General Services Admin.
General Telephone Co. of the Midwest
General Telephone Co. of the Southwest
General Tire & Rubber Co.
Gerber Products Co.
The Gillette Co.
Glass Containers Corp.
Globe-Union, Inc.
Goldman, Sachs, & Co.
B.F. Goodrich Co.
Goodyear Tire & Rubber Co.
W.R. Grace & Co.
Graphic Controls Corp.
Great Lakes Carbon Corp.
Great Northern Nekoosa Corp.
Green Giant Co.
Grumman Aerospace Corp.
Gulf Oil Corp.
Hanes Knitwear Division
John H. Harland Co.
Harris Corp.
The Hartford Insurance Group
Hartford Steam Boiler Inspection & Insurance Co.
Hartz Mountain Corp.
Hennessy Industries, Inc.
Hercules, Inc.
Heublein, Inc.
Hewlett-Packard Co.
Hobart Corp.
Hoffmann-LaRoche Inc.
Holiday Inns, Inc.
Homelite, Div. of Textron
Honeywell, Inc.
George A. Hormel & Co.
Host International, Inc.
Hughes Aircraft Co.
Husky Oil Co.
Hyatt Corp.
ICI United States, Inc.
IU International Management
INA Corp.
Itel Corp.
Illinois Bell Telephone Co.
Illinois Central Gulf Railroad
Illinois Tool Works, Inc.
IMCO Services
Indiana Bell Telephone Co.
Ingersoll-Rand Co.
Inmont Corp.
Intercraft Industries Corp.
Interlake, Inc.
International Business Machines Corp.
International Harvester
International Multifoods
International Nickel Co.
International Paper Co.
International Telephone & Telegraph
Jewel Cos., Inc.
Johns-Manville Corp.
Johnson & Higgins
S. C. Johnson & Son, Inc.
Johnson & Johnson
Jones & Laughlin Steel Corp.
KDI Corp.
Kaiser Aluminum & Chemical
Kaiser Steel Corp.
Keebler Co.
Kellogg Co.
Kemper Insurance Cos.
The Kendall Co.
Kennecott Copper Corp.
Kimberly-Clark Corp.
Koppers Co., Inc.
Kraft, Inc.
The Kroger Co.
Kutar Rock & Huie
The LTV Corp.
Lehn & Fink Products Co.
Libby, McNeill & Libby, Inc.
Libbey-Owens-Ford Co.
Liberty Mutual Insurance Co.
Liggett & Myers, Inc.
Eli Lilly & Co.
Lindsley Lumber Co.
Thomas J. Lipton, Inc.
Lockheed-Georgia Co.
Loctite Corp.
Lukens Steel Co.
M&M/MARS, Inc.
MacDermid, Inc.
Mallinckrodt, Inc.
Horace Mann Educators Corp.
Manpower, Inc.
Manufacturers Life Ins. Co.
Marathon Oil Co.
Marion Laboratories, Inc.
Marriott Corp.
Marsh & McLennan, Inc.
Martin Marietta Corp.
Masonite Corp.
Massachusetts Mutual Life Insurance Co.
Massey-Ferguson, Inc.
Mattel, Inc.
Oscar Mayer & Co. Inc.
McCullouch Industries, Inc.
J. Ray McDermott & Co., Inc.
McDonald's Corp.
McDonnell Douglas Corp.
McGraw-Edison Co.
McGraw-Hill, Inc.
The Mead Corp.
F. W. Means & Co.
Medtronic, Inc.

ATTACHMENT C—E-R-C MEMBER COMPANIES—Continued

Medusa Corp.
Memorex Corp.
Merck & Co., Inc.
Metropolitan Life Ins. Co.
Metropolitan Property & Liability Ins. Co.
Michelin Tire Corp.
Michigan Bell Telephone Co.
Michigan Consolidated Gas Co.
Midas-International Corp.
Miles Laboratories
Miller Brewing Co.
Mitchell Energy and Development Corp.
Mitre Corp.
Mobay Chemical Co.
Mobil Oil Corp.
Mohasco Corp.
Monsanto Co.
Moore Business Forms, Inc.
Morton-Norwich Products, Inc.
Motorola, Inc.
Mountain Bell Telephone
NRC Corp.
NL Industries
Nabisco, Inc.
Nalco Chemical Co.
National Bulk Carriers, Inc.
National Can Corp.
National Car Rental Systems
National Distillers and Chemical Corp.
National Steel Corp.
Nationwide Mutual Insurance
Natural Gas Pipeline Co.
The Nestle Co., Inc.
New England Mutual Life
New England Telephone
New Jersey Bell Telephone
New York Life Insurance Co.
New York Telephone
Niagara Mohawk Power Corp.
NIBCO, Inc.
A. C. Nielsen Co.
Nordson Corp.
Norris Industries
North American Philips Corp.
Northern Indiana Public Service Co.
Northern Natural Gas Co.
Northern Petrochemical Co.
Ohio Bell Telephone Co.
Olin Corp.
Onan Corp.
Otis Elevator Co.
Owens-Corning Fiberglas
Owens-Illinois, Inc.
PCA International, Inc.
PPG Industries, Inc.
Pacific Gas & Electric Co.
Pacific Northwest Bell
Pacific Telephone Co.
Packaging Corp. of America
Pan American World Airways
Parke, Davis & Co.
Ralph M. Parsons Co.
Payless Drug Stores Northwest, Inc.
Peat, Marwick, Mitchell & Co.
Peavy Co.
J. C. Penney Co.
Pennsylvania Power & Light
Pennwalt Corp.
Pennzoil Co.
Permutit Co.
Pfizer, Inc.
Pharmacia, Inc.
Phelps Dodge Corp.
Philip Morris Industrial
Philip Morris International
Phillips Petroleum Co.
The Pillsbury Co.
Pinkerton's, Inc.
Piper Aircraft Corp.
Pitney-Bowes, Inc.
Polaroid Corp.
Polysar Limited
Potlatch Corp.
Premier Industrial Corp.
Price Waterhouse & Co.
The Procter & Gamble Co.
Prudential Insurance Co.
Public Service Electric & Gas Co.
Pullman, Inc.
Quaker Oats Co.
Quasar
RCA Corp.
Ralston Purina Co.
Rand McNally & Co.
Raymond International, Inc.
Raytheon Co.
Red Lobster Inns of America
Reliance Insurance Cos.
Republic Steel Corp.
Resource Sciences Corp.
Rexnord, Inc.
R. J. Reynolds Industries
Rheem Manufacturing Co.
Richardson-Merrell, Inc.
Roadway Express, Inc.
Robertshaw Controls Co.
H. H. Robertson Co.
A. H. Robins Co., Inc.
Rockwell International
Rocky Mountain Bank Note
Rohm and Haas Co.
Rohr Industries, Inc.
Rolls-Royce Motors, Inc.
Rosemount, Inc.
Royal-Globe Insurance Cos.
Joseph T. Ryerson & Son
SCM Corp.
Saga Corp.
St. Regis Paper Co.
Sambo's Restaurants, Inc.
Samso

ATTACHMENT C—E-R-C MEMBER COMPANIES—Continued

Sandia Laboratories
Sandoz, Inc.
Sangamo Weston, Inc.
Saxon Industries, Inc.
Schering-Plough Corp.
Jos. Schlitz Brewing Co.
Schulumberger Limited
L. D. Schreiber Cheese Co.
O. M. Scott & Sons Co.
Scott Paper Co.
Scovill Manufacturing Co.
Joseph E. Seagram & Sons
Seaboard Surety Co.
G.D. Searle & Co.
Sentry Insurance
Shell Oil Co.
Sherwin-Williams Co.
Signode Corp.
Singer Co.
Skil Corp.
SmithKline Corp.
Social Security Admin.
Sonoco Products Co.
Sony Corp. of America
South Central Bell
Southern Bill Telephone Co.
Southern Natural Gas Co.
Southern Railway System
Southwestern Bell Telephone
Spectron Corp.
Spencer Gifts, Inc.
The Sperry & Hutchinson Co.
Sperry New Holland
Sperry Univac
Sperry Vickers
E.R. Squibb & Sons, Inc.
Standard Brands, Inc.
Standard Oil Co. of Ca.
Standard Oil Co. (Indiana)
Standard Oil Co. (Ohio)
The Stanley Works
State Farm Insurance Cos.
Stauffer Chemical Co.
Steelcase, Inc.
J.P. Stevens & Co., Inc.
Levi Strauss & Co.
Stromberg-Carlson Corp.
Sun Chemical Corp.
Sun Co., Inc.
Sundstrand Corp.
Sunkist Growers, Inc.
Superior Surgical Mfg. Co.
Sybron Corp.
Syntex Corp.
System Development Corp.
TRW Systems Group, TRW, Inc.
Talon Division of Textron
Target Stores, Inc.
Technicon Instruments Corp.
Technicon Medical Information Systems Corp.
Tektronix, Inc.
Tenneco, Inc.
Teradyne, Inc.
Texaco, Inc.
Texas Eastern Transmission
Texas Gulf, Inc.
Texas Instruments Inc.
3M Co.
Time, Inc.
The Timken Co.
Toyota Motor Sales, Inc.
Trans Union Corp.
Travelers Insurance Co.
Travenol Laboratories Int'l.
20th Century-Fox Film Corp.
U.S. News & World Report, Inc.
USV Pharmaceutical Corp.
Unigard Mutual Insurance Co.
Union Camp Corp.
Union Carbide Corp.
Union Mutual Life Insurance.
Union Pacific Railroad Co.
Uniroyal, Inc.
United Air Lines
United Brands, Inc.
United Parcel Service, Inc.
U.S. Steel Corp.
United Technologies Corp.
Universal Foods Corp.
The Upjohn Co.
Varian Associates
Vetco, Inc.
Vydec, Inc.
Wagner Electric Corp.
Walker Manufacturing Co.
Montgomery Ward & Co.
Warner-Lambert Co.
Welch Foods, Inc.
Wescom, Inc.
Western Electric Co.
Western International Hotels
Westinghouse Electric Corp.
Roy F. Weston, Inc.
West-Point Pepperell, Inc.
Westvaco Corp.
Weyerhaeuser Co.
Wheelabrator-Frye Inc.
Wheeling Pittsburgh Steel Corp.
The Wickes Corp.
Wm. Wrigley Jr. Co.
The Williams Cos.
Wisconsin Telephone Co.
Worcester Controls Corp.
X-L Co., Inc.
Xerox Corp.
Youngstown Sheet and Tube Co.
Zenith Radio Corp.

STATEMENTS OF JOHN E. OTTO, EXECUTIVE ASSISTANT DIRECTOR OF THE FEDERAL BUREAU OF INVESTIGATION; FREDERICK RODY, DEPUTY ADMINISTRATOR FOR THE DRUG ENFORCEMENT ADMINISTRATION; G. JERRY SHAW, PRESIDENT OF THE SENIOR EXECUTIVE ASSOCIATION; AND WILLIAM D. NORTH, SENIOR VICE PRESIDENT AND CHIEF COUNSEL, NATIONAL ASSOCIATION OF REALTORS

Senator PACKWOOD. Mr. Otto, do you want to start?

Mr. OTTO. Yes, sir. Thank you, Mr. Chairman.

I am the Executive Assistant Director in Charge of Law Enforcement Services for the FBI. I am also the Chairman of the FBI's Career Board. As such, I make recommendations to the Director in connection with all of our career development promotions. Usually these promotions involve geographic relocations and transfers.

I, myself, in a 16-year career, have had 10 transfers, not only in connection with investigative assignments, but also in connection with administrative assignments.

I would like to begin by saying that the taxation of reimbursements for expenses incurred in connection with moves is of grave concern to the FBI as will be demonstrated.

Last year we made approximately 320 career development promotions or transfers and overall in the neighborhood of 1,000 total transfers for investigative and administrative purposes.

We believe that the relocation of our managers is especially important because we have to have a national frame of reference or national perspective in the type of work we do.

Although we are concerned with all financial hardships borne by our agents when they are transferred, we are most concerned with the taxation of reimbursements which are made in connection with these transfers.

A random survey of 50 agent transfers revealed that all of these agents exceeded the $3,000 maximum on deductions with one agent exceeding it by approximately $20,000.*

We estimate that in fiscal year 1982, the average transfer of an agent in our career development program will cost over $12,000.

After taking a $3,000 maximum deduction, the average agent will find that his or her taxable income could be increased by as much as $9,000 which is not disposable income.

This agent will further find that he or she is paying taxes on their income at a higher rate due to this increase.

Because these agents are taxed on these reimbursements, the net effect is that their reimbursement is reduced by the amount of the additional tax liability which is incurred.

We are convinced that this tax liability will continue to grow.

It is interesting to note some of the results of a recent survey of our managers at the supergrade level, GS-16 and above. In part, this survey dealt with the effects of promotions and related transfers on their financial life.

A large number of survey respondents mentioned the additional tax liability which occurs when Government reimbursements exceed the $3,000 deduction.

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* See also the contents of this hearing for a subsequent letter received from the FBI.

The additional tax burden on each of these managers averaged over $3,000, nearly $4,000.

This resulted in a reduction of already inadequate reimbursements, and invariably in the individual being pushed into an artificially higher tax bracket.

From personal experience, from just having completed my returns this past year and having sustained a transfer from the Chicago office, it made a difference of being in a 43 percent or 49 percent income tax bracket, an artificial level.

Thank you, sir.

Senator PACKWOOD. The only statement I would disagree with, I hope, is that the tax situation is going to get worse. If the President has his way it will get slightly better. It is not going to alleviate the problem you now face, but I hope it is not going to get worse than the present problem.

Mr. Rody.

Mr. RODY. Mr. Chairman, my name is Frederick A. Rody, Jr. I am Deputy Administrator of the Drug Enforcement Administration. I have no prepared text. But I join my colleague, Mr. Otto, in echoing the concerns expressed by him as it relates to the hardship, financial hardship, to our agents.

