

Stenographic Transcript Of

HEARINGS

Before The

COMMITTEE ON FINANCE

UNITED STATES SENATE

EXECUTIVE SESSION

Washington, D. C.

June 27, 1980

Alderson Reporting Company, Inc.

Official Reporter

300 Seventh St. S. W. Washington, D. C.

EXECUTIVE SESSION

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FRIDAY, JUNE 27, 1980

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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, the Hon. Russell B. Long (Chairman) presiding.

Present: Senators Long, Byrd, Nelson, Gravel, Bentsen, Matsunaga, Moynihan, Baucus, Boren, Bradley, Roth, Danforth, Chafee, Heinz, Wallop, Durenberger.

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Chairman Long. Let me ask the committee to come to order, please, and the members to take their seats.

Now, we have a lot of things we would like to act upon today if we can, and we will do the best we can; but I ask members to cooperate in making the priority decisions first, because we have some things which involve expiring dates where the legislation will be chaos if we don't act by the close of business on June 30.

We have a matter or two which were left hanging at the time we left yesterday. There is so much going on here.

Senator Roth. Mr. Chairman, could I raise a question with the distinguished Chairman?

1 Chairman Long. Yes.

2 Senator Roth. I wonder if it will be possible for us to
3 consider our tax cuts today.

4 (Laughter.)

5 Chairman Long. If you have something that is expiring, okay,
6 we will consider it.

7 (Laughter.)

8 Senator Bradley. You are referring to the gasoline tax, are
9 you not?

10 Senator Roth. I would like to have that expire, yes.

11 Chairman Long. I would like to ask that we simply let the
12 staff on a priority basis lay before us the decisions which are
13 the most urgent first. Then hopefully we can make those decisions,
14 and then we will go on to the others; and we will get as many of
15 them made as we can, because some of this requires Senate action
16 by the end of June 30.

17 Is that Monday or Tuesday?

18 Mr. Shapiro. That is Monday.

19 Chairman Long. So some of this requires action by the House
20 and Senate by Monday or the close of business Monday.

21 So why don't you, Mr. Shapiro, lay before us the priority
22 items that have to be decided first. Then we will take the items
23 which have a little more time behind that.

24 Mr. Shapiro. The first item is the staff wants to point
25 out a difference with regard to the reconciliation package you

1 have already agreed to. In the one-sheet package we had, one of
2 the changes you agreed to was to raise the 80 percent cash rule
3 up to 85 percent with regard to the estimated payments, and we
4 said that was only for large corporations.

5 Actually that was a mistake in the handout. The original
6 Administration proposal and all the staff materials distributed
7 to all of the members had that rule and that \$900 million revenue
8 effect for all corporations. The word "large" corporations should
9 not be in there, and I referred to as "large."

10 So for the record I would like to say what should be the case
11 is the 80 percent going up to 85 percent which raises \$900 million
12 for purposes of reconciliation was intended to be for all corpora-
13 tions.

14 Chairman Long. Without objection that will be agreed to.

15 Mr. Shapiro. All right. Other than that the committee has
16 agreed to their reconciliation package, and I thought you might
17 want to finish that since you have to file that.

18 Chairman Long. That is agreed.

19 Now, Mr. Bradley thought about it overnight, and he thinks
20 it would be better if we did not put the superfund in here, and
21 we should wait and consider that in the ordinary course of the
22 matter, so we will not have the superfund item.

23 Now, what else requires an immediate priority decision?

24 Mr. Shapiro. The next item is the multi-employer legislation.
25 As you may note, that has in effect a termination date of June 30.

1 There is legislation which must be enacted by June 30, either a
 2 revision of the provisions or an extension of the rules. So that
 3 the present law -- in other words, the provisions which were
 4 enacted in 1974 would not go into effect for an extended period
 5 of time.

6 As of right now there is every effort being made by the staff,
 7 the Finance Committee, and the Labor Committee to work out the
 8 bill. This is a joint jurisdiction where both the Labor and
 9 Finance Committees are working on the bill.

10 The background on this is that the House has passed a bill
 11 H.R. 3904 that is at the desk. The Senate Labor Committee is
 12 working on its version of the bill, and it completed it. It report
 13 out S. 1076.

14 The Finance Committee considered the legislation a couple of
 15 weeks ago, and it completed its version. Subsequent to that time,
 16 as the staff indicated to the committee, the two staffs of the
 17 Finance and Labor Committees were working to try to reconcile
 18 differences between the two versions in order that one version can
 19 be brought to the floor.

20 It has taken a considerable amount of time because it is a
 21 detailed, technical piece of legislation. Those rules are being
 22 drafted, and the sessions and negotiations have been going on at
 23 length on the appropriate matters. Where certain Senators in
 24 the Finance Committee have special interests, they have been kept
 25 abreast of those changes.

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1 The schedule right now is to bring the bill on the floor on
2 Saturday, to take H.R. 3904 from the desk and to amend it with
3 a compromise version of the bill. Then that bill would have to go
4 back to the House on Monday to be passed by the House. There is
5 no intention to have a conference.

6 Now, as of the present time, the staff has worked on a number
7 of provisions. The Senate Labor Committee is meeting to review
8 some of those today. They are very technical and detailed, and by
9 and large, the staff of the Labor Committee's revisions are
10 consistent with the views most of the members of this committee
11 had at that time.

12 However, I would like to suggest that the Finance Committee
13 staff work with a designated chairman with regard to the majority
14 side, and that Senator Dole have a designee on the minority side,
15 and they would view all the changes so that when that compromise
16 package comes up, it will be viewed by representatives of the
17 majority and the minority, and at the same time the staff will
18 take every effort to work with other Senators who may have provisio
19 we are aware of. For example, one provision Senator Durenberger
20 is very involved in. Any discussion of that would not be taken
21 without his concurrence at that stage. That is one of the major
22 provisions still being reviewed that is still open.

23 And ultimately if it is not reviewed it may require a separate
24 vote, because staff would not make any modifications to that,
25 since Senator Durenberger had the committee agree on that position.

1 So that is one position the staff would not make a modification
2 on without his concurrence, because that was a specific position
3 worked on in committee.

4 Other than that one, every other change the committee agreed
5 to the staff has discussed with the Senators and the appropriate
6 staff people, and we would still like to continue reviewing it;
7 but we think the modifications the Finance Committee staff have
8 worked out should have the approval of the committee, but we would
9 like to review it again with other members.

10 As I said, the one major issue we know which has not been
11 resolved in which there is an interest with a specific Senator is
12 one which Senator Durenberger has.

13 Chairman Long. Let me just suggest then that I will designate
14 a Democratic Senator -- after consulting with the staff I will
15 designate a Democratic Senator who is knowledgeable in this area,
16 and if you can get Senator Dole to designate someone, you can.
17 And hopefully they will get together and suggest the amendments
18 which they think ought to be added to the bill.

19 Of course, that does not bind any Senator to that judgment.
20 Every Senator can be available tomorrow to talk about that matter,
21 but we ought to try to pass this bill tomorrow, should we not?

22 Mr. Shapiro. That's correct. The staff does not want the
23 responsibility for making modifications to the Finance Committee's
24 decisions without having discussed it with the committee members
25 and getting their approval.

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And as you said, this does not bind any Senator. When bill comes up, any Senator can move anything. There is no agreement that any Senator is bound by any of these changes. It is just that there has been an effort to pass this bill. It is a very quick process, a very technical bill. I can assure you right now that it will not work technically in all respects. The effort, however, is to have a bill so that the policy will be put forward.

And to the extent modifications are needed -- and I assure you they will be needed -- that a technical corrections bill will be passed sometime later in the session to make the bill technically work.

Chairman Long. Senator Bentsen.

Senator Bentsen. Mr. Chairman, on the capital gains tax that Senator Wallop had proposed, I have a technical amendment. You have a situation where you have foreign shareholders who may sell stock, one to another, and that could, if we are not careful in how we draft this, trigger that tax.

Chairman Long. How about holding that up until we can get to it.

Senator Bentsen. Oh. I thought you had gone through the reconciliation.

Chairman Long. No, sir, we have not. We are not there yet.

Senator Bentsen. All right.

Chairman Long. We are trying to take care of the most important ones.

1 Senator Matsunaga. On the one we are on now, on June 10 I
2 offered an amendment to exempt California and Hawaii law from the
3 pre-emption provisions of ERISA. However, since then we have had
4 considerable opposition to the inclusion of the California law.

5 I have conferred with Senator Cranston, and he has agreed to
6 a modification of my amendment to withdraw California from it. And
7 if it is not too late, I ask unanimous consent that my amendment,
8 which was adopted in the committee unanimously, be modified to
9 exclude California from the exemption of the pre-emption provisions
10 of ERISA.

11 Chairman Long. Is that in this bill we are talking about
12 here?

13 Mr. Shapiro. No. In the multi-employer bill the committee
14 agreed to that was one of the provisions added by the committee.
15 What the rule is is that under ERISA, the ERISA provisions pre-
16 empted all the state laws. However, in the case of Senator
17 Matsunaga's amendment, in the case of Hawaii and California, it
18 was saying ERISA would not pre-empt those with regard to their
19 health care laws, which means California and Hawaii health laws
20 could be more stringent than required by ERISA.

21 What has happened subsequently is there has been a question
22 raised with regard to California, and Senator Matsunaga would like
23 to remove that and say that ERISA will continue to pre-empt
24 California laws, but it will not pre-empt Hawaii laws.

25 Chairman Long. Is there objection?

1 (No response.)

2 Chairman Long. Without objection, agreed.

3 Senator Durenberger. Mr. Chairman, just a brief observation,
4 if I may, on Bob's comment on the negotiations. First, to compli-
5 ment the committee on its good judgment in putting together a bill
6 that I think most of us prefer and which I think is much better
7 than the Labor bill, and also to compliment the committee on its
8 judgment for accepting my amendment and the sunset amendment becaus-
9 I think both of them, from what I can tell, have been used to our
10 substantial advantage and the substantial advantage of people
11 involved in the plan in the negotiating process.

12 And I just want to make sure, because my amendment has been
13 used to what I think are good ends as far as this committee's posi-
14 tion is concerned, that either I or my designee be included in
15 whatever negotiations are going to take place on this. Because
16 at the present time, much as I would like to be able to be in a
17 position to agree to various compromises -- and I have made some
18 concessions; they have not been anywhere near the point they should
19 be at, and it is absolutely essential that I be involved in that
20 negotiation.

21 Chairman Long. I was going to suggest that Senator Bentsen
22 on this side of the aisle, and I was expecting you to be designated
23 on the other side of the aisle, if there is no objection from
24 your colleagues, if that is satisfactory with them.

25 Is that okay with you, Senator Danforth?

1 Senator Danforth. Sure.

2 Chairman Long. Senator Heinz?

3 Senator Heinz; (Nods affirmatively.)

4 Chairman Long. Then on the recommendation of your colleagues,
5 you work with Senator Bentsen and see if you two can get together
6 on some amendments to be offered on the floor. Any Senator can
7 offer any amendment he wants to. I must say at this point I am
8 not nearly as knowledgeable on this subject as some of the rest
9 of you are, and I am counting on you.

10 Senator Bentsen. Mr. Chairman, I will certainly be delighted
11 to work with my colleague on it.

12 Senator Durenberger. I believe Senator Wallop is going to
13 be here by 10:30, so if we could delay just five minutes on
14 Senator Bentsen.

15 Chairman Long. An item must be done. We are going to have
16 to pass that bill to extend that airport tax. Is that the
17 airport users?

18 Mr. Shapiro. Yes. The revenues with regard to the airway
19 users' tax, the 8 percent ticket tax, and the 5 percent transporta-
20 tion and property tax, and the \$3 head tax. These were enacted
21 in 1970 for a ten-year period. They expire June 30th. The House
22 has passed an extension of these taxes for a five-year period.
23 However, you have not had an opportunity in the Finance Committee
24 to deal with that as yet. And the House, recognizing that, has
25 passed a three-month extension of those taxes to allow the Finance

1 Committee time to deal with it.

2 A bill was sent over to the Senate. It was intended to be
3 kept at the desk because prior to that time you had agreed to a
4 three-month extension. However, inadvertently the desk referred
5 it to the Finance Committee, so it is here in committee.

6 When it was brought up a while back there was an objection to
7 doing it at this particular time by a member of the committee, so
8 the committee has not formally acted with regard to the bill in
9 the committee.

