1981-82 MISCELLANEOUS TAX BILLS, XVII

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 232 and S. 2741

SEPTEMBER 23, 1982

Printed for the use of the Committee on Finance

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1981-82 MISCELLANEOUS TAX BILLS XVII

THURSDAY, SEPTEMBER 22, 1982

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

The subcommittee met, pursuant to notice, at 8:30 a.m. in room 2221, Dirksen Senate Office Building, the Honorable Bob Packwood (chairman) presiding.

Present: Senators Packwood and Long.

Also present: Senator Hayakawa.

[The press release announcing the hearing and the Joint Committee on Taxations description of S. 232 and S. 2741 and the text of S. 232 and S. 2741 follow:]

Press Release No. 82-165

P R E S S   R E L E A S E

FOR IMMEDIATE RELEASE
September 17, 1982

UNITED STATES SENATE
COMMITTEE ON FINANCE
Subcommittee on Taxation and Debt Management
2227 Dirksen Senate Office Bldg.

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

The Honorable Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, announced today that the Subcommittee will hold a hearing on Thursday, September 23, 1982, on two miscellaneous tax bills.

The hearing will begin at 8:30 a.m. in Room 2221 of the Dirksen Senate Office Building.

The following proposals will be considered:

S. 232--Introduced by Senators Hayakawa and Cranston. S. 232 would restate and clarify the normalization rules relating to the investment tax credit and accelerated depreciation for public utility property. The bill would also provide a special transition rule concerning possible loss of eligibility for the investment tax credit and accelerated depreciation due to certain California public utility commission orders.

S. 2741--Introduced by Senators Hayakawa and Cranston. S. 2741 would amend the Tax Reform Act of 1969 with respect to the application of the excess business holdings provisions to private foundations.

DESCRIPTION OF S. 232

RELATING TO

ACCOUNTING TREATMENT OF THE INVESTMENT TAX CREDIT AND ACCELERATED DEPRECIATION FOR PUBLIC UTILITY RATEMAKING PURPOSES

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

This pamphlet is prepared by the staff of the Joint Committee on Taxation for the Committee on Finance Subcommittee on Taxation and Debt Management hearing scheduled for September 23, 1982, on S. 232 (relating to the tax consequences of the ratemaking accounting treatment of accelerated depreciation and investment credit for public utility property).

The first part of the pamphlet is a summary of present law and the bill scheduled for the hearing: S. 232 (introduced by Senators Hayakawa and Cranston). The second part of this pamphlet is a more detailed description of present law and the bill.

I. SUMMARY

For property placed in service after 1980, public utilities generally are allowed the investment credit and accelerated cost recovery only if the benefits of the investment credit and accelerated cost recovery are normalized for ratemaking purposes. For property placed in service before 1981, similar rules apply to investment credits and accelerated depreciation, but certain companies are exempted from the normalization requirement. Normalization generally requires that tax benefits be taken into account for ratemaking purposes over the service life of the asset that generates the benefits.

Subject to certain exceptions for grandfathered companies, normalization rules for accelerated depreciation were imposed in 1969. Subject to the same general grandfather exceptions, normalization rules for the investment credit were imposed in 1971. Except as provided in certain transition rules, the normalization rules were made mandatory and more comprehensive for property placed in service after 1980.

S. 232—Senators Hayakawa and Cranston

Normalization Requirements for Public Utility Property and Special Transition Rule

The bill would restate and make more specific the normalization rules relating to the investment credit (sec. 46(f) and accelerated depreciation (sec. 167(l)). It is anticipated that the bill will be amended to make corresponding amendments to the normalization rules for accelerated cost recovery (sec. 168(e)(3)). The bill would also give the Treasury Department specific authority to provide regulations setting fourth conditions under which ratemaking projections and adjustments are inconsistent with the normalization rules. The amendments generally would apply to taxable years beginning after December 31, 1979.

The bill would also provide a special transition rule. Under the special rule a ratemaking projection or adjustment that violated the normalization requirements would not result in a public utility's loss of eligibility for the investment credit or accelerated depreciation if the projection or adjustment (1) applied for a period ending before March 1, 1980, (2) was included in an order entered by a public service or public utility commission before March 13, 1980, and (3) was used to determine the amount of rates which were ordered to be collected or refunds which were ordered to be made.

In 1980, the Committee considered H.R. 6806 (96th Congress), which contained the same provisions as S. 232, and favorably reported H.R. 6806 but that bill was not acted on by the Senate in the 96th Congress.

On September 20, 1982, the House passed H.R. 1524, which contains the same provisions as S. 232 with certain technical amendments.

II. PRESENT LAW AND DESCRIPTION OF BILLS

A. Present Law

In general

Generally, utility regulatory commissions allow a utility to charge customers so that the utility can collect enough revenues to cover its cost of service. The cost of service includes annual operating expenses and annual capital expenses. Operating expenses include expenses such as labor, fuel, State and local taxes, and Federal income taxes. Capital expenses include an annual depreciation charge for operating assets and a rate of return on the utility's rate base (the basis of its operating assets).

Accelerated depreciation methods, accelerated cost recovery, and investment credits were enacted to encourage higher rates of investment in new and replacement property. By reducing the initial cost of equipment or permitting a more rapid recovery of capital, these investment incentives increase the estimated after-tax rate of return from the asset.

For investments in public utility property, there are two general ways a utility regulatory commission can account for the benefits of accelerated depreciation, accelerated cost recovery, and investment credits in setting utility rates. One way, flow-through accounting, treats these benefits as a current reduction in Federal income tax expense. Thus, current operating expenses are reduced and the benefit is flowed through to the current utility customers. A second way, normalization accounting, treats these benefits as a reduction in capital expenses. As a reduction in capital expense, the benefits are still flowed through to customers. However, because the benefits are flowed through as reduced depreciation charges or returns on reduced rate base, they are flowed through to customers over the service life of the asset that generated the tax benefit. Thus, under normalization accounting, the benefit of reduced capital expenses for a specific capital investment is enjoyed by all the utility customers who pay the capital expenses of the investment.

Accelerated depreciation and accelerated cost recovery

When accelerated depreciation was provided under the 1954 Code, there were no special provisions relating to the ratemaking treatment of accelerated depreciation for regulated utilities. The stated congressional intent was to stimulate the economy by fostering capital formation. However, because Federal income tax expense represents an element of cost of service for ratemaking purposes, some regulatory agencies treated the reduction in current tax liability resulting from accelerated depreciation as a current reduction in cost of service and therefore flowed it through to customers currently as lower rates. This practice, which is known as "flow-through" ratemaking, meant that accelerated depreciation would provide no investment incentive.

In response to what Congress saw as an undesirable trend toward flow-through ratemaking, Code section 167 was amended as part of the Tax Reform Act of 1969. Under Code section 167(l), a utility which had not previously used accelerated depreciation for Federal tax purposes could thereafter use accelerated depreciation only (1) if the utility used a "normalization" method of accounting in its books of account and (2) if the regulatory agency used a normalization method of setting rates.[1]

Code section 167(l)(3)(G) provides that:

"In order to use a normalization method of accounting with respect to any public utility property—

"(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

"(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation."

The Treasury Regulations (§ 1.167(l)-1(h)) interpret this section defining normalization to require that: (1) a utility's tax expense for ratemaking purposes must be computed as though straight-time depreciation were being used for tax purposes; (2) the full amount of the deferred taxes (i.e., the difference between tax expense computed first using accelerated and then using straight-line depreciation) must be reflected in a reserve and thus be available for capital investment; and (3) the regulatory agency may not exclude from the rate-base an amount greater than the amount of the reserve for the period used in determining the tax expense as part of cost of service. The Treasury Regulations (§ 1.167(a)-11(b)(6)) also interpret section 167(l) as requiring that, in addition to the benefits of accelerated methods of depreciation, some or all of the benefits of shortened useful lives under the ADR system must be normalized.

Thus, a normalization method of accounting results in the benefits of the tax deferrals from accelerated depreciation being reflected in the rates charged to customers as a reduction in capital expenses over the period of tax deferral.

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[1] In general, these rules apply to public utility property used in a public utility activity. Property is public utility property if, during any period, it is used predominantly in a public utility activity. Public utility activities to which the depreciation method limitations apply means the trade or business of furnishing or selling:

(1) Electrical energy, water, or sewage disposal services;

(2) Gas or steam through a local distribution system;

(3) Telephone services;

(4) Other communication services (whether or not telephone services) if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701); or

(5) Transportation of gas or steam by pipeline, if the rates, for the furnishing or sale, are established or approved by certain regulatory bodies.

By allowing utilities to use accelerated depreciation only if normalization were followed, Congress had two principal objectives: first, to assure that the deferred taxes derived from accelerated depreciation would be available to the utilities as investment capital until paid to the Treasury and, second, to avoid the additional loss of Federal tax revenues that it believed would result because flow-through ratemaking would reduce utility profits.

When Congress enacted the accelerated cost recovery system (ACRS) in the Economic Recovery Tax Act of 1981 (ERTA), it decided that the full benefits of ACRS should be normalized by all public utilities. Therefore, except as provided in a special transition rule for rate orders issued before enactment of ERTA, all public utilities are required to normalize the tax benefits of ACRS accelerated depreciation, shortened useful lives, salvage value rules, and placed-in-service averaging conventions.

Investment tax credit

When Congress restored the investment tax credit in 1971, it provided that the investment credit for public utility property generally would not be available if the credit was flowed through to utility customers at a rate faster than that permitted under one of two optional normalization rules. However, utilities permitted to use flow-through accounting for the benefits of accelerated depreciation under the grandfather rules of the Tax Reform Act of 1969 were also permitted to use flow-through accounting for the investment tax credit if they made an affirmative election. In the Revenue Act of 1975, Congress increased the amount of the credit for public utility property that could be used to offset tax liability and increased the amount of the credit for public utility property from 4 percent to 10 percent. For this additional credit, flow-through accounting was not permitted to the grandfathered utilities unless the utility made a new affirmative election.

When Congress revised the investment tax credit provisions in the Economic Recovery Tax Act of 1981, it generally repealed the flow-through exception for all property placed in service after 1980. Thus, except as provided in a transition rule for rate orders issued before enactment of ERTA, all public utilities must use one of two normalization methods to account for investment credits for public utility property placed in service after 1980.

The two optional normalization rules of section 46(f) are known as the rate base reduction rule and the ratable flow-through rule. Both of these normalization rules permit some of the benefit of the investment tax credit to be flowed-through to utility customers as a reduction in capital expense. Taxpayers generally are subject to the rate base reduction rule unless they made an election in 1972 to be subject to the ratable flow-through rule or, if eligible, made an election to use flow-through accounting. For a limited group of utilities, gas pipeline companies, a special election also was available in 1972 that prohibited any flow-through of the credit, either as a reduction in current operating expense or a reduction in capital expense over the service life of the qualifying property.

Under the rate base reduction rule, some of the benefits of the investment tax credit may be flowed through to utility customers as a reduction to capital expense by excluding the credit from the utility's rate base. In this way, the utility customers are not required to pay a rate of return to the utility on the part of the cost of equipment that was paid for, in effect by the investment tax credit. However, under this rule, no other adjustment may be made to the operating expenses or capital expenses included in the utility's cost of service. Thus, no adjustment is permitted to be made, by reason of the credit, to the utility's Federal income tax expense or depreciation allowance included in its cost of service. The utility, therefore, is allowed to retain the use of the credit as capital and is allowed to include in its cost of service a depreciation allowance for the part of the equipment cost paid for, in effect, by the investment credit.

Under the ratable flow-through rule, the benefits of the investment tax credit may be shared with utility customers by denying any depreciation allowance in the utility's cost of service for the part of the equipment cost that was paid for, in effect, by the investment credit. Under this rule, no additional adjustment may be made by reason of the credit to the utility's operating expenses or capital expenses included in its cost of service. The utility, therefore, is allowed to retain the use of the credit as capital and is allowed to include in its cost of service a rate of return on the part of equipment cost paid for, in effect, by the investment credit.

Projections, estimates, and adjustments

The application of the depreciation and investment tax credit normalization rules has generated considerable controversy and uncertainty, due in part to the nature of the ratemaking process. In setting utility rates, it is customary to use a "test period" as a surrogate for the period when utility rates will actually be collected. Based on the experience of the test period (investment levels, operating expenses, etc.) appropriate rates are established. In some jurisdictions, adjustments are made to the test period experience to reflect expected changes in the future relationships between investments, expenses, and revenues. An example of such an adjustment would be a change in the Federal income tax rate to take effect after the close of the test period.

The proper application of the normalization rules with respect to the use of adjustments, estimates, and projections has been especially controversial in California. Prior to 1969, the California Public Utilities Commission generally required utilities under its jurisdicton to flow through the tax benefits of accelerated depreciation to customers immediately. However, in accordance with Code provisions making the use of accelerated depreciation elective, Pacific Telephone and Telegraph Company and General Telephone Company of California, the telephone companies under the Commission's jurisdiction, did not elect to take accelerated depreciation for Federal tax purposes. In a 1968 decision, the Commission found that it was imprudent for the companies to use straight-line depreciation for Federal tax purposes, and the Commission set rates as if accelerated depreciation had been elected and flowed through the tax benefits of this imputed accelerated depreciation to the customers. This 1968 decision was modified by the Commission in 1970 to allow the companies to elect accelerated depreciation with normalization as prescribed by the Code. However, in 1971 the California Supreme Court annulled the 1970 decision on the grounds that (1) the 1968 decision did not have to be modified because of the intervening passage of the Tax Reform Act of 1969 rules requiring that public utilities (other than public utilities which had previously used accelerated depreciation and flowed it through to their customers) could elect accelerated depreciation only if the benefits of such depreciation were normalized and (2) other methods of normalization should have been considered.

After protracted litigation (including three more decisions of the California Supreme Court and two unsuccessful petitions for certiorari to the U.S. Supreme Court), the Commission entered an order which requires the telephone companies to use certain methods of accounting to measure the amount of the benefits from accelerated depreciation and the investment credit that are to be shared with the utility customers.

The Internal Revenue Service has issued private letter rulings that take the position that these methods do not comply with the normalization requirements. The IRS has asserted deficiencies for some of the taxable years in issue. As a result, these telephone companies are faced with a situation in which they may be deemed ineligible to claim accelerated depreciation and the investment tax credit even though the allowance of these benefits has already been reflected in reduced rates or refunds to utility customers. Another California utility (Southern California Gas Company) apparently has a similar problem relating to the manner in which the investment tax credit may be taken into account in establishing a utility's rate of return.

It is understood that the California Public Utility Commission has not required the use of these controversial accounting methods for any period after March 1, 1980.

B. Issues

The principal issues raised by the bill are (1) whether it is appropriate to provide a transitional rule that would exempt utilities from the normalization requirements of present law for accounting periods that ended prior to March 1, 1980, if the utilities used accounting methods which were prescribed by order of a State or local government public service or utility commission and (2) whether it is appropriate to make the normalization rules more specific in a manner generally based on current Treasury regulations.

One subsidiary issue raised by the bill is whether the complete forgiveness of tax in the transition rule is appropriate or whether some sort of "penalty" should be imposed. Another subsidiary issue is whether the cut-off date in the transitional rule is appropriate.

C. Description of S. 232

Explanation of Provisions

The bill contains two amendments to the normalization rules which do not materially change the substance of present law as that law is interpreted by Treasury regulations. It also contains a special rule applicable to periods prior to March 1, 1980, and designed to benefit Pacific Telephone and Telegraph Company (a subsidiary of A.T. & T.), General Telephone Company of California (a subsidiary of General Telephone & Electronics Corporation), and Southern California Gas Company.

Accelerated depreciation and accelerated cost recovery

The bill would add a new provision (Code sec. 167(l)(3)(H)) which clarifies the present definition of the normalization method of accounting (in Code sec. 167(i)(3)(G)) for accelerated depreciation in a manner which generally follows the interpretation of this provision now contained in Treasury regulations.

This added provision generally provides that normalization is not complied with if, for ratemaking purposes, a procedure or adjustment is employed which uses estimates or projections of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes unless these estimates and projections are also used in determining the other two such items and the rate base.

The Treasury would also be given authority to prescribe regulations which define other procedures and adjustments which are inconsistent with normalization. This specific authority to prescribe regulations is not intended to limit the Treasury's normal authority to interpret, by regulations or otherwise, these new Code provisions or existing Code provisions relating to normalization.

This provision is intended to make it clear that California's so-called "Average Annual Adjustment" method (and any other similar method) of making adjustments for ratemaking purposes does not comply with the normalization requirements of Code section 167(l)(3)(G).

The new Code provision to be added by the bill (Code sec. 167(l)(3)(H)) specifies only one manner in which the normalization rules may be violated. Thus, compliance with this provision is a necessary but not exclusive condition for eligibility for accelerated depreciation.

It is anticipated that the bill will be amended to make corresponding amendments to the normalization rules for accelerated cost recovery (sec. 168(e)(3)).

Investment tax credit

The bill would add a new provision (Code sec. 46(f)(10)) to the rules relating to normalization of the investment tax credit. The new provision generally provides that the normalization rules are not complied with if a procedure or adjustment is employed which uses an estimate or projection of the taxpayer's qualified investment for purposes of the investment tax credit unless such estimate or projection is consistent with the estimates and projections of property which are used, for ratemaking purposes, with respect to the taxpayer's depreciation expense and rate base.

The Treasury Department would also be given authority to prescribe regulations which define other procedures and adjustments which are inconsistent with the requirements of the rate base method or the ratable flow-through method. This specific authority to prescribe regulations is not intended to limit the Treasury's normal authority to interpret, by regulations or otherwise, these new Code provisions or existing Code provisions relating to normalization.

This provision is intended to make it clear that California's so-called "Annual Adjustment" method (and any other similar method) of making adjustments for ratemaking purposes does not comply with the requirements of Code section 46(f).

The new Code provision to be added by the bill (new Code sec. 46(f)(10)) specifies only one manner in which the normalization rules may be violated. Thus, compliance with this provision is a necessary but not exclusive condition for eligibility for the investment tax credit.

Special rule for periods prior to March 1, 1980

The bill would provide that violations of the normalization requirements of present law (and of the bill) will not result in a public utility's loss of eligibility for the investment tax credit or accelerated depreciation if (a) such violations involved the use of estimates, projections or adjustments to the taxpayer's rate of return and (b) such estimates, projections, or adjustments only applied for any period ending prior to March 1, 1980, and were included in a qualified order. For purposes of this special rule, a qualified order is an order of a public utility commission—(1) which was entered before March 13, 1980, (2) which used the estimates, projections, or rate of return adjustments to determine the amount of the rates to be collected by the taxpayers or the amount of a refund with respect to rates previously collected, and (3) which ordered such rates to be collected or refunds to be made (whether or not such order actually was implemented or enforced). Since the special rule would apply to rates which were determined for periods prior to March 1, 1980, an order may be a qualified order even if it requires that refunds be paid after March 1, 1980, so long as such refunds are attributable to adjustments to rates charged prior to that date.

As indicated above, this transitional rule is designed to benefit Pacific Telephone and Telegraph Company, General Telephone Company of California, and Southern California Gas Company.

Effective Date

The provisions of the bill (other than the special rule) generally would apply to taxable years beginning after December 31, 1979. However, these provisions can be overridden by the special rule for periods prior to March 1, 1980.

The bill explicitly provides that, in applying the normalization rules (Code secs. 46(f) and 167(1)(3)) to taxable years beginning before January 1, 1980, no inference shall be drawn from the amendments to these rules (new Code secs. 46(f)(10) and 167(1)(3)(H)) or from the special rule. However, this no inference rule is not intended to limit the relief provided by the special rule.

Revenue Effect

The permanent changes made by the bill would have no revenue effect assuming that rate orders in effect for periods ending after March 1, 1980, are in compliance with the normalization rules as to be revised by the bill.

If the orders of the California Public Utilities Commission applicable prior to March 1, 1980, to the three utilities which would be benefitted by the special rule do *not* comply with the current normalization rules in the Code, the special rule in the bill would result in a revenue loss of approximately $2,200 million attributable to accounting periods prior to March 1, 1980. Approximately $117 million of this amount has been paid into the Treasury and may be the subject of claim for a refund. If the transitional rule is enacted, such amount would probably be repaid during fiscal year 1983. The remainder of the $2,200 million revenue loss generally would occur in the fiscal year or years in which determinations of tax liability for the affected companies would otherwise become final. Such losses would probably occur in fiscal years after 1987 because of the timing of the audit process and delays of presumed litigation.

If these orders do comply with the current normalization rules, the special rule in the bill would result in no revenue loss.

Prior Congressional Action

The provisions of S. 232 were considered by the committee in H.R. 6806 (96th Congress), which was reported favorably in 1980, but that bill was not acted on by the Senate in the 96th Congress.

On September 20, 1982, the House passed H.R. 1524, which contains the same provisions as S. 232 with certain technical amendments.

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DESCRIPTION OF S. 2741

Relating to

EXTENSION OF TIME FOR DIVESTITURE OF EXCESS BUSINESS HOLDINGS BY THE AHMANSON FOUNDATION

Scheduled for a Hearing

on September 23, 1982

by the

Subcommittee on Taxation and Debt Management

of the

Senate Committee on Finance

Prepared by the Staff

of the

Joint Committee on Taxation

September 22, 1982

JCX-41-82

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INTRODUCTION

This document provides a description of S. 2741, which is scheduled for a public hearing on September 23, 1982, by the Subcommittee on Taxation and Debt Management. S. 2741 (introduced by Senators Hayakawa and Cranston) would amend the Tax Reform Act of 1969 with respect to the application of excess business holdings provisions to certain private foundations. (The bill is intended to benefit the Ahmanson Foundation of California.)

The first part is a brief summary of the bill. This is followed in the second part by a more detailed description of present law and the bill.

(Description of a second bill, S. 232, also scheduled for the September 23 Subcommittee hearing, is provided in a separate staff pamphlet, JCS-35-82, distributed on September 21.)

I. SUMMARY

S. 2741--Senators Hayakawa and Cranston

Extension of Time for Divestiture of Excess Business Holdings by the Ahmanson Foundation

The bill would extend the time period by 10 years for the Ahmanson Foundation of California to meet the divestiture requirements for excess business holdings imposed on private foundations by the Tax Reform Act of 1969.

II. DESCRIPTION OF BILL

S. 2741--Senators Hayakawa and Cranston

Extension of Time for Divestiture of Excess Business Holdings by the Ahmanson Foundation

Present Law

The Tax Reform Act of 1969 imposed an excise tax upon the excess business holdings of a private foundation (Code sec. 4943). Generally, under the excess business holdings provisions, the combined ownership of a business by a private foundation and all disqualified persons cannot exceed 20 percent of the voting stock of the business (35 percent if other persons have effective control of the business).

The 1969 Act provided that, if a private foundation and disqualified persons together had holdings on May 26, 1969, in excess of the permitted amounts under the general rules, then those holdings could be retained if they consisted of not more than 50 percent of the business. If the combined holdings exceeded 50 percent of the business on that date, then over a transitional period the combined holdings have to be reduced to 50 percent (ultimately to 35 percent if the disqualified persons hold, in the aggregate, no more than 2 percent of the business; if they hold more than 2 percent, then the combined holdings may continue to be as much as 50 percent, of which the foundation itself may hold no more than 25 percent). Where the holdings of the private foundation alone were more than 95 percent, the transitional period is 20 years (i.e., until May 26, 1989). Where the combined holdings of the private foundation and disqualified persons were more than 75 percent, the transitional period is 15 years (i.e., until May 26, 1984). Where the combined holdings were more than 50 percent but not more than 75 percent, the transitional period is 10 years (i.e., May 26, 1979).