I might add that we are a little different from the FBI. DEA is confronted with what we call a required mobility policy. Before we will permit employees to come in to our service, they have to sign that they are agreeable to transfer. This applies to all our core employees; that is, special agents, compliance investigators, intelligence analysts, and chemists.

We feel this is necessary to carry out our mission, our statutory mandate, in order to meet the changing drug trends, in order to provide security to our agents, a large number of whom work undercover.

As an example, last week we closed an operation in Miami, called Operation Grouper, with the arrest of approximately 135 defendants. We immediately had to transfer six of the undercover agents from that area.

Lastly, we feel mobility is necessary to enhance our organization and our management process by placing our best qualified and most experienced people in those key critical positions.

The options available to us otherwise would, of course, be to discontinue such a policy; however, we believe this would adversely affect the carrying out of our mission. We don't believe that we would be able to adequately protect agents' safety who work in these sometimes extremely dangerous atmospheres. We don't believe that we would have the best managers in the key places.

I can also echo my colleague's experience, having 25 years of service, having moved some seven times, and two times since 1978, from Seattle to Miami and in turn from Miami to Washington, D.C.

I assure you, Mr. Chairman, there are financial hardships associated with those moves.

Senator PACKWOOD. There are. In my part of the Federal Government, we hope not to move as often as that. [Laughter.]

Mr. Shaw.

Mr. SHAW. Mr. Chairman, the Senior Executives Association which I am representing is a professional, nonprofit corporation, formed by

members of the Senior Executive Service and supergrade employees of the Federal Government. We are committed to efficient and effective leadership in Government by competent and professional career executives.

While we view the pay cap as being the single most significant issue concerning the continuing ability of the Federal Government to retain and to recruit competent executives and top-level managers, the nondeductibility of certain moving expenses is probably the second most significant issue at this time.

Because of inadequate expense reimbursements and nondeductible moving expenses incurred in moves solely made for the convenience of the Government, it is unrealistic to expect Government employees to continue to make these moves to positions of more responsibility and at the same time incur substantial losses in doing so.

These problems in the Government service are exacerbated versus that in private industry, since the Government does not have the flexibility to adjust compensation for employees' moves as economic conditions change.

For instance, many private employers arrange for the purchase of employees' homes, reimburse almost all costs incurred which arise from a move required by the employer and provide bonuses to reimburse employees for State, local, and Federal taxes incurred.

The private employers who testified before state that they do so.

In many cases, these employers also provide arrangements to financially shield employees from increased mortgage interest rates between their old and new duty locations.

Federal employees do not have access to most of these benefits, although they do incur the same costs.

Regarding the issue specifically before you today, we fully support S. 565, with several minor modifications. It has been our experience, and confirmed by several studies that the limitations in section (a) (1), of $1,500, is inadequate to cover premove travel, meals and lodging, and searching for a new residence and temporary living expenses.

The inadequacy of this amount is caused by the effects of inflation from 1969, when this provision was enacted.

Our recommendation is that that dollar amount be increased to $2,500.

We agree with the Treasury Department that they should be given the necessary legal authority to make adjustments in that amount when necessary.

We fully support the provisions in S. 565 to increase the limits on the deduction of qualified resident expenses to the maximum reimbursement allowed Federal employees for such expenses, presently $12,000.

We are of the opinion that tying the deduction into the maximum reimbursement allowed Federal employees will be a conservative approach and only allow reasonable amounts to be deducted.

We have had a number of executives who are required to move by their Federal employer recently. Most of these executives have informed us that they will resign, retire, or request removal from the executive cadre before they will undertake another move.

The same executives have advised us that if they were forced to move again in the foreseeable future they would have no alternative but to file for bankruptcy.

Mr. Chairman, it is obvious that the actual costs of moving far exceed the current tax deductible limits, and thus, an amendment is appropriate.

This is especially true for Government employees who are required to move and do so only to discover that severe losses are sustained due to inadequate reimbursement and the further sacrifice they find when they prepare their tax return and find their losses are increased substantially since they must pay income taxes on all reimbursements in excess of $3,000.

It is obvious that this inequity has negatively impacted on the Government's ability to successfully attract and retain the most competent staff necessary to maintain the efficiency and effectiveness of its operations.

Thank you.

Senator PACKWOOD. Thank you very much.

We will conclude with Mr. North.

Mr. NORTH. Senator, my name is Bill North. I am general counsel and senior vice president of the National Association of Realtors.

The National Association of Realtors has filed a prepared statement. I would only like to add certain points of stress.

The National Association exists by reason of the mobility of the American people. We believe that the American people are the most valuable asset that this country has in terms of its productivity.

We believe that it is a measure of productivity and that a valuable resource like our human resources should be readily mobile if they are to be optimally used.

We believe that S. 565 will improve the mobility of our productive population, and thereby avoid the cost of labor turnover, retraining, recruitment costs and minimize on employment.

We think there is an additional reason S. 565 deserves enactment and that is to better facilitate access of small business to available employment resources.

The large, heavily capitalized businesses which frequently relocate employees, have, as you have heard earlier in the panel, long established programs under which they ameliorate the costs of relocation.

But, many of the small, under capitalized corporations that are trying to become established, trying to establish a nationwide identity, find it extremely difficult to transfer key employees to other locations where they can be of optimum use.

There is a third reason, however, that S. 565 deserves enactment and that is our concern with the discrimination which has occurred as a result of certain IRS policies and rulings which have created a type of alchemy whereby you can convert a nondeductible moving expense into deductible expenses by merely causing the property to be sold to a third-party home-buying company and then paying that company's fees and costs of purchase.

As a consequence of this, there have been many thousands of people who would like to have sold their own home on their own terms, have been compelled for tax reasons, income reasons to utilize the services of third-party companies at an additional expense.

We feel that S. 565 will help very much in this situation.

Thank you.

[Prepared statements of Messrs. Otto, Shaw, and North, follow:]

STATEMENT OF JOHN E. OTTO, EXECUTIVE ASSISTANT DIRECTOR, FEDERAL BUREAU OF INVESTIGATION

Mr. Chairman, I am the Executive Assistant Director for Law Enforcement Services for the Federal Bureau of Investigation (FBI). I am also the Chairman of the FBI Career Board. In that capacity, I make recommendations to the Director of the FBI on all promotions to positions up to and including the position of Assistant Director. In my present capacity, and as an individual who has made ten transfers in my sixteen years of FBI service, I am very familiar with both the financial and emotional hardships which are a part of any move as a Government employee. I therefore appreciate, on behalf of myself and the approximately 7,750 Special Agents, the opportunity to share with you some of the financial problems which our Agents face when they are transferred.

This morning I would like to focus my remarks on the transfers which we make through our Career Development Program, however, the problems that I will highlight are evident in any transfer which we make. Our Career Development Program governs the promotion and administrative advancement procedures for Special Agents.

We have 59 Field Offices and 438 Resident Agencies (sub-offices under the Field Offices) throughout the Nation in addition to FBI Headquarters here in Washington which must be staffed. Although we are promoting in place when possible in the interest of efficiency and relieving some of the hardships on our Agents, the filling of most of our supervisory vacancies involves a transfer because of our desire after careful consideration to nationalize rather than regionalize the management of the FBI.

In general it has been the experience of our Agents that there are substantial hardships, including financial hardships, which are associated with a transfer from one geographic location to another. The financial hardships are aggravated by the fact that inadequate reimbursements for transfer expenses are taxed as ordinary income when they exceed $3,000.

In late 1979 a survey of Special Agents in Charge of seven of our major Field Offices elicited responses from all seven on the deleterious effect of transfers on the Career Development Program. These SAC's estimated that only about one-third of the FBI Special Agents with management aptitude were participating in the Career Development Program, largely because of the financial hardships associated with transfers. Due to the costs involved, many of our Agents including many who are involved in the Career Development Program view moves which are a necessary part of the program as being financially punitive and at times ruinous. As I noted above, our Agents are finding that it is becoming more difficult financially for them to move especially when they make a lateral move at no increase in salary and in the process must buy a home with a higher interest rate and absorb many of the costs associated with the move. Monthly mortgage payments in excess of $1,200 are no longer uncommon for these Agents.

Although we are concerned with all financial hardships borne by our Agents when they are transferred, the area that we are most concerned with is the taxation of reimbursements which are made in connection with transfers. Unless so noted, the data on this problem is not limited to our Career Development transfers. We find that 100 percent of our transferred Agents exceed the $3,000 tax deduction limit for expenses incurred in connection with a move. These figures were based upon a random survey of 50 FBI Special Agent transfers. All of these Agents exceeded the $3,000 limit with one Agent exceeding it by $19,330. The average cost of these 50 transfers was $9,026. Therefore, the average Agent of this group who was transferred faced an increased tax liability on over $6,000 in income in addition to certain non-reimbursable expenses. During Fiscal Year 1979 the Bureau transferred 1,383 employees (1,297 Special Agents and 86 support employees) at a total cost of $8,552,300.

Although we know that the average transfer during fiscal year 1979 cost $6,183 and that the taxable income of the average transferred Agent was increased as a result of the transfer by $3,183, we know that many of our Agents incurred larger, additional tax liabilities as a result of these moves. We know that we have a number of single or younger, married Agents who move from rental property to rental property and thus incur few expenses. These moves hold down the average costs. On the other hand we have many Agents with families whose moves cost $8,000 to $12,000 in reimbursable expenses thereby increasing their taxable income by $5,000 to $9,000. Our Budget and Accounting Section recently sampled 100 transfers which occurred during fiscal year 1979. When inflation factors were applied it was estimated that in fiscal year 1982 the average Career Development

transfer will cost $12,933. After taking a $3,000 deduction this Agent will find that his taxable income has been increased by $9,933 which is not disposable income. He will further find that he is paying taxes on his income at a higher tax rate due to this increase. Because these Agents are taxed on these reimbursements, the net effect is that their reimbursement is reduced by the amount of the additional tax liability which they incur. We are convinced that this tax liability will continue to increase.

We recently conducted a survey of all of our managers at the GS-16, 17, and 18 level. The purpose of this survey was to obtain information on their progression through the administrative ranks and to discover the effect that this advancement has had on their financial situation, their family life, and their perceptions of career advancement. In assessing the impact of moves on their financial situations a large number of the survey respondents mentioned the additional tax liability which occurs when Government reimbursements exceed the $3,000 deduction. The additional tax burden on each of these respondents averaged $3,860. This resulted in a reduction of already inadequate reimbursements and invariably in the individual being pushed into an artificially higher tax bracket. The survey also revealed that 42 percent of the respondents incurred an average loss of $6,450 per transfer including tax losses.

Although I have not been able to discuss all of the problems which we have identified, I have been able to highlight the major financial problem associated with a transfer. Before I close I want to focus for a moment on the emotional costs because our Agents have found that moving is both an emotional and financial hardship on both them and their families. The emotional costs are self-evident. A transfer takes the Agent, the Agent's spouse and children away from familiar surroundings in which they feel secure and where they have developed a circle of friends. They must then begin anew to develop this security and the human relationships that they had. After several of these moves, some children tend to not want to establish close relationships with people since they anticipate the pain of having to leave.

Working spouses must begin the stressful task of job hunting. Many non-working wives feel the loss of familiarity and security to an even larger extent. Much of the responsibility for finding new doctors, dentists, places to shop, churches and areas of recreation falls upon them. Although it would be difficult and perhaps impossible for us to alleviate these hardships, we can reduce the financial hardships and in so doing reduce the emotional strain on these families. In closing my remarks, I want to thank you for your interest in these matters which are of such great concern to us.

By a letter dated March 5, 1981, Senator Stevens has advised us that any examples which we might have regarding these problems would be helpful in the Senate's efforts to remedy this situation. If you are also interested in this information we will provide you with the same examples.

I will now be happy to answer any questions which you have on this matter.

SUMMARY OF STATEMENT, G. JERRY SHAW, PRESIDENT, SENIOR EXECUTIVES ASSOCIATION

SUMMARY

The Senior Executives Association, which I am representing, is a professional non-profit corporation formed in the Fall of 1980 by members of the Senior Executive Service and Supergrade Executives of the federal government. The Association is committed to efficient and effective leadership in Government by competent and professional career executives.

We feel we are eminently qualified to testify regarding the deductibility of moving expenses since our officers and members are participants of the elite Senior Executive Service and Supergrade Executive cadre.

While we view the pay cap as being the single most significant issue concerning the continuing ability of the Federal Government to recruit competent executives and top-level managers, the non-deductibility of certain moving expenses is probably the second most significant issue at this time. Because of inadequate expense reimbursements and non-deductible moving expenses that were incurred solely for the convenience of the government, it is unrealistic to expect that government employees will continue to make geographic moves to positions of

more responsibility and incur substantial losses. In the larger sense, these are losses that public servants are absorbing to promote the public interest.

These problems in government service are exacerbated since the government does not have the flexibility of private industry to compensate employee moves as economic conditions change. For instance, many private employers arrange for the purchase of employees' homes, reimburse almost all costs incurred which arise from moves required by the employer, and provide bonuses to reimburse employees for state, local and federal taxes incurred. In many cases, these employers also provide arrangements to financially shield employees from increased mortgage interest rates between their old and new duty locations. Federal employees do not have access to most of these benefits although they do incur the same costs.

Regarding the issue specifically before us today, we fully support S. 565 with several minor modifications. It has been our experience and confirmed by several studies that the limitations in section (A)(i) of $1,500 is inadequate to (1) cover premove travel, (2) meals and lodgings in searching for a new residence, and (3) temporary living expenses in the new location for a period of 30 days. The inadequacy of this amount is caused from the effects of inflation since the time that section 217(b)(3)(A) was added to the Internal Revenue Code in the 1960's. Since 1969, the Consumer Price Index has increased by more than 130 percent. Our recommendation is that the dollar amount in section (A)(i) be increased to $2,500 and reevaluated periodically to remain in step with the cost of living.

We fully support the provisions in S. 565 to increase the limits on the deduction of qualified residence expenses to the maximum reimbursement allowed Federal employees for such expenses, presently $12,000. We are of the opinion that tying the deduction into the maximum reimbursement allowed Federal employees will allow a conservative approach and reasonable amounts to be deducted.