10 Now, that has to be done by June 30th because effective
11 July 1 there is no tax on airline passengers, and the airlines
12 have written all of their tickets, and all of their computers are
13 geared to imposing the taxes.

14 Chairman Long. Let me just say I don't object. It's all
15 right with me for Senator Baker to make the point he made. He
16 made the point the bill was not held at the desk in the proper
17 fashion, and therefore, he made the motion that the bill under
18 the rules should go to the Finance Committee, which is all right
19 with me in view of the fact that he was right, I think, on his
20 point. It was not properly held at the desk. That is a technical
21 matter. But this matter must not be permitted to expire. I will
22 create absolute chaos if this measure does expire.

23 So I will offer on behalf of myself, if the committee doesn't
24 want to go along with me, but I will offer it on behalf of the
25 committee if the committee does want to go along with me, an

1 amendment to whatever we call up, including the multi-employer
2 bill, just whatever comes up I will offer this 90-day extension --
3 that is what you are suggesting -- of those airway user taxes,
4 so that we can avoid chaos by having those taxes expire for a
5 day or so only to be re-enacted.

6 Senator Bentsen. Mr. Chairman, I am very supportive of
7 what you are trying to do. I would hope that you would attach it
8 to some other piece of legislation, if you can.

9 Chairman Long. I will attach it to anything that comes up.

10 Senator Bentsen. Well, the multi-employer is a controversial
11 piece of legislation.

12 Chairman Long. But I am told that bill is going to have to
13 become law.

14 Mr. Shapiro. Either that bill or an extension.

15 Senator Bentsen. That is correct. Either that bill or an
16 extension. That is right.

17 Chairman Long. Whatever goes to the Senate I am going to
18 offer the extension of these taxes on, because they expire midnight
19 June 30, and it is highly irresponsible for the Congress not to
20 act on the matter. It would be irresponsible of us and irresponsib
21 of the Senate not to act on the matter between now and the first
22 of next month. So I will have to offer it, and I would like to
23 have the agreement of the committee that it should be offered.

24 I think it's just my duty, that's all. It's not that I love
25 the taxes all that much. It's just that I know what my duty is, and

1 I have to do it.

2 So I see no objection here to that. But that is what I have
3 to do, even if I do it only as one Senator.

4 What's the next thing we've got to look at?

5 Mr. Shapiro. Those are all of the items that were the special
6 order items.

7 Chairman Long. Those are the priority items which had to be
8 decided?

9 Mr. Shapiro. (Nods affirmatively.)

10 Chairman Long. Where do you suggest we go from here?

11 Mr. Stern. At this point there was only one item the staff
12 actually put on the agenda, technical amendments to the tariff
13 bill, but it is just a matter of what Senators want to bring up.

14 Senator Durenberger. Mr. Chairman.

15 Chairman Long. I believe Mr. Durenberger spoke first down
16 there.

17 Senator Durenberger. Yes. This is a matter that relates to
18 the budget reconciliation process we went through last week, and
19 I think I wrote to each of the members of the committee with regard
20 to one of the actions.

21 Chairman Long. I will call on Mr. Durenberger, and then Mr.
22 Baucus, and then Mr. Danforth, in that order.

23 Senator Durenberger. One of the actions we took last Thursday
24 and I apologize individually to each of you for not being present
25 at that time, but we were marking up something in Governmental

1 Affairs -- and it is the issue of abandoning one of the traditional
2 cornerstones of the Medicaid program which has been freedom of
3 choice. And I think we did it, as I understand it, in a relatively
4 brief period of time with limited discussion and questions by
5 Senator Ribicoff, I believe, relative to the impact on teaching
6 hospitals.

7 But I find it a very, very significant change in public policy
8 regarding Medicaid. And in fact, what we did would permit the
9 states to arrange to purchase services for its Medicaid population
10 through what is called in this language "cost effective arrange-
11 ments" for services that meet applicable state and federal laws.
12 In effect, it turns over to the states the deciding what hospitals,
13 what clinics, what combinations of doctors and so forth would be
14 involved in providing health care services for Medicaid-eligible
15 populations.

16 It goes so far as to say that states could not pay less for
17 in patient hospital services under this provision than the cost
18 found to be reasonable and necessary.

19 I do not argue with reasonable and necessary cost, but I am
20 very apprehensive about the impact of setting up this kind of
21 standard, putting it in the hands of the states with the small
22 amount of discussion we had on it, Mr. Chairman.

23 Now, it may be a good idea. It may be the way we ought to
24 go. I guess there is an estimate that it would save \$93 million.
25 But the process of determining who is going to be able to get what

1 kind of health care services and what kind of facilities I think
2 is one we ought to give greater thought to and perhaps more guide-
3 lines.

4 I know we can't change the reconciliation resolution at this
5 time, but I would like, if possible, Mr. Chairman, that after what-
6 ever discussion we need here, we take a roll call vote of this
7 committee to determine the individual attitudes of members of this
8 committee regarding the abandonment of the concept of freedom of
9 choice.

10 I understand the House is opposed to abandoning it. I know
11 the Administration is strongly opposed to it. I know a lot of the
12 people involved in this process, both on the delivery side and the
13 recipient side, are strongly opposed to it and have not had an
14 opportunity to address themselves to it. And I think it would be
15 helpful when this position gets into conference that we clearly
16 know where the members of the Finance Committee stand on this issue.

17 Chairman Long. Mr. Constantine.

18 Mr. Constantine. Mr. Chairman, since the committee adopted
19 the provision, the National Governors' Association, the National
20 Congress of State Legislators, the National Association of Councils,
21 and the National Conference of State Welfare Administrators have
22 strongly endorsed the provision.

23 There is a telegram from Governor Jerry Brown also supporting
24 it.

25 Senator Durenberger. Oh, I must be wrong.

1 (Laughter.)

2 Mr. Constantine. The provision was carefully drafted to meet
3 the concerns on accessibility, any serious adverse effect on
4 medical education programs which were expressed here. And the
5 argument, I guess, in favor of the amendment is that the states
6 are spending \$12 billion of state money for Medicaid. This would
7 give them within a given area an opportunity to negotiate arrange-
8 ments based upon the actual cost at which the services are avail-
9 able in that area.

10 It contains many more safeguards and quality standards than
11 any of the block grant approaches which several have proposed to
12 the states which have no quality safeguards. It is a competitive
13 element, Mr. Chairman, in the sense that what you are doing is
14 selecting facilities actually available which can provide care,
15 meeting proper standards at costs which are actually available in
16 that area.

17 I believe last year there was one suggestion during the
18 budget discussion that we simply pay the lowest cost facility in
19 an area. This goes considerably beyond that. The bill saves
20 \$91 million in fiscal 81, estimated by CBO, rising to \$363 million
21 in federal funds by 1985, exclusive of the state savings which
22 would probably be about another 40 to 45 percent of that.

23 The states want it, and that was the reason we recommended it.

24 Chairman Long. That is something we did decide, didn't we?
25 We put that item in because we were trying to find enough money

1 to meet the budget resolutions. As I take it, the Senator wants
2 a showing of who favors it and who doesn't favor it, and it's
3 all right with me. But I would hope you would wait until we have
4 more Senators in the room to do that, because at this moment it
5 would create a problem.

6 Now, Senator Baucus has an item.

7 Senator Baucus. Mr. Chairman, the bill I have up today is
8 a bill from the IRS Subcommittee.

9 Chairman Long. Go ahead, sir.

10 Senator Baucus. Essentially I would like to move the bill,
11 S. 1444. Essentially, this is a bill to allow reasonable attorneys'
12 fees and court costs to taxpayers where they prevail in either
13 Tax Court or Federal District Court, and they are suing for a
14 deficiency.

15 Under present law where taxpayers are defendants, they are
16 entitled to receive attorneys' fees, but the courts have imposed
17 a very rigid standard. As a practical matter, it is very difficult
18 for taxpayers when they are plaintiffs in actions to be awarded
19 attorneys' fees.

20 The standard is really that under the bill the taxpayers
21 prevail in all or substantially all of the matters before it,
22 and if the government's position is unreasonable, the plaintiff
23 is awarded attorneys' fees. There's a \$20,000 limitation and a
24 five-year sunset provision in the bill. That is essentially the
25 bill.

1 Chairman Long. I assume there will be discussion. Does
2 Treasury favor this?

3 Senator Baucus. Treasury favors the bill as it is presently
4 written, as I understand. Senator Bentsen and I have a suggested
5 amendment to the bill, but in its present form I understand
6 Treasury favors the bill.

7 Mr. Lubick. This is something we have been working on for
8 a very long time, Mr. Chairman. The bill we originally proposed
9 was much more restrictive than the bill Senator Baucus has worked
10 on.

11 We have been suggesting since this problem has been kicking
12 around for a long time that if we could get some reasonable legisla-
13 tion enacted to deal with cases when there has been harassment
14 of taxpayers by unreasonable provisions, we could put it in effect
15 and see how it works.

16 And Senator Baucus has worked very hard on it, and we have
17 cooperated. And the bill as it stands is, I think, a very good
18 bill which will accomplish the purposes necessary.

19 We would like to see it enacted even though it goes a little
20 bit beyond what we would have preferred. We think it is a very
21 reasonable attempt to solve the problem, and it would be a great
22 step forward for the protection of taxpayer rights. So we would
23 urge its adoption.

24 Chairman Long. Without objection, then, the bill will be
25 agreed to. We will have to add that to something else.

1 Senator Matsunaga. Mr. Chairman.

2 Senator Bradley. Mr. Chairman.

3 Chairman Long. Is this on this bill?

4 Senator Bradley. No, it isn't.

5 Chairman Long. Well, I have put my own name down here to
6 come along after a while, after Mr. Danforth.

7 Senator Heinz. Don't forget me, Mr. Chairman.

8 Senator Bradley. Mr. Chairman, I have an amendment on the
9 floor that comes up right after this vote, and I just wanted to
10 ask you when S. 2484 would come up. I have an amendment to S. 2484
11 and would like to --

12 Chairman Long. 2485? Well, all right. Let me suggest we
13 go over and vote -- there's a roll call going on right now -- and
14 that we come back here and do as much business as we can.

15 (Recess.)

16 Chairman Long. Let's come to order, please.

17 Mr. Heinz told me on the way over he thought we ought to
18 try to meet this afternoon if need be so that every Senator present
19 would have an opportunity to propose his suggestion, and that seems
20 fair enough. I am willing to meet for a while this afternoon if
21 other Senators are willing to show up and make themselves available.

22 So if there is no objection on behalf of someone here in the
23 committee, I have asked the majority leader, unless he hears to
24 the contrary, to see if he can clear a consent request for the
25 committee to meet this afternoon while the Senate is in session

1 and vote on more of these measures that we have available to us.

2 The next man in line on this line is Mr. Danforth.

3 Senator Danforth. Thank you, Mr. Chairman.

4 In the technical corrections bill, the Finance Committee
5 agreed -- as a matter of fact, the Senate bill included a provision
6 with respect to the deductibility of prizes and awards which were
7 given to people who were not direct employees of the donor. For
8 example, the situation of when General Motors offers a trip to the
9 best salesman of a dealer even though the salesman is not an
10 employee of General Motors.

11 That provision was in the technical corrections bill. It
12 ran into problems with the House because they took the view it
13 was more substantive than technical. Also, Treasury wanted to
14 expanded the reporting requirements in that bill, doing away with
15 the \$600 rule and applying it to all such prizes. And I think it
16 has been pretty well worked out. This is the second time this has
17 been through the Finance Committee. I think it was unanimous
18 the first time it went through, but I would like to, if I could,
19 get this matter taken care of.

20 Chairman Long. Is there objection?

21 (No response.)

22 Chairman Long. Well, without objection, agreed.

23 Senator Danforth. Mr. Chairman, procedurally what will happen
24 to this now?

25 Chairman Long. Well, we are going to find a horse for your

1 rider after a while. At the moment the rider is on foot, but he
2 has our blessings.

3 (Laughter.)

4 Chairman Long. Senator Talmadge wrote me about a matter, and
5 I thought we ought to consider it. I have put my name down to
6 consider something. Senator Talmadge said, "I have requested
7 several bills be placed on the agenda for the meeting, and I would
8 hope S. 1831, my REIT bill, can be raised for this committee's
9 consideration."

10 The bill was sponsored by Gaylord Nelson. Its companion bill
11 has been approved by the House Ways and Means Committee.