Issue

The issue is whether the Ahmanson Foundation of California should be allowed more time to divest itself of certain excess business holdings in accordance with the provisions of the Tax Reform Act of 1969.

Explanation of the Bill

The bill would extend the period of time available for certain private foundations to divest themselves of excess business holdings in a savings and loan association (an insured institution as defined in sec. 408(a)(1)(A) of the National Housing Act) or a savings and loan holding company (as defined in sec. 408(a)(1)(D) of the National Housing Act).

The extended divestiture period would apply to private foundations where on May 26, 1969: (1) the private foundation and disqualified persons with respect to the private foundation together owned directly at least 80 percent of the voting stock of the savings and loan association if each savings and loan holding company had been dissolved on that date and its assets distributed to its shareholders; (2) at least 80 percent of the fair market value of the assets of the private foundation consisted of voting or nonvoting stock of such savings and loan association and one or more holding companies; and (3) the outstanding principal balance of residential loans held by the savings and loan association exceeded $2 billion. In addition, the divestiture time period would be so extended only if and for so long as, after the end of the present statutory period of 15 years, the private foundation, its disqualified persons, and its related and subordinate parties (as defined in sec. 672(c)) have been divested irrevocably of the power to vote any stock in the savings and loan association or its holding companies that would constitute excess business holdings but for the new extension provision.

Under the bill, a private foundation which qualifies for the extended divestiture period for its qualified savings and loan business is generally permitted 10 additional years to meet the divestiture rule beyond the 15-year period provided by present law (i.e., until May 26, 1994), but must gradually divest itself of its excess business holdings over that 10-year period under a divestiture formula. Under that formula, the number of shares of voting stock (whether owned directly or indirectly by the private foundation) that are excess business holdings by the end of the 15-year period must be reduced by 10 percent of such number by the end of each year of the 10-year extension.

The intended beneficiary of the bill is the Ahmanson Foundation of California. However, any private foundation that meets the requirements would qualify for the extension of the divestiture time period.

Effective Date

The provisions of the bill would be effective as of May 26, 1969.

Revenue Effect

This provision is not expected to affect budget receipts through fiscal year 1987.

Other Congressional Action

A similar provision, for a 5-year extension to meet divestiture requirements, was approved as a Senate floor amendment to H.R. 4961 (Tax Equity and Fiscal Responsibility Act of 1982), but was not agreed to in conference.

97TH CONGRESS
1ST SESSION

S. 232

To amend sections 46(f) and 167(l) of the Internal Revenue Code of 1954 with respect to the treatment of public utility property.

IN THE SENATE OF THE UNITED STATES

JANUARY 22 (legislative day, JANUARY 5), 1981

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

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A BILL

To amend sections 46(f) and 167(l) of the Internal Revenue Code of 1954 with respect to the treatment of public utility property.

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

SECTION 1. NORMALIZATION METHOD FOR PURPOSES OF DEPRECIATION.

Paragraph (3) of section 167(l) of the Internal Revenue Code of 1954 (relating to definitions for purposes of depreciation in the case of utilities) is amended by redesignating subparagraphs (H) and (I) as subparagraphs (I) and (J), respectively, and by inserting after subparagraph (G) the following new subparagraph:

"(H) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS, ETC.—

"(i) IN GENERAL.—One way in which the requirements of subparagraph (G) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (G).

"(ii) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS.—The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (G)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

"(iii) REGULATORY AUTHORITY.—The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in clause (ii)) which are to be treated as inconsistent for purposes of clause (i)."

SEC. 2. COMPUTATIONS FOR PURPOSES OF INVESTMENT CREDIT.

Subsection (f) of section 46 of such Code (relating to limitation in case of certain regulated companies) is amended by adding at the end thereof the following new paragraph:

"(10) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS, ETC., FOR PURPOSES OF PARAGRAPHS (1) AND (2).—

"(A) IN GENERAL.—One way in which the requirements of paragraph (1) or (2) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of paragraph (1) or paragraph (2), as the case may be.

"(B) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS.—The procedures and adjustments which are to be treated as inconsistent for purposes of subparagraph (A) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's qualified investment for purposes of the credit allowable by section 38 unless such estimate or projection is consistent with the estimates and projections of property which are used, for ratemaking purposes, with respect to the taxpayer's depreciation expense and rate base.

"(C) REGULATORY AUTHORITY.—The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in subparagraph (B)) which are to be treated as inconsistent for purposes of subparagraph (A)."

SEC. 3. EFFECTIVE DATES.

(a) GENERAL RULE.—The amendments made by sections 1 and 2 shall apply to taxable years beginning after December 31, 1979.

(b) SPECIAL RULE FOR PERIODS BEFORE MARCH 1, 1980.—

(1) IN GENERAL.—Notwithstanding the provisions of sections 167(l) and 46(f) of the Internal Revenue Code of 1954 and of any regulations prescribed by the Secretary of the Treasury (or his delegate) under such sections, the use for ratemaking purposes or for reflecting operating results in the taxpayer's regulated books of account, for any period before March 1, 1980, of—

(A) any estimates or projections relating to the amounts of the taxpayer's tax expense, depreciation expense, deferred tax reserve, credit allowable under section 38 of such Code, or rate base, or

(B) any adjustments to the taxpayer's rate of return,

shall not be treated as inconsistent with the requirements of subparagraph (G) of such section 167(l)(3) nor inconsistent with the requirements of paragraph (1) or (2) of such section 46(f), where such estimates or projections, or such rate of return adjustments, were included in a qualified order.

(2) QUALIFIED ORDER DEFINED.—For purposes of paragraph (1), the term "qualified order" means an order—

(A) by a public utility commission which was entered before March 13, 1980,

(B) which used the estimates, projections, or rate of return adjustments referred to in paragraph (1) to determine the amount of the rates to be collected by the taxpayer or the amount of a refund with respect to rates previously collected, and

(C) which ordered such rates to be collected or refunds to be made (whether or not such order actually was implented or enforced).

(c) No Inference.—The application of subparagraph (G) of section 167(l)(3) of the Internal Revenue Code of 1954, and the application of paragraphs (1) and (2) of section 46(f) of such Code, to taxable years beginning before January 1, 1980, shall be determined without any inference drawn from the amendments made by sections 1 and 2 of this Act or from the rules contained in subsection (b) of this section. Nothing in the preceding sentence shall be construed to limit the relief provided by subsection (b).

(d) Delay in Making Refunds or Credits.—No refund or credit of any overpayment of tax attributable to the amendments made by this Act shall be made or allowed before October 1, 1981.

97TH CONGRESS
2D SESSION

S. 2741

To amend the Tax Reform Act of 1969 with respect to the application of the excess business holdings provisions to private foundations.

IN THE SENATE OF THE UNITED STATES

JULY 15 (legislative day, JULY 12), 1982

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

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A BILL

To amend the Tax Reform Act of 1969 with respect to the application of the excess business holdings provisions to private foundations.

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

SECTION 1. APPLICATION OF DIVESTITURE REQUIREMENTS.

Paragraph (4) of subsection (1) of section 101 of the Tax Reform Act of 1969 is amended by adding at the end thereof the following new subparagraphs:

"(D) Subject to the provisions of subparagraph (E), the 15-year period described in section 4943(c)(4)(B)(ii) for the disposition by any private foundation of excess business holdings shall be suspended for an additional 10-year period, beginning when the 15-year period described in section 4943(c)(4)(B)(ii) would end but for this subparagraph, with respect to holdings in an insured institution (as defined in section 408(a)(1)(A) of the National Housing Act (12 U.S.C. 1730a(a)(1)(A))) and in each savings and loan holding company (as defined in section 408(a)(1)(D) of the National Housing Act (12 U.S.C. 1730a(a)(1)(D))) that owns stock of such insured institution (or that owns stock of a savings and loan holding company that owns stock of such insured institution), if, on May 26, 1969—

"(i) the private foundation and disqualified persons with respect to the private foundation (as defined in section 4946(a)(1)) together would have owned directly at least 80 percent of the voting stock of such insured institution had each such savings and loan holding company been dissolved on that date and its assets distributed to its shareholders;

"(ii) at least 80 percent of the fair market value of the assets of the private foundation was represented by its ownership of voting or nonvoting stock of such insured institution and of one or more such savings and loan holding companies; and

"(iii) the outstanding principal balance of residential loans held by such insured institution exceeded $2,000,000,000.

"(E) The suspension of the 15-year period provided in subparagraph (D) shall apply only if and for so long as—

"(i) from and after the end of such 15-year period, the private foundation shall have irrevocably divested itself, its disqualified persons, and its related and subordinate parties (as defined in section 672(c)) of the power to vote such of its voting stock of such insured institution and of each such savings and loan holding company that, in each case, would constitute excess business holdings but for subparagraph (D); and

"(ii) by the end of each 1-year period following the end of such 15-year period, the number of shares of voting stock of such insured institution, and of each such savings and loan holding company, owned directly or indirectly by the private foundation, is not, in each case, more than (I) the number of such shares that does not constitute excess business holdings (determined without regard to subparagraph (D)), plus (II) 10 percent of the number of such shares that would have constituted excess business holdings at the end of the 15-year period but for subparagraph (D), multiplied by the number of years remaining in the additional 10-year period described in subparagraph (D).

"(F) The savings and loan holding companies described in subparagraph (D) shall be deemed to be business enterprises for purposes of chapter 42.

"(G) The divestiture of the power to vote voting stock, pursuant to subparagraph (E)(i), shall not cause the stock in question to be considered as other than voting stock held by the private foundation.".

SEC. 2. EFFECTIVE DATE.

The amendment made by this Act shall be effective as of May 26, 1969.

Senator PACKWOOD. Ladies and gentlemen, I think we may as well start.

Today we have two bills, S. 232 and S. 2741. There is a panel on the first bill, and they will testify together—Mr. Hart, Mr. Dalenberg, and Mr. Curtis. For the second bill, we have one witness, Mr. Belin.

So, if Mr. Hart, Mr. Dalenberg, and Mr. Curtis are here, we will start on S. 232. This bill involves the subject of normalization and the California Public Utilities Commission and the rules as they apply under the Internal Revenue Code.

I might say this bill is not new to this committee. I will give a little chronology to it. In 1980 we had hearings on this bill in the Ways and Means and Finance Committees. The bill was reported by the Ways and Means Committee, and passed by the House of Representatives.

The bill was reported by the Senate Finance Committee and was called up on the Senate floor on December 16, 1980. However, it died because there were efforts to add unrelated amendments to it, and we were in the throes of the end of the session. We could not get the votes to have cloture, and we could not get the people to drop their amendments. Consequently, the bill was not passed.

The Ways and Means Committee held hearings on this bill on June 21, 1982. It was approved by the Ways and Means Committee, and was approved by the House of Representatives on September 20. We are now holding hearings here, so it is not a new subject. It is one which this committee has looked upon favorably in the past, and I would hope we could do so again.

Mr. Hart, do you want to go ahead?

Mr. HART. Yes. Thank you, Mr. Chairman.

STATEMENT OF ALBERT M. HART, VICE PRESIDENT-GENERAL COUNSEL AND SECRETARY, GENERAL TELEPHONE CO. OF CALIFORNIA, SANTA MONICA, CALIF.

Mr. HART. I certainly appreciate the opportunity to appear on behalf of General Telephone of California on this bill.

As you say, the bill is very well known to the committee, and the background and details are contained in my statement. The summary of that statement has been lodged with the committee, but I will not go into those points, to save time.

I would like, however, to point out the tremendously serious financial position that General Telephone is in as a result of this particular dilemma. We have been fighting this battle for approximately 10 years.

My statement reviews in great detail the administrative and court proceedings that we have been through, up to and including the Supreme Court of the United States.

We feel that the only way to solve the dilemma now is through this legislation. We support it and enlist the aid of the Congress in passing the legislation.

By now, our potential liability is about a half a billion dollars, which is approximately 40 percent of our entire common equity.

Senator PACKWOOD. I might interject here by saying through no fault of your own, you followed the Federal law to the letter. This is not a case where you are asking for forgiveness because you have not done what the Federal law allowed or permitted or directed you to do.

Mr. HART. That is absolutely true, Senator. That is why I refer to it as "a dilemma." We are between the State regulatory agency and the Federal taxing authority, and we have been pretty well whipped around between those two agencies.

Another factor that has entered the equation is that, beginning the first of 1983, interest on back taxes will be compounded; and, as we calculate, the interest alone in the case of General Telephone of California will reach $800 million by the year 1988. That date has significance only in that if we litigate the matter with the Internal Revenue Service it will probably be 1988 before we get a resolution on it.

In addition to that, our company is in the biggest construction program that we have ever been in our history. We are spending over $4 billion over a 5-year period, and between our normal capital needs and the threat of a massive payback of these tax liabilities to the Federal Government, it has become harder and harder to finance.

It could very well be that as time goes on, if this matter isn't taken care of, we will be unable to finance it all and provide telephone service to California.

Our bonds have been downgraded twice during the period that this contingent liability has been pending, as recently as August, 1982, by Moody's. The major rating agencies have said that this tax uncertainty is a significant element of risk in assessing the company's credit.

We were forced to abort a preferred stock issue a while back because of the downgrading, and we have been forced to sell bonds at private placement rather than public offering because of the overhang of the contingent liability.

So we feel that the only satisfactory solution is this bill, S. 232. We certainly enlist your support and ask that you give the bill your favorable consideration.

Senator PACKWOOD. It will certainly have mine, and we will be having a markup later today. I would hope that we can adopt it at that time.

Mr. HART. Thank you.

[The prepared statement of Albert M. Hart follows:]

Statement of

ALBERT M. HART

Vice President-General Counsel and Secretary

General Telephone Company of California

Mr. Chairman and Members of the Subcommittee:

My name is Albert M. Hart. I am Vice President-General Counsel and Secretary of General Telephone Company of California ("General"). General is the largest operating telephone company within GTE, serving more than four million telephones in California.

It is my pleasure to appear before you today and testify on S. 232. This measure would correct a serious inequity having a very detrimental impact upon our ability to provide service to our customers.

INTRODUCTION

S. 232 addresses a serious inequity caused by conflicting federal and state positions concerning the proper method of accounting for the tax benefits of accelerated depreciation and the investment tax credit.

Congress carefully fashioned sections 46(f) and 167(l) of the Internal Revenue Code to require "normalization" of the tax benefits to ensure that the benefits have their intended effect of providing an incentive for capital investment. The governmental authorities in one state, namely the California Supreme Court and the California Public Utilities Commission, have seen fit to interpret those provisions to achieve an increased allocation of the tax benefits to present customers at the expense of the affected utilities and future customers,

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and in violation of the generally understood meaning of the statutory normalization provisions.

As a result, the eligibility of certain California utilities for the tax benefits has been placed in jeopardy, exposing them to staggering amounts of back tax liability. If these amounts were to be paid, they would dangerously decapitalize the utilities and have the potential to destroy their ability to provide service to the public. General is one of the affected utilities. The company has a total investment of $3.4 billion in telephone plant and equipment in the State of California.

The provisions contained in S. 232 are not new. An identical bill received a favorable response in the last Congress, failing only in the final hour when the Senate was acting under unanimous consent. Undoubtedly, this favorable response reflected Congress' recognition of the terribly inequitable situation in which General and the other affected utilities find themselves.

S. 232'S PRIOR HISTORY

During the last Congress, the Senate Finance Committee and this Subcommittee reported out an identical bill (H.R. 6806) by voice vote. It was brought to the Senate floor under a unanimous consent procedure on the final day of the last Congress, but failed to pass when one senator objected to the bill for reasons totally unrelated to its merits.

The House Ways and Means Committee on September 15, 1982, reported out H.R. 1524, a companion bill to S. 232. This bill is identical to S. 232 except for technical changes to reflect the passage of the Economic Recovery Tax Act of 1981 ("ERTA").

In addition, in section 209(d)(4) of ERTA this Congress has stated its intent to address the matter of normalization in the near future, granting the Treasury Department only interim authority to issue regulations "until Congress acts further." I understand that Congress limited the Treasury's authority in anticipation of prompt legislative action in this area, as would be accomplished by enacting S. 232.

In view of this background, I would strongly hope that this Committee and Congress will see their way clear to give their prompt approval to S. 232. By this action, the future viability of General would be resolved and it can get on with its business of serving the public.

NORMALIZATION REQUIREMENTS

The tax benefits of accelerated depreciation and the investment tax credit were expressly designed by Congress to provide an incentive for capital investment. If, however, the tax benefits are not available to a public utility because a regulatory commission, in setting rates, requires that the benefits be passed on (or "flowed-through") to customers in the form of current rate reductions, the stimulus for capital investment is lost.

A utility is normally entitled to recover its cost of providing service to the public. Since one component of a utility's cost of service is its tax expense, absent a statutory restraint, a regulatory commission could flow-through the tax benefits to present customers in the form of current rate reductions by computing a utility's tax expense net of the two tax benefits. This is a form of ratemaking known as "flow-through ratemaking."

In 1969, Congress took steps to put an end to what it viewed as an undesirable trend to flow-through ratemaking by enacting the normalization requirements for accelerated depreciation. The requirements provided, as a condition of eligibility, that the tax deferrals resulting from accelerated depreciation be "normalized," i.e., set up as a reserve rather than used currently to reduce rates, as is done under flow-through ratemaking. This rule carefully balances the interests of all concerned -- it provides capital to a utility by permitting it to use the tax savings from accelerated depreciation and it provides a benefit to the utility's customers in the form of lower rates since the deferred tax reserve is typically excluded from the rate base on which a utility is permitted to earn a return.

In reinstating the investment tax credit in 1971, Congress again expressed its displeasure with flow-through ratemaking and required, also as a condition of eligibility, that the credit be "normalized" to prevent the immediate flow-through of the tax benefit to a utility's customers. In enacting these requirements, Congress again balanced the interests of the utilities, and present and future customers.

More recently, the current Congress has very clearly indicated its continuing support for the normalization requirements. In enacting the ACRS capital recovery and the investment tax credit provisions in ERTA, Congress explicitly required that those tax benefits will not be available to any utility unless the benefits are normalized. This action represents an even stronger Congressional commitment to normalization. In the past, when Congress had taken steps to require normalization, it had "grandfathered" some flow-through ratemaking, permitting the continued use of flow-through ratemaking in certain situations where utilities were already subject to such ratemaking.* Under ERTA, unlike prior law, there are no grandfather provisions and no exceptions. For all utilities, normalization is the only acceptable method. Otherwise, the tax benefits will not be available.

I submit that, as Congress has continually recognized, there can be no question about the wisdom of the normalization requirements. To accomplish the Congressional intent of stimulating capital investment, these requirements are

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*These prior rules that permitted the continued use of flow-through ratemaking in certain circumstances had no application to General.

unquestionably necessary. Flow-through ratemaking is completely contrary to this intent.

The Treasury Department has reached the same conclusion in testimony earlier this year (June 21, 1982) on H.R. 1524 before the Ways and Means Committee. During the last Congress, then Deputy Assistant Secretary Daniel Halperin testified to the same effect in testimony on H.R. 6806 -- S. 232's identical predecessor -- before this Subcommittee on November 19, 1980.

The action taken by the Federal Communications Commission in its Report and Order, released on December 5, 1980, in Docket No. 20188 provides further support for these conclusions. The FCC substantially revised its depreciation practices to improve the capital recovery of telephone companies for the avowed purpose of encouraging increased capital investment, with the expectation that the new investments will result in benefits to customers that far outweigh any initial increases in telephone rates.

Finally, the Federal Energy Regulatory Commission has recently stated its strong support for the concept of normalization. In Orders Nos. 144 (May 14, 1981) and 144-A (February 22, 1982), the Commission implemented a policy that requires the normalization of additional book and tax timing differences not covered under the normalization provisions of the Internal Revenue Code.

THE UNIQUENESS OF THE NORMALIZATION REQUIREMENTS

While the normalization requirements are necessary to accomplish the intent of Congress, they do create a unique situation in which a utility's eligibility for the tax benefits is dependent not upon any action taken by it, but rather upon action taken by a third party, i.e., the action taken by a regulatory commission in setting rates. Typically, a person takes an action and is responsible for the consequences. Here, a regulatory commission can take an action, but the consequences fall upon a utility. It is this separation of action from consequences which has placed General in a terribly unfair position.

The California Public Utilities Commission, responding to actions taken by the California Supreme Court, adopted newly devised, partial flow-through methods designed to flow-through a portion of General's tax benefits to current customers in violation of the generally understood meaning ascribed to the normalization requirements. The California authorities took these actions notwithstanding the fact that General took every conceivable action to convince them to the contrary. As a consequence, ironic as it may be, General -- and not the California Commission or Supreme Court -- has incurred a substantial potential liability for back taxes (and interest) of $495 million as of December 31, 1981. As bad as this is for General, the situation will only worsen. The recently passed Tax Equity and Fiscal Responsibility Act requires the daily compounding of interest (at current prime rates) on tax deficiencies. As a result of this, General's potential liability for back taxes (and interest) will quickly grow to an almost unimaginable amount. Using reasonable projections for the prime rate, General's potential liability for interest alone will exceed $800 million by 1988.

In addition, on the assumption that the partial flow-through methods satisfy the normalization requirements, the Commission ordered General to refund to customers approximately $110 million of the tax benefits (including interest) in June 1980 and June 1981. Hence, if General is ultimately found not to satisfy the normalization requirements as a result of the actions taken by the California governmental authorities, General will be required, in effect, to return the tax benefits to the federal government by paying the back tax liability, even though it has already paid a portion of the same benefits to its customers.

The cumulative effect of all this is almost beyond imagination. Surely, the members of this Committee will agree that General has been placed in a terribly unfair and inequitable position. The title of an article which appeared in the September 10, 1979 issue of Fortune magazine aptly describes General's plight -- The Tax Break That Turned Into a Nightmare. I submit that General's situation, caused by no action on its part, presents a compelling case for relief.

This is the reason for S. 232. It is designed to prevent a similar problem from arising in California and elsewhere in the future and to provide relief to General (and others similarly situated) during a limited transitional period ending on March 1, 1980.

HOW GENERAL'S SITUATION AROSE

Following the enactment in 1969 of the normalization requirements pertaining to accelerated depreciation, General elected to use accelerated depreciation for federal income tax purposes. The California Commission issued decisions that, for the period beginning January 1, 1970, General and another California telephone company could use accelerated depreciation and could normalize their tax expense in compliance with the generally understood meaning of the normalization requirements. Subsequently, the California Supreme Court in 1971 annulled the Commission's ruling on procedural grounds, stating that the Commission had erred in failing to at least consider alternatives to normalization that would be more favorable to current customers and remanded the matter to the Commission for it to consider such alternatives.

In 1974, three years later, and after a rehearing before the California Commission, the Commission again decided that General could use a full normalization method in fixing rates. At the same time, in deciding a separate rate increase application, the Commission reaffirmed that position and adopted a ratable cost-of-service reduction for the investment tax credit in compliance with the generally understood normalization requirements in section 46(f)(2) of the Code. Late in 1975, the California Supreme Court annulled the 1974 Commission orders with respect to the treatment of accelerated depreciation and the investment tax credit, remanding once more for consideration of alternatives to normalization, on the one hand, and flow-through, on the other.

