EXECUTIVE COMMITTEE MEETING

TUESDAY, OCTOBER 3, 1989

U.S. Senate

Committee on Finance

Washington, D.C.

The meeting was convened, pursuant to notice, at 3:15 p.m. in room SD-215, Dirksen Senate Office Building, the Hon. Lloyd Bentsen (chairman) presiding.

Also present: Senators Matsunaga, Moynihan, Baucus, Boren, Bradley, Mitchell, Pryor, Riegle, Rockefeller, Daschle, Packwood, Dole, Roth, Danforth, Chafee, Heinz, Durenberger, Armstrong, and Symms.

Also present: Vanda McMurtry, Staff Director and Chief Counsel; Ed Mihalski, Chief of Staff, Minority.

Also present: Jerry Olson, Assistant Secretary to HHS, Ken Gideon, Assistant Secretary for Tax Policy, Department of the Treasury; Robert Wooton, Acting Tax Legislative Counsel for Tax Policy, Department of the Treasury; Ronald Pearlman, Chief of Staff, Joint Committee on Taxation; Tom Gustafson, Director of Policy, HCFA; Don Muse, Senior Tax Analyst, CBO.

Also present: Dr. Marina Weiss, Chief Health Counsel, Majority; Ms. Anne Weiss, Professional Staff Member, Majority; Joseph Humphreys, Professional Staff Member, Majority; Richard Lauderbaugh, Professional Staff Member, Majority; Stuart Brown, Deputy Chief of Tax, Joint Tax Committee; Pat Oglesby,

Chief Tax Counsel, Majority; Norm Richter, Tax Counsel, Majority; Randy Hardock, Tax Counsel, Majority; Maurice Foley, Tax Counsel, Majority; David Reishus, Economist, Joint Committee on Taxation; Tom Barthold, Economist, Joint Tax Committee; Jim Ricciudi, Senior Analyst for Income Security, Minority; Linda Paul, Professional Staff Member, Minority; Sharon Salmon, Professional Staff Member, Minority.

[The press release announcing the hearing follows:]

The Chairman. Please cease conversation so that others may hear the comments of those who present the Reconciliation mark.

We will first proceed on Income Security. We are controlled somewhat by the information becoming available to get it in front of the forum for you.

Let me state what the hope of the Chair is insofar as scheduling. We will go with Income Security, and then I would anticipate, next, Spending. And when we complete that, we will move on to the tax issues. I would hope we could finish sometime tonight. My assumption is it will be quite late. The staff has been working on into the night and early this morning trying to prepare this information for us, and they have been under considerable pressure to get it accomplished. We certainly are grateful for the dedication they have expressed in doing it.

Mr. Humphreys, if you would proceed.

Mr. Humphreys. Yes, Mr. Chairman.

I am working from a set of tables which has the heading "Income Security Package" at the top of it, and the first series of items are items related to Social Security, which are included in the package.

The first item is to create the Social Security Administration as an independent agency. It would be an agency outside of any cabinet department. It would be headed

by a single executive appointed by the President with the advice and consent of the Senate. There would also be a nine-member advisory board, of which five members would be appointed by the President, with Senate confirmation; two members by the House, and two members by the Senate, all of these on a bipartisan basis.

The second item is to increase the amount of earnings --

Senator Chafee. Mr. Chairman?

The Chairman. Yes.

Senator Chafee. Mr. Chairman, how do you wish to proceed here? If we have questions to raise, do you want us to wait until the end of the list, or how do you want to do this?

The Chairman. I would like you to raise them as we go along.

Senator Chafee. Could I ask a question that has been bothering me, and it has been bothering others? That is, what are we going to include in this package?

Here, we are going into a very, very major piece of legislation, an independent agency as Social Security. Now, like most others, I can't clearly define what "reconciliation" is; but I find great trouble justifying that particular provision being on reconciliation. What happens is that this comes to the floor in a non-amenable package, no right of filibuster. It just deeply bothers me, what we are

doing here. And I suppose there will be some that I will like coming along through here.

Could you briefly state what the ground rules we are operating under are?

The Chairman. Senator, we are faced with -- I believe this piece of legislation is on the Reconciliation on the House side, is that correct?

Mr. Humphreys. That is correct. The House has many similar items in their bill, and the experience in past years has been that, a couple of years ago, with Social Security items, this committee decided not to do them, and we went into conference. The House insisted that we consider them in conference, and we wound up in a situation where the Finance Committee was not able to bring its position to the conference, hadn't developed a position to bring to the conference.

The Chairman. On this particular provision, we have had hearings on it, and, in all candor, if the House wasn't doing it, I would prefer we not do it. But I feel that Senator Moynihan has a much better proposal, and if we go into that conference, I would much prefer that we have this to counter any arguments. But I would defer to Senator Moynihan.

Senator Chafee. Well, Mr. Chairman, I am not here to beat the thing to death, and I really don't want to get into the merits of this particular provision as much as I am the

procedure. Senator Armstrong has raised this point many times, and it is disturbing, what we are doing.

The Chairman. Senator Heinz?

Senator Heinz. Mr. Chairman, I have one question of fact, and one of opinion.

The one of fact is, for what period of time is the single executive appointed by the President?

Mr. Humphreys. For a period of four years.

Senator Heinz. So if the President didn't get around to doing it for a year, that term would run for an extra year, into the next Presidential term?

Mr. Humphreys. No. I believe it is designed to be co-terminus with the President's term of office. If he didn't get around to appointing somebody, the previous commissioner would continue to serve until a successor qualified, but that successor would serve for the remainder of the term. So it would be coincident with the President's term.

Senator Heinz. All right.

Mr. Chairman, I just want to make the following point:

This may be a responsible way of addressing the interest of many members in having a so-called independent administrator of Social Security. But I do think it begs the central question that we are all getting asked about by our constituents, both workers and retirees, and that is: "When are we going to get the Social Security Trust Funds

completely out of the Federal Budget?" If we do not do that immediately -- and I recognize that Reconciliation is probably not the place to do it, for all the problems that might occasion -- I think we will be stuck with the reputation that all we did was fool around with the status of the Social Security Administration and did nothing on the real issue, which is to stop this game of deficit deception that we have been playing for too long.

It is my hope, Mr. Chairman, that the committee won't be passive in addressing this issue. I know that many members -- the Senator from New York and others -- are deeply interested in doing something about it. Senator Moynihan and I both have bills in. We cosponsored each others' bills. And we have this tendency to go through a commendable effort in Reconciliation to get the budget deficit down; and then, when we look around, after the numbers are counted up, the real deficit isn't down, it is up, because we are playing games with the annual increment of surplus in the Social Security System.

So, this Senator and I suspect many others are interested in getting that issue addressed. And if we don't do it in committee, we will be forced to do it on the floor, in the context no later than the Debt Ceiling Bill, and I just don't think there are the votes to pass a Debt Ceiling Bill without the Congress addressing this issue.

Thank you, Mr. Chairman.

The Chairman. Thank you, Senator.

Senator Moynihan. Mr. Chairman?

The Chairman. Senator Moynihan?

Senator Moynihan. May I just say to my friend from Pennsylvania -- he and I are cosponsors, as he said -- we will come to that matter on the Debt Ceiling Bill, which will be about two weeks or three.

The Chairman. Senator Armstrong?

Senator Armstrong. Mr. Chairman, I want to make two observations about this particular provision. First, I want to pick up where Senator Chafee left off about the process.

I must admit I have mixed feelings, because there are items included in this bill, particularly the very next item, on the earnings test, which are very close to my heart and a number of others. But the reality of it is that we have created a monstrosity, not only from the standpoint of creating kind of an impossible legislative situation, but in the sense that we really prejudice the budget process.

I think there are a lot of us, and I believe I am one of them, at least -- I may be the only one. But I am going to guess there are a lot of Senators who will never vote again for any kind of a reconciliation instruction, because they think it is so prejudicial to the overall legislative process that it becomes fiscally responsible and irresponsible in a

legislative sense.

I have just glanced at a 27-page list which is headed "Preliminary List of Extraneous and Other Problem Provisions in the Senate Reconciliation Bill." I can't vouch for it, but it was represented to me by the staff of the Budget Committee as provisions which are in violation, to some degree or another, of the so-called Byrd Rule. The Byrd Rule, as all Senators remember, was adopted when it was thought the process was being abused when legislation was put on this Reconciliation measure.

So I just want to echo what Senator Chafee has said, and also to say that I believe there is at work somewhere in the Senate an attempt to put together a package, or a unanimous-consent agreement, or something, where we would strip out every extraneous provision -- the good ones, the bad ones, those that we understand, those that we don't, which is most of them -- and simply put through a Reconciliation measure of very limited scope which would fulfill the Reconciliation instruction and permit us to avoid a sequester rather than bogging down on these other issues.

If such a measure were to come before us, I, for one, would think that would be a very good idea.

Mr. Chairman, having said that, I am prepared to go either way. I hope we will slim it down and take everything out, including the things that are of interest to me.

I would like to make one or two observations about this particular item, on its merits:

The Administration feels strongly that this is not a good idea. I mentioned this in the session yesterday. I have since talked both to OMB and to the White House, and they argue that this is a bad deal for senior citizens, that by splitting Social Security off as a separate agency, we eliminate the present, in effect, one-stop-shopping concept. They feel that many programs of HHS are very closely related to and of great interest to Social Security programs and the recipients, and that by splitting the two -- well, the analogy they use is, "Suppose somebody came forward with a provision to split the Navy Department off from the Department of Defense?" They just don't think it makes sense.

I wanted to mention that. I am not prepared at this point to carry the banner for them. I have discussed it with Senator Moynihan, who has done a thoughtful and patient job, as he always does, and who I judge has certainly got the votes for his position, if we contested it here in committee.

But I didn't want to be in a position of sand-bagging members. It may be that some of us will want to take a run at this on the floor, and I didn't want to do that without at least staking out that area of interest here today.

The Chairman. Thank you, Senator.

All right. If you would proceed, Mr. Humphreys.

Mr. Humphreys. The next item is the Social Security Earnings Test or Retirement Test. Under present law, once a retired worker who is age 65 to 69 -- it doesn't apply above age 70. Once a retired worker in that age level reaches earnings of $8888 a year, he loses $1.00 in benefits for every $2.00 in earnings.

This proposal would increase the amount of earnings that an individual can have with no loss of benefits to $11,700, starting next year, 1990, and then to $14,520 in the following year, 1991. And in addition to being able to earn $14,520 with no loss of benefits, the reduction rate on the next $5,000 of earnings under this proposal would be lowered from its present law level of $1.00 of benefits lost for every $3.00 earned to a lower level of $1.00 lost for every $4.00 earned, and then above that you would go back to the $1:00 for $3.00 under present law.

The next item on the list is what essentially pays for that item, and this is to build into the wage index that is used for indexing both benefit entitlement levels, and the amount of earnings subject to tax, the deferred compensation payments that are subject to Social Security Tax, have been since 1983, but were incorrectly, actually, not built into the indexing series. This would build those into the indexing series for the tax base immediately, and for the benefit computation levels starting once there were two years to

measure against each other, so that would be effective starting in 1993, that the benefit indexing points would go up.

The next item has to do with adopted children. Under present law, if a beneficiary of Social Security has a natural child after he becomes entitled to retirement or disability benefits, that child automatically qualifies. However, if he adopts a child, the child does not qualify. This would allow an adopted minor child to qualify on the same basis as a natural child.

The next item has to do with benefits for individuals who were on the Social Security Disability Benefits roles. If they are found to be ineligible, and they appeal the finding to an administrative law judge, under a present law provision that is about to expire at the end of this year, the individual is allowed to continue receiving benefits until an administrative law judge has ruled on his case. This provision would provide an additional one year extension of that continuation-of-benefits option.