12 What can you tell us about that?

13 Mr. Shapiro. This involves some changes that were made in
14 the Tax Reform Act of 1976 and its impact on the real estate
15 investment trust. Prior to 1976, real estate investment trusts
16 were not permitted to have either carryovers or carrybacks. What
17 a real estate investment trust is is where they have essentially
18 past investments, and they pay out their income currently. There-
19 fore, when it was enacted, they were not allowed to carry back
20 or carry forward any losses because they were supposed to make
21 distributions, and because of the way they were set up, carrybacks
22 would cause complexity because you had a change in ownership,
23 and since you passed all the income, you would affect different
24 shareholders.

25 However, during the 1970s because of the economic situation

1 and other reasons, you had some real estate investment trusts that
2 were terminating their status. Some wanted to have carrybacks
3 and carryforwards because they were losing money. In other cases
4 you had some that wanted active investments, and they were required
5 to be passive, so they were terminating their real estate invest-
6 ment trust status.

7 In 1976 there were two changes enacted which affected the
8 REITs. The first one applied to all corporations generally, and
9 that is, the carryover period which was previously three years
10 carryback and five years carryforward was extended to a seven-
11 year carryforward period, so a total of ten years, three back
12 and seven forward.

13 In the case of REITs, for the first time the Congress allowed
14 REITs to have carryover in which to carry over their losses, and
15 this was permitted for eight years. So the REITs in 1976 could
16 have a carryover but not a carryback.

17 However, the way the change worked is it was only available
18 to losses that were incurred after October 4, 1976. So if a loss
19 was incurred in tax years ending before 1976, the eight-year
20 carryforward was allowed only if the entity was a REIT for all
21 of the years from the loss year through the carryover period.
22 A distinction, however, for losses incurred after 1976. In that
23 year the eight-year carryforward was available without regard to
24 REIT status.

25 Now, one of the reasons why that was put in that way is

1 for the retroactive period, not to give any benefit to those who
2 terminated. That is why Congress did that.

3 The particular bill that Senator Talmadge has now has two
4 changes to it. The first one -- and it deals with the changes
5 which occurred in the 1976 act -- the first one is the rule that
6 said that you had to be a REIT in a loss year for purposes of your
7 pre-1976 law, and the change that was then there in Senator
8 Talmadge's amendment is to say that you do not have to be a REIT
9 throughout the carryover period. And that was the first change
10 that he proposed.

11 The second problem with the existing situation is the rule
12 said if you were not a REIT in a loss year, you could not get the
13 benefit of the carryover period. Senator Talmadge's amendment
14 also deals with that by saying you get one additional year as far
15 as the carryover period is concerned for each year that you could
16 not carry back the loss.

17 So let me give you an example of the way that will work, be-
18 cause this is Senator Talmadge's specific case of Georgia. If
19 you had a REIT which was a REIT in 1972, '73, and '74 but you
20 terminated the status, and therefore in 1975 it was not a REIT;
21 however, there was a loss in 1975.

22 In that case, the REIT corporation was not allowed to carry
23 it back because the law said you could not carry back any losses
24 to a year in which you were a REIT.

25 What Senator Talmadge's amendment would say is that to the

1 extent a corporation could not carry back a loss to a prior year
2 because of the rule which said that you cannot carry it back to
3 when you were a REIT, that corporation could be permitted to carry
4 it over as much as eight years. In other words, they could get
5 five years right now, but they would be able to carry it over
6 three more years, one year for each year that they could not carry
7 back.

8 That is the specific case in Georgia, and although there are
9 two changes here, the second one is the one which is of particular
10 concern to Senator Talmadge.

11 Chairman Long. What is Treasury's reaction to it?

12 Mr. Halperin. Mr. Chairman, we have opposed at least a portion
13 of the bill. It is a rather technical matter, but the question is
14 you have a number of different loss carry forward rules in the
15 code. Which one should apply in this circumstance?

16 It is our feeling it ought to be the status of the corporation
17 in the year the loss occurred that determines the carryover rule
18 which should be applicable. What people are asking for here is to
19 say well, in 1975 we were a regular corporation, but if you look
20 back at what we were some earlier year, we were a REIT back in '74
21 and '73, and therefore, we ought to have the REIT rule for the
22 '75 carryforward.

23 We think that is an ad hoc type solution, that the right
24 answer is to treat that company in 1975 like every other regular
25 corporation in 1975 and not give it a special benefit because it

1 had some earlier status.

2 Chairman Long. I just brought the matter up because Senator
3 Talmadge had given me a letter asking the matter to be considered.
4 I believe he said in his letter that Senator Nelson was interested
5 in the matter.

6 Can you clarify that, Senator Nelson?

7 Senator Nelson. Mr. Chairman, yes. I would have to refresh
8 my memory on the details, but at the time the issue was before us,
9 there were two problems, and one was in Georgia and the other was
10 in Milwaukee, Wisconsin.

11 And I have the colloquy here between myself and Mr. Halperin,
12 and Treasury endorsed the proposal, respecting first Wisconsin.
13 And I wonder if Mr. Halperin would be prepared to summarize the
14 reason for that. I am not prepared to address the Georgia situation
15 in any way.

16 Mr. Halperin. Mr. Chairman, in our testimony we did not
17 object to the particular provision Senator Nelson is interested
18 in. The difference is that the corporation involved in that case
19 was a REIT in the year in which the loss occurred, and the question
20 is whether it should get the benefits of the carryforward rules
21 of a REIT, whether or not it stays a REIT in future years.

22 And we thought the key point was the status in the year of
23 the loss. And since the Wisconsin company was a REIT in the year
24 of the loss, we have not objected to that portion of the bill.

25 Senator Byrd. May I ask a question at this point? Refresh

1 my memory. As I recall at the hearing, the Treasury did not oppose
2 the Wisconsin case but did oppose the Georgia case, is that correct?

3 Mr. Halperin. That is correct, Senator Byrd.

4 Senator Byrd. So insofar as the bill itself is concerned,
5 it favors part of it and opposes part of it.

6 Mr. Halperin. That is our testimony, yes.

7 Chairman Long. In view of this, I believe we ought to hold
8 this matter and bring it up when Senator Talmadge is here.

9 Senator Nelson. I wonder, Mr. Chairman, they are two differ-
10 ent cases tied together in one bill, and I wonder if we can't
11 just act on the first Wisconsin aspect to which the Treasury has
12 no objection so that that is disposed of, and then tackle the
13 other one.

14 Chairman Long. Why don't we agree then to the part of it
15 that involves the Wisconsin case, and we consider the matter that
16 involves the Georgia case when Senator Talmadge is here. So we
17 will agree to the portion Senator Nelson had in mind, and we will
18 not take action on the other portion.

19 Is there any objection?

20 (No response.)

21 Chairman Long. Without objection, so agreed.

22 I have put your name down, Senator. I have a whole bunch of
23 others on this list here.

24 Senator Matsunaga. Do you have me down?

25 Chairman Long. I will.

1 Senator Bentsen. Do you have me down?

2 Chairman Long. Let's see. I've got Mr. Heinz down here,
3 then I have Mr. Moynihan, Mr. Bentsen, Mr. Ford.

4 Senator Matsunaga. I had my hand up before we recessed. I
5 thought I was on the list before we recessed.

6 Chairman Long. Well --

7 Senator Matsunaga. Well --

8 Senator Moynihan. Put Matsunaga in my place.

9 Chairman Long. It's all right with you to put him in before
10 you?

11 Senator Chafee. Would you put me at the end of the list,
12 Mr. Chairman?

13 (Laughter.)

14 Chairman Long. All right, Mr. Chafee.

15 All right, Mr. Heinz.

16 Senator Heinz. Mr. Chairman, I have three items, the first
17 two of which I think are relatively non-controversial; and I
18 would like to bring up what is under my name on the agenda as
19 item number two, which is a letter on which I worked with the
20 committee staff and all members of the staff to draft, on the
21 issue of the Commerce Department's using Section 617 of the Tariff
22 Act of 1930 as a means of, in my judgment, wrongly in the future
23 compromising claims under the Anti-Dumping Act.

24 This has been reviewed with staff, and I will, if anyone
25 wants further explanation, be happy to go into the explanation.

1 But if it is non-controversial, in the interest of time I would
2 just not say anything more unless people are curious.

3 Chairman Long. Is there any objection from the Treasury or
4 from the staff?

5 Mr. Foster. Mr. Chairman, the situation is the Department
6 of Commerce has used the authority that they have or they claim
7 they have under the Tariff Act of 1930 to compromise the television
8 anti-dumping duty case against Japanese televisions.

9 Senator Heinz has raised the issue of whether this is appropri-
10 ate action by the Department of Commerce given the fact that the
11 committee, the Congress, and the Administration agreed through very
12 detailed procedures on the way in which dumping duties should be
13 calculated, assessed and collected.

14 And his concern is that if they have and use this authority
15 to compromise claims for anti-dumping duties, they would be able
16 to circumvent these procedures. So what he is proposing is a
17 letter to Secretary Klutznick requesting him not in the future
18 to use this authority to compromise anti-dumping claims.

19 The Administration now is defending a case relating to the
20 Japanese television dumping case. This letter makes no statements
21 with respect to that case, but says as a matter of policy we think
22 you should not use this in the future.

23 There does seem to be a genuine issue of policy here in the
24 sense that there were these detailed procedures set up in the law,
25 and there is the possibility of political pressures being brought

1 that might result in a compromise of these cases in a way not
2 intended by the Congress in enacting this law.

3 And let me just add to that statement, the Chairman will
4 recollect with, I am sure, great specificity, the lengths to which
5 he, Senator Moynihan, and I went to make sure that there was a
6 very narrow area for what are called undertakings under the Anti-
7 Dumping Act, where with the Chairman's help we defined exactly
8 what anyone who sought a compromise could and could not do.

9 The use of Section 617 would destroy everything we agreed
10 to and have worked toward, and I think the Chairman will recollect
11 our meetings.

12 Chairman Long. Mr. Moynihan.

13 Senator Moynihan. Precisely, Mr. Chairman. We worked very
14 hard to produce the 1979 multinational trade agreement, and sudden-
15 ly we look up and we have reorganized the government, and we look
16 up and what have we got? We found something, Smoot-Hawley, they
17 prefer to what we did.

18 We know -- well, at least it means they are catching up with
19 Smoot-Hawley. I mean, honest to God.

20 (Laughter.)

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21 Chairman Long. Which bill are we looking at? Which item is
22 it?

23 Senator Heinz. It is a letter, Mr. Chairman, a letter the
24 committee would send.

25 Chairman Long. All in favor say "Aye."

1 (There was a chorus of "Ayes.")

2 Chairman Long. Opposed, "No."

3 (There was no response.)

4 Chairman Long. The "Ayes" have it.

5 Senator Heinz. Mr. Chairman, I thank the committee.

6 I would like to call up H.R. 4309, the cold finished steel
7 bar classification.

8 As background, what happened some time ago was some very
9 small diameter cold finished steel bars got erroneously classified
10 as wire. The result is it has a very much lower duty as wire
11 and a lot of, therefore, cold finished steel bar from abroad is
12 coming in and is under duty by as much as \$40 per ton.

13 Everyone I have talked to, Mr. Chairman, agrees it was simply
14 a mistake in classification in the first instance. The House
15 bill I am calling up, H.R. 4309, corrects that misclassification.

16 There is an issue with respect to 4309 or correcting the
17 misclassification, and that is, in doing so we would, unless we
18 took certain actions which are taken, I submit, in 4309, we would
19 be accused of increasing the duties on a tariff item which we,
20 according to the GAT, do not have a right to without compensation.

21 The GAT is clear that if you decide to increase the tariff
22 on an item, that you are within your rights to do so except that
23 other signatories to GAT may claim compensation.

24 H.R. 4309, which has passed the House, did so by temporarily
25 reducing the duty on other cold finished steel bars from 8.5

1 percent to 7.5 percent ad valorem, and then after a period of time,
2 which I recollect is two years, the duties all return to 8.5
3 percent.

4 One of the most severe critics of any protections that I know
5 of in the House side is Congressman Bill Frenzel of Minnesota,
6 and even Congressman Frenzel said on the floor of the House, "I
7 believe H.R. 4309, as amended" -- and that is what we are offering
8 here -- "is a good compromise which will not be damaging to U.S.
9 interests and will not abrogate the responsibilities of the U.S.
10 under the GAT."

11 And that comes from someone who did not vote for it but
12 had some kind words to say. So I hope we can get this misclassifi-
13 cation corrected.