It is estimated that during 1979 the Federal Government moved over 100,000 people. It is safe to assume that most of the moves required employees to pay additional income tax on moving reimbursements in excess of the current limitations contained in section 217 of the Internal Revenue Code. In effect, the additional taxes paid are a "tax on mobility".

The Director of the Office of Personnel Management, in a memorandum to the Secretary of the Treasury dated August 4, 1980, stated as follows: "Top officials are concerned that relocation policies are having a negative impact on the efficiency and effectiveness of the Federal service. . . ."

We have had a number of executives who were required to move by their Federal employer. Most of these executives have informed us they will resign, retire or request removal from the executive cadre before they will undertake another move. These same executives have advised us that if they are forced to move again in the foreseeable future, they will have no alternative but to file for bankruptcy if the move is consummated.

Mr. Chairman, it is obvious that the actual costs of moving far exceed the current tax deductible limits for job-related moves provided by section 217 of the Internal Revenue Code.

This is especially true for Government employees who are required to move and do so only to discover that severe losses are sustained due to inadequate reimbursement, and the further sacrifice when they prepare their tax return and find their losses are increased substantially since they must pay income taxes on most reimbursements in excess of $3,000. It is obvious that this inequity has negatively impacted on the Government's ability to successfully attract and retain the most competent staff necessary to maintain the efficiency and effectiveness of the Federal Government.

Statement of G. Jerry Shaw, President, Senior Executives Association

Mr. Chairman and distinguished members of this committee, it is an honor and a pleasure to have the opportunity to appear before you today. We thank you for initiating these hearings regarding the deductibility of moving expenses since we feel this issue is causing serious problems for private industry and almost disaster for federal agencies and Departments.

The Senior Executive Association, which I am representing, is a professional nonprofit corporation formed in the fall of 1980 by members of the Senior Executive Service and Supergrade Executives of the Federal Government. The association is committed to efficient and effective leadership in Government by competent and professional career executives. We are dedicated to obtaining

adequate pay, training, benefits, and recognition for the approximately 7,000 career senior executives, who manage the Federal agencies and bureaus on a day-to-day basis, who implement the laws, policies, and initiatives of our political leadership, and who provide executive direction to the Federal workforce numbering in excess of 2 million employees. One of the primary problems standing in the way of retention of our most experienced and competent executives is the issue before you today.

We feel we are eminently qualified to testify regarding the inadequacy of the current deductibility of moving expense provisions of the code, since our officers and members are participants in the elite Senior Executive Service and supergrade executive cadre, and as such, have and are being literally required to move "at the drop of a hat" for the convenience of the Government. In addition to our personal experiences with geographic moves, we are acutely aware of the problems being encountered in recruiting highly qualified top- and mid-level managers when the job would require them to make a geographic move. These highly qualified candidates do not want the positions because of the resulting net economic losses they would sustain which consist primarily of the nondeductibility of moving expense reimbursements.

While we view the pay cap as being the single most significant issue affecting the Federal Government's ability to recruit and keep competent executives, the nondeductibility of many moving expenses is certainly in second place. It is unrealistic to expect that Government employees will continue to make geographic moves to positions of more responsibility when necessary and also be willing to continue to absorb significant economic losses.

I am sure you have recevied or will receive testimony from the private sector regarding the impact of the nondeductibility of moving expenses and the resulting unnecessary increase in their cost of doing business. But there is a potentially more significant problem of restricting productivity by creating barriers to the deployment of a corporation's most valuable asset—its human resources.

The problems in Government service are exacerbated since we do not have the flexibility of private industry to automatically increase compensation for employee moves as economic conditions change. For instance, many large private employers now arrange for the purchase of employees' homes, reimburse almost all costs incurred which arise from moves required by the employer, and provide bonuses to reimburse employees for State, local, and Federal taxes incurred. In many cases, these employers also provide arrangements to financially reimburse employees for increased mortgage interest rates between their old and new duty locations. Federal employees do not have access to most of these benefits, but, they do incur the same costs.

We fully support S. 565 with some minor modifications. It has been our experience, confirmed by several studies, that the limitations in section (A)(i) of $1,500 is inadequate to cover premove travel, meals and lodgings in searching for a new residence, and temporary living expenses in the new location for a period of 30 days. The inadequacy of this amount is a result of the effects of inflation since the time section 217(b)(3)(A) was added to the Internal Revenue Code in the 1960's. Since 1969, the Consumer Price Index has increased by more than 130 percent, and $1,500 just doesn't buy what it used to. We recommend that the dollar amount in section (A)(i) be increased to $2,500 and reevaluated periodically to remain in step with the cost of living.

We fully support the provisions in S. 565 to increase the limits on the deduction of qualified residence expenses to the maximum reimbursement allowed Federal employees for such expenses, presently $12,000. The provision that this deduction will not be reduced by deductions for other indirect moving expenses is equitable, and will substantially reduce losses being incurred for moves for benefit of the employer. We are of the opinion that tying the deduction into the maximum reimbursement allowed federal employees is a conservative approach, and will result in only reasonable amounts being deducted.

For the remainder of this statement, I would like to summarize some specific cases and studies that emphasize the need for S. 565, particularly as it impacts on federal employees.

It is estimated that during 1979 the federal government moved over 100,000 people. It is safe to assume that most of the moves required employees to pay additional income tax on moving reimbursements in excess of the current limitations contained in Section 217 of the Internal Revenue Code. In effect, the additional taxes paid are a "tax on mobility". A random sample of 50 FBI

Special Agents who were transferred during fiscal year 1979 indicated that 100 percent of these transferred exceeded the $3,000 deduction. Assistant Attorney General, Alan A. Parker, estimated that during fiscal year 1982 the average cost of the transfer in the FBI Career Development Program will cost $12,933 and after taking a $3,000 deduction, each Agent's taxable income would be increased by approximately $9,000. The taxation of these reimbursements for expenses incurred is grossly unfair in light of other pay restrictions government executives must endure.

The Director of the Office of Personnel Management, in a memorandum to the Secretary of the Treasury, dated August 4, 1980, stated as follows: "Top officials are concerned that relocation policies are having a negative impact on the efficiency and effectiveness of the Federal service . . . Tax policies are frequently cited as a disincentive to geographic mobility . . . Since real estate costs alone normally exceed $3,000, employees who move for the benefit of the employer find that they have assumed a substantial tax burden." I feel it significant that the Director of OPM also stated in his memorandum that "The Internal Revenue Service is one of several federal agencies which has requested us to re-evaluate relocation practices."

We have had a number of executives who were required to move by their federal employer complain to us about their escalating moving costs and the inadequate reimbursements, and then paying additional income tax for the reimbursements they did receive. Most of these moves were payless promotions resulting in increased responsibility with no increased pay. The result was to make relocation for the benefit of the government an expensive proposition. Most of these executives have informed us they will resign, retire or request removal from the executive cadre before they will undertake another move, because if they were moved again in the foreseeable future, they would have no alternative but to file for bankruptcy. Two recent examples that vividly come to mind involved executives whose losses exceeded $12,000 and $25,000 respectively on their last moves.

Mr. Chairman, it is obvious that the actual costs of moving far exceed the current tax deductible limits for job-related moves provided by Section 217 of the Internal Revenue Code and that this inequity has negatively impacted on the Government's ability to successfully attract and retain the competent staff necessary to maintain the efficiency and effectiveness of the federal government.

We, therefore, strongly urge that S. 565 be enacted into law with the amendment we suggested, of raising the $1,500 limitation of 26 USC 217(b)(3)(A)(i) to $2,500.

I thank the committee for the privilege of appearing before you. I will be pleased to answer any questions.

Statement on Behalf of the National Association of Realtors

My name is William D. North, I am Senior Vice President and General Counsel of the National Association of Realtors. The National Association represents some 750,000 men and women who are engaged in or concerned with the purchase, sale, management, appraisal, and development of real estate. The National Association is also a spokesman for many of the chief concerns of American homeowners who now comprise more than 65% of American households.

The National Association of Realtors supports S. 565, introduced by Senator Ted Stevens (R–AK), for three basic reasons, each of which independently would more than justify enactment, but which, collectively, make enactment an equitable and economic imperative.

The first reason S. 565 deserves enactment is the salutary effect it would have on employee opportunity and productivity. By reducing the effective cost of moving, S. 565 would encourage employers to relocate employees rather than release them when their jobs can be better performed elsewhere. At the same time, and for the same reason, S. 565 would make it economically possible for a larger number of men and women to accept job opportunities they would otherwise be compelled to reject.

The certain consequences of S. 565 would be greater employee mobility and with such mobility would come a substantial savings in human resources. S. 565 would address both of the nation's most serious concerns, inflation and unemployment, in a positive fashion; inflation by reducing labor turnover, retraining and recruitment costs, and unemployment by enabling the worker to go where the work is.

The second reason S. 565 deserves enactment is to equalize the ability of small business to compete with large business to recruit and retain qualified employees. Large, heavily capitalized businesses which frequently relocate employees have long-established programs to ameliorate the costs of relocation. Sometimes these programs involve the purchase of the employee's home by the company; sometimes they involve the hiring of a relocation company to purchase the property. Whatever the program, they inevitably involve a capital commitment substantially beyond anything the small business usually can afford.

This disparity in programs has not only discriminated against the relocation efforts of small business, but has also reintroduced the discrimination between the new employee and the old employee which the 91st Congress sought to remedy in the 1969 Tax Reform Act Amendments.

The third reason S. 565 deserves enactment is to restore the ability of hundreds of thousands of relocating employees to control the sale of their old home and their search for a new one.

The high cost of moving has compelled an alarming number of companies and employees to enter into agreements with relocation companies to purchase the employee's home. Under these agreements, non-deductible moving expenses are transformed into tax deductible fees and payments. The price of this Tax Code alchemy is high, however, not only in terms of the added fees to relocation companies which are involved but also because such agreements normally compel the employee to use exclusively the brokerage and other services of the relocation company or organizations affiliated with or paying fees to it. Such agreements not only discriminate against companies and employees unable or unwilling to accept them, but also against every real estate broker who is not owned by or affiliated with a relocation company.

Conclusion.—a tax law is most harmful when it may readily be avoided by some persons subject to it, but not by others in similar and ofttimes competitive circumstances. The present Code treatment of indirect moving expenses is unreasonably and arbitrarily harmful under this standard and should be amended.

S. 565 would cure the inequities which exist under present law, make costly tax avoidance arrangements unnecessary, and preserve competition in the delivery of real estate services.

Senator PACKWOOD. Thank you very much.

[Whereupon, at 12:48 p.m., the hearing adjourned, subject to the call of the Chair.]

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

STATEMENT OF SENATOR GRASSLEY

While equity between foreign and domestic qualified pension plans is an important step toward creating uniformity in the law, such a move should be carefully evaluated. Creating a more favorable investment climate within the United States ought to improve our Nation's balance of trade payments. I strongly support the principle of achieving a favorable balance of payments by fostering a vigorous trade economy.

Nevertheless, I am very concerned about the provision of this legislation which allows foreign qualified pension plans to invest in U.S. farmland. My esteemed colleague, Senator Wallop, has spotted this problem and stated he would offer clarifying amendments to resolve this difficulty.

As a member of the House of Representatives, I worked hard to enact the Foreign Investment in Real Property Tax Act to make foreign investors in U.S. agricultural farmland subject to the same capital gains tax treatment as U.S. citizens buying and selling farmland. Our intent was to stop giving foreigners an advantage over U.S. citizens in the capital gains treatment of one of our most important resources—agricultural farmland. I believe the Congress has a valid public policy interest in preventing the purchase of the nation's food base by foreigners.

In the same vein, I feel it would be a mistake to permit qualified pension plans benefitting foreigners to buy and sell agricultural land without any tax consequences. Our land is too valuable to be given away freely to foreigners. I fully support Senator Wallop's efforts to remedy the unwarranted consequences of S. 502.

LAW OFFICES, COHEN AND URETZ,
Washington, D.C., March 30, 1981.

Hon. ROBERT PACKWOOD,
Chairman, Senate Subcommittee on Taxation, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: We offer this statement for inclusion in the printed record with respect to S. 502. This bill would exempt certain foreign pension plans from tax on their U.S. source investment income and would also exempt such income when earned by a life insurance company on behalf of a foreign pension plan.

We represent Stichting Philips Pensioenfonds A and B, which are Netherlands pension plans providing benefits to the employees of Philips, N.V., a Netherlands corporation. Our clients are interested in this proposed legislation, and they have indicated to us that an exemption from U.S. taxation of income of foreign pension plans would have a positive long-term impact on the amount of their investment in the United States. In this statement, we will summarize the strong policy reasons for passage of this legislation and comment on the reasons given by the Treasury Department for its opposition to the bill.

I. POLICY REASONS FOR EXEMPTION OF FOREIGN PENSION PLANS

The passage of S. 502 would operate to encourage investment by foreign pension plans in the United States. A foreign pension plan which would be subject to the proposed legislation by definition benefits from a favorable rate of taxation in its own country. In contrast, under current law, the foreign pension plan would be subject to the 30-percent withholding tax (or a reduced treaty rate) on income from its U.S. investments and would, in some circumstances, be subject to capital gains taxation on the sale of its assets in the United States. Thus, the foreign pension plan has a tax disincentive to invest in the United States; in fact, even if it otherwise viewed investment opportunities in the United States as more attractive, it might not invest in the United States because of this tax disincentive. At the present time, then, tax factors have a distortive negative effect on investment behavior. The removal of the tax disincentive created by current law would lead to an increase in the flow of foreign capital to the United States.

There are two major reasons that it is very desirable that this foreign capital be attracted to the United States. First, as has been widely discussed, there is currently a shortage of investment capital in the United States. This shortage would be alleviated in part by the passage of S. 502. It should be pointed out in this connection that, unlike many tax incentive measures, this legislation would not operate merely to divert investment capital from one sector of our economy to another. Rather, it would increase the total amount of investment capital by tapping additional sources of capital.