The next item is an essentially technical item to assist in the administration in computerizing the claims process. It eliminates a number of very old computation methods that were grandfathered in over a period of years and substitutes a slightly more liberal assumption that makes it easy to computerize those benefit computations.

The next item relates to so-called Prouty Benefits. In the late 1960s, Congress enacted a special benefit for people who would reach age 72 before the late 1960s. This payment was intended to phase out, and it really became unnecessary when the Congress enacted the Supplemental Security Income Program in 1972. But because of some changes that have been made in the law, it suddenly appears that people will begin to qualify under this old program again in a couple of years if it is not eliminated. So this eliminates that provision.

The Chairman. Let's stop there, Mr. Humphreys.

They now have a vote in the Senate. This is not one of those things where one can stay and the rest leave. Let's all leave at the same time and then come back. And, please, come right back.

(Whereupon, at 3:32 p.m., the meeting was recessed.)

AFTER RECESS

(3:52 p.m.)

The Chairman. If you will cease conversation, we will get underway here.

Now, there are quite a number of these items that we went through yesterday. Rather than repeat all of those, I would like you, Mr. Humphreys, to deal with those that are changes, deletions, additions. That does not preclude, obviously, any member from asking questions about any one of the items that we went through yesterday.

Would you proceed with that in mind?

Mr. Humphreys. Yes, sir.

Well, the remaining items at the bottom of this page, starting with "Authority to Prescribe Magnetic Media," are essentially small, almost technical clean-up type items, most of which were requested by the Administration.

So, if there are no questions on that, I will go over to the next page, which deals with Social Security and Supplemental Security Income Items. These are items that affect both programs.

The first one, Representative Pay Reform, was discussed yesterday.

The Benefits for Participants in Non-State Rehabilitation Programs is just an essentially technical item.

The next several items on the page, except for the last item, are designed to improve services. Attorneys' fees was discussed yesterday. There has been no change in that.

So that would conclude the items that deal with Social Security and Supplemental Security Income.

Then on the next page, headed "Supplemental Security Income," are items that affect just the Supplemental Security Income program.

The first three items were describe yesterday. This is package of items designed to deal with improving the way in

which childhood disability benefits are determined.

The next item was not described yesterday. It is a small item which allows children who could be in institutions but are kept at home by their parents to get the personal-needs allowance that they would have gotten if they had been kept in an institution. It is a limited number of children.

The next item allows children of military service people who are stationed abroad, who have disabled children, to continue to qualify for SSI Disability Benefits while they are abroad.

The next several items are improvements that, in the way in which the SSI program works for disabled individuals, this was generally described yesterday. The main one is the first one there, which would allow a Social Security Disability recipient to transfer over to SSI and qualify under a special work program there at the point where he loses his Social Security.

The last items on the page exclude gifts of transportation down to valuation of in-kind support, clean up a lot of little almost technical problems in the operation of the SSI program that have been discovered over the years. None of them have any great significance.

The next page is Aid to Families with Dependent Children. The first item was described yesterday, which would preclude certain regulations from going into effect

until April of 1991.

The next item authorizes the State of Minnesota to run a particular welfare-reform demonstration project.

The next item on the page is a new item. This would establish a penalty in the form of loss of matching for Aid to Families with Dependent Children in the case of any State that fails to meet the October 1, 1990, deadline in the law for implementing the new Welfare Reform JOBS Program that was enacted last year.

The next page deals with a number of provisions relating to the Child Welfare and Foster Care Program. These were described yesterday. The major ones are an increase in the authorization for child welfare service and an extension and an increase in the Foster Care Independent Living Program.

The next page has four almost technical improvements in the way the offset program works for child support for non-welfare families. The first item extends the program; the others make it work a little better.

The last page is has two relatively minor unemployment compensation provisions. One is for States operating self-employment demonstration projects; it relieves them, up to $600,000 for the project, of the requirement that they repay any benefit costs, additional benefit costs, that people in the project incur.

The second one allows States that want to do this -- and

there is one State that has been prevented from doing this, and that is Minnesota -- to recover unemployment compensation taxes from people who didn't pay those taxes and subsequently become eligible for benefits. This would allow them to withhold the benefits, to get back the taxes that the individual didn't pay. That has probably some savings, but CBO can't estimate it.

That is the income security package, except for one item I didn't mention on the first page. I skipped over it, and Senator Moynihan reminded me that I had skipped over it; and that is that this would require annual earnings and benefits statements to be made available at request. In the short run, starting in 1995, they would have to be sent to everyone age 60 and above, and then starting in 1999 they would have to be sent annually to everyone.

That is the income security package.

The Chairman. Questions? Comments?

Senator Chafee. Yes.

That sending of those statements, who would have to send them?

Mr. Humphreys. The Social Security Administration would send them out, to the extent it was reasonably able to obtain the address information, primarily from Internal Revenue Records.

Senator Chafee. Isn't that quite a task, for them to

have to do that?

Mr. Humphreys. Will it cost? Yes.

Senator Chafee. It is not just the cost; it is the administrative and --

Mr. Humphreys. Well, the Agency now is able to do this, in fact, at request. The first part of the requirement is that they do this at request. In effect, they are already doing it. The state of their computers is such that they -- in fact, they have been promoting this, with some advertising, sort of inviting people to write in for these statements. So that is no longer a concern.

The Chairman. Mr. Olson, did you want to make a comment?

Mr. Olson. Senator Chafee, we have opposed the mandating of requiring those statements. The approach that we have been using and the interest that has been generated has been simply on a request basis, and we would feel much more comfortable with that approach. So, on this particular line item, we have opposed it.

The Chairman. Are there further comments or questions?

(No response)

The Chairman. Are we prepared to go on with the other spending items?

Senator Heinz. Mr. Chairman, concerning comments or questions, do you mean if you have something to say or offer,

"Speak or offer now, or forever hold your peace"?

The Chairman. I may prefer that, but I hardly would be that optimistic.

(Laughter)

Senator Heinz. Mr. Chairman?

The Chairman. Yes?

Senator Heinz. As the members of the committee who were present yesterday know, I am anxious to try and go farther than the committee has on the way the disability of children is determined.

I am pleased to report that we worked out some technical language to revise the procedures for determining disability among children, so that we specifically include consideration of activities of daily living, and we know how to do that. What I must tell you I don't have is, I don't have a very good offset to pay for it.

So what I want to do is to make one small modification at this time, which has a nearly insignificant cost, and that is a specific amendment to require that a pediatrician be involved, insofar as is practicable, in the determination of disability of a child.

I think the committee has made a couple of very helpful improvements in this area. They don't go as far as I would like. I am referring to the pre-effectuation review requirement. I commend the Chairman for his Outreach Program

for Disabled Children. I think that is very Important. But, obviously, if the determination process remains flawed, we are going to have a lot of children wrongly denied, and in my judgment the determination process does, notwithstanding these improvements, remain flawed.

What I would like to do is add that the Secretary shall also determine whether the effects of limitations on the child's activities of daily living are resulting from the impairment or combination of impairments that render the child disabled. But I don't have the money to do that available.

So, I would like to insist that we include the pediatrician amendment that I just described.

Senator Moynihan. Mr. Chairman, may I associate myself with Mr. Heinz?

Senator Pryor. Mr. Chairman, I would also like to associate myself. We held a Pepper Commission hearing in August, and we had some 1400 people. One of the testifiers, one of the witnesses, was an 11-year-old girl, Jennifer Nelson, from North Little Rock, who missed about one out of every four school days; she had to take 70 pills -- 70 -- each day. In addition to this, on test days, some days she could blow up a balloon and therefore was falling through the cracks and not eligible for whatever program.

I strongly associate myself with the Heinz proposal, Mr. chairman.

The Chairman. May I have staff comment on it?

Mr. Humphreys. Senator Heinz' proposed amendment to require, insofar as possible, a pediatrician or specialist to review the determination seems to us to be a valuable change, something that the Administration probably should be doing now, and it would seem to us to improve the process.

The Chairman. Would the Administration care to comment?

Mr. Olson. Yes, Mr. Chairman.

We have looked at the language that is being put together by Senator Heinz, and it appears to us to be just fine.

Senator Daschle. Mr. Chairman?

The Chairman. Yes. Senator Daschle?

Senator Daschle. I don't know that I oppose the amendment, but I am very concerned about what ramifications this may have in rural areas. We have a handful of pediatricians in South Dakota, total. We have no pediatricians in most of the rural areas of South Dakota.

If you are suggesting that in these areas a pediatrician would have to give some kind of final certification for eligibility purposes, it could present some real problems I would be interested if the Senator could address that.

Senator Heinz. The pediatrician review of these decisions would take place wherever there was a regional office that makes these reviews. Maybe there is a regional

office in the Senator's State and maybe there isn't, but they are done at a headquarters location, and they are typically not done in the many small and rural towns that both his State and my State would have a lot of, and where pediatricians would be in equally short supply.

So, as a practical matter, what we are talking about is having a pediatrician who is available in a particular area where a lot of this processing is already done. I doubt that it has any effect of the kind the Senator is worried about.

Senator Pryor. I think, too, Mr. Chairman, the language states the Secretary "shall make every reasonable effort" to assure that a qualified pediatrician or other appropriate specialist evaluates the case. So, I would assume that would allay the fears of Senator Daschle.

Senator Heinz. I was just trying to deal with the practical aspects of where are these things done. They are typically done where there is a fairly substantial medical community. Then, even if there isn't, Senator Pryor is correct in his reading of the actual language.

The Chairman. Senator, are you prepared to move?

Senator Chafee. Mr. Chairman, who chooses the pediatrician?

Senator Heinz. It would be chosen by HCFA.

Senator Chafee. Thank you.

The Chairman. Senator, are you prepared to move?

Senator Heinz. Yes, Mr. Chairman.

The Chairman. All right.

Senator Heinz. I move the amendment.

Voice: Second.

The Chairman. All in favor of the amendment stated make it known by stating Aye.

(Chorus of Ayes)

The Chairman. Opposed, a similar sign.

(No response)

The Chairman. What I would anticipate doing is that we vote on the Chairman's mark after we have finished with the section.

I would propose that we vote on the Chairman's mark after we have finished the section.

All right.

Senator Heinz. Mr. Chairman, may I thank the committee?

I would like to just bring to the Chairman's attention the fact that there is a provision in the House bill dealing with additional reviews of children. Their procedure is technically, I am told, not as good as what we have subsequently worked out, but I hope it will be possible, in conference, assuming that we ever get to conference with the House, for the Senate to take the best parts of the House proposal.

The Chairman. All right.

Are we prepared to move on with the spending provisions?

Dr. Weiss. Yes, Mr. Chairman.

You have before you a package on which the top sheet is labelled "Discussion Draft, Reconciliation Summary." I draw your attention to that sheet, because it summarizes for you what we believe to be, at this point in time, the net deficit reduction package amounts that are included in the materials we have laid before you.

I should say that these are not final estimates from the Congressional Budget Office, nor will we have final estimates until the legislative language is complete. But this is the best that we have at the moment. There are still a few items outstanding, but you can at least keep score here as we go along, based on what we know at this point.

Essentially, the Deficit Reduction Package saves about $3.6 billion in FY-90. There are spending initiatives included in this package totalling, in the area of health, about $780 million; in income security, just over $60 million. The net effect on the deficit is 2.799, and the committee's target under the budget resolution is 2.768. So you can see that we are quite close.

The Medicare target, discrete Medicare target for this committee, is $2.3 billion for 1990.

The first several pages of this document review the individual budget cuts.

Senator Chafee. What are you working from?

Dr. Weiss. Excuse me, Senator Chafee?

Senator Chafee. Are you working from the Discussion Draft?