14 Chairman Long. We have a problem here. Let me read what
15 it says on this memo.

16 "The Administration does not object to the reclassification,
17 but does object to an upward adjustment of duties as inconsistent
18 with U.S. GAT obligations. The compensatory reductions in duties
19 contained in the bill do not 'cure' any GAT inconsistencies. They
20 only attempt to compensate for it. The European communities have
21 sent an aide memoire to the Department of State, which contains
22 its views that the bill as passed by the House modifies schedules
23 in a manner contrary to the GAT, and that the increases in duty
24 resulting from reclassification would constitute a substantial
25 duty increase."

1 Of course, that is what you want to do, I assume. You want
2 to increase the duty.

3 By how much, Mr. Foster?

4 Mr. Foster: What the bill does is increases the duty on one
5 item of bar, a small diameter bar, but in order to compensate for
6 that increase in duty, it lowers them on other bar items. So for
7 the first two years there is actually a net reduction in total
8 duties collected. At the end of that two year period, then all
9 of the bar would be classified at one rate, and there would begin
10 to be an increase in duties at that point.

11 During that two-year period the directions in the House
12 report, and presumably in the committee report if it reports it
13 favorably to the Administration, are to go out and negotiate to
14 make this consistent with the GAT. There is that two-year period
15 given for negotiations.

16 So while it is technically inconsistent with our international
17 obligations, there is an effort to compensate within the terms of
18 the bill, and there is some question that given this effort to
19 compensate, whether the European communities would actually desire
20 to pursue a case in GAT. They may not decide to because they
21 actually receive a reduction in total duties for that two-year
22 period. So that is the status of it at this point.

23 The Administration has lodged a formal objection to the bill
24 because of that inconsistency; yet they recognize and they
25 participated in the efforts to arrive at a compromise on the bill.

1 Senator Heinz. I think what Mr. Foster is saying is formally
2 the Administration is opposed. Informally, they really don't
3 much care. They are lodging formal opposition because they feel
4 they have to play the game according to the rules under GAT. The
5 people I have talked to in USTR and Commerce really do not feel
6 that the bill as written is any problem to them.

7 Chairman Long. Do we have someone here from USTR to speak
8 for them?

9 Mr. Foster. I do not believe so, Mr. Chairman.

10 Senator Heinz. See how much they care, Mr. Chairman?

11 Chairman Long. Have they indicated concern to you, Mr. Foster?

12 Mr. Foster. We only have a letter from the Department of
13 State indicating concern. We do not have a letter from any other
14 agency.

15 Chairman Long. Those in favor of the bill say "Aye."

16 (There was a chorus of "Ayes.")

17 Chairman Long. Opposed, "No."

18 (There was no response.)

19 Chairman Long. The "Ayes" have it.

20 Senator Heinz. Mr. Chairman, would you like for me to bring
21 up trading companies now, or shall I defer that?

22 Chairman Long. What?

23 Senator Heinz. Senator Bentsen, Danforth, and Roth, and I have
24 the second item on the agenda, S. 2757 relating to the formation
25 of export trading companies attached at document C. I do not want

1 to be unfair to anyone else, but I see Senator Danforth and
2 Senator Bentsen here, and I know Senator Bentsen has some views
3 on this. And it might accommodate this schedule if we took the
4 matter up now.

5 Senator Bentsen. As long as it does not pre-empt my turn,
6 Mr. Chairman.

7 Let me say on that particular piece of legislation on which
8 my colleagues and I joined together in sponsoring, the more we
9 have been able to get into it and talking to Treasury, they are
10 talking about a loss of revenue of some \$300 to \$700 million.
11 And I am very much for the trading company legislation that is
12 now out of the Banking Committee, but I think what we are going
13 to have to do, although the definition of a trading company as
14 it is in that piece of legislation is, I think, good for trading
15 purposes, I am concerned about it for tax purposes, Mr. Chairman.

16 Some advantages might be taken which are not in line with
17 the objectives we are trying to accomplish. I think an accounting
18 firm, for example, could spin off a subsidiary and have themselves
19 an advantage. So, frankly, I would rather defer that bill until
20 we have been able to work with Treasury and try to come up with
21 language that would try to tighten the definition from the DISC
22 standpoint to accomplish the objective.

23 Chairman Long. I would suggest -- and I think in fairness
24 we ought to let every Senator bring something up before we -- so
25 that each person could get a chance to suggest one item and then

1 have a second round. So if it's all right with you, I would like
2 to call on Senator Matsunaga.

3 Senator Heinz. I have no objection if the understanding is
4 we can come back to this.

5 Chairman Long. Sure.

6 Senator Heinz. That is fair.

7 Chairman Long. We will sort of proceed on the basis of the
8 old common law theory that every dog is entitled to one bite.
9 After everyone has brought up one measure, we will come back to
10 the others.

11 Senator Heinz. The Chairman is a great master of the hound.

12 (Laughter.)

13 Chairman Long. Thank you, Senator Heinz.

14 Mr. Matsunaga.

15 Senator Matsunaga. Thank you, Mr. Chairman.

16 Mr. Chairman, on December 11 last year this committee ordered
17 H.R. 3122, the miscellaneous tariff bill, to be favorably reported.
18 The bill contained an amendment of mine to suspend the tariff on
19 certain binoculars. This is item number P as put out by the staff.

20 Well, at that time upon the suggestion of staff, instead of
21 making the exemption permanent, I made it for two years because
22 it was suggested that the Ways and Means Committee of the House
23 would not accept a permanent proposal. However, since then, the
24 Ways and Means Committee itself has come out with a bill providing
25 for permanent exemption of the duty on certain types of binoculars

1 which are not manufactured in the United States.

2 So I would suggest, Mr. Chairman, that we go along with
3 the House version and make the duty exemption permanent, and that
4 the change be included in the technical committee amendment to be
5 added on the floor inasmuch as the fate of H.R. 3122 is rather
6 uncertain.

7 Chairman Long. What can the staff tell us about this bill?

8 Mr. Foster. Mr. Chairman, there are no objections from any-
9 body to Senator Matsunaga's proposal. As he indicated, it was
10 originally made a temporary suspension with the idea of trying to
11 get action on 3122 by the House last year. Since action was not
12 accomplished and the House has since had a chance to look at this
13 provision and has agreed to Senator Matsunaga's original proposal,
14 Senator Matsunaga would now like to make it a permanent duty-
15 free treatment.

16 And again, neither the Administration or any private interests
17 object to this.

18 Chairman Long. Any objection?

19 (No response.)

20 Chairman Long. Without objection, so agreed.

21 Mr. Moynihan.

22 Senator Moynihan. Thank you, Mr. Chairman.

23 I have a measure here, S. 650, on which hearings were held
24 February 29, and it goes to the question of employee trusts
25 and their ability to hold debt-financed real estate. For reasons

1 that go back to a particularly ingenious skulduggery by a
2 particularly ingenious lawyer in the 1970s, persons could escape
3 a large amount of tax by selling property to a trust and receiving
4 back income in capital gains rather than in real income.

5 The Congress has prevented employee trusts from holding such
6 real estate which in many circumstances they would wish to do.
7 It is a trust for pension purposes. And the effort has been made
8 to enable them to go back to a situation where they can hold such
9 property but without the loophole effect and without the tax
10 avoidance effect.

11 Now, this has been negotiated with the Treasury, and it is
12 my understanding Mr. Lubick is quite satisfied with the legislation.
13 I wonder if it might be best if he were to put the proposition to
14 you.

15 Chairman Long. All right, sir. Now, do we have material pre-
16 pared on this bill?

17 Mr. Shapiro. Yes. It is item R on your list.

18 Senator Moynihan. Hearings were held February 29 by Senator
19 Byrd.

20 Chairman Long. All right, sir. Let's hear from Treasury.

21 Mr. Lubick. I don't know if you have before you a description
22 of the arrangement that we have worked out. The notion was to
23 permit pension trusts to invest in real estate. Originally the
24 bill dealt with group pension trusts investing in debt-financed
25 real estate.

1 It appeared to us that if the principle was appropriate of
2 investment in real estate for group pension trusts, it ought to
3 be applicable to all pension trusts, whether they are participating
4 through some common investment mechanism or individually.

5 So the first modification extends the permission to invest
6 in this type of real estate to pension trusts generally. In order
7 to prevent abuse, in effect, marketing the tax exemption, we
8 have listed a number of circumstances under which debt-financed
9 real estate would not qualify for an exception to the general
10 prohibition of taxing unrelated business income debt-financed
11 property acquired by an exempt organization. And the circumstances
12 we have worked out as appropriate to maintain the taxation as
13 unrelated income are where the purchase price is determined in
14 whole or in part by reference to profits, revenues, income from
15 the property -- in that case it is very much like the Clay Brown
16 case to which Senator Moynihan referred -- or where the property
17 is leased to the transferor. In effect he has not given up his
18 use. He simply stays in possession. Or in the case of non-recourse
19 debt where it is owed to the transferor or related party, whichever
20 is subordinate, a second mortgage situation. Or it bears -- and
21 this is the last crucial element put in place -- or it bears a
22 rate of interest significantly less than that which would apply
23 if we had third party financing.

24 In other words, if you went to a bank and got a conventional
25 mortgage, we would be assured that the relationship of the purchase

1 price and the interest paid would guarantee us that the property
2 was being purchased at fair market value. In some other situation
3 you would find you would be in a situation where perhaps the
4 parties could negotiate a lower interest rate, a higher than fair
5 market value purchase price which could lead to the abuse we were
6 concerned with.

7 So the standard we have set is that even in the two-party
8 situation where you are dealing with a purchase money mortgage,
9 you do have a rate of interest which is not significantly less
10 than the normal third party rate, and under those circumstances
11 we think that this would be satisfactory legislation.

12 Chairman Long. Is there no objection then?

13 Senator Matsunaga. Mr. Chairman, may I raise a question and
14 make inquiry as to why this applies only to employee trusts and
15 not to eleemosynary trusts?

16 (Pause.)

17 Senator Moynihan. It is obviously a good question, Senator.

18 (Laughter.)

19 Mr. Halperin. Senator Matsunaga, there is a distinction in
20 the reasons for the tax exemption. In the case of employee
21 trusts, the basic exemption is of the investment income the
22 employee trust earns. For the charitable trust organizations,
23 the investment income of a charity, an exemption is really a by-
24 product of the main reason, which is to give a tax deduction for
25 the contributions.

1 Also, in the case of an employee trust, what you are talking
2 about is deferral, and the income is eventually taxed to the pen-
3 sioners. So there is really a different question as to how one
4 wants to treat the investment income of the two entities, and we
5 felt comfortable with this particular change for pension trusts
6 as part of the basic exemption for the income earned by this trust;
7 but we don't feel comfortable with it in the case of tax-exempt
8 organizations. And I think it raises additional questions which
9 need to be considered.

10 Senator Matsunaga. I won't pursue it at this time, but I
11 intend to pursue it at some time.

12 Senator Moynihan. Can we not agree that we will do so?

13 Senator Matsunaga. (Nods affirmatively.)

14 Chairman Long. Do you move the amendment?

15 Senator Moynihan. I move the amendment.

16 Chairman Long. All in favor say "Aye."

17 (There was a chorus of "Ayes.")

18 Chairman Long. Opposed, "No."

19 (There was no response.)

20 Chairman Long. The "Ayes" have it.

21 Next we will call on Mr. Bentsen.

22 Senator Bentsen. Mr. Chairman, I would like to bring up an
23 amendment which has been agreed to by the author of the piece of
24 legislation, and I understand discussed with Treasury and staff
25 and agreed to by them. And I was called out of the room during

1 S. 1444's discussion, and I would like unanimous consent to
2 propose this amendment that all agree to.

3 What it is is to award fees for professional services
4 within a \$20,000 cap. You are talking about the accountant
5 fees you have to incur sometimes in preparation of the
6 defense of a law suit, to limit it to those professional
7 services, if I may.

8 Mr. Lubick: Included in the \$20,000 awarded for
9 attorney's fees --

10 Senator Long: What item is that on the list?

11 Mr. Lubick: That was Senator Baucus's bill.

12 Mr. Shapiro: Item B.

13 Senator Long: Item B. All right.

14 Senator Bentsen: Now, I know we get only one bite out
15 of the apple, but my problem is that limitation was placed
16 on just a moment ago, and Senator Wallop and I wanted to
17 bring up a point before. He was not here, and it was asked
18 that I defer until he is here, and if I could, I would like
19 to bring it up while he is here.

