

BENEFITS FOR TROOPS IN THE PERSIAN GULF

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

S. 82, S. 199, S. 246, S. 252, S. 254,
S. 342, S. 354, and S. 355

FEBRUARY 27, 1991



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1991

44-492 ss

S 361-43

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BENEFITS FOR TROOPS IN THE PERSIAN GULF

WEDNESDAY, FEBRUARY 27, 1991

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:14 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Baucus, Bradley, Daschle, Breaux, Packwood, Danforth, Chafee, Durenberger, Symms, and Grassley.

[The press release announcing the hearing follows:]

[Press Release No. H-4, Feb. 22, 1991]

FINANCE COMMITTEE TO CONSIDER BENEFITS FOR TROOPS; BENTSEN SAYS ADDITIONAL STEPS CAN AID SOLDIERS AND FAMILIES

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, announced Friday a hearing on proposed benefits for troops in the Middle East.

The hearing will be at 10 a.m. on Wednesday, February 27, 1991 in the Dirksen Senate Office Building, Room SD-215.

"Last month, Congress gave our Persian Gulf troops and their families some real peace of mind by passing a bill, which originated with the Finance Committee, to allow them more time to file their taxes. But there are other steps we can and should take," Bentsen said.

"The Persian Gulf Task Force, which Senator John Glenn has chaired and I'm a member of, is putting together a package of benefits for our military personnel and a number of these are under the jurisdiction of the Finance Committee. I want to take a close look at those and other measures to help our troops and military families," Bentsen said.

The proposals to be discussed include:

- Raising the \$500 per month exclusion for military pay to officers in a combat zone to \$2000 per month.
- Permitting Operation Desert Storm personnel to make penalty-free withdrawals from IRAs and employer-sponsored retirement plans.
- Permitting states to issue mortgage revenue bonds to finance home mortgage loans for veterans of Operation Desert Storm.
- Providing an exclusion from gross income for any compensation received from the armed services by Operation Desert Storm POWs and MIAs.
- Permitting an employer to include an employee's Desert Storm service in calculations for qualified pension plans.
- Allowing an above-the-line deduction for certain expenses incurred by reservists and National Guardsmen.
- Permitting military personnel stationed abroad to qualify for the earned income tax credit.
- Removing certain restrictions on unemployment benefits for ex-servicemen.

"Our troops in the Persian Gulf are under tremendous pressure and they're doing a fine job. They are far from their families, who are undergoing hardships of their own," Bentsen said.

"We ought to give these and other measures close consideration as we explore what more we can do to benefit our armed forces and their families," Bentsen said.

**OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR
FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE**

The CHAIRMAN. This hearing will come to order. I want to apologize to those in attendance. We have just had a private briefing concerning the Uruguay Round and free trade agreements, and we had quite an extended discussion, as you can imagine.

Last month Congress took the first step in addressing some of the concerns of the troops in Operation Desert Storm. One of the things we did was to extend the time for filing returns and paying income taxes. There were many other things that we also felt had to be done, including the Chairman of this committee, and other Members of the Congress, but we deferred action on those in order to expedite passage.

We assured our colleagues at the time that we would give other issues full consideration; and that is what we are doing today. So I am looking forward to hearing what my distinguished colleagues have to say in their testimony this morning.

We have an excellent panel of experts. We will hear from two servicemen's wives, who truly understand some of the sacrifices that are being made.

The Persian Gulf Task Force under the able chairmanship of my friend, Senator Glenn, has been considering additional measures, and some of those come under the jurisdiction of this committee.

Under current law the entire pay of enlisted personnel is excluded from taxes. But officers may only exclude \$500 a month. That level was set about 25 years ago and there has been no change to take account of inflation since that time. Adjusting that exclusion for inflation would make it approximately \$2,000 today. We ought to consider increasing that exclusion.

During the Vietnam War prisoners of war and soldiers missing in action received a total exclusion on income that they earned while captured or missing. I think we need to extend that rule to our soldiers who have fallen into enemy hands in this war. I believe that is the least we can do to ease the burden for their families.

We should also consider waiving the 10-percent penalty when Desert Storm troops withdraw funds from their IRA's. Many of these families are facing very serious financial difficulties, and their IRA may be the only savings that they have available.

Under current law, they would have to pay income taxes and a 10-percent penalty on the withdrawal. We surely do not want to penalize taxpayers under these conditions.

We also want to look into the rules for unemployment benefits for ex-servicemen. In the early 1980's this program was changed to require a month's waiting period and to limit the duration of benefits to a maximum of 13 weeks, making that program less generous for former servicemen than for other unemployed persons.

Perhaps those rules made sense during a peacetime expansion of the armed services. But I have real questions whether they are appropriate today.

Of course, we hope those returning after the Gulf conflict are going to find their jobs waiting for them. But some will not, and they should have fair access to unemployment benefits.

With our troops in the Persian Gulf facing substantial hardships and danger, the least the Congress can do is to recognize their extraordinary efforts and do its part to ease the disruptions and the hardships they are facing.

I would like to turn to the Ranking Member, Senator Packwood, for any comment he might make.

[The prepared statement of Senator Bentsen appears in the appendix.]

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Mr. Chairman, only one. Your State and mine, and three others, are the only ones that have Veterans Home Loan Programs. And at the moment the veterans of the Desert Storm/Desert Shield operation would not be eligible to participate in that program. I would hope at a minimum, as we are considering these proposals, that we would extend the eligibility so that the veterans of this effort will not be discriminated against.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Baucus, do you have any comments?

Senator BAUCUS. I have no statement, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator SYMMS. Mr. Chairman, I would like to ask unanimous consent to insert my remarks in the record at this point.

Thank you.

The CHAIRMAN. Yes, of course.

Senator BREAUX. Mr. Chairman, I have the same request.

[The prepared statements of Senators Symms and Breaux appear in the appendix.]

The CHAIRMAN. We have a number of our colleagues here this morning. We are very pleased to have them.

I would call on Senator Glenn, who is chairing that.

Senator GLENN. Mr. Chairman, I believe Senator Ford has a few minutes here and he has to go to a funeral. I would be glad to let him go first.

Senator FORD. I have discussed this with my colleagues and they have graciously agreed, since the funeral of former Senator John Sherman Cooper will be this morning.

The CHAIRMAN. We are very pleased to have you. Senator Ford, if you would proceed.

STATEMENT OF HON. WENDELL H. FORD, A U.S. SENATOR FROM KENTUCKY

Senator FORD. I thank you very much and I appreciate the opportunity to testify today in favor of extending the tax benefits enacted last month in H.R. 4 to our military personnel, particularly reservists and National Guard supporting Operation Desert Shield and now Desert Storm in locations outside the combat zone.

I commend the Chairman for holding these hearings. He understands the needs and is attempting to do what he feels is right and in the best interests of our military personnel. No matter what our individual positions were at the onset of the conflict, we have now

come together in a united voice, supporting our troops and their families.

These hearings today reinforce that message as we consider their special needs both during and after the conflict. As the Chairman knows, I first raised the issue of expanding tax benefits to our troops serving outside the combat zone during the debate on H.R. 4.

As a co-sponsor of S. 8, I supported that legislation and congratulate this committee on the expeditious and bipartisan handling of it. But as I stated then that legislation in my opinion simply did not go far enough to recognize the hardships being faced by our military personnel and especially their families, particularly reservists and National Guard serving outside the Persian Gulf.

Mr. Chairman, as you know, of the over 160,000 National Guard and Reserve personnel activated today, only about 60,000 are serving in the Persian Gulf region and stand to be assisted by the legislature we adopted last month.

However, the remaining 100,000-plus reservists and National Guardsmen are watching an April 15 tax filing date, quickly approach without the ability or resources to go home every night to work on tax forms, or to collect receipts and files.

These personnel, and those in the regular military forces, serving outside the Gulf Region in support of Desert Storm are no less deserving of our understanding and our assistance during this conflict. Many of our reservists were activated on very short notice, initially called up last August for only 90 days. That deployment was then extended to 180 days, and now has been potentially extended for up to 2 years.

These dedicated personnel responded willingly to the call, but obviously had no way of knowing that their deployment would extend beyond our April 15 filing deadline. Although current law allows these personnel to receive an extension of filing time, tax dates remain due on April 15; and penalties and interest continue to accrue.

For those who have faced business losses or downturns due to their employment an extension of filing time alone is very little or no help at all. For Federal income tax filing purposes geographic location does not determine hardship. For many of our reservists any deployment creates a tremendous hardship. This is particularly true for those small businessmen, sole proprietors or health care professionals serving in rural areas.

The fact that these dedicated men and women are away from their homes and offices, and so may not have ready access to needed tax files, creates a tremendous hardship. That is true whether they are deployed 40 miles, 400 miles or 4,000 miles from home.

So, Mr. Chairman, I encourage the Committee to extend the tax benefits we provided in H.R. 4 for our military personnel stationed in the Persian Gulf to all personnel activated in support of Desert Shield and now Desert Storm.

I commend the Chairman and the committee for their action on these matters and I look forward to working with them.

In closing, Mr. Chairman, I ask that letters from the Reserve Officer's Association and the National Guard Association in support of this position be included in the hearing record.

The CHAIRMAN. Without objection that will be done.

Senator FORD. I also ask that a letter from Senator Sam Nunn, Chairman of the Armed Services Committee to you, Mr. Chairman, dated February 8, 1991, in support of extending these benefits to reservists serving away from home be included in the hearing record also.

The CHAIRMAN. That will be done, Senator Ford.

[The letters, mentioned above, appear in the appendix.]

Senator FORD. Mr. Chairman, I thank you for the time. I will be more than pleased to answer any questions.

The CHAIRMAN. Well, we will not hold you, Senator Ford. We understand your obligations.

Senator FORD. You are might nice, Mr. Chairman.

I do thank my colleagues for giving me the benefit of a time crunch.

The CHAIRMAN. Thank you.

[The prepared statement of Senator Ford appears in the appendix.]

The CHAIRMAN. Senator Glenn is the Chairman of the Task Force on the Persian Gulf War Benefits. We are very pleased to have him here. He has made quite a study of this issue. Thank you very much, Senator.

STATEMENT OF HON. JOHN GLENN, A U.S. SENATOR FROM OHIO

Senator GLENN. Thank you very much, Mr. Chairman. I do appreciate the opportunity to appear and want to compliment you on moving as expeditious as you and the other committee members have to address this, both with legislation already passed and with what you are doing here today.

The first bill that I will address, one that has been referred to this committee as S. 199, is a bill that would amend the Internal Revenue Code of 1986 to exclude from income the pay received for active service by a member of the Armed Forces of the United States in a dangerous foreign area. The bill would increase from \$500 to \$2,000 the monthly military income that could be excluded by officers.

Mr. Chairman, the reason I introduced S. 199 was because I felt that even before combat started in the Persian Gulf that the conditions there were just as arduous and practically as dangerous then as they are now. The bullets were not flying then but our forces were thin, and the likelihood of sustaining losses had Saddam Hussein decided to attack was almost certain.

Right after hostilities began in the Gulf, the President on January 21 signed an Executive order designating the Arabian Peninsula area, air space, and adjacent waters as a combat zone. This designation meant that for Federal income tax purposes military pay received by enlisted personnel while serving in the combat zone would be exempt in its entirety from Federal income tax.

For officers in the combat zone, existing law limits the exemption to \$500 per month. The combat zone designation also triggers

a provision in existing law that provides that members in the Armed Forces in the combat zone will not have to file their income tax returns until at least 180 days after they depart the Persian Gulf, without penalty.

As you know, Mr. Chairman, the Finance Committee took the lead earlier this year to provide this latter benefit before the onset of hostilities, and also to provide that refunds received as a result of delayed filing also would accrue interest. I want to applaud the committee's prompt action to come to the aid of our military personnel placed in harm's way, and their families.

Obviously, since the Persian Gulf area has been declared a combat zone the portion of my bill S. 199 which would provide for income tax exclusion for members of the Armed Forces in dangerous foreign areas—which I must say was targeted to military personnel deployed to the Gulf—is moot.

However, the portion of S. 199 that would raise the monthly exemption limit for officers is not moot. The current monthly limit of \$500 per month for officers was set in 1965. And just simply adjusting for pay raises and adjusting for inflation since then would raise the limit to \$2,000 per month by keeping the same basic relationship between the exemption and monthly pay that existed then. So I urge the committee to act favorably on this portion of S. 199.

The other bill I introduced that is under the jurisdiction of this committee, Mr. Chairman, is S. 205, a bill that would equalize unemployment compensation for separating military personnel to the same standard for civilian personnel. Right now unemployed civilian personnel are entitled up to 26 weeks of unemployment compensation, starting 1 week after they are separated from employment.

On the other hand, separating military personnel are entitled to only 13 weeks of unemployment compensation, and then only after they are separated from military service for 4 weeks.

Last year the Armed Services Committee included a provision in the fiscal year 1991 Defense Authorization bill that passed the Senate that is identical to S. 205. We had worked in that on a Manpower Subcommittee on Armed Services that I chair. The reason the Armed Services Committee included that provision was to provide a safety net for military personnel equal to their civilian counterparts.

This inequity first came to our attention when we were considering the long-term force reductions that were being planned for our Armed Forces last year in the wake of the developments in Eastern Europe and the Soviet Union.

We planned a 25-percent reduction in military manpower over the next 5 years. The budget just submitted by the President maintains this same direction of reduction, notwithstanding the Persian Gulf conflict. Military personnel will have to be separated from the military services, either voluntarily under early out programs or perhaps even forced to separate.

In looking at how we should take care of these separating personnel we discovered the disparity in the unemployment benefits between military and civilian personnel, and we moved to correct it.

Because of a jurisdictional question raised by the House in the Conference on the fiscal year 1991 Defense Authorization Act, and at the request of the Chairman of the Senate Finance Committee, we agreed to recede on the provision with the understanding it would be addressed this year.

Mr. Chairman, I know that some would question why we need to move out smartly on enacting S. 205 since we are not reducing our forces at this time. It is a good question, but I believe there also is a good answer: The answer is that the plan that manpower reductions, releasing 100,000 people this year, and releasing 100,000 people next year, and so on until we have reduced by half a million people over a 5-year period has been put on hold only temporarily.

As soon as the Persian Gulf conflict is terminated, and we all hope it will be soon, the military services all plan to get right back on that path of reductions in cutting back.

For example, in order to stabilize manpower levels the military services have put a hold on separations. Several thousand military personnel who had dates of separation late last year and early this year have been involuntarily extended in the military indefinitely.

This "stop loss" policy, as it is called, is still in effect. When the reduction is effected, I expect there will be a rush of those people to get out and get on with their lives as they expected. Many will have had their employment plans or their education plans disrupted. They will face a future that is more uncertain than they faced before their plans were disrupted.

I think we owe it to these people and their families to at least have a safety net equal to the safety net we provide civilian personnel where they run into problems securing employment.

We are not talking about a huge problem here because we put in a pretty good transition program last year that includes job assistance. This unemployment compensation safety net needs to be there for those who may fall through the cracks.

Mr. Chairman, I want to thank the committee for holding this hearing. We want to make sure that we do take care of our military personnel and their families as they serve in these difficult times, and certainly to not forget them when they return.

I believe bills S. 199 and S. 205 do a small part to keep this faith with our military personnel, and hope the committee will act favorably on them.

We have CBO cost estimates on these bills if you wish to get into that. I would be glad to answer any questions, Mr. Chairman.

[The prepared statement of Senator Glenn appears in the appendix.]

The CHAIRMAN. Senator Glenn, we will have to consider the costs, of course. I understand S. 205 is estimated to cost \$61 million in 1991 and \$656 million over 5 years.

The other bill is S. 199. It would replace the requirement that an area be designated a combat zone with a requirement that an area be designated a dangerous foreign area.

I understand from the staff that we could save \$108 million if we moved the effective date of S. 199 up to January 1, 1991 and retained the requirement that the area be designated a combat zone, if revenue considerations forced us in that direction. I would like to have your opinion.

Again, if we have to face difficult choices because of revenue considerations, how would you balance the proposals? Which is more urgent?

Senator GLENN. Well, I had not really thought about it in prioritizing one to the other, Mr. Chairman. I guess I would probably come down on the side of saying that combat service would take precedence in that case.

Now the unemployment part in S. 205 is going to cover a greater number of people, but we do not know yet the exact number of people that will be getting out at a particular time.

The cost estimates that you have on S. 205 are the same that I have also. The CBO cost estimate on S. 199 is \$34 million.

The unemployment figures for S. 205, however, are a bit more soft, I believe. The \$61 million cost for fiscal year 1991 is an estimate since we do not know how many people will have difficulty adjusting and how their unemployment benefits would go. So that one is a little less certain.

The CHAIRMAN. I must say, Senator, you have devoted a great deal of effort to this task and we are most appreciative of your contribution.

Senator GLENN. Thank you, Mr. Chairman.

We appreciate your efforts also. You are a member of the Task Force and we appreciate the work that you are doing on this also. We are going to get our package out just as fast as we can.

The CHAIRMAN. Good. Good.

Are there other comments for Senator Glenn before we move on?

[No response.]

The CHAIRMAN. All right.

We will take you gentlemen in the order of seniority here. Senator Kasten?

STATEMENT OF HON. BOB KASTEN, A U.S. SENATOR FROM WISCONSIN

Senator KASTEN. Mr. Chairman, thank you; and thank you for the opportunity to testify before this subcommittee. I want to say at the outset that I support the legislation that Senator Ford was speaking about also.

My legislation refers to the point that the Senator from Oregon, Mr. Packwood, brought up in his opening comments. On February 5, 1991, I introduced the Veterans of Operation Desert Storm Home Ownership Act of 1991. This legislation is very simple. It would make sure that the brave men and women called to duty in the Persian Gulf receive the same housing benefits that their predecessors from World War I, the Korean War, and the Vietnam War enjoyed.

Let me just give you a brief background on the Mortgage Revenue Bond Program.

The CHAIRMAN. I must say, Senator Kasten, I promised you I would have early hearings on this and we would move; and we are doing that.

Senator KASTEN. I appreciate your help.

Current law does not permit certain States to issue bonds to make home loans to veterans discharged after January 1, 1977 fol-

lowing the Vietnam era. This limitation on Veterans Mortgage Bonds was enacted in the Deficit Reduction Act of 1984. The issuance of these bonds was cut back to amounts based upon previous volume levels and limited to only those veterans who had served on active duty prior to January 1, 1977.

The 1984 Act also limited the issuing of these bonds to the five States that were currently participating in this tax exempt program—Wisconsin, California, your State of Texas, Mr. Chairman, Alaska and the State of Oregon.

This legislation creates a sense of equity, which defines as qualified veterans all American service men and women serving in the theater of hostilities as determined by the President since August 2, 1990.

We have two versions of this legislation. The first is S. 354 and the second is S. 355. One version, S. 354, would amend the Tax Code to permit tax exempt State bonding for mortgage loans to Operation Desert Storm veterans living in one of the five States that I just mentioned. These States were the only States, as Senator Packwood pointed out, participating in the program prior to June 22, 1984.

Now even though not all 50 States participated in the tax exempt bonding programs prior to 1984, I believe that some of my colleagues may wish to extend this measure to veterans of their home State. Therefore, S. 355 would allow every State to do what the five States had been doing. But I separated out the two, Mr. Chairman, because I simply want to reestablish what was in place before we change the law, particularly so that the State of Wisconsin can issue these bonds.

To clarify very briefly the difference between Veterans Mortgage Bonds and Qualified Mortgage Bonds, I am going to submit a side-by-side comparison which defines the differences. For example, Veterans Bonds have no income limit, no purchase price limit or first-time residence limit; and there were other changes that were enacted.

I do not think, Mr. Chairman, that any of us would want to turn our backs on the troops in Desert Storm. These brave young men and women of the Armed Services have taken up the challenge of defending Americans' ideals. To those who have heeded this call, we as a nation owe the same respect as was shown to the veterans of past conflicts. My home ownership bill is an important step in this direction.

I would ask unanimous consent, Mr. Chairman, that my entire statement appear in the record, along with a memo by the Congressional Research Service which provides background and an analysis of this program, and also the side-by-side comparison which I referred to and took my testimony.

The CHAIRMAN. That will be done. Thank you, Senator.

[The prepared statement of Senator Kasten, along with the additional material mentioned above, appear in the appendix.]

The CHAIRMAN. Senator Shelby.

STATEMENT OF HON. RICHARD C. SHELBY, A U.S. SENATOR
FROM ALABAMA

Senator SHELBY. Thank you, Mr. Chairman. Mr. Chairman, I ask unanimous consent that my entire statement be made a part of the record.

The CHAIRMAN. It will be done.

Senator SHELBY. Mr. Chairman and members of the Finance Committee, I will try to be brief. I introduced Senate Bill 82, which is legislation that would permit penalty-free withdrawals from retirement plans for individuals called to active duty.

Who does this affect? It affects these citizens in our country who have been summoned from their regular jobs, forced to disrupt their lives and put families and careers on hold as they answer the call of duty of their country. For many of these Americans, active duty imposes an economic hardship. For those with employers unwilling or unable to make the difference in compensation, call up notices represent a dramatic loss of income, as everyone here knows.

Families in which the only working parent has been called for active service may face a devastating economic crunch, exacerbated by the shortage of jobs available for the remaining parent during this time of recession.

Mr. Chairman, for this reason, I introduced this legislation to lighten the load of some of those summoned to active service. Senate Bill 82 would permit members of the Armed Services Reserve and the National Guard to receive distributions from their qualified retirement plans, such as Individual Retirement Accounts, without penalty.

Specifically, Mr. Chairman, this legislation would exempt individuals ordered to active duty after August 1, 1990 in connection with Operation Desert Storm from the usual 10 percent penalty for early use of funds from a qualified retirement plan.

The spouses of individuals summoned to active duty may also receive penalty-free distributions from their qualified retirement plans under this legislation. This exemption is only, Mr. Chairman, for those summoned to active duty in connection with this crisis. Those who were serving on active duty before this crisis have not suffered the sudden change in income that reservists and Guard members have, and therefore do not have the same need for this exemption.

Mr. Chairman, I believe that this is a necessary step for those that it will assist—the 206,000 brave and patriotic Americans who have answered the country's call.

I believe that it is good legislation. It is my understanding that the Joint Committee on Taxation has advised that the cost of this legislation is negligible.

Now what does that mean? I am not sure, Mr. Chairman. I understand that it means it is hard to quantify but it is likely to be very low. Again, is this legislation represents a small effort to help some of our men and women in the Gulf. I hope this committee will consider it favorably and conduct a mark-up soon.

The CHAIRMAN. Thank you, Senator.

[The prepared statement of Senator Shelby appears in the appendix.]

The CHAIRMAN. Are there questions of Senator Shelby?

[No response.]

The CHAIRMAN. If not, Senator, I know of the other demands on you. We are pleased to have you.

Senator SHELBY. Thank you.

The CHAIRMAN. Senator Craig, we are pleased to have you.

STATEMENT OF HON. LARRY CRAIG, A U.S. SENATOR FROM IDAHO

Senator CRAIG. Chairman Bentsen, and members of the committee, thank you very much.

Let me say at the outset that the legislation now in the form of an amendment before your committee, S. 342, that I introduced earlier this month, was mentioned by you this morning when you spoke of the 10 percent penalty factor. It is very similar to Senator Shelby's approach, although mine is broadened a little bit to include largely all annuities or any of those kinds of programs that fit under Section 7702(A) modified contracts and endowments, to recognize that there should not be a penalty for those who are serving in both Desert Storm/Desert Shield, and to provide as much benefit as possible in these unique circumstances when certain troops are called up that might have these types of retirement and/or savings type programs. That is exactly what my proposed amendment or legislation does, Mr. Chairman.

As it relates to the consequences of revenue, to the Treasury—and I know that we have to be concerned about that and we should be concerned about it—I am not talking about a loss of tax revenue. Frankly, I am talking about not collecting penalties; and therein, I think, lies a fundamental difference that we should all be very concerned about.

There is no impact, at least there is estimated to be no impact, on the revenues of government projected to be collected for the very simple reason that I just expressed: because we are dealing with a penalty and not, in fact, a reduction in tax.