Dr. Weiss. Yes, sir. Discussion Draft, Reconciliation Summary is the top sheet. I think the time on it is 2:18 p.m., today -- warm off the press, I guess.

The second through about the fourth page document for you the areas where the budget cuts are achieved. I believe we went through these at some length yesterday.

The Chairman. Let's just deal with those that are new or changed.

Dr. Weiss. All right.

The Chairman. Unless there is a question by one of the members.

Dr. Weiss. Then, if you will turn to the sixth page of that compendium of information, we can run through the Spending Initiatives.

We have divided these materials for you into a list of items that have a cost associated with them and a list of items that are considered non-costers.

Senator Rockefeller. Are the pages numbered?

Dr. Weiss. No, the pages are not numbered, Senator Rockefeller.

Senator Chafee. What are you working from?

Dr. Weiss. Excuse me, Senator Chafee?

Senator Chafee. Are you working from the Discussion Draft?

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Senator Rockefeller. Are the pages numbered?

Dr. Weiss. No, the pages are not numbered, Senator Rockefeller.

The Chairman. Would you identify the heading for them, please, on that?

Dr. Weiss. "Discussion Draft, Spending Initiatives." I believe it is the sixth page in your materials. These were put together by different people, and, as a consequence, there wasn't time to put page numbers on them.

All right. At the top of the document you will see that there is an Infant and Child Health package listed. This is a consensus package that was developed over the course of several months, and it includes many initiatives that individual members have brought to this debate, on improved coverage, on Medicaid, and the Maternal and Child Health Care Program of Pregnant Women, Infants and Young Children. The latest number we have for that is just under $200 million. That is a consensus package. We believe we have support on both sides for those items.

The Rural Health Care Package: $162 million -- again, developed in consultation with many of your offices, and many of your individual initiatives are reflected in that package.

There is a Physician Payment Reform package that has been developed by Senator Rockefeller and Senator Durenberger, and that was discussed at some length yesterday.

There is also a Health Maintenance Organization, an HMO, package that has been included and is not listed here, but it is a consensus package, as I understand it.

Am I right, Shannon?

Voice. We are all set on that.

Dr. Weiss. And the Physician Referral, a set of provisions on physician referral that again were developed under a consensus-type of process.

Then we move into a series of individual provisions. I think you see them numbered, beginning on that page labelled "Discussion Draft/Spending Initiatives," under the category "Miscellaneous Health Provisions." They number approximately 36.

Did you want me to go through those one-by-one?

The Chairman. I don't want to go through those that we have covered before. Let's just speak to those that we have not covered with the committee members before, or that are changes, or to any questions that might arise.

Senator Symms. Mr. Chairman?

The Chairman. Yes. Senator Symms.

Senator Symms. Marina, I had one question on item no. 16. I have been working with you. What do you have in item no. 16 now, on CNRAs?

Mr. Lauderbaugh. Senator Symms, the CRNE fee schedule provision would set a national fee schedule for CRNE services. It would be set at $14 and $21.

Senator Symms. So, that is basically the language I had originally?

Mr. Lauderbaugh. Yes.

Senator Symms. Okay. Thank you.

Thank you, Mr. Chairman.

The Chairman. All right.

Dr. Weiss. All right, Senator Bentsen.

Item no. 14 has changed a little bit since you saw it yesterday, in that we appear now to have a cost estimate, preliminary; but instead of $100 million, we are looking at something on the order of $35 million in FY-90. This is an effort to deal with the problem relating to teaching facilities that have nursing schools and allied health schools associated with them, and it involves a moratorium and some further work with the Department to try to get this straightened out.

Senator Dole. This is a problem that affects the University of Kansas, but also St. Louis University, the University of Mississippi, the University of Virginia, Penn State, Syracuse, Texas, and a few others are likely to be affected.

I think Marina has described it, but I hope we can include it in this package.

The Chairman. Yes, I see no problem with that. Would you like to move that?

Let me ask you, aren't these the items that we have in the Chairman's mark?

Dr. Weiss. Yes, Mr. Chairman, that is correct.

The Chairman. These items are in the Chairman's mark, and we will be voting on that as a package, unless someone wants to question one of the items.

Senator Dole. This is an effort to prevent hospitals from retroactive losses.

The Chairman. Yes.

Senator Heinz. Mr. Chairman, I am a little confused. Did you say that all of these items, these 36 items called "Miscellaneous Health Provisions" are in the Chairman's mark?

The Chairman. That is correct.

Senator Heinz. And so Senator Dole's provision is in the Chairman's mark?

The Chairman. That is correct. If someone feels to the contrary on one of these items, of course let us know.

Senator Durenberger. Question.

The Chairman. Yes.

Senator Durenberger. May I have a question on item no. 23, the AAPCC?

Dr. Weiss. Yes.

Senator Durenberger. Can you explain to me, I thought we were aiming to move the AAPCC from -- this is what we pay the competitive medical plans to go into these TEFRA risk contracts, where the elderly get to buy just one health insurance policy rather than a whole bunch of them. We have

been paying them at 95 percent of this so-called AAPCC. Actually, they have been paying them at like 92 percent.

I think, in those of your States where people have found they just can't make this work, we have concluded that one of the ways to begin to improve the competitive medical plans, which is a John Heinz invention from way back in 1982, is to move the payment, the 100 percent of the AAPCC. This doesn't look like it does it, and I was just wondering what this actually does.

Dr. Weiss. Yes, Senator Durenberger. The constraint here is a fiscal constraint. Over a period of three years we move to that 100-percent standard that you describe; but because of concern about staying under not only the budget resolution targets for purposes of reconciliation, but also stretching out those costs for purposes of the Byrd Rule, we have built this increase over a period of three years.

Senator Durenberger. If I may ask, Mr. Chairman, which is the problem that I should deal with now? Is it the Byrd Rule problem, or is it just coming up with some money? If so, would you tell me how much I need to come up with?

(Pause)

Senator Durenberger. I am sorry I didn't raise this earlier, but I actually didn't see this bill this morning.

Dr. Weiss. $195 million in the first year, were you to go to 100 percent.

Senator Durenberger. If we went to 100 percent in the first year, it would be $195 million?

Dr. Weiss. Yes, Senator Durenberger.

Senator Durenberger. Okay.

The Chairman. That would give us a real problem, obviously.

All right. What I would like to do is go on through these, and then if there is no dissent on an item in there, then that we have a vote on the Chairman's mark. And then we go back and see what add-ons the members might feel they would want to bring about, in addition.

Senator Armstrong. Mr. Chairman?

The Chairman. Yes, Senator.

Senator Armstrong. Mr. Chairman, are you at this point entertaining discussion on all the items in this package? I am not clear on where we are.

The Chairman. Yes. I will take discussion on any one of the items, obviously.

Senator Armstrong. Mr. Chairman, I would like to a word about the Physician Payment Reform Proposal, which has been developed over a period of time by our colleague Senator Rockefeller and Senator Durenberger, with a lot of input and a lot of very active lobbying by the doctors.

I believe this will be a very popular proposition. I believe it is also one horrible mistake. Unless there is

something about it I don't understand, it really comes down to this sort of a proposition:

We are going to try to equalize, at least to some extent and within certain restraints, between professional specialties and geographic regions. And I don't know how to put it any more simply than to say we are either going to level up or we are going to level down. And I find it very unlikely that we are going to level down. The guys in the high-priced specialties are not going to take a pay cut, and the doctors who practice in high-priced areas -- Boston, Palo Alto, Washington, D.C., wherever they are -- are not going to take a pay cut. So, if we equalize, the tendency is going to be to level up.

My hunch is that it is going to be very, very expensive. I don't have any documentation of this; but, when we discussed it yesterday, somebody through out the number that in routine kinds of surgical procedures like an appendectomy there could be a differential of as much as 50 and perhaps even 100 percent between a low-priced area like, say, Burlington, Colorado, and a high-priced area like Bethesda, Maryland. If that is true, we are building into this system an enormous incentive to increase the total cost of the package.

I just want to say it: The fix is in. I am not going to offer an amendment, because I know it wouldn't pass. But I just want to remind my colleagues that a few months ago we

passed a very popular proposal on catastrophic health care. It was extremely popular until people figured out what it did, and I will just tell you that, when this starts to kick in, there is going to be a storm of controversy, and in my opinion there should be. It is a time bomb waiting to explode. It is The Son of Catastrophic Health Care," in my opinion.

Senator Rockefeller. Mr. Chairman?

Senator Pryor. Mr. Chairman?

The Chairman. Senator Rockefeller.

Senator Rockefeller. In response to the distinguished Senator from Colorado, I might point out two things. One is that those who are receiving substantial payments at this point will indeed receive a cut, because it is in the law. Because a cut is not a happy thing, and because nobody, by human nature, wants to receive a cut, we very specifically phase it in over a period of five years so as to make sure that, as we accumulate data and information, if we make any mistakes in the course of that time, we can correct them. But that their costs or their reimbursement under Medicare will come down is absolute.

As to the matter of the explosive time bomb --

Senator Armstrong. But not with respect to any particular physician, I believe.

Senator Rockefeller. With respect to physician

categories and the ones who are charging the high prices at this point.

Senator Armstrong. I thought, in the discussion yesterday, that you pointed out that there was a hold-harmless clause with respect to an individual physician.

Senator Rockefeller. No. Until the fee schedule is in place in 1996, everybody is going to be affected by it, regardless of where they are and what they practice, in one manner or another -- family doctors and that whole cluster, which gets at preventive health and all of that, will go up; some of the anesthesiologists and others, more high charged, will come down. The will still be above the family practice, but they will come down.

Senator Armstrong. Absolutely?

Senator Rockefeller. Absolutely.

Senator Armstrong. Or relative? I thought, again, in the discussion yesterday, that the explanation was that they would be restrained so they wouldn't grow as fast as somebody else, so the gap would narrow.

Senator Rockefeller. You are confusing a point. After the fee schedule is in place, Medicare will continue to grow, because the number of beneficiaries are continuing to grow, and the Medicare inflation index, economic index, continues to grow. We are trying to slow down the growth of Medicare from its present 17 percent. After that is in place, then, you

know, those doctors are going to be receiving their cuts.

Now, as for the time bomb, it is precisely the opposite. If you look at the scoring of this, whereas it cost zero in 1990, it costs us minus in 1991. After that it goes up sharply. In fact, on a net basis for '90 through '94, it is over $2 billion that we will be saving.

Senator Armstrong. Yes, I remember how we scored Catastrophic Health Care a year ago, too.

Mr. Chairman, I have had my say. The fundamental premise of this seems to me to be demonstrably unsound. Price-fixing doesn't work. When you get into this kind of a complicated price-fixing scheme, it has just got all sorts of potential to go wrong, and in my judgment it is certain to do so.

But a year or two from now -- and I know this is going to pass -- a year or two from now we can take a look at it and say, "Well, it was 100 percent right," or, "It was 100 percent wrong," but I just didn't want to let the moment pass without noting that this is a program that, in my view, at least, is not going to work. It is going to be very costly, and it is going to engender, in time, a lot of controversy.

The Chairman. Thank you.

Who is seeking recognition?

Senator Pryor. I was, if no other member is offering an amendment or discussion.

The Chairman. Well, what I am asking, Senator, is that

we go all the way through these, not adding at this point. But if you want to strike a provision, make your motion, make your argument.

I would hope that, since we had discussed these, we could get through them and have a vote on this package, and then go back and add whatever has to be added, if there is no objection to that procedure.

Senator Durenberger. Mr. Chairman, I just want to clarify that instruction.

I raised the issue on No. 23, the AAPCC. I have a couple of suggestions on how to raise a little bit of money and maybe phase this in to 100 percent over two years rather than over three years, or some compromise. Would you want me to try to debate that right at this instance, or should I think about it and work with your staff a little bit?

