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1 EXECUTIVE SESSION (Morning session)
2 THURSDAY, JULY 1, 1982
3 U.S. Senate
4 Senate Finance Committee
5 Washington, D.C.

6 The Committee met, pursuant to recess, at 9:24 a.m.
7 in room 2221, Dirksen Senate Office Building, Hon.
8 Robert Dole (chairman) presiding.

9 Present: Senators Dole, Packwood, Roth, Danforth, Heinz,
10 Wallop, Durenberger, Armstrong, Symms, Grassley, Long, Byrd,
11 Bentsen, Matsunaga, Moynihan, Baucus, Boren, Bradley and
12 Mitchell.

13 Also present: Ms. Burke, and Messrs. Lighthizer,
14 Chapoton, DeArment, Stern, McConaghy, Hardee, LeDuc, Belas,
15 Glickman, Morrison, and Brockway.

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1 The Chairman. I know it's very crowded and we
2 apologize for that. And I apologize also for those who have
3 been waiting for two days for us to begin, including my
4 colleagues on my left. But it seems to me that unless the
5 Republicans could agree on how to do this, it would not be
6 totally appropriate to ask the Democrats to help us raise
7 taxes to meet what we think will help bring the deficit
8 down, along with the spending reductions made last week.
9 I would hope we might proceed as we have in the past. And
10 that would be to have a discussion of the different items.
11 I think the staff has, as I think they have in the past, stayed
12 up most of the night putting together materials.

13 I think, Mark, you have distributed a short summary
14 plus a longer summary now to each member of the Committee.

15 Mr. McConaghy. That's correct, Mr. Chairman. The long
16 one is just going to be distributed. It is being xeroxed.
17 The short one we have, and we have been over it.

18 The Chairman. Does anybody have a statement before we
19 begin? Senator Long?

20 Senator Long. I don't have anything, but I do just
21 want to say this. I was called last night and told that
22 this information that is here before me was available.
23 Well, I was called last night and told that this information,
24 which is before me here, was available. And I told my wife
25 to tell the people that I would just as soon wait and see it

1 when we came to the Committee this morning. Frankly, I did
2 not want to have any advantage over any other Democrat on
3 this Committee. I thought it would be better that we meet
4 and discuss the matter and make whatever suggestions we want
5 to make in due course. I have not read all of the matter,
6 but I will study it with interest.

7 The Chairman. We had planned to deliver it to each
8 member last night. The Capitol Police were going to help
9 us but by the time the staff was able to get it together, it
10 was about 10:00. And I guess at that time, some may have
11 been sleeping. Senator Byrd.

12 Senator Byrd. Would the Chairman clarify the procedure?
13 Would we vote on each item as we go through it?

14 The Chairman. We can do it any way we like. What I
15 hoped we might do -- again, it depends on the will of the
16 Committee -- is to have a discussion of each item. Maybe
17 if we could proceed then to adopt the package and then move
18 to delete any provision that anybody wants to delete. Or,
19 we can do it the other way around. But, obviously, some of
20 these matters are somewhat controversial so anybody who
21 wants to vote on any provision will have that opportunity.

22 Senator Byrd. Could we do that as we go through it?

23 The Chairman. I thought first we might have a short
24 explanation. And then come back one at a time. Anyone
25 else?

1 Senator Byrd. Which package will we be dealing with?

2 The Chairman. I think first you are going to start
3 with the four paged one.

4 Mr. McConaghy. The five paged short summary, Senator
5 Byrd, with the revenue attached, and the total on page 6 of
6 the revenue. I'm sorry. It's six pages. It's entitled
7 "Revenue Increase Package."

8 Senator Long. How long has the staff had this
9 information?

10 Mr. Stern. We first got it at a quarter of nine.

11 Senator Long. A quarter of nine this morning.

12 Mr. Stern. Yes, sir.

13 The Chairman. That one was available, I think. I got
14 mine at 8:00.

15 Mr. DeArment. Although one member of the minority
16 staff got it last night at midnight. One member's staff.

17 Senator Long. Well, I was informed that something was
18 available last night. What was that that was available
19 last night?

20 Mr. DeArment. That was this document.

21 Senator Long. Did the staff have that information last
22 night?

23 Mr. Lighthizer. The personal staff of one minority
24 member was here when we finished it, Senator Long. And that
25 staff member got one last night.

1 The Chairman. Senator Bradley.

2 Senator Bradley. Mr. Chairman, I want to compliment
3 you for your opening statement that you made at the end of
4 the hearing day before yesterday. It sounded to me like
5 it came out in support of a fair, simplified restructuring
6 of the tax code. And I think that with your leadership,
7 that might indeed happen in due course. And I would hope to
8 be able to give the Committee the opportunity to reduce
9 marginal tax rates dramatically. And I know you would too.
10 I, frankly, don't know if we will have that opportunity during
11 this mark-up. We might. But certainly we will at least
12 have a chance to vote for a dramatic reduction of the marginal
13 tax rate sometime this year, maybe even in this mark-up.
14 And I was very pleased to see at least from your statement
15 that you were supportive of that direction.

16 The Chairman. I thank you, Senator Bradley. And I
17 appreciate your initiative, along with Congressman Gephardt
18 and others. We believe even in this package that there are
19 some changes that I think many who have that view will find
20 interesting. Hopefully, acceptable.

21 Anybody else?

22 (No response)

23 The Chairman. Maybe we can proceed.

24 Senator Grassley. I have a statement I want to put in
25 the record.

The Chairman. Without objection.

(THE PREPARED STATEMENT FOLLOWS:)

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Chuck Grassley

Opening Statement
Finance Comm.
markup July 1.

~~Stinson~~ Hollywood
~~2219~~

Mr. Chairman. With sincere regret, all of us begin this mark up session

to raise taxes. Pursuant to our Reconciliation orders, we must increase revenues by 98.3 billion in the next three years.

^{Small businesses} With corporate liquidity squeezed tight and many ^{taxpayers} ~~corporations~~ in loss positions, none of us relish the task before us.

It is my hope that this exercise will yield some positive benefits. Many of the measures we are considering today do not raise taxes, they require individuals to pay tax they already owe or pay that tax in a timely fashion. One of the focal points of this effort is the Dole-Grassley compliance bill. When this measure was introduced it created some controversy; now many Senators find this bill a much less offensive way of raising revenue than increasing taxes. My view is it makes more sense to collect as much of the revenue already owed the government before we begin searching for new ways to increase taxes. This bill also takes important steps toward improving the taxpayer's view of our system. Since it makes an attempt to collect tax from everyone, it enhances the perception that the system is fair and will improve voluntary compliance.

In addition to collect the revenue already owed the government in a timely fashion, this revenue raising exercise will broaden the base of our current tax system by limiting the deductions, exclusions and credits that taxpayers currently claim. During the past months, all of us on the committee have been the targets of intensive lobbying efforts to preserve certain tax advantages for various groups. We have all seen the constituencies which would be affected by each proposed "revenue enhancer". To the extent that we limit or deny some special benefits to specific groups, we increase our revenue base and enable ourselves

to move toward a simplified, lower rate tax system. Our current system of taxation is a narrow based, high rate tax. As long as we are faced with the unsavory task of raising revenue, I would prefer to move in the direction of enacting a broad based, lower rate tax. In my opinion, a broad based tax is fairer, has less effect on economic decision making, and would be simpler to administer than our present system.

Toward that end, the Chairman has agreed to include a bill I introduced earlier this year in our package. S. 2376 supported by Senators Durenberger and Wallop on this committee and eight other Senators asks Treasury to study a series of alternative tax systems---a simplified tax on gross income; a consumption tax; a percentage tax on consumption; and a simplified, broader based income tax. Treasury's view on the size of these respective bases, the administrability of the various systems and the ramifications of replacing our current system with an alternative system need to be studied in depth. Receiving this information from one source will improve the consistency of the data, and permit us to compare one system with another. In 6 months we can determine which system makes the most sense and what sort of rate, either progressive or flat, will be necessary to raise the funds needed to operate the government.

While the bulk of the task before us is very unpleasant, it is my hope that we can salvage some good from this exercise by resolving to investigate a simpler and fairer way to tax ourselves.

Independent Contractor
Grossley Mitchell
DRAFT
REPORT LANGUAGE

Included within the scope of the safe harbor tests are subcontractors, which are frequently utilized in the construction and homebuilding industry. Typically, a general contractor hires subcontractors as independent contractors to accomplish a particular result. The general contractor contracts with a developer who owns the project. Often, the developer may also be the general contractor. The general contractor is, therefore, the service-recipient with regard to subcontractors.

Subcontractors must perform their services within a time frame dictated by the sequential nature of the construction process. For example, in homebuilding, foundations must be laid, followed by general frame work, followed by electrical work, followed by plumbing, followed by heating and air conditioning duct work, followed by installation of insulation, followed by carpentry work, followed by flooring, followed by finish drywall, followed by painting and installation of appliances, cupboards, cabinets, etc.

Despite the fact that subcontractors must coordinate the performance of their service with the performance of other services, the Committee specifically intends to cover subcontractors within the control of hours safeharbor. Provisions in the Committee bill establish that an individual, such as a subcontractor, will be considered to control the scheduling of hours worked even though the control is limited -- because of operating procedures and specifications required in the service-recipient's contract with a third party other than the individual independent contractor, or because of the need of the individual subcontractor to coordinate his service with the performance of other services. Since the general contractor's obligations are with the developer, the subcontractors, therefore, are following operating procedures and specifications required by contract between the developer and general contractor, even though the developer and general contractor may be related parties. Also, ultimately, the developer-owner is responsible for coordinating the performance of services on the project. Since subcontractors are responsible to the general contractor, service-recipient, subcontractors will meet the coordination of service requirement.

Therefore, subcontractors fall within the control of hours test even though their work must be coordinated by third parties or performed in accordance with contractual obligations of the service-recipient owed to the owner.

With regard to the place of business test, space furnished on the job site for the storage of tools, plans, etc., does not constitute a place of business for a subcontractor, and thus does not require the payment of a fair rental. Additionally, the mere fact that a subcontractor spends a majority of his working time on a particular job site will not cause that site to constitute a principal place of business. Here, the important criteria is the temporary nature of the relationship, as evidenced by either the ability of the subcontractor to enter into more than one contract, or a contract which has a specific duration which will terminate upon completion of the project.

The income fluctuation test requires remuneration to be based on entrepreneurial skill engaged in the completion of a given project. For example, a contract for the completion of all flooring in the homes of a discrete project would be subject to the risk of income fluctuation, if payment is based upon the job rather than number of hours worked. The similarity of repetitive nature of elements of a total project will not disqualify such a contract which otherwise meets the income fluctuation test.

1 The Chairman. Mark, are you going to begin?

2 Mr. McConaghy. Yes. We can go through the six paged
3 summary, and then go back to it in more detail.

4 The first item here deals with the Airport and Airway
5 Trust Fund. The item essentially imposes an 8 percent ticket
6 tax. And puts that money in the trust fund. Presently,
7 that's a 5 percent ticket tax. This increases it to 8 per-
8 cent and makes sure that those funds go into the trust fund.
9 In addition, it would increase the tax on non-commercial
10 gasoline. In the case of non-jet fuel, it would be \$.12 a
11 gallon. In the case of jet fuel, it would be \$.14 a gallon.
12 It would restore the old airway weigh bill tax to 5 percent.
13 That's on freight. And it would restore the international
14 departure tax to a level of \$3.00 per person. That's
15 essentially the Administration's package. They would have
16 gone a little bit higher on the non-commercial gas tax. This
17 raises \$1.1 billion in 1983; \$1.3 billion in 1984; and
18 \$1.5 billion in 1985. It also would have an exception for
19 helicopters that are used in timber and natural resource
20 operations. They would be exempt from the fuels tax, if that
21 helicopter does not take off on land or at a facility which
22 is eligible for federal aid airport financial assistance.

23 Senator Long. Could I ask a question about that? To what
24 extent is this the same tax that existed up until a couple of
25 years ago? We had an 8 percent airways tax that applied about

1 a year or so ago.

2 Mr. McConaghy. Senator Long, the history of that tax
3 essentially was in July, I think it was, of 1980. On
4 October 1, 1980, I guess, that's when we ceased to put that
5 tax in the ticket fund, the trust fund. But it did continue
6 at 5 percent, but that money goes in presently to the
7 general fund. Prior law used to be an 8 percent tax. And
8 then it dropped down to 5 percent. And that 5 percent goes
9 into the general fund today. This would take it back up to
10 8 percent and put it in the airport trust fund.

11 Senator Long. This tax on gasoline -- has that been
12 there or is that being added? Is that something new?

13 Mr. McConaghy. It was there, Senator Long. Today,
14 it has dropped down to \$.04 on gasoline, non-jet fuel. And
15 here we are talking about general aviation, non-commercial,
16 use. Prior to it going down again in that September date,
17 it was at \$.07 a gallon. And both jet fuel and non-jet
18 fuel.

19 The Chairman. I might say that Senator Packwood has
20 a great deal of interest in this provision. And he will be
21 along when we come back the second time.

22 Senator Long. Now does the Administration support this
23 proposal?

24 Mr. Chapoton. We support the proposal, Senator.

25 Senator Baucus. Mr. Chairman, a slight question here.

1 I wondered if Mark could tell me how much revenue is
2 attributable to the gasoline tax portion of this provision.

3 Mr. McConaghy. I will look it up in just a moment.

4 Senator Baucus. Perhaps we could come back to it
5 later.

6 Senator Long. Let me ask this question. Now I have a
7 note that Senator Cannon is strongly opposed to putting the
8 Commerce Committee bill as an amendment to this bill. I
9 believe it's intended that if the Commerce Committee bill is
10 made an amendment to this bill, it would be subject to a
11 point of order on the grounds that the Finance Committee
12 would be reporting an amendment not within its jurisdiction.

13 The Chairman. We checked with the parliamentarian,
14 Senator Long, and I think Mr. Lighthizer can address that
15 question.

16 Mr. Lighthizer. Senator Long, I think that the
17 intention is to report two separate amendments, if the
18 Committee desires. One would be the amendment which raises
19 revenue and cuts spending. And the other would be this
20 amendment which is within the jurisdiction of the Committee
21 on Commerce or the Commerce Committee. When we then went
22 to the floor, that amendment would be subject to a point of
23 order, and would fall, presumably, if the Senate sustained
24 the ruling of the chair.

25 Senator Long. It seems to me that the Finance Committee

1 should not report that Commerce Committee bill. I think I was
2 in support for the Commerce Committee bill as a member of
3 the Commerce Committee. I would be pleased to support the
4 bill, assuming it is the same thing I voted for when the
5 Committee voted. And I think it was supported by an
6 overwhelming majority. But it seems to me that we have
7 enough of a problem to do what is required to be done in
8 terms of revenue without trespassing on the jurisdiction of
9 the other committees.

10 The Chairman. Senator Packwood will be here, and I know
11 he wants to address that. But I think Mr. Lighthizer gave
12 you a satisfactory response. It would be subject to a point
13 of order.

14 Mr. McConaghy. Senator Baucus, the amount raised by
15 the \$.12 per gallon on non-commercial gasoline (non-jet
16 fuel) is \$43 million in 1983; \$45 million in 1984; and
17 \$47 million in 1985. On jet fuel at \$.14 a gallon, it
18 would be \$86 million in 1983; \$90 million in 1984; and
19 \$97 million in 1985.

20 Senator Baucus. So if it was not presumably a \$.12 a
21 gallon tax, it would be down to \$.08. Instead of \$43 million
22 million -- do you know what the revenue would be then?

23 Mr. McConaghy. If it went down to \$.08 -- I think that
24 would drop it roughly a third, Senator Baucus, so that would
25 probably drop it from \$43 to \$27 or \$28 million. From \$45

1 down to about \$30 million. And from \$47 to \$30 or \$31
2 million.

3 Senator Baucus. Thank you very much.

4 Mr. McConaghy. The second item on the list is what is
5 labeled here as ITC basis adjustments. Today, if I buy a
6 piece of property, I get a 10 percent investment tax credit.
7 And I would depreciate the purchase price. And I would not
8 have to make an adjustment to the purchase price for the
9 investment tax credit. This proposal would require that
10 there be a basis adjustment to that cost of the property by
11 half of the investment tax credit.

12 The third item here --

13 Senator Byrd. Let's don't go too fast on that.

14 The Chairman. Go ahead.

15 Senator Byrd. Does that mean, then, that the invest-
16 ment tax credit would be limited to 95 percent?

17 Mr. McConaghy. No, Senator Byrd. The investment
18 credit would still be 10 percent. The way it would work
19 would be as follows: If I bought a piece of property for
20 a million dollars, I would still get the 10 percent invest-
21 ment tax credit on it if the property qualified, meaning
22 if it was tangible personal property. That, essentially,
23 would be \$100,000.00. And then after I got that investment
24 tax credit, today I depreciate the cost of that asset at
25 \$1 million, not at \$950 million. I do not, today, have to

1 reduce the cost by the amount of the investment tax credit.
2 This would say I do have to reduce that million dollars by
3 half of the investment credit for depreciation purposes, but
4 I would still get the full 10 percent credit. So under the
5 example I would get \$100,000.00 in investment tax credit,
6 and I would depreciate \$950,000.00. I would have to make
7 a basis adjustment for half of the ITC.

8 Senator Byrd. Thank you.

9 Senator Bentsen. What you are trying to do is avoid
10 the situation where they are getting more than full
11 expensing.

12 Mr. McConaghy. Right.

13 The Chairman. Right.

14 Senator Bentsen. Where they go more than 100 percent.
15 It's a rough approach to it, but that's what you are trying
16 to do.

17 Mr. McConaghy. That's right.

18 Senator Byrd. But you don't ever go more than 100
19 percent.

20 Mr. McConaghy. You don't get back that amount, Senator.
21 You are correct. It is more complicated.

22 Senator Byrd. I think that ought to be made clear. You
23 never get back more than 100 percent.

24 Mr. McConaghy. That's correct.

25 The Chairman. We want to make certain that it's not

1 richer than expensing. In fact, many of us, on our side,
2 thought it ought to be 90 percent rather than 95 percent.
3 But after Mark and others explained it carefully to us, we
4 agreed that perhaps this is the right figure.

5 Mr. McConaghy. The next item is essentially part of
6 that to get to that result. And that is, today, we do have
7 increases in the percentage with respect to depreciation
8 and those increases go into effect in 1985 and 1986. Those
9 increases would take the classes of property at a percent
10 which would be 175 percent in 1985, and 200 percent in 1986.
11 Today, it's 150 percent of those accounts. This would repeal
12 those increases that are scheduled to go into effect in
13 1985 and 1986.

14 Senator Baucus. Mark, I want to double check the
15 point. I think the Chairman made it. Is it clear that these
16 supervisions -- that result is they don't depreciate more
17 than expenses?

18 Mr. McConaghy. That is correct, Senator Baucus.

19 Senator Baucus. For 1983 as well as for subsequent
20 years. Is that correct?

21 Mr. McConaghy. Generally, that's right. It would be
22 a little bit more than that until 1985 and 1986. But,
23 generally, that's right. It's very close to it.

24 Senator Baucus. You say a little more in 1985 and 1986.
25 What do you mean?

1 Mr. McConaghy. A little more than that in certain
2 classes in the early years. But then it would all be right
3 at expensing in 1985 and 1986.

4 Senator Baucus. And also for the years beyond 1985
5 and 1986?

6 Mr. McConaghy. That's correct.

7 The Chairman. In fact, you might give them the 1986
8 and 1987 numbers on that last figure. It indicates it
9 rather substantially. About \$10 billion a year.

10 Mr. McConaghy. It would jump up in 1986 to somewhere
11 around a \$10 billion pickup in revenue, Senator Baucus.
12 And in 1987, it would pick up another \$18 million.

13 Senator Mitchell. Mark, would you explain what you
14 mean when you say it will be a little more than that until
15 1985 and 1986? The reasons for that and what you mean by
16 "a little more"?

17 Mr. McConaghy. Well, essentially, it would be right
18 at expensing, Senator Mitchell. But you would take the
19 combination of what you have today, which is 150 percent,
20 times that account, and make that one-half basis adjustment.
21 And that, depending on what discount rate you use -- but
22 within 1 or 2 percent, essentially, would be right at
23 expensing.

24 Senator Chafee. Mark, Mr. Chairman, one question.
25 Going back to the historic rehabilitation credit. What's the

1 maximum they can get on that now?

2 Mr. McConaghy. Twenty-five percent if it's an
3 historic structure, Senator Chafee. Twenty percent if it is
4 not historic, but it is a structure that is over 30 years,
5 I believe it is. And 15 percent if it is a structure that
6 is at least 20 years long. So if it is an historic structure,
7 they would get a rehabilitation credit for the rehabilitation
8 expenditures of 25 percent.

9 Senator Chafee. Well now, under this, I understand the
10 taking down to the 95 percent. But how would this work with
11 a \$1,000.00 structure, say, and the 25 percent tax credit?
12 Would that come down to 95 or would that go down to 87?

13 Mr. McConaghy. It would be a basis adjustment for
14 one-half of that credit, Senator Chafee. Today, we do have
15 a basis adjustment in the law for the rehabilitation
16 credit that is at the 15 percent level and 20 percent. But
17 as to the historic structure, you get that credit and there
18 is no basis adjustment. This change would also apply to
19 that historic structure so that it would have a basis
20 adjustment for one-half of that 25 percent credit.

21 Senator Chafee. And you say you have it for the
22 others now?

23 Mr. McConaghy. We do have a full basis adjustment for
24 that 15 percent credit and the 20 percent credit. Yes, sir.

25 Senator Chafee. Now what would happen to those under

1 this? Would those go up? Would it only be a half? Or
2 would that continue to be the full basis?

3 Mr. McConaghy. That would continue the full basis as
4 it is under present law, Senator Chafee.

5 Senator Chafee. Thank you.

6 Senator Moynihan. The 25 percent credit for historic
7 structures is not affected, however. The initial 25 percent?

8 Mr. McConaghy. It would be affected to the extent that
9 this basis adjustment would reduce the basis of the property,
10 but it wouldn't reduce the credit. You are right, Senator
11 Moynihan.

12 Senator Long. Let me ask Mr. Chapoton if the
13 Administration supports these two.

14 Mr. Chapoton. Mr. Chairman, we support the half
15 basis adjustment. We want to keep the benefit of the --
16 the combined benefit of ACRS and the investment tax credit
17 at no faster than expensing. This is a way to do it. And
18 we support this way of doing it. The other way to do it
19 was when you get to 1985 and 1986, you could take ACRS up,
20 and make the full basis adjustment. But we think this is
21 a satisfactory way of doing the same thing.

22 Senator Long. So I take it that you support both the
23 second and third recommendations?

24 Mr. Chapoton. Yes, sir.

25 Senator Baucus. When you say "Administration," you

1 mean the full Administration; not just Treasury?

2 Mr. Chapoton. I mean the full Administration. Yes, sir.

3 Senator Baucus. Thank you.

4 Mr. McConaghy. The next item deals with --

5 Senator Bentsen. Why don't we just say it? We are
6 talking about the President, aren't we?

7 Mr. Chapoton. I'm talking about the Administration,
8 representing the entire Administration, including the
9 President.

10 The Chairman. He's included in the Administration.

11 (Laughter)

12 Senator Long. I'm glad we got that understood.

13 (Laughter)

14 Mr. McConaghy. The next one deals with accelerated
15 corporate payments and that change, essentially, would be
16 that the amount that would have to be paid in estimated
17 taxes quarterly would have to be 90 percent of that tax
18 rather than 80 percent of the estimated tax per quarter.

19 It, however, would provide that underpayments as a
20 result of some misestimate on any portion between 80 percent
21 and 90 percent would be penalized only at half the rate of
22 the basic penalty that applies under existing law. So,
23 today under existing law, I have to make estimated
24 corporate tax payments. And, essentially, they have to be
25 80 percent current for each quarter. There are a couple of

1 safe harbor rules, but this basically would take that
2 estimated tax payment up from 80 percent to 90 percent, so
3 I would have to be 90 percent current each quarter. However,
4 essentially the safe harbors with minor adjustments would
5 continue.

6 Senator Byrd. When you say "minor adjustments," what
7 do you mean by "minor adjustments?"

8 Mr. McConaghy. Today, there are a number of adjust-
9 ments or a number of safe harbor rules that apply, Senator
10 Byrd, so that I can look at past years' tax liability and
11 if I need certain percentages of past years' tax liabilities,
12 then I am safe from any estimated tax payment.

13 Senator Byrd. Well now, do you change that?

14 Mr. McConaghy. They would go up to 85 percent in
15 1985, and 90 percent in 1986, I think, under the
16 Administration's proposal.

17 Mr. Chapoton. That's correct. That's for corporations
18 who have more than a million dollars in taxable income in
19 any of the three preceding years.

20 Senator Byrd. I'm not clear whether you changed that
21 safe harbor provision or not.

22 Mr. Chapoton. There are three changes here, Senator.
23 The one you are addressing now is the provision dealing with
24 the safe harbor. The basic rule in the present law is you
25 must pay 80 percent of your current tax liability in estimated

1 tax. There is no penalty imposed, however, if the corpora-
2 tion pays 80 percent of last year's tax liability. This
3 change would do -- I will mention the third later -- two
4 basic changes in those rules. The basic rule that you must
5 pay 80 percent of current tax would be changed to 90
6 percent of current tax. That's for all corporations.

7 In addition, the rule that you would have no penalty
8 if you pay at least 60 percent of the prior -- let's see --
9 80 percent of the prior year's tax liability would be
10 increased to 85 percent. Large corporations must pay 85
11 percent of prior year's tax liability beginning in 1985.
12 And 90 percent in 1986 and thereafter.

13 Mr. McConaghy. Those were scheduled, Senator Byrd,
14 to go up under the law that we passed previously. And this
15 just speeds that up just a little bit.

16 Senator Byrd. Well now, if a corporation pays 90
17 percent of the tax it had to pay for the previous year -- if
18 it based its quarterly payments on 90 percent of the tax
19 it paid the previous years, is that a safe harbor?

20 Mr. Chapoton. That would be a safe harbor. Yes, sir.

21 Mr. McConaghy. The next item on the list deals with
22 pensions. And it basically makes three or four changes, the
23 first of which would be to lower the limits on both what we
24 call a "defined" contribution plan, and a "defined" benefit
25 plan. Today, under a defined contribution plan, a person can

1 get a deduction for putting away essentially \$45,000.00.
2 That's the upper maximum limit. In the case of a defined
3 benefit plan, that individual can put enough in a plan so
4 that at age 55 he is entitled to receive an amount or
5 actuarially computed he would be able to have an annual
6 amount of \$136,000.00 per year. And those are indexed. We
7 indexed them back in 1974 when they went into the law.

8 The first change here would reduce those amounts to
9 \$30,000.00 in the case of a defined contribution plan from
10 \$45,000.00. And in the case of a defined benefit plan, it
11 would reduce the amount from \$136,000.00 to \$90,000.00. That
12 would be the first change.

13 The second change deals with the age at which I can
14 compute the defined contribution. As I said, today I can
15 actuarially figure out how much I would need to put away
16 to be able at age 55 to receive an amount equal to
17 \$136,000.00 annually. This change would say in making the
18 computation of the new limits, \$90,000.00, you would use
19 age 62; not age 65.

20 And the third change here today deals with what we call
21 the so-called "1.4 rule." And that rule, essentially, is
22 that if I have two plans, I can have an amount in each plan
23 so that the combination of those amounts is greater than
24 what I would have if I only had one plan. For example,
25 today if I were able to have a defined benefit plan and fully

1 funded, so at age 55 I would be able to have annually
2 \$136,000.00, I could also have an amount in a defined
3 contribution plan for an extra four-tenths or 40 percent.
4 So I could put in four-tenths or 40 percent of the
5 \$45,000.00 that is the limit, if I only had that plan by
6 itself. That would be somewhere around \$18,000.00. The
7 combination of my full defined benefit plan and my full
8 defined contribution plan could be 140 percent of what I
9 could have had if I had only had one plan. This change would
10 take that 1.4 down to 1.25, so it would say that if I had
11 two plans, I could fully fund one of them. And I could have,
12 in effect, a quarter of what I would be permitted in the
13 other plan.

14 The other change here deals with loans. Today, we
15 do not permit loans with respect to self-employed plans,
16 H.R. 10 plans. In the case of certain kinds of those, we
17 never did permit loans. We do not permit loans in the case
18 of IRAs or KEOGHs. Last year we took the rest of H.R. 10s
19 and said there can be no loans from those plans. This would
20 make a step in the direction of saying with respect to
21 corporate plans, we would limit the amount of loans that
22 corporate pension plans can make. Today, they can make
23 loans. There has been a criticism that I can put money in
24 the plan and borrow it back the next day. And this change
25 would say, essentially, you can borrow back so you can have

1 a principal balance of \$10,000.00.

2 The last change deals with the so-called "H.R. 10s."
3 Essentially, the self-employed or partnership plans. Today,
4 they have limits of \$15,000.00. We made that change last
5 year. Before that change last year in the H.R. 10s, you
6 could put away \$7,500.00. Last year, we changed it to
7 \$15,000.00. This further change suggested here would take
8 that amount in an H.R. 10, self-employed plan or partnership
9 plan, up to \$30,000.00, which would be the new corporate limit.
10 And it would take it up in three stages of \$5,000.00 per
11 year so that the year this went into effect, 1983, they would
12 be permitted in an H.R. 10 plan to go up to \$20,000.00; in
13 1984 up to \$25,000.00; in 1985, they would go up to
14 \$30,000.00.

15 The other change I forgot in the first instance is
16 we would prevent indexing of those amounts for a two year
17 period. And then we would index after the two year period
18 to essentially the Social Security index.

19 Senator Bentsen. Mr. Chairman, the complexity of this
20 issue is a good example of why I am very concerned about
21 the process by which we are trying to vote on some \$20 billion
22 worth of new taxes in the short period of time that we have
23 had to consider them. Now you, gentlemen, on your side,
24 have had a couple of days. And that is not much obviously.
25 But we have had virtually none. And to say that we are going to

1 go into this complicated a field -- I was one of the authors
2 of ERISA. I can't imagine a more complicated, more complex
3 subject than that was. And how difficult it was to try to
4 get some kind of equity. Even yet, we have substantial
5 flaws in the legislation. And this addresses part of them.
6 But you are talking about a situation here where you are going
7 to, say, age 62. As I recall, we would be giving for
8 government employees -- they would still be left at age 55.
9 And I don't quite understand the fairness in that kind of
10 a disparity.

11 You get into a situation where you have got a 1.4
12 on a defined contribution and a defined benefit where you
13 put the two of them together and you go to 1.25. I don't
14 know why you did that. I don't know how it affects the
15 low and middle income worker. I'm not concerned about the
16 high income worker in that situation. But I don't know how
17 that low and middle income worker comes out.

18 I'm concerned about taking this major step -- and it is
19 going to be repeated in many instances here -- in something
20 that is as far-reaching as this. In 1973, we forced the
21 change of most of the pension plans in this country. We did
22 another one in 1978. And then we came with the multi-
23 employer. And now we are coming with another one with very
24 little time to consider it.

25 And, again, I fully agree that there are some serious

1 flaws in the present program that have to be addressed. But
2 these are concerns to me that -- I really wish this thing
3 was frozen and we had some hearings and made a decision on
4 which we had been given more time to consider the results.

5 Mr. McConaghy. Senator Bentsen, on the 1.4 going to
6 1.25, as to who would be affected, I think we could answer
7 by saying that we have looked at the number of plans that
8 are presently having contributions over that 1.0 limit.
9 And, essentially, this change would directly affect about
10 200,000 people out of about 45 million that would be covered
11 under the plans themselves.

12 Now the issue there, obviously, is if I can, in my
13 second plan, put in 25 percent of the otherwise limits or
14 a quarter of it, rather than 40 percent, am I going to
15 continue that plan or am I going to drop that plan? Some
16 think perhaps if you went down to 1.0 that that person
17 who was fully funded in one plan and couldn't get anything
18 else under that sort of formula would drop that second
19 plan. By taking it to 1.25, it still allows that person at
20 the top to get another quarter in that second plan. And
21 many think those would be continued.

22 The Chairman. I don't quarrel with Senator Bentsen
23 because he is the expert in this area. But we have had the
24 information available since June 15 in the booklet. That
25 may not be long enough either because this is a complicated

1 program. What we have tried to do is just take a look at
2 some of the areas that we think should be corrected. There
3 is no doubt about it -- we need to go in and probably have
4 complete hearings and maybe do a more thorough overhaul of
5 the entire program.

6 But it seemed to many that this program -- that at least
7 we ought to cap those at the upper end. And I think, as
8 Mark has indicated, we affect between 180,000 and 200,000
9 upper income Americans. But we believe it is something that
10 should be done. Now we don't do enough, but we at least
11 make a start.

12 Mr. McConaghy. This does not deal, Senator Bentsen,
13 with any of the so-called rules relating to integration,
14 meaning plans that are integrated with Social Security. It
15 doesn't attempt to look at that issue, which is a rather
16 complicated issue.

17 Senator Baucus. Mr. Chairman, may I ask whether the
18 President supports this proposal?

19 Mr. Chapoton. Senator Baucus, we supported in
20 testimony before the House certain provisions of the Rangle
21 Bill. We opposed certain provisions of the bill. We did
22 support the provisions in this bill, dropping the limits,
23 as long as there was indexing, dropping the maximum limits
24 that could be put into a pension plan. This bill does --
25 this provision does do that. We had expressed concern about

1 lowering the 1.4 even though it probably makes no sense being
2 in the law. If you have a cap that is supposed to exist,
3 it doesn't make sense, if you have two plans, to raise the
4 cap. We were concerned about the affect of changing
5 rank and file. This change, however, as we understand it,
6 would affect only the limit -- dropping from 1.4 to 1.25
7 would only affect the dollar limits and not beyond that. And
8 so we support these changes.

9 Senator Baucus. So the Administration --

10 Mr. Chapoton. The one thing that we have concern about
11 this is the attractiveness of doing something in this area,
12 to us, was bringing parity between self-employed persons
13 and corporate employees. As I understand it, this provision
14 does not retain indexing of the limits for the self-employed
15 persons. We are concerned about that. We would like to
16 have absolute parity, no matter the form of business or
17 organization.

18 Senator Baucus. What I am trying to determine is if
19 some of these provisions are voted on and passed out as
20 committee, what course are they going to have as far as
21 the Senate by the White House?

22 The Chairman. They are going to have support by the
23 White House.

24 Senator Baucus. That's why I'm asking.

25 Mr. Chapoton. We are going to support this package

1 that was agreed to yesterday.

2 Senator Baucus. Does the President specifically support
3 this specific pension provision?

4 The Chairman. I don't think he has had time to
5 examine it all. But he does support the provision. We had
6 this gang of 17 and met for five weeks, and this is one of
7 the items in that area. So the President is aware that we
8 are looking at pensions and capping the other limits. He
9 may not be aware of every provision in here. I don't suggest
10 that he knows about the anti-borrowing provision or raising
11 the KEOGH limits. But we try to keep him informed on a
12 daily basis.

13 Senator Long. As I understand, we heard of a provision
14 and it was thrust among members from time to time. That was
15 apparently a broader provision. And I believe that it
16 affected pension systems to the extent that organized
17 labor was rather upset about the matter.

18 If I understand what you are recommending here, this
19 does not deal in the area where organized labor would --
20 or does it?

21 Mr. Chapoton. That is my understanding as well, Senator
22 Long. That was primarily the integration with Social
23 Security.

24 Senator Long. Let me just ask you. Is organized labor,
25 to your knowledge, opposed to what you are recommending here?

1 Mr. McConaghy. To my knowledge, they are not opposed
2 to what is recommended here. As Mr. Chapoton said, Senator
3 Long, if we got into the issue of what happens when you have
4 a pension plan integrated with the Social Security system,
5 then they certainly would have a very strong interest. But
6 this does not deal with that question.

7 Senator Long. I want to get this straight. It looks
8 to me -- and I could be badly in error and I want you to
9 speak to it if I am in error about this. It looks to me
10 as though what you are talking about here are the plans
11 that tend to benefit high income professional people, most
12 of whom have incomes over \$100,000.00 a year.

13 Mr. McConaghy. That's correct, Senator Long.

14 Senator Long. In other words, these are where people
15 have incorporated their law firms or their medical practice.
16 Generally speaking, you are talking about high income
17 individuals who are getting more benefits than they could
18 get under the KEOGH plan?

19 Mr. McConaghy. That's correct. Today, I could
20 obviously show you, with a combination of these rules, how
21 I could put away \$165,000.00 per year, as a deduction, and
22 have \$12 million left when I wanted to retire. That's the
23 sort of thing this is directed at. That's correct.

24 Senator Chafee. And, also, you could borrow against
25 it.

1 The Chairman. You borrow it right back at a higher
2 rate.

3 Mr. McConaghy. You borrow it back. That's correct.

4 Senator Byrd. May I ask this question? Is this
5 basically the Rangel bill?

6 Mr. McConaghy. It does not go nearly as far, Senator
7 Byrd, as the Rangel bill. Part of the Rangel bill would
8 take the limit down to 1.0, if you had two plans, not
9 1.25. The other parts of the Rangel bill deal with this
10 issue of integration and require changes that I think are
11 major with respect to how a plan that is integrated with
12 Social Security would operate, and what benefits would have
13 to be provided under such a plan. That portion of it, I
14 think, is very complicated. And certainly has raised the
15 most question with respect to the hearings. I think the
16 Treasury -- and Buck may want to comment -- testified that
17 they would like to look at this area some more. But this
18 does not deal with those issues. It does not deal with the
19 estate and gift tax provisions that were in Mr. Rangel's
20 bill -- the exclusions for annuities. It does not deal with
21 a provision that would put the non-discrimination rule on
22 fringe benefits. It does not deal with any of those issues.

23 The Chairman. Senator Bradley.

24 Senator Bradley. Mr. Chairman, it sounds like a good
25 proposal. I just want to make sure that it does what the

1 sheet says.

2 What was done is to reduce from \$136,000.00 to
3 \$90,000.00 the amount the person in the upper income brackets
4 can put away. Right?

5 Mr. McConaghy. The amount he can put away to fund the
6 benefit at age 55 of \$136,000.00.

7 Senator Bradley. Does this in any way affect the guy
8 who is making \$15,000.00 who has been putting away \$4,000.00?
9 Will he automatically be put back or will he or she still be able
10 to put away \$4,000.00?

11 Mr. McConaghy. He or she will still be able to put
12 away \$4,000.00, Senator Bradley.

13 The Chairman. He will like this provision though.

14 Senator Bradley. Then I have one more question. It
15 relates to the item just previous which is accelerated
16 corporate payments. This presents some problem for the
17 firm whose business is cyclical. Let's say the firm that
18 makes fertilizer to sell to the farmers. Their money comes
19 in in the first quarter usually. Maybe the first two
20 quarters. And then they don't have anything. And the
21 question is is there anyway that we could make this fairer
22 for the firm that has the problem of cyclical revenue?

23 Mr. Chapoton. Senator, I am just not certain. This
24 raises the limits. Whatever problems they had before, if
25 they had problems -- there are several exceptions. Let me

1 interrupt myself to state that I misstated in an answer to
2 Senator Byrd's question a minute ago. When you asked me
3 whether basing the present year's payment on 90 percent of
4 last year's tax liability -- would that avoid penalty. My
5 answer was "yes." That is incorrect. The present law
6 exception for last year's liability is 100 percent of last
7 year's liability. That would stay the same. In addition,
8 under this provision for larger corporations, there would be
9 the requirement, going up in 1985 and 1986, that in addition
10 to making 100 percent of last year's liability, you have got
11 to have 85 percent of this year's liability. And in 1986,
12 90 percent of this year's liability.

13 Senator Byrd. Well then you don't have the same safe
14 harbor that you have at the present time of 100 percent.

15 Mr. Chapoton. For the larger corporation -- for over
16 a million dollars -- that is correct that you must also
17 meet criteria for this year's tax liability. You must meet,
18 beginning in 1985, 85 percent of current year's tax liability.

19 Senator Byrd. Instead of what?

20 Mr. Chapoton. Instead of -- I believe it is 80 percent.
21 Let me check that. It's rising to 80 percent. It will be
22 80 percent under current law in 1984. This would take it
23 up to 85 and 90 percent in the following two years.

24 Senator Bradley. Mr. Chairman, getting back to the
25 point. As I understand it, it's not the intent here to

1 penalize the firm that has, because of the nature of its
2 business, the bulk of its revenues coming in in the first
3 quarter. Couldn't we make some kind of technical correction
4 here that would at least assure some fairness across differ-
5 ent industries and different companies? I know that I have
6 raised this with Joint Tax. And as I understand it, there
7 might be a way to work it out.

8 Mr. McConaghy. I think we have been looking at it,
9 Senator Bradley. And we might take care of that minor
10 problem for you. Yes. We will bring something back to you.

11 Senator Bradley. Okay. So you will have something
12 later today?

13 Mr. McConaghy. Yes, Senator Bradley.

14 Senator Mitchell. The purpose of this has been stated
15 as equalizing corporate plans with self-employed plans. And
16 also to reduce the maximum benefit for higher income persons.
17 And in response to Senator Bradley's question, Mr. McConaghy
18 said that persons below the cap could continue to make their
19 contributions. That's obviously true. The question is is
20 there any way in which adoption of this proposal could
21 have an adverse impact on those who participate in such
22 plans below the cap?

23 Mr. McConaghy. Well, I think it could in this sense,
24 Senator Mitchell. If I, today, were an employer and I
25 had two plans -- a defined benefits plan and the defined

1 contribution plan -- and I had the maximum so that I was
2 funding for myself an amount which I would be able to retire
3 with an annual amount of \$136,000.00 at age 55, and that
4 plan were integrated with Social Security so that I got
5 credit in that plan for the amount of Social Security
6 benefits the rank and file were going to get, and then I had
7 an additional plan on top of which was a defined contribution
8 plan -- and in that plan I could put away that extra 40
9 percent, but in that plan I would have to provide certainly
10 an amount -- the same percentage of pay for the rank and
11 file as well. Now to the extent that I am putting away
12 \$18,000.00 in that plan, and perhaps an amount for rank and
13 file in that plan--we would have to give you salary ranges
14 and so forth--and the cap went down from 1.4 to 1.25, if I
15 wanted to as an employer, I could continue with the rank and
16 file as I had in the past. However, because I might not be
17 able in that second plan to put away quite the \$18,000.00
18 but a quarter of 45, essentially, which would be about
19 \$10,000.00, I may cut proportionately the people that are in
20 that second plan in the defined contribution plan.

21 I think if we showed you some figures that would be a
22 very minor amount. It would be up to me as a decision on
23 whether I wanted to cut the rank and file. And I certainly
24 wouldn't have to. And it wouldn't be any more expensive to
25 maintain it. But what I would be saying is well, if I can't

1 get that extra 40 percent, why should I give that amount to
2 the rank and file.

3 Senator Mitchell. So one possible consequence, one
4 possible consequence, is the dropping of plans that now
5 provide coverage for lower and middle income persons, who
6 would then be uncovered as a result of that. What you are
7 saying is you can't assess how widespread that would be, but
8 you have identified that as a possible consequence. Is that
9 correct?

10 Mr. McConaghy. That's a possible consequence. There
11 would only be 200,000 people in that category with that
12 second plan that are over that 1.0. And they wouldn't, I
13 don't think, drop it if you went to 1.25. They would
14 perhaps just lower the amount in that second plan by 15
15 percent of the amount you could put in that second plan.

16 I think we could show you calculations where that
17 amount is very minor. And in that second plan, when we
18 ran numbers on it, I think about 95 percent of the benefit
19 goes to the top paid. And 5 percent perhaps in that second
20 plan, under existing rules, goes to the rank and file. So
21 I don't think they would necessarily drop it. And it
22 wouldn't cost them anymore to maintain it at that level.

23 Senator Bradley. I just want to again clarify. Is
24 there anything in present law that would prevent you from
25 dropping the amount that you set aside for lower income

1 persons in your company if you chose to do it? My guess is
2 that there isn't anything in law that prevents you from doing
3 that if you choose to do that. So my question is is what you
4 just said that you think that because we are reducing the
5 cap for the upper income individual then there is a
6 possibility that in retaliation for him or her not being able
7 to get her pension put away bigger -- that they might
8 retaliate by cutting lower income individuals? As I
9 understand it, that could happen now.

10 Mr. McConaghy. That's correct, Senator Bradley.

11 The Chairman. That hasn't changed.

12 Senator Mitchell. No. But the incentive to do so may
13 be increased as a result of the change. Isn't that correct?

14 The Chairman. It's very minor. There were full page
15 ads that were going to scuttle the whole program if we
16 even touched this. That was those upper cats who didn't
17 want to --

18 Senator Mitchell. Could I just continue, Mr. Chairman?

19 The Chairman. Sure.

20 Senator Mitchell. And I would like to ask you, Mr.
21 McConaghy, and, Mr. Chapoton, is there any other conceivable
22 way, in your judgment, that adoption of this proposal might
23 affect persons in covered plans now contributing below the
24 cap? The middle income, the working person. In other words,
25 I understand the intention of this is not directed at persons

1 in that category. But is there any way, indirect or direct,
2 that they could be adversely affected by adoption of this
3 proposal?

4 Mr. McConaghy. There is no direct way. That's correct,
5 Senator Mitchell. Indirectly, as Senator Bradley said, if
6 they wanted to make that kind of adjustment, they certainly
7 could.

8 Senator Mitchell. I understand that. In addition to
9 the possibility, which you have just described, is there any
10 other way in your judgment?

11 Mr. Chapoton. No, Senator. I think there is no other
12 way. The question you addressed and the question Mr.
13 McConaghy addressed is the one that is constantly raised
14 however. That is, whether by dropping the amounts that the
15 upper paid can provide -- whether they will either terminate
16 a plan or fail to put in a plan because they lack the
17 incentive to do so.

18 Senator Mitchell. Right. And you say, Mr. McConaghy,
19 that you have some figures on that?

20 Mr. McConaghy. We could show you, Senator Mitchell,
21 where in the present situation where people maintain two
22 plans -- they are obviously going to vary based on age and
23 so forth, but in those that go over 1.0 today -- what the
24 kind of typical benefit would be for the rank and file. And
25 the typical benefit for essentially the people at the top.

1 And how, if any, that would change if the employer decided
2 he wanted to cut a little bit down below. And I think we
3 would probably conclude that 90 to 95 percent in that second
4 plan is going to end up with that top employer. And that's
5 assuming that everybody down below fully vests.

6 Senator Mitchell. Could I ask one further question
7 about the loan provision? I understood you remarks, Mr.
8 McConaghy, that a person in a self-employed plan or an
9 individual in a KEOGH plan cannot borrow.

10 Mr. McConaghy. That's correct, Senator. Last year
11 we made the change that no one in an H.R. 10 KEOGH could
12 borrow.

13 Senator Mitchell. And under the corporate plan they
14 can. And it has been suggested that one of the abuses is
15 that they make a large contribution and then borrow it back
16 and get the tax deferred on it until the money is received.
17 And also deduct the interest.

18 If that is the case, why are we simply placing a limit
19 on outstanding loans if the purpose is to make the two
20 separate programs as equal as possible, which we are doing
21 by reducing the maximum contribution for corporate plans,
22 and increasing the maximum contribution for individual plans
23 so that by 1985 they will be the same amount? Why not go all
24 the way on loans? What is the rationale for \$10,000.00?

25 Mr. McConaghy. I think the judgment, Senator Mitchell,

1 was that in certain kinds of plans, a cash and carry plan
2 or a thrift plan, some had maintained that unless there was
3 some provision for limited borrowing that people would not go
4 into those two plans. I think that some also felt that with
5 respect to pension plans that were not thrifts or cash and
6 carries that some do have loan teachers even though many
7 are not utilized at this point for smaller amounts. And that
8 if you permitted some principal amount outstanding, but no
9 greater than that, that would be a way to resolve it and
10 allow that limited portion.

11 Another way to deal with it certainly would be just to
12 prohibit the loans or to prohibit the loans for key employees
13 where many feel the major abuse is. But it was decided
14 that because of many people saying that with respect to
15 cash and deferred and thrifts that they just wouldn't go
16 into the plan, the rank and file, unless they had the
17 opportunity to borrow a limited amount. It was decided that
18 \$10,000.00 would be permitted as an outstanding principal
19 amount and no more.

20 Senator Mitchell. Would you define for me what you
21 mean by "cash and carry" and "thrift plans"?

22 Mr. Chapoton. Senator, that's basically a plan that
23 an employee has an option of putting amounts in rather than
24 current salary.

25 Mr. McConaghy. He can pick and choose.

1 The Chairman. That is agreeing with Senator Bentsen
2 in parts. Some of these areas, before we just start making
3 arbitrary changes, we want to be certain we know where we
4 are. And that is probably an area that should be addressed.
5 But we thought at least we could take this on small steps
6 without any adverse impact. Just cut off one of the abuses.
7 I think you make a good point.

8 Senator Mitchell. Well, I was just trying to get at
9 the rationale for it. How was the figure of \$10,000.00
10 arrived at?

11 Mr. Chapoton. The \$10,000.00 is an arbitrary figure,
12 I would assume, Senator Mitchell. The concern is not only
13 the abuse case but these are supposed to be for retirement
14 and if they are borrowed out, they are obviously not
15 available for retirement. But there is a very legitimate
16 concern. We worried that some employees will not go into
17 these plans without a possibility of a loan provision for
18 needs for education or for other hardship provisions. And so
19 some minimal amount of borrowing seems desirable, provided
20 it doesn't undermine entirely the retirement factor of the
21 plan.

22 Mr. McConaghy. Senator Mithcell, one point I meant to
23 mention. On the H.R. 10 plans, the rank and file essentially,
24 the non-owner or the non-partner can today borrow. We did
25 not prevent that last year.

1 Senator Mitchell. Is it limited in any way? Is there
2 a dollar limit on it?

3 Mr. McConaghy. Under this bill, it would be limited to
4 say that you couldn't have an outstanding principal balance
5 of more than \$10,000.00.

6 Senator Mitchell. No, I mean, prior to this. You just
7 said that under existing law persons -- rank and file as
8 you described them -- under an H.R. 10 plan can borrow.

9 Mr. McConaghy. They can borrow.

10 Senator Mitchell. Is there any limit on that now?

11 Mr. McConaghy. No, Senator, there is not.

12 Senator Mitchell. It's unlimited?

13 Mr. McConaghy. That's correct.

14 Senator Mitchell. I see.

15 Senator Long. Mr. Chairman.

16 The Chairman. Senator Long.

17 Senator Long. Are you through, Senator Mitchell?

18 Senator Mitchell. Yes.

19 Senator Long. David Hardee of our minority staff
20 presented questions to me that I would rather he ask.

21 The Chairman. Sure.

22 Senator Long. I would suggest that Mr. Hardee ask the
23 questions.

24 The Chairman. Go ahead, Dave.

25 Mr. Hardee. Yes, Mr. Chairman. In looking at these

1 proposals, there are several things that we would rather
2 not decide at the staff level because we think they are
3 senatorial type decisions that just occurred to me.

4 One is that you stated -- and it is applaudable that
5 you are increasing the KEOGH limit up to the corporate
6 limit so that we have parity. I assume by that you also
7 want to bring KEOGH under the same increase ceiling that
8 the corporate plans would have. Is that true? That is
9 different from current law. That is why I bring it to your
10 attention. So that KEOGH, after two years, will increase
11 the same way that the corporate plans will increase.

12 Mr. McConaghy. That will be the issue I think, Senator
13 Dole, that we referred to as to whether or not we would
14 index essentially those limits similar to the indexing of
15 the corporate limits. The suggestion was to freeze it for
16 two years at the lower limits, and then index it to Social
17 Security. I think there are certainly good arguments to be
18 made to go ahead and make that change.

19 The Chairman. But I might say that we decided not to
20 do it for two years on the theory that we would be
21 addressing the same issue, the larger issue, in Social
22 Security after the Advisory Commission reports. And then we
23 would use that same formula index. But they should be the
24 same.

25 Mr. Hardee. And you would use the Social Security

1 increase as being the increase?

2 The Chairman. Well, that's what we have in mind.

3 Mr. Hardee. Okay. One of the reasons we need -

4 Senator Mitchell. Just a minute. What is the answer
5 to your question? That the increase would apply to all
6 plans, individual as well as corporate?

7 Mr. McConaghy. If you made this change, Senator
8 Mitchell, then with respect to the non-corporate plans, there
9 would be parallel indexing with the corporate plan.

10 The Chairman. Parity.

11 Senator Baucus. At this point, what do you mean by
12 Social Security increase?

13 Mr. Hardee. Okay, Senator Baucus. If you look at
14 current law, it says that this ceiling will increase the
15 same way that the Social Security payments increase.

16 Senator Moynihan. At the same percentage rate.

17 Mr. Hardee. And then if you look at the Social Security
18 law, the Social Security law says increases with the cost of
19 living rate.

20 Senator Baucus. So the increase would be the same
21 rate as the Social Security benefit increases?

22 Mr. Hardee. Yes. Now under the Republican proposal
23 there would be a flat two year freeze on that. And then I
24 assume -- does it then follow the Social Security formula?

25 Mr. McConaghy. And I think the answer would be we would

1 provide the same parallel indexing, if that were the wish
2 of the Committee.

3 Senator Baucus. So I understand this. Would the Social
4 Security increase by the CPI increase? Or the amounts at
5 which the Social Security benefits increase?

6 Mr. Hardee. Okay. Current law in the Internal Revenue
7 Code says it will increase by the way benefits increase.
8 They are proposing that you freeze it for two years.

9 Senator Moynihan. Mr. Hardee, you are using the word
10 "way" in a way that we don't understand. You mean the rate
11 of the amount?

12 Mr. Hardee. That's correct.

13 Mr. McConaghy. That Social Security index is
14 basically the CPI index, just using a different quarterly.
15 The same index.

16 Senator Baucus. So you take the CPI and index it at
17 100 percent.

18 Mr. McConaghy. Quarterly. That's correct.

19 Senator Baucus. So if you changed that index, it
20 would change. If you didn't, it would stay the same.

21 Mr. Hardee. The point I am making, Senator, is that
22 if we did nothing on this cap here, but then you come along
23 and you solve your Social Security problem by putting a
24 ceiling on Social Security benefits, that same ceiling would
25 then apply here without any other legislation.

1 Senator Baucus. Right.

2 Mr. Hardee. Okay. Senator, one of the reasons that
3 we want to bring KEOGH up to corporate plans is to have
4 parity and to keep lawyers and doctors from incorporating
5 themselves. Once we bring this up to parity, there are
6 going to be a lot of lawyers and doctors who are incorporated
7 who don't want to be incorporated anymore. And we would like
8 to be able to give them an out so that they can get rid of
9 their corporations and go back under normal law. That will
10 take a number of series of complicated amendments. But we
11 would like some direction to let the staff work that out so
12 that corporations -- so we can get rid of all these
13 professional corporations.

14 The Chairman. That's fine with me. If you can work
15 it out at the staff level and then submit it to us, we will
16 take a look at it.

17 Mr. McConaghy. I think we would have to do a lot of
18 work on that and then bring something back.

19 The Chairman. Right. We may not be able to put it in
20 this.

21 Senator Long. Well, the point is if we had had the
22 law the way you made it, they wouldn't have incorporated to
23 begin with. And so while we are passing it, we ought to go
24 ahead and provide a way that they can unincorporate, and
25 get back to the way we think they should have been.

1 The Chairman. Can you do that in time?

2 Mr. McConaghy. Yes. The thrust of this is to try to
3 get more parity. And certainly we could try to work that out
4 and bring something back to you, Mr. Chairman.

5 The Chairman. We will have a week of drafting time and
6 maybe we can do it.

7 Senator Chafee. Mr. Chairman.

8 The Chairman. Senator Chafee.

9 Senator Chafee. Mr. McConaghy, aren't there problems
10 with that in that as I understood the rationale of the
11 KEOGH originally, the reason that the limits were kept --
12 and indeed there is a difference here in that under the
13 qualified contribution plan it is 25 percent, whereas under
14 the KEOGH it is 15 percent. And as I understood the
15 rationale, the reason the KEOGH originally was kept so
16 low, not only in the amount -- \$7,500.00 and now \$15,000.00 --
17 was to encourage people to go into the qualified plans so
18 that their employers would -- they would have to create a
19 plan for their employees as well. Is that correct?

20 If you have a KEOGH now, you are
21 an individual practitioner or lawyer, presumably, you have to
22 make KEOGHs available for the employees, but that doesn't
23 mean you make any contributions to those.

24 Mr. McConaghy. There are different rules, Senator
25 Chafee, with respect to KEOGHs, depending upon whether it's

1 an owner-employee plan or a non-owner-employee plan. And
2 they do require different standards of eligibility and
3 different standards of vesting in the number of other things
4 that are different with respect to corporate plans.

5 Those rules generally require faster vesting in an
6 owner-employee plans. That's one where there is essentially
7 a 10 percent shareholder or partner. Those are different
8 than the vesting rules with respect to corporations.

9 I think that if we were going to do what was suggested
10 we would have to bring some modifications back to you. But
11 there are rules that do attempt in the H.R. 10s to make sure
12 that the rank and file have benefits as well as the top
13 people.

14 Senator Chafee. Well, in brief, my concern is that
15 by making the KEOGH as attractive as the qualified plan, you
16 are possibly encouraging the sole owner to proceed on his
17 own and leave out his employees.

18 Mr. Chapoton. No, Senator Chafee. If I could address
19 that. Historically, I think there was a concern that
20 partnerships and sole proprietorships would benefit only
21 themselves and not their employees. But, in fact, there is
22 no reason that will occur anymore under that form of
23 business organization -- partnership or sole proprietorship --
24 than it might under a single man corporation. The purpose of
25 the qualified plan area is to cover a broad range of

1 employees. You want that whether it is a partnership or a
2 corporation.

3 There was a feeling that I think is not justified that
4 in the sole proprietorship or in corporations there would be
5 fewer common law employees covered. But there is no reason
6 to assume that.

7 Both plans -- both corporate plans and self-employed
8 plans -- require that the common law employees be covered.

9 Mr. McConaghy. I think, Senator Chafee, what is being
10 suggested here is that we try to take a look and make sure
11 that we can achieve as much parity as possible. We can work
12 in the H.R. 10 professional corporation area. There is
13 certainly a concern, as Mr. Chapoton stated, that in those
14 plans there are not the benefits provided for the rank and
15 file. I assume that the Committee would not want to let one
16 individual incorporate himself and not cover anybody who
17 would otherwise be employees. I think we need to take a long
18 look and try to mesh together essentially so that there is
19 protection for the rank and file. And we would be glad to
20 work on that and bring something back to the Committee.

21 Senator Mitchell. Isn't that a good argument for not
22 acting on this today?

23 Mr. McConaghy. With respect to the H.R. 10 portion, I
24 think you would need a proposal. I think those things have
25 nothing to do with the first part, which are the limit

1 changes, Senator Mitchell.

2 Senator Mitchell. I think you have just made a very
3 eloquent statement as to why we shouldn't act on this. Maybe
4 we should have hearings.

5 Senator Bradley. Also, wouldn't you need a proposal
6 on the question that Mr. Hardee raised before we can really
7 decide that?

8 Mr. McConaghy. Really, the harder part of this is what
9 has been made as a suggestion here with respect to H.R. 10s
10 and the big corporate plans to try to achieve that parity.
11 That portion of it we are going to have to work on. If we
12 try to follow through with this suggestion, that will
13 require some work. The other issue here that is complicated
14 is integration. And we are not dealing with that. We were
15 not attempting to achieve full parity on H.R. 10s, but we
16 can try to bring something back to you. But that really
17 is not related to the other changes.

18 Mr. Hardee. And Mr. McConaghy meant parity in terms of
19 the top limits, not all the other rules, because they are
20 too extensive to do this morning, I would think.

21 I only had two other comments, Mr. Chairman. You have
22 got actuarial reduction from 55 to 62. A lot of large
23 corporate plans don't base retirement on a retirement age,
24 but rather years of service so that when an employee has
25 30 years of service, he gets X benefit, regardless of his age.

1 And I assume that you don't want to cut back on that years
2 of service requirement.

3 The Chairman. Right.

4 Mr. McConaghy. We are not requiring under this
5 proposal actuarial reductions. It's only the dollar amount
6 that is reduced. And we have reviewed the plans and made --

7 Mr. Hardee. So as long as you have your years of service
8 in and your retirement plan relates to years of service, then
9 there is no cut back even though you may have 30 years at
10 55 or you may have 30 years at 62?

11 Mr. McConaghy. That's correct.

12 Mr. Hardee. You get the same benefits?

13 Mr. McConaghy. That's correct.

14 Mr. Hardee. And I had some questions on the 1.4 rule.
15 I had a lot of large employers come in to me and they said
16 that that would affect the rank and file if you cut it back
17 to one and a quarter. And they suggested an alternative,
18 which would be to have a 1.4 rule, but not let the
19 contribution to the plan each year exceed 25 percent of
20 compensation. Just look at the tax return and take
21 compensation, and whatever you contribute to your corporate
22 plans could not exceed 25 percent of that and get a
23 deduction. And it seems to be the thought that that would
24 have less effect down the line on the lower paid employees.

25 The Chairman. I don't want to criticize any upper paid

1 employees. I'm not so certain they are concerned about the
2 ones down the line. And we made minimal changes in this
3 provision. And we understand that the primary groups were
4 not objecting to the change to 1.25. They would rather not
5 do it but I don't know if that is an acceptable change or not.
6 I don't think so.

7 Mr. McConaghy. I think, Mr. Chairman, this, of course,
8 takes that down only as to the dollar limits -- the 1.4 to
9 the 1.25. Directly, that would only affect, we feel,
10 200,000 people. I mean there are only 200,000 people that
11 really are in the situation that would be affected by that
12 out of 45 million.

13 I think the suggestion made as a percentage of comp
14 may, in fact, impact more on the rank and file in the
15 hundred corporation area. And so I would think we would
16 want to explore that change before we did it. No one wants
17 to reduce their benefits. But it wouldn't go down to 1.0.
18 Certainly in that other bill, it would have more affect
19 on the outside.

20 The Chairman. Senator Bentsen.

21 Senator Bentsen. Mr. Chairman, at the appropriate
22 time, I would like to introduce an amendment for the funding
23 of annuities for clergymen by church foundations. Now this
24 is one that you are a co-sponsor of. And so is Senator
25 Chafee and Senator Mitchell.

1 The Chairman. Does it cost me anything?

2 Senator Bentsen. No. It has little or no revenue
3 impact, as I understand it. We did, on the Section 403(b)
4 annuities as done by the foundations -- I think that the
5 Treasury is in concurrence with this that they did not mean
6 to preclude those on their ruling that was done in, I
7 believe, March of this year. Now we had some other
8 differences but I think most of them have been worked at.
9 And at the appropriate time I would like to pose that
10 amendment.

11 The Chairman. Could I just ask Mr. Chapoton?

12 Mr. Chapoton. Mr. Chairman, as I understand it, if it
13 is limited, as we discussed -- I want to familiarize myself
14 with it again. If it is limited to that one issue, we would
15 have no objection.

16 Senator Bradley. How do you define "clergymen?" Is
17 it someone who is actually working or someone who has
18 graduated from divinity school?

19 Mr. Chapoton. I think the present law does result in
20 a discrimination in certain cases on clergy on the one hand
21 as distinguished from other employees or entitled to
22 benefits under 403(b) plans -- employees of educational
23 institutions. There is a definite problem in that they have
24 less benefits and we were trying to correct that situation.

25 Senator Bentsen. Well, this allowed -- 1910 allowed

1 some catch-ups.

2 Mr. Chapoton. The catch-up is the point we are agreeing
3 to.

4 Senator Bentsen. The catch-up and that they can do the
5 funding of such annuities. They are not precluded from these
6 church foundations or not? The provisions of 1910, as we
7 have tried to work them out with Treasury, is what I am
8 talking about. And I think you pretty well worked them out.

9 Mr. Chapoton. Yes. We had some problems with some of
10 the provisions of 1910, but those --

11 The Chairman. I think on that basis why don't we assume
12 that the amendment is accepted. And then if there is a
13 problem, you raise a problem with it.

14 Senator Bentsen. All right.

15 The Chairman. Mr. Chapoton?

16 Mr. Chapoton. Yes. We will be happy to do that, Mr.
17 Chairman.

18 The Chairman. Mr. Hardee, do you have further
19 questions.

20 Mr. Hardee. No further questions.

21 The Chairman. All right. Next?

22 Senator Baucus. Can this proposal index contributions
23 under KEOGHs as well as the corporate?

24 The Chairman. Yes. After two years.

25 Senator Baucus. Second, I was wondering what effect,

1 if any, this proposal will have on those employees subject
2 to mandatory early retirement provisions like policemen,
3 airline pilots, firemen and so forth? Does this proposal
4 have any adverse effect at all upon them?

5 Mr. McConaghy. Well, the ceiling would be reduced from
6 \$136,000.00 to \$90,000.00, Senator Baucus. But they are no
7 where near the \$90,000.00 per year ceiling.

8 Senator Baucus. So it in no way affects them?

9 Mr. McConaghy. Not at the present time. No.

10 Senator Baucus. The employees I was talking about?

11 Mr. McConaghy. That's correct.

12 Senator Bentsen. Mr. Chairman, I have another
13 technical amendment that has passed this Committee but has
14 not resulted in legislation. And that was the question on
15 the judgeships in Texas. And I believe that Treasury had
16 no objections to this.

17 Mr. Chapoton. This is the same provision that we have
18 been through before? We have had no objection.

19 The Chairman. Without objection.

20 Mr. McConaghy. The next item deals with the medical
21 and casualty deductions. Today, with respect to a
22 casualty loss, I am entitled to a deduction, if the
23 casualty is incurred and the amount is over \$100.00, and
24 that amount is not reimbursed by insurance.

25 So if, for instance, I suffer a \$4,000.00 loss, and I

1 am not paid by insurance for that loss, then I can deduct
2 \$3,900.00, the amount above \$100.00. The first change here
3 would say that we are going to make a modification to the
4 casualty loss deduction provision so that deductions would
5 now be permitted with respect to losses, first, over \$100.00,
6 and then more than 10 percent of the adjusted gross income
7 of the individual.

8 In addition to that, with respect to medical deductions,
9 today, I am entitled to deduct one-half of the medical
10 premium that I pay up to \$150.00. In addition, with
11 respect to drugs, I can take that portion of drugs over
12 1 percent, throw it into a larger pool, and to the extent
13 that my other medical expenses exceed 3 percent of adjusted
14 gross income, I am entitled to a deduction.

15 The change with respect to medical expenses here would
16 raise essentially that 3 percent floor to 10 percent so that
17 I would be entitled to a deduction for medical expenses
18 unreimbursed to the extent they were more than 10 percent of
19 my adjusted gross income. But the deduction for the
20 medical premium equals to one-half of the medical premium
21 I pay up to \$150.00 would be retained.

22 Senator Byrd. Let me ask you this, if I may. Let me
23 give you an example. If a person earning \$40,000.00 owns a
24 home and there is damage to the home -- casualty loss of
25 say \$10,000.00 -- under this, he would be permitted to deduct

1 only \$4,000.00 of that loss.

2 Mr. McConaghy. It depends on what his adjusted gross
3 income would be, Senator Byrd.

4 Senator Byrd. Well, if his adjusted gross income is
5 \$40,000.00.

6 Mr. McConaghy. Then 10 percent of that would certainly
7 be \$4,000.00. And he would be entitled to deduct that
8 portion of his loss above the \$4,000.00. In your case,
9 \$6,000.00.

10 Senator Byrd. Oh, the amount above \$4,000.00 would be
11 deductible. He would have to absorb the first 10 percent
12 of his adjusted gross income.

13 Mr. McConaghy. Exactly.

14 Senator Bradley. Mr. Chairman.

15 The Chairman. Senator Bradley.

16 Senator Bradley. So basically this means that people
17 have to pay more for medical care. Right?

18 Mr. McConaghy. I don't know how to answer that,
19 Senator Bradley. I would say they would not have to pay
20 more for medical care. Obviously, to the extent they have
21 medical insurance and get reimbursed today, they do not get
22 a deduction for that. It is only for the portion of the
23 medical loss that is unreimbursed that they get a deduction.

24 Senator Bradley. And this would allow a deduction for
25 a larger portion of unreimbursed or smaller proportion?

1 Mr. McConaghy. Smaller portion, depending upon their
2 adjusted income, Senator Bradley.

3 Senator Bradley. So that because they could reduce
4 their taxes by a smaller amount, that means that they would
5 end up paying more for medical coverage? Right?

6 Mr. McConaghy. I think that's correct.

7 The Chairman. It's a little effort and a flat rate
8 tax.

9 Senator Bradley. Yeah, well, this sets the stage for
10 a very reasonable discussion. And that is if you are going to
11 force people to pay more for medical programs, if you are
12 going to deny them the kind of help that you have given them,
13 what are they getting in exchange? And I would argue that
14 if they are getting significantly lower tax rates that this
15 might be a reasonable approach. The fact is that they are
16 not getting significantly lower tax rates, which raises the
17 question about the way you cut taxes is important and not
18 just the cutting of taxes. And this particular provision
19 in the context of dramatically lowering the marginal rate
20 might make some sense. What it simply means is you are
21 raising the amount people have to pay for their medical
22 services. And I, frankly, don't think in this context it is
23 the fairest kind of proposal that we could make. I under-
24 stand that it generates some revenue. But it's the linking
25 of the reduction of marginal tax rates with the elimination

1 of loopholes that is absent in this whole exercise.

2 What we are engaged in is an attempt to close loopholes
3 with a stick because essentially -- not many people will
4 agree on this Committee, I guess -- but because of a tax
5 bill that was not thought through. And it produced this
6 recession. So now we are coming back to try to raise taxes
7 selectively on people across the board. And we happen, in
8 this case, to be raising taxes on those people who don't
9 have sufficient medical coverage and will have to pay more
10 for their medical expenses. So I think this is a perfect
11 example of where it is -- in the proper context this might
12 be appropriate, but it is certainly, in my view, not
13 appropriate in this context.

14 Mr. Chapoton. Senator Bradley, if I might just
15 comment. The 3 percent of existing law -- it has been in the
16 law for many, many years. It was designed to say that when
17 medical expenses are in the catastrophic nature or
18 unusually large then some tax benefit would be given. I
19 think the logic of raising that floor is that medical
20 expenses have increased significantly. And that an
21 unusually high degree of medical expenses would call for a
22 higher floor.

23 It also seems appropriate to do something of this
24 base broadening category when we are having marginal rate
25 cuts. As you well know, we are having a 10 percent rate

1 cut starting today, and another 10 percent next year.

2 Senator Bradley. Yes, well, I would argue that if
3 this kind of change in the medical deduction was made in the
4 context of a competition bill or medical care in the country
5 it might make some sense. But it isn't. It's being done
6 to plug a gap in budget that is created by the recession
7 essentially.

8 And my second point is, yeah, we are getting a little
9 marginal rate reduction. But the marginal rate reduction
10 is insignificant. The fact that we haven't taken a bold
11 enough action to cut marginal rates only is the result of
12 our Committee in trying to eliminate credits, exclusions
13 and deductions. So here we are kind of nibbling around the
14 edges in a way that, in my view, hurts people who are out
15 there trying to make it with rates with very little
16 reduction in taxes.

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1 Senator Bradley. Yes, well, I would argue that if this
2 kind of change in medical deductions was made in the context
3 of a competition bill for medical care, in that case it might
4 make some sense. But it isn't. It is being done to close
5 a gap in the budget that is created by the recession,
6 essentially.

7 My second point is that, yes, we will get a little
8 marginal rate reduction, but marginal rate reductions is
9 insignificant. The fact is we haven't taken a bold enough
10 action to set a marginal rate, only as a result of our
11 timidity in trying to eliminate a present solution to the
12 deductions.

13 So here we are, kind of nibbling around the edges in
14 a way that, in my view, hurts people who are out there
15 trying to make it with very little reduction in taxes.

16 Let's say you have a catastrophic medical problem, and
17 you don't have access to health insurance. Right now you
18 would be able to deduct over 3 percent of your gross income
19 in expenses if the expenses exceeded 3 percent. What you
20 are telling that person now is, "You have got to get to
21 10 percent." Now, what is he getting for the increased
22 medical costs that he will be incurring? The answer is --
23 you have just given it to me -- \$2 a week in a tax reduction,
24 or \$4 a week in a tax reduction. That is not sufficient.

25 If he was getting \$50 a week in a tax reduction; if his

1 marginal rate was dropped not to 50 percent but to 14 percent
2 you might be able to argue that point. But it is not
3 credible in this context, as are a number of these actions
4 that the committee is considering.

5 So that is something that we will evidently discuss
6 from time to time. But I think it applies to a number of
7 the measures that are coming to the committee now. The
8 result is that people are going to be paying more for their
9 medical expenses, that the older person out there, or the
10 working family that didn't get the health insurance that
11 they wanted, that aren't union members and therefore not
12 covered, are going to have to pay 10 percent of their
13 income for health expenses now without any deduction
14 whatsoever, as opposed to 3 percent.

15 MR. CHAPOTON. Well, Senator Bradley, we should keep
16 in mind also that about 68 percent, near 70 percent, of
17 taxpayers do not itemize.

18 You are correct on the point that if someone has a
19 catastrophic illness, from 3 to 7 percent will be
20 nondeductible, and therefore that portion of the medical
21 cost will increase.