Second, foreign pension plan investments are particularly attractive sources of additional capital. Investments by pension plans tend to be long-term because the laws of many countries effectively discourage trading and speculation. In addition, foreign pension plans would be very unlikely to exercise day-to-day control over companies or ventures in which they are investing.

II. COMMENTS ON TREASURY TESTIMONY

The Treasury Department, in the testimony of Assistant Secretary of the Treasury (Tax Policy) John E. Chapoton, gave several reasons for its opposition to the bill. We believe that, upon analysis, the reasoning of the Treasury Department is seriously flawed.

The Treasury Department gave several policy arguments for opposing S. 502. First, it questioned whether foreign pension plans should be singled out from among other types of foreign investors for exemption from U.S. taxation. The primary reason for special treatment of foreign pension plans, however, is simple: unlike foreign manufacturing companies, for example, foreign pension plans covered by the bill are subject to a reduced rate of taxation or are exempt from taxation in their own countries. Consequently, to remove a tax disincentive to invest in the United States, such plans must be given favorable treatment in the United States. The same reasoning does not apply to most other types of foreign investors. In addition, as we have noted above, foreign pension plan investment is likely to be particularly desirable because of its relative permanency compared

to other types of investments and because it is likely to be more passive than most types of investments.

Second, the Treasury Department expressed its belief that S. 502 would conflict with the recently passed Foreign Investment in Real Property Tax Act. We believe, to the contrary, that S. 502 is consistent with the policy underlying the Foreign Investment in Real Property Tax Act: "to establish equity of tax treatment . . . between foreign and domestic investors."[1] Under current law, U.S. pension plans have two advantages vis-a-vis foreign pension plans, as noted in the Joint Committee Staff's discussion of S. 502.[2] Foreign pension plan income is immediately subject to U.S. taxation, whereas taxation of the investment income of U.S. plans is, in effect, deferred until distribution of the income to participants. Moreover, the U.S. income of foreign pension plans is subject to tax twice, once in the U.S. and a second time in the foreign country upon distribution, whereas the investment income of similarly situated U.S. plans is taxed only once. Under S. 502, the overall tax burden on U.S. and foreign plans would be equalized.

Third, the Treasury Department has indicated that the legislation is ill-conceived because it has the effect of promoting the goals of a foreign country in which we have no interest. The legislation would, however, also have the effect of promoting U.S. goals. As discussed above, the legislation would operate to increase the amount of investment capital in the United States. The resulting increase in U.S. productivity could be considerable.

Fourth, the Treasury Department stated that the objectives sought by S. 502 are best achieved by the treaty process. The difficuly with this approach in dealing with the problem is that the negotiation of treaties is typically quite time-consuming and the Treasury Department has often been reluctant to open the process of negotiation. It would appear that the advantages of S. 502 are too great to wait for the uncertain process of treaty renegotiation.

Finally, the Treasury Department has stated that the legislation would cause a transfer of U.S. tax dollars to a foreign treasury and has estimated the revenue loss at $90 million. It appears that this alleged revenue effect is mere speculation at this point. In this connection, it may be noted that to the extent foreign pension plans do not currently invest in the United States because of the tax disincentive to do so, the loss of U.S. tax dollars as a result of the legislation is illusory. Moreover, to the extent there is a short-term loss of U.S. tax-dollars, the amount of such loss would be only a fraction of the new U.S. investment capital which would be created. If U.S. investment and productivity are increased, the long-term revenue effect would be negligible and more than outweighed by the benefits of S. 502.

In addition to the policy arguments given by the Treasury Department, it also discussed several technical problems with the legislation. In particular, it has stated that it would be difficult to police the requirements for exemption in the legislation and that the reciprocity provision in S. 502 is unworkable. We believe that these technical problems have been exaggerated by the Treasury Department and that they can easily be overcome. Thus, these technical problems should not be viewed as barriers to adoption of the basic concept of the legislation.

Sincerely yours,

HENRY G. ZAPRUDER.
ROGER A. PIES.
DANA L. TRIER.

THE NATIONAL ASSOCIATION OF PENSION FUNDS,
Bedford Park
Croydon CR0 0XF, England, March 30, 1981.

ROBERT LIGHTHIZER, ESQ.,
Chief Counsel, Finance Committee,
Dirksen Senate Office Building, Washintgon, D.C.

DEAR SIR: Our organisation was formed nearly sixty years ago as a forum at which managers and others concerned with the design, administration and financial well-being of United Kingdom pension funds, could meet to discuss problems

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[1] Report of the Committee on the Budget of the House of Representatives to Accompany H.R. 7765, Rept. No. 96–1167, 96th Congress, 2d session (1980), at 511.

[2] Description of Tax Bills (S. 352, S. 483, S. 502 and S. 565), Prepared for the Use of the Committee on Finance by the Staff of the Joint Committee on Taxation, JCS–6–31 (March 13, 1981), at 9 and 10.

of mutual interest and concern. On behalf of our membership, we are hereby submitting to the Senate Finance Taxation Sub-committee our views in support of S. 502 (the "Bill") which seeks to exempt pension funds outside the United States from U.S. taxation.

To obtain the views of our membership on the effect of the Bill on future investment activities in the United States, we circulated among 250 pension fund managers a questionnaire, a copy of which is annexed hereto. Answers to our questionnaire continue to be received, but in order to expedite the filing of this statement, we have only incorporated data furnished by the first 67 private sector pension funds to respond.

Since pension funds for the benefit of employees of governmental authorities are exempted from U.S. taxes on investment income under Section 892 of the Internal Revenue Code and Treasury Regulations thereunder, we omitted from our analysis data furnished by funds in the public sector. As a matter of general interest, however, 17 of these funds held as of December 31, 1980 U.S. equity securities with a market value of $575 million and commercial real estate with an acquisition cost of $209 million. Because of the privileges extended to these funds under Section 892 of the Code, many showed no particular interest in the enactment of the Bill.

The data furnished below on investment activity in the private sector includes information furnished by two investment managers who manage investment portfolios of pension funds. The funds invested by each of the two managers are treated as private sector pension funds for purposes of this presentation and rank among the nine largest funds referred to below. Not included in our survey were those assets of pension funds which are managed in the U.K. by insurance companies and which themselves are of significant size. It should be noted that U.K. pension funds and insurance companies hold approximately 60% of all shares of U.K. companies listed on the London Stock Exchange.

As previously stated, the summary statistical information presented below is based on the responses of 67 private funds and two investment managers, as follows:

	(Dollars in millions)
Market value of total assets as at December 31, 1980:	
67 funds	[1] 29,314
9 largest funds	19,063
New funds available for investment in 1981:	
67 funds	3,884
9 largest funds	2,360
Market value of U.S. assets:	
67 funds:	
Debt securities	10
Stock	1,936
Commercial real estate	121
Total	2,067
9 largest funds:	
Debt securities	3
Stock	1,296
Commercial real estate	113
Total	1,412

[1] A conversion rate of $2.25/£1 was used to convert Sterling into U.S. dollars.

The target set by the nine largest funds for total investment outside the U.K. varies between 7 percent and 30 percent of total assets and for investment in the United States between 5 percent and 12½ percent of total assets.

The statistics show that pension fund managers in the United Kingdom prefer to invest locally, probably largely because of their greater familiarity with domestic market conditions, the absence of foreign exchange risks and exemption from U.K. tax on revenue. Investment in offshore funds generally, and in portfolio securities and real estate in the United States in particular, needs encouragement. Tax considerations heavily influence investment decisions. This is evidenced by the fact that fund managers are increasing their investments in Australia since Australia, by administrative action, agreed to exempt funds from withholding taxes.

In 33 questionnaires, funds in the private sector stated that they would increase investment in U.S. equity securities if the Bill were enacted. Of the nine

largest funds, seven said they would increase their investment in U.S. equity securities if the Bill were enacted, whereas only two funds, controlling about 19.3 percent of total assets of the nine largest funds, answered negatively. Five out of the nine said they would invest additional funds in U.S. real estate if the Bill were enacted.

As to taxation, U.K. pension funds are exempt from U.K. tax on investment income, including interest and dividends on portfolio securities, rentals from real estate and gains from disposition of portfolio securities or real estate. If the Bill were not enacted, dividends on U.S. stock would remain subject to a 15 percent withholding tax in the United States and capital gains from the sale of real estate or shares of real estate holding companies to a tax of about 28 percent. (No tax is withheld in the United States on interest on debt securities, but the funds have refrained from purchasing large amounts of bonds and other debt securities because yields on U.K. debt securities were, as a rule, more attractive.)

In the case of equity securities, the average dividend on U.S. equity securities is currently about 25 percent lower than on U.K. equity securities. (Based on a 4.54 percent dividend yield on the Standard and Poors Index (as of March 18, 1981) and a 5.95 percent dividend yield on the Financial Times 500 Share Index (as of March 24, 1981.) The 15 percent withholding tax on dividends increases the yield gap to approximately 35 percent, and may tip the scale in favour of the purchase of equity securities on non-U.S. issuers.

Until now, eight of the nine largest funds in the private sector have refrained from investing in real estate in the United States, where, at least initially, yields from industrial, commercial or residential properties are substantially lower than the inflation rate. The principal inducement for investing in U.S. real property is no doubt the possibility of capital appreciation. For this reason, capital gains taxes on foreign owned real estate, which were introduced in the U.S.A. in December 1980, significantly diminish the profit potential of real estate investments for foreign pension funds.

The tax on capital gains is particularly burdensome because it is imposed upon a profit denominated in U.S. currency. Since retirement payments to the private funds' beneficiaries are payable in Sterling, the Fund must compute its profits in Sterling rather than in foreign currency. For example, if a private fund invested in U.S. real estate when the Dollar/Sterling exchange rate was $1.70/£1 and sold the property when such rate was $2.20/£1, the sales price would have to exceed the cost of acquisition by 29.4 percent to avoid a loss expressed in Sterling. If a 28 percent capital gains tax is assessed on the profit expressed in U.S. dollars, the increase in value of the property would have to be at least 40 percent over initial cost to avoid a loss.

We understand that at the hearing on the Bill held before the Sub-committee on March 16, 1981, a representative of the United States Treasury asked why foreign pension plans alone should receive tax exemption and why, if tax incentives are to be offered to foreign investors, the exemption should not be extended to all of them. This question ignores the effect of foreign tax credits in the field of international taxation. The foreign pension plan in the U.K. is exempt from local tax and therefore has no use for the tax credits that are available to investors, who are subject to U.K. taxation on dividends or capital gains tax. In the case of taxpayers, these taxes are credited against taxes otherwise payable in the United Kingdom. To grant tax-paying investors tax exemption might indeed "transfer tax dollars from the U.S. Treasury to the treasury of a foreign country." Not so, however, in the case of a foreign pension plan where U.S. taxes must diminish the post-tax return on the investment and objectively are a yield-reducing factor.

In our opinion, the readiness with which our members have answered our questionnaire and are assisting our endeavors to support the enactment of S. 502 is indicative of the beneficial effect that the Bill, if it were to become law, would have on the investment activities of U.K. pension funds in the U.S. We respectfully submit that the Bill should be enacted.

H. L. JAMES, *Director General.*

(1) Name of Fund:

(2) Total assets under management at 31.12.80:[1]

By cost:

By market value:

(3) What was the actual percentage of your Fund's assets invested outside the U.K. as at 31 December 1980?

[1] Unaudited figures will suffice rounded to the nearest £1,000. If figures are not available at this date, please give figures at nearest date and specify the date.

(4) Amount of the above assets invested in the U.S.:
Cost and Market Value (if available):
(a) Bonds:
(b) Equities:
(c) Real Estate:
(1) Commercial property:
(2) Farmland:
(5) What is expected to be the Fund's annual amount available for investment in all areas in 1981?
(6) What is your target percentage for investment overseas?
(7) What is your target percentage for investment in the U.S.?
(8) If there were no withholding tax on dividends would you increase your investment in U.S. equity securities?
(a) No or hardly:
(b) Yes:
(9) If there were no withholding tax on rentals or no tax on gains from the disposal of real estate, would you increase your investment in real estate in the U.S.A.?
(a) No or hardly:
(b) Yes:

LAW OFFICES, GROOM & NORDBERG,
Washington, D.C., April 1, 1980.

At the March 16, 1981 hearing of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, representatives of the Treasury Department opposed S. 502—a proposal to allow certain foreign pension plans to invest in the United States on the same basis that currently applies to domestic pension plans—on several grounds. On behalf of eight major U.S. life insurance companies that strongly support the enactment of S. 502, this memorandum explains why the proposal is consistent with the basic policy considerations reflected in the statement of the Treasury Department, and why it does not involve the administrative and similar problems suggested by the Treasury. In short, this memorandum demonstrates that the Treasury Department's opposition is misplaced, and that S. 502 is a sound proposal that warrants prompt favorable action by the Congress.

1. Foreign pension plans should receive more favorable U.S. tax treatment than other foreign investors

In essence, the most basic objection of the Treasury Department focuses on why foreign pension plans alone, as opposed to all foreign investors, should be exempt from U.S. tax. This is certainly a legitimate question to ask about the proposal. We believe there are at least four sound reasons why the bill properly distinguishes foreign pension plans from other foreign investors.

(*a*) Unlike foreign investors generally, the foreign pension plans to which the proposal would apply are generally exempt from tax in their home countries. Consequently, when the foreign pension plan decides whether to invest in its home country (where there is no tax), or in the U.S. (where there is a tax), the mere existence of a potential U.S. tax liability is a disincentive to U.S. investment, sometimes a very strong one.

The investment perspective of a foreign pension plan contrasts significantly with that of other foreign investors for whom tax considerations are a relatively neutral factor in the investment decision. When the taxable foreign investor makes an investment decision, he must assume generally that a tax will be payable to one country (his own) or to the country in which the investment is made (e.g., the U.S.). If the foreign investor does pay tax to the U.S. on his U.S. investment income, he usually will be able to credit the U.S. tax paid against the tax he would have paid to his own country on that income.