So this legislation would go slightly further than that of my colleague Mr. Shelby in the sense that it would broaden to all annuities that fall under that status of the IRS Code.

I think it proper and fitting that we recognize the difficulties—as we are attempting to do through your actions in this committee—of those who are serving in our stead and this nation's stead in the Persian Gulf theater; and at the same time recognize that they should not, under these extraordinary circumstances, be penalized for any action they might have to take in the preservation of their families and their households.

The CHAIRMAN. Thank you very much.

[The prepared statement of Senator Craig appears in the appendix.]

The CHAIRMAN. Are there questions of Senator Craig?

Senator SYMMS. Mr. Chairman, I have no questions. But I would just like to take this opportunity to welcome my new colleague for his first appearance before this committee, which I am sure there

will be many others. But I thank you very much for your interest and your input on this important subject.

Senator CRAIG. Thank you.

The CHAIRMAN. Thank you very much, Senator. We are pleased to have you.

Our next witness, Mr. Michael Graetz, is the Deputy Assistant Secretary of the U.S. Department of the Treasury. Mr. Graetz, if you would come forward.

Mr. Graetz, I want to apologize to you and the other witnesses, but I have a meeting with the President of Columbia that I agreed to make and I will have to do that. Senator Baucus will be chairing the hearing.

STATEMENT OF MICHAEL J. GRAETZ, ESQ., DEPUTY ASSISTANT SECRETARY (TAX POLICY), U.S. DEPARTMENT OF THE TREASURY

Mr. GRAETZ. Thank you, Mr. Chairman. I would request that my full statement be inserted in the record and I will abbreviate my remarks to the committee.

I am pleased to be here to present the views of the administration on a number of proposals to provide tax relief to members of the Armed Services. Most of the proposals listed in the committee's hearing announcement are specifically designed to benefit military personnel participating in Operation Desert Storm, although some of the proposals would grant tax relief to all reservists or other military personnel.

Before discussing these proposals in detail, I would like to make a few general observations. In the current crisis in the Persian Gulf area, the President and the Congress have acted quickly to ensure that tax relief afforded by the Internal Revenue Code is available to the military men and women serving in that area and to expand in some respects the scope of that relief.

On January 21, 1991 shortly after the commencement of hostilities, the President signed an Executive order designating the Persian Gulf area as a combat zone which triggered certain tax relief provisions.

Within a few days thereafter Congress passed, and on January 30, 1991, the President signed into law legislation that extended and liberalized Section 7508 which generally extends the time for taking actions required under the tax laws.

On February 14 the President signed an Executive order designating the Persian Gulf Desert Shield area.

Over the course of time Congress has enacted a number of laws to provide tax relief to members of the Armed Forces in times of war. The oldest of these dates before World War I—and most were in place long before the Vietnam War began.

Today as we turn to address additional proposals for tax relief for military personnel, the ground war continues in Iraq and Kuwait. Our thoughts are with the brave men and women serving in the Gulf region.

Evenhandedness to our military personnel is generally best served by relying on direct appropriations rather than tax benefits to compensate our troops for their sacrifices. Tax relief may be discriminatory, with income tax relief generally benefiting most those

with higher income, and special tax provisions serving those whose particular circumstances enable them to take advantage of targeted relief.

In addition to this cautionary note, our testimony today has been guided by a number of general principles. First, we believe that relief provisions that materially complicate the ability of a tax-paying public to comply with the tax laws should be avoided.

Second, we should try to avoid placing high compliance burdens on the private sector. We also believe that relief provisions for military personnel should not produce unfair tax advantages relevant to similarly situated taxpayers who do not qualify for such tax relief.

Today's gesture of goodwill should not become a permanent source of tax inequities. Historically, military personnel actually serving in a combat zone have received the greatest relief. Proposals that offer to extend tax relief to military and other personnel in more usual circumstances deserve close scrutiny. Likewise, we should endeavor to ensure tax fairness between reservists and other military personnel.

Even within the combat zone proposals whose benefits inure mainly to a few individuals will be less attractive than those with a wider scope.

Finally, review and modification of benefits available to military personnel serving in the Persian Gulf conflict should be done in a coordinated way and not on a piecemeal basis. In addition, modifications which result in increased costs must fit within the parameters of the 1990 Budget Act.

In the remainder of my statement I will address the specific items listed in the committee's announcement. The first proposal would increase the exclusion amount for commissioned officers to \$2,000 a month. Although consideration ought to be given to a direct adjustment to combat pay for officers in lieu of an expanded income tax exclusion, the administration supports this proposal so long as appropriate offsets are provided.

The exclusion amount for commissioned officers was last increased to \$500 in 1966 and the rise in military wages and price levels justifies an increase in that exclusion amount to \$2,000 today.

The next proposal would permit Operation Desert Storm personnel to make penalty-free withdrawals from IRA's and employer-sponsored qualified plans. There are currently before the Congress a wide variety of proposals to permit penalty-free withdrawals from IRA's and a variety of circumstances. Those include unemployment, illness, disability, and for such worthwhile expenditures as children's education.

The administration has opposed each of these provisions. In general, the special tax benefits accorded individual retirement accounts and employer-sponsored qualified plans are incentives directed toward retirement savings. Therefore, the administration does not support any withdrawals from IRA's or qualified plans which would result in premature consumption of retirement savings.

Another proposal would permit States to issue qualified Veterans Mortgage Bonds to veterans of Operation Desert Storm. The ad-

ministration opposes this proposal. When Congress phased out the issuance of Veterans Mortgage Bonds in 1984, its reason for doing so was concern about the increasing volume of these bonds and the potential for their expansion. The administration believes these concerns are as valid today as in 1984 when the restrictions were first imposed.

The next proposal would extend the income exclusion for POW's and MIA's to commissioned officers and civilian employers of the Federal Government who are in missing status and Operation Desert Storm. The administration supports this proposal.

Another proposal would permit an employer to take into account, under qualified pension plans, periods of absence due to military service. The administration supports permitting employers to take periods of absence due to military service into account under an employers' qualified pension plan; and otherwise to facilitate continuing participation in qualified plans during such periods.

The administration opposes the provision to allow an above-the-line deduction to all military reservists for expenses, such as the cost of uniforms and travel and meals while away from home in connection with their Reservist duties. We believe that this proposal primarily would benefit reservists in the United States in peacetime, as well as in the current conflict, rather than reservists now serving in the Persian Gulf.

Moreover, it would complicate the administration of the tax laws and taxpayers' attempts to comply by adding an additional line to Form 1040, the individual income tax form, and additional material to the instructions.

The administration supports the proposal to extend eligibility for the earned income tax credit to military personnel stationed overseas, subject to offsetting the revenue loss involved. In this connection the Defense Department and the Treasury Department have identified certain potential improvements in the reporting of relevant information to military personnel.

The administration also supports the proposal to equalize military unemployment and civilian unemployment. Our support, however, is conditioned on appropriate offsets and on the proposal being limited to three categories of separated service members—activated reservists; involuntary separated personnel; and personnel extended beyond their regular release date.

The final proposal—S. 252—would exclude military separation pay from current income tax to the extent that the pay is rolled over into a tax-deferred retirement program. The administration does not support this proposal. As we understand it, military severance pay is awarded to those who have been involuntarily denied a military career in recognition of the Federal Government's responsibility to help military men and women ease their transition into civilian life.

To permit deferral of current income tax on this pay would benefit those individuals who could otherwise afford to satisfy their transition expenses with other funds.

In conclusion, Mr. Chairman, I would like to mention certain efforts by the Internal Revenue Service to respond to tax questions raised by Operation Desert Storm. Since August 1990 the Internal

Revenue Service has endeavored to provide procedures and guidance to ease the tax burdens of our troops in the Persian Gulf area and of their families as well as others affected by the crisis.

To date, this has resulted in the completion of several important projects, including the issuance of guidance in the form of answers to frequently asked questions arising from the crisis, guidance to enable military personnel and others serving in Operation Desert Storm to file early for tax refunds, and the announcement of a special procedure that will ensure that applications for Federal tax exemption of organizations set up to help participants in Operation Desert Storm can be processed expeditiously and quickly.

The Service has also made available free electronic filing to families of individuals serving in Operation Desert Storm. In addition, the Service is nearing completion of several other important projects relating to the operation. The Internal Revenue Service is committed to continuing its policy of addressing tax matters affecting Armed Services personnel in the Persian Gulf fairly and expeditiously.

This concludes my prepared remarks, Mr. Chairman. I would be pleased to answer any questions the committee might have.

Senator BAUCUS. Thank you, Mr. Graetz.

[The prepared statement of Mr. Graetz appears in the appendix.]

Senator BAUCUS. With respect to the penalty-free withdrawals, I am just wondering whether the administration would still oppose them if there were some caps, say as to amount or limitations on time during which withdrawals can be made.

Mr. GRAETZ. Well, Mr. Chairman, our concern with penalty-free withdrawals from IRA's is that once the depletion of retirement savings from these accounts becomes permissible, there will be any number of deserving cases that this permission will be extended to.

We are very reluctant to change those rules. We all perceive—I think members of this committee, as well as the administration—the need for broader tax incentives for encouragement of savings more generally. But we are not inclined to move in this direction.

Senator BAUCUS. With respect to the provisions increasing officers exclusion up from \$500, I guess, to \$2,000 you said the administration supports that change so long as there are appropriate offsets. What do you mean by that? Are you recommending areas where revenues should be increased—that is, that we should increase revenues somewhere to offset the cost?

Mr. GRAETZ. Under the 1990 Budget Act the Congress and the administration will have to offset revenue losses from this kind of proposal. We estimate the revenue loss from this increase at about \$12 million a month. So it is not a huge amount of revenue, and there are any number of proposals that have been around that might offset that.

There are a number of proposals in the budget on the expenditure side, as well as some revenue proposals. The reporting requirements for the earned income tax credit is another possibility that I mentioned in my testimony.

Senator BAUCUS. Have you given any thought to grossing up officer pay to achieve the same result?

Mr. GRAETZ. We have given some thought to that. And we think that is an approach that ought to be taken quite seriously. It has a

number of advantages in terms of the potential of obtaining some contributions, perhaps, from some of our foreign partners in the conflict as well as other potential advantages. We would urge the committee to consider that as an alternative.

Senator BAUCUS. But which do you prefer between the two?

Mr. GRAETZ. I think that we have a slight preference for doing it directly as opposed to doing it through the Tax Code, Senator.

Senator BAUCUS. Thank you. I have no further questions.

Senator Packwood?

Senator PACKWOOD. Mr. Secretary, in the Oregon Veterans Bond Program average income of the borrower is about \$30,000 to \$40,000; the average size of the loan is about \$60,000 to \$65,000. In this case the average income is very close to the median. We do not have many people making \$10,000 to \$20,000 that borrow, even with the program.

Why your fear that this is somehow going to be an extraordinary benefit to upper income people?

Mr. GRAETZ. In the historic use of tax exempt bonds for these kinds of purposes the Treasury over the years has discovered that much of the revenue that is involved in providing the tax exemption goes not to the recipients of the loans, necessarily, but to financial intermediaries and others who are engaged in putting together these tax-free bonds.

It has always been the case that there have been inequities in providing this kind of benefit this way. We know that the Veterans Administration has a direct loan program. We would urge the committee to take a look at that program and see if it might not better serve these purposes than expanding the use of tax-free bonds which we regard as historically an inefficient way to provide this kind of benefit.

Senator PACKWOOD. Well, you may think it is inefficient. Oregon has done over 300,000 of these. We have about 98,000 loans outstanding now. It has been a very popular, and successful, program in the State.

Let me ask you a second question then. If we expanded to the current Desert Storm Veterans, all we are doing is increasing eligibility, but we are still subject to the bonding limits, the volume limits; why does it in your judgment increase the cost of the program?

Mr. GRAETZ. There are a number of proposals, Senator, and we have not estimated all of them. We did look at the broadest proposal, which is one that was suggested here earlier. As we understand it, it would not apply any of the caps that currently apply to qualified bonds and would extend the program to all 50 States rather than a handful of States that currently enjoy the program.

Our estimate is that that kind of proposal might result in the loss of as much as \$700 million of revenue over the budget period.

Senator PACKWOOD. But it would be limited to the States that currently have the program and if they were within the volume cap, there is no additional cost.

Mr. GRAETZ. Frankly, we have not looked at that specific proposal. But I would be glad to confirm that with you once we make sure that that is the case, that there is no additional revenue cost. But I think that there are revenue costs, because of the phase-out of vet-

erans who are eligible under the 1984 Act for these kinds of loans. I would think that an increase in the people who are eligible would, in fact, increase the number of these bonds that would be issued and probably would involve some revenue loss.

But as I say, Senator, we just do not have that number. We have not estimated that particular proposal, but we would be glad to do that.

Senator PACKWOOD. I would appreciate it.

Thank you, Mr. Chairman.

[The information requested follows:]

DEPARTMENT OF THE TREASURY,
Washington, DC, March 18, 1991.

Hon. BOB PACKWOOD, *Ranking Republican,*
Committee on Finance,
U.S. Senate,
Washington, DC.

Dear Senator Packwood: During my recent testimony before the Senate Finance Committee, you requested a revenue estimate for a proposal to provide mortgage financing for veterans of Operation Desert Storm using the proceeds of tax-exempt veterans mortgage bonds. Specifically, you requested an estimate of a proposal that (1) limited such financing to the five states currently authorized to issue these bonds and (2) subjected new issues for Desert Storm veterans to current volume caps.

The Treasury Department has found that only one (California) of the five states participating in the veterans mortgage bond program is currently at its volume cap. The other four have substantial room under their volume caps to allow for increased issuances, if their programs were expanded to include veterans of Operation Desert Storm.

The table below presents the revenue estimates you requested, prepared by the Office of Tax Analysis.

REVENUE ESTIMATE—VETERANS MORTGAGE BOND PROPOSAL

(In millions of dollars)

	Fiscal Years						
	1991	1992	1993	1994	1995	1996	1991-1996
Revenue Effects	—*	--2	--8	-15	-21	-27	-73

--* = Revenue loss of less than \$500 thousand

Please let me know if you have any further questions or require additional information.

Sincerely,

MICHAEL J. GRAETZ, *Deputy Assistant*
Secretary, Tax Policy.

Senator BAUCUS. Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman.

I do not think that you spoke to this point, and even if you did, I want to ask again. This is in regard to the fact that we have made accommodations for the late filing of income tax without penalty for people who are in the combat zone. But the suggestion has been raised to me, and I think I am in agreement with it, that routines are upset for families who are called up from the Guard and Reserve whether they are actually in combat, defined combat area or not.

So my question to you is: administration's view or opinion, on if we would allow that same extension to people who were called up, but not necessarily in the combat zone.

Mr. GRAETZ. Senator Grassley, we would not support a blanket extension of the waivers that now apply under Section 7508 to people in the combat zone to military personnel serving in the United States generally or to reservists serving in the United States generally.

Let me just say that under present procedures there is available to taxpayers an automatic extension of filing returns until August 15. There is also a liberal extension of filing to October 15. Under current law, the Commission, I think, has the authority to apply that quite broadly to these reservists and enable them to delay the filing of those returns.

There is also authority to waive penalties which I am sure we would be prepared to do in the circumstances that you are concerned about in these areas.

The only real difference here is the running of interest on underpayments. There is considerable reluctance to encourage people to delay their prompt compliance with the tax laws by waiving interest that would otherwise be due. We think we might be creating a very bad precedent here.

Senator GRASSLEY. Yes.

Make it clear that I was suggesting this for reservists and Guards people who were called up and not for people who were in the regular military, but still leading the same life that they would otherwise have led not being in the combat zone.

I guess, you know, some accommodation of not paying a penalty is one thing. But I think I would disagree with you on the interest for those people who are really in a different mode of life just for a few months out of the year. I mean just a few months maybe out of a life time. So I would just beg to differ with that. But anyway, at least you gave me your view and I am thankful for that.

Another instance would be, and I suppose we are talking about a handful of people that may have been farmers called up in the Reserve or the Guard, but I have had some instances in my State where because of the family farming operation they have had to sell livestock. This gets into the involuntarily converted property that is covered by Section 1033.

There have been some exceptions to Section 1033 in the past. We have had exceptions for reclamation laws, livestock destroyed by disease, livestock sold on account of drought and replacement of livestock where there has been an environmental contamination.

I have at least one instance in which both father and son were called up in the Navy Reserve. They are going to have to sell livestock as a result of that. I presume when they get back out they will be buying livestock back. So consequently, it is a case of not having that money taxed at this point of a forced sale.

Let me plead with you, just in case you do not understand, when we talk about a family farming operation, we are talking about where the family provides the labor, the management, and the capital, and not where they are working for somebody else or where it is a corporation, where they hire a lot of help to do this. We are talking about where these people were doing the labor.

So I bring that to the attention of the committee, but also bring it to your attention for consideration and any comment you might

want to make. But I guess I would like to have you make sure you studied it before you make a comment.

Mr. GRAETZ. We will be glad to do that, Senator.

Senator BAUCUS. Thank you, Senator.

Senator Durenberger?

Senator DURENBERGER. Mr. Chairman, I have a brief opening statement that I would appreciate being a part of the record.

Senator BAUCUS. Without objection.

Senator DURENBERGER. Two questions of Michael. But, first a comment.

I agree with the first of your principals about targeting relief. The notion of direct targeted relief ought to be preferred to changes in general tax policy that wrap everybody in the same blanket. Having said something nice, I would also associate myself with Bob Packwood, in encouraging you to take a look at the revenue implications.

I think your point may have been a correct one about expanding the tools available to Desert Storm participants. I would also like to associate myself with his request that you look at the State bond cap levels and that you look at that tax exempt bond financing issue as well.

There are issues I would like to raise with you and ask that you examine. One is the problem that might be facing some of the veterans coming home, particularly the reservists and the Guardsmen, when they try to get back into their health insurance programs.

Because of break in service provisions in company-related health plans, people coming back are going to face readmission to the plan as though they were starting over. One of the fears that I have is that they then come up against the preexisting condition clause and some other similar clauses. As a result, they might have to come up against a waiting period before they are reinsured.

I would hope that you might look at what legislative provision, if any, is necessary for automatic reinstatement or requalification without any break in service for returning Guardsmen and reservists.

Mr. GRAETZ. Yes, we would be glad to do that, Senator. The problem may be a real one in terms of waiting periods in some plans. These plans apparently vary a good bit from plan to plan. At least with respect to conditions that were preexisting before the person left the plan, there seems to be a great deal of equity in your suggestion that that should not then disqualify them for a period after they come back.

So I think that there is a good bit of equity in the suggestion and we will take a careful look at it.

Senator DURENBERGER. The second question I have relates to the potential—I do not know how real it is—but the potential that when some of these men and women come back with some debt accumulation, which they were not able to pay off during the period of time they were in the Service, that some credit companies—and this may sound hard to believe—might be willing to forgive some portions of the accumulated interest or some portion of the debt itself. My concern is that this forgiveness might end up being considered a gift and therefore subject to a taxation.

I am curious as to what your position might be on some legislative provision that would overcome that liability in the event that it happened.

Mr. GRAETZ. Well, Senator, we would not be inclined to support general exclusions from income of cancellation of indebtedness income that would normally be included—although I would point out that under the Code now there are a number of circumstances of hardship where the Code provision specifically excludes forgiveness of indebtedness income.

Some of those might apply in some of these circumstances, although I don't think they would be as broad as you might have in mind. But, in general, the tax law has provided that when one receives loan proceeds and then does not have to pay them back, one has income at the time that the loan is forgiven, and we believe that that is an important principal to maintain in the Code. So we would be quite reluctant to liberalize that.

Senator DURENBERGER. But would you at least be willing to explore a definition of hardship that might apply in a case that is as service specific as this?

Mr. GRAETZ. We would be glad to take a look at it.

Senator DURENBERGER. Okay. Thank you.

Senator BAUCUS. Thank you very much.

Senator GRASSLEY. Is it possible to have 2 more minutes?

Senator BAUCUS. It is possible if you can cut that down one.

Senator GRASSLEY. I think I can do that.

We have had some recruiters, military recruiters that have told recruits that bonuses paid for educational expenses were not taxable, that it was somehow an extra incentive the Federal Government provided to get good recruits.

Now, unfortunately, the problem is that the IRS has apparently determined otherwise and says that these incentives are taxable under Section 61 of the Code. The IRS in a letter to me attempted to make the comparison where the Service has held that the repayment of an employee's loan by an employer is taxable. I think that this is a somewhat strained analogy, since the Federal Government is not an ordinary employer and this loan repayment program directly benefits our Government.

I would like to have your comment on that. If you do not know about it, study it and see if we can work something out.

Mr. GRAETZ. Well, in general the Code does provide a number of exemptions specifically for certain fringe benefits that are connected with military service and also provides that those that are not specifically listed are included in gross income.

So without having a chance to follow exactly the proposal you are describing, I would at least initially think that the IRS's interpretation of current law is the correct interpretation.

Senator GRASSLEY. And the IRS wrote to me that it was taxable, but I question that decision.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator.

Thank you, Mr. Secretary, very much for your testimony.

Our next witness is Lt. Gen. Donald Jones, Deputy Assistant Secretary of Defense for Military Manpower and Personnel Policy. He

is accompanied by Dr. George Kundahl, Principal Deputy Assistant Secretary of Defense for Reserve Affairs.

General, we are very happy to have you here. We look forward to your testimony.

STATEMENT OF LT. GEN. DONALD W. JONES, U.S. ARMY, DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR MILITARY MANPOWER AND PERSONNEL POLICY, WASHINGTON, DC, ACCOMPANIED BY DR. GEORGE G. KUNDAHL, PRINCIPAL DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR RESERVE AFFAIRS, WASHINGTON, DC

General JONES. It is good to be here, Mr. Chairman.

Mr. Chairman, members of the Committee on Finance, it is distinct pleasure to appear before you this morning and to present the views of the Department of Defense on tax matters affecting military members and their families.

Our troops in the Persian Gulf appreciate this committee's recent action to permit delays in filing returns and to permit paying interest on refunds. This action reinforces the nation's commitment to support our troops in the Gulf.

Today we would like to set forth the general policy on taxation of service members and then address a number of specific issues. Our broad approach to tax policy has three major tenets.

First, the Department of Defense shares Treasury's view that the tax system generally should not be used to solve problems of military compensation.

Second, we support the efforts to simplify the taxes for all taxpayers, including those wearing a uniform.

And third, and perhaps most important in the current context, we are very cautious about proposals to change military-specific tax rules.

Many of these rules have been in place for a long period of time or were developed to address a specific problem for military taxpayers. We are concerned, for example, that well-meaning efforts to address problems of one group may create inequities for others.

Therefore, we urge careful analysis of all potential consequences of each such proposal, and careful deliberations in hearings such as this one. Today we would like to address five classes of tax issues of concern to the military. The first is the combat zone exclusion.

Special treatment for members of the Armed Forces in time of war or major armed conflict has been a part of our tax laws since World War I. Soldiers, sailors, marines, and airmen serving in combat during World War II, Korea, and Vietnam were allowed to exclude all or a portion of their pay from taxation. Under current law, the combat pay exclusion has been in effect in the Persian Gulf area since the President declared it a combat zone as of January 17.

An exclusion from taxable income for soldiers, sailors, airmen and marines serving the nation in times of war is not a military compensation issue. Rather, the exclusion is the answer originally provided by this committee in 1918 to the question of who should bear the financial burdens of government in times of war. Details

of the exclusion have changed over the years to reflect changing circumstances. I think several changes are now in order.

The first issue pertains to withholding. Under current law, all compensation for service in the combat zone is excluded from wages for withholding purposes. This includes commissioned officers, even though commissioned officers may only exclude \$500 for income tax purposes. This can create a financial difficulty if an officer fails to set aside sufficient funds to satisfy his tax liability.

So we would request this committee to correct this problem by limiting the exclusion from withholding to the amount excluded from the wages.

The second issue involves tax treatment of POW/MIA's. During the Vietnam conflict, the combat zone exclusion applicable to enlisted members was extended to all POW's including commissioned officers and civilians. Such treatment was also applicable to crew members of the USS Pueblo and the hostages held in Iran.