As a result, in 1977, the California Commission issued an order in which it interpreted the Internal Revenue Code as permitting a change from the normalization procedures theretofore used, which clearly satisfied the normalization requirements in the Code and preserved eligibility, to newly devised, partial flow-through methods of setting rates. Under these new methods, the Commission achieved an additional flow-through of General's tax benefits to current customers, requiring it to reduce rates for the future and make refunds, going back to 1971. The Internal Revenue Service has ruled that the Commission's partial flow-through methods embodied in the 1977 order do not meet the statutory standards for eligibility.*

On November 8, 1977, the Commission granted a stay of the 1977 order pending judicial review. General, on December 7, 1977, appealed the order to the California Supreme Court. On July 13, 1978, the California Supreme Court denied the appeal. General then petitioned the United States Supreme Court, requesting review of the California Supreme Court's action. On December 11, 1978, the United States Supreme Court denied

*Private IRS letter rulings nos. 7845018 (August 9, 1978) and 7836048 (June 9, 1978).

review, despite the urging of the Solicitor General of the United States. The Solicitor General stated to the Court that the California Commission's order caused General to lose its eligibility for accelerated depreciation and the investment tax credit. On January 5, 1979, General filed a petition for rehearing, which the high court denied on February 21, 1979.

Following the denial of review by the United States Supreme Court, the Commission, on March 14, 1979, ordered the filing of a refund plan and a reduced tariff, as required by the Commission's 1977 order. The United States District Court for the Central District of California subsequently denied a request by General for a preliminary injunction that would have stayed the Commission's order, which denial was affirmed by the United States Court of Appeals for the Ninth Circuit on July 18, 1979. An appeal from the latter ruling was denied by the United States Supreme Court.

Having exhausted all possible appeals, General Telephone filed a refund plan and a reduced tariff, the Commission held hearings with respect thereto and, on February 13, 1980, the Commission ordered refunds of $110 million as a result of its 1977 order.

THE URGENT NEED FOR LEGISLATION

As of December 31, 1981, General's potential federal income tax liability is a staggering $495 million and equals approximately 45 percent of its common stock equity. The mere existence of this potential liability already presents difficult financial problems to General. Its outside auditors have required General to restate its financial statements to reflect the potential loss of eligibility for the tax benefits and, as a result, General's financial picture looks bleak. In late 1979 and, again, in March 1981, Standard & Poor's has downgraded its ratings for General's securities. These downgradings in ratings lead not only to increased interest costs in any financing at a time when interest rates are already at extremely high levels, but may also substantially limit the amount of potential funds available to General.

The problem is exacerbated by the recent change in the tax law to daily compounding of interest on tax deficiencies. As noted above, General projects that, by 1988, its potential liability for interest alone will exceed $800 million, equal to approximately 72% of its common equity. At the same time, the demand for communications services in California continues at unprecedented levels and requires continuing, enormous capital expenditures. General projects capital expenditures of some $4 billion for the 1980-1984 five-year period, an increase of approximately 120 percent over the preceding five-year period. With the financial cloud hanging over General's head, it is uncertain whether the necessary external funds can be found to meet this demand. If somehow the funds can be found, it will only be at an increased cost borne by the customers.

If you do not act favorably on this bill, the only available means for resolving this dispute will be tax litigation brought in the Tax Court, a district court or the Court of Claims. The resolution of the tax litigation can be expected to take many years. During these years, of course, the existence of the potential liability for back taxes will have grave effects on General and on its customers.

If the California Commission's partial flow-through methods are held not to satisfy the Code's normalization requirements by a final court determination, the determination will, of course, provide no relief to General and may be the death-knell for General and telephone service provided by it in California.

If, on the other hand, it is determined that the partial flow-through methods satisfy the normalization requirements and the back taxes are, therefore, not payable, there is little doubt that other regulatory commissions throughout the country will be encouraged to flow-through all or a part of the tax benefits. This is especially true today since, under ERTA, regulatory commissions will be setting rates for many utilities which, for the first time, are required to normalize their tax benefits if they are to continue to be eligible for the benefits. The use of flow-through methods by regulatory commissions would clearly undermine the avowed purpose of Congress in enacting the normalization requirements, <u>i.e.</u>, the intention to provide an incentive for capital investment to the highly capital-intensive utility industry.

Surely, allowing this controversy to be determined by litigation would be a mistake -- neither of the possible results of litigation is desirable. Only legislation can provide the necessary equitable relief to General while, at the same time, assuring that the Code's normalization requirements will accomplish their desired objective.

THE NECESSARY RELIEF

I believe you will agree that the situation in which General finds itself is unconscionable. It is caught in the middle between conflicting federal and state positions. General is no mere bystander -- at stake is some $495 million as of December 31, 1981.

S. 232 would provide the equitable relief so desperately needed. It provides, in effect, that the partial flow-through methods adopted by the California Commission will not retroactively result in the loss of the tax benefits to General (and others similarly situated). The bill limits this relief, as it properly should, to as short a period of time as is possible, namely, to a period ending on March 1, 1980. In other words, from that date forward, the Commission must adhere to full normalization of the tax benefits or General will not be eligible for any post-March 1, 1980 tax benefits. This, I believe, would be clear to all.

This portion of S. 232 is, thus, a very limited response designed to overcome a particularly egregious problem. It goes only as far as necessary to provide a solution -- and no further.

THE BILL ALSO MAKES CHANGES TO PREVENT FUTURE MISUNDERSTANDINGS

S. 232 would amend the normalization requirements in sections 46(f) and 167(l) of the Code to prevent any future misunderstandings of the requirements.* It adds specific language to make clear that the California Commission's partial flow-through methods do not satisfy those requirements. The bill also grants to the Secretary of the Treasury the explicit power to adopt regulations prescribing other procedures and adjustments that are inconsistent with the normalization requirements. I believe this accomplishes two very important objectives: first, it provides a clear signal to all that the federal government is serious about requiring adherence to full normalization; and secondly, it places the Treasury Department in a much better position to issue binding regulations explaining the meaning to be ascribed to the normalization requirements.

I believe that the changes made by the bill to sections 46(f) and 167(l) of the Code would provide a complete answer to any concern that the relief provided to General (and others similarly situated) in the bill may encourage other regulatory commissions to stray from strict adherence to full normalization, with the expectation that Congress will enact a similar relief bill for them. The general changes made by

*Since the introduction of S. 232, ERTA has been enacted, with new normalization provisions governing ACRS capital recovery. S. 232 should be revised, as has already been done in the House to the companion bill (H.R. 1524), so that its rules will apply to these provisions as well.

S. 232 clearly, and quite forcibly, indicate just the contrary. Congress, in S. 232, is reaffirming its support for full normalization. The message from Congress would be perfectly clear -- full normalization is the only alternative. This will be understood by the California authorities and other state courts and regulatory commissions.

Even beyond this, it seems a simple matter to make clear in the legislative history accompanying S. 232 that no one should expect any further relief for failure to comply with the requirements of full normalization. Compelling equitable grounds exist for the relief afforded to General in S. 232. After Congress reaffirms its support for full normalization in S. 232 and makes the requirements more explicit, there can be no equitable justification for a state court or regulatory commission to adopt any flow-through method, partial or otherwise.

The Report of the Senate Finance Committee accompanying H.R. 6806 -- S. 232's identical predecessor -- dated November 25, 1980, accomplishes this result. It states (at page 10) that the relief provided by the bill "is designed to meet a specific, one-time problem which has arisen as a result of a misapplication of the normalization requirements" and that the Senate Finance Committee "does not intend that the provision of relief in this instance should be regarded as a precedent for similar relief in subsequent incidents."

THE APPROPRIATENESS OF THE RELIEF

I believe that the members of this Subcommittee will agree that the position in which General finds itself presents a compelling equitable case for the relief provided in S. 232, i.e., the elimination of the potential back tax liability. Simply stated, General is caught between conflicting federal and state interpretations of the normalization rules. The California governmental authorities have required General to use newly devised, partial flow-through methods of normalization. The use of these methods is not of General's choosing. But it is General and its customers -- not the California authorities -- that would be required to pay the back taxes.

Where a state's governmental authorities have interpreted some of the Code's most complicated provisions to permit a result presumably unintended by Congress, basic fairness requires that the provisions first be clarified and only thereafter should a tax be enacted for noncompliance. In addition, the relief in S. 232 is fair vis-a-vis other utilities. It does not treat General any more favorably than other utilities which normalize their tax benefits.

In any dispute, it is always attractive to seek a fair compromise. S. 232 represents such a compromise. In forgiving the back taxes, the bill accepts the partial flow-through methods of the Califonia authorities for the period prior to March 1, 1980, but requires, as it must, that after that date rates be established on the basis of full normalization if the tax benefits are to be available.

I submit that this compromise is particularly appropriate in the present circumstances. The California Supreme Court and Commission have made what I believe to be conciliatory moves to resolving the dispute. Since mid-February 1980, the Commission has issued orders permitting General's rates to be collected on a full normalization basis, subject to a possible refund down the road if the issue is not resolved in a manner that effectively precludes a refund. Thereafter, the California Supreme Court, for its part, denied petitions to review the California Commission's full normalization order. It is now time for Congress to take the final step in resolving the dispute by enacting S. 232. If it does, I am confident that rates will be set in California and in all other states on a full normalization basis, and General can get on with its business of serving the public.

Senator PACKWOOD. I see Senator Hayakawa has arrived. Before I move on to the other witnesses, I might call upon Senator Hayakawa.

Senator HAYAKAWA. Good morning, Mr. Chairman.

Senator PACKWOOD. Good morning, Sam. Do you want to testify now, or do you want to wait until the panel has finished?

Senator HAYAKAWA. No. Actually, I am in no hurry, and I would like to hear from the other witnesses.

Senator PACKWOOD. That's fine. We will proceed with the other witnesses. But first, I think Senator Long has a question.

Senator LONG. Mr. Hart, I do have one question to ask you.

First, let me say that I am of the opinion that your company is very well represented here in Washington. They have good Washington representation, and they do it in good faith and with good judgment. Those who represent you here in Washington were very eager that I be at this meeting this morning.

Of course, I am familiar with the bill. I did hearings on this bill before; but, because your people thought it was important that I be here—the committee usually doesn't meet before 9:00, but it was scheduled for 8:30 to hear you—I was up at daybreak. It was before daybreak, actually, to read the newspaper and visit with Mrs. Long, and one thing and another. I get down here 10 minutes before the meeting was scheduled to commence, and I look around, and I don't see your chief executive officer. If it is important enough, if it means as much as you say it does, if it is important enough for me who is already familiar with the bill to be down here at 8:20, why isn't he here?

Mr. HART. Well, I have been in touch with him, and he is very, very interested in the bill and would certainly have been here, except that he had a commitment that was absolutely impossible for him to get out of.

Senator PACKWOOD. Russell, I will say we had initially, scheduled this bill on October 4, and since it appears we may be in recess by then, I moved the hearing to this date.

Senator LONG. How about the others, your friends from the Pacific Telephone. They are involved in this matter, too, aren't they?

Mr. DALENBERG. That's me, Senator.

Senator LONG. Where is the first team? I think you fellows are probably good substitutes, and I'm sure you do a good job where you are; but where is the first team?

Mr. DALENBERG. Somebody back in San Francisco thinks that I am the first team on this one. I can assure you that the chairman of our board and every other officer and every director of Pacific Telephone, and similar delegations from our parent AT&T would be here this morning if they thought that you would have wanted them.

With respect to Pacific Telephone, Senator, our liability, in the absence of this statute, will come to almost a $1.5 billion by the end of this year. It is growing so fast you can hardly keep up with it under the latest change in the law which causes that interest rate to be compounded daily.

Senator PACKWOOD. I might also say, Russell, that this is important enough, not just to Pacific Telephone, that Charlie Brown, the president of AT&T, was here last week talking with as many members as he could get appointments with, personally, on this subject.

Senator LONG. Mr. Brown has explained his concern about the matter to me personally.

I just want to ask this question, and maybe you can give us some guidance on it. As I understand it, we have passed a law to provide an incentive for your people to make investments. Because we suspected that the California Commission would try to make you flow through whatever tax savings you had to your customers, I believe we put in the law that you don't get the tax paid if they make you flow it through.

Then, as I understand the situation, they then ordered you to claim the credit and to reduce your rates. Then the Treasury proceeded to say, as we had anticipated, "Well, that being the case, you don't get the credit." So you had paid the money out, and you never got the money. That is the problem, is it not?

Senator PACKWOOD. That's exactly it.

Senator LONG. I think you have an overwhelming case of equity.

Now can you advise me—if we want to provide the incentive, and we don't want to just provide this money for a rate cut but we want to provide it for an incentive to provide a more modern service—can you tell me and advise me how we can do that on our end?

Mind you, I am sympathetic to your problem. We know you didn't create the problem. We played our part in creating it, and here is a fiasco created by the Congress plus the California Commission.

Now, would you mind explaining to me how you think we might achieve our result when we try to provide you with an incentive? But, at the same time, we are not trying to provide a general rate increase. If California is going to take this thing and use it for a rate reduction among their customers, I don't know why Louisiana shouldn't do the same thing. Can you tell me, how can we achieve this result that we are trying to do?

We want to give you an incentive, not to cut the rates but an incentive to provide a better service. Now, how can we do this?

Mr. DALENBERG. I think, Senator, that the best avenue to accomplish what you have described is to pass this bill.

This bill does a couple of things. First of all, it clarifies the meaning of this word "normalization." That word has been in the statute; it has been defined in rather difficult terms by the regulations promulgated by the Treasury; but there have been a lot of legitimate questions as to the precise meaning of that term.

When California made its mistake in this situation, the California Commission itself ruled that it had hoped that it met the requirements of normalization. Then the Internal Revenue Service, when it reviewed it, said it had not.

Now, our structure under the tax law does not permit a quick resolution of those kinds of controversies. There is no court that has specific jurisdiction to resolve the mixed question of Federal and State jurisdiction here; but if we clarify that law, we think that in large measure the kinds of problems that Mr. Hart and the rest of us have faced in California for the last 10 or 15 years will be finished.

In addition to that, the statute does what you perceived. It relieves the utilities that are caught in the middle of this, who have tried to do everything correctly themselves. It relieves those utilities of at least this current obligation to pay these enormous back taxes.

We think with the combination of this, this clarification and the expressed notice in the legislative history of this statute, that this is a one-time occasion, that Congress isn't going to do this every time you turn around. We think, with those in conjunction, that this will finish this long difficult chapter of what is normalization in California.

Senator PACKWOOD. I am inclined to think you are correct. I think what California did was aberrant, and you are not going to see it happen with other commissions. As I understand it, we have currently solved our problem with them. It is what happened in the past that we are trying to rectify.

Mr. DALENBERG. Yes, sir, Congress went a long way to solving the problem with last year's Tax Act, which requires normalization of all the utilities instead of a few utilities based on the grandfather provision in the 1969 act.

California last year observed the normalization provisions in the proper fashion for all the other utilities, but they are looking to what is going to happen in the statutes; and indeed, in early October we expect to have hearings in front of the California Commission where the action of Congress will be reviewed.

Senator LONG. Let me just say that I think this is a supreme example of how the road to hell can be paved with good intentions.

Now, we have passed the law to encourage you to do exactly what you did; that is, to expand these investments and to expand your operations, to provide better service. After we did that, we set into motion a series of events in which your company—both of you—have been virtually crucified for doing what Congress in effect urged you to do and gave you a tax incentive for doing.

It is clear that the Congress never intended this. I was on the committee at the time, and the Chairman I guess, and we had no intention of anything like that happening. The sum total effect is that in complete good faith you did what your Government at the Federal level expected of you.

The State government, I'm sure in good faith themselves, seeking to serve their constituents out there, those in California, acting under the authority of the laws of that State, proceeded then to require you to do things contrary to what we had intended; and the sum total effect was you didn't get the benefits, and you were required to undergo a very heavy expense—that is, of reducing your rates, reducing your revenues without receiving the additional revenue that would offset it.

I think that really is a supreme example of someone in Government—in this case, the Congress—trying to be useful to its citizens and winding up doing more harm than good, enough to practically break them. So, I really think there is a burden on us to help correct this situation. I tried to help you last year, and I intend to try to help you gain this year.

Senator PACKWOOD. Gentlemen, I think your case has been made very well. Mr. Dalenberg and Mr. Curtis, you are welcome to go ahead; but at the moment you have got a jury that is convinced.

Senator LONG. If you don't talk us out of it, I think you will win. [Laughter.]

Senator LONG. But for the benefit of those who are not here, I do think that you ought to be recorded.

Senator PACKWOOD. Their entire statements will be included in the record, of course.

STATEMENT OF ROBERT V. R. DALENBERG, VICE PRESIDENT AND GENERAL COUNSEL, THE PACIFIC TELEPHONE & TELEGRAPH CO.

Mr. DALENBERG. Senator, I think I have said about all I intended to say by way of summary of my testimony, which is in your record.

We need the help, and we think it will help the utility industry generally in the United States in clarifying this statute, and we think that the California Commission will follow the Federal law in the future.

That is all I would say this morning, unless you have questions.

[The prepared statement of Robert V. R. Dalenberg follows:]

TESTIMONY OF ROBERT V. R. DALENBERG
VICE PRESIDENT AND GENERAL COUNSEL
THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT
MANAGEMENT OF THE SENATE COMMITTEE ON FINANCE
SEPTEMBER 23, 1982

I am pleased to appear before you today to testify in support of S. 232 on behalf of the American Telephone and Telegraph Company, Pacific Telephone and Telegraph Company and the other Associated Companies of the Bell System (listed on Attachment A).

S. 232 provides clarification of the requirements for public utilities with respect to the Investment Tax Credit and liberalized tax depreciation. It further provides that deviations from the statutory language as clarified (for periods prior to March 1, 1980) shall not result in a penalty, through forfeiture of eligibility for the Investment Tax Credit and liberalized tax depreciation.

This bill is essentially identical to H.R. 6806 which was passed by the House of Representatives and favorably voted out of this Committee by voice vote in the second session of the 96th Congress. Unfortunately, Congress adjourned before it could clear the Senate. We strongly urge this Committee to approve the bill.

Background of Controversy

Some background is essential to an understanding of the issues addressed by S. 232 and the propriety and urgency of their resolution through this bill.

Public utilities are penalized through forfeiture of liberalized tax depreciation and Investment Tax Credit if the normalization requirements of Sections 46(f) and 167(l) of the Internal Revenue Code are not met. These penalties have been enacted to ensure that the Congressional objectives of providing incentives for capital investment through these tax benefits can be attained. A need for their clarification has arisen from conflicting interpretations by the California Public Utilities Commission (CPUC) and the Internal Revenue Service (IRS).

In rate orders involving The Pacific Telephone and Telegraph Company ("Pacific") which had been in effect prior to February 13, 1980, the CPUC used a methodology for treating

Investment Tax Credit and liberalized tax depreciation which it considered to be in compliance with the terms of Sections 46(f) and 167(l). The IRS, on the other hand, has ruled that the CPUC's ratemaking treatment in these orders violates those sections.* The result of this conflict is that Pacific, potentially, faces penalties in the form of retroactive ineligibility to claim liberalized tax depreciation and Investment Tax Credit. For Pacific, this amounts to approximately $1.2 billion in back tax liabilities with the effects of after-tax interest as of December 31, 1981.

From the outset, Pacific strenuously objected to the CPUC's methodology for fear that the Commission's actions could jeopardize its eligibility. For this reason, Pacific made every possible effort to avoid implementation of the CPUC orders which have caused this potential penalty. The Company exhausted every available legal avenue, including petitions to the United States Supreme Court. Despite these efforts, no court has ever passed on the question of whether these orders are consistent with federal law, and the CPUC's orders became final with the questions of their effect on Pacific's tax liability still unresolved. In September 1979, on the basis of the CPUC's orders, the IRS assessed an $89 million tax deficiency plus interest of $28 million against Pacific for the tax year 1974.

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*Private letter rulings no. 7836038 (6/8/78) and 7843065 (7/27/78).

Years subsequent to 1974 are still subject to audit. Pacific paid the asserted 1974 deficiency in February 1980 and recently filed a claim for refund of that amount with the Service. If the IRS denies the refund claim, Pacific intends to contest the deficiency in court but final judicial determination can be expected to require many years.

In view of these uncertainties, the CPUC ordered that from February 13, 1980 forward Pacific's customers are to pay rates on a basis clearly consistent with the normalization requirements of the tax law. However, that CPUC order also provides that customers may be entitled to refunds if it is subsequently determined that the CPUC's previous methodology is not in violation of the normalization requirements.

In the interim, however, the Company is placed in the paradoxical situation of already having made refunds to customers (over $320 million) on the assumption that the CPUC's previous methodology does not render Pacific ineligible for the past tax benefits, while at the same time facing the possibility of forfeiting to the government <u>all</u> of the past tax benefits (more than $1.2 billion including interest) on which those refunds were based. Furthermore, because the CPUC maintains that its methodology does not result in ineligibility for the tax benefits, the ratemaking process continues to assume the Company's eligibility for liberalized depreciation and Investment Tax Credit, notwithstanding the IRS rulings.

The dilemma in which the Company finds itself is an unjust situation. It is caught in the middle of a conflict between the CPUC and the IRS, facing penalties not for its own actions, but for the actions of its regulatory authority.

Already the controversy and the attendant uncertainties have had adverse financial impact. Pacific has the lowest bond rating in the Bell System. It is questionable, and in fact it may be impossible for Pacific to finance such a staggering back tax liability and at the same time finance the facilities required to serve properly the customers of California. Indeed, it would be tragic if the underlying intent of the ITC and accelerated tax depreciation provisions to stimulate investment were undermined through misinterpretation to such an extent that the Company's ability to finance required facilities were severely impaired, causing irreparable harm to the Company and its customers alike.

This controversial situation also involves two other similarly situated California utilities (General Telephone Company of California and Southern California Gas Company). The controversy has already spanned almost a decade. Absent legislation, there is no way to resolve it short of lengthy and complex litigation between the Companies and the IRS. This can take many years and the length of time involved to litigate the question is particularly harsh because it casts a lingering shadow of uncertainty over the financial position of the telephone companies and their ability to provide facilities required for communications services so essential to the economy of California.

Moreover, litigation alone cannot provide a satisfactory resolution of this problem. There is no doubt that utility commissions in states other than California will follow closely any litigation which the utilities are obliged to undertake. There can be no winner in such a confrontation: a victory by the IRS would impose harsh penalties on the companies and their customers, while a contrary decision would only encourage other jurisdictions to seek to defeat the Congressional purpose underlying the normalization requirements.

Why S. 232 is Needed

The proposed legislation is the most viable solution since it provides the assurance, which litigation cannot, of a resolution equitable to all concerned. In making it clear that only strict adherence to the normalization requirements will be allowed in the future while eliminating the harsh penalty for the past, S. 232 is consistent with and furthers the intent of Congress embraced in the normalization requirements.

Very briefly, the bill would clarify the normalization requirements of I.R.C. Sections 46(f) and 167(l) so that any misunderstanding of their meaning can be avoided in the future. It includes specific language which would make it clear that the methodology employed by the CPUC between 1974 and February 13, 1980 does not comply with the law. In addition, the Secretary of the Treasury is given explicit authority to prescribe by regulation procedures and adjustments which will be deemed inconsistent with normalization, in addition to those already specified in the statute.

There is a special rule for periods before March 1, 1980 which, in effect, provides that the California methods will not retroactively result in penalties for Pacific, General Telephone Company of California, and Southern California Gas Company. However, the March 1, 1980 date assures that such relief will apply only to misinterpretations occurring in the past and will not provide exceptions to California or any other jurisdictions thereafter.

It will be clear from the legislative history of the bill that further relief for future violations of the normalization requirements cannot be expected. In addressing the special rule providing limited relief, the Report of the Ways and Means Committee accompanying H.R. 6806, July 30, 1980, page 11 states as follows:

> This special rule is designed to meet a specific, one-time problem which has arisen as a result of misapplication of the normalization rules in certain California cases. The committee remains convinced that the normalization rules provided in the Code are appropriate for public utilities and does not intend that the provision of relief in this instance should be regarded as a precedent for similar relief in subsequent incidents.

