EXECUTIVE SESSION

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FRIDAY, JULY 21, 1978

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United States Senate,

Committee on Finance,

Washington, D.C.

The Committee met, pursuant to notice, at 10:15 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long, (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Nelson, Bentsen, Curtis, Hansen, Dole, Packwood and Danforth.

The Chairman. Let me just call the Committee to order, because there is a matter that we ought to be discussing about this bill, and I am not sure while every Senator needs to hear it. While we get a quorum here, we can discuss a matter that troubles me, and I am not sure -- let me ask Mr. Stern -- I would rather have Mr. Constantine explain this problem to me. Apparently he and Senator Talmadge see it in the same way and they have explained it to me, at least on one occasion. I swear, every time I hear the other side of it, I am confused all over again.

If I am to understand what you are proposing here is 5 percent return on hospitals. Is that correct?

Mr. Constantine. Senator, I think that the bill increases

the allowable rate of return to for-profit institutions to two times the average rate of return on Social Security investment, from one and one-half times in present law. The present return is about -- we allow 11 percent on net equity now. Under the bill, it would be about 15 percent before taxes.

I think the argument that the for-profit hospitals make is that is a before-tax return, Senator, so for some of them, 11 percent could get to 5 percent after taxes.

Senator Long. Well, ordinarily it would seem to me that just moving in the field of pure economics, where you say it is a good thing to do, it ought to be as profitable as the average manufacturer, let us say, the rule of thumb that the other industries look to.

What is the average of manufacturing?

So one, the argument is why, if they need to attract capital, why should they not be the same as the average manufacturer? That is number one.

Number two, let us assume that you borrow money, well, let us say at 9 percent nowadays. All right. And, of course, that 9 percent, you pay no corporate income tax on that 9 percent capital to be taxed only to the individual who does the lending, or the institution.

Now, if the money that is loaned goes in at 9 percent, which is not taxed at the corporate level, then if you are in a 48 percent bracket, would you not need to make 18 percent in order

that your equity be treated as favorably as the borrowed money that is borrowed to put in the business?

Mr. Constantine. Yes, sir.

Senator Long. Why should not the tax treatment on the equity of the business be on a par with the tax treatment and the after-tax return on the borrowed money? Why should it not be at a minimum, to be as attractive to put money into it as to borrow money?

Mr. Constantine. That is the posture the Committee took in 1966 when it added to the original Medicare statute. There was not a return from the Administration, and this Committee had a provision to add that one and a half times return to try to equate investment and borrowing.

If you do not get a turn on equity, there is no point in putting money in. If you borrowed, we would reimburse the borrowing costs. The dilemma we had, Senator -- I talked to Dave Jones again yesterday, Chairman -- there is a lot of validity to their point about a bona fide return on investment.

The problem is, they want to pay that guaranteed return to all hospitals regardless of whether they are efficient, ineffieient, or regardless of whether you want to attract capital. In many cases there are places where you do not want to attract new hospital investment, and others you do.

The Chairman. I can go with you on the idea, that it is in fact no problem to say, all right, now. We do not want to reward

the inefficient. If you have an inefficient operation, we do not want to reward him with that competitive return. He ought to be required to be an efficient operator.

And we do not want to use that to have you build a hospital somewhere where there is excess to need. We do not want that.

But now, if you assume that this is an efficient operation and then you assume that it is a service needed in the community, if you make those two assumptions, then why should not the return on capital be as favorable a one as to what the return would be after taxes if you borrowed the money to achieve the same result. And why should it not be as favorable as the average investment that is available on an equity basis?

Mr. Constantine. Senator, there is no quarrel with you there. We agreed with Mr. Jones on that yesterday, speaking for the investor-owned hospitals, and he is going back and developing an approach to increase the return, to put it on a par with borrowed money for efficient facilities.

So you are not giving the return to everyone indiscriminately, but where an investor-owned hospital is providing necessary service and is operating efficiently, that it would get a return equal to the borrowing. He is coming back with that.

The Chairman. It would be all right with me to say that the average return on investor-owned hospitals after taxes would be about the same as the average return for the average manufacturer after taxes. It seems to me that in doing so, you ought to try to

have it come to the point, what are they making on their equity, and that it be a little better than what they are making on the borrowed money.

I think you would like to encourage equity investment, compared to the whole thing being on borrowed money. At a minimum, it ought to be at least as favorable as it would be if you had to borrow all of the money to do the job.

To me, that is just common sense. I would be willing to settle for a situation out of 100 hospitals, you just put them on a chart in terms of who is doing the best job. If you arrive at the middle point, number 50, so the average, right in the middle, would work out to where it is an average for manufacturing and half of them do well and half of them do a little better.

If you think the private hospital effort is a good idea, and apparently it is catching on -- my impression is that they do a very good, efficient job. They had better, or else they are going to lose money. If you do it that way, I do not see where everybody would not be satisfied and happy.

I do not see that it is fair to deny them the same rate of return that works out to be about the average for manufacturing.

Mr. Constantine. We can draft something up, Mr. Chairman, and come back to you with that.

Senator Bentsen. May I interrupt so I can better understand this, Mr. Chairman? I understand the logic of what you are saying and am sympathetic with it. As you strive for that norm,

are you talking about that average -- I do not think this is what you meant, being the maximum of what they can make, or not. If that is the maximum, then the average goes below that. How do you put a top on that? How do you put a limit?

The Chairman. As I understand it, the bill you hae here is a bill that penalizes the inefficient and rewards the efficient. Is that not right?

Mr. Constantine. Yes, sir.

The Chairman. All right.

Then you would think that the average return that you are going to provide for hospitals would work out to be about the same as the average for other businesses competing for capital, about the average of manufacturing. And now, if that is the case -- furthermore, you would hope it would be as attractive to put your money on an equity basis as it would to put your money, to lend your company the money to do the business with.

So if you tried to work it out that way, you would then have this industry about asprofitable as an average for manufacturing, with those who do a very superior job being rewarded for it, to make it more than average. Those doing a lousy job will be penalized for their inefficiency.

If you want the hospital industry to compete effectively for capital, that is the way it should work out.

Mr. Constantine. They would get more. That would be the best return on their investment. If they earned incentive payments,

that would be in addition to the return on equity. They would get additional payments, vonus payments, as the result of productivity through the performance.

Senator Bentsen. I do not want to guarantee them against failure either, though. If they are inefficient, there is no reason to see them compensated. You do not do that in this situation?

Mr. Constantine. No, sir. That is what Senator Long is getting at. The increased return on equity would be available to the efficient institutions, the relatively efficient ones, and the ones that are necessary, that it would not just go indiscriminantly to everyone.

Senator Nelson. I really do not understand how that would work. How do you measure productivity? How do you measure efficiency? What is that standard?

You can keep your beds filled, you know, longer than they should be filled because that is profitable. Once you are empty, you are not making money.

What is your measure of productivity and efficiency?

Mr. Constantine. In this bill, the measure is a comparison of like hospitals and like cost centers with similar hospitals. The test used is the average. You measure all hospitals of the same type -- short-term, general hospitals between 200 and 300 beds. They are grouped together. Then their costs are prepared and an average calculated. The average is calculated

for area wage level differences, so you know where you are. Those below the average in cost are rewarded. Those who are under the bill between the average and 15 percent above it get their costs only, and those who are above 115 percent of the average are reduced to that level.

So that you do have, for better or worse, a benchmark of productivity of one hospital relative to similar hospitals.

The thrust of this bill is to determine the reasonableness of a given hospital's performance in terms of comparing it with other hospitals.

The Chairman. Let me say this. The for-profit hospitals that I have seen in Louisiana have made a tremendous impression on me, in terms of what they have had to offer. They appear to be so far ahead of an average community hospital, that you should hardly speak of the two in the same breath -- the latest equipment, all the latest procedures and everything, made to meet a high standard seeking to arrive at the ultimate in terms of efficiency.

That is how the private system ought to operate. That is how they all ought to operate, to tell you the truth, so when somebody comes in and takes over a hospital and does it that way, I think the public benefits. But if you think it is a good idea and want it done, letting them compete with the others, then it should be on such a basis that the profit they would make would be about the same as if they put their money into

something else.

Certainly the profit that they make on their investment ought to be as good as they could make if they just put it into good, solid loan programs. It ought to be as profitable to take the front risk as it is to take the preferred risk, and, that being the case, they ought to be able to make as much money on their equity as they do on the money they are borrowing, even their own money that you lend to it on a preferred basis.

Mr. Constantine. We will take something up and bring it to you and discuss it, if you do not mind, with some of the other people.

The Chairman. I am not trying to make them more profitable than the other guy. I am just trying to make them as profitable as the other guy.

Senator Curtis. Do you have a figure for the median cost of a hospital room, semi-private, and the average cost?

Mr. Constantine. The average is about $180 a day now.

Senator Curtis. Semi-private?

Mr. Constantine. Yes, sir.

Senator Curtis. What is the median?

Mr. Constantine. About the same, Senator.

Senator Curtis. Do you have it broken down by states?

Mr. Constantine. We have the Department people here. Do you have the data by states? Median hospital per diem costs?

Mr. Fullerton. I do not have it with me.

Senator Curtis. I still think the simplest thing, probably we cannot do it at this stage, is to change our system. Instead of reimbursing their costs, they have a fixed fee per day for hospitalization and let the Federal government get out of the business of running the detail of the hospital and that is the amount that they get.

I doubt if we could make such a change right now, if we are going to get this bill out.

The Chairman. Senator, if you are going to do that, you ought to try to do something. If you approach it that way, you ought to try to do something about the number of days they spend at that hospital.

Senator Curtis. Oh, yes, that would be a matter that they would have to have control over.

Senator Talmadge. Mr. Chairman, what I suggest we do, we have had this bill for over a year. We have been working on it three years -- is to vote on Section 2, which is the criteria to determine reasonable cost of hospital services under Medicare and Medicaid and see if the Committee wants to adopt that approach.

I understand that Senator Nelson will offer an amendment to cover beyond Medicare and Medicaid which, of course, comes under the jurisdiction of the Human Resources Committee. I do not have any objection to extending it. I think the Human Resources Committee already has.

The important thing is to determine whether or not we are

going to use this criteria to try and reward efficient hospitals and penalize inefficient hospitals, and get a handle on it in that manner.

That is what Section 2 does. I think staff has some suggestions, also, to add to it.

The Chairman. Have we discussed those suggestions?

Mr. Constantine. Yes, sir. We have suggested staff suggestions. They are listed in this handout. They have been discussed.

The only point that has not been discussed was the question of whether, until such time as there is a health care facilities cost commission, we suggested to establish that, until such time they develop equitable means of fairly comparing hospital ancillary costs, beyond the routine room and nursing service -- there was a provision in here that would permit the Commission to put an interim limitation on those ancillary costs, using a market basket of goods and services which hospitals purchase.

The state of the art is kind of rugged. What we would suggest is that the proposal relate only to hospital routine costs as it were offered. The only time that the interim limitation on ancillaries -- that is, using the market basket -- would apply on ancillary hospital costs would apply before the Commission is ready with proper means of rewarding and penalizing classifying radiology, laboratory pathology, pharmacy, all of those other services in hospitals.

If this voluntary effort fails, that is, the voluntary

effort is the program of the American Hospital Association, the AMA -- I guess Blue Cross is involved -- the Federation of Hospitals, and their objective, it has been recognized in both Ways and Means and Interstate and Foreign Commerce, is to reduce the rate of increase in hospital expenditures over 1976-77 base years by 2 percent, reduce that by that, by at least 2 percent in 1978 and 4 percent over the base year in 1979.

It looks like they are going to make their target this year, and we are simply saying to allow adequate time to do the comparison of ancillary services equitably, we have an approach recognizing the voluntary effort. And if those targets are realized as it applies to Medicare and Medicaid ancillary costs, then no limitation would be applied to those costs, as long as the voluntary effort was working, and until such time as the Health Care Facilities Cost Commission had a proper means of comparing those costs and rewarding, or penalizing.

It is simply realizing that, in large part, we do not have the methodology to fairly compare those costs among hospitals at this point in time, but it does put a safeguard in in terms of not letting them run wild. You would not put an interim limit in unless the voluntary effort failed.

This approach here was discussed with the American Hospital Association and the Federation of American Hospitals, and they indicated that is satisfactory to them. They thought this is fair, simply to avoid putting something in before the Commission

prepared to do it, as fairly as possible.

Before I forget, at this point, we also recommend that if the Committee acts in this area, that it include in its report the recognition of the voluntary effort and that it expects that as long as the voluntary effort is proceeding that the Department of Justice and Health, Education and Welfare will allow them to proceed.

There has been a lot of effort on the part of HEW and the Department of Justice, a lot of confusion created as to whether the hospitals and the doctors, and so on, can work together to try to moderate these costs voluntarily, and it is handicapping and hampering some of the efforts in some of the states. We would recommend that the Committee recognize that effort. We think that the recognition is not unilateraly, because both Interstate and Foreign Commerce and Ways and Means are both working around recognition of the voluntary effort as well; just some formal recognition in the report, at least, would be helpful in resolving any legal issues.

Senator Curtis. How long would you let this voluntary effort be tried?

Mr. Constantine. The test of the voluntary effort, the criteria, is a five-year period.

Senator Curtis. Before anything could be triggered?

Mr. Constantine. Yes, sir.

Senator Curtis. Is that something new, or is that the way

it was?

Mr. Constantine. Senator, the original Talmadge bill, S. 1470 as it was introduced, dealt with adjusted routine costs only and that is what is spelled out here. It then said that the Secretary would come back with recommendations for classifying and comparing for all other hospital costs.

Now, during the course of the hearings on the bill last June, and again in October, or last July and October, there was quite a bit of criticism of it because it did not go to ancillary costs as well. Routine costs account for 40 percent, and the ancillary and out-patient department costs account for the balance of hospital costs.

In an effort to deal with that --

Senator Curtis. Then labor does not cost anything?

Mr. Constantine. Labor?

Senator Curtis. Yes.

Mr. Constantine. Labor is a little more than 50 percent of the hospital costs. They are included in the routine costs and in the ancillary costs, the wage component.

Senator Curtis. The ancillary costs including labor is only 40 percent?

Mr. Constantine. No, sir. The routine costs are about over 40 percent, about 40 percent of hospital costs. Those are essentially the routine room, board, administrative routine and nursing costs.

Senator Talmadge. Mr. Chairman, could we vote on Section 2 and then take amendments thereafter?

Senator Curtis. Does Section 2 commit us to the commission that has been described by Mr. Constantine?

Mr. Constantine. As I understand Senator Talmadge's proposal to Section 2, the Medicare and Medicaid Reimbursement Reform for hospitals, including the suggestions and recommendations in here, which does include the establishment of the Health Care Facilities Cost Commission.

Senator Curtis. Now, I have never seen the legislative language. Maybe you have it now. Do you?

Mr. Constantine. No, sir.

Senator Curtis. But you had several pages of description, and it was language that, in all probability as the years go by, the Commission would have very, very broad powers, and it was not in the Talmadge bill. And I am willing to go along here with a few changes if we stayed somewhat nearer the original Talmadge bill, but that Commission, that is having government control of the whole operations, sight unseen.

Mr. Constantine. If I could explain the Commission, it was an effort to respond to the type of concern that you had expressed about delegating authority to the Secretary of HEW. The Commission would have 15 members, of whom eight would be governmental, Federal, state and local representatives, at least three hospital representatives and the other three would be third-party

payers.

The purpose of the Commission was to have a mechanism that would not have regulatory authority, Senator. They would make the determinations as to how the system of classifying and comparing hospitals established under Section 2 could be refined and improved, to do as much equity as possible. They would deal only with the types of health care facilities covered under Medicare and Medicaid.

For example, we have difficulty in defining what a medical center is. The bill says a medical center is the principal hospital of a medical school for working purposes. At Senator Talmadge's direction forthree years, we worked with the American Medical Colleges trying to come up with a better definition and we have not been able to. We need a better definition. The Commission's job would be to come up with that kind of refinement.

The question of what do you add to reimbursement for intensity, for justifiable increase and expansion of services, it is a very difficult one to answer. That would be the function of the Commission; what are appropriate incentive payments.

Again, you would have a mechanism for ongoing refinement of the system by a group that would visible instead, as we described, some GS-12 in the bowels of HEW making policy. At least you wind up with visibility and a mechanism which Congress can judge in terms of efficacy.