The Chairman. Well, if you are talking about a change in one of these, I would assume now would be the time to do it.

Senator Durenberger. All right, Mr. Chairman. Then I would propose that, with regard to item no. 23, which is labelled as the "AAPCC," that we move to 100 percent of AAPCC in two years rather than -- I think it is three or three and a half, or something, as proposed. And that the financing for that come from capping the prevailing charge of the Allowance for a Designated Specialty. This is called A Designated Specialty Cap on Medicare Part-B Payments. I think there is a

provision similar to this in the House bill. That raises some money: $30 million in Fiscal Year '90, $35 million in Fiscal Year '91.

And the secondary I suggest we go to is establishing upper payment limits on durable medical equipment -- again, I believe this is an area that the House touched on to some degree -- Establish caps on carrier-wide fee schedules for durable medical equipment items at approximately, I think, 105 percent of the national median average.

The House does it at 95 percent; I am suggesting about 105, and I think that might raise the money, but I am not sure. So I would offer it by way of a suggestion for those of you who are interested in making these competitive medical plans work. I just don't think we can wait like going up a half a percent next year, and then something the year after, and something the year after that. I think it really would be helpful if we got this moving a little more quickly.

I would recommend doing it all in one year, I suppose; but I can't creatively think of where all the money would come from.

So I would like to move that.

The Chairman. Well, let us have comment on that. You have carried us a bit fast here, Senator. Let us be sure we understand the implications of it.

(Pause)

Mr. Lauderbaugh. Senator Durenberger, the proposals that you have made are legitimate proposals. The only objections I have heard to the specialty differentials is from some of the specialty societies. It would lead to the elimination of the specialty differentials a year or so --

The Chairman. Please pull the mike right up to you.

Now, will you repeat what you said?

Mr Lauderbaugh. Yes. What I said was that both of the proposals that Senator Durenberger made are in the House bill. They are legitimate proposals. The only objection I have heard to the designated-specialty provision is from some of the medical specialty societies. It would have the effect of eliminating the specialty differential.

The Chairman. Now, let me ask, do the proposals that the Senator has made pay for what he is seeking to do here?

Dr. Weiss. Mr. Chairman, I have just been advised by CBO that one of the proposals that Senator Durenberger offers has been included in the House bill and is priced at between $30 and $40 million.

The second proposal, I'm told, CBO has not yet priced; but under any circumstances there would be a deficit in the second and third year based on what CBO knows of the proposal at this point in time. So, we are a little bit short.

The Chairman. Could I ask, then, Senator, that you regroup and see what you can find, and let us move on? We

will come back and revisit this particular item.

Senator Durenberger. Thank you very much, Mr. Chairman.

The Chairman. All right.

Senator Boren. Mr. Chairman, just a question.

The Chairman. Yes, Senator Boren.

Senator Boren. In the Rural Health Package, I note that the Rural Referral Centers are included. Now, I know in the House bill that is a three-year extension. Do we have the same proposal here?

Dr. Weiss. No, Senator Boren, you do not. What you have before you is a proposal that would extend the moratorium for those facilities to a point six months beyond the time when the Department of Health and Human Services makes a report to the Congress about which facilities should be continued in that status and which should not. We did that largely at the request of the Administration.

Senator Boren. If that report were to come out, then, and we were not in session, and I think there are almost 100 such referral centers in States represented by members of the committee, would we have an opportunity -- that is such an important factor -- if they were to come out with that, would we have an opportunity to have time to take some action to prevent that from occurring? Or would they just automatically, then, be closed down within six months?

Dr. Weiss. Jerry Olson is here from the Department of

Health and Human Services. Perhaps he would like to speak to that issue.

Mr. Olson. I guess the comment, Senator Boren, would be that it seems to be certainly advisable that, before the Administration or the Agency simply comes out with a report, that the Members of Congress be consulted as to the potential impact, and we would give you every assurance that that would be the case.

Senator Pryor. Mr. Chairman?

The Chairman. Senator Pryor.

Senator Pryor. Pardon me, if Senator Boren has completed his.

This amendment, or this change, I think, Marina and Mr. Chairman and colleagues, gives a number of us a great deal of heartburn, because we certainly respect you, and we respect Mr. Olson, but we don't know what HCFA is going to do, not even tomorrow much less six months from now, and this affects adversely, I know, three of my rural health centers in Arkansas. In our centers, also in Oregon, Montana, Oklahoma, West Virginia, South Dakota, and Idaho, there could very well be an adverse impact.

Mr. Chairman, the Rural Health section of this whole package I think is one of the strongest statements on rural health care that we have made in a long time, and I would hate to see this glitch be passed out. I hope we can change it,

and I have such an amendment. I do have several cosponsors. I don't know whether this is the appropriate time. It is only the possibility of a $15 million hit over the next five years, and I don't know whether this is the appropriate time, Mr. Chairman, or not; but I don't want it to fall through the cracks.

The Chairman. Let us see some numbers.

Dr. Weiss. Mr. Chairman, I am advised that the cost may be a little bit higher than that, but there is a little bit of room, still, based on the numbers that we have, I think, since this morning.

Senator Pryor. Well, now, I think a while ago I heard you save about $60 million. Maybe I could, as we say, "slurp into" that a little bit to help pay for just a little bit of equity.

Dr. Weiss. Well, I believe I also said that these numbers aren't final as yet.

Senator Pryor. I understand that. Thank you.

I just didn't want to lose my opportunity, Mr. Chairman.

The Chairman. Yes, of course.

Yes, Senator Danforth. Is this on the same subject?

Senator Danforth. No.

The Chairman. Well, let us find out -- first, I am trying to resolve this one.

Are you proposing your amendment, Senator?

Senator Pryor. I would like to propose it at this time, yes.

The Chairman. All right.

Senator Symms. I second it.

The Chairman. Can I get further comments on it?

Staff, do you have any further comments?

Senator Dole. It conforms to the House bill, at three years?

Dr. Weiss. Yes, that is correct, Senator Dole.

Senator Pryor. The cost. That is correct.

The Chairman. And you say the cost is -- ?

Senator Dole. Negligible.

Senator Pryor. The cost estimate I have is, in 1990, $15 million, and no cost estimate thereafter that I have. I don't have a cost estimate on anything thereafter.

The Chairman. All right. And you so move?

Senator Pryor. I so move.

Senator Symms. I second it.

The Chairman. Is there any discussion?

(No response)

The Chairman. All in favor of the motion, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Thank you. Motion carried.

Senator Pryor. Thank you, Mr. Chairman.

The Chairman. All right.

Senator Riegle. Mr. Chairman, may I make an inquiry at that point?

The Chairman. Well, yes, an inquiry. Yes.

Senator Riegle. I understood that, setting that aside -- we just disposed of that -- that any other items that anybody wants to raise that may require additional spending in here you wanted to hold until the end.

THe Chairman. I would hope so, Senator, as we went through this whole package and looked at them. And if we could get a vote on that, we could get a feel for how much money we have spent.

I know there are a number of Senators that want additional add-ons.

Senator Riegle. I raise it at this point, and I will follow that order. It affects this rural hospital/urban hospital question. So, in effect, it is in this zone of discussion. It does cost some money, but if it is your preference to hold the remainder of those off until the end --

The Chairman. I would prefer that, if we can. I think we could make greater progress.

The Chairman. Senator?

Senator Danforth. Mr. Chairman, I apologize, but I am already late for a meeting of the Impeachment Committee for Judge Nixon, and there is a technical point relating to my

State. I think it a similar thing has been done for New Jersey. It involves Medicaid Disproportionate Share. It has no revenue effect. It is not part of the package; but, because it is a small item, and because I am going to have to step out of the room, I wonder if I could --

The Chairman. I understand. And no revenue impact.

Mr. Lauderbaugh. Senator Bentsen, it was brought to our attention just recently, and I have looked at it. It seems to be a legitimate transition problem.

The Chairman. All right.

Mr. Lauderbaugh. And they do seem to be complying with the spirit of the law.

The Chairman. Is there any objection?

(No response)

The Chairman. If not, we will put it in the package.

Senator Danforth. Thank you, Mr. Chairman.

The Chairman. Senator Dole?

Senator Dole. I was going to ask, pertaining to this package -- it is not a cost item, but it is an important item.

The Chairman. If it is not a cost item, fine.

Senator Dole. It is the Physician Payment Reform, and it goes back to the Durenberger-Rockefeller Amendment, but we have modified that amendment to provide that no authority is given to the Secretary to provide for an opt-out of any physician group until the Congress decides, after receipt of

the study.

Again, this affects Rural Health Care. The Durenberger-Rockefeller proposal calls for a study: Under what circumstances certain physician practice groups like HMOs can opt out of the new volume-performance standards. The study is due, as I understand it, in May of 1991; but the Secretary in the meantime can proceed to put this opt-out in place in October without any congressional approval.

Our concern, and I hope it is a concern of many who live in Rural States, is that we not end up in a situation where the only physicians treated more favorably are those in large groups -- a clear disadvantage for the sole practitioners located in the rural areas. Our rural physicians are often among the most fiscally conservative and should not be left out.

I think I can say with some credibility that HHS has not traditionally looked very favorably upon rural issues, without Congress forcing the issue.

So I think it has been called to the attention of staff. I think Sheila has talked to Marina about it.

I don't quarrel with the other. This is not going to do away with the possibility of an opt-out; it will simply require Congress to act, based on the results of the study before you could do that.

The Chairman. Would staff comment on that?

Dr. Weiss. Yes, Senator. We have looked at the description this morning. I did talk with Sheila about it briefly. We believe this is consistent with the intent of the Rockefeller-Durenberger package, to have congressional comment and opportunity for Congress to act on a variety of issues.

But perhaps Senator Rockefeller or Senator Durenberger would like to comment on this.

Senator Durenberger. Mr. Chairman, if I might, just briefly?

The Chairman. Yes, Senator Durenberger.

Senator Durenberger. I think we all come from similar kinds of States, where, to some degree, in rural areas -- and Bob Dole is reflecting this -- the sole practitioner or the two or three people in the little group in the small town are competing with a larger group in a town maybe 40 or 50 miles away. I think all of us are very sensitive to the issue that Bob raised.

It is probably just important to restate here that we are not trying to shift the burden by the so-called "opt-out." The opt-out doesn't mean that physicians who are in an eligible group no longer have to meet the volume performance standards or some of these other criteria that we set up for payment. In other words, everybody is going to have to meet the same objective, the same restraint, to comply with the complaint that Bill made here earlier. But the group can be

permitted, according to this study, a different way of going about meeting the same objective than an individual practitioner might be. In other words, the individual practitioner gets a rate of payment commensurate with his specialty.

In a group, you might lump the payments by procedure, regardless of which specialty is providing it. But the overall dollar amount would be in some way limited.

So I think we have overcome the very appropriate concern that Bob Dole has expressed in the way we have constructed it.

The Chairman. Well, I share the concern of Senator Dole. What you are calling for is a further clarification, isn't that so?

Senator Dole. Right. I am just saying that, after the study, Congress ought to act. We ought to decide. It is going to be pretty difficult to craft this legislation on who can opt out and who cannot opt out.

I have a lot of little towns in my State with one or two doctors. I don't quarrel with those at Mayo's or other places, but I think Congress ought to craft the legislation, not let the Administration in the interim here start letting large groups opt out. That is all I am suggesting, Mr. Chairman.

The Chairman. All right. Is there further comment on it?

Senator Baucus. Mr. Chairman, I just want to endorse what Senator Dole is saying.

The Chairman. All right.

Senator Baucus. Based upon experience, I think we have to have this provision in here.

The Chairman. Is there opposition?

(No response)

The Chairman. If not, all in favor of the provision make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

Senator Dole. And this is not a cost item, Mr. Chairman.