We believe S. 232 is fully deserving of this Committee's support. It contains the same language as the bill that was introduced as H.R. 6806 in the 96th Congress on March 13, 1980, generally receiving the full support of Congress. Since then, the Economic Recovery Tax Act of 1981 (ERTA of 1981) has been enacted. However, the need for S. 232 still remains. In fact, the ERTA of 1981 reinforces the need for S. 232 because in that legislation Congress has reaffirmed its commitment to the normalization requirements through their continuation and expansion to include even those utilities which had been excepted from the requirements under prior law.

In considering the ERTA of 1981, the Congress recognized the continuing need for this legislation. As an interim solution, the ERTA of 1981 includes a provision which specifically grants the Secretary of the Treasury authority to prescribe interim regulations with respect to normalization under the accelerated cost recovery system until Congress acts further. In proposing this particular provision, Senator Cranston (D.-Calif.) made the statement: "The amendment I am offering will not affect the overall objective of S. 232 in any way whatsoever". Senator Dole (R.-Kan.), Chairman of the Committee on Finance, responded to the concerns raised by Senators Cranston and Hayakawa (R.-Calif.) for action on S. 232:

> "Mr. President, let me say to both distinguished Senators from California that, certainly, the Senate Committee on Finance, in our role on the measure, will give every consideration and do all we can to expedite the resolution of this very serious concern of both Senators." (Emphasis added.)

While the passage of the ERTA of 1981 in no way diminishes the need for S. 232, it should be noted that since this bill was introduced prior to the enactment of the ERTA of 1981, a conforming amendment to the bill will be necessary to reflect new Section 168(e)(3) of the Code. A suggested amendment is attached at the end of this statement (Attachment B).

In summary, S. 232 provides a timely response to the pressing needs:

1) An end to the California controversy and the attendant financial and economic problems, and
2) Clarification of the normalization requirements to avoid future misinterpretations, in California and elsewhere.

The limited relief provided by this legislation is appropriate as a remedy to the unfortunate plight of the affected California utilities. Without such relief, Congress' objectives of stimulating investment would be frustrated. There is little to be gained, and much to be lost, if the affected utilities incur the massive penalties and forfeitures which must be paid according to the IRS rulings. The relief S. 232 would grant does not confer favored treatment - it merely restores the affected companies to parity with other taxpayers whose eligibility for the tax benefits has not been placed in jeopardy. At the same time, Congress' message is clear - nothing less than strict adherence to the normalization requirements will be allowed.

For these reasons, we respectfully urge this Committee to support S. 232.

ATTACHMENT A

BELL SYSTEM COMPANIES

American Telephone and Telegraph Company
The Bell Telephone Company of Pennsylvania
The Diamond State Telephone Company
Bell Telephone Laboratories, Incorporated
The Chesapeake and Potomac Telephone Company
The Chesapeake and Potomac Telephone Company of Maryland
The Chesapeake and Potomac Telephone Company of Virginia
The Chesapeake and Potomac Telephone Company of West Virginia
Cincinnati Bell, Incorporated
Illinois Bell Telephone Company
Indiana Bell Telephone Company, Incorporated
Michigan Bell Telephone Company
The Mountain States Telephone and Telegraph Company
New England Telephone and Telegraph Company
New Jersey Bell Telephone Company
New York Telephone Company
Northwestern Bell Telephone Company
The Ohio Bell Telephone Company
Pacific Northwest Bell Telephone Company
The Pacific Telephone and Telegraph Company
and Bell Telephone Company of Nevada
South Central Bell Telephone Company
Southern Bell Telephone and Telegraph Company
The Southern New England Telephone Company
Southwestern Bell Telephone Company
Western Electric Company, Incorporated
Wisconsin Telephone Company

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ATTACHMENT B

The following changes in S. 232 are recommended to reflect the changes in the Internal Revenue Code affected by the Economic Recovery Tax Act of 1981:

On the first page, strike out line 5 and all that follows down through line 3 on page 3, and insert:

(a) General Rule.--Paragraph (3) of section 168(e) of the Internal Revenue Code of 1954 (relating to special rule for certain public utility property) is amended by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS, ETC. --

"(i) IN GENERAL.--One way in which the requirements of subparagraph (B) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (B).

"(ii) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS.--The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (B)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

"(iii) REGULATORY AUTHORITY.--The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in clause (ii)) which are to be treated as inconsistent for purposes of clause (i)."

(b) Amendment to Section 167(l).--Subparagraph (G) of section 167(l)(3) of such Code (defining normalization method of accounting) is amended by adding at the end thereof the following new sentence:

"For purposes of this subparagraph, rules similar to the rules of section 168(e)(3)(C) shall apply."

Page 6, strike out lines 10 through 13.

Amend the title of the bill so as to read: "A bill to amend the Internal Revenue Code of 1954 to provide that certain procedures and adjustments shall be treated as inconsistent with the normalization method of treating public utility property."

Senator PACKWOOD. Mr. Curtis?

STATEMENT OF JOHN J. CURTIS, DIRECTOR OF TAXES, SOUTHERN CALIFORNIA GAS CO., PACIFIC LIGHTING CORP., LOS ANGELES, CALIF.

Mr. CURTIS. Mr. Chairman, I am testifying on behalf of the Southern California Gas Co., who, as you know, is also involved partially in this particular problem. Our exposure is essentially for the investment tax credit only, and of course our exposure at the end of this year has increased to $30 million. Those numbers pale in significance compared to the exposure of the two telephone companies, but are significant to us.

I would like to submit my testimony into the record and simply state that we are in complete agreement with everything eloquently said by the other two witnesses.

If you have any specific questions about our problem, I would be happy to answer them; but I think the record is well made and well stated, and I will stand on it.

Senator PACKWOOD. As best I can tell, your problem is identical to that of Pacific Telephone & General Telephone.

Mr. CURTIS. Absolutely.

[The prepared statement of John J. Curtis follows:]

TESTIMONY OF JOHN J. CURTIS, DIRECTOR OF TAXES OF PACIFIC LIGHTING CORPORATION ON BEHALF OF PACIFIC LIGHTING CORPORATION AND SOUTHERN CALIFORNIA GAS COMPANY IN SUPPORT OF H.R. 1524 BEFORE THE SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT SEPTEMBER 23, 1982

Mr. Chairman, I am testifying today on behalf of Pacific Lighting Corporation and its principal subsidiary, Southern California Gas Company, which is the nation's largest gas distribution company in terms of number of customers served. We want to thank this committee and its staff for holding these hearings and permitting me to comment. We strongly favor S. 232/ H.R. 1524.

Passage of S. 232/H.R. 1524 will assure that public utilities can retain two very important economic incentives provided by Congress, accelerated depreciation (both under prior law and under the accelerated cost recovery system) as well as investment tax credit.

To be eligible, Congress has required that utilities account for these benefits both in rates and on their books using specific accounting methods contained in the law and explained in Treasury Regulations. Failure of the utility or its regulatory commission to conform to these accounting methods results in forfeiture of the tax benefits.

Several years ago, the California Public Utilities Commission ordered two California telephone companies to account for accelerated depreciation and investment tax credit using Commission created variations to the restrictive accounting methods found in the federal law and regulations. The Commission believed that its methods conformed to the requirements in the law. However, in private rulings the Internal Revenue Service determined otherwise and charged the telephone companies with over one billion dollars in back taxes.

In 1976, Southern California Gas Company found itself in the middle of a similar dispute between the California Commission and the Internal Revenue Service concerning the ratable flowthrough requirements of the investment tax credit. This dispute is still lingering, and threatens Southern California Gas Company's eligibility for much of the Company's investment tax credit.

Specifically, in 1975 SoCal Gas elected, pursuant to Section 46(f)(2), ratable flowthrough for the additional investment tax credit provided by the Tax Reduction Act of 1975. A taxpayer making such an election loses the credit if its regulatory agency requires it to flow through the credit in its rates faster than ratably.

In 1976 the California PUC reduced SoCal's rate of return by .25% in an offset case and ordered refunds.

The California Commission concluded that its rate of return reduction would (and I quote) "best recognize SoCal's reduction of risk because of increased cash flow, increased interest coverage, and relieved financial requirements resulting from the Tax Reduction Act of 1975." (PUC Decision #86117, 7/13/76.)

The PUC also expressly concluded that its action did not result in faster than ratable flowthrough and thus would not cause SoCal to forfeit the additional ITC. The California Supreme Court affirmed the Commission's refund orders in 1979, roughly 31 months after the Commission's decision. As a result SoCal's rates were determined on the assumption that it was eligible for the additional ITC.

However, in a letter ruling to SoCal Gas, the IRS concluded, contrary to the California PUC and the California Supreme Court, that the PUC's action would cause SoCal to lose eligibility for the additional credit because it did result in faster than ratable flowthrough.

Consequently, SoCal now faces the ominous possibility of losing the additional credit provided by Congress in 1975 while at the same time charging lower rates on the assumption that it is eligible for the additional credit.

Unfortunately, the PUC refund orders, the California Supreme Court Decision, and the IRS Rulings were issued prior to the publication of the Treasury Regulations interpreting Section 46(f). These regulations indicate what ratemaking practices will or will not cause a utility to lose the credit. The California Supreme Court modified its decision after the regulations were published to conclude that SoCal would still not lose eligibility for the additional credit. After this decision SoCal requested that the IRS revoke its earlier ruling and rule, as the California Supreme Court has concluded, that

SoCal would not lose eligibility for the credit. The IRS was extremely reluctant to reconsider its conclusion and suspended its consideration of SoCal's request when the first legislation on this matter, H.R. 6806, was scheduled in 1980 for hearing before the House Ways and Means Committee. As of today the IRS consideration of SoCal's request is still in suspense.

We believe it would be unfair to SoCal, its ratepayers, and the PUC if SoCal lost the additional ITC for many years because California issued a rate of return adjustment in 1976 while the law was unclear and before interpretive regulations were published.

In our statement we have not addressed the specific problems of the two California telephone companies in detail because their past and present testimony contains a clear statement of their dilemma. While the telephone companies' problem is not exactly like SoCal's, both problems similarly arise essentially out of a controversy between the California Commission and the Internal Revenue Service over the lawful and proper interpretation of federal tax law and regulations.

These controversies between the California Commission and the Internal Revenue Service create a very serious dilemma for the two California telephone companies and Southern California Gas Company as well as a potential dilemma for other utilities who may become involved in similar controversies.

Wherever a utility regulatory body issues an order which the Internal Revenue Service determines is not in conformity with the tax laws, the affected utility will be required to go to court to resolve the issue. The court battle will undoubtedly go on for several years and cost the taxpayers and the ratepayers large sums of money. Further, the tax liability of the utility can become chaotically unpredictable.

If the utility lost in court, it would be deprived of the tax benefits Congress intended for them to have, and, depending on state regulatory law, the utility could very well be unable to recover their tax losses in rates. Even if the utility ultimately prevailed, the protracted uncertainty over its tax liability would adversely affect its financial standing causing higher debt costs and ultimately higher rates.

Wherever such a situation is created, the utility is deprived of most, if not all, of these economic incentives provided by Congress in the tax law.

S. 232/H.R. 1524 is designed to avoid these terrible consequences and to rectify the unfair tax position that the affected utilities find themselves in. S. 232/H.R. 1524 clarifies in the tax law that the accounting methods ordered by the California Commission or any similar methods contemplated by other commissions do not conform to the accounting requirements which must be met by public utilities to claim accelerated depreciation, accelerated cost recovery or investment tax credit. Enactment of S. 232/H.R. 1524 will help insure that public utilities throughout the country will not lose the economic incentives that Congress provided due to confusion or a misreading by regulatory bodies of the accounting requirements in the tax law. S. 232/H.R. 1524 does this expressly for past problems, and by clearly dealing with this past confusion in precise new statutory language, it should prevent a recurrence in the future.

Most importantly, S. 232/H.R. 1524 has no adverse impact on federal revenues. Congress has always intended that public utilities receive the tax benefits in question along with other industries. It was never contemplated that these benefits would be lost due to technical difficulties with the law. Passage of S. 232/H.R. 1524 will mean that Congress' original intent and policy will be implemented.

For these reasons, we urge you to act favorably on S. 232/H.R. 1524 and to do so as quickly as possible to remove the cloud that has been hanging over the affected companies.

Senator PACKWOOD. Senator Hayakawa, you are welcome to testify on both bills if you wish. There are no other witnesses other than the Ahmanson Foundation witness when this panel is done.

Senator HAYAKAWA. Thank you, Mr. Chairman, I shall do both.

STATEMENT OF HON. S. I. HAYAKAWA, U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator HAWAKAYA. Mr. Chairman, I would like to thank you for scheduling this hearing on the two bills I introduced, S. 232 and S. 2741, and I am grateful for the opportunity to comment on them.

The first bill, S. 232, is remedial legislation necessary to resolve the dispute between the California Public Utilities Commisson, affirmed by the California Supreme Court, and the Internal Revenue Service relating to the accounting procedures associated with eligibility for certain Federal tax benefits.

When the Congress authorized the investment tax credit and accelerated depreciation, it intended that the benefits derived therefrom be directed toward investment in plant and equipment as an incentive for such investment. In the case of regulated utilities, Congress mandated that intent by requiring specific accounting and reporting procedures.

In California, three utilities took advantage of the Federal tax benefits, intending to use the freed resources for capital improvements. In response, the California Public Utilities Commission—after three decisions of the California Supreme Court nullifying a previous Commission ruling—ordered that the utilities follow a particular method of accounting to provide a share of the tax benefits to the ratepayers. Subsequently, the Internal Revenue Service issued a private letter ruling stating that the accounting procedures proscribed by the California PUC did not comply with those envisioned by the Congress as establishing eligibility for these benefits. Thus, by complying with the PUC order, the companies involved have been judged ineligible for benefits they have already taken and passed on to their customers. The companies are caught in the middle—and are the ones with a financial risk—between two regulatory bodies with different interpretations of the intent of Congress.

The legislation I introduced, S. 232, resolves this problem by clarifying the intent of Congress with respect to the "normalization requirements." It also forgives any potential tax liability experienced by the utilities involved resulting from compliance with the California PUC's pass-through order.

The three utilities involved—Pacific Telephone & Telegraph, General Telehphone Co. of California, and Southern California Gas Co.—have a tremendous financial stake in this matter and are guilty only of complying with their regulator's orders; they ought not to be held financially liable for a dispute in which they were not an active or responsible party.

Support for this legislation is easily demonstrated by its history. In the 96th Congress, legislation having the same effect was approved by the House Ways and Means Committee, passed by the House, approved by the Senate Finance Committee, and would have become law except for the objections of one Senator. Those objections were sufficient under the parliamentary situation.

Senator PACKWOOD. Whose objections, I might add, Sam, were not directed to the substance of this bill. He wanted to add other provisions to it, totally unrelated to this, and there were objections to his provisions. That is why the bill stalled.

Senator HAYAKAWA. This Congress, the Ways and Means Committee has reported a companion measure, H.R. 1524, the House passed it, and this subcommittee is hearing this bill. I earnestly hope that this legislation can be given the opportunity for passage under conditions that prevent a single Senator from thwarting the will of the majority.

The second bill before the subcommittee would extend for 10 years the time in which the Ahmanson Foundation must dispose of its stock holdings of H. F. Ahmanson & Co., the holding company of Home Savings of America, the largest savings and loan association in the United States.

Under current law the Ahmanson Foundation must dispose of substantially all of its H. F. Ahmanson & Co. shares by May 25, 1984. The foundation has attempted in good faith to meet that deadline, but there are a number of factors which have prevented the efficient disposition of the stock. Initially, the stock was not publicly traded and a substantial number of shares were subject to intervening income interests.

In July 1972, the foundation and the concerned parties signed a Property Exchange Agreement to separate the approximately 3 million shares of Ahmanson stock in which they had interests. The application for approval was filed with the California Attorney General; however, the attorney general refused to approve the exchange and in August 1973 brought suit against the foundation to prevent the exchange. During the litigation, Mr. Chairman, and for a period of time thereafter, the attorney general specified that he would oppose any efforts on the part of the foundation to dispose of "any" of its Ahmanson shares. Until this year the foundation was not freely able to dispose of its Ahmanson stock.

Further complicating the recent attempts to meet the statutory deadline, economic conditions have severely reduced not only the value of savings and loan association stock but the market for such stock. An attempt to dispose of the large holdings of Ahmanson at this time would not only result in a tremendous loss to the foundation but would also have severe repercussions on the value of savings and loan stock, generally. At a time when Congress is considering legislation to restore vitality to the industry, forcing the sale at a significantly depressed price of the Ahmanson stock does not seem to me to be in the national interest.

S. 2741 seeks to avoid this problem by extending for 10 years the time within which the foundation must comply with the disposition requirements of section 4943 of the Internal Revenue Code. Unlike similar measures intended to benefit other private foundations, this legislation insures that the original purpose of the law is carried out. In return for extending the compliance deadline, the bill provides that the foundation will divest itself irrevocably of the power to vote the stock it otherwise would have had to dispose of.

In addition, the foundation will be required to dispose of the stock in question gradually, over a 10-year period, at the rate of 10-percent per year to insure that the foundation will proceed diligently with its disposition efforts.

As you know, Mr. Chairman, I offered substantially the same legislation as an amendment to the Tax Equity and Fiscal Responsibility Act of 1982 when it was being considered in the Senate. Although the amendment was accepted unanimously in the Senate, the conferees deleted it and all the other provisions dealing with private foundations. I hope that the committee will again put this legislation before the Senate.

I appreciate having the opportunity to comment on these two bills, and I thank the Chairman for holding this hearing.

Senator PACKWOOD. Senator Hayakawa, thank you very much.

[The prepared statement of Hon. S. I. Hayakawa follows:]

STATEMENT OF SENATOR S. I. HAYAKAWA, TESTIFYING BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

ON

S. 232 AND S. 2741

SEPTEMBER 23, 1982

Mr. Chairman, I would like to thank you for scheduling this hearing on two bills I introduced, S. 232 and S. 2741, and I appreciate having the opportunity to comment on them.

The first bill, S. 232, is remedial legislation necessary to resolve the dispute between the California Public Utilities Commission, affirmed by the California Supreme Court, and the Internal Revenue Service relating to the accounting proceedures associated with eligibility for certain federal tax benefits. When the Congress authorized the investment tax credit and accelerated depreciation, it intended that the benefits derived therefrom be directed toward investment in plant and equipment, as an incentive for such investment. In the case of regulated utilities, Congress mandated that intent by requiring specific accounting and reporting proceedures.

In California, three utilities took advantage of the federal tax benefits, intending to use the freed resources for capital improvements. In response, the California Public Utilities Commission-- after three decisions of the California Supreme Court nullifying a previous Commission ruling--ordered that the utilities follow a particular method of accounting to provide a share of the tax benefits to the ratepayers. Subsequently, the Internal Revenue Service issued a private letter ruling stating that the accounting proceedures proscribed by the California PUC did not comply with those envisioned by the Congress as establishing eligibility for the benefits. Thus, by complying with the PUC order, the companies involved have been judged ineligible for benefits they have already taken and passed on to their customers. The companies are caught in the middle--and are the ones with a financial risk--between two regulatory bodies with different interpretations of the intent of Congress.

The legislation I introduced, S. 232, resolves this problem by clarifying the intent of Congress with respect to the "normalization requirements." It also forgives any potential tax liability experienced by the utilities involved resulting from compliance with the California PUC's pass-through order. The three utilities involved (Pacific Telephone & Telegraph Company, General Telephone Company of California, and Southern California Gas Company) have a tremendous financial stake in this matter, and are guilty only of complying with their regulator's orders; they ought not to be held financially liable for a dispute in which they were not an active or responsible party.

Support for this legislation is easily demonstrated by its history. In the Ninety-sixth Congress legislation having the same effect was approved by the House Ways and Means Committee, passed by the House, approved by the Senate Finance Committee, and would have become law except that the objections of one Senator were sufficient under the parliamentary situation to kill the bill. This Congress, the Ways and Means Committee has reported a companion measure, H.R. 1524, the House passed it, and this Subcommittee is hearing this bill. I earnestly hope that this legislation can be given the opportunity for passage under conditions that prevent a single Senator from thwarting the will of the majority.

The second bill before the Subcommittee would extend for ten years the time within which the Ahmanson Foundation must dispose of its stock holdings of H. F. Ahmanson & Company, the holding company of Home Savings of America, the largest savings and loan association in the United States.

Under current law, the Ahmanson Foundation must dispose of substantially all of its H. F. Ahmanson & Company shares by May 25, 1984. The Foundation has attempted in good faith to meet that deadline, but a number of factors have prevented the effecient disposition of the stock. Initially, the stock was not publicly traded, and a substantial number of shares were subject to intervening income interests. In July of 1972, the Foundation and the concerned parties signed a Property Exchange Agreement to separate the approximately 3 million shares of Ahmanson stock in which they had interests. The application for approval was filed with the California Attorney General. However, the Attorney General refused to approve the exchange and in August 1973 brought suit against the Foundation to prevent the exchange.

During the litigation, and for a period of time thereafter, the Attorney General specified that he would oppose any efforts on the part of the Foundation to dispose of "any" of its Ahmanson shares. Until this year, the Foundation was not freely able to dispose of its Ahmanson stock.

Further complicating the recent attempts to meet the statutory deadline, economic conditions have severely reduced not only the value of savings and loan association stock, but the market for such stock. An attempt to dispose of the large holdings of Ahmanson at this time would not only result in a tremendous loss to the Foundation, but would have severe repercussions on the value of savings and loan stock generally. At a time when Congress is considering legislation to restore vitality to the industry, forcing the sale at a significantly depressed price of the Ahmanson stock does not seem to be in the national interest.

S. 2741 seeks to avoid this problem by extending for ten years the time within which the Foundation must comply with the disposition requirements of Section 4943 of the Internal Revenue Code. Unlike similar measures intended to benefit other private foundations, this legislation ensures that the original purpose of the law is carried out. In return for extending the compliance deadline, the bill provides that the Foundation will divest itself irrevocably of the power to vote the stock it otherwise would have had to dispose of. In addition, the Foundation will be required to dispose of the stock in question gradually over the ten year period, at the rate of ten percent per year, to ensure that the Foundation will proceed diligently with its disposition efforts.

As you know, Mr. Chairman, I offered substantially the same legislation as an amendment to the Tax Equity and Fiscal Responsibility Act of 1982, when it was being considered in the Senate. Although the amendment was accepted unanimously in the Senate, the conferees deleted it, and all the other provisions dealing with private foundations. I hope that the Committee will again put this legislation before the Senate.

I appreicate having the opportunity to comment on these two bills, and I thank the Chairman for holding this hearing.

Senator PACKWOOD. I would like to read one statement from Senator Danforth. Is there anybody here from the administration? He has a question that he wants answered.

[No response.]

Senator PACKWOOD. He assumed somebody would be here. It is as follows:

> Mr. Secretary, you have testified that the Administration does not oppose this bill. I would like the record to show—

He is talking here about the utilities bill—

> I would like the record to show that I am in favor of it. I concur with your reasoning that any asserted tax liabilities would be challenged in court and that the additional taxes would not be collected for at least several years.
>
> Mr. Secretary, I would like to know, however, how your position on this bill can be reconciled with your position on a bill I introduced earlier in the Congress, S. 1928. To refresh your memory, that bill would provide that discounts received by a number of utilities as a result of the settlement of breach-of-contract actions would not be taken into account as income in the year of the settlement.
>
> At the hearings held in this Subcommittee on May 7th no opinion was offered by the Administration on the substance of the issue; rather, the Administration is opposed to S. 1928 because it "strongly believes that these disputes should not be addressed by the Congress through private relief legislation."
>
> Would you please explain the difference that makes S. 1928 private relief legislation?