The staff recommended the Commission, Senator, as to have

a greater input of people outside of government for visibility and for ongoing refinement, to make the rough edges smoother over time.

The Chairman. If we are going to get this bill out of Committee, you are going to have to learn to answer a question in 30 seconds.

Mr. Swoap. Mr. Chairman and Members, the difficulty that some of, including the membership, are operating under is the fact that what Jay has been describing is not what is reflected in the staff document that was released on June 15th. Apparently, there have been some changes from that staff document.

For example, the formula that is used to trigger the standby cap on ancillary costs is now different than what is in the June 15th staff memorandum. Senator Curtis asked about the time period during which the voluntary effort would be permitted to proceed. It was indicated that it was five years, but as I read what was just handed to me, which is a description of a formula, that it could be as short as a two-year period because the voluntary effort is proceeding in '78 and '79.

If that voluntary effort failed in 1979, then the Commission would have the authority to invoke the standby cap in ancillary costs.

The other change, apparently, that I just noticed, is that apparently the membership of the Health Facilities, Health Commission, has changed in some respects, becuase you indicated

that there are now eight public members. Is that correct?

Mr. Constantine. We said that at least a majority must be public members.

Mr. Swoap. The staff document of June 15th, the last thing that we have indicates that three members would be representatives of hospitals and five members would represent the public.

All I am saying, we are shooting, in a sense, at a moving target and we need to be absolutely sure of what formula is now being considered, and it appears that the formula could be invoked in a shorter period of time.

Senator Curtis. I do not want to be an obstructionist, and I would like to get rid of this thing as well as everybody else, but I have had my fingers burned on OSHA and on price controls and a lot of other things, and this is some language that frightens me. This is not from some outside source, but it is from the staff bulletin, page 4, paragraph 8. The Commission -- this was not in the Talmadge bill; it has been thought up since. "The Commission would monitor and study all aspects of the interim and permanent reform program and propose such changes and refinements as found appropriate. Such changes would be implemented unless specifically rejected by the Secretary. The Commission would be directed also to develop more equitable cost-effective reimbursement in the following specific categories."

The Chairman. Why do we not just strike out the part that says "such changes that would be implemented unless specifically

rejected by the Secretary, and let them make recommendations.

Senator Curtis. And let the Congress make the changes.

The Chairman. We cannot wait around on that. Let them monitor and recommend and come back. Then if we wanted to make the change, we can make it. But it will be a year before they will be in a position to do it anyway.

Mr. Constantine. On some of the things, Mr. Chairman, you have to make changes rather quickly, such as they have the job of coming up with what do you do with marginal admissions costs?

The Chairman. Jay, let them come up here and tell us, look, here is what we want to do, and we will pass a resolution for them. If we are going to report the bill, we should resolve some of these controversies, and I think we would be better off to say, let them study this. Let them recommend what they think ought to be done and just bring them up here. And if we think it is all right, we will pass a resolution approving it. Is that all right with you?

Senator Curtis. It would be far better -- I think that we should have this outside help to recommend to us, but a Commission that can implement their findings when we do not even have the legislative language before us, frightens me.

Mr. Constantine. Senator, two points -- and I can do this in 30 seconds. We gave this to Mr. Swoap three weeks ago, at the last mark-up on how that was done. In the description here of how that Commission is made up, it says 15 persons: three members

would be representatives of hospitals and 12 members would represent public governmental programs and private third-party programs committed to control costs, control objectives in their own programs. In other words, it is much more than governmental people there.

The Chairman. Why do we not just say that the program would be implemented unless a resolution is passed by either the House that it would not be implemented, then let them send up here, have a procedure where we can just vote it out, and a majority of Congress can vote on it. If you do not want to implement it, do not.

Mr. Constantine. That would work.

Senator Nelson. You are talking about ancillary?

Mr. Constantine. Yes, sir, primarily. Also, to refine the classification. The bill has a classification of hospitals by size, type --

The Chairman. Do not give us any more.

All in favor, say aye?

Senator Danforth. Wait a second. Your proposal, Mr. Chairman, is the old one-House veto concept, is that right?

The Chairman. That is right.

Senator Danforth. You want this Commission to be able to adopt whatever regulations they want with respect to ancillary costs?

The Chairman. We are talking about changes. The Commission

would monitor and study all aspects of the interim program and permanent reform program and propose such changes as they find appropriate. Where you say such changes would be implemented, say, all right, such changes would be implemented unless vetoed by a resolution passed by either House.

Senator Danforth. Just so I can clarify my understanding of this, we are talking about the so-called ancillary costs, is that not right? Is that not all we are talking about now?

Mr. Constantine. They could also refine the per diem comparisons as well, as they got more information.

Senator Curtis. On that page 4, Senator Danforth, it lists six things that they can do.

The Chairman. By the time they do all that, that amounts to changing the law. Just give us the right to veto it. Either House could veto it.

In the Senate, we have a report out there, and after two hours of debate, vote.

Senator Hansen. If the Senator from Missouri would yield, I just observed that while, theoretically the one-House veto does provide a mechanism for Congress to apply some legislative range on the Executive Branch of government, it seems that it is a pretty cumbersome and difficult way to bring about the control that I would hope that we might have.

I say that because we are busy. There will be a full legislative program. It is a difficult thing to try to stimulate, first,

enough understanding of what is at issue, to catch the interest of a majority of members of either House, and then to try to get such a resolution of disapproval through in 15 days. I think that makes pretty ineffective what I suspect Senator Danforth has in mind.

I would prefer to take the other approach, to let the appropriate agencies come forward with the recommendations and if they can sell this Committee first on the desirability and efficacy of it, let us give the approval and recommend it that way. The one-House veto, that is a tough thing to make work, in that opinion.

Senator Packwood. Mr. Chairman?

The Chairman. Yes.

Senator Packwood. I agree. This Commission, as appointed, is going to end up to be a Commission who will want to impose price controls on hospitals. A majority of the members are coming from government bodies. They are not going to be receptive to any problems the hospitals have. A one-House veto will not work. We will end up with most of these price controls going into effect, and I think it is an unwise way to back into it.

Senator Bentsen. Mr. Chairman, I would come down on the same side of the argument. A one-House veto normally deals with the implementation of laws by regulation that we have already passed. Here you are talking about taking a different approach. You are doing something different than we have already agreed to, so you

make a good argument that the Commission ought to come back and make a presentation on those things that they differ on what we, in fact, are recommending.

I would prefer that approach, frankly.

The Chairman. If you do it that way, that means you have to pass an Act of Congress.

Senator Danforth. Mr. Chairman, let us review the bidding here. Let us suppose we go the route of the Talmadge proposal. It seems to me you make a distinction between the routine costs and the ancillary costs. With respect to the routine costs, if we go the Talmadge route, we will have pretty well made the policy decisions, I think; with respect to the ancillary costs, we would have made almost no policy decisions. Is that a fair statement?

Mr. Constantine. Yes, sir.

Senator Danforth. That is to say, with respect to the routine costs, we would have decided the percentage ranges. We would have decided the notion of classification. Otherwise, as I understand it, we would leave it up to the Commission to make the precise determinations as to how the classifications work. Is that not right?

Mr. Constantine. Yes, sir.

Senator Danforth. My understanding is in respect to ancillary costs, we do not know enough to make those kinds of determinations. The state of the art -- is that not what you said? The state of

the art was not refined enough so that we could make a judgment as to how you control ancillary costs.

Mr. Constantine. Yes, sir.

Senator Danforth. I would be willing to delegate a substantial amount of discretion to a Commission to, with respect to routine costs, because I think we would have crossed that policy bridge. But, with respect to ancillary costs, it seems to me that is the area where really this Commission should come back to Congress and we should be proceeding at that point, not by a one-House veto, but just by opening up the question of health cost containment again, and specifically with respect to ancillary costs.

The Chairman. I would like to reach one decision this morning. I move we strike the provision where it says "such changes would be implemented." Just strike it.

Senator Packwood. That is great.

Senator Curtis. With the understanding they make recommendations to Congress.

The Chairman. Let them make their recommendation to Congress and we will worry about it later, how we are going to implement it.

Senator Danforth. With respect to the routine costs, would the whole thing just fail if that were stricken?

Mr. Constantine. If you knock the ancillaries out?

Senator Danforth. Let us just take the routine costs question

in isolation. Now, then. If you struck this, if you struck this sentence, "Such changes would be implemented unless specifically rejected by the Secretary," would that, in effect, sabotage the Talmadge bill with respect to return costs?

Mr. Constantine. Just moderately. They might say that for rural hospitals the classification of the bill, by size, is not quite right. It does not yield an equitable result. Then they have to come back to Congress on that. But we do not anticipate too many changes on the routine side, based on our discussions with the various hospital groups.

It is the ancillary area that will be the problem.

Senator Danforth. Your view is that this sentence applies, really applies, to the decisions that would otherwise be made by the Commission on ancillary costs?

Mr. Constantine. Yes, sir. The point is, the Secretary has all that authority today. This relates only to Medicare and Medicaid, Senator.

Senator Danforth. Only Medicare and Medicaid.

Mr. Consantine. The Secretary has the authority today to do these things.

Senator Danforth. I agree with the Chairman.

The Chairman. All in favor of just striking the provision to be implemented, say aye.

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

Are we now ready to vote on this Section, Section 2?

All in favor, say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

(No response)

Senator Danforth. Section 2 being --

The Chairman. Reasonable costs of hospital services.

Senator Danforth. This is the whole 115 percent full. reimbursement. Is that what we are talking about? No reimbursement over 115 percent?

Mr. Constantine. Unless there is an exemption.

Senator Danforth. Bonus for getting under 100 percent?

Mr. Constantine. Yes, sir.

Senator Danforth. That is what we are approving, then?

The Chairman. Yes.

Senator Danforth. Let me ask this. Is there any incentive in this bill for a hospital to narrow the difference between 100 percent and 115 percent of the average?

Mr. Constantine. You mean if they are at 115 percent, would they try to move down towards the average? Yes, sir, because the average is recalculated annually, and the hospital that is right at the top of the range, if it did not moderate its costs, could very well be above it and have its reimbursement reduced somewhat

the following year. It does have an incentive to be as efficient as possible.

Senator Danforth. Would there not be incentive for a hospital that is at 100 percent to move up to as close as 115 percent?

Mr. Constantine. It runs a real risk. It would not know where it would stand in the following year when they did the calculation of averaging out all of the like hospitals. They might be over the limit. They run a real risk that way.

Senator Danforth. Basically, I have a couple of questions with respect to this whole section. The one question is whether there is really an adequate incentive for this 15 percent range, whether there is an adequate incentive to be at the low end rather than at the high end of the range, whether it is refined enough, whether there should be further gradations between 100 percent and 115 percent.

Senator Bentsen. I think the Senator makes a very valid point with the inflation factor, and the problem of trying to get down to the bottom edge of the 100 to 115 percent. As I understand it, your routine level would be the 100 percent factor and then you get half of the savings below that, up to 5 percent. Is that the way it reads.

It is going to be quite a job to drop below that next year, it seems to me that with the inflation factor that you have, to get to the lower range of that excess 15 percent. I still do not understand why there is not real incentive in that.

Mr. Constantine. Say that you are at 90 percent of the average. That average is calculated each year and assuming everyone goes up at the same rate of inflation, you still come up at 90 percent of the average, all things being equal, so you would still earn your incentive payment.

Senator Bentsen. Say you are at 105 and you are very successful in getting down to the norm. You get no incentive at all, and you are hopeful that next year that you can drop it again. Is that the idea?

Mr. Constantine. Yes, sir.

Senator Bentsen. The carrot is out at least a year on that kind of a deal?

Mr. Constantine. Yes, sir.

The 15 percent point in doing the computer runs is the point at which the incentives the first year, the incentive payments and the penalty payments, were roughly in balance, and then the system operates as to moderate costs. It was also to allow for the imposition of measurement, as well, to allow some range of tolerance initially.

Senator Danforth. I have had a little bit of difficulty in trying to figure out why the government is willing to reimburse hospital costs at the average as opposed to somewhere below the average and if the same services are available in a community at a range, I do not know why we would pick the average rather than the low point in the range as normative for our reimbursement.

I certainly do not know why we pick 115 percent of average as normative for reimbursement.

Mr. Constantine. Senator, the 15 percent was the point. It could have been 20 percent, initially it was 20 percent, to pick a point at which the first year the incentive payments to hospitals and the penalty balanced out. The objective was to have a cost monitoring system, not a cost cutting system, and that is where the 15 percent was, and also to allow some leeway because of the difficulty in measuring precisely the differences between hospitals.

You could pick up the average and save a lot more money if you went down to an average, but you would not allow for any margin of error initially. After the first year, the 15 percent, the way it operates, becomes less than 15 percent and in subsequent years it keeps coming down. So I guess that after 5 years it is, in effect, 10 percent above the average and so on. It works down.

It is to allow more tolerance initially than subsequently.

Senator Danforth. Would it be possible to beat this? Would it be possible for us to do a better job in squeezing that 15 percent rather than just waiting? Your theory is that the bill is going to work and therefore the average cost is going to be relatively lower in future years than it is at the outset, and therefore, it does not make any difference whether you have the 15 percent differential?

Mr. Constantine. It is almost guaranteed to work, Senator. You can pick a point that you want to cut and how did you want to

go. Each year when the average is recalculated, one half of the excess, the cost above 115 percent is disregarded in calculating the average. So that means that you are constantly ratcheting the average.

Senator Curtis. May I ask one question?

In the light of the change suggested by the Chairman that causes the Commission to recommend to the Congress instead of implementing, what additional items are in Section 2 that were not in the original Talmadge bill?

Mr. Constantine. Some of the points were the modification of the numbers, Senator. The original bill had 120 percent and was above average of the range and was silent on what you do with the costs above 120 percent in calculating the average the second year.

The suggestions are, as I explained to Senator Danforth, 115 percent above the average and disregarding one-half of the excess in calculating the average for subsequent years. The state exception was liberalized in the staff recommendation.

The state rate-making systems were exempt under the original bill where there had previously been approved under the Social Security demonstration program. This bill, the amendment as it now stands, would exempt any state where the state has a rate-making system for hospitals. It is reasonable, seems reasonable, and applies to all hospitals in the state and all payors in the state.

The only time that you would terminate a state system is if at the end of any two-year period it costs the government more than they would have paid had their regular Medicare and Medicaid system operated in that state. The costs are then reduced by 1 percent until the costs are recovered. That is a modification of the original bill.

Senator Curtis. The original just exempted it when they had a state plan?

Mr. Constantine. No. They eliminated it in only certain states, the states that had programs in operations or approved at that time. This permits the state, a new state, to come forward at any time with the plan.

Senator Curtis. It also makes it possible for the Federal government to come in under certain circumstances and take away the exemptions.

Mr. Constantine. That is right. Where the state plan, at the end of the year period, costs more than the Federal government would otherwise have been paying under Medicare and Medicaid. In other words, it is to deal with an inefficient and costly state plan.

Senator Curtis. What are some of the other important changes over the original Talmadge Section 2?

Mr. Constantine. The basic change, as I described earlier, Senator, dealing with ancillaries, in the original bill, or the attempt to deal with ancillary costs, the original bill dealt with

only adjusted routine going in and then the Secretary was to come back with recommendations for dealing with the non-routine costs. This bill has a mechanism for dealing with the ancillary costs which is described here.

I think that has been changed somewhat by your decision now on the commission.

Mr. Swoap. Is it correct to say that the provision relative to ancillary costs is very close to what was in the original Talmadge bill except now the Commission will make the recommendations rather than the Secretary?

Mr. Constantine. I think that is a fair statement.

Senator Curtis. Congress will still have to act?

Mr. Constantine. That is a fair statement.

What I assume happens is that the present method of reimbursing hospitals for their ancillary costs under your decision would continue. The routine costs would be reimbursed, as described in the bill, and in the write-up, and that the Commission would recommend approaches towards classifying and comparing the ancillary costs and presenting improvements in the routine. That is my understanding of what you have done.

Senator Nelson. May I make one comment?

This hospital containment, Section 2, applies only to Medicare and Medicaid, which, as Senator Talmadge mentioned a little while ago, is within the jurisdiction of the Finance Committee. I am prepared to accept that, although I will be

prepared to accept that, although I will be offering an amendment which would cover all third-party payers. Medicare and Medicaid is only one-third of the total cost.