We recommend the committee extend similar treatment to commissioned officers and civilians who are POW's/MIA's in the conflict in Southwest Asia and DOD would like to see this exclusion for POW's/MIA's be made permanent.

We would also like to express our appreciation for the recent action of this committee and the Congress for the postponement of the time to file tax returns and the payment of taxes for members serving in Desert Shield/Desert Storm or for those members in support of those military operations.

This delay has allowed them the opportunity to devote their full time and attention to the military operations.

Several issues regarding IRA's should also be addressed. Current law limits the ability of active participants in the employer-provided retirement system to deduct contributions to an individual retirement account. Members of the Reserves on active duty for a period of less than 90 days are not considered active participants in the military retirement system for purposes of deducting IRA contributions. If otherwise qualified, they may deduct contributions to an IRA.

The reservists who are called to active duty in excess of 90 days should not be deprived of the opportunity to deduct contributions due to the military service. We believe current law should be amended to permit these reservists to continue to be regarded as not actively participating in the military retirement system for IRA purposes.

There is also a discrepancy between unemployment compensation for civilians and military members. Civilians are authorized 26 weeks of unemployment compensation after a 1-week waiting period, while military members are entitled to 13 weeks after a 4-week waiting period.

This is an equity issue which we feel should be corrected. We have submitted legislation that would permit members who are involuntarily separated to have 26 weeks of compensation after a 1-week waiting period. We feel this procedure should also apply to those personnel who were involuntarily retained as a result of operations in the Persian Gulf and reservists who were called up under Title 10, Section 673 provision.

Now the second group of issues concern a tax treatment of military families. Today, more of our total force is married and more members have children than at any time in history. As a result, circumstances affecting the quality of life of our military families are an increasingly important consideration for the Defense Department.

These concerns extend to tax matters with particular impact on military families and there are three areas that we suggest the committee consider for remedial action. The first is earned income tax credit. Under the current law, low income families can qualify for a refundable income tax credit if their adjusted gross income is under \$21,245. But to qualify a member must live in the United States. So consequently, members stationed overseas are not entitled to that credit.

There are also some administrative problems that also need to be resolved, such as clarifying the ambiguity associated with identifying nontaxable items that should be included in earned income for purposes of computing the earned income tax credit.

The IRC Code should be amended to make Service members stationed overseas eligible for earned income tax credit. During the 101st Congress, the Secretary of Defense on behalf of the administration, requested enactment of legislation to remedy these difficulties. DOD still urges favorable action on this proposal.

There is one issue pertaining to separation pay. Current law permits employees who receive lump sum distributions from a qualified pension plan to roll over this amount to an IRA without penalty. Income tax on the amount contributed is deferred until retirement.

A proposal has been submitted that would permit members who receive separation pay from the Armed Forces to roll that pay over to the IRA in the same way. Separation pay is not distribution for the military retirement system. It is payable only to those involuntarily separated. There is no vesting. Given these circumstances, preferential treatment of separation pay appears inconsistent with current policies governing IRA contributions.

Mr. Chairman, this concludes our statement. We would be happy and pleased to answer any questions the committee may have at this time.

Senator BAUCUS. Thank you very much, General.

[The prepared statement of General Jones appears in the appendix.]

Senator BAUCUS. You probably mentioned it, although I probably missed it, that is the degree to which you agree or disagree with the Treasury's views on penalty-free withdrawals and also a mortgage revenue bond treatment. Do you agree or have a different point of view with the Treasury?

General JONES. I do not think we really have a view at this point on either one. We have had some discussion on the penalty-free withdrawal issue. And we realize that we put the Reserve component people through some unique situations. They have to give up their civilian job and come onto active duty not knowing how many days. Many dropped out of school and other things that they made sacrifices for.

So I would tell you that we are sensitive to the issue. We think we do need to look at that issue and try to find some way to get some relief for them.

I guess I should ask Dr. Kundahl to respond to that since he is in Reserve Affairs.

Senator BAUCUS. All right. Doctor?

Dr. KUNDAHL. Access to pension plans is not as important as access to IRA's. Many reservists are self-employed or have businesses and professions that they must return to and must restart. We recognize that they need funds to do that.

While we are not in a position today to recommend penalty-free withdrawals from IRA's, we recognize that this could be a problem for returning reservists.

Senator BAUCUS. What about the mortgage revenue bond provisions?

Dr. KUNDAHL. I do not believe we have a position on that.

General JONES. I do not have a position on that. I do not think so.

Senator BAUCUS. What is your view on grossing up officers' pay to accomplish the same objective as raising the exclusion from, say, \$500 to \$2,000?

General JONES. We certainly would not disagree in principle with raising it to the level of inflation. That would be about the same level of the \$2,000. However, the details are still being worked out in the Department of Defense. There are some things to be worked out on it. But we would not disagree with that principal.

Senator BAUCUS. So among all of the provisions that have been suggested here today, the ones you have suggested as well as those by various Senators who have introduced legislation, which ones are the most urgent? If you had to rank them according to some priority, which ones would you rank at the top?

Dr. KUNDAHL. There are several, I think, from a Reserve perspective. One is to extend beyond 90 days the period reservists may be on active duty and still make tax-free contributions to an IRA. Another would be to provide some period of time upon release from active duty for a Reservist to reinvest the proceeds of an earlier home sale.

We would like to consider periods of qualified military service in determining additional vesting for accrued benefits in defined employee pension plans. And finally, as General Jones said, extending unemployment compensation for reservists to 26 weeks after a 1-week waiting period, as provided for other members of our society.

General JONES. I would basically agree, Mr. Chairman. I think with a force draw-down which we are going to face, which Senator Glenn mentioned, we are probably going to have to release about 500,000 active duty Service members over a 5-year period. A large number of that group will be possibly career people who will be involuntarily separated.

So I would think the unemployment compensation would be very, very beneficial to help that group as their career is interrupted. They came on active duty expecting to serve a full 20 or 30 year career and they are going to be cut short of that.

And then I think for our young enlisted members that we ought to correct the earned income tax credit and apply that. We have

about 25,000 members serving overseas who are entitled to that benefit and we certainly ought to make that a number one priority also.

And then I would also agree with Dr. Kundahl about the exclusion for POW/MIA people in the Iraqi situation. We ought to extend that benefit.

Senator BAUCUS. Am I to infer though that because you do not have a position yet on penalty-free withdraws or mortgage revenue bonds that that is lower on your list of priorities?

General JONES. I do not say it is any lower. Since we do not have a position on that yet, I am not really in a position to put it.

Senator BAUCUS. Will you have a position soon?

General JONES. I would hope so. Yes, sir.

Senator BAUCUS. We hope so, too.

I have no further questions. I see that there are no other Senators here. I want to thank you very much, General, for sitting very patiently and also very much for your testimony.

General JONES. Thank you, Mr. Chairman.

Senator BAUCUS. We look forward to an expeditious markup on this so we can provide the relief that is necessary. Thank you very much.

General JONES. Thank you, Mr. Chairman. We certainly appreciate the interest this committee has shown in our people and our families. So thank you very much.

Senator BAUCUS. You bet.

Now we will have a panel which will include Carol Wignall, wife of Capt. William Wignall, U.S. Air Force, in Virginia; Sgt. Becky Gommel, U.S. Air Force, wife of Gunnery Sgt. Lee Gommel, also from Virginia; and Mrs. Fran Kraus, State volunteer coordinator with the Colorado National Guard and member of the Committee on Families with the National Guard Association.

Carol, why don't you begin?

STATEMENT OF CAROL WIGNALL, WIFE OF CAPT. WILLIAM WIGNALL, U.S.A.F., GRAFTON, VA

Mrs. WIGNALL. Thank you, Mr. Chairman. My name is Carol Wignall. My husband, Capt. William Wignall, is an F-15 pilot stationed at Langley Air Force Base, VA. Bill has been deployed to Saudi Arabia since August 7, 1990. The months since his departure have been a roller coaster of emotions, finances, and opinions.

During the past 7 months, I have had the good fortune to be part of a very supportive group of spouses from Langley. We try to meet weekly to boost each other's spirits, share experiences and keep in touch. My three children have also benefited greatly from the contact with the other children of deployed military members.

A couple of months into the deployment, the group of spouses began comparing notes on how much the separation has impacted all of us. It appeared that Murphy had paid a visit to almost every household. The million different things that can and do go wrong seemed to affect everyone. One wife asked me how much money I had saved. Guiltily, I confessed that I had a very hard time saving anything.

Yardwork, housework, childcare, home repair, volunteering and supporting each other constantly compete with one another for my time. I am sure as a Senator you are very busy and realize that it is just not possible for one person to do everything that should be done.

I have found that I have had to spend money hiring someone to do the things my husband would normally do. The broken water heater, running toilets, and the majority of yard work has had to be hired out. During the three seasons Bill has been gone, Mother Nature has continued to grow grass, change leaves, and started the spring growing season. All of the mowing, raking, planting, and pruning that Bill normally does, has had to be done by neighborhood kids trying to earn money.

About the end of September, I received my first "Saudi" phone bill. Although there is not a price I could put on the relief I felt at hearing first-hand that Bill was doing well, adjusting to the environment, stress and uncertainty, my bill was well over \$300 which was not in my monthly budget. After that first phone bill, I now set the timer so Bill and I will not talk too long and we can better control our expenses.

With most of the hospital staff deployed from Langley, almost all of my family's health care has been off-base. With three children, chicken pox, flu, pneumonia, strep throat, and ear infections have traveled from one to another causing numerous visits to the doctor's office.

Consequently, my CHAMPUS payments have increased significantly since August. With April's impending increase in the CHAMPUS deductible, I am anticipating needing additional money for medical expenses.

Early in January, my support group, which includes a CPA and a military budget officer, we all began discussing income taxes and how to deal with them. For many of us it would be the first time we had to figure them out without our husbands. We discussed workshops to help each other and filing extensions.

When the legislation passed allowing 6 months after the military members return, we all celebrated. What a relief that that additional stress had been lifted. Thank you for your support of that legislation.

January 16 was the day that we at Langley will not forget. Seeing the streaks of light aimed at the Baghdad sky, and wondering if that was our husband being shot at—on television—caused us all to gather around and watch the news coverage almost non-stop. Once again housework and cooking became sporadic and almost non-existent. My children still needed to eat, however, and I thanked my lucky stars that Taco Bell was still down the street.

During all this time there has been a lot of financial stress placed on my family. As with any military separation, including remote tours, it costs the family much more to maintain closeness. The postal expenses, telephone bills and increased child care bills are all very important to be able to afford.

The military member needs to be able to talk to his children to let them know he loves them and that he misses them. The family left at home needs to be able to take time off from the 24-hour job of reassuring children and household maintaining.

The expenses incurred while separated could be alleviated by lower interest rates on mortgages, no penalty IRA withdrawals, decreased CHAMPUS costs, and most significantly increasing the non-tax pay for officers from \$500 to \$2,000.

Thank you and pray for the safe return of all our military members.

Senator BAUCUS. Thank you very much, Carol.

[The prepared statement of Mrs. Wignall appears in the appendix.]

Senator BAUCUS. I have to leave now. Senator Bradley will be here for the duration of the hearing.

Thank you very much for your testimony though. Thank you.

Why don't you proceed, Becky?

Sergeant GOMMEL. Yes, sir.

**STATEMENT OF SGT. BECKY GOMMEL, U.S. AIR FORCE, WIFE OF
GUNNERY SGT. LEE S. GOMMEL, FAIRFAX, VA**

Sergeant GOMMEL. Mr. Chairman, although I do not have a formal statement I do have a few comments that I would like to make in regards to our troops in the Gulf.

I, as an active duty military member, am very fortunate that I have an understanding as to the way the military pay system works and as to the way the support of the military is of our troops.

Upon notification that my husband was deploying I immediately went to my finance center to find out how this was going to affect my family and my home and the management of my financial situation. This is not something that a normal dependent, civilian wife may be accustomed to doing. She may not know her outlet; she may not know exactly where she can go or he can go, the spouse.

Because I did do that I was aware of the deductions and the changes in my husband's pay, the fact that separation allowance would be cut because he is going to be living in field conditions. And although he did not leave for the desert until the 29th of January, the separate rations allowance was cut immediately upon his arrival at Camp Lejune for training.

Our family support centers are supporting our families here at home. And any benefits that those military members deployed to the Gulf, which are being considered in the proposals, I feel should really be thought about carefully. We have men and women risking their lives for us and for the same freedoms that we as Americans have to give the Kuwaitees.

That is really all that I have to say. Thank you very much.

Senator BRADLEY. Mrs. Kraus?

**STATEMENT OF FRAN KRAUS, STATE VOLUNTEER COORDINATOR,
COLORADO NATIONAL GUARD, AND MEMBER, COMMITTEE ON FAMILIES,
NATIONAL GUARD ASSOCIATION OF THE U.S., LITTLETON, CO**

Mrs. KRAUS. Thank you, Mr. Chairman.

I am very thankful for this opportunity to share with you today some of the family issues that all of us are facing within the National Guard, the systems that are currently in place to make this

plan work and to make the transition time from Guard status to active duty status a little bit better.

As mentioned, I am Fran Kraus. I am the volunteer for the State of Colorado; and I serve as the State volunteer coordinator for the Colorado National Guard Family Support Program, a national program out of the Department of Defense, through the National Guard Bureau for both the Army and the Air National Guard.

This program has been in place through a joint regulation since 1987. This is a federally funded network nationwide with a family support program in each State. The program has one paid position in each State, and a national family program manager at the National Guard Bureau.

Part of my responsibility is to develop a volunteer network for support groups through leadership training and community networking and assistance. Family readiness is the bottom line. To retain the Guard member you must also retain the family.

I am also a member of the National Guard Association of the United States Committee on Families, Area VI Representative, consisting of 14 States, to address special needs and concerns in families in peacetime and mobilization. I am also a member of the Sixth Army Advisory Council where we provide leadership training for volunteers in the family program arena and address family concerns and resolutions.

The Service men and women in the National Guard have joined for a variety of reasons and, as a result, during a crisis such as Operation Desert Storm we see a variety of needs with which the families are now being concerned. The impact of mobilization is a shared responsibility between the family, the employer, the Guard and community, totally, truly, becoming the community partnership.

As mentioned, mobilization is a shared responsibility. The military can do many, many things to assist our families and believe me they are. I see things every single day and hear about it not only in my State but nationwide through my travels.

Even though our family support network is in place, we also have to look to the community for our support on a day-to-day basis through understanding and financial assistance to our families. With our family support programs we are able to be there emotionally and to assist one another and to share our concerns.

Many of the financial needs, however, go outside of that arena. We do have the financial assistance in place through the Army Emergency Relief Fund and various other relief funds through other services. However, the communities are providing emergency relief funds to assist our families. They are doing this through corporate sponsorships and through corporate challenges, and also by individual unit support group fund raising.

Through our education to the communities of our needs they have been able, truly, to meet those needs. The employer's support is crucial in this endeavor. This affects the companies. We understand that. But to us, it also means to us that our people have to have a comfortable place to return to for their reemployment upon their return.

However, this does not help the company at this particular time, possibly, because it reduces their performance level and their

strength in their work force. But, truly, we hope that they understand and that they will keep in mind that that person was an excellent employee prior to their being called up.

Many stresses face us as a result of Operation Desert Storm. This is a critical time in the life of a Guard family. A suddenly reduced income only adds to other concerns that family members must deal with. Inconsistent pay information again only adds to that complication. Medical care is disrupted if current employer policy does not provide a workable or affordable means to continue the employee portion of that payment.

These stresses become easier to handle due to support systems in place and with the assistance of family assistance centers across each State that provide information, referral assistance and follow-up. Above all, all services working together to support our families through joint support systems and financial assistance make handling stresses easier.

Many are concerned over the CHAMPUS program. CHAMPUS is costly and currently does not provide a COBRA type policy, plus a deductible for out-patient care is doubling and mental health care in the hospitals is being reduced when the emotional stresses are now the greatest.

So those are items that need to be addressed and need to be looked at more thoroughly. CHAMPUS needs to be extended to those people upon their return to give them a time for a transition back.

Single parents—suddenly we have grandparents dealing with all of the needs of small children. They have now become parents once again themselves. They are handling and trying to deal with all the stresses that are provided.

Tax guidelines are currently being worked on and as mentioned here today, are actively being pursued and hopefully resolved soon.

I would like to say, though, in summary, however, that with all the people that have been involved with this call-up, and the numbers of families that we are looking at in addition to the individual Guard members called up, that this is going very, very well.

I believe this is due to the fact that within the Colorado National Guard and all the National Guards across the United States that we have taken the time to educate our families about what is available to them if ever this event were to occur, as it has.

We suggest that any opportunity be given to families and considerations be given those families as well. Education is a key and communication is a key. This truly makes a statement about our members and their willingness, resolve and readiness to serve. They have taken their job seriously and so have their families. Family readiness has become their mission through education, support and community involvement.

Mr. Chairman, thank you. I would like to submit my written testimony for the record.

[The prepared statement of Mrs. Kraus appears in the appendix.]

Senator BRADLEY. Thank you very much, Mrs. Kraus, Mrs. Gommel, and Mrs. Wignall. Let me thank you for your testimony. I think that your own personal stories bear witness, not only to the commitment that your spouses are making, but the commitment

you make everyday in helping bring this Desert Storm to a successful conclusion.

Mrs. Kraus, I, in particular, appreciate your suggestions and we will certainly try to do what we can to try to help each of you bear the burden as families for the events of the last several months.

Thank you very much for your testimony. It was extremely helpful.

Mrs. KRAUS. Thank you.

Senator BRADLEY. Our last panel consists of Sgt. Maj. C.A. McKinney, and Col. Christopher Giaimo.

Mr. McKinney?

STATEMENT OF SGT. MAJ. C.A. MCKINNEY, U.S.M.C. RET., LEGISLATIVE COUNSEL, NON-COMMISSIONED OFFICERS ASSOCIATION, ALEXANDRIA, VA

Sgt. Maj. MCKINNEY. Thank you, Mr. Chairman.

Let me first of all extend appreciation for the invitation to appear today on behalf of my Association and the Military Coalition. I would be remiss if I did not take this opportunity to thank the National Guard Association and the National Military Families Association and the Air Force Sergeant's Association for sponsoring the young ladies appearing in the previous panel.

My statement was prepared with the help of the Military Coalition, which is a 24-member group of quasi-military organizations. I extend special thanks to a few of them that really did a great job in helping me put my prepared statement together. They are listed in the back of my statement, along with a list of the coalition membership.

We have included a number of proposals in my particular statement. I would like to touch on those just briefly. First of all there is tax exclusion. This is to provide for both enlisted and officers relief from taxation of all compensation received while serving in a dangerous foreign area.

We believe that it is almost unconscionable that our nation can ask its citizens to go to a dangerous foreign area or a combat zone, a hostile environment in any case, if you will, risk life and limb, and then tax them for the opportunity to do so. We just feel it is a little out of place to do that.

Also in retrospect, the term "dangerous foreign area" would replace "combat zone" and we think that is most appropriate since we have B-52's flying out of Diego Garcia, et cetera, which should be included in a dangerous area simply because they can be killed just as quickly in 30 seconds over a target as those on the ground who are doing the fighting in the tanks or with a rifle.

It also would extend certain tax requirements, perhaps those similar to H.R. 4, to National Guard and Reserve members called to active duty and sent to military stations in the United States, away from home but outside of a normal travel time. Certain Guard and Reserve members would be given additional time to file tax reports, et cetera.

We would also ask for the authorization for free withdrawals from retirement accounts. Guard and Reserve members and active duty personnel serving in the Gulf area would be permitted to

withdraw funds from existing retirement accounts without a tax penalty. Such withdrawals would have to be on an emergency basis and directly related to Operation Desert Storm.

Our fourth proposal would permit transfers of separation pay for troops involuntarily separated during or following Operation Desert Storm. And the authority to transfer any part or all of the separation payments received into the qualified retirement plan would be without taxation.

We also ask that imminent danger pay be excluded from gross income at any time, regardless of when it is provided. We asked for a tax break for reservists to provide deductions from gross pay—those expenses including travel, et cetera, that our National Guardsmen and reservists incur as a result of training with their Reserve unit.

Seventh, the earned income tax credit, that has been on the books for years. It has been something we have never been able to figure out, why certain servicemembers are allowed to have earned income tax credits in the United States, but if they move their family under Government orders overseas they cannot have it. It is one of those things we say, well, there is no reason for it, it is just policy.

I did not mention UCX—unemployment compensation in my statement. But we do include that now. It has been another goal of our Association to see that benefits are extended in the same manner as for civilians.

I know our list is a little heavy, Mr. Chairman. However, a few of these issues should have been resolved before Desert Storm operation. We ask your indulgence in considering these proposals.

Thank you.

Senator BRADLEY. Thank you very much, Mr. McKinney.

[The prepared statement of Major McKinney appears in the appendix.]

Senator BRADLEY. Mr. Giaimo?

**STATEMENT OF COL. CHRISTOPHER GIAIMO, U.S.A.F. RET.,
DEPUTY DIRECTOR, GOVERNMENT RELATIONS, THE RETIRED
OFFICERS ASSOCIATION, ALEXANDRIA, VA**

Colonel GIAIMO. Mr. Chairman, thank you for holding this hearing. My statement is essentially a compliment to Sergeant Major McKinney's statement; and I, too, in addition to speaking on behalf of The Retired Officers Association represent the Military Coalition.

Let me first address, and briefly, the proposal that would exclude from taxation the first \$2,000 of monthly compensation received by officers presently serving in the dangerous foreign area of the Persian Gulf.

As you know, effective with the commencement of hostilities on January 17, 1991 the total military income of all enlisted personnel and warrant officers presently serving in the Persian Gulf became excluded from taxation. Likewise, a monthly exclusion of \$500 became effective for officers. This amount, \$500, is a carryover from the Vietnam era authority which permitted such an exclusion.

What this amendment seeks to do is merely to keep the same relationship between military compensation and exclusion that existed during the Vietnam era.

Mr. Chairman, I have taken the liberty of attaching for your consideration a comparison pay chart which reflects the basic pay rates in effect during three specific eras--1967, 1972 and 1991. What this chart demonstrates is that during the height of the Vietnam conflict all pay of enlisted members was excluded from the Federal tax. In 1967 a typical enlistee had an exclusion ranging from \$102 per month in basic pay to \$694 in basic pay for 1989. In addition another \$65 per month in hostile fire pay was also excluded from taxation. For warrant officers the exclusion ranged from \$533 to \$810.

In 1991, by comparison, the exclusion for enlisted personnel is much higher. It has gone up proportionately. Officers on the other hand are still limited to the \$500 of exclusion of basic pay from Federal income tax. In 1967 a typical O-1 had a pay range of \$321 per month to approximately \$1,285 per month for an O-6 or a Colonel.

To better put this in perspective, the \$500 exclusion represented 100 percent of the basic pay of a first lieutenant and second lieutenant in 1967 and approximately 81 percent of the basic pay of a captain. By way of comparison, if this relationship of basic pay to exclusion for the same O-3 were to be maintained today, the exclusion would be approximately \$2,043.

Similarly, if the almost four-fold increase in the consumer price index since 1967 were to be factored in the \$500 exclusion would increase to approximately \$2,000.

The Retired Officers Association strongly urges your favorable consideration of this amendment. During the Vietnam era when many of our members were proudly serving their country you saw fit to recognize their sacrifices by passing the original tax exclusion. We now ask you to do likewise for our brother and sister officers who are also proudly serving.

Also before you for consideration is an amendment which seeks to remove the tax penalty for a military member or dependent for the early withdrawal of funds from an IRA account, annuity contract or other retirement plan. You have heard today the hardships that our military families have had to endure with their husbands or wives gone. They are indeed manifold.

This amendment, if enacted, would ease their financial burdens. We urge you to favorably consider this. It gives the financial flexibility these families need to meet crises in extraordinary circumstances. As you know, there are certain exclusions which permit penalty-free withdrawals. We are asking you to favorably extend this to military families today who have spouses in the Persian Gulf.

Mr. Chairman, that concludes my statement. Thank you very much.