In essence, then, for a foreign pension plan, any U.S. tax that must be paid necessarily reduces the resulting investment yield in relation to a comparable investment in his country of residence. This cannot be said for other foreign investors. Consequently, while S. 502 may be considered to provide an "incentive" for foreign pension plans to invest here, it really just removes a "disincentive" that has no direct counterpart for foreign investors generally.

(*b*) The distinction that has just been made also highlights another significant difference between the proposal to exempt foreign pension plans (S. 502) and

a much broader proposal (not made) to exempt all foreign investors from U.S. tax. We call this the "international revenue-sharing" consideration. Simply stated, when the U.S. foregoes collecting a tax from a foreign investor that is subject to tax in his home country, the foreign investor will have no U.S. tax credit; as a result, he generally will pay more taxes to his home country. Thus, an exemption for taxable foreign investors generally would involve a very immediate and substantial transfer of tax dollars from the U.S. to foreign countries. On the other hand, since foreign pension plans themselves pay no (or little) tax to their home countries, the foreign tax credit mechanism is irrelevant. No significant or immediate transfer of tax dollars is involved.[1]

(c) There are at least two precedents that support a tax-exemption for foreign pension plans. First, foreign charitable and educational organizations already are able to qualify for U.S. tax exemption under the rules that apply primarily to domestic charities, schools, etc. IRC § 501(c)(3); *see* Rev. Rul. 66-177, 1966-1 C.B. 132; Rev. Rul. 71-460, 1971-2 C.B. 230. In this regard, the United States has no stronger policy interest in the charitable or educational activities of these foreign organizations than it has in the retirement benefits provided by foreign pension plans. However, as in the case of foreign pension plans, the imposition of a U.S. tax on foreign charities (which are tax-exempt in their home countries) also would be a disincentive to U.S. investment, and not merely a neutral factor.

Second, by Treasury Regulation, foreign pension plans that are maintained by foreign governments or their instrumentalities are exempt from U.S. tax on their passive investment income. Treas. Reg. § 1.892-1(b)(4). Admittedly, this exemption primarily reflects international comity considerations. However, since these considerations would not necessarily extend to the participants in these foreign governmental plans, the current U.S. tax exemption for one category of foreign pension plans does reflect a policy that provides additional support for S. 502.

(*d*) Finally, there is a non-tax distinction that, we think, supports a tax distinction between foreign pension plans and other foreign investors. While it is difficult to quantify, pension plans, as a broad class, invest on a long-term basis, consistent with their long-term obligations to their participants. At a time when there is general agreement that the U.S. needs to expand its capital base, long-term investments, such as those made by pension plans, tend to be the most stable and valuable ones. In this sense, (and recognizing that there is a sound tax policy basis for doing so), it seems particularly sensible for us to try to attract foreign pension capital as opposed to other sources of foreign capital that are much more likely to fluctuate in relation to political, international trade and other considerations.

In summary, the distinction that S. 502 makes between foreign pension plans and other foreign investors is a very sound one. It is supported by principles of tax neutrality, the absence of significant and immediate international revenue-sharing effects, relevant precedents, and economic sense.

2. S. 502 is consistent with the policy of the Foreign Investment in Real Property Tax Act

The Treasury Department asserts that S. 502 would conflict with the policy objectives of the recently-enacted "Foreign Investment in Real Property Tax Act" ("FIRPTA") and, in addition, would partially reopen the potential for tax avoidance intended to be closed by that Act. We strongly disagree with both of these assertions.

We believe that S. 502 is clearly consistent with the basic underlying policy of FIRPTA. In this regard, that policy was succinctly described in the Treasury Department Study that preceded the Congress' consideration of this legislation. Specifically, the Treasury Department stated:

"In considering U.S. taxation of foreigners on their U.S. source capital gains, a critical issue is *tax equity—a foreign investor with more than a minimal presence in the United States should not bear a lighter tax burden than a comparable domestic investor.*" Department of the Treasury, *Taxation of Foreign Investment in U.S. Real Estate* (May 4, 1979), p. 52 (emphasis added).

The Finance Committee generally agreed with this policy as it stated when it favorably reported its version of FIRPTA:

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[1] We discuss below (pp. 8-10) the much more remote and insignificant "transfer" that the Treasury Department described in its testimony.

"The Committee believes that it is essential to establish equity of tax treatment in U.S. real property between foreign and domestic investors." S. Rept. No. 499, 96th Cong., 1st Sess., p. 8 (1979).

In our view, S. 502 addresses the same general problem—tax equity—that FIRPTA addresses with respect to taxing foreign investors on their capital gains from U.S. real estate. Before FIRPTA, a taxable foreign investor could minimize or avoid paying U.S. tax on such gains, even though a comparable (i.e., taxable) domestic investor ordinarily would have to pay U.S. tax on the same gains. S. 502 would promote tax equity in the other direction by ensuring that foreign pension plans do not bear a heavier U.S. tax burden than their domestic counterparts. That is, a U.S. pension plan generally would not pay tax on its gains from U.S. real estate and, under S. 502, neither would a foreign pension plan that satisfied the requirements of the bill.

Notwithstanding the broad consistency of purpose of FIRPTA and S. 502, the Treasury Department proceeds to suggest a more refined and conceptual basis for disagreement. Specifically, the Treasury Department states that foreign pension plans are not "comparable" to domestic pension plans in the sense that we provide tax incentives for U.S. plans for U.S. social policy reasons, i.e., to encourage employers to provide for their employees' retirement and thereby lessen the responsibility that the U.S. Government would otherwise bear (presumably through the Social Security system). We recognize that the U.S. has no strong social interest in encouraging foreign businesses to provide pensions for their employees. At the same time, we believe the Treasury Department should recognize that the U.S. also has no strong social interest in promoting the activities of foreign charities, schools, etc., yet these organizations can currently invest in the U.S. on a tax-exempt basis. In any case, the Treasury's conceptual "social" distinction between foreign plans and their functionally comparable U.S. counterparts unreasonably ignores the fact that—for this specific category of foreign investor—U.S. taxes act as as disincentive, rather than merely a neutral factor, in the decision whether to invest in the United States.

Finally, while we believe that the three requirements that S. 502 would impose on foreign pension plans seeking to rely on the tax exemption are adequate to prevent abuse, we ourselves, and we assume the sponsors of the proposal also, would be willing to work with representatives of the Treasury Department to develop additional reasonable limitations that may be needed to prevent abuses. Certainly, to the extent there might be a limited potential for abuse, it makes more sense to close off that potential rather than to perpetuate the broad tax inequity that S. 502 is designed to eliminate.

3. The nontaxability of participants in foreign pension plans is clearly insignificant, if not an irrelevant, consideration to the basic proposal

As discussed previously, because the class of foreign investors to which S. 502 would apply are generally tax-exempt in their home countries, the proposal does not involve any significant or immediate transfer of tax dollars from the U.S. to foreign governments. The Treasury Department does not disagree with this statement. Instead, the Department focuses on the fact that the ultimate recipients of pensions from the foreign pension plans—the foreign employees—will not be subject to U.S. tax on the very small piece of their pension that may be allocable to the U.S. investment earnings of the plan itself.

We think this contention proceeds from a basic premise that is incorrect. Specifically, the Treasury Department assumes that foreign pension plans will be willing to make substantial investments in the U.S. even if they have to pay taxes here that they do not have to pay (and, therefore, do not need a foreign tax credit for) at home. Yet, the very purpose of the proposal is to attract the funds of foreign pension plans to the U.S. by removing the current tax impediment to their investing here.

Apart from the faulty starting point of this contention, the nation that we would be "transferring tax dollars" through the foreign pension plan's participants does not make much sense as an economic matter, and certainly it is not supported by any strong U.S. tax policy concerns.

Economically, the contention is a weak one because it focuses on the ultimate payment—5, 10 or 20 years in the future—of a pension to the foreign participant. Clearly, even if the proposal is enacted, the overwhelming sources of the funds for this pension payment will have been the contributions that the participant's employer made to the plan and the plan's investment earnings from sources outside the U.S. To the extent that a small portion of this payment is attributable to

U.S. source investment income—generated years before by investments that supplemented U.S. capital formation needs, created jobs, etc.—the price paid in "lost revenues" would be a very small one, if any revenue were lost at all. Indeed, there could well be a revenue gain to the extent that the investments of foreign pension plans helped finance U.S. business expansion and increased employment that generated revenues for the U.S.

From a tax policy standpoint, we are unable to discern any strong U.S. interest in ensuring that nonresidents who receive pensions from U.S. sources (that include, in part, investment income earned in the U.S.) pay taxes on the U.S. source investment income piece. More than 20 tax treaties—including our treaties with the principal foreign countries whose pension plan sponsors have expressed strong interest in making U.S. investments—provide reciprocally that "pensions and annuities" received by a resident of one country from sources in the other country shall be taxed only by the country of residence. Consequently, it appears that little, if any, tax is currently being (or would be) collected on the payment of pensions from the U.S. to nonresident individuals.

In summary, the Treasury Department's concern that we not transfer tax dollars to foreign pension plan recipients must be dismissed as a remote one that merely diverts attention from the basic purpose of the proposal—to promote U.S. capital formation needs in a way that does not have the effect of directly and immediately transferring U.S. tax dollars.

4. The IRS would not have to become experts in foreign pension laws in order to monitor compliance

Under the proposal, the exemption would be available to foreign pension plans that satisfy the following three basic requirements:

(*a*) the plan is maintained primarily to provide retirement or similar benefits, primarily to nonresident alien employees;

(*b*) the assets of the plan are held separately from the assets of the employer pursuant to the laws of the foreign country; and

(*c*) the plan is tax exempt (or subject to a reduced rate of tax) in its home country.

We must note at the outset that none of the many representatives of foreign pension plans with whom we have spoken consider these requirements to be burdensome or difficult to satisfy. Neither should the Internal Revenue Service. Compliance with the first two requirements should readily be established from the terms of the plan documents or from basic data that will always be in the possession of the employer/sponsor of the plan. With respect to the third requirement (tax-favored status in the home country), some foreign countries (like the United States) have procedures under which the taxing authorities make written determination of tax-exempt status. In other foreign countries, foreign plans must have some means (such as reporting requirements) for claiming tax-favored status. Moreover, there is no reason why the general U.S. tax principle—that a person who seeks to rely on a tax exemption bears the burden of establishing his entitlement to the exemption—would not apply.

In addition, where the foreign pension plan invested in the U.S. through a life insurance company or a similar financial institution, the financial institution (who for example, otherwise may be required to withhold taxes from the plan, and in the case of a life insurance company that issues a pension funding contract, needs to establish compliance in order to compute its own tax liability) would have the information needed to establish the plan's entitlement to the exemption. This information would be available to the IRS.

Consequently, the perceived substantial administrative burden on the IRS must be rejected as a "make weight" argument.

5. Section 896 represents a reasonable approach to reciprocity

S. 502 provides the Executive Branch with the discretionary authority to revoke the tax exemption of a foreign pension plan on the basis that the foreign plan's home country does not provide comparable favorable treatment to U.S. plans investing abroad. While we also question whether—in view of the capital formation purposes of the proposal—any such provision is necessary, we disagree with the Treasury Department's assertion that the particular reciprocity mechanism of the proposal, i.e., section 896 of the Internal Revenue Code, is unworkable. As a practical matter, this feature of the bill would not require the Treasury and the IRS to "study all foreign tax laws" because (a) to the extent that U.S. pension plans have or may invest abroad, such investments would be concentrated in a few industrialized countries (e.g., the United Kingdom, Japan), and (b) simi-

larly, only plans organized under the laws of a limited group of foreign countries would qualify under the proposal itself.

Indeed, in view of the major purpose of S. 502—to attract foreign pension capital to the U.S.—we think that section 896 is a particularly reasonable approach to the traditional U.S. interest in reciprocity. More specifically, section 896(b) becomes operative only at the discretion of the President, and, in exercising that discretion, the President would have to make a determination that the revocation of the tax exemption for the foreign plans that are investing here "is in the public interest." We assume that, in making that determination, the President could reasonably take into account the capital formation purposes of the proposal.

6. Tax treaties are not an adequate alternative to S. 502

While it is logical for the Treasury Department to state that it is more appropriate to address international tax issues in a tax treaty framework, that logic breaks down, and misses the basic point of, this particular proposal.

The principal problem with the treaty process is a practical one—that it takes many years to work these matters out, even with a single country. The U.S. needs additional capital now and, hopefully, it will not need it 5 or 10 years from now. Similarly, foreign pension plans are interested in investing in the U.S. now, but they may not be 5 or 10 years from now. We think that the Congressional tax-writing committees are in a much better position to make a timely judgment on this issue than could be made under the treaty process that is largely carried on outside the review of the tax committees.

Apart from the important matter of time, legitimate questions can be raised with respect to whether foreign countries will be interested in taking affirmative steps to encourage their plans to invest here, whether the United States itself should take affirmative steps to encourage U.S. plans to invest abroad and the numerous other complications inherent in the tax treaty process.

7. Life insurance companies are already at a competitive disadvantage with respect to managing the assets of foreign pension plans

The Treasury Department statement indicates that, if the proposal to allow foreign pension plans to qualify for tax-exempt status is adopted, it would not oppose the provision of the bill (subsection (c)) that would be needed to enable life insurance companies to manage the U.S. investments of such plans on the same tax-exempt basis. However, the Treasury Department's comment that separate life insurance company tax amendments would not be appropriate in the absence of a general tax exemption for foreign plans fails to recognize the significant competitive disadvantages that life insurance companies currently suffer with respect to managing the funds of foreign pension plans. Those two basic disadvantages are explained briefly below by example. They demonstrate why appropriate amendments to resolve the problems in this area that are unique to the life insurance industry should be adopted, even if the basic proposal to exempt foreign pension plans from tax on their U.S. investment income were not adopted.