Senator Curtis. Here, or on the Floor?

Senator Nelson. Right here. I will offer a substitute, or whatever you want to call it, that adopts a major part of what Senator Talmadge has, expands the coverage to all third-party payers which Senator Talmadge did not do, for whatever reason. I guess it is not the jurisdiction of this Committee.

Senator Talmadge. That was the principal reason.

Senator Nelson. The human resources bill covers all Medicare and Medicaid and third parties. It is designed as a substitute, but I do not care how it is treated.

I am willing to accept this, recognizing that I will be proposing an amendment that expands it to all third parties when we complete action on this.

The Chairman. The Senator can do that. I am not going to vote for it. I would just as soon vote on it now, if you want to.

Senator Nelson. That is all right.

In the draft, the HEW has worked along with the Committee here and then they have taken an amalgam of proposals of which end up making their estimate $28 billion to $30 billion in savings in the next five years, which is about half, around half, of what the Human Resources bill would do. Most all, I think almost all,

of the Talmadge proposal, but expands it to cover third-party payers, it has a different wage pass-through.

Herman's may be better than that, so I will offer that at some stage. I do not care where.

If we are going to do something about hospital costs --

Senator Talmadge. If the Senator would yield, mine is the prevailing wage in the community whereas yours is straight, all unsupervisory personnel.

Senator Nelson. I am not arguing the merits of that particular one. That is a part of the Human Resources bill. It does seem to me that if we are going to do something about controlling hospital costs, then we do end up covering all third-party payers, or you have covered only one-third of the total cost.

I will offer it in time. I am perfectly willing to adopt Herman's proposal and then offer this.

The Chairman. You can offer a substitute for the whole bill.

Senator Talmadge. Actually, his is not a substitute. It just expands on my bill to include all third party payers beyond Medicare and Medicaid. The other principal change is the wage pass-through, as I recall.

Senator Nelson. That is correct. I do not know how this is drafted, but in any event, it is an amendment to expanding the Talmadge proposal.

Senator Danforth. Mr. Chairman, this Commission, I take it that our understand that this will be a very active Commission. It

is not going to be an advisory commission that meets twice a year. They are going to be very active.

Will they have adequate resources, staffing and facilities and so on, to do a thorough job?

My concern with the Talmadge approach -- I think it is as good as anything I have seen -- but I am really concerned that it does not go far enough, that the whole question of the 115 percent, for example, has to be thoroughly analyzed, and I hope the Commission would be able to do that and believe that it has a mandate from this legislation to analyze whether or not the 100 percent, the 115 percent reimbursement scheme is the appropriate one.

I also expressed during the course of a previous meeting, my concern about whether or not we should be reimbursing by classification of hospital rather than by -- is it cost mix?

Mr. Constantine. Case mix.

Senator Danforth. My theory is as follows. A young woman in my office yesterday had her tonsils removed in the city of St. Louis, and she had it done at, I suppose, the most expensive hospital in the city. Had she been a Medicaid patient, I take it Uncle Sam would have been picking up the bill.

I just wonder whether we should not be reimbursing for service performed as opposed to number of days in a hospital.

Would the Commission have the jurisdiction to analyze this kind of question? Would it feel it has a mandate?

Mr. Constantine. Your question has validity. A number of

states have raised that same issue. I recall Illinois did, because they have to put someone in for a tonsillectomy at the University of Chicago Hospital at one cost when there is another hospital nearby.

What we would propose to do -- this was my understanding of Senator Talmadge -- we will draft what you believe you want here. If you request it, I think it would be very helpful if we come up with the list, a non-exclusive list, a list of what areas the Committee expects the Commission to do and assign priorities to those areas. That might answer your concern and indicate the directions the Committee wants them to go in.

Senator Danforth. Your understanding is that this will be a very active Commission?

Mr. Constantine. It would have to be because we have so many problems and so few answers.

Senator Danforth. Are the members paid for their services?

Mr. Constantine. Other than the governmental people, who would not be paid for their service.

Senator Packwood. How is this Commission going to be anything but biased against the hospitals?

Mr. Constantine. Today, this is only reimbursing under Medicare and Medicaid. Today, this Commission in the place of HEW, if you want to argue, you might say is no great friend. Today, he has all the authority that you are giving this Commission today by itself.

The reason that a majority was picked from Federal, state and local is because this is a group determining or making a recommendation as to how the Federal and state dollar should be spent.

Senator Packwood. How is this going to be any different? I have seen this in welfare payments for prescriptions and welfare payments in states for hospital services where you are trying to do everything that you can to keep your costs down, so you force it off against the vendors.

What on earth do you expect a Commission to do which is made up of a majority of the people who are from programs paying the costs?

Mr. Constantine. As we said earlier, it will be no better or no worse than the people on it. I would doubt that the states, for example, would accept a group making decisions which involve forcing their expenditures, a nongovernmental group, for example, a group dominated by the hospitals, determining how much hospitals should receive.

It is that kind of dilemma. We have discussed -- the hospitals like this idea and the Federation of Hospitals and the American Hospital Association because today they have absolutely no input to HEW, they have no formal input in how those formulas are established for the payments made.

This at least gives them some input, gives them some visibility.

But, Senator, the people in the states vary. We have some

states doing a superb job in reimbursement. Others are doing a pedestrian one. It really depends on whether these people are there in their own right because of their expertise, or there simply to do something on the lowest cost basis.

I think one suggestion we could make is that, in as much as the Commission is only recommending now, you could increase the proportion of nongovernmental people. In other words, when it was implementing as previously, the argument had merit, I thought, for having the government determine how much government is going to pay.

Senator Packwood. What you have is a Commission, the majority of which are foxes recommending how to put the lock on the chicken coop. I think I know which way they are going to come down.

Mr. Constantine. Fewer foxes than we have today, Senator. That is all.

Senator Hansen. Mr. Chairman, if I could be heard. I was on a hospital board one time in one of the privately operated hospitals in Wyoming and a major share of our escalating costs, I think, came about as a result of governmental action.

The minimum wage is raised, and that affects it. Now, it is easy, you know? A minimum wage in Washington, D.C. has a little different effect on people than it does in the small, rural Western community where people can walk to work, where you do not have the high living costs, and everything else that is associated

with living in a metropolitan area.

We tore up -- we are a first-class hospital; we have a first-class hospital. Mr. Rockefeller gave three-quarters of a million dollars to it. Merrill assigned one of their chief hospital architects to the construction of it. I think we have torn up the floor in the operating suite four different times. Everytime a new Commission looks the thing over, why, they decide what we have is not good enough. They just about broke us.

You have no idea how much extra costs over which the hospital had not a darn thing to do with, resulting from governmental action of one kind or another. So I have to be sympathetic to the point you are making, Senator Packwood.

It seems to me to have a 15-man Commission, 12 of them, as I understand you to say there, representing these Federal programs, just insures --

Senator Packwood. A majority have to represent government programs. There are 15 -- three from the hospital area and twelve representing public and private third-party programs, Medicare and Medicaid, Blue Cross, and in every case it is a representative of a program who is looking to cut their costs at the expense of somebody, and that somebody is going to be the hospitals.

Senator Danforth. My view is that is good. I think they should be a Commission of tightwads.

Senator Packwood. They will not be tightwads. These are

people looking to pass on that cost to somebody else.

Senator Danforth. Hopefully they will be people who are going to be willing to pay less for hospital costs.

Mr. Constantine. The only point I would make, Senator, there is truth to what I am saying. The point is the present situation today, the potential that the Secretary can unilaterally do things on his own, this is a softening of present policy and the hospitals support it. Obviously, they want a little more representation on this. They feel this is considerably better than the present situation.

Senator Packwood. What language did the House come up with on their Commission?

Mr. Constantine. They took the Commission idea. They asked to see --

Senator Packwood. Their Commission is just recommendatory, is it not?

Mr. Constantine. Yes.

Senator Packwood. How are they appointed?

Mr. Swoap. Senator Packwood, the Commission that was reported from the Commerce Committee would be composed of 11 members, three hospital administrators, two practicing physicians and six consumers.

Senator Packwood. I like that a lot better.

Senator Talmadge. What is next, Mr. Constantine?

Mr. Constantine. As I understand this, Mr. Chairman, that

we will draft along the lines here and then bring it back to the Committee so if there is anything --

Senator Talmadge. That is correct.

Senator Nelson. Mr. Chairman, from my check, I have five proxies and my own vote, but there are **not** votes to offer the amendment to expand the coverage from Medicare to all third-party payers, in the Committee. There are some objections by some that run to the merits, by others on the grounds that it is not within the jurisdiction of the Committee, so there is no point in offering it and wasting the time of the Committee.

I will offer it if this bill does leave this Committee and go to the Floor as an amendment on the Floor. I do not want to waste everybody's time.

Senator Talmadge. The Senator, of course, has a right, if we can get a bill reported to the Senate, I think we can pass a bill this year. If we do not, I do not think we are going to be able to, and I would hope that the Senators will be cooperative and let's get this bill reported out today.

What is next, Mr. Constantine?

Mr. Constantine. Mike just wanted to make sure that the Committee had approved Section 2 with the changes and as modified with respect to the Commission.

Senator Talmadge. That is correct.

Mr. Constantine. Section 3 deals -- this is in the original bill with no changes. The only change we would suggest on this

would be an effective date change.

This is to provide assistance in the closing and conversion of underutilized facilities.

Senator Talmadge. Authorize payments to facilitiate closing of underutilized facilities, a part of the original bill. Is there any objection?

Without objection, it is agreed to.

Item 4?

Mr. Constantine. This is Section 1122, dealing with Federal matching, Federal review of capital expenditures. That is where the state planning agencies disapprove a capital expenditure, Medicare and Medicaid will not reimburse for the capital-related items. This was in the original bill.

Senator Talmadge. Is there any objection?

Without objection, it is agreed to.

We have already approved Section 10, I believe.

Mr. Constantine. That is correct.

Senator Talmadge. Section 11.

Mr. Constantine. We discussed Section 11 which would put some limitation on reimbursement on the determination of a reasonable charge, so in one area of the state, a large state, the reasonable charge under Medicare would not be more than one-third higher than the statewide average -- that is, Medicare would not automatically increase those payments if it was in excess of this provision, would save $110 million the first year.

This is to avoid wide variations between one area and another.

Senator Talmadge. Any objection?

Without objection, agreed to.

Item 12?

Senator Curtis. Mr. Chairman, I am opposed to item 12 and section 15, as related. I think it is filled with danger. I cannot support any bill that has it in.

I think it is filled with danger. It is a stringent redefinition of physician's services.

Senator Talmadge. Why do we not just strike those two sections, then?

Senator Curtis. Very well.

Senator Talmadge. Any objection?

Those two will be stricken. That is Sections 12 and 15.

All right. Section 13.

Mr. Constantine. This is a provision which was in the original bill. It is to deal with a minor problem that the allergists have.

Senator Talmadge. Is there any objection? Without objection, approved.

Number 14?

Mr. Constantine. Number 14 is in the original bill dealing with payment of claims where the beneficiary, family of a deceased beneficiary --

Senator Talmadge. Is there any objection? Without objection, approved.

20?

Mr. Constantine. This was in the original bill. It deals with the swing bed approach to let underutilized small hospitals service long-term care. The Hospital Association supports it. The Administration supports it.

Senator Talmadge. Any objection?

Without objection, approved.

21?

Mr. Constantine. This is essentially what the Administration is now doing by policy, but when a provision was introduced as a part of the original bill, there was some question as to whether this was intended -- this was to clarify the legislative intent.

The Department has subsequently implemented this administratively.

Senator Talmadge. Is there any objection? Without objection, it is approved.

22?

Mr. Constantine. This is a provision that would conform -- this was in the original bill -- to make the Secretary of HEW the final -- give him final approval authority for the participation of the skilled nursing facility under Medicaid, as well as Medicare.

In 1972, you passed a similar provision. In conference, it

was limited to Medicare facilities, participating in the Medicare and Medicaid bill.

Senator Talmadge. Is there any objection?

Without objection, it is approved.

23?

Mr. Constantine. This, again, is another provision dealing with visits from institutions by patients from a skilled nursing facility. The Department adopted this policy. It is a question of putting it into law, as to whether you want it in the statute to nail down legislative intent.

Senator Curtis. To permit treatment outside the institution?

Mr. Constantine. Yes, sir, without putting a specific number on the number of visits. There was a policy, for example, if you were away six days from a skilled nursing home, you were not considered a skilled nursing patient. The Department said this is a matter of professional judgment.

Senator Curtis. Eliminates the temptation to put them back in when they would rather be outside?

Mr. Constantine. Not quite. It eliminates the arbitrary pulling away of their eligibility for skilled nursing home care in a state where you can leave the nursing home for a week-end for certain types of patients.

The Department has taken care of it.

Senator Talmadge. Is there any objection?

Without objection, agreed to.

Item 30.

Mr. Constantine. We would recommend at this point -- this is the amendment establishing the Health Care Financing Administration. The staff would recommend that Section 30 be deleted. It has been done administratively.

Senator Talmadge. Without objection, Section 30 will be deleted.

31?

Mr. Constantine. Section 31 deals with state Medicaid administration. Mr. Chairman, some of this is being done by the Administration administratively. This deals with incentives for states, technical assistance to the states strongly endorsed by the National Conference of State Legislatures.

Some of this, however, is being taken care of in other legislation and the staff would like approval of this section which was in the original bill, giving us a chance to draft out those provisions which were taken care of in other laws and bring it back to you.

Senator Talmadge. You want to bring it back modified?

Mr. Constantine. Yes, sir.

Senator Talmadge. It is approved, and we will review it, as modified.

Section 32?

Mr. Constantine. Section 32 is in the original bill. There

is some opposition to it. It is basically designed to expedite the issuance of regulation and allow adequate time for comment by interested parties.

At the time this was drafted, Senator, when you introduced it, you pointed out that a number of states were complaining about the lack of adequate comment time and this was designed to allow a proposed regulation to assure that they would have at least 60 days.

Senator Talmadge. Does the staff recommend we keep it, or eliminate it?

Mr. Constantine. I think it can come out now.

Senator Talmadge. Without objection, it will be deleted.

33.

Mr. Constantine. 33 was in the original bill. The Department supports the elimination of a task force here, or one advisory group.

Senator Talmadge. What is this we are repealing?

Mr. Constantine. This would repeal it.

Senator Talmadge. What?

Mr. Constantine. The Health Insurance Benefits Advisory Council.

Senator Talmadge. Is there objection?

Without objection, agreed to.

Senator Bentsen. On the next one, Section 40, I agree with the objective of what you are trying to accomplish there because

I would normally oppose anything that the higher the costs, the more profit they made. But there are some contracts that are structured where a percentage or part of the costs or expenses, but where they give a larger percentage for the savings below comparable costs for industry.

I want to see that type of contract protected, because it achieves an objective we want.

Mr. Constantine. Yes, sir. We were suggesting a modification on the original one. There are types of percentage contracts, for salesmen for example.

Senator Bentsen. I am talking about management.

Mr. Consantine. The second was, any percentage contracts the Secretary should have the authority to approve, those things where they are consistent with incentives to efficiency and so on.

We will give you language.

Senator Bentsen. I wan t to see language drafted that does not preclude that type of contract.

Mr. Constantine. Yes, sir.

Senator Talmadge. We will modify that accordingly. Without objection, it will be modified in according with Senator Bentsen's suggestions.

41.

Mr. Constantine. This is ambulance service. This was, I believe, a problem raised in states, Montana, Wyoming, where

Medicair will pay for ambulance service to the closest hospital that is qualified. This was in the original bill. This essentially says we will pay for the closest hospital equipped and staffed to provide to service the patient's needs.

Senator Talmadge. Is there objection?

Without objection, it is agreed to.

42.

Mr. Constantine. This is an amendment that the Finance Committee and the Senate has previously approved, the pulmonary, pediatric pulmonary centers are presently funded out of various appropriations. This gives them standing, formal standing.

Senator Talmadge. Is there objection?

Without objection, agreed to.

43.

Mr. Constantine. On 43, this was in the original amendment, but probably too broad. This dealt with the situation in Georgia, I believe, and in another state where they sought to put in a co-payment on prescription drugs of 50 cents or something, and they came in and said that was a violation of the Human Experiment Act, and the whole thing was tied up in the courts.