Senator BRADLEY. Thank you very much, Colonel Giaimo.

(The prepared statement of Colonel Giaimo appears in the appendix.)

Senator BRADLEY. Let me ask each of you, particularly you, Mr. McKinney, since your list was a little longer. If you were going to

pick one or two tax items that you thought would be most helpful, what would be the one or two items that you would pick?

Sgt. Maj. MCKINNEY. Regrettably, I did not poll the Military Coalition in that respect. However, on behalf of my particular organization, the Non-Commissioned Officers Association, two of our main goals have been over the years to do something about unemployment compensation and to do away with that restriction on earned income tax credits overseas.

A third item we have always had for a goal over the years is to allow the Guard and Reserve to deduct certain expenses related to their military duties or Reserve duty.

However, in light of Desert Storm, it might—and I am just saying, it may be; I do not know. I would have to get back to the committee if you would like to know what the Coalition would really prefer in that respect.

Senator BRADLEY. No, I found your comments very hopeful.

Let me ask you, have you been contacted by many reservists who are experiencing some hardship in meeting the filing deadline?

Sgt. Maj. MCKINNEY. We have been asked by a number of our reservists. We do have Reserve and Guard members. We hear from them, as well as from the number of Guard and Reserve organizations that we have in the coalition. They are very concerned about it, sir.

Senator BRADLEY. In terms of your recommendations, do you think there is a difference between reservists who are assigned overseas in Desert Storm and other reservists?

Sgt. Maj. MCKINNEY. If they are assigned away for home, for example; and they cannot get back to their home base in a reasonable amount of time, particularly if they are in business or have a partnership or are self-employed. It is very difficult for them to be accessed to tax material that they may need. So I think it should be extended at least until they can get back home and do something.

Senator BRADLEY. Those are very helpful suggestions.

Mr. Giaimo, if you were going to pick your number one, what would it be?

Colonel GIAIMO. Well, speaking on behalf of the Retired Officers Association, obviously we would be most interested in seeing the exclusion raised from \$500 to \$2,000, as suggested in Senator Glenn's amendment. If for no other reason, just strictly on the basis of equity.

Those rates were set in an earlier era, let's just simply update them to today's cost of living standards. That would be our number one.

One that I did not mention, I think that you also should favorably consider an amendment dealing with POW's/MIA's. As you know, we have had several of those so far. Hopefully, we will not have too many more, if any. But I think that the same tax break that was given to them during the Vietnam era should again be extended to current POW's/MIA's, namely that their entire income be considered to be tax free.

Senator BRADLEY. Well, let me thank both of you very much for your testimony. I appreciate you taking the time to come in today and share your thoughts with us. I am sure they will be given seri-

ous consideration; and I hope we will be acting, certainly this year, on these overall of issues.

Let me thank you.

Sgt. Maj. MCKINNEY. Thank you.

Colonel GIAIMO. Thank you, Senator.

Senator BRADLEY. The hearing is concluded.

[Whereupon, the hearing was adjourned at 11:53 a.m.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR LLOYD BENTSEN

Last month Congress took a first step in addressing the concerns of our troops and their families by delaying the tax filing deadline for them. A number of Senators, myself included, had additional steps we wanted to take to help our troops. But we deferred in order to move the bill quickly. It sailed through Congress and the President signed it in short order.

I assured my colleagues then that their other proposals would receive full consideration, and that's what we're doing today. I'm looking forward to hearing what our colleagues and a distinguished panel of experts—including a couple of servicemen's wives, who probably know best of all the sacrifices being made by our troops and their families—have to say.

The Persian Gulf Task Force has been considering additional measures, and the Senate Finance Committee has jurisdiction over a number of these and other possible initiatives.

Under current law the entire pay of enlisted men and women is excluded from taxes. Officers may exclude only \$500 a month—a level that was set 25 years ago. Adjusting for inflation, that exclusion would be about \$2,000 today. So we should consider increasing that exclusion.

During the Vietnam war prisoners of war and soldiers missing in action received a total exclusion on income they earned while captured or missing. We need to extend that rule to our soldiers who have fallen into enemy hands in this war. This is the least we can do to ease the burden on families of these soldiers.

We also will consider waiving the 10 percent penalty when Desert Storm troops withdraw funds from their IRAs. Many of these families are facing very serious financial difficulties and that IRA may be the only savings they have available. Under current law if they take out the money they have to pay income tax and a 10 percent penalty on the withdrawal. We surely don't want to penalize taxpayers under these circumstances.

We also want to look into the rules for unemployment benefits for ex-servicemen. In the early 1980s, this program was changed to put in a month's waiting period and to limit the duration of benefits to a maximum 13 weeks—making it a much less generous program for former servicemen than for other unemployed persons. Perhaps these rules made sense during a peacetime expansion of the armed forces, but I have real questions about whether they are appropriate now. Of course, we hope those returning after the Gulf conflict will find jobs waiting for them. But some will not and they should have fair access to unemployment benefits.

With our troops in the Persian Gulf facing significant hardship and great danger, the least we in Congress can do is recognize their extraordinary efforts and do our part to ease the disruptions and hardships they are facing.

Attachments.

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DESCRIPTION OF PROPOSALS
RELATING TO
TAX TREATMENT OF MILITARY PERSONNEL

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

February 26, 1991

JCX-3-91

INTRODUCTION

This document,¹ prepared by the Staff of the Joint Committee on Taxation, provides a description of proposals relating to the tax treatment of military personnel and their families, scheduled for a public hearing by the Senate Committee on Finance on February 27, 1991.

Part A of the document describes general income tax proposals relating to military personnel. Part B describes proposals relating to pension and retirement plans.

¹ This document may be cited as follows: Joint Committee on Taxation, Description of Proposals Relating to the Tax Treatment of Military Personnel (JCX-3-91), February 26, 1991.

A. General Tax Proposals

1. Increase exclusion from tax for officers; replace combat zone designation with designation of "dangerous foreign area" (S. 199)

Present Law

Exclusion for combat pay

Gross income does not include certain combat pay of members of the Armed Forces (sec. 112). If enlisted personnel serve in a combat zone during any part of any month, military pay for that month is excluded from gross income. In addition, if enlisted personnel are hospitalized as a result of injuries, wounds, or disease incurred in a combat zone, military pay for that month is also excluded from gross income; this exclusion is limited, however, to hospitalization during any month beginning not more than two years after the end of combat in the zone. In the case of commissioned officers, these exclusions from income are limited to \$500 per month of military pay.

Designation of a combat zone

The President may issue an Executive Order declaring that an area is a combat zone. In addition to triggering the exclusion for combat pay (described above), such a designation of a combat zone triggers a suspension of the period of time for performing various acts under the Internal Revenue Code (such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax), as well as several other special provisions.

On January 21, 1991, President Bush signed Executive Order 12744, designating the Persian Gulf Area as a combat zone. The designation was retroactive to January 17, 1991, the date combat commenced in that area, and continues in effect until terminated by another Executive Order. Thus individuals serving in the Persian Gulf Area are eligible for the military pay exclusions described above, beginning January 17, 1991.

The Executive Order specifies that the Persian Gulf Area is the Persian Gulf, the Red Sea, the Gulf of Oman, a portion of the Arabian Sea, the Gulf of Aden, and the total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar and the United Arab Emirates.

Description of S. 199

Increase in exclusion limit for officers

In the case of commissioned officers, the limit on the exclusion from income would be raised to \$2,000 per month of military pay.

Application to dangerous foreign areas

The bill would also replace the requirement that an area be designated a combat zone with the requirement that an area be designated a dangerous foreign area. To trigger the exclusion from income provisions described above, the President would be required to issue an Executive Order designating that Armed Forces of the United States in that area are being or have been subject to certain hostile activities. Those hostile activities are defined as: (1) hostile fire; (2) explosion of hostile mines; (3) imminent danger of hostile fire or the explosion of hostile mines; or

(4) the threat of physical harm or imminent danger on the basis of civil insurrection, civil war, terrorism, or wartime conditions.

Effective date

The provisions of the bill would be effective as of October 1, 1990.

2. Exclude military pay of Operation Desert Storm MIAs/POWs from gross income

Present Law

Gross income does not include certain combat pay of members of the Armed Forces (sec. 112). If enlisted personnel serve in a combat zone during any part of any month, military pay for that month is excluded from gross income. In addition, if enlisted personnel are hospitalized as a result of injuries, wounds, or disease incurred in a combat zone, military pay for that month is also excluded from gross income; this exclusion is limited, however, to hospitalization during any month beginning not more than two years after the end of combat in the zone. In the case of commissioned officers, these exclusions from income are limited to \$500 per month of military pay.

Members of the Armed Forces and civilian employees of the Federal Government in "missing status" as a result of the Vietnam conflict may claim an exclusion from income for their compensation for any month during any part of which such persons are in missing status. In order to be classified in "missing status," a person must be in active service and determined to be (1) missing, (2) missing in action, (3) interned in a foreign country, (4) captured, beleaguered, or besieged by a hostile force or (5) detained in a foreign country against his or her will.

The "missing status" exclusion applies to all compensation for active service of members of the Armed Forces (enlisted personnel and commissioned officers) and civilian employees of the Federal Government. A person absent from his or her post of duty without authorization is not eligible for the exclusion.

Description of Proposal

The proposal would extend the exclusion from income for those in "missing status" to members of the Armed Forces and civilian employees of the Federal Government in "missing status" as a result of Operation Desert Storm.

3. Expand authority to issue qualified veterans' mortgage bonds (S. 354 and S. 355)

Present Law

Interest on bonds issued by States and local governments to finance their direct activities is excluded from income (sec. 103). Interest on bonds issued by these governmental units to finance activities of private persons ("private activity bonds") is taxable unless a specific exclusion is included in the Code (sec. 141).

Present law excludes from income the interest on qualified veterans' mortgage bonds, which are general obligation private activity bonds issued as part of certain

programs in effect before June 11, 1984, to provide mortgage loans to veterans (sec. 143(l)). Only five states are eligible to issue qualified veterans' mortgage bonds: Alaska, California, Oregon, Texas, and Wisconsin.

Mortgage loans made with the proceeds of qualified veterans' mortgage bonds may be made only to veterans who served on active duty before 1977, and who apply for the loan before the later of (1) 30 years after the veteran leaves active service or (2) January 31, 1985.

Issuance of qualified veterans' mortgage bonds is subject to annual volume limitations based on the historical level of issuance of these bonds between January 1, 1979, and June 22, 1984, in lieu of the general State volume limitations applicable to most other private activity bonds.

Description of S. 354

S. 354 would expand authority to issue qualified veterans' mortgage bonds from the five States currently eligible to all States (including D.C. and U.S. possessions). The bill also would repeal the annual volume limitations applicable to these bonds, and would expand the set of borrowers eligible for mortgage loans financed with the bonds to include veterans who served in Operation Desert Shield or Desert Storm.

The provisions of the bill would apply to bonds issued after August 1, 1990.

Description of S. 355

S. 355 would expand the set of borrowers eligible for mortgage loans financed with qualified veterans' bonds to include veterans who served in Operation Desert Shield or Desert Storm. All other present-law requirements, including those determining which States are eligible to issue these bonds, would be retained.

The provisions of the bill would apply to bonds issued after August 1, 1990.

4. Extend eligibility for the earned income tax credit to military personnel stationed overseas

Present Law

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC) of up to 16.7 percent (17.3 percent for taxpayers with more than 1 qualifying child) of the first \$7140 of earned income for 1991. The maximum amount of credit for 1991 is \$1192 (\$1235 for taxpayers with more than 1 qualifying child), and this maximum is reduced by 11.93 percent (12.36 percent for taxpayers with more than 1 qualifying child) of earned income in excess of \$11,250. The EITC is totally phased out for workers with earned income over \$21,245. Earned income consists of wages, salaries, other employee compensation (including certain allowances provided to military personnel), and net self-employment income.

To be eligible for the EITC, the taxpayer must have a "qualifying child". In order to be a qualifying child, an individual must satisfy a relationship test, a residency test, and an age test. The relationship test requires that the individual be a child, stepchild, a descendant of a child, or a foster or adopted child of the taxpayer. The residency test requires the individual have the same place of

abode as the taxpayer for more than half the taxable year. This household must be located in the United States. The age test requires that the individual be under 19 (24 for a full-time student) or be permanently and totally disabled.

In addition, there are two additional credits that are part of the EITC. A supplemental young child credit is available for qualifying children under the age of one year old. This young child credit rate is 5 percent and the phase-out rate is 3.57 percent. It is computed on the same base as the ordinary EITC (the maximum credit for 1991 is \$357). A supplemental credit for health insurance costs is also provided for taxpayers who purchase health insurance policies that include coverage for qualifying children. The health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. It is computed on the same base as the ordinary EITC (the maximum credit for 1991 is \$428). The maximum credit available to a taxpayer is limited to the amount paid for the health insurance coverage.

To claim the EITC, the taxpayer must complete a separate schedule and attach it to his or her return. In addition, to claim the EITC, the taxpayer must supply the taxpayer identification number (Social Security number) for each qualifying child over the age of one year old.

Description of Proposal

The first part of the proposal would extend eligibility for the EITC to military personnel stationed overseas. For purposes of determining eligibility for the EITC, a member of the military stationed outside the United States on extended active duty would be considered as maintaining a household in the United States.

The second part of the proposal would value basic allowances for housing and subsistence (provided by the military) as earned income for purposes of computing the EITC and would provide information reports on these valuations to recipients on an annual basis. This increased information flow to military personnel would allow persons claiming the EITC to determine more accurately the actual amount of their earned income.

5. Extend tax deadline deferral rules to reservists and members of the National Guard that are not in combat zone

Present Law

Section 7508 suspends the period of time for performing various acts under the Internal Revenue Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, for any individual serving in the Armed Forces of the United States (or in support of the Armed Forces) in an area designated as a combat zone.

The designation of a combat zone must be made by the President in an Executive Order. The starting date and the termination date of combat also must be designated by Executive Order.

Pursuant to Treasury regulations, members of the Armed Forces outside the combat zone who perform military service in direct support of operations in the combat zone and under conditions that qualify such members for Hostile Fire Pay (as specifically defined) are deemed to have served in the combat zone during the period of such qualifying service. (Treas. Reg. sec 1.112-1(j)(1)).

On January 21, 1991, President Bush signed Executive Order 12744, designating the Persian Gulf Area as a combat zone. The designation was retroactive to January 17, 1991, and continues in effect until terminated by another Executive Order.

Description of Proposal

The proposal would extend the tax deadline deferral rules to all reservists and members of the National Guard who are ordered to active duty in connection with Operation Desert Shield or Desert Storm, regardless of where they actually serve.

6. Allow reservists and members of the National Guard to deduct certain expenses from adjusted gross income (S. 246)

Present Law

Taxpayers may generally deduct from gross income the ordinary and necessary expenses of carrying on a trade or business (sec. 162). Unreimbursed employee business expenses are allowed only as itemized deductions and are allowed only to the extent they exceed 2 percent of the taxpayer's adjusted gross income (sec. 67).

Description of S. 246

S. 246 would allow reservists and members of the National Guard to deduct from adjusted gross income certain expenses made in connection with their duties, without regard to whether or not they itemize deductions. Such expenses include (1) expenses of travel, meals, and lodging while away from home and (2) expenses of transportation and uniforms.

The bill would be effective for taxable years beginning after December 31, 1989.

7. Eliminate certain restrictions on rollover of gain on sale of principal residence for certain military personnel

Present Law

No gain is recognized on the sale of a personal residence to the extent that the amount of the adjusted sales price of the old residence is reinvested in a new residence within a specified period of time (sec. 1034). In general, this reinvestment must occur within a period beginning two years before the date of sale of the old residence and ending two years after that date.

Special rules apply to members of the Armed Forces of the United States. In general, the running of any time period in connection with the rollover of gain on the sale of a principal residence is suspended during any time the taxpayer serves on extended active duty after the date of sale of the old residence, except that this suspension does not extend beyond four years after the date the old residence is sold.

Two special rules also apply. The first special rule applies to members of the Armed Forces who either are stationed outside the United States or are required (after returning from a tour of duty outside the United States) to reside in on-base Government quarters pursuant to a determination by the Secretary of Defense that adequate

off-base housing is not available at a remote base site. For these individuals, the suspension period does not expire before one year after the last day of being stationed outside the United States or of being required to live in qualified on-base housing, except that the suspension period does not extend beyond eight years (rather than four years) after the date the old residence is sold.

The second special rule applies to members of the Armed Forces serving in a combat zone designated by the President pursuant to section 112. The IRS has stated that the suspension of time provisions (under section 7508) that are triggered by the designation of a combat zone suspend the running of the period within which a new residence must be purchased (Rev. Rul. 69-343, 1969-1 C.B. 305). Thus, the period during which the taxpayer is in the combat zone, plus the next 180 days, is not considered in computing the applicable replacement period within which a new home must be purchased.

Description of Proposal

The proposal would eliminate two requirements from the special rule applicable to members of the Armed Forces who are required to reside in on-base Government quarters. It would delete the restriction making this provision applicable only to those who have returned from a tour of duty outside the United States. It would also eliminate the requirement that the Secretary of Defense must determine that adequate off-base housing is not available at a remote base site. Thus, members of the Armed Forces who are required to reside in on-base Government quarters would be subject to no further restrictions in order to be eligible for the same rules as members of the Armed Forces who are stationed overseas.

B. Pension-Related Proposals

1. Allow penalty-free withdrawals from qualified retirement plans, annuities, and endowment contracts (S. 82 and S. 342)

Present Law

Under present law, early withdrawals from employer-sponsored retirement plans, individual retirement arrangements (IRAs), annuity contracts, and modified endowment contracts are generally subject to a 10-percent tax in addition to income tax (secs. 72(q), (t), and (v)). The 10-percent tax does not apply to distributions (1) made after attainment of age 59-1/2, (2) made on account of death or disability, or (3) in the form of substantially equal periodic payments over the life of the individual or the lives of the individual and his or her beneficiary. Certain other exceptions to the additional tax also apply depending on the type of arrangement from which the withdrawal is made.

Description of S. 82

S. 82 would waive the 10-percent additional tax in the case of distributions from employer-sponsored plans and IRAs made to a reservist or the spouse of a reservist who is ordered to active duty in connection with Operation Desert Shield. To qualify for the exception, the distribution must be received during the period of such active duty.

Description of S. 342

S. 342 would waive the 10-percent additional tax applicable to retirement plans, IRAs, annuity contracts, and modified endowment contracts in the case of distributions to

persons who have performed active duty service in connection with Operation Desert Shield or Desert Storm. To qualify for the exception, the distribution must be received during the period beginning on the date the individual first performs such active duty service and ending on the date which is 180 days after the termination of such service. The provision would apply to distributions after August 1, 1990.

2. Permit rollovers of military separation pay (S. 252)

Present Law

Present law provides for payments to officers and enlisted personnel upon involuntary separation from the armed services (10 U.S.C. sec. 1174). In general, such payments can be made to persons who have at least 6 and no more than 20 years of service in the military.² The amount of the payments is determined under one of the following formulas: (1) 10 percent of the product of (a) the individual's years of service and (b) 12 times the individual's monthly basic pay at time of discharge; or (2) one-half of such amount. The formula used depends on the status of the individual and determinations made by the Secretary of Defense.

Separation payments are generally includible in gross income when received.

Under present law, certain distributions from qualified pension plans, qualified annuities, and tax-sheltered annuities may be rolled over to an IRA. Amounts that are rolled over are includible in gross income when withdrawn from the IRA and may also be subject to the 10-percent early withdrawal tax. In order to qualify for such treatment, the rollover must be made within 60 days of receipt of the distribution. Present law does not provide for the tax-free rollover of other payments (such as severance pay).

Description of S. 252

S. 252 would permit military separation pay (as defined in 10 U.S.C. 1174) to be contributed to an IRA. The contribution would be treated the same as a rollover of a distribution from a qualified pension plan. Thus, such amounts (and income thereon) would be includible in gross income when withdrawn. The 10-percent early withdrawal tax would apply to withdrawals of such amounts the same as it applies to other IRA withdrawals. The proposal would apply to pay received after December 31, 1990.

3. Provide that Desert Shield or Desert Storm service does not cause a break in service

Present Law³

In general, all years of service with an employer must be taken into account under a qualified pension plan in determining whether the employee meets the requirements for participation in the plan and in determining if the employee has a vested right to pension benefits. No credit need be

² Payments may also be made in some cases to officers with at least 5 years of service.

³ This discussion relates only to the rules of the Internal Revenue Code. Other laws may also apply and may have more stringent requirements. A discussion of other laws is beyond the scope of this document.

provided, however, for periods during which an employee is considered to have a break in service. In some cases, an employee who returns to work for an employer after incurring a break in service may lose credit for pre-break service. A plan may provide that a one-year break in service occurs in a 12-month measuring period in which the employee does not complete more than 500 hours of service.

In general, in the case of a nonvested participant, years of service with the employer maintaining the plan before any period of consecutive 1-year breaks in service are required to be taken into account after a break in service unless the number of consecutive 1-year breaks in service equals or exceeds the greater of (1) 5 or (2) the aggregate number of years of service before the consecutive 1-year breaks in service.

A plan may take into account service that is permitted to be disregarded under the break in service rules. A plan may also provide that a participant will not incur a break in service due to certain leaves of absence.

Description of Proposal

Under the proposal, absences from work due to active duty service in connection with Operation Desert Shield or Desert Storm could not be taken into account in determining whether an individual has had a break in service.

- Permit Desert Shield and Desert Storm service to be taken into account for qualified plan purposes

Present Law⁴

Present law provides rules for determining years of service that are required to be taken into account for participation, vesting, and benefit accrual purposes. In general, these rules do not require that military service or periods in which the participant is on a leave of absence be taken into account.

Present law contains limitations on the contributions and benefits that are payable from a qualified pension plan. In the case of a defined benefit plan, the maximum annual benefit payable under the plan is the lesser of \$102,582 (for 1991) and 100 percent of the individual's average compensation for his or her highest 3 years. In the case of a defined contribution plan, the maximum annual additions that can be made on behalf of a participant is the lesser of \$30,000 or 25 percent of the participant's compensation for the year. A combined limit applies to individuals who

⁴ This discussion relates only to the rules of the Internal Revenue Code. Other laws may also apply and may have more stringent requirements. A discussion of other laws is beyond the scope of this document.

participate in a defined benefit plan and a defined contribution plan maintained by the same employer.

Under a special rule for defined contribution plans, the plan may provide that in the case of someone who is permanently and totally disabled and not a highly compensated employee compensation means the compensation the participant would have received for the year if the participant was paid at his or her rate of compensation immediately before becoming disabled. This rule applies only if the contributions made with respect to such compensation are nonforfeitable when made.

Description of Proposal

The proposal would clarify that service in connection with Operation Desert Shield or Desert Storm may be taken into account for all purposes under the plan. In addition, the proposal would permit compensation to be imputed during periods while the participant is in Desert Shield Service under rules similar to the present-law rule for disability.

PREPARED STATEMENT OF SENATOR JOHN BREAUX

I would like to commend the chairman for holding this hearing. Our country is aware of the sacrifices made by these brave men and women serving in Operation Desert Storm. I believe we should closely consider the measures we will discuss today, as well as other measures, as we examine what we can do to alleviate the burden borne by our armed forces and their families. This issue is of particular importance to my State, which I am proud to say has the second highest number of Guardsmen and reservists (over 9,000) serving in Operation Desert Storm.

Under current law, the entire pay of enlisted personnel is exempt from taxation. Officers may exclude \$500 per month from tax liability. While this may seem to be a benefit, it is important to be aware of the fact that many of the Guardsmen and reservists officers serving in Desert Storm are earning less income than their normal occupations compensate them. They are making a financial sacrifice while serving our country and it is important that Congress attempt to alleviate the financial strain they will experience due to this sacrifice.

I expect there to be considerable discussion on whether proposals to increase pay and benefits of military personnel and veterans will trigger automatic spending cuts included in last year's budget. Some will argue that these proposals will fall under a budget act exemption for emergency funding requirements of the Gulf deployment. I think it is important that the committee and the administration carefully review benefit proposals to determine whether they would qualify as emergency war funding.