20 Senator Long: Are you talking about the item on
21 Senator Baucus' bill?

22 Senator Bentsen: No. I thought we had disposed of
23 that. I am sorry.

24 Senator Long: Do you have any objection to the Bentsen
25 amendment to the Baucus bill?

1 Mr. Lubick: No. This is the amendment which would
2 allow expert witness fees to be treated as attorney's fees,
3 and that is perfectly satisfactory within the same limit.

4 Senator Long: Without objection, so agreed.

5 Now, do you want to talk about the other one?

6 Senator Bentsen: The question arose on the capital
7 gains provision of Senator Wallop, in a situation where you
8 would have foreign shareholders selling the shares to each
9 other. I am sure that was not the intent of Congress or the
10 senator, to see that the tax was triggered by that.

11 Now, if you had a case where you had a dissolution of
12 the corporation and that United States land was passed out,
13 obviously you would trigger the tax and you would have to go
14 on a new basis. So what I am asking is that we see that it
15 does not apply in the sale of the shares from one foreigner
16 to another.

17 Senator Wallop: Mr. Chairman, as I understand this,
18 this would not relieve a Canadian corporation or another
19 from an obligation of a transaction of one property for
20 another property or the disposal of a property entirely.

21 Senator Bentsen: That is correct.

22 Senator Wallop: That would remain in effect. And if
23 the company were to dissolve its U.S. holdings, then at that
24 time, no matter whether they did it as a company or by
25 distribution to the shareholders, at that time that would

1 still be --

2 Senator Bentsen: That is correct.

3 Senator Wallop: And you are only seeking to exempt the
4 foreign stock transactions between foreigners.

5 Senator Bentsen: Yes. And I would like to leave it to
6 staff to draw the precise language to take care of that
7 problem.

8 Senator Long: I want to call on Mr. Lubick.

9 Mr. Lubick: Mr. Chairman, in this particular case we
10 had some discussion with Senator Bentsen's staff as to how
11 to handle it. There are a number of circumstances involved,
12 one of which is in the particular situation we were dealing
13 with, a publicly traded stock over a Toronto stock exchange,
14 and a number of the factors you have mentioned, that there
15 ought to be at least consideration of a tax if there were
16 liquidation.

17 We were not quite clear as to what theory we ought to
18 cover the case on. We agreed the case ought to be covered,
19 and there were at least three different ways. We wanted to
20 consider all of the implications of covering the case and
21 maintaining consistently Senator Wallop's original principle.

22 We had suggested that because of the differences
23 between the House and Senate versions, that we ought to
24 agree that we will take care on an appropriate theory of the
25 particular situation in the conference, but we would like to

1 have a little time, if we could, to study the implications
2 of which route we choose to accomplish the particular
3 objectives so we can also make it compatible with Senator
4 Wallop's objectives.

5 Senator Long: Will we have that in conference? If so,
6 I think we can handle it for you.

7 Mr. Shapiro: Yes, it would be in conference.

8 Senator Long: It would be.

9 Senator Bentsen: Mr. Chairman, that is fine with me.
10 We are trying to accomplish the same objective here. If
11 they would draw the language to achieve that and do it in
12 conference, I would be very pleased.

13 Senator Long: Without objection, agreed.

14 Next we will take Mr. Boren's idea.

15 Senator Boren: Mr. Chairman, this is the third item on
16 the agenda. It is staff document D, S.2367. I think it is
17 pretty simple to explain what it is. Section 1246 of the
18 Code indicated that a foreign investment company on its
19 passive income would have its income treated at ordinary
20 income tax rates.

21 We have two categories of companies operating overseas.
22 You have a foreign operating company, which, under certain
23 provisions of law operating in developing countries, these
24 operating companies would have their incomes taxed at
25 capital gains rates. Then to make sure that passive

1 investment companies did not take advantage of that
2 provision, 1246 was enacted to say that if it was a passive
3 company, their income should be treated as ordinary income.

4 Now, there are some situations, and one which has been
5 brought to my attention, where a company was an operating
6 company and then later liquidated and became a passive
7 company. In trying to bring their earnings back into the
8 country, they were going to be charged regular income tax
9 rates on all of their earnings, not only the passive
10 earnings but the operating earnings, as well.

11 So what this bill does is clarify the situation and, I
12 think, carries out the original intent of Congress that
13 income earned in an operating company in developing
14 countries would be taxed at capital gains rates. Income
15 earned by a company during the time they were merely a
16 passive investment company would be taxed at the regular
17 income rate. It merely clarifies that, that that
18 apportionment should be made if a company is bringing back
19 earnings partly earned as passive and partly earned as
20 operating.

21 Senator Byrd's committee held hearings on this, and it
22 has been discussed with Joint Tax and Treasury. My
23 understanding is there was no objection to this bill.

24 Senator Long: Mr. Byrd, what do you think about the
25 bill?

1 Senator Byrd: I think it is all right.

2 Senator Long: What does Treasury think?

3 Mr Lubick: We agree with Senator Boren. There is one
4 point we thought ought to be made clear in the committee
5 report, and I believe he was in agreement with that, that
6 any gain not covered by Section 1246 is covered by 1248,
7 which is on liquidation of foreign corporations where
8 certain earnings for certain periods may be taxed as
9 capital, and other periods as ordinary incomes.

10 So I think everyone was in agreement that that was
11 proper.

12 Senator Boren: That is correct. The part they earn as
13 an operating company taxed as capital gains; the part they
14 earn as a passive company taxed at ordinary income tax rates.

15 Senator Long: Does the Treasury have no objection,
16 then?

17 Mr. Lubick: No.

18 Senator Long: All in favor, say "aye."

19 (A chorus of "ayes.")

20 Senator Long: Opposed, "no."

21 (No response.)

22 Senator Long: The "ayes" have it.

23 Now let's hear from Mr. Byrd.

24 Senator Byrd: I call up, on behalf of Senator Jepsen,
25 S. 2396. I understand that the Treasury has no objection to

1 this proposal.

2 Mr. Lubick: That is correct, Senator Byrd.

3 Mr. Brockway: This provision deals with the tax on
4 undistributed personal holding company income. Presently
5 there is a 70 percent tax on that amount which is
6 distributed. However, lending and finance companies are
7 excluded from the definitions and provisions of the personal
8 holding company provisions.

9 A lending or finance corporation is defined as
10 qualifying for this exception and exclusion from the
11 provisions if 60 percent of its ordinary gross income is
12 derived from the active and regular conduct of lending over
13 finance business. In determining what the lending and
14 finance business is, it includes making and borrowing,
15 purchasing accounts receivable and notes if the installment
16 obligations at the time they acquired them have a remaining
17 useful maturity of more than 560 months.

18 There also is a business expense test which must be
19 satisfied, as well. What this bill does is, in effect,
20 amend the definition of what is a lending and finance
21 business, modifying it by permitting it to include loans
22 that have maturities up to 144 months. It also modifies
23 somewhat the business expense test by removing a cap of \$1
24 million. Essentially that is it.

25 Senator Byrd: Hearings were held on April 28th, if I

1 recall correctly. The Treasury can speak now to that
2 point. They did not oppose the bill.

3 Mr. Lubick: That is correct, Senator Byrd. I would
4 like to note for the record that so far we have agreed with
5 5-1/2 out of 6 bills which the members have put forth, which
6 indicates something must be wrong on one side or the other.

7 Senator Long: So you would not oppose this bill?

8 Mr. Lubick: No, sir.

9 Senator Byrd: I move its adoption.

10 Senator Long: All in favor, say "aye."

11 (A chorus of "ayes.")

12 Senator Long: Opposed, "no."

13 (No response.)

14 Senator Long: The "ayes" have it.

15 Now let 's hear from Mr. Chafee.

16 Senator Chafee: Mr. Chairman, this is a resolution
17 which is F in your file. This is a very simple resolution.
18 It just says Congress does not favor the withholding of
19 Federal income tax on interest and dividend payments. We
20 have 66 co-sponsors on this, 12 from this committee. It is
21 innocuous in many ways. It just represents the will of the
22 people, I guess, as best we can understand it.

23 Senator Long: All in favor, say "aye."

24 (A chorus of "ayes")

25 Senator Long: Opposed, "no."

1 (No response)

2 Senator Long: The "ayes" have it.

3 I want to say that Mr. Gravel wanted to bring something
4 up. Next I will call Mr. Heinz. Are either of them here?
5 We will have to see.

6 (Pause.)

7 Senator Long: Mr. Matsunaga, then.

8 Senator Wallop: Mr. Chairman, at some time I am
9 prepared to bring up one on behalf of Senator Dole.

10 Mr. Stern: Mr. Chairman, I have some technical
11 amendments to H.R. 3102 the staff wanted to bring up.

12 Senator Long: I wish someone would send word to
13 Senator Bradley that if he wants to bring a matter up, he
14 should come over here if he can; otherwise, perhaps we could
15 meet this afternoon. But he wanted me to bring some
16 particular matter up. He gave me a note, and I can't find
17 it. I have so many notes around here I can't find it.

18 Mr. Stern: I believe his concern related to S. 2484.

19 Senator Long: Apparently he is interested about moving
20 a date on S. 2484. Have we voted on that?

21 Mr. Stern: That is a matter on the list. It appears
22 that Senator Talmadge might want to bring it up. It has not
23 been brought up yet.

24 Senator Long: If we get to it, we will talk about it.
25 That is not the matter of the REIT, is it?

1 Mr. Stern: No, sir.

2 Senator Long: All right. Then Mr. Heinz is recognized.

3 Senator Heinz: Mr. Chairman, thank you very much. I
4 would like to return, if we may, to the export trading
5 companies, referred sequentially from the Banking Committee
6 which reported our bill -- I serve on the Banking Committee
7 -- to the Finance Committee because of the two provisions in
8 it which deal with Subchapter S and DISC.

9 I think the central issue of controversy revolves
10 around the DISC provisions in the trading companies
11 legislation. I was pleased to note the other day when on
12 the House side the administration Secretary Klutznick
13 strongly endorsed the trading companies legislation before
14 the House Banking Committee, and I am pleased to note the
15 House is moving very rapidly on this legislation. All of a
16 sudden it seems to be a very popular piece of legislation,
17 in spite of the fact for two years we have had great
18 difficulty, and Senator Danforth can speak with some
19 authority on this subject, in getting much enthusiasm from
20 the people downtown for any such measures.

21 I understand that Senator Bentsen has some reservations
22 about some of the revenue effects of this treatment. If his
23 desire is to postpone this for subsequent consideration, I
24 will not press for consideration; but I think it might be
25 useful, Senator Bentsen, if we might discuss some of you

1 concerns and some of the possibilities that we might look
2 into in that regard at this time.

3 Senator Bentsen: Yes. The estimates that have been
4 made thus far show a loss of some \$300 to \$700 million in
5 revenue as a result of this piece of legislation if it
6 passed. And the trading company definition as it comes out
7 of the Banking Committee, I think, serves its purpose very
8 well when we are talking about trade and exports.

9 But if we got to the tax considerations on it, I am
10 afraid you are going to find some substantial abuse that
11 takes place unless we give some further consideration to the
12 definition. Therefore, I would like to see us defer this and
13 for staff and Treasury and Senator Heinz and Stevenson and
14 Danforth, who are all deeply interested in this and
15 co-sponsors of it, if we can't work out additional
16 definitions to assist in this regard, Mr. Chairman. I don't
17 think we are at a point to act on it now.

18 Senator Heinz: Mr. Chairman, let me just for the
19 record state what we did in the Banking Committee.
20 Essentially the reason there is an issue here is that we
21 have expanded, for the purposes of achieving greater export
22 ability on behalf of trading companies, we have sought to
23 make them eligible for DISC.

24 Now, that in and of itself would not create a major
25 problem, as I understand it. But we have also expanded the

1 definition of what would be eligible for DISC by permitting
2 services. Now, under present DISC eligibility, there are
3 certain kinds of services of a very limited nature which are
4 eligible for DISC treatment, and they happen to be the kind
5 of services directly tied to the marketing of a product such
6 as actually related to the sale or engineering of a product
7 or the managerial services furthering the production of
8 export receipts.

9 But there are a lot of things which are simply not
10 included. Consulting is not included, or accounting
11 services, overseas offices, insurance, legal services, data
12 processing, transportation. The problem, quite frankly, is
13 that all the other people who compete against us really do
14 not operate at that kind of a disadvantage.