Senator PACKWOOD. We will get an answer from the administration on that prior to our markup.

Gentlemen, Sam, thank you very, very much for taking the time. I appreciate it.

Senator HAYAKAWA. Thank you, Mr. Chairman.

Senator PACKWOOD. Thank you, Sam.

I see former Congressman Corman in the audience. Jim, I didn't have you on the witness list. Are you here to testify, or just to watch today?

Mr. CORMAN. I am here to enjoy. It is a very enjoyable experience. Thank you, Mr. Chairman.

Senator PACKWOOD. Thank you.

We will conclude, then, with S. 2741, and we will hear from Mr. Daniel Belin, who is a trustee of the Ahmanson Foundation from Los Angeles.

Good morning, Mr. Belin.

STATEMENT OF DANIEL N. BELIN, TRUSTEE, AHMANSON FOUNDATION, LOS ANGELES, CALIF.

Mr. BELIN. Good morning, and thank you, Mr. Chairman. Thank you, Senator Hayakawa, for your statement in support of the Ahmanson Foundation's position.

Senator PACKWOOD. Mr. Belin is accompanied by Mr. Paul Berger, a distinguished lawyer in Washington, D.C.

Mr. BELIN. By Richard Hubbard, who is a partner of Mr. Berger.

Senator PACKWOOD. By Mr. Richard Hubbard.

Mr. BELIN. My name is Daniel N. Belin. I am a practicing attorney in Los Angeles and a trustee of the Ahmanson Foundation. I want to thank this committee for the opportunity to testify, and I thank Senators Hayakawa and Cranston for their sponsorship of S. 2741.

S. 2741 would amend the transitional rules under section 4943 of the Internal Revenue Code to give the Ahmanson Foundation a limited extension of time to dispose of its principal asset—the stock of H.F. Ahmanson & Co., a holding company of Home Savings of America, which is the largest savings and loan association in the United States.

The bill, which has no revenue impact, is designed to give the foundation the opportunity to comply with the divestiture provisions of the Code in an orderly fashion, an opportunity it has not yet had because of circumstances beyond its control.

The disposition of the Ahmanson shares is required under Code section 4943, enacted as part of the Tax Reform Act of 1969 in response to concerns about the ownership of businesses by private foundations. Under current transitional rules of the 1969 act, the foundation has until May 25, 1984, to dispose of substantially all of its Ahmanson holdings.

I should note at this point that none of the abuses at which 4943 was directed has been present in the case of the foundation. The stock ownership hasn't produced any competitive advantage for Ahmanson or Home Savings, which are fully taxable entities. The foundation's managers have not failed to devote sufficient time to the foundation's affairs and have not used the foundation's stock ownership to benefit Ahmanson at the expense of the foundation.

There have been no financial transactions between the foundation and Ahmanson. Income from the Ahmanson stock has been devoted entirely to charitable purposes and has no been reinvested in Ahmanson's business.

Upon passage of the 1969 Act, the foundation, with the advice of legal counsel and investment advisers, began efforts to make the required disposition but was hampered by factors beyond its control.

First, Ahmanson had two classes of stock, and neither was publicly traded. Tc overcome this problem, Ahmanson was reorganized to have only one class of stock; the stock was registered, and a public offering took place. These steps took several years to accomplish.

Second, about one-third of the foundation's holdings in Ahmanson were subject to intervening income interests, making the stock virtually unmarketable. To overcome this problem, the foundation entered an agreement with the holder of the intervening-income interests to separate their interests in the Ahmanson stock. The consummation of this agreement, however, was opposed by the California Attorney General who filed suit in 1973 to increase the foundation's share of the stock involved.

The Attorney General also notified the foundation of his view that the maximum return to the foundation would result from selling the stock in a single block to a single purchaser at a premium. He told the foundation that, unless it would agree not to sell any of its stock during the pendency of the litigation, he would proceed to obtain an injunction precluding such sale by the foundation.

The foundation, upon receiving advice of counsel that the attorney general would succeed in obtaining such an injunction, agreed not to make any such sales during the pendency of the litigation.

It was not until early 1978 that the litigation was dismissed, pursuant to a settlement agreement. Even after dismissal of that litigation, the attorney general continued in his view that the stock should be sold in a single block at a premium, and the foundation hired an investment banking firm to seek a buyer on that basis. By mid-1980 this firm advised the foundation that prospects of a sale to a single buyer were quite dim and that piecemeal sales would be necessary.

In early-1981 the attorney general of California agreed not to oppose partial dispositions of the stock, and the foundation has since begun to make partial dispositions.

The foundation's current advice from its investment bankers, however, is that, given current and foreseeable market conditions, there is not sufficient time to make the required disposition of Ahmanson stock by the May 1984 deadline without very seriously depressing the price of Ahmanson stock, which would substantially reduce the capacity of the Ahmanson Foundation to make charitable gifts. Further, because Ahmanson stock represents about 15 percent of the total value of all savings and loan stocks which are traded on exchanges or over the counter, a forced sale of the foundation's shares might well result in a sharp decline in the market price of savings and loan stocks generally.

Senator PACKWOOD. I want to emphasize that point, so that all of the members will be aware of it.

Is the Ahmanson share of the stock 15 percent of all of the publicly traded savings and loan stocks in the United States?

Mr. BELIN. That is correct.

Senator PACKWOOD. So, clearly, a disposition of any block of stock of that size, or even significantly less than that, clearly has an effect on all other savings and loan stock prices.

Mr. BELIN. That would seem readily apparent, and that is in fact the advice that has been received by the foundation from its investment bankers.

Senator PACKWOOD. I assume the effect is to depress all the other prices if you are going to put this size of a block of stock on the market at a time when S&L stocks are not the hottest property going right now.

Mr. BELIN. The investment bankers add that even though there would be a reason—namely, the imposition of a statutory deadline—the market wouldn't perceive that as justification; therefore, the market prices generally would spiral down.

I should stress that S. 2741, Mr. Chairman, is designed to insure that the original purposes of section 4943 will be carried out.

To insure that the foundation's ownership of the Ahmanson stock will not create even an appearance of conflict of interest, the foundation will divest itself irrevocably of the power to vote the Ahmanson stock it would have to dispose of absent the legislation. To insure that the foundation will proceed diligently in its disposition efforts, the bill requires the foundation to dispose of the stock in question gradually over a 10-year period.

In closing, I want to emphasize that S. 2741 is a fair solution. It does not exempt the foundation from the divestiture rules; it simply gives the foundation a reasonable chance to comply with the rules without having to dispose of its assets in forced sales at sacrificial prices—a chance it has not yet had because of the circumstances I have described. The extension of the disposition period will have no revenue impact and will enable the foundation to preserve its assets so that it can continue and improve its ability to carry out its charitable purposes.

I have appreciated the opportunity to testify. I would like the opportunity to make the material which we filed a part of the record.

Senator PACKWOOD. Your entire statement will be in the record.

Mr. BELIN. Thank you, Mr. Chairman.

[The prepared statement of the Ahmanson Foundation follows:]

September 23, 1982

SUMMARY STATEMENT OF THE AHMANSON FOUNDATION IN SUPPORT OF S. 2741

1. S. 2741 would amend the transitional rules under section 4943 of the Internal Revenue Code to provide the Ahmanson Foundation with an extension of the time within which it must dispose of stockholdings in H. F. Ahmanson & Company ("Ahmanson"), the holding company of Home Savings of America, the largest savings and loan association in the United States.

2. Section 4943, enacted as part of the Tax Reform Act of 1969 in response to concerns about the ownership of businesses by private foundations, requires a private foundation such as the Foundation to reduce its holdings in a corporation to specified levels by specified times. Under current law, the Foundation must dispose of substantially all of its Ahmanson shares by May 25, 1984.

3. In the opinion of expert investment bankers, the extension is necessary to avoid sales of Ahmanson stock at significantly depressed prices, a resulting sharp decline in the market price of Ahmanson stock, and, because Ahmanson stock represents about 15% of the total value of all traded savings and loan stocks, a resulting sharp decline in the market price of savings and loan stocks generally.

4. The foregoing effects on the market price of Ahmanson stock and the stock of all savings and loan institutions, in the opinion of expert investment bankers, would have a highly detrimental impact on the ability of savings and loan institutions to raise sorely needed equity capital for an already ailing industry.

5. As of March 31, 1982, the Foundation held 27.5% of the stock of Ahmanson, with a value, based on the closing price on March 31, 1982, on the New York Stock Exchange, of over $70 million. The Foundation's efforts to dispose of the stock, pursuant to the mandate of the Tax Reform Act of 1969, have been hampered (a) by the initial facts that the stock was not publicly traded, and that a substantial number of the shares were subject to intervening income interests, (b) by

protracted litigation involving the California Attorney General (during which none of the stock could be sold), and (c) by the severely depressed state of the savings and loan industry.

6. The Foundation, with assets of over $100 million, carries out its charitable purposes by making grants to cultural, scientific, educational and charitable organizations. Over the past ten years, the Foundation has made grants of more than $50 million, with an emphasis on grants to cultural institutions, institutions of higher education, hospitals, and medical research institutions.

7. In the Foundation's case, none of the abuses at which section 4943 was directed has been or is present: the Foundation's managers have never failed to devote sufficient time to the Foundation's affairs; they have never used the Foundation's stock ownership to benefit Ahmanson at the expense of the Foundation; the Foundation's stock ownership has never produced any competitive advantage for Ahmanson; there have been no financial transactions between the Foundation and Ahmanson; income from the Foundation's Ahmanson stock has been devoted entirely to the Foundation's charitable purposes, and has not been reinvested in Ahmanson's business.

8. The Bill extends for ten years the current disposition deadline for the Foundation's Ahmanson stock, thus affording the possibility of an orderly disposition of that stock, without sales at sacrificial prices and the resulting serious adverse effects on the savings and loan industry. At the same time, the Bill ensures that the original purposes of section 4943 will be carried out, as follows:

-- To ensure that the Foundation's ownership of the stock will not create any appearance of conflicts of interest or diversion from the affairs of the Foundation on the part of the Foundation's managers, the Foundation will divest itself irrevocably of the power to vote the stock it otherwise would have to dispose of. This mechanism will also alleviate any concern that the Foundation's ownership of the stock could produce a competitive advantage for Ahmanson.

-- To ensure that the Foundation will proceed diligently with its disposition efforts, the Foundation will be required to dispose of the stock in question gradually over the ten-year period, at the rate of 10% per year.

9. The application of the Bill is limited to private foundations with very large holdings in the savings and loan industry, so that the extension is available only where the current deadline poses a seriously detrimental threat to this vital segment of the nation's economy.

Attachment 1

The Ahmanson Foundation - Detailed
Statement of Need for Legislation

The Ahmanson Foundation (the "Foundation") was formed in 1952 at the behest of Howard F. Ahmanson and his wife, Dorothy G. Ahmanson, now both deceased. The Foundation, a California nonprofit corporation with its offices in Los Angeles, is tax-exempt as a charitable organization under section 501(c)(3) of the Internal Revenue Code (the "Code"), and is a "private foundation" under section 509(a) of the Code.

The Foundation carries out its purposes through making grants to cultural, educational, scientific and religious organizations. The present market value of the Foundation's assets is over $100 million. Over 75% of the value of the Foundation's assets is represented by its direct and indirect holdings in H. F. Ahmanson & Company ("Ahmanson"), a holding company, the principal value of which derives from its ownership of approximately 99.7% of the stock of Home Savings of America ("Home Savings"), the largest savings and loan association in the United States.

A. Background

Howard F. Ahmanson came to Los Angeles, California, from Omaha, Nebraska, in the late 1920's. Upon moving to California, he formed an insurance agency, which he named "H. F. Ahmanson & Company." Shortly after the Second World War, he acquired two small savings and loan associations (subsequently merged, and now called "Home Savings of America"), as an adjunct to his insurance business. The businesses thrived. Although the insurance business grew, the savings and loan business grew at a much more rapid rate. By 1961, the assets of Home Savings reached $1 billion, and at present exceed $15 billion.

Mr. Ahmanson was most generous in his financial support of philanthropic and cultural activities in the Los Angeles area. In the 1960's, he contributed the funds to build the Ahmanson Theatre of the Los Angeles Music Center, and the Ahmanson Gallery of the Los Angeles County Museum of Art. At the time, these were the largest single gifts made to those institutions. During his lifetime, Mr. Ahmanson gave substantial financial support to other charitable endeavors, both in the Los Angeles area and in his native Nebraska.

During the 1950's and 1960's, Mr. Ahmanson and his wife made substantial gifts of Ahmanson and Home Savings stock to the Foundation. Mr. Ahmanson died in 1968. The value of his gross estate was in excess of $100 million. Mr. Ahmanson left more than 90% of his net after-tax estate (including a large block of Ahmanson stock) to the Foundation.

B. Activities of the Foundation

During the last ten years, the Foundation has given more than $50 million to charitable, educational, scientific and cultural causes. Institutions that have received support from the Foundation include museums, centers for the performing arts, universities, hospitals, and organizations providing charitable services. The principal recipient of the Foundation's museum grants has been the Los Angeles County Museum of Art. The Foundation has been the largest single donor to that museum, having supplied more than $10 million to permit gallery construction and the acquisition of works of art. Largely because of the financial support received from the Foundation, the Los Angeles County Museum of Art has become, in the fewer than 20 years of its existence, one of the most respected museums of art in the United States.

Grants by the Foundation to centers for the performing arts have included substantial gifts to the music centers of Los Angeles and San Francisco, to the planned music center in Orange County, and to the University of California at Los Angeles. The Foundation has made numerous and varied grants to organizations providing charitable services to the community, providing a broad base of support to those organizations.

The Foundation's gifts to universities have included grants to fund particular research projects in medicine and in the humanities, to provide scholarships for students with financial need, to permit the acquisition of books and equipment, to construct buildings, and to provide funds to offset general operating expenses. Recent grants to universities have included a $1 million grant to the University of California at Los Angeles for the construction of its new Brain Research Laboratory and grants aggregating more than $1.5 million to the University of Southern California for its Cancer Research Institute.

The Foundation's support of hospitals has permitted a number of the major hospitals in the Los Angeles metropolitan area to provide better care for patients. These grants have been primarily for the purchase of needed hospital equipment and for funding major research projects.

Grants from the Foundation have ranged from small grants in the $100 to $500 range, to large grants in excess of $1 million. Foundation grants of $100,000 or more made during the past ten years are set forth in the materials in Attachment 2.

The Foundation has prided itself in operating with a small number of staff personnel, in order to minimize expenses and thereby maximize disbursements for charitable purposes. Salary and operating expenditures have traditionally been less than 2% of the amount distributed for charitable purposes by the Foundation.

C. Administration of the Foundation

The Foundation is governed by a Board of Trustees consisting of six members. Four of these trustees (two nephews of Mr. Ahmanson, Mr. Ahmanson's son, and an officer and director of Ahmanson who is unrelated to the Ahmanson family) have held their positions since before the enactment of the Tax Reform Act of 1969. Mr. Ahmanson's two nephews and son are beneficiaries of irrevocable trusts (all established prior to 1969) that at present own approximately 40% of the stock of Ahmanson. These three trustees also own directly Ahmanson stock representing in the aggregate less than 1% of the outstanding Ahmanson stock, and two of them are officers and directors of Ahmanson. The other two of the six trustees became trustees of the Foundation on September 30, 1968 and March 27, 1980, respectively. They are not directors, officers or employees of Ahmanson; they are unrelated to the Ahmanson family; and in the aggregate they hold fewer than 1,000 shares of Ahmanson stock.

D. Description of Ahmanson

Ahmanson is a holding company whose principal asset consists of approximately 99.7% of the outstanding stock of Home Savings, the largest savings and loan association in the United States. The balance of Ahmanson's assets consists almost entirely of its holdings (in each case over 80% of the stock) in several different insurance companies. Ahmanson has a single class of stock, which is publicly traded on the New York Stock Exchange. The market value of all the Ahmanson stock outstanding as of March 31, 1982 (23,700,252 shares) exceeded $250 million.

The principal shareholders of Ahmanson as of March 31, 1982, were:

Shareholder	Shares Owned	Percentage of Outstanding Shares
Ahmanson Foundation	6,527,068[1]	27.5%
Bank of America, as trustee	5,526,000	23.3
First Interstate Bank, as trustee	2,590,000	10.9
Torrey Clark & Co. Inc.	1,630,900	6.9
Title Insurance & Trust Company, as trustee	1,540,000	6.5

Ahmanson is governed by a Board of Directors with eight members, two of whom are nephews of Mr. Ahmanson. Of the remaining six directors, none of whom are members of the Ahmanson family, three are officers of Ahmanson or Home Savings, and three are employees of neither Ahmanson nor its subsidiaries.

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[1] As of March 31, 1982, the Foundation owned 5,636,068 shares directly, of which 337,500 shares were subject to present interests (expiring in 1999) in other tax-exempt entities, and had an indirect interest in 891,000 shares through its ownership of 99 shares of nonvoting stock (which comprise 99% of the equity interest) of Ahmanco, Inc., a California corporation, whose principal asset is 900,000 shares of Ahmanson stock.

The Board of Directors of Ahmanson makes decisions concerning investments and acquisitions by Ahmanson, and selects the boards of directors of Ahmanson's subsidiaries, but is not involved directly in the management of those subsidiaries, each of which has independent management.

E. Relationship Between the Foundation and Ahmanson

The Foundation has never entered into commercial transactions, e.g., leases, sales or loans, with Ahmanson or any of its subsidiaries. The Foundation has never made contributions to the capital of Ahmanson or its subsidiaries and has never influenced Ahmanson with respect to the payment of dividends. There have been no acts of self-dealing between the Foundation and its trustees. Those trustees who are also directors of Ahmanson have never, because of their duties as Ahmanson directors, been forced to devote less time than was appropriate to their duties as trustees of the Foundation. Ahmanson and its subsidiaries are taxable corporations.

F. The Foundation's Holdings of Ahmanson Stock

All of the Foundation's Ahmanson holdings are derived from gifts of stock made prior to the Tax Reform Act of 1969, of which the principal gifts were made by Mr. Ahmanson and his wife.

Under the provisions of section 4943 of the Code (enacted in 1969 as part of the Tax Reform Act of 1969), the Foundation was required to dispose of substantially all of its stock in Ahmanson and Home Savings by May 25, 1984. The history of the Foundation's disposition efforts, described in greater detail in the materials in Attachment 3, may be summarized as follows.

At the outset, disposition efforts were hampered because the stock of Ahmanson and Home Savings was not publicly traded, because the stock held by the Foundation was primarily nonvoting stock, because approximately 32% of the Foundation's stock consisted of shares in which Mr. Ahmanson's first wife had retained income interests, because any disposition efforts were subject to the review of the Attorney General of the State of California, and because Mr. Ahmanson's second wife had presented claims in court asserting an interest in certain stock that passed to the Foundation on Mr. Ahmanson's death.

After a lengthy analysis, legal counsel and investment bankers made specific recommendations to the Foundation, pursuant to which the following steps were taken. Ahmanson was reorganized and recapitalized in 1971, so that it had a single class of stock and so that Home Savings became a virtually wholly owned subsidiary of Ahmanson. Also in 1971, the Foundation settled the litigation with Mr. Ahmanson's second wife. In 1972, a public offering of Ahmanson stock created a public market. Also in 1972, the Foundation and Mr. Ahmanson's first wife entered into an agreement to separate their interests in the Ahmanson stock in which they each held an interest. The consummation of this agreement, however, was opposed by the California Attorney General, who filed suit in August 1973, taking the position that the exchange did not result in the receipt of sufficient stock by the Foundation. The California Attorney General informed the Foundation that, because of his view that the Foundation should seek to dispose of its Ahmanson stock in a single block to a single purchaser at a premium, he would move to enjoin any effort by the Foundation to sell <u>any</u> of its Ahmanson stock during the litigation. The litigation was not dismissed until January 1978.

After dismissal of the litigation, the California Attorney General continued to take the view that the Foundation should dispose of its Ahmanson stock in a single block at a premium. The Foundation therefore engaged an investment banking firm to seek a buyer for the stock on this basis. These efforts were diligent but unsuccessful, primarily because of drastic changes in the economy that adversely affected the savings and loan industry. In mid-1980, the investment banking firm advised the Foundation that prospects for a sale to a single buyer were dim and that dispositions by way of secondary offerings and Rule 144 sales would be necessary if the Foundation were to have a chance of meeting the May 1984 disposition deadline. After numerous discussions, the Foundation in January 1981 secured the agreement in principle of the California Attorney General not to oppose partial dispositions by way of secondary offerings. Preparations for a secondary offering in early 1981 had to be abandoned when Ahmanson entered into an acquisition agreement to expand its insurance business that involved the issuance of marketable Ahmanson stock. Since June 1981, the Foundation has disposed of 772,900 Ahmanson shares through gifts to charities and sales under SEC Rule 144.

The Foundation, however, has received current advice from its investment banking firm that, based on current and foreseeable market conditions, the Foundation does not have sufficient time to make the required dispositions of its Ahmanson stock by May 1984 without a serious disruption of the market price of the stock of Ahmanson. Since Ahmanson stock in the aggregate represents about 15% of the value of all publicly traded stock of savings and loan institutions, a sharp decline in the price of Ahmanson stock, in the opinion of the investment banking firm, would lead to a sharp decline in the market price for all savings and loan stocks. Such a consequence would severely limit the ability of savings and loan institutions to raise capital in the equity markets, at a time when the need for such capital is critical because of the recent large losses in the industry. Thus a failure to extend the time for the disposition of the Foundation's Ahmanson shares would have seriously detrimental effects far beyond the impact on the Foundation, and would weaken further an already troubled major segment of this country's economy.

In the opinion of the investment banking firm, a ten-year extension of the disposition deadline is necessary to avoid these adverse consequences.

G. Proposed Legislation

The Bill extends the 1984 disposition deadline for ten years and thus permits the Foundation to dispose of its Ahmanson shares in an orderly fashion, without serious adverse effects on the savings and loan industry, while at the same time ensuring that the original purposes of section 4943 will be fulfilled.

In enacting section 4943, Congress expressed a concern that, where a foundation owned a business enterprise, there might be a temptation for the Foundation's managers "to divert their interest to the maintenance and improvement of the business and away from their charitable duties." S. Rep. No. 91-552, 91st Cong., 1st Sess. 39 (1969). As noted, the Foundation's trustees have never in the past failed to devote sufficient time to the affairs of the Foundation, and they have not utilized the Foundation's ownership of Ahmanson stock to benefit the business of Ahmanson at the expense of the Foundation. In order to prevent any future possibility or appearance of the kind of conflict of interest referred to by Congress, the Bill requires the Foundation to divest itself irrevocably of the power to vote those Ahmanson shares that it would have to dispose of, but for the Bill.

The legislative history of section 4943 also reflects the concern of Congress that, where a business enterprise is owned by a charity, the business may be run in a way that unfairly competes with other businesses, whose owners must pay taxes on income from the business. S. Rep. No. 91-552, 91st Cong., 1st Sess. 39 (1969). The Foundation's stock ownership in Ahmanson, however, does not produce any competitive advantage for Ahmanson. Ahmanson and its subsidiaries are taxable entities; there have never been financial transactions between the Foundation and Ahmanson or its subsidiaries; the Foundation has never made contributions to the capital of Ahmanson or its subsidiaries; and the Foundation has never influenced Ahmanson's dividend policy. Again, the Bill, by requiring a divestiture of voting power, will serve to alleviate concerns about potential competitive advantage.