PREPARED STATEMENT OF SENATOR LARRY CRAIG

Thank your Mr. Chairman, for allowing me to appear before your committee this morning.

There are currently thousands of American reservists serving in the Gulf as part of Operation Desert Storm. Their contributions and the burdens they bear are well known.

What sometimes is forgotten, however, are the burdens borne by their families back home.

Many of these families are finding themselves without a provider and in unexpectedly tough financial straits. Those who have put money aside, investing in the future in certain retirement or savings plans, are now confronted with a tax law that penalizes them if they need to withdraw from them to make ends meet.

That doesn't make sense when these people are already making sacrifices from which we all benefit.

That's why I'm asking you to consider my bill, S. 342. It's a very simple and straightforward measure to allow members of the Armed Forces or Reserves who are active in Desert Storm to withdraw money from annuities, IRA's, and other retirement plans without a penalty for early withdrawal.

It won't add to the debt because it's revenue neutral. But it will help many families who deserve our support.

Mr. Chairman, these are extraordinary times requiring extraordinary contributions from our men and women in uniform, and we must do what we can to assist them and their families.

My measure is not intended to be a comprehensive solution to all the problems faced by our men and women in the Persian Gulf. But it is a necessary and sensible reform to be added to the comprehensive legislative package now being put together.

As a member of the Desert Storm Legislative Task Force, I urge you to give it your full consideration.

Thank you.

PREPARED STATEMENT OF SENATOR WENDELL H. FORD

I appreciate the opportunity to testify today in favor of extending the tax benefits enacted last month in H.R. 4 to our military personnel, particularly reservists, supporting Operation Desert Shield in locations outside the combat zone. I commend the Chairman for holding these hearings. No matter what our individual positions were at the onset of this conflict, we have now come together in a united voice supporting our troops and their families 110 percent. These hearings today reinforce that message as we consider their special needs both during and after this conflict.

As the Chairman knows, I first raised the issue of expanding tax benefits to our troops serving outside the combat zone during the Senate debate on H.R. 4. As a cosponsor of S. 8, I supported that legislation and congratulate this committee on the expeditious and bipartisan handling of it. But as I stated then, that legislation simply did not go far enough to recognize the hardships being faced by our military personnel and their families, particularly reservists, serving outside the Persian Gulf.

Of the over 160,000 National Guard and Reserve personnel activated to date, only about 60,000 are serving in the Persian Gulf region and stand to be assisted by the legislation we adopted last month. The remaining 100,000 plus reservists are watching an April 15 tax filing date quickly approach without the ability or resources to go home every night and work on tax forms or collect receipts and files. These personnel, and those in the regular military forces serving outside the Gulf region in support of Desert Shield, are no less deserving of our understanding and assistance during this conflict.

Many of our reservists were activated on very short notice, initially called up last August for only 90 days. That deployment was then extended to 180 days, and now has been potentially extended for up to two years. These dedicated personnel responded willingly to the call, but obviously had no way of knowing that their deployment would extend beyond the April 15 filing deadline. Although current law allows these personnel to receive an extension of filing time, taxes remain due on April 15, and penalties and interest continue to accrue. For those who have faced business losses or downturns due to their deployment, an extension of filing time alone is of little help.

For Federal income tax filing purposes, geographic location does not determine hardship. For many of our reservists, any deployment creates a tremendous hardship. This is particularly true for those small businessmen, sole proprietors, or health care professionals serving in rural areas. The fact that these dedicated men and women are away from their homes and offices, and so may not have ready access to needed tax files, creates the hardship—and that is true whether they are deployed 40 miles, 400 miles, or 4,000 miles away from home.

I encourage the committee to extend the tax benefits we provided in H.R. 4 for our military personnel stationed in the Persian Gulf to all personnel activated in support of Desert Shield. I commend the Chairman and the committee for their action on these matters and look forward to working with you in support of our troops.

Attachments.



U.S. SENATE, COMMITTEE ON ARMED SERVICES,
Washington, DC, February 8, 1991.

Hon. LLOYD BENTSEN, *Chairman*,
Committee on Finance,
U.S. Senate,
Washington, DC.

Dear Lloyd: During a recent visit to the Army's National Training Center, I was approached by National Guardsmen of the 48th Infantry Brigade from Georgia who have been activated to support the Persian Gulf conflict about extending the date for filing of their Federal income taxes without penalty. I have also received similar inquiries from other National Guardsmen and Reservists who have been activated to support the Persian Gulf conflict and who are in training or assigned away from home within the United States.

I understand that the Finance Committee will be marking up legislation in the near future on Federal income tax and other matters related to military personnel serving in support of the Persian Gulf conflict. I urge the Finance Committee to consider broadening the current authority for extending the Federal income tax filing deadline for military personnel serving in the Persian Gulf to cover activated National Guardsmen and Reservists who are in training or otherwise activated and away from home in the United States.

Over 200,000 National Guardsmen and Reservists have been activated thus far in operation Desert Storm, and this figure will continue to grow in the near future. I believe that we can help alleviate some of the considerable personal turbulence experienced by these dedicated citizen soldiers and their families by providing the same relief in filing their Federal income taxes that we have already provided for those soldiers serving in the combat theater.

Sincerely,

SAM NUNN, *Chairman*.



NATIONAL GUARD ASSOCIATION OF THE UNITED STATES

ONE MASSACHUSETTS AVENUE NORTHWEST • WASHINGTON, D.C. 20001 • (202) 789-0031

24 January 1991

Honorable Wendell Ford
United States Senate
Washington, D.C. 20510

Dear Senator Ford:

The enthusiastic support of the Congress in providing protections for the members of the Armed Forces serving as a result of Operation DESERT SHIELD is commendable and greatly appreciated. One such effort, which the Congress is dealing with in an expeditious fashion, is the extension of time for filing income tax returns.

The bills that are under consideration this week, HR 4 and S 9, appear to have overlooked an important category of personnel, which is of concern to the National Guard Association of the United States. Of the approximately 166,000 National Guard and Reserve personnel activated in support of DESERT SHIELD, only a little over 60,000 are currently in the Persian Gulf. The bill under review does not adequately address the problems of approximately 100,000 members of the Guard and Reserve who have been assigned to duty stations in Europe and the United States to fill the void of active component units being moved into the Gulf region. They are physically relocated, under pressing and restrictive schedules and unable to return home and, in many instances, incurring significant financial difficulties.

Members of the National Guard are proud to be serving their country in this time of crisis. Their commitment to the defense of our nation has routinely required adjustments in their life to accommodate training and readiness requirements. As a result of the current call to active duty, a large portion of the 166,000 National Guard and Reserve personnel are experiencing financial difficulties. As the length of their duty has been extended from 90 days to one year, those difficulties that were manageable are quickly becoming genuine hardships. Families are facing problems in providing the basic necessities of life such as food and shelter.

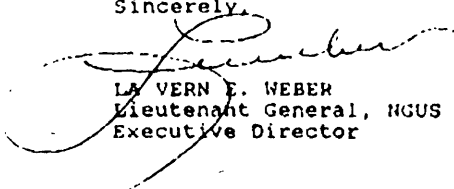
An overwhelming majority of these individuals will experience significant difficulties in filing their income tax returns. Everyone fully recognizes the obvious problems for personnel in the Persian Gulf. However, the problems of National Guard members who have not yet deployed to the Persian Gulf or have deployed to other areas have inadvertently been overlooked in the crafting of these bills.

Members, once activated, had to quickly reorganize their lives amidst post-mobilization training and unit deployment activities. The military system assisted them in putting their legal affairs in order, however, National Guard members are typical of the American public. Very few would have compiled and organized their income tax documents to such a degree that anyone else could step in and take over the process. Further, those personnel called in August for 90 days had no indication or reason to expect that they would still be on active duty beyond mid-February, much less beyond mid-April.

The family members left behind are having to make monumental adjustments to their life and they are continually faced with the problems of changes in family income and support. The original provisions for extension for members in a combat zone were crafted in the 1950s to address the Korean War. The DESERT SHIELD mobilization by its size, the short amount of time prior to mobilization and deployment, and the uncertainty of the length of the commitment (90 days, then 180 days, and now 365 days) is unparalleled.

Expanding the provisions of the tax filing extension to cover all personnel activated in support of DESERT SHIELD will, in actuality, cause little or no loss of any revenue to the federal government. The individual's tax situation will be unchanged. Even so, the lifting of this burden from families would signal the Nation's support for their sacrifices in support of our national interests.

Sincerely,



LT. VERN E. WEBER
Lieutenant General, NGUS (Ret.)
Executive Director



Reserve Officers Association of the United States

The Professional Association Representing All Officers

January 24, 1991

The Honorable Wendell H. Ford
United States Senate
Washington, D.C. 20510

Dear Senator Ford:

The Reserve Officer Association greatly appreciates your efforts to provide protection and relief for the many members of the Guard and Reserve who are being activated to support Operation DESERT STORM. The Congress has been very supportive of the men and women called upon to serve in the Persian Gulf generally, and of Reservists particularly. I am concerned that Reservists and all members of the Total Force be treated equitably.

The Congress is to be commended for its actions to extend the time for filing income tax returns for members of the military. However, the legislation adopted by the House and the proposed Senate bill appears to provide an extension only for those individuals sent to the Persian Gulf. The legislation would discriminate against approximately 100,000 Reservists who, though not subjected to the dangers and rigors of the Gulf Region, are similarly displaced in overseas and Continental US locations, are separated from their personal and business records, and will face the same difficulties in filing their tax returns. Many of these Reservists will have suffered very real and severe hardships as a result of their being displaced to serve their country in its military and are deserving of the same consideration for tax purposes provided other members of the Total Force called upon to support DESERT STORM.

Reservists, those serving in the Persian Gulf and those assigned elsewhere, have been activated, voluntarily and involuntarily, with little or no time allowed to rearrange their lives. While Reservists have, with very few exceptions, responded very willingly, the hardships experienced in their family and personal lives have been significant. Many were initially called up for 90 days, then extended to 180 days, and they may now have to serve for one year. There has been little opportunity to plan and provide order in their lives.

The Reserve Officers Association recognizes that many active personnel have also been displaced by Operation DESERT SHIELD/STORM and some have experienced similar hardships. Because the Association supports equal treatment for all members of the Total Force, it would not withhold support for active-duty personnel who are equally affected, but we are immediately concerned with the failure of this legislation to treat all members of the Guard and Reserve with the same consideration.

Again, thank you for your efforts to recognize the contributions and the hardships of members of the Guard and Reserve who are participating in Operation DESERT STORM. I hope my comments will be helpful in your deliberations.

Sincerely,

Evan L. Hultman
Major General, AUS (Ret.)
Executive Director

PREPARED STATEMENT OF COLONEL CHRIS GIAIMO

Mr. Chairman, Members of the Committee: I am Colonel Chris Giaimo, USAF-Retired, Deputy Director for Government Relations for The Retired Officers Association (TROA), which has its national headquarters at 201 North Washington Street, Alexandria, Virginia. Our Association has a membership of over 370,000 active duty, retired and reserve and National Guard officers of the seven uniformed services. This figure includes over 54,000 auxiliary members who are the survivors of former members.

I wish to thank the Chairman, and members of the Committee for holding this hearing to discuss several proposed amendments to P.L. 99-514, The Internal Revenue Code of 1986. These amendments, if enacted, would provide some modicum of tax relief for our servicemen and women serving in the Persian Gulf region and would serve to recognize in a small way the extraordinary sacrifices these Americans have already made for our nation during Operation Desert Shield and are continuing to make during Operation Desert Storm.

Mr. Chairman, let me first address the proposal that would exclude from taxation the first \$2,000 of taxable monthly compensation received by officers presently serving in the "dangerous foreign area" of the Persian Gulf. As you know, effective with the commencement of hostilities on January 17, 1991, the total military income of all enlisted personnel and warrant officers presently serving in the Persian Gulf became excluded from taxation. Likewise, a monthly exclusion of \$500 became effective for officers. This amount, \$500, is a carryover from the Vietnam era authority which permitted such an exclusion. What this amendment seeks to do is merely to keep the same relationship between military compensation and exclusion that existed during the Vietnam era.

Mr. Chairman, I have taken the liberty of attaching for your consideration a comparison pay chart which reflects the basic pay rates in effect during 1967, 1972 and 1991. What this chart demonstrates is that, during the height of the Vietnam conflict, all pay of enlisted members was excluded from the Federal income tax. In 1967, for a typical enlistee, this exclusion ranged from \$102 per month in basic pay for an E-1 to \$694 per month in basic pay for an E-9. In addition, another \$65 per month in hostile fire pay was also excluded from taxation. For warrant officers the exclusion ranged from \$533 for a W-1 to \$810 for a W-4.

In 1991, by comparison, the exclusion for enlisted personnel ranges from \$754 for an E-1 to \$2,911 for an E-9; for warrant officers from \$2183 for a W-1 to \$3319 for a W-4. In addition, \$110 per month in imminent danger/hostile fire pay is also excluded from Federal taxation.

Officers, on the other hand, were limited and are still limited to a \$500 exclusion of basic pay from Federal income tax. In 1967, the basic pay of a typical officer ranged from \$321 per month for an O-1 to \$1,285 per month for an O-6. To better put this into perspective, the \$500 exclusion represented 100% of the basic pay of an O-1 and O-2 and approximately 81% of the basic pay of an O-3. By way of comparison, if this relationship of basic pay to exclusion for the same O-3 were to be maintained today, the exclusion would be approximately \$2,043. Similarly, if the almost four fold increase in the Consumer Price Index (CPI) since 1967 were to be factored in, the \$500 exclusion would increase to about \$2,000.

The Retired Officers Association strongly urges your favorable consideration of this amendment. During the Vietnam era, when many of our members were proudly serving their country, you saw fit to recognize their sacrifices by passing the original tax exclusion amendment. We now ask you to do likewise for our brother and sister officers who also proudly serve.

Mr. Chairman, also before you for consideration is an amendment which seeks to remove the tax penalty incurred by a military member or dependent for the early withdrawal of funds from an IRA account, annuity contract or other retirement plan.

I need not tell you of the financial hardships being incurred by the families of those military personnel deployed to the Persian Gulf. I know you've heard about them from your very own constituents back home. They are, indeed, manifold. Furthermore, there is evidence to suggest that these hardships are even more onerous for the families of reservists, Guardsmen and retirees called to active duty. Many were forced to leave much higher paying employment in order to serve their country and, they did so willingly.

This amendment, if enacted, would help ease these financial burdens. You know better than I why the tax penalty was originally imposed. It was to discourage the early and frivolous withdrawal of funds from these initially tax-exempt deposits. Yet, in your wisdom, you did see fit to allow a tax exemption in extraordinary cases;

cases such as the untimely death of a depositor. Mr. Chairman, what we have before us today are extraordinary circumstances. Families having to cope with vastly diminished earnings capacity; families having to make ends meet with the prime bread winner half a world away. Permitting these families to dip into their retirement funds without a tax penalty is a necessity; a necessity brought on by the extraordinary circumstance of war. The Retired Officers Association therefore strongly urges your favorable consideration of this amendment. It is the right thing to do, it is the humane thing to do.

Mr. Chairman, before closing, let me recommend an additional proposal which The Retired Officers Association and other member organizations of the Military Coalition proffer for your consideration.

This proposal concerns POWs/MIAs and has not been addressed in any proposed amendment. Mr. Chairman, we are indeed fortunate that given the massive scope of military operations in the Persian Gulf, as of today our military forces have suffered relatively few POW/MIA losses. That is not to say, however, that we have been totally spared this sacrifice and that we will not experience more such losses in the coming days. We've all seen televised pictures of our captured pilots and heard reports of captured ground forces. Our proposal with regard to these personnel and their families is relatively straight-forward and is aimed at recognizing the extraordinary sacrifices they are presently enduring.

The proposal Mr. Chairman, concerns an extension, if you will, to Section 112(d) of P.L. 99-514, the Internal Revenue Code of 1986. That section deals specifically with an exclusion of all compensation received by a military member for service performed while a prisoner of war, missing in action, interned in a foreign country, etc. Section 112(d), as you will note, deals exclusively with Vietnam era military personnel. We strongly urge you to enact legislation to extend this exclusion to all military members presently experiencing the same status. The President has announced by Executive Order, that January 17, 1991 is the date for commencement of a "period of conflict" in the Persian Gulf. We therefore recommend you extend the Section 112(d) exclusion to those POWs/MIAs who have been lost since that date.

On behalf of The Retired Officers Association, I wish to thank you for the opportunity of testifying here today and I stand ready to address any questions you have relative to this legislation or my Association's position thereon. In addition to TROA and The Non-Commissioned Officers Association, the Associations whose names appear on the attached list concur with the positions enunciated here and have requested that they be associated with our remarks.

BASIC PAY RATE COMPARISONS

	1967	1972	1991
E-1 < (2 yrs).....	\$102	\$307	\$754
E-2 < (2 yrs).....	106	342	845
E-3 > (2 yrs).....	129	356	926
E-4 > (3 yrs).....	236	413	1042
E-5 > (6 yrs).....	304	488	1268
E-6 > (10 yrs).....	360	578	1502
E-7 > (17 yrs).....	446	717	1872
E-8 > (18 yrs).....	514	826	2156
E-9 > (26 yrs).....	694	1115	2911
O-1 < (2 yrs).....	321	566	1444
O-2 > (2 yrs).....	444	712	1816
O-3 > (4 yrs).....	616	989	2523
O-4 > (12 yrs).....	817	1255	3199
O-5 > (16 yrs).....	929	1492	3807
O-6 > (26 yrs).....	1285	2063	5260

PREPARED STATEMENT OF SENATOR JOHN GLENN

Mr. Chairman, I appreciate the opportunity to appear before this Committee to speak in support of two bills I have introduced that I believe will benefit military personnel who are serving in support of Operation Desert Storm.

The first bill I will address is S. 199, a bill that would amend the Internal Revenue Code of 1986 to exclude from income the pay received for active service by a member of the Armed Forces of the United States in a dangerous foreign area. The bill would also increase from \$500 to \$2,000 the monthly military income that could be excluded by officers.

Mr. Chairman the reason I introduced S. 199 was because I felt that even before combat started in the Persian Gulf that the conditions there were just as arduous and practically as dangerous as they are now. The bullets weren't flying then, but our forces were pretty thin and the likelihood of sustaining losses had Saddam Hussein decided to attack was almost certain.

Right after hostilities began in the Persian Gulf, the President, on January 21, 1991 signed an executive order designating the Arabian Peninsula area, airspace and adjacent waters as a combat zone. This designation meant that for Federal income tax purposes military pay received by enlisted personnel while serving in the combat zone would be exempt from Federal income tax. For officers in the combat zone, existing law limits the exemption to \$500 per month. The combat zone designation also triggers a provision in existing law that provides that members in the armed forces in the combat zone will not have to file their income tax returns until at least 180 days after they depart the Persian Gulf, without penalty. As you know Mr. Chairman, the Finance Committee took the lead early this year to provide this latter benefit before the onset of hostilities, and to also provide that refunds, as a result of delayed filing would accrue interest. Mr. Chairman, I applaud the Committee's prompt action to come to the aid of our military personnel placed in harm's way and their families.

Obviously, since the Persian Gulf area has been declared a combat zone, the portion of my bill, S. 199, which would provide for income tax exclusion for members of the armed forces in dangerous foreign areas, and which I must say was targeted to military personnel deployed in the Persian Gulf, is moot. However, the portion of S. 199 that would raise the monthly exemption limit for officers is not moot. The current monthly limit of \$500 per month for officers was set in 1965. Just simply adjusting for pay raises and adjusting for inflation since then would raise the limit to \$2,000 per month and keep the same relationship between the exemption and monthly pay that existed then. So I urge the Committee to act favorably on this portion of S. 199.

Mr. Chairman, the other bill I introduced that is under the jurisdiction of this Committee is S. 205, a bill that would equalize the unemployment compensation for separating military personnel to the same standard for civilian personnel. Right now, unemployed civilian personnel are entitled to up to 26 weeks of unemployment compensation one week after they are separated from employment. On the other hand, separating military personnel are entitled to only 13 weeks of unemployment compensation four weeks after they are separated from military service.

Mr. Chairman, last year the Armed Services Committee included a provision in the Fiscal Year 1991 Defense Authorization Bill that passed the Senate that is identical to S. 205. The reason the Armed Services Committee included the provision was to provide a safety net for military personnel equal to their civilian peers. This inequity first came to my attention when we were considering the long term force reductions that were being planned for our armed forces last year in the wake of the developments in Eastern Europe and the Soviet Union. Because of a planned 25% reduction in military manpower over the next five years, and the budget just submitted by the President maintains this direction of the reduction notwithstanding the Persian Gulf conflict, military personnel will have to be separated from the military service either voluntarily under early-out programs or forced to separate. In looking at how we should take care of these personnel; we discovered the disparity in the unemployment benefit between separating military and civilian personnel and moved to correct it. However, because of a jurisdictional question raised by the House in the conference on the Fiscal Year 1991 Defense Authorization Act and at the request of the Chairman of this Committee, we agreed to recede on the provision with the understanding that it would be addressed this year.

Mr. Chairman, I know that some would question why we need to move out smartly on enacting S. 205 since we are not reducing our forces at this time. That is a good question and I believe I have a good answer.

The answer is that the planned manpower reduction—minus 100,000 this year and minus another 100,000 next year—has been put on hold only temporarily. As soon as the Persian Gulf conflict is terminated, and I hope it will be soon, the military services all plan to get right back on the glide path and cut back. For example, in order to stabilize manpower, the military services have put a hold on military separation. Several thousand military personnel who had dates of separation late

last year and early this year have been involuntarily extended in the military indefinitely. This "stop-loss" policy is still in effect. When the plug is pulled, I expect there will be a rush for the door.

Many of these people will have had their employment plans and education plans disrupted and will face a future more uncertain than they faced before their plans were disrupted. I think we owe it to these people and their families to at least have a safety net equal to the safety net we provide civilian personnel in case they run into problems securing employment. I don't think we are talking about a huge problem here because we put in a pretty good transition program last year that includes job assistance. But I think the safety net needs to be there for those who may fall through the cracks.

Mr. Chairman, I want to thank the Committee for holding this hearing. I know that we all want to make sure that we take care of our military personnel and their families as they serve in these difficult times and to not forget them when they return. The bills I have introduced, S. 199 and S. 205, do a small part to keep this faith with our military personnel and I hope the Committee will act favorably on them.

Mr. Chairman, I am available to answer any questions you or members of this Committee may have on S. 199 or S. 205.

PREPARED STATEMENT OF MICHAEL J. GRAETZ

Mr. Chairman and Members of the Committee: I am pleased to present the views of the Administration on a number of proposals to provide tax relief to members of the Armed Services. Most of the proposals listed in the Committee's hearing announcement are specifically designed to benefit military personnel participating in Operation Desert Storm, although some of the proposals would grant tax relief to all military personnel. Before discussing these proposals in detail, I would like to make a few general observations.

DESERT STORM TAX LEGISLATION

In the current crisis in the Persian Gulf area, the President and the Congress have acted quickly to ensure that the tax relief afforded by the Internal Revenue Code is available to the military men and women serving in that area and to expand in some respects the scope of that relief. On January 21, 1991, shortly after the commencement of hostilities, the President signed Executive Order 12744, designating the Persian Gulf area as a combat zone. This triggered the exclusion from taxable income of combat pay under section 112 of the Internal Revenue Code, the postponement under section 7508 of the time for filing tax returns or taking other actions required under the tax laws, and other tax relief that I shall describe below.

Within a few days thereafter, Congress passed and, on January 30, 1991, the President signed into law legislation (P.L. 102-2) that extended the coverage of section 7508 to include individuals serving in the "Persian Gulf Desert Shield area" (as designated by Executive Order) at any time back to August 2, 1990. This legislation also liberalized prior law by causing interest on overpayments of tax generally to be credited to the taxpayer during the section 7508 suspension period. Finally, this legislation extended the section 7508 suspension period to include periods of hospitalization in the United States with certain limitations. On February 14, the President signed Executive Order 12750, designating the Persian Gulf Desert Shield area.