Assume that a foreign pension plan (a) wishes to invest in equity securities of U.S. companies, (b) is organized in a foreign country with respect to which there is a tax treaty that reduces the U.S. withholding tax on dividends from U.S. sources from 30 percent to 15 percent, and (c) would not be considered to be engaged in a U.S. trade or business. The plan is considering three approaches to U.S. investment:

(1) Directly investing in U.S. securities;

(2) Investing in U.S. securities by purchasing shares of a mutual fund (that satisfies the requirements of sections 851–55 of the Code); and

(3) Investing in U.S. securities by acquiring an insurance company contract that provides for the investment of funds in a pooled separate account (described in section 801(g) of the Code) the assets of which consist of securities of U.S. companies.

The U.S. tax effects of each of the alternatives are as follows:

(1) Direct investment

(i) Under the tax treaty, dividends received with respect to the securities would be subject to a U.S. withholding tax of 15 percent.

(ii) Under the Code (sec. 871), capital gains derived on the sale of the securities would not be subject to U.S. tax.

(2) Mutual fund

(i) The mutual fund itself would not be taxable on any of the dividend or capital gain income since, in general, such funds are treated as "conduits" for Federal income tax purposes.

(ii) Under the tax treaty, ordinary income dividends received by the foreign pension plan on its mutual fund shares would be subject to a U.S. withholding tax of 15 percent.

(iii) "Capital gain dividends" distributed by the mutual fund, and any gains derived by the foreign pension plan on its sale of mutual fund shares, would not be subject to any U.S. tax. Rev. Rul. 69-244, 1969-1 C.B. 215.

(3) Life insurance company separate account

(i) Under the Code, the life insurance company would not be taxable on any of the dividend income to the extent that the dividends were credited to the foreign pension plan.

(ii) However, capital gains generated by the sale of the securities held for the foreign pension plan would be currently taxable at the life insurance company level. This tax on the insurance company would, of course, reduce the investment yield to the foreign pension plan.

(iii) The character of income in the hands of a life insurance company would not be retained upon the payment of the income to the foreign pension plan (or any other contractholder). Consequently, payments made by the life insurance company to the foreign pension plan generally would be subject to a 30 percent withholding tax. IRC § 871(a)(1)(A).

As the foregoing example shows, the Treasury Department has failed to recognize the very significant competitive disadvantages that life insurance companies now suffer with respect to managing the assets of foreign pension plans.[3] That is, if such plans were to invest in the U.S. through a life insurance company they would not only have to bear an indirect tax on their capital gains at the insurance company level but, more importantly, they could not take advantage of any of the tax treaty benefits that are clearly available to them when they directly invest in the U.S. or when they invest here through other U.S. financial institutions (including mutual funds and, in many cases, banks) that are treated as "tax conduits" for this purpose.

In summary, we strongly urge the Subcommittee to act to remove the existing U.S. tax impediments to foreign pension plan investments in the U.S. generally. However, even if the Subcommittee does not do so, appropriate amendments should be adopted to remove the anti-competitive U.S. tax impediments to U.S. investments by foreign pension plans through life insurance companies.

8. The Treasury Department's revenue loss estimate is inflated

At the hearing, the Treasury Department indicated that the proposal would involve a revenue loss (it is unclear over what period) of roughly $90 million. In contrast, the staff of the Joint Committee on Taxation, correctly recognizing that there is insufficient information on this particular subject, indicated a much more modest revenue loss. In general, the staff estimated a cost of $10 million per year for each $1 billion net increase in U.S. investment by foreign pension plans.

The Treasury Department, of course, did not explain its methodology or the assumptions it used in arriving at a $90 million estimate. Even if that estimate proved to be correct, it seems to us that—in relation to the many other capital formation proposals that have been made—it is a very modest price to pay for a significantly expanded U.S. capital base. However, we continue to believe that the loss would not be nearly as much. Specifically, we understand that foreign pension plans have not made significant investments here on a taxable basis and it seems that they are unlikely to do so in the future. Consequently, there should be little, if any, direct revenue loss from the proposal. Moreover, to the extent that we forego collecting some tax on U.S. investments that would not have made otherwise, we think the benefits to the U.S. economy will far outweigh the cost.

The foregoing discussion establishes that the Treasury Department's current opposition to S. 502 is unwarranted, and we would be pleased to discuss all of the above points further with representatives of the Treasury Department. Clearly, when all of the features of S. 502 are carefully considered, the logical conclusion

[3] We note that these same disadvantages would affect investments in U.S. debt securities and, to a lesser extent, investments in real estate.

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is that the current U.S. tax obstacles to U.S. investment by foreign pension plans should be removed.

THEODORE R. GROOM.

Attorney for Aetna Life & Casualty, Connecticut General Life Insurance Co., The Equitable Life Assurance Society of the United States, John Hancock Mutual Life Insurance Co., Metropolitan Life Insurance Co., Phoenix Mutual Life Insurance Co., The Prudential Insurance Company of America, and The Travelers.

SANN & HOWE,
New York, N.Y., March 26, 1981.

STATEMENT CONCERNING S. 502

We are a law firm representing, among other clients, several major European pension plans.

We agree with the statements submitted by representatives of the insurance and banking industries at the hearing on S. 502 held on March 16, 1981. In particular, we can confirm that there are foreign pension plans which would be pleased to make substantial investments in the United States—in securities and also in real estate, both leveraged and unleveraged—if they could make these investments on the same tax-free basis as they can at home.

Such investment would clearly be beneficial to this country both in terms of U.S. capital formation and in terms of employment of U.S. advisers and managers by the pension plans. It would undoubtedly create a significant number of new jobs, especially at the middle-management, clerical, skilled and semi-skilled levels, in the fields of acquisition and management of investments. We would expect U.S. real estate investment and development, requiring intensive local management, maintenance and construction services for which foreign investors ordinarily look to Americans, to be particularly productive of new jobs.

Moreover, S. 502 should be productive of tax equity in subjecting foreign pension plans to the same U.S. tax regime applicable to U.S. pension plans. This equitable intent of the bill is reinforced by the bill's provision for eventual loss of exemption by a pension plan established in a country which does not afford a corresponding exemption to U.S. pension plans investing in that country.

Accordingly, we strongly support S. 502 and urge its enactment. However, we do recommend that, in enacting this measure, Congress add certain provisions to the bill which would put foreign pension plans' investments in debt-financed U.S. assets on the same footing as U.S. pension plans' investments in such assets and which would dovetail S. 502 with the provisions (especially the reporting provisions) of the Foreign Investment in Real Property Tax Act of 1980. We submit herewith a technical memorandum detailing the supplementary material which we suggest be added to S. 502. We are most concerned that, if these provisions are not added to S. 502, the bill—in subjecting foreign pension plans to the unrelated business income tax on debt-financed assets and to the administrative burdens of reporting under FIRPTA—may have the unintended effect of discouraging foreign pension plans' investments in the United States.

TECHNICAL MEMORANDUM CONCERNING SUGGESTED SUPPLEMENTS TO S. 502

So that S. 502 may be appropriately dovetailed with the Foreign Investment in Real Property Tax Act of 1980 and so that S. 502 will not unintentionally impose an unrelated business income tax on debt-financed income of foreign pension plans whose funds available for investment the bill seeks to attract to the United States, we suggest that the following provisions be added to S. 502. A detailed explanation of the proposed additions follows the text of the additions.

1. "Section 514(c)(9)(C) (relating to unrelated debt-financed income and deductions) is amended by inserting 'or any foreign pension plan within the meaning of section 501(c)(22)' immediately after 'section 401'."

2. "Section 897(c)(1)(A) (relating to United States real property interests) is amended by deleting the phrase 'subparagraph (B)' and substituting therefor the phrase 'subparagraphs (B) and (C)'."

3. "Section 897(c)(1) (relating to United States real property interests) is amended by adding thereto the following subparagraph (C):

" '(C) Exclusion of interest held by foreign pension plan.—The term "United States real property interest" does not include any interest held by a foreign pension plan within the meaning of section 501(c)(22).' "

* * * * * * *

TECHNICAL EXPLANATION OF ABOVE PROPOSED ADDITIONS

Addition No. 1, amending section 514(c)(9)(C).—Formerly, United States pension plans were subject to the unrelated business income tax imposed by section 511 with respect to debt-financed income within the meaning of section 514. These provisions were intended essentially to prevent exempt organizations from engaging in certain transactions with related persons. However, effective January 1, 1981, Congress has enacted section 514(c)(9), providing, in essence, that the unrelated business income tax does not apply to the debt-financed real estate income of a qualified trust within the meaning of section 401. At the same time, the new section specifies that it does not offer exemption to property involved in certain dealings between a qualified trust and a related party.

However, a "qualified trust" must be a domestic entity and it must comply with the provisions of ERISA. Given the purpose of S. 502 to extend U.S. pension plans' tax regime to foreign pension plans, the reference to "foreign pension plans within the meaning of section 501(c)(22)" should be added to section 514(c)(9)(C) since, by hypothesis, foreign pension plans are not domestic entities and may not comply with ERISA in all its detail.

If this change is not made, the position of the foreign pension plan will in many instances be adversely impacted by S. 502. This is because subsection (b) of S. 502 subjects foreign pension plans for the first time to the unrelated business income tax. This tax is imposed (after the first $50,000 of taxable income per year) at flat rates in excess of 28 percent and scaling up to 46 percent. It does not allow for the 28 percent maximum tax on long-term capital gains which section 1201 makes available to other taxpayers. Foreign pension plans may therefore find themselves facing a 46 percent tax on capital gains if S. 502 is enacted without the recommended change. Undoubtedly, the imposition of the unrelated business income tax on debt-financed income would be a significant disincentive for foreign pension plans to invest in the United States—or even to retain their existing debt-financed investments in this country.

Additions nos. 2 and 3, amending the definition of "United States real property interest".—This addition is necessary for two reasons:

(*a*) To make it unarguably clear that the tax on foreign investors' real estate gains imposed by section 897 is not applicable to a foreign pension plan which qualifies as an exempt organization under section 501(c)(22).

(*b*) To exempt such foreign pension plans from the reporting requirements imposed by section 6039C, which were enacted to enforce payment of the section 897 tax. Since the suggested addition to S. 502 goes to the definition of "United States real property interest" and since the involvement of a "United States real property interest" is necessary for section 6039C to impose any reporting requirements, the proposed amendments to section 897(c)(1) would automatically exempt qualifying foreign pension plans from the section 6039C reporting requirements. We would recommend that the Committee report specify that the proposed amendments to section 897(c)(1) were intended also to exempt qualifying foreign pension plans from reporting under section 6039C. Alternatively, if the Committee prefers, such clarification might be provided by the addition of a fourth supplement to S. 502, which could read as follows:

"Section 6039C(e) (relating to special rules for reporting of United States real property interests) is amended by adding thereto the following paragraph (3):

"(3) Foreign pension plans.—A foreign pension plan within the meaning of section 501(c)(22) shall be excluded from (A) the corporations to which subsection (a) of this section applies, (B) the entities to which subsection (b) of this section applies, and (C) the persons to whom subsection (c) of this section applies.' "

Summarizing, we respectfully recommend that, in enacting S. 502, the Congress add to the measure the supplementary provisions detailed and explained above.

If we can be of assistance to Congress in connection with any matter covered in this technical memorandum or the attached statement, we invite you to contact either Edwin A. Howe, Jr. or John Sann at the above address or telephone number.

Respectfully submitted,

EDWIN A. HOWE, JR.

STICHTING UNILEVER PENSIOENFONDS "PROGRESS,"
Rotterdam, Netherlands, April 16, 1981.

MR. ROBERT LIGHTHIZER,
Chief Counsel, Finance Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. LIGHTHIZER: With reference to the hearing on 16th March, 1981 on S. 502, we respectfully submit to the Senate Finance Taxation subcommittee for insertion in the hearing record, that in our opinion, Dutch pension funds would increase their investments in U.S. equity securities and real estate if S. 502 were to become law. Elimination of the 15 percent withholding tax on dividends would improve rather low yields on U.S. equity securities and elimination of capital gains tax on profits from disposition of real estate would increase growth prospects of investments with low initial yields and foreign exchange risks. Dutch Pension Funds ought to be able to prove readily that they meet criteria for tax exemption under S. 502, because they are maintained to provide retirement benefits to employees, with assets that are segregated from the assets of the employer under Dutch Law and income of the plan is in Holland exempt from tax.

Yours sincerely,

G.O.J. VAN TETS, *President.*
R. CLEMENT, *Vice President.*

PHILIPS PENSIOENFONDSEN

DIRECTIE

Eindhoven, April 10, 1981

Mr. R. Lighthizer
Chief Counsel, Finance Committee
Room 2227
Dirksen Senate Office Building
WASHINGTON D.C. - U.S.A.

Dear Mr. Lighthizer,

With reference to the hearing on March 16, 1981 on section 502, we respectfully submit to the senate finance taxation sub-committee for insertion in the hearing record, that, in our opinion, Dutch pension funds would increase their investments in U.S. equity securities and real estate if section 502 were to become law.

Eliminiation of the 15 per cent withholding tax on dividend would improve rather low yields on U.S. equity securities and elimination of capital gains tax on profits from disposition of real estate or shares of real estate holding companies would increase growth prospects of investments, with low initial yields and considerable foreign exchange risks.

Dutch pension funds ought to be able to prove readily that they meet criteria for tax exemption under section 502 because:

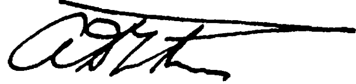
2/..

a. our pension funds are maintained primarily to provide retirement benefits to employees;

b. the assets of the plan are segregated from the assets of the employer under Dutch law;

c. under Dutch law the income of the plan is exempt from tax.

Yours faithfully,



Drs. A.D.J. van Riel

Adopted by the membership of
Independent Sector on April 29, 1981

Board's Recommendation For An INDEPENDENT SECTOR Position Favoring Amendment of the Foundation Disbursement Requirement

Last fall, our Government Relations Committee began consideration of a possible recommendation that IS take a position supporting amendment of the tax laws governing the required annual disbursement for foundations.

That review has included an optional session for all interested Members, extensive discussion and study of background materials at two meetings of the Committee, and extensive discussion at two Board meetings.