Senator Boren. Mr. Chairman?

The Chairman. All right.

Senator Boren. One other non-cost item. This may already be in report language; I just wanted to ask. I think Senator Rockefeller is aware of this.

In regard to the reimbursement rates for independent rural pathology labs, there is an overhead reimbursement always provided for hospital-based labs in the larger communities. It is my understanding it wasn't clear as to whether there would be similar reimbursement for overhead cost to rural labs, where you have them in different locations, free-standing.

I was hoping we could simply put report language in that would say that we urge the PPRC to establish an overhead reimbursement rate for physician services through the independent laboratories serving rural areas that would be comparable with the same kind of reimbursement treatment that is provided for hospital-based pathology labs.

I don't think this would be controversial. I wonder if we could just make sure we have some report language in for that.

The Chairman. Would staff have any comment on that?

Dr. Weiss. Yes.

Senator Boren, this is a legitimate problem. In view of the Physician Payment Review Commission, they will be looking at it, and, yes, we do have language. We have statutory language rather than report language.

Senator Boren. Would you have statutory language that asks them to establish a similar overhead reimbursement for rural areas?

Dr. Weiss. It asks PPRC to look at this issue and make a report to you, so that you can then act appropriately.

Senator Boren. Thank you very much.

The Chairman. All right. If there is no objection, we will have that.

Yes?

Senator Pryor. I have a non-cost item, Mr. Chairman.

The Chairman. All right. Senator Pryor.

Senator Pryor. The Omnibus Budget Reconciliation Act of 1987 required the States to come up with enforcement remedies and enact new laws by October 1, 1989. Well, HCFA has not come up with their regulations advising and setting up the guidelines.

The long story is short, Mr. Chairman. I am requesting -- and I have the sponsorship of HCFA, the nursing home industry, consumer representatives, State and health facility licensure and certification officials -- to delay this requirement, only until April 1, 1991.

It is a no-cost item, and I think it is constructive. And under the situation, I hope it will have the support of the Administration and the committee.

The Chairman. Does staff have a comment on that?

Dr. Weiss. Mr. Chairman, I understand we only learned of Senator Pryor's initiative last evening, and Richard tells me you should take it.

Senator Pryor. Thank you.

The Chairman. Are there any questions?

Mr. Olson. Mr. Chairman, we also would concur and support that wholeheartedly.

The Chairman. All right. If there is no objection, we will put it in.

Thank you.

All right, Marina, if you will proceed.

Dr. Weiss. Mr. Chairman, you had asked for us to identify other items that were not discussed at length yesterday. I would like to call to your attention item no. 20.

Mr. Lauderbaugh. Item no. 20 deals with coverage for the drug Ipichin, that is a drug for treating anemia in kidney patients. A determination has been made that it is a covered drug under the Medicare program, but there is a restriction in current law on its self-administration at home, by the patient at home. This amendment would permit patients to administer the drug at home, so they don't have to go to a dialysis facility to receive it.

Dr. Weiss. As we know, this is non-controversial.

The Chairman. All right.

Dr. Weiss. Item no. 30, the Respite Demonstration Project in New Jersey, is not included on this list, and it would be a continuation of the waiver.

Senator Durenberger. Did we move that out of Catastrophic, Mr. Chairman? Is this the one that was in the Catastrophic Bill (laughing)?

Senator Bradley. This was the Father of Catastrophic.

The Chairman. All right.

Dr. Weiss. Item no. 33 was discussed yesterday. But at the time we thought there was no cost associated with it; now

we learn there is a $5 million cost. So we draw that to your attention.

The Chairman. All right.

Is that it?

Dr. Weiss. Yes, sir.

The Chairman. May I have a motion, then, on the mark at this point?

Senator Moynihan. I so move, Mr. Chairman.

The Chairman. Is there a second?

Senator Symms. Mr. Chairman, excuse me.

The Chairman. Yes.

Senator Symms. Are you moving for the entire rural and the first mark?

The Chairman. That is correct.

Senator Symms. I have one item that I wanted to bring up to the committee that has been discussed before in this committee. There may be other Senators who have this situation. It is strictly an Idaho amendment, the way I have it written, but there could be others who have the same problem.

The Chairman. Senator, could I do this? Could we get the vote on the mark, and then new items we'll discuss? Since there are many of those to be brought up.

Senator Symms. I see. Thank you.

The Chairman. All right.

The motion has been made. Is there a second?

Voices: Second.

The Chairman. All in favor of the motion stated, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed, a similar sign.

(No response)

The Chairman. All right. Well, I must say that is a major move forward. Thank you very much.

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. Is it adequate to say that, now that we have spent a lot of money, now is the time to move along?

The Chairman. You are going to have to be pretty snug.

(Laughter)

Senator Moynihan. Mr. Chairman?

The Chairman. Yes.

Senator Moynihan. In a matter very much of the kind Senator Danforth raised, in the Medicaid Part-A area where the inpatient capital provision is, which exempts the high disproportion of chair hospitals, there is one hospital in New York which is well above the ratio for 1988. I think Dr. Weiss is nodding her agreement.

The New York Hospital, the second oldest in the country, is now well above the disproportionate level that is required;

but we are using 1987 data. The question is, could you mix '87 and '88? I believe this is in the House provision, and I would just like to raise it as something we might discuss in conference.

The Chairman. Oh, yes. I see no problem with that.

All right, Senator.

Senator Riegle. Mr. Chairman, I want to raise one that I know Senator Dole also has an interest in, as does Senator Rockefeller and Senator Heinz, and that is this issue that we discussed yesterday of so-called rural hospitals that are, in effect, in the immediate proximity of an urban area, and they are caught in that situation where their cost pressures and what they have to pay for -- personnel and staff, and so forth -- are essentially comparable.

We took an action on the so-called Luger-Riegle Hospitals two years ago to try to solve that problem. Through an inadvertency, the money to compensate them at a proper rate was taken out of the urban hospitals. We tried to find a way to solve that. The staff has worked with us. We think we have a way to do it.

There is a cost involved. It is estimated to be, I think, about $28 million.

Is that right or wrong, Marina?

Dr. Weiss. I have good news for you, Senator Riegle. I think it is 24 now.

Senator Riegle. Well, that is good news.

In any event, I don't know where we are in terms of earlier actions with respect to the footings on the discussion draft, but it looked to me as if there was, in terms of the mark put before us, enough room to accommodate an item of that size. But in any event, I think we don't want to backtrack here, because we have made this decision already. I would hope that we could handle this item. I know Senator Dole may want to be heard on this as well.

The Chairman. Would staff comment on this? Is this one that involves about five or six States?

Dr. Weiss. Fourteen States involved, Mr. Chairman. And at the time that the original provision was adopted, the language of budget neutrality was included, so it was anticipated that other hospitals would lose some funding in order to offset these costs.

The Luger-Riegle-Heinz-Dole-Rockefeller proposal, which has been developed in consultation with the Prospective Payment Assessment Commission and with staff on both sides, would cost $24 million in the first year and $162 million over five years.

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. May I just provide a slight additional historical footnote?

This goes all the way back to over '87, when we were trying to actually more fairly define the criteria by which the reimbursement for these borderline hospitals would be set, and we had it pretty well worked out.

But in conference, apparently what happened was that some very critical language was dropped, and the result was that we didn't get quite what we wanted. Although we tried to fix it last year, in fact our fix didn't make the situation any better; it may well have made it worse.

The intention all along of the Congress, as I understand it, was to treat these rural hospitals adjacent to urban areas fairly. One of the issues was commuting criteria, and obviously that is a significant element.

So, what we are trying to do is right a wrong that we have tried on several other occasions to do, but so far we have failed.

Dr. Weiss, Marina, would you generally agree with that historical background? Have I stated the issue correctly?

Dr. Weiss. Yes, Senator.

Senator Heinz. The entire Weiss team there?

Ms. Anne Weiss. No relation, Senator.

Senator Heinz. When one falters, the other charges in?

(Laughter)

The Chairman. Let me understand what is happening here. Are they averaging out? Or are they averaging up? Or what is

happening.

Dr. Weiss. Mr. Chairman, this is essentially a closed system, and what you are dealing with is reallocation of funds within a closed system.

There have been persistent problems with certain rural hospitals that have above average demands on their personnel and resources and so forth, and hospitals such as those that are described by Senator Heinz, that are geographically located close enough to a large major metropolitan area so that they have to compete for staff and offer higher salaries, and so forth.

The Chairman. What is the difference in the 14 States from other States? Why don't the other States have the same problem? I don't quite understand this.

Ms. Anne Weiss. I believe it is 16 States, Mr. Chairman. I'm sorry.

The Chairman. All right.

Ms. Anne Weiss. These 16 States had hospitals in them that, in the 1987 Reconciliation Bill, Congress directed the Secretary to treat as though they were located in nearby cities. The remaining States, the other 34 States, have no such hospitals in them, and they are not affected by this proposal.

The provisions in the 1987 Bill effected payment to hospitals that were treated as though they were in urban areas

and also effected payment to the urban areas that they were moved into, for the purpose of Medicare payments.

The Chairman. Well, it was kept revenue-neutral, so some of them had to take a cut. That is what was happening.

Ms. Anne Weiss. That is correct.

The Chairman. Now what is happening is, they are asking for additional funds to bring it up.

Senator Dole. Want to reinstate the '87 provisions.

Ms. Anne Weiss. Technically, as I understand this amendment, what it would do is guarantee each of the affected classes of hospitals -- hospitals that were paid as urban before the 1987 bill, hospitals that were redesignated as urban under the 1987 bill, and hospitals that were and remain rural under the 1987 bill. In each case those hospitals would, in effect, be paid the higher of what they would have been paid without the 1987 bill, or what they would be paid with the 1987 bill. It is basically a hold-harmless for all affected hospitals.

The Chairman. But a net cost increase.

Ms. Anne Weiss. That is correct. And the estimated cost. I believe the current CBO estimate -- and I am certain that is sensitive to seeing the precise legislative language -- the current CBO estimate, as Marina has said, is $24 million in Fiscal Year 1990.

The Chairman. And then what?

Ms. Anne Weiss. Thirty million in '91, 33 million in '92, $36 million in '93, and $39 million in '94, for a total of $162 million.

The Chairman. Are there any questions or comments?

Senator Heinz. Mr. Chairman, may I add one other comment here?

The Chairman. Yes.

Senator Heinz. These, of course, are static cost estimates. What is a practical matter in one of my counties, Beaver County, which is within commuting distance of Pittsburgh and a lot of major and rather expensive health care facilities, is that several of the hospitals in Beaver County which get this unfairly low rate will be forced to closed.

Where are they going to go for health care? They are going to commute into downtown Pittsburgh, and they are going to go to Allegheny General Hospital or Presbyterian University Hospital, the University of Pittsburgh Hospital, all of which are going to result in much higher rates of reimbursement, because that is the way it is. And the hospitals that could be doing this more cheaply, under this amendment, will in fact not be doing it, and the cost of this amendment will prove to be illusory, because the cost will be picked up at some other hospital as these hospitals which are discriminated against close.

Senator Moynihan. May I agree with Senator Heinz?

The Chairman. Are there any further questions?

(No response)

The Chairman. Do you move the amendment?

Senator Heinz. Yes.

The Chairman. Is there a second?

Senator Moynihan. Second.

Senator Dole. Second.

The Chairman. All in favor, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Carried.

Let me see where we are on the target now, insofar as how much room we have in meeting our objectives, moneywise.

Dr. Weiss. If you could give us just a minute, Mr. Chairman.

The Chairman. All right. Fine.

(Pause)

Mr. Muse. Senator?

The Chairman. Yes.