OVERVIEW OF TAX PROVISIONS APPLICABLE TO DESERT STORM MILITARY PERSONNEL

Over the course of time, Congress has enacted a number of laws to provide tax relief to members of the Armed Forces in time of war. The oldest of these dates from World War I, and most were in place long before the Vietnam War began. Today, the Internal Revenue Code incorporates many of these provisions. The most important follow:

Section 112 excludes from the income of members of the Armed Forces all or a portion of compensation received for active service in a combat zone or while hospitalized as a result of wounds, disease or injury incurred while so serving.

Section 7508 postpones the time for filing returns, paying taxes, claiming refunds, and taking any other action required or permitted under the tax laws by disregarding the period that a member of the Armed Forces serves in a combat zone or is hospitalized as a result of injury incurred while so serving and the next 180 days thereafter.

Section 692(a) eliminates certain income tax liabilities of a member of the Armed Forces who dies while serving in a combat zone or as a result of wounds, disease or injury incurred while so serving. The tax liabilities affected are those for the year of death and any prior year ending on or after the date the member first served in the zone. Uncollected taxes for prior years are also forgiven.

Section 2201 provides that virtually all of the Federal estate tax does not apply to a citizen or resident of the United States if that person was killed in action while serving in a combat zone, or died as a result of wounds, injury, or disease suffered while serving in a combat zone. This provision does not eliminate estate taxes that are credited to the states on account of state death taxes.

Section 3401(a)(1) excludes from the definition of wages for withholding purposes all compensation paid for active service in a month for which the employee is entitled to the benefits of section 112.

Section 6013(f) allows the spouse of a member of the Armed Forces (or of certain civilian employees of the Federal Government) who is in missing status as a result of service in a combat zone to elect to file a joint return under certain circumstances.

Section 134 excludes from income a broad range of military allowances and kind benefits, including, for example, the value of quarters, subsistence and a variety of travel expenses, medical benefits and household expenses. The committee report accompanying the adoption of section 134 contains a list of about 30 military benefits that are specifically excluded under this provision.

In addition to the tax relief provisions found in the Internal Revenue Code, the Soldiers' and Sailors' Civil Relief Act of 1940, continued in effect in subsequent legislation and now found in U.S.C. Title 50 Appendix, contains two important provisions affecting the calculation and collection of the tax liabilities of members of the Armed Forces. Section 513 of the Act, 50 U.S.C. app. §573, defers the collection of income tax from any person in military service for a period extending up to six months after the termination of service if the person's ability to pay the tax is materially impaired by such service. No interest accrues during the period of deferral. Section 206 of the Act, 50 U.S.C. app. §526, generally sets a limit of six percent on the rate of interest that may be charged to a person in military service during the period of service on liabilities, including tax liabilities, incurred prior to entry into military service.

ANALYSIS OF PROPOSALS

Today, as we turn to address additional proposals for tax relief for military personnel, a ground war is underway in Kuwait. The thoughts of each of us are with the brave men and women serving our country in the Gulf region.

Evenhandedness to our military personnel is generally best served by relying on direct appropriations—rather than tax benefits—to compensate our troops for their sacrifices. Tax relief may be discriminatory, with income tax relief generally most benefitting those with higher incomes and with special tax provisions serving only those whose particular circumstances enable them to take advantage of targeted tax relief.

In addition to this cautionary note, our testimony today has also been guided by a number of general principles. First, we believe that relief provisions that materially complicate the ability of the taxpaying public to comply with the tax laws should be avoided. Proposals that would necessarily add lines to the tax forms in widest use, such as the Form 1040, or complicate the instructions to those forms, should be resisted. Second, we should try to avoid placing high compliance burdens on the private sector. Former employers and others who have had an employment or other business relationship with a member of the military should not be unnecessarily burdened in the process of providing tax relief.

We also believe that relief provisions for military personnel should not produce unfair tax advantages relative to similarly situated taxpayers who do not qualify for the relief. Today's gesture of goodwill should not become a permanent source of tax inequities. Historically, military personnel actually serving in a combat zone have received the greatest tax relief. Proposals that offer to extend tax relief to military and other personnel in more usual circumstances deserve close scrutiny. Likewise, we should endeavor to ensure tax fairness between reservists and other military personnel. Even within the combat zone, proposals whose benefits inure mainly to a few individuals are less attractive than those with a wider scope of relief.

Finally, review and modification of benefits available to military personnel serving in the Persian Gulf conflict should be done in a coordinated, rational way and not on a piecemeal basis. Further, modifications to the benefit structure that result in increased costs must fit within the parameters of the 1990 Budget Act. This

means that discretionary expenditures (net of offsets) must fit within the spending caps, and revenue losses and mandatory expenditures, must be paid for on a pay-as-you-go basis.

The Administration welcomes the opportunity to participate in a process that reviews benefit proposals comprehensively, applies rational criteria to their assessment, and fits them within the Budget Act. To that end, Administration representatives are currently scheduled to meet with the Republican and Democratic Desert Storm Task Force Chairmen, Senators McCain and Glenn, on Thursday, February 28, 1991.

My comments on legislative proposals being considered by this Committee today are subject to two qualifications:

- these proposals must be considered in the comprehensive context I have described; and
- the Administration reserves the right to withdraw its support for particular measures if the overall package does not meet the tests suggested.

In the remainder of my statement, I will address the specific items listed by the Committee in the hearing announcement. I also understand that the Committee has requested the Administration's position on S. 252, introduced by Senator Warner on January 23. Accordingly, our comments on S. 252 are included in this statement.

Combat Pay Exclusion (Section 112)

CURRENT LAW

Enlisted personnel in the Armed Forces may exclude from income all compensation received for active service in a combat zone or while hospitalized as a result of wounds, disease or injury incurred while serving in a combat zone. In the case of hospitalization, this exclusion is unavailable for any month beginning more than two years after the date of termination of combatant activities in the zone. Personnel performing service in direct support of military operations in the combat zone who qualify for hostile fire or imminent danger pay are also entitled to this benefit.

Under current law, commissioned officers are entitled to the exclusion on identical terms as enlisted personnel, but the amount excluded is limited to \$500 per month.

PROPOSAL

The proposal would increase the exclusion amount for commissioned officers to \$2,000 per month.

ADMINISTRATION POSITION

Although consideration ought to be given to a direct adjustment to combat pay for commissioned officers in lieu of an expanded income tax exclusion, the Administration supports this proposal so long as appropriate offsets are provided. The exclusion amount for commissioned officers was last increased to \$500 in 1966, in connection with the Vietnam War. The increase in military wages and in price levels since that time justifies an increase in the exclusion amount to \$2,000, so that the exclusion can once again provide relief comparable in real terms to that which it formerly provided.

Penalty-free Withdrawals from IRAs and Qualified Employer-Sponsored Retirement Plans by Operation Desert Storm Personnel

CURRENT LAW

Individuals are permitted to make contributions to IRAs up to the lesser of \$2,000 or the individual's compensation for the year. Contributions to IRAs are deductible if the taxpayer does not participate in a qualified retirement plan or has adjusted gross income below a stated threshold amount. Earnings on amounts held in IRAs are tax-deferred.

Retirement plans sponsored by employers are accorded special tax treatment if certain qualification requirements are met. Specifically, contributions to qualified plans are deductible up to specified limits, the participants are not taxable on the contributions or benefits provided until amounts are actually distributed, and earnings on amounts held in trust are tax-exempt.

Withdrawals are permitted from IRAs at any time, but are permitted only from certain types of employer-sponsored plans and then only under circumstances specifically enumerated by the plan. Withdrawals from IRAs, except those from nondeductible contributions, are subject to income tax. Similarly, withdrawals from quali-

fied plans, except those from after-tax employee contributions, are subject to income tax. In general, withdrawals from IRAs and qualified plans prior to age 59½ are also subject to a 10 percent additional tax.

PROPOSAL

The proposal would permit Operation Desert Storm personnel to make penalty-free withdrawals from IRAs and employer-sponsored qualified plans.

ADMINISTRATION POSITION

There are currently before the Congress a wide variety of proposals to permit penalty-free withdrawals from IRAs for a variety of circumstances, including unemployment, illness or disability, and for such worthwhile expenditures as children's education. The Administration has opposed each of these proposals. In general, the special tax benefits accorded individual retirement accounts and employer-sponsored qualified plans are incentives directed toward retirement savings. Therefore, the Administration does not support any withdrawals from IRAs or qualified plans which would result in premature consumption of retirement savings. The President's fiscal year 1992 Budget proposal which would permit penalty-free IRA withdrawals for first-time home purchases is fully consistent with this position as homeownership constitutes a principal source of retirement savings.

Qualified Veteran's Mortgage Bonds

CURRENT LAW

Qualified veterans' mortgage bonds are general obligation bonds of a state, the proceeds of which are used to finance mortgage loans to veterans. The issuance of qualified veterans' mortgage bonds is currently limited to those states that had qualified veterans' mortgage bond programs in effect before June 22, 1984 (Wisconsin, Texas, Oregon, California and Alaska). Loans financed with qualified veterans' mortgage bonds may be made only to veterans who served on active duty before January 1, 1977. The loan must be made with respect to a principal residence and must be applied for before the later of 30 years after the veteran leaves active service or January 31, 1985.

Each state program is subject to an annual volume limitation based on issuance levels between January 1, 1979 and June 22, 1984. In addition, 95 percent of the net proceeds of an issue of qualified veterans' mortgage bonds must be used for the purpose of the issue; i.e., to make mortgage loans to veterans to purchase principal residences.

PROPOSAL

The proposal would permit states to issue qualified veterans' mortgage bonds to veterans of Operation Desert Storm.

ADMINISTRATION POSITION

The Administration opposes this proposal. When Congress phased out the issuance of veterans' mortgage bonds in 1984, it stated that its reason for doing so was concern about "the increasing volume of veterans' mortgage bonds being issued by a number of States (more than \$3.5 billion in the years 1980 through 1982) and the potential for expansion of veterans' mortgage bond programs to states that had not issued those bonds in the past." Congress decided to limit the issuance of these bonds to preexisting state programs, to amounts based on previous volume levels, and to veterans who served in active duty before 1977 to limit the potential Federal revenue loss from expansion of veterans' mortgage bond programs. The Administration believes these concerns are as valid today as they were in 1984 when the restrictions were imposed.

Additionally, the proposed rules for qualified veterans' mortgage bonds impose no limitation on the income of the veteran and no limitation on the purchase price of the residence. Veterans with substantial family or other wealth would therefore be able to use government subsidized mortgages to purchase expensive homes without any showing of the need for such subsidy on the part of the veteran. Moreover, much of the Federal revenue loss from such a tax-exempt bond program would benefit bondholders and financial intermediaries rather than the intended beneficiaries. The Administration feels this would be an inefficient allocation of government resources.

Further, the Administration believes that this proposal would substantially duplicate an existing direct subsidy entitlement program that more efficiently channels

Federal resources to facilitate homeownership by veterans. The VA mortgage guarantee program is already available to veterans (provided that they qualify for a mortgage). It guarantees a portion of the mortgage, effectively allowing veterans to purchase a home with no downpayment, and generally provides an interest rate below the private market rate. The percentage subsidy decreases with the size of the loan.

Income Exclusion for Persian Gulf POWs and MIAs

CURRENT LAW

Regulations under section 112 provide that a member of the Armed Forces in active service in a combat zone who there becomes a prisoner of war or missing in action is deemed to continue in active service in the combat zone for the period for which the member is entitled to that status for military pay purposes. In the case of the Vietnam conflict only, section 112(d) adds certain additional relief provisions. Under one of these provisions, the exclusion amount is not limited for commissioned officers who are in missing status (which includes prisoners of war). Under another, an unlimited exclusion is provided to civilian employees of the Federal Government who are in missing status.

PROPOSAL

The proposal would extend additional relief provisions similar to section 112(d) to commissioned officers and civilian employees of the Federal Government in missing status in Operation Desert Storm.

ADMINISTRATION POSITION

The Administration supports this proposal.

Inclusion of Operation Desert Storm Service in Calculations under Qualified Pension Plans

CURRENT LAW

The Internal Revenue Code and ERISA provide rules for determining what years of service are required to be taken into account under a qualified pension plan for participation, vesting and benefit accrual purposes. These rules generally do not require that periods of absence due to military service be taken into account. However, other laws may require periods of military service to be taken into account under an employer's defined benefit pension plan where the reservist is reemployed by the employer following military service (see *Alabama Power Co. v. Davis*, 431 U.S. 581 (1977) (requiring such periods to be taken into account under a defined benefit pension plan); compare *Raypole v. Chemi-trol Chemical Co., Inc.*, 754 F.2d 109 (6th Cir. 1985) (permitting such periods to be ignored for purposes of determining benefit allocations under a discretionary profit-sharing plan).

Under the Code, annual contributions to a defined contribution plan are limited to the lesser of \$30,000 or 25 percent of compensation for the year. This limit could preclude or reduce significantly contributions to an employer's qualified plan during a period of military service where the reservist is no longer receiving the same compensation from the employer as he or she was receiving before being called up to military service.

PROPOSAL

The proposal would permit an employer to take into account under qualified pension plans periods of absence due to military service.

ADMINISTRATION POSITION:

The Administration supports permitting employers to take periods of absence due to military service into account under an employer's qualified pension plan and otherwise to facilitate continuing participation in qualified plans during such periods. In the case of defined contribution plans, the proposal would require a modification of the present law limitation imposed on such plans to permit an employer to impute compensation at the pre-military service level during the period of military service. In that regard, a similar provision (Section 415(c)(3)(C)) exists under present law which applies in cases of periods of absence due to permanent and total disability.

Above-the-Line Deductions for Reservists

CURRENT LAW

Employees are generally allowed to deduct trade or business expenses "above the line" (i.e., in arriving at adjusted gross income) only under a reimbursement arrangement with the employer which requires the employee to substantiate the expenses. Otherwise, virtually all unreimbursed employee trade or business expenses as well as any expenses that are reimbursed under a nonaccountable plan must be treated as miscellaneous itemized deductions, deductible only to the extent that the taxpayer's total miscellaneous itemized deductions exceeds two percent of adjusted gross income. In addition, generally only 80 percent of the otherwise allowable cost of food, beverages and entertainment is allowable as a miscellaneous itemized deduction.

PROPOSAL

The proposal would allow an above-the-line deduction to all military reservists for expenses, such as the cost of uniforms, and travel and meals while away from home, in connection with their reservist duties.

ADMINISTRATION POSITION

The Administration opposes this proposal. The proposal would not benefit reservists who have been called to duty stations in the Persian Gulf area because they are not generally incurring expenses of the type addressed by the proposal. Instead, the proposal primarily would benefit reservists in the United States in peacetime as well as during the current conflict. It would complicate the administration of the tax laws and taxpayers' attempts to comply by adding provisions to both the individual income tax form and its instructions. The limitations on deductions of employee business expenses were enacted to simplify tax reporting and reduce recordkeeping requirements. We do not believe that exempting reservists from tax rules that apply to other employees, including other government employees and members of the military, would promote equity in the tax laws. Direct appropriations are a better method of insuring a strong and effective reserve force.

Extend EITC to Military Personnel Stationed Overseas

CURRENT LAW

Current law provides a refundable earned income tax credit (EITC) to certain low-income workers. Low-income workers with qualifying children may be eligible for an EITC of up to 17.3 percent of the first \$7,140 in earned income. The maximum amount of the EITC is \$1,235 for 1991. The EITC is reduced by an amount equal to 12.36 percent of the excess of adjusted gross income (AGI) or earned income (whichever is greater) over \$11,250. The EITC is not available to taxpayers with AGI over \$21,245.

Families eligible for the EITC may also qualify for two supplemental credits. The eligibility criteria, income and phaseout requirements are the same as those for the EITC. An additional credit is provided for qualifying children under the age of one, as of the close of the taxable year of the taxpayer. The maximum credit for 1991 is \$357. A credit is also available to taxpayers for qualified health insurance expenses that include coverage for a qualifying child. The credit percentage is six percent of earned income and the phaseout rate is 4.285 percent. For 1991, the maximum credit is \$428.

In order to be eligible for the EITC, qualifying children must have the same principal place of abode as the taxpayer for more than one-half of the taxable year and such abode must be in the United States. Thus, military families stationed overseas are not eligible for the EITC.

PROPOSAL

The proposal would extend eligibility for the EITC to military personnel stationed overseas.

ADMINISTRATION POSITION

The Administration supports this proposal, subject to offsetting the revenue loss involved. In this connection, the Defense Department and the Treasury Department have identified certain potential improvements in reporting of relevant information to military personnel. Such reporting would serve to notify military employees that

certain items excluded from gross income, such as combat zone compensation, quarters and subsistence (whether provided in-kind or by basic allowances in lieu of these in-kind benefits), are included in the computation of earned income for EITC eligibility purposes. Such amounts would also be reported to the Internal Revenue Service.

Extension of the Period of Unemployment Compensation for Individuals Involuntarily Separated from the Armed Forces

CURRENT LAW

Separated military personnel who are unemployed for 4 weeks after being separated from military service are eligible for up to 13 weeks of unemployment compensation.

PROPOSAL

The proposal would conform the military unemployment compensation regime to the civilian regime; *i.e.*, former service members would qualify for unemployment compensation one week after separation from active military service and the maximum period of unemployment compensation would be extended from 13 weeks to 26 weeks.

ADMINISTRATION POSITION

The Administration supports this proposal provided that appropriate offsets are provided and the enhanced benefits are limited to the following three categories of separated service members: activated reservists, involuntarily separated personnel, and personnel extended beyond their regular release date.

Rollovers of Military Separation Pay into Eligible Retirement Plans (S. 252)

CURRENT LAW

Generally, current income tax and, if otherwise applicable, early distribution penalties may be avoided on distributions from qualified pension plans and other tax-preferred retirement programs (including IRAs) if these distributions are "rolled over" to another retirement plan. There are a number of technical requirements that must be satisfied under current law in order to qualify for rollover treatment.

PROPOSAL

S. 252 would exclude military separation pay from current income tax to the extent the pay is rolled over to a tax-preferred retirement program. The severance pay rollover generally would be required to satisfy the requirements of existing law for pension rollovers, and the penalties for early withdrawal from retirement programs under existing law would apply.

ADMINISTRATION POSITION

The Administration does not support this proposal. As we understand it, military severance pay is awarded to those who have been involuntarily denied a military career in recognition of the Federal Government's responsibility to help military men and women ease their transition into civilian life. To permit deferral of current income tax on this pay would benefit those individuals who could afford to satisfy their transition expenses with other funds.

INTERNAL REVENUE SERVICE ACTIVITY

In conclusion, I would like to mention certain efforts by the Internal Revenue Service to respond to tax questions raised by Operation Desert Storm. Since August of 1990, the Service has endeavored to develop procedures and guidance designed to ease the tax burdens of our troops in the Persian Gulf area and their families, as well as others affected by the crisis. To date, this has resulted in the completion of several important projects including the issuance of guidance in the form of answers to frequently-asked questions arising from the Persian Gulf crisis, guidance to enable military personnel and others serving in Operation Desert Storm to file early for tax refunds, and the announcement of a special procedure that will ensure that applications for Federal tax exemption of organizations set up to help participants in Operation Desert Storm are reviewed and processed quickly. The Service has also made available free electronic filing to families of individuals serving in Operation Desert Storm. In addition, the Service is nearing completion of several other impor-

tant projects, including a pamphlet containing a series of questions and answers and proposed regulations relating to the combat zone compensation exclusion and section 7508. The Internal Revenue Service is committed to continuation of its policy of addressing tax matters affecting Armed Forces personnel in the Persian Gulf fairly and expeditiously.

PREPARED STATEMENT OF LT. GEN. DONALD W. JONES

Good morning Mr. Chairman and members of the Committee on Finance. It is a distinct pleasure to appear here today to present the views of the Department of Defense on tax matters affecting military members and their families.

Our troops in the Persian Gulf appreciate this committee's recent action to permit delays in filing returns and to permit paying interest on refunds. This action reinforces the Nation's commitment to support our troops in the Gulf.

Any review and modification of benefits available to veterans of the Persian Gulf conflict should be done in a coordinated, rational way and not on a piecemeal basis. Further, modifications to the benefit structure which result in increased costs, must fit within the parameters of the Budget Agreement. This means that discretionary expenditures (net of offsets) must fit within the spending caps and mandatory expenditures must be paid for on a pay-as-you-go basis.

The Administration welcomes the opportunity to participate in a process that reviews benefit proposals comprehensively, applies rational criteria to their assessment, and fits them within the Budget Agreement. To that end, Administration representatives are presently scheduled to meet with the Republican and Democratic DESERT STORM TASK FORCE Chairmen, Senators McCain and Glenn on Thursday, February 28, 1991.

To facilitate the business of this Committee we will comment on the pieces of legislation being considered by this Committee today—subject to two qualifications:

1. these proposals must also be considered in the comprehensive context we have described; and
2. the Administration reserves the right to withdraw its support for particular measures if the overall package does not meet the tests suggested.

TAX POLICY

Today, we would like to set forth our general policy on taxation of service members, and then to address a number of specific current issues. Our broad approach to tax policy for service members has three major tenets. First, the Department of Defense shares Treasury's view that the tax system generally should not be used to solve problems of military compensation. Second, we support efforts to simplify the taxes for all taxpayers, including those wearing a uniform. Third, and perhaps most important in the current context, we are very cautious about proposals to change military-specific tax rules.

Many of these rules have been in place for a long time or were developed to address a specific tax problem for military taxpayers. We are concerned, for example, that well-meaning efforts to address problems of one group may create inequities for others. Therefore we urge careful analysis of all potential consequences of each such proposal, and careful deliberations in hearings such as this one. Today we would like to address four classes of tax issues of concern to the military. The first is the combat zone exclusion.

COMBAT ZONE

Special tax treatment for members of the Armed forces in time of war or major armed conflict has been a part of our tax laws since World War I. Soldiers, sailors, marines, and airmen serving in combat during World War II, Korea, and Vietnam were allowed to exclude all or a portion of their pay from taxation. Under current law, the combat pay exclusion has been in effect in the Persian Gulf area since the President declared it a combat zone as of January 17. An exclusion from taxable income for soldiers, sailors, airmen, and marines serving the nation in times of war is not a military compensation issue; rather, the exclusion is the answer originally provided by this Committee in 1918 to the question of who should bear the financial burdens of government in times of war. Details of the exclusion have changed over the years to reflect changing circumstances. Several changes are also now in order.

Withholding

Under current law, all compensation for service in a combat zone is excluded from wages for withholding purposes. This is true for all members including commissioned officers even though commissioned officers may only exclude \$500 from gross income. This can create financial difficulties if an officer does not set aside sufficient funds to satisfy his tax liability—in effect, to do his own withholding. We request the committee correct this problem by limiting the exclusion from withholding to the amount excluded from income.

POWs/MIAs

Another very important issue that needs revision is the tax treatment of POWs/MIAs. During the Vietnam conflict, the combat zone exclusion applicable to enlisted members was extended to all prisoners of war including commissioned officers and civilian employees. Such treatment was also applicable to crew members of the *USS Pueblo* and hostages held in Iran. We recommend the Committee extend similar treatment to commissioned officers and civilian employees who are POWs/MIAs in this conflict with Iraq. We suggest that the exclusion to POWs/MIAs be made permanent.

MILITARY FAMILIES

The second group of issues concerns the tax treatment of military families. Today more of the total force is married and more members have children than at any time in history. As a result, circumstances affecting the quality of life of military families are an increasingly important consideration for the Defense Department. These concerns extend to tax matters with particular impact on military families. There is an area that we suggest the Committee consider for remedial action.

Earned Income Credit

Under current law, low-income families (including the families of young, junior enlisted members) can qualify for a refundable income tax credit of as much as \$1,413 in 1991. This credit is indexed for inflation. Military families have two problems under current law. First, the tax credit is not available to military families serving overseas. The second problem is a concern for potential erroneous computation of the credit due to confusion over nontaxable allowances and in-kind housing, inadequate reporting, and inconsistencies with regard to advance payment.