On the basis of that consideration, the Board is fully persuaded that the sector as a whole has a stake in the health of foundations and that the law governing annual payout is not conducive to such health. Specifically, the law leads to unsound investment practices and to shrinking assets.

Therefore, the Board, on recommendation of our Government Relations Committee, recommends that INDEPENDENT SECTOR adopt the following position:

THE EXISTENCE OF PLURALISM AND INDEPENDENT ORGANIZATIONS WILL CONTINUE ONLY IF THERE ARE MULTIPLE SOURCES OF SUPPORT, INCLUDING AND ESPECIALLY NON-GOVERNMENTAL SOURCES.

FOUNDATIONS REPRESENT ONE OF THE RELATIVELY FEW SOURCES OF SUCH INCOME. UNFORTUNATELY, CURRENT LAW REQUIRES A PAYOUT OBLIGATION OF FOUNDATIONS WHICH WILL INEVITABLY SHRINK FOUNDATION ASSETS AND THUS LEAVE LESS MONEY FOR ANNUAL DISTRIBUTION TO VOLUNTARY INSTITUTIONS. SPECIFICALLY, THE LAW REQUIRES FOUNDATIONS TO ANNUALLY PAY OUT AN AMOUNT EQUAL TO 5% OF ASSETS OR ACTUAL NET EARNED INCOME, WHICHEVER IS HIGHER. THUS, IN A YEAR WHEN INCOME ON INVESTMENTS IS 7%, A FOUNDATION IS REQUIRED TO DISTRIBUTE THE FULL 7% AND IN A YEAR WHEN INCOME IS 2%, A FOUNDATION IS NEVERTHELESS REQUIRED TO PAY OUT 5%.

BECAUSE THE SECTOR AS A WHOLE HAS A STAKE IN THE FUTURE VIABILITY OF FOUNDATIONS, INDEPENDENT SECTOR FAVORS AN AMENDMENT TO THE LAW. WE FAVOR A REASONABLE DISBURSEMENT REQUIREMENT, BUT REMOVAL OF UNREALISTIC REQUIREMENTS.

WE, THEREFORE, SUPPORT THE COUNCIL ON FOUNDATIONS' POSITION TO AMEND THIS LAW TO CALL FOR A FLAT 5% ANNUAL DISBURSEMENT REQUIREMENT. NOTHING IN THIS WOULD PREVENT A FOUNDATION FROM DISTRIBUTING MORE THAN 5%.

CURRENT MEMBERSHIP OF INDEPENDENT SECTOR

Aetna Life and Casualty Company
Agudath Israel of America
Aid Association for Lutherans
Alcoa Foundation
Alliance for Volunteerism
American Arts Alliance
American Association for Higher Education
American Association of Fund-Raising Counsel, Inc.
American Association of Homes for the Aging
American Association of Museums
American Cancer Society
American Citizens Concerned for Life
American Council for the Arts
American Council of Voluntary Agencies for Foreign Service
American Federation of Arts
American Heart Association
American Hospital Association
American Kidney Fund
American Lung Association
American Red Cross
American Social Health Association
American Telephone and Telegraph
American Theatre Association
Appalachian Mountain Club
Arrow, Inc.
Aspira of América, Inc.
Association for International Practical Training
Association of Black Foundation Executives, Inc.
Association of Governing Boards of Universities and Colleges
Association of Jesuit Colleges and Universities
Association of Junior Leagues, Inc.
Association of Science Technology Centers
Atlantic Richfield Foundation
Avon Products, Inc.
Mary Reynolds Babcock Foundation
BankAmerica Foundation
Bankers Trust Company
Bethlehem Steel Corporation
Blue Cross and Blue Shield Associations
Borden Foundation
Bristol-Myers Fund
Business Committee for the Arts, Inc.
Call for Action, Inc.
Camp Fire, Inc.
Carnegie Corporation of New York
Carter Hawley Hale Stores, Inc.
Catalyst
CBS, Inc.
Center for Responsive Governance
Chase Manhattan Bank, N.A.
Chevron U.S.A., Inc.
Children's Aid International
Citizen's Scholarship Foundation of America, Inc.
Clearinghouse on Corporate Social Responsibility
Cleveland Foundation
Coca-Cola Company
Committee for Corporate Support of Private Universities, Inc.
Committee for Public Justice, Inc.
Commonwealth Fund
Connecticut General Insurance Corporation
Conoco, Inc.
Conservation Foundation
Continental Bank Foundation
Continental Group Foundation, Inc.
Council for Advancement and Support of Education
Council for American Private Education
Council for Financial Aid to Education
Council for the Advancement of Small Colleges
Council of Better Business Bureaus Philanthropic Advisory Service Division
Council of Jewish Federations
Council on Foundations
CPC International, Inc.
Crum and Forster Foundation
Charles A. Dana Foundation, Inc.
Dart Industries
Arthur Vining Davis Foundations
Dayton Hudson Foundation
Deere and Company
Geraldine R. Dodge Foundation
Gaylord Donnelley Foundation
Duke Endowment
E. I. Du Pont de Nemours and Company
Durfee Foundation
Dyson Foundation
Eastman Kodak Company
Eaton Corporation
Educational Testing Service
Epilepsy Foundation of America
Equitable Life Assurance Society of the United States
Evangelical Council for Financial Accountability
Exxon Corporation
Family Service Association of America
Ford Foundation
Ford Motor Company Fund
Foremost-McKesson Foundation, Inc.
Foundation Center
Fresh Air Fund
Gannett Foundation
General Conference of Seventh Day Adventists
General Electric Company
General Mills Foundation
General Motors Corporation
Girl Scouts of the U.S.A
Girls Clubs of America, Inc.
Grace Foundation
William T. Grant Foundation
Grotto Foundation
Gulf + Western Foundation
Gulf Oil Corporation
George Gund Foundation
Josephine and Peter Haas Fund
Walter and Elise Haas Fund
Hawaiian Foundation
Edward W. Hazen Foundation
William and Flora Hewlett Foundation
Hewlett-Packard Company Foundation
Hogg Foundation for Mental Health

Hospital Research and Educational Trust
IBM Corporation
Independent College Funds of America, Inc.
Independent Research Libraries Association
International Service Agencies
International Telephone and Telegraph
James Irvine Foundation
Ittleson Foundation
Jerome Foundation
Robert Wood Johnson Foundation
Johnson & Johnson
Joint Action in Community Service
Joyce Foundation
Henry J. Kaiser Family Foundation
W. K. Kellogg Foundation
Charles F. Kettering Foundation
Kraft, Inc.
Leukemia Society of America, Inc.
Levi Strauss Foundation
Lilly Endowment, Inc.
Henry Luce Foundation
Lutheran Council in the U.S.A.
Lutheran Resources Commission—Washington
Lyndhurst Foundation
March of Dimes Birth Defects Foundation
McGraw-Hill Foundation
Merck Company Foundation
Joyce Mertz-Gilmore Foundation
Metropolitan Life Foundation
John Milton Society for the Blind
Mobil Oil Corporation
Philip Morris, Inc.
Charles Stewart Mott Foundation
National American Indian Court Judges Association
National Assembly of Community Arts Agencies
National Assembly of National Voluntary Health and Social Welfare Organizations, Inc
National Assembly of State Arts Agencies
National Association for Hospital Development
National Association of Bilingual Educators
National Association of Independent Colleges and Universities
National Association of Schools of Art
National Association of Schools of Music
National Audubon Society
National Black Media Coalition
National Board of Young Men's Christian Associations
National Board of Young Women's Christian Association of the U.S.A.
National Catholic Development Conference, Inc
National Coalition of Hispanic Mental Health and Human Services Organizations (COSSMHO)
National Community Education Association
National Concilio of America
National Conference of Catholic Charities
National Council of La Raza
National Council of the Churches of Christ in the U.S.A.
National Council of Women of the United States, Inc.
National Easter Seal Society, Inc.
National Executive Service Corps
National Fund for Medical Education
National Health Council, Inc.
National Hospice Organization, Inc.
National Image, Inc.
National Information Bureau, Inc.
National Mental Health Association
National Parks and Conservation Association
National Puerto Rican Forum, Inc.
National School Volunteer Program, Inc.
National Self-Help Clearinghouse
National Society for Autistic Children
National Society of Fund Raising Executives
National Trust for Historic Preservation
National Urban Coalition
National Urban Fellows, Inc.
National Urban League, Inc.
National Wildlife Federation
Nature Conservancy
New England Mutual Life Insurance Company
New World Foundation
New York Community Trust
New York Life Foundation
New York Times Company Foundation, Inc.
Nordson Foundation
Northwest Area Foundation
Opera America
Overseas Development Council
Owens-Illinois, Inc.
Parents Without Partners
Partners for Livable Places
J.C. Penney Company, Inc.
People-to-People International
Pepsico Foundation, Inc.
Pfizer Foundation, Inc.
Piton Foundation
Planned Parenthood Federation of America, Inc.
Population Crisis Committee/Draper Fund
Population Resource Center
Procter and Gamble Fund
Prudential Foundation
RCA Corporation
Reading is Fundamental, Inc.
Republic Steel Corporation
Rockefeller Brothers Fund
Rockefeller Family Fund
Rockefeller Foundation
Rosenberg Foundation
Safeco Insurance Companies
Russell Sage Foundation
Salvation Army
Schering-Plough Corporation
Dr. Scholl Foundation
Shell Companies Foundation, Inc.
Sherwin-Williams Company
Lois and Samuel Silberman Fund
Alfred P. Sloan Foundation
Spencer Foundation
Standard Oil Company (Ohio)
Jules and Doris Stein Foundation
W. Clement and Jessie V. Stone Foundation
Student Conservation Association, Inc.
Support Center
Synagogue Council of America
Syntex (U.S.A.), Inc.
Taconic Foundation, Inc.
Tandy Corporation
Teachers Insurance and Annuity Association of America/College Retirement Equities Fund (TIAA-CREF)
Telecommunications Cooperative Network
3M Company
Time Inc.
Times Mirror Foundation
Tosco Corporation
Travelers Insurance Companies
Trebor Foundation
Trust for Public Land
Union Carbide Corporation
Union of Independent Colleges of Art
United Negro College Fund
United States Catholic Conference
United States Committee for UNICEF
United States Olympic Committee
United States Steel Foundation, Inc.
United Way of America
Urban Institute
VOLUNTEER: The National Center for Citizen Involvement
Volunteers of America
Izaak Walton League of America
Women and Foundations Corporate Philanthropy
Xerox Corporation
Zero Population Growth

BEST COPY AVAILABLE

Stichting Shell Pensioenfonds

Mr. R. Lighthizer
Chief Counsel, Finance Committee
Room 2227 Dirksen Senate Office Building

WASHINGTON D.C.

U.S.A.

Your ref.:

Our ref.: FNPH (FNPH/1 - FNPH/2 - SOG - FNXH/23) ☎ (070) 77 18 83

The Hague, 26th May, 1981

Dear Mr. Lighthizer,

With reference to the hearing on March 16. 1981 on S. 502, we respectfully submit to the senate finance taxation sub-committee for insertion in the hearing record, that, in our opinion, Dutch pension funds would increase their investments in U.S. equity securities and real estate if S. 502 were to become law. Elimination of the 15 percent withholding tax on dividends would improve rather low yields on U.S. equity securities and elimination of capital gains tax on profits from disposition of real estate or shares of real estate holding companies would increase growth prospects of investments with low initial yields and considerable foreign exchange risks.

Dutch pension funds ought to be able to prove readily that they meet criteria for tax exemption under S. 502 because the Dutch requirements in the tax and social laws about pension funds and -regulations are at least as rigid as those of the ERISA 1974. E.g. according to section 11 (3) of the Wage Tax Act and therefore also for the Income Tax Act a pension regulation in the sense of the law can only have as object the maintenance of employees and former employees, when they become invalid and/or of old age and the maintenance of their widows and orphans by means of a pension that does not exceed an amount which, taking into account the service years and remuneration received, is by common social consent reasonable.
A pension is a gradual payment depending on life of the retiree, so that only in exceptional cases lump sum payment may be allowed.

- 2 -

Stichting Shell Pensioenfonds
Postbus 162
2501 AN DEN HAAG
Nederland

Telex: 31006
Telefoon: (070) 77 91 11
Telegram: Penfund

Gevestigd te Den Haag
Carnegielaan 12
Stichtingsregister S 151226

Mr. R. Lightizer
Washington D.C.

26.5.1981

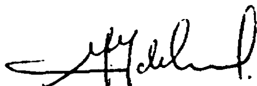
The Dutch Pension and Saving Funds Act requires an employer, who has given pension entitlements to cover his obligations with a separate pension fund or with insurance companies and sets a number of conditions and controls to saveguard the employee.

The funds regulations have to be apprcved by the Minister of Social Affairs and it is supervised (like the insurance companies) by a governmental body: the Insurance Chamber. The money received by the pension fund have to be invested segregated from the assets of the employer.
The fund may not possess more than 5% of its investments in shares and/or in claims on an employing company with which it is connected.

The income of the pension fund from the investments necessary to cover its obligations is exempt from corporation tax and Netherlands dividend tax provided its regulations are in accordance with art. 11 (3) of the Wage Tax Act mentioned above (section 5 (b) Corporation Tax Act).

Yours faithfully,

Stichting Shell Pensioenfonds



- Drs. J.J. de Kort -

U.S. DEPARTMENT OF JUSTICE,
FEDERAL BUREAU OF INVESTIGATION,
Washington, D.C., June 1, 1981.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Taxation nad Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR CHAIRMAN PACKWOOD: On March 16, 1981, Executive Assistant Director John Otto testified before your Subcommittee regarding S. 565 which was introduced by Senator Ted Stevens. If enacted, this legislation would permit a taxpayer to deduct reimbursements attributable to qualified residence sale or purchase expenses up to an amount equaling the maximum allowed under the Federal Travel Regulations. During his testimony, Mr. Otto mentioned that we recently conducted a survey of all of our managers at the GS-16, 17, and 18 levels. The purpose of this survey was to obtain information on their progression through the administrative ranks and to discover the effect that this advancement has had on their financial situation, their family life and their perceptions of career advancement. I am enclosing a copy of this survey and have also forwarded a copy to Senator Stevens.[1]

I am also enclosing for your use a copy of Mr. Otto's statement before the Subcommittee on Civil and Constitutional Rights, House Committee on the Judiciary on March 25, 1981, inasmuch as this statement sets forth the full range of problems which are faced by our Agents when they are transferred. As Mr. Otto testified on March 16 before your Subcommittee and again on March 25, although we are concerned with all financial hardships borne by our Agents when they are transferred, the area that we are most concerned with is the taxation of reimbursements which are made in connection with transfers.