22 The main benefit of the medical expense deduction, of
23 course, is middle and upper income taxpayers who do itemize
24 deductions already.

25 Senator Long. Well, Mr. Chapoton, you are talking

1 about that most people don't itemize. But any poor soul
2 who has a catastrophic medical expense is going to itemize,
3 isn't he?

4 Mr. Chapoton. A catastrophic illness would presumably
5 put him into an itemizing category, and this would cut back
6 somewhat the benefit of the deduction.

7 Senator Bradley. But this doesn't improve health care.
8 This doesn't improve the financial circumstance of the person
9 who has got to pay more. All it does is plug a revenue gap
10 that has been left by a recession. I mean, that is all we
11 are doing here. We are trying to plug a revenue gap that
12 has been created by a recession. And, if you want me to
13 go through, we all know why we are in the recession.

14 Senator Long. Well, I think we understand the arguments
15 for and against.

16 Mr. McConaghy. The next item deals with original
17 issue discount and coupon stripping. Essentially the
18 proposal would legislatively do what the Treasury
19 regulations that were issued recently accomplish, and that
20 is they would provide that the formula for the inclusion of
21 interest and the deduction of interest would be changed to
22 reflect actually how that annual interest is earned. Today
23 that is not the formula; the formula is just pro rata. As
24 a result, a number of zero-discount bonds have been going
25 out, taking advantage of the provision that exists under

1 current law.

2 The second change deals with what we call so-called
3 coupon stripping, where essentially I buy a bond and I
4 strip off the coupons and, let's say, hold them. I sell
5 the bond. I obviously am going to sell the bond at a loss
6 if I allocate all my basis of the bond to the naked bond,
7 and, correspondingly, take the loss in this year and not
8 have the income until a later year. So this also follows
9 the regulations that Treasury issued.

10 Under the change in the statute that is suggested here
11 with respect to original issue discount, the change would
12 be made as of May 3, 1982 -- that's the date of the Treasury
13 regulations. As to coupon stripping, that date would be
14 June 9, the same as the press release on those. They
15 really were press releases of the Treasury, not changes in
16 regulations.

17 Senator Bentsen. Mr. Chairman, if I might comment on
18 that, I certainly think the law ought to be changed, too.
19 But it does require the law to be changed. And I am one
20 who has historically been against retroactivity in these
21 situations, that we ought to do it from the date that this
22 committee starts its consideration or acts on it.

23 Frankly, instead of doing it by press release where you
24 would have every lawyer and every tax accountant trying to
25 check out every press release that is coming out, we ought

1 to be doing it when the Congress itself starts the
2 consideration of it.

3 Frankly, I think the date, as I think in each of these
4 instances, ought to be at that point rather than
5 retroactively. Instead of May the 3rd, I think it ought to
6 be as of today. And I sure think the law needs changing.

7 Mr. Chapoton. Mr. Chairman, if I might respond to
8 that, I think we all agree that the law does need to be
9 changed. This was -- addressing specifically the major
10 problem, the original issue discount proposal -- simply
11 a glitch in the law that should not have been there.

12 The result was that issuers of obligations learned that
13 they could greatly accelerate the deduction of interest by
14 issuing zero-coupon bonds.

15 We got a number of calls that something had to be
16 done because a great volume of zero-coupon bonds were being
17 issued, and they had no choice but to issue them because of
18 the tremendous tax benefit that would be involved.

19 Had we stated a prospective date, there would have been
20 a significant volume of bonds issued after that date. I
21 thought, in most quarters, a date on the effective date of
22 the announcement which was, I think, expected in many
23 quarters, indeed welcomed in many quarters, was appropriate.
24 Had we been prospective, we would have had a real problem
25 on our hands.

1 Senator Moynihan. Wouldn't you have accomplished your
2 purpose, and couldn't we maintain our regular order which
3 would be to make this date July 1, inasmuch as your press
4 release has the inhibiting effect which you intended?

5 Mr. Chapoton. Well, I don't know, Senator. I would
6 be concerned about the transactions that went forward during
7 that interim period, banking on some delay in the effective
8 date. The proposal would give a deduction for the real
9 interest rate. We are not talking about denying a
10 deduction. Whatever non-tax benefits exist for these
11 transactions would continue to exist; but you would not
12 be able to get a deduction for more than the actual interest
13 cost.

14 Indeed, using zero-coupon bonds, the deduction in the
15 early years can far exceed even the amount of principal
16 obtained by the borrower.

17 Senator Moynihan. Are you saying that would matter to
18 us? Of course, in some measure the good faith of the
19 Treasury Department is involved here, or your reputation
20 for plain dealing. If it is, obviously we want to do right
21 by you.

22 Mr. Chapoton. Well, we certainly were dealing in good
23 faith, and we think that it was an appropriate announcement
24 date -- effective date.

25 Senator Bentsen. I just don't believe that we ought to

1 let the Treasury do these things by press release. I really
2 think it is something for us to do when you are talking about
3 a change in the law, and you get into a retroactive situation.
4 I frankly don't like to see that type of thing done, and
5 traditionally we don't do it. There are rare exceptions.

6 Senator Moynihan. Well, the Chairman does it sometimes.

7 The Chairman. Put that on -- "Oh, right." Like
8 leasing?

9 I understand the problem on this, and I think we can
10 just reserve on it. We will discuss it maybe over the
11 lunch hour with you.

12 Senator Bentsen. I have no question at all that the
13 law should be changed. I think it should. It is just a
14 question of my traditional opposition to the retroactivity.

15 Senator Mitchell. Mr. Chairman, I would like to
16 express my support of the sentiment expressed by Senator
17 Bentsen.

18 Mr. DeArment. The next item deals with the Federal
19 Unemployment Tax. The proposal, effective January 1, 1983,
20 would raise the CETA wage base from \$6000 to \$7000, and the
21 tax rate would be increased from 3.4 percent -- Federal Tax
22 rate -- to 3.5. That would have the effect, in those states
23 that have a less than \$7000 wage base, that those states
24 would bring their wage bases for state unemployment tax
25 purposes to \$7000.

1 Effective January 1, 1985, the Federal Tax rate would
2 be increased to 6.12 percent -- that's 6 percent permanent
3 tax and a 2 percent temporary extended-benefit tax -- and
4 the credit for employers against the tax would be increased
5 to 5.4 percent. This would require that states would have
6 a maximum experience-rated tax rate of 5.4 percent; although
7 obviously there is an array of taxes, and that would just be
8 the top of the experience rating. It would tend to broaden
9 the experience-rating band and strengthen experience rating.

10 Senator Byrd. What you are doing is really to double
11 the tax; from 3.4 to 6.2 is virtually a doubling of the tax.

12 Mr. DeArment. No, the net Federal tax would stay the
13 same. It would be a net of .8 percent. And, while the
14 maximum required experience-rated state tax rate would
15 go from 2.7 to 5.4, that would not require that taxes be
16 doubled in the states; indeed, there is no state at 2.7.
17 Virginia, for instance, is already at 6.9. So, Virginia,
18 without any change, right now already has a rate of
19 experience-rated tax rates on employers that exceeds 5.4
20 percent. And many states already do have.

21 Senator Byrd. But if it goes from, say, 2.7 to 5.4?

22 Mr. DeArment. That is the amount of the federal credit,
23 and it will be the maximum tax rate that a state will have
24 to have under an experience-rated system.

25 That doesn't necessarily mean that at any given point

1 there will be an employer in that top band that would
2 actually pay 5.4. But, basically, the states look at those
3 employers who have experienced the most unemployment claims
4 of their employees and the least, and set the rate based
5 on the use of the system. So there is basically an array
6 of tax based on the employer's experience. This would
7 simply strengthen that requirement by widening the base.

8 Senator Byrd. But small business is being hit pretty
9 hard already on this program. Now, this would certainly
10 substantially increase the burden on small business, would
11 it not?

12 Mr. DeArment. The increase in the Federal Tax would
13 have an effect on all employers, and to that extent all
14 employers would also be affected.

15 It is sort of a state-by-state analysis to what extent
16 24 states already have taxable wage bases above \$6000;
17 a number of them already have tax rates --

18 Senator Byrd. You are increasing both the wage base
19 and the tax.

20 Mr. DeArment. That's right.

21 Senator Byrd. That is bound to be a substantial burden
22 because you are picking up between \$2- and \$3 billion.

23 Mr. DeArment. The increase in the Federal Tax rate
24 as a result of this proposed change would be about \$1.20
25 per month per employee.

1 Senator Byrd. But I assume that these figures that you
2 have here on this sheet are what the Federal Government will
3 get, not the state government.

4 Mr. DeArment. Under the unified budget, it's a
5 combination of both, because the unemployment trust fund
6 is reflected in the federal budget, to the extent that there
7 is increase in --

8 Senator Byrd. Well, does the Federal Government pick
9 up 1.4 and 2.3 and 3 billion, or does it not pick it up?

10 Mr. DeArment: That is the total budgetary effect upon
11 the federal budget. To some extent, I think the majority
12 amount of that is the Federal Tax; but some portion of it
13 is also an increase of the state tax which is reflected in
14 the balances of the unemployment trust fund.

15 Now, the unemployment trust fund draws loans from the
16 Federal Government to the extent that there is not
17 sufficient money to pay out state benefits. We are currently
18 in a position, we are putting general revenues from the
19 Federal Government into the trust fund which will then --

20 Senator Byrd. What I would like to know, yea or nay,
21 is does the Federal Government pick up \$1.4 billion, next
22 year \$2.3 billion, and the following year \$3 billion, or does
23 part of that go to the states?

24 Mr. DeArment. The Federal Government picks that money
25 up in --

1 Senator Byrd. Picks that money up. That's what the
2 Federal Government itself picks up.

3 Mr. DeArment. Senator, there are two proposals here:
4 one affects state taxes. The Federal Budget reflects
5 balances in the unemployment trust fund.

6 Senator Bentsen. Mr. Chairman, is the Senator through?

7 Senator Byrd. I will yield.

8 Senator Bentsen. It does have a direct and a major
9 impact on small business, and small business is in real
10 trouble in this country. You had a 41 percent increase
11 in bankruptcies of small businesses last year over the
12 preceding year, and you have got an increase this year over
13 last year. And for everyone that goes through formal
14 bankruptcies you have eight to ten that just close their
15 doors.

16 Now, you have got a situation here where you are putting
17 an increased burden on them at a time when they are in
18 trouble and at a time when you have high unemployment in
19 this country. So it also further discourages the hiring
20 of people.

21 And you have got a situation, too, where small business
22 hires over 50 percent of the people in this country. So
23 the timing on it is a very difficult one for small
24 businesses.

25 Senator Bradley. Would the Senator yield there?

1 Mr. Chairman, this is another one of those
2 proposals that, in your search for revenue, you shoot
3 yourself in the foot.

4 We are in a deep recession. You have got 10 million
5 people unemployed; and what you are saying now is, if you
6 want to employ someone else, put someone to work, you have
7 got to pay a higher tax. So it's a very clear disincentive
8 to putting people to work at a time where you have got the
9 highest unemployment in the nation's history since the
10 Depression.

11 I don't see the rationale for this in a general
12 economic sense. Do we want people to work or not? What
13 you are saying, as the Senators from Texas and Virginia
14 have said, if you are in a small business, and you have got
15 a possibility of hiring a person in a recession, you say,
16 well, what is it going to cost me to hire him?

17 What the committee is saying in this proposal is, "It's
18 going to cost you more after this proposal is enacted than
19 it will right now to hire that person." That might just
20 be what the person needs not to hire him.

21 Mr. DeArment. It is about \$1.20 a week more, in that
22 order.

23 Senator Bradley. Well, It's a marginal disincentive
24 for hiring people in the country in a time when we are in
25 the deepest recession since the 1930s.

1 Senator Long. Mr. DeArment, you are talking about it
2 being \$1.20 more. But that's \$1.20 multiplied by the number
3 of employees that he already has there, isn't it?

4 Mr. DeArment. It is for all employees \$1.20 per
5 month. It is about \$14 a year.

6 Senator Long. Just to get your answer in context,
7 let us assume I have 1000 employees in a business out here.

8 Mr. DeArment. Right.

9 Senator Long. So you have increased my tax by, let's
10 say, \$1.20 multiplied by 1000, a week. Is that what we
11 are talking about?

12 Mr. DeArment. That is what we are talking about.

13 Senator Long. Well, if I am thinking about hiring
14 one more guard, I am talking about \$4- or \$5000 in taxes
15 a month, not just the \$1.20 a week that you were talking
16 about. It seems to me you are talking about that rate
17 multiplied by the number of employees that you have got
18 multiplied by the number of weeks.

19 Mr. DeArment. Actually, it's a thousand per month.
20 I misspoke earlier in talking with Senator Bradley. I said
21 it was \$1.20 per week; I misspoke. It is \$1.20 per month;
22 \$14 a year. So in your example it would be about \$1000.

23 Senator Long. Multiplied by the number of employees.

24 Mr. DeArment. That is correct.

25 Senator Long. All right. Thank you.

1 Mr. DeArment. No, no. If you hired one more it would
2 be --

3 Senator Bradley. If you have 1000 employees, you have
4 to pay \$1400 more per month. What is it, per month or
5 per year?

6 Mr. DeArment. Fourteen per year.

7 Senator Bradley. Fourteen thousand, right. I was never
8 too good at math.

9 Senator Chafee. Except that wouldn't apply in every
10 state. Some states are up over the 7000 now.

11 Mr. DeArment. The increase in the Federal Tax would
12 apply to every state.

13 Senator Chafee. Oh, yes.

14 Senator Byrd. May I ask Mike Stern if he would comment
15 on this issue?

16 Mr. Stern. Well, the question that you raised,
17 Senator Byrd was: Of the total amount of \$1.4 billion,
18 \$2.3 billion, and \$3 billion raised in the three fiscal
19 years, 1983 through 1985, how much of that is the net
20 Federal Tax, and how much of that is increased state taxes
21 which, as Mr. DeArment pointed out, is counted in the
22 combined budget.

23 And the breakout that I understand the Labor Department
24 has is, that of the \$1.4 billion, \$600 million is Federal
25 and \$800 million is state; of the \$2.3 billion, \$1 billion

1 is Federal, and \$1.2 billion is state; and then of the
2 \$3 billion in 1985, \$1.1 billion is Federal, and \$1.9 billion
3 is state.

4 The reason that distinction is important is because,
5 while the Federal numbers are presumably firm numbers, a
6 state may restructure its tax system so as not to raise that
7 much additional money.

8 Mr. DeArment. Yes, that's correct. That's the Labor
9 Department's estimate of what they think will happen.

10 Mr. Stern. The state numbers are, in a sense, much
11 softer numbers; because a state legislature can restructure
12 its tax system so that even though the wage base goes up
13 they may experience rate in a way that they don't raise
14 this.

15 Senator Byrd. Well, is this correct? What we are
16 really doing under this proposal, we are substantially
17 increasing the burden on small business. But a substantial
18 part of that increase in revenue is going to the states
19 and not to the Federal Government.

20 Mr. Stern. I think it would be correct to say,
21 Senator Byrd, that if the states do what the Labor
22 Department is predicting, that is reflected in these numbers
23 here, yes, it will be a substantial increase in the burdens.

24 Senator Byrd. But the Federal Government is not
25 picking up the additional revenue. The states are getting

1 a part of the additional revenue, and a substantial part
2 of it.

3 Mr. DeArment. Senator Byrd, to the extent that the
4 Federal Government doesn't have to pump billions of dollars
5 of general revenues into the unemployment trust fund to
6 cover state payment of benefits, it will directly accrue
7 to the Federal Government even if we didn't have this under
8 a unified budget.

9 Senator Byrd. Well, that's the only way states are
10 borrowing, so to speak, from the trust fund.

11 Mr. DeArment. Yes, states are borrowing. And to the
12 extent that the unemployment trust fund has sufficient
13 funds, we have been putting billions of dollars in recent
14 years into the federal trust fund to cover that borrowing,
15 \$13.5 billion.

16 Senator Byrd. But that has not gone to all of the
17 states; that has gone to a few of the states.

18 Mr. DeArment. It has gone to those that have had to
19 borrow.

20 Senator Byrd. That's right. But all of them have
21 not borrowed.

22 Mr. DeArment. That is correct.

23 Senator Byrd. It seems to me that this is really an
24 unjustified burden to put on small business at this
25 particular time, particularly when the Federal Government

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1 is going to get so little of it.

2 Mr. DeArment. One of the factors in terms of why there
3 is some desire for this tax increase is the federal tax
4 money funds, the employment service and job placement. There
5 has been some interest in maintaining a strong employment
6 service and job-placement program to place people who are
7 unemployed.

8 So, while this has the effect that you suggest on
9 small business at a particular inopportune economic moment,
10 there is also the need to maintain an effective employment
11 service function.

12 Senator Byrd. Well, this is partly just a spending
13 program, an increased spending program.

14 Mr. DeArment. That's right.

15 Senator Byrd. I don't think much of this proposal.

16 Senator Mitchell. Are the sums advanced to the states
17 grants? Or are they repayable?

18 Mr. DeArment. I beg your pardon?

19 Senator Mitchell. You gave as a justification for
20 this the monies advanced to the states.

21 Mr. DeArment. The employment service is not --

22 Senator Mitchell. No, I am not talking about the
23 employment service. Earlier you used the figure of
24 \$13 billion.

25 Mr. DeArment. Those are loans to the states.

1 Senator Mitchell. Those are loans that are repayable?

2 Mr. DeArment. They are repayable.

3 Senator Mitchell. With interest?

4 Mr. DeArment. No, only the ones that occur after
5 April 1st are subject to interest. The others are repayable
6 to the extent the state is default under the penalty tax.

7 Senator Mitchell. But that's the only point I wanted
8 to make, that they are repayable. Your justification for,
9 in effect, contradicting the distinction pointed out by
10 Senator Byrd was that, well, it all goes to help the Federal
11 Government anyway because we are advancing these sums to
12 the states. In the context of that discussion it appeared
13 as though these were grants to the states. It was not if
14 they are repayable.

15 Mr. DeArment. Yes, but a lot of these loans are very
16 old. They are theoretically repayable, but they have not
17 been coming back.

18 Senator Mitchell. Some of the states are not current?

19 Mr. DeArment. Indeed. I suspect that a good chunk
20 of that \$13 billion relates back to the 1974-75 recession.

21 Senator Bradley. Mr. Chairman, is there any way that
22 we could at least limit this rate increase for states that
23 are really in disastrous positions now, with incredibly
24 high unemployment?

25 Take Michigan, for example. I don't know what their

1 unemployment is, but it is close to 22 percent, I understand,
2 or 20 percent. But it is very high unemployment. Is there
3 any way we could get a kind of sliding scale so that this
4 full tax increase doesn't go into effect in a state with,
5 say, over 7 percent or 8 percent unemployment? And then
6 you put the tax increase in on a phased basis for states
7 that had lower and lower unemployment?

8 Otherwise, you are going to keep states with very
9 high unemployment on the bottom for a long time to come.

10 Is there any way we could phase this in for those
11 states, with a sliding scale?

12 The Chairman. I am not certain that can be done, but
13 we can explore that.

14 Senator Bradley. Could we do that?

15 It is my understanding that you could phase it in with
16 a minimal revenue impact, something like \$15-20 million.

17 The Chairman. Well, let's look at it. We are coming
18 back to all these issues again.

19 Go ahead.

20 Senator Mitchell. I think we should phase this right
21 out.

22 The Chairman. If you have a substitute, we would be
23 glad to discuss it.

24 Mr. McConaghy. The next item deals with the Medicare
25 tax on Federal employees. Today, of course, Federal

1 employees are not subject to F.I.C.A. This would say that,
2 with respect to that portion dealing with Medicare, which
3 is really a rate of 1.3 percent, that Federal workers
4 essentially would be covered.

5 Today I think approximately 80 percent of all retired
6 Federal workers over 65 are covered and receive the benefits
7 of Medicare because of either previous employment or because
8 of a spouse. So this would subject Federal workers to that
9 Medicare tax, and of course all of them would be eligible
10 for the benefits. That money would go into the H.I. trust
11 fund.

12 Senator Long. Can we have some prediction as to how
13 the Federal workers are going to feel about this? My
14 impression is when we considered something relevant to this
15 at some time back, it went along fine until we heard from
16 the Federal workers. I just wonder what we can expect from
17 them. Are they going to like this?

18 The Chairman. They are going to be in better health.

19 Mr. McConaghy. Well, I don't think you have a vote
20 at the table here, Senator Long. They are really super
21 excited about it.

22 The Chairman. I assume they don't want this, but it
23 is the right thing to do. It may not be painless, but it's
24 the right thing to do.

25 Senator Packwood. Mr. Chairman, could I ask Mark a

1 question?

2 Mark, what is the situation with Federal employees now,
3 who worked their entire career for the Federal Government,
4 when they retire? They have no Medicare coverage, right?

5 Mr. McConaghy. Unless they have previous --

6 Senator Packwood. Unless they have some other,
7 non-Federal earnings.

8 Mr. McConaghy. That is correct, Senator Packwood.

9 Senator Packwood. So, in essence, what we are saying
10 is we are going to extend the protection of Medicare to
11 them but ask them to pay for it.

12 Mr. McConaghy. Exactly.

13 Senator Heinz. Mr. Chairman?

14 The Chairman. Senator Heinz?

15 Senator Heinz. Bob Packwood stole my question, but
16 I have some others on this.

17 Now, Mark, is it not correct that there are two other
18 groups of employees that are in a somewhat similar position
19 to Federal employees, namely the state and local government
20 employees, who number around 4 million people, and about
21 1 million employees of non-profit institutions, both groups
22 of which, it is my understanding, don't pay anything into
23 Medicare, but nonetheless should they have the necessary
24 quarters of coverage after their state or local or nonprofit
25 coverage -- and I guess those numbers of quarters are now

1 up around 31 or so -- can get it? Is that right? *

2 Mr. McConaghy. I think so. I am not sure on the
3 percentages. I think maybe about half of them under
4 voluntary agreements of state and locals may be covered,
5 Senator Heinz. But generally you are right.

6 Senator Heinz. It would be good to get those statistics
7 because that would indicate we are dealing with one issue
8 but not the entire issue, and that we may be singling
9 Federal employees out here.

10 A second question. As I understand it, in addition to
11 the roughly 20 percent of the 2 million Federal employees
12 who are career and who would pay, as Senator Packwood said,
13 in but get very little out because they would be covered
14 under the Federal Retirement Benefits Program, what
15 percentage of Federal employees have actually earned their
16 Social Security including their Medicare benefits?

17 Mr. McConaghy. I think about 60 percent by reason of
18 their own minimum coverage, Senator Heinz.

19 Senator Heinz. So that leaves about 20 percent who
20 are getting Medicare based on spouse's working record or
21 something such as that?

22 Mr. McConaghy. That is correct.

23 Senator Heinz. So we have really three groups of
24 Federal employees -- the career people, the people who have
25 "earned it" and the people who are getting a ride on their

1 spouse's. And then we have the other state and local and
2 nonprofit employers.

3 Well, let me ask you this. Isn't it true that the
4 Federal employees just experienced a fairly stiff increase
5 in their insurance premiums last year?

6 Ms. Burke. Yes, Senator Heinz, it is correct that their
7 health insurance premiums did increase.

8 Senator Heinz. By about what percentage did they go
9 up?

10 Ms. Burke. I don't know across all plans, Senator. It
11 would depend on the size of the plan. In some cases it was
12 more than in other cases.

13 Senator Heinz. My information -- it may not be right,
14 but maybe you can check it when we come back to this -- is
15 they went up about 30 to 50 percent.

16 My last question: We have had a pay cap on Federal
17 employees for how long?

18 Ms. Burke. I don't know the answer to that, Senator.

19 Senator Heinz. And I guess a subsidiary question:
20 Is there anybody else under the budget resolution other
21 than Federal employees that is subjected to the 4-percent
22 pay cap?

23 The Chairman. We don't have jurisdiction over that.

24 Ms. Burke. I don't know, Senator.

25 Senator Heinz. So, as far as we know, they are the

1 only people who would be subject to that kind of a
2 limitation.

3 Thank you, Mr. Chairman.

4 Senator Mitchell. Mr. Chairman, could I ask one
5 question?

6 (No response)

7 Senator Mitchell. Senator Packwood inquired as to the
8 20 percent of the Federal employees who are not covered
9 by Medicare by virtue of not having been employed other
10 than in the Federal Government or not through their
11 spouses, and this is intended to extend coverage to them.
12 What do they do now for medical coverage after retirement?

13 Ms. Burke. They are offered, under the Federal
14 Employees Health Benefits Plan, Senator, a retirement plan
15 which includes health insurance. They may choose to continue
16 their Federal employee health benefits upon retirement. So,
17 in many cases they would obviously choose to do so.

18 Senator Mitchell. So they do have an alternative that
19 is available to them by virtue of their employment?

20 Ms. Burke. Yes, sir. In fact, most individuals who
21 retire, both those who have earned coverage under Medicare
22 and those under FEVA, would choose if they are offered both
23 to retain both, and indeed the Federal employees plan wraps
24 around Medicare. Medicare, in all cases, pays first. And
25 FEVA simply becomes a wraparound in those cases.

1 Senator Mitchell. So the 80 percent that we are talking
2 about, probably the majority of them have coverage under
3 both plans, as you suggested.

4 Ms. Burke. Yes, Senator, that is correct.

5 Senator Mitchell. And this would make mandatory for
6 the remaining 20 percent the same thing. Is that correct?

7 Ms. Burke. That is correct, Senator. It would apply
8 Medicare to all Federal employees.

9 The Chairman. Can I follow that up? How does this
10 differ from what we attempted to do last year on FEVA?

11 Ms. Burke. Last year, Senator, rather than create
12 coverage for all Federal employees, we simply made Medicare
13 secondary to Federal employment health benefits in those
14 cases where individuals had both coverage; so Medicare became
15 a secondary payor for people covered under both.

16 The Chairman. And then, secondly, as I understand,
17 many Federal employees who qualify for Medicare have minimum
18 coverage. Is that correct?

19 Ms. Burke. That is correct, Senator.

20 The Chairman. Plus, some will now be able to qualify
21 for Medicare who would not have been able to qualify for
22 Medicare.

23 Ms. Burke. Yes, sir. About 20 percent.

24 Senator Baucus. Mr. Chairman?

25 Senator Mitchell. Excuse me. Could I finish?

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1 I guess the point I was trying to make is that those
2 employees who are now eligible for Medicare, the 80 percent,
3 are eligible on terms and conditions to those available to
4 all Americans, are they not?

5 Ms. Burke. That is correct, Senator.

6 Senator Mitchell. They are not getting a special
7 treatment, they have to comply with whatever the
8 requirements for eligibility are?

9 Ms. Burke. Minimum quarters. That is correct.

10 Senator Mitchell. And they make whatever contributions
11 are required of anybody who is to be a participant in the
12 program. Is that correct?

13 Ms. Burke. That is correct, Senator. They would have
14 had to qualify with at least minimum quarters of coverage.

15 Senator Mitchell. Right. So, this doesn't extend
16 coverage in the sense that it makes something available to
17 someone that is not otherwise available; it in effect is a
18 mandatory provision compelling them to participate?

19 Ms. Burke. It provides insurance to all Federal
20 employees, not simply those who qualify under minimal
21 coverage.

22 Senator Mitchell. Right.

23 Now, what would happen to those who have participated,
24 who are eligible by virtue of other employment, and have
25 paid in? They would be eligible anyway; now they will have

1 to pay here, as well?

2 Ms. Burke. That is correct, Senator. They would
3 continue, as all covered employees do, to pay taxes through
4 the time of their employment.

5 Senator Mitchell. Thank you.

6 Senator Baucus. Mr. Chairman, I would ask Sheila:
7 As I understand, the revenue estimates here are the net
8 result of the increase of tax that Federal employees would
9 pay, offset against the additional payments out of the
10 health insurance trust fund.

11 Ms. Burke. That is correct, Senator.

12 Senator Baucus. And that would be because of the
13 additional 20 percent that would be covered?

14 Ms. Burke. Those numbers are also reflective of the
15 fact that the Federal Government as a payor pays a certain
16 amount -- they pay half of the tax; they pay 1.3 percent.
17 So those numbers are net numbers that are solely the result
18 of increase in income to the trust fund from the tax itself,
19 and it also recognizes in the outyears the additional cost
20 of those populations.

21 Senator Baucus. Those are increases to the health
22 insurance trust fund?

23 Ms. Burke. That is correct, sir.

24 The Chairman. Next?

25 Mr. McConaghy. The next item deals with

1 taxpayer compliance. This essentially is a bill that
2 was introduced by The Chairman and Senator Grassley. It is
3 S. 2198.

4 The Chairman. Do you want to comment on this, Senator
5 Grassley? If so, go ahead.

6 Senator Grassley. Is this the compliance on these
7 provisions from the Commissioner?

8 The Chairman. Yes.

9 Senator Grassley. No, I think they ought to go into
10 detail on it.

11 The Chairman. Go ahead, Mark.

12 Mr. McConaghy. There is a 5 or 6-page more detailed
13 technical discussion of the provisions and the modifications.
14 Essentially, I think we might go through the key aspects,
15 and if there are questions obviously we will handle them.

16 Senator Grassley. There is one thing I could comment
17 on that isn't printed here because we left it out of the
18 original bill: We had IRS exempted from the provisions of
19 the Paperwork Reduction Act. Senator Dole and I had that
20 in our original bill. We thought about that, considered
21 it, and have taken out that exemption now.

22 The Chairman. So they are not exempt from the Paper
23 Reduction Act since they create about half of it.

24 Mr. McConaghy. The key aspects, really, of this bill
25 are as follows: One, there are penalties that would be

1 imposed on tax-shelter promoters and persons who assist
2 others in committing tax fraud. Two, a penalty would be
3 imposed on large underpayments of tax arising from what
4 we would call aggressive filing positions on returns -- there
5 are certainly defenses permitted to that. Three, the
6 registration of most long-term bonds, essentially over one
7 year; flexible registration allowing book-entry systems would
8 be contemplated; the information return system generally
9 be expanded in a number of ways and strengthened -- most
10 significant would be improved information reporting on
11 independent contractors, foreign transactions, and tip
12 income.

13 Five, there would be a system of voluntary withholding
14 on pension payments, and information returns obviously
15 would be restructured with respect to those.

16 Six, our interest rates on deficiencies and refunds
17 would be adjusted so that they would be semi-annual
18 adjustments with interest compounded daily.

19 Seven, the procedures for third-party summons would be
20 streamlined.

21 I think that really is the highlight or the key aspects
22 of the provisions.

23 In addition, additional IRA funding would be called for
24 in the sense of the Senate resolution on this -- IRS funding
25 for agents.

1 The Chairman. As I understand -- and Andre LeDuc has
2 been working on this -- this provision is the culmination of
3 I guess several years' effort from IRS, with members of this
4 staff in the years past, and with direct sellers, realtors,
5 independent truckers. I think there is near unanimous
6 support for what we seek to do.

7 There would be one amendment offered. There may be
8 more than that, but one that I know of by Senator Symms.
9 It corrects the problem that one corporation has or are
10 perceived to have under the proposal.

11 Andre, have there been any other changes made other
12 than those outlined by Mr. McConaghy?

13 Mr. LeDuc. Mr. McConaghy outlined the principal
14 provisions, and indeed, to the extent there has been
15 any controversy, the controversial provisions.

16 The Chairman. For the record, what will be the revenue
17 increase if we adopt this provision?

18 Mr. LeDuc. In Fiscal Year 1983 it will be \$4.3 billion;
19 in Fiscal 84 it will be \$5.9 billion; and in Fiscal 85 it
20 will be \$7.3 billion.

21 Senator Long. How much of this would you estimate
22 will be collected by these provisions by tips?

23 The Chairman. About \$400 million, I think.

24 Mr. Brockway. Yes. The estimate with respect to the
25 improvement in the reporting system on tips would be

1 \$200 million in Fiscal 83, \$600 million in Fiscal 84, and
2 \$700 million in Fiscal 85.

3 The Chairman. It has been estimated that \$10 billion
4 in tip income is unreported each year. We are not seeking
5 withholding; we are looking at information reporting. Is
6 that right, Jim?

7 Mr. McConaghy? That is correct, Mr. Chairman, and I
8 think that figure may be a little low. I think it may even
9 be more unreported.

10 The Chairman. More than what?

11 Mr. McConaghy. Than the \$10 billion.

12 The Chairman. More than \$10 billion?

13 Mr. McConaghy. Yes.

14 The Chairman. Oh. I'm sorry.

15 Senator Chafee. Mr. Chairman, could somebody explain
16 the tip provision in more detail?

17 The Chairman. I can't.

18 (Laughter)

19 Senator Chafee. No, I didn't mean you.

20 Mr. LeDuc. Senator, under the proposal the owner of
21 a full-service restaurant would be required to allocate
22 7 percent of his gross receipts other than receipts of
23 carryout sales to his tipped employees for reporting
24 purposes. That allocation would be made by the employer
25 by agreement with the employees or by the employer in the

1 absence of agreement.

2 The employer would also report to the IRS its total
3 gross receipts, its gross receipts from charge transactions,
4 and the aggregate amount of charged tips.

5 Senator Mitchell. If an employer has gross receipts of
6 a million dollars, he does what? He distributes as income
7 to employees 7 percent of that total?

8 Mr. LeDuc. Senator, he reports to the IRS a total
9 of 7 percent of that million dollars, assuming it is not
10 from carryout sales.

11 As amounts to his employees, they are not taxed on
12 that amount unless they so report it themselves to the
13 Internal Revenue Service.

14 Senator Mitchell. So this is just a figure that is
15 reported by the employer, irrespective of the number of
16 employees, the length of employment of an individual
17 employee, irrespective of actual tips or anything like that?

18 Mr. LeDuc. Senator, the proposal contemplates that the
19 allocation of that aggregate 7 percent would, in the first
20 instance, be by agreement with the employees; and, in the
21 absence of agreement, as he determines in good faith.

22 Senator Mitchell. But I am still trying to understand
23 what the relationship is between the allocation of 7 percent
24 of gross receipts as a figure on a report filed with the
25 Internal Revenue Service, and the income of the individual

1 employees who work for the restaurant.

2 Mr. LeDuc. Senator, our statistics indicate that tip
3 rates approximate 10 to 15 percent of gross receipts.
4 Seven percent is designed to substantially undershoot that
5 mark but to give the IRS some indication of where either
6 the employees agree tips are being paid or where the
7 employer believes in good faith there are tips being
8 received.

9 Senator Mitchell. Well, I --

10 Mr. Brockway. Senator, you might find it helpful to
11 know that the proposal does not directly call for
12 withholding on this 7-percent amount allocated.

13 The theory of this provision is to create the
14 necessary data base to enable the IRS to conduct effective
15 audits. Under present law it is necessary, in auditing the
16 employees of an establishment, to go back and start by
17 reconstructing the gross receipts of the establishment and
18 reconstructing a tip rate for the establishment, and then
19 trying to figure out how much of that would have been earned
20 by particular employees.

21 What the proposal is designed to do is to provide the
22 IRS with the aggregate data from which to derive the tip
23 rate, and also with an indication of what the employer and
24 employees believe is the sharing arrangement among the
25 tipped employees.

1 A tipped employee could clearly show from his own
2 records that he had less income, and the IRS would have the
3 burden of proving that he had more than a 7-percent tip
4 income.

5 Senator Mitchell. Well, then, if I understand it, all
6 you are talking about is establishing a percentage of
7 gross receipts and requiring every restaurant to file some
8 kind of a plan.

9 Mr. McConaghy. A report, so that there is an audit
10 trail, Senator Mitchell.

11 Senator Mitchell. A report that describes the method
12 of allocating that 7 percent among the employees?

13 Mr. McConaghy. Essentially, that is correct.

14 Senator Mitchell. Is this the Federal Government
15 mandating tip allocation among employees in restaurants?

16 Mr. McConaghy. No.

17 Senator Mitchell. It seems like this is the contrary
18 of getting the Government off people's backs.

19 Mr. LeDuc. Senator, that is not our intent. However,
20 for the record, we should note that our statistics show that
21 tip compliance is the worst of any compliance rate.

22 Mr. McConaghy. Senator Mitchell, really, the Service,
23 GAO, and others believe that the tip compliance is about
24 16 percent, and that that money out there is probably as
25 high as \$15 to \$20 billion that is not reported at all.

1 The Chairman. And of course the working men and women,
2 their rate is 99 percent compliance. There is a lot of
3 revenue that somebody else is paying because somebody isn't
4 paying.

5 Senator Long. Well, now, is that a suggestion that
6 these people who work in restaurants and hotels are not
7 working? It is my impression that those people are hard
8 workers, too.

9 The Chairman. It is not that they are not working;
10 it is that somehow the income is overlooked.

11 Senator Byrd. Mr. Chairman, I am sympathetic with
12 what you are trying to accomplish, but I don't see exactly
13 how this accomplishes it.

14 Now, you mentioned the tip rate, that you need to know
15 the tip rate. Well, the 7 percent doesn't give you the
16 tip rate, does it?

17 Mr. McConaghy. No. That's correct, Senator Byrd. It
18 just attempts, as was explained, to provide a base and an
19 audit trail for the Service then to be able to look.

20 The first thing it does today in a tip case is try to
21 establish the gross receipts of that restaurant, and then
22 perhaps figure out how much essentially would be allocated
23 to that particular individual.

24 Senator Byrd. Well, they would have to do the same
25 thing under this proposal.

1 Mr. McConaghy. This just shows, essentially, what the
2 gross receipts would be, obviously, because the amount
3 reported would be 7 percent of those gross receipts. If the
4 employer and the employee want to work out an allocation
5 formula, then obviously that should provide certainly a
6 resolution of it between the employee and the IRS as to
7 how much of that perhaps is allocated to him.

8 Still, the employee can obviously show that he did not
9 in fact receive that amount, and this is purely reporting.
10 It is not withholding of any tip amount.

11 It is an attempt to give an audit trail to the IRS.

12 Senator Byrd. How does it give an audit trail when
13 you take an arbitrary figure of 7 percent? When you say
14 that tips actually are 16 percent? I don't see how that
15 gives you anything that you don't have now other than the
16 gross receipts.

17 Mr. McConaghy. It would give them also the aggregate
18 receipts from credit cards and what the credit card tips
19 would be, and obviously in the aggregate, and that certainly
20 is going to give them a relationship as to what essentially
21 the normal percentage is on the charge receipts and the
22 charge tips.

23 Senator Grassley. And didn't our hearings show that
24 about half the tips are charged on credit cards?

25 Mr. McConaghy. I think it is a little bit lower than

1 that, Senator Grassley.

2 The Chairman. About 40 percent, I think.

3 Senator Byrd. But isn't this going to be a tremendous
4 burden on a small restaurant to do all of this?

5 Mr. LeDuc. Senator, the proposal would provide an
6 exception for the small restaurant with 10 employees or less.

7 Senator Long. Well, I would like to suggest 10 to 15
8 employees. Let me ask you this: Has a hearing been
9 conducted on this matter?

10 Mr. LeDuc. Yes, sir.

11 Senator Long. Did the restaurant and the hotel people
12 come to that hearing and testify? Could that be made
13 available to us?

14 The Chairman. They were not enthusiastic, about it,
15 Senator.

16 (Laughter)

17 Senator Grassley. Senator Long, this proposal we have
18 is a compromise of what was worked out in the original
19 Dole-Grassley Bill that they testified. I am not intimating
20 that they are in support of this, but at least this is
21 different and a compromise. One of the reasons it is a
22 compromised is to take care of some of the paperwork problems
23 created by our original proposal.

24 The Chairman. When it gets into the controversial
25 areas, I refer to it as "The Grassley-Dole Bill."

1 (Laughter)

2 Senator Long. I have had the restaurant people and
3 the hotel people importune me many times about this, and of
4 course their position is, as I understand it, that they
5 contend that this is not their income. It is not paid to
6 them. It is the relationship between the customer and the
7 waiter or the person who provides the service. And generally
8 they contend that they shouldn't be put in this crossfire
9 between the Government and a tipped employee.

10 Mr. McConaghy. That, Senator Long, is an issue of
11 whether it is a gift or income, and the test on that is
12 whether it is given with "detached and disinterested
13 generosity."

14 The dealers in Las Vegas made that argument that it
15 wasn't received for services performed; it was received in
16 detached and disinterested generosity. They have lost those
17 cases in court, but that is the argument.

18 Senator Long. I don't quarrel with anybody going down
19 to Louisiana and serving that crab fisherman down there who
20 has been catching all those blue crabs and paying no tax
21 on it. He collects good money, and no tax. I don't object.
22 I think the Internal Revenue Service ought to pursue that
23 fellow and make him pay taxes on what he sold those crabs
24 for. But these restaurant people do have a point, that this
25 is not their income, that it is the other fellow's income

1 over there, and sometimes they know about it and sometimes
2 they don't.

3 But this 7 percent that you are talking about to give
4 you an audit trail, that's an arbitrary assumption, is it
5 not? That is just your assumption, a legal assumption that
6 they collected 7 percent. It might be 7, it might be
7 anything. Right?

8 Mr. McConaghy. That is correct, Senator Long.

9 The Chairman. Isn't there some evidence that in some
10 of the larger restaurants you actually pay to get the job?
11 It's so good that you don't pay any tax.

12 Mr. LeDuc. That was asserted at the hearing, Senator.

13 The Chairman. What was the amount?

14 Mr. LeDuc. They were four-figure amounts, Senator.

15 Senator Byrd. They were what?

16 Mr. LeDuc. Four-figure amounts. In several thousands
17 of dollars. So that would be limited to larger restaurants.

18 Senator Long. Mr. Chairman, let's understand, there
19 is a difference between the tips the waiter gets and the
20 the burden on the fellow that owns the restaurant, the
21 employer.

22 Mr. LeDuc. Senator, if I may clarify the proposal.
23 It would require information reporting by the employer of
24 the restaurant. It would not impose a tax upon him.

25 Senator Mitchell. May I follow up that with one

1 more question?

2 I still don't understand the relationship of the
3 7-percent allocation to the income of the employees. Let
4 me ask by example.

5 An employer files an information return, gross receipts,
6 anybody can figure out what 7 percent of that is. Now you
7 take all of the income tax returns of all of the people
8 who have worked in that establishment during the year. If
9 you add up all of the tips and they come out to a total of
10 5 percent of the gross receipts, what does that establish?
11 Is there any relationship?

12 Mr. LeDuc. Senator, the statistics available to us
13 show that tip rates are over 10 percent of total gross
14 receipts. So if you reported tips of 5 percent in that
15 establishment it would suggest that the overall tip rate
16 was 5 percent -- an unlikely result in most establishments.

17 Senator Mitchell. Well, I know, but what would that
18 do? What would this law do?

19 Mr. LeDuc. It would require the employer to allocate
20 an additional 2 percent of his gross receipts by agreement
21 among his employees or by himself in good faith.

22 Senator Mitchell. So what you are saying is that
23 you are establishing a mandatory minimum tip rate in the
24 United States of 7 percent.

25 Mr. McConaghy. I don't think necessarily, Senator.

1 I think all it does is say that this amount would be
2 allocated for information reporting purposes. And to the
3 extent, obviously, that the employee did not receive those
4 tips, it is a mere matter for him to show the IRS "I did not
5 receive that kind of tip income; I received x-kind of
6 income." It does not impose a tax; it just puts that
7 audit trail. So if you in fact had received 7 percent tips
8 on basically your receipts, this is what the information
9 shows you would have received during the year. But it does
10 not impose a tax; it doesn't impose withholding; it just
11 gives that information to the IRS for purposes of an audit
12 trail.

13 Senator Mitchell. Well, so what you are saying is that
14 for every person who performs services for which tips are
15 given in restaurants, you create a paper structure in which
16 a presumption exists that he received as tips the equivalent
17 of his portion of 7 percent of the gross receipts.

18 Mr. McConaghy. If he would report that amount it's
19 really a safe harbor for him. But if he didn't get that
20 amount, then obviously he has to demonstrate that to the
21 Service.

22 Senator Mitchell. And he has to, then, prove that he
23 didn't get the amount that the allocation suggests?

24 Mr. LeDuc. He would make that proof, Senator, from his
25 books and records which under present law he is required

1 to maintain.

2 Senator Grassley. So from that standpoint there is no
3 new recordkeeping for any person who does receive tips as
4 part of their income?

5 Mr. LeDuc. No, sir. And indeed it may lessen the
6 recordkeeping obligation through the safe harbor.

7 Senator Byrd. May I ask this. If you are a
8 restaurant owner and I am an employee, can you come to me
9 and ask me how much I have made? And am I required by law
10 to tell you how much I have made in tips?

11 Mr. LeDuc. You are under present law, Senator.

12 Senator Byrd. You are required to tell the employer?

13 Mr. LeDuc. Yes, sir. That is present law, but this
14 proposal is designed to improve compliance with existing
15 law.

16 Senator Byrd. But what I don't understand is how you
17 can improve the compliance -- and I think these people ought
18 to pay taxes; everybody else has to pay additional taxes
19 to make up for what they don't pay, so I'm not arguing the
20 case that they shouldn't pay taxes. But if you put it on the
21 basis of 7 percent when you know that it is over 10 and
22 probably 16, I don't understand exactly what you are gaining
23 by it.

24 The Chairman. I guess it is to make certain that you
25 did not overstate --

1 Mr. LeDuc. Senator, this proposal is a two-way street;
2 that is, it provides a safe harbor for the employee. The
3 IRS must carry the burden of proof if it believes a higher
4 amount was received. So there was an intent not to go below
5 7 percent, because that would be unduly burdensome on the
6 Internal Revenue Service, which believes that tip rates
7 exceed 10 percent in most full-service restaurants. And
8 they have elaborate statistical evidence to show that.

9 At the same time, it was believed that because of
10 tip-splitting and tip-sharing arrangements, attempting to
11 go to 10 percent of 12 percent as was described in the
12 pamphlet furnished to the committee might be too high,
13 and this is a rough measure as the committee has remarked.

14 The Chairman. Well, I might say to Senator Byrd, I
15 think it might be well just to have someone from the IRS
16 here this afternoon to go back through this.

17 Senator Byrd. Yes.

18 Senator Baucus. Mr. Chairman, I still don't understand
19 how this works. So, let's explain it this afternoon.

20 The Chairman. We are coming back to all these again.
21 We wanted to go over it one time.

22 Senator Baucus. If we could, though, just go through
23 an example of how this works, to clarify some of the
24 problems.

25 The Chairman. All right. Could you give an example?

1 Senator Baucus. Assume that I am an employer and I have
2 a certain amount of gross receipts. Then what is the
3 requirement under this proposal?

4 Mr. LeDuc. Senator, let's assume you are an employer
5 and you have \$10,000 in gross receipts other than from
6 carryout sales.

7 In example one, your employees report to you for their
8 W-2s, as required under present law, that they have received
9 tips aggregating 8 percent of your gross receipts; that is,
10 they have received, in this example, \$800 of tips. Your
11 obligation will be solely to report to the Internal
12 Revenue Service and to withhold on such amounts the amounts
13 reported to you by the employees. That is present law.

14 If, however, your employees have reported to you only
15 \$600 in tips; that is a 6-percent rate. You will be
16 required either to agree with your employees where the
17 additional \$100 is to be allocated; or, if you fail to
18 reach agreement with your employees, you must make that
19 allocation yourself and at that point report the additional
20 \$100 but not withhold on it.

21 Senator Mitchell. And do you have to include in that
22 report the method of allocation? Or just that Joe Jones
23 got \$10 and Mary Smith got \$20?

24 Mr. LeDuc. Senator, it is simply a report of the
25 amount together with information on total gross receipts of

1 the restaurant and charge tips. There is no filing of a
2 plan.

3 Senator Mitchell. Is the report required by law now
4 made at any particular time in the calendar year?

5 Mr. LeDuc. The employer report is made when he files
6 his W-2 for the employees, because the employees report to
7 the employer under present law the tips they have received
8 periodically through the year.

9 Senator Mitchell. They do do that?

10 Mr. LeDuc. They are required to report, Senator.

11 Senator Mitchell. What happens, since this is an
12 industry with a substantial turnover, if a fellow comes
13 to the end of the year and finds that there is only
14 5 percent reported and he has to allocate the extra 2 percent,
15 and 23 of the people who worked as waitresses and waiters
16 in his establishment, he doesn't know where they are
17 during the past year? Does he have to go out and find
18 them?

19 Mr. LeDuc. Today, Senator Mitchell, he would have to
20 provide a W-2 for that individual anyway.

21 Senator Mitchell. That's right. Providing a W-2,
22 though, is a different thing from --

23 Mr. McConaghy. This amount would just show up on the
24 W-2, as well. So it would be on the same document.

25 Senator Mitchell. I understood you to say they had to

1 make an allocation of the difference between 7 percent and
2 whatever the reported amount lesser than that was.

3 Mr. LeDuc. That is correct, Senator. That would be
4 an additional item on the form W-2. It would be another
5 box.

6 Senator Baucus. But what if that party is gone, if
7 you can't find him?

8 Mr. McConaghy. Well, it's the same problem, then,
9 Senator Baucus, that we have under existing law with respect
10 to the W-2 for wages itself; and that is, it has to be
11 sent to his address. That is the requirement under law,
12 and this is just another item that would appear on the
13 W-2.

14 Senator Byrd. Do you have special penalties on the
15 employer under this proposal that do not exist now?

16 Mr. McConaghy. No special penalties, Senator Byrd.

17 The Chairman. I might say, in case there are other
18 questions, we will have someone from the IRS here. But we
19 have tried to approach this very gingerly, I guess, because
20 it is a very sensitive issue. But if in fact -- I didn't
21 know it was \$20 billion -- that it is somewhere between
22 \$16 and \$20 billion of income unreported, then I think we
23 have an obligation to try to get those people to pay some
24 income tax so that others don't have to pay quite as much.

25 So we are going to try to work it out. It is a very

1 difficult area.

2 I remember being on the committee before when the tip
3 issue came up.

4 Let me announce at this time that we will recess at
5 12:15 for lunch. I understand Senator Long would like to
6 meet with the Democrats from 1:30 to 2:30. So we will
7 reconvene at 2:30.

8 It is my hope, and I want to accommodate everyone, but
9 to put it positive, we would like to continue this afternoon
10 and this evening. If we can't finish, then tomorrow.
11 Because we are mandated by the resolution to report to the
12 Senate by the twelfth of this month, and it will take
13 some time, if in fact we pass this package or any part of
14 it, for the staff to prepare that report.

15 It is also my understanding that there is a recess
16 which begins at the close of business today or tomorrow,
17 and I guess we come back on the twelfth.

18 Senator Buacus. Mr. Chairman, I understand the
19 schedule, and I certainly understand your wishes. It is
20 my understanding, though, by a simple resolution we can
21 change that date of July 12. Frankly, I think in the
22 spirit of good public service here it should take some time
23 to look at the provisions.

24 Senator Long already indicated that we, on our side,
25 have had virtually no time to look at them. The first time

1 I heard about it, frankly, was in the Washington Post, about
2 some of the words. I had not seen them until after I had
3 read about it in the paper. And I'm wondering if we could
4 discuss these provisions, as you have indicated today. I
5 think it would be better for everyone concerned if you were
6 to, then, lay this over until after the recess. We could
7 pick it up for two or three days, or three or four days,
8 of next week, and by a simple resolution extend that date
9 of July 12th to an appropriate later date.

10 The Chairman. Well, I must say I don't share that
11 view. We have all had the same information. We have had
12 a booklet published on the 15th of June with every
13 conceivable option and an explanation of that option has
14 been available to everyone.

15 We met the last two days to see if we could find an
16 agreement on our side. I understand it is complicated, but
17 it would seem to me that if in fact we are serious about
18 trying to bring interest rates down and to reduce the
19 deficit, then sooner or later we are going to have to
20 consider the recession instead of the recess. And we could
21 meet next week. I don't have any quarrel with that. And
22 we don't need special authority to do that.

23 So I would hope if we don't finish Friday that we come
24 back on -- Monday is a holiday -- come back on Tuesday and
25 do it next week.

3 do better than anyone anticipates.

4 The Chairman. Sure.

5 Senator Long. I think anyone who is not knowledgeable
6 around here, who is a stranger in this room, perhaps ought
7 to be told that the Republican members have been meeting
8 for two days and discussing these provisions, and the
9 Democrats drifting back to the meeting were indicated,
10 "Oh, well, we'll study it; but come back later on when
11 we fellows agree what we want to do." To us, some of this
12 is somewhat new.

13 Let me say, I don't envy the Chairman of the committee
14 his job. I once had such a job, but I don't envy the
15 Chairman at all this \$20 billion tax increase. You are
16 welcome to it.

17 (Laughter)

18 Senator Long. But we, on this side of the aisle,
19 do need time to discuss this matter. That's why I suggested
20 to the Chairman that during the recess I would like the
21 opportunity to speak to the Democrats for about an hour,
22 and we might move a little faster this afternoon when we
23 do.

24 We simply want to make our suggestions and make our
25 input, and we hope that we might make this contribution.

1 before this matter comes to a conclusion.

2 The Chairman. We would like a contribution of about
3 \$20 billion if you could come up with that.

4 Senator Long. Well, I've got a little amendment that
5 would pick up a few dollars.

6 The Chairman. No, I think that's fine. And we have
7 been meeting as Republicans, but that's not unprecedented
8 to have meetings. It's something I picked up in the old
9 days in this committee, when I used to walk by the
10 Democratic caucus, wondering what was going on.

11 Senator Long. Well, I'm glad you brought that up,
12 Mr. Chairman, because I'm not the one who started those
13 party caucuses. Our Republican friends thought of that,
14 and after a while I had to start holding them in self
15 defense.

16 But I am not complaining about any of that. All I am
17 saying is that everyone -- and I'm sure the Chairman, and
18 I hope that the Republican members -- would recognize
19 that those of us on this side of the aisle need an
20 opportunity to study these matters just as the majority has
21 been doing. I'm sure they are thoroughly familiar with
22 which explains why we have been asking so many questions
23 and why the others have not. They had their chance to
24 ask a lot of questions and to make an input, and we would
25 like the same opportunity.

1 May I say, I know of no desire to have any delay
2 other than just the kind of procedure that is expected when
3 you are considering a major tax measure. We want the
4 opportunity to see what we have here and to make our
5 suggestions.

6 The Chairman. I understand, Senator Long. There is
7 no effort to push anybody on this -- just normal speed.

8 Senator Long. You don't have to keep the forum here
9 while we are asking questions, Mr. Chairman, as far as I'm
10 concerned. As long as we have the dignity of the Chairman
11 here, or someone in his place, why, we will just move on
12 ahead and discuss it.

13 The Chairman. Sure. Thank you.

14 The next item?

15 Senator Baucus. Mr. Chairman, before you go on to the
16 next item I have one question.

17 The Chairman. Fine.

18 Senator Baucus. That is Section 125. I am wondering
19 if Mark or somebody could explain to me what amount of
20 additional materials have to accompany a return in order to
21 avoid an additional penalty which would occur if the tax
22 liability ultimately came out to be \$4-5000?

23 As I understand, Section 125 is a traditional penalty
24 for those of the taxpayers who, due to some reasonable
25 difference of opinion as to what constitutes a deduction or

1 a credit, or so forth, ultimately find out that they are
2 wrong, and the change of the tax liability is more than
3 \$5000.

4 According to 125, to avoid that additional penalty the
5 taxpayer would have to have additional material on their
6 return or accompanying the return. The question is: What
7 constitutes additional material? Isn't there a lot more
8 paperwork involved here?

9 Mr. McConaghy. Senator Baucus, just a quick response
10 to that is that, first, if he has an opinion of counsel which
11 essentially says that position is a reasonable position, that
12 would be available, and that would satisfy it. He wouldn't
13 have to have any additional information.

14 So, to the extent that it is more likely than not that
15 that position he would be able to sustain, which is really
16 the CPA or the legal opinion, that would satisfy, which
17 he normally gets in many cases today.

18 Also, he would just have to adequately disclose the
19 items on the return. And, obviously some of that would
20 have to be done by regulations; but essentially he would
21 have to put down on the return enough information that
22 shows that that particular item has been disclosed.

23 Senator Baucus. So if it is the opinion of counsel
24 that such and such is reasonable --

25 Mr. McConaghy. That, it is more likely than not, would

1 be sufficient except in certain cases.

2 Senator Baucus. Thank you.

3 Senator Grassley. Mark, or Andre, does our revenue
4 estimates include money from assessment of penalties? Or an
5 increased assessment of penalties? And, if so, how much
6 of our revenue estimate is included in that?

7 And you say there is some included. I want to know
8 that it is reasonable, and I would like to get some
9 statement from Treasury that it can be accomplished and
10 that they intend to pursue that; because otherwise we are
11 going to be short on the revenue.

12 Mr. McConaghy. The revenue that we do have in here
13 certainly does include an amount that is picked up from
14 those increases in penalties, Senator Grassley.

15 Mr. Chapoton. I might add, Senator Grassley, I think
16 the overwhelming major portion of the revenue increase is
17 from compliance and not from the penalties themselves.

18 Senator Grassley. You are right on that, but I would
19 like to address just the penalty portion.

20 Mr. Chapoton. Fine. We can get that figure.

21 In response to your other point, I think you are raising
22 the question whether penalties would in fact be imposed
23 for failure to comply with information reporting and that
24 type of a thing. I understand that in the past penalties
25 have not always been imposed for failure to comply with

1 the information-reporting requirements of the law.

2 We have discussed that with the Internal Revenue
3 Service, and they will impose penalties for failure to
4 file information reporting. Of course, those penalties
5 will be somewhat strengthened under this bill -- will be
6 considerably strengthened under this bill.

7 The Chairman. Senator Byrd?

8 Senator Byrd. Thank you.

9 In regard to improving the compliance, your memorandum
10 on page 2, you mentioned certain returns must be filed on
11 magnetic media, to require all filers to file in
12 machine-readable form. What returns would be involved in
13 that?

14 Mr. McConaghy. Well, I think maybe Treasury might
15 want to comment; but most return information today is filed
16 on magnetic tape -- information returns, Senator Byrd. I
17 am not sure of the percentages.

18 Mr. Chapoton. I am sorry, Senator Byrd. Would you
19 repeat the question?

20 Senator Byrd. I was asking, Mr. Secretary, it mentions
21 on page 2 of the memorandum dealing with compliance that
22 certain returns must be on magnetic media, and all filers
23 must file in machine-readable form. What does that mean?

24 Mr. Chapoton. That means that, where the capability
25 exists, that employers will be required to file information

1 returns on wage withholding or other types of information
2 they are required to file on machine-processable information
3 rather than paper.

4 Senator Grassley. That basically means just in block
5 form.

6 Mr. Chapoton. In tape form.

7 Senator Grassley. Well, it can be in tape form if
8 they have it.

9 Mr. Chapoton. Or in block form that can be read by
10 a machine. Correct.

11 Senator Grassley. But at no additional cost?

12 Senator Byrd. Does that require new equipment?

13 Mr. Chapoton. No. It would not be imposed where the
14 reporter did not have the equipment available.

15 Senator Grassley. Senator, I pursued that, because
16 I had the same concern you had. And I got the same answer
17 about two months ago.

18 Senator Byrd. And you are satisfied with it?

19 Senator Grassley. Yes.

20 Senator Byrd. Thank you.

21 Senator Mitchell. Mr. Chairman, could I make one
22 further inquiry?

23 The Chairman. Senator Mitchell.

24 Senator Mitchell. On the question of independent
25 contractors. I didn't know if you were going to have a

1 separate explanation of that or would it be appropriate
2 to ask questions now. Did you plan a separate explanation?

3 Senator Grassley. Also, Senator Mitchell, I have some
4 questions on independent contractors, too.

5 Senator Mitchell. Well, maybe I could just ask a
6 couple of questions.

7 I wanted to know whether the provision regarding
8 independent contractors is designed to include subcontractors
9 particularly in the construction trades and home building.

10 Mr. McConaghy. Certainly.

11 Senator Grassley. Would you yield, Senator Mitchell?
12 I evidently have the same questions you have, so I won't
13 pursue it.

14 Senator Mitchell. Fine.

15 Mr. McConaghy. Senator Mitchell, under the safe
16 harbor rules that are built in, certainly subcontractors
17 could be included within that safe harbor.

18 Senator Mitchell. "Could" be included?

19 Mr. McConaghy. Would be included.

20 Senator Mitchell. Would be included. All right.
21 Then that is clear that they are included?

22 Mr. McConaghy. That's correct, if they meet the
23 safe harbor requirements like anyone else they would be
24 included.

25 Senator Mitchell. Right, if they meet the other tests.

1 Mr. McConaghy. That is correct.

2 Senator Mitchell. I have some suggested report
3 language which I would like to submit, just to make certain
4 that there is no question about that.

5 Mr. McConaghy. Fine.

6 Senator Grassley. Senator Mitchell, are your questions
7 related to the fact that sometimes people involved in the
8 construction industry, and self employed with their own
9 business, their hours aren't totally regulated by themselves,
10 because as they fit into the construction process they have
11 to be there at a certain time to do their work?

12 Senator Mitchell. That is correct, not only the
13 hours but the place-of-business requirement, and other
14 things.

15 I wanted to make clear that some of them may not
16 meet precisely the tests, and we just want to make certain
17 that they are included.

18 Mr. McConaghy. Yes, certainly. And there is a
19 specific proposal that says, essentially, if you don't have
20 complete control of your hours because it is completed in
21 segments like that, then you don't have to worry about the
22 control tests. But we will be glad to read it.

23 Senator Mitchell. Well, I'm glad we established that.

24 Senator Grassley. So, previous to our bringing it
25 up, you felt that this situation was adequately covered

1 in the safe harbor provisions?

2 Mr. McConaghy. That is correct, Senator Grassley.

3 Senator Mitchell. And I will, as I indicated, submit
4 the proposed draft language to you in that regard.

5 Mr. McConaghy. Fine.

6 (The information follows.)

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1 Mr. McConaghy. That brings us, I think, to the
2 telephone tax, which is on page 3. The current telephone
3 tax is 1 percent. It is scheduled to be that for another
4 year, and then be repealed as of 1984.

5 This proposal would increase that telephone tax for
6 1983 to 2 percent. It would go up to 3 percent in 1984
7 and in 1985, and then go down to 2 percent for 1986 and
8 thereafter.

9 The next proposal deals with withholding on dividends
10 and interest. It is on page 3. What that proposal would
11 do would be to have a flat 10-percent withholding rate
12 on payments of dividends and interest. Payments to certain
13 kinds of institutions, or course, and the elderly, would
14 be exempted. And payments made by individuals would
15 generally be exempted. At the same time that proposal would
16 lower the holding period for capital gains -- the long-term
17 capital gain period -- from one year to six months.

18 This essentially, on the withholding, is the same
19 proposal as the Administration's.

20 Senator Long. Let me ask a question about that.

21 Why can't you achieve that objective by just contracting
22 with enough young lawyers or having enough agents to go
23 out and sue these people?

24 It occurs to me that when I was a young lawyer I hung
25 my shingle out, and everybody was predicting I wouldn't make

1 it in that town anyhow, I would have sued anybody --
2 anybody. I think most young lawyers are that way.

3 I recall some fellow came to me and told me a sad
4 story and said, "What I want to know, lawyer, is can they
5 sue me?" I said, "Hell, yes, they can sue you." He said,
6 "Why? I haven't done anything wrong."

7 I said, "What you don't seem to understand is that
8 anybody can sue you about anything. You send me somebody
9 you want to sue, and I'll sue him right now.

10 "I didn't say they could win, I said they can sue you."

11 It occurs to me that if you would just contract with
12 enough people to do this job, especially a lot of young
13 lawyers who are having a hard time trying to make ends
14 meet, they could go pursue these fellows, track them down
15 and sue them, and get the money for you.

16 Mr. Chapoton. Well, Senator Long, this question comes
17 up constantly. The first question is why don't we have
18 perfect or better matching of information returns with
19 actual returns filed so we then would know whether a
20 particular taxpayer has paid tax on interest and dividends
21 he has received. And of course, to the extent that matching
22 is perfect, you can determine that information. But matching
23 is not perfect where information is filed on paper, where
24 the information return comes in on paper, and we have a lot
25 of problems with correct taxpayer identification number.

1 Over 10 percent of the information that comes in has the
2 wrong taxpayer identification number or no taxpayer
3 identification number. Another provision of the Dole-
4 Grassley Bill attempts to deal with that question.

5 And then, once you have aggregate figures, you can tell
6 that a taxpayer has underpaid tax on dividends and interest,
7 you have got to go to the individual item to see whether it
8 relates to a mistaken calculation or a mistake from a
9 particular institution, or find out where the error is.

10 And those, of course, are very costly procedures,
11 time-consuming procedures, and difficult to go through from
12 the Service's standpoint.

13 But once you go through them you often have very
14 small amounts. It simply would not be cost-effective to
15 pursue those individual amounts, nor do I think it would
16 be desirable to pursue those amounts if you simply are
17 talking about hiring more Internal Revenue Service agents,
18 having more presence of the Internal Revenue Service
19 pursuing taxpayers.

20 It seems to me a much happier way to achieve compliance
21 is through withholding, as we do with wages where withholding
22 is certainly the most effective way of tax compliance.

23 Senator Long. I would think that if you had a heavy
24 enough penalty on it, if I were a young lawyer out seeking
25 to collect this thing, I could almost collect the money by

1 telephone. We would call these people and say, "Either
2 bring me the check or else I am going to sue you. You
3 will have to pay the court costs, and you are going to
4 have to pay the costs of the penalty as well," I would
5 think that that person would bring the check to you in
6 person if you had that type of procedure.

7 Mr. Chapoton. I'm afraid that would cause a lot of
8 ill will toward the Internal Revenue Service, though.

9 Senator Long. It's going to cause ill will to pursue
10 them, anyway. I am not saying you are going to make any
11 friends by suing people. You have been a lawyer, Mr.
12 Chapoton, in private practice. You may make him cry by
13 suing some fellow, if he sees how diligent you are, but
14 isn't it true that more often than not -- you don't make
15 a friend out of a fellow by suing him -- you will get the
16 money if you go after him.

17 Mr. Chapoton. That is correct. But let's assume
18 the amount in some cases will be small -- \$200, \$300, \$400,
19 \$500. Those are very expensive to collect even in non-tax
20 areas. They are very expensive to collect, those amounts,
21 and you always have the problem that the person will say,
22 well, he doesn't owe that because of other factors. You
23 are getting into an audit of the return where he claims that
24 he doesn't owe that tax. It is a very time-consuming
25 process to pursue a particular tax return.

1 Senator Mitchell. Mr. Chairman, would you yield, one,
2 just to follow up Mr. Chapoton?

3 In response to Senator Long's question you suggested
4 that his proposal would create some ill will. Do you
5 anticipate that this proposal is going to create a lot of
6 good will?

7 (Laughter)

8 Mr. Chapoton. Senator Mitchell, this proposal has not
9 been a popular one with the Congress, or with us, for that
10 matter; but when you look at the alternatives, particularly
11 raising people's taxes, we just came down on the side that
12 it is a lot easier to collect taxes that are now due than
13 raise new ones.

14 Senator Mitchell. Well, I'm inclined to agree with
15 you, but all I am suggesting is that it is a risky thing
16 for you to be suggesting that an argument against the
17 proposal is that it will create ill will, because that
18 applies to alot of the proposals that are being presented
19 here.

20 Mr. Chapoton. That applies to a lot that we are doing
21 here today. Yes, sir.

22 Senator Baucus. I am just curious. Could you give
23 the revenue estimates for the change in the holding period
24 to achieve capital gains?

25 Mr. McConaghy. Yes, Senator Baucus. In 1983 it would

1 be .1, .2, and .2 for 1984 and 1985. That's a hundred
2 million in 1983, \$200 million in 1984, and \$200 million
3 in 1985.

4 The Chairman. Next?

5 Mr. McConaghy. The next one deals with the possession
6 corporations limit. It tries to solve a problem.

7 Today taxpayers have taken the position they can
8 transfer, tax free, intangible assets that they create in
9 the U.S.

10 Senator Symms. Excuse me. Are you going off the
11 taxpayer compliance now?

12 Mr. McConaghy. We were, Senator.

13 Senator Symms. I would just like to bring up this
14 one point. We did discuss this yesterday. It was not
15 settled, to my knowledge.

16 The Chairman. I might say I indicated that you would
17 have an amendment. We are going through them now just to
18 touch on them; then we are going back.

19 Senator Symms. Oh. So, if we go back to that I just
20 want to bring up that one point. Then you were going to
21 make some contacts with some of those industry people, also.
22 Otherwise I would like to make that very clear that we may
23 want to do something about this direct-seller question.

24 The Chairman. I indicated that.

25 Mr. McConaghy. In this provision, as I said, today

1 taxpayers will go ahead and transfer intangibles tax-free to
2 a possessions corporation down, for instance, in Puerto
3 rico, and none of that income generated by that patent or
4 copyright or trademark, or whatever it may be, generally
5 a patent has to be allocated back to the U.S. corporation
6 that created it.

7 This proposal would really say that income that
8 qualifies for the possession and credit would not include
9 income which is allocable to intangibles that have been
10 transferred down there.

11 In addition, the current rule that permits a qualifying
12 corporation to earn up to 50 percent passive income would
13 be changed to permit only 10 percent passive income.

14 Yes, Senator?

15 Senator Matsunaga. Mr. Chairman?

16 The Chairman. Yes, Senator Matsunaga?

17 Senator Matsunaga. Is it not true that by this
18 tax provision in Puerto Rico and in the territories they
19 have been able to create jobs which otherwise would not have
20 been created?

21 Mr. McConaghy. That is true, Senator Matsunaga.

22 Senator Matsunaga. So there is the danger of greater
23 joblessness in Puerto Rico if this provision goes through,
24 is it not?

25 Mr. McConaghy. That is true, Senator Matsunaga. I

1 think Treasury did a study several years ago with respect
2 to, for instance, the drug companies. The conclusion was
3 that the benefits from these provisions really amount to
4 about a \$43,000 credit per employee. That was several
5 years ago; I don't know what it is now.

6 But you are right as to what the issue is, and that is
7 how much tax benefit are we going to provide essentially
8 to those? Certainly, to some extent it does create some
9 jobs.

10 The Chairman. That doesn't mean the employee was paid
11 \$43,000, does it?

12 Mr. McConaghy. No, the corporation got a tax credit
13 for that. That is correct.

14 Senator Matsunaga. Incidentally, what is the present
15 rate of unemployment in Puerto Rico and the others today?

16 Mr. McConaghy. We think it is on the order of
17 23 percent, Senator Matsunaga.

18 Senator Matsunaga. Well, I'm afraid that if this
19 provision is adopted we may be losing rather than gaining
20 as is anticipated.

21 Mr. McConaghy. This doesn't do away with the credit
22 for active business income, Senator Matsunaga.

23 Senator Matsunaga. But then you will have tax-eaters
24 instead of tax-payers if you take jobs away.

25 Mr. McConaghy. Well, it does not do away with the

1 credit with respect to income from active business; it
2 just says to the extent that an intangible is transferred
3 from up here to down there, tax-free, then essentially
4 that income generated by it would not qualify for the credit.

5 But, with respect to other income, active business
6 income, this does not take the credit away whatsoever.

7 Mr. Chapoton. Mr. Chairman, I should interject here
8 that we have been spending a lot of time on the problems
9 involved in Section 936. We are attempting to revise the
10 regulations under that provision.

11 We do not support this change, because we have some
12 concerns about the way Section 936 works. We would prefer
13 to address these concerns in the regulations. This would
14 go a lot further than that.

15 Senator Matsunaga. Oh, Treasury does not support this?

16 Mr. Chapoton. We did not support this provision.

17 Senator Matsunaga. You are not supporting this?

18 Mr. Chapoton. Not this provision. No, sir.

19 The Chairman. That is not unprecedented. We support
20 it.

21 Senator Bradley. Mr. Chairman? On this particular
22 provision, for what reason do you not support it?

23 The Chairman. There are no good reasons.

24 (Laughter)

25 Mr. Chapoton. We would like to pursue the regulatory

1 approach that we are now pursuing in dealing with Puerto
2 Rico. Our regulatory approach, let me hasten to add, will
3 not be a revenue pickup; it will, we think, make the
4 Section 936 rules work better.

5 Senator Bradley. In your view will we get revenue from
6 this proposal?

7 Mr. Chapoton. Yes, sir. Our revenue estimates
8 indicate that we will.

9 Senator Bradley. What happens -- say we take this
10 action -- if Puerto Rico decides to apply the corporate
11 tax? Does that tax qualify for the tax credit?

12 Mr. Chapoton. No.

13 Senator Bradley. The foreign tax credit?

14 Mr. Brockway. Senator, it would not qualify for it
15 on the income qualifying for the credit -- that is, if it
16 were the income that qualified for active business income of
17 a tax. If they applied the tax on the intangibles income,
18 if they tried to draft a rule to tax that, then that would
19 qualify for the credit because that would now be subject
20 to U.S. tax; so the monies, if they did construct a tax,
21 would go to the Puerto Rican Treasury.

22 Senator Mitchell. Let me just read something. This
23 is, I think, the Governor of Puerto Rico speaking: "Should
24 Section 936 be repealed, and we subject these corporations
25 to our normal 45 percent corporate tax rate, the Federal

1 Government would allow a foreign tax credit to be given to
2 these firms for monies paid to Puerto Rico."

3 Is that a correct statement?

4 Mr. Chapoton. That would be a correct statement. Yes,
5 sir.

6 Senator Mitchell. His final sentence, then, of this
7 paragraph is: "This would leave little or no revenue to
8 be collected by the U.S. Government." So the point is,
9 what revenue are we getting from this proposal if the result
10 of it is going to be Puerto Rico is simply taxing those
11 same companies and getting an offset in the Federal Income
12 Tax?