During the 101st Congress, Secretary Cheney, on behalf of the Administration, requested enactment of legislation to remedy these difficulties. In addition, at hearings on the matter before the House Committee on Ways and Means last year, DoD and Treasury urged the Congress to enact this remedial legislation. Treasury repeated this request late in the 101st Congress. DoD urges favorable action on this proposal.

INDIVIDUAL RETIREMENT ACCOUNTS

Several matters regarding IRAs should be addressed.

Reserve Issue: Active Participants

Current law limits the ability of active participants in an employer-provided retirement system to deduct contributions to an Individual Retirement Account. Most members of the Armed Forces are considered active participants in the military retirement system even though the military retirement system is not a qualified retirement system and retired pay is generally viewed as reduced compensation for reduced services rather than deferred compensation for past services.

Under current tax law, members of the Reserves on active duty for a period less than 90 days are not considered active participants in the military retirement system for purposes of deducting IRA contributions. If otherwise qualified, they may deduct contributions to an IRA. By law, the President's recent call up of Reserves is limited to specific periods. These Reservists will be on active duty in excess of 90 days but should not be deprived of their opportunity to deduct contributions due to this military service. We believe current law should be amended to permit these Reservists to continue to be regarded as not actively participating in the military retirement system for IRA purposes.

Rollover of Separation Pay into IRA

Generally, current law permits employees who receive a lump sum distribution from a qualified pension plan to roll over this amount to an IRA without penalty. Income tax on the amount contributed is deferred until retirement. A proposal has

been submitted that would permit members who receive separation pay from the Armed Forces to roll that pay over into an IRA in the same way.

Separation pay is not a distribution from the military retirement system. It is payable only to those involuntarily separated. There is no vesting. It is intended to reduce financial difficulties of those who are involuntarily deprived of an opportunity for a military career and to assist in making the transition to civilian life by those who are not eligible for retired pay. Although akin to severance pay of a civilian employee, in some cases, members who received separation pay may eventually complete sufficient service to become entitled to military retired pay. In these circumstances, retired pay is reduced by the amount of separation pay.

Given these considerations, preferential treatment of separation pay appears inconsistent with current policy governing IRA contributions.

UNEMPLOYMENT COMPENSATION

Although not a tax issue, we appreciate this opportunity to address an important matter regarding unemployment compensation related to force reduction.

Under current law, unemployed citizens other than members of the Armed Forces are permitted up to 26 weeks of unemployment compensation after a waiting period of one week. Separated members of the Armed Forces remaining unemployed for 4 weeks are permitted up to 13 weeks of unemployment compensation. We believe as a matter of equity that involuntarily separated service members should be eligible for the same number of weeks as their civilian counterparts. We also support this change for those members who were retained on active duty in connection with DESERT SHIELD/DESERT STORM and reserve members recalled to active duty under section 673 provisions.

PREPARED STATEMENT OF SENATOR BOB KASTEN

Mr. Chairman, thank you for the opportunity to testify before this committee regarding mortgage revenue bond financing for veterans of Operation Desert Storm.

On February 5, 1991, I introduced the Veterans of Operation Desert Storm Homeownership Act of 1991. This legislation is very simple. It would make sure that the brave men and women called to duty in the Persian Gulf receive the same housing benefits that their predecessors from World War II, the Korean war, and the Vietnam war enjoyed.

Let me give you a little background on the mortgage revenue bond program for veterans. Current law does not permit certain States to issue bonds to make home loans to veterans discharged after January 1, 1977—following the Vietnam era. This limitation on veterans mortgage bonds was enacted in the Deficit Reduction Act of 1984.

Congress decided to limit tax-exempt bond funding for these veterans mortgages because it was concerned about the rising volume of bonds being used by a number of States—and therefore about the potential tax revenue loss for the U.S. Treasury. The issuance of these bonds was cut back to amounts based upon previous volume levels and limited to only those veterans who had served on active duty prior to January 1, 1977. The 1984 act also limited the issuing of those bonds to the five States that were currently participating in this tax-exempt bond program: Wisconsin, California, Texas, Alaska, and Oregon.

My legislation creates a sense of equity which defines as qualified veterans all American service men and women serving in the theatre of hostilities as determined by the President since August 2, 1990.

One version of my legislation, S. 354, would amend the Tax Code to permit tax-exempt State bonding for mortgage loans to Operation Desert Storm veterans living in one of the five aforementioned States. These States were the *only ones* participating in the program prior to June 22, 1984.

Even though not all 50 States participated in tax-exempt bond funding programs prior to 1984, I believe that my colleagues may wish to extend this measure to veterans of their home States. For this reason, I introduced a second piece of legislation, S. 355, which will allow every State to provide this program to veterans of Operation Desert Storm and prior wars should they so desire.

Mr. Chairman, to clarify the difference between veterans mortgage bonds and qualified mortgage bonds, I submit a side-by-side comparison which clearly defines the difference. For example, veterans bonds have no income limit, no purchase price limit, or first-time residence limit.

One of the most important differences in veterans and qualified mortgage bonds is that in my state of Wisconsin the Housing and Economic Development Authority

issues qualified mortgage bonds in an amount sufficient to exhaust Wisconsin's volume cap limitation. Thus, any qualified mortgage bonds issued by Wisconsin on behalf of its veterans would be in direct competition with Wisconsin's existing home loan program.

I have requested a revenue estimate for my legislation from the Joint Committee on Taxation. Preliminary indications from the staff is that the revenue loss from my legislation is very low--perhaps less than \$100 million. I will provide you with the exact figures very soon.

Mr. Chairman, I don't think any of us would want to turn our backs on the troops in Desert Storm. These brave young men and women of the Armed Services have taken up the challenge of defending America's ideals. To those who have heeded this call, we as a nation owe the same respect as was shown to veterans of past conflicts. My home ownership bill is an important step in this direction.

I have also attached a memo by the CRS, which provides an excellent background analysis of this program.

Thank you, Mr. Chairman.

Attachments.



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February 2, 1991

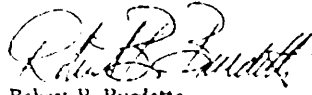
TO : Hon. Robert W. Kasten, Jr.
Attention: Cyndi Ward

FROM : American Law Division

SUBJECT : Hypothetical Proposal To Extend Benefits Of Qualified
Veterans' Mortgage Bonds Nationwide

This memorandum notes changes which would be required in hypothetical proposed legislation in order to make the benefits of qualified veterans' mortgage bonds available nationwide.

The hypothetical proposal described in your FAX would amend IRC §143(i)(4) by changing the current date limitation so as to allow veterans whose service occurs in connection with *Operation Desert Shield/Storm* to satisfy all of the conditions of the statutory definition for the term "qualified veteran." This would have the effect of allowing those States which were already allowed under the existing §143 to issue qualified veterans' mortgage bonds for veterans of prior conflicts to issue such bonds for veterans of the present conflict. It would not, however, either alter the amount cap under §143(i)(3)(B) or alter the restriction under §143(i)(2). Both of these unaltered provisions have the effect of limiting the number of States allowed to issue relevant bonds (paragraph (3)(B) by disallowing States that had not issued qualified veterans mortgage bonds prior to June 22, 1984, from doing so in the future and paragraph (3) by fixing as a ceiling on the amount of qualified veterans' mortgage bonds which can be issued by any particular State a sum equal to a percentage of the qualified veterans' mortgage bonds issued by that same State between January 1, 1979, and June 22, 1984). Obviously, if a State had issued no relevant bonds between the specified two dates, a percentage of the amount concerned would be zero.


Robert B. Burdette
Legislative Attorney

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January 31, 1991

TO: Hon. Bob Kasten
 FROM: American Law Division
 SUBJECT: Legislative History of Limiting State Tax-Exempt Funding for Mortgage Loans to Veterans to Those Veterans Whose Active Service Occurred Prior to January 1, 1977

This memorandum responds to your request for a legislative history of the limitation presently imposed under IRC §1430(b)(4)(A). That limitation only allows tax-exempt bond funding for mortgage loans made to those veterans who served in active duty at some time before January 1, 1977.

The limitation in question appears in the Internal Revenue Code where it does as a result of a comprehensive revision of all the rules relating to tax-exempt bonds issued by State and local governments that was made by the Tax Reform Act of 1986 (Public Law 99-514). While the 1986 revision made many changes in the federal tax treatment of State and local governments' bonds, the only change it made with respect to the limitation in question was to move it to its present location in the Code from the place where it had previously been codified. With respect to qualified veterans' mortgage loans, the so-called "blue book" for the 1986 Act¹ stated, in relevant part, that

The five States previously authorized to issue qualified veterans' mortgage bonds are permitted to continue issuing such bonds generally subject to the eligibility and other requirements contained in prior law.

Id., the "General Explanation of the Tax Reform Act of 1986," by the Joint Committee on Taxation (May 4, 1986), at page 1180. "Blue books" are often mentioned always published by the Joint Committee on Taxation, all publications of which are found between 401 and 409 covering enactment of major tax bills. They are *post hoc* explanations of staff. Technically, they are not part of official legislative history² (that term is traditionally used by reviewing courts since they neither were available to Members of Congress before any vote on legislation and thus cannot be deemed to represent views endorsed by the majority who voted to enact the legislation nor represent expressions of *Members'* understandings as to congressional intent.

Prior to the Tax Reform Act of 1986, the rules relating to tax-exempt funding of mortgage loans to veterans had been set out under IRC §103A. The relevant limitation appeared in subsection (c) of former §103A. Subsection (c) was captioned "[a]dditional requirements for qualified veterans' mortgage bonds". At paragraph (4) of subsection (c) of the former §103A, a statutory definition identical to the one currently set out at §143(d)(4)(A) appeared. In particular, like the current definition, the former one had the effect of limiting State tax-exempt funding of mortgage loans to veterans to those veterans whose active service had occurred prior to January 1, 1977.

The limitation under scrutiny was added in 1984 by the committee of conference on the bill ultimately enacted as the Deficit Reduction Act of 1984 (Public Law 98-369). The conference report's entire discussion of the amendments to the treatment of qualified veterans' mortgage bonds was, as follows:

6. Qualified veterans' mortgage bonds

Present law

Under present law, unlimited amounts of tax-exempt general obligation bonds may be issued to provide mortgages for the purpose of financing residences for veterans (qualified veterans' mortgage bonds). Unlike qualified mortgage bonds, the authority to issue these bonds did not expire on December 31, 1983.

House bill

The House bill provides that, beginning in 1985, the State ceiling for qualified mortgage bonds is to be reduced by the volume of qualified veterans' mortgage bonds issued by the State during the preceding year. In addition, the authority to issue qualified veterans' mortgage bonds is to sunset (together with the sunset for qualified mortgage bonds) on December 31, 1983.

This provision is generally effective for qualified veterans' mortgage bonds issued after December 31, 1983, except for bonds authorized by a State referendum before October 18, 1983, or pursuant to a State referendum before December 31, 1983, which referendum was authorized by action of the State legislature taken before October 18, 1983.

Senate amendment

No provision. However, the Senate amendment includes a section of the Senate resolution that (1) qualified veterans' mortgage bonds not be considered in applying State volume ceilings for qualified mortgage bonds, and (2) that no sunset date be enacted for qualified veterans' mortgage bonds.

CRS-3

Conference agreement

The conference agreement does not include the volume limitations or sunset date for qualified veterans' mortgage bonds contained in the House bill. However, the conference agreement provides that (1) the authority to issue qualified veterans' mortgage bonds is limited to programs that issued such bonds before June 22, 1984; (2) loans made with the proceeds of qualified veterans' mortgage bonds issued after June 22, 1984, are to be limited to veterans who served prior to January 1, 1977, and (3) applications for a loan made with the proceeds of qualified veterans' mortgage bonds must be made before the later of (a) the date which is 30 years from the date of discharge from military service, or (b) January 31, 1985. Additionally, under the conference agreement, qualified veterans' mortgage bonds are limited to principal residences as defined for purposes of qualified mortgage bonds.

The conference agreement further provides that State qualified veterans' mortgage bond programs may not issue bonds in excess of the average annual volume of bonds issued for the period 1979-1983.²

The "bluebook" for the 1984 Act³ includes the following relevant assertions:

Qualified veterans' mortgage bonds

In deciding to continue the qualified mortgage bond program, Congress was concerned by the increasing volume of veterans' mortgage bonds being issued by a number of States (more than \$3.5 billion in the years 1980 through 1982), and the potential for expansion of veterans' mortgage bond programs to States that had not issued these bonds in the past. To limit the potential Federal revenue loss from expansion of veterans' mortgage bond programs, Congress decided to impose limitations on these bonds that, essentially, limit their issuance to preexisting State programs and to amounts based upon previous volume levels. In addition, to limit the future use of veterans' mortgage bonds, issuance of these bonds is limited to veterans who served in active duty before 1977. Congress believed that these changes will prevent further increases in the issuance of veterans' mortgage bonds without unduly harming those States that have developed and maintained such programs. These changes also are intended to reduce the inequity between States that emphasize a veterans' bond program and those that rely primarily on qualified mortgage bonds or MIO.⁴

² See H. Rept. 98-861, at pages 1189-1190.

³ Published December 31, 1984.

SIDE-BY-SIDE OF DIFFERENCES BETWEEN
VETERANS MORTGAGE BONDS AND
QUALIFIED MORTGAGE BONDS

	VETERANS' BONDS	QUALIFIED MORTGAGE BONDS
A. First time Residence	Not Applicable	No ownership in a residence for 3 years
B. Purchase Price	Not applicable	No more than 90% of average area price
C. Income Limit	Not applicable	Family income not exceed 115% of applicable area family income.
D. Volume Cap	Average amount of veteran's bonds between 1/1/79 and 6/22/84.	Population based limit.

1
This data compares only federal law requirements. Each state may impose additional requirements.

PREPARED STATEMENT OF FRAN KRAUS

Mr. Chairman, I am thankful for this opportunity to share with you today issues facing our families within the National Guard and the systems that are currently in place to help with these issues.

I am Fran Kraus, a volunteer from the state of Colorado. I serve as the State Volunteer Coordinator for the Colorado National Guard Family Support Program—a national program out of the Department of Defense, through the National Guard Bureau (Army and Air National Guard) since 1987. This is a federally funded network nationwide with a Family Support Program in each state. The program has one paid position in each state and a National Family Program Manager at the National Guard Bureau.

Part of my responsibility in this position is to develop a volunteer network for support groups through leadership training, community networking and assistance. Family readiness and retention is the bottom line. To retain the Guard member you must retain the family.

I serve on the National Guard Association of the United States Committee on Families, as Area VI Representative, covering 14 states. This committee addresses special needs and concerns of families during peacetime and mobilization. I also serve on the 6th Army Advisory Council which provides leadership training for volunteers in the Family Program arena and related family concerns and resolutions.

The servicemen and women in the National Guard have joined for a variety of reasons and, as a result, during a crisis such as Operation DESERT STORM, we see a variety of concerns surfacing. The impact of a mobilization is a shared responsibility between the family, employer, Guard and community—truly becoming the Total Community Partnership.

The military can do many things to assist our families with the family support network in place. But we look to the community for the day-to-day support through understanding and financial assistance to our families who have a special need or family financial crisis. Special funds have been set aside through corporations or matching fund programs for family emergency needs. These are over and above the funds provided by our military system. Through our education to the community of our needs, they have been able to meet those needs.

Employer support of the Guard and Reserve is critical. We understand the role of the employer. This call-up affects business performance, strength, etc. and we understand that. Yet, it is vital that employers understand our role as part of the Na-

tional Guard family. It is important for them to recognize the needs of the Guard member and family member support. The impact of the call-up has affects on the employer of the spouse as well.

Families are dealing with stresses related to Operation DESERT STORM, one of these concerns relates to income. Mobilization is a critical time in the life of a Guard family. Suddenly reduced income only adds to the other concerns that family members must deal with. Inconsistent pay information further adds to that complication, along with processing concerns. Medical care is disrupted if the civilian employer benefits policies does not provide a workable or affordable means to continue that coverage. CHAMPUS now becomes the health carrier for family members and this provides another challenge.

Due to the support system that is in place, these stresses become easier to handle. Family Assistance Centers in each state are available to provide information, referral assistance and follow-up. All branches of service are working together to support our families, which is a plus for all concerned families and our communities.

Let me address some of our areas of concern.

CHAMPUS is costly and currently doesn't provide a COBRA type policy for our families upon the return of the member from active duty. Unfortunately, the deductible for outpatient care is doubling and hospital care for mental health patients is being reduced when the emotional stresses are the greatest!

Business closures are taking place as a result of the activation of Guard members who are self-employed or part of small partnerships. These members upon return from active duty will need assistance to restart their business. Micro loans (not tied to SBA) to reopen the businesses are going to need priority attention. A family member is now trying to run the business and may have given up his or her job to do so. This substantially affects the income of the family.

We are concerned about single parents.

Children are now with guardians. Many times these guardians are the grandparents. These guardians must learn or relearn the process of parenting through education and support. In cases where one parent remained, there is now, all of a sudden, a single parent—a major stress factor.

Career development assistance is of vital importance for returning members. They need to feel they can come back and fit into where they were or possibly build a better life.

Tax guidelines currently do not address those called to active duty but NOT serving in the combat zone. Being called to active duty in any form is disruptive to families.

The Soldiers' and Sailors' Relief Act, originally written in 1940, must be revised in a timely fashion to address the current needs and the future. This is critical and impacts the family. The failure to adjust the Act over time has created some real financial hardships. We need to make the Act flexible to changes in the economy.

Another area of concern is personal growth. Families adjust and grow which is a blessing and a challenge. One person leaves but a changed person returns home. The same applies to the person(s) left behind. Now we have two new personalities and new challenges in reunion.

Successes are equally important to gain family readiness.

Where a support system (support groups) was developed ahead of time, mobilization impacts and stresses were reduced. Information strengthens the ability to cope and the support system assists in problem solving. The value of the system is showing within the Guard. We are the leaders for all services. We need to share lessons learned and build or preserve the family support tools for the future. To preserve these tools, we need to sell the Guard on a day-to-day basis in the community. We need to maintain standing family committees during peace-time. Transitioning back to a peacetime is a time of adjustment and reunion. There may be employment problems because of changes in business structure or closure. This may cause problems as the member tries to re-enter the job market. Medical care is also a transition problem. We need to put a program in place that is affordable (COBRA) for a predetermined transition period.

During transition, there are emotional and financial stresses. Career counseling could be provided. By helping the member, they can more quickly integrate into the community.

I feel we are very fortunate. We should recognize when looking at the number of Guard members called to active duty how well they and their families have progressed through this crisis. This truly makes a statement about our Guard members and their willingness and readiness to serve. They have taken their duty seriously,

and so have their families. Family readiness has become their mission through education and support.

PREPARED STATEMENT OF C.A. (MACK) MCKINNEY

Mr. Chairman. I am Retired Marine Sergeant Major C. A. (Mack) McKinney, Legislative Counsel, Non Commissioned Officers Association of the USA (NCOA), and Co-Chairman, The Military Coalition.

The Non Commissioned Officers Association (NCOA) is a 160,000-member, federally-chartered organization representing active duty, reserve, national guard, retired, and veteran noncommissioned and petty officers of the United States Armed Forces. Many of the Association's membership is now serving in the Persian Gulf area.

The Military Coalition, a 24-member consortium of private military organizations, bonds together to share resources for the well-being of its memberships and the military community as a whole. The organizations have more than 1½ million members and represent a military community in excess of 9 million past and present servicemembers and families. The Coalition's organizational list and representatives is attached at the end of this statement.

In behalf of the Association and the Coalition, I extend gratitude to this distinguished Committee for the opportunity to address those tax issues that are of concern to U.S. servicemembers serving in the Persian Gulf area or recalled to active duty because of Operation Desert Storm.

THE ISSUES

The issues covered in this statement are as follows:

- tax exclusion of certain military pay from gross income—
- extension of time for performing certain acts under internal revenue laws—
- allowing penalty-free withdrawals from retirement plans—
- granting tax-free transfers of separation pay to qualified retirement plans—
- excluding imminent danger pay from gross income—
- allowing members of reserve components to deduct certain expenses in computing adjusted gross income—
- extend Earned Income Tax Credits (EITC) to certain servicemembers overseas.

TAX EXCLUSIONS

NCOA and the COALITION endorse the Senate bill, S. 199, that excludes from income the compensation received for active service as a member of the Armed Forces of the United States in a dangerous foreign area.

In addition to changing the words "combat zone" to "dangerous foreign area," which reflects today's modern geopolitical scenario, the bill increases the limitation applied to commissioned officers from \$500 to \$2,000. Most of the COALITION's enlisted associations believe that the limitation should be increased to cover all compensation earned in a dangerous foreign area.

The group bases its rationale for this position on the simple need for equity among those who lay their lives on the line so that Americans and many peoples of foreign nations may enjoy freedom from want and fear. It is almost unconscionable to them that our nation can ask its citizens to go to a dangerous foreign area, a hostile environment if you will, risk the loss of life or limb, and tax them for doing so.

Further, NCOA has for years sought equity in compensating both enlisted and officers when all things are equal. For example: Enlisted organizations have been successful in having Congress equalize hazardous duty pay for everyone assigned to duties that may cause one to lose his or her life or limb. Separation pay and per diem were other issues that NCOA worked to bring equity in payments to both enlisted and officer. So, it is only fair that the Association seeks equity for commissioned officers now that the shoe is on the other foot.

There is fault in the administration of the exclusion in gross pay. There are those who do not physically remain in a dangerous foreign area for more than five (5) days nor are they evacuated within that time frame as a result of wounds suffered in action. They should not be authorized exclusion of any compensation above the amount earned for the number of days actually spent in a dangerous foreign area.

EXTENSION OF TIME

NCOA and the COALITION address the extension of time for performing certain acts under the internal revenue laws for two reasons: First—to extend gratitude to

those in this august body who worked to adopt the bill, H.R. 4, in a most expeditious manner; and second—to seek application of the provisions of H.R. 4 to members of the National Guard and Reserve who've been called to active duty and are serving at other than their home stations.

Almost all of these reserve component members have changed from some civilian employment to a new status of military duty. Many are in extraordinary situations, such as self-employment, and business ownerships and partnerships, that require access to detailed tax records. Although active duty servicemembers change locations, their income and most circumstances remain stable.

PENALTY FREE WITHDRAWALS

NCOA and the COALITION support the bill, S. 82, with a proposed amendment (see below), that allows penalty-free withdrawals from retirement plans by individuals called to active duty in the Armed Forces for Operation Desert Shield (now "Desert Storm"). The amendment would be to include all servicemembers, regardless of component, who are serving in the area defined in S. 199 (if adopted) or H.R.

4. Personal funds should be made available to allow recovery from economic impacts brought on by the member's absence and assignment to a dangerous foreign area. And though it is recognized that many National Guardsmen and Reservists and their families may face extraordinary financial difficulties, so will certain members in the Regular component.

For example, being assigned to Operation Desert Storm is only temporary duty, not a permanent change of station. Thus, there are no government reimbursements for servicemembers' families to return home while the member is in the Persian Gulf area. These and other families are facing extreme budgetary problems while their servicemember sponsors are away from home. If they should have an individual retirement fund available, the Federal Government should allow them penalty-free access to those funds.

TAX FREE TRANSFER OF SEPARATION PAY

At the same time NCOA and the COALITION seek penalty-free withdrawals of certain retirement plans, the group also recommends the authorization of the transfer of separation payments, received pursuant to 10 USC 1174, to a qualified individual retirement plan without taxation.

Last year Congress authorized the downsizing of the U.S. Armed Forces. More than 500,000 servicemembers are to be separated, involuntarily if need be, over a 5-year period (1991-95).

To assist in their transition to civilian life, the servicemembers involuntarily separated would be entitled to separation pay. Eligibility was established at the 6-year level. Anyone under 6-years of active service was not entitled to the payment. However, it is expected that most of those separated involuntarily would have closer to 10 or more years. Thus, one might say that receipt of separation pay for them will be in lieu of any future retirement payments they may have earned if allowed to fulfill the 20 years to qualify for military retired pay.

Many of these servicemembers, originally programmed for involuntary separation in Fiscal Year 1991, were ordered to the Persian Gulf area. They were put on hold (stop-loss) awaiting the result of Operation Desert Storm.