I trust that the enclosed information set forth in the survey will be helpful to you and the other Members of the Subcommittee.

Sincerely yours,

WILLIAM H. WEBSTER, *Director.*

STATEMENT OF JOHN E. OTTO, EXECUTIVE ASSISTANT DIRECTOR, FEDERAL BUREAU OF INVESTIGATION BEFORE THE SUBCOMMITTEE ON CIVIL AND CONSTITUTIONAL RIGHTS, COMMITTEE ON THE JUDICIARY, HOUSE OF REPRESENTATIVES OF THE UNITTED STATES, MARCH 25, 1981

Mr. Chairman, I am the Executive Assistant Director for Law Enforcement Services for the Federal Bureau of Investigation (FBI). I am also the Chairman of the FBI Career Board. In that capacity, I make recommendations to the Director of the FBI on all promotions to positions up to and including the position of Assistant Director. An integral part of the FBI's Career Development Program involves transfers as a part of appointments to positions of increasing responsibility. In reaching my present capacity, I have made ten transfer in my sixteen years of FBI service; I am very familiar with both the financial and emotional hardships which are a part of any move as a Government employee. I therefore appreciate, on behalf of myself and the approximately 7750 Special Agents, the opportunity to share with you some of the financial problems which our Agents face when they are transferred in order to accept promotional advancement.

This morning I would like to focus my remarks on the transfers which we make through our Career Development Program; however, the problems that I will highlight are evident in any transfer which we make. Our Career Development Program governs the promotion and administrative advancement procedures for Special Agents. We have 59 Field Offices and 438 Resident Agencies (sub-offices under the Field Offices) throughout the Nation, in addition to FBI Headquarters here in Washington which must be staffed. Although we are promoting Agents in place when possible in the interest of efficiency and relieving some of the hardships on our Agents, the filling of most of our supervisory vacancies involves a transfer because of our considered desire to nationalize rather than regionalize the management of the FBI.

Before I address the hardships associated with the transfers, I will take a few minutes to explain the FBI's Career Development Program. The Career Development Program is a significant cause of transfers, but as you will see, eliminating career development transfers is *not* a realistic option for the FBI.

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[1] The survey was made a part of the official files of the committee.

The FBI operates a system which fills management vacancies as they occur. We do not make transfers for the sole purpose of moving a manager after he has served for a specified period of time in one assignment. In filling vacancies this way we give developmental experience to our managers and insure that our Headquarters is staffed by Agents both with recent Field experience and with the special expertise that we need here at Headquarters. We also insure that our Field Offices are managed by managers who have a broad background of experience including Headquarters assignments.

Entry into the Career Development Program is voluntary. This chart illustrates a typical advancement pattern for an Agent who has entered the career advancement path and performed well. An Agent starts his career as a "street Agent" conducting investigations in a Field Office. He may move one or more times as the needs of the Bureau dictate.

After several years of Field experience, a street Agent, who demonstrates management aptitude, is eligible to become a relief supervisor on one of the squads in the Field Office where he or she is assigned. A relief supervisor gains management experience by assisting the squad supervisor, and by acting as the supervisor when the designated supervisor is absent.

We do have a system of evaluating the management potential of participants in the Career Development Program. The Supervisory Level Management Aptitude Program (MAP I) evaluates persons prior to their becoming Field supervisors. The Executive Level Management Aptitude Program (MAP II) is used to identify those persons who have the aptitude to serve as an Assistant Special Agent in Charge (ASAC).

After the relief supervisor has successfully completed MAP I, he is eligible for either promotion to fill an existing squad supervisory vacancy in the Field or to fill a Headquarters vacancy. In order to limit transfers we are promoting in place where possible. In order to simplify our discussion I will, however, limit my comments to the Agent who is transferred to Headquarters prior to serving as a Field supervisor.

Although the investigative work of the FBI is done in our Field Offices and Resident Agencies, FBI Headquarters in Washington also has an important role: It coordinates the investigative and administrative efforts of the local offices and sets policy. The relief supervisor moves to a position at Headquarters as a Headquarters supervisor. This experience, generally lasting two to four years, will provide the Agent the national perspective in preparation for his later assignment as a supervisor in a Field Office or Resident Agency—what we call the "Field."

We fill many Field supervisory vacancies with Headquarters supervisors. After serving as a Field supervisor this individual is eligible for promotion to an ASAC opening in the Field or back to Headquarters as a Unit Chief. The Agent who returned to Headquarters as a Unit Chief would next move back to the Field as an ASAC. The Agent may then be returned to Headquarters either as a Section Chief or a full Inspector. And, finally, he may be reassigned to the Field as a Special Agent in Charge (SAC).

Although in the past it has taken an Agent as many as seven moves to reach this pinnacle, we are making every effort to limit the transfers necessary to reach this position to three to five transfers.

The financial hardships associated with a transfer are a result of the fact that the reimbursements which the Government makes in connection with expenses which are incurred during a transfer are in most cases very inadequate. These financial hardships are aggravated by the fact that these inadequate reimbursements are taxed as ordinary income when they exceed $3,000. Although Federal wages are not the subject of this hearing, in order for me to correctly characterize these financial hardships, I must mention the Federal pay cap. As a result of the pay cap, the financial hardships associated with a transfer are further aggravated when in most instances the promotion and transfer do not result in an increase in salary. In fact, as a result of escalating mortgage interest rates, inadequate reimbursements, and the taxation of these reimbursements, most promotions result in a reduction of the employee's disposable income!

In late 1979 a survey of Special Agents in Charge of seven of our major Field Offices elicited responses from all seven on the deleterious effect of transfers on the Career Development Program. These SAC's estimated that only about one-third of the FBI Special Agents with management aptitude were participating in the Career Development Program, largely because of the financial

hardships associated with transfers. Due to the costs involved, many of our Agents, including many who are involved in the Career Development Program, view moves which are a necessary part of the program as being financially punitive and at times ruinous. As I noted above, our Agents are finding that it is becoming more difficult financially for them to move especially when they make a lateral move at no increase in salary and in the process must buy a home with a higher interest rate and absorb many of the costs associated with the move. Monthly mortgage payments in excess of $1,200 are no longer uncommon for these Agents.

Before addressing the taxation of reimbursement for expenses incurred in connection with a move, I would like to address with some specificity the inadequacies of reimbursements in connection with a transfer. This, I hope, will put the taxation issue in perspective and leave you with the conclusion that taxes are an unreimbursed expense, in a system of reimbursements that is already severely inadequate. We are most concerned with the level of reimbursements for temporary quarters expenses, expenses incurred in connection with the sale and purchase of a residence, and the weight limit of 11,000 pounds in connection with the movement of household goods.

As I have already noted, we are very concerned about the adequacy of the $8,000 limit on reimbursements in connection with the sale of a house. A survey of real estate purchase vouchers which we processed during FY '79 indicated that approximately 12 percent of the employees submitting such vouchers exceed the $8,000 reimbursement limit related to the sale of a residence by an average of approximately $800.00. This survey included transfers of our support personnel and single Agents whose expenses are monetarily less than those of the typical married Agent. We are currently reviewing the data on household goods which were moved pursuant to career development transfers during FY 1980. We will make this data available to ou when the survey is completed. In an area where the real estate commission is 6 percent an Agent would exceed the $8,000 limit on the basis of the real estate commission paid on any home selling for more than $133,333. Where the commission is 7 percent he would exceed the limit with a home selling for $114,285 or more. In addition to the excess commission the Agent would be required to pay all other expenses above $8,000 such as the cost of the seller's title policy, transfer taxes, etc. In our major metropolitan areas it is not unusual to find modest houses in the $115,000 to $135,000 range and above. These figures are based on exceeding the $8,000 limit on the basis of the commission alone. Considering other reimbursable expenses, in many geographic areas an Agent will exceed the limit anytime he sells his home in excess of $100,000.

We have also noticed that weight allowances for the movement of household goods are unrealistic. For instance, an Agent with dependents is reimbursed only for the movement of household goods up to 11,000 pounds. Yet a sampling of our Government Bill of Lading method vouchers showed that approximately 20 percent of such shipments exceeded the 11,000 pound limit. I want to emphasize that this study does not take into account the fact that many employees sell some of their household goods prior to the move so as to come within the weight limitations. We have reviewed vouchers in which our Agents have been personally billed $500 to $3,000 for the transportation of excess weight. Our Agents therefore face the choice between selling their possessions or paying transportation charges each time they move.

Another significant expense involves the temporary quarters allowance. Government employees are reimbursed for a maximum of only 30 days of temporary quarters. Even under optimum conditions few people are able to execute a move without being in temporary quarters for in excess of 30 days. It is not uncommon for our Agents to be on duty at their new office of assignment for up to a year before they are able to sell their homes and move their families. Therefore, they find themselves in the position of maintaining two households during this period and bearing any transportation costs for periodic visits with their families. Most Agents indicate that these costs run them a mnimum of $400–$600 per month while the family is separated and they are only able to meet such expenses by dipping into savings.

This problem has been further aggravated by statutory provisions which reduce these per diem payments to a level which is below those which are authorized in connection with Government travel on official business. Currently, an Agent who is in temporary quarters is allowed $37.50 per day for the first 10

days of temporary quarters, $25.00 per day for the second 10 days and $18.75 per day for the third 10 days. In most large cities these payments will not cover the expenses which are incurred for meals and lodging at a motel or other quarters available on a short term basis.

The area that we are most concerned with is the taxation of reimbursements which are made in connection with transfers. Unless so noted, the data on this problem is not limited to our career development transfers. We find that 100 percent of our transferred Agents exceed the $3,000 tax deduction limit for expenses incurred in connection with a move. These figures were based upon a random survey of 50 FBI Special Agent transfers. All of these Agents exceeded the $3,000 limit with one Agent exceeding it by $19,330. The average cost of these 50 transfers was $9,026. Therefore, the average Agent in this group of transfers faced an increased tax liability of over $6,000 in income in addition to certain non-reimbursable expenses. During Fiscal Year 1980 the Bureau transferred 1,131 employees at a total cost of $8,396,000. Although we know that the average transfer during FY '80 cost $8,468 and that the taxable income of the average transferred Agent was increased as a result of the transfer by $5,468, we know that many of our Agents incurred larger, additional tax liabilities as a result of these moves. We know that we have a number of single or younger, married Agents who move from rental property to rental property and thus incur few expenses. These moves hold down the average costs. Our average cost of a career development transfer for FY '80 was $10,146; increasing the taxable income of Agents by as much as $7,146. Our Budget and Accounting Section recently sampled 100 transfers which occurred during FY 1979. When inflation factors were applied it was estimated that in FY 1982 the average career development transfer will cost $12,933. After taking a $3,000 deduction this Agent will find that his taxable income has been increased by as much as $9,933 which is not disposable income. He will further find that he is paying taxes on his total income at a higher tax rate due to this increase. Because these Agents are taxed on these reimbursements, the net effect is that their reimbursement is reduced by the amount of the additional tax liability which they incur. We are convinced that this tax liability will continue to increase.

We recently conducted a survey of all of our managers at the GS-16, 17, and 18 level. The purpose of ths survey was to obtain information on their progression through the administrative ranks and to discover the effect that this advancement has had on their financial situation, their family life, and their perceptions of career advancement. In assessing the impact of moves on their financial situations a large number of the survey respondents mentioned the additional tax liability which occurs when Government reimbursements exceed the $3,000 deduction. The additional tax liability burden on each of these respondents averaged $3,860. This resulted in a reduction of already inadequate reimbursements and invariably in the individual being pushed into an artificially higher tax bracket. The survey also revealed that 42 percent of the respondents incurred an average loss of $6,450 per transfer including tax losses.

Although I have not been able to discuss all of the problems which we have identified, I have been able to highlight the major financial problems associated with a transfer. Before I close I want to focus for a moment on the emotional costs, because our Agents have found that moving is both an emotional and financial hardship on both them and their families. The emotional costs are self-evident. A transfer takes the Agent, the Agent's spouse and children away from familiar surroundings in which they feel secure and where they have developed a circle of friends. They must then begin anew to develop this security and the human relationships that they had. After several of these moves, some children tend to avoid establishing close relationships with other children since they anticipate the pain of having to leave. Working spouses must begin the stressful task of job hunting. Many nonworking spouses feel the loss of familiarity and security to an even larger extent. Much of the responsibility for finding new doctors, dentists, places to shop, churches and areas of recreation falls upon them. Although it would be difficult and perhaps impossible for us to alleviate these hardships, we can reduce the financial hardships and in so doing reduce the emotional strain on these families.

The problems that I have detailed this morning do more than injure individual Agents. They are damaging our Career Development Program. As I have noted we know that many Agents with management aptitude are choosing not to participate in the program, largely because of the financial hardships associi-

ated with transfers. Frankly, in light of these costs, such Agents may have made a reasonable choice.

The Bureau is doing what it can. We plan to reduce the number of transfers to the minimum consistent with the goal of maintaining a well-trained management group to direct a national organization. In addition to reducing the number of transfers, we are working hard to give earlier notice of transfers. We recently increased the period within which the employee may report to the new assignment. The additional time to make arrangements should reduce the costs associated with moves.

These measures are the only ones within our power. Mr. Chairman, they are not enough.

In closing my remarks, I want to thank you for your interest in these matters which are of such great concerns to us.

I will now be happy to answer any questions which you have on this matter.