13 Mr. Chapton. Senator, the problem has been allocating,
14 and it is a very difficult problem, allocating the income
15 of a corporation or a firm or related firms between Puerto
16 Rico and the mainland.

17 To the extent the firm allocates it to Puerto Rico
18 now, it is tax exempt. This provision would say that if
19 it attempts to allocate or transfer a patent to Puerto
20 Rico, and claims that the income is attributable to Puerto
21 Rico, that it would no longer be exempt. That very question
22 in particular fact situations is in litigation now.

23 But if U.S. law is that that income does not escape
24 taxation if it is transferred or attempted to be transferred
25 to Puerto Rico, then I suspect there would be no attempt to

1 to transfer it to Puerto Rico.

2 Senator Mitchell. So that we have the potential here
3 of no revenue gains?

4 Mr. Chapoton. No. I think the assumption is that
5 the intangible would not be transferred to Puerto Rico,
6 and therefore it would be earned in the U.S. with no
7 exemption.

8 Senator Moynihan. Mr. Chairman?

9 Mr. Secretary?

10 Mr. Chapoton. I'm sorry.

11 Senator Moynihan. Well, I'll ask Mr. Chapoton or
12 Mr. McConaghy: Has the Government of Puerto Rico been
13 consulted about this specific matter?

14 I spoke just yesterday to Governor Romero Barcello,
15 and he did not seem privy to this at all.

16 Mr. Chapoton. No. This matter came up, and we have
17 not discussed it with Puerto Rico.

18 The Chairman. But I might say it is one of the options
19 that have been under consideration for some time.

20 Senator Long. Have we had a hearing on this subject?

21 The Chairman. No.

22 Senator Moynihan. I would like to say, Mr. Secretary,
23 Mr. Chairman, as you know, the State of New York is the
24 region from which Puerto Rican affairs are managed from the
25 Federal Government in its regional offices.

1 And it seems to me for a disputed sum of money, whether
2 there will be or not we don't know, to impose a matter of
3 this order on the Government of Puerto Rico without hearing
4 from it, without letting it give its say, and at a time when
5 this Administration has very admirably proposed a
6 Caribbean Basin Initiative, which is designed to give
7 benefits to other islands similar to those of Puerto Rico,
8 it seems to me not in the democratic spirit that this
9 commonwealth relationship has prospered. I know no one
10 intended it to be other than that, but I do feel it is
11 that.

12 Senator Long. Here is one thing that bothers me about
13 this proposal. Usually when you find some place where you
14 are going to pick up a billion dollars by just closing some
15 loopholes, when you look into it more deeply you usually
16 find that it is more involved than what you meet on the
17 surface.

18 Now, people came to me speaking for one of the drug
19 companies that has a patent down there, and so I told them
20 in advance I thought they were wasting their time
21 coming to me. But as we discussed the matter I discovered
22 more and more that I didn't know as much about that thing
23 as I thought I did. All I knew is what someone told me,
24 and I wasn't even fully apprised of what the facts in the
25 matter were.

1 I do think that we ought to take a close enough look
2 here to see if there is more than meets the eye here, and
3 that this could indeed be a disaster for that government
4 down there in Puerto Rico. If they are actually achieving
5 the billion dollars by their taxes, one way or the other,
6 or some major part of it, and they would be very much
7 distressed by that, I think that that would make a difference
8 to us. So if the question is whether this is some gimmick
9 that the drug companies are getting away with or whether
10 this is something that is a very considerable item in the
11 economy of that island, that makes a big difference to us.
12 And, while they don't have a Senator to represent them in
13 the United States Senate, I think we have a special burden
14 to try to see to it that we are fair to them when we make
15 a decision.

16 I would hope that a hearing might be arranged on this
17 matter before we finally wrap this matter up, before we
18 vote on it in the Senate.

19 I am not saying that we couldn't report the bill until
20 holding it; I just think that, at a minimum, the governor
21 and anyone who wanted to speak for Puerto Rico ought to
22 have a chance to tell their case, and perhaps some of the
23 industries affected might have a chance to speak.

24 You do think, Mr. Chapoton, that there is a net gain
25 of a billion dollars, and it doesn't take the billion dollars

1 away from Puerto Rico? Is that your opinion?

2 Mr. Chapoton. That is correct. That is our revenue
3 estimate; that is correct.

4 The Chairman. Mr. Brockway?

5 Mr. Brockway. Yes, Senator. I should have given a
6 more complete answer to Senator Bradley, that the taxes
7 imposed by Puerto Rico, if they were to impose them on this
8 income, would now qualify for the foreign tax credit as any
9 other foreign-source income.

10 I don't expect Puerto Rico to start taxing that in any
11 substantial way, because the taxpayer would have to have
12 other foreign-source income to use the crediting in. To
13 the extent that they did have other foreign-source income,
14 they could use it. But they would have to have other
15 foreign-source income. Most U.S. corporations are already
16 in an excess foreign-tax-credit position; so they would
17 net dollar-out-of-pocket in that change, so they would
18 recommend strongly to Puerto Rico not to increase the tax.

19 But to the extent that Puerto Rico taxed, it would go
20 to their treasury. Those who were not in an excess-credit
21 position, they could then use the credit. So there would
22 be some interaction from that result if they actually did
23 increase a tax.

24 This proposal basically adopts what the IRS litigating
25 position has been, that, one, income attributable to these

1 intangibles developed in the U.S. and transferred down,
2 the IRS litigating position has been that is U.S. income,
3 and this adopts that long-standing approach that the
4 companies report on the position that this is attributable
5 to Puerto Rico.

6 The Chairman. Senator Mitchell wanted to ask a
7 question.

8 Senator Mitchell. I just wanted to ask Mr. Chapoton
9 one general question.

10 You said that the Administration does not support this
11 provision?

12 Mr. Chapoton. That is correct.

13 Senator Mitchell. Then I want to go back and ask you
14 if there are any other proposals that have been discussed
15 this morning which the Administration does not support?

16 Mr. Chapoton. Senator Mitchell, I will point that out.
17 There are individual items. I have raised, I think, a
18 couple of problems on individual items as they came up.
19 We have not covered a provision so far that we oppose.

20 Senator Mitchell. We have not?

21 Mr. Chapoton. We have not, before this one.

22 Senator Mitchell. Can we then, so we don't have to
23 keep asking the question, assume that in the absence of a
24 statement by you to the contrary that the Administration
25 supports each and every proposal out of this committee?

1 Mr. Chapoton. We support the provision. I don't want
2 to be walked into the provision of saying if we had designed
3 it we would have designed it precisely the same way. We
4 have worked with the staff and the Chairman on certain
5 details of some provisions. We may have designed them
6 differently, as is often the case.

7 Senator Mitchell. No, I understand that. I am not
8 talking about all of the details. But in the absence of a
9 contrary statement by you may we assume that the
10 Administration supports these proposed resolutions?

11 Mr. Chapoton. That is correct.

12 Senator Mitchell. Thank you.

13 Senator Moynihan. Mr. Chairman, I hope we might
14 reserve -- we are not making any judgment, anyway, right
15 now, but on this particular matter it really raises serious
16 questions.

17 The Chairman. It raises serious questions for some
18 who haven't paid taxes for a long time, I know that. This
19 is one of our fairness provisions.

20 Senator Bradley. Mr. Chairman, could I just raise one
21 question?

22 The Chairman. Senator Bradley.

23 Senator Bradley. The Governor of Puerto Rico has
24 communicated to various members of the committee, and I
25 think he has communicated to you, that the amount of jobs

1 that the 936 companies generate in Puerto Rico is something
2 of the nature of 150,000 jobs.

3 Now, I don't think the committee wants to be in the
4 position of doing anything that would jeopardize those
5 jobs, so I think it is important that we at least look at
6 this a little more carefully.

7 Senator Matsunaga. And, Mr. Chairman, I would urge
8 that the Delegate from Puerto Rico, Mr. Colluro, be heard
9 on this matter also. I know for a fact that he is anxious
10 to do so.

11 The Chairman. Well, we will be glad to visit with
12 him. I certainly want to look at this very carefully, but
13 it is not a secret. There was a big two-page story in
14 the local paper here about a month or two ago on this
15 little tax haven. And it is something we have been looking
16 at for some time. It may not survive, but at least it has
17 gotten some attention.

18 If we are going to require the Administration's
19 approval with every amendment, then there may be other
20 amendments that will have to be rejected.

21 Mr. Brockway. The next provision, Senator, addresses
22 the situation of international petroleum companies' use of
23 their foreign oil extraction taxes and exploration losses
24 to offset their tax on low-tax oil-related income conducted
25 in low-tax countries, such as oil trading operations or

1 refining operations.

2 The proposal here would modify the special limitations
3 applied to foreign oil extraction taxes so that none of
4 the extraction taxes or losses could be used against this
5 low-tax income. And then it would also say that low-tax
6 income such as the oil trading and oil refining, other
7 oil-related income that arises in third countries which
8 are not the country of extraction or not the country
9 of consumption of the petroleum products would be
10 currently subject to tax on the present anti-tax-haven
11 rules in the Code.

12 Mr. Chapoton. Now this is the other provision, Senator,
13 that we do not support. We are concerned about ending
14 deferral for this particular industry, for this particular
15 type of income.

16 We are concerned about ending deferral, singling out
17 out this type of income and ending deferral of tax on it.

18 Senator Long. As I understand that you have a problem
19 here, that the American oil companies are trying to help
20 solve this energy crisis.

21 One important aspect of that is to try to find oil
22 all around the world to help break the OPEC cartel.

23 Now, I know domestically we have almost 40 percent of
24 our rigs stacked right now, have we not? Or something
25 approaching that?

1 Mr. Chapoton. I believe that is correct. I think the
2 rig count is below 3000 now. Yes, sir. So it's up to
3 46.

4 Senator Long. So we've got a real problem here in the
5 United States, and we really ought to be trying to do
6 something about it to get the drilling going again.

7 Would this have the effect of taxing those in the
8 oil-exploration business in a fashion less favorable than
9 those in other lines of endeavor doing business overseas?

10 Mr. Chapoton. Yes, sir. It would have the effect.

11 Let me back up just a bit. There is a concern about
12 the way the foreign tax credit works with respect to foreign
13 extraction income, and whether what purport to be taxes or
14 taxes which are entitled to a foreign tax credit are in
15 fact royalties which are not entitled to a credit but are
16 entitled only to a deduction. That has been a problem that
17 has plagued the Treasury for a number of years.

18 Indeed, we have had a set of regulations dealing with
19 it. We are now working on a new set of regulations. It is
20 a significant problem.

21 This deals with that problem partially, and it does go
22 further and ends deferral on foreign oil, on certain types
23 of income abroad -- non-extraction, but oil-related income
24 abroad.

25 Senator Long. Well, now, don't we have a problem here

1 to the extent that we tax our companies more heavily than
2 their competitors in this international effort to produce
3 energy? It would tend to take our companies out of it.

4 Mr. Chapoton. Certainly, if we tax them more heavily
5 they are less competitive.

6 Senator Long. Some countries aren't even taxed at
7 all on what they can make overseas. Some are much more
8 favoring us already, are they not?

9 Mr. Chapoton. Yes, sir. Some.

10 Senator Long. Well, thank you.

11 Senator Bradley. Mr. Chairman, let me just ask
12 Treasury: Do you think that this change will in any way
13 alter the oil industry's likelihood of going out and
14 seeking oil in new places in the world?

15 I mean, we all understand we want to get off Persian
16 Gulf oil. One of the incentives is to try to search for oil
17 in other more secure places around the world.

18 Is it your sense that this will reduce that search for
19 oil in more secure places around the world?

20 Mr. Chapoton. Senator, that's a hard question to
21 answer. I am really not sure I can say. It will change
22 the system of taxation. It is not a very dramatic change.
23 It is significant to the companies that are affected.

24 I would just have to pass on that one.

25 Senator Bradley. But do you think it will change

1 drilling patterns?

2 Mr. Chapoton. I doubt that it will change drilling
3 patterns.

4 The Chairman. We might just take the next item, which
5 would finish page 3. It is doubling the cigarette excise
6 tax. And then we will recess until 2:30.

7 Mr. McConaghy. The next proposal is to double the
8 Federal Excise Tax on all cigarettes from 8 cents,
9 essentially, to 16 cents. A different adjustment would have
10 to be made for small ones, I think. But this essentially
11 has not been changed since 1966. The tax went in at that
12 point on the equivalent of 8 cents a pack, and this would
13 take it up to 16 cents a pack.

14 The Chairman. Are there any questions on that one?
15 Does the Administration support that?

16 Mr. Chapoton. Yes, sir.

17 The Chairman. We will stand in recess until 2:30.

18 (Whereupon, at 12:32 p.m., the hearing was recessed.)
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1 The Chairman. I think when we recessed, Art, we
 2 were on the bottom of page. I know not all the Members
 3 are here, but I know that everyone is represented by Staff.

4 I doubt that there are any amendments to be offered
 5 by any member, but in the event that some strange happen-
 6 stance that somebody might have an amendment, I would hope
 7 that without any strict guidelines, that obviously they'll
 8 be handled in the daylight and we will ask if they are
 9 prepared now, if we could see that Mark McConaghy receives
 10 them we could be looking at them this afternoon. And, those
 11 that appear to be technical in nature or in effect, the
 12 revenue neutral, and agreed upon by Treasury and the joint
 13 committee and our own minority and majority staffs, I see
 14 no reason they could not be a part of the package.

15 So, it would expedite things if anybody on either
 16 side has any such amendment.

17 I think the next item on page 4 is the corporate
 18 minimum tax preference reform.

19 Mr. McConaghy. That's correct, Mr. Chairman. This,
 20 in the write-up, I think, that is being passed our presently,
 21 which would go into some detail, this would look at preferences
 22 directly and essentially cut them down across the board by
 23 15 percent.

24 The cutback, of course, on this one is only for
 25 corporations, so it is taking the preference provisions and

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1 cutting them back by 15 percent.

2 For example, specifically it would look at intangible
3 drilling costs and with respect to integrated oil companies
4 who presently expense the entire amount of their intangibles,
5 it would mean that 85 percent of that would be currently
6 expense and the other 13 percent would be spread over a five-
7 year period, given ACRS treatment and that would include
8 the investment credit.

9 With respect to percentage depletion for hard
10 minerals, that would be reduced by 15 percent and so forth.
11 The preferences are -- the bad debt reserve, of course, is
12 one. Bank interest to the extent that it is used to carry
13 tax exempt interest, this benefits structures essentially
14 and how that would operate is that 15 percent of it would
15 be subject to 1245, pollution control facilities, mineral
16 exploration development costs. And then in addition to
17 taking and cutting those preferences back by 15 percent
18 it would take the investment credit level that we now have
19 and today you can offset up to 90 percent of your tax
20 liability by the investment credit, this would move that
21 percentage down to 85 percent so that I could offset up
22 to 85 percent of my tax liability with the investment
23 tax credit.

24 It would retain the add-on minimum tax and it
25 would provide an adjustment, essentially, so that people

1 would not from the combination of one preference and basically
2 that's bad debts and intangibles, they would not be hit by
3 both the add-on and the cutback here.

4 That raises \$700 million in 1983, \$1.2 billion
5 in 1984 and \$1.1 billion in 1985.

6 The next item is construction period, interest
7 and taxes. Essentially today --

8 Senator Long. Would you mind telling me now on
9 this corporate minimum tax, what are you going to tax --
10 What do you tax that is not taxed now?

11 Mr. McConaghy. I'm sorry, Senator Long, I didn't
12 hear the question.

13 Senator Long. Tell me, do we have a corporate
14 minimum tax at the present time?

15 Mr. McConaghy. We do, Senator Long, and there are
16 basically six preferences in that corporate minimum tax.
17 The present minimum tax is an add-on tax to the extent that
18 you have tax preference which are in excess of the greater
19 of either the regular income tax or \$10,000.. Then to
20 the extent of that excess today we have an add-on minimum
21 tax at the rate of 15 percent.

22 Those tax preferences that are listed for purposes
23 of today's add-on minimum tax are accelerated depreciation
24 on real property in excess of straight-line, amortization
25 of certain pollution control facilities. In the case of

1 financial institutions certain of them, it is the excess
2 of the bad debt deduction over their actual experience,
3 percentage depletion in excess of adjusted basis, 1846 of
4 capital gains and though it is going to phase-out, the
5 amortization of child care facilities is the sixth preference
6 under today's corporate add-on minimum tax.

7 The Chairman. That's in addition to what you
8 have now. Now, do you reduce some of these minimum taxes
9 that are presently there? Oh, I see. The present year tax
10 is an add-on tax. Right now it is an add-on?

11 Mr. McConaghy. Correct, Senator Long.

12 The Chairman. This would not be an add-on, is
13 that right?

14 Mr. McConaghy. This would not be an add-on. It
15 would look at this combination of preferences on 1 through
16 8 and it would cut them back by 15 percent. It has much
17 less effect than imposing a tax on 15 percent on an aggregate.

18 The Chairman. By the time you get through, you
19 increase taxes by \$1.2 billion next year?

20 Mr. McConaghy. An additional \$1.2 billion in
21 1984 and an additional \$1.1 billion in 1985.

22 Senator Byrd. This is not an alternative minimum
23 tax?

24 Mr. McConaghy. It is not an alternative minimum
25 tax, Senator Byrd. It looks at the preferences directly

1 and attempts to cut them back and does by 15 percent. Many
2 people said that we should look at this kind of an approach
3 as opposed to trying to develop all these types of surtaxes
4 and the original proposal that the administration sent up
5 and we should develop a proposal that looks at essentially
6 cutting back those preferences directly, that's the proper
7 way to go and that's what we essentially were asked to
8 design and that is what is in the package.

9 Senator Byrd. There is not an alternative minimum
10 tax. You told Senator Long it is not an add-on minimum
11 tax either?

12 Mr. McConaghy. That is correct. It looks at the
13 preferences themselves and cuts them back.

14 Senator Long. Is this tax that is being recommended
15 here now, is this an add-on tax or is it an alternative tax?

16 Mr. McConaghy. It really is a minimum tax preference
17 reform, I would call it, Senator Long. It is not an add-on
18 minimum tax. It is not an alternative minimum tax. It
19 looks at those kinds of preferences that we include in a
20 minimum tax and it cuts them back slightly, in this case
21 15 percent.

22 Many of the people that came in after the Admini-
23 stration proposed their original minimum tax which would
24 have raised additional money beyond this said, why don't
25 you just look at those preferences directly and cut them

1 back a little bit, rather than coming up with all these
2 other complicated schemes. That is what this proposal does.

3 Senator Symms. Mr. Chairman, I'd like to ask another
4 question right along that line that Senator Long is asking
5 a question.

6 If these preference items that we are talking about,
7 how long have they been in the tax -- What is the precedent
8 that we are talking about here?

9 Mr. McConoghy. They vary, Senator Symms, all over
10 the lot. Ninety percent investment credit started this
11 year. Prior to that time it was 50 percent of tax liability,
12 offset with the investment credit. That phased in.

13 Percentage depletion, essentially it goes way back.
14 Disc is 1971. Motor carriers was last year. Structures
15 we have had for a long period of time.

16 Senator Symms. So, what we are saying is we just
17 reduce by 15 percent all of the preference items?

18 Mr. McConaghy. That is correct.

19 Senator Symms. Well, what would be wrong, Mr. Chairman,
20 with the suggestion that maybe we would sunset this in
21 or is that in the language?

22 Mr. McConaghy. It is not in the language as presently
23 constructed, Senator Symms.

24 Senator Symms. If we would sunset it, it might cause
25 the committee in two or three years to at least take another

1 look at the preference items. All I would be saying is
2 that along the line of what you first made the point that
3 maybe we should be selecting -- maybe some of these or time
4 to review them, whether they should be preference items or
5 not.

6 Mr. McConaghy. If you did for revenue purposes, I
7 think you certainly would want to do it at least pass 1985,
8 Senator Symms. But, that is certainly something that you
9 could do.

10 Senator Symms. Mr. Chairman, when would that be
11 appropriate if we wanted just to sunset this or would that
12 be -- We're just going through -- We're not in the amend-
13 ment process now -- not in the sunset yet?

14 Senator Symms. Not in the daylight.

15 Mr. Chairman. After we have gone through -- What we
16 thought we might do first is go through each item with a
17 brief description and start back from the beginning and
18 if there was further discussion or amendment, it would
19 happen at that time.

20 Senator Byrd. Let me ask one question about this
21 minimum tax. Mark, on the bad debt reserve. Take an
22 example. If a corporation has a bad debt totalling \$100,000.
23 does that mean that they would be able to deduct only \$85,000?

24 Mr. McConoghy. No, that's just for financial institutions.

25 Senator Byrd. Only for financial institutions?

1 Mr. Moynihan. Mr. Chairman?

2 Mr. McConaghy. And only on that artificial portion
3 of the bad debt reserve by Statute above their actual
4 experience.

5 Mr. Moynihan. Mr. McConaghy, may I speak to the
6 designation of this as a corporate minimum tax. I read it
7 to be a 15 percent reduction in certain tax deductions that
8 corporations can make and we are reducing the size of those
9 reductions.

10 What has this got to do with what we have generally
11 thought to be a minimum tax which is a device that is to
12 prevent you from using so many deductions that you pay no
13 tax at all?

14 Mr. McConaghy. Well, I think, Senator Moynihan,
15 corporate minimum tax preference reform, most people would
16 conclude that these items that were listed here were
17 preferences for purposes of the corporations -- for purposes
18 of corporation's computation of tax. Many times we try to
19 get at these preferences through various kinds of minimum
20 tax such as the one the Administration proposed to try to
21 propose, in effect, some tax on those preferences.

22 Others have suggested that instead of going through
23 those complications, why don't you just look at those
24 preferences directly and cut them back somewhat and in
25 this case it cuts them back.

1 Mr. Moynihan. I wonder if we could hear from Mr.
2 Chapoton on this, because it seems to me, if I understand
3 the working of the corporate minimum tax, the higher amount
4 of deductions taken of the kind listed here, the sooner
5 the minimum tax triggers in. And by lowering those deductions,
6 the later the minimum tax figures in.

7 Mr. Chapoton. Well, Senator, that is correct, but
8 also note as you lower deductions, you are in the same time
9 lowering the preference and indeed I guess I would not
10 agree with your initial statement. If you had no preference
11 deductions, there would be no minimum tax under any type of
12 minimum tax.

13 Mr. Moynihan. But, it would seem to me that this
14 particular proposal will end up with fewer corporations paying
15 the minimum tax.

16 Mr. Chapoton. That is true, because fewer corporations,
17 there would be fewer preference deductions being allowed.

18 Mr. Moynihan. I am not against this proposal, but
19 this is a proposal to reduce the number of corporations
20 that pay the minimum tax.

21 Mr. Chapoton. Well, let me -- I think Mr. McConaghy
22 went through it, but there is a present add-on minimum tax
23 in the law, as you know.

24 We proposed, in lieu of that, an alternative minimum
25 tax which would take these same preferences and impose a

1 15 percent alternative rate on these preferences plus your
2 regular taxable income, if that were higher than your
3 normal tax liability.

4 There were many objections to the complexity caused
5 by the minimum tax, saying that it hit unfairly between
6 industries and the statement, as Mr. McConaghy said, that
7 we heard alot and I'm sure the staff here heard alot, that
8 if you want to do something about the overuse of preferences,
9 we should look at the preferences individually and cut them
10 back individually.

11 Mr. Moynihan. You are just reducing the preference?

12 Mr. Chapoton. That is what is being done in this
13 proposal, as I understand it, is a reduction of preferences
14 and that does -- I think that that probably makes more
15 sense.

16 Mr. Moynihan. You won't mind me suggesting that in
17 the Committee report we list the preference reduction
18 section, unless you are just so attached to the idea that
19 there is going to be a corporate minimum tax in this Bill
20 and even if there is not, you are going to say so?

21 Mr. Chapoton. We have referred to this as a -- It
22 is a preference cutback, I'm not disagreeing with that.
23 The minimum tax preference is why it gets this name, but
24 it is a preference cutback and it is in lieu of our minimum
25 tax proposal.

1 Mr. Moynihan. Well, can we agree that we will call
2 it a preference cutback.

3 Mr. Chairman. You can call it anything you want.

4 Mr. Moynihan. Well, it just seems to me a certain
5 amount of terminological inexactitude is necessary on the
6 other side there, but that it ought to be called attention
7 to.

8 Senator Byrd. The fact is it does raise revenue.

9 Mr. Chairman. It does have some people paying taxes,
10 or some corporations.

11 Mr. McConaghy. The next item deals with construction
12 period interest and taxes and the rule today, so that you
13 know it with respect to an individual taxpayer if he incurs
14 interest in taxes during the construction period, those
15 interest in taxes are required to be capitalized and spread
16 over a ten-year period, rather than to be currently expensed,
17 except for one type of construction, and that's low-income
18 housing.

19 However, in the case of a corporation, there is no
20 rule similar to that, and in that case interest and taxes
21 are currently expensed during the construction period.

22 This change would require that in the case of corpora-
23 tions there would be a requirement to capitalize interest
24 and taxes during the construction period with respect to
25 construction other than residential construction.

1 Senator Bentsen. I'd like to understand from Treasury,
2 in talking about doing that are we talking about Section
3 1250 on real property? Is it limited to that?

4 Mr. McConaghy. This really does not deal with Section
5 1250 at all, Senator Bentsen, directly. It would just
6 say that when a corporation is constructing a property
7 other than residential property that the interest and taxes
8 that are incurred during that construction period will be
9 required to be capitalized and spread over a ten-year
10 period rather than being currently expensed as under exist-
11 ing law.

12 Senator Bentsen. Well, in other words, are you talk-
13 ing about extending it to 1245?

14 Mr. McConaghy. No, just real property.

15 Senator Bentsen. Well, that's what I am trying to
16 get to, real property. So, it is not the 1245, it is
17 just real property?

18 Mr. McConaghy. Yes, but some real property is subject
19 to 1245 today, as a result of changes we made in ERTA
20 last year. So, this just would go to real property
21 itself and say, when you are constructing real property,
22 interest and taxes during the construction period would
23 be capitalized and amortized over ten years.

24 Senator Bentsen. Mr. Secretary, do you want to comment
25 on that?

1 Mr. Chapoton. No, Mr. McConaghy is right. Some 1250
2 property is now subject to 1245 is the point he was making.
3 This only applies to real property.

4 Senator Bentsen. Well, let me understand then. Would
5 it include structures affixed to the ground, such as farm
6 implement sheds, pipelines, the rest of it?

7 Mr. Chapoton. No, it would not. It would include only
8 buildings.

9 Senator Byrd. Well, does not that run counter to what
10 we have been trying to do in legislation of last year to
11 encourage expansion?

12 Mr. Chapoton. The legislation last year provided
13 faster cost recovery for all buildings and equipment. This
14 is a rule that is already applicable to individuals and it
15 simply makes that rule applicable to individuals applicable
16 to corporations.

17 It will have the effect of not allowing, as early
18 as they are now allowed, certain expenses in connection
19 with the construction of a building, that is, the interest
20 and taxes that are incurred during the period of construction
21 of the building will have to be capitalized and recovered
22 over a ten-year period so they will not be deducted
23 immediately and therefore there will be a referral of that
24 deduction.

25 These same buildings will have a force of a 15-year

1 recovery period at an accelerated rate, if they wish.

2 Senator Byrd. But, after the building is structured
3 and utilized, then taxes and interest paid at that point
4 would be --

5 Mr. Chapoton.--are deductible, that's correct. Fully
6 deductible when paid.

7 Mr. Chairman. This ends the discrimination between
8 an individual and a corporation.

9 Senator Matsunaga. But, Mr. Secretary, as I recall,
10 the 1976 Act limited the tax to individuals because there
11 was abuse in the tax shelter use by individuals, but there
12 was no such abuse on the part of the corporation. Am I
13 not correct?

14 Mr. Chapoton. Well, as I've often said, an abuse is
15 in the eyes of the beholder. In any case, where this item
16 is an item of capital nature, it is a part of the construc-
17 tion of the building, if it is deducted early, it has the
18 effect, obviously, of offsetting other income since there
19 is no income from the building at that time before construc-
20 tion is completed.

21 So, in the case of individuals, it was a very popular
22 shelter device, that's correct. It has the same effect in
23 the case of a corporation, of course.

24 Senator Matsunaga. But, did I understand you correctly
25 in response to Senator Byrd's question that the proposal

1 would be contrary to the Treasury's proposed -- completed
2 contract regulation which would allow construction here,
3 interest and taxes to be deducted as a period expense?

4 Mr. Chapoton. No, that is a different situation,
5 Senator. That is on the side of the building, the construc-
6 tion company. This deduction relates to the builder, the
7 owner of the building who is having it built. He may have
8 a contractor to do it. The completed contract rules deal
9 with the taxation of the contractor. These rules deal with
10 the taxation of the owner of the building, the corporation
11 that is having the building constructed.

12 Senator Matsunaga. Would this not tend to delay con-
13 struction?

14 Mr. Chapoton. It will have the effect of reducing the
15 early tax benefits from the construction of a building.
16 With this deduction, these tax benefits can offset income
17 from other sources.

18 Under this rule, these expenses would have to be
19 capitalized and recovered over the next ten years. So,
20 the tax advantage that now exists would not longer exist,
21 that is correct.

22 Senator Matsunaga. What I am fearful of is that --
23 Well, the hotel construction going on in Hawaii -- Well,
24 Hawaii I cite only as an example. And, this might delay
25 the expeditious construction of needed hotel space.

1 Mr. Chapoton. It would help the economic recovery and
2 then they would all be filled.

3 Senator Matsunaga. But, if we don't have the hotel
4 space to accommodate, those who want to spend the money that
5 they will be accumulating under your program, well, we
6 would not profit from it or benefit from it.

7 Mr. Chapoton. Those hotels, as of last year, have a
8 15 year write-off period and that is a very significant --

9 Senator Matsunaga. I realize that.

10 Mr. McConaghy. The next one deals with so-called
11 MODCO, the taxation of life insurance companies. And, I
12 think there has been some arrangement that has been worked
13 out and I think Mr. Belas is going to go through that
14 arrangement.

15 Senator Bentsen. I would say, Mr. Chairman, that I do
16 believe we have worked out a reasonable compromise with
17 you and your proposal and if Mr. Belas would get into the
18 technicalities of it, I think it would be helpful. I
19 think Senator Chafee is satisfied with the compromise.

20 Mr. Chairman. I want to thank you, Senator Bentsen, for
21 your valuable assistance in being the expert in this area
22 and also Senator Chafee. Senator Chafee is here.

23 We are just getting into the MODCO and Mr. Belas will
24 give me a description of what I understand may be acceptable
25 compromise?

1 Mr. Belas. I believe this would be acceptable to the
2 industry. We worked this out with Senator Bentsen's staff
3 and Senator Chafee's staff in close conjunction with the
4 industry.

5 Mr. Chairman. Can you pull the mike up just a bit,
6 Rich?

7 Mr. Belas. Mr. Chairman, the primary problem that
8 Treasury attempted to address in its proposals last February
9 was a type of insurance between insurance companies called
10 modified co-insurance.

11 While the transactions themselves had longstanding
12 business purposes behind them, in recent years the trans-
13 actions had been used for substantial reductions in life
14 insurance company taxation.

15 Senator Bentsen and Senator Chafee and the other co-
16 sponsors introduced a bill which would have addressed the
17 modified co-insurance unintended tax benefit and also at
18 the same time revise some of the other rules relating to
19 Subchapter L of the Internal Revenue Code, the portion of
20 the Code that deals with life insurance companies.

21 We have worked out on the staff level a compromise, of
22 which the major portions of which are as follows.

23 The modified co-insurance provisions would be repealed
24 as of January 1st, 1982, the special tax treatment for the
25 modified co-insurance transactions, and also similar

1 reinsurance transactions which have the same effect would
2 also be repealed or denied favorable tax treatment.

3 Because of the possibility of intended or possible
4 hardship to certain reinsurers, however, the proposal would
5 allow a three-year recapture period so that the additions
6 to income would not have to be taken into income in one
7 year.

8 There would be a grandfather provision for the modified
9 co-insurance in related-type transactions except in the
10 case of fraud.

11 The second major portion of the proposal relates to
12 the deductibility of policyholder dividends. There is
13 currently in the law a small company special deduction
14 which is limited to \$250,000 worth of policyholder dividends.

15 This would be raised to \$1 million. but an affiliated
16 group limit would be applied so that only one \$1 million.
17 deduction would be allowed for an affiliated group.

18 Secondly, the \$1 million. deduction would be limited
19 or targeted to smaller companies.

20 The second policyholder dividend issue would be to
21 allow and to make sure that 100 percent of policyholder
22 dividends would be deductible for qualified pension business.

23 Third, there would be a safety net or safe harbor
24 which would allow up to 77 and a half percent of policyholder
25 dividends on nonqualified business to be deducted for mutual

1 companies and 85 percent of such policyholder dividends
2 to be deducted by stock life insurance companies.

3 The third major area of the proposal concerns deferred
4 annuities. The Treasury has proposed and the proposal in-
5 cludes a modification of Section 72, which deals with the
6 taxation of annuity contract so that any withdrawals from
7 an annuity contract would be deemed to be income first. The
8 taxable amounts of investment income on those contracts
9 would be deemed to be taken out first if there were a with-
10 drawal from the contract.

11 A similar rule would apply to loans. There would be
12 a ten percent penalty similar to that imposed on IRA's for
13 withdrawals prior to age 59 and a half or within ten years
14 of the contribution, whichever period is shorter.

15 The ten percent penalty, however, would not be applied
16 to the whole amount in the contract, however it would be
17 applied only to the investment income portion.

18 Also, as suggested by Treasury, the package would in-
19 clude a 100 percent excess interest deduction for amounts
20 credited to the deferred annuity business, that is a life
21 insurance company deduction.

22 The fourth major area deals with a special type of
23 formula called the Menghy formula. And, the formula would
24 be changed from an arithmetic computation to a geometric
25 computation, however unlike the Bill 2353, as introduced,

1 there would be no special cap on that deduction or on that
2 formula.

3 The fifth portion of the Bill relates to consolidated
4 returns. An affiliated group of life insurance companies
5 would be allowed to compute their consolidated returns on
6 a bottomline, consolidation method, for the stop gap period
7 of this bill.

8 The sixth area of the Bill deals with reserve evaluations.
9 Section 818(C)(2) of the Internal Revenue Code, which provides
10 an approximate revaluation formula for preliminary term
11 reserves would be reduced from \$21 per thousand dollars of
12 insurance in force to \$19. per thousand dollars of whole
13 life insurance in force.

14 This would apply to business written after March 31st,
15 1982.

16 The seventh portion of the Bill deals with a grand-
17 father protection. There would be grandfather treatment
18 of excess interest deductions, prior consolidated return
19 treatment claimed and modified coinsurance transaction
20 related-type transactions, except for fraud would all be
21 grandfathered for transactions and for instance, before
22 January 1st of 1982.

23 Mr. Chairman. We're going to ask Treasury to comment
24 on the proposal, but I assume they approved this provision?

25 Mr. Belas. Mr. Chairman, I understand the Treasury still

1 has certain objections to certain portions of this package.

2 Mr. Chairman. Let's go ahead and finish.

3 Mr. Belas. There is one final major portion of it.

4 There is a new or recent type of life insurance product
5 recently being introduced, referred to in the industry as
6 universal life. It is a flexible premium type of policy.

7 The proposal would prescribe guidelines. The eligibility
8 of proceeds from universal life products for income tax
9 death benefit exclusions under Section 101 of the Code,
10 and except for grandfather protection for prior periods,
11 would not prescribe treatment of excess interest.

12 There was a small technical problem that would be
13 solved by the proposal which would say that no reserve deduc-
14 tions would be allowed for interest guaranteed beyond the
15 annual evaluation date. That would take care of a possible
16 problem over a statement of reserves.

17 Mr. Chairman. Now, I notice on the revenue side there's
18 a change in 1984 of 1.6 to 1.5?

19 Mr. Belas. That is correct, sir. That is the latest
20 joint committee estimate for this proposal.

21 Mr. Chairman. And, I only note that because that
22 would not make the package \$100 million lighter which would
23 make it \$98.3, which is precisely the target we have.

24 Now, Mr. Chapoton, do you want to comment on the
25 package?

1 Mr. Chapoton. I'll be very brief, Mr. Chairman.
2 The package we proposed repealing MODCO, and doing nothing
3 further. We have had, since that proposal was made, many
4 and long discussions with the industry. This is in the
5 nature of a stop gap proposal.

6 Mr. Chairman. What is the length of this proposal?

7 Mr. Chapoton. Three years.

8 Mr. Belas. Most of the provisions will terminate after
9 1985. It will go through 1982, through 1985.

10 Mr. Chapoton. There are permanent provisions in it.
11 It deal repeal MODCO, the use of MODCO altogether and it
12 certainly goes in the correct direction.

13 The parts of it that bother us, I am somewhat disturbed
14 by the grandfathering of prior transactions which had no
15 substance whatsoever. As I understand this proposal, we
16 would grandfather all except where there might be fraud
17 involved.

18 In the case of the pension deduction, we agree that
19 100 percent of pension business of insurance companies,
20 we agree 100 percent deduction should be allowed. I think
21 we do need drafting discretion to make sure that the deduction
22 doesn't exceed 100 percent. The staff has worked on that.

23 The so-called preliminary term adjustment, it is a very
24 complicated subject, as I might say all of this is, but
25 the preliminary term adjustment is a \$21. per thousand.

1 I understand that we dropped \$19. in this agreement.

2 We had proposed in our further discussions with the
3 industry that that didn't really make any sense having any
4 artificial allowance and that we should take that to zero
5 and if that has a result of overtaxation elsewhere in the
6 industry, then adjust elsewhere. But, we're willing on a
7 stop gap basis to live with it like this.

8 But, I would think that there should be committee
9 report language to prevent cases that aren't entitled to
10 any preliminary term, they are not really whole life policies.

11 Mr. Chairman. Could he just wind up and then -- Is
12 that the end?

13 Mr. Chapoton. No, one more item and it is the signi-
14 ficant one, the so-called universal life or variable
15 premium policy.

16 As I understand this agreement, we would allow 100
17 percent deduction of so-called excess interest in that case,
18 is that right?

19 Mr. Belas. It is not in the proposal at this time.

20 Mr. Chapoton. Oh, it is not in the proposal.

21 Senator Heinz. Mr. Chairman, that was my question.
22 Is the deduction on excess interest on universal life in
23 here and if it is, is it at 100 percent for stocks and
24 90 percent for mutuals?

25 Mr. Belas. The proposal, as agreed upon, I believe,

1 is silent on that. You would have to make a choice on how
2 you would handle that.

3 Senator Heinz. Mr. Chairman, is there objection with
4 that? Is there a problem with that?

5 Mr. Chairman. I want to hear from Treasury on it.

6 Mr. Chapoton. We would submit that the deduction should
7 be limited in the same way as the excess interest is generally
8 treated under the proposal, that is, an 85 percent deduction.

9 The concern here is these are life insurance policies,
10 they have a significant investment feature to them. If
11 100 percent deduction is allowed or if it is left open for
12 litigation so that 100 percent deduction is allowed, the
13 effect is the investment income earned through this invest-
14 ment feature will not be taxed at all. It is not taxed at
15 the company level and not taxed at the investor or policy-
16 holder level and we think that would be a serious move,
17 obviously, over time, to this type of investment vehicle.

18 Some limit on the amount deductible would be appropriate,
19 we think.

20 Mr. Chairman. I would hope we might -- In other words,
21 you have two reservations, one in that area and one in
22 the grandfather clause.

23 Mr. Chapoton. Yes.

24 Mr. Chairman. And we are just going through it for
25 the first time. Is there a chance there can be a resolution

1 of those two issues?

2 Mr. Belas. Mr. Chairman, on the grandfather, I believe
3 it will be very difficult with Senator Bentsen and Senator
4 Chafee to work out something under grandfather. If I am
5 mistaken, we would be happy to work that on the staff level.

6 On the excess interest issue, the universal life
7 issue, there are three options that you have before you.
8 One is to allow 100 percent and perhaps 90 percent or some-
9 thing, for mutual companies, if you think there should be
10 the continued differential.

11 Second would be to allow a litigating position to
12 give the safety net percentages to these type products
13 and to allow the industry to litigate what the appropriate
14 amount above that might be and the third would be to allow
15 only the percentages allowed in the safety net percentages
16 as in the proposal.

17 (Continued.)

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1 The Chairman. Assuming we can resolve that --
2 I'm not certain how right now -- then, are you objecting
3 to the proposal because of the grandfather clause?

4 Mr. Chapoton. No, this would be the most signifi-
5 cant part. With that change we would be happy to go along
6 with this proposal.

7 Senator Heinz. Mr. Chairman, I am not sure that
8 I heard Mr. Chapoton incorrectly. I think he said he would
9 be opposed to the third option.

10 Mr. Chapoton. No, I would vote for the third
11 option.

12 Senator Heinz. Oh, I'm sorry. Thank you.

13 The Chairman. Either Senator Bentson --

14 Mr. Bensen. Well, I think overall on the proposal
15 what you're saying is the situation where when this
16 legislation taxing life insurance companies was first put
17 into effect in 1959, they were paying about 2.4 percent of
18 the corporate tax related to other corporations, but it was
19 based on the Walter Menghy formula which talked about
20 interest rates at four, five and six percent.

21 You had a great distortion on interest rates that
22 started in the late '70's which at a very major phase
23 escalated the tax liabilities of the insurance companies,
24 not as it was intended when the law was written.

25 They then went to MODCO, and obviously MODCO is

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1 something that has to be corrected, but they went to it
2 because of what was happening in the way of a tax burden.

3 This particular piece of legislation that we are
4 talking about now will bring up their tax burden to something
5 that approaches 5.4 percent as compared to the rest of the
6 corporations, substantially above what it was when the
7 legislation was first drafted to tax life insurance companies
8 in '59.

9 It tries to preserve -- one of the reasons that
10 we keep talking about industry in this -- we are trying to
11 preserve in this tax effort the competitive balance between
12 the mutuals and the stock companies. And that is not an
13 easy job.

14 But they've tried to strike that kind of balance
15 in this and hopefully have done it equitably so we are in no
16 way destroying the competitiveness between these two branches
17 of the life insurance industry. I think a reasonable job
18 has been done in that regard.

19 Now, things have been put into this that are going
20 to force both of these parties back to the bargaining
21 table. That's Treasury and the life insurance industry
22 because both of them have things in here that haven't
23 satisfied them. And as the Secretary said, it is an
24 exceedingly complex area, and it is going to take hearings,
25 and we have here an interim solution. And that is all it is.

1 But we must say, I think, to the benefit of the
2 industry, that they are the only industry that has come up
3 on their own and said, you know, we are ready to go ahead
4 and pay a substantial increase in taxes.

5 Now, the chairman said that's not enough, and
6 they have now gone back, and we have worked with them,
7 and that has been increased to this point. Overall, I think
8 it is a reasonable compromise. It leaves everybody a little
9 dissatisfied.

10 Senator Grassley. Senator Bensen, how long do
11 you consider the interim now? Originally we were talking
12 about two years.

13 Senator Bentsen. You're talking about a maximum
14 of two years. As Mr. Chapoton and the Secretary says there
15 are some things that are affirmative in this that Treasury
16 wanted, but most of the things have a maximum of two years.

17 Mr. Belas. It will terminate at the end of 1985
18 now, Senator.

19 The Chairman. Senator Chafee.

20 Senator Chafee. Mr. Chairman, Mr. Chapoton
21 pointed out that MODCO has been repealed in his opening
22 statement, and, thus, it, of course, put tremendous leverage
23 on the company to put back. We just hope Treasury will be
24 as enthusiastic to meet them.

25 Mr. Chapoton. Senator Chafee, I can assure you of

1 our enthusiasm. There are several things in here. The
2 preliminary term adjustment is a problem we want to revisit.
3 We will certainly revisit in any event the treatment of
4 Universal Life.

5 And I am concerned if this committee decides that
6 the Universal Life product which is a very sound product --
7 I don't mean to imply that it is as defined under this
8 agreement is a very sound product, and I don't mean to
9 imply otherwise.

10 But it would contain a very substantial investment
11 feature. Indeed, could that aspect of it would be emphasized
12 and without some reduction, some limit on the reduction.
13 See there is no tax at the holder level, and so if you
14 have 100 percent deduction at the company level, there would
15 be no tax on this income whatsoever, on income earned
16 through this investment feature whatsoever.

17 And we are concerned on that on an interim basis,
18 and of course, I think there will be a significant -- a
19 possibility -- maybe a significant possibility that a stop-
20 gap will be rolled over for another year or two or longer,
21 and we would be concerned about that as well.

22 Senator Chafee. Well, I think it is the hope of
23 everyone that we can get this thing settled in a couple
24 years.

25 The Chairman. I would hope -- you know -- we're

1 going through the first round -- that we can ask them to
2 focus on the question raised by Treasury. Here we're trying
3 to make certain that everybody gets to pay a little tax,
4 and it looks like we may be creating a loophole here that
5 does just the opposite.

6 Let's try not to leave that unsettled.

7 Mr. Belas. Mr. Chairman, may I make one last
8 comment on this? I believe you have a handout, and there are
9 a couple of typographical errors. One, it refers to the
10 Menghy formula as being a permanent provision and the
11 deferred annuity provision as being temporary. That is the
12 other way around. The deferred annuity provision is the
13 one that would be permanent.

14 And finally it does refer to leaving the issue of
15 excess interest to litigation, and as I understand it,
16 the proposal should have said that it is an open issue.

17 The Chairman. All right. Let's focus on that.
18 If you have somebody, Mr. Capoton, that can discuss that
19 with Rick and John.

20 Mr. McConaghy. The next item on the list deals
21 with dividend reinvestment provisions. Essentially that is
22 a provision which allows a certain amount of dividends paid
23 by public utilities to be excluded. It is \$1500 in the
24 case of a joint return and \$750 today in the case of an
25 individual return. That provision was put in last year and

1 expires in 1985. This essentially would repeal or terminate
2 that provision as of December 31, 1982.

3
4 The next item deals with the individual minimum
5 tax. There is a handout that should be circulating. Today,
6 as you know, we have both an add-on and an alternative mini-
7 mum tax in the case of individuals. The add-on individual
8 minimum tax works similar to the corporate add-on minimum
9 tax and that is to the extent that someone has tax preferences
10 which are greater than one-half of their regular taxes paid
11 or \$10,000, then essentially there is a 15 percent tax
12 imposed on that excess.

13 The add-on minimum tax picks up the following
14 six preferences that are similar to the corporate preferences;
15 accelerated depreciation on real property, accelerated
16 depreciation on leased personal property, pollution
17 amortization of pollution control facilities, percentage
18 depletion in excess of the adjusted basis of the property,
19 child care facilities, and intangible drilling costs in
20 excess of the amount amortizable in excess of net income
21 from oil and gas production.

22 In addition, we have today an alternative minimum
23 tax in the case of individuals. Really there are two items
24 that are in that alternative minimum tax. They are the
25 deduction for long-term capital gains. That's at 60 percent

1 deduction and the amount of a taxpayer's adjusted itemized
2 deductions.

3 All itemized deductions other than medical
4 casualty state and local taxes in excess of 60 percent of
5 adjusted gross income are considered to be the amount that
6 gets included in alternative minimum tax. We then apply a
7 ten percent rate on taxable income defined this way
8 between 20 and \$60,000; and 20 percent on the amount in
9 excess of 60,000.

10 The proposal in front of you really would get
11 rid of the existing add-on minimum tax for individuals and
12 the alternative minimum tax that is under present law
13 for individuals, and essentially it would replace it
14 with the proposal that is listed on page two of that
15 handout.

16 And the way this alternative minimum tax would
17 apply, you would come up with what we would call an expanded
18 tax base, and then you would apply certain rates to it.
19 You would start with adjusted gross income and then you
20 would add back all existing tax preferences. The ones
21 I just went over -- in addition you would add back interest
22 and dividend income to the extent it was excluded from
23 income such as interest on All Savers, the 100 and \$200
24 dividend exclusion.

25 You would then add interest on tax-exempt bonds

1 issued after 12/31/82 at the end of this year. You would
2 then subtract the full charitable contribution deduction,
3 the medical and casualty deduction that you would be
4 entitled to, home mortgage interest, and interest to the
5 extent of investment income, and real net operating losses.

6 That, then, would give you something called a
7 minimum expanded tax base, and on that expanded tax base,
8 we now arrive at minimum taxable income. You would take a
9 tax rate of zero on the first 40,000, if you had a joint
10 return, ten percent tax on 40 to 60,000, and a 20 percent
11 tax on amounts over 60,000.

12 Now, you would only pay that tax if, in fact, it
13 were greater than the tax you would pay under the regular
14 computations.

15 So, in effect, what it does is get rid of the add-
16 on tax today and the alternative minimum tax, takes the
17 same preferences, adds two additional preferences, and
18 then arrives at an amount at which we would impose a tax
19 of ten percent on amounts between 40 and 60,000; and 20
20 percent on amounts over 60,000 in the case of a joint
21 return. So it expands the base somewhat.

22 Senator Long. And how much are you going to raise
23 by the time you get through doing all that?

24 Mr. McConaghy. This, Senator Long, would raise
25 in 1984 200 million; in 1985, 300 million; and continue to

1 go a little bit progressive at that rate.

2 Senator Long. Well, let me just put my protest.

3 Mr. McConaghy. A good portion of that, by the
4 way, is from repealing, meaning that this is the net figure.
5 Obviously, you lose a good deal of money from getting rid
6 of today's add-on minimum tax and today's alternative
7 minimum tax. This would replace it.

8 Senator Long. Let me just put my little protest
9 in. The existing minimum tax is horribly complicated.
10 It's a confused mess. And I thought it was difficult
11 to make anything worse than the one we have now or more
12 complex, more confusing and more difficult to handle.

13 This one -- I think this one beats them all.
14 This is even worse than the old one. So that it is
15 incredibly complex and it is between two incredibly complex,
16 difficult to administer pieces of legislation. The old one
17 had at least one advantage: the people who have to live with
18 the old one at least know what it is.

19 But this one you have to learn what it is. And
20 to go through -- now, but look at one difference here.
21 This one here under Item C would tax the interest on
22 tax exempt bonds. I thought that is the one thing that
23 Congress had stayed consistent on up until now that we
24 were not going to let the Treasury tax these state and local
25 bonds. That is the one thing they have been wanting to do

1 for 50 years is to get into court and try to prove -- and
2 try to get the court to reverse itself. But whether the
3 Supreme Court ruled its constitutional, you can't tax these
4 tax exempt bonds, they could do it. But the difference is
5 that up until now Congress hasn't given any basis to get
6 into court to contest that.

7 Let the Treasury take the states to court to
8 claim that you can tax state government. I would say
9 for what little is gained by as revenue. It doesn't justify
10 changing from one to the other. It is important to get to
11 it. I want to urge that we not agree to this. And I
12 would like to suggest that we just stay with the old one
13 rather than go to this.

14 Senator Bentsen. Is the Senator through? I don't
15 want to intrude.

16 Senator Long. I am through.

17 Senator Bentsen. Let me ask some questions
18 concerning this so I can better understand it. On the
19 excluded interest and dividended income, adding that
20 fact to your adjusted gross income, what would be that type
21 of interest in dividend income that would be excluded?

22 Mr. McConaghy. Today we have a dividend exclusion.
23 We have a net interest exclusion, and we have an exclusion
24 for All Savers certificates under this.

25 Senator Bentsen. Oh, sure. All right. Now, you

1 got to C where you list those things that you subtract,
2 and you have your home mortgage interest and other interest
3 to the extent of investment income. At the present time,
4 don't we have a corridor between that, between the invest-
5 ment income?

6 Mr. McConaghy. Today we have a special provision,
7 Senator Bentsen, dealing with investment interest, and it
8 provides that you can deduct your investment income, your
9 investment interest to the extent of investment income
10 plus \$10,000.

11 Mr. Bentsen. \$10,000. That's the corridor; isn't it?

12 Mr. McConaghy. Right.

13 Mr. Bentsen. So you would remove the \$10,000
14 corridor; is that right?

15 Mr. McConaghy. After this alternative minimum tax
16 that excess above investment income would be included in the
17 alternative minimum tax. That is correct.

18 Mr. Bentsen. So you no longer have the corridor.

19 Mr. McConaghy. For purposes of this alternative
20 minimum tax that is correct. Not for purposes of the
21 regular tax. It would stay there.

22 Mr. Bentsen. Oh, I understand that. Yes.

23 Mr. Moynihan. Mr. Chairman, could I ask Mr. McConaghy,
24 in the new proposal, the Item A in calculation says all
25 existing preferences. Do I take that to mean the six

1 preferences in the current tax as against all references
2 that can be found in the tax code?

3 Mr. McConaghy. That is correct. It is really the
4 six preferences in the add-on minimum tax and one of the
5 preferences in the alternative minimum tax which is capital
6 gain, and then it would add two other preferences here as
7 well.

8 Now, there is a typographical error I'm sorry about
9 and that is in addition to excluded interest and dividend
10 income and interest on tax exempt bonds, there would be
11 two other or three other preferences, and they would be
12 mining exploration, development expenditures, circulation
13 expenditures so it broadens the list of preference, Senator
14 Moynihan, by adding five additional preferences to the
15 list of preferences, collapses the add-on and the minimum
16 tax together, and imposes a tax at the rates listed on page
17 two on that.

18 Senator Moynihan. But it is that now. I don't suppose
19 anybody knows what all the existing preferences are in the
20 tax code. Or that man doesn't have to work for the
21 joint committee on economic --

22 Mr. McConaghy. I would not have to try to designate
23 which items were preferences under the code, Senator
24 Moynihan.

25 Senator Moynihan. Thank you.

1 The Chairman. Senator Danforth?

2 Senator Danforth. In your view, is it simpler or more
3 complex than the present law?

4 Mr. Chapoton. It's probably simpler than the present
5 law because you have two minimum taxes in present law. One
6 of them is an alternative minimum tax. I should add we
7 reviewed the possibility of proposing an individual minimum
8 tax and decided not to do so because there would be a little
9 additional money, and because of the difficulty of doing
10 so.

11 But I think an alternative minimum tax is, if one wants
12 a minimum tax, is probably more appropriate than an add-on
13 minimum tax. It does do what a minimum tax and most people
14 think what a minimum tax is doing. That is that the taxpayer
15 must pay some minimum amount of tax on economic income.
16 And, indeed, that is what we proposed in a corporate minimum
17 tax.

18 Senator Danforth. So it is your view that this would
19 be somewhat simpler than the present law?

20 Mr. Chapoton. I would agree with Senator Long that
21 minimum taxes are complex. If you have one rather than
22 two, it probably is somewhat simpler.

23 Senator Danforth. Now, let me ask one other question.
24 A lot of times people complain that there are a lot of
25 relatively high income individuals who end up paying no

1 taxes at all or almost no taxes, and it is something of a
2 national scandal. It's part of the cause for the so-called
3 taxpayer revolt.

4 The figures come out, as they do periodically, indicating
5 that there are "x" thousands of people in the country who
6 have incomes of over a quarter of a million dollars or what-
7 ever, and they end up paying no taxes at all.

8 And now from the standpoint of equity, and from the
9 standpoint of fairness, and from the standpoint of trying to
10 reduce the possibility of people getting off scot-free
11 without paying any taxes or almost no taxes, would this
12 provision, in your opinion, tend to make the tax system
13 fairer than it is today?

14 Mr. Chapoton. You are addressing that to me, Senator?

15 Senator Danforth. Either. I would like to hear from
16 both you and from the joint committee.

17 Mr. Chapoton. It would address that very question.
18 And you have to be concerned, as we've discussed and discussed
19 with the members about the different preferences, and one
20 of them that you must be concerned about is the tax exempt
21 interest, but it certainly does go to the very point.

22 That is it says that the code will require all taxpayers
23 to pay taxes, to pay some taxes on economic income, at least
24 not be able to avoid paying taxes with these preferences.
25 And this is a very broad list of preferences.

1 Mr. McConaghy. Senator Danforth, we did run based on
2 1979 income levels this morning distribution and what
3 average tax increases would be and how this would be
4 compared to what we have under existing law. Now they would
5 be -- the '79 levels would be blown up just a little bit for
6 1981. But what we find is that it hits people that are in
7 the very upper income brackets harder, over \$200,000 of
8 expanded income, for instance, those individuals would have
9 an average tax increase of \$12,020.

10 In the bracket between 100 and 200, they would have
11 an average increase of \$3,095, and the average bracket from
12 50 to 100,000, they would have an average increase in tax
13 of \$1174.

14 On balance below 50,000, essentially there would be
15 a tax decrease because this would not pick them up. But
16 above 50,000, it would start to pick them up significantly.

17 Senator Byrd. Can I ask both Treasury and Joint
18 Committee this? Is my understanding correct that under the
19 present law, high income individuals -- only way that that
20 individual can escape paying some tax is if his or her
21 entire assets are in tax exempt bonds?

22 Mr. McConaghy. I think, Senator Byrd, that certainly
23 is one way and probably an easier way to avoid paying
24 tax to have all your investments in tax exempt interest.
25 There are other kinds of combinations obviously of tax

1 shelters that I can put together. Many of those are
2 preferences, but if I can put them together in certain
3 ways I could come close to paying very little tax, but it
4 is the easiest way to escape it altogether, of course, is
5 with tax exempt interest.
6
7 Senator Byrd. Not only the easiest way but I was under
8 the impression that because of tax preferences recaptured,
9 so to speak, that that is the only way that very high income
10 taxed individuals can escape all taxation.

11 Mr. Chapoton. Well, I would agree with McConaghy.
12 There would be ways. It probably wouldn't be smart
13 economically, but there would be ways, I'm certain, if one
14 spent enough time at it that one could reduce one's tax
15 liability to zero, through a combination of shelter-type
16 investments. And he knows a lot about tax exempt bonds.

17 That is where the deductions in the investment are
18 greatly accelerated over economic cost.
19 Senator Byrd. And my other question is is it wise or
20 appropriate to include tax exempt bonds as a preference item?
21 Now, in 1969 this committee explored pretty carefully this
22 question of tax exempt bonds, and every governor in every
23 state in the union opposed it, and most mayors communicated
24 with the committee in opposition to it.

25 Mr. Chapoton. We have some concern about including
tax exempt bonds. We remember well the '69 experience, and

1 rate. So you've already been taxed. You've been taxed
2 the benefit of the state government. You're getting less
3 return on your investment than you would if you bought
4 a security from the federal government.

5 But they have been taxed already. That was the case he
6 made because they get this lower yield. Now, furthermore,
7 in many, many years, the return on these state and local
8 bonds has been less than the depreciation of the value of
9 the money.

10 So in many cases it was really no real income at all.
11 It didn't even keep you whole against inflation. But beyond
12 that, once you let them establish a principle that we are
13 going to tax these tax-exempt bonds, you are going to have to
14 go to the Supreme Court and get them to reverse themselves
15 because they have held that it is not constitutional. You
16 are familiar with that?

17 Mr. Chapoton. I am familiar with that case. I remember
18 that was a split decision. It was, I believe, before the
19 turn of the century, and it's been a rather controversial --
20 Senator Long. The majority came down on my side.

21 (Laughter.)

22 Senator Long. I've never heard a government lawyer
23 talk about a split decision unless it was split against
24 him. I didn't think that you were that kind of a lawyer,
25 Mr. Chapoton. I thought you were the kind of lawyer that

1 I would go pay my money to hire. I thought that you were the
2 kind of lawyer that said, look, back in the days when you
3 could rely on what the Supreme Court said from day to day.

4 They had this matter before them, and back in those
5 days the court ruled just exactly the way that we always
6 thought it was supposed to be, and we think that even the
7 Supreme Court said something back when John Jay was on the
8 Supreme Court or John Marshall was on the Supreme Court,
9 that is still good law.

10 But now you're the head people down there, and I never
11 thought you were one of them, but if you're the head people
12 down there in the basement of the Treasury, and some of them
13 have worked up from the basement of the Treasury. But you're
14 saying for years if we could just somehow or other get this
15 thing through the country -- if we could just somehow get
16 something through so on some kind of a basis -- just any
17 kind of basis -- they can tax these state and local bonds,
18 we might be able to get those people to reverse themselves.

19 Now, I'm trying to hold out long enough so Mr. Reagan
20 can put more people on that court that would leave the
21 old decisions the way they used to be. And it seems to me
22 that you shouldn't try to reverse them before Mr. Reagan
23 can put a few more conservative, strict constructionists on
24 that Supreme Court. If you had the kind of judgment that I
25 think would see it the way it has always been, I might be

1 willing to give you a people a chance to have a second
2 start at that matter, but up till now under your predecessor,
3 those people I've been talking about in the Treasury --
4 not the Secretary of Treasury, not the Under Secretary of
5 the Treasury, but somebody around has kept sneaking these
6 things in these bills.

7 And somehow they swept it past the House, and we can
8 catch it and send -- thou shall not do this, and so we would
9 knock it out, and that would be the end of it for another
10 year or two until back it comes again.

11 I'm surprised at you, Mr. Chapoton. I thought you knew
12 better than that.

13 Mr. Chapoton. Senator Long, let me quickly add this
14 is not our proposal. We have --

15 Mr. McConaghy. Senator Long, I would like to add that
16 Mr. Chapoton was here in 1969 when that provision came
17 through.

18 Mr. Chapoton. Short memory, but not that short. And
19 we think -- I think one must be concerned about the
20 immediate impact on the tax exempt market for doing something
21 like this. And we have expressed that concern.

22 Senator Long. It's got to shake them all up; hasn't it?
23 It has got to scare them to death.

24 Mr. Chapoton. It will shake them up.

25 Senator Long. Mr. Dole said he hopes so. He's not

1 afraid to scare them a bit. Well, they can only stand so
2 many shocks at one time. Now, they've got plenty of
3 shocks in this bill the way it is now. So I would suggest
4 that when we get around to voting on this, just what little
5 we have gained on this matter ought to be left out.

6 So far you've done a lot of improvement on this.
7 Compared to what this minimum tax was the first phase I saw
8 of it, it had been enormously improved.

9 Now, I want a suggestion for further improvement. Drop
10 what's left of it. Then, you would have a real improvement.

11 The Chairman. We'll take that under consideration.

12 Next?

13 Senator Matsunaga. I might add, Mr. Chairman, that when
14 you run for president in 1984, you say I'll take all these
15 taxes that the former Congress enacted and just save you my
16 people.

17 The Chairman. Well, we are just trying to be fair on our
18 side. Maybe we've overdone it. Let's go on to the next
19 item.

20 Senator Long. I just thought that the chairman of this
21 committee, John Dole, was a man I could depend on to stand
22 up and fight and save state and local government. You just
23 never can tell what happens to someone especially when they
24 begin to think about the Presidency of the United States.
25 It just seems to do something.

1 The Chairman. I don't want to establish parenthood
2 for this amendment, but it didn't come from the chairman --
3 put it that way.

4 Senator Durenberger. Mr. Chairman, before we leave
5 this, can I ask just to clarify on the subtractions from the
6 base. We've got almost all the deductions in there except
7 state and local taxes. Is that inadvertent?

8 Mr. McConaghy. Except one, Senator Durenberger?

9 Senator Durenberger. State and local taxes.

10 Mr. McConaghy. That should not be a deduction under
11 this proposal, Senator Durenberger.

12 Senator Durenberger. It would not be.

13 Mr. McConaghy. No.

14 The Chairman. The next proposal deals with the
15 industrial development bonds. There are really two parts
16 to it. It is contained in the package that you have in
17 front of you. The first we will go to changes other than
18 those that are mortgage subsidy bonds. The first change
19 would be that with respect to industrial development
20 bonds, actually all private purpose bonds, there would be a
21 reporting requirement that would be enforced with respect
22 those bonds to the IRS and to the Treasury.

23 The second change would be that there would be a
24 public meeting or a public hearing that must be held before
25 any industrial development bond may be issued. The third

1 that there be an approval on the part of the highest elected
2 official of the issuing jurisdiction to approve those bonds,
3 and then there would be a rule dealing with what we call
4 anti-double dip similar to the Administration's proposals,
5 and that is to the extent of facilities which are placed
6 in service after the end of this year and are financed by
7 any industrial development bond except an industrial
8 development bond issued before July 1, 1982 that if they
9 chose that financing, then their depreciation would be
10 under a different schedule, and that schedule would be
11 one using not the regular short ACR lives and not the longer
12 ENP lives as suggested by the Administration but the minimum
13 tax lives which are in between.

14 So a five year, essentially asset would be able to
15 depreciate over eight years rather than five years if it
16 chose to finance that facility with industrial development
17 bonds. Next, we would get rid of kind of what we call
18 clean limit on being able to issue under the smaller issue
19 exception \$1 million where I can tack on a million dollars
20 on to my issue.

21 Next, we would get rid of the revenue ruling that the
22 Treasury came out with dealing with so-called composite
23 issues or umbrella bonds. They would be permitted under
24 this proposal so long as no user financed more than one
25 facility from that composite issue, and no composite issue

1 includes facilities in more than one state. Next, the
2 proposal would pick up a provision that is contained in
3 HR-4717 which is in conference dealing with research and
4 development expenditures, and it would say that those really
5 -- the amount credible under Section 44 of the Code would not
6 be counted as capital expenditures for purposes of the
7 capital expenditure limitations.

8 Finally, there would be a sunset in 1985 with respect
9 to small issue, IDB's, and then there are two or three
10 modifications to the mortgage subsidy bond proposal that is
11 contained in HR-4717 which has passed the Senate and is
12 currently in conference, and that would raise the arbitrage
13 limitations with respect to mortgage subsidy bonds so that
14 arbitrage on a \$30 million issue would be able to be 1 1/8
15 point instead of one percent under current law.

16 And that would phase up so that at the point of \$100
17 million issue, then that arbitrage limitation would increase
18 from presently 1.0 to 1 1/16 percent. In addition, it would
19 make changes, and all of these are in 4717 where there would
20 be first time home buyers are required to be there. Under
21 present law this would say that of an issue of mortgage
22 subsidy bonds, only 80 percent of those home buyers have to
23 be first time home buyers.

24 It would change the level of the purchase price
25 limitation so that the mortgage subsidy bonds could not

1 exceed 90 percent of the average residential purchase
2 price. That is today. That would be liberalized to 110
3 percent, and 120 percent, I believe, in targeted areas.

4 Lastly, it has a minor provision, also contained in
5 4717 which deals with liquidating reserves as mortgages
6 come in, and it would say you would not have to liquidate
7 those reserves where liquidation would result in a loss.
8 So that would be the entire package that is outlined here
9 on page five of the short summary dealing with industrial
10 development bonds.

11 The Chairman. Let me say at the outset that we under-
12 stand, of course, this is a very, very sensitive and very
13 controversial provision. We've tried to indicate some of
14 the problems in the chart. I don't really want to take time
15 to go through that chart, but if you just take a look at
16 what's happened so if we could see the chart.

17 Between '76 and '81, this chart demonstrates the
18 phenomenal growth in the private purpose portion of tax
19 exempt bond market. The green part at the bottom shows
20 the traditional uses: roads, sewers, schools and other
21 things. The annual rate of growth in this area has been
22 approximately one percent, almost no growth at all.

23 The yellow portion of the chart shows the growth in
24 private pollution control, housing, non-profit organization,
25 student loan bonds, and the growth has been about 20 percent

1 per year. The red zone which has really been the growth
2 area between '76 and '81 represents a so-called small issue
3 IDB. It is a very small part of the market in '76, but a
4 very substantial growing part of the market today. This
5 type of bond -- those used by the private taxpayers for
6 any use has grown at an annual rate of 50 percent.

7 The bottom line appears to be from what we were told
8 that the private purpose bond use is growing by leaps and
9 bounds while the public purpose bonds for hospitals and
10 schools and other things remain static or decline in terms
11 of real dollars. And that is why the Administration came
12 forth with much more -- with a better proposal -- a more
13 substantial proposal.

14 I'm not certain the Administration -- this isn't much
15 of a compromise. It does a few things, but I think at
16 least an indication plus the sunset in '85 of the small
17 issues will force us to take a look because -- I hope Mr.
18 Chapoton might indicate how much this market is going to
19 grow unless we do something in the next to ten to 20 years.
20
21
22
23
24
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1 Mr. McConaghy. There were a couple of comments, since
2 I guess, Mr. Chairman, that were interesting. One is that of
3 the tax exempt bond market today about 55 percent of that tax
4 exempt market is being financed with private-purpose bonds that
5 used to be 25 percent. Obviously those that financed schools,
6 waters, and sewers, and so forth have gone down in the last
7 ten years both in absolute dollars and certainly as a percent.

8 Mr. Chapoton. Yes, Mr. Chairman, we have been alarmed about
9 the very significant growth in private-purpose bonds. As
10 Mr. McConaghy said we will consume an estimated 55 percent of
11 the entire tax exempt market this year, obviously having an
12 impact on the cost of borrowing to state and local governments
13 for traditional governmental purposes.

14 We had proposed that the bonds be restricted in several
15 ways but the basic purpose of our restrictions were two-fold.
16 One, to make the locality the issuer--state or local govern-
17 ment issuing the bonds--have a meaningful input into the deci-
18 sion whether or not to issue the bonds. At present there is
19 no reason for them to do. It is at no cost to the local govern-
20 ment to provide financing for a business in their locality.
21 There is no competitive advantage since all localities now can
22 do it, and do do it.

23 Our proposal was that they do it administratively; that
24 there has to be public approval of the bond; and that there be
25 a financial commitment after 1985. We suggested that they must

1 contribute to the project one percent of the cost either
2 through actual contribution or through exempting the project
3 from ad valorem taxes, or providing local services; some type
4 of commitment to the project to show that the localities
5 thought it was a good project as well.

6 In addition, we did want to deny the double benefit of
7 the accelerated cost recovery system and tax exempt financing.
8 But, if credit was available we would allow the credit.

9 ~~The Chairman.~~ I know there are other questions, but I
10 just ask the question -- you support the compromises at least
11 to --

12 ~~Mr. Chapoton.~~ Yes, we can support this. It goes part
13 of the way; it doesn't go nearly as far -- it does have the
14 Sunset provision which will cause an examination of this in
15 three years.

16 ~~Senator Bradley.~~ Mr. Chairman.

17 Mr. Chairman, what is the marketing proposal that you
18 have suggested here?

19 ~~Mr. Morrison.~~ Senator Bradley, there is no specific
20 marketing exception to the rules. However, the modified
21 anti-double-dip rule would not apply.

22 ~~Senator Bradley.~~ I can't understand you. Would you --

23 ~~Mr. Morrison.~~ The modified anti-double-dip rule, the
24 ACRS provision in the compromised proposal would not apply
25 with respect to a bond-financed project that is also partly

1 financed with a UDAG grant or loan.

2 Senator Bradley. Okay. So, it is tied to the UDAG
3 criteria?

4 Mr. Morrison. It's not only tied to the UDAG criteria;
5 it's tied to an actual HUD UDAG grant.

6 Senator Bradley. It has to be a UDAG grant issued?

7 Mr. Morrison. That's correct.

8 Senator Bradley. So that if you wanted to build a
9 facility in a depressed area, in order to qualify for both
10 ACRS and tax exempt financing you would have to also get a
11 UDAG grant?

12 Mr. Morrison. To qualify for full ACRS cost recovery,
13 yes, that's correct. If you didn't, you would be forced
14 under the proposal to use the straightline recovery method
15 over the minimum tax lives.

16 Senator Bradley. So that it is not just a matter of who
17 would be eligible for UDAG, but you have to have actually
18 received the UDAG before you can -- well, Mr. Chairman --

19 Mr. Morrison. Our preliminary estimates showed that
20 perhaps 35 percent of the population of the country lives in
21 UDAG eligible areas and that --

22 Senator Bradley. Well, let me suggest that if you took
23 the UDAG definition--it's in the Community Development Act
24 of 1974--and along with additional criteria it relayed to,
25 say for example, unemployment rate at one-and-a-half times

1 the national average or 20 percent poverty population, or
2 20 percent population decline in the last ten years; you would
3 then have reduced that 35 percent dramatically, and you would
4 have successfully targeted those precise areas of the country
5 where you would like to bring the greatest incentives to the
6 private sector to invest.

7 So, I think that to be -- can we talk about this a little
8 bit? Is it possible a more precise targeting?

9 ~~The Chairman.~~ We'd be happy to discuss it. I don't
10 know what -- if you would like to tighten it up some if
11 you wanted to -- if you're trying to tighten it up.

12 ~~Mr. McConaghy.~~ We certainly can, Senator Bradley. Any-
13 time you're drawing those lines it's pretty tough to draw
14 precise kinds of lines, and as Mr. Morrison said, under this
15 definition it looks as though 35 percent of the population of
16 the country would be covered by --

17 ~~Senator Bradley.~~ Well -- but if you put these additional
18 essentially depressed areas criteria in there; I mean, if
19 you've lost 20 percent of your population in the last decade
20 that's not exactly a "boom town." Or if you have a very high
21 poverty population, or if you have unemployment of a percent
22 of one-and-a-half times the national average, what you're
23 talking about is a hard core area. If you're trying to get
24 the private sector to invest you don't want to tie it just
25 to a UDAG program that is decreasing each year.