Mr. Muse. At this time CBO does not have either legislative language or in cases three, we have not completed three of the 111 estimates. Given what we know right now, it would appear you are all right. But, again, we do not have final numbers at this time point.

The Chairman. On four am I all right?

Dr. Weiss. Mr. Chairman?

The Chairman. What?

Dr. Weiss. We have done a very informal calculation here. Assuming that Senator Pryor's amendment does not carry an additional cost, we believe that, while your target is 2.768, you are now at 2.775.

The Chairman. Give me that again -- 2.768 and --

Dr. Weiss. You are at 2.775, and your target is 2.768. So, you are within $7 million.

The Chairman. And we are on the wrong side of that?

Dr. Weiss. No, no.

The Chairman. Oh, on the right side.

Senator Dole?

Senator Dole. Marina, I've got a question. It is in the same area, but it is a different type of hospital. It is a hospital in Hutchinson, Kansas. I would like the staff to see if they could be of some help.

Hutchinson is located in a designated rural area; but because of its size, 400 beds, and the nature of its services, it has been designated as a Rural Referral Center, which results in a higher payment, but it still receives the Rural Wage Index.

Hutchinson argues that it is larger than 50 percent of the hospitals in the adjoining urban areas and therefore has the same wage requirements. It creates a real problem for that community. It is rural all around the city of

Hutchinson, and I am wondering. I don't think there is much cost. There probably is some cost with reference to it, but I am wondering if the staff can give me any suggestions on that.

Dr. Weiss. Yes, Senator Dole. I believe we have been working with your staff on this, and with the folks at Hutchinson Hospital, to see if we can craft a provision that is affordable under this package. I think we will continue to work on that, if that is agreeable to you.

Senator Dole. If there is no objection, I will just see if the staff can do it.

The Chairman. Sure. Of course.

Senator Symms. Mr. Chairman?

The Chairman. All right. Senator Symms.

Senator Symms. I have a question that is similar to that situation. It deals with the Geographical Classification Review Board. I guess my question is, I have had this amendment hanging around this committee for two years, which some of you are familiar with, on the question of Trubbuck, Idaho, being a suburb of Pocatello, and they use the same medical facilities, and the two combined make an urban-sized area, but separately it still classifies Pocatello as a rural area.

Do I understand it correctly that maybe this Geographical Classification Review Board could act on this?

Ms. Anne Weiss. That is correct, Senator. ANd in fact,

the original language in the Rural Health Care Bill introduced by Senator Bentsen, Senator Dole, and cosponsored by many or most members of the committee, has been reviewed and revised in some cases to assure that many of the hospitals we have heard from who are in similar circumstances will have appeal rights before this independent board.

Senator Symms. So, Mr. Chairman, I guess the question, then, is would it be the preference of the Chairman to put all of these -- I am sure that Pocatello and Trubbuck aren't the only places in the United States that have a similar situation. Should we put them all in the same category and let the Review Board do it, or do you want these amendments?

There is just a street that goes through there. You just walk across the street. There is no geographical separation. The people all live in the Pocatello community and they use the --

The Chairman. I would assume we would want the Review Board to try to do this.

Ms. Anne Weiss. That is correct.

The Chairman. Because if you have quite a number of these, and that is the purpose of this Review Board.

Senator Symms. Well, then, I have an amendment I don't have to offer, Mr. Chairman.

The Chairman. All right.

Senator Bradley?

Senator Bradley. Mr. Chairman, I would like to raise the issue of the home visiting programs.

As you know, yesterday I suggested that the Commission on Infant Mortality, which Lauten Childs heads, feels very strongly that this is a very important service, to get people who are in rather desperate circumstances access to the kinds of things they need, better health care, that will reduce infant mortality.

Now, one of the ways that I suggested was to say 5 percent of the MCH Block Grant would be spent on this. There were some people who thought that wasn't a good idea. Last night I suggested a separate authorization for this program, and there was some objection to that.

What I would like to suggest today is that the Maternal and Child Health Bureau be required to implement just five demonstration projects in various places of the country, so that we can demonstrate that this works or it doesn't work.

The other thing I would suggest in this area: In the mark you have "Optional Coverage of Home Visiting for Medically-Fragile Infants." If we could expand that to also include the "medically-fragile infants" and also "the high-risk pregnant women," I think that would go some way to testing the concept of home visiting, and I am informed it would cost about $3 million, which would be under the $7 million that we have to use.

The Chairman. All right.

Senator Bradley. So it would be a demonstration program in five States, and it would be expanding the existing Home Visiting for Medically-Fragile Infants to include High-Risk Pregnant Women.

Dr. Weiss. One point of clarification, Senator Bradley. When you say "high-risk pregnant women," is that medically-fragile pregnant women?

Senator Bradley. Yes.

Dr. Weiss. All right. As I understand it, the cost estimate is very small. With an effective date of July 1st in Fiscal Year '90 the first-year cost would be $3 million; the second year and the outyears about $10 million -- in that range.

The Chairman. For the demonstration projects?

Dr. Weiss. No. The demonstration project is an authorization-only, and that is not scored against the Committee on Finance. This would be a direct expenditure through the Medicaid program, so it would in fact be an entitlement.

The Chairman. Are there comments? Questions?

(No response)

The Chairman. Is there a motion?

Senator Bradley. I move the amendment.

The Chairman. The motion is made. All in favor, make it

known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

The Chairman. Motion carried.

Senator Bradley. Thank you very much, Mr. Chairman.

The Chairman. Senator Rockefeller?

Senator Rockefeller. Mr. Chairman, I think it is probable that the House will vote down Catastrophic Care this afternoon. In my judgment it is likely that the Senate will do the same. Therefore, the one thing that seniors are looking for in this country, long-term care, seems to me even more important.

The Pepper Commission, which a number of us in here serve on, will be looking at long-term care. There was a proposition that was advanced by myself and others, which is supported by the National Mental Health Association and many others, to extend long-term care to the poorest and the most fragile in our society through a unique way.

Medicaid, as the Chairman well knows, has a great bias towards nursing homes, and this amendment would simply say that long-term care shall be provided at the "option of the State, in the home, and in a community-based setting."

I feel incredibly strongly about home-based care. I think it is the direction in which this country has to move.

Community-based care, exactly the same. The costs are infinitely cheaper than at nursing homes.

We have struggled mightily over a great period of months to reduce the cost of this, so that it affects those who can only do a certain number of acts of daily living, and we have cut down that down; primary and second Alzheimers, and we have cut that down. We have restricted it as much as we can.

It does have a cost of $30 million if we make it effective July 1st of next year, and it does have a cost of $135 million the next year.

And I understand that the House has passed this. It will be in conference. And their figures for it are virtually exactly the same as ours in terms of its cost, and I recognize its cost.

It seems to me absolutely incredible that this Congress passed nothing -- and it would be my judgment, if we don't do this, that we will pass nothing on long-term care in this entire session.

I have reviewed the committee. I do not think that I have the votes to carry this. I am obviously very disappointed in that. But there is an opportunity in conference for us to try to get something from this, so that there will be something, under Medicaid in this case, optional to the States for our most fragile or most elderly senior citizens on the basis of long-term care carried out in the

home and in a community-based setting.

I would simply inquire of the Chairman whether the Chairman would be willing to consider or to give me some hope that this is something that we might look at with more than casual interest in conference.

The Chairman. In the conference.

Senator Rockefeller. I do not have the votes to prevail at this point.

The Chairman. Yes, Senator. We certainly will seriously look at it in the conference. I know of your concern; you have been a strong proponent, and it is one that all of us would like to work toward, to see what we can accomplish. The cost problems are the concern; but I know that thought is shared by many members of this committee on both sides of the aisle. So, we will explore it to see what we can do in the conference.

Senator Matsunaga. You don't have the votes in the committee? The votes are not here in the committee?

Senator Rockefeller. The Chafee Amendment seems to be subtracting a number of votes on the other side of the table that I would otherwise perhaps have.

Senator Mitchell. Mr. Chairman, if I may, I would just like to express my support for Senator Rockefeller's position. This is an important provision. We are, of course, facing a serious problem on long-term care. This is a limited effort

but a, nonetheless, important one, and I believe it will be very good public policy if it can be adopted. I hope that the Chairman will be able to do that in the conference, as he has indicated.

The Chairman. All right. Thank you.

Further comments?

Senator Pryor. I would like to add my thoughts to Senator Rockefeller, and I would certainly hope something can be done here.

The Chairman. Well, I certainly share the concern, and it is a step in the right direction.

Yes?

Senator Durenberger. Mr. Chairman, I have a couple of items that I would like to present as add-ons.

Senator Chafee. Mr. Chairman, could I just say one word on that, since my name was invoked?

The Chairman. Yes, of course.

Senator Chafee. I am for the Rockefeller amendment. I don't think the Senator meant to imply that my proposal was -- well, I wasn't sure what he was implying.

(Laughter)

Senator Chafee. Whatever it was, I want to insist that my heart is pure and my motives clean.

The Chairman. All right.

Senator Durenberger?

Senator Durenberger. Mr. Chairman, the Minnesota Department of Human Services has been testing a pre-paid capitated approach to providing medial assistance services since July of '85. They would like to expand the demonstration into a permanent State plan option but need a little time to negotiate the specifics with HCFA.

So I would like to move that Minnesota be included with New Jersey in a provision that was established for New Jersey in Section 1903(m)6(a), page 725713, which allows New Jersey to operate its managed care program as a State plan option. To the best of my knowledge, there should be negligible --

The Chairman. Does staff see any problem with this?

Dr. Weiss. It seems fine.

The Chairman. The Administration doesn't say anything about it?

Mr. Olson. No.

The Chairman. All right, fine. We would approve it.

Senator Durenberger. Mr. Chairman, a second item.

Dr. Weiss. Excuse me, Senator Durenberger.

Senator Durenberger. Yes.

Dr. Weiss. Is there a cost associated wtih that provision?

Senator Durenberger. It says it can be done budget-neutral.

Dr. Weiss. Are you proposing that it be done budget-

neutral?

Senator Durenberger. It is fine with me, I guess.

The Chairman. Okay?

Dr. Weiss. Okay.

Senator Durenberger. Mr. Chairman, in the HMO amendment area -- this is by way of a clarification, a suggestion -- we have this problem of the 50-50 requirements, and we have worked out some very broad language, I think, on the so-called 50-50 calculations for Medicare contracts.

What I would like to do is propose that additional language be added to that as follows:

"Where two related corporate entities are in fact acting as a functionally integrated organization in the same geographic area, the total membership of the integrated organization may be considered for purposes of Section 1876(f). If the Secretary finds that the related entities are functionally integrated in all aspects, except that not all PPO affiliated providers are also affiliated with the HMO, then the Secretary may use the percentage of common provider affiliation in determining the proportion of the PPO membership that may be deemed to be HMO members for purposes of Section 1876(f)."

Senator Bradley. Did you say "f" or "g"?

(Laughter)

Senator Durenberger. The first time I said it, or the

second time I said it?

Would it be appropriate to just add that by way of clarification?

The Chairman. Do we have a problem with this?

I want staff to comment on it.

Dr. Weiss. Mr. Chairman, we have not seen that before. I am advised it may affect the Humana Corporation -- is that correct?

Senator Durenberger. Well, I wasn't going to say that, but I think that is where I remember it coming from. You haven't seen the language? Oh.

Well, they are certainly entitled, because I spoke so fast, to see the language, Mr. Chairman.

Could I raise a third point while they are looking at the issue?

The Chairman. Sure. Of course.

Senator Durenberger. Mr. Chairman, I am going to raise this, and I don't know what I am going to do with it, but I am just going to talk about it a little bit first, and I am going to hope to be brief.

One of the recommendations, as I understand it, and I didn't see this until an hour or so ago -- and I apologize for that; I should have seen it earlier -- is changes in capital reimbursement for hospitals.