In order to ensure that the Foundation will proceed diligently with its disposition efforts, the Bill requires the Foundation to dispose of its excess business holdings in stages over the ten-year extension period, e.g., by the end of the first year of the extension period, the Foundation must dispose of at least 10% of its excess holdings; by the end of the second year, it must have disposed of at least 20% of its excess holdings; and so on.

Finally, by limiting the application of the ten-year extension period to foundations with very large holdings in the savings and loan industry, the Bill ensures that the extension period will be available only where meeting the current 1984 deadline would have a serious detrimental impact on a major segment of the United States economy.

Attachment 2

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1972 - OCTOBER 31, 1973

Total Number of Grants: 547 Total Amount: $3,511,371

High: $2,000,000 Low: $10

Grants $100,000 and over

LOS ANGELES COUNTY MUSEUM OF ART Los Angeles, CA	Purchase of Fra Bartholomeo-"Holy Family"	$ 480,000
CREIGHTON UNIVERSITY Omaha, NB	Ahmanson Law Center Building Fund	$2,000,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1973 - OCTOBER 31, 1974

Total Number of Grants: 643 Total Amount: $3,278,838

High: $1,500,000 Low: $10

Grants $100,000 and over

LOS ANGELES COUNTY - USC MEDICAL CENTER AUXILIARY Los Angeles, CA	Cancer Center	$ 121,000
LOS ANGELES COUNTY MUSEUM OF NATURAL HISTORY Los Angeles, CA	Foundation Restoration and Renovation of Foyer	$ 100,000
MUSEUM ASSOCIATES Los Angeles, CA	Purchase of painting by Franz Hals "Portrait of a Man"	$1,500,000
SALK INSTITUTE, THE San Diego, CA	Cancer Research	$ 100,000
SOLID ROCK FOUNDATION Garden Grove, CA	Purchase of 160 acre Barkas Estate	$ 100,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1974-OCTOBER 31, 1975

Total Number of Grants: 705 Total Amount: $3,507,573

High: $750,000 Low: $10

Grants $100,000 and over

COMMUNITY TELEVISION OF SOUTHERN CALIFORNIA Los Angeles, CA	General Support	$ 105,700
LOS ANGELES COUNTY USC CANCER CENTER Los Angeles, CA	New building fund	$ 500,000
MUSEUM ASSOCIATES Los Angeles, CA	For acquisition of two Veronese Paintings "Geometry and Navigation" and "Astronomy"	$ 750,000
WHITTIER COLLEGE Whittier, CA	Endowment	$ 150,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1975-OCTOBER 31, 1976

Total Number of Grants: 321 Total Amount: $4,913,462

High: $500,000 Low: $100

Grants $100,000 and over

CALIFORNIA INSTITUTE OF THE ARTS Valencia, CA	Scholarship Fund	$ 100,000
CALIFORNIA LUTHERAN COLLEGE Thousand Oaks, CA	New Dimensions Program	$ 100,000
CLAREMONT GRADUATE SCHOOL Claremont, CA	Graduate Program in Management	$ 150,000
COMMUNITY TELEVISION OF SOUTHERN CALIFORNIA Los Angeles, CA	Towards matching grant by Ford Foundation	$ 100,000
HUNTINGTON MEMORIAL HOSPITAL Pasadena, CA	Expansion of Pediatric Department	$ 100,000
LOS ANGELES COUNTY MUSEUM OF ART Los Angeles, CA	-Museum Associates Heeramaneck Collection	$ 300,000
	-Art Storage Space	$ 130,000
OCCIDENTAL COLLEGE Los Angeles, CA	Capital Fund	$ 250,000
PEOPLE-TO-PEOPLE HEALTH FOUNDATION Washington, D. C.	Learning Resource Center	$ 130,000
UNIVERSITY OF CALIFORNIA Los Angeles, CA	-Remodelling Brain Research Institute	$ 500,000
	-Biomedical Library	$ 200,000
UNIVERSITY OF KANSAS ENDOWMENT ASSOCIATION Lawrence, KS	Toward endowment of Chair in Music	$ 100,000
UNIVERSITY OF SOUTHERN CALIFORNIA/LOS ANGELES COUNTY CANCER CENTER Los Angeles, CA	Building Fund	$ 500,000
YOUNG MEN'S CHRISTIAN ASSOCIATION OF METROPOLITAN LOS ANGELES Los Angeles, CA	Getting Ready for "Tomorrow" fund	$ 100,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1976-OCTOBER 31, 1977

Total Number of Grants: 312 Total Amount: $4,111,076

High: $800,000 Low: $16

Grants $100,000 and over

CREIGHTON UNIVERSITY Omaha, NB	Purchase of property adjacent to Law Center	$ 140,000
KANSAS UNIVERSITY ENDOWMENT ASSOCIATION Lawrence, KS	Professorship at University of Kansas Medical Center	$ 280,000
LOS ANGELES COUNTY MUSEUM OF ART Los Angeles, CA	-Purchase of "The Magdalen" by George de la Tour	$ 800,000
	-Heeramaneck Collection	$ 300,000
PEOPLE-TO-PEOPLE HEALTH FOUNDATION Washington, D. C.	Learning Center Budget	$ 150,000
UNIVERSITY OF CALIFORNIA Los Angeles, CA	Remodelling of Brain Research Institute	$ 500,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1977-OCTOBER 31, 1978

Total Number of Grants. 349 Total Amount: $7,719,425

High: $1,000,000 Low: $100

Grants $100,000 and over

CALIFORNIA INSTITUTE OF THE ARTS Los Angeles, CA	Scholarships	$ 100,000
CAREY INTERNATIONAL UNIVERSITY Pasadena, CA	Toward purchase of Pasadena Nazarene College Campus	$ 100,500
CEDARS-SINAI MEDICAL CENTER Los Angeles, CA	Expansion of Health Sciences Information Center	$ 300,000
EAR RESEARCH INSTITUTE Los Angeles, CA	Biomedical Computer Center	$ 100,000
HARVARD SCHOOL Studio City, CA	Challenge grant, New Dimensions	$ 335,000
HARVEY MUDD COLLEGE Claremont, CA	Endowed Scholarship Fund	$ 100,000
INDEPENDENT COLLEGES OF SOUTHERN CALIFORNIA Los Angeles,CA	Support of member colleges and universities	$ 100,000
KANSAS UNIVERSITY ENDOWMENT ASSOCIATION Lawrence, KS	-Endowed professorships -Visiting lectureship in Art History	$ 150,000 $ 150,000
MUSEUM ASSOCIATES Los Angeles, CA	Purchase, "The Magdalen" by George de la Tour	$1,000,000
NATURE CONSERVANCY, THE Arlington, VA	Towards purchase of Santa Cruz Island	$ 150,000
OCCIDENTAL COLLEGE Los Angeles, CA	-Capital fund drive -Lucille Gilman Memorial Fund	$ 250,000 $ 100,000
PEOPLE-TO-PEOPLE HEALTH FOUNDATION Washington, D.C.	Renovation and Restoration of new headquarters office and training center	$ 150,000
PEPPERDINE UNIVERSITY Malibu, CA	Law School Fund	$ 250,000
PERFORMING ARTS COUNCIL, MUSIC CENTER Los Angeles, CA	Matching fund for NEA Challenge grant	$ 500,000
STANFORD UNIVERSITY Stanford, CA	Construction of 3rd floor addition to J. Hugh Jackson Library at the Graduate School of Business	$ 200,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1977-OCTOBER 31, 1978 (Continued)

Grants $100,000 and over

UNITED STATES INTERNATIONAL UNIVERSITY San Diego, CA	$25,000 - Library $25,000 - Scholarship $50,000 - Reparis/Maintenance	$ 100,000
UCLA, CENTER FOR HEALTH SCIENCES Los Angeles, CA	Biomedical Library expansion	$ 150,000
UCLA FOUNDATION Los Angeles, CA	-Biomedical Library Book Purchase Fund	$ 300,000
	-Museum of Cultural History, Programs	$ 200,000
	-Research Library,Special Book Collections	$ 100,000
UCLA, SCHOOL OF MEDICINE Los Angeles, CA	Facility expansion for Jules Stein Eye Institute	$ 100,000
UNIVERSITY OF CALIFORNIA, SAN DIEGO La Jolla, CA	Building fund - Cancer Center Facility and Medical Library	$ 100,000
UNIVERSITY OF SOUTHERN CALIFORNIA Los Angeles	Library Book Acquisition Fund	$ 100,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1978-OCTOBER 31, 1979

Total Number of Grants: 374 Total Amount : $6,793,519

High: $500,000 Low: $100

Grants $100,000 and over

AMERICAN FRIENDS OF THE HEBREW UNIVERSITY Los Angeles, CA	To Fund Cancer Research	$ 250,000
CALIFORNIA INSTITUTE OF THE ARTS Valencia, CA	Scholarships	$ 150,000
CALIFORNIA LUTHERAN COLLEGE Thousand Oaks, CA	General operating fund	$ 100,000
CAMPBELL HALL SCHOOL North Hollywood, CA	Math/Science Complex Building Fund	$ 100,000
DESCANSO GARDENS GUILD, INC. La Canada, CA	Toward Construction of Education Exhibition Center	$ 100,000
HUNTINGTON LIBRARY AND ART GALLERY HENRY E. San Marino, CA	Capital Improvements Fund	$ 100,000
INDEPENDENT COLLEGES OF SOUTHERN CALIFORNIA Los Angeles, CA	Support of member colleges and universities	$ 150,000
KANSAS UNIVERSITY ENDOWMENT ASSOCIATION Lawrence, KS	To complete Art History Library in Spencer Museum	$ 500,000
MUSEUM ASSOCIATES Los Angeles, CA	Purchase of painting "Bacchus and Ariadne" by Guido Reni	$ 500,000
OCCIDENTAL COLLEGE Los Angeles, CA	Library Endowment fund	$ 250,000
OTIS ART INSTITUTE OF PARSONS SCHOOL OF DESIGN Los Angeles, CA	Otis/Parsons Merger	$ 150,000
PEOPLE-TO-PEOPLE HEALTH FOUNDATION Washington, D. C.	Renovation and Restoration of Health Sciences and Teaching Center at Carter Hall	$ 150,000
PEPPERDINE UNIVERSITY Malibu, CA	Towards construction of Fine Arts building	$ 500,000
PLANNED PARENTHOOD/WORLD POPULATION Los Angeles, CA	Training Center Fund	$ 100,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1978-OCTOBER 31, 1979 (Continued)

Grants $100,000 and over

REGENTS OF THE UNIVERSITY OF CALIFORNIA Los Angeles, CA	Toward Expansion Program at Jules Stein Eye Institute	$ 100,000
SAN FRANCISCO PERFORMING ARTS CENTER San Francisco, CA	Building Fund	$ 250,000
UCLA FOUNDATION Los Angeles, CA	Research support for the Center for Health Enhancement	$ 100,000
UNIVERSITY OF SOUTHERN CALIFORNIA Los Angeles, CA	Toward Doheny Library Book Acquisition Fund	$ 100,000
WILSHIRE UNITED METHODIST CHURCH Los Angeles, CA	Refurbishing and rebuilding of 1925 Moller Pipe Organ	$ 150,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1979-OCTOBER 31, 1980

Total Number of Grants: 361   Total Amount: $11,821,865

High: $1,500,000   Low: $100

Grants $100,000 and over

AMERICAN FILM INSTITUTE Beverly Hills, CA	Capital Campaign Fund	$ 100,000
AMERICAN HEART ASSOCIATION, GREATER LOS ANGELES AFFILIATE Los Angeles, CA	Establishment of a professorship in cardiology at the UCLA School of Medicine	$ 100,000
CALIFORNIA INSTITUTE OF THE ARTS Valencia, CA	Scholarship Support	$ 150,000
CALIFORNIA LUTHERAN COLLEGE Thousand Oaks, CA	General support	$ 100,000
CARNEGIE INSTITUTION OF WASHINGTON Washington, D. C.	Support of Hale Observatories	$ 100,000
CEDAR CREST COLLEGE Allentown, PA	One-to-one challenge grant, new and increased gifts to college	$ 100,000
CHILDREN'S HOSPITAL OF LOS ANGELES Los Angeles, CA	For Pediatric Neurology Program	$ 100,000
CLAREMONT UNIVERSITY CENTER Claremont, CA	Construction of new Management and Policy Building at Claremont Graduate School	$ 250,000
CREIGHTON UNIVERSITY Omaha, NB	Toward library acquisition fund and endowment for The Ahmanson Law School	$ 100,000
INDEPENDENT COLLEGES OF SOUTHERN CALIFORNIA Los Angeles, CA	Support of member colleges and universities	$ 150,000
JAPANESE AMERICAN CULTURAL AND COMMUNITY CENTER Los Angeles, CA	Library Acquisition Fund	$ 100,000
LOMA LINDA UNIVERSITY Loma Linda, CA	Toward completion of new medical building	$ 100,000
LOYOLA MARYMOUNT UNIVERSITY Los Angeles, CA	Toward construction of Athletic/Recreation complex	$ 100,000
MARIANNE FROSTIG CENTER OF EDUCATIONAL THERAPY Los Angeles, CA	Toward Capital Campaign	$ 250,000

Grants $100,000 and over

MARLBOROUGH SCHOOL Los Angeles, CA	Challenge grant toward construction of new gym	$ 500,000
MUSEUM ASSOCIATES Los Angeles, CA	-Purchase of Directors Residence	$ 350,000
	-Toward completion of Ahmanson Gallery	$1,500,000
	-Acquisition of painting "Soap Bubbles" by Chardin	$ 850,000
	-Acquisition fund for South Asian Art under Direction of Dr. Pratapaditya Pal	$ 100,000
NATURE CONSERVANCY, THE Arlington, VA	Toward completion of purchase of Santa Cruz Island	$ 250,000
OCCIDENTAL COLLEGE Los Angeles, CA	Library Endowment Fund	$ 250,000
PEPPERDINE UNIVERSITY Malibu, CA	Construction of Fine Arts Complex	$ 500,000
PLANNED PARENTHOOD/WORLD POPULATION Los Angeles, CA	General Support	$ 100,000
REGENTS OF THE UNIVERSITY OF CALIFORNIA Los Angeles, CA	-Grant for reconstruction of auditorium in Josiah Royce Hall at UCLA	$ 500,000
	-Completion of UC San Diego Cancer Center and Medical Library	$ 100,000
STANFORD UNIVERSITY, SCHOOL OF MEDICINE Stanford, CA	For purchase of equipment for Department of Medical Microbiology	$ 100,000
UNITED WAY, INC. Los Angeles, CA	Building and renovation, and telephone installation for Los Angeles County Information and Referral Federation	$ 200,000
UCI FOUNDATION Los Angeles, CA	For completion of first phase of construction of University and Conference Center	$ 600,000
UCLA FOUNDATION Los Angeles, CA	-General support of Museum of Cultural History	$ 300,000
	-Acquisition fund, Department of Special Collections, UCLA Research Library for Aldine Press Collection	$ 100,000
UNIVERSITY OF SOUTHERN CALIFORNIA Los Angeles, CA	For Library Acquisition fund and Doheny Library	$ 100,000
UNIVERSITY OF SOUTHERN CALIFORNIA, SCHOOL OF MEDICINE Los Angeles, CA	Acquisition of Radiation Equipment for The Ahmanson Laboratory at the Norris Cancer Research Institute	$ 445,000

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1980-OCTOBER 31, 1981

Total Number of Grants : 287 Total Amount: $10,128,918

High: $1,501,237 Low: $100

Grants $100,000 and over

ART CENTER COLLEGE OF DESIGN Pasadena, CA	To match NEA Challenge grant for endowment	$ 201,562
CALIFORNIA INSTITUTE OF THE ARTS Valencia, CA	Scholarship fund	$ 200,000
CALIFORNIA LUTHERAN COLLEGE Thousand Oaks, CA	General support	$ 100,000
CARNEGIE INSTITUTION OF WASHINGTON Washington, D. C.	Support of Hale Observatories	$ 100,000
CEDARS-SINAI MEDICAL CENTER Los Angeles, CA	Support for research on X-sectional echocardiography/ischemic heart disease	$ 160,000
CHILDREN'S HOSPITAL OF LOS ANGELES Los Angeles, CA	Support for Pediatric Neurology Program	$ 100,000
CITY OF DEL MAR Del Mar, CA	Contribution of property for the City of Del Mar	$ 250,000
CREIGHTON UNIVERSITY Omaha, NB	Toward law school endowment and library acquisition	$ 100,000
GREATER LOS ANGELES ZOO ASSOCATION Los Angeles, CA	Toward construction of Koala Bear exhibit	$ 200,000
HENRY E. HUNTINGTON LIBRARY AND ART GALLERY San Marino, CA	Toward renovation of Rare Book Reading Room	$ 100,000
INDEPENDENT COLLEGES OF SOUTHERN CALIFORNIA Los Angeles, CA	Support of Member colleges and universities	$ 200,000
MUSEUM ASSOCIATES Los Angeles, CA	-Purchase Titian Painting "Portrait of Giacomo Dolfin" for Los Angeles County Museum of Art	$1,058,950
	-Toward completion of the Ahmanson Gallery in the Los Angeles County Museum of Art	$1,501,237
OCCIDENTAL COLLEGE Los Angeles, CA	Toward capital program for new construction and building improvements	$ 251,550

THE AHMANSON FOUNDATION

SUMMARY OF SCHEDULE OF GRANTS DISBURSED

DURING THE FISCAL YEAR

NOVEMBER 1, 1980-OCTOBER 31, 1981 (Continued)

Grants $100,000 and over

OTIS ART INSTITUTE OF PARSONS SCHOOL OF DESIGN Los Angeles, CA	Toward acquisition of Student Housing facilities	$ 150,000
PEPPERDINE UNIVERSITY Malibu, CA	Construction of Fine Arts Complex	$ 500,000
PLANNED PARENTHOOD/WORLD POPULATION Los Angeles, CA	General support	$ 100,000
PLAZA DE LA RAZA Los Angeles, CA	Challenge Grant for construction of Ruben Salazar Bicentennial Building	$ 500,000
STANFORD UNIVERSITY Stanford, CA	For School of Medicine, Department of Microbiology for purchase of lab equipment	$ 100,000
UCLA FOUNDATION Los Angeles, CA	-General support for UCLA Mental Health Program for Physicians in Training	$ 100,000
	-For William Andrews Clark Memorial Library toward establishment of a 17th and 18th Century Studies Center	$ 120,000
	-Endowment for Museum of Cultural History	$ 100,000
UNIVERSITY OF SOUTHERN CALIFORNIA Los Angeles, CA	-Toward Doheny Library Book Acquisition Fund	$ 100,000
	-For establishment of Thomas and Frances Webster Leukemia Wing at the Norris Cancer Research Institute	$1,100,750
YMCA OF METROPOLITAN LOS ANGELES Los Angeles, CA	For New Urban Center YMCA	$ 250,000

Attachment 3

THE AHMANSON FOUNDATION

Detailed Description of Disposition Efforts

The Ahmanson Foundation (the "Foundation"), a private foundation formed in 1952 under the provisions of the California General Non-Profit Corporations Law, owned, as of March 31, 1982, 6,527,068 shares (approximately 27.5%) of the common stock of H. F. Ahmanson & Company ("Ahmanson").[1] Ahmanson is a holding company, whose principal asset is approximately 99.7% of the outstanding stock of Home Savings of America ("Home Savings"), the largest savings and loan association in the United States. The balance of Ahmanson's assets consists almost entirely of its holdings (in each case over 80% of the stock) in several different insurance companies.

The Foundation's Ahmanson holdings derive from gifts of Ahmanson, Ahmanco and Home Savings stock made to the Foundation prior to enactment of the Tax Reform Act of 1969. The principal gifts were made between 1956 and 1965 by Howard F. Ahmanson and his wife, Dorothy G. Ahmanson (who, after their divorce, remarried and became Dorothy G. Sullivan), and in June 1968 on the death of Mr. Ahmanson. At the time of these gifts, Ahmanson had two classes of stock outstanding -- voting common stock and Class A nonvoting stock. In a number of the gifts, the donors reserved income interests in the donated stock for themselves or their designees for their lifetimes or for their lifetimes plus additional periods of 20 or 30 years.

During the period of the formation of, and additional stock contributions to, the Foundation, Mr. Ahmanson and Mrs. Sullivan formed a number of irrevocable trusts for the benefit of themselves and members of

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[1] The Foundation owned 5,636,068 shares directly, of which 337,500 shares were subject to present interests (expiring in 1999) in other tax-exempt entities, and indirectly owned 891,000 shares through its ownership of 99 shares of nonvoting stock (which comprise 99% of the equity interest) of Ahmanco, Inc. ("Ahmanco"), a California corporation, whose principal asset is 900,000 shares of Ahmanson stock.

their families, and transferred the majority of the remaining Ahmanson stock to these trusts. On the death of Mr. Ahmanson in June 1968, the majority of the voting stock of Ahmanson passed to Ahmanco, the one voting share of which was to be voted by his son and his son's heirs. Simultaneously, the 99 nonvoting shares of Ahmanco (representing 99% of the economic entitlement to Ahmanco) passed from Mr. Ahmanson's estate to the Foundation.

As of the date of enactment of the Tax Reform Act of 1969, there was no market for the Ahmanson, Ahmanco or Home Savings stock, all of which was owned by either Ahmanson, Ahmanco, the Foundation, Ahmanson family members, or irrevocable family trusts. The details of these holdings are set forth in Attachment 4.

Under the provisions of section 4943 of the Internal Revenue Code (enacted in 1969 as part of the 1969 Tax Reform Act), the Foundation was required to dispose of substantially all of its stock in Ahmanson, Ahmanco and Home Savings by May 1984. This requirement posed several problems of enormous magnitude:

First, there was no public market for the stock, a problem compounded because there were two classes of Ahmanson stock and because the majority of each class of Ahmanson stock was held by Ahmanco and irrevocable trusts, which were each precluded by their governing instruments from selling the stock.

Second, approximately 32% of the Foundation's Ahmanson holdings were shares in which Mrs. Sullivan had a retained income interest for her lifetime, and in the case of the vast majority of these shares, for an additional period of 20 years following her death. The split ownership of these shares presented enormous complexities, both in terms of how the Foundation could sell its interests in stock in which another person had income rights for an indefinite period of time, and in terms of how to separate the interests of Ahmanson and Mrs. Sullivan in those shares.

Third, any effort of the Foundation with regard to the resolution of these problems was subject to the review of the Attorney General of the State of California, who had the responsibility to represent the interests of unascertained charitable beneficiaries of all California private foundations, and who had shown considerable zeal in representing such interests.

Fourth, in his estate plan, Mr. Ahmanson provided for a $5,000,000 marital trust for the benefit of his second wife, Mrs. Caroline L. Ahmanson, whom he married in 1965 following his divorce from Mrs. Sullivan, and for two $1,000,000 trusts for the benefit of his son and friends. After payment of death taxes, the residue of his estate, which included stock in Ahmanson, Ahmanco and Home Savings, was given to the Foundation. Mrs. Caroline L. Ahmanson, however, claimed an interest in this residue under the then California Mortmain Statute (which invalidated certain charitable gifts where the testator died within 30 days following execution of a will, which was the case with Mr. Ahmanson). Mrs. Caroline L. Ahmanson formally asserted her claim in the probate proceedings for the estate.