1 Mr. McGonaghy. We could certainly look at that. It depends
2 upon that test area you draw. If they were able to draw the
3 issuer their own test area, then obviously they could gerry-
4 mander anyway they wanted to meet your definition. We could
5 look at it.

6 The Chairman. Let's have Senator Chafee and then
7 Senator Boren.

8 Senator Chafee. Mr. Chairman, in the bill that I
9 originally presented, along with the Senators Danforth and
10 Heinz and others, we had some basic reforms which revolved
11 around eliminating commercial projects except in distressed
12 UDAG areas, and amongst the commercial projects that we were
13 targeting in on were the shopping centers, K-Mart's, restau-
14 rants, recreational facilities, and so on. However, we
15 couldn't get a consensus on that in the joint committee, and
16 I believe, treasury both resisted a restriction based on a
17 definition of the establishment that we could provide the
18 IDB's for. So, we couldn't get a consensus on that nor on
19 the -- well, that's the basic thing. We had problems with
20 the targeting, too.

21 The Chairman. That's true. There was an effort as
22 Senator Chafee indicates, and I think that you indicated
23 it's very difficult to do that, and there might --

24 Mr. Chapoton. We also attempted to look at targeting,
25

1 and we finally concluded that the best way to allow targeting
2 or to have targeting is to have the local government--either
3 state or local government--have a decision to make whether the
4 bonds were used in certain areas, and then they indeed were
5 targeted. Now, there's no need to target it, and it's very
6 difficult for the federal government to write rules where they
7 should be targeted. You run into very difficult problems
8 immediately.

9 Senator Byrd. What would you think about eliminating
10 all private-purpose bonds?

11 Mr. Chapoton. I'm sorry, Senator. I --

12 Senator Byrd. What would you think about eliminating all
13 private-purpose --

14 Mr. Chapoton. I think that would be a very dramatic step
15 right now, in all honesty.

16 Senator Byrd. It's too dramatic.

17 Mr. Chapoton. I think it would be too dramatic.

18 The Chairman. We certainly need to focus on this. It's
19 going to be out of hand and then there won't be any way to
20 change it.

21 Mr. Chapoton. It is a serious problem for traditional
22 bond issues as I know you know.

23 The Chairman. Senator Boren and then Senator Durenberger
24 and then Senator Wallop.

25 Senator Boren. I'd like to --

1 Mr. Chapoton. That is correct.

2 Senator Boren. Also, is there -- there is no cap. Is
3 there any local contribution requirements still in the bill?

4 Mr. Chapoman. That's correct.

5 Senator Boren. There is none.

6 Mr. Chapoman. There is none.

7 Senator Boren. What impact do you think, because we've --
8 uncertain areas and particularly in rural areas in my state
9 it's been very important in terms of bringing in industry
10 that they will offer this additional incentive -- how much
11 benefit will there be left by the time we have changed the
12 appreciation rules and gone to straightline; how much benefit
13 and how much attraction will be left to utilize these because
14 they had been a very important tool in certain cases.

15 Mr. Chapoman. There will be benefit left under the
16 Treasury's proposal, Senator Boren. It would be just about --
17 there would be a little benefit, but pretty close to a toss-up
18 on whether one would choose tax exempt financing or the faster
19 cost recovery. If interest rates are --

20 Senator Boren. Prime.

21 Mr. Chapoman. If the differential would spread -- see,
22 the differential between taxable and tax exempt now is very
23 small. But the inevitable conclusion that you reach when you
24 look at the use of tax exempt bonds for private purpose as
25 an incentive device is that indeed that they are an incentive

1 because everybody can offer them, and if you don't the facility
2 will go elsewhere. But it is a zero sum game in that instant
3 because all localities can and do offer them.

4 Senator Boren. So, you're saying in your original pro-
5 posal you felt that you almost had it equalized in terms of
6 the choice, given the interest rate spread. Is this true of
7 the compromise package, or would you say there would still exist
8 some --

9 Mr. Chapoman. I would say that there would a very
10 definite advantage to tax exempt financing under this proposal.

11 Mr. McConaghy. Senator Boren, there wouldn't be any case
12 in which it wouldn't be advantageous to go ahead and issue
13 tax exempt bonds and use these other lives compared to
14 existing --

15 Senator Boren. You're talking in terms of a -- say a
16 ten million dollar project, what would you think the
17 differential -- what would the differential be given the
18 current interest spread in the market? Any way of figuring
19 that in terms of a rough estimate?

20 Mr. Morrison. Senator Boren, a \$10,000 investment under
21 present law you would have present value of tax benefits,
22 and the present law includes ACRS, the ITC, and the given
23 value of IRB's of -- and a discount rate of 12 percent,
24 \$5,037. Under the --

25 Senator Boren. 5,037 --

1 Mr. Morrison. I'm sorry. That's for ten year equipment.
2 For five year equipment it would be \$5,377. Under the
3 compromised proposal, with eight-year straightline investment
4 credit and IRB's, the present value of the tax benefits would
5 still be in excess of expensing, but at \$4,777.

6 The Chairman.. Senator Durenberger.

7 Senator Durenberger.. First, a question mark. I noticed
8 the summary relative to the permitting of ACRS refers to
9 low income housing, and I wanted to be sure that the reference
10 there is consistent with the definition of eligibility for
11 tax exempt financing for rental housing not limiting beyond
12 those requirements for the 20 percent low income occupancy;
13 is that correct?

14 Mr. McConaghy. That is correct, Senator.

15 Senator Durenberger. Secondly, I understand that there
16 are -- you've explained this both in terms of industrial
17 development, bonds, and some of the MRB proposals. I think
18 there is still negotiations going on somewhere relative to
19 additional elements on MRB that might go in here. Is that
20 also correct?

21 Mr. McConaghy. There are a couple of items, I think,
22 Senator --

23 Senator Durenberger. I don't need to discuss them;
24 I just want to be sure --

25 Mr. McConaghy. Well, they are contained in 4717. They

1 deal with multifamily housing.

2 Senator Durenberger. Just a last general observation,
3 speaking I guess to my colleague from Oklahoma, the cap isn't
4 in here because that was just a recommendation one person on
5 this side put forward as the way to come to grips with the
6 issue of financing that was withdrawn. The local contribution
7 isn't in here because of constitutional problems in a lot of
8 states.

9 But I think it's fair to say in terms of the consensus,
10 Mr. Chairman, that there's been a lot of stories out there
11 about what actually happened on this issue. The fact of the
12 matter is we've had a half a dozen proposals to restrict IDB's,
13 including the nature of the one proposed by the -- or suggested
14 by the Senator from Virginia, and a half a dozen proposals to
15 expand them. I think those of us who care a lot about this
16 area, particularly as an impact on housing and community
17 development, felt that this wasn't the time to go in depth
18 into the issue; and what the consensus coming from this side
19 in terms of recommendations to you is the best that we felt
20 we ought to do this year, then tackle the issue head-on in
21 the next year or so as The Chairman pointed out.

22 The Chairman. Senator Wallop.

23 Senator Wallop. Yes. Mr. Chairman, I want to say that
24 I approve of the new rules that are in the mortgage revenue
25 bond area and would just ask a question of Treasury. If they

1 have any idea what would happen if those rules were applied to
2 issues already sold under the old rule but some money remaining
3 in them? Would that have a major effect?

4 What's happened -- let me begin by explaining this. In
5 Wyoming we have an issue, but given what's happened to first-
6 time homebuyers, and that's the rule that I'm talking about,
7 given what's happened in the general level of economy there
8 is some money that is sold but can't be put out because the
9 first-time homebuyers are not that numerous in there, which
10 presumably would impact on any second issue that they would
11 go -- having to figure on the 80 percent figure for --

12 Mr. Chapoton: You're addressing the alleviation of
13 allowing 20 percent second --

14 Senator Wallop: Yes. I just wonder if it would make
15 any significant difference on issues already sold under the
16 old rule if the new rule applied as to 80 percent first-time
17 homebuyers instead of a 100 percent?

18 I don't think it would make any difference.

19 Mr. Chapoton: Senator, I'm just not aware. Of course,
20 the issues -- the money would be out there. I guess there
21 would be some issues that would be -- have money available
22 and can't find first-time homebuyer, but --

23 Senator Wallop: That's right. The issue is already
24 sold but whatever tax effect is presumably already taken
25 place, whatever revenue effects on the government. Could we

1 just bring that up and see if that can be accommodated? I
2 don't want to do anything that has a major revenue effect,
3 but if it doesn't it would be of great help.

4 Mr. Chapoton. We can look at that.

5 Senator Wallop. Sure. Thank you very much. Thank you,
6 sir.

7 Senator Chafee. Mr. Chairman, I'd just make -- like to
8 make one point clear. On your IDB reform sheet here you're
9 talking to the extended facilities in place after December 31,
10 1982 or financed by any IDB and so forth, but that is any
11 IDB issued after yesterday?

12 Mr. McConaghy. There is a change that would be inserted
13 on line two, Senator Chafee. It would in effect accomplish
14 exactly what you say, and that is, except IDB's which are
15 issued before today, yes.

16 Senator Chafee. Thank you.

17 Senator Byrd. May I ask the Secretary Chapoton --

18 Mr. Chapoton. Yes, sir.

19 Senator Byrd. It appears to me that this does very
20 little toward tightening up a very severe problem that the
21 Treasury has.

22 Mr. Chapoton. This does very little to tighten up. Any
23 proposal in this area must deal only with future issues, we
24 all recognize that.

25 Senator Byrd. Oh, yes.

1 Mr. Chapoton. Even our proposal in early years was --
2 I say even our proposal, it wasn't particularly dramatic, not
3 at all like putting a lid on bonds or simply terminating. It
4 had very little revenue back in the first year, but it is a
5 problem that I think many members realize, and we certainly
6 do, must be addressed.

7 But one thing that gives us the greatest comfort in this
8 proposal is it does have a sunset of the small issue bonds
9 which is where the largest growth has occurred, and that means
10 the Congress will have to deal with the problem within the
11 next three years. And if it deals with more than just
12 extending the sunset we may have a meaningful decision.

13 Senator Byrd. What's a small issue bond?

14 Mr. McConaghy. Yes, sir.

15 Senator Byrd. How much is a small issue --

16 Mr. McConaghy. \$120 million dollars --

17 Mr. Chapoton. \$10 million. Go up on the capital
18 expenditure if you have a due-day grant. But you can issue
19 up to \$10 million at any time under the small issue exemption.

20 Mr. Brockway. I might say in reference --
21 start reviewing this program --

22 The Chairman. The sunset may be '85, but the sun's
23 going to come up before then.

24 Mr. Chapoton. We certainly would support that,

25 Mr. Chairman.

1 Senator Chafee. Also, I would point out, Mr. Chairman,
2 that this reform, modest though it is, gets two-thirds --
3 saves two-thirds of the revenue of the Treasury's proposal.

4 The Chairman. Next.

5 Senator Chafee. In the three years. Is that right,
6 Mr. Chapoton?

7 Mr. Chapoton. Yes, but I think that would not be
8 indicative of the relative program -- the out years it would
9 be quite different I'm told.

10 Senator Boren. Mr. Chairman, one last question on it.
11 How does it change the current law in regard to the treatment of
12 pollution control facilities and also conversion facilities?

13 I see reference here in the material to it. What changes
14 would be made under the compromise package from current law in
15 terms of treatment?

16 Mr. Morrison. Senator Boren, when pollution control
17 bonds are used to financed rehabilitations of current
18 facilities or to install pollution control equipment in
19 plants that are in operation as of today, no new restrictions
20 would apply. None of the ACRS double-dip new restrictions
21 would apply.

22 As to new plants, however, the ACRS double-dip would
23 apply.

24 Senator Boren. What is the rationale for applying a
25 different standard to -- it looks like that would discriminate

1 against growing areas where you have new facilities being
2 established. Why would there be a difference of policy between
3 the use of this mechanism to encourage pollution abatement --

4 The Chairman. They're mandated to do it anyway.

5 Senator Boren. -- from one area to another?

6 The Chairman. Aren't they under law required to do it?

7 Mr. Chapoton. That's correct. In the financing a
8 pollution control facility with tax exempt bonds was enacted
9 in 1968, at which time many old plants were required to put
10 in pollution control facilities, non-productive facilities,
11 required by state and federal restrictions. That's still
12 the case. But now most of the older plants have been retro-
13 fitted, and --

14 Senator Boren. Would it apply to public utilities as
15 well?

16 Mr. Chapoton. No. Public utilities -- it's only
17 private facilities.

18 Senator Boren. Well, I'm talking about facilities that --
19 in other words, where you would simply pass on the extra
20 cost and the rate base.

21 Mr. Chapoton. If it's a -- if it's a public utility
22 facility, yes, these rules would apply.

23 Senator Boren. So, in other words, the fact that a
24 utility that is building a new facility could not utilize
25 this would end up increasing the cost to the rate payers in

1 the area; is that correct?

2 Mr. Chapoton. To the extent that they would lose a part
3 of the depreciation benefit if they financed it with tax
4 exempt bonds.

5 I might point out, the problem now is that in any new
6 facility pollution control and safety requirements must be
7 put in is a significant part of the cost of the facility in
8 every case. It is not put in because tax exempt financing
9 is put in because of local and federal law requirements.
10 So what happens is every facility is partially financed with
11 tax exempt bonds as a significant part of the total issue of
12 the tax exempt bonds.

13 Senator Boren. Well, I understand that. But it seems
14 to me that if we're dealing with an area where we're talking
15 about rate -- where something goes into a rate base under
16 the supervision of a publically regulated business, that
17 we're simply then shifting that burden to the local rate payer
18 and in a sense would be discriminating against those regions
19 of the country where you are having growth and where you're
20 building more new facilities, power generation, for example.

21 Mr. Chapoton. I think in that context the question is
22 whether all federal tax payers pay the cost or the local
23 users of the output pay the cost?

24 Senator Boren. Well, the federal taxpayers pay the cost
25 if it is the rehabilitation of an existing facility under

1 this amendment, but they would not pay the cost if it were a
2 new facility.

3 Mr. Chapoton. That is correct. I don't think there
4 will be many --

5 Senator Boren. It seems discriminatory to me on a
6 regional basis.

7 Mr. Chapoton. Oh, I see, what --

8 Senator Boren. If you're Western --

9 The Chairman. Let's take a look at that, if we can.
10 Maybe we can accommodate that change.

11 Let's move on to completed contracts.

12 Mr. McConaghy. The next one deals with the completed
13 contract that's similar to the proposal of the administration.

14 Senator Baucus. Mr. Chairman, are we still on IDB?

15 The Chairman. Yes. Well, we'll go back to IDB if --

16 Senator Baucus. What about non-profit hospitals,
17 particularly rural hospitals? Are they affected in any way?

18 Mr. McConaghy. They're exempt from all these rules,

19 Senator Baucus, except for the reporting rules.

20 Senator Baucus.. What?

21 Mr. McConaghy.. Except for reporting rules which would
22 be imposed.

23 Senator Bradley.. Mr. Chairman, what has the staff
24 concluded on the targeting provision that I had suggested
25 and --

1 The Chairman. I don't think they've had time. We're
2 coming back to that. I've asked them to get together and try
3 to work it out. I think Mr. Lighthizer is doing that now.

4 Mr. McConaghy. The next one deals with the completed
5 contract method of accounting. Essentially it's close to the
6 administration's proposal, but a little bit less onerous their
7 original proposal.

8 We do three basic things. First, it would tighten really
9 the rules dealing with when a completed contract is completed,
10 when it's terminated, and how you aggregate contracts. Those
11 changes are identical to the changes contained in
12 Senator Danforth's Bill S2690.

13 Second, it would say that with respect to taxpayers other
14 than certain contractors, they would be required to allocate
15 a portion of their costs to the contract rather than deducting
16 them currently if the contract had an estimated completion
17 date of more than two years.

18 The third thing it would do would exempt certain
19 contractors from those new allocation rules, and that is
20 where a construction contractor essentially had gross
21 receipts in the three preceding years of an average of
22 over \$25 million -- of -- under \$25 million, or any contract
23 whose expected completion date is three years of less.

24 It would have the effect under this other handout that's
25 being put out of listing the kinds of items. Basically the

1 administration's proposals would have required that interest
2 had to be allocated to the contract to the extent that it was
3 attributable to that contract. Most general administrative
4 expenses would have to be allocated, and so forth. This
5 proposal would cut back on the types of items that would have
6 to be allocated to the contract and would allow many of them
7 to continue to be deducted as period costs. It would have
8 a transitional rule that would say that to the extent that
9 the new rules would require more items to be capitalized,
10 those would be capitalized according to a table. That's listed
11 on page 2 of the handout. That table would provide that
12 a third of them would be required to be capitalized in
13 1983; two-thirds in 1984; and then this full rule would kick
14 in as to those that now would be required to be spread over
15 the contract rather than deducted currently.

16 The Chairman. I know there are questions on this, but
17 I wanted to checked with Mr. Chapoton. This is a rather
18 different proposal as far as revenue.

19 Mr. Chapoton. Yes.

20 The Chairman. It is the one that the administration
21 recommended. Now, with the changes made and the reduction
22 in revenue gained do you support this proposal?

23 Mr. Chapoton. Well, we can accept this proposal,
24 Mr. Chairman. Our proposal would have gone a great deal
25 further, particularly in dealing with the completed contract

1 method itself which does allow very significant deferral of
2 taxable income.

3 There are two problems, as Mr. McConaghy indicated, that
4 we saw. One is the completed contract method itself which
5 allows no income to be reported until the contract is completed.
6 And the second is the deduction of so-called period costs in
7 the early years when they are related to income that will not
8 be reported until significantly later.

9 But, we do think that it is important that this problem
10 be dealt with, and this is certainly a method of dealing with
11 it.

12 Senator Long, I would like to ask a question to
13 Senator Danforth, if I may. I came here prepared to support
14 Mr. Danforth's proposal. I want to ask the Senator from
15 Missouri, does your proposal -- this proposal as it stands
16 now, is there any assurance that the regulations involved will
17 be published in the usual way with the opportunity for the
18 public to view and comment?

19 Senator Danforth: Yes. It's my understanding Treasury
20 regulations spelling out, for example, what are period costs
21 and what are not. They would have to be put out by the
22 Treasury. They would be published in the usual way with a
23 period for comment.

24 It's also my understanding that interest, general, and
25 administrative expenses, and research and experimental

1 expenditures, including independent research and development
2 as defined in Section 174 will continue to be treated as
3 period costs.

4 However, certain other costs, including research and
5 development, which is specifically contracted for, will be
6 required to be capitalized in such cases.

7 I would like to just add one point. That on the hand-
8 out that we've been given on paragraph three at the top of
9 the handout, "General Administrative Expenses," that are
10 allocated to the contract under the defense pricing regula-
11 tions are similar rules in the case of non-defense contracts
12 that was not my understanding of the arrangement that was
13 agreed to. I don't think that we determined any particular
14 set of external regulations to determine what general and
15 administrative expenses will and will not be period costs.

16 It was my understanding that that would be left to
17 Treasury rate.

18 Mr. McConaghy. We can certainly make a change, Senator.

19 Mr. Chapoton. I think that's consistent with our under-
20 standing. There may be those that were directly allocable
21 would be capitalized, but not under a specific formula such
22 as --

23 Senator Danforth. Right.

24 Mr. Chapoton. Also, I'd just like to mention that the
25 regulations would not be effective for contracts entered into

1 before December 31, 1982, and that there would be a three-
2 year phase-in in the regulation. We would hope for committee
3 report language indicating though that there will be such
4 regulations issued because we didn't want to go --

5 The Chairman. Yes.

6 Mr. Chapoton. -- forward without committee's clear
7 understanding of what we were doing.

8 The Chairman. Senator Byrd.

9 Senator Byrd. I favored a proposal offered by
10 Senator Danforth. I would like to ask Senator Danforth
11 whether this proposal is satisfactory to him, and is somewhat
12 similar to what he had --

13 Senator Danforth. Well, I think, Senator Byrd, it's
14 very much like any other compromise that you would always
15 rather like to get exactly what you asked for. The bill that
16 I introduced I thought was a good bill. But I really think
17 that after protracted discussion with the Treasury Department
18 and with other members of the committee, that what we have
19 arrived at is a fair arrangement, and I'm satisfied with it.

20 Senator Byrd. Thank you.

21 The Chairman. Any other questions on this --

22 Senator Mitchell. Mr. Chairman.

23 The Chairman. Senator Mitchell.

24 Senator Mitchell. Would either Mr. McConaghy or
25 Mr. Chapoton explain -- identify and describe briefly the areas

1 in which this proposal differs from S2690, the bill originally
2 introduced by Senator Danforth.

3 Mr. McConaghy. S2690 deals with when the contract is
4 terminated or completed and how you aggregate the contracts,
5 but it does not deal with the issue of period costs,
6 Senator Mitchell.

7 Senator Mitchell. So, as I look at this handout, all of
8 the portions of this handout that deal with the allocation of
9 period costs to the contract, and those are -- well, eight
10 are listed here, in that respect this is different from the
11 Danforth bill?

12 Mr. McConaghy. That's correct. In other respects it
13 is identical as to the termination and the aggregation of
14 contracts. But you are absolutely correct.

15 Senator Mitchell. In other words, there are essentially
16 three parts to this and two of which are identical to the
17 Danforth bill, one of which is completely different because
18 it doesn't exist?

19 Mr. McConaghy. Yes. There's really one that's the
20 same as the Danforth bill. The other two here are dealing
21 with the same allocation problem. So, Senator Danforth's
22 bill does not deal with the allocation problem, and therefore
23 wouldn't deal with either two or three here, but it is
24 the same as the number one item dealing with when the contract
25 is terminated.

1 Senator Mitchell. One factual question. Now, on the
2 special rule for contractors, the first provision reads
3 contract -- this is average gross receipts over the preceding
4 three years as 25 million less? That's an aggregate of
5 25 million over a three year period, or an average --

6 Mr. McConaghy. An average --

7 Senator Mitchell.-- annually?

8 Mr. McConaghy. An average annually. You take a three
9 year period; if the three year total happened to be 74,999
10 they would meet that \$25 million average and be out from the
11 restriction.

12 Senator Mitchell. So, the word -- whose annual average
13 gross receipts?

14 Mr. McConaghy. That's correct.

15 Senator Mitchell. Thank you.

16 THE CHAIRMAN. Next.

17 I might say, since other members are
18 here, I had indicated earlier if members should have an
19 amendment they might want us to consider I would hope that
20 they would let the staff know now so that the majority and
21 minority staffs, somebody in the joint committee and Treasury
22 can be meeting on those while we're doing this, and we may
23 find some agreement.

24 SENATOR LONG. I'll tell you one right now,

25 Mr. Chairman. In Section 162 we had a hearing, and you were

1 here to hear Common Cause testify for it, and Congress Watts
2 testified for it.

3 The Chairman. What's this?

4 Senator Long. Taxpayer's union testified for it. They
5 testified anything other than their own proposal testified for
6 this suggestion that we simply amend the law so that we
7 strike out everything about Senators and Congressmen insofar
8 as claiming our travel expenses. What that would mean to
9 most of us would be that we could claim travel expenses in
10 our state, or claim the expense of maintaining a home in
11 our state, rather than a home up here.

12 Now, I'm also working on a constitution amendment that
13 would have the President appoint a board to fix our salaries
14 rather than us do it. I think that we ought to do both, but
15 but I think the answer is we ought to take the salary thing
16 out of our own hands and hope that we could have a board
17 appointed that would figure our salary with what it ought
18 to be, and that we just treat ourselves like everybody else
19 as far as expenses are concerned.

20 The Chairman. Okay. We'll be happy to look at that
21 and I assume it will have wide support at the appropriate time.

22 Senator Long. Did the Treasury support that? Have
23 you looked at that --

24 The Chairman. The media supports it I know. So -- I
25 know the media is for it.

1 Senator Wallop. Mr. Chairman.

2 The Chairman. Oh, excuse me.

3 Senator Wallop. I would just say this. I appreciate
4 what Senator Long is trying to do, and I especially appreciate
5 what he's trying to do with the constitutional amendment.
6 But I'll be damned if I want anybody telling me that I live
7 in Washington. There's too many people out in the hinderlands
8 that believe that we come to Washington and get hooked by the
9 Potomac and that we do indeed live there.

10 As far as I'm concerned, my home is Wyoming and I work
11 in Washington. I think that for anybody, you know, even just
12 for tax purposes to tell you and to have it out for all time
13 in public that you live in Washington is pretty --

14 Senator Long. We don't do that. We just --

15 Senator Wallop. I thought that's what you said.

16 Senator Long. We just --

17 Senator Wallop. You said you get travel expenses when
18 you're away from home back in your state.

19 Senator Long. We just black out part of the law that
20 creates an irrebuttable presumption on the behalf of members
21 of Congress. We just have to go by the same rules that apply
22 to everybody else.

23 The Chairman. Let me say that we're not discussing the
24 amendmen now. I just said if anybody has amendments -- we'll
25 be glad to get into this. I know it's exciting. I wouldn't

1 want to miss the discussion. But I think the record should
2 indicate it because there has been some questions asked if
3 there had been any amendments accepted during the caucus of
4 members, and I will include in the record there was an amend-
5 ment which exempt the offshore and logging helicopters which
6 Senator Long and Senator Packwood had -- there is a mortgage
7 bond provision which Senator Roth and Durenberger, which has
8 already been passed as an HR4717, which is contained in the
9 package.

10 There was annuities for clergymen, a technical amendment,
11 adopted this morning which Senator Bentsen offered. The Texas
12 judges provision which Senator Bentsen offered, that was
13 accepted. That's also in 4717, so it's had hearings in the
14 past.

15 The extension of the targeted jobs tax credit offered
16 by Senator Heinz has been included in the package. Credit
17 for summer youth employment, which is part of the targeted
18 jobs credit offered by Senator Grassley has been included.

19 The general revenue sharing, technical amendment for
20 New Jersey that Senator Bradley offered. There's an AFDC
21 amendment which Senator Moynihan and I agreed that should be
22 made a part of the spending reduction package. We now determine
23 the cost is minimal, about \$40 billion -- \$40 million over a
24 three year period. Isn't that what Senator Moynihan said?

25 Senator Moynihan. Yes, Mr. Chairman.

1 The Chairman. And finally, a technical amendment affecting
2 public employee pension plans by Senator Wallop. So, those
3 are all of the amendments that have been acted upon, and if
4 there are amendments I would hope that staff--Mr. Lightizer,
5 has a basket and he can take those now. It might expedite
6 action on all of the amendments -- those that we can act on
7 early this evening.

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1 Senator Armstrong. Mr. Chairman, I would just mention
2 in the spirit that you've suggested, but let me ask you, the
3 amendment which some of us discussed on the deduction of
4 expenses in connection with illegal activities, drug activities;
5 is that included at this point?

6 The Chairman. That is in there; isn't it? That should
7 have been added.

8 Senator Armstrong. Also, it's my understanding that we
9 agreed to include the tax to the spirit of S1919, which is the
10 energy impact bill that Senator Wallop and I have introduced,
11 that that has been included as well.

12 The Chairman. I think we may have discussed that; if
13 not, we will -- that should be raised.

14 Senator Armstrong. My understanding is that then if
15 there is a problem with it we'll be glad to explain it to
16 everybody. I think it is not controversial. The hearing has
17 been held. Then, Mr. Chairman, I have --

18 The Chairman. Why don't we submit that admendment to
19 Mr. Lighthizer.

20 Senator Armstrong. I believe he has the information
21 on it. What's your desire? At the right time we move it,
22 or --

23 The Chairman. No, no. I just want to give notice
24 that if you have any amendments let us have them now.

25 Senator Armstrong. Okay. Let me mention two or three

1 others that I do intend to offer.

2 Again, I think for the most part they are matters with
3 which the Committee is familiar. I will be offering an amend-
4 ment to provide an exemption from the requirement that founda-
5 tions spin off certain businesses, and this is the so-called
6 Broadmore Bill. It relates to the Broadmore Hotel in
7 Colorado Springs, and I think that is familiar to the Committee
8 and has been considered.

9 The Chairman. Right.

10 Senator Armstrong. Then, Mr. Chairman, I'm not sure if
11 Senator Bentsen has already indicated that he intends to offer
12 an amendment on auto lease back. But I think he does. If it
13 hasn't come to the attention of staff, I intend to join him
14 in offering that.

15 Then, Mr. Chairman, I'm going to offer an amendment to
16 index the basis of capital gain, and to pay for the revenue
17 loss related to that, that is, to permit taxpayers in the
18 computation of capital gains to index the basis for inflation,
19 and to pay for that by adjusting the ITC basis adjustment
20 from 95 to 90 percent.

21 The Chairman. All right. Well --

22 Senator Armstrong. So, those are the amendments that I
23 will have to offer.

24 The Chairman. If we just submit the amendments, we'll
25 explain them later, if we can. Let's move on to the next --

1 Senator Matsunaga. Mr. Chairman, when do you expect to
2 take up the amendments?

3 The Chairman. Well, we expect to take those up later.

4 Senator Matsunaga. Tommorrow?

5 The Chairman. Tonight.

6 Senator Matsunaga. Or tomorrow.

7 The Chairman. Tonight. We hope to. If in fact it works
8 out as we hope, it will be tonight. If not, tomorrow.

9 Senator Matsunaga. How late do you expect to go tonight?

10 The Chairman. Well, we don't want to stay too late.
11 Maybe 10 or 11.

12 I don't want to rush anyone, but I think we're moving
13 very well here. Once we go through we only have about three
14 more items. I understand Senator Long would like to be
15 recognized. We'll do that.

16 Then depending on what happens after he's recognized,
17 we'll do something else. If he wins we'll adjourn. I mean
18 if --

19 Senator Long. Mr. Chairman, I had the amendment on the
20 study which actually the Treasury --

21 The Chairman. The amendment on the study I think you
22 have.

23 Mr. McConaghy. Yes, we do have that.

24 The Chairman. I think others had amendments, but we'll --
25 just give them to -- safe harbor leasing, I think, is next.

1 Mr. McConaghy. Dave. Dave Brockway is going to go over
2 safe harbor leasing, Mr. Chairman.

3 Mr. Brockway. The proposal is to phase out the tax
4 benefit transfer of water -- type of leases submitted -- The
5 proposal was to phase out the tax benefit transfer of washout
6 type of leases permitted in last year's act and to modify the
7 safe harbor leases to liberalize the leverage these type of
8 treatments -- leverage these type of leases that would be
9 allowed under the safe harbor; and also to make certain changes
10 to protect against certain abuses that have been pointed out
11 in the safe harbor leases -- leasing provisions.

12 The phase out would operate by limiting the amount of
13 eligible property that a lessee could subject to the wash sale
14 type of lease to 25 percent of the lessee's eligible property
15 placed in service in 1982; 20 percent of the lessee's eligible
16 property placed in service in 1983; 15 percent in 1984; and
17 thereafter the lessee would have to use the liberalized
18 leverage lease safe harbor rules.

19 There's one exception to the phase out for mass commuting
20 vehicles. They would continue without limitation through --
21 and this should read 1987 rather than 1986. It's a mistake
22 in the writeup. If there is a binding contract or accepted
23 bid before March 31, 1983, the rule dealing with the leverage
24 lease type of transaction where there would be modified,
25 liberalized in several respects that these are the type of

1 leases where they -- the tax benefits are allowed only where
2 there is an economic substance in the transaction, and that
3 would require as under the old revenue procedure that applied
4 under prior law that the lessor be the owner of the property,
5 and that the lessee have no interest in the property. That
6 is, the lessor would have to be ~~to~~ finance the property.

7 Also, the profitability and cash flow tests of prior
8 law would have to be satisfied. That is, the lessor would
9 have to make a profit on a cash basis absent taking into
10 account the tax benefits.

11 The liberalized rule that would be provided would be that
12 lessees unlike the old Reproc leases would be allowed to have
13 a fixed price purchase option in the lease and that fixed
14 price purchase option could be as low as 10 percent of the
15 original cost of the property.

16 Also, the lessor could have a put option in the contract
17 so that the parties could agree that the lessee user could
18 have the property at the end of the lease term.

19 Second, that as under the Reproc leases the lease rental
20 payments could vary up to 10 percent of the level straightline
21 amount. This gives the lessee and lessor more flexibility in
22 arranging the lease payments so they more closely match the
23 cash flows of the lessor in the transaction.

24 Third, the lease term could not exceed 90 percent of
25 the ADR class life of the property as contrasted with the

1 current safe harbor rule which allow lease term of up to
2 150 percent of the ADR class life of the property.

3 The proposal would also modify all safe harbor leases,
4 both those wash out type leases during the phase out period
5 and also the new liberalized leverage lease type transactions
6 so that first these leases would not be available for property
7 leased to a public utility.

8 Second, the lessor could not generate accarry back through
9 the transaction to use carry backs of net operating losses
10 or investment tax credits to offset tax liability for a prior
11 year.

12 Third, safe harbor leasing could not be used to increase
13 tax benefits associated with percentage depletion or the
14 foreign tax credit, and also that the safe harbor leases
15 could not be used in transactions between related parties.
16 These would typically be in percentage depletion or foreign
17 tax credit situations.

18 Finally, the safe harbor leases would not be available
19 for property predominately used outside the United States by
20 foreign users who aren't subject to tax on the income from
21 the use of the property.

22 So, in effect the safe harbor lease could not transfer
23 tax benefits from a user who would not be subject to tax
24 where the user himself would not have tax benefits and so that
25 the lessor would not be able to buy them.

1 The changes would generally apply to leases entered into
2 after today. As I mentioned, there would be an exception to
3 that for mass commuting vehicles. Also, there would be a
4 binding contract rule for property acquired before February 19.

5 Finally, the rules which restrict the use of safe harbor
6 leasing in the case of percentage depletion, foreign tax
7 credit, related parties, and foreign use property, would also
8 not apply to property -- would apply to property placed in
9 service after February 19, 1982.

10 The revenue effect of the proposal would be to increase
11 revenues by 1.3 billion in physical '83; 2.5 billion in
12 physical '84; and 3.5 billion in physical '85.

13 Senator Byrd. Mr. Chairman.

14 The Chairman. Senator Byrd.

15 Senator Byrd. I would like to get just three figures
16 from you.

17 Mr. Brockway. Yes, Senator. It's -- in physical '83 --

18 Senator Byrd. Yes, but what I would like to get from
19 you is assuming the law remains as it is, how much is the
20 revenue loss in each of those three years?

21 Mr. Brockway. Well, if you had repeal of safe harbor
22 leasing completely affecting in the year it would be \$3.2
23 billion.

24 Senator Byrd. No, no. That's not my question. My
25 question is if you make no change in the present law, what

1 would be the revenue --

2 The Chairman. What will it cost?

3 Senator Byrd. What would be the revenue -- total revenue
4 loss? This doesn't pick up the total revenue loss.

5 Mr. Brockway. Correct.

6 Senator Byrd. What is the total revenue loss?

7 Mr. Brockway. The total revenue loss would be 3.2 billion
8 in physical '83; 5.2 billion in physical '84; and 7.0 billion
9 in physical '85.

10 Senator Byrd. So, you are picking up say roughly one-
11 half.

12 Mr. Brockway. Correct.

13 Senator Byrd. Thank you.

14 Senator Durenberger. Mr. Chairman.

15 The Chairman. I might say I know Senator Durenberger
16 has a keen interest in this, and you can either do it now,
17 Dave, or later. We're not -- what we want to do is go through
18 first and then come back and offer amendments, whatever.

19 Senator Durenberger. All right. Just a couple of
20 questions to clarify the proposal.

21 The Chairman is correct in stating that I have an
22 amendment that will modify the safe harbor provisions, and
23 will not affect the leverage leasing provisions. But I just
24 to be sure that I understand what it is that is being changed
25 with regard to both safe harbor and leverage leasing.

1 The so-called abuses, I guess, of safe harbor that we
2 have been reading about and hearing about, are all those abuses
3 covered in this proposal?

4 Mr. Brockway. Well, Senator, I think abuse is in the
5 eye of beholder. Certain ones that you've discussed are dealt
6 with in here dealing with the foreign tax credit and depletion,
7 and also with carry-backs where a lessor could enter into a
8 lease and create a carry-back of ITC, or NOL's carry them
9 back into prior years and offset tax liability in prior years.

10 Senator Durenberger. Are all of the concerns that were
11 raised by the so-called Occidental Petroleum abuse, are those
12 taken care of?

13 Mr. Brockway. I think that's generally referred to as
14 the transaction where you can increase your foreign tax credits.
15 Yes, that would be covered by this this to stop that.

16 Senator Durenberger. There are no provisions here, then,
17 for applying benefits to any prior tax year?

18 Mr. Brockway. Yes. This would prevent you to generate
19 a refund by entering into -- becoming a lessor and create a
20 net operating loss or investment credit carry-back and
21 generating a refund from prior years tax liability.

22 Senator Durenberger. And the cap on the lessor is at
23 what percentage?

24 Mr. Brockway. There is no cap on the lessor in this
25 proposal. There is a cap on the lessee. That's how it phases

1 out. But there is no cap on the lessor other than the carry-
2 back rule.

3 Senator Durenberger. So that in this provision a lessor
4 may in effect negate all tax liability through the use of
5 safe harbor --

6 Mr. Brockway. That is correct.

7 Senator Durenberger. What is the --

8 Mr. Brockway. Excuse me, -Senator, I mean obviously the
9 lessor would be subject to the 90 percent limitation of invest-
10 ment tax credit so that that would be the binding effect.

11 Senator Durenberger. Is there any limitation other than
12 the existing limitation on interest that may be charged on
13 lease --

14 Mr. Brockway. Well, in this transaction there is not
15 any lessee financing so that that limitation is only applicable
16 to the wash sale type of lease where the lessee and lessor --
17 the lessee lends the money to the lessor on the property,
18 and the rental agreement -- the rents offset the leases. So
19 you can subject the interest payments at any level.

20 Here the lending -- if the lessor is getting outside
21 financing, he's getting it from a third party; so that would
22 be a market set rate in this transaction. Just the market
23 would set it. Whatever the lessor can borrow at.

24 Senator Durenberger. Your modification to the safe harbor
25 eliminates the lessee financing entirely.

1 Mr. Brockway. Correct.

2 Senator Durenberger. And that has a 10 percent limita-
3 tion on the residual rather than the current 20?

4 Mr. Brockway. Well, rather than the old 20 percent.

5 Although the other distinction from the old rule is that
6 you can have a fixed price purchase option so that the lessee
7 knows that he can acquire it at the 10 percent.

8 Senator Durenberger. Can I ask a couple of revenue
9 questions?

10 One, what savings do you calculate from the safe harbor
11 portion of this proposal?

12 You gave some savings figures of 1.3, 2.5, and 2.5.

13 Mr. Brockway. Correct. That's the savings on the entire
14 package. The other numbers I gave Senator Byrd were for the
15 entire cost of safe harbor leasing.

16 The 1.3, 2.5, and 3.5 was for the entire proposal
17 described.

18 Senator Durenberger. Okay.

19 Now, I'm asking you within that proposal the savings that
20 relate to changes made in wash sales or safe harbor leases,
21 how many dollars are attributable in savings to safe harbor
22 leases over current law?

23 Mr. Brockway. I'm not sure I understand the question.
24 I think that the entire savings are attributable to requiring
25 that you have a transaction where the lessor is the owner of

1 the property and provides the financing and has to have an
2 economic profit, and so that the operation of those rules
3 results in the lessor having to acquire the property with
4 more equity than is -- and that that reduces the total tax
5 benefits available in the transaction. And that's what raises
6 the revenue.

7 You lose revenue in this package from the phaseout. But
8 that's the one part that raises the revenue. As distinguishing
9 between that and the changes dealing with the carry-back or
10 the -- well, I guess there's one other piece that has a
11 substantial revenue impact, and that's regulated utilities;
12 and I'm not sure what percentage that would be. Although,
13 it's a meaningful number.

14 Senator Durenberger. Well, are wash sales, as you call
15 them, still permitted for a period of time under that?

16 Mr. Brockway. They are permitted for -- in calendar
17 '83 it's the 25 percent; in calendar '84 it's 20 percent.
18 25 in '82; 20 in '83; and 15 in '84.

19 Senator Durenberger... All right.

20 Now, you're telling me that we are going to end up
21 with one form of lease after we --

22 Mr. Brockway. After the phaseout period then the safe
23 harbor would not longer permit the wash sale type of
24 transaction. That's correct.

25 Senator Durenberger. But we're still going to call

1 this safe harbor?

2 Mr. Brockway. It is a safe harbor in that these leases
3 we're describing here would not qualify under the old revenue
4 procedure. They've been changed in several respects such as
5 allowing limited use property and allowing the fixed-price
6 purchase option and lowering the residuals so that the lessee
7 could buy it. These changes would not satisfy the old revenue
8 procedures. So these are rules that are safe harbor as --

9 Senator Durenberger. Well, I'm just trying to pull
10 apart in this proposal the amount of revenue savings that
11 are attributable to in effect liberalizing, as you might call
12 it, the old REVROC 7521 and those that are attributable to
13 the various changes that are proposed in wash sales. Is
14 that possible for you to do that?

15 Mr. Brockway. I don't think so. Maybe in part I've
16 confused the issue. This type of transaction is permitted
17 right now under the safe harbor enacted last year -- The ones
18 that are permitted in this proposal.

19 They would not have been permitted absent the enactment
20 of the safe harbor. What this does is changes certain of
21 the rules in Section 168 to no longer allow the wash sale
22 leases but still permit this type of lease. There are a
23 number of this type of lease going out right now under the
24 safe harbor.

25 Senator Durenberger. One last question, Mr. Chairman.

1 I'll save whatever other comments I want to make for a question
2 I want to ask for later. But given the analyses that have
3 been made by Treasury and various reports on what happens to
4 the investment tax credit and other tax benefits, as between
5 the old REVROC 7521 and the current safe harbor, could you
6 give us some idea of -- and on the assumption that under the
7 old 7521 the -- somewhere between 40 and 55 percent of the
8 tax benefits flowed through to the lessee and the rest stayed
9 with the lessor, and under these studies that we've looked
10 at, something in the neighborhood of 80 to 85 percent went
11 to the lessee, and the balance with the lessor. Have you got
12 some idea of what happens to the tax benefits under these
13 changed leasing procedures?

14 Mr. Brockway. Well, Senator, our analysis of the tapes
15 under safe harbor indicated that of the total revenue loss
16 created by the leases entered into under the safe harbor
17 about 76 percent of the revenue loss went to the lessee and
18 the remainder went to the lessor or the middleman in trans-
19 action.

20 Senator Durenberger. And what was under your study
21 under leverage --

22 Mr. Brockway. We do not have have numbers for the
23 leverage lease type transaction because there wasn't a data
24 base that did it. Our analysis from looking at it does not
25 suggest that there is a 40 percent amount of the tax benefits

1 going to the lessee/lessor. But we do not have at the
2 moment --

3 Senator Durenberger. Well, let's take '76 then and give
4 me some figures on physical '83, '84, '85, '86 and beyond as to
5 what happens to the tax benefits under this proposal? What
6 percentage would you expect us to find if we studied it a year
7 from now and the year after, and the year after that?

8 Mr. Brockway. I think, Senator, that that would be
9 speculation at the moment. To do that there's nothing
10 inherent in the structure of a leverage lease that would make
11 it be more or lease efficient in terms of splitting up the
12 revenue laws between the lessor and the lessee that you can
13 construct a leverage lease, and we've discussed this with
14 lessors and lessees; they say that the transaction are
15 generally equally efficient.

16 You can construct them that way. The problem for many
17 lessees under the prior law was that they would enter into
18 the lease, and they could not have a fixed price purchase
19 option. And at the end of the lease if they wanted to have
20 the property back they would have to again in effect buy
21 the property over again.

22 But there is nothing inherent in the structure of the
23 transaction. What is inherent in the structure of the
24 transaction is that it reduces somewhat by requiring more
25 equity financing by the lessor. It reduces somewhat the tax

1 benefits involved. So, the pie is shrunk. But there is
2 nothing inherent in it that says that more or less of the
3 pie -- the smaller pie goes to the lessor and the lessee.
4 And it's just a matter of dispute among people in the market
5 as to which would be more effective.

6 The Chairman. Senator Grassley.

7 Senator Grassley. Senator Durenberger touched a little
8 bit on it, but just for clarification, I want to know that
9 the fixed priced-- fixed purchase price option applies to
10 all leases and not just leverage leases.

11 Mr. Brockway. It would apply to all transactions
12 covered in the safe harbor, which is -- so that it wouldn't
13 make any difference whether -- in that situation whether
14 the lessor could finance the transaction entirely, which that
15 would be a non-leverage lease. And the fixed price purchase
16 option would also apply to that transaction.

17 So that --

18 Senator Long. Just let me ask a question about what
19 Senator Durenberger -- now, you also --

20 The Chairman. No, we're just going through the explana-
21 tion.

22 Senator Long. Let me just make this further -- I personally
23 would like to keep what the Committee has done on the part
24 of the -- already. The Senator might want to add to that
25 and say some more on it. I would like -- I don't want -- to

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1 be anymore difficult -- I would like -- I hope -- that's
2 the kind of thing he had in mind.

3 Senator Durenberger. I certainly do.

4 The Chairman. We'll go on then.

5 Senator Matsunaga. Mr. Chairman, may I ask a few ques-
6 tions now?

7 As I understand it, the safe harbor leasing was enacted
8 to help business utilize the benefits of ACRS, businesses
9 which otherwise could not have received any benefits under
10 ACRS. Am I correct?

11 Mr. Brockway. That's correct, Senator.

12 Senator Matsunaga. All right. Now, we are reverting
13 back to pre-ERTA which calls for restoring economic substance
14 as a requirement for lease treatment you say.

15 Mr. Brockway. That's correct, Senator.

16 Senator Matsunaga. All right. Now, as applied to the
17 airlines, how would your proposal operate?

18 Mr. Brockway. This would apply in a similar fashion
19 to the leverage leases that airlines used prior to the
20 enactment of the changes last year. That in fact that's the
21 typical way that airlines finance the acquisition of their new
22 aircraft is that they would enter into a transaction where a
23 leasing company would own the airplane and lease it to them
24 because the airline did not have sufficient tax base to use
25 the benefits even under prior law.

1 This would continue that method of transferring the tax
2 benefits and associated with the financing of the airline, but
3 it would also liberalize it to resolve at least one of the
4 significant problems that airlines had before that they felt
5 when they financed the airlines under leverage leases that the
6 old rules required that there would be no fixed price purchase
7 option at the end of the lease. And so the airlines would have
8 to pay rental payments during the course of the lease that would
9 be more than the amount of the original cost of the plane.
10 And they would have to cover that. And then they would have
11 to acquire the airline if they wanted it, which was a fine
12 transaction if the airline -- the airplane did not substantially
13 appreciate in value.

14 But for the airlines unfortunately the airlines did over
15 the last 20 years tend to substantially appreciate over their
16 lives. And so the airlines found themselves in the position
17 of having to acquire the aircraft for a substantial price.
18 This is different than in industry such as computers where
19 the lessors had property which by the end of the lease turned
20 out not to have any worth, and the airline property turned
21 out to have -- or the airplanes the property turned out to
22 have substantial worth at the end of the lease.

23 This problem is dealt with in this proposal by allowing
24 the fixed price purchase of no more than 10 percent.

25 Senator Matsunaga. Well, that's a long answer, but would

1 it affect the airlines adversely, or would not affect the
2 airlines at all in their present mode of leasing from the
3 manufacturers?

4 Mr. Brockway. The airlines would be permitted to lease
5 under this --

6 Senator Matsunaga. They would continue?

7 Mr. Brockway. They would continue --

8 Senator Matsunaga. As they are.

9 Mr. Brockway. They definitely would continue to lease
10 in this fashion.

11 Senator Matsunaga. What about the tax benefits? Would
12 they be able to transfer that to the --

13 Mr. Brockway. Right. That is the nature of this type
14 of safe harbor lease is to allow a pass through of some of
15 the benefits.

16 Senator Matsunaga. So, even under your proposal that
17 would continue you are saying?

18 Mr. Brockway. That's correct, Senator. But it requires
19 economic substance so the transaction has to have a business
20 purpose.

21 Senator Matsunaga. As the airlines are operating today,
22 do you consider the airlines having met the requirement of
23 economic substance? When they enter into a -- as they are
24 operating today.

25 Mr. Brockway. In a wash sale lease, no, Senator. That

1 transaction is designed not to have any economics to it at all
2 other than the straight transfer of the tax benefits.

3 Senator Matsunaga. Well, inasmuch as the airlines, say
4 of the six of the twelve major airlines reported losing and
5 when you take the aggregate of all twelve carriers, the major
6 carriers as a group experienced over a -- a loss of a half-a-
7 billion dollars last year.

8 Now, how do you then expect them to take advantage of
9 the ACRS?

10 Mr. Brockway. Well, through the use of proposed safe
11 harbor they could take advantage of it by leasing their
12 aircraft from lessors who would take advantage of ACRS and
13 would pass it through in the form of lower rentals.

14 This is the standard way that airlines -- many airlines
15 have financed aircraft.

16 Senator Matsunaga. This may not be fully related, but
17 supposing the lessee, the airlines, makes improvements on
18 the plane leased. Now, who would get the tax benefit? The
19 lessee or the lessor?

20

21

22

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1 Senator Matsunaga. Looks like --

2 Senator Moynihan. We finally got you.

3 Mr. Brockway. When the lessee makes an improvement
4 to the airplane, it is income to the lessor. If it is
5 property, it is nonseverable from the aircraft and so it is
6 property that reverts back to the lessor at the end of the
7 leasing.

8 Senator Matsunaga. If the lessee is willing to make
9 the improvements and definitely coming from the state of
10 Hawaii where we are isolated, where air transportation
11 means so much, it is to the benefit of the consumers and
12 to the benefit of the airlines that they improved the leased
13 planes, for example, by putting on new engines which are
14 fuel efficient.

15 And, if the lessor is going to be charged, increase
16 his property by it and therefore become taxable to a greater
17 extent, then how do you expect a lessor to agree to such
18 an arrangement, even though the lessee is willing to pay
19 for such improvement?

20 Isn't there -- I hope that that would, -- Under your
21 proposal, the lessor would not be credited or be deemed
22 to have enjoyed capital increase.

23 Mr. Brockway. Senator, I understand that to cover
24 that situation you can provide in the lease that if the
25 lessee makes a nonseverable improvement, that he would

1 be required to compensate the lessor for the tax effect, --
2 Senator Matsunaga. But, under the present language,
3 that is not clear, is it?

4 Mr. Brockway. Senator, you would need a specific
5 amendment to exclude it from gross income of the lessor
6 in that transaction. Right now it would be included in
7 the lessor's gross income and it would be a indemnification.

8 In order to make sure that it was excluded from the
9 lessor's income when the less made the improvement, you
10 would need a specific amendment.

11 Senator Matsunaga. So, we would need a specific amend-
12 ment.

13 Mr. Brockway. Otherwise, there would be income of the
14 lessor.

15 Senator Long. Mr. Chapoton, what is the Treasury's
16 position on this proposal?

17 Mr. Chapoton. Senator, we do not chair altogether
18 the joint committee's conclusion on the efficiency of war
19 sale/leases. We have studied them, are still studying
20 them. As you know, farms are required now of taxpayers
21 entering into so-called war sale/leases and we will continue
22 to study them.

23 However, we are concerned about the perception problem
24 that leasing has caused, the safe harbor leasing. We've
25 all seen numerous articles in magazines and newspapers where

1 it is generally regarded as something of a ripoff of the
2 American people. We are concerned about that and we have
3 looked at that in great length. We have gone over provisions
4 that would attempt to deal with some of the so-called abuses,
5 but it turns out in reality that alot of the abuses are in
6 the way the provision works itself.

7 We can accept and live with the proposal. It would
8 permit safe harbor leasing to continue for a period of
9 years, on a limited amount of the lessee's property. It
10 would also facilitate significantly the use of the old
11 leverage lease rules, the new rules Mr. Brockway described
12 and that is an important element, so we can live with this
13 provision.

14 Senator Matsunaga. Although you can live with it --
15 Mr. Chairman. Alot of us can life without it too,
16 without any of it.

17 Senator Matsunaga. But, it is your position that as
18 the provision, as it now stands and as it was provided in
19 ERTA was not objectionable from your point of view?

20 Mr. Chapotaon. It was not objectionable?

21 Senator Matsunaga. Yes.

22 Mr. Chapoton. No, we were -- I would have to say
23 we were very concerned about specific aspects of it and
24 we have been concerned about the perception of it and so
25 we did not --

1 Senator Matsunaga. Are you a Harvard Law grad?

2 Mr. Chapoton. No, sir, I am not.

3 Senator Matsunaga. Oh, you are not. Well, I tell
4 you -- Recently -- I don't know if you have seen -- The law
5 review editors of Harvard Law School came out supporting
6 the original position, one that it would treat economical
7 equivalent transaction in the same way, it will provide
8 certainty and establish simple administration. And, it
9 came out in support of the safe harbor provision as is.

10 Mr. Chapoton. Senator, there has been an awful lot
11 of analysis of this, different conclusions have been reached
12 on that point. The efficiency, we think, is better than
13 the joint Committee, but there is alot to be discussed in
14 the analysis of safe harbor leasing.

15 Senator Matsunaga. Well, we will discuss it later
16 when we bring it up again.

17 Senator Long. Mr. Chapoton, since you said you are
18 not a Harvard, might I just dash the hope that you might
19 be a graduate of some land-grant college. A Treasury
20 official, a tax lawyer, a graduate of a land-grant college,
21 I think that would be a great improvement over what --
22 What college did you graduate?

23 Mr. Chapoton. University of Texas.

24 Mr. Chairman. All right. Can we move onto the next
25 item? We are coming back to this issue. It will take some

1 time. We only have two items left, I understand, and I
2 think we can move to those.

3 Mr. Brockway. The next proposal contains the provisions
4 of Senator Danforth's Bill dealing with mergers and acquisi-
5 tions. The Bill is generally designed to deal with certain
6 transactions where taxpayers use the corporate reorganization
7 rule to dispose of business assets of an ongoing business
8 appreciated property without recognizing complete gain
9 on the property and only realizing the recapture gain on
10 the property while the acquirer of the property receives
11 a step up in basis in the assets.

12 The general rule, of course, is the taxpayer on disposi-
13 tion of property recognizes full gain. However, in a liquida-
14 tion, the taxpayer, when the business terminates the entire
15 business, the taxpayer, the corporation is only subject to
16 certain recapture taxes.

17 In addition, when certain partial liquidation transac-
18 tions, certain redemptions, limited transactions, redemptions
19 of stock transactions, the corporation can dispose of
20 appreciated property and not recognize full gain on the
21 transaction but only recognize recapture gain.

22 The problems that come up through the use of these
23 liquidation redemption rules where a corporation might
24 acquire stock from another corporation and then picking
25 assets that had appreciated, great appreciated value but low

1 basis, might then either cause a distribution of the
2 property and a partial liquidation or a redemption which
3 is, in effect, a purchase of the underlying assets, but
4 the seller of the target company would not sell the property
5 directly which would have triggered a gain recognition
6 of the property, but would have only had a recapture.

7 And, where you have this, you may have heard of a
8 variety of transactions in this regard. Mobil S market
9 is one of the more prominent ones utilizing these rules
10 where the transaction can occur to acquire part of the
11 assets of the target company without recognizing full gain.

12 There's a -- The proposal here would require recogni-
13 tion of gain on these transactions. Another rule deals
14 with the situation where one corporation acquires all the
15 stock of another corporation. The general rule on a liquida-
16 tion, there's a carryover basis. No gain is recognized,
17 but there is a carryover basis.

18 However, if one corporation acquires more than 80
19 percent of the stock of another corporation, the acquiring
20 corporation can treat the transactions as a purchase of
21 the assets, in effect, by treating it as a liquidation,
22 by liquidating in five years and then it gets a step up
23 basis in the assets and only recognizes -- The recapture
24 gain that gets full recapture, this is a type of transaction
25 described and this proposal would simplify those rules.

1 The Chairman. Does the Administration support these
2 provisions?

3 Mr. Bancello. Yes, Mr. Chairman, we do.

4 Mr. Chairman. There have been hearings held on these
5 two measures in the house.

6 Mr. Bancello. That is correct.

7 Mr. Chairman. The Administration did testify in
8 support?

9 Mr. Bancello. The Bill that was in the House was
10 different than Senator Danforth's Bill. We made a number
11 of recommendations for changes in that, and Senator Danforth's
12 Bill does include those changes which have been drafted
13 into the new section.

14 Mr. Chairman. There's nothing in either provision
15 that you have a disagreement?

16 Mr. Bancello. No, sir, we don't.

17 Mr. Chairman. Senator Byrd?

18 Senator Byrd. Yes, Mr. Chairman, I'm neither for it
19 not against it. I don't know anything about it. This
20 Committee, as far as I know, has not had hearings on such
21 a proposal, has it?

22 Mr. Chairman. No.

23 Senator Byrd. It is a pretty complex subject and the
24 ramifications are rather wide, are they not?

25 Mr. Bancello. It is a structural change in the taxation

1 of corporations and the ramifications are substantial,
2 that is correct.

3 Senator Byrd. Mr. Chairman, something of this magnitude
4 complexity, do we want to handle this without hearings on
5 it at all?

6 Mr. Chairman. I might say, Senator Byrd, that the
7 reservation has been expressed. In fact, we spent, I
8 think, probably several hours staff time, as well as meeting
9 with Senators. Mr. Glickman is totally familiar with this
10 proposal. We tried to extract every assurance that we were
11 not embarking on some unchartered course of not having some
12 adverse impact.

13 Maybe Mr. Glickman might elaborate on that.

14 Mr. Bancello. As the Chairman said, Senator Byrd,
15 over the last several days a number of hours had been spent
16 on this. But, in preparation for the hearing before the
17 Ways and Means Committee, there were a number of our attorneys
18 that spent many many hours analyzing the Bill that was
19 considered there.

20 Senator Byrd. You were looking at it from the Govern-
21 ment's point of view. Did anyone analyze it from the
22 business point of view?

23 Mr. Bancello. Senator Byrd, the way we tried to view
24 this Bill -- This is a technical change in the Subchapter C
25 area and one of the principle concerns we had was depending

1 upon the quality of the attorney or tax advisor involved,
2 you could possibly accomplish things by manipulating the
3 rules that someone else might not be able to achieve.

4 Senator Byrd. Well, isn't that true of any tax law?

5 Mr. Bancello. In many tax laws it is and I think
6 we should all endeavor to try to make that type of maneuver-
7 ing not the sine qua non of whether the deal goes forward
8 or whether one person gets a better deal than someone else.

9 And, we tried to make the provision neutral so that
10 when you make the acquisition we're talking about or make
11 the decision to buy the stock and then have that stock
12 redeemed, the tax consequences are not going to change
13 depending upon the structure you devise.

14 We think that would be a very nice way for the entire
15 tax system to work.

16 Senator Byrd. Maybe my colleagues are experts on this
17 section. I must say, I don't know a thing in the world
18 about it. We've always been leary of getting into these
19 complex far reaching tax proposals when no hearings have
20 been held, when those in the business community and private
21 citizens who will be effected have had no chance to present
22 a viewpoint. This may be the finest proposal ever presented,
23 I don't know. I don't say it isn't.

24 Has the minority staff looked into this proposal?

25 Mr. Bancello. Senator, hearings were held on this Bill

1 on the House side and me, I was in private practice for
2 ten years doing this kind of transaction. And, I attended
3 those hearings and I listened to an awful lot of commentators
4 who substantiated what my private practice experience
5 indicated and that is that there is alot of abuse in this
6 area, but it is extremely complex. And, there are alot of
7 interrelationships.

8 And, because of the abuse, I tried to raise some
9 interest at the staff level. After the hearings were
10 introduced on the House side, I could not raise any interest
11 on the staff side.

12 I didn't know anything else about this proposal until
13 I read about it in the newspaper this morning. And so, the
14 minority staff has not had a chance to examine the proposal
15 at all and to see. There are abuses, but it is extremely
16 complex and it is something that needs some time and study
17 on it.

18 Senator Bentsen. Let me ask a question, Senator,
19 for a moment.

20 I can recall one of the abuses and a rather serious
21 one where a company went out and wanted to buy a subsidiary
22 and bought the stock, parent company, as I recall, and
23 then turned around and traded that stock for it and had
24 in effect, I guess a partial -- but then took a new stepped
25 up phase. That is an obvious abuse and it ought to be

1 corrected.

2 But, what I'm trying to find out here is, can't much
3 of this be done by regulation by the Treasury?

4 Mr. Bancello. Senator Bentsen, there are a number of
5 things that can possibly be done by regulations and we have
6 a regulations project started. But, depending upon the
7 transaction involved, many of the abuses, many of the sub-
8 stantial abuses, transactions which we think should be
9 changed --

10 Senator Bentsen. You know the one I cited, and that
11 is a prime example of what you are talking about.

12 Mr. Bancello. The transaction, as you cited, we cannot
13 solve that type of transaction by regulation. Now, there
14 was one transaction in which the transaction was really
15 wired together. In other words, when they bought the stock,
16 they already had a deal arranged pursuant to which the
17 redemption would take place. We have a project underway
18 right now to look at that from a ruling standpoint to see
19 if we can stop it.

20 But there are other deals out there where stock is
21 purchased, many times in tender offers where they don't
22 get control and then they want out and they reach a deal
23 in which they're redeemed out through appreciated property
24 without any gain being recognized at the corporate level.

25 If there is no tie-in between the original acquisition

1 and that type of transaction, even though they pay cash
2 for the stock and now they end up with a piece of property
3 that has appreciated in value. We have more questions
4 as to that type of transaction, whether we can or cannot
5 stop it.

6 And, the real problem here goes to the question of the
7 purchase of stock by the corporation with appreciated
8 assets without any gain being taxed at the corporate
9 level where there is a step-up in basis at the shareholder
10 level after the redemption.

11 Senator Symms. Give us an example of what you're
12 talking about.

13 Mr. Bancello. I didn't hear who asked the question.

14 Going to Senator Bentsen's transactions, Senator
15 Symms, the two transactions I can think of, is one of
16 them corporation A -- or, Senator Bentsen said, corporation
17 A wanted to buy a subsidiary of corporation B.

18 If he had bought the subsidiary for cash, corporation
19 B would have had a gain on the difference between whatever
20 its cost basis in the stock was and the fair market value.

21 But instead of doing that they entered into a trans-
22 action in which corporation A bought stock in corporation
23 B with the clear understanding that subsequent to that
24 acquisition that corporation B would buy that stock back
25 in in exchange for that subsidiary, which we generally

1 refer to as a redemption and that transaction under current
2 law, if there is no tie between the two, there probably will
3 be no gain at corporation B's level on that type of trans-
4 action.

5 Now, as I stated earlier, if it is a tie we're looking
6 at a wire, in other words, where they did it solely for
7 that purpose and everybody agreed going in, we're looking
8 at that transaction right now.

9 If that is not the situation, an unpopular tender
10 offer goes out in which they end up with a small block of
11 stock and then they reach this deal, even though cash has
12 passed hands, there would be no gain at corporation B's
13 level and I think that, at least Treasury's position is
14 that in that type of situation it would be appropriate to
15 have a gain at corporation B's level.

16 Senator Byrd. Well, Treasury has testified that this
17 represents a very sweeping change and many ramifications.
18 I wonder whether we are being fair either to ourselves or
19 to individuals throughout the nation or business community
20 to take something of this magnitude with ramifications
21 everyone admits it does have and handle it on a freak basis
22 without any public hearings on it, anybody have an oppor-
23 tunity to present varying viewpoints on it, that's my only
24 point.

25 I'm not arguing against tightening up.

1 Mr. Bancello. Senator Byrd, that's the type of question
2 that I can't respond to, as to whether this committee
3 feels that it should look closer at. All I can say is
4 that Treasury has reviewed the issue and we feel comfortable
5 with the approach that has been adopted, that it solves
6 some of the problems which we see out there and hopefully
7 some of the others we're going to be able to take care of
8 through regulations.

9 Senator Danforth. May I also ask if the joint
10 committee has looked at it?

11 Mr. McConaghy. We have looked at it, Senator Danforth.
12 It is part of a previous Bill and was modified at your
13 request. We have looked at it. It is certainly a major
14 change, there's no question about that.

15 Senator Danforth. This is not a surprise in any sense,
16 as far as either joint committee or Treasury are concerned.
17 It is a matter that the cases involved have been commented
18 on, they are very well-known transactions and the legislation
19 has been examined, reviewed, revised, as I understand it,
20 by Treasury Department. So, it's not exactly a novel or
21 surprise matter.

22 Mr. McConaghy. That is correct.

23 Mr. Hardee. It is a surprise to the minority staff,
24 Senator. And, in fact, before the Republican caucus, in
25 talking with the joint tax and majority, I did not realize

1 this provision had interest and was planning to move or
2 we would have been alot more active in it.

3 Mr. Chairman. We didn't realize it had so much interest
4 either until somebody brought it up. I wonder if we might
5 go on to the targeted job. We are coming back to this again.

6 Mr. McConaghy. The last one deals with the targeted
7 job credit, which is due to expire at the end of this year.
8 This proposal would extend that targeted jobs credit for a
9 three-year period and it would also add a group to the
10 eligible group and that group would be economically dis-
11 advantaged youth, age 16 to 17. They would become an
12 eligible target group for summer employment.

13 Mr. Chairman. As I understand, this is an extention
14 of the present law?

15 Mr. McConaghy. That's correct, Mr. Chairman.

16 Mr. Chairman. Again, we are coming back to each one
17 of these, but I think that explains that provision.

18 Senator Matsunaga. Does this in parenthesis mean
19 loss rather than gain?

20 Mr. Chairman. Yes, loss. And, we hope we can retain
21 this amendment but right now we are obliged to raise 98.3
22 billion. Our figures now are 98.3 billion and depending
23 on what may be deleted or what amendments may be adopted,
24 then we'll have to go back and review our priorities.

25 Senator Packwood. Mr. Chairman --

1 Mr. Chairman. Senator Packwood?

2 Senator Packwood. We are going to start down the
3 list now. We are done with our discussions.

4 Mr. Chairman. I am going to recognize Senator Long.

5 Senator Packwood. Let me ask the Secretary a question
6 because I may have to prepare an amendment depending upon
7 his answer.

8 Buck, I'm getting mixed signals as to whether or not
9 the Administration wants tuition tax credits added on this
10 bill. And, if they want it, Pat Moynihan and I have been
11 working on this for five years and we are prepared to go,
12 but it cannot be one without the Administration and I'm
13 curious, do you know what their position is?

14 Mr. Chapoton. Yes, Senator Packwood. That has been
15 discussed. The Administration thinks the best way to go
16 on tuition tax credit is for this committee to hold the
17 hearings that have been scheduled by the chairman and
18 address it at that time --

19 Senator Packwood. And do not put it on this bill?

20 Mr. Chairman. In fact, I might add the hearing has
21 been scheduled for July 15th.

22 Senator Packwood. I might say with that, I'm not sure
23 we can win it with the Administration's support, right now
24 it is an uphill battle. But, I know we can't with it and
25 with that I will not offer it.

1 The Chairman. Senator Long?

2 Senator Long. Mr. Chairman, I, of course, was
3 not a party to putting together the Bill we had before us.
4 There are a considerable number of items in this Bill that
5 I can vote for, however I cannot support everything in the
6 Bill and I will vote against certain provisions. But,
7 as a matter of fiscal responsibility, I think that someone
8 here should accept the Chairman's challenge to try and put
9 some revenue in the Bill to replace some of that that we
10 would take out and therefore I am going to propose that we
11 defer part of the third year tax cut.

12 I believe we have a sheet -- Do you have a sheet
13 prepared here to pass out to the Senators?

14 Now, I had originally planned to propose that we defer
15 part of the third year tax cut and that we delete certain
16 items which are shown on the back of this sheet. I am not
17 going to propose the second part of that at this point.
18 I'm simply going to suggest that we defer part of the third
19 year tax cut on the theory that if this were agreed to
20 we would have the slack to eliminate parts of the Bill
21 that the Committee finds most objectionable and the
22 Committee could use its own judgment. I would join with
23 the Committee in seeking to eliminate the points that we
24 find most objectionable.

25 As I stated, on the back you see the ones that I

1 would have ordinarily off-hand think of keeping. But, I'm
2 not going to suggest that. I'm just going to suggest the
3 first part of the page, because if this is agreed to, we
4 would have enough revenue that we could strike any one
5 of several provisions.

6 In fact, I have a list here of 14 significant provisions
7 that could be eliminated if this were agreed to. But, the
8 Committee might want to chose different items, depending
9 upon its own judgment.

10 Now, I would like to ask Mr. Hardee who has worked very
11 hard on this to explain how much revenue this would pick
12 up and just who would be effected by it. Suppose, really,
13 to say that all those in the third year who have \$40,000.
14 or less of income would receive the ten percent tax cut
15 and it would be deferred until we have a balanced budget
16 as far as the others are concerned.

17 Mr. Hardee, Well, first, Senator, we defer the whole
18 tax cut for three months. We're taking up President Reagan
19 on his offer with Tip O'Neill when he said, if you'll get
20 me a good budget, I'll be willing to compromise and defer
21 the third year for three months.

22 So, we got a budget and we have chosen to defer the
23 third year for three months, so it would not go into effect
24 until October 1 of next Fall. That picks up 6.7 billion
25 in FY '83.

1 After that we give a 50 percent tax cut of the whole,
2 in terms of dollars, of the whole '83 cut. Fifty percent,
3 though, will be distributed to the lower and middle income
4 people, those people who get the bulk of their three-year
5 tax cut in the third year, so it is intact.

6 So, if you have a joint return with an economic income
7 of \$40,000. or less with two children, you will get your
8 full ten percent tax cut. And, then that tax cut phases
9 out between \$40,000. and \$46,000. Below \$40,000. we figure
10 that at least 75 percent of the taxpayers will get their
11 full ten percent tax cut in 1983 and then some part, between
12 \$40,000. and \$46,000. will get part of their tax cut and
13 above \$46,000., the tax cut will be deferred until we do
14 get a balanced budget.

15 Senator Long. How much revenue will that raise in
16 the third year -- '84 and '85?

17 Mr. Hardee. In fiscal year '84 it raises 13.5 billion.
18 In '85 it raises 17.1 billion. The postponing of indexing,
19 until we get a balanced budget, is 9 billion for fiscal
20 year '85.

21 Senator Long. My thought, Mr. Chairman, is that
22 when we support this --Even if the amendment is not agreed
23 to that we ought to have something in the Bill, so that
24 Members on the floor who might want to eliminate, that
25 has something that adds to the Bill otherwise, or if they

1 left something out, anything out of the Bill, they would
2 have nowhere to go to add something to it.

3 And, (Senator Long's microphone is obviously defective.
4 Words are skipped and distorted.) -- something from the
5 Bill -- I would ask that this be in the effective language,
6 but was shown before how we can draft something so that
7 you can say that the following language is not effective
8 until Congress -- by joint resolution or whatever, and so
9 you got the language there -- might want to leave out some
10 part of what we are recommending. That would then make it
11 possible for anyone who wants to offer an amendment --
12 strike this part of that part and he would eliminate the
13 third year tax cut in order to bring that about.

14 I am suggesting, as I stated, to simply add this
15 revenue to the Bill at this point. The purpose of doing
16 that is to make it possible to --

17 The Chairman. I appreciate very much the spirit in
18 which this has been offered and I certainly want to try
19 to accommodate a vote on the third year or some modification
20 in the reconcilliation package. I think we need to work
21 out some language without opening up the whole thing and
22 I can understand some who want that vote. I believe we
23 can do that.

24 Yes, Mike?

25 Mr. Bancello. Mr. Chairman, I wanted to say that

1 the material handed out talks about an alternative tax
2 package, but that is not what Senator Long is offering
3 at the moment, just to make it clear, since the material
4 that was handed out does include a table that has other
5 things on it.

6 Senator Long. The material that I distributed was --
7 Please understand that I've had a short time to work on
8 this, after I saw the proposals, and so the Committee
9 prepared the proposal packet insert. I am at this point
10 only offering the insert.

11 But, I do this because there are, on this side of the
12 isle, a consider number who would like to vote against
13 certain things that are in the recommended tax here. We
14 want to do it on the basis of fiscal responsibility. We
15 want to make it clear that this how -- or one way that
16 we would go about filling in the gap in the event -- the
17 view, for example, on the medical expense, for example,
18 it should prevail.

19 Now, if we prevailed on just striking one or two
20 provisions we wouldn't need -- But basically our thought
21 is that we would reduce the third year for those 25 percent
22 of the taxpayers who are best able to pay and if we were
23 not able to strike but one or two provisions of the Bill,
24 then we would add more of the tax cut back in.

25 The Chairman. I think I understand that. I would

1 like to put in the record a letter from President Reagan
2 that restates his firm committment to observing all of
3 the third year, as is, a reference to his willingness to
4 postpone a three months was in the course of a negotion
5 with the Speaker that didn't go anywhere. You don't give
6 up -- you don't get anything back. And, that's what happened
7 in that session.

8 Senator Long. Well, the Speaker didn't take him up,
9 but some of us might have taken him up.

10 The Chairman. Right. I wish the Speaker -- I won't
11 get into that -- wish him well. I think there's no need
12 to debate. I think everybody understands this issue. I
13 know there are mixed views on it. I would like to have
14 Mark give some comment without not -- not extensive comment
15 on distribution of third year tax cut.