We have been wrestling here with how to do capital

reimbursement for hospitals for a long time. In effect, what we all wanted to do was blend the capital reimbursement in with the regular DRG system. We couldn't figure out a way to do it, so we settled for direct reimbursement.

Then, in order to make a little money, we started cutting back on the direct reimbursement, to 10 percent, to 15 percent, and this year there is a new wrinkle that has been added that I just think we need to know about. And if everybody here thinks it is a great idea, then I guess I can't fight it. But the wrinkle that has been added is that we are going back to 100 percent of reimbursement for capital costs for rural hospitals and for disproportionate share hospitals. And to finance that, we are going to 20 percent on all other hospitals.

Now, I am not sure -- maybe Marina or someone else can tell us -- why we are doing that. But to me it smells a lot like the disproportionate share hospitals piggy-backing on rural hospitals. I think the rural hospitals are an insignificant part of the total here, and the disproportionate share hospitals I would guess are a fairly large part of it.

If, in fact, we want to help the disproportionate-share hospitals, it would strike me we ought to help them directly, in terms of reimbursement as we do now, not indirectly through the capital system. But I am not sure whether anybody noticed that this thing was in there.

The Chairman. Senator, for those who were here yesterday, they heard that, and they saw that, and we did discuss it.

Senator Durenberger. Oh, I'm sorry.

The Chairman. But that's fine for you to bring it up again.

Would you are to comment?

Dr. Weiss. Yes, Mr. Chairman.

The 20-percent figure, Senator Durenberger, was largely a compromise between what had been the case prior to October 1st, with a 15-percent cut, and what the Administration recommended in the form of a 25-percent cut.

The sole community hospital exemption has always been there. The new wrinkle, you are quite correct, is the disproportionate share hosiptals, and that was included at the request of many members of the committee.

Senator Durenberger. Well, Mr. Chairman, as I say, I don't know what to propose; but I look around at some of the many members of this committee who don't have disproportionate share hospitals.

I want you to know that down in Rochester, Minnesota, at the Mayo Clinic, they've got a disproportionate share hospital, but they are also making an awful lot of money down there, and you are going to be paying for this one out of your small SMSA hospitals. I just think you ought to know that,

that in effect there is more to this than meets the eye.

I don't deny the fact that in New York City, and in Los Angeles and Chicago, there are some very pressing needs in inner-cit hospitals. I am just saying that those needs are going to be financed, at least in part, in this bill, by taking money from our small urban hospitals in the rest of the country. I am not sure whether, with all these many people, I want to put it to a vote or not.

The Chairman. You know, that is interesting that you would say that about Mayo's, because they were telling me how much money they were losing.

Senator Rockefeller. Well, I really regret not having been here yesterday for the discussion of it.

Senator Chafee. Mr. Chairman?

The Chairman. Yes, Senator.

Senator Chafee. Mr. Chairman, I would just like to take a few minutes, if I might, and I will be brief.

The Chairman. Sure.

Senator Chafee. Yesterday I alerted my colleagues that I planned to offer a revised version of the Medicaid Home and Quality Services Act, which is 384.

There are 13 members of this committee that are cosponsors of that Act: Senators Matsunaga, Moynihan, Baucus, Bradley, Mitchell, Pryor, Riegle, Rockefeller, Daschle, Dole, Armstrong, and Dole, and that is a pretty formidable lineup.

In addition, we have 54 members of the Senate as cosponsors. So, a majority of the Senate has clearly indicated support for a major reform of the Medicaid Program as it applies to those with developmental disabilities. We have had hearings on this and spent a lot of time on it. I have been on this for about 5 years now.

The cost savings would be a $60-million saving according to the CBO over the next 5 years.

Now, I have had enormous pressure to go forward with this, for two reasons: one, that it is the right thing to do; and, second, the House has included it in its reconciliation package, which addresses the same issue. And it is a bill which I and others believe -- the House bill -- is significantly different from the one I proposed.

What I worry about is, if there is no Senate position on this issue when you go to conference, I think it puts it at a serious disadvantage. That is the very point we brought up the first thing this afternoon, Mr. Chairman, when I questioned about that Social Security as an independent agency, and your answer, as you recall, was that the House had the provision, and that it is wise for the Senate to have a provision, likewise.

Now, I am concerned, as I mentioned, about the House language, for a variety of reasons. And I might say my concerns are shared by the Senate Mental Retardation program

directors, the Association for Retarded Citizens, the United Cerebral Palsy Association, and a whole other number of groups. And I think the House bill could lead to people being de-institutionalized without any certainty of services or quality of care, because it doesn't create a system of services, support, and protection in the States as does my proposal. It just makes some optional community services for the States to adopt, and they can drop them at will.

I think the House approach could result in the thing we all fear, which is de-institutionalization without proper care. You and I have discussed that, Mr. Chairman, in the past.

The House bill also makes significant changes to the current institutionalization services which deserve careful consideration.

In short, Mr.Chairman, I think it would be a serious mistake to include no provision in this Reconciliation Bill that we are working on this afternoon, in view of what the House has, unless we adopt here some reasonable alternative approach.

Now, I must say I've had great concerns over the broad scope of this Reconciliation legislation and what we are doing, and I voiced those in the past. I suppose that, by backing off from this, I would be doing what you might call "the right thing"; although, I am not sure that that restraint

has been shown very often.

But I do think it is necessary, in respect for the 54 Members of the Senate and the 13 members of this committee who have cosponsored this Act, to have some assurance that this proposal has a fair shot sometime down the road.

So, my point, Mr. Chairman, is, would it be possible to schedule a mark-up on this legislation before the end of the year, and to reach an agreement that the provisions relating to this issue in the House Reconciliation Bill could be set aside until we have reached some kind of a conclusion on 384?

Now, I am informed that this can be done. And once 384 was passed by the Senate, we could then begin a conference with the House on the Senate-House bills. I think that would resolve fairly the situation that we have here, and I believe that is the similar approach we took with the Welfare Reform Bill -- is that right, Marina?

Dr. Weiss. Yes, Senator Chafee. That is correct.

Senator Chafee. So that is the way I would like to proceed, Mr. Chairman.

The Chairman. Senator, frankly, you know I have some concern over the legislation, some very serious concern, and I really am opposed to the House provisions. I think they are quite a mistake.

Senator Chafee. Well, so do I.

The Chairman. I would rather have that kind of a mark-

up with a freestanding bill.

Senator Chafee. On my bill.

The Chairman. On your bill, correct.

Senator Chafee. But then, we would have to --

The Chairman. That means we would have to resist the House provision on that.

Senator Chafee. That's right.

The Chairman. I am prepared to do that.

Senator Chafee. But the only reason I suggested setting aside those provisions in the House bill is that at least we would have something to go to conference with. What I worry about is that if we pass something here along the lines of this legislation, then we get nowhere with the House, we have no vehicle to go to conference with the House on.

The Chairman. Could I get some comments from the members?

I would much prefer to do the freestanding. And I would agree to work to bring about a mark-up and to resist the House provisions, as Chairman of the Committee. I will do that.

Senator Chafee. The only other part that we haven't followed through on or discussed is the suggestion that you take those House provisions that are in their Reconciliation and set them aside, as I understand can be done. Then, you can go to a conference on our bill when we get it, and theirs. How is that? I mean, that is the line I would recommend.

Senator Heinz. Would the Senator yield to a point of clarification? How do you "set them aside"?

Senator Chafee. Well, in the byzantine labyrinths of Reconciliation, apparently this is possible. As Marina said, we did it in the Welfare Reform.

The Chairman. Oh. I would be happy to probe that with the Parliamentarian and see what we can do on it. I am interested in the objective, and I would like to achieve it, but I would like to be sure of our parliamentary positions on that.

Senator Mitchell. Mr. Chairman?

The Chairman. Yes.

Senator Mitchell. Mr. Chairman, I want to address a related matter, in a similar vein. But first, if I may say, Senator Chafee has raised a very important but a controversial and emotional one.

Two years ago, when I was chairman of the subcommittee and he introduced the bill, we held a hearing. I think he and Senator Durenberger will recall it arouses very strong, passionate feelings on both sides, arising from the fact that different States are proceeding to make community facilities available at different rates. In those States where the de-institutionalization process is likely to be met by available community services, there is strong support for this approach, as in Rhode Island and Maine. In those States where that

process is not as advanced, there is great fear, deep-seated fear, on the part of the institutionalized persons and their families as to what the effects might be.

I think it does deserve special attention, and I commend Senator Chafee for pursuing it. As he knows, it is extremely emotional on all sides, and I hope that some way we will be able to work it out.

If I might address a separate subject, Mr. Chairman, if I might, just briefly?

The Chairman. Yes. Of course. Go ahead, Senator.

Senator Mitchell. I ask that it also be seriously considered in the future.

At one time we provided that occupational therapy would be a fourth skilled services for determining eligibility under the Medicare Home Health Benefit. The law was then repealed, and there had been some considerable controversy about the cost of reinstating that benefit.

I have introduced legislation that would permit that, because I think it does greatly enhance the quality of home health service available to persons who need it, and I hope at some point we will be able to give this serious consideration.

I recognize the fiscal constraints that apply now, particularly in light of the uncertainty over the costs that would result. I hope that we will be able to get perhaps some

more specific clarification of the cost and give serious consideration to this at some future time.

The Chairman. Mr. Majority Leader, we would be pleased to do that, and we will try to get you additional information to study for that purpose.

Senator Mitchell. Thank you.

The Chairman. Senator Rockefeller?

Senator Rockefeller. Mr. Chairman, there is one piece of business that we need to do with respect to Physician Payment Reform, because there is still a hole in it that we have to fill.

I have to make a motion on this, and I have to say that it is not controversial. I think that Marina will back me up on that. But we need to set the first Medicare Volume Performance Standard, and we have to do it within this bill.

Obviously, we are trying to get the cost of the program down. We don't want to sacrifice quality as we do that, so in a sense we are budget-driven, but we are also quality of care-driven, and that is a very tenuous and difficult rope to walk on.

In any event, I would recommend that we begin this process in a moderate way, without doing anything really dramatic in our fist fiscal year. Accordingly, I would specifically propose that we adopt a Performance Standard rate that is one-half of one percent below the base line that will

be established -- that is, the rate of growth that we ultimately decide upon today, depending upon where we come out.

For example, if we came out to about an 11-percent baseline, then I would propose a 10.5 percent performance standard. I think that sends a signal that we are serious about reduction of cost, but, on the other hand, that we also are serious about quality of care.

I am sure Marina would have some comment on that, and I would so move it.

The Chairman. May we have a comment from staff on that?

Dr. Weiss?

Dr. Weiss. We see no objection to that, Mr. Chairman.

The Chairman. The Administration?

Mr. Olson. We also would agree.

The Chairman. Fine.

We have a motion to that effect. Is there any objection?

(No response)

The Chairman. If not, it so carries.

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. Mr. Chairman, I want to offer an amendment to close a loophole that a very smart lawyer just discovered within the last year -- why are you smiling, Dr. Weiss? -- that will permit nursing homes to balance-bill

nursing home Medicare residents' beneficiaries, which would be a first. We have never had that happen, and we don't want it to happen, because this loophole would allow those beneficiaries, in effect, to be exploited by this little loophole.

The loophole goes back to 1973, where we intended to give hospitals, which were still reimbursed on the old cost method, an appeal right to permit them to balance-bill if there was a hardship. No hospital ever used that. When we shifted to Prospective Payment, of course, there was no need for that provision.

It is about to be exploited by nursing home operators, and my amendment, in brief, does two things:

First, it deletes the section, which is section 1866(a)2(b)2)ii of the Social Security Act, see 45 C.F.R. 413.35 -- just so everybody is exactly clear on what we are doing -- and it would also require that HCFA recommend by June 1990 legislative language for a Prospective Payment System for Skilled Nursing Facilities, SNFs and HHAs, effective FY-91. The latter is a good thing to have, so we don't have this kind of problem in the future.