We would suggest that the Committee make it clear that this provision be modified to say that the Human Experimentation Act does not apply to deductibles and co-payments and similar administrative expenses.

Senator Talmadge. Any objection to the modification?

Modify it, and bring it back. Without objection, it will be modified and agreed to.

44.

Mr. Constantine. Section 44 we will step back from and let the Committee decide what it wants to do. This was a provision, Mr. Chairman, to essentially ordinarily prohibit the release of the names and the amounts paid to physicians on behalf of Medicare payments.

Senator Talmadge. I think we ought to strike that provision. We have had definite assurances from the Secretary that he, in the future, will exercise extraordinary care. We have had reports that they have released huge payments to dead doctors, things of that nature. That is what you are aiming at?

Mr. Constantine. Yes, sir, and inadequate reporting of live doctors.

Senator Talmadge. Why do we not eliminate this provision?

Senator Danforth. If we eliminate it, I want to know what is going to happen.

Senator Talmadge. It will be a matter of public information and then --

Mr. Constantine. It will be present policy of releasing the information of those held up in the courts right now, of releasing it and the Secretary pledged accuracy to the Committee.

Senator Danforth. The provision would prohibit it, but I do not understand how we have advanced any costs by having the Secretary

of HEW pledge that he will be accurate. Was he intentionally inaccurate before?

Senator Talmadge. No. I just think it was careless bungling which Federal agencies are prone to do, particularly HEW.

Senator Danforth. HEW has now promised they will never bungle again?

Senator Talmadge. We have assurances that they will give extraordinary care.

Senator Bentsen. You are leaving it in?

Senator Talmadge. Striking it.

Senator Curtis. Leaving in the right to publicize.

Senator Talmadge. This would prohibit the Secretary from not releasing information about payments to doctors.

Senator Danforth. I am for keeping it in.

Senator Talmadge. Let's have a vote on it. Everybody who is for keeping it in, hold up your hand.

(A show of hands)

Senator Talmadge. It prevailed. It will be agred to.

All right. Now, that is now item 45.

Mr. Consantine. 45 essentially deals with a provision that I believe involves a transfer of assets for purposes of establishing Medicaid eligibility. The states want this.

There is a suggestion in qualification to change it to any person, not just a relative, the transfer of assets to any person, not just a relative, and the term property be changed to assets.

Senator Talmadge. Any objection?

Senator Hansen. I want to raise this point. As I understand this, the Section would allow states to deny Medicaid benefits for up to a year in the case of aged, blind or disabled individuals who dispose of their property to relatives for less than fair market value. Overall, if you are talking about giving something away, that is one thing. I would hope that you are not going to nitpick. I am thinking about somebody who may have a small farm or something and it may be part of a unit.

Is this statute going to be used to say that you sold your farm for $2,000 less than it should have been sold for and, as a consequence, knock them out?

Mr. Constantine. I think, Senator, you can just say substantially less. There is no intention of nit-picking. The states want this. They came in with example after example.

Senator Talmadge. What we are trying to do here, Senator, is get around this provision where people deliberately convey their assets to members of their family.

Senator Hansen. I am in full accord. It is just the language that is concerning me here. It says "for less than fair market value."

Senator Talmadge. Why do we not modify that and tighten it up in the Committee Report, make it clear that what we are trying to do is to avoid and eliminate this racket they run where they transfer their assets to be eligible for Medicare and Medicaid.

Senator Hansen. I fully support that.

Senator Talmadge. It will be modified and explained in the Committee Report and agreed to.

Mr. Swoap. I might point out this provision did pass the Congress when SSI was first implemented, so we looked at that language to see how it passed previously.

Mr. Constantine. It was agreed to in conference.

Senator Talmage. 46. This is something Senator Long raised.

Mr. Constantine. Yes, sir.

This provision would increase the allowable rate of return on net equity and for private facilities participating in Medicare and Medicaid from the present one and a half times the average rate of return on Social Security investment to two times, in effect, from 11 percent to 14 percent, or 15 percent pre-tax.

Senator Talmadge. How much rate of return would it permit?

Mr. Fullerton. 14.

Senator Talmadge. Why do we not put a cap on a 14 percent return in equity, then? Is that agreeable.

Senator Bentsen. That is pre-tax, let us understand.

Senator Talmage. After-tax.

Mr. Constantine. Pre-tax.

Senator Talmadge. What would you suggest? I know that Senator Long feels strongly about it, and we ought to treat these people right. What is reasonable?

Mr. Constantine. I think if you let us bring this back along

the lines that the Committee discussed initially, that Senator Long was interested in -- increasing the rate of return on net equity for efficient institutions, not just guaranteeing 14 percent to everyone, then you could look at that and make whatever changes you want.

Senator Talmadge. Why do you not discuss it with the Department and Senator Long, what they think it ought to be.

Mr. Constantine. Yes, sir, and we will bring it back.

Senator Talmadge. You bring it back to the Committee.

Senator Hansen. Mr. Chairman, if I could, I was just thinking about this. It is a difficult thing to try to determine what is a fair rate of return in the number of the states. This is one of the responsibilities of the Public Service Commission.

I hope maybe, as this issue is examined, some attention or consideration might be given to the approach that Public Service Commissions have undertaken in order to establish a workable formula that is not going to be to myopic.

Senator Talmadge. Get with Senator Long and the Department, Senator Hansen, on that and bring back something reasonable.

Without objection, it will be agreed to as modified and reviewed by the Committee.

I would like to offer one amendment. Jay, do you remember, you and I discussed an idea that was brought to us by one of Atlanta's leading urologists? There are many minor operations now that can be performed in offices at a very minor expense and

in the present law, you have to go to a hospital for hundreds of dollars. I can give you an illustration.

I had a TUR, which is a Trans-Uretheal Resection in 1969. My urologist has been President of the National Urology Association. Those things have a tendency to come back. He wants to be certain that, if mine comes back, that he catches it in time, particularly if it might come back in a malignant form.

So, sitting in his office, in ten minutes, with a local anaesthetic, he performed on me a biopsy and I got up and walked out in a matter of minutes and drove my car home.

Under present law, those things have to be provided in a hospital, bill the government for it. Do you have an amendment drafted along those lines?

Mr. Constantine. Yes, sir, and I would like to describe it, if I might, because the Administration, I believe, supports it.

Mr. Fullerton. Yes, sir, with a couple of changes.

Senator Talmadge. Do the changes make it less expensive or more expensive? It has be under approved conditions, as I understand it.

Mr. Constantine. The physician can do surgery in his office today. We do not, in fact, recognize --

Senator Talmadge. What is the amendment?

Mr. Constantine. It is an amendment for approved-type, surgical type procedures, initially listed by the National Professional Standards Review Council or any appropriate -- after

consultation with appropriate medical organizations -- as to which ones would be covered.

There would be an allowance in addition to the professional service fee to recognize the average overhead costs in the physician's office for providing the service. This is based on, as Senator Talmadge indicated, when he went down to Dr. McDonald's clinic and went on through there, to cover some of that overhead.

What we would recommend, where this surgery is performed in his office, that we pay the reasonable charge, the Medicare reasonable charge plus the overhead allowance without a deductible and without co-insurance which benefits the patients and where the doctor takes the assignment he agrees to accept that as full payment for that service, so the patient benefits from that as well.

There would be no special review done beyond the ambulatory service, the existing review mechanisms, the PSR and/or a carrier would look at those, as well as anybody else would.

Just the procedures, really.

Senator Talmadge. Mr. Fullerton, what is your suggestion?

Mr. Fullerton. Mr. Chairman, we have a couple of concerns that derive from possible situations where we might be paying more under this amendment for the same service than we are now.

Senator Talmadge. We want to pay less. The idea is to keep them out of the hospital.

Mr. Fullerton. Yes, sir. That is exactly right. What we

would like to do is work with Jay on the drafting of the amendment.

Senator Talmadge. You work with Mr. Constantine to perfect the language and bring it back to the Committee to look at.

Senator Curtis?

Senator Curtis. I want to say --

Senator Talmadge. It will be approved tentatively, prior to drafting.

Senator Curtis. I would like to express our thanks to Senator Talmadge and the Chairman of the Committee for their consideration of all members of the Committee in this matter. I will go along with sending this to the Senate Floor. It has been here a long time. I would want to reserve the right, after we look at some of this language, we may want some of this language on the Floor and also we are getting late in the session and if we decide that the House has passed, or is about to pass something that looks as good or better and it could be adopted to avoid a conference, that we might want to reserve the right to do that.

Senator Talmadge. Every Senator, ov course, reserves that right, Senator Curtis, and I want to thank you and every member of this Committee for your cooperation. This will give us an opportunity to get this bill to the Floor, and I am sure that there will be many amendments that are controversial, as we have seen from the House. They have been marching up the hill and down the hill doing nothing, and it is in that status.

What I would suggest we do is tentatively approve the bill

today, direct the staff to bring it back in its perfected legislative form, and then at that point we will have another look at it and order it reported to the Senate.

Is that agreeable?

Mr. Constantine?

Mr. Constantine. Mr. Chairman, I want to point out at that time there are some Senators -- Senator Dole has several additional provisions. Senator Nelson and other Senators have indicated they have additional amendments. I suspect that would be the point at which you would want to raise those.

Senator Nelson. Would you be having another meeting on Monday or Tuesday or something like that?

Senator Talmadge. Can we meet Monday? Will we have language perfected by Monday?

Mr. Constantine. I doubt it, Senator.

Senator Talmadge. You cannot?

What would you suggest, Mike?

Mr. Stern. As of now, Mr. Chairman, the Executive Session is scheduled for Thursday a week from yesterday. If it is ready by then, you could take it up then.

Senator Talmadge. Why do you not do that? Leave it this way. You work with Mr. Constantine and staff -- of course, you are the boss.

When it is prepared, check with Senator Long, and let's have the Executive Session where we can report it.

Mr. Stern. Yes, sir. If we are not able to do it by the end of next week, we have more Executive Sessions scheduled for the week after that, as soon as we can.

Senator Nelson. Mr. Chairman, I would like to make one point on this. I have five proxies that I am not prepared to cast because they are not here, and they favor third-party coverage. They may be others who are not here who favor it.

I would want to reserve the opportunity to offer the third-party coverage, if the rest of them want to vote on that, at the time that we meet next week.

Senator Talmadge. Is there any other business?

Senator Packwood. I have one routine matter of business, Mr. Chairman, on the issue of the Tuition Tax Credit bill that will be scheduled for debate.

The proponents have agreed to back off on the issue of refundability for two years, until 1980, to make the primary, secondary and college part of the uniform. So what we simply need is an approval from the Committee to modify the bill as we all have it to apply to refundability only after 1980 and request a waiver from the Budget Committee. It has been worked out with Mike and the Budget Committee.

Senator Talmadge. Is there any objection?

Without objection, so ordered.

Senator Long is on his way over here. Will you please remain.

Is Mr. Cassidy here? I understand he is on his way up.

Mr. Stern. I might mention for the record, Mr. Chairman, this waiver that Senator Packwood refers to applies to the Finance Committee bill and any Floor amendments that would raise the cost of the bill.

(A brief recess was taken.)

Senator Talmadge. The Committee will come to order. The Chairman has returned.

The Chairman. I would like the staff to explain this Section 410 of a bill. I believe that was an authorization bill, and the provision went through on that bill that I did not know about, nor did anybody on the Committee understand what that was.

I would suggest that Mr. Cassidy tell us about that.

Mr. Cassidy. On June 28th, the Senate passed the Foreign Relations Authorization Act for fiscal year '79, H.R. 12598, and most of the bill authorizes appropriations for the operation of the State Department. However, there are two sections we did not become aware of until two days ago the most significant of which is Section 410.

The bill has not gone to conference, however, conferees have been named on both sides.

Section 410 is entitled reviewing trade practices, and a copy of it is before you now. The first subsection (a) states in essence that all laws which authorize or require discrimination with respect to trade were enacted solely for reasons of American

foreign policy. This, according to the Foreign Relations Committee staff, is to establish jurisdiction of the Foreign Relations Committee over all discriminatory trade statutes in the future.

We believe that at least two major statutes within the jurisdiction of the Finance Committee would be covered by this, and possibly more. The two are what is now Title IV of the Trade Act of 1974, which covers trade with Communist countries. The most important provision, or the most controversial provision of which, of course, is the Jackson-Vanik amendment. And of course the other law which would clearly be covered are the tariff schedules of the United States which explicitly provide for higher rates of duties against imports from most Communist countries.

Another major piece of legislation which could be covered by this is the generalized system of preferences which permits imports from certain developing countries to enter the United States free of duty.

We believe, also, this could cover laws within the jurisdiction of the Banking Committee, such as the Export Administration Act, which prohibits certain exports to Communist countries if they are military significance.

The second provision of the statute is in (b), is the operative provision that requires not later than January 20th, 1979, the President report to the Chairman of the Committee on Foreign Relations all provisions of U.S. law which require such discriminatory practices, to evaluate each practice and to recommend

draft legislation which would, in the President's judgment, advance the United States' foreign policy interest.

There is another section that involves jurisdiction over trade matters and it would require the Secretary of State or the President to approve all international agreements before they are concluded. The State Department would write the regulations to administer this section.

This could put the Secretary of State in the position of approving all Trade Agreements, all tax treaties, all monetary agreements negotiated by the Treasury, and virtually all other international agreements before they are approved.

The Chairman. That is very kind of them to tell us. That is awfully generous of them, considering these are matters under our jurisdiction.

Mr. Cassidy. One other thing. In the report on the bill under this Section 410, it says the provisions of this section, which were initiated by Senator McGovern, are self-explanatory and then they report the provision verbatim. There is no other explanation in the report.

The Chairman. Unfortunately, that is something that they have passed on their authorization bill. It passed the Senate. I did not know it was there. In fact -- I hate to say it -- I was not there that day.

I really think this would be of concern to a great number of people. For example, I really do not think that business in this

nation or our labor movement wants to have our experts fighting those battles in a closet on top of Mount Olympus, take charge of the destiny of their jobs or their investments.

This provision says here that all of these measures were enacted solely for the conduct of foreign policy, that none of this apparently, the interests of an American in saving his investment has nothing whatsoever to do with the reason why we passed any of those bills, or why they continue, nor do the jobs of any Americans or the unemployment situation that exists in this country. None of that is very relevant.

The only important thing is the international aspects of it. What I am concerned about, it is difficult to defeat a conference report, but I expect that is about the kind of thing we are going to be confronted with.

Senator Packwood. Is there an alternative, Mr. Chairman, of repeating this language and putting it on the miscellaneous bills here and sending it out and taking it to conference after their bill?

Senator Talmadge. The last act would prevail.

The Chairman. I would assume, if that were the case, that they would exert their parliamentary rights to keep it from passing, which I would suspect would not leave them any choice but to do the same thing.

Senator Bentsen. Mr. Chairman, did it pass both bodies?

The Chairman. It did not pass the House.

Senator Bentsen. It has not.

The Chairman. It has passed the Senate. It is in conference between the two Houses.

Senator Bentsen. How can it be in conference?

Mr. Cassidy. An authorization bill did pass the House; it did not have this language. It came to the Senate and was amended with this language.

Senator Talmadge. Why do we not authorize the Chair to write Chairman Zablocki a letter from this Committee about that language?

Mr. Cassidy. . Chairman Ullman has already written such a letter to Chairman Zablocki.

Senator Nelson. Does it apply to Ways and Means?

Mr. Cassidy. . It could, because sub-section (a) asserts all of these discriminatory statutes were not solely for reasons of foreign policy.

The Chairman. It seems to me -- I discussed this matter with Senator Byrd -- I say we have a problem here. I asked that he notify us whenever they bring a conference report back and that they notify us when a conference report is called up. If we do not have any greater recourse, we ought to be available to discuss that conference report.

Senator Talmadge. Maybe Zablocki would disagree with that and not accept it, if we write a letter from the Chairman of this Committee?

The Chairman. I would be glad to do so. I think also --

Senator Talmadge. Ullman has already done so, according to Mr. Cassidy.

Senator Curtis. Mr. Chairman, I agree with you wholeheartedly on passing this. I have spoken to Senator Baker, the Minority Leader, about it, who is a member of the Foreign Relations Committee.

Mr. Cassidy. Also on this Conference Committee.