16 I think its very interesting when we look at how the
17 third year, the second ten percent, the first ten percent
18 being effective today, having been celebrated by Senator
19 Roth with an apple pie party at the Sylvan Theater earlier
20 today.

21 I think we should have some indication on the third
22 year distribution.

23 Senator Bradley. Mr. Chairman, before Mr. McConaghy
24 begins, we are not proposing to take the third year tax
25 cut away from anybody earning under \$40,000. in income,

1 so I hope that your comments about the distribution will
2 be related to what the proposal is and not the proposal
3 to defer the entire third year. That's not what we're
4 doing.

5 The Chairman. I want to make it a part of the record
6 and find out what happens to the -- what happened to the
7 rate, those above \$40,000. I assume that might be of some
8 interest too.

9 Mr. Romero. -- the people in the lower end of the
10 scale. The people on the top end of the scale got more
11 than the proportion of the amount in the first year and
12 a half primarily because 70 came down to 50. And, for
13 example, in responding to Senator Bradley in the 30 to
14 50 percent bracket, that cut coming in the third year
15 would have been about 37 and a half percent of the entire
16 cut that they got over that three-year period and then the
17 50 to 100 class, that essentially is 37.9.

18 So, it's really, I think, in that area where they
19 would get the biggest percentage of their cut yet to come
20 which obviously would be effected.

21 Senator Bradley. Mr. Chairman --

22 The Chairman. Could I just ask -- What happened to
23 the people in the rates above \$40,000. to \$46,000. under
24 this proposal?

25 Mr. Hardee. Senator, from \$40,000 to \$46,000, there's

1 a gradual phase-out of the cut. Above 46,000 there would
2 not be any third year tax cut until we reach the trigger
3 point or the balanced budget.

4 That's where you have the other half of the revenue.

5 Senator Bradley. So, Mr. Chairman, I would argue,
6 as Senator Long has, that this is a balanced proposal and
7 it is certainly one that we have offered in the sense
8 of trying to be fiscally responsible. If we are going to
9 move, for example, to eliminate the medical deductions,
10 we want to at least replace the revenue and it seems respon-
11 sible to us that if now under current law you can deduct
12 over three percent if you have medical expenses that exceed
13 three percent of your income.

14 And, under this proposal that the Committee is con-
15 sidering, you would have to exceed ten percent of your
16 income. That is going to result in some increased health
17 expenses for alot of people out there who are working and
18 it is our judgment that it is those people who shouldn't
19 have to pay the higher health costs from this and it is
20 those individuals who should get the benefit of the ten
21 percent tax cut that comes into effect in July of 1983.

22 So, we will probably be making a number of these
23 moves to strike things that are in the package, but we
24 do that with the idea that we'd like to be revenue neutral
25 so that we meet the suggestion of the Senate.

1 Senator Byrd. I'd just like to make a very brief
2 statement. I have an objective viewpoint in regard to the
3 third year of the tax cut. I am not wedded to it. I'm
4 flexible. I may, at one point or another, vote to defer
5 or to rearrange it a little bit.

6 I don't think I want to vote to change it at the
7 present time, but I want the record to show that I may at
8 some subsequent point in this Committee meeting or on the
9 floor vote contrary to the way I'm going to vote thus now.

10 Mr. Chairman. Let me say again for the record -- I
11 don't want to be misunderstood. We are going to try to
12 work out something, Senator Long, that this can be offered
13 on the floor and I think Mike and Bob Lighthizer, they
14 can work on it. I don't want to deny anyone the right,
15 even under this procedure, to lose that opportunity and I
16 don't want to lose on the floor either, so it's -- but
17 try to accommodate.

18 I think we are probably ready to vote.

19 Senator Mitchell. Could I just say that I commend
20 Senator Long for this proposal. It is a fiscally responsible
21 proposal. Almost all of the economists, private economists,
22 many leading business organizations, many businessmen
23 around the country have heard that the most responsible
24 step Congress can take to reduce the deficit is to defer,
25 at least in part, the third year of the tax cut.

1 We've heard alot of talk about the need to control
2 the deficit, to bring interest rates down. This is an
3 opportunity to demonstrate our commitment to that and I
4 think it's a very sound proposal, one which deserves the
5 support of all the members of the Committee.

6 Senator Bentsen. Mr. Chairman, if I might comment
7 just a minute here. Certainly I've supported tax reduction
8 and I supported increasing defense expenditures and I
9 thought we ought to slow the growth of money supply. And,
10 if we had tried to do just one of those, we would have got
11 along with it just fine. Maybe two out of three.

12 But, when we try to do all three at the same time
13 at the speed we tried to do them, this economy just could
14 not digest it. I don't think it's a time to give up objec-
15 tives, but I do think it's a time to take more time in
16 accomplishing some of those objectives.

17 We did some major things for those of major income
18 in lowering their tax rate from 70 to 50 and a further
19 reduction of the capital gains and now in this situation
20 I think Senator Long has proposed something that is fiscally
21 responsible and I'm one that sees that that tax cut is
22 deferred only for three months and then after that only
23 for those who have substantial incomes who had received
24 other considerations under the tax Bill we received last
25 year and I am pleased to support it.

1 Senator Chafee. Mr. Chairman, I'm not very enthusiastic
2 about the third year tax cut and would go for a deferment
3 of it under some conditions. I think, as you indicated,
4 that's a possibility of those chances arising in the future.
5 In the meantime we have a program here that does balance
6 the -- come up with the revenues that we have to come up
7 with, but at some later time I might chose to vote for the
8 postponement of the third year cut.

9 Senator Packwood. Mr. Chairman, you'll recall when
10 the Republicans caucused, I indicated that my first preference
11 to reach our revenues was a broad-based energy consumption
12 tax, if we could not have that an elimination or parring
13 down of the third year of the tax cut and if we couldn't
14 have that, whatever we could find to come up with the
15 roughly \$100 billion I'm going to support Senator Long.
16 It is my preference to the package we have. If it fails,
17 I'll support the package.

18 Mr. Chapoton. Mr. Chairman, the point has already been
19 made that the third stage of the tax cut is significantly
20 weighted toward the lower income and that a deferral or
21 elimination of the third year would fall most heavily on
22 the below \$40,000. or \$30,000. income class.

23 This proposal seeks to avoid that problem by askewing
24 the rates. The problem -- And then similar proposals
25 were made and discussed and analyzed during last year's

1 bill at great length and each of them ran into a problem
2 that I think this type of a proposal runs into also, but
3 this proposal does keep the maximum rate at 50 percent,
4 as I understand it.

5 But you get into a steep graduation of rates at some-
6 place in the scale when you try to do this thing. For
7 example, if I just review these rates proposals quickly,
8 you are in the -- there's \$16,000-\$20,000 range is in 22
9 percent brackets, this was after fully effective, -- \$20,000.
10 to \$24,000. and then 25 percent bracket, \$24,000-\$29,000 and
11 28 -- it would be in the 28 percent bracket when fully
12 effective, but under this proposal, would be in a 35 percent
13 bracket, so you would have a ten point jump from the \$20,000.
14 \$24,000. range to the \$24,000-\$29,000, from a 25 percent
15 marginal rate to a 35 percent marginal rate and the next
16 jump would be a full five points in the \$29,000. to \$35,000.
17 income range would be in the 40 percent bracket.

18 And then it smooths out again and picks up with the
19 normal schedule, 42, 46, and on up to 50, the normal schedule
20 as would go into effect -- it would be a smoother schedule.

21 But anytime you askew the rates like this, you have
22 these very steep marginal rate increases somewhere in the
23 scale.

24 I just point that out that the point has been made
25 fully that if you do nothing, if you simply defer the tax

1 cut, the effect falls certainly most heavily on the lower
2 end of the scale.

3 Senator Bradley. Keep in mind that anyone who makes
4 under \$40,000 in income gets the full ten percent tax
5 deduction.

6 Senator Long. I just want to make this point, if I
7 might, Mr. Chairman.

8 Mr. Chairman, the purpose of this proposal is to set
9 the stage, not only to take care of things like medical
10 expenses, but to take care of some of the best provisions
11 that the Administration has suggested down through the
12 years having to do with industrial expansion.

13 For example, here's a letter by a Mr. Richard Ron who
14 is the Chief Economist of the Chamber of Commerce of the
15 United States. This is not a bunch of Democrats when I'm
16 reading this letter, you know.

17 The Chairman. I don't think he's a Republican either.

18 Senator Long. It says that, we believe it would be a
19 tragic mistake for the Senate Finance Committee to vote for
20 nearly \$100 billion dollars in new taxes over the next
21 three years just as the economy is about to receive its
22 first major benefit from last year's tax reductions.

23 The \$21 billion dollar increases for fiscal year 1983
24 are fully -- 70 percent of the \$30 billion dollars in
25 reduction. In particular, many of these provisions will

1 harm savings, investment, cash flow, thus stopping the
2 recovery which has already begun, among the anti-investment
3 proposals, or the new minimum tax on individuals and corpora-
4 tions, withholding on dividends and interest, after tax
5 collections from companies, -- leasing and depreciation, --
6 repeal the tax deferral for reinvestment for dividends,
7 partial taxation of merger and acquisitions -- lower limits
8 on pension contributions and restrictions on completed
9 contract method.

10 I simply stop at that point. But, the point is that
11 the purpose here is to set the stage to continue the incentives
12 that would do the most to spur recovery, that's what we
13 have in mind.

14 The Chairman. I have the greatest respect for Mr. Ron,
15 but it is a known fact that the Chamber leadership is
16 opposed to any tax increases. They are for more tax cuts,
17 I think probably more tax cuts.

18 They want to protect-- They don't want anybody to pay
19 a minimum tax. Businessmen, they don't want to touch leasing.
20 They don't want to do anything that might effect business,
21 just take it away from the individual taxpayer. That's
22 been their attitude. That is called supply side, I believe,
23 is what they used to call it.

24 There aren't many supply siders left, but there's still
25 a few in the Chamber -- not this Chamber but in the other

1 Chamber.

2 So, I think it's time to vote.

3 The Clerk. Mr. Packwood?

4 Mr. Packwood. Yea.

5 The Clerk. Mr. Roth?

6 Senator Roth. Nay.

7 The Clerk. Mr. Danforth?

8 Senator Danforth. Nay.

9 The Clerk. Mr. Chafee?

10 Senator Chafee. Nay.

11 The Clerk. Mr. Heinz?

12 Senator Heinz. Nay.

13 The Clerk. Mr. Wallop?

14 Senator Wallop. Nay.

15 The Clerk. Mr. Durenberger?

16 Senator Durenberger. Nay.

17 The Clerk. Mr. Armstrong?

18 Senator Armstrong. Nay.

19 The Clerk. Mr. Symms?

20 Senator Symms. Nay.

21 The Clerk. Mr. Grassley?

22 Senator Grassley. Nay.

23 The Clerk. Mr. Long?

24 Senator Long. Yea.

25 The Clerk. Mr. Byrd?

1 Senator Byrd. Nay.

2 The Clerk. Mr. Bentsen?

3 Senator Bentsen. Yea.

4 The Clerk. Mr. Matsunaga?

5 Senator Matsunaga. Yea.

6 The Clerk. Mr. Moynihan?

7 Senator Moynihan. Yea.

8 The Clerk. Mr. Baucus.

9 Senator Baucus. Yea.

10 The Clerk. Mr. Boren?

11 Senator Boren. Nay.

12 The Clerk. Mr. Bradley?

13 Senator Bradley. Yea.

14 The Clerk. Mr. Mitchell?

15 Senator Mitchell. Yea.

16 The Clerk. Mr. Chairman?

17 The Chairman. Nay.

18 The Clerk. The Yeas are 7 and the Nays are 12.

19 The Chairman. The Nays are 12, the Yeas are 7. The

20 Amendment is not agreed to.

21 Senator Long. I just want to anew my suggestion,

22 Mr. Chairman, that in view of the fact that the Democratic

23 caucus at one time recommended at one time almost unanimously

24 that the third-year tax cut be deferred as part of the

25 budgetary reducing -- budget reducing proposal, that in

1 one fashion or the other, that this bill, that it contain
2 language that would set the stage to offer such an Amendment.

3 The reason I say it, as said before, Senators, I think,
4 should have an opportunity on the floor to vote to reduce
5 or eliminate some of the items that are in this bill and
6 they would be subject to point of order, -- to raise additional
7 revenue and I think -- this opportunity or some opportunity
8 to offer alternatives.

9 The Chairman. I'll certainly try to fashion some way
10 to do that. I don't have any desire to try to avoid that.

11 Senator Symms. Mr. Chairman, I might just say, one
12 package that hasn't been on here and for the benefit of
13 our colleagues on the other side of the isle, I'm still very
14 interested, even though the Administration has leaned quite
15 heavily on me for the last 24 hours to see us raise some
16 revenue from the Interstate Trust Fund, even if it has to
17 be suspended, as far as spending, for up to 24 months. And,
18 we might keep that in mind. I hope we don't get some kind
19 of a rule that would make it, if we do happen to strike
20 out some of these taxes that are on this measure, that we
21 don't end up with some kind of a rule where we couldn't
22 offer that as an amendment to raise some of that revenue
23 to keep the thing under the \$98.7 billion.

24 And, I've got a proposal worked out that I think is
25 pretty fair. If it ever becomes appropriate, we might look

1 at that anyway.

2 I might also say, Mr. Chairman, I find this like I'm
3 sure all my colleagues, that there aren't any of these
4 taxes that are very pleasant and I'm very sympathetic to
5 the letter that Senator Long just read from Richard Ron,
6 personally. But, I think if the Administration would have
7 accepted the suggestion that the Chairman and others on
8 the Committee and the Budget Committee made last fall to
9 really go in and have some real true entitlement reform,
10 we could have cut out \$20 billion dollars in spending.
11 We wouldn't be in here asking to raise \$20 billion dollars
12 now.

13 This old game is, you always tax the other buy, but
14 don't tax me. And, I don't see any easy way to raise any
15 tax, as far as I'm concerned. I'd rather vote against all
16 of them. But, we do have a problem that we didn't cut
17 spending enough.

18 And, since we haven't cut spending enough, we're going
19 to have to bite the bullet here on something and I would
20 still like to have the Committee and the Administration
21 consider that we've got a declining road system in this
22 country and we ought to raise some revenue and put it in
23 the highway trust fund, even if it means a suspension of
24 spending it for 24 months and it would help the budget
25 picture and it would be a way to maybe avoid some of these

1 other taxes. I don't know just which ones, but I'll hold
2 that back and see what happens. If we end up that we've
3 chopped out \$4 or \$5 billion of these because we don't
4 have the votes, well, we could come up with a fuel user's
5 fee and a tax on rubber, which would be acquated out to
6 try to be evenly distributed over cars and trucks and so
7 forth, and I think it's a possibility the Committee might
8 keep under consideration.

9 The Chairman. I thank the Senator from Idaho, and he
10 did, as he indicated -- in fact, I don't think it's a secret.
11 In our caucus, we did adopt a gas tax and then that word
12 filtered downtown and we unadopted a gas tax.

13 The President talked to me about it, talked to the
14 Senators about it. We want to try to accommodate the
15 President. We have so far.

16 And now I'm going to make -- I'm not unsympathetic
17 with Mr. Ron, no one misunderstood. We're not here raising
18 revenue because it's Thursday afternoon.

19 We're here because people in this country are crying
20 out to do something about high interest rates and the
21 high deficits and we are raising revenues as a last resort.

22 And, I must say that I think this Committee has been
23 very responsible on the spending reduction side and I hope
24 that we'll have a responsible package when we finish the
25 revenue side.

1 So, I don't disagree with anyone who doesn't want new
2 taxes, though I must say that in the package that now hope
3 that we can adopt by a voice vote and open it up to Amendment
4 or deletion, we find a number of areas that deal with
5 equity, fairness, balance, that should be addressed whether
6 there's a deficit or a surplus and I would hope that in
7 those areas that we -- and we'll go through those now that
8 we can have other broad support.

9 Now, is there any objection to adopting on a tentative
10 basis the package and then going through one at a time,
11 asking for amendments or if they want a roll call vote on
12 airport and airways? We'll proceed on that basis.

13 Senator Long. Mr. Chairman, you can do it if you want
14 to, but there are some of us that would like to vote on
15 everything that's in the package first, vote on these
16 various items and then based on what the package is, see
17 what remains intact and then vote on the package after
18 we've taken opposition on the individual items.

19 Senator Bentsen. I don't want to be in a position of
20 being on record as voting for the entire package.

21 The Chairman. Well, then, let's proceed then and take
22 just one step at a time.

23 Senator Mitchell. Mr. Chairman, --

24 The Chairman. Yes?

25 Senator Mitchell. As I indicated, I intended to offer

1 an Amendment to skew the composition of the tax cut for
2 1982 and in view of the discussion that just occurred, it
3 seemed relevant to it. Would this be an appropriate time
4 to do that? It wouldn't take very long and I would expect
5 that vote would be similar to the last one, but I would like
6 to do it at this time, if possible.

7 The Chairman. Fine.

8 Senator Mitchell. Mr. Chairman, my Amendment is identical
9 to the Amendment offered last year by Senator Bradley and
10 myself and would provide a greater portion of the tax cut
11 for 1982 to those in the middle and lower income brackets,
12 that is, everybody with a family income of less than \$50,000.
13 and a proportionately smaller portion of the tax cut, those
14 making more than \$50,000. a year.

15 Last year when the Administration presented their
16 tax program, it was argued in defense of the ten percent
17 across-the-board cut that this was necessary because the
18 objective was to encourage savings and we were told by
19 the Administration and other spokesmen and economists that
20 those who make more, the higher end of the income scale,
21 are more likely to save a larger portion of the tax cut
22 than those at the middle and I recall one economist who
23 used the example.

24 He said, if you give one man a \$5,000. tax cut, more
25 of that is likely to be saved than if you give 50 people \$100

1 They're more likely to spend it since they get it in smaller
2 increments.

3 Now, of course, a year has passed and as the Chairman
4 has just indicated, there aren't many supply siders left
5 and the conventional economic wisdom is that the way they
6 were going to get out of the recession is through consumer
7 demand increasing and the money that's coming in this tax
8 cut along with the Social Security cost-of-living adjustment
9 has been cited by economists and by some Administration
10 spokesmen as the way we're going to get out of the recession,
11 consumer demand is going to increase.

12 If, as the Administration argued last year, giving
13 more of the tax cut to higher income persons is appropriate
14 because they will save it, and if, as some in the Administra-
15 tion argue this year, we want the tax cut to be spent so
16 that we will stimulate consumer demand, then logic dictates
17 that we ought to change the composition of the tax cut to
18 give a greater portion this year to those in the middle
19 and lower income brackets who will spend it and hopefully
20 then provide the kind of consumer surge that we need and
21 want to get us out of the recession that we're in.

22 So, not only is it far more equitable in my judgment,
23 it makes sound economic sense, if what the Administration
24 has been saying is correct.

25 And therefore, Mr. Chairman, I propose that the

1 composition of the tax cut be changed in accordance with
2 the Amendment offered last year and in accordance with a
3 Bill that I have introduced. The effect of it is to provide
4 a greater portion of tax relief for those making less than
5 \$50,000. a year.

6 I would point out that those who make more than \$50,000.
7 a year in our society paid prior to this tax program being
8 enacted, less than a third of the income tax. The consequence
9 of the tax cut, when Social Security taxes and inflation
10 are factored in is to give that category of Americans nearly
11 two-thirds of the reductions.

12 That is, those making more than \$50,000., who paid a
13 third of the income taxes, got about, a little less than
14 two-thirds of the tax reduction.

15 Meanwhile, conversely, of course, those making less
16 than \$50,000. who paid two-thirds of the taxes in this
17 country prior to the enactment of it get now somewhere
18 around a third of the reduction when inflation and Social
19 Security taxes are factored. This was confirmed just two
20 weeks ago when the Treasury Department issued a report,
21 stating that for Americans making less than \$40,000. a year,
22 there would, in effect, be an aggregate, taking that group
23 as an aggregate, and increasing taxes when one factored in
24 the effects of inflation and Social Security tax.

25 So, I think, Mr. Chairman, from the standpoint of

1 economics and from the standpoint of equity and from the
2 standpoint of trying to give a greater portion of the tax
3 reduction that's been proposed in '82 to those making less
4 than \$50,000 a year who represent the overall majority of
5 Americans and all working and middle class Americans, I
6 offer this Amendment.

7 The Chairman. Want a roll call?

8 Senator Mitchell. Yes, sir.

9 The Chairman. The Clerk will call the roll.

10 The Clerk. Mr. Packwood?

11 Senator Packwood. Nay

12 The Clerk. Mr. Roth?

13 Senator Roth. Nay.

14 The Clerk. Mr. Danforth?

15 Senator Danforth. Nay.

16 The Clerk. Mr. Chafee?

17 Senator Chafee. Nay.

18 The Clerk. Mr. Heinz?

19 Senator Heinz. Yea.

20 The Clerk. Mr. Wallop?

21 Senator Wallop. Nay.

22 The Clerk. Mr. Durenberger?

23 Senator Durenberger. Nay.

24 The Clerk. Mr. Armstrong?

25 Senator Armstrong. Nay.

1 The Clerk. Mr. Symms?
2 Senator Symms. Nay.
3 The Clerk. Mr. Grassley?
4 Senator Grassley. Nay.
5 The Clerk. Mr. Long?
6 Senator Long. Yea.
7 The Clerk. Mr. Byrd?
8 Senator Byrd. Nay.
9 The Clerk. Mr. Bentsen?
10 Senator Bentsen. Nay.
11 The Clerk. Mr. Matsunaga?
12 Senator Matsunaga. Yea.
13 The Clerk. Mr. Moynihan?
14 Senator Moynihan. Yea.
15 The Clerk. Mr. Baucus?
16 Senator Baucus. Yea.
17 The Clerk. Mr. Boren?
18 Senator Boren. Yea.
19 The Clerk. Mr. Bradley?
20 Senator Bradley. Yea.
21 The Clerk. Mr. Mitchell?
22 Senator Mitchell. Yea.
23 The Clerk. Mr. Chairman?
24 The Chairman. Nay.
25 The Chairman. 12 nays and 8 yeas.

1 Senator Moynihan. Mr. Chairman, may I be recorded as
2 yea.

3 The Chairman. I think you were recorded as yea.

4 All right, let's proceed to airport and airways taxes.
5 I don't believe there's any opposition. Any objection to
6 the first item airport --

7 Senator Baucus. Mr. Chairman, I have a slight question
8 of why we need to increase gasoline tax?

9 Senator Packwood. The reason for that is that it used
10 to be seven cents, as you recall, and when the ADAP law
11 expired in 1980, it dropped back to four cents.

12 But in terms of the cost of aviation gas now, aviation
13 gas is approaching \$2. a gallon. It was seven cents at the
14 time it was \$.30 a gallon and I will say this whole package
15 is a very fragile coalition of airport operators and major
16 commercial aircarriers and everybody involved in the industry
17 none of them are happy with all parts of it. I don't want
18 to say that everybody endorses all parts of it, but it is
19 a package and if we start changing it, it isn't going to
20 fall apart.

21 And, I don't think it is an unfair tax today. The
22 private airplane owners use a great portion of the airways
23 and even this tax will not pay that portion of it. But,
24 I would be very reluctant to see it drop below the \$.12.

25 Senator Baucus. I understand, but my point is that

1 was raising gasoline tax generally, jet fuel, the tax increase,
2 the tax we passed on, it just seems to me that general
3 aviation, maybe a weekend pilot -- pass on the cost.

4 Particularly, we're not increasing other fuel tax --

5 Senator Packwood. Well, we're adding a business jet
6 fuel tax that never existed before.

7 Senator Baucus. But I'm talking about service trans-
8 portation, tax increase there. Does that agree with the
9 proposal here, but --

10 Senator Packwood. I also might add on this that a
11 bulk of the money in this ADAP fund goes into construction.
12 I checked with both the building contractors and the
13 building trades today. The amount of money involved in
14 this will produce about 260,000 jobs. It's much like
15 highway money. And, if you talk about a jobs program,
16 this is as good a jobs program as we're going to get out
17 of this Congress.

18 Senator Baucus. Mr. Chairman, I'm not going to press
19 the issue.

20 The Chairman. Is there an objection?

21 Senator Armstrong. Mr. Chairman, I want to just ask
22 a question. I'm not going to object about the tax, but I
23 want to be sure that there's an understanding, at least,
24 of what goes with this.

25 Did we agree that we were going to include with this

1 some kind of authorizing legislation as a part of the
2 Bill or is it going to be offered as a separate Amendment?

3 Senator Packwood. It's part of the Bill. I will tell
4 you why we did it that way, Bill. The normal process wasn't
5 reconcilliation, -- is Finance would pass a tax and it
6 would go to Commerce and I have a letter from the majority
7 of the Commerce Committees who do not object to the pro-
8 cedure on this, and we would then go ahead with the authoriza-
9 tions and the Bill would go forward in concert together.

10 There has been no tax financed for two years that has
11 not passed any airway tax. So, believe it or not, some of
12 the money that still exists goes into the Highway Trust
13 Fund, others of the money goes into the general fund. And,
14 there are some, very frankly, that would just as soon con-
15 tinue that, that have it go into the general fund.

16 But the Commerce Committee, the majority of the
17 Commerce Committee has agreed to go ahead and allow it to
18 be placed on here. It would normally be a different
19 process if it wasn't for the reconciliation package.

20 Senator Armstrong. Could you just -- For those
21 of us who are not intimately familiar with it, I am sympathetic
22 to the needs of the ADAP fund. Does the Bill which is
23 attached hereto change in any significant way the present
24 distribution of funds?

25 In other words, you're hooking on here, the spending

1 side of this, as I understand it, or the authorizing side
2 of this?

3 Senator Packwood. That's correct.

4 Senator Armstrong. Could you describe for us, at least
5 briefly, what we're really getting with this?

6 Senator Packwood. What you are getting is basically
7 the following. And, this is first what we call the airport
8 development part of it, \$454 million in '82, \$600 million
9 '83, \$600 million '84, \$600 million '85, and because the
10 tax goes on, although our budget doesn't go on, \$1 billion
11 \$40 million in '86 and \$1.2 billion in '87, which is for
12 airport building, airport development, runways, facilities,
13 hard goods, if you want to call it that.

14 Then, in addition, we pick up 100 percent of the
15 cost of facilities and equipment and 100 percent of the
16 cost of research and development, although those are not
17 new categories for the Federal Aviation Administration
18 and about 60 percent of their operating budget.

19 And, there, I might say there is an incredible amount
20 of money in there and this is -- if you want to call it a
21 public works program, it can go quickly because the plans
22 are there for reliever airports, secondary airports, the
23 non-hub airports.

24 Senator Armstrong. Could you say how much that is?

25 Senator Packwood. \$510 million over six years.

1 Senator Armstrong. Mr. Chairman, I just have two
2 additional questions. One is, as to the budgetary impact,
3 as I understand it, the function we're performing here is
4 to raise revenues in response to a reconciliation instruction
5 and I want to be sure that we're not inadvertantly hooking
6 on spending that subverts the underlying purpose of the Bill.

7 Senator Packwood. No. I can assure you, Bill, this
8 meets the mark that was proposed by the budget committee
9 in the reconciliation.

10 Senator Armstrong. Finally, my last question is this.
11 In the event that Senators wish to offer an Amendment to
12 the underlying Bill, by including it in this legislation
13 it would make such amendments in order on the floor,
14 wouldn't it?

15 (Continued.)
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1 Mr. Lighthizer. The answer to that is, yes,
2 Senator. If the substantive ADAP legislation is included
3 in the reconciliation bill, then it is not subject to
4 amendment on the floor other than by germane amendments.

5 Senator Packwood. Germane amendments?

6 Mr. Lighthizer. That's correct. And it will have the
7 same time limitation as the rest of -- it will be, in effect,
8 part of reconciliation.

9 Senator Armstrong. The reason I make that point
10 I have no particular amendment in mind, but I'm interested
11 in the problem, particularly the problem of reliever airports,
12 as you have correctly sensed, and while I don't object
13 based on what I know, I don't know enough to be sure I might
14 not want to offer an amendment.

15 And as I understand what counsel is telling us an
16 amendment would be in order if we include the text of the
17 authorizing bill as a part of the committee bill when it
18 goes to the floor.

19 Senator Packwood. I cannot -- I find it hard to believe
20 that it could be ruled out of order if it related to reliever
21 reports when that is part of the program.

22 Senator Armstrong. Thank you, Mr. Chairman. I have no
23 objection. In fact, I am delighted to this program.

24 The Chairman. All in favor of the amendment say aye.

25 (Chorus of ayes.)

1 The Chairman. Opposed, no. Senator Baucus is going
2 to be reported in the negative. Next?

3 Senator Matsunaga. Mr. Chairman?

4 The Chairman. And Senator Matsuaga.

5 (Senator Baucus and Senator Matsuago vote nay.)

6 Senator Matsunaga. Mr. Chairman, the agreement is
7 to report the substantive ADAP legislation as a separate
8 finance committee amendment.

9 Senator Packwood. No, I don't think so.

10 The Chairman. That is something we have to resolve.

11 Senator Long. Let's let the chairman work out the
12 how you're going to handle it because obviously you're
13 don't want to --

14 Senator Packwood. Yes. I have a letter from the
15 parliamentarian. Wait till I find it. In response to an
16 inquiry this morning regarding the use of Rule 15 against an
17 amendment offered by the committee which contains significant
18 matter within the jurisdiction of another committee, I
19 would inform you that any senate committee that proposed
20 either a complete substitute for a bill or a series of
21 committee amendments. If the former course is followed, a
22 point of order which is sustained causes the entire committee
23 substitute to fall.

24 If the latter course of a series of committee amendments
25 is followed only the particular amendment against which

1 the point of order lies would fall if the point of order
2 is sustained, and all I'm saying is if we split it out, I
3 want to split it out with the money so that they are voting
4 as a whole on the program on the money.
5

6 And I can assure the committee, I think, if the money
7 is in here, and the money is intended to go for airports,
8 and the substantive legislation is not here, there will
9 be movements to strike the taxes, and I cannot concede that
10 they will last if we are going to try to take the money
11 and put it into the general fund or some other fund when
12 it is intended for airport and airway purposes.

13 The Chairman. Well, let's, Bob, let's get together
14 with John here and see if we can work that out. Next, ITC
15 base adjustment -- is there any?

16 Senator Byrd. Mr. Chairman?

17 The Chairman. Senator Byrd?

18 Senator Byrd. I raise this point because I think it is
19 one of elementary fairness. It may or may not require an
20 amendment, but I assume that any contracts -- binding
21 contracts which have been entered into for the purchase of
22 property or equipment prior to the effective date of this
23 proposal would be excluded from the adjusted figure that
24 we have in this proposal.

25 The Chairman. Did you get the question mark?

Mr. McConaghy. We can write a rule, Senator Byrd, for

1 binding contracts essentially --

2 Senator Byrd. Well, it seems to me, Mr. Chairman, that
3 that would be appropriate and fair that where a company
4 has relied upon the law, entered into binding contracts,
5 that they should have the benefit of the law as it existed
6 at the time, and not the new law.

7 Mr. McConaghy. Why isn't that good enough. Yes, we
8 could do that when we adjusted the credit, we provided that,
9 but I would suggest that if you have binding contract rule,
10 you also require at least that the property be placed in
11 service by the end of 1983.

12 Senator Byrd. Well, it may not be possible for that
13 to be done.

14 Mr. McConaghy. That would be the issue, Senator Byrd.
15 How long do you want to be able -- if I enter into a binding
16 contract toward the end of this year with delivery of equip-
17 ment out in 1990, do you want that to be grandfathered or --

18 Senator Byrd. Well, I would think that if a company
19 relying on the law as existed at the time entered into a
20 binding contract, even though the delivery might not be for
21 18 months or 24 months or six months or whatever it might
22 be that that company should be -- should have the opportunity
23 for the same tax advantage that was existing in the law at
24 the time that he made the contract.

25 Mr. McConaghy. I would suggest that if you did that,

1 that you also had it placed in contract rule so that -- or
2 placed in service rule so that if it wasn't at the end of
3 1983, at least it would be placed in service by the end of
4 1984. That would give from today, for instance, two and a
5 half years for that property to be placed in service under
6 binding contract entered into.

7 The Chairman. That may be -- the Treasury had a
8 comment on that.

9 Mr. Chapoton. That is always a sympathetic point.
10 I would simply point out that the purpose of this amendment
11 is as discount rates come down to make the provision not
12 faster than expensing. It does affect slightly the cost
13 recovery benefit. It does not affect the investment tax
14 credit which is the upfront tax benefit.

15 But it does reduce slightly over the five years in most
16 cases the five years of cost recovery, the amount that may
17 be recovered. But it means those companies will have
18 slightly better than expensing.

19 Senator Byrd. Well, but they've already had that.
20 Those who have relied on the law and have now had the
21 equipment in place, they --

22 Mr. Chapoton. That is correct. We estimate that the
23 effect would be slight revenue though with the change it
24 would have to be placed in service by the end of '84, it
25 would decrease the revenue.

1 Without a placed in service requirement, we estimate
2 -- this is '84 -- .2, 200 million in '84, and 300 million
3 in '85 would be reduced on that, but I don't know what
4 amount.

5 The Chairman. And we need to find -- maybe we better
6 lower it then because we are going to have to find \$500
7 million, if we are going to start -- maybe it should be
8 changed. But as I understand who's keeping track of the
9 revenue numbers? We're right now at what -- 98.3. That's
10 correct.

11 Mr. McConaghy. 98.4.

12 The Chairman. We're not at four because in the MODCO --

13 Mr. McConaghy. 98.3. That's correct.

14 The Chairman. And what is our target?

15 Mr. McConaghy. 98.3, Mr. Chairman.

16 The Chairman. And how much of this?

17 Mr. Chapoton. Before the change -- before limiting it
18 to property placed in service by the end of 1984, it would
19 be 500 million over the end of -- over the three year period.

20 Senator Byrd. Well, I argue for it only on the grounds
21 of equity and fairness. The taxpayer has a right to rely
22 on the law as it existed at the time he made a binding
23 contract.

24 Mr. McConaghy. We are going to try to look at the revenue
25 on placed in service by the end of 1983, and see if that

1 brings it down at all.

2 The Chairman. Let's pass this amendment and come back
3 to it. I know Senator Armstrong has an amendment.

4 Senator Byrd. Are you going to approve the amendment
5 or pass it by? Which?

6 The Chairman. I wanted to check what it is going to
7 entail. And I know Senator Armstrong has an amendment to
8 this amendment. Can you wait and let us -- we'll come
9 back to this in just a few minutes. Repeal the 1985 and
10 '86 ACRS changes. All in favor say aye.

11 (Chorus of ayes.)

12 The Chairman. Opposed, no. Ayes have it.
13 Accelerate corporate payment. All in favor say aye.

14 (Chorus of ayes.)

15 The Chairman. Opposed, no. Ayes have it. Pensions?
16 Anymore discussion on pensions?

17 Senator Armstrong. Mr. Chairman, just one question.
18 I did not recall that there was any discussion about changing
19 the status of these pensions with respect to integrating
20 with Social Security. Is there anything in the proposal
21 that does that?

22 The Chairman. No.

23 Mr. Chapoton. There is nothing in there.

24 The Chairman. There is?

25 Mr. McConaghy. That's correct.

1

The Chairman. There is not.

2

Mr. McConaghy. There is nothing on integration.

3

That is correct.

4

Senator Armstrong. There is no change that in any way integrates these pensions with Social Security?

6

Mr. McConaghy. That's correct, Senator Armstrong.

7

Senator Armstrong. Thank you. That was my recollection but someone indicated to the contrary, and I just wanted to be sure that --

10

The Chairman. All in favor of that provision say aye.

12

(Chorus of ayes.)

13

The Chairman. Opposed no. The ayes have it. Ten percent separate medical and casualty. Anybody wish further discussion?

16

Senator Long. I would like a roll call, Mr. Chairman.

17

The Chairman. The clerk will call the roll.

18

Senator Matsunaga. Mr. Chairman, did we take a vote on the pension tax?

20

The Chairman. Yes.

21

Senator Matsunaga. I thought the question was being raised in the previous.

22

23

The Chairman. Well, we'll go back and reconsider it if you have a question.

24

25

Senator Matsunaga. Well, I would like to be recorded

1 no.

2 The Chairman. The record will indicate that Senator
3 Matsuaga reported no on the pension.

4 Mr. Lighthizer. Mr. Packwood?

5 Senator Packwood. Aye.

6 Mr. Lighthizer. Mr. Roth?

7 Senator Roth.

8 Mr. Lighthizer. Mr. Danforth?

9 Senator Danforth. Aye.

10 Mr. Lighthizer. Mr. Chafee?

11 Senator Chafee.

12 Mr. Lighthizer. Mr. Heinz?

13 Senator Heinz. Aye.

14 Mr. Lighthizer. Mr. Wallop?

15 Senator Wallop. Aye.

16 Mr. Lighthizer. Mr. Durenberger?

17 Senator Durenberger. Aye.

18 Mr. Lighthizer. Mr. Armstrong?

19 Senator Armstrong. Aye.

20 Mr. Lighthizer. Mr. Simms?

21 Mr. Simms. Aye.

22 Mr. Lighthizer. Mr. Grassley?

23 Senator Grassley. Aye.

24 Mr. Lighthizer. Mr. Long?

25 Senator Long. No.

1 Mr. Lighthizer. Mr. Byrd?

2 Senator Byrd. No.

3 Mr. Lighthizer. Mr. Bentsen?

4 Senator Bentsen. No.

5 Mr. Lighthizer. Mr. Matsunaga?

6 Senator Matsunaga. No.

7 Mr. Lighthizer. Mr. Moynihan?

8 Senator Moynihan. No.

9 Mr. Lighthizer. Mr. Baucus?

10 Senator Baucus. Yes.

11 Mr. Lighthizer. Mr. Boren?

12 Senator Boren. Aye.

13 Mr. Lighthizer. Mr. Bradley?

14 Senator Bradley.

15 Mr. Lighthizer. Mr. Mitchell?

16 Senator Mitchell. No.

17 Mr. Lighthizer. Mr. Chairman?

18 The Chairman. Aye. On this vote, the ayes are 11.

19 And the nays are four. Mr. Bentsen wanted to be recorded
20 so the nays are five.

21 Senator Bentsen. And Bentsen wanted to be recorded
22 no on the pension along with Senator Matsunaga.

23 Senator Bradley. I would like to be recorded on the
24 negative on the medical vote.

25 The Chairman. Would you retally those. I think you

1 counted wrong. But Bentsen, no. Boren, no. Senator Bradley
2 no.

3 Mr. Lighthizer. Mr. Matsunaga is no, also. ll.

4 The Chairman. ll.

5 Mr. Lighthizer. ll yeas; 8 nays.

6 The Chairman. ll yeas. 8 nays. The agreement is
7 agreed to, or the provision is agreed to. The next
8 provision is OID and coupon stripping. The only question
9 there I understand is the effective date. Is that
10 correct?

11 Mr. McConaghy. That is correct, Mr. Chairman.

12 The Chairman. Has that been resolved?

13 Mr. McConaghy. I don't believe it has been resolved.
14 The concern was raised by Senator Bentsen. There is
15 no --

16 Mr. Chapoton. I think not. We just feel when something
17 like this must be stopped. One has no choice. The department
18 has no choice but to make the proposal effective on the
19 date of the announcement or all sorts of havoc will break.

20 If you go back now and undo that, I have no idea what
21 transactions went forward and hope that would happen, but
22 it was clearly in our view anyway, an unintended benefit in
23 the tax law.

24 Senator Bentsen. Well, let me say, Mr. Chairman, that
25 when the Secretary says goes back, all havoc will be wreaked,

1 I just don't think we ought to be in a position where everyone,
2 every tax lawyer, every accountant has to be reading press
3 releases, and trying to decide. I think that is something
4 that is decided here in the Congress.

5 And historically that is the way it is done. There
6 have been some exceptions, but most of the time we do it
7 either on the date of enactment or we do it on the day
8 we started considerations, but not on press releases by
9 Treasury. And I --

10 The Chairman. What is the date now?

11 Mr. Chapoton. May 3 on original issue discount, and
12 I believe May 8 or 9 -- or the date of -- June 9 on the
13 coupon stripping transaction.

14 The Chairman. And is there a precedent for what
15 Treasury did in this case? Is the way it is normally done?

16 Mr. Chapoton. I don't have it readily in mind a
17 precedent, but this we have done. Yes, that has been the
18 case. When I said all havoc would break lose, indeed
19 the concern we have had many calls that something had to
20 be done. Many transactions were going to try to get under
21 the wire when it was pretty clear that Treasury had to
22 do something. I said had we announced on May 3, for
23 example, that the rule would be effective when enacted
24 by Congress or a month later, there would have been a
25 tremendous volume of transactions.

1 The Chairman. This provision itself is totally justified,
2 isn't it?

3 Mr. Chapoton. I have not heard an argument.

4 Senator Bentsen. Oh, absolutely. I agree with that,
5 Mr. Chairman. I think that the --

6 The Chairman. Why should anybody get a windfall if
7 they cut it off on May 3.

8 Senator Bentsen. Well, the point being that this was
9 the law, and the law was complied with, depended on, and
10 it requires a change in the law. And I've just been one
11 who is opposed to retroactivity. That's been my general
12 policy.

13 Mr. Chapoton. I would point out that --

14 The Chairman. We can either -- we might pass over it
15 and maybe you could discuss it with staff. You want to do
16 that?

17 Senator Bentsen. I don't think there is much need to.

18 The Chairman. Does anybody want a regular vote.

19 Senator Bentsen. I think the effective date ought to
20 be determined.

21 Senator Symms. Mr. Chairman, now that it's already
22 passed, if we do do it on today's date instead of
23 retroactively, it doesn't look to me like all the problems
24 that Mr. Chapoton talked about could happen.

25 Senator Bentsen. No, I agree with that, Senator Symms.

1 I wonder what happens, though, the next time we find a
2 mistake like this. I wonder two things. One, what -- keep
3 in mind on the general coupon bond that the interest
4 deduction in the first year in many cases would exceed the
5 principal amount borrowed.

6 The interest deduction would exceed the principal
7 amount borrowed. We know that that is a problem. The
8 next time we run into a problem like that and we make an
9 announcement that we are going to propose legislation, and
10 we will propose the effective dates from that point forward,
11 certainly there would be a rush in transactions to come
12 under the wire for when the legislation would be enacted,
13 hopefully not to have the date of the announcement.

14 The Chairman. Well, we can have a vote.

15 Senator Bentsen. I think the effective date ought to
16 be now. It's fine. If you want to have a vote, try a
17 voice vote, petition or --

18 The Chairman. All in favor of changing the date, say
19 aye.

20 (Chorus of ayes.)

21 The Chairman. Opposed?

22 (Chorus of nays.)

23 The Chairman. The no's have it. The question then
24 recurs on the provision itself. Is there anybody who wants
25 a roll call on the provision itself? If not, it will be

1 agreed to. A voice -- all in favor say aye.

2 (Chorus of ayes.)

3 The Chairman. Opposed, no.

4 Senator Moynihan. Mr. Chairman, may I be recorded in
5 favor of Senator Long's earlier proposal?

6 The Chairman. Yes.

7 Senator Moynihan. Thank you. Aye.

8 The Chairman. The next is the PUDA provision. Is
9 there any further discussion? Request for a roll call
10 on that?

11 Senator Byrd. Yes.

12 The Chairman. The clerk will call the roll.

13 Mr. Lighthizer. Mr. Packwood?

14 Senator Packwood. Aye.

15 Mr. Lighthizer. Mr. Roth?

16 Senator Roth. Aye.

17 Mr. Lighthizer. Mr. Danforth?

18 Senator Danforth. Aye.

19 Mr. Lighthizer. Mr. Chafee?

20 Senator Chafee. Aye.

21 Mr. Lighthizer. Mr. Heinz?

22 Senator Heinz. Aye.

23 Mr. Lighthizer. Mr. Wallop?

24 Senator Wallop. Aye.

25 Mr. Lighthizer. Mr. Durenberger?

1 Senator Durenberger. Aye.
2 Mr. Lighthizer. Mr. Armstrong?
3 Senator Armstrong. Aye.
4 Mr. Lighthizer. Mr. Symms?
5 Senator Symms. Aye.
6 Mr. Lighthizer. Mr. Grassley?
7 Senator Grassley. Aye.
8 Mr. Lighthizer. Mr. Long?
9 Senator Long. Aye.
10 Mr. Lighthizer. Mr. Byrd?
11 Senator Byrd. No.
12 Mr. Lighthizer. Mr. Bentsen?
13 Senator Bentsen. No.
14 Mr. Lighthizer. Mr. Matsunaga?
15 Senator Matsunaga. Aye.
16 Mr. Lighthizer. Mr. Moynihan?
17 Senator Moynihan. No.
18 Mr. Lighthizer. Mr. Baucus?
19 Senator Baucus. No.
20 Mr. Lighthizer. Mr. Boren?
21 Senator Boren. No.
22 Mr. Lighthizer. Mr. Bradley?
23 Senator Bradley. (No response.)
24 Mr. Lighthizer. Mr. Mitchell?
25 Senator Mitchell. No.

1 Mr. Lighthizer. Mr. Chairman?

2 The Chairman. Aye. The yeas are what?

3 Mr. Lighthizer. 13. And the nays are six, Mr. Chairman.

4 The Chairman. The yeas are 13. The nays are six.

5 The provision is agreed to. Next is the Medicare tax on the

6 federal employees. Anymore discussion on that? The

7 clerk will call the roll.

8 Mr. Lighthizer. Mr. Packwood?

9 Senator Packwood. Aye.

10 Mr. Lighthizer. Mr. Roth?

11 Mr. Roth. Aye.

12 Mr. Lighthizer. Mr. Danforth?

13 Senator Danforth. Aye.

14 Mr. Lighthizer. Mr. Chafee?

15 Senator Chafee. Aye.

16 Mr. Lighthizer. Mr. Heinz?

17 Senator Heinz. Aye.

18 Mr. Lighthizer. Mr. Wallop?

19 Senator Wallop. Aye.

20 Mr. Lighthizer. Mr. Durenberger?

21 Senator Durenberger. Aye.

22 Mr. Lighthizer. Mr. Armstrong?

23 Senator Armstrong. Aye.

24 Mr. Lighthizer. Mr. Symms?

25 Senator Symms. Aye.

1 Mr. Lighthizer. Mr. Grassley?

2 Senator Grassley. No.

3 Mr. Lighthizer. Mr. Long?

4 Senator Long. Aye.

5 Mr. Lighthizer. Mr. Byrd?

6 Senator Byrd. Aye.

7 Mr. Lighthizer. Mr. Bentsen?

8 Senator Bentsen. No.

9 Mr. Lighthizer. Mr. Matsunaga?

10 Senator Matsunaga. No.

11 Mr. Lighthizer. Mr. Moynihan?

12 Senator Moynihan. No.

13 Mr. Lighthizer. Mr. Baucus?

14 Senator Baucus. No.

15 Mr. Lighthizer. Mr. Boren?

16 Senator Boren. No.

17 Mr. Lighthizer. Mr. Bradley?

18 Senator Bradley. (No response.)

19 Mr. Lighthizer. Mr. Mitchell?

20 Senator Mitchell. No.

21 Mr. Lighthizer. Mr. Chairman?

22 The Chairman. Aye.

23 Mr. Lighthizer. 11 to 8, Mr. Chairman. 11 ayes and

24 8 nays.

25 The Chairman. 11 yeas and eight nays. The provision

1 is agreed to. Next is the taxpayer compliance reform.

2
3 Mr. McConaghy. I think, Mr. Chairman, the only issue
4 there was the question of tips, and we asked the fellow from
5 the Internal Revenue Service, Mr. Goldberg, to come and
6 be available if there are any questions. Other than
7 that, why it was the only issue in the package, I believe.

8 Senator Long. I would like the roll call on just the
9 tips. I do not object to the other part.

10 The Chairman. I want to go back to the tip provision
11 to make certain we were accurate this morning. What's the
12 amount of unreported tip income?

13 Mr. Brockway. For 1981, 2. -- well, the taxes lost
14 to unreported tip income is \$2.3 billion. That translates
15 into approximately 10 plus billion dollars.

16 The Chairman. \$10 plus billion in unreported income.

17 Mr. Brockway. That's \$7 plus billion in unreported
18 income.

19 Senator Chafee. Would he translate that into tax?

20 Mr. Brockway. The tax is 2.3 billion, and at a rate
21 of around 25 percent average, that would translate to about
22 8 billion unreported.

23 Less than 20 percent of the tip income is reported
24 today. It's approximately 16 percent.

25 Senator Symms. Mr. Chair, what is the procedure to
collect it?

1 The Chairman. It's based on a compromise that we worked
2 out yesterday. It's a difficult thing to deal with very
3 honestly.

4 Mr. Brockway. I understand that this morning one of
5 the concerns that was raised was the paper work burden that
6 would be imposed on employers. S-2198 in its original
7 form would have required a charge transaction -- by charge
8 transaction allocation, the revised proposal eliminates
9 that requirement.

10 In doing so, substantially relieves the burden that
11 would be imposed on employers and complying with reporting
12 requirements.

13 The Chairman. Is there any further discussion?

14 Senator Heinz. Mr. Chairman, what does this provision
15 raise? This particular provision?

16 Mr. McConaghy. It is .3 in 1983, .8 in 1984, and 1.1
17 in 1985, Senator Heinz.

18 The Chairman. So if that failed that would reduce
19 the savings and the tax compliance.

20 Mr. McConaghy. By a total of 2.2 billion over that
21 three years, Mr. Chairman.

22 The Chairman. Any further?

23 Senator Long. We've already indicated -- those of us
24 who are going to vote against it. We've already indicated
25 who we are.

1 Mr. Lighthizer. Mr. Packwood?

2 Senator Packwood. Aye.

3 Mr. Lighthizer. Mr. Roth?

4 Senator Roth. Aye.

5 Mr. Lighthizer. Mr. Danforth?

6 Senator Danforth. Aye.

7 Mr. Lighthizer. Mr. Chafee?

8 Senator Chafee. Aye.

9 Mr. Lighthizer. Mr. Heinz?

10 Senator Heinz. For keeping the tips, aye. Keeping
11 the compliance, aye.

12 Mr. Lighthizer. Mr. Wallop?

13 Senator Wallop. Aye.

14 Mr. Lighthizer. Mr. Durenberger?

15 Senator Durenberger. (No response.)

16 Mr. Lighthizer. Mr. Armstrong?

17 Senator Armstrong. Aye.

18 Mr. Lighthizer. Mr. Symms?

19 Senator Symms. Aye.

20 Mr. Lighthizer. Mr. Grassley?

21 Senator Grassley. Aye.

22 Mr. Lighthizer. Mr. Long?

23 Senator Long. No.

24 Mr. Lighthizer. Mr. Byrd?

25 Senator Byrd. No.

1 Mr. Lighthizer. Mr. Bentsen?

2 Senator Bentsen. No.

3 Mr. Lighthizer. Mr. Matsunaga?

4 Senator Matsunaga. No.

5 Mr. Lighthizer. Mr. Moynihan?

6 Senator Moynihan. No.

7 Mr. Lighthizer. Mr. Baucus?

8 Senator Baucus. No.

9 Mr. Lighthizer. Mr. Boren?

10 Senator Boren. No.

11 Mr. Lighthizer. Mr. Bradley?

12 Senator Bradley. No response.

13 Mr. Lighthizer. Mr. Mitchell?

14 Senator Mitchell. No.

15 Mr. Lighthizer. Mr. Chairman?

16 The Chairman. Aye. On this vote, the yeas are eight
17 and nays are eight. There is one, two -- the yeas are
18 nine, and the nays are eight.

19 Senator Long. I suggest --

20 The Chairman. Right. Maybe. Maybe. The provision is
21 agreed to. Next is the telephone tax. We try to phone
22 them first. Any further discussion on the telephone tax?
23 Anybody want a voice vote? All in favor say aye.

24 (Chorus of ayes.)

25 The Chairman. Opposed, no.

1 (No response.)

2 The Chairman. Next is an easy one.

3 Senator Grassley. Senator Dole, were we voting just
4 on -- we've got the rest of the taxpayers plan.

5 The Chairman. That's correct. Oh, excuse me. We
6 did -- is there any objection to the balance of the taxpayers
7 compliance. All in favor say aye.

8 (Chorus of ayes.)

9 The Chairman. Opposed, no. Now, we'll move on to the
10 withholding on dividends and interest which includes in the
11 package reducing the holding period for long term capital
12 gains would be reduced six months. There will also be,
13 and I think if don't want to be inaccurate on this -- the
14 provision -- or regulation that will make -- help banks and
15 S&L's as far as float is concerned.

16 Mr. Chapoton. In the provision as drafted we want to
17 take into account the initial cost of setting up the system
18 in the time between withholding a deposit period. We would
19 have to have some authority to take that into account in
20 drafting the float.

21 Senator Long. Mr. Chairman, I would like to ask that
22 we have two votes. One vote on the withholding on it, and
23 the other part on the long-term capital gain.

24 The Chairman. In other words, you want on the holding
25 period and one on the dividends and interest?

1 Senator Long. That's correct.

2 The Chairman. All right. First, we'll vote on
3 the withholding on dividends and interests.

4 Senator Symms. Mr. Chairman, we are going to have a
5 chance for possible perfecting amendments to these later;
6 is that correct?

7 The Chairman. That's correct.

8 Mr. McConaghy. The revenue splits out about one-quarter
9 to dividends and about three-quarters to interest on that.

10 The Chairman. That isn't the vote, though, isn't it?
11 You want to vote on withholding first; right?

12 Senator Long. Right.

13 Mr. Lighthizer. Mr. Packwood?

14 Senator Packwood. Aye.

15 Mr. Lighthizer. Mr. Roth?

16 Senator Roth. Aye.

17 Mr. Lighthizer. Mr. Danforth?

18 Senator Danforth. Aye.

19 Mr. Lighthizer. Mr. Chafee?

20 Senator Chafee. No.

21 Mr. Lighthizer. Mr. Heinz?

22 Senator Heinz. No.

23 Mr. Lighthizer. Mr. Wallop?

24 Senator Wallop. Aye.

25 Mr. Lighthizer. Mr. Durenberger?

1 Senator Durenberger. No.
2 Mr. Lighthizer. Mr. Armstrong?
3 Senator Armstrong. Aye.
4 Mr. Lighthizer. Mr. Symms?
5 Senator Symms. Aye.
6 Mr. Lighthizer. Mr. Grassley?
7 Senator Grassley. No.
8 Mr. Lighthizer. Mr. Long?
9 Senator Long. No.,
10 Mr. Lighthizer. Mr. Byrd?
11 Senator Byrd. No.
12 Mr. Lighthizer. Mr. Bentsen?
13 Senator Bentsen. No.
14 Mr. Lighthizer. Mr. Matsunaga?
15 Senator Matsunaga. No.
16 Mr. Lighthizer. Mr. Moynihan?
17 Senator Moynihan. No.
18 Mr. Lighthizer. Mr. Baucus?
19 Senator Baucus. No.
20 Mr. Lighthizer. Mr. Boren?
21 Senator Boren. No.
22 Mr. Lighthizer. Mr. Bradley?
23 Senator Bradley. (No response.)
24 Mr. Lighthizer. Mr. Mitchell?
25 Senator Mitchell. No.

1 Mr. Lighthizer. Mr. Chairman?

2 The Chairman. Aye. On this vote, the nays are 12.
3 The yeas are seven. The amendment is not agreed to, and
4 I will withdraw the holding period provision.

5 Senator Long. Mr. Chairman, I would -- I am willing
6 to vote for the withholding.

7 The Chairman. I think we'll just withdraw the holding
8 period amendment and move on to the possessions credit.
9 All in favor say aye.

10 (Chorus of ayes.)

11 The Chairman. Opposed no. Ayes have it. That
12 provision is agreed to. Foreign oil income -- all in favor
13 say aye.

14 (Chorus of ayes.)

15 The Chairman. Opposed, no.

16 (No.)

17 The Chairman. The ayes have it. One for the negative.

18 Senator Long. I would like to record a negative.

19 Perhaps we ought to have a roll call vote.

20 The Chairman. Mr. Clerk call the roll.

21 Mr. Lighthizer. Mr. Packwood?

22 Senator Packwood. Yes.

23 Mr. Lighthizer. Mr. Roth?

24 Senator Roth. Aye.

25 Mr. Lighthizer. Mr. Danforth?

1 Senator Danforth. Aye.
2 Mr. Lighthizer. Mr. Chafee?
3 Senator Chafee. Aye.
4 Mr. Lighthizer. Mr. Heinz?
5 Senator Heinz. Aye.
6 Mr. Lighthizer. Mr. Wallop?
7 Senator Wallop. Aye.
8 Mr. Lighthizer. Mr. Durenberger?
9 Mr. Durenberger. Aye.
10 Mr. Lighthizer. Mr. Armstrong?
11 Mr. Armstrong. Aye.
12 Mr. Lighthizer. Mr. Symms?
13 Mr. Symms. Aye.
14 Mr. Lighthizer. Mr. Grassley?
15 Senator Grassley. Aye.
16 Mr. Lighthizer. Mr. Long?
17 Senator Long. No.
18 Mr. Lighthizer. Mr. Byrd?
19 Senator Byrd. Aye.
20 Mr. Lighthizer. Mr. Bentsen?
21 Mr. Bentsen. (No response.)
22 Mr. Lighthizer. Mr. Matsunaga.
23 Senator Matsunaga. Aye.
24 Mr. Lighthizer. Mr. Moynihan?
25 Senator Moynihan. Aye.

1 Mr. Lighthizer. Mr. Baucus?
2 Mr. Baucus. Aye.
3 Mr. Lighthizer. Mr. Boren?
4 Senator Boren. No.
5 Mr. Lighthizer. Mr. Bradley?
6 Senator Bradley. Aye.
7 Mr. Lighthizer. Mr. Mitchell?
8 Mr. Mitchell. Aye.
9 Mr. Lighthizer. Mr. Chairman?
10 The Chairman. Aye. On the this vote, the yeas are
11 16; the nays are two. The provision is agreed to. Next
12 is doubling the cigarette excise tax. All in favor say
13 aye.
14 Senator Long. We'd like the recall on that, please.
15 The Chairman. Roll call.
16 Mr. Lighthizer. Mr. Packwood?
17 Mr. Packwood. Aye.
18 Mr. Lighthizer. Mr. Roth?
19 Senator Roth. Aye.
20 Mr. Lighthizer. Mr. Danforth?
21 Senator Danforth. Aye.
22 Mr. Lighthizer. Mr. Chafee?
23 Senator Chafee. Aye.
24 Mr. Lighthizer. Mr. Heinz?
25 Mr. Heinz. Aye.

1 Mr. Lighthizer. Mr. Wallop?
2 Senator Wallop. Aye.
3 Mr. Lighthizer. Mr. Durenberger?
4 Senator Durenberger. No.
5 Mr. Lighthizer. Mr. Armstrong?
6 Senator Armstrong. Aye.
7 Mr. Lighthizer. Mr. Symms?
8 Senator Symms. (No response.)
9 Mr. Lighthizer. Mr. Grassley?
10 Senator Grassley. Aye.
11 Mr. Lighthizer. Mr. Long?
12 Senator Long. No.
13 Mr. Lighthizer. Mr. Byrd?
14 Senator Byrd. No.
15 Mr. Lighthizer. Mr. Bentsen?
16 Senator Bentsen. No.
17 Mr. Lighthizer. Mr. Matsunaga?
18 Senator Matsunaga. No.
19 Mr. Lighthizer. Mr. Moynihan?
20 Senator Moynihan. Aye.
21 Mr. Lighthizer. Mr. Baucus?
22 Senator Baucus. Aye.
23 Mr. Lighthizer. Mr. Boren?
24 Senator Boren. Aye.
25 Mr. Lighthizer. Mr. Bradley?

1 Senator Bradley. No.

2 Mr. Lighthizer. Mr. Mitchell?

3 Senator Mitchell. No.

4 Mr. Lighthizer. Mr. Chairman?

5 The Chairman. Aye. On this provision the ayes are

6 12. The nays are six. The next item is a corporate

7 minimum tax, preference reform. Anymore discussion?

8 Senator Durenberger?

9 Senator Durenberger. Let me just add a thought if I

10 may to the argument that Senator Long made earlier relative

11 to the tax exempt bond portion of the minimum tax. There

12 has always been, at least, in interest rates between

13 taxable and tax exempt bonds. I think in the early

14 '70's that was somewhere in the neighborhood of a 40

15 percent spread, and like 60 percent interest rate --

16 60 to 70 percent interest rate difference.

17 The spread today is very small. The spread is like

18 83 to 84 percent, and in effect, that is costing state and

19 local government a lot of money. Last year state and

20 local governments issued \$25 billion worth of general

21 obligation bonds to build infrastures, schools and roads

22 and water works and all that kind of project. The average

23 life on those bonds was 12 years, so they are locked into

24 high interest rates for those 12 years at a ten percent

25 rate, for example, and on \$25 billion in bonds. That is

1 \$30 billion. My point is that a slight change in the spread
2 has very big cost implications for state and local govern-
3 ment. If the differential had been the traditional 70
4 percent rather than the 83, 84, 85 percent last year, state
5 and local government would be paying \$6 billion less in
6 interest costs over the period of those bonds.

7 Now, we know there is a spread because of tax exemption,
8 but the size of the spread, and I think this is my point --
9 the size of the spread is determined by supply and demand
10 in the municipal bond market. We very recently have
11 impacted on supply and demand by doing some very sensible
12 things.

13 We've created all sorts of new tax investments to compete
14 with them. We have created All Savers Certificates and
15 improved IRA's and Keogh's and a whole variety of these
16 good tax policies. But all of it puts pressure on the
17 municipal market.

18 So now we come along and say to that market which is
19 already pretty sick that we are going to dilute the basic
20 exemption which gives some life to the spread in the first
21 place, and I don't think that we should do that. I don't
22 think that we should be raising the cost to state and local
23 government at a time when we're asking them to take on more
24 responsibility, and I think that was Senator Long's point,
25 and I am going to support him by moving to delete from the

1 minimum tax provision the tax exempt bond.

2 Senator Long. That is not in the proposal. That is
3 not in the corporate minimum tax proposal; is it?

4 Senator Durenberger. I'm sorry. Are you on the
5 corporate --

6 Senator Long. Yes.

7 Senator Durenberger. I won't regive my speech.

8 The Chairman. I thought it was very good.

9 Senator Durenberger. Thanks.

10 Senator Long. Does the corporate minimum --

11 Senator Durenberger. I don't have the agenda in front
12 of me.

13 Senator Long. Does the corporate minimum apply to --

14 Mr. McConaghy. I think we were on the corporate
15 minimum tax, not the individual minimum tax.

16 Senator Long. Does the corporate minimum apply to
17 tax exempt bonds?

18 Mr. McConaghy. Only to the extent, Senator Long, with
19 respect to an allocation of assets between -- of a financial
20 institution between their tax exempt assets or taxable
21 assets. Part of the interest that they pay out to the
22 extent of that would be --

23 Senator Long. Then it does apply.

24 Mr. McConaghy. Yes, that's correct.

25 Senator Long. It does apply.

1 Mr. McConaghy. Just to those institutions.

2 Senator Long. Well, I would like to move that that
3 part be stricken from it, the part that has to do with
4 tax exempt.

5 Mr. Chapoton. Senator, if I might comment on that.
6 The provision is directed at the fact it was in our minimum
7 tax -- alternative minimum -- corporate minimum tax proposal.
8 It was directed at the fact that banks is the result of
9 allowing -- being allowed an interest deduction on debts
10 used to purchase tax exempt bonds -- have exceedingly low
11 effective rates of tax.

12 Our proposal went to that point, and this proposal goes
13 to that point. It does have some impact on the tax exempt
14 market.

15 Senator Long. Well, half the time, the banks don't
16 want to buy the bonds anyhow, but the mayor and the governor
17 come around and putting their arm on to make them buy those
18 bonds many times because they want to put in local improve-
19 ments. I know how they financed that Dome Stadium down there
20 at New Orleans, for example. They twisted their arm and
21 made them buy the bonds, and it's not all that -- it's not
22 always that good a deal for the bank. Anyway, it seems to
23 me if we are going to vote to tax these tax exempt bonds
24 without letting these governors and the mayors come up
25 and the bankers -- if they importune to buy that bond

1 we'll be making a big mistake. If you hadn't changed your
2 mind by that time, you will change your mind by the time
3 you hear from all your mayors and your local officials and
4 by the time they say what that does to them. All the
5 school districts and all of the rest of them. I just
6 think that's a bad mistake, and I just don't think we ought
7 to do that.

8 We're not that hard up for money. Votes down my
9 amendment to pick up \$75 billion, you're not that hard up
10 for money.

11 Senator Wallop. I think it's fair to say that neither
12 are the banks when it comes to paying taxes that hard up for
13 money.

14 The Chairman. I think we might take a look at the 18
15 large banks. Have you got some figures on that? How
16 burdened they are with taxes?

17 Mr. McConaghy. We did look at your request, Mr. Chairman,
18 at the largest banks and for a period of three years we looked
19 at the top 18 or 20 banks. They had income essentially
20 that resulted in payment of approximately one percent on
21 if you measure it based on economic income.

22 Senator Long. If you want to tax the bank, you don't
23 have to tax these tax exempt. You hadn't got to tax the
24 states in order to do it.

25 Senator Moynihan. Mr. Chairman, may I point out that

1 the proposal -- a year and a half ago, we had to deal with
2 a very serious proposal to deny tax exemption -- the tax
3 deduction for banks that held tax exempt bonds from school
4 bus -- tax exempt deposits from school board.

5 And this would not have quite the same impact, but it
6 would have some -- a not inconsiderable impact in reducing
7 the income to school boards. Yet on the accounts they have,
8 the accounts they have in banks, and it would indirectly
9 raise the school taxes.

10 Senator Byrd. May I ask this question?

11 The Chairman. Yes.

12 Senator Byrd. Is this proposal before us now a
13 modified form of the original proposal, or is it the
14 original proposal?

15 Mr. McConaghy. It is the original proposal with
16 respect to the corporate minimum tax preference reform that
17 you have in front of you, Senator Byrd.

18 Senator Matsunaga. So are we now considering the
19 amendment offered by Senator Long?

20 Mr. McConaghy. Yes.

21 The Chairman. What would be the revenue impact of
22 Senator Long's amendment?

23 Mr. McConaghy. It would be about a total of 1.5 --
24 or 150 million over a three year period. It would be
25 25 million in 1983; 65 million in 1984; 94 million in 1985.

1 A total of 184 million over the three year period.

2 Senator Long. Now, when you look at the principle
3 involved here, Mr. Chairman, and members, I submit that
4 -- that's fine. Look at what's involved here.

5 We are talking about the interim way the federal
6 government taxes state government, taxes all the school
7 district, tax the city government. It's utterly ridiculous
8 for that little tidbit of money to create an entering way
9 here to tax state and local government. It just doesn't
10 make any sense.

11 Mr. Chapoton. Senator Long, the present law is that
12 for an individual and for most corporations, interest on
13 debt used to acquire tax exempt obligations is not
14 deductible.

15 Historically, that rule does not apply to banks. All
16 this provision does is say that a portion of the interest
17 on bank borrowings to buy tax exempt bonds is not deductible.
18 It does not -- it has the effect of making it marginally
19 less attractive for banks to hold tax exempt bonds.

20 It does not tax the interest.

21 Senator Long. All right. Now, why do we want to make
22 it less effective for banks to hold tax exempt bonds?
23 Find a mayor or a governor trying to finance a civic center
24 or a highway or any public improvement, even a school
25 house, who do they go? They go to banks and say, well,

1 look, you know, you're a citizen of this community. You owe
2 it to us to buy those bonds.

3 Mr. Chapoton. Well, we discussed this proposal that
4 was in our proposal would have been much more significant
5 than our original February proposal. We discussed with
6 many issuers this very question.

7 The industrial development bond proposal would have
8 far offset the impact -- the favorable impact on the market
9 from restricting the use of private purpose bonds would
10 have far outweighed the rather minimal impact of this
11 change. But it will --

12 Senator Long. Now, here we're talking about a few
13 dollars. We're talking about a principle. We're talking
14 about something that has been protected by the Congress
15 down through the years. We are talking about the fact that
16 the country is not going to tax away the power of these
17 state governments to exist or local government.

18 And for that little bit of money, we do that without
19 even giving these governors a chance to come up here and
20 be heard. I think it's utterly ridiculous.

21 The Chairman. Let me make a suggestion. Let's pass
22 this and maybe we can figure out --

23 Senator Bradley. Mr. Chairman, is it my understanding
24 that Senator Long is moving to remove from the minimum
25 corporate tax and tax reference related to municipal bonds.

1 Senator Long. State and local bonds.

2 Senator Bradley. I think we still have to vote on that?

3 The Chairman. Well, we'll come back to the entire
4 provision if it's all right. Let's move on to construction
5 period, interest and taxes for discussion on that. Anybody
6 want a roll call on that?

7 Senator Matsunaga. I ask for roll call.

8 The Chairman. Clerk will call the roll.

9 Mr. Lighthizer. Mr. Packwood?

10 Senator Packwood. Aye.

11 Mr. Lighthizer. Mr. Roth?

12 Mr. Roth. (No response.)

13 Mr. Lighthizer. Mr. Danforth?

14 Senator Danforth. Aye.

15 Mr. Lighthizer. Mr. Chafee?

16 Senator Chafee. Aye.

17 Mr. Lighthizer. Mr. Heinz?

18 Senator Heinz. No.

19 Mr. Lighthizer. Mr. Wallop?

20 Senator Wallop. Aye.

21 Mr. Lighthizer. Mr. Durenberger?

22 Senator Durenberger. No.

23 Mr. Lighthizer. Mr. Symms?

24 Senator Symms. Aye.

25 Mr. Lighthizer. Mr. Grassley?

1 Senator Grassley. Aye.

2 Mr. Lighthizer. Mr. Long?

3 Senator Long. No.

4 Mr. Lighthizer. Mr. Byrd?

5 Senator Byrd. (No response.)

6 Mr. Lighthizer. Mr. Bentsen?

7 Senator Bentsen. No.

8 Mr. Lighthizer. Mr. Matsunaga?

9 Senator Matsunaga. No.

10 Mr. Lighthizer. Mr. Moynihan?

11 Senator Moynihan. No.

12 Mr. Lighthizer. Mr. Baucus?

13 Senator Baucus. No.

14 Mr. Lighthizer. Mr. Boren?

15 Senator Boren. No.

16 Mr. Lighthizer. Mr. Bradley?

17 Senator Bradley. No.

18 Mr. Lighthizer. Mr. Mitchell?

19 Senator Mitchell. No.

20 Mr. Lighthizer. Mr. Chairman?

21 The Chairman. Aye and Symms, aye, and Roth, aye.

22 Senator Armstrong. And Armstrong aye.

23 The Chairman. Mr. Armstrong. On this vote the yeas

24 are 10. The nays are eight. The provision is agreed to.

25 Next is the MODCO amendment that Senator Bentsen -- do you

1 want a roll call on that. All in favor of that say aye.

2 (Chorus of ayes.)

3 The Chairman. Opposed, no. The ayes have it.

4 Voice vote. Dividend reinvestment plan provision. Buck or
5 Mark, could you give us just a quick summary of this
6 provision?

7 Mr. McConaghy. Yes. Under existing law as of last
8 year if I had a plan where I can either take the dividend
9 or cash normally that would have been taxable last year.
10 We said to the extent of \$1500 in a joint return, and 750
11 in the case of a single return, we would not tax that
12 dividend if it were reinvested back in that public utility
13 company.

14 This would repeal that provision on dividend reinvest-
15 ment.

16 The Chairman. Those in favor aye.

17 (Chorus of ayes.)

18 The Chairman. Opposed no?

19 (No).

20 Senator Packwood. No. Could I be recorded as no?

21 The Chairman. They ayes have it.

22 Senator Baucus. I would like to be recorded no.

23 Senator Matsunaga. I wish to be recorded as no.

24 Mr. Chairman, we need a roll call, I guess.

25 The Chairman. We'll have a roll call.

1 Mr. Lighthizer. Mr. Packwood?

2 Senator Packwood. No.

3 Mr. Lighthizer. Mr. Roth?

4 Mr. Roth. Aye.

5 Mr. Lighthizer. Mr. Danforth?

6 Senator Danforth. Aye.

7 Mr. Lighthizer. Mr. Chafee?

8 Senator Chafee. Aye.

9 Mr. Lighthizer. Mr. Heinz?

10 Senator Heinz. Aye.

11 Mr. Lighthizer. Mr. Wallop?

12 Senator Wallop. Aye.

13 Mr. Lighthizer. Mr. Durenberger?

14 Senator Durenberger? Aye.

15 Mr. Lighthizer. Mr. Armstrong?

16 Senator Armstrong. Aye.

17 Mr. Lighthizer. Mr. Symms?

18 Senator Symms. (No response.)

19 Mr. Lighthizer. Mr. Grassley?

20 Senator Grassley. (No response.)

21 Mr. Lighthizer. Mr. Long?

22 Senator Long. (No response.)

23 Mr. Lighthizer. Mr. Byrd?

24 Senator Byrd. Aye.

25 Mr. Lighthizer. Mr. Bentsen?

1 Senator Bentsen. No.

2 Mr. Lighthizer. Mr. Matsunaga.

3 Senator Matsunaga. No.

4 Mr. Lighthizer. Mr. Moynihan?

5 Senator Moynihan. No.

6 Mr. Lighthizer. Mr. Baucus?

7 Senator Baucus. No.

8 Mr. Lighthizer. Mr. Boren?

9 Senator Boren. No.

10 Mr. Lighthizer. No Bradley?

11 Senator Bradley. No.

12 Mr. Lighthizer. Mr. Mitchell?

13 Senator Mitchell. No.

14 Mr. Lighthizer. Mr. Chairman?

15 The Chairman. Aye.

16 Senator Grassley. Grassley votes aye.

17 Senator Durenberger. How am I recorded?

18 Mr. Lighthizer. Aye.

19 Senator Durenberger. I want to change that to no.

20 The Chairman. On this vote, the yeas are eight. The

21 nays are nine. That's not agreed to.