15 As a result, if we do not find a way of putting our
16 trading companies -- I appreciate the fact that Senator
17 Bentsen does support the concept of trading companies on an
18 equal footing with the Japanese and others -- we will still
19 be fighting the battle of exports with one arm tied behind
20 us.

21 As I think most of my colleagues know, the Japanese
22 don't have these kinds of problems. They are doing rather
23 well. In fact, the sixth largest exporter from the United
24 States isn't an American firm. It is the Mitsui Trading
25 Company. We have met the enemy, and they are not us in this

1 instance. They are people who are fighting very effectively.

2 If Senator Bentsen's principal concern is the revenue
3 loss for this year, one of the things we could do is delay
4 the effective date on this to 1982. Would that kind of
5 solution be the kind of solution that the senator from Texas
6 seeks?

7 Senator Bentsen: I would share the comments of the
8 senator from Pennsylvania when he talks about we are trying
9 to do what our competitors are doing, to put us on an equal
10 footing, and to add the additional services. I am certainly
11 supportive of that.

12 But I have also been advised that we can see some
13 situations in which they take some advantage of the DISC,
14 where, in effect, they are not really contributing to
15 exports. It is a service that you would have to strain the
16 imagination some to reach that point of view.

17 With that in mind, I don't think we are prepared to act
18 at this time. I would like to work further with Treasury,
19 and I would like to hear Treasury's comments on it, Mr.
20 Chairman.

21 Senator Heinz: Mr. Chairman, I have no objection. I
22 just want to try and elicit for the benefit of all senators
23 the concerns that are here. If I hear Senator Bentsen
24 correctly -- and I hope you will correct me if I am mistaken
25 -- he has a revenue loss problem that is related to, I

1 suspect, a policy problem, which has to do with his fear
2 that a lot of the companies that now are eligible for DISC
3 treatment could simply convert into trading companies and
4 get th expanded tax deferrals even though this might not do
5 anything to increase exports.

6 I would say that that is an understandable and
7 resolvable problem.

8 Senator Bentsen: I think it is, too, and that is why I
9 think we need a little time to accomplish that. I am quite
10 prepared to work at it.

11 Senator Heinz: Perhaps what we might consider doing is
12 to limit the expanded DISC treatment for services only to
13 services provided by companies that service unaffiliated
14 companies. That way, since most of the DISCs are really
15 owned and operated by one large company as it is now, we
16 could eliminate, I think, a lot of the unnecessary revenue
17 loss that would not be productive.

18 But I do not press that point, right now, Mr.
19 Chairman. I just wanted to suggest that perhaps the senator
20 and I have some common ground in this regard.

21 Senator Bentsen: There is no question about that.

22 Mr. Lubick: One of the problems, Senator Heinz, with
23 the definition you are talking about is in effect you are
24 permitting all of the large New York, Washington and other
25 city law firms that are providing services on an

1 unaffiliated basis simply to incorporate their legal
2 departments that are furnishing services related to exports
3 or the accounting firms furnishing accounting services.

4 That is what produces a lot of this large revenue loss.

5 You have those persons who are adequately equipped to
6 work in the area and who are in the business right now doing
7 it. You are not going to produce any extra imports, but you
8 are going to permit a great deal of tax exemption and
9 deferral for these large law firms and accounting firms
10 simply for doing what they are already doing.

11 That will not contribute to our export policy, and it
12 seems an inefficient way to stimulate exports.

13 Senator Long: I thought it was agreed you would
14 withhold this for the time being.

15 Senator Heinz: I believe Senator Danforth has a
16 comment.

17 Senator Danforth: Could I ask a question on where we
18 stand on this? This bill, as reported out of the Banking
19 Committee, has three titles, one title relating to trading
20 companies, the other relating to trade associations, the
21 Webb-Pomerene issue, and the third title, the DISC title.
22 Because of the DISC title, it was referred to the Finance
23 Committee because it is a revenue matter.

24 Now, what is the status with respect to the rest of the
25 bill?

1 Mr. Stern: Are you sure it was referred to the Finance
2 Committee? I thought it was just on the Senate calendar
3 waiting for the Finance Committee to act on it.

4 Senator Danforth: I know we are discussing --

5 Senator Bentsen: Let me say what happened on that. I
6 introduced Title 3 as a separate bill, and it was referred
7 to the Finance Committee, as I understand it.

8 Mr. Stern: That is correct. As I understand it, there
9 are two bills here: one, the bill reported by the Banking
10 Committee, which includes tax provisions and would be
11 subject to a point of order because it includes a provision
12 -- I don't know the jurisdiction of the Banking Committee,
13 but the tax provisions were introduced as a separate bill
14 which has been referred to the Finance Committee.

15 In any case, I believe the Banking Committee is waiting
16 for the Finance Committee to finish its actions on the tax
17 portion before it will take it up on the Senate floor.

18 Senator Danforth: I am not on the Banking Committee,
19 but did the Banking Committee take this up, the first two
20 titles?

21 Senator Heinz: The Banking Committee could certainly
22 eliminate Title 3, which is the tax provision, and go to the
23 Senate floor. It would be preferable if we could, as
24 quickly as possible, deal with this, hopefully get a
25 resolution of it, and then bring the entire bill. The DISC

1 provisions, particularly, in fact, if we do modify them the
2 way Senator Bentsen suggested, we will get the kind that
3 will help bring about the kind of behavior we want people to
4 engage in.

5 Senator Danforth: I am all for DISC, but I don't want
6 to wait around forever for the bill. So I wonder if we
7 could agree to some subsequent consideration of this DISC
8 matter, and then if the Banking Committee, with your
9 support, could press ahead by calling up for consideration
10 Titles 1 and 2.

11 Senator Heinz: I think that is a constructive
12 suggestion, Mr. Chairman. When might we be able to return
13 to this particular matter?

14 Mr. Stern: Mr. Chairman, as far as the scheduling of
15 the Committee goes, based upon the Senate's action
16 yesterday, the Committee is about to schedule hearings on a
17 major tax cut bill after the recess. So I am not quite sure
18 when you would get to this matter. For the Committee to act
19 on that bill by September 1st really only allows about four
20 weeks for action, two of them on hearings, say one for
21 markup and one for staff work. So I am not quite sure when
22 you would be getting back to this.

23 Senator Heinz: Mr. Chairman, maybe we could include
24 this in the hearings and in the markup.

25 Senator Long: This could be offered on a tax cut bill.

1 It is a revenue measure.

2 Mr. Stern: The hearings have been held.

3 Senator Heinz: Can we include hearings when we have
4 hearings on tax matters after the recess? Can we include
5 these in the hearings?

6 Mr. Stern: Senator Heinz, I believe hearings were held
7 the other day on this subject in Senator Byrd's subcommittee.

8 Senator Heinz: So it is the Committee's view no
9 further hearings are necessary?

10 Mr. Stern: At any rate.

11 Senator Heinz: Senator Bentsen, you don't feel
12 hearings are necessary?

13 Senator Bentsen: I don't think so at all. I think we
14 have accomplished that.

15 Senator Heinz: Fine. Very well.

16 Senator Bentsen: It is now a question of trying to
17 tighten up the definitions so we don't have tax evasion.

18 Senator Long: You just want to take more time before
19 you vote on it, is that correct?

20 Senator Bentsen: That is correct.

21 Senator Long: We can vote on it later on. And if you
22 can agree, you can add it to some other bill out there on
23 the floor. There are all kinds of possibilities to add it
24 on.

25 Senator Gravel.

1 Senator Gravel: Thank you, Mr. Chairman.

2 The first item I would like to take up, we have just
3 passed out information in front of you. We will recall in
4 1978 in the Tax Act we had a provision setting up Subchapter
5 U of the Tax Code.. This created for the first time the
6 GSOC program. Included in the material just passed out to
7 you is a GSOC brochure that the Educational Committee in
8 Alaska that I caused to be formed laid out what was possible
9 under this program for the people of Alaska, or the people
10 in any state. In fact, there are a couple of states, the
11 State of Maryland the State of Delaware, which are now
12 looking into the possibility of creating this.

13 Along with the glossy piece, we have a question and
14 answer brochure which deals in greater detail. The AGSOC is
15 an acronym taking off from the GSOC. The GSOC is a general
16 stock ownership plan. AGSOC is Alaska general stock
17 ownership corporation.

18 Under the law we have passed, we hae a couple of minor
19 incongruities which should be corrected based on the studies
20 done by the State of Alaska, and that is that the stock
21 which is owned by a person, he receives 90 percent of the
22 dividends. He must declare 90 percent of the dividends to
23 the people. If you don't do that, you suffer a tax levy in
24 addition to that.

25 The amendment would clarify two points: one, the

1 problem of temporary ownership that would exist if a person
2 died and it would be held by the estate; and two, it would
3 also permit the deductibility of the taxes that were paid by
4 the corporation, and if the money is not then passed out to
5 the shareholders so that the shareholder does not have a
6 liability in question. Both are covered in paragraphs one
7 and two in full detail.

8 So I am just asking that we would correct both of these
9 technical points. Bobby may have something to add to that.

10 Mr. Shapiro: Essentially they are as Senator Gravel
11 indicated. As you know, the GSOC is authorizing a state to
12 set up a general stock ownership plan. There are two
13 special problems. One is it requires individuals to be
14 shareholders. In a case where an individual may die, one of
15 the amendments would allow a state to be a shareholder in
16 that specific case.

17 There is also a problem with regard to the way the GSOC
18 was set up. That is, since it is required to distribute 90
19 percent of its taxable income each year or by January 31st
20 of the next year, there is a penalty if it does not. That
21 penalty is that it pays a tax equal to 20 percent of any
22 deficiency of the amount it doesn't pay out, and the
23 amendment would make it clear that the 20 percent penalty
24 tax on deficiency would be deductible from the GSOC's
25 taxable income for the year it is paid.

1 There are also a number of other smaller minor
2 technical modifications to make the provisions work, and
3 that is essentially the amendment Senator Gravel has
4 proposed.

5 Senator Byrd: I might say hearings were held on this on
6 March 4, and I see no objection to it. I understand
7 Treasury has no objection.

8 Senator Long: Treasury has no objection?

9 Mr. Lubick: No.

10 Senator Long: All in favor, say "aye."

11 (Chorus of "ayes.")

12 Senator Long: Opposed, "no."

13 (No response.)

14 Senator Gravel: I thank my colleagues.

15 The next item I wanted to bring up, I have just been
16 informed that Senator Bentsen would like to be added as
17 co-sponsor to this bill, along with my present co-sponsors,
18 Mr. Hatfield, Levin and Hayakawa. This is S. 2447. Under
19 the Internal Revenue Code, tax exempt financing for solid
20 waste disposal is permitted. However, non-returnable
21 beverage containers are a classic example of solid waste.
22 Fifteen states have adopted beverage container laws, and
23 these laws are under consideration in another 20 states.

24 These laws effectively require bottlers to convert to
25 reusable bottles. This conversion requires new capital

1 investment, which is, in effect, governmentally mandated for
2 the control of solid waste. The IRS has refused to rule
3 that these expenditures are for solid waste disposal
4 facilities.

5 Under present law, the following result occurs. If a
6 taxpayer purchased a truck with which to collect discarded,
7 non-returnable bottles along with land, warehouses and
8 machinery to store the bottles, crush them, clean the glass
9 and recycle it into new bottles which he sells at a profit,,
10 tax-exempt financing would be available for all phases of
11 this capital investment.

12 However, if another taxpayer sells soda in
13 non-returnable bottles, and because of the passage of a
14 state bottle law, he converts to the use of returnable
15 bottles in the process, purchasing new bottles, trucks with
16 which to collect the bottles, along with land, warehouses
17 and machinery to store the bottles, clean and sterilize
18 them, he cannot use tax-exempt financing for any of the
19 capital costs.

20 The obvious discrepancy is, I think, apparent, and this
21 is merely an effort to rectify that situation.

22 Senator Long: Yes, sir?

23 Mr. Lubick: We regard this, Mr. Chairman, as a very
24 serious breach of the tax exempt principles, which have been
25 limited to quasi-governmental activity. This would permit

1 tax-exempt financing for a business, to finance it going
2 into the soda bottling business, financing its original
3 inventory of soda bottles. It has nothing to do with solid
4 waste. This is tax-exempt financing for the conduct of an
5 active business.

6 Moreover, it would allow it in the very situation where
7 it is not needed by virtue of the fact that the states
8 involved have various penalties to require going into that
9 kind of business. People are going to go into that business
10 anyway. In effect, they are giving a competitive edge
11 through the state legislation to prohibit going into the
12 disposable bottle business, either through a penalty on the
13 use of disposable bottles or what have you.