Hopefully they'll return safely to the United States. When they do they'll be discharged, separated, or released from active duty. It would be a most gracious gesture on the part of this Congress to allow them to transfer any part or all of their separation payment to a qualified retirement account without payment of a tax on the amount transferred. It's the least Congress can do to thank these men and women for being inconvenienced, but more so for being ordered to a hostile environment when they believed they were on their way home.

IMMINENT DANGER PAY

Imminent danger pay is a payment made to servicemembers assigned to and serving in a hostile environment (37 USC 310). Most servicemembers serving in a dangerous foreign area and, in particular, Operation Desert Storm, forego basic allowances for subsistence (BAS) when ordered to depart from their home stations. BAS for enlisted servicemembers is \$184.20 each month and \$129 for commissioned officers. Both sums are not taxable.

To replace this loss, the member receives imminent danger pay at \$110 each month, but it is taxable if not excluded in law pursuant to such conditions as described in 26 USC 112 or H.R. 4.

Again, NCOA and the COALITION believe most strongly that no taxation of a servicemember's compensation should occur when that member is undergoing an alien threat to his or her life or limb. The group recommends the exclusion of imminent danger pay regardless of the circumstances under which it is paid.

TAX BREAKS FOR RESERVISTS

The bill, S. 246, will provide that certain deductions of members of the National Guard and Reserve units of the Armed Forces will be allowed in computing adjusted gross income. The deductions include expenses of travel, meals, lodging away from home, transportation, and uniforms while performing service with a Guard or Reserve unit.

National Guard and Reserve members incur a number of expenses related to participation in required training duty. The 1986 tax law effectively eliminated exclusion of these expenses from gross income for most members. Only those with itemized deductions in excess of percent of gross income can continue to receive any tax credit. This has an adverse effect on those members in the lower grades who have less income and gain nothing itemizing deductions.

NCOA and the COALITION recommends the adoption of S. 246. Expenses related to volunteer service in the Armed Forces of the United States should be recognized.

EARNED INCOME TAX CREDIT

Our last measure has been of significant concern to NCOA and the COALITION for some time. It is Earned Income Tax Credits (EITC) for junior enlisted servicemembers assigned overseas.

Operation Desert Storm provides the opportunity to highlight this oversight and seek change to existing tax rules.

EITC was enacted in 1975 to provide a tax credit for low income taxpayers with children. However, the law limits the credit to families living in the United States. Young servicemembers' families may benefit from EITC until they accompany their servicemember sponsors overseas as the result of official military orders. They immediately become ineligible for that tax year and any tax year they remain overseas under those orders.

Enlisted members assigned overseas with their families, who are now deployed to Operation Desert Storm, will have their compensation tax exempt during the period of hostilities. But at its conclusion, they may return to their overseas locations, their old taxpaying status, and ineligibility for EITC.

NCOA and the COALITION believe this is the time to review the issue and move to correct the inequity as soon as possible. Hopefully, this distinguished Committee will agree.

CONCLUSION


Mr. Chairman. NCOA and the COALITION echo your remarks of January 24, 1991, while managing the bill, H.R. 4, on the Senate floor: "With our troops in the Persian Gulf facing significant hardship and great danger, the least we can do in this Congress is recognize the major disruption, the extraordinary disruption, and make sure we do not add to their concerns . . ." The proposals herein will not only relieve those concerns but aid in welcoming home our troops from Operation Desert Storm.

As the Chairman proposed on that January day, ". . . we will have another opportunity to do what we can to take care of meritorious proposals to benefit our men and women in the gulf."

Mr. Chairman. That opportunity is here. It is now.

SPECIAL THANKS

Special thanks from NCOA is extended to the NATIONAL GUARD ASSOCIATION OF THE U.S. NATIONAL MILITARY ASSOCIATION, NAVAL RESERVE ASSOCIATION, and the U.S. ARMY WARRANT OFFICERS ASSOCIATION for their immediate response to NCOA and assistance in the preparation of this statement.



THE MILITARY COALITION

January 1991

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PREPARED STATEMENT OF SENATOR BARBARA A. MIKULSKI

I want to let the Committee know that this week I will introduce legislation recognizing some American war heroes—this country's Merchant Marine. We don't read about these men and women in the papers, or see them on the evening news. They work behind the scenes. They spend months in dangerous waters and foreign ports, separated from their families. They risk their lives in minefields and combat zones, sailing where foreign crews will not go. When their country calls, they are the first to volunteer. But America's Merchant Mariners don't get the recognition and the thanks they deserve.

My bill recognizes the effort and sacrifice of our Merchant Mariners, and rewards them for putting their lives at risk. This bill simply makes income earned by Merchant Mariners in a combat zone tax exempt, up to \$2,000 per month. It follows the logic of another bill, S. 199, introduced by Senator Glenn and others, of which I am a co-sponsor. S. 199 makes military income earned in a combat zone tax-exempt up to a limit of \$2,000 per month for officers, and unlimited for enlisted men and women. My legislation salutes those brave troops, and that their success also depended upon the courage and sacrifice of our Merchant Marine.

Today, Kuwait is free again, and it seems as if the fighting in the Gulf may finally be over. In one of the most astounding military operations ever, Kuwait has been liberated and Saddam driven back to Baghdad in six short weeks. All Americans should be proud of what our troops have done.

But we cannot forget any of the men and women who made this victory possible. Our Merchant Marines were a critical link in the chain. They ferried the Patriot Missiles and the M-1 tanks. They hauled the gas masks chemical warfare suits. The TV pictures of Iraqi troops—ragged and starving—drive home the critical importance of the task our Merchant Marines undertook. They helped build a city the size of Baltimore in the middle of the desert and carried cargoes that foreign crews wouldn't. They willingly sailed into mined waters and docked at ports targeted for SCUD missile attacks. And these Merchant Mariners served as volunteers, leaving their jobs and families behind.

PREPARED STATEMENT OF SENATOR RICHARD SHELBY

Mr. Chairman, members of the committee, I appreciate your giving me the opportunity to discuss with you the legislation that I introduced to assist members of the Armed Forces Reserves and the National Guard. I am pleased that this committee is fulfilling the pledge that it made last month when it reported the Dole bill to consider the various proposals designed to assist our servicemen and women in the Gulf. I hope that a markup will soon follow.

Although it appears that we have entered the last phase of the war in the Persian Gulf, the need to enact a package of changes to assist our service personnel is no less pressing. At this time, 206,000 Americans, members of the Armed Forces Reserves and the National Guard, have been summoned for active duty. These citizens have been summoned from their regular jobs, forced to disrupt their lives and put families and careers on hold as they answer the call of their country.

For many of these Americans, active service poses an economic hardship. For those with employers unwilling or unable to make up the difference in compensation, call up notices represent a dramatic loss of income. Families in which the only working parent has been called for active service may face a devastating economic crunch, exacerbated by the shortage of jobs available for the remaining parent during this time of recession.

For this reason, I introduced legislation to lighten the load of some of those summoned to active service. S. 82 would permit members of the Armed Forces Reserves and the National Guard to receive distributions from their qualified retirement plans, such as individual retirement accounts, without penalty. Specifically, this legislation would exempt individuals ordered to active duty after August 1, 1990, in connection with operation desert storm from the usual 10% penalty for early use of funds in a qualified retirement plan. The spouses of individuals summoned to active duty may also receive penalty-free distributions from their qualified retirement programs.

Unfortunately, this exemption is not for all military personnel, but only for those summoned to active duty in connection with this crisis. Those who were serving on active duty before this crisis have not suffered the sudden change in income that reservists and Guard members have and therefore do not have the same need for this exemption.

We must acknowledge, too, that this effort would not assist all Reserve and Guard forces on active duty, only those with qualified retirement plans. Some of the younger servicemen and women may not have yet begun to prepare for retirement and thus may not have this option open to them. I am hopeful that other measures can be taken to assist these persons.

However, I view this as a necessary step for those who it will assist. 206,000 brave and patriotic Americans have answered this country's call and should not be penalized unnecessarily by our Government. While the income of a Guard or Reserve member may represent helpful additional income in time of peace, it provides very little for a family suddenly forced to live on this stipend. This legislation is a necessary effort to assist service men and service women recently summoned to active duty.

The Joint Committee on Taxation has advised me that the cost of this legislation is "negligible." It I understand that to mean that it is hard to quantify but is likely to be very low. It is also true that this legislation is likely to increase the Federal Government's receipts in the short term because those service men and women that receive distributions will pay full taxes this year on that revenue.

Again, I appreciate the Finance Committee's efforts in seeking to assist our men and women in the Gulf and am glad for the opportunity to testify here today. I look forward to working with you and am prepared to answer any questions.

Thank you.

PREPARED STATEMENT OF SENATOR STEVE SYMMS

Thank you, Mr. Chairman. I will be brief because I look forward to hearing what our colleagues and the other witnesses have to say.

I want to join my colleagues in giving praise and thanks to the brave soldiers, sailors, airmen and Marines for the outstanding job they are doing to free Kuwait and to destroy Saddam Hussein's military machine.

You cannot help but be impressed with the resounding success of our troops—in the air, in the land of itself, and on the ground. Even our military leaders have commented on how the troops have performed beyond expectation. And I believe there are two basic reasons for the success.

First of all, the men and women of our volunteer force are second to none. They are bright, eager, enthusiastic and well-motivated. They are trained for their job like no other force in the world. And when duty calls, you can count on their commitment to carry out the task. Mr. Chairman, they deserve the nation's gratitude and appreciation.

The second reason, Mr. Chairman, is that the money we have spent on our weaponry has been money well-spent. In Congress, we've argued about the need for certain weapons programs—some of which are in the theater of operations today. And, as we debate the fiscal year '92 Defense budget later this year, we'll do it again. But the critic's and naysayer's arguments that certain weapon systems wouldn't work have proven to be unfounded.

Some people, for example, said the PATRIOT would never defend against a ballistic missile. And some questioned why we would spend so much money on so-called "smart" bombs or the stealth" fighter. Well, Mr. Chairman, I think the answer can be found just watching the amazing footage in the news, in the daily Pentagon briefing sessions we see on TV, and in the comments from the soldiers who use them and depend on them. These systems have performed with remarkable success.

One way of expressing our thanks is to make sure the troops have the best, warmest reception possible when they come home. To this end, in January I organized "OPERATION HOMEFRONT"—a grassroots volunteer effort to support our troops and their families. And in the Senate I introduced Senate Resolution 17, which passed the Senate in February, which encourages all other states to start their own "OPERATION HOMEFRONT" operations.

But Mr. Chairman, the hearing today focuses on the need to provide some tax relief to our troops in the Gulf and their families here at home. In my recent meetings with several family members who had a son, daughter, husband or wife in the Gulf, there was an overwhelming belief we need to review some of the personnel programs we will be talking about today. As a member of this Committee and as a member of the Senate Desert Storm Task Force, I look forward to working on these problems.

In particular, I think we need to look at the proposal to allow those serving as part of Operation Desert Storm to withdraw their money from an Individual Retirement

ment Account without suffering a tax penalty. I believe we may be hearing from my fellow Idahoan, Senator Craig, on this provision.

We also need to look at the rules limiting pension contributions. Many employers are paying their employees the difference between their military and their regular pay. And some of these employers are willing to contribute to the pensions of these servicemen and women as though they were still at home. There are restrictions on what the employer can do, and I think we need to look at loosening these restrictions for our people serving as part of Operation Desert Shield.

Thank you Mr. Chairman.

PREPARED STATEMENT OF SENATOR JOHN WARNER

Mr. Chairman, I want to thank you and the other members of this Committee for the opportunity to provide comments on the purposes of my bill, S. 252 which I introduced on January 23, 1991, to provide a savings incentive for members of the Armed Forces who are involuntarily discharged from active duty.

Mr. Chairman, the strength of our defense depends largely on the skillful and professional commitment of our military personnel. Americans are now witnessing the value of this commitment—a voluntary commitment—by supporting our allies in the war in the Persian Gulf.

However, despite the fact that our military represents the largest "volunteer" force in the history of our Nation, more than 18 percent of these soldiers, sailors and airmen and women—or 363,405 military personnel—will be involuntarily discharged from active duty status over a five-year period, beginning this fiscal year. This action was mandated last year by the Congress in response to the changing military and political situations in Eastern Europe and the Soviet Union and in an effort to reduce the Federal deficit.

Mr. Chairman, I wish to strongly stress the significance of this involuntary action on the men and women in uniform who chose military service as a professional career. This represents the largest reduction of an all volunteer force. Soon, thousands of well-trained and well-educated men and women will be involuntarily notified that they must seek other means of employment. Severance pay, which originated nearly 200 years ago with the act of May 14, 1800, modestly compensates military personnel for their service as they transition into civilian life. The amount of severance pay is calculated based on the number of years of active duty service—more than 5 years but less than 20 years—and the individual's monthly basic pay.

My bill, S. 252, would recognize the valuable contribution of military service by modifying Federal tax rules to defer taxation of severance pay where the veteran chooses to invest this money in an eligible retirement account such as an Individual Retirement Account, or retirement account sponsored by a future employer of the veteran. My bill does not change the existing Federal rules requiring such transfers to occur within 60 days of receiving the severance pay.

Mr. Chairman, my bill would provide a compassionate alternative to our men and women in uniform who are involuntarily discharged from active duty by offering them an opportunity to invest in their future and the future of their families. It would also contribute toward improving our national rate of savings. Americans save a smaller share of gross national product than citizens of any major industrialized nation. Low savings rates increase the cost of capital and reduce research, development, and productivity growth.

We can only speculate as to the total amount of severance payments and the amount of deferred revenue based on initial payments and subsequent income. However, the Congressional Budget Office advises that if all military personnel reductions occur as mandated in the fiscal year 1991 Defense Authorization Act, total severance payments could amount to \$3.71 billion by the end of fiscal year 1995. Moreover, the anticipated revenue deferred on this amount could be as high as \$4.5 billion, assuming that all servicemembers elect to transfer 100 percent of their severance pay into an eligible retirement account. Such a high rate of transfer will not of course occur. I would also point out that these revenue deferrals are just that—deferrals—not losses. Finally, these deferred revenues were not previously counted in any CBO or other Federal Government projection.

Mr. Chairman, my bill is a small but significant step at demonstrating the respect and gratitude of our Nation for the professional sacrifices of the men and women of our Armed Forces. I urge your favorable consideration of this legislation.

PREPARED STATEMENT OF CAROL WIGNALL

Good Morning, my name is Carol Wignall. My husband, Captain William Wignall, is an F-15 pilot stationed at Langley AFB, VA. Bill has been deployed to Saudi Arabia since August 7, 1990. The months since his departure have been a roller coaster of emotions, finances, and opinions. During the past seven months, I have had the good fortune to be part of a very supportive group of spouses from Langley. We try to meet weekly to boost each other's spirits, share experiences, and keep in touch. My three children have also benefited greatly from the contact with other children whose fathers or mothers are deployed.

A couple of months into the deployment, the group of spouses began comparing notes on how much the separation has impacted all of us. It appeared that Murphy had paid a visit to almost every household. The million different things that can and do go wrong seemed to affect everyone. One wife asked me how much money I had saved. Guiltily, I confessed that I had had a very hard time saving anything.

Yardwork, housework, childcare, home repair, volunteering and supporting each other constantly compete with one another for my time. I'm sure you as Senators are very busy and realize that it is just not possible for one person to do everything that should be done. I have found I have had to spend money hiring someone to do things my husband would normally do. The broken water heater, running toilets, and the majority of yard work has had to be hired out. During the three seasons Bill has been gone, Mother Nature has continued to grow grass, change leaves, and started the spring growing season. All of the mowing, raking, planting, and pruning that Bill normally does, has had to be done by neighborhood kids trying to earn money.

About the end of September, I received my first "Saudi" phone bill. Although there is not a price I could put on the relief I felt at hearing first-hand that Bill was doing well, adjusting to the environment, stress and uncertainty, my bill was well over \$300.00, which was not in my monthly budget. After that first bill, I now set the timer when Bill calls so we will not talk too long, and I can better keep my expenses in line.

With most of the hospital staff deployed from Langley, almost all of my family's health care has been off-base. With three children, chicken pox, flu, pneumonia, strep throat, and ear infections have traveled one to another causing numerous visits to the doctor's office. Consequently, my CHAMPUS payments have increased significantly since August. With April's impending increase in the CHAMPUS deductible, I am anticipating needing additional money for medical expenses.

Early in January, my support group, which includes a CPA and a military budget officer, began discussing income taxes, and how to deal with them. For many of us it would be the first time we had to figure them out without our husbands. We discussed workshops to help each other and filing extensions. When the legislation passed allowing six months after the military member's return, we all celebrated. What a relief that that additional stress had been lifted. Thank you for your support of that bill Senators.

January 16 was a day that we at Langley will not forget. Seeing the streaks of light aimed at the Baghdad sky, and wondering if that was our husband being shot at—on television—caused us all to gather around and watch the news coverage non-stop. Once again housework and cooking became sporadic and almost non-existent. My children still needed to eat, and I thanked my lucky stars that Taco Bell was down the street.

During all this time there has been a lot of financial stress placed on my family. As with any military separation, including remote tours, it costs the family much more to maintain closeness. The postal expenses, telephone bills and increased child care bills are all very important to be able to afford. The military member needs to be able to talk to his children to let them know he loves them and to let them know he misses them. The family left at home needs to be able to take time off from the 24 hour job of reassuring children, and household maintaining.

The expenses incurred while separated could be alleviated by lower interest rates on mortgages, no penalty IRA withdrawals, decreased CHAMPUS costs, and most significantly increasing the non-tax pay for officers from \$500.00 to \$2,000.00.

Thank you Senators for listening and pray for the safe return of our military.

COMMUNICATIONS

LAURA MILCOFF, HEARING ADMINISTRATOR
SENATE FINANCE COMMITTEE
30-305, WASHINGTON, D.C.

MS. MILCOFF,

I AM WRITING IN REGARDS TO THE HEARING HELD 2/27/91 ON PROPOSALS TO BENEFIT TROOPS IN THE PERSIAN GULF CONFLICT. I WOULD LIKE TO GO ON RECORD AS BEING IN FAVOR OF THE PROPOSALS. SPECIFICALLY:

1. THE PROPOSAL PERMITTING OPERATION DESERT STORM PERSONNEL TO MAKE PENALTY-FREE WITHDRAWALS FROM AN IRA AND EMPLOYEE SPONSORED RETIREMENT PLANS.
2. PERMITTING AN EMPLOYER TO INCLUDE AN EMPLOYEE'S DESERT STORM SERVICE IN CALCULATIONS FOR QUALIFIED PENSION PLANS.
3. ALLOWING AN ABOVE-THE-LINE DEDUCTIONS FOR CERTAIN EXPENSES (e.g. travel away from home, transportation and uniforms) INCURRED BY RESERVISTS AND NATIONAL GUARDSMEN.
4. EXTEND THE RETURN FILING DEADLINE FOR ALL RESERVISTS AND NATIONAL GUARD MEMBERS ON ACTIVE DUTY, REGARDLESS OF WHERE THEY SERVE.

ALTHOUGH MY HUSBAND HAS BEEN IN THE NAVY RESERVE FOR 14 YEARS, WE HAD NO KNOWLEDGE OF THE SAILOR SOLDIER RELIEF ACT. WHEN HE WAS ACTIVATED IN AUGUST 1990, WE HAD NO IDEA WHAT SALARY HE WOULD RECEIVE, IF HE WOULD RECEIVE A PER DIEM ALLOWANCE, OR WHERE HE WOULD BE STATIONED. WE WERE QUITE CONCERNED ABOUT HOW HE WOULD MEET OUR FINANCIAL OBLIGATIONS. BE WITHDRAWING FUNDS FROM OUR EMPLOYER SPONSORED RETIREMENT PLAN, WE WERE ABLE TO MEET OUR OBLIGATIONS WITHOUT FEDERAL ASSISTANCE. WHEN I READ IN THE NEWSPAPER OF TROUBLE THE BANKS ARE HAVING BECAUSE THEY HAD TO DECREASE MORTGAGE INTEREST RATES FOR DESERT STORM PERSONNEL, I AM DISGUSTED TO THINK THAT WE ARE BEING PENALIZED FOR TAKING RESPONSIBILITY FOR OUR OWN OBLIGATIONS WITH OUR OWN RESOURCES.

MY HUSBAND IS STILL SERVING IN BREMERTON, WASHINGTON. THERE WAS NO BIG FARE-ELL DEPARTURE FOR HIM OR HIS COMPANIONS. THEY LEFT WITH QUIET, TEARFUL GOODBYES FROM THEIR OWN HOMES. MOST OF THEM CAME TO THEIR WARLIKE DESTINATIONS. MANY OF THEM HAVE MADE SIGNIFICANT SACRIFICES TO FULFILL THEIR MILITARY RESPONSIBILITIES. NO ONE COMPLAINED ABOUT GOING.

THEY HAD BEEN TRAINED FOR THIS. BUT BECAUSE THEY WERE STATESIDE, RATHER THAN IN THE GULF, THERE HAS BEEN NO "THANK YOU". ALL WE HAVE HEARD IS "PRAY FOR THE MEN AND WOMEN IN THE GULF", "SUPPORT OUR MILITARY MEN AND WOMEN OVERSEAS", NOTHING ABOUT THE THOUSANDS FILLING VACANCIES HERE IN THE STATES. TO HEAR THAT COMBAT PAY WOULD NOT BE PAID AND THAT DESERT STORM PERSONNEL IN THE GULF WOULD NOT HAVE TO FILE THEIR TAX RETURN FOR 180 DAYS AFTER THEY RETURNED HOME WAS THE LAST STRAW. I FEEL NONE OF THE MEN AND WOMEN SERVING IN THE U.S. GAVE UP THEIR LIFE, BUT I THINK THEIR SACRIFICES HAVE BEEN JUST AS GREAT AS THOSE WHO SERVED IN THE GULF. I FEEL THERE SHOULD BE NO DIFFERENCE IN BENEFITS DEPENDING ON WHERE YOU SERVED, EXCEPT OF COURSE, FOR COMBAT PAY.

THERE WILL BE NO BIG HOMECOMING FOR THESE MEN AND WOMEN. THEY'LL RETURN AS QUIETLY AS THEY LEFT. BUT THEIR CONTRIBUTION AND SACRIFICES TO THIS CONFLICT SHOULD NOT GO UNRECOGNIZED. I BELIEVE THAT PASSAGE OF THESE PROPOSALS ARE THE LEAST OUR GOVERNMENT CAN DO TO SHOW THEIR GRATITUDE AND SUPPORT TO RESERVISTS AND NATIONAL GUARD MEMBERS WHO COLLECTIVELY MADE THIS CAMPAIGN A SUCCESS.

SINCERELY,

Lisa Hodge

LISA HODGE
5455 SOUTH 3925 WEST
ROY, UTAH 84067

BEST AVAILABLE COPY

14 March 1991

Laura Wilcox
Hearing Administrator
Senate Finance Committee
S.D. - 205
Washington D. C. 20510

Ms. Wilcox:

As an activated reservist, I am in favor of all proposals to benefit any military personnel serving in conjunction with Operation Desert Shield/Storm. I am in favor of extending the deadline date for filing federal and state income taxes, regardless of where served.

In conjunction with this proposal, please include above the line deductions to compensate for additional expenses incurred; ie. travel expenses from our homes, travel expenses at various military commands, necessary additional uniforms purchased by activated reservists and national guardsmen.

Because of involuntary separation from our civilian place of employment, most are concerned about employment sponsored retirement plans. Legislation to have employers calculate time served under orders during this time of world crisis or in any future action of this magnitude, would be of great benefit to Reservists and National Guardsmen and their individual retirement plans.

I am also in favor of suspending the penalty for early withdrawals on IRA's and employee sponsored retirement plans for Reservist's, National Guardsmen and their spouses, when used to compensate for the significant wage differences and financial hardships incurred by this military action.

Please take into consideration all of these proposals. Your favorable vote will demonstrate your Support for the Troops. Thank you for your time and consideration in this important matter.

Sincerely,

Rodney A Hodge, AM1, USNR

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