In an effort to resolve the problems posed by the enactment of the Tax Reform Act of 1969 to the unique factual circumstances facing the Foundation, the Foundation sought advice from both legal counsel and investment bankers. Their recommendations, made in 1970 and 1971 after an exhaustive analysis of the problems, were as follows:

1. Ahmanson, upon approval of its shareholders, would undertake a reorganization and recapitalization, in which all outstanding shares of Ahmanson voting common stock and Class A nonvoting stock, and the Home Savings stock held by the Foundation, would be exchanged for a new class of Ahmanson voting common stock.

2. Ahmanson thereupon would undertake a public offering of a portion of its stock, and permit the Foundation to sell a portion of its Ahmanson stock in that public offering. Under California law, other Ahmanson shareholders would have to be offered a proportionate right to participate in the public offering.

3. The Foundation and Mrs. Sullivan would enter into an exchange agreement with regard to Ahmanson shares in which each had an interest, whereby the Foundation would transfer all of its interest in a portion of the stock to Mrs. Sullivan, and she would transfer all of her interest in the balance of the stock to the Foundation, with the exchange being subject to favorable rulings from the Internal Revenue Service and approval of the California Attorney General. The exchange would be made in accordance with valuation and actuarial tables contained in the Federal Estate Tax Regulations. On

consummation of the exchange, the Foundation and Mrs. Sullivan each would have full and outright ownership of a portion of the split ownership stock.

The Foundation and Ahmanson proceeded to implement these recommendations. The reorganization and recapitalization of Ahmanson was consummated in 1971. All Ahmanson shareholders exchanged their voting and non-voting Ahmanson stock for a new class of Ahmanson voting common stock, and the Foundation exchanged its Home Savings stock for shares of the new Ahmanson voting stock. The exchange ratios were approved by investment bankers and in rulings issued by the Internal Revenue Service.

At about the same time, the Foundation and Mrs. Caroline L. Ahmanson began to litigate her claim to invalidate the gifts from Mr. Ahmanson's estate to the Foundation. After filing pleadings, taking depositions, and participating in several court hearings, the parties settled Mrs. Ahmanson's claim in April 1971.

At this point, the Foundation, Ahmanson and the other participating shareholders proceeded with the public offering of Ahmanson stock. The offering was completed in October 1972. It involved the sale of 3,600,000 shares of Ahmanson stock, among which 800,000 were newly issued by Ahmanson in order to raise working capital, 857,421 were owned outright by the Foundation, and 750,000 were shares in which the Foundation and Mrs. Sullivan had joint interests. The proceeds of sale of those 750,000 shares were placed in escrow until completion of the final exchange agreement between the Foundation and Mrs. Sullivan.

In July 1972, the Foundation and Mrs. Sullivan signed a Property Exchange Agreement in order to separate their interests in the approximately 3,000,000 shares of Ahmanson stock in which they each had interests.[2] Applications for several rulings (on the receipt of which the transactions were conditioned) were promptly submitted to the Internal Revenue Service, and the rulings were issued between October 1972 and June 1973. In addition, an application for approval was filed with the California Attorney General. The Attorney General, however, refused to approve the exchange, and in August 1973, brought suit in the Los Angeles County Superior

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[2] The 3,000,000 shares included the 750,000 shares sold in the public offering.

Court against the Foundation and Mrs. Sullivan in order to prevent the exchange. The suit alleged that the exchange was unfair and did not result in the receipt of sufficient stock by the Foundation. There followed a number of amended complaints and cross-complaints by the various parties to the litigation against one another, substantial discovery, court hearings and other pretrial proceedings.

During the course of the litigation, the Attorney General filed a second lawsuit against Ahmanson and its shareholders, charging that the Foundation should have been permitted to participate to a greater extent in the 1972 public offering. Among the remedies ultimately sought by the Attorney General was the imposition of constructive trusts on shares of Ahmanson stock, or proceeds of sale of Ahmanson stock, held by various shareholders, all for the benefit of the Foundation.

Further, the Attorney General made it clear to the Foundation that, for so long as the litigation was pending, he would vigorously oppose any effort on the part of the Foundation to dispose of <u>any</u> of its Ahmanson shares, because of his views that (a) a sale of all the Foundation's Ahmanson stock (the amount of which, he believed, would be increased as a result of the litigation) to a single buyer could be made at a substantial premium (and therefore maximize the Foundation's return) and (b) a reduction of the number of Ahmanson shares owned by the Foundation would enhance impermissibly the opportunity for certain parties related to the Foundation to realize a premium for large blocks of Ahmanson stock held in trusts for their benefit.

After vigorous activity in these lawsuits, the Attorney General and the other parties agreed to settle their differences in both cases. In 1976, the parties executed an initial Settlement Agreement, under which the Foundation was to receive substantially more Ahmanson stock, and substantially more from the escrowed proceeds of the 1972 sale, than the Foundation would have received under the Property Exchange Agreement with Mrs. Sullivan. The settlement process was complex, with the Settlement Agreement undergoing several amendments. The Settlement Agreement was conditioned on the receipt of new rulings from the Internal Revenue Service, which were issued in late 1977. The settlement was thereupon consummated, and in January 1978, the litigation was dismissed.

Once the litigation was resolved, there was certainty for the first time as to the number of Ahmanson shares owned by the Foundation. The Attorney General continued to take the position that all the Ahmanson stock held by the Foundation should be sold at a premium to one buyer who would seek control of Ahmanson through such acquisition, and therefore be willing to pay a premium for such control. In communications with representatives of the Foundation on this subject, the Attorney General renewed his assertion that he had the statutory authority to require disposition in a manner to maximize the return to the Foundation, and that he would take legal action to prevent a disposition in any other manner.

In order to receive professional assistance in its efforts, the Foundation retained three prominent New York investment banking firms -- Goldman, Sachs & Co., Salomon Brothers and The First Boston Corporation -- to give it advice with regard to maximizing its return for its Ahmanson stock. The Foundation informed the investment banking firms that it wished to dispose of all of its Ahmanson stock by May 25, 1984, the date required for disposition under provisions of the Tax Reform Act of 1969. By early 1979, the Foundation had received written reports from each of these three investment banking firms. Copies of the reports were also submitted to the Attorney General, whose representative participated in discussions with the investment banking firms.

Each of the firms recommended that the Foundation first seek to dispose of its Ahmanson stock for a premium price to a single buyer. The firms agreed that such a premium price might be available from a domestic or foreign buyer, provided that the buyer could acquire additional Ahmanson stock from other shareholders. All three firms further noted that, under applicable California law, all Ahmanson shareholders would have to be offered the same premium for their shares, for if they were not, they could assert that a portion of the premium received by the Foundation was held for their benefit.

After participating in these discussions and reviewing these reports, the Foundation determined to attempt to enter into a "block sale" of all of its shares for a premium price, and, on May 1, 1979, engaged Goldman, Sachs & Co. as its investment advisor, instructing it to seek a buyer for all of the Foundation's Ahmanson stock at the highest premium obtainable.

Goldman, Sachs & Co. made extensive efforts to locate an interested buyer for the Foundation's stock, but these efforts were unsuccessful. In large part, the lack of success was due to the dramatic adverse changes in the economic circumstances in which savings and loan associations operated. Other adverse factors included (a) the fact that the subsidiaries of Ahmanson, especially Home Savings, operated in highly regulated industries and were therefore not as free as unregulated companies to act in an increasingly competitive environment; (b) the high concentration of Ahmanson's activities in a limited geographical area; (c) the overall uncertainty as to the future direction of regulatory policies governing the savings and loan industry; and (d) the inability of savings and loan associations, in part due to regulation and in part due to their capital needs, to pay a high percentage of their income in dividends.

In May 1980, Goldman, Sachs & Co. reported to the Foundation that, because of the dramatic changes in the economy and for the other reasons stated above, the Foundation ~~could not~~ expect to receive a premium for its stock, and that, in view of the statutory disposition deadline date of May 1984, the Foundation should proceed in an effort to dispose of its stock through a series of registered public secondary offerings. The Foundation was advised further that, after an initial secondary offering, it should seek to dispose of Ahmanson stock through gifts (in satisfaction of its annual distribution requirement under the 1969 Tax Reform Act) and sales under Rule 144. Additional secondary offerings and private placements then could be considered.

After receiving this advice, the Foundation commenced discussions with the Attorney General's office concerning the possibility of a secondary offering. In January 1981, the Foundation secured the Attorney General's agreement in principle that, in light of deteriorating economic conditions and the dim prospects for the sale of all the Ahmanson stock at a premium, he would not oppose a decision by the Foundation to proceed with a secondary offering.

On January 19, 1981, the Foundation submitted a written request to Ahmanson for permission to proceed with a secondary offering of Ahmanson stock. That request was accepted by Ahmanson on February 9, 1981, and efforts were immediately undertaken to prepare for the secondary offering. During the course of this preparation, however, Ahmanson entered into an agreement, announced in March 1981, to expand its insurance business through the acquisition of stock in another insurance company, part of the consideration for which was to be shares of Ahmanson stock that could be sold immediately by the seller. On the advice of Goldman, Sachs & Co. that the Foundation could not effectively sell stock in the secondary market during the pendency of a potential disposition of these additional Ahmanson shares, efforts to proceed with the secondary offering were suspended. Goldman, Sachs & Co. recommended further that the Foundation seek to dispose of as much stock as permissible under applicable law and the existing market conditions through gifts and through sales pursuant to Rule 144. Between June 1981 and March 1982, the Foundation was able to dispose of 772,900 Ahmanson shares through these means.

The Foundation has received current advice from Goldman, Sachs & Co.[3] that, based on current and foreseeable market conditions, the Foundation does not have sufficient time to dispose of its remaining Ahmanson stock by May 1984, without a serious disruption of the market price of Ahmanson stock and, because of the leading position of Ahmanson in the savings and loan industry, a serious disruption of the market price for common stocks of other savings and loan companies, with a concomitant highly detrimental impact on the ability of the savings and loan industry to raise equity capital.

Goldman, Sachs & Co. has recommended that the Foundation seek a ten-year extension in the time for the Foundation to dispose of its Ahmanson stock, so that orderly dispositions may be made at other than distress prices. Goldman, Sachs & Co.'s opinion is based on a number of factors, including the size of the Foundation's holdings, the relatively small float and low trading volume in Ahmanson shares, the low level of interest of investors in savings and loan stocks, the existence of other major shareholders interested in selling their Ahmanson shares, the depressed operating results of Ahmanson and other companies in the savings and loan industry, and the uncertain future for the savings and loan industry. Goldman, Sachs & Co. has expressed its opinion that, if the deadline is not so extended, it may not be possible to avoid forced sales of the Foundation's Ahmanson holdings at distress prices, which would have a negative impact on the savings and loan industry generally.

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[3] A copy of the opinion of Goldman, Sachs & Co. is Attachment 5.

Attachment 4

STOCK OWNERSHIP

AS OF MAY 26, 1969

H. F. Ahmanson & Company:

	Voting Stock	Nonvoting Stock
Ahmanson Foundation	201*/	30,720**/
Ahmanco, Inc.	600	-
Ahmanson family members and trusts for their benefit	199	75,991
Total	1,000 shares	106,711 shares

*/ Of these shares, 200 were subject to intervening income interests.

**/ Of these shares, 19,720 were subject to intervening income interests.

* * * *

Home Savings:

H. F. Ahmanson & Company	56,603
Ahmanson Foundation	12,416
Ahmanson family members and trusts for their benefit	559
Total	69,578 shares

Attachment 5

Goldman.Sachs & Co. | 55 Broad Street | NewYork, NewYork 10004
Tel 212-676-8000

Goldman Sachs

April 16, 1982

Daniel N. Belin, Esquire
McKenna, Conner & Cuneo
3435 Wilshire Boulevard
Los Angeles, CA 90010

Dear Mr. Belin:

We are writing this letter in response to your recent inquiry on behalf of The Ahmanson Foundation (the "Foundation"). As of March 31, 1982, the Foundation owned (directly or indirectly) 6,527,068 shares of common stock of H.F. Ahmanson & Company ("Ahmanson"), a holding company whose common stock has been listed on the New York Stock Exchange since 1972 and whose principal asset is 99.7% of the stock of Home Savings of America ("Home Savings"), the largest savings and loan company in the United States. Under Section 4943 of the Internal Revenue Code, the Foundation is required to dispose of substantially all of its Ahmanson stock by May 25, 1984. You have asked us to assess the impact of this requirement and to summarize our efforts to date in assisting the Foundation in this disposition.

This letter sets forth the general background of the matter, specific alternatives which we have explored and recommendations with regard to future action. As explained in detail below, we believe that a ten-year extension of the existing 1984 deadline is necessary to enable the disposition of the Foundation's Ahmanson holdings in an orderly fashion at other than distress prices and to avoid a material adverse impact on the market for savings and loan stocks in general, which in turn could increase greatly the difficulty for companies in the industry to raise much needed additional capital.

I. BACKGROUND

Ahmanson is a holding company whose assets consist almost entirely of 99.7% of the stock of Home Savings and the stock of several insurance companies. On March 31, 1982, there were 23,700,252 shares of common stock of Ahmanson outstanding. A summary of the stock ownership of Ahmanson as of March 31, 1982 is set forth below in Table I.

Table I
AHMANSON STOCK OWNERSHIP (March 31, 1982)

Owner	No. of Shares	Percentage of Total
Foundation	6,527,068	27.5%
Irrevocable Trusts established between 1950 and 1955	9,656,000	40.7
Other disqualified persons	1,881,834	8.0
Other shareholders	5,635,350	23.8
Total	23,700,252	100.0%

At the time the 1969 Tax Reform Act became law, Ahmanson was a privately held corporation with two classes of stock outstanding. In order to create a public market for its stock and to permit listing on the New York Stock Exchange, it was necessary to reorganize Ahmanson's capital structure to provide for a single class of stock, and to make other arrangements for a public offering. The reorganization was accomplished between 1970 and 1971. In early 1972, the Foundation entered into an exchange agreement with an individual who held income interests in 3 million Ahmanson shares owned by the Foundation, regarding the division of the parties' interests in those shares. The implementation of the exchange agreement was conditioned on favorable rulings from the Internal Revenue Service, which were received. By mid-1972, Ahmanson and its shareholders were prepared to proceed with the first public offering of Ahmanson stock. In October 1972, the offering took place, and 3,600,000 shares of Ahmanson stock were sold to the public. Shortly thereafter the stock was listed on the New York Stock Exchange.

Goldman Sachs was one of the managing underwriters of this initial public offering, and since that time has remained in close contact with both Ahmanson and Home Savings. As set forth in Appendix I, we have carried out numerous financings for Home Savings and have served as its commercial paper dealer.

In 1973, the California Attorney General brought suit against the Foundation and others in order to preclude the consummation of the exchange agreement between the Foundation and the co-owner of the above-mentioned 3 million shares. That litigation continued until January 1978, when it was dismissed pursuant to a settlement agreement among the parties. During the litigation period, we had numerous discussions with you about the effect of that litigation on the ultimate disposition of the Foundation's shares. You informed us that the California Attorney General had taken the position that, while the litigation was pending, the Foundation could not dispose of any of its remaining Ahmanson shares. This was because of his view that the resolution of the litigation would result in the Foundation's receiving additional shares of Ahmanson stock, which in turn would permit it to obtain additional compensation as a control premium for the sale of its Ahmanson shares.

Shortly after the settlement of the litigation, the Foundation asked three investment banking firms, including Goldman Sachs, to make recommendations as to the most effective methods of disposing of its Ahmanson stock. We submitted our written report in October 1978, and therein proposed several possible alternatives, including: (i) the sale of the entire block held by the Foundation to a single purchaser, (ii) a series of secondary offerings, and (iii) sales under Rule 144 of the Securities and Exchange Commission.

We recommended that, in order to maximize the value of its Ahmanson holdings, the Foundation first should attempt to sell its stock to a single buyer at a substantial premium over the traded market price. We were aware that the California Attorney General had taken the strict position that the Foundation should dispose of its Ahmanson stock in this manner in order to maximize its return. We recognized, however, and so advised the Foundation, that it would be difficult to find a single buyer willing to purchase these shares on that basis. This was principally because of the extremely large size of the proposed transaction, certain negative investor perceptions toward the savings and loan industry, and growing uncertainties about the economic climate as it affected long term mortgage lending in this country. As an alternative strategy, we recommended that, if we could not find a single buyer, the Foundation should attempt a disposition of its shares through a series of secondary offerings, coupled with smaller sales under Rule 144. We understand that the reports of the other two investment banking firms, submitted to the Foundation by early 1979, proposed similar strategies.

Following submission of their reports to the Foundation, we met with both the trustees of the Foundation and a representative of the Office of the California Attorney General, to discuss the reports and to answer questions. We understand that there were subsequent discussions between the Foundation and the Office of the California Attorney General with regard to these reports.

On May 1, 1979, the Foundation engaged us to serve as the Foundation's financial advisor with regard to the disposition of Ahmanson shares. We thereupon embarked upon extensive efforts, as outlined below, to dispose of the Foundation's holdings of Ahmanson stock.

II. DISPOSITION ALTERNATIVES

A. Sale to Single Buyer

In considering the sale of the Foundation's stock to a single buyer, it was our view that any buyer willing to pay a premium for such stock would do so only if he believed that he would be able subsequently to acquire all remaining Ahmanson shares. It was apparent that the Foundation's Ahmanson stock holdings were sufficiently large to permit a buyer to establish a significant control position in Ahmanson. This not only would enhance his ability to purchase the remaining Ahmanson shares, but also would put him in a position to block any attempted acquisition by someone else.

Based on the $22-1/4 closing stock price of Ahmanson on April 30, 1979, the market value of the 7,657,143 Ahmanson shares then owned by the Foundation was approximately $170 million, while the market value for the entire 22,928,213 shares of Ahmanson then outstanding was approximately $510 million.* Moreover, we were looking for a substantial premium in excess of market value. The size of this proposed transaction substantially limited the number of potential buyers.

The effort to find a single buyer was further complicated by the fact that Ahmanson's principal investment was in the savings and loan industry, which had come to be viewed by investors as highly cyclical and a poor investment in times of increasingly high interest rates. There has historically been a very close relationship between interest rates and the savings and loan industry's earnings and stock prices. In periods of declining interest rates, savings and loan earnings and stock prices have typically shown significant increases. This is because the income received by savings and loans is fixed at prior (higher) rates, whereas amounts paid by the savings and loans for the use of money (principally to depositors) declines. In contrast, in periods of rising interst rates, savings and loan earnings and stock prices typically show significant declines. This is because the costs of the savings and loans' available funds are increasing, whereas the return on most assets was fixed at the prior (lower) interest rate.

* Appendix II sets forth the market price of Ahmanson stock during the period October 1972 through March 1982.

The turbulent money market conditions since October 1979, evidenced by a dramatic increase in interest rate levels in the U.S. money markets, has had a major adverse effect on our ability to market the Ahmanson shares. These adverse conditions resulted in the savings and loan industry's realizing only a 0.15% return on net assets during 1980, compared to higher returns in prior years. In 1981, the savings and loan industry had aggregate losses of approximately $4.6 billion, and industry lossses may exceed that amount in 1982. Although Home Savings is the largest savings and loan association in the United States, its own operating results were consistent with these general industry trends, and are shown in Table II.

Table II

Year	Profit (Loss) (in millions)
1976	$ 66.5
1977	95.2
1978	107.0
1979	110.5
1980	48.8
1981	(51.3)

Goldman Sachs was highly qualified to know the most likely prospective buyers for Ahmanson, having been involved in 166 completed mergers and acquisitions (principally on behalf of sellers) during the five years 1975 through 1979. Through our Investment Banking Services Department, we follow most companies in the United States that earn over $2 million annually after taxes, and make an effort to be in particularly close contact with companies that earn over $100 million annually, i.e., companies of the size that conceivably could have afforded to purchase the Foundation's Ahmanson shares.

We explored a possible sale of the Foundation's stock with a number of potential purchasers in the U.S. during the period beginning May 1979. Although several of these prospective buyers expressed some preliminary interest in purchasing the shares, no firm offers were received. Many of the potential buyers mentioned their reluctance to pay a premium for a company whose operations and assets were not only concentrated in the savings and loan industry, but also limited to a single state.

We also explored the sale of the Foundation's shares to foreign investors. Goldman Sachs is very experienced in the sale of U.S. companies to foreign buyers, having been involved in thirty such transactions between 1976 and 1980. During the same time period, we executed financings raising over $12 billion for non-U.S. companies located in Europe, South America and the Far East. Goldman Sachs Investment Banking personnel based in Europe and the Far East are in regular contact with many large foreign companies on a variety of investment banking services, including their acquisition objectives. Because of our knowledge of these objectives, we knew that very few foreign companies would be interested in buying a U.S. savings and loan company, for two reasons: (1) most foreign financial institutions do not make long term fixed rate mortgage loans, and view that aspect of a savings and loan's portfolio as a poor risk, and (2) many foreign companies (especially commercial banks) are interested in acquiring U.S. commercial banks, and the acquisition of a savings and loan under current U.S. banking regulations would restrict them from purchasing a commercial bank in the U.S.

We advised the Foundation of our opinion that it was extremely unlikely that interest in a purchase of the Foundation's Ahmanson shares could be generated abroad. Nonetheless, working in conjunction with our international staff, we identified three foreign companies that we believed were those most likely to have such an interest. We contacted these three companies, all of whom declined to pursue the proposed transaction for one or both of the reasons mentioned above.

Between May 1979 and October 1979, the price of Ahmanson stock ranged from a low of $19 1/4 in October to a high of $28-1/4 in July. In the five months from November 1979 through March 1980, Ahmanson stock declined from a high of $24-3/4 to a low of $15, due in large measure to a steep increase in interest rates and the prospects for future increases resulting from Federal Reserve Board Chairman Volcker's announcements of changes in monetary and credit policy.

The prospect of increasing interest rates in early 1980 called further attention to potential earnings problems for Ahmanson and for the savings and loan industry in general. Even though interest rates declined substantially in the spring and summer of 1980, this decline did not last long enough to change potential buyers' attitudes toward the cyclicality of savings and loan earnings. Although we were hopeful that the market factors having an adverse impact on the savings and loan industry would ease, we became convinced by early summer 1980 that we would be unable to locate a buyer for the Ahmanson shares at a significant premium over the market price, in light of the continuing dramatic changes in interest rates and the resulting adverse effects on savings and loan earnings and stock prices. Consequently, we advised the Foundation that under the circumstances, particularly because of the pending May 1984 disposition deadline, it was time for the Foundation to consider a secondary offering of a portion of its Ahmanson stock.

B. Secondary Offerings

A secondary offering involves the sale by shareholders of a portion of their existing holdings to the public. In analyzing the possibilities of a secondary offering by the Foundation, we faced certain constraints.

First, as a requirement for any secondary offering, the company whose stock is to be sold is required to file with the Securities and Exchange Commission a registration statement containing pertinent business and financial information.

Second, the sale of Ahmanson stock pursuant to a secondary offering would have to take into account that certain irrevocable trusts, whose aggregate Ahmanson holdings were even larger than those of the Foundation, had indicated an interest in selling a portion of their own Ahmanson shares. Certain of those trusts were allowed from the outset to dispose of their Ahmanson shares, while others, although initially restricted, have recently received court approval to dispose of the shares. In order to avoid the market disruption that would result from the trusts' attempting to sell a portion of their shares while the Foundation was marketing its shares pursuant to a secondary offering, it would be necessary to offer the trusts the opportunity to participate in the secondary offering. Assuming that these trusts would participate in the sale on a pro-rata basis, the Foundation's shares would represent approximately 40% of the total which could be sold in any public offering. Although this would not preclude the Foundation from disposing of some shares pursuant to a secondary offering, it would make it highly unlikely that the Foundation could comply with the divestiture of the required number of shares by the May 1984 deadline. We also noted that, even if the trusts did not choose to participate in the secondary offering, it still would be necessary to obtain their agreement not to sell their shares during the public offering, as the market for Ahmanson stock could otherwise be severely disrupted.