Senator Curtis. I am going to speak to other members, too. It seems to me that this nullifies the entire gain to be made by setting up a Special Trade Office. We wanted to separate diplomacy from the trade matters, and this goes right back to the same old thing.

Senator Talmadge. Mr. Chairman, may I bring up another matter?

The Chairman. If there is no objection, I will ask the staff to help me compose a letter to Mr. Zablocki, also to the Majority Leader and to the conferees on behalf of the Senate about this matter, and tell them if this matter remains in there, we would be compelled to oppose the Conference Report and we would like to be notified before they bring it in so we can be there to oppose it.

Senator Talmadge. This Fugitive Fathers law expires October 1, 1978. On July 22nd, the Senate approved an amendment that I offered to make it permanent. It was made a part of H.R. 4007.

This report was filed with the Senate on June 26, 1978. It

was listed on the Senate calendar as calendar number 886.

This report was vitiated on July 18, 1978, according to the Congressional Record.

I move that that amendment be offered on some House-passed bill where it can be sent to the Senate expeditiously.

The Chairman. Without objection, agreed.

Senator Packwood. On the Hospital Containment Act, did we agree to adopting the House language on the creation of the cost commission?

Senator Curtis. The composition?

Senator Packwood. The composition.

Senator Talmadge. I did not hear you.

Senator Packwood. As we were discussing the composition of that Cost Control Commission on your bill, I asked what the House language was. It was read. I assume that is what we put in, similar language. Is that correct?

Senator Talmadge. Yes.

The Chairman. Let me ask you, where do we stand on the cost containment bill?

Senator Talmadge. We have ordered it tentatively reported with modifications to be brought back to the Senate in legislative language at a time that Mr. Stern and you can work out in Executive Session, which we can officially report it.

The Chairman. Thank you very much, gentlemen.

(Thereupon, at 12:05 p.m. the Committee adjourned.)

A G E N D A

SENATE FINANCE COMMITTEE

Thursday, July 27, 1978

10:00 A.M.

1. Debt limit bill (H.R. 13385) (See staff document A)

2. Aircraft and Airport Noise Reduction Act of 1978 (S. 3279) (See staff document B)

3. Various minor revenue bills on which a hearing was held June 19 (See staff document C)

July 25, 1978

INCREASE IN TEMPORARY DEBT LIMIT (H.R. 13385)

(Prepared by the Staff of the Committee on Finance)

House Bill. -- Under present law, the permanent debt limit is set at $400 billion, with a temporary additional limit of $352 billion, effective through July 31, 1978. H.R. 13385 would:

1. Increase the temporary debt limit from $752 billion to $798 billion;

2. Extend the period in which the temporary debt limit applies until March 31, 1979;

3. Increase from $27 billion to $32 billion the limitation on the amount of long-term bonds that may be issued bearing interest above 4¼ percent.

Budget Outlook. -- The actual fiscal year 1977 deficit on a Federal funds basis was $54.5 billion; the unified or consolidated deficit was $45.0 billion. The estimates for fiscal year 1978 in the Administration's July budget update project a $62.9 billion deficit in Federal funds and a $51.1 billion deficit on a consolidated basis. These figures are shown in the table below:

(dollars in billions)*

	1977 Actual	1978 Estimate	1979 Estimate
Federal funds:			
Receipts	$240.4	$269.4	$298.3
Outlays	294.9	332.2	361.4
Deficit (-)	-54.5	-62.9	-63.1
Unified budget:			
Receipts	$356.9	$401.2	$448.2
Outlays	401.9	452.3	496.6
Deficit (-)	-45.0	-51.1	-48.5

* Totals may not add due to rounding.

July 25, 1978

AIRCRAFT AND AIRPORT NOISE REDUCTION ACT OF 1978 (S. 3279)

(Prepared by the Staff of the Committee on Finance)

On July 11, 1978, the Senate Commerce Committee favorably reported S. 3279, a bill to assist airport and aircraft operators in reducing noise levels around the nation's airports. The bill provides, regarding taxes, as follows:

Existing excise taxes on air transportation of passengers and property would be reduced and noise abatement charges would be imposed for a five-year period.

For domestic air transportation, the existing passenger ticket tax would be reduced from 8 percent to 6 percent. The tax on cargo would be reduced from 5 to 3 percent.

For international air transportation, the existing $3 passenger departure tax would be suspended for a period of up to ten years while the international noise abatement charges are in effect for air carriers who voluntarily meet all Federal noise requirements.

The House Ways and Means Committee has ordered favorably reported a similar bill, H.R. 11986, which reduces the present airline passenger and freight taxes by two percentage points and suspends the present $3 international departure tax for a five-year period from October 1, 1978 until October 1, 1983. In place of these reduced or suspended taxes, the bill imposes a 2 percent domestic passenger and freight tax, and international departure taxes of $2 or $10, depending upon the amount of the fare.

Domestic air carriers who operate large jet aircraft which do not comply with existing noise standards will be entitled to claim refunds or credits of these new taxes for specified percentages of their costs in bringing their noisy aircraft into compliance or replacing these aircraft. Foreign carriers may similarly obtain refunds of excise taxes paid under the bill for costs of bringing their U. S. operating fleets into compliance.

The Senate bill would, in general, establish a program to assist airports and surrounding communities to develop and carry out programs to reduce existing noncompatible land uses and to prevent future noncompatible land uses around airports.

It also would authorize additional funding for airport construction and development of $100 million for 1979 and $260 million for 1980.

Finally, the Senate bill provides financial assistance to aircraft operators for compliance with Federal noise regulations by imposing noise abatement charges which are to be retained by the aircraft operators. It would also permit aircraft operators to request waiver of noise rules where binding commitments have been made for the replacement of certain aircraft. Passenger charges should not be increased because noise abatement charges are not expected to exceed the ticket taxes and departure fees temporarily reduced or suspended.

July 26, 1978

VARIOUS MINOR REVENUE BILLS ON WHICH A HEARING WAS HELD JUNE 19
(For description of bills, including revenue effects, see pamphlet distributed with Agenda.)

(Prepared by the Staff of the Joint Committee on Taxation)

BILLS WHICH WITNESSES DID NOT OPPOSE OR SUGGEST MODIFYING:

1. H.R. 8535: Child care credit for amounts paid to certain relatives (pamphlet pp. 30-31).

2. H.R. 8811: Revocability of election to receive Tax Court judge retired pay (pamphlet pp. 32-33).

BILLS WHICH WITNESSES SUGGESTED MODIFYING:

1. H.R. 1337: Constructive sale price for excise tax on certain articles (pamphlet pp. 11-12).--The Fruehauf Corporation, Detroit, Michigan, and Mervin W. Wilf, counsel for Strick Corporation, Fort Washington, Pennsylvania, recommended a committee report statement that use, under the bill, of a percentage constructive price for trucks, buses, highway tractors, or trailers "sold at retail" applies to any retail sale by a manufacturer, and not solely to manufacturers who sell only at retail.

   The International Harvester Company recommended an amendment to the bill which would permit manufacturers who sell a substantial portion of their taxable trucks, etc., to independent retail dealers to elect to use their lowest price to such dealers as the excise tax base for retail sales, rather than the percentage constructive sale price otherwise required by the bill.

   The Treasury Department recommended that the effective date of the bill be changed to September 30, 1978, in order to eliminate the need to adjust excise taxes on sales made before enactment of the bill.

2. H.R. 2028: Excise tax treatment of home producers of beer or wine (pamphlet pp. 15-16).--Senator Cranston (and other witnesses) recommended amending the bill to conform with S. 3191, by eliminating the requirement that home producers of beer must register with Treasury and by eliminating the provision that the amount of home-produced beer on hand in any household at any one time (including beer in process) may not exceed 30 gallons.

Senator Curtis recommended amending the bill to make the age requirement for tax-free home beer and wine production (in the bill, 18 years or older) conform to the appropriate minimum drinking age in the State in which the production occurs.

3. H.R. 2852: Credit or refund of fuel excise taxes for aerial applicators (pamphlet pp. 17-18).--The Treasury Department recommended amending the bill to provide that a cropduster will be entitled to receive a credit or refund of fuel excise taxes only if the farmer otherwise eligible (as under existing law) for the credit or refund waives such rights in favor of the cropduster.

4. H.R. 3050: Tax treatment of returns of magazines, paperbacks, and records (pamphlet pp. 21-23).--Publishers of paperbacks and records recommended that the adjustment to income attributable to adopting the method of accounting provided in the bill be spread over a 5-year period (as provided in the bill with respect to magazine returns), rather than being placed in a "suspense account."

General Mills, Inc., Minneapolis, Minn., and Pillsbury Company recommended amending the bill to allow a deduction for the estimated cost of redemption of coupons issued by manufacturers of food and other products; this amendment would overturn a 1978 IRS ruling that disallows such a deduction with respect to "media" and "cents-off" coupons.

The Treasury Department recommended that the adjustment to income attributable to adopting the method of accounting provided in the bill with respect to magazine returns be placed in a "suspense account," rather than being spread over a 5-year period (as under the bill).

5. H.R. 5103: Excise taxes on tires and tread rubber (pamphlet pp. 24-27).--The Private Brand Tire Group recommended a committee report statement that no inference is intended as to applicability of bill provisions for excise tax credits or refunds with respect to sales of tires for which warranty adjustments are made where the tire manufacturer does not extend a warranty or guarantee to the ultimate consumer, but reduces the price to the dealer to reflect the anticipated warranty or guarantee expenses which the dealer may incur.

Sears, Roebuck & Co. recommended a committee report statement that if a warrenty runs solely from the manufacturer to a private brand dealer, and if the private brand dealer in turn gives the ultimate consumer a warranty

at least as good as that which runs from the manufacturer to the private brand dealer, the private brand dealer is to be considered to be the customer for purposes of the excise tax refund or credit with respect to warranty adjustments on tires. As a result, it would only have to be established that such an adjustment in the tax was made between the manufacturer and the private brand dealer in order for the manufacturer to obtain a credit or refund of the excise tax; the dealer would not be required to keep records proving that the adjustment had been made to the ultimate consumer

6. H.R. 6635: Interest rate adjustments on retirement savings bonds (pamphlet pp. 28-29).--The Treasury Department has recommended that the bill be amended (1) to permit the interest rate on already issued retirement bonds to be changed to match the interest rate on new retirement bonds rather than to match the interest rate on Series E savings bonds and (2) to change the effective date so that the bill applies to interest accrual periods that begin after the date of enactment of the bill, with respect to bonds issued before, on, or after the date of the bill's enactment.

BILLS SUPPORTED BY SOME WITNESSES BUT OPPOSED BY THE TREASURY DEPARTMENT:

1. H.R. 1920: Repayment of alcohol taxes and duties after loss due to disaster or damage (pamphlet pp. 13-14).--The Treasury Department has opposed the bill, arguing that it would, in effect, provide free fire, casualty, and flood insurance for merchants for the portion of their alcoholic beverage inventories attributable to excise taxes and customs duties, whereas merchants holding other types of products do not receive similar protection against losses, and there is no reason to provide such protection on a general basis.

2. H.R. 2984: Exemption from excise tax for farm, horse, or livestock trailers and semitrailers (pamphlet pp. 19-20).--The Treasury Department has opposed the bill, arguing that it would discriminate against single unit trucks (i.e., without trailers or semitrailers) and nonfarm trailers and semitrailers of the same carrying capacity, and that determination of whether a trailer was designed for farming purposes could be difficult and add to the complexity of the law.

[COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON JUNE 19, 1978

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JUNE 16, 1978

U.S. GOVERNMENT PRINTING OFFICE
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CONTENTS

I. INTRODUCTION

The bills described in this pamphlet have been scheduled for a hearing on June 19, 1978, by the Subcommittee on Taxation and Debt Management of the Committee on Finance. The bills include 11 bills which have passed the House of Representatives.

The pamphlet first briefly summarizes the bills, in the order in which the bills were listed in the press release announcing the hearings. This is followed by a discussion of each bill, setting forth present law, the issue involved, an explanation of what the bill would do, the bill's effective date, the revenue effect of the bill, any prior Congressional consideration of the bill, and the position of the Treasury Department with respect to the bill.

II. SUMMARY

1. S. 3134

Subsistence Allowance for Law Enforcement Officers

In 1977, the U.S. Supreme Court held that cash meal allowances paid to New Jersey highway patrol officers constitute gross income to the recipients and are not excludable under section 119 of the Code, relating to meals furnished for the convenience of the employer. The bill (S. 3134) provides an exclusion from gross income for statutory subsistence allowances received after 1969 and before 1978 by State police officers (including highway patrol officers).

2. H.R. 810

Treatment of Payment or Reimbursement by Private Foundations for Expenses of Foreign Travel by Government Officials

Present law in effect prohibits any "self-dealing" between private foundations and "disqualified persons." Under these rules, any payment or reimbursement by a private foundation of expenses of government officials generally is classified as an act of self-dealing. However, a limited exception in existing law permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States.

The bill (H.R. 810) broadens this existing exception to permit a private foundation (other than a foundation supported by any one business enterprise, trade association, or labor organization) to pay or reimburse government officials for certain expenses of foreign travel under similar types of limitations as apply under current law in the case of expenses for domestic travel.

3. H.R. 1337

Constructive Sale Price for Excise Tax on Certain Articles

Present law imposes a manufacturers excise tax on trucks, buses, highway tractors, and trailers at a rate of 10 percent of the price at which the manufacturer or importer sells a taxable product. Statutory rules provide for constructive sale prices in certain cases, including sales at retail by the manufacturer. In the case of a manufacturer selling at retail, the Internal Revenue Service has developed constructive prices as a percentage of the manufacturer's retail selling price.

The Service also has ruled, however, that in cases of such retail sales, if the manufacturer's actual costs in making and selling the article exceed the percentage constructive price, the costs instead will be used as the base for computing the manufacturer's excise tax.

The bill (H.R. 1337) provides that percentage constructive prices are to be used in cases where a manufacturer sells trucks, buses, highway tractors, or trailers at retail, and prohibits the use of manufacturer's costs as an alternative tax base in such situations.

4. H.R. 1920

Repayment of Alcohol Taxes and Duties After Loss Due to Disaster or Damage

The bill (H.R. 1920) expands the definition of the circumstances under which a loss of distilled spirits, wines, rectified products, or beer held for sale gives rise to payments by the Treasury, to those holding the products for sale, of amounts equal to the excise taxes and customs duties earlier paid on these products. At present, the only recognized circumstance which can give rise to such payments is a Presidentially declared "major disaster." The bill provides for payments on account of losses resulting from fire, flood, casualty, or other disaster, or from damage (not including theft) resulting from vandalism or malicious mischief.

5. H.R. 2028

Excise Tax Treatment of Home Producers of Beer or Wine

The bill (H.R. 2028) allows any individual 18 years of age or older to produce wine and (if the individual registers with the Treasury Department) to produce beer for personal and family use up to certain quantities without incurring the wine or beer excise taxes or any penalties. The maximum amounts which may be produced free of tax are 200 gallons of wine and 200 gallons of beer per year in a household in which there are two or more individuals 18 years or older. If there is only one individual 18 years or older in the household, the annual limit is 100 gallons of wine and 100 gallons of beer. In addition, the bill provides that the amount of such home-brewed beer on hand in any household at any one time (including beer in process) may not exceed 30 gallons.

6. H.R. 2852

Credit or Refund of Fuel Excise Taxes for Aerial Applicators

Present law provides an exemption from the excise taxes imposed on gasoline and special fuels if such fuels are used for farming purposes. Under the bill (H.R. 2852), an aerial applicator, such as a cropduster, who uses fuel (on which taxes have been paid) for farming purposes is authorized to claim the applicable excise tax repayment or income tax credit directly, in place of the farmer.

7. H.R. 2984

Exemption From Excise Tax for Farm, Horse, or Livestock Trailers and Semitrailers

The bill (H.R. 2984) provides an exemption from the 10-percent manufacturers excise tax on sales of trailers and semitrailers which are (1) suitable for use with "light-duty" towing vehicles and (2) de-

signed to be used for farming purposes or for transporting horses or livestock. The exemption also applies to sales of separate bodies and chassis for these trailers and semitrailers.