14 So, in the very situation we are talking about, there
15 is already an edge in favor of those going into the
16 returnable type of bottles. To use tax-exempt financing
17 here doesn't have anything to do with the purposes that have
18 been traditionally used for tax-exempt bonds.

19 As we have indicated, every expansion of tax-exempt
20 financing into the private sector is one which is highly
21 inefficient because a large part of the subsidy goes to high
22 income taxpayers or other persons who have nothing to do
23 with the benefited activity.

24 There are significant revenue losses, problems of tax
25 equity, and this just goes far beyond the bounds that the

1 Committee has historically set.

2 Senator Byrd: Mr. Chairman.

3 Senator Wallop: Mr. Chairman, I would just like to --

4 Senator Long: Mr. Byrd.

5 Senator Byrd: I yield.

6 Senator Wallop: Senator Dole, I think, has spoken to
7 the chairman and wanted to be heard on this bill, and asked
8 earlier --

9 Senator Long: Is this the bill Senator Dole wanted to
10 be heard on?

11 Mr. Stern: That is correct. He asked the Committee to
12 go over on this until he could be here.

13 Senator Long: If you want to speak to it, you may, but
14 I had agreed that we would hold up for Senator Dole.

15 Senator Gravel: I wish we could hear a few comments
16 from the members.

17 Senator Long: All right. Senator Byrd.

18 Senator Byrd: I have consistently opposed expanding
19 the tax-exempt bond programs, and I would have to oppose
20 this measure and support the Treasury's position on it.

21 Senator Long: In view of Senator Dole's request, he
22 started out by requesting we not meet. And then I said,
23 well, why don't you just look those bills over and limit
24 your request to the things you feel strongly about or that
25 you very much want to be heard on. He indicated that he

1 would like to ask that this not be voted on in his absence,
2 and I think we must respect that request.

3 Senator Gravel: I understand that we can bring it up
4 at another time, Mr. Chairman. I would like to prepare some
5 comments for the record because I think the Treasury is
6 really all wet on this.

7 Senator Long: Now let's hear from Mr. Matsunaga. He
8 has something he wants to bring up.

9 Senator Matsunaga. Mr. Chairman, when the Crude Oil
10 Windfall Profits Tax Act was considered as law, it included
11 tax incentives for the production of alternative energy.
12 Senator Nelson offered an amendment proposing a tax credit
13 for processed wood or wood pellets sold as fuel. By
14 amendment, which I had offered in negotiations with Senator
15 Nelson, Senator Nelson did offer an amendment, and in
16 explanation of his amendment he stated that his amendment
17 did include biomass items such as sugar cane, bagasse.

18 But then, when the language of the statute itself was
19 drawn up, then the interpretation given by the Treasury was
20 that bagasse was not included. But the intent of Senator
21 Nelson was that it be included. This, incidentally, is Item
22 Q.

23 I would offer an amendment, Mr. Chairman, to clarify
24 the language. It is a matter of clarification to include
25 bagasse and pelletized biomass such as bagasse, and that the

1 date be moved from December 21, 1982 to October 1, 1983.

2 Senator Long: Mr. Wallop indicated he wanted to
3 represent Senator Dole with regard to this.

4 Senator Wallop. Not with regard to this, no. This is
5 Senator Dole's S. 1859, the one on the agenda.

6 Senator Long: Is there any objection, then?

7 Mr. Shapiro: I want to add one clarification. There
8 was a lot of confusion about this amendment when it was
9 brought up. This was a Senate floor amendment that Senator
10 Nelson offered. His statement did indicate some of the
11 items he wanted covered, but his own language which he
12 submitted to the desk did not cover these items. So it was
13 not the staff which drafted it, because it was not done in
14 the Committee.

15 There was a difference in the amendment he submitted at
16 the desk. It was not the Committee staff drafting it. Just
17 a clarification because there was a lot of confusion at the
18 time about the difference between the draft language and his
19 statement, that it was not the Committee's draft. This was
20 done on the Senate floor and not in committee.

21 Senator Matsunaga: This is right. This is the
22 amendment offered by Senator Nelson.

23 Mr. Shapiro: Yes, on the Senate floor.

24 Senator Long: Let's hear from Mr. Lubick to get his
25 thoughts about this.

1 Mr. Lubick: Mr. Chairman, we have three problems with
2 the legislation. First of all, this, as a tax incentive,
3 would be very wasteful. It would not induce any energy
4 savings. Already today, wood chips and wood processed waste
5 products are used extensively, and we estimate we are
6 producing up to 1-1/2 quads of energy annually from these
7 products.

8 Production cost estimates for them range from \$1 to \$2
9 per million BTUs, and with the market price of imported oil
10 continuing to rise, there is no need for any additional
11 incentive to stimulate this type of production. It is
12 already under way. The price is already an adequate
13 incentive, and so any additional tax incentive would simply
14 be a windfall to producers for doing what they are already
15 doing.

16 To the extent that a subsidy is required, Congress has
17 already provided adequate assistance for woodchips and
18 biomass. Under Title 2 of the Energy Security Act, there is
19 an authorization of \$1.45 billion in financial assistance
20 for the production of energy from all kinds of biomass,
21 including timber, agricultural and urban waste products.

22 Finally, the bill would expand the credit to producers
23 for use themselves, and that is simply inadministratable.
24 Under the existing law, the credit is limited to products
25 sold at arm's length, and that can be checked. We wouldn't

1 have any controls over the credit claimed for use by a
2 producer himself. So we are very much opposed to this
3 legislation.

4 Senator Matsunaga: I might point out, Mr. Chairman, that
5 with this incentive of \$3 tax credit, an equivalent of a
6 barrel of oil produced, at least in Hawaii, there are plans
7 to go into greater production of bagasse and bagasse
8 products.

9 Senator Long: Didn't we provide this kind of subsidy,
10 Mr. Shapiro, for fuel produced by other sorts of products,
11 wood products?

12 Mr. Shapiro: Senator, you did. You had a general \$3
13 production credit. But then you had a phaseout, and the
14 phaseout in effect meant the provision would never go into
15 effect, because when you put the provision in the Finance
16 Committee, the price of oil was below the phaseout level.
17 The phaseout level was between \$22.50 and \$29.50, and the
18 proposal was that the Committee wanted to provide an
19 incentive for these certain kinds of programs to help make
20 them competitive.

21 But the point was that when the oil got to a certain
22 point, they no longer needed the incentive. Now, by the
23 time you got to the Senate floor, the price of oil had
24 jumped and it passed your phaseout, and your \$3 credit would
25 never have gone in effect.

1 On the Senate floor you had a provision that had a
2 special rule for qualified processed wood fuel that said
3 that that fuel would not be subject to the phaseout under
4 special circumstances, so the phaseout would not apply.
5 That is what presented the difference here, because the
6 Senate floor amendment technically did not correspond to
7 Senator Nelson's floor statement.

8 You actually had it in committee and you spent a lot of
9 time on it, but it was phased out by the time it went to the
10 Senate floor.

11 Senator Matsunaga: And, of course, the tax credit
12 would apply only for three years.

13 Mr. Shapiro: That is correct.

14 Senator Matsunaga: Three years after production.

15 Mr. Lubick: Mr. Chairman, we are phasing out the credit
16 for those types of additional sources of energy, shale and
17 the like, that are going to be very expensive and require
18 great undertakings to produce. It only seems logical that
19 there ought to be the same phaseout, at the very least, for
20 that which is already heavily in production and that which
21 has been shown to be economically viable.

22 It doesn't make any sense to say we are going to phase
23 it out for these items we have not yet got under way that
24 are going to be very costly and expensive, and yet not to
25 phase it out for that which is very substantially in use. It

1 doesn't make any sense even to give the credit in the first⁷⁰
2 place, but if so, the protection already in the law, based
3 upon the price of oil, is certainly an adequate incentive.

4 Senator Matsunaga: I think, Mr. Chairman, we might be
5 misled by the statement being made here, because wood
6 pellets are already included by the Nelson amendment, and
7 that is the big item. What I am proposing is merely to
8 include, as it was intended by Senator Nelson, other biomass
9 items such as sugar cane bagasse.

10 So I agree with Secretary Lubick that it is a big item,
11 but he is talking about what the Nelson amendment already
12 accomplished. What I am proposing is merely an addition of
13 an item which was intended to be included but was not.

14 Senator Long: Well, let's vote on it. Those that
15 favor the Matsunaga proposal say "aye."

16 (A chorus of "ayes.")

17 Senator Long: Opposed, "no."

18 (A chorus of "noes.")

19 Senator Long: The Chair is in doubt.

20 Those that favor it, raise your hand.

21 (A show of hands.)

22 Senator Long: Those opposed?

23 (A show of hands.)

24 Senator Long: As of now, I think the amendment is
25 agreed to, but I suggest we vote on it again later. I think

1 we ought to vote on it again later on, Senator. I will
2 bring it up again later.

3 Mr. Stern: Mr. Chairman, for purposes of the press
4 release, shall I say it has been tentatively agreed to or
5 passed over or what?

6 Senator Long: In fairness, I think that we ought to
7 reconsider and vote on it when we have a fuller attendance,
8 and I will submit it later on. As far as I am concerned, I
9 am for your amendment, but --

10 Senator Matsunata: If the release, if any, could say
11 tentatively agreed to, that makes me a very effective
12 senator.

13 Senator Long: Then it is tentatively agreed to.

14 Senator Byrd: May I ask a question of staff? Has S.
15 650 been considered?

16 Mr. Stern: It was brought up and tentatively agreed
17 to, yes, sir.

18 Senator Long: Do we want to discuss S. 2484? Are you
19 interested in that, Mr. Durenberger?

20 Mr. Durenberger: Yes, I am, and I can explain it.
21 Very briefly, the 1976 Tax Act extended certain recapture
22 provisions to all foreign losses. The rules were intended
23 to assure that foreign tax credits couldn't be used against
24 U.S. source income. The acts required that in cases where a
25 loss in foreign operation reduces U.S. tax on U.S.-source

1 income, the loss is to be recaptured if the company
2 subsequently derived income from abroad.

3 In general the recapture is accomplished by reporting
4 the foreign income which is subsequently derived as income
5 from domestic sources. The Act provided two transition
6 rules. The first was an exemption from the recapture
7 application provided that corporations sustained losses in
8 three out of the last five taxable years beginning prior to
9 1976 and had sustained an overall loss for the five-year
10 period, provided the corporation terminated its investment
11 before January 1 of 1977.

12 The Act also included a second, more limited exception
13 for taxpayers who satisfied the other requirements of
14 sustained losses over a five-year period but failed to
15 qualify because the operations of the foreign subsidiary
16 were not terminated in 1976. If the operation was
17 terminated before 1979, the loss would not be subject to
18 recapture, only to the extent of the deficit of the
19 subsidiary's earnings and profit statement as December 31,
20 1975.

21 The rules governing this area were changed and made far
22 more restrictive. As enacted, it was more restrictive than
23 even, I believe, the Treasury had originally proposed.
24 Several corporations attempting to compete overseas were
25 trapped by the expanded coverage of the recapture rule and

1 were given a transition period of less than 90 days to
2 liquidate a foreign holding in order to avoid the rule.

3 Alternatively, at the urging of the companies which
4 realized that foreign subsidiaries could not be liquidated
5 that quickly, a limited exception was enacted, but this,
6 too, proved inadequate. So the 1976 legislation gave
7 corporations until January 1, 1977 to complete the disposal
8 of foreign subsidiaries.

9 This amendment would extend the transition rules to
10 December 31, 1977.

11 Senator Bradley: Mr. Chairman.

12 Senator Long: Yes, sir.

13 Senator Bradley: Mr. Chairman, I would like to support
14 Senator Durbenberger's amendment. I note for the record
15 that the House has in a similar bill a December 1977 date,
16 and I think this would conform our bill to the House bill.

17 Senator Long: Any objection, Mr. Lubick?

18 Mr. Lubick: The problem is not so much the amendment,
19 although we find that objectionable, but the basic bill
20 itself, Mr. Chairman. This is a situation where the
21 Congress tried to deal with a double dipping situation where
22 a loss was claimed, and then subsequently, foreign income is
23 earned. It simply denies the credit to the extent of the
24 prior loss.

25 At the time of the 1976 act, there was worked out an

1 arrangement to deal with some of these situations where the
2 taxpayers had businesses that potentially were losers, so
3 that we would allow them a transition period. As a matter
4 of fact, the very taxpayers who were involved, who were
5 behind this legislation, were parties to the deal and got
6 very substantial relief.