Third, the market for Ahmanson stock is relatively thin and the amount of float (i.e., the number of Ahmanson shares held by the public, excluding shares held by the Foundation and the trusts) is less than 30% of the total number of shares outstanding. In addition, many of these shares are owned by institutions, who for the most part hold such shares for investment purposes. Under such circumstances, secondary offerings cannot be accomplished more than once or twice a year, even assuming the most positive market conditions, without risking a significant adverse effect on the stock price, which in turn would reduce the proceeds that could be realized from subsequent offerings.

Fourth, the matter was further complicated by the position of the California Attorney General, who since 1973 had insisted that the Foundation dispose of its Ahmanson shares at a premium to a single buyer. We understood from you that his right to intercede in such matters was supported by appropriate statutory and case-law authority in California, and we were aware of an instance involving another foundation in which the California Attorney General had intervened successfully to preclude that foundation's disposition of stock which he found to be inappropriate.

In the summer of 1980, you reported to us that you had several conversations with the Deputy Attorney General involved in overseeing the Foundation's affairs, about the possibility of the Foundation's proceeding with a secondary offering. In September 1980, you and S.J. Weinberg, Jr., a partner of Goldman Sachs, met with the Deputy Attorney General. At that meeting, the Deputy indicated that in light of the diminished prospects for finding a single buyer who would be willing to pay a premium for the Foundation's shares, he was now willing to consider a secondary offering on the part of the Foundation. Discussions continued with the Deputy Attorney General during the fall of 1980. In early January 1981, you informed us that the Foundation had received an agreement in principle from the Deputy Attorney General not to oppose a decision of the Foundation to proceed with a secondary offering.

In February 1981, based upon receipt of the aforementioned agreement from the Office of the California Attorney General, the Foundation asked us to begin to prepare for a secondary offering. Concurrently, the Foundation formally requested approval from Ahmanson to proceed with this secondary offering, and Ahmanson agreed to file the registration statement as requested. We then commenced work on the documentation necessary to file a registration statement for a secondary offering of two to three million shares of Ahmanson stock. This work was in process when the proposed acquisition by Ahmanson of Bankers National Life Insurance Company ("Bankers Life") was announced on March 25, 1981. Ahmanson viewed this acquisition as a critical step in its diversification efforts.

Under the proposed agreement for acquisition of Bankers Life, Ahmanson had agreed to pay Orion Capital Corporation, the sole shareholder of Bankers Life, $25,000,000 of Ahmanson common stock, and to grant Orion independent registration rights which would have permitted Orion to sell the shares immediately upon closing. It was our judgment that the market could not absorb both the shares to be issued in connection with the proposed acquisition of Bankers Life and the shares proposed to be offered by the Foundation through the planned secondary offering. It therefore became necessary for the Foundation to postpone the secondary offering until after the closing of the Bankers Life acquisition.

In September 1981, the closing of the Bankers Life transaction was further delayed, and subsequently the terms of the transaction were significantly revised. The acquisition was completed on December 3, 1981, on revised terms, which did not contemplate the issuance of Ahmanson common stock until on or after October 31, 1985. The securities issued in connection with the Bankers Life acquisition therefore were no longer an obstacle to the completion of the secondary offering by the Foundation. We therefore advised the Foundation that, subject to market conditions, it could proceed with a secondary offering upon receipt of audited financial statements of Ahmanson for the calendar year 1981. We have received the Company's financial statements for 1981 and have advised the Foundation that due to the Company's substantial loss in the fourth quarter, which resulted in a net loss for the full year 1981, and in light of recent press reports concerning the number of financial failures of members of the savings and loan industry which have occured and are expected during 1982, a secondary offering of any significant number of Ahmanson shares should not be undertaken at this time.

C. Private Placement

From the time that it became apparent that the Foundation would not be able to sell its Ahmanson shares to a single purchaser at a premium, we also considered the possibility of a private placement of the shares with institutional investors. We did not actively pursue this course, however, because in our judgment and based on our experience such institutions could not be expected (then or now) to pay a premium over market for Ahmanson common stock, since the acquisition of control would not be a factor in their purchase. The likelihood that such a placement could be made, even without the premium factor, was further reduced because there is no well developed or reliable market for the placement of equity securities with institutional investors, transactions of this size are unusual, and most institutional investors do not purchase unregistered shares of common stock in a private placement.

D. Sales Pursuant to Rule 144

As another alternative to the sale of Ahmanson shares to a single buyer at a premium, we considered a sale of a portion of the Foundation's shares pursuant to the provisions of Rule 144, issued by the Securities and Exchange Commission under section 4(c) of the Securities Act of 1933. Basically, Rule 144 permits limited sales of unregistered securities at certain times in ordinary trading transactions by major shareholders of the issuer. Although we advised the Foundation that sales pursuant to Rule 144 could be made prior to or between secondary offerings, we also noted that certain restrictions contained in Rule 144 limit the number of shares that may be sold in any three month period, and prohibit the solicitation of bids in connection with such sales. Accordingly, the Foundation could not rely on this means for disposing of a substantial portion of its Ahmanson shares.

Beginning in the summer of 1981, when the secondary offering was delayed by the pending Bankers Life acquisition, the Foundation commenced dispositions of shares under Rule 144. As of March 31, 1982, the Foundation has disposed of approximately 403,000 shares of Ahmanson stock by this means.

III. CURRENT DISPOSITION DEADLINE

It is our opinion that, under current market conditions and for the reasons stated above, the Foundation cannot meet the May 1984 disposition deadline without disposing of its Ahmanson shares at a substantial discount below the already depressed market price for Ahmanson shares. Such a sale at a discount price also could be expected to have a negative impact on the entire market for savings and loan stocks as (notwithstanding the statutory time limitation) a sale at an obviously "distressed" price would be interpreted in the marketplace as a further loss of confidence in the savings and loan industry by a major investor, and would likely serve as a signal to others to sell their own savings and loan shares. According to published statistics, the stock of Ahmanson, with an aggregate market value on April 16, 1982 of approximately $261 million, represents approximately 15% of the approximately $1.8 billion market value of the stock of the 45 savings and loan associations traded on the New York or American Stock Exchanges or actively traded over the counter.

In our opinion, because Ahmanson shares represent 15% of the value of shares of all publicly traded savings and loan stocks, a sharp decline in the market price for Ahmanson stock could be expected to lead to a decline in the market price for all savings and loan shares.

A poor market for savings and loan shares due to adverse economic conditions and the substantial operating losses in the industry, aggravated by a forced sale of Ahmanson shares, would have effects far beyond those to the Foundation. As the savings and loan industry suffers losses, there is a genuine need for capital replenishment from private sources. In the absence of such replenishment, there could be enormous demands on the FSLIC and upon the federal government to make major infusions of capital in order to permit these institutions to continue in operation.

Many savings and loan institutions were organized as mutuals. One way for a mutual savings and loan institution to raise capital is to convert from a mutual to a stock form, and to raise capital by the sale of stock in the conversion. Lower market prices for savings and loan stocks, however, would have a serious adverse effect on the ability of such mutual institutions to raise capital when it is most needed. There would be little justification to sell stock of a converting mutual in the present market if the sale of such stock would not raise adequate capital. By the same token, existing stock associations would be unable to raise capital through additional stock offerings if the sales would result in lower proceeds and in a substantial dilution of interests of existing shareholders.

Present economic conditions are such that it cannot be determined either how many Ahmanson shares could be sold in any secondary offering or how many such secondary offerings could be accomplished between now and May 1984. Further, the Foundation cannot count on being able to sell more than its pro rata share of Ahmanson stock in any combined secondary offering. It is reasonable to conclude, however, that the number of shares that could be sold in any such secondary offering would be reduced by the following factors: (a) the normal trading volume of Ahmanson shares and the amount of Ahmanson's float, (b) expectations of additional offerings providing severe pressure on the market price of Ahmanson stock, and (c) the increased volatility of interest rates and the sensitivity of savings and loans' earnings and stock prices to those rates.

It is well known in the investor community that savings and loan stocks have recently been among the worst performers in the stock market and one of the stock groups in greatest disfavor by investors. Under these circumstances, it will take a much longer time to dispose of approximately 6,000,000 shares of Ahmanson stock than it would take to dispose of similar blocks of stock of companies in most other industries. Our view is that, although an upturn in market conditions would make it easier to sell more shares in a shorter time period, such events are not likely to occur now or in the near future. Indeed, it is more likely that market conditions will remain unstable, making it difficult to market significant public offerings of Ahmanson common stock. Furthermore, the existence of the May 1984 deadline could be perceived in the market place as evidence of a need on the part of the Foundation to continue with secondary offerings during these adverse market conditions. The anticipation of sales of large blocks of stock over the period until May 1984 would further depress the market.

IV. CONCLUSION AND RECOMMENDATIONS

In view of the size of the Foundation's holdings of Ahmanson stock, the relatively small float and low trading volume in Ahmanson shares, the limited interest by current investors in savings and loan stocks, the existence of other major shareholders interested in selling their Ahmanson shares, the depressed operating results of Ahmanson and all other savings and loan companies, the state of uncertainty with regard to possible major changes within the banking and savings and loan communities, and other considerations discussed above, we believe it is critical that the Foundation have additional time to pursue various alternatives in its effort to dispose of its stock in an orderly way. Only then will the Foundation be able to dispose of its shares at other than distress prices; and only then will the public interest in maintaining an orderly market for savings and loan association stocks be preserved. While the Foundation is diligently pursuing the disposition of its Ahmanson shares, current conditions and future uncertainties for the savings and loan industry make it impossible for there to be any assurance that the Foundation will be able to dispose of its holdings in an orderly fashion, at other than distress prices, prior to the current deadline. Although it is impossible to fix a precise time in which to accomplish the desired objectives, a ten year extension should permit an orderly disposition of the shares, allowing for market fluctuations and other unforeseen events. If the deadline is not so extended, it may not be possible to avoid forced sales of the Foundation's holdings at significantly depressed prices, which in turn would likely have a negative impact on the entire savings and loan industry.

Very truly yours,

Goldman, Sachs & Co.

GOLDMAN, SACHS & CO.

11-414 O - 82 - 9

Appendix I

HOME SAVINGS & LOAN ASSOCIATION - FINANCINGS COMPLETED BY GOLDMAN SACHS

Date	Principal Amount	Description
1977	$200,000,000	7 1/4% Mortgage-Backed Bonds, Series A, Due 6/15/82
1977	$100,000,000	7 1/4% Mortgage-Backed Bonds, Series B, Due 11/15/83
1977	$100,000,000	7 7/8% Mortgage-Backed Bonds, Series C, Due 11/15/85
1978	$110,032,278	Mortgage-Backed Certificates, First Series, Variable Pass-Through Rate
1978	$103,082,725	Mortgage Pass-Through Certificates, Second Series, Variable Pass-Trough Rate
1979	$104,078,402	Mortgage Pass-Through Certificates, Fourth Series, 10% Pass-Through Rate

Appendix II

H.F. AHMANSON & CO.

1972	High	Low	Close	Vol.(00's)
October	32 3/8	28	32 3/8	9,674
November	33 1/8	29 3/4	31 1/8	13,722
December	32 1/2	28	30 1/2	6,609
1973				
January	31 1/4	24 1/4	25 3/8	5,313
February	25 3/4	22 1/8	22 5/8	1,469
March	22 3/4	20 3/8	21 1/8	2,221
April	23 1/8	16 3/8	17 1/4	1,610
May	18 7/8	14 3/4	14 7/8	3,169
June	15 1/8	13 1/4	13 1/2	1,889
July	16	11 1/2	14	2,027
August	15	11 5/8	15	927
September	17 1/2	12 1/4	16 1/2	2,604
October	16 5/8	14 1/8	14 1/8	1,873
November	14 1/8	10 3/8	10 3/4	3,419
December	11 3/8	8 3/4	10 3/4	1,648

AHMANSON H F & CO

	HIGH ($)	LOW ($)	CLOSE ($)	VOLUME (100'S)
MONTHLY:				
1974				
JANUARY	13.625	10.000	13.500	1276
FEBRUARY	13.875	12.000	12.875	2239
MARCH	13.250	10.750	10.875	2153
APRIL	11.625	9.750	10.000	716
MAY	11.125	9.000	9.625	963
JUNE	11.750	7.625	7.750	1482
JULY	8.750	7.000	7.375	586
AUGUST	7.875	5.875	6.125	594
SEPTEMBER	8.000	5.625	7.125	891
OCTOBER	8.750	7.000	8.375	1060
NOVEMBER	8.375	6.500	6.750	804
DECEMBER	7.500	6.250	6.875	1595
1975				
JANUARY	10.500	6.375	10.375	2509
FEBRUARY	10.500	8.875	9.625	745
MARCH	10.500	8.750	9.500	2051
APRIL	9.750	8.625	8.625	619
MAY	11.875	8.625	11.750	3595
JUNE	12.000	9.875	10.250	1851
JULY	11.125	9.500	9.500	1960
AUGUST	9.625	7.750	8.125	1493
SEPTEMBER	8.500	7.250	7.250	2319
OCTOBER	9.250	7.000	8.625	1993
NOVEMBER	9.000	8.375	9.000	718
DECEMBER	9.750	8.250	9.750	1095
1976				
JANUARY	12.625	9.250	12.625	2249
FEBRUARY	13.875	12.000	12.000	3081
MARCH	13.500	12.000	12.750	1451
APRIL	14.375	12.625	13.375	1992
MAY	13.375	11.125	11.625	1237
JUNE	12.750	10.625	12.375	1155
JULY	13.250	12.125	12.750	1261
AUGUST	14.000	12.125	13.875	1657
SEPTEMBER	14.250	13.375	13.500	1288
OCTOBER	14.500	13.250	14.500	1774
NOVEMBER	16.375	13.875	16.000	2670
DECEMBER	17.000	15.875	16.375	3367
1977				
JANUARY	16.500	15.125	16.125	2223

AHMANSON H F & CO

	HIGH ($)	LOW ($)	CLOSE ($)	VOLUME (100'S)
1977				
FEBRUARY	17.125	15.750	16.125	2035
MARCH	18.375	16.000	18.250	1900
APRIL	20.000	17.500	17.750	1995
MAY	18.875	16.875	16.875	808
JUNE	18.375	16.875	17.500	1180
JULY	18.125	16.000	16.125	955
AUGUST	19.875	16.000	18.875	2099
SEPTEMBER	21.000	18.875	21.000	865
OCTOBER	21.500	18.250	18.875	1887
NOVEMBER	20.500	18.625	20.125	1379
DECEMBER	20.250	18.375	18.875	1026
1978				
JANUARY	19.000	15.875	16.250	1472
FEBRUARY	17.375	16.125	16.625	492
MARCH	19.000	16.625	18.750	1093
APRIL	21.375	18.375	21.250	3313
MAY	22.000	19.000	19.375	3999
JUNE	22.875	19.375	20.250	3365
JULY	23.625	20.000	23.250	5142
AUGUST	26.750	23.000	25.000	4412
SEPTEMBER	26.500	24.000	24.250	1396
OCTOBER	25.625	19.375	19.625	952
NOVEMBER	20.125	18.000	18.250	2653
DECEMBER	19.375	17.625	18.125	2087
1979				
JANUARY	22.500	18.125	22.500	531
FEBRUARY	22.750	19.500	20.250	369
MARCH	22.750	19.750	22.000	1039
APRIL	22.625	20.750	22.250	710
MAY	22.375	21.625	22.250	423
JUNE	28.000	21.875	27.500	1368
JULY	28.250	24.125	24.125	1800
AUGUST	27.875	24.250	26.000	1698
SEPTEMBER	26.375	23.625	25.375	1104
OCTOBER	25.250	19.250	21.000	2570
NOVEMBER	24.500	20.750	24.250	1308
DECEMBER	24.750	20.500	21.125	823
1980				
JANUARY	22.250	20.000	20.375	1501
FEBRUARY	20.750	17.125	18.500	1070
MARCH	18.500	15.000	16.875	5204
APRIL	18.375	16.375	18.250	857

AHMANSON H F & CO

	HIGH ($)	LOW ($)	CLOSE ($)	VOLUME (100'S)
1980				
MAY	23.500	18.000	22.250	4007
JUNE	25.000	22.375	23.250	1796
JULY	23.750	19.625	20.250	1009
AUGUST	21.500	19.500	21.000	2322
SEPTEMBER	24.750	19.875	20.000	1729
OCTOBER	22.000	19.250	19.250	1354
NOVEMBER	21.250	18.250	19.125	3362
DECEMBER	20.000	18.250	19.500	3179
1981				
JANUARY	19.500	18.000	18.875	5846
FEBRUARY	19.000	18.375	18.500	2158
MARCH	21.000	18.375	19.500	4059
APRIL	19.875	16.625	17.750	3162
MAY	17.875	17.000	17.250	1460
JUNE	19.500	16.875	18.250	4357
JULY	18.250	15.875	16.500	10504
AUGUST	16.875	15.875	16.750	4421
SEPTEMBER	17.875	15.625	16.000	3709
OCTOBER	16.625	14.750	14.750	1561
NOVEMBER	16.750	14.500	16.000	4341
DECEMBER	16.375	14.125	15.125	4872
1982				
JANUARY	15.125	11.500	12.500	4756
FEBRUARY	12.250	9.625	11.750	1711
MARCH	11.625	10.250	10.750	3779

Senator PACKWOOD. Russell?

Senator LONG. No questions.

I am pleased that you did submit your statement, with the list of contributions that the foundation has made. I think it is rather impressive.

Mr. BELIN. Thank you.

Senator LONG. It shows all the things that the foundation has worked in. I see it has done a lot for the arts as well as for medical research and education. I think it has a good record of making worthwhile contributions to worthy colleges.

Mr. BELIN. We are very grateful to you for your comments.

Senator PACKWOOD. I hope that at last we will be able to help you out. We have come so close before and have not quite succeeded.

Mr. BELIN. Thank you, Mr. Chairman.

Senator PACKWOOD. Thank you very much.

Senator Hayakawa, do you have anything more?

Senator HAYAKAWA. No, Mr. Chairman.

Senator PACKWOOD. Gentlemen, thank you very much.

The hearing is adjourned.

[Whereupon, at 9:04 a.m., the hearing was concluded.]

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

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October 6, 1982

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

Re: S.2741
Hearings on September 23, 1982

Dear Senator Packwood:

This statement is submitted for the record of the Hearings held on September 23, 1982, pertaining to the above bill which provides relief in a particular situation with respect to the divestiture required under IRC § 4943 of "excess business holdings" of a private foundation.

S.2741 is an attempt to alleviate in the particular case one of the many problems existing under § 4943. The fact is that experience has demonstrated that § 4943 creates many difficulties not anticipated by the Congress in the enactment of the Tax Reform Act of 1969. Those difficulties necessitate a general re-examination of IRC § 4943.

In brief, the statute, when enacted, reflected a desire on the part of some to divorce the conduct of charitable foundations from business decisions involved in operating companies. Thus, § 4943 requires, in general, that a private foundation and its "disqualified persons" cannot have more than a 20% equity interest in a business corporation; but certain holdings on May 26, 1969 were permitted to be retained subject, however, to reduction over a period of time through transitional phases and the "downward ratchet rule."

Section 4943, however, in practice has created more burdens on business and created more involvement--rather than less--of businesses with foundations. All this is likely to be to the detriment of the businesses involved, the foundations and communities they serve. Moreover, the statute was and is misdirected for the reason that other provisions enacted in 1969 serve to curb the abuses or concerns regarding foundation conduct. In particular, IRC §§ 4941, 4942 and 4944 prevent self-dealing between the foundation and disqualified persons, require the foundation's assets to be invested so as to produce a return which is currently distributable to charity, and prevent the acquisition of "jeopardizing investments."

The need for a re-examination of and relief under § 4943 is clearly demonstrable. The following are illustrative of the problems requiring a new approach.

(1) The tax law makes "take-over targets" out of corporations with foundation stockholders. The statute requires foundations to sell stock to reduce their holdings in a business. This puts the corporation at the mercy of those who would like to buy into the corporation. The companies which have appealed to the Congress for relief are marked as take-over targets because they have foundations as stockholders.

(2) The required divestiture under § 4943 reflects a serious threat to locally controlled businesses. Many of the cases being presented to the Congress involve a business which is the heart of a community, either by providing substantial employment or by being important to the quality of life in the community.

(3) The statute promotes dissension among shareholders and creates the possibility of dissident family members using the tax laws to force a change in ownership of a business. Members of a family who are disqualified

persons and who may or may not have any involvement in a business can, by buying stock in a corporation, force a foundation to dispose of its stock. This puts a dissident family member in a position of either forcing a buyout of himself or a take-over by others.

(4) A corporation with a foundation stockholder faces a dilemma as to the extent to which it can expand or make acquisitions without forcing divestiture of stock by the foundation. The Treasury has not yet, after a dozen years. issued Regulations under § 4943 as to when and the extent to which a corporation with a foundation stockholder can expand or acquire a business. The uncertainty is not only unfair to businesses but puts a business in the middle between the interests of different stockholders.

(5) Many other problems of complexity exist under this section which either defy solution or play into the hands of those who would use it to create dissension in control of a business. The attribution rules may permit stockholder A to force a reduction of the interest of stockholder B's family by creating a charitable lead trust with stock to be held ultimately in trust for B's lineal descendants.

(6) The section creates an insoluable problem in many cases where stock is required to be sold but there is little or no market, or the market conditions are adverse, or there are legal restraints on sale or a fair realization, or there is an almost impossible valuation problem.

(7) Section 4943 has the effect of making foundations "second class citizens" with respect to maintaining their investments. What if a corporation makes a public offering of shares or if a corporation adopts a dividend reinvestment plan for shareholders? Can a foundation participate like other shareholders to avoid dilution? A decision should be made by foundation trustees based on prudent investment criteria rather than arbitrary tax rules.

(8) Section 4943 has the effect of interfering with sound business practices and depriving individuals of rights and benefits which otherwise would be available. If a corporation adopts a stock bonus plan or an incentive stock option plan (such as that encouraged by ERTA '81), it apparently cannot include among the employees to be provided such incentives any person with a family member serving on the board of the foundation or having an ancestor who was a contributor, unless it is prepared to force the foundation to sell stock.

(9) If stock is given or bequeathed to a foundation, the foundation is required to dispose of it (if it constitutes excess business holdings) within five years after receipt. This is frequently too short a time, considering the volatility of the market or lack of market for shares.

(10) It is unfair for those donors who made transfers of stock in good faith to foundations prior to May 26, 1969, before § 4943 was approved, to have the donee foundation required to dispose of shares or be limited by the artificial restraints described above. Pre-May 26, 1969 holdings are subject to various limitations, and while they may be retained in part, any required partial divestiture is likely to force a complete divestiture as a prudent method of disposition of holdings.

(11) Section 4943 is unfair to those foundations and communities which have benefited from maintenance of profitable holdings by forcing an arbitrary divestiture for reasons unrelated to the best interests of the community and charities.

Other examples can be given of arbitrary and unfair results and numerous problems stemming from the application of § 4943. In the final analysis, the question is whether, on one hand, the provisions of § 4943 really have any relevance to the accomplishment of charitable objectives or, on the other hand, constitute an unnecessary and dangerous interference with business and community life.

The Committee should re-examine all of the problems created by § 4943. As presently constituted, the section is a major deterrent to private initiatives in creating new foundations and a handicap in the preservation of the local control of community resources.

Very truly yours,

Norman A. Sugarman

Norman A. Sugarman

NAS/jp