22 Senator Danforth. Could I say a word about the

23 individual --

24 The Chairman. And I might say we'll leave that open.

25 Senator Danforth. Mr. Chairman, let me say that for

1 all the talk about taxing municipal bonds, the individual
2 minimum tax as it is now in this package would affect an
3 estimated 200,000 taxpayers out of a total of some 75 million
4 taxpayers.

5 Therefore, it is, I think, stretching matters consider-
6 ably to say that the issue is whether or not we are going to
7 tax municipal bonds. This tax would not, under any circum-
8 stances, apply to anybody who files a joint return with
9 income under \$40,000 after deducting all charitable con-
10 tributions and home mortgages and other deductions as well.

11 So the question is an alternative minimum tax, an
12 alternative computation. This proposal is aimed at those
13 relatively wealthy individuals who so arrange their affairs
14 that virtually all of their income is derived from preference
15 items.

16 Now, we have heard ever since we started debating the
17 tax cut of last year that the purpose of cutting taxes
18 according to some of the detractors of what we did was
19 simply to confer benefits on the wealthy, and that the
20 wealthy are ripping off the system and the country. And
21 that that is the nature of the tax cut. Many of us who
22 supported the tax cut have attempted to make the argument
23 that no, the point of a tax cut is not to confer benefits on
24 the wealthy or anybody else.

25 It is to try to create an economic system in this

1 country where there is some incentive for growth, for
2 savings, for expansion of the economy of our country. I
3 believe that it is essential if we are going to have a
4 credible tax system which is supported by the American
5 people to make it clear that a handful of taxpayers
6 who are way in the top income bracket are not going to be
7 able to devise a system which allows them to pay virtually
8 no taxes, or in some cases no taxes at all.

9 For everybody else -- everybody -- even the high income
10 people who don't create the kind of arrangement where they
11 are availing themselves of every preference that they
12 can to the point where they aren't paying any taxes.
13 Everybody else can buy municipal bonds to their heart's
14 content. And not pay a penny of tax on them.

15 So the point is not one of the bonds market. Taxing
16 200,000 people out of 75 million is not going to affect the
17 cost of municipal bonds. What this is going to do is to
18 create much greater credibility on the part of the
19 American people that we have a fair and equitable tax system.

20 Senator Long. Have you carried, Senator, that argument
21 to its logical conclusion. You would proceed to tax
22 state and municipal bonds just the same way you tax every-
23 thing else. Now, before the Senator showed up on the scene
24 we had this item in conference between the House and the
25 Senate and someone had that horrible example of Mrs. Dodge

1 out there somewhere or other, and said Mrs. Dodge puts all
2 her money in tax exempt bonds, and she pays no tax. Back
3 at that time, little Carl Curtis was one of the ranking
4 members on the Republican side of the aisle. And he said
5 I'm not willing to destroy state government to tax Mrs.
6 Dodge.

7
8 Now, that's about we have involved here, and this is a
9 proposal to do indirectly what they have not succeeded in
10 doing directly. But when you do this, you set the stage
11 for them to go to court and try to get that Supreme Court
12 to reverse itself and say the federal government can tax
13 tax-exempt bonds, and once that's done, then you really
14 do have a problem if you want to tax them just like you
15 tax anything else.

16 Senator Packwood. Mr. Chairman, I agree totally with
17 Senator Danforth, and we are stuck on the horns of a dilemma
18 in this system. We encourage people to buy municipal bonds.
19 We encourage them to take advantage of tax incentives that
20 we say are for the good of this country, and by and large,
21 they are.

22 And by taking advantage of what we have offered them
23 in the tax law, they can arrange their affairs to pay no
24 tax. And from the standpoint of the credibility of the
25 tax system, that cannot happen. And that simply cannot be
allowed to happen no matter what kind of preferences we have

1 given in law or what kind of incentives we've given, and there
2 is no way to resolve this. No way to resolve it, and so
3 you've got to take the lesser of the evils and the lesser
4 of the evils is far and away that everyone in this country
5 has to pay some tax so that the great bulk of the people
6 who have to pay a fair percentage of their income in tax
7 don't feel that they are being cheated by those who have
8 income significantly greater than theirs.

9 Senator Chafee. Mr. Chairman?

10 The Chairman. Yes.

11 Senator Chafee. Mr. Chairman, it seems to me that
12 we just can't tolerate a system whereby some people through
13 a device can get away with paying no tax at all. And I
14 don't think it is tearing down the city and local, state
15 governments by embarking on the course we are embarking on
16 here today.

17 But far more importantly it seems to me is to preserve
18 the integrity of the system. The lower income person without
19 these massive preferences has his pay docked at work, the
20 withholding, his income tax is withheld, and he has to pay
21 his taxes, and I don't think that because we are concerned
22 about federal and state government, local and state govern-
23 ment that we should subvert the system in order to take care
24 of that one problem.
25

1 I just don't think it's that significant. I don't
2 think it necessarily follows because we embark on this
3 course that we are therefore out to end the preference for
4 municipal and state bonds.

5 Senator Long. All you're doing is driving the entering
6 wedge. That's all.

7 The Chairman. Anybody want a roll call?

8 Senator Moynihan. Yes.

9 The Chairman. I would just say -- we're not talking
10 about much money, and these are really upper income
11 Americans. We'll see where it falls.

12 Mr. Lighthizer. Mr. Packwood?

13 Senator Packwood. Aye.

14 Mr. Lighthizer. Mr. Roth?

15 Senator Roth. (No response.)

16 Mr. Lighthizer. Mr. Danforth?

17 Senator Danforth. Aye.

18 Mr. Lighthizer. Mr. Chafee?

19 Senator Chafee. Aye.

20 Mr. Lighthizer. Mr. Heinz?

21 Senator Heinz. Aye.

22 Mr. Lighthizer. Mr. Wallop?

23 Senator Wallop. Aye.

24 Mr. Lighthizer. Mr. Durenberger?

25 Senator Durenberger. Aye.

1 Mr. Lighthizer. Mr. Armstrong?
2 Senator Armstrong. Aye.
3 Mr. Lighthizer. Mr. Symms?
4 Senator Symms. Aye.
5 Mr. Lighthizer. Mr. Grassley?
6 Senator Grassley. No response.
7 Mr. Lighthizer. Mr. Long?
8 Senator Long. No.
9 Mr. Lighthizer. Mr. Byrd?
10 Senator Byrd. (No response.)
11 Mr. Lighthizer. Mr. Bentsen?
12 Senator Bentsen. Aye.
13 Mr. Lighthizer. Mr. Matsunaga?
14 Senator Matsunaga. No.
15 Mr. Lighthizer. Mr. Moynihan?
16 Senator Moynihan. Aye.
17 Mr. Lighthizer. My Baucus?
18 Senator Baucus. Aye.
19 Mr. Lighthizer. Mr. Boren?
20 Senator Boren. Aye.
21 Mr. Lighthizer. Mr. Bradley?
22 Senator Bradley. (No response.)
23 Mr. Lighthizer. Mr. Mitchell?
24 Senator Mitchell. Aye.
25 Mr. Lighthizer. Mr. Chairman?

1 The Chairman. Aye.

2 Senator Roth. Mr. Chairman, Roth votes aye.

3 The Chairman. At this vote, the yeas are 15 -- 16.

4 Senator Matsunaga vote aye.

5 Senator Byrd. Vote me aye, please.

6 The Chairman. Next is the IDB reform. Are there any
7 amendments to be offered to that. I think Dave had a
8 question.

9 Senator Boren. Were we ever able to offer anything --
10 work out anything on the power generation where we were talk-
11 ing back about those that are controlled by public regulatory
12 bodies where the rate payers would be paying the loss?

13 Mr. Chapoton. I'm sorry, Senator Boren. We have not
14 done anything further on that.

15 Senator Boren. Is there any revenue impact of the
16 sunset provision in terms of this three years, in terms
17 of this bill?

18 Mr. McConaghy. There is in the out years, Senator
19 Boren.

20 Senator Boren. Not in terms of the three years we are
21 dealing with under the budget resolution?

22 Mr. McConaghy. That's correct.

23 Senator Boren. I would like to move -- I am concerned
24 about us doing away with the IDB's after three years. I
25 realize we have said we will come back to it, but I would

1 like to move that we take the sunset provision out of the
2 IDB proposal.

3 The Chairman. I would say in response to that if we don't
4 keep the sunset provision, we never will address the
5 problem, and if we've got a real problem, and I think it's
6 affecting local and state governments and public purpose
7 uses, and we didn't do very much in this area to start
8 with, and the one reason we didn't -- we said well, we'll
9 sunset small issue bonds in '85, and that will require us
10 to come back and take another look.

11 And I know the administration wanted to go much further.
12 It's a very sensitive issue. We felt we had done enough
13 to indicate that at least we had reform in mind even though
14 it may not have appeared that way. Want a voice vote?

15 Senator Wallop. Mr. Chairman, the only thing --
16 I understand they have not yet been able to respond to my
17 question, and would hope that we could address it at some
18 time before we are finished?

19 The Chairman. All in favor of removing the sunset say
20 aye.

21 (Chorus of ayes.)

22 The Chairman. Opposed, no.

23 (Chorus of nays.)

24 The Chairman. All in favor of the amendment say aye.

25 (Chorus of ayes.)

1 Senator Moynihan. I have a small matter which I think
2 Mr. Chapoton knows about.

3 The Chairman. Oh, excuse me.

4 Senator Moynihan. And does know about. It is part
5 of the law that the municipal government can issue tax
6 exempt bonds for facilities for the local furnishing of
7 electric energy or gas, and the problem is local furnishing
8 is defined as two counties, and it happens that the city of
9 New York is divided into five counties. And this would make
10 it possible for the city of New York to do what every other
11 city can do. I'm sorry to be provincial, but it's our
12 biggest city.

13 The Chairman. Has that been addressed by Treasury?

14 Mr. Chapoton. We've said, and I've advised Mr.
15 Moynihan that the distinction in present law is very
16 difficult to justify indeed, and that when the issue of
17 tax exempt bonds, industrial development bonds was addressed
18 in a comprehensive way, that, too, should be addressed so
19 we -- this is at least being addressed partially, and I
20 think it would not have any great revenue impact so we
21 would not.

22 The Chairman. Are you willing to accept that modifica-
23 tion?

24 Senator Moynihan. I would appreciate that, Mr.
25 Chairman, and thank you.

1 The Chairman. Senator Wallop, is there something they
2 can resolve now with you or do they come back to it?

3 Mr. Wallop. Mr. Chairman, it was my question as to
4 the treatment of -- under the new rule where only 80 percent
5 had to be first time home buyers as opposed to the present
6 rule of 100 percent, and the question related to those
7 issues which had already been sold so that there is nothing
8 new entering the market.

9 And if they could be subject to the new rule rather
10 than the old rule. I don't think there is a revenue effect.
11 Of it one, it's been virtually inconsequential.

1 Mr. Chairman, as -- I haven't followed whatever
2 we've been negotiating in the back room today, so I'm
3 just going to give you the proposal and see if you have an
4 adverse reaction before I put it as an amendment.

5 This relates to multi-family IRV's and the question
6 is eligibility. The technical definition of an eligible
7 project of the regulation has the effect of excluding
8 townhouses, detached units built for rental purposes, yet
9 preferred housing for lower income families with children
10 as single unit or townhouse.

11 Relying on the provisions of the 1080 Act, that won't
12 go into it, because you know, state and local agencies
13 have developed these types of projects, expecting that they
14 will be permissible projects. The proposed regulations
15 prohibits, however, future construction of townhouses and
16 detached single units.

17 But it is my understanding that the necessary changes
18 have to be made statutorily rather than by Regulation
19 and so I would be proposing to amend whatever is before
20 us to make the following types of projects eligible. One,
21 attached townhouses and two, single family detached houses,
22 occupied solely by low income individuals.

23 The Chairman. Has Treasury looked at this?

24 Mr. Chapoton. You're just talking about past issues.
25 I'm advised that if the discussions had gone on that we

1 would be willing to -- we do think we can do that by
2 regulation --

3 The Chairman. If it's going to cost any money, we
4 don't --

5 Mr. Chapoton. It's an interpretation of the existing
6 law and it would be for the future as well as for the past.
7 I think we have had discussions --

8 The Chairman. We're about \$12 billion short, so I
9 don't want to give anymore away here.

10 Mr. Chapoton. I think it would be no revenue that
11 we would measure.

12 Senator Durenberger. That's suitable for me. I have another
13 on revenue impact. The package that we have before us,
14 as I understand it, includes a single family provision, 4717,
15 and I would like to include the multi-family provisions,
16 as well, which would make low income requirements the longer
17 of ten years, the term of the subsidy or half the term
18 of the bond and secondly, clarify the low income eligibility
19 at 80 percent of medium income instead of tying it to
20 Section 8, which would be changing.

21 Mr. Chapoton. Well, Senator, are you listing
22 all the provisions that are in HR-4717?

23 Senator Durenberger. We're going to conference on the
24 12th of July on it.

25 Mr. Chapoton. I thought we had decided late

1 yesterday these would not be in this bill and they would
2 be taken up at that time?

3 The Chairman. I've written to Chairman Rowsinkowski
4 and they suggested we go to conference on the 12th of July.

5 Senator Durenberger. How do you feel about it, Mr. Chairman?

6 The Chairman. I don't know what the cost is -- about
7 \$50 million.

8 Mr. McConaghy. I think that is the cost over a
9 three-year period, Mr. Chairman --

10 Senator Symms. How much?

11 Mr. McConaghy. About \$50 million over a three-year
12 period.

13 Senator Symms. \$50?

14 Mr. McConaghy. Yes.

15 Senator Symms. That's good.

16 I'll move that they be included.

17 The Chairman. Well, maybe we can pass over this
18 provision right now until we determine the larger figure,
19 how we're going to recover the \$12 billion.

20 Let's move on to completed contracts.

21 Senator Mitchell. I want to make a move for the
22 completed contract, Mr. Chairman.

23 The Chairman. Go ahead.

24 Senator Mitchell. I move, Mr. Chairman, that we
25 substitute for the provision in the package -- I move

1 that we substitute provisions of S-2690, that was the Bill
2 introduced by Senator Danforth, for the completed contract
3 provisions which are in the package before us and discuss
4 that length so --

5 Speaker. What's the revenue on that?

6 Senator Mitchell. The revenue difference is \$100
7 million in the first year and I think \$500 million difference
8 in the second year. The difference between the two.

9 The Chairman. As I understand, there has been some
10 agreement on this.

11 Senator Mitchell. No, I don't think there has, Mr.
12 Chairman. I would like a roll call. And, if I could just
13 say briefly that the abuse as cited by Treasury are corrected
14 by tightening up on the definition of contract completion,
15 not by changing the allocation of period costs to contract
16 costs.

17 Secondly, in 1976 after several years of debate and
18 discussion it was determined that those certain period
19 costs were period costs and not clearly out with the contract.

20 Now, S-2690 proposed to qualify that determination,
21 without any, in my judgment, reasonable justification,
22 that's now being reversed. And finally, it ought to be
23 noted that what this provision does is to build into the
24 law a bias against independent contractors and in favor of
25 large companies that engage in self-construction.

1 Because, what it says is that for independent contractors,
2 what would otherwise be period costs are actually allocable
3 to the contract, but that is not true with respect to large
4 companies which engage in their own construction. I think
5 that's a clearly inequitable unfair result and therefore,
6 Mr. Chairman, I move the adoption of my amendment substituting
7 S-2690 as introduced by Senator Danforth for the provisions
8 of this bill.

9 Senator Danforth. Mr. Chairman, I very much
10 appreciate the comments and the spirit of Senator Mitchell
11 and his support for the Bill that I introduced. Just to
12 inform the Committee of the various revenue consequences
13 of what's been proposed to date, the original proposal
14 of the Administration, which was to terminate the completed
15 contract method of accounting would have produced an
16 estimated \$11.1 billion dollars over these three years,
17 1983, '84, '85.

18 Through a period of negotiation, the Administration
19 then altered its position and came back with a proposal
20 which would have produced \$7.9 billion. My bill, by contrast,
21 would have produced an increased \$3.8 billion over the three
22 years.

23 And during a long period of negotiation, very intense,
24 culminating about noon or a little after noon yesterday,
25 we compromised on what is part of the package now which would

1 produce \$5.2 billion over the three-year period of time.

2 So, I think we did fairly well in the negotiations and
3 my own view is that a deal is a deal. I honestly believe
4 that I reached the high water mark at about noon yesterday
5 and I'm little bit concerned about being carried away by
6 the ebbing tide.

7 I would say that the period costs in the present law
8 will continue to apply to those firms with gross receipts
9 of under \$25 million a year, so that the small contractor,
10 the independent contractor, will be able to proceed as
11 in my bill.

12 But, this only applies to contractors with gross
13 receipts of over \$25 million and then only for contracts
14 in the construction industry which last for more than three
15 years, which aren't completed in the first three years.

16 Senator Mitchell. I appreciate the Senator's comments.
17 I will only say, in return, of course, that a deal is a
18 deal for those who are part of a deal.

19 Mr. Chapoton: Senator Mitchell, in response to your
20 first point, the treatment of period costs is involved here
21 only where the income side is deferred.

22 If period costs, -- and presently period costs are
23 deductible, or these costs would be changed in this proposal
24 or deducted. You know, the income is not realized until
25 the end of the contract which can be a substantial deferral.

1 And, I must say, we can go through the cases with
2 you but there are many examples of very large contractors
3 for defense and nondefense with very significantly amounts
4 of income being reported to shareholders, publically reported
5 to shareholders and are paying no tax whatsoever.

6 And, it seemed to be the clearest case of the type
7 of thing that should not be allowed to be continued and,
8 of course, my proposal went much further, and I can say
9 that Senator Danforth's original Bill did not correct that
10 situation and that was the point we made.

11 Senator Mitchell. I don't disagree with the objective. I
12 just disagree with the procedure used to get there.

13 Senator Chafee. Mr. Chairman, I'm prepared to vote.

14 The Chairman. I'd like to call the roll.

15 Senator Chafee. What is the question? On the
16 amendment?

17 The Chairman. Yes.

18 Senator Chafee. On Senator Mitchell's amendment
19 to the provision?

20 The Chairman. Yes, Senator Mitchell's amendment.
21 What's the revenue loss in his amendment?

22 Mr. McConaghy. The revenue loss would be 1.5 billion
23 over the three-year period, .1, .5, .9.

24 The Chairman. The clerk will call the roll.

25 The Clerk. Mr. Packwood?

1 Senator Packwood. Nay.
2 The Clerk. Mr. Roth?
3 Senator Roth. Nay.
4 The Clerk. Mr. Danforth?
5 Senator Danforth. Nay.
6 The Clerk. Mr. Chafee?
7 Senator Chafee. Nay.
8 The Clerk. Mr. Heinz?
9 Senator Heinz. Nay.
10 The Clerk. Mr. Wallop?
11 Senator Wallop. Nay.
12 The Clerk. Mr. Durenberger?
13 Senator Durenberger. Nay.
14 The Clerk. Mr. Armstrong?
15 Senator Armstrong. Nay.
16 The Clerk. Mr. Symms?
17 Senator Symms. Nay.
18 The Clerk. Mr. Grassley?
19 Senator Grassley. Nay.
20 The Clerk. Mr. Long?
21 Senator Long. Yea.
22 The Clerk. Mr. Byrd?
23 Senator Byrd. Nay.
24 The Clerk. Mr. Bentsen.
25 Senator Bentsen. Yea.

1 The Clerk. Mr. Matsunaga?

2 Senator Matsunaga. Yea.

3 The Clerk. Mr. Moynihan?

4 Senator Moynihan. Yea.

5 The Clerk. Mr. Baucus?

6 Senator Baucus. Yea.

7 The Clerk. Mr. Boren?

8 Senator Boren. Yea.

9 The Clerk. Mr. Bradley?

10 Senator Bradley. Yea.

11 The Clerk. Mr. Mitchell?

12 Senator Mitchell. Yea.

13 The Clerk. Mr. Chairman?

14 The Chairman. Nay.

15 The Chairman. On this vote the yeas are 7 and the
16 nays are 13. The amendment is not agreed to.

17 Could we have a -- oh, excuse me. Now, all in favor
18 of the completed contract proposal say yea. Opposed nay?
19 The Court, Senator Mitchell knows, the Yea's have it.

20 Could I have the figures on, if we repealed safe
21 harbor leasing what the savings would be and how much
22 would we have to make up?

23 Mr. Brockway. Senator, over the years it would
24 be 15.4, '83 it would be 3.2, '84 would be 5. --

25 The Chairman. Just add those, 15.4 --

1 Senator Packwood. How much are we off the target
2 to date?

3 Mr. Brockway. 14.7. That assumes --

4 Senator Bradley. Could we have those numbers again?

5 Mr. Brockway. 15.4

6 Senator Bradley. A year?

7 Mr. Brockway. '83 it would be 3.2, '84 5.2, '85,
8 7.0.

9 The Chairman. As I understand the Democratic Convention
10 advocated repeal of leasing --

11 Senator Bradley. Mr. Chairman, I might also say that
12 the Democratic Convention heartedly endorsed dramatically
13 dropping the tax rate to 14 percent and eliminating all
14 credit exclusions and deductions with a few exceptions.

15 I think that if we're serious, maybe later in the night
16 we'll take a vote on dropping that rate to 14 percent and
17 maybe wholesale elimination of alot of these credits and
18 deductions, just to reference upon any footnote that has
19 the Democratic Committee Convention should also reflect
20 the full range of its view.

21 Senator Matsunaga. Mr. Chairman, are we on the safe
22 harbor leasing?

23 Mr. Chairman. Well, we're not quite on safe harbor
24 leasing. It's floating around at this point.

25 What was the figure? How much are we off the target

1 as we get to this?

2 Mr. DeArment. 14.7.

3 The Chairman. If we repealed safe harbor leasing
4 where would we be?

5 Mr. DeArment. 15.4.

6 Senator Armstrong. Mr. Chairman, if I could check
7 the figures on that. The net addition would not be 14.7.

8 Mr. McConaghy. Mr. Chairman, this proposal as listed
9 would pick up 7.3 billion. If you repealed it, which isn't
10 this proposal, it would be 15.4.

11 The Chairman. So, you'd pick up about \$7 billion?

12 Mr. McConaghy. About \$8 billion, that's correct.

13 The Chairman. Well, I think -- I think we'll move
14 on to mergers and acquisition reform.

15 Is there -- I know Senator Byrd had -- I don't know if
16 he has any amendments. I know he's concerned about this
17 provision because of its complexity.

18 Is there any further discussion, Senator Byrd?

19 Senator Byrd. I don't think so. I don't know enough
20 about it to have amendments to it. I just wonder whether
21 it is wise to have such a far reaching piece of legislation
22 without having hearings on it and having an opportunity for
23 people to have their views known.

24 The Chairman. Let me ask Senator Danforth who proposed
25 the amendment to comment on it.

1 Senator Danforth. Mr. Chairman, last year when we
2 passed the tax cut of last year, much that was in that tax
3 cut was designed to try encourage economic expansion through
4 getting businesses to invest more in new plant and equipment
5 and research and development and so on. And, it turns out,
6 as a matter of fact, I think largely because of high interest
7 rates, that the investments that we anticipated were really
8 not forthcoming.

9 I think part of the problem is something other than
10 the high interest rates and it is that we have developed
11 a phenomenon in this country where more and more attention
12 of the business community as being directed not at gross
13 or modernization or making better products, but rather
14 acquiring other businesses.

15 And, this has been something which I think has not
16 only absorbed alot of attention of our business leadership,
17 but it's also something that has had a devastating effect
18 on certain communities, communities which once had very
19 excellent business leadership, where corporate headquarter
20 cities have become instead divisional headquarter cities
21 as the acquisition boom has continued to boom.

22 And, it turns out, and this is something which is
23 not original with me, it was developed by Congressman Stark.
24 It turns out that the acquisition trend of the fad toward
25 acquisitions is something that has been encouraged by the

1 tax laws. That is, the tax laws are not neutral to
2 acquisitions, that it's possible to structure acquisitions
3 so that the business can attain properties with a stepped-up
4 basis without any offsetting tax being paid.

5 So, a considerable amount of attention has been devoted
6 by the Treasury, by the Joint Committee to trying to correct
7 an anomaly in the tax law which artificially encourages
8 acquisitions.

9 And, this proposal is designed to at least make the
10 tax laws neutral with respect to acquisitions by attempting
11 to correct some well-known and much-discussed problems that
12 are now in the law. That's the whole point of it.

13 The Chairman. All in favor say yea.

14 Senator Byrd. I have an amendment which I'm asking
15 Treasury to take a look at. I understand it keeps the
16 revenue but -- in other words, the focal point.

17 The Chairman. Do you want to comment, Mr. Glickman?

18 Mr. Glickman. Mr. Chairman, there are three suggestions
19 here. The first one would deal with our consolidated return
20 regs. And, I think that we already said the project as
21 we said before and we are going to determine whether we are
22 going to solve some of the problems. I think our authority
23 and our abilities are limited there.

24 The other two would, in essence, were strict, the
25 applicability of the provisions in Senator Danforth's Bill,

1 in their application. These were some of the things that
2 were discussed yesterday and the day before with various
3 members of the staff. And, I've got questions about both
4 of them. Do you want me to go into detail with them?

5 The Chairman. I don't want to hear all of it, but
6 give me the part I understand.

7 Mr. Glickman. In essence, the first one, as I under-
8 stand it, would say that there is a one-year holding period,
9 if you held your stock for more than one year and then
10 there's a redemption, that this new rule we're talking
11 about would not apply. It just seems to me that that puts
12 a premium on people going in, buying the stock and then
13 agreeing to hold for a one year period of time and then
14 going through the procedure and that, I don't think we
15 really prevented the type of problem that we were concerned
16 about, or at least the Joint Committee and the Ways and Means
17 Committee was concerned about.

18 And, the last one concerns the second part of Senator
19 Danforth's Bill, and it talks about liquidation within a
20 one-year period of time. Again, I think that Senator
21 Danforth's Bill really goes much farther than this and
22 requires that once the decision is made to liquidate, the
23 decision is made as of the date of acquisition and on that
24 one we clearly think that that's the answer that is the
25 correct answer.

1 So, on each one of them, I just don't think that they
2 add anything to the Bill.

3 The Chairman. Well, they didn't take anything away
4 from the Bill?

5 Mr. Glickman. Well, the first one, as I said, is in
6 our regs, so I don't think that does anything --

7 The Chairman. Defeated the first one?

8 Mr. Glickman. Yes, we will make whatever changes we
9 can to the regs. The second too, I think that it does
10 take something away from the Bill. It limits the applicability
11 of the Bill.

12 The Chairman. What does it do to the revenues?

13 Mr. Glickman. Mark --

14 Senator Byrd. My understanding is it has no appreciable
15 effect on the revenue.

16 Mr. Glickman. I don't think it has any effect on the
17 revenue. I would be very surprised.

18 But at the same time it does, it seemed to me, as it
19 does cut back limiting applicability of the --

20 The Chairman. Right, but in the meantime wouldn't
21 it be -- If it doesn't have that revenue impact it would
22 give us the opportunity that I think we should have in
23 this committee to take a look at it and it still wouldn't
24 do violence to some of the abuses that were referred to.

25 I don't want to get involved in Senator Danforth's

1 amendment, but it might be -- Have you looked at it, Mark,
2 as far as that goes?

3 Mr. Glickman. One of our staff just now -- Let me
4 ask the Joint Committee, since they can walk around it to
5 some degree mark through these provisions, maybe it would
6 have more of a revenue impact than I thought.

7 The Chairman. Let me suggest that while we're studying
8 that we go on and --

9 Senator Boren. Mr. Chairman, I wonder if I might
10 mention one other point on this provision. I think this
11 has been worked out with Senator Danforth and staff.

12 We need to clarify -- This has an effective date of
13 August 31st. We need to clarify the way the transition
14 rules, some of those things that are now in process, and I
15 would propose that we would grandfather in those public
16 tender offers made before July 1st, 1982, and those under-
17 bind contracts entered into before that date. I would
18 propose that as a transition rule and I think that -- I
19 don't believe Senator Danforth would have any objection,
20 but it would not change the effective date being August
21 31st, but there are some that are pending in which there
22 could be some people who are not willing parties to it that
23 would be penalized if we don't clarify that.

24 The Chairman. Has that been -- I don't know who it
25 applies to, maybe no one in particular. We want to make

1 certain that --

2 Mr. McConaghy. There are a number of transactions
3 outstanding. We don't know if they're going to go through
4 or not. We'd really have to analyze those transactions,
5 Mr. Chairman. Of one or two we know, there could be some
6 significant money involved. They are not in this revenue
7 estimate, because we didn't know if they would go through
8 but we'd have to look at the transactions before we could
9 give --

10 The Chairman. Do you have any objection to Senator
11 Boren's amendment?

12 Mr. Glickman. With respect --

13 The Chairman. Any serious objection?

14 Mr. Glickman. With respect to the second part of it,
15 I don't have anything. With respect to the first, since
16 they are in-house type of deals -- I mean, if we're talking
17 about a binding type of transaction, I just have a question
18 as to what kind of problems this would raise. I don't have
19 a real strong feeling one way or the other.

20 The Chairman. Senator Bradley?

21 Senator Bradley. Mr. Chairman, I, maybe this is the
22 appropriate time, bring up the study on monetary policy that
23 I had raised. Treasury has accepted the amendment.

24 Been accepted?

25 The Chairman. Study has been accepted, yes.

1 I'm not certain how quickly we can resolve the questions
2 raised by Senator Byrd. We could go on to the targeted
3 jobs credit extension and then come back to it.

4 Senator Byrd. I don't want to continue the issue, Mr.
5 Chairman. I just -- it has to be recorded in the negative.
6 Do whatever you think best.

7 The Chairman. Can we -- Buck, have you had a chance
8 to look at Senator Byrd's -- Has anybody had a chance to
9 see whether we -- what we can do?

10 The first change he suggested is acceptable. The other
11 two, there were some reservations.

12 Mr. Chapoton. Mr. Chairman, I think it does undercut
13 the second one, particularly the -- and I guess the -- no
14 both, the second and third cut in pretty dramatically to the
15 purpose of Senator Danforth's Bill.

16 The Chairman. Pardon me? Excuse me.

17 Mr. Chapoton. I think that both the second and third
18 change would cut in pretty dramatically to the purpose
19 of Senator Danforth's Bill and I think that we would not
20 like those changes.

21 The Chairman. Let me suggest this. I certainly don't
22 want to shut off anyone's rights. This is a serious
23 amendment.

24 I wonder if we might adopt the amendment and then
25 have a hearing before we finally consider it on the Senate

1 floor. Would that be helpful?

2 Senator Byrd. That would be fine.

3 The Chairman. Adopting the amendment, but maybe --
4 the merger and acquisition amendment --

5 Senator Danforth. You mean the --

6 The Chairman. Yes, provision, and then we could
7 schedule a hearing the week of the 12th and if we find
8 a problem, we ought to address it.

9 Senator Byrd. I think that would be fine, yes.

10 The Chairman. All right. Let's set the hearing on
11 the 14th of July, this year.

12 Is there any objection to the provision under those
13 conditions?

14 Senator Byrd. I think that's satisfactory.

15 The Chairman. All in favor say yea. Opposed no.
16 The yeas have it and we will have -- if there is some
17 conflict on that date, Bob, we'll work it out.

18 Senator Heinz, the next provision is the targeted jobs
19 tax credit extention, which you and I think others have
20 an interest in.

21 Senator Bradley. Mr. Chairman, can I be recorded on
22 the individual amendment in favor?

23 The Chairman. Yes, the record reflects it on the
24 individual minimum tax. I think before we go to this,
25 Senator Heinz, Senator Long --

1 Senator Long. I wanted to get this -- Could we have --
2 Was the vote on the matter of whether the -- Could we have
3 a vote on whether to have the tax exempt bonds on the
4 individual minimum tax?

5 Mr. Lighthizer. We did not have a vote on that,
6 Senator, a vote on the proposal, Senator.

7 Senator Long. Pardon me?

8 Mr. Lighthizer. The Committee had accepted the
9 proposal, but there was no vote on that specific provision.

10 Senator Long. Well, how about the corporate tax?

11 The Chairman. We're holding that open because we
12 can work that out with --

13 Mr. McConaghy. That one is pending, Senator Long,
14 the whole corporate minimum tax.

15 Senator Long. Because, the point that I'm interested
16 in is that I would like to propose in both cases that we
17 not tax these tax exempt funds directly or indirectly on
18 either one of these two taxes. I'd like to --

19 Mr. McConaghy. Vote for the amendment?

20 Senator Long. That's right.

21 Senator Danforth. Mr. Chairman, I would like to just
22 argue vigorously against that as far as the individual
23 tax is concerned for the reason that the individual tax
24 is an alternative tax. It is simply an alternative computa-
25 tion, so we're not really talking about the concept of

1 taxing municiple bonds. What we're talking about is whether
2 or not people with high incomes can still arrange their
3 affairs one way or another so that they avoid taxes
4 altogether.

5 And, as I said earlier, this relates to some 200,000
6 out of 75 million taxpayers. If everybody else and even
7 for these individuals, so long as they're in effect not
8 paying any taxes at all, they can buy all the municiple
9 bonds they want without paying any taxes on them.

10 The Chairman. Do you want to vote on it?

11 Senator Long. I'm simply saying that we shouldn't
12 tax the state and municiple bonds directly or indirectly.

13 Senator Bradley. Mr. Chairman, if we have a vote
14 on this, I would ask for a division between individual
15 and corporate.

16 The Chairman. We haven't voted on the corporate.
17 That's still pending. The individual, Senator Long --

18 Senator Long. Just on the individual and I would
19 like to move that we let this known fact not apply to
20 state and local bonds.

21 Senator Bentsen. Let me comment, if I may, Mr. Chairman.
22 I understand Senator Long's concern and I guess this is
23 the first time I will have ever voted to even indirectly
24 tax municiple bonds. But, I think the situation in this
25 country is serious where people really are looking at what

1 they believe to be a very unfair tax system. And, voluntary
2 compliance in this country is terribly important when it
3 comes to paying taxes, and one of the great strengths of
4 our country and yet we see us moving more and more to under-
5 ground income and not just tax avoidance but tax evasion.

6 And, therefore, I think, even though I'm concerned
7 about even an indirect tax on municipale bonds, I think
8 we're looking at an even larger issue and that's the percep-
9 tion of unfairness in the tax system.

10 And, I really don't believe anyone ought to be able
11 to take advantage of enough of these things where they have
12 a very major income and end up paying no tax. So, I think
13 that becomes the overriding issue and that's why for the
14 first time I'm going to vote for tax, even an indirect tax
15 on municipale bonds.

16 The Chairman. Then the Clerk will call the roll on
17 Senator Long's amendment.

18 Senator Danforth. Mr. Chairman, could I inquire --
19 Is this only with respect to the minimum tax?

20 The Chairman. Individual. He would exempt, as I
21 understand it, bonds from the individual minimum tax --
22 interest on tax exempt bonds.

23 The Clerk. Mr. Packwood?

24 Senator Packwood. Nay.

25 The Clerk. Mr. Roth?

1 Senator Roth. Nay.
2 The Clerk. Mr. Danforth?
3 Senator Danforth. Nay.
4 The Clerk. Mr. Chafee?
5 Senator Chafee. Nay.
6 The Clerk. Mr. Heinz?
7 Senator Heinz. Nay.
8 The Clerk. Mr. Wallop.
9 Senator Wallop. Nay.
10 The Clerk. Mr. Durenberger?
11 Senator Durenberger. Yea.
12 The Clerk. Mr. Armstrong?
13 Senator Armstrong. Nay.
14 The Clerk. Mr. Symms?
15 Senator Symms. Nay.
16 The Clerk. Mr. Grassley?
17 Senator Grassley. Nay.
18 The Clerk. Mr. Long?
19 Senator Long. Yea.
20 The Clerk. Mr. Byrd?
21 Senator Byrd. Nay.
22 The Clerk. Mr. Bentsen?
23 Senator Bentsen. Nay.
24 The Clerk. Mr. Matsunaga?
25 Senator Matsunaga. Nay.

1 The Clerk. Mr. Moynihan?

2 Senator Moynihan. Nay.

3 The Clerk. Mr. Baucus?

4 Senator Baucus. No.

5 The Clerk. Mr. Boren?

6 Senator Boren. Nay.

7 The Clerk. Mr. Bradley?

8 Senator Bradley. Nay.

9 The Clerk. Mr. Mitchell?

10 Senator Mitchell. Nay.

11 The Clerk. Mr. Chairman?

12 The Chairman. Nay.

13 The Chairman. On this vote the yeas are 2 and the
14 nays are 18. The amendment is not agreed to. And now,
15 Senator Heinz?

16 Senator Heinz. -- to try and do with this, and I
17 don't know whether we can do it right now or not. I hope
18 we can.

19 We have a problem with the way we have drawn the
20 language here which is this. The way the credit works
21 in the law now, we only allow disadvantaged cooperative
22 education students to take part in the program. That's
23 current law. It wasn't everything that we wanted. It is
24 what we had to accept last year.

25 And, that really hurts the program. Our best policy

1 would be to find a way to allow all economically disadvantaged
2 students, which we do and also to find an affordable way
3 to allow all cooperative education students, disadvantaged
4 or not, to remain in the program.

5 Now, why is it a problem the way we have it now? The
6 reason is that since the program is limited in cooperative
7 education and vocational education only to disadvantaged
8 students, the following happens. The businesses that par-
9 ticipate in the program start saying, well, you're only
10 going to give us disadvantaged kids. The teachers who
11 run the program, the teachers who hold the classes in
12 vocational education or at the high school, they have to
13 pick out the kids. They have to identify the kids that
14 are disadvantaged and that means they have to ask alot of
15 embarrassing questions in front of the class and the kids
16 don't like it either, the students, the ones we want to
17 help.

18 So, what I would propose, and I'm not quite sure
19 whether there's going to be any revenue effect or not,
20 is that for all cooperative vocational education students,
21 we economize on the program by giving them half the wage
22 base and if necessary, rather than giving a 50 percent
23 credit, go down to 40 or even 35 percent credit, which
24 I think, Mr. Chairman, would make it revenue neutral or
25 pretty close to it.

1 The Chairman. Is this -- I should be familiar. Senator
2 Spector was talking about it. Is this a different jobs
3 program?

4 Senator Heinz. What's that?

5 The Chairman. Senator Spector was offering an amend-
6 ment today on another Bill and it is related to some program
7 where you -- This would be different, I guess.

8 Senator Heinz. I don't know what he did, but I'm
9 advised it is not the same.

10 The Chairman. Not the same. Mark?

11 Mr. McConaghy. This -- To bring in all cooperative
12 educational people would be about \$600 million over the
13 three-year period. Senator Heinz is not suggesting that.
14 He's suggesting that we do two things, I think, cut first
15 the wage base in half. Our best judgment on revenue
16 on that would be about .1, .2 rounded and then he's
17 suggesting further that perhaps we could apply some per-
18 centage to it.

19 We don't have that percentage figure at 40 percent,
20 Senator Heinz. We could try to get it.

21 Senator Heinz. That would be pretty close, though,
22 wouldn't you think, Mark?

23 The Chairman. How long would it take? I think we'll
24 be here for a while.

25 Mr. McConaghy. Could we try to get it in maybe ten or

1 fifteen minutes?

2 Senator Heinz. Is there much objection to doing this,
3 Mr. Chairman?

4 Mr. Chapoton. Could I understand -- Would we be
5 reducing the credit for the disadvantaged co-op?

6 Senator Heinz. What's that?

7 Mr. Chapoton. Would we be reducing the credit for
8 the disadvantaged co-op students the credit?

9 Senator Heinz. All co-op students, disadvantaged or
10 not, would be treated the same.

11 Mr. Chapoton. Reduced from present?

12 Senator Heinz. Yes, that's right.

13 Mr. Chapoton. Last year we went through this to try --
14 One of the problems that we had seen in the program earlier
15 was in extending it to co-op students that many who would
16 not fit in the disadvantaged category --

17 Senator Heinz. That is why we are reducing -- Cutting
18 the wage base in half and talking about cutting the credit,
19 the percentage credit, from 50 or say 40 or 35 percent.
20 And, the reason for that is that our experience with the
21 compromise last year hasn't been totally salutary because
22 it causes the business people, it causes the teachers and
23 it causes the students some concern to have to identify
24 who is disadvantaged or not within a group of people
25 sitting in one room.

1 It would be like saying, going around here and trying
2 to figure out which are disadvantaged senators and which
3 aren't.

4 Mr. Chapoton. But in the process we would be cutting
5 the credit available for those who the program was most
6 important?

7 Senator Heinz. No, no, we would retain the eligibility
8 for economically disadvantaged youth. That's part of the
9 program, that's part of current law.

10 Mr. Chapoton. I understand. But, who are we going
11 to take the money away from if we're not going to have
12 any revenue loss there?

13 Senator Heinz. You're taking it away from the
14 economically disadvantaged youth that have been participating
15 in the cooperative vocational education program, which are
16 something above 50 percent of the kids that are participating
17 in the co-op program. That's where that comes from, Bob.

18 Mr. Chapoton. I'd like a little time to look at this,
19 if possible, Mr. Chairman.

20 Senator Heinz. May I suggest that last year the
21 Treasury Department ably represented, as always, I think,
22 in this case by you, Buck, withdrew your objections to
23 the amendment when we cut the wage base in half.

24 Mr. Chapoton. Well, that's right, but we also cut
25 out non-disadvantaged cooperative students and I think we

1 thought that was a very important --

2 Senator Heinz. No, not in the amendment last year.
3 We didn't do that.

4 Mr. Chapoton. Well, we did it at some time, I thought.

5 Senator Heinz. We did that in conference, but not
6 here. That was some magic you were able to work after-the-
7 fact. That's why we have this problem.

8 The Chairman. Let me suggest at this point, I think
9 we're going to have a brief caucus on the Republican side
10 and if we don't come back, that means we didn't get any
11 agreement.

12 But, I would say about 30 minutes from now let's re-
13 convene at 8:45 p.m. and we'll have a chance to discuss
14 this amendment. I don't care, but others are trying to
15 make planes and things -- 9 o'clock? 9 o'clock is fine.

16 But I want to make certain before everybody leaves
17 that any amendment you may have are in the hands of staff
18 so that we can speed up that process.

19 (Thereupon there was a Republican caucus.)

20 (On the record at 10:27 p.m.)

21 The Chairman. If there's no objection, I would like
22 to move to reconsider the vote on withholding on dividends
23 and interest.

24 Senator Long. Mr. Chairman, that's all right with
25 me on one condition, provided at this time the tides go to

1 the defense rather than the offense, vote to reconsider
2 as part of majority vote. With that understanding, it is
3 all right with me.

4 The Chairman. And, that would be coupled with the
5 holding period. For long-term capital gains, it would be
6 reduced to six months.

7 I assume there will be a roll call. Clerk will call
8 the roll.

9 The issue is on withholding.

10 Senator Matsunaga. Is this a vote to reconsider or
11 what is it?

12 The Chairman. We have agreed to reconsider.

13 Senator Matsunaga. Oh, you have agreed to reconsider?

14 The Chairman. Vote on the amendment.

15 Senator Matsunaga. With an amendment to exempt small --

16 The Chairman. Yes, there will be authority given to
17 the Secretary, based I assume, on deposits to exempt small
18 S&L's, small banks, credit unions.

19 Senator Matsunaga. Credit unions and industrial loan
20 companies?

21 The Chairman. Right.

22 The Clerk. Mr. Packwood.

23 Senator Packwood. Yea.

24 The Clerk. Mr. Danforth?

25 Senator Danforth. Yea.

1 The Clerk. Mr. Chafee?
2 Senator Chafee. No.
3 The Clerk. Mr. Heinz?
4 Senator Heinz. Yea.
5 The Clerk. Mr. Wallop?
6 Senator Wallop. Yea.
7 The Clerk. Mr. Durenberger?
8 Senator Durenberger. Yea.
9 The Clerk. Mr. Armstrong?
10 Senator Armstrong. Yea.
11 The Clerk. Mr. Symms?
12 Senator Symms. Yea.
13 The Clerk. Mr. Grassley?
14 Senator Grassley. Yea.
15 The Clerk. Mr. Long?
16 Senator Grassley. Nay.
17 The Clerk. Mr. Byrd?
18 Senator Byrd. Nay.
19 The Clerk. Mr. Bentsen?
20 Senator Bentsen. Nay.
21 The Clerk. Mr. Matsunaga?
22 Senator Matsunaga. Yea.
23 The Clerk. Mr. Moynihan?
24 Senator Moynihan. Nay.
25 The Clerk. Mr. Baucus?

1 Senator Baucus. Nay.

2 The Clerk. Mr. Boren?

3 Senator Boren. Nay.

4 The Clerk. Mr. Bradley?

5 Senator Bradley. Yea.

6 The Clerk. Mr. Mitchell?

7 Senator Mitchell. Nay.

8 The Clerk. Mr. Chairman?

9 The Chairman. Yea.

10 The Chairman. On this vote the yeas are 11 and the
11 nays are 9. The provision is agreed to.

12 The next item is safe harbor leasing.

13 Senator Durenberger. Mr. Chairman?

14 The Chairman. Senator Durenberger?

15 Senator Durenberger. Mr. Chairman, I am going to
16 propose that an alternative to the proposal that was explained
17 to us here a couple of hours ago, -- they indicated to
18 you earlier that I would -- and take a few minutes just to
19 put in perspective what it is we're talking about, the whole
20 issue of the sale of tax benefits and did they originate
21 with safe harbor leasing and the Economic Recovery Tax Act,
22 and so forth, and I guess I never believed they did and I'll
23 endeavor to put my amendment in that kind of perspective.

24 And, I suggest to you that it all started with the
25 investment tax credit about 20 years ago. And, as a result

1 of the presence of the investment tax credit in the market-
2 place we saw a growth in the leasing of tax benefits between
3 companies that couldn't take advantage of the investment
4 tax credit because they were too small to have earned a
5 profit or in some other position where they weren't yet
6 profitable.

7 Treasury moved on several occasions over the last 20
8 years to tighten up on the so-called sale of tax benefits
9 and while they were doing that a curious thing was happening
10 in the economy and I guess particularly, in some of the
11 basic, what I call the infrastructural industries in this
12 country.

13 The ITC has tended over the years to widen the
14 difference between dominant forces and the other forces
15 that are needed for competition in a lot of these intra-
16 structural industries.

17 These were industries, Mr. Chairman, that were impacted
18 adversely, not by economic factors within the industry,
19 not by the normal competition within the industry, but by
20 international competition, by environmental regulation,
21 by energy problems, a whole variety of problems that are
22 not cured by the elements of free enterprise and competition
23 within the industry.

24 We were at the point in the last couple of years where
25 fewer than half of the companies doing business in this

1 country made any profit.

2 Chief among these were the companies and the industries
3 like steel and auto and transportation, mining, forest
4 products, agriculture, all of the key infrastructure
5 industries in this country.

6 And, we approach the Economic Recovery Tax Act, at
7 least in part, with the notion that 10-10-10 and 10-5-3
8 were going to put American Industry back on its feet all
9 by itself.

10 And, from the comments I've heard here today at
11 various times, obviously, just adjusting tax rates and
12 depreciation rates has not put America back on its feet.

13 One of the reasons was that with fewer than half of
14 the companies in this country making any profit, the
15 accelerated depreciation we put into effect was of little
16 value to those companies.

17 I learned the nature of this problem, I guess over
18 the last three years, that the feet of the master, the
19 former Chairman of this Committee and that is the problems
20 of infrastructural industry in this country and what we
21 ought to do about it. And, while we were considering the
22 ERTA, I thought refundable investment tax credits would
23 be just one whale of an idea and thought it would be a
24 great idea to apply them only to a few of these basic
25 industries, but we had a new Administration that thought

1 refundability was welfare and we didn't get anywhere with
2 it and that caused us to take a look at the equity that
3 exists in leasing.

4 And perhaps we took too quick a look at it and didn't
5 do a perfect job. I'm sure we didn't do-- I know we didn't
6 do a perfect job in putting together the so-called safe
7 harbor leasing provisions because as soon as the law went
8 into effect we all got bludgeoned with publicity associated
9 with some part of safe harbor leasing.

10 But in order to illustrate, I guess, the difference
11 between my amendment and the amendment or the proposal
12 that is before us, let's just make it clear that there's
13 about four basic ways to use investment tax credits in
14 this country. One is if you are a company with high earnings
15 and high re-investment, you can take all kinds of advantage
16 of the investment tax credit.

17 If you have high earnings and no need for re-investment,
18 you can go out and find some little company someplace that
19 falls in a category of little or no earnings and a large
20 demand for investment and ends up with alot of unused in-
21 vestment tax credit.

22 And, I guess we've lived through the last three-four
23 years with an awful lot of mergers and acquisitions in
24 this country that were motivated solely by the acquisition
25 of unused investment tax credit.

1 And, as Senator Danforth pointed out earlier tonight,
2 that wasn't good for the economy. It didn't generate any
3 new jobs. It created alot of acquisition of companies and
4 alot of firing of employees in connection with the acquisition.
5 That's not a very good solution.

6 Leverage leasing, to a degree, has been available under
7 Rev. Proc. 7521 to some companies in this country and within
8 those companies to some purposes, companies with low earnings
9 and high investment demand and excess investment tax credits
10 could engage under certain circumstances under leverage
11 leasing.

12 But, the market power, because of the structure of
13 Rev. Proc. 7521, the market power was all with the leasing
14 company. They had the money, they had all of the leverage
15 and as a result something in the neighborhood by all the
16 studies we've seen, something in the neighborhood of 60
17 percent of the investment tax credits ended up with the
18 lessors and somewhere in the neighborhood of 40 percent
19 ended up with the company that was motivated to buy the
20 equipment or build the plant and create jobs and opportunities
21 for America.

22 But safe harbor has brought to the country, -- and
23 I am not going to read, as I had planned to, some of the
24 editorials that have run all around this country on this
25 subject.

1 Safe harbor leasing has brought jobs. It has brought
2 investment. It has brought opportunities to small businesses,
3 to new businesses. I wish I had my Allis Chalmers brochure
4 here so I could show you the difference to the farmers of
5 America and the difference between leverage leasing and
6 safe harbor leasing for these kinds of companies that I've
7 just described.

8 So, we are living now with the tar brush that we
9 got from some parts of that legislation that was passed
10 last year and that tar brush has covered an awful lot of
11 businesses, an awful lot of jobs, and an awful lot of
12 people and opportunities all over this country because
13 it, in effect, has given "safe harbor leasing" some kind
14 of a bad name and everybody around this table has been
15 dealing with that problem ever since the window opened up
16 last October 1st or 31st, whenever, or October 1st and
17 closed November 18th and alot of people crawled through
18 it.

19 Now, I'm going to go through my amendment and try to
20 show you why I think that in the name of fairness, in
21 the name of equity, in the name of the one thing in ERTA
22 that so far has really created some investment in this
23 company, that changes in the existing leasing legislation
24 will take care of the abuses, will limit, perhaps, in some
25 cases more than I feel we ought to limit the benefits of

1 safe harbor leasing, but I feel very strongly that if we
2 adopt these recommendations we're going to save a pile of
3 money by doing it. But by doing it, I hope for the period
4 of time in which we need this particular form of leasing
5 of tax benefits to turn this country around that it is
6 going to be available to us.

7 Now, the first of the -- Some of these amendments are
8 contained in both of the Bills before us or my amendment
9 and the proposal before us and others are somewhat different.

10 The first problem that we faced was that some lessors,
11 most notably General Electric, and I use them only because
12 they've been made famous by it, have virtually eliminated
13 their tax liability through heavy involvement in the leasing
14 market.

15 We propose to limit the amount of tax liability that
16 any lessor may negate through leasing transactions to 50
17 percent of the tax liability. Secondly, some lessors,
18 again most notably General Electric, acquired tax benefits
19 and carried them back to prior years, forcing tax refunds.
20 That was a famous one.

21 My amendment prevents any lessor from applying benefits
22 to any prior tax year.

23 The third provision is that a few companies, most
24 notably Occidental Petroleum used excess foreign tax credits
25 to automatically shelter their income from safe harbor leasing.

1 This amendment contains the provisions in the proposal
2 before us which would make companies in that, the Occidental
3 position, ineligible for safe harbor leasing.

4 Some leases included unreasonably high rates of interest
5 in lessee/lessor financing. And, in effect, what that did
6 was to create unreasonably high interest deductions for the
7 parties involved, again at our expense.

8 And, in this case right now, the law provides for a
9 rate 3 percent above the Treasury rate. I propose to go
10 5 percent below the Treasury rate.

11 Next, some companies use the so-called window provision
12 of the law to sell old tax benefits costing the Treasury
13 money without producing any new investment. In case anybody
14 thinks we're going to open the window again, that's the
15 one that closed on November 18th, 1981. This provides that
16 the window will stay closed.

17 Next is the term of the lease. Under the current
18 law, the term of the lease is determined at 150 percent
19 of ADR. We're proposing 100 percent of ADR.

20 Next and very important matter and the one I found
21 most hard to come to grips with given the dollar figures
22 that we're faced with here is the lessee cap. This is
23 the one that's presently -- There is no cap on the amount
24 of investment that the lessee can put into safe harbor
25 leasing.

1 My proposal is in the 1982 that that cap be 45 percent,
2 in 1983 45 percent, in 1984, 40 percent and in 1985, 40
3 percent.

4 The Bill also has a sunset provision. At the end of
5 1985 -- Or is it just three years?

6 Mr. Chapoton. Three years.

7 Senator Durenberger. It's a three-year sunset, right?
8 It's a three-year sunset and that's because of the need to
9 continually review and re-evaluate this whole business of
10 tax expenditures.

11 On the amount of depreciation available to the lessors,
12 on five year property that will be eight years -- excuse me --
13 that's correct, five year property is eight years. Three
14 year property is five years.

15 Let's see. I think I have the language regarding
16 mass transit that is comparable to the language in the
17 Bill before us.

18 Mark, have I missed anything?

19 Mr. McConaghy. No, I think you've covered it all,
20 Senator Durenberger. The depreciation lives, would go to,
21 in effect, the minimum tax so that the five year goes to
22 eight years, straight line and the three year goes to five
23 years, straight line.

24 The anti-abuse rules, I think, would apply effective
25 the February 19th date, but everything else would apply

1 generally July 1st, 1982, just like your provision is
2 written up.

3 Starting in January 1st, 1985, there would be a change
4 to the existing REVPROC leasing and that would be to permit
5 the fixed price purchase option at no less than 10 percent
6 of the original cost of the property.

7 The Chairman. Are there provisions marked in this
8 proposal that would, in effect, prevent states and munici-
9 palities and nonprofits that are going to go into the
10 profit side, co-ops and others are all jumping into this
11 program.

12 Mr. McConaghy. I think, Mr. Chairman, we would like
13 authority to look at those kinds of cases that are trying
14 to go taxable and therefore be able to use wash sale leases
15 to prevent that from happening, so we would like that to
16 be part of it.

17 Mr. Chairman. Do you have any objection to that?

18 Do you want to speak on this? Senator Baucus?

19 Senator Baucus. I appreciate what the Senator from
20 Minnesota is trying to do here. In all candor, I think
21 that it is moving in the wrong direction.

22 It is clear to me that the vast majority of the
23 American people, when asked their views on safe harbor
24 leasing want a repeal of safe harbor outright.

25 Chairman, I frankly think that the right, out of

1 faith, judgment, common sense, the American people, -- I
2 think we should repeal it. I'm not going to take the time
3 of the Committee tonight.

4 Lots of reasons come to my mind. One, as stated by
5 the Chairman, we're trying to broaden the base, to not enact
6 more credit exemptions deductions.

7 When this measure was passed a short time ago, I don't
8 think this many focused on safe harbor at all, -- very
9 quickly, very easily and this now is the first opportunity
10 we have to decide whether we want to broaden the base or
11 whether we want to narrow the base.

12 I suggest that the spirit of reform, which has proven
13 generally that -- that the base be broadened -- whether
14 we want to stop safe harbor or not and I suggest that we
15 not adopt it, repeal it.

16 It's an inefficient mechanism on its refundability
17 in disguise. 75 percent of the benefits go to the lessee.
18 That's about 100 percent. Refundability would give a full
19 100 percent to the lessee. Also, it doesn't distinguish
20 between good management and bad management.

21 If you're a good manager and you're an unprofitable
22 company, you still are part of the benefits -- if you're
23 a good manager starting up, you're new, you are too. But
24 it's very inefficient mechanism.

25 And, I suggest that we don't go the direction -- but

1 repeal it.

2 In fact, Mr. Chairman, I offer a -- motion -- amendment
3 that appeals safe harbor leasing outright, go back to the
4 leasing provisions we had before we enacted the tax --

5 Senator Armstrong. Mr. Chairman.

6 Mr. Chairman. Senator Armstrong?

7 Senator Armstrong. Well, Mr. Chairman, as usual,
8 Senator Baucus is just one jump ahead of me because I
9 was ready to offer exactly the same motion, Max, and for
10 exactly the same reason.

11 My judgment, this whole safe harbor leasing operation
12 is a ripoff of gigantic magnitude and I'm one of those
13 who opposed the bail-out of Chrysler. I opposed the bail-
14 out of Lockheed. I opposed the bail-out of New York City
15 and yet what we're doing in safe harbor leasing makes
16 those bail-out operations look like child's play by comparison.

17 Now, I appreciate what Senator Durenberger has said
18 and I think there is -- Well, I frankly think what he is
19 proposing is a substantial improvement over where we are
20 in the present law, but it doesn't really justify, in my
21 opinion, continuing it under any circumstances. I think
22 Senator Baucus is correct. We did not focus on this issue
23 a year ago.

24 The results, I think, came as a great surprise, not
25 only to the people around the country, but to most members

1 of this Committee. Actually, I'll tell you that the actual
2 way this has worked out was a great surprise for the Senator
3 from Colorado and there's just every reason for us not to
4 let this continue.

5 I'm not going to take very long to raise these issues,
6 Mr. Chairman, because I think it's pretty clear that the
7 votes have been worked out and as somebody said earlier
8 in the evening, a deal is part of the deal, if you're part
9 of the deal. I just want to make it clear I'm not part
10 of that deal and I hope there will be a few members of this
11 Committee that will join me in voting with Senator Baucus
12 and I hope we prevail, but if, as I suspect, perhaps we
13 don't have enough votes, I hope there will be some interest
14 in carrying this issue to the floor.

15 I don't want to take alot of time, but I do want to
16 take off three or four very specific reasons. First, are
17 the abuses. Now, these have been passed over, in a sense,
18 as sort of technical things that just sort of unforeseen
19 developments in the law, but we're talking about astronomical
20 amounts of money where huge firms with very large profits
21 have totally escaped paying taxes or have reduced their tax
22 liability to an extent which is simply not justified on any
23 equitable basis.

24 I'm talking about GE. I'm talking about Standard.
25 I'm talking about Occidental. I'm talking about other
examples that are well-known to members of the committee.

1 Senator Armstrong. Notion subsidizes unprofitable
2 investments. It literally skews the whole financial system
3 so that productive capital is directed into less productive
4 investments rather than more productive investments.

5 Somebody says that safe harbor leasing are a form of
6 corporate welfare like food stamps. In my opinion, it's even
7 worse than that because what we are doing is encouraging on
8 a huge scale the misallocation of resources into enterprises
9 that would otherwise not attract these financial resources.

10 This leasing concept, and I am troubled even by the term
11 "leasing." We're not really talking about leasing anything.
12 What we're talking about is nothing but just transferring tax
13 credits around to the advantage of everybody except other tax-
14 payers. And most taxpayers, most individuals, and even a lot
15 of small companies have no way in the world to participate in
16 this great raffle of tax credits that is going on around this
17 country. It is as a practical matter almost always is going
18 to be the big guys. Well, I have nothing against the big
19 guys. I'm for them.

20 But when they have an option like this that is simply
21 not available to small businessmen or to individuals as a
22 practical matter, I think it raises a question of whether or
23 not it's a good tax policy.

24 It brings me to the third point I want to raise which
25 is that the whole notion of safe harbor leasing distorts the

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1 neutrality of our tax laws and it contributes to this idea which
2 has been so widely discussed in the last several days, both in
3 public and private, which was pointed out by the senator from
4 Texas earlier, that there is a perception that the tax laws are
5 not fair. I don't think that that's an unfounded perception,
6 Lloyd. I think that there is a substantial element of un-
7 fairness in our tax code arising in a large part not from
8 deliberate intent but because of the very complexity of our tax
9 laws. We get the thing so complicated the only people who can
10 make the system work are those who can afford to hire a
11 battalion of lawyers to work the thing out for them.

12 Again, that means the big guys. It doesn't even include
13 the similarly situated small concerns or individuals who
14 simply don't have access to the high-powered legal talent
15 or have the time or dedication to do it.

16 Finally, and I just note this in passing that this whole
17 notion skews the tax system toward investment in assets that
18 are depreciable rather than other kinds of assets, particular-
19 ly the investment in people, in know-how and patents and
20 that kind of thing.

21 Now, Mr. Chairman, I hope we'll adopt the motion which
22 Senator Baucus has offered. If for any reason it is not
23 adopted by the committee, I will put an extensive report on
24 this matter and detail my thoughts in somewhat greater length
25 in my views that will accompany the committee report to

1 the floor.

2 The Chairman. Thank you, Senator Armstrong. Senator
3 Byrd?

4 Senator Byrd. Could I ask Senator Durenberg how do
5 your proposal -- how does it change the figures in the current
6 proposal before us?

7 Senator Durenberger. I'll ask Mark to respond to that.

8 Mr. McConaghy. I think, Senator Byrd, that over a
9 three year period it would pick up revenue of approximately
10 7.6 billion.

11 Senator Byrd. Senator Durenberger's would.

12 Mr. McConaghy. That's correct, Senator Byrd.

13 The Chairman. As opposed to 7.3.

14 Senator Byrd. Well, now, in the first year the
15 figures we have before us in this original proposal is
16 1.3 for the first year. Now, what is Senator Durenberger's
17 for the first year?

18 Mr. McConaghy. The estimates that we hve are 1.4
19 billion, Senator Byrd, in that year; 2.6 in the next
20 year; and 3.6 in the following year.

21 Senator Byrd. It picks up more than the original
22 proposal does?

23 Mr. McConaghy. \$300 million, yes.

24 Senator Byrd. Thank you.

25 Senator Armstrong. We also have on the table since we

1 have the amount of the proposal in our work sheet, and also
2 the amount to be contributed by the Durenberger proposal,
3 could we also have the number that would be applicable to
4 the Baucus motion?

5 The Chairman. About 15.4.

6 Mr. McConaghy. 15.4 would be the repeal. The 15.4
7 would break down to the 3.2 for Fiscal 1983; 5.2 for
8 Fiscal 1974, and 7.0 for Fiscal 1985, Senator Baucus.

9 Senator Matsunaga. Mr. Chairman?

10 The Chairman. Senator Matsunaga?

11 Senator Matsunaga. May I put a question to Senator
12 Baucus? Would you propose the repeal of ACRS?

13 Senator Baucus. Well, no. I would modify it according
14 to the way we have thus far. So that we keep ACRS only
15 as --

16 Senator Matsunaga. And Senator Armstrong, would you
17 propose the repeal of ACRS?

18 Senator Armstrong. I'm sorry. I was distracted, and
19 I didn't hear what the --

20 Senator Matsunaga. Would you propose the repeal of
21 ACRS, accelerated cost recoveries?

22 Senator Armstrong. Could I just take on one windmill
23 at a time, Senator?

24 Senator Matsunaga. Well, my reason for asking is that
25 your proposal would be inconsistent if you did not call for

1 a repeal of ACRS because leasing was provided to permit those
2 companies which could not take advantage of ACRS to have
3 the benefit of ACRS. Without the leasing provisions, they
4 could not possibly take advantage of ACRS provisions.

5 And the abuse that came about, frankly I think was
6 overplayed by the press, and the proposal now made by
7 the Senator from Minnesota, Mr. Durenberger, I think just
8 shuts off those abuses and with those abuses being now
9 denied, I think the ACRS and leasing provisions as
10 originally intended can be put into effect so I support
11 the Durenberger proposal.

12 Senator Armstrong. If I may respond to your inquiry
13 just briefly. Let me ask if you had seen the chart that
14 was prepared by the staff of the Senate Finance Committee
15 which addresses itself, I think, to the concern that you
16 have just raised.

17 Now, the issue of fairness, and the level playing
18 field being profitable and unprofitable companies is a
19 matter that is subject to some judgment. But the fact
20 of the matter is that any company which is unprofitable,
21 in a sense, at the margin -- at the margin of any
22 operation, at the margin of any investment, enjoys an
23 advantage over any profitable company, and the reason is
24 simply that on their marginal operation, at the next
25 increment of income they pay no income tax as compared

1 with any profitable company which has to factor that in when
2 they consider investing in new operations, and so while
3 I understand what you are saying, my review of it does not
4 support your conclusion that you have to be for repealing
5 ACRS if you are in favor of repealing safe harbor leasing.

6 Now, it so happens, I would say to the Senator, that
7 there are some aspects of the ACRS that also trouble me al-
8 though I do not favor its repeal, but win, lose, or draw
9 in this amendment, I have another amendment that addresses
10 itself at least on the tangent to the question that you
11 are raising, and we will get to it presently.

12 But in the meantime, I had hoped that you would re-
13 consider and vote with Max and me on this.

14 Senator Long. Mr. Chairman. I want to ask a question.
15 And perhaps the staff and Treasury can help me with this.
16 Does this amendment put any cap on the leverage leasing
17 that was in effect before safe harbor?

18 Mr. McConaghy. No, it does not, Senator Long.

19 Senator Long. So the caps are only on the safe harbor
20 part of the --

21 Mr. McConaghy. That's correct. On the wash sale
22 leases or safe harbor leases.

23 Senator Long. I just want to say this. State my
24 view on the matter briefly, but for many years we have
25 had tax subsidies. We have had certain subsidies where we

1 appropriate the money. We've had it in the budget --
2 we've had tax subsidies. And many cases, those have been
3 the proud achievements of administrations. In the Eisenhower
4 Administration it was accelerating depreciation. Senator
5 Kennedy became president. He wanted to get rid of
6 accelerated depreciation, and go instead with the investment
7 tax credit.

8 The Democratic administration goes out, a Republican
9 administration comes in, they say give us both -- give us
10 accelerated depreciation and give us the investment tax
11 credit. Both of them are tax subsidies.

12 And those are the only tax subsidies. We've subsidized
13 conduct that we think is good for the company or good for
14 people, whatever, and it seems to me that for us repeal
15 safe harbor, and to take away leverage leasing amounts to
16 levying a very heavy tax on major industries, many of which
17 are having a very difficult time making it at this moment.

18 Now, just take one. There is no payroll in Louisiana,
19 but I'm interested in the principle. It would cost us
20 billions upon billions of dollars for Chrysler Corporation
21 to go bankrupt or to go belly-up. And that is just one
22 them. There are others that are involved.

23 Now, when you engage in conduct of subsidizing an
24 activity -- be it with the -- whether you do it with
25 appropriations or whether you are doing it with tax code,

1 it is contrary to any principle of government subsidy that
2 you deny the subsidy to those who need it the most. And
3 I really think that we ought to save as much of it as we
4 can.

5 Now, my position on that is very clear. I don't expect
6 to change any minds, but I just want to make my position
7 clear for the record that I am going to vote for the
8 Durenberger Amendment because that is the best we have
9 available to us at this moment. Personally, as far as I'm
10 concerned, I would leave the safe harbor the way it was.
11 But nearest I have a chance to vote for that would be Mr.
12 Durenberger's Amendment so I vote for that.

13 Senator Boren. Mr. Chairman?

14 The Chairman. Senator Boren.

15 Senator Boren. What percentage of the benefit that
16 is now being reaped by the company which is profitable which
17 is purchasing the tax benefit, in essence? Will they still
18 be able to read? In other words, if the company -- let us
19 say in a certain transaction that the company which is
20 a healthy company is obtaining, let us say, 30 percent of
21 the advantage, tax advantage of a certain proposition.
22 What will they be able to gain under the proposition?

23 What limitations will there be under your proposal?

24 Senator Durenberger. Well, first on the basic issue
25 of what happens to the tax benefit in a lease arrangement,

1 all I've got to go on is some studies that have been made
2 in some -- you know -- a thousand reports that have come to
3 me from individual companies that have been involved in
4 either leverage leasing under the old rules or under safe
5 harbor leasing.

6 Under the current leverage leasing rule, somewhere in
7 the neighborhood of 40 to 55 percent of the tax benefits
8 in a leverage leasing transaction flow through to the leasee,
9 the company making the investment.

10 All the rest stays either with the lessor, with lawyers,
11 with accountants, with lease arrangement that would, you
12 know, make a stack of agreements two feet high, but the
13 person that makes the investment is 40 to 45. Studies the
14 Treasury has made that I have seen -- the study that
15 Arthur Anderson and Company has made that I've seen and
16 also what I've heard from those who are involved in the
17 process say that currently or with the experience that
18 we've had with safe harbor leasing, 84 percent of the
19 benefits go to the leasee, 16 percent stay with the lessor.

20 Senator Boren. Let's take the example of the
21 Occidental case which has been mentioned. How would that
22 be handled differently under your proposal?

23 Senator Durenberger. It couldn't be handled at all.
24 They just don't qualify for safe harbor leasing.

25 Senator Boren. Under your proposal?

1 Senator Durenberger. Right.

2 The Chairman. Senator Moynihan?

3 Senator Moynihan. Mr. Chairman, since we seem to be
4 discussing both propositions, I wonder if I could ask --

5 The Chairman. I think the Durenberger is a substitute
6 for the provision on this sheet. Is that correct?

7 Senator Moynihan. Yes. If I could ask the Senator
8 Durenberger -- the tactical provision of the law having
9 nothing to do with safe harbor leasing which prohibits
10 closely held companies from taking part in it, and I
11 believe the Treasury is of the view that that was never
12 intended, and I wonder if you would accept as part of your
13 proposal the view that closely held companies would be
14 eligible under the same rules that other corporations
15 would be held?

16 I believe the Treasury is of the view that this
17 appropriate.

18 Senator Durenberger. That's true. Perhaps I ought
19 to buck --

20 Mr. Chapoton. We did not oppose that.

21 The Chairman. How do you define a closely held --

22 Mr. Chapoton. The present rules define closely held
23 and deny the right to be leasor of closely held businesses.

24 Mr. McConaghy. Mr. Chairman, I think we really have
25 to look at the revenue on that. That change would make

1 professional corporations and all others come in and be
2 able to use safe harbor leasing.

3 Senator Moynihan. The proposal is to keep professional
4 corporations and such like out but be strictly to the --

5 The Chairman. We better --

6 Senator Moynihan. How would you like to do that, Mr.
7 Chairman. I would be happy, of course, to have the revenue.
8 Do you want to look at it and see when you --

9 The Chairman. Maybe we better look at the revenue.

10 Senator Moynihan. If the revenue is negligible, could
11 you accept the idea?

12 The Chairman. I could, if it's negligible, but it --
13 do you have any estimate, Mark? Do you need some time?

14 Mr. McConaghy. We think it may be three or 400 million
15 over a three year period, Mr. Chairman.

16 Senator Durenberger. Not anxious -- unless we can
17 draft something that is better --

18 Senator Moynihan. Can we undertake to see if we can
19 draft something very tight.

20 The Chairman. You might work it out with the dividend
21 reinvestment which was lost by one vote.

22 Senator Durenberger. But if we can get it down to
23 100 million or so --

24 Senator Bradley. Mr. Chairman, one question of
25 Senator Durenberger, just as a point of clarification.

1
2 Your 50 percent cap, as I understand it, applies only to
3 tax benefit transfer leasing. It does not apply to
4 traditional leasing. Is that correct?

5 Senator Durenberger. That's correct.

6 The Chairman. Excuse me, Mark.

7 Mr. McConaghy. Mr. Chairman, I think there were two
8 other items I didn't hear if they were mentioned. One was
9 regulated utilities would not be eligible for this, and the
10 second was that lessors that acquire the investment tax
11 credit would not be able to claim more than 50 percent of that
12 credit in the first year; 25 percent in the second, and
13 then 25 percent in the third year.

14 The Chairman. As I understand it, the public transit
15 would use the feature which was in the original proposal.

16 Senator Durenberger. That's my proposal.

17 The Chairman. That's a lower percentage.

18 Mr. McConaghy. That would be the mass transit language
19 in the committee amendment as well as the same antiabuse
20 depletion and foreign tax credit language as was in the
21 committee.