8. H.R. 3050

Tax Treatment of Returns of Magazines, Paperbacks, and Records

Under present law, sellers of merchandise who use an accrual method of accounting generally must include sales proceeds in income for the taxable year when all events have occurred which fix the right to receive the income and the amount can be determined with reasonable accuracy. The Internal Revenue Service has taken the position that accrual-basis publishers and distributors of magazines, paperbacks, or records must include the sales proceeds of these items in income when they are shipped to purchasers, and may reduce income for returns only in the year the items actually are returned unsold by the purchaser.

The bill (H.R. 3050) permits an accrual-basis publisher or distributor of magazines, paperbacks, or records to elect to exclude from income amounts attributable to items returned within 2 months and 15 days (in the case of magazines) or 4 months and 15 days (in the case of paperbacks and records) after the close of the taxable year in which the sales of the items were made.

9. H.R. 5103

Excise Taxes on Tires and Tread Rubber

The bill (H.R. 5103) clarifies the treatment of credits or refunds of the manufacturers excise tax on new (or retreaded) tires where sales are later adjusted as the result of a warranty or guarantee.

The bill also provides for credits or refunds of the manufacturers excise tax on tread rubber where tax-paid tread rubber is (1) wasted in the recapping or retreading process, (2) used in the recapping or retreading of tires the sales of which are later adjusted under a warranty or guarantee, or (3) used in the recapping or retreading of tires which are exported, sold to State or local governments, sold to nonprofit educational institutions, or sold as supplies for vessels or aircraft.

In addition, the bill modifies the statute of limitations so that a credit or refund of the tread rubber or new tire tax can be obtained for a period of one year after the warranty or guarantee adjustment is made. Also, the bill imposes a tax on tread rubber used in recapping or retreading certain tires abroad, if those tires then are imported into the United States.

10. H.R. 6635

Interest Rate Adjustments on Retirement Savings Bonds

Under present law, the interest rate on an individual retirement bond issued by the Treasury Department or a retirement plan bond issued by the Treasury Department remains the same from the date

of issuance until the bond is redeemed (generally when the owner retires, becomes disabled, or dies). The bill (H.R. 6635) authorizes the Treasury Department to make upward adjustments in the interest rate on outstanding retirement bonds, so that such a bond will earn interest at a rate consistent with the rate then established for Series E U.S. savings bonds.

11. H.R. 8535

Child Care Credit for Amounts Paid to Certain Relatives

Under present law, payments by a taxpayer to certain relatives for child care services qualify for the child care credit only if the relatives' services constitute "employment" as defined for purposes of social security taxes. Because of the operation of that definition, payments to grandparents to care for their grandchildren generally are not treated as qualifying for the credit.

The bill (H.R. 8535) repeals the requirement that qualifying child care services of relatives must constitute "employment" under the social security tax rules. Thus, otherwise qualifying payments to grandparents to care for their grandchildren will be eligible for the child care credit. Also, the bill disallows the credit for amounts for child care services paid by the taxpayer to his or her child if the child performing such services is under age 19.

12. H.R. 8811

Revocability of Election to Receive Tax Court Judge Retired Pay

The bill (H.R. 8811) allows an individual who has filed an election to receive retired pay as a Tax Court judge to revoke that election at any time before retired pay would begin to accrue, thereby enabling that individual to seek to qualify for benefits under the civil service retirement system (but not under both retirement systems).

III. DESCRIPTION OF BILLS

1. S. 3134

Subsistence Allowance for Law Enforcement Officers

Present law

Section 61 of the Code defines gross income as including "all income from whatever source derived," and further specifies that it includes "compensation for services." Treasury regulations provide that gross income generally includes compensation for services paid other than in money, including the value of meals which an employee receives in addition to salary (secs. 1.61–1(a), 1.61–2(d)(3)).

The Congress has provided a number of express statutory exceptions to the broad definition of gross income. One exception provides that an employee's gross income does not include the value of employer-furnished meals if they are supplied for the employer's convenience and on its business premises (sec. 119).

In *Commissioner* v. *Kowalski*, 98 S. Ct. 315 (1977), the United States Supreme Court held that New Jersey's cash payments to its police troopers for meals consumed while on highway patrol duty constitute gross income to the troopers.[1] In arriving at its decision, the Court pointed out that in 1954 the Congress had enacted a companion provision to section 119 which allowed an exclusion of up to $5 per day of statutory subsistence allowances received by police officials. This provision was repealed in 1958[2] in order "to bring the tax treatment of subsistence allowances for police officials into line with the treatment of such allowances in the case of other taxpayers. . . ."[3] Thus, if cash meal allowances were excludable from an employee's gross income under section 119, the Court reasoned, the repeal of the former $5-per-day exclusion would be rendered ineffective.

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[1] In *Central Illinois Public Service Co.* v. *U.S.*, — U.S. —, 41 AFTR2d 718 720 (1978), the Supreme Court noted that "it is fair to say that until this Court's' very recent decision in *Kowalski*, the Courts of Appeals have been in disarray on the issue whether, under §§61 and 119 of the 1954 Code or under the respective predecessor sections of the 1939 Code, [cash meal] reimbursements were income at all to the recipients * * *."

In *Central Illinois*, the Court held that cash reimbursements for employees' lunch expenses did not constitute "wages" subject to withholding under the law applicable at the time the reimbursements were made, even though the reimbursements constituted gross income. The Court's decision did not alter the treatment of meal reimbursements for FICA (Treas. regs. sec. 31.3121(a)–1(f)) or FUTA (sec. 3306(b)) purposes.

[2] Technical Amendments Act of 1958, sec. 3, 72 Stat. 1606, 1607.

[3] H.R. Rep. No. 775, 85th Cong., 1st Sess. 7 (1957).

Issue

The issue is whether certain subsistence allowances received by law enforcement officers should be excluded from gross income.

Explanation of the bill

The bill in effect applies the Supreme Court's *Kowalski* decision to State police officers on a prospective basis only.

The bill provides an exclusion from gross income for statutory subsistence allowances received by an officer during the years 1970 through 1976 to the extent that the allowances were not included in income on the officer's income tax return (including an amended return filed before December 1, 1977). In addition, the bill excludes from gross income statutory subsistence allowances received by an officer during 1977. The bill applies to police officers (including highway patrolmen) employed by a State or the District of Columbia on a full-time basis with the power to arrest.[1]

Effective date

The bill applies to statutory subsistence allowances received after December 31, 1969, and before January 1, 1978.

Revenue effect

It is estimated that the bill would result in a decrease in budget receipts of $8 million for fiscal year 1979.

Departmental position

The Treasury Department opposes the bill on the ground that it would provide an unjustified tax refund to individuals who chose not to follow the clear and long-standing interpretation of the law by the Internal Revenue Service. The Department believes that any tax exclusion for subsistence allowances received by State police officers would be unfair to the overwhelming majority of workers who had to pay tax on the compensation out of which they bought their lunches and met their other subsistence needs.

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[1] The press release issued by the Subcommittee on Taxation and Debt Management of the Committee on Finance to announce the June 19 hearing stated that the issue of the tax treatment of statutory subsistence allowances paid to law enforcement officers would be considered at the hearing, and referred to S. 2872. The latter bill would amend section 119 of the Code, retroactively to January 1, 1970, to provide that certain amounts paid to full-time law enforcement officers (including conservation officers, wardens, prison guards, and coroners) as statutory subsistence allowances are excludable from gross income. Subsequent to issuance of the press release, the House Committee on Ways and Means reported H.R. 12841 (H.R. Rep. No. 95-1232), section 3 of which is substantially identical to S. 3134 described in the text above.

2. H.R. 810

Treatment of Payment or Reimbursement by Private Foundations for Expenses of Foreign Travel by Government Officials

Present law

The Tax Reform Act of 1969 added a provision to the Code (sec 4941) which in effect prohibits "self-dealing" acts between private foundations and certain designated classes of persons (referred to as "disqualified persons") by imposing a graduated series of excise taxes on the self-dealer (and also on any foundation manager who willfully and knowingly engages in self-dealing acts). Under this provision, the payment or reimbursement by a private foundation of expenses of a government official generally is classified as an act of self-dealing (sec. 4941(d)(1)(F)).

A limited exception to this provision permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States (sec. 4941(d)(2)(G)(vii)). Under this exception, it is not an act of self-dealing for a private foundation to pay or reimburse a government official for actual transportation expenses, plus an amount for other traveling expenses not to exceed 1¼ times the maximum *per diem* allowed for like travel by Federal employees. However, no such private foundation payment or reimbursement to government officials is permitted for travel to or from a point outside the United States.

Issue

The issue is whether private foundations should be permitted to pay or reimburse government officials for expenses for foreign travel and, if so, under what circumstances.

Explanation of the bill

The bill provides that a private foundation does not engage in an act of self-dealing in paying or reimbursing certain expenses of government officials paid or incurred for travel between a point in the United States and a point outside the United States. The maximum amount thich can be paid or reimbursed by a private foundation for any one wrip by a government official is the sum of (1) the lesser of the actual cost of the transportation involved or $2,500, plus (2) an amount for all other traveling expenses not in excess of 1¼ times the maximum amount payable under section 5702(a) of title 5, United States Code (relating to like travel by a U.S. Government employee) for a maximum of 4 days.[1]

[1] Under 5 U.S.C. 5702(a), in the case of travel outside the continental United States, the President or his designee has the authority to establish the maximum *per diem* allowance for the locality where the travel is performed. Currently, for example, 1¼ times the daily amount so established for travel expenses in London is $102.50, for travel in Paris, $100.00, and for travel in Tokyo, $110.00.

The exception added by this bill is not available to a private foundation if more than one-half of the foundation's support (as defined in sec. 509(d)) is normally derived from any one business enterprise, any one trade association, or any one labor organization, whether such support takes the form of interest, dividends, other income, grants, or contributions.

Effective date

The bill would apply with respect to travel beginning after the date of enactment.

Revenue effect

It is estimated that this bill would not have any direct revenue effect.

Prior Congressional action

An identical bill (H.R. 2984, 94th Cong.) was passed by the House of Representatives by voice vote on May 18, 1976, but was not acted upon by the Senate Finance Committee or considered by the Senate.

Departmental position

The Treasury Department recommends that the bill should be amended to limit the permitted amount of reimbursable transportation expenses to the cost of the lowest coach or economy air fare charged by a commercial airline.

The recommended change would make the reimbursable amounts under the bill consistent with the limitation on deductions for attending foreign conventions under the Administration's 1978 tax program. The Treasury Department would not oppose the bill if this change were made.

3. H.R. 1337

Constructive Sale Price for Excise Tax on Certain Articles

Present law

Under present law, a manufacturers excise tax of 10 percent is imposed on the sale by a manufacturer or importer of trucks, buses, highway tractors, and their related chassis, bodies, and trailers (sec. 4061(a)).[1] Generally, the tax is based on the price at which a taxable item is sold by the manufacturer.

However, present law also provides for a constructive sale price if taxable articles are sold by a manufacturer or importer to other than a wholesale distributor (sec. 4216). If a manufacturer or importer sells a taxable article at retail—i.e., directly to ultimate consumers—the constructive sale price is the lower of (1) the price for which the article was sold, or (2) the highest price at which competing articles are sold by wholesale distributors, as determined by the Treasury Department (sec. 4216(b)(1)).

The Internal Revenue Service has ruled that if a manufacturer sells taxable items at retail, the price at which competing items are sold to wholesale distributors is considered to be 75 percent of the established retail price (Rev. Rul. 54–61, 1954–1 CB 259). The "established retail price" is the highest price for which a manufacturer sells, or offers to sell, an item for use by an independent purchaser who ordinarily would not be expected to buy more than one item. If a taxable item actually is never sold at its list price, because of discounts or other price modifications, the "established retail price" is the price resulting from the minimum discount off the list price (Rev. Rul. 68–519, 1968–2 CB 513).

The Service also has ruled that if a manufacturer's actual cost of making and selling a taxable item is greater than the percentage constructive price referred to above, then its actual cost is used in lieu of the percentage constructive price for purposes of computing the applicable excise tax (Rev. Ruls. 54–61 and 68–519, as noted above). This method of calculating the tax base has been referred to as the "cost floor" rule.

Issue

The issue is whether the "cost floor" rule should be applied for purposes of determing a constructive sale price if a manufacturer sells trucks, buses, and similar articles at retail.

Explanation of the bill

The bill amends the constructive sale price rule to eliminate the use of a constructive sale price based upon the manufacturer's costs in cases where trucks, buses, highway tractors, and related articles tax-

[1] The tax is scheduled to be reduced to 5 percent on October 1, 1979. Revenues from this tax go to the Highway Trust Fund (through September 30, 1979).

able under section 4061(a) are sold at retail by a manufacturer. The excise tax in these situations is to be determined by using a percentage constructive sale price based on the price for which such articles are sold, in the ordinary course of trade, by manufacturers, as determined pursuant to Treasury regulations. As under present law, the Internal Revenue Service may establish percentages to be used for determining the excise tax base. However, under the bill, the percentage constructive price is not to exceed 100 percent of the actual sale price.

Effective date

This bill would apply to articles which are sold by the manufacturer or producer after September 30, 1977.

Revenue effect

The bill is estimated to reduce budget receipts by $1 million in fiscal year 1979 and by $500,000 annually thereafter. These revenues would otherwise go into the Highway Trust Fund (through September 30, 1979).

Departmental position

The Treasury Department supports the bill. However, the Department recommends that the effective date of the bill be changed to September 30, 1978, in order to eliminate the need to adjust excise taxes on sales made before enactment of the bill.

4. H.R. 1920

Repayment of Alcohol Taxes and Duties After Loss Due to Disaster or Damage

Present law

The excise taxes and customs duties on distilled spirits, wines, rectified products, and beer are paid or determined before these products leave the site of their production and enter marketing channels. If the products subsequently are lost, made unmarketable, or officially condemned while held for sale, amounts equal to the taxes and duties can be paid by the Treasury to wholesalers or retailers holding the products for sale only if the cause is a "major disaster" so declared by the President (sec. 5064 of the Code). Similar repayment rules apply to tobacco products lost in major disasters so declared by the President (sec. 5708).

Issue

The issue is whether payment by the Treasury of alcohol excise taxes and duties should be authorized for losses resulting from vandalism or malicious mischief or from disasters of a lesser magnitude than those which are declared by the President to be "major disasters."

Explanation of the bill

The bill provides for payment (without interest) by the Treasury of amounts equal to the alcohol excise taxes and duties paid or determined on distilled spirits, wines, rectified products, or beer held for sale but lost or ruined because of certain events if these events occurred in the United States. These events are: (1) fire, flood, casualty, or other disaster or (2) breakage, destruction, or other damage (not including theft) resulting from vandalism or malicious mischief.

As under present law with respect to Presidentially declared major disasters, payment is not to be available for taxes, or taxes and duties, the loss of which was indemnified by insurance or otherwise.

Present law does not impose any "floor" or minimum amount for which a claim for repayment of taxes, or taxes and duties, may be filed under the Presidentially declared major disaster provision. The bill imposes a $250 floor on any claim arising from any single disaster or damage, other than one for which a claim would have been allowable under present law. The bill makes no change on this point with respect to claims that would have been allowable under present law.

The bill provides that no claim under this section is allowable unless it is filed within 6 months after the date of the loss, except that in the case of a Presidentially declared major disaster, the claim period is not to expire before the day which is 6 months after the date on which the President determined the disaster occurred.

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Effective date

The bill would apply to disasters (or other specified causes of loss) occurring on or after the first day of the first calendar month which begins more than 90 days after the date of the bill's enactment.

Revenue effect

It is estimated that the bill would reduce revenues by about $500,000 annually, beginning with fiscal year 1979.

Departmental position

The Treasury Department opposes the bill on the following grounds. The bill would, in effect, provide free fire, casualty, and flood insurance for merchants for the portion of their alcoholic beverage inventories attributable to excise taxes and customs duties. Merchants holding other types of products do not receive similar protection against losses, and there is no reason to provide such protection on a general basis. The Treasury Department also recommends repeal of the "major disaster" provisions of present law for both alcoholic beverages and tobacco products, since these provisions also grant holders of alcoholic beverages and tobacco products free insurance that is not given merchants who lose other merchandise in a "major disaster."