7 Then they decided they wanted to continue to try to
8 make a go of the business without binding it down and
9 without terminating it, and they did not succeed. But they
10 sustained additional losses, and they are trying to get the
11 advantage of that. Now, this is a situation, in other
12 words, where they went ahead, after having made a deal, and
13 took a chance, knowing what the law was, and operated and
14 did not succeed. Now they are seeking relief which was
15 thought inappropriate and which they agreed ought not to
16 have been given at that time.

17 We think that there ought to be some finality to these
18 situations. The basic fundamental provision I think nobody
19 disputes, that there ought not to be the double claiming
20 both of the loss and then get foreign tax credits for the
21 income earned subsequently. We would strongly oppose the
22 legislation.

23 Senator Long: Those in favor, say "aye."

24 (A chorus of "ayes.")

25 Senator Long: Those opposed?

1 (No response.)

2 Senator Long: I vote no, but the "ayes" have it.

3 I want to bring up this matter that Senator Durenberger
4 and I are sponsoring here, Section S. 1859. That has to do
5 basically, as I understand it --

6 Mr. Stern: I think you are referring to Section 11 of
7 H.R. 5505, are you not, Item I?

8 Senator Long: Yes, that is right. Under present law,
9 social clubs and some nonprofit organizations such as
10 national organizations of fraternities and sororities are
11 exempt organizations. Code 501(c)(7) provided these
12 organizations must be organized and operated exclusively for
13 pleasure, recreation and nonprofitable purposes, with no
14 part of the net earnings inuring to the benefit of a private
15 shareholder.

16 However, Section 501(i) provides that an organization
17 otherwise exempt from income taxes, an organization
18 described in Section 501(c)(7) is to lose its exempt status
19 for any taxable year if at any time during the year the
20 organization is chartered by laws or any other governing
21 instrument or policy statement containing a provision which
22 discriminates against any person on the basis of race, color
23 or religion.

24 The exempt status is granted under Section 501(c)(8) to
25 fraternal beneficiary societies, orders or associations

1 which operate under the lodge system or for the exclusive
2 benefit of members of a fraternity operating under the lodge
3 system and which provides payment for the life, sick,
4 accident or other benefits of the members of the society or
5 association or their dependents.

6 The issue is whether the exempt status of Section
7 501(c)(7) should be provided for auxiliaries of a fraternal
8 benefit society which is exempt under Section 501(c)(8) and
9 which limits its membership to members of a particular
10 religion. What I had in mind was the Knights of Columbus.
11 I suppose Mr. Durenberger had in mind the Knights of
12 Columbus.

13 I want to make it clear that insofar as there is
14 discrimination in favor of religion, I have already gone to
15 bat for the Masons, and I think having done so, I have a
16 right to stand up and be counted for the Knights of
17 Columbus. What pause does that give you, Mr. Lubick?

18 Senator Heinz: Mr. Chairman, I just want to be counted
19 with you.

20 Senator Long: Please understand, I have already led
21 the parade for the Masons and I think I have a right to go
22 to bat for the Knights of Columbus, as well. Do you find
23 anything wrong with that, Mr. Lubick?

24 Mr. Lubick: We don't see how you can deny exempt
25 status to the Knights of Columbus.

1 Senator Durenberger: Mr. Chairman, I assume you use
2 the Knights of Columbus as an example because it is one of
3 the better examples or one which includes the most numbers;
4 but in my amendment it includes auxiliaries of a fraternal
5 beneficiary society to a club, for example. There are
6 Catholic alumni clubs which limit their membership to
7 members of a particular religion.

8 It was simply done on the basis that 501(i) was
9 intended, as it clearly said, to prohibit discrimination
10 against persons on the basis of race, and was never intended
11 to preclude the existence of religiously-oriented clubs.

12 Senator Bradley: Mr. Chairman, I appreciate everything
13 Senator Durenberger said. In New Jersey we call it the
14 Knights of Columbus.

15 (General laughter.)

16 Senator Long: I am glad Mr. Durenberger made it clear
17 that this goes beyond the Knights of Columbus. Anyone in a
18 similar situation qualifies. We are not trying to
19 discriminate against anybody. We just want to see the
20 Knights of Columbus are not discriminated against.

21 All in favor say "aye."

22 (Chorus of "ayes.")

23 Senator Long: Opposed, "no."

24 (No response.)

25 Senator Long: The "ayes" have it.

1 Senator Boren: Mr. Chairman.

2 Senator Heinz: Mr. Chairman, I have an item, unless
3 someone else does.

4 Senator Matasunaga: I take it, Mr. Chairman, that the
5 Yankee Samurais are included.

6 General laughter.)

7 Senator Heinz: Mr. Chairman, I would like to call up
8 an item on the addendum. Not fishbait. I am glad you are
9 going to handle fishbait, Mr. Wallop. That is an important
10 item. This has to do with Section 7 of H.R. 4746, which
11 would make investment tax credits available for investments
12 by the Communication Satellite Corporation, COMSAT, in
13 property owned or used by the International Maritime
14 Satellite Organization, INMARSAT.

15 Some time ago, the Committee adopted the same treatment
16 -- in fact, it was 1971 -- for investments by COMSAT in
17 property owned or used by the International
18 Telecommunications Satellite Corporation, INTELSAT. This
19 would give INMARSAT parallel treatment, and with the goal of
20 accelerating our effective participation in it.

21 I understand that there is no administration objection
22 to the bill. Treasury, I am told, although they can speak
23 for themselves, does not object, and I understand that the
24 House report supports this position. The revenue
25 implications are minor, and I know, as I say, of no

1 objection to this.

2 Mr. Lubick: We have no objection, Senator.

3 Senator Long: No objections?

4 Without objection, so ordered.

5 Mr. Chafee wanted to be heard.

6 Senator Chafee: Mr. Chairman, I would like to return
7 to the one Senator Durenberger had -- I am sorry Senator
8 Bradley has left -- to that seal power one, the one we
9 dealt with a minute earlier.

10 Senator Long: 2484?

11 Senator Chafee: Yes, I have it here, W.

12 Mr. Chairman, I listened to Mr. Lubick and have been
13 pondering this. I know we have had a tentative vote; but as
14 I understand your explanation, you are saying the very
15 companies that were involved and are now coming in and
16 seeking some kind of relief were involved in the original
17 arrangement which gave them some kind of postponement, is
18 that correct?

19 Mr. Lubick: They got the transitional rule. The
20 transitional rule that was in there was one which was for
21 their benefit.

22 Senator Chafee: Mr. Chairman, I don't know where we
23 stand on this. Is this going to come up? I would like to
24 be recorded. I did not vote because it just wasn't
25 completely clear to me.

1 Senator Long: Well, why don't we take the view that
2 this is tentatively agreed to, and we will vote on it again
3 before we report it.

4 Senator Chafee: Well, I don't know. I should not have
5 mentioned seal power. I see that is in this W thing. But
6 in any event, wherever we stand on the vote, I would like to
7 be recorded as "no."

8 Mr. Lubick: Mr. Brockway can perhaps clarify some of
9 the history that occurred while I was not here.

10 Senator Long: If someone wants to discuss it again
11 before it goes on the calendar, we will do it.

12 Senator Wallop: Mr. Chairman, I had that one I noted
13 to you I would like to bring up on behalf of Senator Dole,
14 which is on the agenda.

15 Senator Long: All right, go ahead and bring it up.

16 Senator Wallop: In effect, what this does is on
17 September 10 last year, Treasury proposed regulations that
18 preclude the consideration of crop share rental in the
19 formula method of special use valuation. The action
20 reversed a position taken by Treasury in regulations
21 proposed one and one-half years earlier, in July of 1978,
22 and the revised regulations, by disallowing the crop share
23 rentals, effectively eliminates special use valuations for
24 states like Kansas where the bulk of leased farmland is on a
25 crop share basis.

1 It also has a fairly common application in Oklahoma,
2 Illinois, South Carolina, Texas, Louisiana and Minnesota.
3 In passing the Revenue Act of 1976, Congress clearly
4 intended special use valuation to be available to farmers,
5 an interpretation that ignores a typical practice in many
6 farm states, frustrates the intent of Congress. And what
7 this bill seeks to do is to simply put it back to the way
8 the regulations were in July of 1978.

9 It is a Percy Dole bill. It is similar to legislation
10 which I have introduced with Senator Byrd, Senator Nelson
11 and others, but that is our inheritance tax legislation
12 which is coming along slower. I think Senator Boren wanted
13 to be heard on this issue.

14 Senator Boren: Mr. Chairman, I am certainly in favor
15 of this, too. As Senator Wallop has said, this is practiced
16 and used in many states, many states represented on this
17 committee, where they do use a crop share rental. We know
18 how important it is in keeping family farms intact to be
19 able to use this method of use valuation.

20 I hope that we will pass this bill. I think Senator
21 Dole is right in what in what he is trying to do.

22 Senator Wallop: The revenue effects are relatively
23 minor, \$1 million this year.

24 Senator Long: Mr. Lubick.

25 Mr. Lubick: Basically we have been discussing this

1 problem for some time. You may recall that Senator Bellmon
2 had an amendment at the time of the windfall profits tax
3 which he was going to offer on this subject, with our
4 approval, which would have accomplished the same result, to
5 clarify the statute.

6 But it had as part of it another provision which we
7 think is vital in this whole area, which deals with a
8 formula by which the discounted value for farm use is
9 calculated. Under the statute, you can make an actual
10 comparison to the use in farming, or if that is difficult to
11 do, you can use a mechanical formula with discounts based
12 upon a capitalization rate of income.

13 For that purpose we suggested, and Senator Bellmon
14 agreed, that the capitalization rate ought to be somewhere
15 around the interest rate used for determining returns on
16 farmland. The rate presently used of capitalization, the
17 land bank interest rate, does not reflect that expected
18 return. The result is we have found situations where the
19 discounts may get up to 50 or 60 percent, which is,
20 admittedly a far different variation from the fair market
21 value in farming.

22 Therefore, the original Bellmon amendment did correct
23 that. I believe he used either the Department of
24 Agriculture's figures, or at least a 5 percent
25 capitalization rate, which is satisfactory to us.

1 Senator Wallop: Mr. Chairman, the Department of
2 Agriculture has said that they are not prepared to do this.
3 I could propose an amendment which would have some objective
4 standards in applying special use valuation, and it would
5 simply provide that in determining the value of crops for
6 crop share rentals, price should be determined by looking at
7 the average price in the three local markets closer to the
8 property in question, and two, during the first five months
9 of the marketing year for that crop.

10 Mr. Lubick: We are not talking about the same thing,
11 Senator Wallop. What we are talking about is the formula
12 whereby the value is based upon the rate of return on
13 production income. That is already derivable from regularly
14 published agricultural data. It is a different subsection.

15 Senator Boren: Mr. Chairman, what Mr. Lubick is
16 talking about is a whole different issue.

17 Senator Wallop: Yes.

18 Senator Boren: He is talking about the issue of how
19 you come up with what the use value should be. We are not
20 prepared to argue that today, and I do not think that is an
21 argument in any way against. You can argue whether use
22 value is appropriate or not. It is in the law. The
23 question is are you going to just arbitrarily exclude from
24 being considered under the use value standard crop share
25 property. I think that is all we are trying to do. We are

1 not trying to change the present law as it applies to use
2 value. Maybe Mr. Lubick is right in wanting it changed, but
3 we don't have to handle that as a technical amendment.

4 Senator Wallop: You can do that in the inheritance tax
5 bill when it comes along.

6 Mr. Lubick: The reason it is serious is it would
7 introduce a lot more estates into a situation where you will
8 then provide a formula which provides a very improper
9 valuation.

10 Senator Wallop: But that is not a part of this issue.

11 Senator Long: Let me ask this. Do we have other items
12 the senators want to bring up here after this?

13 Senator Wallop: The fishbait one.

14 Senator Long: If we are going to have others to bring
15 up, I would like to come back in here at 2 o'clock, then,
16 and we could finish discussing this and go to the others.
17 So I would suggest that we break now and come back at 2
18 o'clock.

19 Senator Durenberger: Could I bring back that issue of
20 Medicaid so we can take a vote and poll the absent members
21 of the Committee?

22 (Whereupon, at 12:50 p.m., the Committee recessed, to
23 reconvene at 2:00 p.m. the same day.)

24

25