22 The Chairman. And you will try to include others
23 that we mentioned?

24 Mr. McConaghy. Yes, as to exempts that are trying to --

25 The Chairman. I think we can probably vote on the
Baucus Amendment. If it fails, then the vote will recur

1 on the substitute.

2 Senator Baucus. Mr. Chairman, I think that is a good
3 idea. Before we do vote, I would like to respond briefly
4 to a point raised by Senator Matsunaga. It is true that
5 unprofitable companies can not afford the ACRS, but it
6 is my understanding that part of ERTA was the provision
7 that companies were allowed to carry forward losses 15
8 years. A company starting up hasn't lost 15 years.
9 Ultimately it seems to me that if a company cannot get
10 15 years, there is something wrong with that somehow.
11 So I suggest there are other ways for start up companies
12 or companies that find themselves -- circumstances beyond
13 their control to get into a profitable situation even if
14 the repeal of safe harbor.

15 The Chairman. Can I just say before the vote, this,
16 of course, has been a matter of great controversy, and
17 on February 19 of this year I indicated in a statement in
18 Wichita, Kansas that it should be modified or repealed, and
19 I think had a vote been taken on February 19, it would have
20 been flat out repealed with a very few votes against
21 repeal.

22 I supported safe harbor leasing for reasons -- I guess
23 maybe we didn't discuss it fully enough last year, but we
24 did indicate in the debate on the economic recovery tax
25 act, I think in response to a question that if we, in fact,

1 we found provisions in this massive, \$750 billion tax
2 proposal that we're perceived to be too generous or were
3 too generous, we would go back and take a look.

4 And that, I think, is the responsibility we have as
5 a committee. I believe that Senator Durenberger's compromise
6 is good. It doesn't do quite what I do as far as economic
7 substance. I know there has been some disagreement within
8 the administration on how we should proceed. I think many
9 hold the view that maybe it shouldn't be touched at all.

10 But Senator Durenberger's compromise -- it does achieve
11 the revenue target by reducing the revenue lost from roughly
12 in half. In fact, maybe a bit more. It will, as I under-
13 stand, at least Senator Durenberger's intention -- I hope
14 it's so drafted to prevent any additional abuses -- the
15 kind we've read so much about it.

16 There is no doubt in my mind that that in itself is
17 why so many people perceive this to be an absolute farce
18 as far as a program is concerned. It will restrict the
19 volume of tax leasing, and I think that's an important
20 step, and it will also liberalize the prior law leasing
21 be allowing fixed price purchase options beginning in 1985.

22 And I think that is something that should be done.
23 In fact, we would have done it in '83 and '84 except for
24 the large revenue loss. And I think also it will make
25 leverage leasing which requires economic substance more

1 efficient, fair, and available to a broad range of users.
2 Now, I certainly share the views expressed by both
3 Senator Baucus and Senator Armstrong, but I also believe
4 tht there is some merit to the program. I hope that, if
5 in fact, we don't achieve what Senator Durenberger hopes
6 to achieve and what the rest of us hope to achieve with
7 this substitute, that obviously we are going to take another
8 look at the program.

9 I think that's a responsibility we have, and I wanted
10 to make certain that Treasury has looked closely at the
11 compromise and shares our view that we have an obligation
12 to the general taxpayer in this country to continue to
13 monitor this program, if we adopt this substitute to make
14 certain that there are no more abuses that we have heard
15 so much about.

16 Mr. Chapoton. That's correct, Mr. Chairman. In
17 addition, the forms that are required on leasing will continue
18 to come in -- on leases that are done-- safe harbor leases
19 that are done, and we will be able to continue to monitor
20 the program.

21 The Chairman. And as far as the public transit is
22 concerned, I'm not certain that will withstand a full
23 court press on the Senate floor. But it is a part of this
24 package.

25 Senator Wallop. Mr. Chairman, the only thing that I

1 would say is while you are focusing on the abuses, and
2 obviously, that is what was in the papers and so it should
3 have been, and I think it's unfair to let it go that it
4 did nothing of benefit to the country. Because plainly
5 a lot of tractors were built that wouldn't have been built.

6 Airplanes were built that wouldn't have been built.
7 Airplanes flew that wouldn't have been flown. Buses and a
8 lot of other things were a measure of success of what we
9 tried to do was to not provide tax benefits only for those
10 companies that were so profitable that didn't need it in
11 an unprofitable time.

12 And our whole effort in there was to make it possible
13 for the marginal company to continue to survive during that
14 time. We did that. We did provide a lot of abuse, and that
15 was an accident, but I think these amendments that are
16 offered by Senator Durenberger are clearly intended to
17 address that, and I would hate to think that all the public
18 in this room or anywhere else thought that only abuse came
19 out of that program because it did not. Much good came
20 from it.

21 The Chairman. I think this probably ran a close
22 second to the publicity on the members' tax deductions.

23 Senator Armstrong. Mr. Chairman, may I make one final
24 observation. We've talked a lot about abuse and as I
25 reflect upon my earlier remarks, I think that there is one

1 aspect of it that I want to clarify. I think that the tax
2 system which we are seeking to amend here, and which
3 Senator Baucus and I, the specific provision we want to
4 repeal is abusive.

5 I just want to be clear that I don't fault anybody
6 who has taken the full advantage of it. That is the specific
7 companies that have used the law that we passed. I do not
8 think deserve to be criticized. In fact, on the contrary,
9 I would assume that companies that had this legal option
10 before them that their directors and executives really
11 have no choice but to make the best of a situation, and
12 obviously, we are all required to comply with laws that
13 are to our disadvantage.

14 And I just wanted to before we vote on this make it
15 clear that my criticism is directed toward the legislation,
16 the practice, and the economic consequences not to any
17 particular person who may have taken advantage of this
18 Act.

19 Senator Bentsen. Mr. Chairman, if I might just make
20 one very short comment. Last year I was the only senator
21 who had an amendment to knowck out safe harbor leasing
22 because I was concerned about the perception and what would
23 develop. And I was not supportive of Senator Durenberger's
24 amendment as he originally brought it about. But I think
25 he's addressed himself to most of my concerns about the

1 problems of perception and put an end to the kind of
2 examples of General Electric and Occidental, and therefore,
3 I will support the amendment.
4

5 The Chairman. I would just say we have not adopted
6 the closely held amendment. The vote will occur -- you
7 want a roll call, Senator Baucus, on the Baucus Amendment
8 which is what -- to repeal leasing. The clerk will call
9 the roll.

10 Mr. Lighthizer. Mr. Packwood?

11 Senator Packwood. No.

12 Mr. Lighthizer. Mr. Roth?

13 Senator Roth. Aye.

14 Mr. Lighthizer. Mr. Danforth?

15 Senator Danforth. No.

16 Mr. Lighthizer. Mr. Chafee?

17 Senator Chafee. No.

18 Mr. Lighthizer. Mr. Heinz?

19 Senator Heinz. No.

20 Mr. Lighthizer. Mr. Wallop?

21 Senator Wallop. No.

22 Mr. Lighthizer. Mr. Durenberger?

23 Senator Durenberger. No.

24 Mr. Lighthizer. Mr. Armstrong?

25 Senator Armstrong. Aye.

Mr. Lighthizer. Mr. Symms?

1 Senator Symms. No.

2 Mr. Lighthizer. Mr. Grassley?

3 Senator Grassley. No.

4 Mr. Lighthizer. Mr. Long?

5 Senator Long. No.

6 Mr. Lighthizer. Mr. Byrd?

7 Senator Byrd. Aye.

8 Mr. Lighthizer. Mr. Bentsen?

9 Senator Bentsen. No.

10 Mr. Lighthizer. Mr. Matsunaga?

11 Senator Matsunaga. No.

12 Mr. Lighthizer. Mr. Moynihan?

13 Senator Moynihan. No.

14 Mr. Lighthizer. Mr. Baucus?

15 Senator Baucus. Aye.

16 Mr. Lighthizer. Mr. Boren?

17 Senator Boren. Aye.

18 Mr. Lighthizer. Mr. Bradley?

19 Senator Bradley. No.

20 Mr. Lighthizer. Mr. Mitchell?

21 Senator Mitchell. No.

22 Mr. Lighthizer. Mr. Chairman?

23 The Chairman. No. On this vote, the nays are

24 15. The ayes are five. And the vote will recur on

25 the Durenberger Amendment. Oh, excuse me. Senator from

1 Missouri.

2
3 Senator Danforth. Mr. Chairman, last summer while the
4 tax bill was on the floor of the Senate, the question arose
5 as to whether or not investment tax credit strip out
6 transactions would qualify for safe harbor leasing.

7 I believe the question was raised by the Treasury Department
8 and at their behest, you and I entered into a colloquy
9 on the floor of the Senate to make clear that such strip
10 out transactions did qualify for safe harbor leasing
11 transaction treatment.

12 Subsequently, in October the Treasury Department issued
13 proposed regulations leaving open the question as to the
14 treatment of these strip out transactions. And during that
15 interim period between the enactment of the statute and
16 the issuance of the proposed regulations, at least one company
17 entered into such a transaction in reliance of the colloquy.

18 And therefore, it would be my hope that either in the
19 bill itself or by committee language or whatever is necessary
20 we could make it clear that any company that would enter
21 -- that did enter into such a transaction relying on the
22 colloquy could qualify provided this occurred prior to the
23 issuance of the proposed regulation.

24 The Chairman. I might say to the Senator that I remember
25 that colloquy, and I've been reminded by the Senator from
Missouri, and I understand the treasury is not in complete

1 accord with --

2 Mr. Chapoton. No, that is correct, Mr. Chairman. The
3 -- we addressed that issue as quickly as we could, all the
4 issues involved in leasing. We determined that the law did
5 not permit the so-called ITC strip inspite of the colloquy
6 which indicated that it would.

7 We think that any company that acted during that interim
8 certainly knew there was a significant possibility that its
9 transaction would not qualify, and therefore, we see no rea-
10 son for treating transactions prior to the date of the
11 recollections any different than those after the date of
12 the regulation.

13 The Chairman. What is the revenue estimate on this,
14 Mark?

15 Mr. McConaghy. It was an agreement that was entered
16 into between two companies. The agreement covered, I think,
17 \$160 million worth of depreciable personal property during
18 that time period. It is about 25 to 30 million in tax that
19 would be involved. The revenue loss of that allowing that
20 would be about 25 to 30 million.

21 The Chairman. Is there any further discussion of this
22 amendment? All in favor of the amendment say aye.

23 (Chorus of ayes.)

24 The Chairman. Opposed no? Amendment is agreed to.
25 Now, the vote will recur on the substitute as amended.

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Mr. Lighthizer. Mr. Packwood?

Senator Packwood. Aye.

Mr. Lighthizer. Mr. Roth?

Senator Roth. Aye.

Mr. Lighthizer. Mr. Danforth?

Senator Danforth. Aye.

Mr. Lighthizer. Mr. Chafee.

Senator Chafee. Aye.

Mr. Lighthizer. Mr. Heinz?

Senator Heinz. Aye.

Mr. Lighthizer. Mr. Wallop?

Senator Wallop. Aye.

Mr. Lighthizer. Mr. Durenberger?

Senator Durenberger. Aye.

Mr. Lighthizer. Mr. Armstrong?

Senator Armstrong. Aye.

Mr. Lighthizer. Mr. Symms?

Senator Symms. Aye.

Mr. Lighthizer. Mr. Grassley?

Senator Grassley. Aye.

Mr. Lighthizer. Mr. Long?

Senator Long. Aye.

Mr. Lighthizer. Mr. Byrd?

Senator Byrd. Aye.

Mr. Lighthizer. Mr. Bentsen?

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Senator Bentsen. Aye.

Mr. Lighthizer. Mr. Matsunaga?

Senator Matsunaga. Aye.

Mr. Lighthizer. Mr. Moynihan?

Senator Moynihan. Aye.

Mr. Lighthizer. Mr. Baucus?

Senator Baucus. Aye.

Mr. Lighthizer. Mr. Boren?

Senator Boren. Aye.

Mr. Lighthizer. Mr. Bradley?

Senator Bradley. Aye.

Mr. Lighthizer. Mr. Mitchell?

Senator Mitchell. Aye.

Mr. Lighthizer. Mr. Chairman?

The Chairman. Aye. On this vote, the yeas are 20,
and nays are zero. Leasing lives. Could we finish IDB's?
I think --

Senator Heinz. Mr. Chairman, I have one thing I
would like to bring up on this.

The Chairman. On leasing?

Senator Heinz. Yes. Which is this. We had some
hearings in this committee about two weeks ago regarding
the public policy implications of the use of safe harbor
leasing by mass transit authorities when such mass transit
authorities were engaged in benefiting from subsidized

1 export credit arrangement. In fact, credit terms below
2 the internationally agreed arrangement that governs the
3 export subsidies and credits that exist between countries.
4 I think that we developed a pretty clear record at that
5 hearing.

Q 6 That while nobody who was engaged in purchasing mass
7 transit cars or using a foreign subsidized export credit.
8 For example, was doing anything wrong in the sense that they
9 were disobeying the law that this was very inappropriate
10 public policy. So what I would like to propose, Mr. Chairman,
11 is that we adopt an amendment which -- wherein the Secretary
12 of the Treasury be empowered to deny the safe harbor --
13 I don't know what the matter with the microphone is --
14 where the Secretary of the Treasury be empowered to deny
15 the safe harbor where a predatory pricing practice such
16 as an export subsidy or the acceptance of an export
17 credit subsidy, in other words, terms below the international
18 arrangement that has been agreed to among the developed
19 countries, and when such has been determined by the
20 appropriate administrating authority.

21 The Chairman. Treasury have any comment on that
22 proposal?

23 Mr. Chapoton. I think I can see no problem we would
24 have with that. I haven't really looked at it before, but
25

1 I think we would have --

2 Senator Moynihan. Mr. Chairman?

3 Mr. Chapoton. I believe we would have no problem with
4 it, Mr. Chairman.

5 The Chairman. Senator Moynihan?

6 Senator Moynihan. Yes. Mr. Chairman, I'm sorry
7 that the Senator from Pennsylvania has raised such a matter
8 at this hour. It's directed at the Metropolitan Transit
9 Authority of New York which in good faith took an offer
10 from a Canadian firm.

11 Senator Heinz. May I correct the Senator? This wouldn't
12 be retroactive.

13 Senator Moynihan. This would not be retroactive?

14 Senator Heinz. No, I don't think we -- it's not the
15 senator's intention, but I think we do want to set policy.

16 It is not my -- as I said in my statement
17 I don't believe that the MTA did anything wrong. It is not
18 my goal to punish the MTA. I think that what is being allowed
19 to take place is bad policy, and I seek to foreclose it in
20 the future.

21 Senator Moynihan. Would the Senator accept an
22 amendment that said that the Secretary of the Treasury has
23 -- is required to make the same review when anybody
24 purchases mass transit equipment from a foreign-owned
25 company in the United States?

1 Senator Heinz. No. Why would the Senator propose
2 that?

3 Senator Moynihan. Well, because we are descending
4 to that level of economic policy.

5 Senator Heinz. I beg to differ with the Senator.
6 The question is whether --

7 Senator Moynihan. All right. No German owned company.
8 How is that?

9 Senator Heinz. Well, the question is whether we should
10 invite U.S. public transit facilities to engage in accepting
11 what we know is nothing less than illegal behavior. Now,
12 it is admittedly --

13 Senator Moynihan. Excuse me. Forgive me.

14 Senator Heinz. It is admittedly a lot cheaper for a
15 citizen who wants a television set to go to a fence and
16 buy one at 50 percent of the best deal he can get because
17 it's been stolen. It is admittedly a lot cheaper for an
18 American citizen to go and buy his mag wheels at Midnight
19 Auto Supplies, it's called.

20 But we don't condone either of those practices. Now,
21 what we are talking about are things that are in violation
22 of international agreements. The arrangement is an
23 international agreement among the OECD nations. And to
24 the extent that anybody accepts the kind of financing that
25 is involved here, they are doing exactly what a citizen does

1 when he goes and buys stolen goods at a discount from a
2 fence. That is a --

3 Senator Moynihan. I cannot allow the conduct of the
4 public authority of New York State to be described -- to be
5 compared to criminal act of buying stolen goods, and I won't,
6 sir. There ought to be public policy. In the interval since
7 we've had those public hearings, we've had the Versailles
8 conference, the economic summit which failed unfortunately.
9 It was not anybody's fault on our side to reach agreement
10 on the levels of subsidy that would be allowed.

11 But I mean are we to distinguish -- would the senator
12 from Pennsylvania -- I assume would not -- why confine this
13 to mass transit? Why not say any purchase abroad subsidized
14 is thereafter not eligible for lease arrangement.

15 Senator Heinz. I would accept that.

16 Senator Moynihan. Yes. Well, that is exactly the
17 direction which we are heading. That is the way international
18 trade is heading. Why don't we do it the way it ought to
19 be done which is get government to government agreements
20 in the context of the economic summit and the OECD which
21 Mr. Chapoton knows perfectly well we are seeking.

22 And Mr. Secretary, surely you don't want to say this
23 kind of conduct --

24 Mr. Chapoton. Let me clarify two things. This -- and
25 I think this is a serious matter. There is -- as I understood

1 the Senator's Amendment, it was discretionary with the
2 Secretary. Did you say there was some confusion here
3 whether you said mandatory or discretionary?
4

5 Senator Heinz. It was not my intention to make it
6 discretionary.

7 Mr. Chapoton. But it would deny the credit if --
8 I mean deny leasing if these facts exist.

9 Senator Heinz. When a finding was made by the
10 administering authority, typically the Commerce Department,
11 that, indeed, an export credit arrangement that did break
12 the internationally agreed upon credit limits -- when that
13 was determined to exist, the Secretary of the Treasury
14 would, in fact, deny the safe harbor.

15 Mr. Chapoton. Well, the result would be actually that
16 the property would not be eligible for safe harbor lease,
17 and it would not be a discretionary act with the Secretary
18 would simply the property would be rendered ineligible.

19 There is now in the law a provision which grants the
20 Secretary discretion to deny the investment tax credit
21 on foreign made goods in certain similar circumstances,
22 and it is a matter that is now coming to the attention
23 of the Treasury Department on a petition of a particular
24 firm, and Senator Heinz, I think I will have to withdraw
25 my earlier statement that we would not oppose it. I think
this is more -- a good deal deeper than I had treated it.

1 And I think I would have to reserve on that. It is a matter
2 that this other provision has given us a good deal of concern,
3 and I see a very close relation.

4 Senator Heinz. Would you accept it if it was dis-
5 cretionary of the Secretary?

6 Mr. Chapoton. No, the discretionary thing would in
7 practice present the problem so I think the feeling, and this
8 is a matter of international significance in international
9 trade. The feeling is that that is not the way to solve
10 these problems so I --

11 The Chairman. Senator Chafee and then Senator Packwood.

12 Senator Chafee. Mr. Chairman, I'm sympathetic with
13 the Senator from Pennsylvania, but I think we are getting
14 into heavy water here. It was getting tangled in the
15 GAT matters, and it seems to me that this isn't the way we
16 should proceed. If there is a violation of an international
17 agreement in some way, then there are procedures to follow
18 other than this. So I would hope that the senator wouldn't
19 press this matter. I think it gets us into very difficult
20 areas.

21 Senator Bentsen. Well, I certainly share the comments
22 of Senator Chafee in that I understand that the company
23 that has grieved in this instance has already started the
24 process.

25 Senator Heinz. Yes. The problem is, Senator Chafee and

1 Senator Bentsen that we can't do anything -- I'm not seeking
2 to do anything about the MTA and bombideer and all of
3 that.

4 Senator Bradley. Would the Senator yield? Should we
5 put local content amendment on this reconciliation act?
6 Would the Senator be supportive of a local content amendment?

7 The Chairman. We've got local content, I think,
8 already.

9 Senator Heinz. The Senator can offer it if he wants.
10 I'm not --

11 Senator Packwood. Mr. Chairman, we have what? Either
12 48 or 84 amendments left when we lost track --

13 The Chairman. I lost track of content coming here.
14 If we can move --

15 Senator Packwood. I am just reminded. We are reaching
16 that dangerous stage where these amendments are going to
17 start coming up that even Secretary Chapoton is not quite
18 sure what the position should be, and I wouldn't ask Senator
19 Long to repeat the story, but this is very similar to when
20 -- on a small ticket tax bill, the anti-trust exemptions
21 for the merger of the National and American Football
22 leagues passed late one night in the Finance Committee.
23 And passed and went through the Senate.

24 Now, we are getting close to that stage is all.

25 Senator Heinz. Mr. Chairman, in deference to Senator

1 Packwood, the National Football League and the hour, I will
2 withdraw the amendment, but reserve the right to offer it
3 later. Thank you.

4 The Chairman. Now, I think we can move to the IDB's.
5 I understand Senator Durenberger -- Senator Durenberger,
6 I understand that you will not press the amendment that is
7 contained in 4717 with reference to what -- multi-family?

8 Senator Durenberger. Well, the figure that we had at
9 50 million for three years is not quite accurate. It's
10 32 million for three years, and I would take it for two
11 years.

12 The Chairman. And I think we will probably finish the
13 conference before we finish this?

14 Senator Durenberger. Do you? Well, my problem is
15 that we've got all of the single family aspects of 4717 are
16 in here, and it's only the multi-family that isn't in, and
17 I really suspect you're going to make it over there and I
18 guess that's the only reason I would like to see it in here.

19 I hate to leave the multifamily out when the single
20 family is in. But if you're somehow confident that you are
21 going to get it out of 4717, I --

22 The Chairman. I'm not opposed to it. In fact, I think
23 I may offered not that amendment --

24 Senator Durenberger. What are the dollars? Do the
25 dollars get down anywhere near 20 or 21? Is it a problem

1 with the dollars now, Mr. Chairman, or --

2 Mr. McConaghy. I'm sorry, Senator Durenberger. I
3 didn't understand the question.
4

5 Senator Durenberger. The Chairman was concerned as
6 to whether or not I would withdraw my proposal on that part
7 of multifamily that is in 4717, and I understand the revenue
8 lost is 32 million over three years.

9 Mr. McConaghy. That's correct.

10 Senator Durenberger. And I was going to cut that back
11 to two years and see if the dollars would influence the
12 chairman's view of presence on this bill.

13 The Chairman. I might say to the Senator of Minnesota
14 I intend to support that in the conference.

15 Senator Durenberger. Mr. Chairman?

16 The Chairman. Senator Durenberger?

17 Senator Durenberger. Yes, Mr. Chairman.

18 The Chairman. As I understand that is in conference.

19 Senator Durenberger. I understand it is in conference,
20 too. I'm not sure when that conference is going to conclude
21 that.

22 The Chairman. No, we are going to conclude it won't
23 be anything left, but the Senator from Kansas supports that
24 provision. What I'm concerned about is starting adding
25 amendments, even though they are only 30 million, that might
trigger the next one at 50 and we would like to sort of

1 curtail those if possible. I can pledge to the Senator
2 that we'll work on that in conference and support it.

3 Senator Chafee. Also, Mr. Chairman, some of us are
4 really anxious to get this IDB through as soon as we can.

5 Senator Bradley. Mr. Chairman, this might be the
6 appropriate time to raise the general issue about 4714, and
7 what its fate might be because earlier when we were discussing
8 the spending measures --

9 The Chairman. Right.

10 Senator Bradley. We -- I think as a committee generally
11 wanted to rectify the mistake that was made in last year's
12 reconciliation act in providing unemployment benefits to
13 ex-servicemen, and you gave us your assurance that you would
14 accept the House provision. It provided at least 13 weeks
15 with a full week waiting period and various other provisos.

16 The Chairman. There was some language that Senator
17 Mitchell offered --

18 Senator Bradley. Right. We are going to have that
19 conference even --

20 The Chairman. Yes, in fact --

21 Senator Bradley. -- though we have lost -- it's become
22 a very thin bill after the --

23 The Chairman. Well, there are still a lot of important
24 matters in it. I hear from Joe Califano everyday on Fannie
25 Mae.

1 Mr. Bradley. So we are still going to have the con-
2 ference in.

3 The Chairman. I wrote a letter to Chairman Ross
4 Konkowski today, the chairman of the conference, suggesting
5 we reconvene on July 12.

6 Senator Bradley. Can I ask one other question on
7 IDB's? Have we been successful at all on any targeting
8 formula?

9 Mr. McConaghy. We have not found one that we feel
10 that would be satisfactory, Senator Bradley.

11 The Chairman. Is that satisfactory?

12 Senator Durenberger. Can I talk about a couple of
13 other things before we tie this one down, and then I'll let
14 you know how satisfactory it is. One is -- kind of hate
15 to characterize it as technical. Earlier we took care of
16 some technical definition problems on multifamily. I'm now
17 told that Treasury feels that it may not have the statutory
18 authority to make the restrictive siting requirement that
19 would assure that the low income individual would not be
20 set apart from the other individuals.

21 I would suggest a restriction -- let me know what
22 I'm talking about so I can explain the rest of it.

23 The Chairman. We'll put it on the record. Want to put
24 it in the record.

25 Senator Durenberger. Well, anyway, I need to suggest

1 the restriction that at least ten percent of each of the
2 buildings in a project be occupied by low income individuals.
3 We have not consulted with HUD whether this might cause
4 problems. Therefore, I recommend we direct staff to draw
5 up appropriate language to avoid separation between low
6 income and non-low income units in consultation with HUD
7 and Treasury.

8
9 Mr. Chapoton. Well, as I understand it, the 20 percent
10 requirement would be met and this would add the requirement
11 that each building -- the 20 percent low income is the
12 requirement of present law. That would not be changed, but
13 it would -- we would make it clear that separate buildings
14 would qualify if ten percent of each building met -- had
15 low income.

16 Senator Durenberger. Do you have any problem with
17 instructing them to work out the language?

18 Mr. Chapoton. Don't have any problem with it if that
19 is the rule.

20 Senator Long. Now, Mr. Chairman, I just want to make
21 this point here. We've been here since nine o'clock this
22 morning. It's approaching midnight, and we have voted
23 for what amounts to 25 tax bills, all to be added on top
24 of some minor House passed bill, and used in an effort
25 to balance the budget. Now, we are proposing to embark
in an area of dealing with what -- about 45 amendments

1 sitting out there and generally -- the first time I was
2 the manager of the original Christmas Tree bill, we had
3 25 amendments on the bill, and it picked up about 25 more
4 on the floor. And we had -- we have enough amendments
5 sitting out there to more than double the number of amend-
6 ments that were on the original Christmas Tree bill.

7 And frankly, Mr. Chairman, I have my doubts that we
8 ought to stick around here with the bill for two or three
9 or four more hours, day break at worse, making a Christmas
10 Tree bill out of this tax bill.

11 If we are going to vote on some of those 45 amendments,
12 it seems to me that you or someone ought to try to work
13 something out on a bipartisan basis where we take a few
14 amendments. Now, when we go out to the floor we'll be under
15 a germaneness rule. We'll have 80 senators out there who
16 can't offer their amendment. And they're going to be pro-
17 testing to high heavens that we load all our pet amendments
18 on the bill, and they didn't get a chance to vote theirs
19 on it.

20 I just think that we better confine ourselves to what
21 this tax bill has to be, and keep these Christmas Tree
22 amendments to a minimum.

23 Senator Durenberger. Mr. Chairman, I will finish the
24 MRB-90B issue before us. I've discussed this one with
25 Treasury which is the district heating issue and a small

1 amendment to 103B4G to allow after the words "any purpose"
2 the words including "District heating and cooling" and after
3 the word "water" words "or steam." And I won't belabor
4 anybody's time with further explanation. I think the Secretary
5 knows about it.

6 The Chairman. Are you aware of it?

7 Mr. Chapoton. I'm aware that would clarify. We would
8 not clarify a ruling request for anything we did not object
9 when we discussed this earlier.

10 The Chairman. It's going to add "steam."

11 Mr. Chapoton. It adds "steam."

12 Senator Bradley. Is that the investment tax credit for
13 District heating?

14 Senator Durenberger. No. It qualifies it under IDB.

15 Mr. McConaghy. I'm assuming that would be under the
16 two county rule.

17 Senator Bradley. Mr. Chairman, I would expand that
18 to provide investment tax credits for District heating if
19 the Treasury would accept that. It's a small revenue number.

20 Mr. Chapoton. I'm not aware of the --

21 The Chairman. Is there an amendment?

22 Senator Bradley. Yes, the staff has the amendment.

23 The Chairman. Well, they're in the sorting process
24 now. Can we vote on the IDB package? I think we only have
25 about four major amendments remaining. I think most of those

1 we can move on rather quickly if we can get off the IDB's.

2 Senator Bradley. Mr. Chairman, before we go let me just
3 say that this -- the exact clarification that was just made
4 for the IDB's with regard to District heating is the
5 clarification that would be made for the ITC's, the exact
6 same thing except that it is ITC instead of IDB.

7 Senator Durenberger. Hurray for Trenton, New Jersey,
8 and St. Paul, Minnesota.

9 Senator Bradley. As the beginning.

10 The Chairman. Who reviewed the amendment? Somebody on
11 joint committee in our staff and --

12 Mr. Chapoton. Senator, that would be an entirely
13 different question. The question of this is whether it's
14 a local furnishing of water, energy or steam. The question
15 was pending on an IRS ruling. IRS wasn't sure it had
16 authority to do it and just clarified it.

17 But the question of eligibility of investment tax
18 credit would be a far broader question.

19 The Chairman. Are we -- well, then, you have no
20 objection to the Durenberger Amendment?

21 Mr. Chapoton. No, sir.

22 The Chairman. "Steam" and you object to the Bradley
23 Amendment?

24 Mr. Chapoton. Yes, sir.

25 The Chairman. Let's vote on the IDB package with the

1 Durenberger Amendment, without the Bradley Amendment. Want
2 a roll call? Or all in favor say aye.

3 (Chorus of ayes.)

4 The Chairman. Opposed, no. The ayes have it. Next,
5 let's return to investment --

6 Mr. McConaghy. We have, Mr. Chairman, the basis
7 adjustment --

8 The Chairman. Right. Let me say in response to
9 Senator Long's I have the same concern, and we don't intend
10 to make this a Christmas Tree, and I would again instruct,
11 as I thought I had earlier, a group to start -- maybe they
12 are in the process of doing that, but a member from
13 Democractic staff, Republican staff, Joint Committee, and
14 Treasury to go through the amendments and only bring us
15 those that have great merit. The others will be considered
16 in blocks. Yes?

17 Senator Bradley. Mr. Chairman, on the ITC, do you
18 oppose the ITC?

19 The Chairman. Now, on the base of adjustment I think
20 Senator Armstrong can --

21 Senator Armstrong. Thank you, Mr. Chairman. I have
22 distributed, I think, to all members a brief explanation of
23 an amendment which I believe is appropriate at this point.
24 And it does two things, both of which I believe are easily
25 understood and perhaps familiar to all members.

1
2 First, it permits tax payers to index his basis in the
3 computation of capital gains. And the reason for this is
4 obvious and well-known to all of us, and that is that as
5 it now works out, taxpayers pay a huge capital gains tax
6 on ersatz gains, the gains that are nothing more than just
7 a reflection of inflation. And for a lot of people in family
8 business and farms and homeowners and anybody who has been
9 through that experience, it really seems most unfair.

10 The revenue implications of this are fairly small.
11 They are about a billion dollars over the next three years
12 although it would grow in the out years beyond that. To
13 pay for this amendment -- by the way, the amendment is
14 described -- I could read the description which I passed
15 around, but the written material which I furnished to members
16 of the committee specifies the specific assets to which this
17 would apply, and basically it is to stocks and real estate
18 and so on.

19 It is in form exactly the proposal which passed the
20 House of Representatives in 1980. I beg your pardon --
21 in 1978 under the sponsorship of Congressman Bill Archer,
22 and so it's a very simple matter. To pay for it, I would
23 propose that we take the basis adjustment from 95 percent
24 to 90 percent which would more than make up the revenue
25 which would be lost under the capital gain adjustment.
I think there is also in addition to just paying for the

1 capital gains provision, I think there is a very good
2 equitable reason to go to 90 percent, and it's just this.
3 That if you buy an asset and get a ten percent investment
4 tax credit at the front end, it's only logical that you should
5 be able to depreciate only the remaining 90 percent value.

6 As it stands at the present time, or at least the
7 proposal would be to take a ten percent tax credit, get ten
8 percent of your money back at the front end, and yet, none-
9 theless be permitted to depreciate 95 percent of the value.
10 You actually have a higher depreciable basis than you had
11 investment in the asset itself.

12 So it seems to me that this is a good place to pick
13 up the money for the capital gains item which I would judge
14 to be quite a popular thing and also is equitable and justi-
15 fied for other reasons as well.

16 The Chairman. Senator Byrd?

17 Senator Byrd. May I ask Senator Armstrong, are you
18 coupling the two together or first would you vote on the
19 capital gains and then get to the other?

20 Senator Armstrong. Well, Mr. Byrd, I would be governed
21 by the desires of others on this committee. I have discussed
22 this with several, and simply because I feel that we are
23 obligated to meet our revenue targets under reconciliation,
24 I was reluctant to separate the two. They are clearly
25 separable. If anybody would like to vote on them separately,

1 if anybody would be more desirous of voting for one or the
2 other separately than together I would be glad to split them,
3 but I think it is perfectly in order for any member to call
4 for them to be separated.

5 Senator Long. I would like to ask for -- I want to vote.

6 Senator Armstrong. I'm sorry. I could not hear.

7 The Chairman. He would like a division.

8 Senator Armstrong. That is fine with me.

9 The Chairman. The first vote will occur on -- oh,
10 excuse me.

11 Mr. Chapoton. Mr. Chairman, if I could state on the
12 reduction, the full reduction -- full basis adjustment --
13 we would certainly oppose that strongly indeed. It would
14 cause some property to have a smaller benefit -- combined
15 benefit of ACRS and investment tax credit than it had
16 prior -- prior to last year's tax bill. In other words,
17 we would be making -- giving less incentive for investment
18 than we had before ERTA, in some cases quite significantly
19 less.

20 That would be of considerable concern to us. I would
21 also comment on the indexing of the capital gains. The --
22 one of the concerns you have in indexing property, bases
23 of property is the fact that the debt carries with it --
24 if the property is financed with long-term debt, that is a
25 form of indexing in and of itself, and though you do have a

1 mismatching -- that is the borrower gets an advantage on
2 debt, and he would get the second advantage on the indexing
3 of the capital gain basis. Indeed, it would make more sense
4 if you index both, both sides, and it is very difficult to
5 index the debt side.

6 Senator Armstrong. Mr. Secretary --

7 Senator Chafee. Mr. Chairman, I hope we wouldn't go
8 down the road of one more indexing. It seems to me that
9 we get constantly lured into these indexing formulas, and
10 I think it's a great mistake to start on one more. I would
11 hope the amendment would be defeated.

12 The Chairman. The question recurs. What is the
13 first --

14 Senator Armstrong. On the indexing provision first?

15 The Chairman. That's the first part of it.

16 Senator Armstrong. Either way, Mr. Chairman.

17 The Chairman. Has the Joint Committee looked at the
18 amendment?

19 Mr. McConaghy. We have looked at the handout that
20 Senator Armstrong has given us, and we have given him some
21 revenue estimates on the net effect, yes. There are some
22 things that we would have to think about to work out.

23 The Chairman. The first vote will recur on the
24 indexing of capital gains. Clerk will call the roll.

25 Mr. Lighthizer. Mr. Packwood?

1 Senator Packwood. No.
2 Mr. Lighthizer. Mr. Roth?
3 Senator Roth. Aye.
4 Mr. Lighthizer. Mr. Danforth?
5 Senator Danforth. No.
6 Mr. Lighthizer. Mr. Chafee?
7 Senator Chafee. No.
8 Mr. Lighthizer. Mr. Heinz?
9 Senator Heinz. No.
10 Mr. Lighthizer. Mr. Wallop?
11 Senator Wallop. Aye.
12 Mr. Lighthizer. Mr. Durenberger?
13 Senator Durenberger. No.
14 Mr. Lighthizer. Mr. Armstrong?
15 Senator Armstrong. Aye.
16 Mr. Lighthizer. Mr. Symms?
17 Senator Symms. Aye.
18 Mr. Lighthizer. Mr. Grassley?
19 Senator Grassley. Aye.
20 Mr. Lighthizer. Mr. Long?
21 Senator Long. Aye.
22 Mr. Lighthizer. Mr. Byrd?
23 Senator Byrd. Aye.
24 Mr. Lighthizer. Mr. Bentsen?
25 Senator Bentsen. No.

1 Mr. Lighthizer. Mr. Matsunaga?

2 Senator Matsunaga. No.

3 Mr. Lighthizer. Mr. Moynihan?

4 Senator Moynihan. No.

5 Mr. Lighthizer. Mr. Baucus?

6 Senator Baucus. No.

7 Mr. Lighthizer. Mr. Boren?

8 Senator Boren. Aye.

9 Mr. Lighthizer. Mr. Bradley?

10 Senator Bradley. No.

11 Mr. Lighthizer. Mr. Mitchell?

12 Senator Mitchell. No.

13 Mr. Lighthizer. Mr. Chairman?

14 The Chairman. What's the vote? Aye. I'm with you
15 in spirit. Nine yeas and 11 nays. Close as amendments
16 can be.

17 Senator Armstrong. Mr. Chairman, two observations.
18 One, the -- I am told that the distinguished chairman of
19 this committee was present on at least 14 occasions when
20 the last indexing legislation was considered before it was
21 finally adopted, and I'll just say that's one.

22 The Chairman. Right.

23 Senator Armstrong. Second, I would defer to the chair
24 or others about the second half of my amendment. I would
25 be glad to withdraw it. I would be glad to have a voice

1 vote on it. I believe in it as a separate proposition,
2 but the specific reason why I proposed it was to provide
3 the financing for the indexing amendment, and so I would
4 be glad to handle it in any way that the chair desires.

5 The Chairman. Be all right with you -- could you
6 withdraw it?

7 Senator Armstrong. I'm certainly willing to. As an
8 isolated proposition, although I believe in it -- on its
9 own I doubt that there is support for it in the committee.

10 The Chairman. I appreciate that. Thank you.
11 Now, are there other amendments? Oh, Senator Byrd?

12 Senator Byrd. We were considering an amendment earlier
13 which -- by this provision would not apply to assets
14 acquired or constructed pursuant to binding contracts entered
15 into before July 1, 1982 which contracts were binding on
16 such date and which are placed in service on or before
17 December 31, 1984. Now it seems to me that is just a
18 question of equity and fairness.

19 The Chairman. Have you determined what the impact of
20 this amendment would be?

21 Mr. Chapoton. I think the revenue estimates, an
22 asterisk in '83, .1 in '84, .2 in '85.

23 Senator Byrd. It wouldn't be involved in '85. Just
24 December 31 '84.

25 Mr. McConaghy. Yes. The revenue loss, I think, would

1 carry over, Senator Byrd, to the extent that it was placed
2 in service out in the future.

3 Mr. Chapoton. 300 million.

4 The Chairman. What's Treasury's position on this
5 amendment?

6 Mr. Chapoton. Well, we have not proposed that, and
7 I recognize the point that Senator Byrd makes, but
8 it seems that the longer the construction period of the
9 property, the more benefit -- well, if you assume con-
10 struction period usually -- a long construction period
11 usually relates to longer economic life property. The
12 property would normally be five year property -- receives
13 very significant benefit under ACRS. We are supporting
14 this basis adjustment to bring the combined benefits back
15 to expensing, and we simply would see no reason to go
16 beyond that, even though the contract may have been entered
17 into thinking that it would be slightly above expensing.
18 It would not be a significant amount in any particular piece
19 of property. And so we would have to oppose the amendment,
20 Senator.

1 Senator Byrd. Would it help you if you submitted it
2 December 31, 1983, that loss would then be very small.

3 Mr. Chapoton. Senator, it will still have a revenue
4 impact of around .2 during these 3 years and it will spread
5 out further. I'm afraid for the same reasons I stated
6 earlier, we would have to oppose.

7 The Chairman. Let's just call the roll on it. The
8 Clerk will call the roll.

9 Mr. Lighthizer. Mr. Packwood.

10 Senator Packwood. No.

11 Mr. Lighthizer. Mr. Roth.

12 Senator Roth. No.

13 Mr. Lighthizer. Mr. Danforth.

14 Senator Danforth. No.

15 Mr. Lighthizer. Mr. Chafee.

16 Senator Chafee. No.

17 Mr. Lighthizer. Mr. Heinz.

18 Senator Heinz. No.

19 Mr. Lighthizer. Mr. Wallop.

20 Senator Wallop. No.

21 Mr. Lighthizer. Mr. Durenberger.

22 Senator Durenberger. No.

23 Mr. Lighthizer. Mr. Armstrong.

24 Senator Armstrong. (No response.)

25 Mr. Lighthizer. Mr. Symms.

1 Senator Symms. (No response.)
2 Mr. Lighthizer. Mr. Grassley.
3 Senator Grassley. No.
4 Mr. Lighthizer. Mr. Long.
5 Senator Long. (No response.)
6 Mr. Lighthizer. Mr. Byrd.
7 Senator Byrd. Aye.
8 Mr. Lighthizer. Mr. Bentson.
9 Senator Bentson. No.
10 Mr. Lighthizer. Mr. Matsunaga.
11 Senator Matsunaga. Aye.
12 Mr. Lighthizer. Mr. Moynihan.
13 Senator Moynihan. No.
14 Mr. Lighthizer. Mr. Baucus.
15 Senator Baucus. No.
16 Mr. Lighthizer. Mr. Boren.
17 Senator Boren. (No response.)
18 Mr. Lighthizer. Mr. Bradley.
19 Senator Bradley. Yes.
20 Mr. Lighthizer. Mr. Mitchell.
21 Senator Mitchell. (No response.)
22 The Chairman. Do I get to vote.
23 Mr. Lighthizer. 3 Yeas, 10 Nays.
24 The Chairman. The Senator is not reported. I'm not
25 reported, I'll vote no. The vote is 11 to 4, 11 to 5. Is

1 that right, 5 yeas, 11 nays, amendment is not agreed to. Are
2 there other admendments to this provision, if not, all in
3 favor of the provision indicate by saying aye.

4 (Chorus of ayes.)

5 The Chairman. What's left, Mark.

6 Mr. McConaghy. I think we have the corporate minimum
7 tax and the targeted jobs credit.

8 The Chairman. Didn't Senator Long have -- we were
9 trying to resolve that --

10 Mr. McConaghy. Yes, I think Senator Long was interested
11 at looking at that provision dealing with the bank interest.

12 Senator Symms. Chairman, unless Senator Long is ready
13 I'll -- Mr. Chairman, the one question that I haven't got
14 resolved in my mind and there seems to be some dispute and
15 I may need some assistance from Mark on it, but I'm very
16 concerned about including this percentage depletion
17 deduction for hard minerals because of the depressed
18 condition the mining industry is in.

19 Now, in checking with the mining companies in my state
20 and other states, I don't know of any of them that aren't
21 in very bad financial condition, which effects all of us if
22 we allow to continue to see the closure of mines in the
23 country and I don't seem to be able to locate the list of
24 preferential items, but anyway, the hard rock minerals were
25 listed to be reduced from 100 percent to 85 percent on a

1 preferential list and the percentage for hard rock minerals
2 will be reduced by 15 percent.

3 Now, it's my understand that right now while they're
4 all losing money, that won't make any difference, but once
5 they start in a recovery, if metal prices should come back,
6 then they would start immediately -- when they get to the
7 point where they might be able to start reemploying people,
8 just in my state alone, in the Cordland mining district,
9 half of the miners have lost their jobs in the last year
10 and are waiting for the price of minerals to turn around.

11 So, I know, Mark, you had some comments about that
12 earlier.

13 Mr. McConaghy. Yes.

14 Senator Symms. Maybe you can explain that to me, but
15 my understanding is that once the turnaround takes place,
16 then immediately if they starte to come into a profit
17 position, then they would be hit.

18 Mr. McConaghy. The issue, of course, is whether they
19 get hit both by the add on minimum tax and the alternative
20 minimum tax suggested here and there is a provision in the
21 proposal that would try to prevent the combination of this
22 proposal and the add on from reducing the benefits from
23 the preferences.

24 The way it would work for instance with respect to
25 percentage depletion of hard minerals, if there was a 15

1 percent cutdown here and let's assume that deduction without
2 the cutdown were 100, that would cut it down to 85. What
3 is attempted here is to go back mathematically on a fraction
4 and say that only 63 percent of that cutdown amount, 85,
5 would be subject to the minimum tax.

6 Now, that result would be if a corporation was on the
7 minimum tax, essentially, this cutdown of preferences would
8 not result in it having any additional tax or being hit
9 twice, it would result in the combination of the same --
10 same thing. Yeah, to the extent that it was paying add on
11 minimum tax. However, to the extent it was not paying
12 add on minimum tax, it's regular taxes were high enough,
13 then, of course, this would have the effect of cutting it
14 back. But if it was paying add on minimum tax already,
15 then this cutback itself would not have an impact any greater
16 than the impact that exists if we were cut down 15 percent.

17 So, I think that takes care of the problems that you
18 had Senator Symms, except for those corporations that are
19 obviously not paying add on minimum tax and because they
20 have enough regular tax. In that case, they would be cut
21 down here by 15 percent.

22 Senator Symms. Well, how does that compare with the
23 treatment oil and gas industry is getting on their percentage
24 depletion. That's a rather healthy industry compared to
25 mining.

1 Mr. DeArment. Oil and gas is being phased down under
2 current law under 613A and it's dropping --

3 The Chairman. The depletion is dropping.

4 Mr. DeArment. -- the depletion is dropping steadily
5 down to 15 percent. It was 20 percent in 1980 and it drops
6 to 15 by 1984 in yearly increments. So that percentage
7 depletion in that area is already cut down.

8 Senator Symms. Well, I know the -- what's the count
9 right now on where we are in the bill dollar wise -- money
10 wise?

11 The Chairman. I think we're about even.

12 Senator Symms. Well, what I would propose maybe we
13 do is if we would exlude this preferential treatment, I mean
14 if we exclude the percentage depletion on the hard rock
15 minerals, that's going to have a, what is it, Mark, \$100
16 million a year?

17 Mr. McConaghy; Yes, \$74 million the first year, 1983,
18 \$133 million '84, \$143 million in '85, a total of about
19 \$340 million.

20 Senator Symms. How much would it be if we took the
21 15 percent that's reduced and then put it on a 5 year
22 depreciation?

23 Mr. DeArment. Percentage depletion is not normally
24 amortized over a period of time like intangibles, so that --
25 I must say --

1 Senator Symms. Could you spread it out over 5 years so
2 it wouldn't be quite -- so the impact -- what I'm worried
3 about is when the recovery comes, hoping that that happens.
4 I mean they're not paying taxes right now because they're
5 all losing money, but --

6 Mr. McConaghy. It's really not like intangibles,
7 Senator Symms, I'm not sure how you would work it. The
8 preferences here work so that if it's a deferral item, then
9 obviously that portion cut down does get spread, but if it's
10 not a deferral item, then it just gets cut down. I'm not
11 sure how we could make that.

12 Senator Symms. Might I go back and make an inquiry.
13 Did we do anything about leasing on mass transit, was that --

14 The Chairman. Yes, we took a different formula.

15 Senator Symms. Was there some revenue picked up there?

16 Mr. DeArment. The whole package as the committee
17 approved it, picked up more than the original, but we're
18 still down by \$600 million.

19 The Chairman. We are? Well, as I understand it, Mark,
20 there isn't a problem and I don't want to --

21 Mr. McConaghy. There's not a problem to the extent
22 that the corporation is presently paying the add on minimum
23 tax, this would not add another burden on top of it and hit
24 percentage depletion twice in that case. If, however, that
25 corporation isn't on the minimum tax, then this would result

1 in a cutdown of that preference. But the add on minimum tax
2 and this would not result in a double burden on it.

3 Senator Symms. Well, it is going to -- obviously it is
4 going to raise \$110 million a year if it's left in.

5 Mr. McConaghy. Those corporations --

6 Senator Symms. So that \$100 million a year is coming
7 out of the depressed mining industry to go to the Treasury
8 of the United States or if we had excluded it, it would
9 leave \$100 million in the mining industry.

10 Mr. McConaghy. Yeah, I think a lot of that Senator
11 Symms is really from mines that are owned by major oil
12 companies that are on paying regular tax and not paying the
13 add on minimum tax. In that case this does result in cutting
14 the preference down.

15 Senator Symms. Well, see, the ones I'm worried about
16 are the ones like Sunshine Mining Company that is closed
17 now and it's part of the 4,000 miners that aren't working
18 in the Cordland mining district.

19 The Chairman. Isn't there some way to take care of
20 those.

21 Senator Symms. They're not owed by oil companies
22 and they don't have any --

23 The Chairman. I wonder if we might do this. I think
24 we can work this out, Steve, why don't -- Dan, you and Rod,
25 and Ann and Steve, you do that for about -- then with this

1 -- pass this for the time being, we got other things.

2 Senator Matsunaga. Excuse me just a second. Are there
3 other -- I think the only other remaining matter, I guess we
4 should finish the package, would be the targeted jobs credit.

5 Senator Heinz. In other words, you have 50 percent of
6 the wage base and only 25 percent credit on that base.

7 Excuse me, 30, thank you. It's been a long night. And,
8 Mark?

9 Mr. McConaghy. Yeah, I think you were also considering
10 the 15 percent the second year. 30 percent the first year
11 and the 15 percent in the second I believe.

12 Senator Heinz. Yes.

13 Mr. Chapoton. I thought that we had some concern about
14 this because it does shift the -- the straight policy concern
15 that it shifts the benefit to cooperative students who are
16 not disadvantaged and reduces benefits for cooperative
17 students who are disadvantaged.

18 I understand Senator Heinz's problem, that one of the
19 change -- I thought the agreement mark was 25 percent to make
20 it a regular neutral agreement.

21 Senator Heinz. We made it 30 and 15 rather than 25.

22 Mr. Chapoton. And still revenue neutral, 30 the first
23 year?

24 Senator Heinz. Yeah, that's my understanding.

25 Just while they're conferring, to answer Buck's point,

1 the vocational program basically is -- has been a good
2 program, but I guess the key thing to focus on is the
3 people who have to make it work are the teachers in the
4 school and the teachers say that the program will work best
5 if we don't try to draw a false distinction in their
6 classroom. It's a real distinction I supposed in some ways
7 between the disadvantaged students and the non-disadvantaged
8 students.

9 We have information that suggests that at least 50
10 percent of the students who are in the cooperative education
11 program are disadvantaged and since the object is to get this
12 program to work and to work well, and cost no more money,
13 we actually help a good deal more students and we help them
14 more humanely if we do it this way.

15 Mr. Chapoton. I understand it's a \$100 million cost
16 though.

17 Mr. McConaughy. Over a 3 year period.

18 Senator Heinz. What, Mark?

19 Mr. McConaughy. Over a 3 year period that would be the
20 total, \$100 million.

21 The Chairman. Are there other questions on the
22 amendment? All in favor of the amendment, say aye.

23 (One aye, chorus of nos.)

24 Now we need to vote on the full provision. All in
25 favor say aye.

1 (One aye.)

2 Opposed, no.

3 (Chorus of nos.)

4 Senator Grassley. Now, wait a minute, I got a little
5 problem where -- in my state we have some general
6 assistance recipients who don't qualify because the law
7 requires that you receive your welfare money in cash and we
8 have some in vouchers and I would like to have those included.

9 Senator Heinz. Well, Mr. Chairman, I've examined this
10 amendment and I think the staff has too, there -- the --
11 there is also an evidence of need that is shown with the
12 vouchers that the problem has been previously that when there
13 is an evidence of need that if there was just a voucher, that
14 would not be sufficient evidence of someone being in that
15 status. I would urge the acceptance of this unless there is
16 some new technical wrinkle in it. Do you have any, Buck?

17 The Chairman. The Treasury does not object, the
18 amendments are approved and now we'll vote on the total
19 jobs tax credit. All in favor say aye.

20 (Chorus of ayes.)

21 Opposed no. Amendments agreed to.

22 Now, what is left, the minimum?

23 Mr. McConaghy. I think corporate minimum tax, Mr.
24 Chairman.

25 The Chairman. And they're negotiating in the back

1 room, so I think in the interium, we'll take the other
2 amendments. Senator Moynihan -- excuse me, Senator Baucus
3 had an amendment.

4 Senator Baucus. I believe it's appropriate at this
5 time to offer an amendment that is not part of the package,
6 is that appropriate at this time?

7 The Chairman. Yes, there's only one matter left that
8 we have not addressed and we're negotiating a problem there.

9 Senator Baucus. Mr. Chairman, the amendment that I have
10 to offer is that the repeal that taps adjustment in
11 determining the windfall profits tax for Crude Obay oil,
12 it's -- the contents is very simple. Today in the lower
13 48 oil companies are determining the windfall profits tax
14 they go through the formula and when the Crude Obay oil is
15 calculated both through the determination to determine the
16 windfall profits tax and the present law, they enjoy the
17 vantage.

18 It's complicated to explain. Essentially, we pass the
19 windfall profits tax, we included statutory amount of \$6.26
20 per barrel for roughly the tariff that is the cost --
21 amortization cost and the costs associated with the
22 Trans Alaska pipe line, first it's determined that the true
23 cost should be about a \$1.00 less than \$6.26. My amendment
24 would eliminate the \$6.26, so that to use the trite
25 expression, a truly level playing field, that is the windfall

1 profits tax both for lower 48 crude and for Crude Obay
2 crude would be determined on the same basis.

3 The talk to the Joint Committee -- it's a bit difficult
4 to estimate what the revenue pick up will be, but we're going
5 to \$250 million voted depends on what those 3 major oil
6 companies do in changing their tariff and ultimately if they
7 raise their tariffs above the cost that is determined by
8 Burk, Burk is going to under the law require them to refund
9 back that excessive tariff anyway.

10 I think it's a very good amendment, it's a very fair
11 amendment, it turns out to be the three majors that own as
12 a practical matter that pipe line do enjoy about a \$1.00 per
13 barrel advantage in the ultimate distribution of the oil that
14 is produced at Crude Obay now.

15 Mr. McConaghy. Senator Baucus, you're right, we don't
16 know the ability of these companies to raise their tariffs,
17 there is a number -- there is litigation going on now, it
18 certainly will pick up some revenue, we're not certain how
19 much that is, but we thing it would not be a problem to
20 take the amendment.

21 Senator Baucus. Mr. Chairman, I understand too that
22 Treausury is not opposed to this amendment, is that
23 correct.

24 Mr. Glickman. Senator Baucus, we are not opposed,
25 it's the right answer.

1 The Chairman. But you favor the amendment?

2 Mr. Glickman. Yes, we do.

3 The Chairman. That's better.

4 Senator Wallop. Mr. Chairman, before anybody runs off
5 and does something that sounds good, the net effect of this
6 will be probably very very little in revenues because they
7 can simply offset by changing their price from one side to
8 the other, but more importantly, the loser is going to be the
9 American consumer both in the unreliability and the decreased
10 exploration -- unreliability of price and the decreased
11 exploration in Alaska.

12 What this was put in for was to protect people from the
13 arbitrariness which is amply demonstrated by the Federal
14 Government in pricing of Alaskan crude oil in the first
15 place and that was the whole reason we put it in, the taps
16 provision. Now, you get up there, they shift the price
17 from one side to the other, you're not taxing companies,
18 you're taking the American consumer right at the time when
19 we've already decided not to do that in here and I just don't
20 think that it's a wise move, Treasury likes it because they
21 like anything that produces a dollar. But it's not going
22 to produce very much in dollars less than \$100 million
23 over the whole time as near as we can tell.

24 Senator Baucus. Mr. Chairman, if I might respond.

25 First of all, if it's not to produce much revenue, then it's

1 the minimus effect. Second --

2 Senator Wallop. Except on the consumer.

3 Senator Baucus. That's my second point. The price of
4 gasoline is determined in the marketplace, that's how the
5 wellhead price for Crude Obar is determined anyway. First,
6 you ascertain what the distribution price is, then you
7 subtract the tariff and then you go back to the wellhead
8 price and then you subtract the adjusted basis price, less
9 the tariff adjustment and that's the amount to which the
10 windfall profits rate is then applied.

11 So, as a practical matter, ultimately it's a marketplace
12 which determines the distribution price for gasoline.

13 Senator Packwood. Any other comment. You got a role
14 call next. Clerk will call the role.

15 Mr. Lighthizer. Mr. Packwood.

16 Senator Packwood. No.

17 Mr. Lighthizer. Mr. Roth.

18 Senator Roth. (No response.)

19 Mr. Lighthizer. Mr. Danforth.

20 Senator Danforth. Aye.

21 Mr. Lighthizer. Mr. Chafee.

22 Senator Chafee. (No response.)

23 Mr. Lighthizer. Mr. Heinz.

24 Senator Heinz. (No response.)

25 Mr. Lighthizer. Mr. Wallop.

1 Senator Wallop. No.
2 Mr. Lighthizer. Mr. Durenberger.
3 Senator Durenberger. Aye.
4 Mr. Lighthizer. Mr. Armstrong.
5 Senator Armstrong. No.
6 Mr. Lighthizer. Mr. Symms.
7 Senator Symms. (No response.)
8 Mr. Lighthizer. Mr. Grassley.
9 Senator Grassley. No.
10 Mr. Lighthizer. Mr. Long.
11 Senator Long. Aye.
12 Mr. Lighthizer. Mr. Byrd.
13 Senator Byrd. Aye.
14 Mr. Lighthizer. Mr. Bentsen.
15 Senator Bentsen. Aye.
16 Mr. Lighthizer. Mr. Matsunaga.
17 Senator Matsunaga. Aye.
18 Mr. Lighthizer. Mr. Moynihan.
19 Senator Moynihan. Aye.
20 Mr. Lighthizer. Mr. Baucus.
21 Senator Baucus. Aye.
22 Mr. Lighthizer. Mr. Boren.
23 Senator Boren. Aye.
24 Mr. Lighthizer. Mr. Bradley.
25 Senator Bradley. (No response.)

1 Mr. Lighthizer. Mr. Mitchell.

2 Senator Mitchell. Aye.

3 Mr. Lighthizer. Mr. Chairman.

4 Mr. Chairman. No. Senator Bradley.

5 Senator Bradley. Aye.

6 The Chairman. Senator Chafee, aye. On this vote the
7 yeas are 14 and the nays are 5.

8 Senator Grassley. Mr. Chairman, I'd like to make sure
9 we have the resolution on flat rate tax that we discussed in
10 our topic. It didn't have a revenue figure with it and it
11 obviously can't, because it isn't on the list here.

12 The Chairman. As I understand that was adopted, it
13 just required -- directed Treasury to make a study of that.
14 But you have not objection to that.

15 Mr. Chapoton. No, we are presently engaged in the
16 study of lower base low rate tax, flat tax.

17 The Chairman. Just to give it more visibility.

18 Senator Bradley. Mr. Chairman, since the subject was
19 raised, I think at some point we want to take a vote on
20 who wants to reduce the marginal tax rate dramatically and
21 who wants to really eliminate these loop holes as opposed
22 to just nibbling around the edges as we have been doing here
23 the last day or so.

24 Now, I'm curious -- do you think it would be appropriate
25 for me to offer that amendment tonight so that we could get

1 people on record or do you think it would be better to wait
2 for some hearings, what's your thought.

3 That Chairman. I didn't say when.

4 Senator Bradley. Do we have a date for the hearings,
5 I mean could we have it in early September? I mean I know
6 you can't agree to a specific date certain, but I think --

7 The Chairman. I think it might depend, when do you
8 think the study may be finished?

9 Mr. Chapoton. Well, it is true, we are shooting for
10 about Labor Day. I don't want to absolutely promise that
11 we'll be far along. That accelerates very dramatically to
12 reach that point, but sometime this fall is what we're --

13 Senator Bradley. The study is evaluating which
14 proposal?

15 Mr. Chapoton. The study is going back to the very
16 basic effect, you need a lot of data.

17 Senator Bradley. You mean like if you eliminate the
18 exclusions you could lower the tax rate back to that basic --

19 Mr. Chapoton. Well, with the story point of the study,
20 Senator Bradley, is I think a lot of the data is gathered
21 from the '76 blueprints for tax reform and it's bringing
22 that information forward simply so you'll have a data base
23 from which to work to analyze various proposals including --
24 including yours which is certainly one that goes -- is
25 extremely interesting and we're taking a hard look at.

1 Senator Bradley. So, what is The Chairman's response
2 to the question posed about when the hearings might be. You
3 said early September.

4 The Chairman. Excuse me.

5 Senator Bradley. We're trying to get a fix on when we
6 might actually be able to look at these proposals in some
7 depth, the Treasury says they'd have their study done by
8 Labor Day, so do you think that maybe by mid September we'd
9 have a chance to have had a hearing?

10 The Chairman. I would think in that area. I mean I
11 don't want to fix a date, the Joint Committee is also doing
12 some work and I'm certain that different staff people are
13 working on it and in my view, it should be a fairly well
14 structured hearing. We ought to know precisely what we're
15 about and then have a lengthy hearing, so I would hope it
16 would happen sometime in September, depending on what else
17 is before the committee.

18 Senator Bradley. Well, I think that that earlier the
19 better. That's about 2 months away, that would give
20 certainly people time to prepare for it. I think the
21 issue is a very simple issue, do you want a simple fair
22 restructuring of the tax system or don't you. And a lot
23 of specific. That's what it's going to come down to. You
24 can have all night sessions and nibble around the edges or
25 you can really kind of get serious about this and decide

1 you're going to make a clean break with the past.

2 So I think that sooner or later we're going to vote on
3 this and sooner or later people are either going to vote for
4 reducing the marginal rate dramatically and eliminating most
5 of the underbrush or not. And just having a sense that we
6 would have a chance to look at this would give me some
7 reassurance that at least this session the Congress might
8 have a chance to make a judgement.

9 The Chairman. Right, I think we can -- there's a great
10 deal of interest in this overall area and we are -- you know,
11 in this package there are a few little areas that I think
12 do nibble around the edges, but you can get a taste of it
13 by voting for the final package.

14 Senator Bradley. Well, you know, if the carrot was
15 big enough, that would be a very attractive proposal. If the
16 carrot is a marginal rate drop to 14 percent, 75 percent
17 of the people, that's a big carrot. But I don't think it
18 is in this package. But the point is we'll have a chance to
19 consider that.

20 The Chairman. Oh, yes. If we don't --

21 Senator Chafee. Does your proposal remove the
22 deduction for home mortgage interest?

23 Senator Bradley. No, it does not.

24 The Chairman. Not that flat.

25 Senator Chafee. How about exemptions for children?

1 Senator Bradley. That's right, that's precisely right.

2 Senator Chafee. Charitable deductions?

3 Senator Bradley. No, it does not, it keeps that so
4 you can continue to give to your church or of course you
5 can --

6 Senator Chafee. Exemptions for children?

7 Senator Bradley. No, it doesn't provide for credit,
8 there's a deduction for child care.

9 Senator Chafee. Casualty losses?

10 Senator Bradley. No, it eliminates those.

11 Senator Chafee. They're out?

12 Senator Bradley. Yes. So I mean you'll have a chance
13 to vote on all those when we take it up --

14 Senator Heinz. I want you to know, Bill -- have you
15 got -- how about the rental value of parsonages?

16 Senator Bradley. We've looked at the Heinz experience
17 and we have --

18 Senator Heinz. That's the one thing I hope you did
19 do on HR636.

20 Sentaor Bradley. We've looked at the Heinze experience
21 and we want to successfully avoid that pitfall.

22 Senator Heinz. I've still got about 30,000 letters
23 from every single clergyman in my state, wondering why I
24 wanted to sunset that provision and I have shipped them to
25 you.

1 The Chairman. Senator Armstrong.

2 Senator Armstrong. Mr. Chairman, have we adopted the
3 package?

4 The Chairman. No, the flat rate.

5 Senator Bradley. That is an endorsement.

6 Senator Armstrong. But I judge in due course we will
7 adopt the flat rate, but I was referring to the package
8 that's before us.

9 The Chairman. No, we're near that point, but we will
10 have hearings on the flat rate proposal and I hope they
11 will come in September. I mean I'm not trying to be
12 evasive, but it would depend on the Treasury study, the
13 Joint Committee and our own Senate schedule, but I have an
14 interest in it also and I'm certain many members do.

15 Senator Bradley. That's fine, Mr. Chairman, that
16 assurance is at least something that we can take away from
17 this dark night and look to a brighter dawn.

18 The Chairman. Thank you. Senator Matsunaga.

19 Senator Matsunaga. Mr. Chairman, I had discussed this
20 matter earlier before the recess and then I discussed it
21 briefly with the Treasury people and they had indicated
22 they would look into the matter, but returning to leasing,
23 as I pointed out earlier, the airlines even before the
24 safe harbor leasing provisions were enacted in '81, the
25 airlines had a practice of leasing planes and making

1 improvements thereon. These are the non-severable improve-
2 ments.

3 Now, under the proposal to achieve needed fuel economy
4 and to cut operational costs as well as to meet FAA standards,
5 the airlines need to retire old engines and replace them with
6 new ones but they hesitate to do this because whenever they
7 do this on this lease planes, the lessor, according to the
8 Revenue Service, enjoys an income. Which means that the
9 lessor will shift that burden to the lessee causing the
10 lessee's cost to even double and so that -- what the
11 airlines would like to seek relief from is this ruling.
12 And as I understand it, there won't be too much of a loss
13 on revenues, but I don't know you have -- Secretary
14 Chapoton had indicated he's look into the matter wondering
15 -- in order to encourage the airlines to go ahead and make
16 the improvements on the planes and even to meet FAA
17 standards, I should think that the improvements made on
18 the plane by the lessee ought not to be considered as
19 income to the lessor.

20 Mr. Chapoton. Senator, I'm aware of the problem, I
21 just -- I don't know how to solve it or maybe whether or
22 not it's a proble, because the law is, of course, that any
23 value added -- that is received by the lessor in a lease
24 transaction, it's commercial transaction, would be income
25 to him.

1 As I understand this case, I believe I'm correct, they
2 rebuild the tail of the airplane or do some significant
3 repair or reconstruction of the airplane, the value does
4 flow to the lessor and the Internal Revenue Service in
5 interpreting the Internal Revenue Code, says that's income
6 to the lessor.

7 If value does flow to the lessor I don't know that I
8 see a basis for saying that that value on the other side
9 the lessee would be entitled to a capital cost recover for
10 his expenditure. I'm just not sure -- it does seem that
11 it shouldn't -- where the parties don't want that to flow,
12 they ought to be able to contract around it. For some
13 reason they must not be able to in that instance, but I
14 don't see how we can say capital expenditure on one side
15 that benefits the other party does not result in income to
16 the other party. I just don't know how to deal with that
17 problem.

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1 The Chairman. Is that the same concern?

2 Mr. McConaghy. We know of one airline that has maybe
3 70-some planes under lease with this problem. With respect
4 to that airline the loss would be probably somewhere around
5 \$400 million.

6 The Chairman. How much?

7 Mr. McConaghy. \$400 million, not starting until 1986.
8 We don't know of any other airlines that are in a similar
9 position. It is a problem, and we don't have a solution to
10 it, either.

11 The Chairman. Well, I might say to Senator Matsunaga
12 we have had this joint committee sifting through the
13 amendments, and they brought back 1-2-3-4-5-6 that, where we
14 have had a Democratic staff member, Republican staff member,
15 Treasury, and joint committee, we believe we can accept.
16 That doesn't mean you can't offer other amendments, but
17 I would hope that we might try to address Senator
18 Matsunaga's problem. But I am not certain.

19 You cannot support the amendment?

20 Mr. Chapoton. Well, we just don't know an acceptable
21 solution.

22 The Chairman. Have you taken a hard look at it?

23 Mr. Chapoton. Well, no. We really just looked at it
24 tonight.

25 The Chairman. Would you be willing to?

1 Mr. Chapoton. Certainly. And we do recognize the
2 problem, It does seem sort of an unusual arrangement.

3 Senator Matsunaga. I would not offer the amendment at
4 this point if I can have your assurance that you will look
5 real hard at it from the point of view of the philosophy
6 which I learned in law school on matters of taxation: You
7 either encourage a socially-desired objective, or you
8 discourage it. In this case I think it is a matter to be
9 encouraged.

10 So if you will look at it from that viewpoint and limit
11 it strictly to airlines, even; because this is going to hold
12 up needed improvements on the planes.

13 Mr. Chapoton. We would be happy to look at it. I think
14 the rule, if there is a solution, would probably apply
15 across the board; because if there is a problem here, the
16 problem would arise elsewhere, and maybe there is a solution,
17 Senator.

18 The Chairman. Well, if you will do that and keep me
19 informed.

20 I think what we might do, if it is all right with the
21 sponsor, I could just quickly go down this list. There is
22 an amendment, Senator Moynihan, which allows an elective
23 pension contribution on behalf of permanently-disabled
24 employees with limitations requiring the benefit to be
25 vested. That is one that has been properly screened,

1 monitored, no objections.

2 Is that true, Mr. McConaghy?

3 Mr. McConaghy. That is correct, Mr. Chairman.

4 The Chairman. The Treasury, I understand, has no
5 objection to that amendment.

6 Mr. Chapoton. That is correct, Mr. Chairman.

7 The Chairman. Is that satisfactorily adopted, Senator
8 Moynihan?

9 Senator Moynihan. Yes. I appreciate that, Mr. Chairman,
10 for disabled workers.

11 The Chairman. Then the amendment will be agreed to.

12 Senator Matsunaga has an amendment to allow corporate
13 joint ventures to use annual accrual methods of accounting,
14 and their early draft is to cover certain cooperatives.

15 I understand that has been addressed by the screening
16 committee?

17 Mr. McConaghy. That is correct.

18 The Chairman. There is no objection from the joint
19 committee or Treasury?

20 Mr. Chapoton. No objection from Treasury.

21 The Chairman. Is that all right if we adopt that
22 amendment?

23 Senator Matsunaga. Thank you, Mr. Chairman.

24 The Chairman. That amendment will be agreed to.

25 Senator Bentsen's -- this may have been adopted -- to

1 treat church employees in a manner similar to that allowed
2 for school and hospital employees with respect to retirement
3 savings.

4 Was that adopted earlier?

5 Mrs. McConaghy... I thought it was worked out earlier.

6 Senator Bentsen. It was adopted, subject to the staff
7 working out the language, and I understand that has been
8 done.

9 Mr. McConaghy. And it is worked out.

10 The Chairman. So, if not, it will be. And I might
11 say the revenue loss in the Moynihan Amendment is less than
12 \$5 million. The Matsunaga revenue loss is negligible.
13 The Bentsen Amendment would be \$5 million a year. So I
14 wanted to put these in the proper perspective. They are
15 very small amendments.

16 Senator Wallop has an amendment that passed the test
17 to impose excise tax on additional categories of recreational
18 equipment. The revenues will be voted to a special fund
19 for conservation. The amendment was offered on behalf of
20 the Administration. It gains approximately \$80 million per
21 year.

22 Is there any objection to that amendment?

23 Mr. McConaghy. No.

24 The Chairman. Does Treasury approve of that
25 amendment?

1 Mr. Chapoton. Yes, sir.

2 The Chairman. There are two others. Senator
3 Durenberger, an amendment for a two-year extension of
4 income exclusion for national research service awards.
5 That has a cost of \$9 million in 1983, and \$8 million in
6 1984. Has that been reviewed by Treasury?

7 Mr. Glickman. Yes, it has, Mr. Chairman.

8 The Chairman. Has that been reviewed by the joint
9 committee? Mark?

10 Mr. Belas. Yes, we have looked at it.

11 The Chairman. Is there any objection?

12 Mr. Glickman. No, Mr. Chairman.

13 The Chairman. Do you support the amendment?

14 Mr. Glickman. We do.

15 The Chairman. Then, Senator Long has an amendment that
16 members of Congress be treated in a manner similar to that
17 of other businessmen with respect to expenses while away
18 from home.

19 Does Treasury have a position on that amendment?

20 Mr. Chapoton. Our position was to stay away from that
21 amendment, Mr. Chairman.

22 (Laughter)

23 The Chairman. Does the joint committee have a position
24 on that amendment?

25 Mr. McConaghy. That is our position, also, Mr. Chairman.

1 (Laughter)

2 Mr. McConaghy. We are further away.

3 The Chairman. Would you like to broaden it to include
4 all Federal employees?

5 Senator Long. Well, it does include all Federal
6 employees.

7 The Chairman. They should all be alike.

8 Senator Armstrong?

9 Senator Armstrong. Mr. Chairman, it is your intention
10 to deal with Senator Long's amendment. I have an amendment
11 which I think fits more properly with the other group that
12 you have been considering that I think truly is not a matter
13 of any controversy. May I present this?

14 Senator Chafee. Well, Mr. Chairman, are you dealing
15 with Senator Long's amendment now?

16 The Chairman. What I am dealing with, everybody turned
17 in their amendments, and we formed a committee composed of
18 a member from the minority, from the majority, the joint
19 committee, and Treasury, on the basis that without approval
20 from all we would not accept those amendments. Now, maybe
21 yours wasn't in the --

22 Senator Armstrong. Well, Mr. Chairman, it was in the
23 list, and it is an amendment which I think is almost certain
24 to be approved by the committee, and is not controversial in
25 the slightest to anybody I know of except the Treasury.