5. H.R. 2028

Excise Tax Treatment of Home Producers of Beer or Wine

Present law

Present law (sec. 5042 of the Code) permits the "head of any family," after registering with the Treasury Department, to produce up to 200 gallons of wine a year for family use without payment of tax. However, a single individual who is not the head of a family is not covered by this exemption. (See Treas. Regs. 27 CFR §§ 240.540 *et seq.*)

The Bureau of Alcohol, Tobacco, and Firearms interprets present law (sec. 5054(a)(3)) as providing that it is illegal to brew beer in one's home for home consumption. As a result, the tax of $9 per barrel (31 gallons or less), which is imposed on the production of beer (sec. 5051(a), is due and payable immediately upon production. In addition, the Bureau takes the position that home brewers are subject to the criminal penalties imposed by the Code (sec. 5687) for liquor tax offenses that are not otherwise specifically covered.

Issues

One issue is whether the present exemption from the wine tax for a head of a family who produces up to 200 gallons of wine a year for family use should be expanded to include other adult individuals.

Another issue is whether there should be an exemption (similar to the exemption for home-produced wine) for beer which is produced by an individual in his or her home for personal use, rather than for commercial sale; and if so, under what limitations or conditions the exemption should be provided.

Explanation of the bill

Wine

The bill modifies the provisions of existing law that permit heads of families to produce wine tax-free for family use. Under the bill, the present limitation of 200 gallons of tax-free production in a calendar year is to apply if there are two or more adults (age 18 or older) in the household. The present law's requirement that any producer of wine under the family-use exemption must be a "head of any family" is repealed; however, the producer must be an adult.

The bill provides that, if there is only one adult in the household, then 100 gallons of wine may be produced by that adult tax-free in a calendar year.

In addition, the bill would eliminate the present-law requirement that the person producing the wine must have registered with the Treasury Department.

Beer

The bill provides essentially the same rule in the case of household production of beer, with the added requirement that, in order not to be subject to the beer tax, the amount of beer on hand at any one time (including beer in process) is not to exceed 30 gallons. Also, the bill requires that producers of beer register with the Treasury Department in order to qualify under the home brewing exception.

The bill also makes it clear that criminal penalties imposed under Federal law in connection with illegally produced beer do not apply to home production which qualifies for the exemption provided in this bill. The provisions dealing with illegally produced beer are amended to make it clear that home production of beer that does not qualify for the new exemption is illegal.

Identical bill

S. 2930 is identical to H.R. 2028.

Effective date

The bill would take effect on the first day of the first calendar month which begins more than 90 days after the date of the bill's enactment.

Revenue effect

The bill is estimated to reduce budget receipts by less than $1.5 million annually, beginning with fiscal year 1979.

Departmental position

The Treasury Department supports the bill.

6. H.R. 2852

Credit or Refund of Fuel Excise Taxes for Aerial Applicators

Present law

Under present law, gasoline and special fuels used by noncommercial aviation are subject to excise taxes totalling 7 cents per gallon (secs. 4041(c) and 4081 of the Internal Revenue Code).[1] Present law provides an exemption from these taxes if the fuel is used for farming purposes (sec. 4041(f)).

The farming-use exemption applies if gasoline or special fuel is sold for use, or used, on a farm in the United States for farming purposes by the owner, tenant, or operator of the farm (secs. 4041(f), 6420(c), and 6427(c)). If the taxes have been paid, the owner, tenant, or operator may obtain a "refund" of the excise taxes, either by a payment under the excise tax system (secs. 6420 and 6427) or by a refundable income tax credit (sec. 39). The repayment and credit provisions also apply if the gasoline or other fuel is used on the farm by someone other than the owner, tenant, or operator (such as a cropduster). In the latter situations, the owner, tenant, or operator reports the number of gallons of fuel consumed on or over the farm and claims the repayment or credit (see Treas. Regs. sec. 48.6420(a)–1(c)).

Issue

The issue is whether aerial applicators, such as cropdusters, should be allowed to claim the credit or refund of aircraft fuel taxes for fuel used on or over farms for farming purposes.

Explanation of the bill

The bill permits aerial applicators, such as cropdusters, to claim the credit or refund of aircraft fuel taxes for fuel used on farms for farming purposes. Under the bill, the farmer is no longer permitted to claim the credit or refund for these taxes. The bill does not change the uses which qualify a taxpayer to claim the credit or payment.

The exemption applies only to the extent that gasoline or special fuels are used for farming purposes by the aerial applicator as determined in accordance with Treasury regulations (secs. 4041(f)(1), 6420(f), and 6427(h)).[2]

Effective date

The bill would apply to fuels used on or after the first calendar quarter which begins more than 90 days after the date of enactment, even if the tax was paid before the effective date.

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[1] The excise tax on gasoline imposed by section 4081 is scheduled to be reduced to 1½ cents per gallon on October 1, 1979 (sec. 4081(b)). At that time, the excise taxes imposed by section 4041(c) are scheduled to be 5½ cents per gallon (to total 7 cents per gallon on aviation fuel; the section 4041(c) taxes are then scheduled to expire on July 1, 1980 (sec. 4041(c)(5)). The revenues from these taxes on fuel used by noncommercial aviation go to the Airport and Airway Trust Fund (through June 30, 1980).

[2] S. 196, which also has been referred to the Committee on Finance, would permit aerial applicators, effective July 1, 1977, to claim the credit or refund of aircraft fuel taxes for fuel used on or over a farm for farming purposes (sec. 2 of the bill).

Revenue effect

The bill is estimated to reduce budget receipts by less than $1 million annually, beginning with fiscal year 1979. These revenues would otherwise go into the Airport and Airway Trust Fund (through June 30, 1980).

Departmental position

The Treasury Department recommends that the bill should be amended to provide that aerial crop sprayers will be entitled to receive credits or refunds of the fuel excise taxes only if the farmers otherwise eligible for the credits or refunds have waived in writing their rights in favor of the aerial crop sprayers. The Department would support the bill if this change were made.

7. H.R. 2984

Exemption From Excise Tax for Farm, Horse, or Livestock Trailers and Semitrailers

Present law

Under present law, a manufacturers excise tax of 10 percent is imposed on sales of chassis and bodies of trucks, buses, highway tractors, or their related trailers and semitrailers by a manufacturer, producer, or importer of such an article (sec. 4061 (a) of the Internal Revenue Code).[1]

Present law provides an exemption from the tax in the case of sales of chassis and bodies of light-duty trucks, buses, truck trailers, and semitrailers (sec. 4061(a)(2)). To be eligible for this exemption, the chassis or body of the truck trailer or semitrailer must be "suitable for use" with a trailer or semitrailer having a gross vehicle weight of 10,000 pounds or less, determined in accordance with Treasury Department regulations (sec. 4061 (a)(2)).[2] Furthermore, in order to be exempt, the truck trailer or semitrailer itself must be suitable for use with a towing vehicle having a gross vehicle weight of 10,000 pounds or less (sec. 4061(a)(2)).

Issue

Present law excludes from the manufacturers excise tax "light-duty" trailers and semitrailers suitable for use with "light-duty" trucks. The issue is whether the "light-duty" limitation on the trailer or semitrailer exclusion should be removed in the case of trailers or semitrailers designed to be used for farming purposes or for transporting horses or livestock.

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[1] The tax is scheduled to be reduced to 5 percent on October 1, 1979. Revenues from this tax go to the Highway Trust Fund (through September 30, 1979).

[2] "Gross vehicle weight" is defined as the maximum total weight of a loaded vehicle (Treas. Regs. § 48.4061(a)–1(f)(3)(i)). The maximum total weight of a loaded vehicle is the gross vehicle weight rating of the manufactured article as specified or established by the manufacturer, unless such a rating is unreasonable in light of the particular facts and circumstances. Generally, a manufacturer must specify or establish a weight rating for each chassis, body, or vehicle sold by it if the item requires no significant post-manufacture modifications (Treas. Regs. § 48.4061(a)–1(f)(3)(ii)).

The manufacturer's gross vehicle weight rating must take into account the strength of the chassis frame, the axle capability (capacity and placement), and the spring, brake, rim, and tire capacities. The lowest weight rating component ordinarily is determinative of the gross vehicle weight (Treas. Regs. § 48.4061 (a)–1(f)(3)(v)). The total of the axle ratings is the sum of the maximum load-carrying capability of the axles and, in the case of a trailer or semitrailer, the weight that is to be borne by the vehicle used in combination with the trailer or semitrailer for which gross vehicle weight is determined (Treas. Regs. § 48.4061 (a)–1(f)(3)(vi)).

Explanation of the bill

Under the bill, an exemption is provided from the 10-percent manufacturers excise tax for certain trailers or semitrailers which are designed to be used for farming purposes or for transporting horses or livestock. The bill, in effect, eliminates the present-law requirement for exemption that a trailer or semitrailer designed for such purposes have a gross vehicle weight of 10,000 pounds or less. However, the bill retains the present law limitations on the size of such a trailer or semitrailer—that it be suitable for use with a light-duty vehicle having a gross vehicle weight of 10,000 pounds or less. If a body or chassis is sold separately, then it must be suitable for use with such a trailer or semitrailer in order to qualify under the exemption.

The bill does not affect the separate 8-percent manufacturers excise tax on truck parts and accessories (sec. 4061(b)).

To avoid creating competitive disadvantages which might arise because of the relative sizes of dealers' inventories, and in conformity with prior practice in excise tax legislation, the bill provides for floor stocks refunds or credits (without interest) with respect to all articles exempted by the bill that are in dealers' inventories on the day after the date of enactment.

Effective date

The exemptions made by the bill would apply with respect to articles sold on or after the day after the bill's enactment.

Revenue effect

The bill is estimated to reduce budget receipts by less than $2 million per year, beginning with fiscal year 1979. These revenues would otherwise go into the Highway Trust Fund (through September 30, 1979). If the bill becomes public law within the next three months, it could also reduce 1978 budget receipts by a negligible amount.

Prior Congressional action

An identical bill (H.R. 6521, 94th Cong.) was passed by the House of Representatives by voice vote on August 24, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate.

Departmental position

The Treasury Department opposes the bill because the bill would discriminate against single unit trucks (i.e., without trailers or semitrailers) and non-farm trailers and semi-trailers of the same carrying capacity. In addition, determination of whether a trailer was designed for farming purposes could be difficult and add to the complexity of the law.

8. H.R. 3050

Tax Treatment of Returns of Magazines, Paperbacks, and Records

Present law

Generally, sellers of merchandise who use an accrual method of accounting must report sales proceeds as income for the taxable year when all events have occurred which fix the right to receive the income and the amount can be determined with reasonable accuracy (Treas. Regs. sec. 1.451-1(a)).

In some cases, the seller expects that accrued sales income will be reduced on account of events subsequent to the date of sale, such as returns of unsold merchandise for credit or refund pursuant to a pre-existing agreement or understanding between the seller and the purchaser. In these instances, the reduction in sales income generally must be recognized in the taxable year during which the subsequent event, such as the return of unsold merchandise, occurs. Deductions or exclusions based on estimates of future losses, expenses, or reductions in income ordinarily are not allowed for Federal income tax purposes.

Under these general tax accounting rules, the Internal Revenue Service has taken the position that accrual-basis publishers and distributors of magazines, paperbacks, or records must include the sales proceeds of these items in income when they are shipped to the purchaser, and may reduce income for returned items only in the taxable year the items actually are returned unsold by the purchaser.

Issue

The issue is whether an accrual-basis publisher or distributor of magazines, paperbacks, or records should be permitted to elect to exclude from income amounts attributable to items returned within a specified period of time after the close of the taxable year in which the publisher or distributor shipped the items to purchasers.

Explanation of the bill

For taxpayers who account for sales of magazines, paperbacks, or records on an accrual method, the bill provides an election to exclude from gross income for a taxable year the income attributable to unsold merchandise returned within a certain time (the "merchandise return period") after the close of the taxable year (new sec. 457 of the Internal Revenue Code). In the case of magazines, the merchandise return period extends for 2 months and 15 days after the close of the taxable year. In the case of paperbacks and records, the merchandise return period extends for 4 months and 15 days after the close of the taxable year.

The bill establishes several requirements to define those returned items which may be used to reduce gross income if a timely election is made: (1) the taxpayer must be under a legal obligation, at the time

of sale, to adjust the sales price of the magazine, paperback, or record on account of the purchaser's failure to resell it; (2) the adjustment to the sales price must be on account of the purchaser's failure to resell the magazine, paperback, or record in its trade or business; and (3) the merchandise must be returned to the taxpayer by the close of the merchandise return period.

The amount to be excluded from gross income on account of otherwise qualifying returns is limited to the lesser of (1) the amount covered by the acknowledged legal obligation with respect to such returns or (2) the amount of adjustment to the sales price agreed to by the taxpayer before the close of the merchandise return period.

The computation of income under the merchandise-return election constitutes a method of accounting. In the absence of a specific statutory rule to the contrary, an adjustment to income attributable to a change in method of accounting (called the "transitional adjustment") is amortized over a period of time prescribed by the Internal Revenue Service, usually 10 years (sec. 481(c)). However, the bill provides specific rules for the transitional adjustments arising out of merchandise-return elections.

In the case of an election to account for magazine returns under this bill, a special 5-year amortization of the transitional adjustment is provided in place of the normal 10-year period. In the case of an election to account for paperback or record returns, the bill establishes a "suspense account" to hold the transitional adjustment. The operative effect of the suspense account is to defer deduction of the transitional adjustment until the taxpayer is no longer engaged in the trade or business of selling the items which were the subject of an election.

In the case of a suspense account established with respect to paperback or record returns, as long as merchandise returns during the merchandise return period remain at or below the level of the initial opening balance in the account, taxable income under the merchandise-return method is the same as it would have been absent an election. However, an increase in returns over the initial opening balance is recognized one year earlier under the elected method.

Effective date

The election provided by the bill could be made with respect to taxable years beginning after December 31, 1976. The time for making the election for any taxable year beginning before the date of enactment of this bill would not expire before the date which is one year after the enactment date.

Revenue effect

The bill is estimated to reduce revenues by $22 million in fiscal year 1979, $11 million in fiscal year 1980, $11 million in fiscal year 1981, $12 million in fiscal year 1982, and $12 million in fiscal year 1983.

Prior Congressional action

A bill relating to accounting for magazine returns (but not paperback or record returns), somewhat similar to this bill, was passed by the House of Representatives by voice vote on August 2, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate (H.R. 5161, 94th Cong.).

Departmental position

The Treasury Department believes that the special relief provided by the bill should be allowed only to those taxpayers who, in the year they elect the new method of accounting, establish a suspense account to delay the deduction for goods returned during the year the election is made before the due date (without extensions of time) for filing the income tax return for the prior year. Requiring a suspense account would prevent a substantial revenue loss in the year of enactment. However, in the case of an election to account for magazine returns under the bill, if it is determined that amortization of the transitional adjustment is preferable to the establishment of a suspense account, the Treasury Department recommends that the normal ten-year amortization period for such adjustments be used instead of the special five-year amortization provided by the bill.

9. H.R. 5103

Excise Taxes on Tires and Tread Rubber

A. New Tires—Credit or Refund If Tire Sale Is Adjusted Pursuant to Warranty or Guarantee (Subsec. (d) of the bill)

Present law

Present law (sec. 4071(a) of the Code) imposes a manufacturers excise tax of 10 cents per pound on new tires of the type used on highway vehicles, and 5 cents per pound on new nonhighway tires.[1]

Since these taxes are imposed on the basis of weight, rather than on the basis of the price for which the tire is sold, changes in the sale price of the tire generally do not affect the amount of tax due on a manufacturer's sale. However, under present practice (Rev. Rul. 59–394, 1959–2 CB 280), if a tire manufacturer sells a customer a new replacement tire pursuant to a warranty or guarantee on the tire that is being replaced, the manufacturers excise tax on the replacement tire is reduced in proportion to the reduction in price of the replacement tire.

The tire industry's practice has been to apply this rule based on the proportionate reduction in the price to the ultimate consumer where the manufacturer's warranty or guarantee runs to the ultimate consumer. The Internal Revenue Service did not dispute this industry practice before the publication of Rev. Rul. 76–423, 1976–2 CB 345. In that ruling, the Service has taken the position that the tax should be reduced in proportion to the reduction in price from the manufacturer to its immediate vendee—usually, a wholesaler or a dealer. Since this price reduction often is proportionately less than the reduction given by the retail dealer to the ultimate consumer, the Service's position generally produces a smaller tax reduction (hence, a larger net tax) than that produced by the rule that focuses upon the adjustment in sale price to the ultimate consumer.