1 And if I may have one minute, I think I can refresh
2 everybody's recollection on it.

3 The Chairman. All right.

4 Senator Armstrong. This is the Broadmoor Hotel
5 Amendment. As drafted, it will also accommodate a
6 foundation in which Senator Durenberger is interested; and
7 it may, although I am not certain, affect other foundations.

8 But the purpose of it is to simply eliminate the
9 existing requirement that the Broadmoor Hotel be divested
10 by the El Pomar Foundation.

11 A year ago at this time I proposed the amendment, and I
12 pointed out all the reasons why Senator Harte and I had
13 introduced this legislation that relates to the State of
14 Colorado and the unique status of the Broadmoor and of
15 El Pomar. And at the recommendation of the Chairman I
16 withheld action on that amendment at that time so that we
17 could have a hearing.

18 Senator Packwood was good enough to conduct the
19 hearing, and I believe, although of course he can speak for
20 himself, that he is prepared to support it.

21 I know of no Senator who opposes it, and I know of a
22 number on the committee who are prepared to support it. I
23 don't think it requires lengthy discussion.

24 Treasury opposes it for reasons that they can state,
25 but I understand, basically, it to be the issue that other

1 foundations have complied with this requirement, and that
2 in some sense it doesn't seem fair to exempt El Pomar and
3 the Broadmoor.

4 I think the hearing clearly showed that there is a
5 unique situation, a unique institution, which justifies
6 that consideration.

7 And so, while I could talk it at length, I think that
8 is the issue. And I would hope we could adopt it.

9 The Chairman. Could we hear from Treasury?

10 Mr. Chapoton. Mr. Chairman, we have dealt with this.
11 I think this question is going to come up in other contexts.
12 In 1969 there was a requirement, after long airings, as
13 many of you remember, many provisions dealing with private
14 foundations. One of the main provisions was a requirement
15 that private foundations divest themselves of business
16 assets.

17 There were several theories for that. I think the
18 principal reason was some concern about abuses where
19 foundations controlled private businesses. In any event,
20 the divestiture requirement was placed in the law.

21 Many foundations had to divest immediately. Others
22 were given longer years to get rid of closely-held
23 businesses. In this case, I believe the El Pomar Foundation
24 had almost 20 years to divest. Most others have divested
25 in the interim. I think this would be a total reversal

1 of the principle decided in 1969, and I don't know of a
2 distinction that would exist here.

3 Senator Armstrong. Mr. Chairman, I can provide that
4 distinction, and there are two. First, it is perfectly
5 correct, as Secretary Chapoton points out, that there have
6 been some foundation situations that contained abuses, where
7 members of the family were using it as a device to control
8 businesses, and so on, and that is not the situation, as
9 the hearing record clearly points out, in the El Pomar
10 case.

11 Second, I would point out that in 1969, when this
12 Act was passed, that it was the will of the Senate to
13 exempt El Pomar. In fact, the Senate version of the bill
14 did so, and somehow that slipped between the cracks, and
15 in fact probably on some dark night in 1969 somebody said,
16 "Well, there is plenty of time; they can always take care
17 of it next year." And that is really what we are doing
18 tonight.

19 The Chairman. Well, you did have hearings on this,
20 Senator Packwood?

21 Senator Packwood. We had hearings. I agree with
22 Senator Armstrong perfectly. It is a unique foundation
23 situation. I am not even sure it would be typical of what
24 we thought of in 1969.

25 The Chairman. I think, if there is no objection, we

1 should have a record vote on it, because it does involve
2 an interest, and I think in fairness to the public and the
3 committee the Clerk will call the roll.

4 The Clerk. Mr. Packwood?

5 Senator Packwood. Aye.

6 The Clerk. Mr. Roth?

7 Senator Roth. Aye.

8 The Clerk. Mr. Danforth?

9 Senator Danforth. Aye.

10 The Clerk. Mr. Chafee?

11 Senator Chafee. Aye.

12 The Clerk. Mr. Heinz?

13 Senator Heinz. Aye.

14 The Clerk. Mr. Wallop?

15 Senator Wallop. Aye.

16 The Clerk. Mr. Durenberger?

17 Senator Durenberger. Aye.

18 The Clerk. Mr. Armstrong?

19 Senator Armstrong. Aye.

20 The Clerk. Mr. Symms?

21 (No response)

22 The Clerk. Mr. Grassley?

23 Senator Grassley. Aye.

24 The Clerk. Mr. Long?

25 Senator Long. Aye.

1 The Clerk. Mr. Byrd?

2 Senator Byrd. Aye.

3 The Clerk. Mr. Bentsen?

4 Senator Bentsen. Aye.

5 The Clerk. Mr. Matsunaga?

6 Senator Matsunaga. Aye.

7 The Clerk. Mr. Moynihan?

8 Senator Moyniha. Aye.

9 The Clerk. Mr. Baucus?

10 Senator Baucus. Aye.

11 The Clerk. Mr. Boren?

12 Senator Boren. Aye.

13 The Clerk. Mr. Bradley?

14 Senator Bradley. Aye.

15 The Clerk. Mr. Mitchell?

16 Senator Mitchell. Aye.

17 The Clerk. Mr. Chairman?

18 The Chairman. Aye.

19 On this vote the Ayes are 19, the Nays are zero. I
20 should think Senator Symms would want to be recorded. So
21 it is 19 to zero.

22 We were on Senator Long's amendment. But Lloyd has
23 another one in this same category.

24 Senator Long. Well, if you don't mind, might we vote
25 on mine?

1 The Chairman. Sure.

2 Senator Long. This is a very simple proposition. It
3 just appears like everybody else, as far as I can see.

4 The Chairman. The Clerk will call the roll.

5 Senator Chafee. Well, Mr. Chairman, could I just say
6 one word?

7 The Chairman. Sure.

8 Senator Chafee. Mr. Chairman, I have introduced
9 legislation along these same lines. I voted this way on
10 various times on the floor. It just seems to me --
11 reluctantly I conclude -- that this is not the time to
12 bring it up in connection with this. I think it will muddy
13 the waters. I think it will just distract attention from
14 a laudable effort we are making in connection with this
15 tax bill. And those are the reasons I would vote against
16 it.

17 The Chairman. COuld I just say, and I would not try
18 to influence the Senator from Rhode Island, my view is that
19 it might lay it to rest. It seems to me that we have
20 kicked this around for so long, and I am not certain there
21 is a solution, but --

22 Senator Armstrong. Mr. Chairman, I will be very brief.
23 I agree with Senator Chafee. I think that the proposal
24 which Senator Long has advanced is the correct answer to
25 the problem; but, as I have confided to him privately, I

1 personally am very reluctant to put it in this bill. If
2 it happens, I won't alter my vote on the final passage of
3 the bill; I won't be upset by it; but my concern is that
4 this provision, if it is included in this bill, will
5 preempt the public's attention on what is an extraordinarily
6 important piece of tax legislation.

7 The reason we are going through this exercise, both
8 the spending cuts which we approved a few days ago and the
9 tax measures, is that we want to make a demonstration that
10 we are going to get Federal revenues and spending into
11 balance, and this is one aspect of it.

12 In fact, it is a dramatic demonstration of that fact
13 because the cynics said eight days ago, when we adopted
14 the budget resolution, "Why, they would never get that
15 implemented." And here we are, practically a week later,
16 proving that the Finance Committee is going to report a
17 reconciliation bill that is right on target with the budget
18 resolution. And that's the focus that we ought to maintain.
19 And my concern is that if we put this matter that deals with
20 our own taxation in this bill, that that is going to be
21 what everybody is going to focus on instead of the larger
22 issue.

23 So I am going to vote No at this time, but I have
24 already said to the Senator that if he wants to put it on
25 the debt bill, or anything else, that I will support him,

1 because I think the principle is correct.

2 Senator Long. Well, let me just make this point
3 clear. I was here in 1952 when Congress passed this
4 \$3000 arbitrary assumption that we were entitled to deduct
5 \$3000 for being away from home in Washington, D.C. That
6 was severely criticized at the time.

7 John Williams, a Republican at that time, had
8 credentials to the Senate, and he severely criticized it.
9 He was applauded for being against it on the grounds that
10 Congress was giving itself a special break it wouldn't give
11 other taxpayers.

12 Subsequently we had this thing offered last year, which
13 was about the most unpopular thing that Congress had done
14 in the whole 33 years I have been around here.

15 The Chairman said we are going to conduct hearings and
16 do something about it. Well, we conducted hearings. The
17 committee did not recommend legislation, so Senator
18 Proxmire offered something on the floor to put it back the
19 way it was when it was \$3000.

20 Now we have a chance to correct it. And, as far as
21 I am concerned, that is just the same old seven-and-six,
22 "Not now, some other time."

23 We have no idea when we will ever have an occasion to
24 vote on it if we don't vote on it now. You talk about tax
25 reform. The people expect us to reform our own bill and

1 take out anything in the law that gives us a special
2 advantage over everybody else. And that is all I'm suggesting
3 here.

4 It has the support of Common Cause, Congress Watch,
5 the National Taxpayers Union, and just anybody else that
6 you want to bring up here to talk about how it ought to be,
7 that's how they say it ought to be.

8 Now, go ahead and say, if you want to that "I'm for
9 this; this is great; this is what we ought to do; but not
10 now." Those who take that arrangement never do find the
11 right time to do it.

12 The Chairman. Well, are we ready to vote?

13 Senator Durenberger. I would just make a brief
14 comment, and that is, we have discussed this issue on every
15 vehicle other than a tax bill. We are marking up a tax
16 bill, and I think this is the appropriate place to include
17 it.

18 The Chairman. And I want to say to Senator Armstrong
19 who has led an effort to change it, I can understand his
20 view. But as one who led the other effort, I hope you
21 understand mine. I am going to vote for it.

22 Senator Armstrong. I do, indeed. And let me stress
23 again that, if I understand Senator Long's proposal, it is
24 exactly to the specification that I believe in; that is, to
25 treat members of Congress for tax purposes just like any

1 other taxpayers -- no better, but no worse, either -- but
2 just like every other taxpayer in America. And I think
3 that's right.

4 So my reservation is only the same as Senator Chafee
5 has expressed.

6 The Chairman. The Clerk will call the roll.

7 Senator Baucus. Mr. Chairman, I just want the record
8 to state why I vote against this. It is the same reason
9 as mentioned by the Senator from Wyoming.

10 As I understand the proposal, the practical effect of
11 this will be that the members of Congress will treat
12 Washington, D.C. as their home, not their states. And I,
13 frankly, think that that is not the impression we should
14 leave here. But that, in my judgment, will very much be
15 the impression by taking this vote.

16 Senator Matsunaga. Which means, Mr. Chairman, that
17 we may not be eligible to run for Senate from our home
18 state.

19 The Chairman. Well, I will take that chance, I guess.

20 The Clerk will call the roll.

21 The Clerk. Mr. Packwood?

22 Senator Long. Let me just say that this doesn't say
23 where your home is. It just strikes out anything about the
24 members of Congress, so you would have to go by the same
25 law as everybody else. It is just that simple.

1 It is just the same rule as for anybody else. That is
2 all it amounts to.

3 The Clerk. Mr. Packwood?

4 Senator Packwood. Aye.

5 The Clerk. Mr. Roth?

6 Senator Roth. Aye.

7 The Clerk. Mr. Danforth?

8 Senator Danforth. Aye.

9 The Clerk. Mr. Chafee?

10 Senator Chafee. No.

11 The Clerk. Mr. Heinz?

12 Senator Heinz. No.

13 The Clerk. Mr. Wallop?

14 Senator Wallop. No.

15 The Clerk. Mr. Durenberger?

16 Senator Durenberger. Aye.

17 The Clerk. Mr. Armstrong?

18 Senator Armstrong. ~~Aye~~ No.

19 The Clerk. Mr. Symms?

20 Senator Symms. Aye.

21 The Clerk. Mr. Grassley?

22 Senator Grassley. No.

23 The Clerk. Mr. Long?

24 Senator Long. Aye.

25 The Clerk. Mr. Byrd?

1 Senator Byrd. No.

2 The Clerk. Mr. Bentsen?

3 Senator Bentsen. No.

4 The Clerk. Mr. Matsunaga?

5 Senator Matsunaga. No.

6 The Clerk. Mr. Moynihan?

7 Senator Moynihan. No.

8 The Clerk. Mr. Baucus?

9 Senator Baucus. No.

10 The Clerk. Mr. Boren?

11 Senator Boren. No.

12 The Clerk. Mr. Bradley?

13 Senator Bradley. Aye.

14 The Clerk. Mr. Mitchell?

15 Senator Mitchell. Aye.

16 The Clerk. Mr. Chairman?

17 The Chairman. Aye.

18 On this vote the Ayes are 9, and the Nays are 10. The
19 amendment is not agreed to.

20 Senator Bentsen?

21 Senator Bentsen. Mr. Chairman, this is along the lines
22 of Senator Armstrong's bill. And what we are talking about
23 is a foundation that owns an independent newspaper in
24 Houston, Texas. It owns the Houston Chronicle. It is the
25 Houston Endowment. We have had hearings on this piece of

1 legislation. It is the situation, once again, where they
2 would have to divest themselves of this independent
3 newspaper.

4 Traditionally these days you find those independent
5 newspapers are sold out to chains, and, frankly, I think we
6 ought to try to preserve as many independent newspapers as
7 we can. And I would ask that the legislation be adopted.

8 The Chairman. As I understand, they presented written
9 testimony. Is that correct?

10 Senator Bentsen. Yes. They had testimony before the
11 hearing where we discussed these issues. They have appeared.

12 The Chairman. Does Treasury have a position on this
13 amendment.

14 Mr. Glickman. Mr. Chairman, our position is the same
15 as was discussed in the Broadmoor issue. We think that
16 we would oppose this amendment.

17 The Chairman. Is there further discussion of this
18 amendment?

19 (No response)

20 The Chairman. The Clerk will call the roll.

21 The Clerk. Mr. Packwood?

22 Senator Packwood. Pass.

23 The Clerk. Mr. Roth?

24 (No response)

25 The Clerk. Mr. Danforth?

1 Senator Danforth. Aye.
2 The Clerk. Mr. Chafee?
3 Senator Chafee. Aye.
4 The Clerk. Mr. Heinz?
5 (No response). Aye.
6 The Clerk. Mr. Wallop?
7 Senator Wallop. Aye.
8 The Clerk. Mr. Durenberger?
9 Senator Durenberger. Aye.
10 The Clerk. Mr. Armstrong?
11 Senator Armstrong. Aye.
12 The Clerk. Mr. Symms?
13 Senator Symms. Aye.
14 The Clerk. Mr. Grassley?
15 Senator Grassley. Aye.
16 The Clerk. Mr. Long?
17 Senator Long. Aye.
18 The Clerk. Mr. Byrd?
19 (No response). Aye.
20 The Clerk. Mr. Bentsen?
21 Senator Bentsen. Aye.
22 The Clerk. Mr. Matsunaga?
23 Senator Matsunaga. Aye.
24 The Clerk. Mr. Moynihan?
25 Senator Moynihan. Aye.

1 The Clerk. Mr. Baucus?

2 Senator Baucus. Aye.

3 The Clerk. Mr. Boren?

4 Senator Boren. Aye.

5 The Clerk. Mr. Bradley?

6 Senator Bradley? Aye.

7 The Clerk. Mr. Mitchell?

8 Senator Mitchell. Aye.

9 The Clerk. Mr. Chairman?

10 The Chairman. Aye.

11 Senator Roth. Mr. Chairman?

12 The Chairman. Senator Roth?

13 Senator Roth. Aye.

14 Senator Packwood. Mr. Chairman, Aye.

15 The Chairman. Senator Packwood, Aye; Senator Roth, Aye.

16 Senator Heinz. Mr. Chairman, Aye.

17 The Chairman. Senator Heinz, Aye.

18 (Pause)

19 The Chairman. On this vote the Yeas are 19, the
20 Nays are zero, and one Present.

21 Now, let me say before we start the amendment derby here
22 that we are not going to have one. We have had two
23 additional amendments that have been cleared by the
24 committee. One, Senator Chafee, with reference to foreign
25 corrupt practices. "Under present law domestic corporations

1 cannot deduct payments to to foreign officials or agents of
2 a foreign government if such payments would be illegal under
3 U.S. law." The proposal would allow a deduction for payments
4 to foreign officials or agents of a foreign government if
5 the payment is legal under the Foreign Corrupt Practices
6 Act, even if the payment violates other U.S. laws. Is
7 that how you understand the amendment?

8 Senator Chafee. That is correct, Mr. Chairman.

9 This would allow the payments which are permitted
10 under the Foreign Corrupt Practices Act. We had hearings
11 on this. Mr. Chapoton appeared.

12 The Chairman. Do they support the amendment?

13 Mr. Chapoton. Yes, sir, we supported the amendment.

14 It brings into conformity the tax law and the Foreign
15 Corrupt Practices Act.

16 The Chairman. And you did testify in support of this?
17 There was a hearing?

18 Mr. Chapoton. Yes, we testified at the hearing in
19 support of it.

20 The Chairman. Was there opposition to the amendment?

21 Senator Chafee. Not that I recall. The other testimony
22 was from the STR's office, in favor of this.

23 The Chairman. All in favor of the amendment say Aye.

24 Senator Bradley. Mr. Chairman, before we vote on it,
25 I don't understand what the amendment is. It sounds like

1 you said that you can deduct a payment to a foreign official.
2 I mean, did I hear right? Does the Treasury support that?
3 I don't want to make a thing at this time, it's just that
4 I have not seen it on any piece of paper nor have I heard
5 anything about it.

6 Senator Chafee. All right.

7 The Foreign Corrupt Practices Act which is currently
8 on our books and has been there since 1977 says, "As used
9 in this Section, the term "foreign official" means any
10 officer or an employee of a foreign government for any
11 department, agency, and so forth. Such term does not
12 include any employee of a foreign government for any
13 department, agency, or instrumentality, therefore, whose
14 duties are essentially ministerial or clerical."

15 In other words, under the Foreign Corrupt Practices
16 Act you are permitted to make certain payments to expedite
17 unloading of a vessel, for example. Those are permitted
18 under the Foreign Corrupt Practices Act.

19 Under the Internal Revenue Code they are not
20 deductible. And this would make them -- because of prior
21 language that existed in the Internal Revenue Code -- this
22 would meke such payments that are legal under the Foreign
23 Corrupt Practices Act deductible under the Internal Revenue
24 Code.

25 Mr. Chapoton. We went into this rather carefully,

1 Senator Bradley.

2 The principal problem is there is a distinction in
3 the Foreign Corrupt Practices Act and in the Internal
4 Revenue Code. The payment, if made here, would be or
5 might be illegal. The confusion is caused because it might
6 be illegal if the same transaction occurred in the United
7 States. But if it occurs abroad, obviously it is not in
8 violation of U.S. law, and it is not a violation of the
9 Foreign Corrupt Practices Act.

10 This is an amendment from a much broader bill that
11 would deal with several problems in the Foreign Corrupt
12 Practices Act. We have supported that bill, and we have
13 supported this amendment.

14 Senator Bradley. Could we have a roll call?

15 The Chairman. The Clerk will call the roll.

16 The Clerk. Mr. Packwood?

17 Senator Packwood. Aye.

18 The Clerk. Mr. Roth?

19 Senator Roth. Aye.

20 The Clerk. Mr. Danforth?

21 Senator Danforth. Aye.

22 The Clerk. Mr. Chafee?

23 Senator Chafee. Aye.

24 The Clerk. Mr. Heinz?

25 Senator Heinz. Aye.

1 The Clerk. Mr. Wallop?
2 Senator Wallop. Aye.
3 The Clerk. Mr. Durenberger?
4 Senator Durenberger. Aye.
5 The Clerk. Mr. Armstrong?
6 Senator Armstrong. Aye.
7 The Clerk. Mr. Symms?
8 Senator Symms. Aye.
9 The Clerk. Mr. Grassley?
10 Senator Grassley. Aye.
11 The Clerk. Mr. Long?
12 Senator Long. Aye.
13 The Clerk. Mr. Byrd?
14 Senator Byrd. Aye.
15 The Clerk. Mr. Bentsen?
16 Senator Bentsen. Aye.
17 The Clerk. Mr. Matsunaga?
18 Senator Matsunaga. Aye.
19 The Clerk. Mr. Moynihan?
20 Senator Moynihan. No.
21 The Clerk. Mr. Baucus?
22 Senator Baucus. No.
23 The Clerk. Mr. Boren?
24 Senator Boren. Aye.
25 The Clerk. Mr. Bradley?

1 Senator Bradley. No.

2 The Clerk. Mr. Mitchell?

3 Senator Mitchell. Aye.

4 The Clerk. Mr. Chairman?

5 The Chairman. Aye.

6 On this vote the Yeas are --

7 The Clerk. Fifteen.

8 The Chairman. And the Nays are?

9 The Clerk. Three, and there is one ~~Passant~~.

10 The Chairman. The Nays are three. The amendment is
11 agreed to.

12 Senator Bentsen. Mr. Chairman, a clarification, if
13 I might ask the Secretary.

14 The Chairman. Yes.

15 Senator Bentsen. On the IDBs, the point was made that
16 they had to be approved, as I recall, by an elected official.

17 In Texas we have something like an industrial
18 commission. They are all appointed, but appointed by the
19 Governor who is an elected official. Would they qualify?

20 Mr. Chapoton. No, they would not. There would have
21 to be approval. That was one of the points -- I wanted to
22 get clarification on that -- that we addressed at some
23 length in our proposal, and I believe that was adopted
24 in this proposal. It would take an elected official. The
25 point being to have a higher visibility -- administratively

1 a higher visibility of approval of private-purpose bonds.
2 So there would have to be a change in local procedures.

3 Mr. McConaghy. Senator Bentsen, under the provision
4 as adopted, though, an elected official could appoint
5 another elected official.

6 The Chairman. Senator Bentsen, there is another
7 amendment that has been cleared and that they have had
8 hearings on that provides the presence in a motor vehicle
9 lease of a terminal rental adjustment clause will not cause
10 the lease not to be treated as a lease for taxpayers prior
11 to the enactment of ERTA in 1981. This provision will
12 apply only where the lessee was a business user.

13 As I understand, this has been addressed by the
14 joint committee, by Treasury, by a member from each staff,
15 and they have agreed. And I understand Treasury has only
16 a mile objection. Is that correct?

17 Mr. Chapton. I am sorry, Mr. Chairman, I was occupied.
18 This is on which amendment?

19 The Chairman. It provides that "The presence in a
20 motor vehicle lease of a terminal rental adjustment clause
21 will not cause the lease not to be treated as a lease for
22 tax purposes prior to the enactment of ERTA in 1981. It
23 applies only where the lessee was a business user."

24 Mr. Chapton. We have opposed that, Mr. Chairman.

25 The Chairman. The Treasury does object to this?

1 Mr. Chapoton. Yes, we do object.

2 Senator Bentsen. Well, this is a situation where
3 you would prevent the retroactive change in the tax
4 treatment of a binding contract-for-lease of a motor
5 vehicle entered into before publication of a new rule
6 changing the regulation.

7 Now, that has been in effect for some 30 years, that
8 they have been using that. The Service tried to change
9 that by a technical memorandum, and that was a reversal
10 of what they had done by audit before, and it is also
11 in spite of U.S. Tax Court rulings.

12 We are just talking about this on the retroactive
13 part of it.

14 Mr. Chapoton. Senator Bentsen, it is my understanding
15 that I think the practice had gone on. When the IRS
16 audited the situation, for the first time it did not
17 reverse a policy; it for the first time held that the
18 lease was not a lease but was a conditional sale arrangement
19 because the terminal rental adjustment clearly had the
20 effect of placing all the risk of ownership on the alleged
21 lessee.

22 Senator Armstrong. Mr. Chairman, I hope we will
23 adopt the amendment that Senator Bentsen is suggesting.
24 In fact, it is my recollection that we discussed this a
25 year ago and that we thought that we had achieved exactly

1 the purpose that the Senator's amendment now accomplishes.
2 We all went home thinking we had solved this problem. And
3 sometime after that it turned out we didn't. Isn't that
4 the recollection that you have, Lloyd?

5 Senator Bentsen. Well, that was my understanding.
6 The proposal produces no revenue loss, and may even save
7 the Federal Government some substantial sums of money.

8 Mr. Chapoton. I don't remember what happened last
9 year.

10 Senator Armstrong. Well, in fact, there was even a
11 colloquy on this matter in the House in which we thought
12 it was nailed down tight, that these car dealers were not
13 going to get caught in this trap. And that is really what
14 we are talking about, is a bunch of people who entered
15 into leases thinking they would be treated as leases, as
16 they have been, as Senator Bentsen points out, for 30 years;
17 and then, in one way or another, the Service came in and
18 said, "No, that's not right." So we attempted to fix it
19 in last year's bill, and there was a colloquy between the
20 Chairman of the Ways and Means Committee and Cecil Heftil
21 on the floor of the House, which again we thought clarified
22 that. So I don't think this is an issue over which there
23 should really be any controversy.

24 Senator Bentsen. I might say, also, this type of
25 lease now will be allowed under safe harbor leasing. So

1 all we are trying to do is to protect any retroactive action
2 on it.

3 Mr. Chapoton. I think that would be true, Senator,
4 only if the lessee is a business user.

5 Senator Bentsen. Well, it is limited to that.

6 Mr. Chapoton. And I think under the prior law, if the
7 lessee were a business user, I believe the IRS position is
8 neutral.

9 Senator Bentsen. That kind of a limitation would be
10 fine on it.

11 The Chairman. Pardon?

12 Senator Bentsen. Limiting it to business usage.

13 The Chairman. Yes. In fact, that's what I suggested,
14 Mr. Chapoton. I think it had to be limited to business
15 use. "It applies only where the lessee was a business user."

16 Mr. Chapoton, we have restricted that. That is how
17 I presented it.

18 Mr. Chapoton. Well, it does give us less trouble if
19 both -- well, obviously the lessor would be a business, but
20 if the lessee has business use of the property.

21 We would not support, but I guess our objections
22 would be diminished.

23 The Chairman. Without objection the amendment will
24 be agreed to.

25 Now, I understand the Treasury now seeks repeal of

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4.25 percent interest rate limit on U.S. bonds, and they would determine what bonds can be issued at market rates consistent with the ability of the markets to absorb them and with the Government's long-term goals in structuring its debt.

As I understand, that is an amendment that the Administration is requesting along with the savings bond proposal which would give the Secretary general discretion to adjust yields on savings bonds.

1 The Chairman. The Treasury now seeks to on bonds. And
2 then they would determine what bonds could be issued at
3 market rates consistent with the ability of the markets to
4 absorb them, and with the government's long-term goals in
5 structuring to death. As I understand, that's the amend-
6 ment the Administration is requesting along with these
7 savings bond proposals, which would give the Secretary general
8 discretion to adjust yields on savings bonds. And in not
9 asking for legislation would spell out how the discretion
10 might be exercised. You want to raise the rate, is that it?

11 Mr. Chapoton. That's correct. We want authority to
12 raise the rate.

13 The Chairman. Any hearings on these?

14 Mr. Chapoton. I've been informed there have been hearings.
15 This is not my area.

16 The Chairman. Treasury have any objections to these
17 amendments?

18 Mr. Chapoton. No, no, we support the amendment.

19 The Chairman. Your amendment?

20 Mr. Chapoton. I believe that is our amendment. We
21 proposed that.

22 The Chairman. Joint.

23 Mr. McConaghy. There has been hearings. The House, on
24 the debt ceiling, decided to take it up to \$100 billion
25 rather than all the way. And that would presumably take

2
1 them through 1984, I think, Mr. Chairman. They did not want
2 to make it unlimited because they didn't know what the effect
3 might be with other bonds in the market. So you could
4 perhaps put a cap at \$100 or \$120 and take it up \$30 or \$50
5 billion. But there was some concern on the effect if it were
6 unlimited.

7 The Chairman. So it should be capped?

8 Mr. McConaghy. I think you could take it up to
9 \$110 billion or something, which would be \$40 billion more,
10 and that would take them through 1984.

11 Mr. Chapoton. This is obviously not my area, Mr.
12 Chairman. I am informed that we can live with the cap.

13 The Chairman. Are there objections to the amendments?

14 Senator Armstrong. Mr. Chairman, I don't know if there
15 are any objections, but some of us at this end of the table
16 aren't sure what we are talking about here. Are we talking
17 about adjusting the interest on --

18 Mr. Chapoton. On long-term Treasury bonds.

19 Mr. McConaghy. Yes. Today, there is a restriction
20 on the amount of long-term bonds that the Treasury can issue
21 at a rate higher than 4-1/2 percent. And that is \$70 billion
22 that they can issue. And they are close to that ceiling.

23 Senator Armstrong. And we are proposing to go to
24 \$110.

25 Mr. McConaghy. That was one suggestion. I think the

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1 amendment, as proposed, was unlimited. There was some
2 concern that perhaps unlimited may create some problems and
3 anxiety in the market with other issues of long-term bonds.
4 Perhaps there ought to be a cap on it. You take it up
5 \$30 or \$40 billion, which would take them through 1984. The
6 Ways and Means Committee did take them up from \$70 to \$100.
7 That ceiling bill never got enacted. So I think many feel
8 that there should be a cap perhaps or a limitation at a
9 \$100 or \$110 million as the amount that can be issued.

10 Senator Armstrong. But this is a sub-limit within the
11 total debt limit?

12 Mr. McConaghy. It's just the amount of long-term
13 bonds that the Treasury can issue within the overall limit
14 at a higher interest rate than 4-1/2 percent. Yes, Senator
15 Armstrong.

16 Senator Armstrong. But in other words, it does not
17 affect the total debt limit, only a sub-limit within that.
18 So the effect of this is not to increase the debt.

19 Mr. McConaghy. That's right. Just to give them
20 authority to issue.

21 Senator Armstrong. Thank you.

22 Senator Heinz. What is the average maturity now?

23 Mr. McConaghy. I think the average maturity is three
24 to four years, Senator Heinz.

25 Senator Heinz. And this is an attempt to stretch it out

4
1 still further?

2 Mr. McConaghy. These are long-term bonds. That's
3 correct.

4 Senator Heinz. So that every Tuesday there won't be
5 quite as much that has to be financed.

6 Mr. McConaghy. That's right.

7 The Chairman. Is there any objection to the amendments?
8 If not, the amendments will be agreed to.

9 Now there is one amendment by Senator Boren and one by
10 Senator Symms. And as far as I know, that would complete
11 the amendments that have been properly screened. Now that
12 doesn't mean you can't offer amendments, but I hope they
13 won't be adopted.

14 Senator Boren's amendment would allow an individual to
15 make an annual election to capitalize intangible drilling
16 costs over ACRS over five years, with the ITC. And, thus,
17 have the non-expensed IDC not considered a preference.
18 I don't understand this.

19 Senator Buren. Mr. Chairman, what that would do is
20 we had a problem in the way the individual tax was originally
21 drawn. They could have provided more generous treatment for
22 major integrated oil companies than it might under certain
23 conditions for an individual. And all this says is that
24 if an individual, independent producer, for example, wishes,
25 he may, on an annual basis, elect to take the 15 percent less

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1 on his IDC and amortize or rather depreciate the other 15
2 percent out over the five year period, just like the major
3 oil companies. So in those situations it would simply allow
4 him to be treated the same way as a major oil company would
5 be treated. And I think this has now been worked out with
6 Treasury.

7 The Chairman. Has this been reviewed by the Joint
8 Committee?

9 Mr. McConaghy. We have looked at it. Yes, Mr. Chairman.

10 The Chairman. Are there any objections?

11 Mr. McConaghy. I think we feel that this is the least
12 offensive way certainly to take care of it.

13 The Chairman. Has it been reviewed by Treasury?

14 Mr. Chapoton. As I understand, it would give the same
15 treatment. If it was the same treatment, we would have no
16 problem.

17 The Chairman. Without objection, the amendment would
18 be agreed to. Senator Symms.

19 Senator Symms. Mr. Chairman, this is what I think is
20 akin to what I think will be a fair agreement. What it would
21 be would be to eliminate the preference for all hard rock
22 minerals except for coal and iron-ore. The rationale for
23 that -- that is where most of the money actually is -- and
24 the rationale for that is that coal and iron-ore receive a
25 special capital gains treatment versus income when the coal

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1 is split from the iron-ore. So they are already getting a
2 little better break than the hard rock minerals.

3 We don't have the revenue numbers, but the estimates
4 are that it would be very minimal because all the hard rock
5 minerals are in a negative position right now as far as
6 profits. Ninety-nine percent of them are losing money.

7 The Chairman. Has this been reviewed by the Joint
8 Committee and by Treasury and by a member from each --

9 Mr. McConaghy. Yes, Mr. Chairman.

10 Mr. Chapoton. Yes, Mr. Chairman.

11 Senator Durenberger. Mr. Chairman, could I just ask
12 why iron-ore -- I don't know anything about it, but I have
13 got a lot of it in my state or some of it.

14 Senator Symms. The reason is that there is a
15 difference.

16 Mr. Chapoton. I was just going to state that we
17 proposed a stronger minimum tax. I would just like to state
18 that again. And this makes a further adjustment.
19 I guess we would have preferred the stronger minimum tax.
20 Now this is a further adjustment that the Minimum Tax
21 Committee is about to adopt.

22 Senator Heinz. Mr. Chairman, I am like Senator
23 Durenberger, only I have got a lot of coal. Why is this
24 fair treatment for coal?

25 Mr. McConaghy. I don't know, Senator Heinz. I suppose

1 one reason could be that coal and iron-ore get capital
2 gain treatment under Section 613 and the others don't.

3 Senator Heinz. But if you are operating a coal mine,
4 how does that help you? Capital gains is only when you
5 sell your mine. If you are an operating entity, I don't --
6 it seems to me that you are giving some special treatment to
7 hard rock minerals, but denying it to an operating coal mine
8 or iron-ore mine. Maybe I don't understand the issue, but
9 that's what it seems like to me.

10 Senator Wallop. I have both coal and iron.

11 (Laughter)

12 Senator Heinz. It's your turn to speak.

13 Senator Wallop. I am just reiterating what both the
14 Senator from Pennsylvania and the Senator from Minnesota
15 said.

16 Senator Symms. Well, we could take them all out.
17 That would be much more expensive. There's no loss to the
18 Treasury right now on all the mines that are all in a non-
19 profit position. And coal and iron-ore do have this other
20 special capital gains treatment that the other minerals
21 don't have-- lead, zinc, silver, copper and so forth -- that
22 are all very depressed.

23 Senator Durenberger. You ought to come up and see how
24 depressed iron-ore is.

25 The Chairman. What's the pleasure? Do you want to vote?

8

1 Senator Heinz. I want to vote it down.

2 Senator Symms. Well, how about -- you could be protected

3 if you wanted to offer an amendment to do so.

4 The Chairman. First, we will call the roll.

5 The Clerk. Mr. Packwood.

6 Senator Packwood. Yes.

7 The Clerk. Mr. Roth.

8 (No response) Aye.

9 The Clerk. Mr. Danforth.

10 Senator Danforth. Aye.

11 The Clerk. Mr. Chafee.

12 Senator Chafee. Aye.

13 The Clerk. Mr. Heinz.

14 Senator Heinz. No.

15 The Clerk. Mr. Wallop.

16 Senator Wallop. No.

17 The Clerk. Mr. Durenberger.

18 Senator Durenberger. Aye.

19 The Clerk. Mr. Armstrong.

20 Senator Armstrong. Aye.

21 The Clerk. Mr. Symms.

22 Senator Symms. Aye.

23 The Clerk. Mr. Grassley.

24 Senator Grassley. Aye.

25 The Clerk. Mr. Long.

9
1 Senator Long. Aye.

2 The Clerk. Mr. Byrd.

3 Senator Byrd. Aye.

4 The Clerk. Mr. Bentsen.

5 Senator Bentsen. Aye.

6 The Clerk. Mr. Matsunaga.

7 Senator Matsunaga. Aye.

8 The Clerk. Mr. Moynihan.

9 Senator Moynihan. Aye.

10 The Clerk. Mr. Baucus.

11 Senator Baucus. Aye.

12 Mr. Clerk. Mr. Boren.

13 Senator Boren. No.

14 The Clerk. Mr. Bradley.

15 Senator Bradley. No.

16 The Clerk. Mr. Mitchell.

17 Senator Mitchell. Aye.

18 The Clerk. Mr. Chairman.

19 The Chairman. Aye.

20 On this vote, 15 yeas, and 3 nays. The amendment is
21 agreed to.

22 Senator Armstrong. Mr. Chairman, was I recorded on that
23 vote?

24 The Chairman. Senator Armstrong is recorded.

25 Senator Armstrong. I would like to record as voting

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1 on it.

2 The Chairman. I think Senator Roth had a question.
3 I think we have taken care of it.

4 Senator Roth. With respect to the action we took on
5 flexible interest rates for long-term bonds, isn't that
6 intended to apply as well to the all savings bonds?

7 Mr. Chapoton. Senator, all I know is that we supported
8 our proposal. And I will have to get a further explanation
9 of exactly what that is designed to allow. And I will just
10 have to inform you of that later. I do not know.

11 The Chairman. Senator Mitchell wanted to have a
12 colloquy. I can't remember what it was.

13 Senator Mitchell. Right, Mr. Chairman. I had intended
14 to offer an amendment to limit the extent to which states
15 may tax a foreign source income of a wholly national
16 corporation. And after discussion with you, I understand
17 you are prepared to make a commitment to have hearings as
18 soon as possible on that. And I would ask for that
19 assurance. And I would not offer the amendment.

20 Senator Packwood. Are these on the unitary tax base
21 again?

22 Senator Mitchell. That's right. I understand there is
23 some opposition to it. And, therefore, the Chairman has
24 agreed to hold hearings.

25 The Chairman. I will do that and do it as quickly as I

1 can, if that is satisfactory.

2 Senator Mitchell. Yes.

3 The Chairman. Thank you. Senator Boren.

4 Senator Boren. May we have permission to revise and
5 extend our remarks and explanations of the amendments we
6 have offered tonight for the record?

7 The Chairman. Yes. You can do that tomorrow some
8 time. In fact, the record will be open, I think, for a few
9 days.

10 Senator Durenberger. Mr. Chairman, your willingness
11 earlier to consider matters in 4717 -- I neglected to include
12 in my suggestion to you the issue of multi-family IDBs for
13 building code compliance and energy conservation, which
14 the House has under consideration on their side. At this
15 point, Mr. Chairman, I would propose an amendment which I
16 inherited because I wasn't here in 1978. It's an amendment
17 very narrowly drawn to permit only the port authority of
18 St. Paul to advance refund a limited number of their
19 industrial revenue bonds. In '77, Treasury issued proposed
20 regulations prohibiting this kind of advance refunding.
21 In '78, certain other municipalities in the country sought
22 and obtained legislative relief from the Congress. St.
23 Paul, at that time, because of the unique nature of their
24 problem, was promised by Treasury that it could be taken
25 care of by regulation. It has not been taken care of by

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1 regulation. And so I propose my amendment.

2 The Chairman. As I understand, there is strong
3 objection to this from Treasury.

4 Mr. Chapoton. That is correct, Mr. Chairman.

5 Senator Packwood. I thought we were only considering
6 amendments that had approval.

7 The Chairman. Well, they are mild objections. This is
8 strong?

9 Mr. Chapoton. We strongly oppose the amendment.

10 The Chairman. You want a roll call, Dave?

11 Senator Durenberger. Please.

12 The Chairman. The Clerk will call the roll.

13 The Clerk. Mr. Packwood.

14 Senator Packwood. No.

15 The Clerk. Mr. Roth.

16 (No response)

17 The Clerk. Mr. Danforth.

18 Senator Danforth. No.

19 The Clerk. Mr. Chafee.

20 Senator Chafee. No.

21 The Clerk. Mr. Heinz.

22 Senator Heinz. No.

23 The Clerk. Mr. Wallop.

24 (No response)

25 The Clerk. Mr. Durenberger.

13

1 Senator Durenberger. Aye.
2 The Clerk. Mr. Armstrong.
3 Senator Armstrong. No.
4 The Clerk. Mr. Symms.
5 Senator Symms. Aye.
6 The Clerk. Mr. Grassley.
7 Senator Grassley. Aye.
8 The Clerk. Mr. Long.
9 (No response)
10 The Clerk. Mr. Byrd.
11 (No response)
12 The Clerk. Mr. Bentsen.
13 Senator Bentsen. No.
14 The Clerk. Mr. Matsunaga.
15 Senator Matsunaga. Aye.
16 The Clerk. Mr. Moynihan.
17 Senator Moynihan. Aye.
18 The Clerk. Mr. Baucus.
19 Senator Baucus. No.
20 The Clerk. Mr. Boren.
21 Senator Boren. Aye.
22 The Clerk. Mr. Bradley.
23 Senator Bradley. No.
24 The Clerk. Mr. Mitchell.
25 Senator Mitchell. Aye.

14

1 The Clerk. Mr. Chairman.

2 The Chairman. No.

3 Senator Matsunaga. Mr. Chairman, Matsunaga votes "aye."

4 The Chairman. On this vote --

5 The Clerk. Seven yeahs and 10 nays.

6 The Chairman. The yeahs are 7 and the nays are 10. The
7 amendment is not agreed to.

8 Senator Heinz. Mr. Chairman, I don't intend to offer
9 an amendment. I would like to ask Treasury a question.

10 The Chairman. Fine.

11 Senator Heinz. I introduced with a number of co-sponsors
12 an amendment to give the Commissioner of the IRS discretion
13 to waive the penalty for the underpayment of estimated tax
14 when reasonable cause existed. This is for the elderly,
15 blind and disabled.

16 What was your concern?

17 Mr. Chapoton. Is this an amendment, Mr. Heinz?

18 Senator Heinz. It's in the form of a bill that I
19 introduced about a month and a half ago. I think we sent
20 it down there -- did we not, Mark? -- as a potential
21 amendment. I understand that there was no agreement on it.
22 I am not going to push it if there is not agreement, but I
23 would just like to find out what the problem was.

24 Mr. Chapoton. I am not sure. I know that that has been
25 a problem. It has been a concern. A lack of abatement on

15
1 estimated taxes.

2 Senator Heinz. My understanding was that the Treasury
3 Department supported that kind of waiver. But, Mark, can
4 you --

5 Mr. McConaghy. We don't have an estimate, Senator
6 Heinz. And we do think it will have an impact on the
7 revenue and it may be somewhat substantial.

8 Senator Heinz. You don't know?

9 Mr. McConaghy. That's correct.

10 Senator Heinz. All right. Well, I won't press that.

11 Senator Matsunaga. Mr. Chairman.

12 The Chairman. Senator Matsunaga.

13 Senator Matsunaga. I offer an amendment only because
14 it has bipartisan support, and it's an extension of existing
15 law just for another two years. And it will bring justice
16 to taxi cab owners and operators to be treated as bus
17 operators. Senators Roth, Durenberger, Moynihan and myself
18 are co-sponsors of that bill which would extend it
19 permanently. However, I am reducing it in my amendment to
20 just two years to provide additional time for the Internal
21 Revenue Service to make a study of the effectiveness on the
22 proposal to cut down the use of fuel. Buses now have a
23 permanent exemption from the tax fuel. And I merely offer
24 this amendment to extend for another two year period the
25 tax exempt status of cab owners and operators on fuel tax.

10
1 The Chairman. Is the Treasury opposed to this?

2 Mr. Chapoton. Mr. Chairman, all I have is a staff
3 memorandum recommending opposition. So without further
4 study, I would have to oppose.

5 The Chairman. I would hope the Senator from Hawaii
6 would not press the amendment.

7 Senator Packwood. Well, Mr. Chairman, damn it, I have
8 got amendments. I thought we were playing a game where we
9 were submitting them. And I have withheld them. And I just
10 want to know what the rules are going to be.

11 Senator Matsunaga. Well, the only reason I offer it
12 is this is a matter of urgency. The present law expires
13 the end of this year.

14 Senator Packwood. We got the whole co-generation
15 amendment that expires this year too. And businesses all
16 over this country are using it in terms of generating new
17 sources of energy. And they have asked to have it extended.
18 It has not been approved by this group. But if we are
19 going to get into the business of submitting them and
20 bringing them up at this stage fine, but I want to find out
21 from the Chairman what the rules are that we are going to
22 play by.

23 The Chairman. Well, as far as the Chairman is concerned
24 I am about played out. We are going to have other
25 opportunities. There are other bills for the Committee,

1 aren't there, Mr. Lighthizer?

2 Mr. Lighthizer. Yes, Mr. Chairman.

3 (Laughter)

4 Mr. Chairman. A mild "yes."

5 Senator Matsunaga. Mr. Chairman, if I can get
6 assurance from the Treasury that they will look into this
7 matter. They said right now they haven't had a chance to
8 study it. But if by chance studying it they might agree to
9 support it -- with that possibility in mind, I will withdraw
10 my amendment.

11 The Chairman. I appreciate that. And I will urge them
12 to study it carefully.

13 Senator Matsunaga. Thank you.

14 Senator Roth. Mr. Chairman, could I ask again Mr.
15 Chapoton --

16 Mr. Chapoton. Yes. I have determined our position on
17 the savings bonds. We have supported the variation of the
18 rates.

19 Senator Roth. So that's in accordance with the bill
20 that Toby Roth and I --

21 Mr. Chapoton. That is correct. Yes, sir.

22 Mr. McConaghy. Mr. Chairman, we are pretty close, I
23 think, on revenue. If we are not careful, we may have to
24 go back on the telephone tax and impose another percent
25 starting in 1983.

1 The Chairman. But I think there is one matter we
2 haven't acted on apparently.

3 Mr. DeArment. That corporate minimum tax. We haven't
4 adopted it.

5 The Chairman. Does anybody want to vote on that?

6 (No response)

7 The Chairman. If not, all those in favor of the
8 corporate minimum tax.

9 Senator Wallop. I don't want to vote on it. I just
10 wanted to explain that with the Symms amendment to that -- I
11 voted against it because it did exclude coal and iron. And I
12 don't believe that it should have. But it's not reason
13 enough to oppose the minimum tax.

14 The Chairman. All in favor of the corporate minimum
15 tax please say "aye."

16 (Chorus of "ayes")

17 The Chairman. Opposed "no."

18 (Chorus of "nos")

19 The Chairman. The "ayes" have it.

20 Now are there any other matters that the staff -- oh,
21 excuse me. We need to determine how we can take care of
22 Senator Long's request so it would be in order to have a third
23 year tax cut modification so we could permit a floor
24 amendment touching on the third year.

25 Mr. Stern. Mr. Chairman, you have done something like

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1 this a couple of times in the past where you will put
2 language in a Committee bill, and then you will add an
3 additional section making the language ineffective. So
4 that the bill as a whole doesn't contain an effective
5 provision. But the language is there. You have done that in
6 cases where you wanted to go to conference on a bill other
7 than a bill that the House passed --

8 The Chairman. I don't have any quarrel with that, but
9 this one wouldn't open up a series of amendments on the third
10 year, would it? I mean you wouldn't have --

11 Mr. Stern. Well, I am not clear as to exactly what you
12 are going to put in. But if you put in, for example, the
13 kind of proposal that Senator Long made earlier, that
14 would be about the scope of what could be offered.

15 Senator Long. Well, all I want to do is to have
16 language in the bill that would make it germane to vote on
17 the third year. But what I had in mind is that if we
18 strike something from the bill -- the way I understand those
19 rules in reconciliations -- it would be subject to a point
20 of order to strike something unless we have revenue that
21 would replace the revenue we lose by striking something out.

22 Mr. Stern. It's not true that it would be subject to
23 a point of order if you lose revenue compared with the bill
24 because the second budget resolution hasn't been adopted yet.
25 And, therefore, for the moment the budget resolution targets

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1 are just targets and the amount that you have to achieve
2 on the reconciliation bill is only a requirement on the
3 Finance Committee to report. Not a requirement of the
4 Senate to pass.

5 So anybody would be in order to strike provisions from
6 the bill but they would be able to offer anything relating
7 to the third year if there weren't something in the bill.

8 Senator Armstrong. Mr. Chairman, I understand completely
9 why you would desire to accommodate Senator Long on this
10 matter. And I share your feelings. But I am concerned about
11 this aspect of it. That coming to the floor as a
12 reconciliation bill, it also comes not only with special
13 germaneness requirements but also with a time limit. And I
14 will say very frankly that I will be very reluctant to
15 face a bill under strict time limits a highly privileged
16 bill; a bill on which you can't filibuster the motion to
17 take it up; and you can't offer addition amendments were
18 the third year amendment to be adopted. And you can't
19 filibuster the final vote on it. We are really destroying
20 a very carefully crafted aspect of the reconciliation process
21 if we make a single very controversial amendment in order,
22 unless we also can find some parliamentary device to protect
23 the rights of members with respect to these other issues.
24 That is, the right to take up the bill; the right for
25 extended debate on final passage of the bill; and the right

21
1 to offer other amendments.

2 And so I don't have something exactly to propose, but
3 I do have a concern about it. And I would personally be
4 very reluctant to see us let this bill go to the floor
5 where we will have a strict time limit. Will staff
6 refresh my recollection? Is it 20 hours?

7 Mr. Stern. Twenty hours and two hours on any
8 amendments within the 20 hours.

9 Senator Armstrong. So theoretically we could face an
10 up or down vote on this amendment. And then face a non-
11 delayable vote on final passage of the bill. And I am
12 concerned about what it does to jeopardize the ultimate
13 passage of this bill, and also where it puts some of the rest
14 of us on this issue. So I just note it as a concern, and
15 hope that there is some way we could avoid getting in that
16 box.

17 The Chairman. Right. I understand. And I don't want to
18 in any way destroy the process. Neither do I want to
19 destroy the good relations on this Committee. And I think
20 we have a good working relationship. I am confident we will
21 defeat the amendment on the floor. If I wasn't, I probably
22 wouldn't treat anything.

23 But if, in fact, it is tightly drawn so we don't have
24 a series of amendments, I would hope that Mr. Lighthizer and
25 Mr. Stern --

27

1 Mr. Stern. I think if you did have an amendment that
2 actually deals with specific tax rates or tax peers in a
3 certain year, it would be germane to offer any kind of
4 amendment.

5 Mr. Lighthizer. It would be hard to preclude a series
6 of amendments.

7 Mr. Stern. In other words, once an issue is germane,
8 then it is germane not just for one kind of an amendment but
9 for various kinds of amendments. They would all relate to
10 what the tax rates --

11 The Chairman. Well, if Senator Long's amendment fails
12 then somebody else could offer one to defer for a year.
13 And then somebody else could defer for three months. We
14 could spend all the 20 hours on the third year.

15 Senator Long. Well, the thought I have in mind is that
16 there are a lot of senators who would like to vote on the
17 third year. Quite a few senators in this Committee voted.
18 They would like to do something about the third year to
19 substitute for other things in the bill.

20 Now the way I understand the rules -- and someone can
21 correct me on that. I will stand corrected -- but the way
22 I understand these rules is the Senate will not have the
23 privilege that we had in this Committee to vote on that
24 same amendment, or to vote on any version of it. I'm not
25 here seeking to vote on the same thing over and over again.

23
1 All I would ask is that those of us who think that the third
2 year is the most logical thing to do with regard to this
3 bill should have the privilege to vote on it on the floor.

4 Now the germaneness rule may very well preclude anyone
5 from voting on that. And I just think that the Senate should
6 be permitted to so express its will. It did have substantial
7 support here.

8 The Chairman. Well, how can we accomplish what I would
9 like to accomplish with Senator Long and still not open up
10 a Pandora's box?

11 Senator Bradley. Mr. Chairman, could all of the
12 Senate Republicans move to waive the rules on this
13 particular amendment when it came up? And all the Democrats
14 voted to waive the rule too. Couldn't we consider it on
15 the floor at that time?

16 Mr. Stern. You can waive the rule.

17 The Chairman. You mean to make that amendment in
18 order?

19 Mr. Stern. I think you do that by so-called Section
20 904 of the Budget Act waiver. That's something that the
21 Budget Committee certainly has been reluctant to do
22 procedurally.

23 Senator Long. There is a very simple proposition.
24 And that is that those in the majority -- are they inclined
25 to permit those to have a vote on the third year. That's a

24
1 very simple proposition.

2 The Chairman. I don't have any quarrel with that. I
3 don't want to be misunderstood. But I just don't want to have
4 to do it eight or nine times.

5 Senator Long. Well, I can't keep somebody else, Mr.
6 Chairman, from bringing up an amendment.

7 Senator Bradley. Mr. Chairman, is there a way we could
8 resolve it? I would ask counsel. Is there a way that we
9 could resolve it that would permit Senator Long to have a
10 vote on his amendment, but with the understanding that if
11 the amendment is adopted then other corrective amendments
12 are in order? And that time limit that would otherwise
13 apply would be waived because the whole notion of senators
14 agreeing to a very tight restricted time limit on a bill of
15 this magnitude rests upon the assumption that the available
16 amendments will be tightly circumscribed and subjected to a
17 stricter rule of germaneness than even in close cloture
18 proceedings.

19 So far as I know, the germaneness rule that the
20 parliamentarian will apply on this bill is stricter than
21 anything else that the Senate ever considers. Even more
22 than what we see in the cloture situation.

23 Senator Long. Let me just make this point. I'm not
24 begging for the right to offer an amendment. I'm just saying
25 that if you want people to respect your rules, you ought to

25
1 try to be fair.

2 Now I personally am one of those who rather consistently
3 vote on a germaneness matter to uphold the chair. The
4 senators will note that almost without exception I vote to
5 uphold the chair regardless of the merits of the proposition.
6 And I encourage others to do likewise. But all the Senate
7 would have to do is just overrule its presiding officer on
8 the matter of germaneness and go ahead and vote on the
9 amendment if he wanted to. And other people like to regard
10 that as a vote on the issue. They vote on the germaneness.

11 I would just like to propose that in the spirit of
12 fairness that we be permitted to have a vote on this measure.
13 I do not anticipate the Senate is going to -- but I do think
14 the Senate should have the privilege of voting on this
15 proposition. And if the majority on this Committee seeks to
16 deny that, that's their privilege. And I am not upset about
17 it. I will just go about my business and do the best I
18 can as the rules permit.

19 The Chairman. If the Republican members on this
20 Committee, Senator Long, would agree to support a waiver so
21 that your amendment -- the one offered today -- would be in
22 order, would that be satisfactory? Is that a possibility,
23 Bob?

24 Mr. Lighthizer. Yes, Mr. Chairman. We could ask the
25 Budget Committee to support a waiver also for that one

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1 amendment.

2 The Chairman. I want to accommodate Senator Long. And
3 I think we all do.

4 Senator Armstrong. I certainly do, Mr. Chairman. But
5 I just want to be sure that in the process of doing so we
6 don't booby trap the bill. And we haven't talked about this
7 privately, but let me just express very directly my concern.

8 There is going to be a lot of heat on this bill. And
9 there is going to be a lot of people who are going to be
10 looking for a way out because this is a tough bill. And
11 it's got some provisions in it, which although I think are
12 balanced and fair, after they have been looked at and after
13 the lobbyist get a chance to go after them, they are going to
14 be pretty hot to handle. And the safety valve, the way out
15 of that from a certain perspective, is to say, well, let's
16 kick all of these in the creek and defer the third year.

17 Now if that amendment gets adopted and we are under
18 limited time and don't have the right under the rules to
19 offer other amendments, we will get into a situation where
20 we won't be able to pass the bill. Or if we do, it would be
21 a bill the President will veto. And I'm not trying to
22 prevent the offering of the amendment. I just want to be
23 sure that if that additional right is afforded to Senator
24 Long that corresponding additional rights are available to
25 other senators in order to put the bill back in shape if that

1 becomes necessary.

2 Senator Long. Well, the majority has plenty of rights
3 under the rules, and I am simply trying to see that they
4 are provided to the minority.

5 But, Senators, do whatever your consciences dictates.
6 As far as I am concerned, I don't care if you settle for
7 that.

8 (Laughter)

9 Senator Roth. Mr. Chairman.

10 The Chairman. Senator Roth.

11 Senator Roth. Mr. Chairman, I would like to show this
12 as reported out.

13 Mr. Stern. If you are going to go the route that
14 Senator Long has suggested, though, you really would need
15 language of some sort in the bill.

16 Senator Roth. That's correct. But we are contesting
17 that you offered it as a committee amendment.

18 The Chairman. But once you put language in the bill
19 that opens up the problem that Senator Armstrong has
20 addressed. The amendment could be endless. And you could
21 knock out certain provisions by delaying the cut three
22 months. You could get rid of withholding that way.

23 Is there a way we can avoid that by some language in
24 the bill?

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Mr. Stern.

The other procedure that was suggested of getting a waiver of the Budget Act could be applied to a specific amendment. That wouldn't be a matter of putting it in the Committee report or having specific language in the bill.

The Chairman. Would there be any objection on our side if we would recommend a waiver of the Budget Act for that specific amendment?

Senator Roth. I don't think that I have the answer to the question raised. There is considerable reference to the User's tax --

The Chairman. Well, I'm just looking for expert advice but I don't hear any. Mike, do you have any good ideas?

Mr. Stern. Well, I wasn't dealing with the question of what happens if the amendment is adopted. I was only dealing with the --

The Chairman. If it gets adopted, I get shot. That's the problem.

(Laughter)

The Chairman. Packwood would be chairman.

Senator Packwood. That's all right.

(Laughter)

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1 The Chairman. Well, I think maybe we will just have
2 to rely on the goodwill of the members of this Committee to
3 work it out.

4 Senator Long. Let me just make this statement, Mr.
5 Chairman. The Democratic caucus voted, rightly or wrongly --
6 they voted some time back -- to recommend to the President.
7 And they did by a unanimous vote. They recommended that the
8 third year ought to be deferred.

9 Now what I offered was not a deferral of the entire
10 third year, but it was a deferral of a substantial part.
11 Now if the Republicans want to deny the Democrats the right
12 to vote on any part of that, they can try. And they may
13 succeed. I will say that if they do, they had better count
14 on passing that bill without any Democratic votes.

15 But I offered the amendment in good faith. And I
16 offered it proposing to protect the revenue in the bill.
17 And as far as I am concerned, it is something that we are
18 entitled to vote on that. I tend to abide by the rules.

19 The Chairman. Would some on my right be willing to
20 support a waiver for a restricted amendment?

21 Senator Wallop. Mr. Chairman, I would, but I don't
22 think there is clear reason for the problem that the Senator
23 from Louisiana is expressing here. Nobody is seeking to
24 deny him the right to the vote that he is asking for. What
25 the Chairman and the Senator from Colorado and others have

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1 expressed is they don't want a wholesale assault on that
2 one amendment. And I hear no assurances coming from that
3 side that they will seek to prevent that. Now if I am going
4 to give assurances that I will support a waiver -- and I
5 have heard they are willing to do that -- I want some
6 assurances back from the other side that they will act
7 accordingly on their behalf.

8 The Chairman. Well, how many Democrats are there, then,
9 in the Senate? Forty-six. If five Republicans would join
10 46 Democrats, there would be a waiver. And if, in fact,
11 we could agree that it would be restricted, that we didn't
12 have a stampede of third year amendments, I would be
13 willing to try to accommodate the wishes of Senator Long.

14 Mr. Lighthizer. You are agreeing to a waiver as to
15 the amendment that Senator Long offered?

16 Mr. Stern. Senator Long offered it in the form that
17 it was only affecting the third year and the indexing. You
18 would permit an amendment that would also perhaps strike
19 some other sections so as to produce the same overall
20 revenue effect.

21 The Chairman. Well, that's where it might get a little
22 touchy.

23 (Laughter)

24 The Chairman. You might strike out.

25 Senator Wallop. Are there no assurances that the other

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1 side will give us in trying to limit the scope?

2 Senator Bradley. Senator, I promise that I will not
3 offer the fair, simplified restructuring of --

4 (Laughter)

5 Senator Wallop. That isn't the point. That's not
6 germane under the set of circumstances.

7 Senator Bradley. Germane is the third year.

8 Senator Wallop. Not unless we qualify it. What we are
9 seeking to do is to qualify an amendment from the Senator
10 from Louisiana. And we want a little bit of assurance that
11 they are not going to engage in a wholesale assault on other
12 things should that fail.

13 Senator Armstrong. Mr. Chairman, I would like to endorse
14 the suggestion that Bill Roth made. I think it has been a
15 good useful discussion. And I am glad I had a chance to
16 express my concerns. But I completely agree that we are not
17 trying to shut out the Senator's right to offer the
18 amendment and have it voted on. But there are some
19 parliamentary difficulties. And so I want to renew his
20 suggestion that we leave it to the Chairman and the ranking
21 Democratic members to work it out. And for my part, I will
22 pledge to be one of the votes for a waiver or anything that
23 you need to do it. If whatever you decide accommodates
24 these concerns, I will be glad to support it in the way of
25 a waiver.

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1 Senator Long. I don't want to be in the position where
2 I have got to plead with the Chairman to offer an amendment,
3 because I might just get lucky and win and there is no
4 telling what might happen. I just think that the majority
5 ought to decide. Maybe it is decided now. I am not going to
6 push it any further. You just go ahead and do whatever you
7 want to do about it. And I will abide by it.

8 (Laughter)

9 Senator Long. I will make my plans accordingly.

10 Senator Matsunaga. May we ask if the majority would
11 be willing to accept an amendment to cut out the third
12 increment or suspend it for one day? And then that gives
13 Senator Long and the Democrats --

14 The Chairman. We wouldn't take even that. Some
15 language that it wouldn't be effective until there is a joint
16 resolution of the Congress or some language that would make
17 it germane. And I guess there is no resolution. I will
18 just indicate that I will -- I don't guess Senator Long has
19 to check with me on anything. But in this case, I don't
20 know how to work it out because it does present some other
21 delicate problems.

22 Senator Bradley, did you have a question on one of the
23 spending reduction proposals?

24 Senator Bradley. No, Mr. Chairman. I think that we
25 had a discussion about it. And you said that you were going

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1 to inquire of the Labor Department to make certain technical
2 corrections as they prepared the bill as it relates to
3 certain unemployment issues.

4 The Chairman. Right. We discussed that with them to
5 see if they could develop some options for a tightly drawn
6 release measure. They report back by July 12th with
7 reference to interest penalty tax. There is no amendment.

8 Senator Bradley. No.

9 Senator Chafee. Mr. Chairman.

10 The Chairman. Senator Chafee.

11 Senator Chafee. Mr. Chairman, I had legislation in
12 dealing with the elimination of the proposed regs under
13 Section 385. And the Treasury Department has assured me
14 that they will delay the effective date of the regs on
15 385 until March 31st of next year. And that is very
16 satisfactory. It is my hope we can have some hearings on
17 those regs in advance of that.

18 Mr. Chapoton. That is correct.

19 The Chairman. Mr. Chapoton, is there anything else
20 that should be addressed?

21 Mr. Chapoton. Not that I am aware of, Mr. Chairman. No.

22 Senator Symms. Mr. Chairman, I have one minor thing
23 I wanted to bring up. I can revise and extend my remarks
24 in the record but I do think we discussed this in the
25 Republican caucus yesterday. And I think the Chairman was

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1 going to try to look into it. But I think we have one small
2 point in this bill requiring direct sellers who purchase
3 more than \$250.00 worth of products as unneeded, unburdensome
4 paperwork for them. And actually I believe that it will
5 cost the Treasury money because it is going to force them to
6 elect to use a different accounting procedure. And I hope
7 we could either yield to the House when we get to conference
8 on that if they have the \$1,500.00 figure. And I think it is
9 a little late in the night to bring up another amendment,
10 but I will revise and extend my remarks in the record and
11 maybe put something in the report about it. But I hope we
12 could fix this issue. It's a very small minor issue compared
13 to the problems of now.

14 (THE INFORMATION FOLLOWS:)

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1 The Chairman. The Senator from Idaho, I am familiar
2 with that. We have been trying to resolve it. I still think
3 there is a chance for resolution. And if it is in the bill
4 and we could do that, it would be a germane amendment.

5 Senator Symms. Would it be germane?

6 The Chairman. My understanding is that it would be
7 germane.

8 Senator Symms. To change the number from \$250.00 to
9 something larger? If that is correct, I think we could do
10 it on the floor.

11 The Chairman. I think that's correct. If, in fact,
12 there is an amendment in the bill, you have the right to
13 offer an amendment to that section. Is that correct?

14 Mr. DeArment. Under the germaneness rules, if there
15 is an amendment in the bill, you are allowed or permitted to
16 make amendments to that amendment.

17 The Chairman. Mr. Lighthizer, do you have something
18 in your hand that you want to put in the record?

19 Mr. Lighthizer. Mr. Chairman, I am told that there has
20 been agreement to speed up the report in the health area
21 that HHS is doing on a prospective payment system. We
22 file the report in five months instead of the 12 months
23 that the Committee agreed to.

24 Senator Durenberger. We passed that, Mr. Chairman. We
25 had a one year and HHS said they could do it in five months so

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1 as to speed it up.

2 Mr. McConaghy. Mr. Chairman, we would also like for the
3 Committee to give us drafting authority. This is going to
4 take some time.

5 The Chairman. Is there any objection to giving the
6 staff drafting authority and to make any technical corrections?
7 And as I understand, the report will be filed on either the
8 9th or before --

9 Mr. Lighthizer. The 9th or the 12th, Mr. Chairman.

10 The Chairman. Are there any other matters to come
11 before the Committee?

12 Mr. Lighthizer. Mr. Chairman, I am told that there are
13 some technical amendments on last year's reconciliation
14 bill in the health area that have been agreed to by the
15 majority and the minority that are truly technical changes
16 as to errors that were made in drafting in reconciliation.

17 The Chairman. Is that right, Mr. Stern?

18 Mr. Stern. I also just have that second-hand. I
19 haven't looked at them myself.

20 The Chairman. Well, if we don't have it, don't worry
21 about it. Forget it. I may just pass that over to you.

22 Mr. Lighthizer. Sheila.

23 The Chairman. Sheila, maybe you ought to address it.

24 Ms. Burke. Senator, these are corrections that are made
25 to last year's reconciliation that were reviewed by the

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1 Administration and by the Democrats and the Republic staffs
2 last December and agreed upon. They are items that we have
3 gone through. And they are actually technical in nature
4 and correct things like grammatical problems, typographical
5 problems, and clarifications of provisions that were
6 agreed to last year.

7 The Chairman. There are no substantive changes?

8 Ms. Burke. No.

9 The Chairman. No revenue changes?

10 Ms. Burke. No revenue changes.

11 The Chairman. They have been cleared with Mr. Hoyer?

12 Ms. Burke. Mr. Hoyer has cleared them. Yes, sir.

13 The Chairman. Is that correct, Mr. Hardee?

14 Mr. Hardee. That's correct.

15 The Chairman. Were there any objections to the
16 technical amendments to that section?

17 (No response)

18 The Chairman. Now what are we going to hook all this
19 onto?

20 Mr. Lighthizer. The staff suggestion is that we
21 report two Committee amendments. One dealing with the
22 substantive A-Dad legislation. And one dealing with the
23 rest of the package.

24 The Chairman. We can't hear.

25 Mr. Lighthizer. Offer them as amendments to H.R. 4961,

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1 which is a miscellaneous tax bill that was sent over by the
2 House, the provisions of which have been taken off and put
3 on 4717 and the black lung bill.

4 The Chairman. So if this package is adopted, it will
5 become part of --

6 Mr. Lighthizer. 4961, H.R. 4961.

7 The Chairman. And the A-Dad measure will become --

8 Mr. Lighthizer. That would also become part of
9 H.R. 4961. They would both be two separate amendments to
10 H.R. 4961.

11 The Chairman. All right. If there are no further
12 comments, we will recur on the revenue package as amended.
13 And the clerk will call the roll.

14 The Clerk. Mr. Packwood.

15 Senator Packwood. Aye.

16 The Clerk. Mr. Roth.

17 Senator Roth. Aye.

18 The Clerk. Mr. Danforth.

19 Senator Danforth. Aye.

20 The Clerk. Mr. Chafee.

21 Senator Chafee. Aye.

22 The Clerk. Mr. Heinz.

23 Senator Heinz. Aye.

24 The Clerk. Mr. Wallop.

25 Senator Wallop. Aye.

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- 1 The Clerk. Mr. Durenberger.
- 2 Senator Durenberger. Aye.
- 3 The Clerk. Mr. Armstrong.
- 4 Senator Armstrong. Aye.
- 5 The Clerk. Mr. Symms.
- 6 Senator Symms. Aye.
- 7 The Clerk. Mr. Grassley.
- 8 Senator Grassley. Aye.
- 9 The Clerk. Mr. Long.
- 10 Senator Long. No.
- 11 The Clerk. Mr. Byrd.
- 12 Senator Byrd. No.
- 13 The Clerk. Mr. Bentsen.
- 14 Senator Bentsen. No.
- 15 The Clerk. Mr. Matsunaga.
- 16 Senator Matsunaga. No.
- 17 The Clerk. Mr. Moynihan.
- 18 Senator Moynihan. No.
- 19 The Clerk. Mr. Baucus.
- 20 Senator Baucus. No.
- 21 The Clerk. Mr. Boren.
- 22 Senator Boren. No.
- 23 The Clerk. Mr. Bradley.
- 24 Senator Bradley. No.
- 25 The Clerk. Mr. Mitchell.

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1 Senator Mitchell. No.

2 The Clerk. Mr. Chairman.

3 The Chairman. Aye.

4 It seems to be a party line. On this vote the "ayes"
5 are 11, and the "nays" are 9.

6 Anything else to come up that the staff can think of?

7 Senator Armstrong. I just have a clarification. Have
8 we adopted, in addition to the bill which Mr. Lighthizer
9 mentioned, the revenue measure, spending measures to be
10 adopted --

11 Mr. Lighthizer. They will be joined in the same
12 legislation -- the same amendment to the same legislation.
13 But I don't believe that you have had the final vote on the
14 spending side, Mr. Chairman.

15 The Chairman. Is there a request for a record vote on
16 the spending side? We had a record vote and then we adopted
17 some technical amendments.

18 Senator Bradley. Did we have a roll call vote?

19 The Chairman. We had a roll call. Always that or some
20 non-controversial amendments.

21 Mr. Lighthizer. Senator, there was a roll call vote,
22 but Senator Bradley asked if we were going to vote on them
23 again for final. And it was my understanding that you
24 indicated that we would.

25 Senator Bradley. We would? Well, then we have to have

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1 a roll call vote.

2 The Chairman. All right.

3 The Clerk. Mr. Packwood.

4 Senator Packwood. Aye.

5 The Clerk. Mr. Roth.

6 Senator Roth. Aye.

7 The Clerk. Mr. Danforth.

8 Senator Danforth. Aye.

9 The Clerk. Mr. Chafee.

10 (No response).

11 The Clerk. Mr. Heinz.

12 Senator Heinz. Aye.

13 The Clerk. Mr. Wallop.

14 Senator Wallop. Aye.

15 The Clerk. Mr. Durenberger.

16 Senator Durenberger. Aye.

17 The Clerk. Mr. Armstrong.

18 Senator Armstrong. Aye.

19 The Clerk. Mr. Symms.

20 Senator Symms. Aye.

21 The Clerk. Mr. Grassley.

22 Senator Grassley. Aye.

23 The Clerk. Mr. Long.

24 Senator Long. Aye.

25 The Clerk. Mr. Byrd.

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1 (No response)

2 The Clerk. Mr. Bentsen.

3 (No response)

4 The Clerk. Mr. Matsunaga.

5 Senator Matsunaga. No.

6 The Clerk. Mr. Moynihan.

7 Senator Moynihan. No.

8 The Clerk. Mr. Baucus.

9 Senator Baucus. No.

10 The Clerk. Mr. Boren.

11 Senator Boren. Aye.

12 The Clerk. Mr. Bradley.

13 Senator Bradley. No.

14 The Clerk. Mr. Mitchell.

15 Senator Mitchell. No.

16 The Clerk. Mr. Chairman.

17 The Chairman. Aye.

18 On this vote -- and Senator Byrd may want to be
19 recorded, so it would be left open -- on this vote the
20 "yeahs" are 12 and the "nays" are 6. That is agreed to.

21 And that would become a part of the same vehicle?

22 Mr. Lighthizer. Yes.

23 The Chairman. Are there any other matters?

24 Mr. Lighthizer. No, there isn't, Mr. Chairman.

25 The Chairman. If not, I want to thank all the

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1 Committee members and I certainly want to thank the staff
2 for their courtesies. And I think we have done -- and
3 certainly the Treasury, Mr. Chapoton, Mr. Glickman and
4 others. And the Joint Committee staff who have been working.
5 I might say not for the past couple of days but for the
6 past several months along with all the health staff and the
7 others who have been very helpful. And we want to also
8 thank all those who have taken such an interest in the
9 public spirit, and have filled the corridors and the rooms.

10 (Laughter)

11 The Chairman. Thank you.

12 (Whereupon, at 1:53 a.m., the meeting was adjourned)

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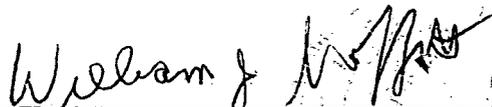
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C E R T I F I C A T E

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2 This is to certify that the foregoing proceedings
3 before the United States Senate Finance Committee, in re:
4 an Executive Session, held on Thursday, July 1, 1982, were
5 held as herein appears and that this is the original
6 transcript thereof.

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10 
11 WILLIAM J. MOFFITT
12 Official Reporter

13 A Notary Public in and for the District of Columbia.

14 My Commission expires April 14, 1984.
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