As originally announced, the 1976 ruling was to take effect with respect to this issue on April 1, 1977. This effective date has been twice postponed by the Service, most recently to April 1, 1978, in order to give the Congress an opportunity to consider whether legislative change is appropriate.

Issues

The issues relate to the proper method of computing the manufacturers excise tax where tire warranty or guarantee adjustments have been made.

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[1] The revenues from these taxes go into the Highway Trust Fund (through September 30, 1979). The tax on new highway tires is to be reduced to 5 cents per pound as of October 1, 1979.

Explanation of the provision

The bill codifies the long-standing administrative practice under which a manufacturer is allowed an excise tax credit or a refund with respect to sales of tires for which a warranty or guarantee adjustment is made on a tire-by-tire basis. The bill also applies the same general principles to cases where warranty or guarantee adjustments are made on an overall basis. In addition, the bill provides corresponding rules for situations where the manufacturer's warranty or guarantee runs only to its purchaser and not to the ultimate consumer.

B. Tread Rubber—Credit or Refund Under Certain Circumstances (Subsecs. (a), (b), and (c) of the bill)

Present law

Present law imposes a tax of 5 cents per pound on tread rubber used for recapping or retreading tires (secs. 4071(a)(4) and 4072(b)).[2]

Tread rubber may be sold tax-free for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles (sec. 4073(c)). Also, a credit or refund (without interest) of the tread rubber tax may be obtained if the tax-paid tread rubber is used or sold for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles (sec. 6416(b)(2)(G)).

In the case of new tires, sales may be made tax-free (or a credit or refund obtained if tax has been paid) if the tires are exported, sold for use as supplies for vessels or aircraft engaged in foreign trade, or sold to a State or local government for exclusive use by such an entity or to a nonprofit educational organization for its exclusive use (secs. 4221(a) and 6416(b)). A credit or refund also is available if the sale of a new tire is adjusted later under a guarantee or warranty. However, if a retreaded tire is exported, etc., or the price is adjusted pursuant to a warranty or guarantee, no credit or refund is available as to the tread rubber tax.

No credit or refund of the tread rubber tax currently is available if the rubber is destroyed, scrapped, wasted, or rendered useless in the recapping or retreading process.

Issue

The issue is whether a credit or refund of the tread rubber tax should be made available in various situations if a credit or refund would be available for new tires in comparable situations.

Explanation of the provision

The bill makes a credit or refund of the tread rubber tax available (1) if rubber is destroyed, scrapped, wasted, or rendered useless in the recapping or retreading process; (2) if the tread rubber is used in the recapping or retreading of a tire and the sales price of the tire is later adjusted because of a warranty or guarantee; (3) if a recapped or retreaded tire is exported, sold to a State or local government for the government's exclusive use, sold to a nonprofit educational organization for its exclusive use, or used or sold for use as supplies for a

[2] Revenues from this tax go into the Highway Trust Fund. This tax is scheduled to expire as of October 1, 1979.

vessel or aircraft; and (4) in certain cases if a retreaded tire is sold by a second manufacturer on or in connection with another article manufactured by the second manufacturer.

C. Statute of Limitations (Subsec. (e) of the bill)

Present law

Under present law, the general time by which a claim for credit or refund of a tax must be filed is 3 years from the time the tax return was filed or, if later, 2 years from the time the tax was paid (sec. 6511).

Issue

The issue is whether the statute of limitations for filing refund claims should be extended with respect to credits or refunds of the excise taxes on tires and tread rubber.

Explanation of the provision

The bill modifies the statute of limitations in cases where a claim for credit or refund of tire tax or tread rubber tax is filed as a result of a warranty or guarantee adjustment. The bill provides that in such a case a claim for credit or refund may be filed at any time before the date which is one year after the date on which the adjustment is made, if otherwise the period for filing the claim would expire before that later date.

D. Imported Recapped or Retreaded U.S. Tires (Subsec. (f) of the bill)

Present law

The excise taxes on tires and tread rubber apply to imported articles as well as those produced or manufactured in the United States. However, if a used tire which has been taxed in the United States is exported, is retreaded (other than from bead to bead) abroad, and is then shipped back into the United States, then there is neither a tax on the imported retreaded tire nor on the tread rubber used in the retreading, because the tire already has been taxed and the tread rubber is considered to have lost its identity.

Issue

The issue is whether used tires which are exported, recapped or retreaded abroad, and then returned to this country, should be subject to the excise tax on tread rubber.

Explanation of the provision

The bill provides that used tires which are exported from the United States, recapped or retreaded abroad (other than from bead to bead), and then reimported into the United States are to be subject to the tax on tread rubber to the extent that tread rubber is incorporated into the tire. For this purpose, the amount of tread rubber to be taken into account is to be determined as of the completion of the recapping or retreading of the tire.

E. General

Effective date

The amendments made by this bill would take effect on the earlier of (1) April 1, 1978, or (2) the first day of the first calendar month which begins more than 10 days after the date of the bill's enactment,

The statute of limitations amendment would apply on and after the effective date. In effect, it would apply to adjustments made (or deemed made) on or after the date one year before the effective date.

Revenue effect

The bill is estimated to reduce budget receipts by less than $300,000 in fiscal year 1979 and by less than $200,000 per year thereafter. (If the bill becomes public law within the next three months, 1978 budget receipts could be reduced by as much as $100,000 and 1979 revenue loss would be reduced by a corresponding amount.) These revenues would otherwise go into the Highway Trust Fund (through September 30, 1979).

Prior Congressional action

A bill with somewhat similar provisions (H.R. 2474, 94th Cong.) was passed by the House of Representatives by voice vote on August 24, 1976. The bill was reported by the Senate Finance Committee (S. Rept. 94–1348) on September 29, 1976, but was not acted upon by the Senate because of lack of time before adjournment.

Departmental position

The Treasury Department does not oppose the bill.

10. H.R. 6635

Interest Rate Adjustments on Retirement Savings Bonds

Present law

Under present law, a person eligible to establish an individual retirement account may purchase retirement bonds issued for this purpose by the Treasury Department. These bonds are not transferable and are subject to many of the restrictions that apply to individual retirement accounts. Retirement plan bonds are issued for H.R. 10 plans established by self-employed persons and for retirement and annuity plans established by employers for their employees. The interest rate on any such retirement bond remains unchanged throughout its life.

By contrast, the interest rates on issued Series E savings bonds are increased whenever there is an increase in the interest rates on new issues of Series E bonds. This adjustment is made in recognition of the holder's ability to redeem the outstanding bond before maturity for the principal and accrued interest and to reinvest the proceeds in new Series E bonds issued with the higher interest rate.

Issue

The issue is whether the Treasury Department should be authorized to increase the interest rate on U.S. retirement plan bonds and U.S. individual retirement bonds so that the investment yield on the bonds is consistent with the yield on Series E savings bonds.

Explanation of the bill

The bill permits the interest rate on U.S. retirement plan bonds (sec. 405(b)) and U.S. individual retirement bonds (sec. 409(a)) to be increased for any interest accrual period so that the investment yield for that accrual period on the bonds is consistent with the investment yield for that accrual period on Series E savings bonds.

Any increased interest rates, and the accrual periods to which these rates apply, are to be specified in regulations to be issued by the Treasury Department. The bill provides that these regulations, to be effective, must be approved by the President.

Effective date

The bill would apply to interest accrual periods that begin after September 30, 1977, with respect to bonds issued before, on, or after the date of the bill's enactment.

Revenue effect

It is estimated that this bill would have no effect on budget receipts, but would result in increased budget outlays of $1 million per year.

Departmental position

The Treasury Department would not object to the bill if it is amended (1) to permit the interest rate on already issued retirement bonds to be changed to match the interest rate on new retirement bonds rather than to match the interest rate on Series E savings bonds and (2) to change the effective date so that the bill applies to interest accrual periods that begin after the date of enactment of the bill, with respect to bonds issued before, on, or after the date of the bill's enactment.

Child Care Credit for Amounts Paid to Certain Relatives

Present law

Present law provides a nonrefundable income tax credit equal to 20 percent of household and dependent care expenses incurred to care for a dependent child under the age of 15 or for an incapacitated dependent or spouse. The maximum tax credit for one year's qualifying expenses is $400 for one dependent and $800 for two or more dependents (sec. 44A of the Code).

The credit is allowed for amounts paid to a relative only if (1) neither the taxpayer nor the taxpayer's spouse is entitled to treat the relative as a dependent for whom a personal exemption deduction could be claimed, and (2) the services provided by the relative constitute "employment" as that term is defined for purposes of social security taxes (sec. 44A(f)(6)).

For social security tax purposes, child care or other domestic services performed in the taxpayer's home by the taxpayer's parent generally do not constitute "employment" (sec. 3121(b)(3)(B)). Also, services by the taxpayer's parent which are not performed in the course of the taxpayer's trade or business generally do not constitute employment, whether or not performed in the taxpayer's home. The Internal Revenue Service apparently takes the position that child care services performed in a grandparent's home are not performed in the course of the taxpayer's trade or business. Under this view, both child care services performed by a grandparent in the taxpayer's home and child care services performed by a grandparent in the grandparent's home generally would not constitute "employment," and hence payments for such services would not qualify as expenses eligible for the child care credit.

However, services performed by a grandparent in caring for a child (living in the taxpayer's home) who is either under 18 or is mentally or physically incapacitated may constitute "employment" if the taxpayer is a surviving spouse or is divorced and not remarried, or if the taxpayer has a mentally or physically incapacitated spouse who is unable to care for the child (sec. 3121(b)(3)(B)). In these circumstances, payments for child care services performed by the child's grandparent may be eligible with respect to the child care credit.

Services performed for the taxpayer by other relatives (other than by the taxpayer's child if under age 21) may constitute "employment" under the social security tax definition if a bona fide employer-employee relationship exists. Therefore, payments to these relatives may qualify with respect to the child care credit if neither the taxpayer nor the taxpayer's spouse can claim a personal exemption deduction for the relative. Services performed by the taxpayer's child, if under age 21, do not constitute such "employment" (sec. 3121(b)(3)(A)) and hence cannot qualify with respect to the credit.

Issue

The issue is whether the child care credit should be allowed for payments to adult relatives in cases where the services rendered by the relatives do not constitute "employment" as that term is defined for purposes of social security taxes.

Explanation of the bill

The bill eliminates the requirement of present law that child care services performed by relatives must constitute "employment" within the meaning of the social security tax definition in order to qualify under the child care credit provisions. As a result, otherwise qualifying amounts paid by a taxpayer for care of his or her child by a grandparent of the child would be eligible for the credit to the same extent as if paid to a person who is not related to the taxpayer.

The bill does not affect the rule of present law that disallows the child care credit for amounts paid to a relative (including amounts paid to a child or to a parent of the taxpayer) for whom the taxpayer or the taxpayer's spouse could claim the deduction for personal exemptions for dependents. Thus no credit would be allowed for otherwise qualifying amounts paid by a taxpayer for child care services performed by a grandparent of the child if either the taxpayer or the taxpayer's spouse could, for the year in which such services are performed, claim a personal exemption deduction for the grandparent.[1]

The bill provides that the credit is not to be allowed for amounts paid by the taxpayer to his or her child (including a stepchild) for child care services if the child being paid is under the age of 19 as of the close of the year in which the services are performed. The credit would not be allowed for any such payments to the child under 19 whether or not either the taxpayer or the taxpayer's spouse could claim a personal exemption deduction for the child being paid for child care services. If the taxpayer's child is 19 or over by the end of the year, payments for child care services performed by the child would qualify for the credit only if neither the taxpayer nor the taxpayer's spouse could claim a personal exemption deduction for the child performing the services.

Amounts paid by a taxpayer to his or her spouse to care for the taxpayer's child (including a stepchild) would not qualify for the child care credit.

Effective date

The bill would apply to taxable years beginning after December 31, 1977.

Revenue effect

The bill is estimated to reduce budget receipts by $3 million in fiscal year 1978, $36 million in fiscal year 1979, $35 million in fiscal year 1980, $37 million in fiscal year 1981, $37 million in fiscal year 1982, and $38 million in fiscal year 1983.

Departmental position

The Treasury Department does not oppose the bill.

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[1] S. 2153, which also has been referred to the Senate Finance Committee, would delete, effective for taxable years beginning after December 31, 1976, the present-law requirement that amounts paid for child care services performed by relatives must be for services which constitute "employment" within the meaning of the social security tax definition in order to qualify for the credit.

Revocability of Election to Receive Tax Court Judge Retired Pay

Present law

If a United States Tax Court judge elects to come under the Tax Court retirement system, all civil service retirement benefits are waived. Thus, any Tax Court judge who elects to be covered by the Tax Court retirement system may not receive any benefits under the civil service retirement system for any service performed before or after the election is made, for services performed as a judge or otherwise.

The Tax Court retirement system is noncontributory. The survivors' benefit provisions, however, require that the judges make contributions (3 percent of salary) if they want coverage for their families. The civil service retirement system is contributory (generally, 7 percent of salary). The civil service system includes survivor benefits with no additional contributions required for those benefits. If a judge elects to come under the Tax Court retirement system, then not only is that judge excluded from civil service retirement benefits, but also the judge's survivors are excluded from the civil service survivors' program, whether or not the judge also elects to come under the Tax Court survivors' program.

Present law has been interpreted as barring an individual who elects to be covered by the Tax Court judges retirement system from ever receiving any civil service benefits, even though the minimum requirement of 10 years of Tax Court service necessary to qualify for Tax Court judge retired pay never may be met, and notwithstanding the fact that the individual otherwise might qualify for civil service retirement benefits. Thus, an individual who has creditable civil service time before and after Tax Court service, and who elected Tax Court retirement pay while a judge, but served in that capacity for less than 10 years, will be precluded from receiving benefits under either system.

Issue

The issue is whether an election to come under the Tax Court retirement system should be allowed to be revoked before retired pay begins to accrue, thereby allowing the individual to qualify to receive civil service retirement benefits.

Explanation of the bill

The bill allows an individual who has filed an election to receive retired pay as a Tax Court judge to revoke that election at any time before the first day on which retired pay would begin to accrue with respect to that individual.

Under the bill, no civil service retirement credit is to be allowed for any service as a Tax Court judge, unless with respect to that

service the amount required by the civil service retirement laws has been deposited, with interest, in the Civil Service Retirement and Disability Fund. The bill also provides that if an individual revokes an election to receive retired pay and thereafter deposits the required amount with the Civil Service Retirement and Disability Fund, service on the Tax Court is to be treated as service with respect to which deductions and contributions had been made during the period of service. Therefore, such a revocation will allow service on the Tax Court to satisfy the civil service rule that an individual must have current covered employment in order to be permitted to revive his or her credits for prior covered employment.

Under the bill, a revocation of an election to come under the Tax Court retirement system also constitutes a revocation of any election to come under the Tax Court survivors' benefit system. In addition, the bill provides that upon a revocation of an election, the individual's account is to be credited with any amounts paid by the individual, together with interest thereon, to the Tax Court judges survivors' annuity fund. This amendment is necessary to prevent the individual from having to contribute to two survivors' annuity systems (U.S. Tax Court and Civil Service) even though his or her survivors would be entitled to benefits under only one system.

This bill applies to any Tax Court judge who has elected the Tax Court retirement system and has not yet retired. It also applies to a former Tax Court judge, Russell E. Train, who did not serve on the Tax Court long enough to qualify for Tax Court retirement, but has been ruled by the Civil Service Commission to be ineligible for civil service retirement benefits because of his Tax Court election, and to any other former Tax Court judge who may be in a similar position.

Effective date

The bill would apply to revocations made after the date of enactment.

Also, if anyone revokes his or her Tax Court retirement system election within one year after the date of this bill's enactment, that individual is automatically treated as satisfying the civil service rule that an individual must have current covered employment in order to be permitted to revive his or her credits for prior covered employment. This provision is expected to apply to Mr. Train's situation, discussed above. After leaving the Tax Court, Mr. Train served in covered employment under the civil service retirement system from 1969 until early in 1977. If this bill had been enacted before the end of that 8-year period, Mr. Train could have complied with the regular civil service rules regarding current covered employment. This effective date provision gives Mr. Train, and anyone else similarly situated, one year to "catch up" to the change in the law.

Revenue effect

It is estimated that the bill will not have any significant revenue effect.

Departmental position

The Treasury Department supports the bill.

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