Dr. Weiss. Mr. Chairman, I am advised by the Congressional Budget Office there would be no cost to this amendment, but I believe the Administration would like to speak on it.

The Chairman. All right.

Mr. Olson. Mr. Chairman, if appropriate, I would like to ask Dr. Tom Gustafson, who is a Director in the Office of Policy Analysis at HCFA, to simply give our comments at this point.

The Chairman. Good. All right.

Dr. Gustafson. Senator, this provision that Senator Heinz is speaking about is sort of a leftover from prior law that is being now used in the light of the Catastrophic Coverage Act and the expansions of the SNF Benefit in that area in a fashion that was completely unanticipated at the time the SNF benefit was expanded.

As the Senator has suggested, smart lawyers have found out about this, and it is sort of a toothpaste-out-of-the-tube situation, as we have no choice administratively but to permit this practice from going on under current law. And once you start doing this and continue to do it, it makes it very difficult to correct the situation in the future.

The Chairman. So you are supportive of the suggestion of the Senator?

Dr. Gustafson. We certainly do not oppose it.

Senator Heinz. Mr. Chairman, I understand; but let's take what we can get.

(Laughter)

The Chairman. Do you move the amendment?

Senator Heinz. Mr. Chairman, unless there is discussion. I don't wish to cut off Senator Armstrong.

Senator Armstrtong. Mr. Chairman, I don't want to drag this out, but are we voting on Senator Rockefeller's proposal or on Senator Heinz' proposal?

The Chairman. On Senator Heinz' at the present time.

Senator Armstrong. Well, I am not quite clear on how Senator Heinz' proposal dovetails. Is it an amendment to Senator Rockefeller's proposal?

Senator Heinz. No. I am sorry if I have confused anybody.

Senator Armstrong. Well, have we adopted Senator Rockefeller's proposal?

The Chairman. I thought we had.

Voice. No.

The Chairman. Which one are you talking about, now?

Dr. Weiss. This is the Volume Performance Standard, setting the first year.

The Chairman. No, that we adopted, or I thought we did.

Senator Rockefeller. We did adopt that.

Senator Heinz. Mr. Chairman, if there is no further discussion, I would move the amendment.

The Chairman. I asked for objections, and nobody had any objections.

Yes. Now, Senator Heinz.

Senator Heinz. Mr. Chairman, if there is no further discussion, recognizing that we are going to see a lot of extra bills land not at HCFA but on senior citizens, and a very large amount, I would move the amendment.

The Chairman. All right. Is there any objection?

(No response)

The Chairman. Then it is adopted.

Thank you.

Senator Heinz. Thank you, Mr. Chairman.

The Chairman. All right. Does that complete our package?

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. I have a couple of other minor items that are no cost.

The Chairman. Let me switch it around and let someone else have a chance.

Senator Heinz. Fine.

The Chairman. Senator Bradley?

Senator Bradley. Mr. Chairman, as you know, the issue of infant mortality is enormously important to all of us. Under current law, Medicaid covers the cost of prenatal care up to 100 percent of poverty.

In this package you have gone to 133 percent of poverty for pregnant women and infants. And as you know, a number of

us are cosponsors of a bill that would raise it to 185 percent of poverty.

Yesterday in our discussions I suggested that we go to 150 percent of poverty; and that, so as to avoid the immediate budget problem, we make that effective in 1992 or 1993.

I know that the Chairman has a deep interest in this area, and I was wondering if there was any support for doing this now.

Let me tell you that if you haven't been called by your favorite Governor, you probably will be called. The Governors are burning up the wires. The Governors say, "Don't mandate anymore coverage on prenatal care or taking care of infants or young children," because they want to have a chance to do something.

Mr. Chairman, this would give them that chance. This would delay it for two years. It would, however, tell them that they should expect to get themselves ready to move it up to 150 percent. And if we don't do that, I am concerned that they might not get the message that we are back and interested, that we see more and more people are covered. If we move it to 150 percent, it would cover another 38,000 pregnant women, and it would cover another 29,000 infants. And I think those are not insignificant numbers for the cost.

The Chairman. Senator, we both have been involved, and many members of this committee, and we have deep concern in

that for pregnant women and for children and babies being born, hopefully with sound minds and bodies. And we have pushed, and particularly those of us from States that have been quite slow in assisting in this area, and, for us, we have carried them very far. It has been a difficult adjustment for them.

And then we have mandated, finally, on them, and I have supported all of that. But I think, for many of us in our States, we deserve some time to try to catch up. I personally would oppose our pushing it any further, at this time.

Senator Bradley. Uh-huh.

Senator Durenberger. Mr. Chairman?

The Chairman. Yes.

Senator Durenberger. I agree with the Chairman's characterization of the commitment of everybody around here. I would just say, with regard to my own conversations with the Governors, that the reason they are burning up the wires is they know the direction this committee is headed, and they know that, particularly under the leadership of this chairman, we are headed in the direction of expanding in the direction of expanding eligibility.

The plea that they made -- and I am sure Jay can share this, also -- the plea that they made was that we take a year, while the Pepper Commission is dealing with this very same subject, including this and the coverage of the 37 million and

so forth, and in effect, the way I heard it was, "We know which way you are headed. Give us a year, and let's see what that Commission may come up with, and we know that you will be back next year with moving it at least to 150 or beyond."

So, I agree with the Chairman's disposition.

The Chairman. Any other comments?

(No response)

The Chairman. Senator Bradley, I hope we defer on this.

Senator Bradley. So, Mr. Chairman, I hear what people are saying, and I do think that the committee as a whole would support a move in this direction, as we have in the past.

As you know, it is optional to 185 percent now in the States. Does the Chairman agree with the characterization of Senator Durenberger, that, you know, when the Pepper Commission comes back with its proposals, that this might be an area where we would want to work next year?

The Chairman. Oh, I certainly agree with that. You know, I have evidenced my deep interest in it. This committee has moved farther in the last two years in this area than it ever has before. But I also know some of the very serious problems back in the States, the fiscal problems that they have. I look at my own State and what it has been through in the last two years. We haven't had a recession; we have had a depression in that State.

So I will be happy to revisit it next year, after we hear

the report of the Pepper Commission.

Senator Bradley. Well, in that case, I won't push the amendment. I would simply also make a plea that in the House bill they go to 185 percent. So, maybe a hedge to 140 out of conference would be a reminder to the Governors that we are still Senators, not Governors.

(Laughter)

The Chairman. All right. Thank you.

Senator Rockefeller?

Senator Rockefeller. Mr. Chairman, this is not in the form of an amendment, but in this draft that we are working from, on the unnumbered page 15, Dr. Weiss, dot number 6, it refers to "expenditure targets," and the word is in there. It has never before appeared in our bills, in our drafts, and we do not have expenditure targets in Physician Payment Reform. We have "performance standards." And I insist on the difference and would ask that the words be changed.

Senator Durenberger. I will second that.

The Chairman. I see no problem with that.

Dr. Weiss. I can't find it here.

The Chairman. Well, find the place he is referring to, and let's change it for him, if there is no objection to changing the terminology.

Senator Rockefeller. It is the 15th page.

I thank the Chairman.

The Chairman. All right. Surely.

Dr. Weiss. We will replace that with "volume performance standards."

The Chairman. All right. Is there anything further?

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. I have two items that I think will be non-controversial. One is to permit services provided by nurse-practitioners in nursing homes to be reimbursed in the same manner that physician assistant services are currently covered. That is not direct reimbursement to the nurse-practitioners; that is to the providers, as we did over '86 for physician assistants.

The reason for the provision is that HCFA and others have done a very thorough evaluation of this in a demonstration project in Massachusetts, which shows that the quality of care is better, the patient satisfaction is better, the cost is the same or less than simply having physicians deliver the care. And the reason for that is that these nurse-practitioners are part of a team, so you get a team concept. They have a little more time to spend than the physicians do; in fact, they have a good deal more time to spend, because they are trained to spend that time, and they cost less.

My understanding is that the Rand Corporation, the University of Minnesota, and Boston University all studied

this and came to the same conclusions.

I understand, too, that there is a cost estimate that is budget-neutral.

The Chairman. Is that correct?

Dr. Weiss. We just want to clarify that you did intend for it to be budget-neutral, Senator Heinz.

Senator Heinz. Okay. My understanding is that it is budget-neutral, but if it is not, I don't want to --

The Chairman. Well, with that proviso --

Ms. Anne Weiss. It is my understanding that the language of the proposal would require the Secretary, if necessary, to reduce payments to the Sculderson facility in order to assure that it is budget-neutral. I believe, if that language is not included, that CBO might assess a cost. I don't know what the cost would be.

Senator Heinz. It is consistent with what we did on Physician Assistants.

The Chairman. Well, if we are talking about budget-neutral, do you see any objection to it, staff?

Senator Moynihan. Well, I think it is a good idea.

The Chairman. All right.

Senator Chafee. I would like to join in that.

The Chairman. All right.

Senator Chafee. They had these demonstration grants on this, and it was quite successful.

The Chairman. Well, if there is no objection, and you put in a budget-neutral provision.

(No response)

The Chairman. No objection? It is passed.

Senator Bradley. Mr. Chairman?

The Chairman. Yes.

Senator Bradley. An issue relating to Johns Hopkins has come to my attention, and that is a request that they receive an extension of six months in order to seek designation as a comprehensive cancer center hospital for reimbursement purposes. They are evidently in a State where there is a waiver in operation, and they say they can't comply in the time frame that they have been allotted, and they were seeking an extra six months to be able to comply as a comprehensive cancer center hospital for reimbursement purposes.

Dr. Weiss. Senator Bradley, could you give us the effective date of your proposal?

Senator Bradley. Effective date: Until December 31, 1990. That is in the Ways and Means', and the effective date would be the same, December 31, 1990.

Ms. Anne Weiss. I believe that the House Ways and Means provision recognized the situation of hospitals that had not yet sought an exemption as cancer centers. The provision included in this package is identical to the Ways and Means

package, and in that regard, to the best of our knowledge, it would recognize the needs of Johns Hopkins Hospitals. So it is already covered.

Senator Bradley. Mr. Chairman, that is good news.

Thank you very much.

The Chairman. All right.

Thank you.

Is that it? All right. Thank you very much.

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. I am sorry; I have one more provision, if I may.

The Chairman. All right, Senator.

Senator Heinz. I am on a roll. This will be the last one, how about that?

The Chairman. All right. Fine.

Senator Heinz. Mr. Chairman, this has to do with CPR in nursing homes, in two ways:

First -- and I am not sure if this is not controversial -- the requirement that there be protocols in nursing homes for the use of artificial rescussitation measures.

The reason I say I am not sure if it is controversial is that the Joint Commission on the Accreditation of Health Care Organizations has already required, as of 1988, that both member hospitals and nursing homes have such protocols, and

abide by them. The issue there is whether the withholding of artificial resuscitation measures is going to be a conscious decision or whether someone -- it is often the physician -- is going to do it in isolation and not in consultation with the patient or the patient's family.

The other issue is whether or not nursing homes should be required to have one person -- it can be anybody, but one person -- who is on duty 24 hours a day who knows how to give CPR, Coronary Pulmonary Rescussitation.

We had hearings in the Aging Committee about a year and a half ago where we discovered that only 30 percent of nursing homes have somebody on duty trained in CPR. Therefore, it is literally better, if you are going to have a heart attack, to run out of the nursing home and have it on the street, because your chances of finding somebody out on the street to give you mouth-to-mouth rescussitation are better than inside a nursing home.

The latter, I don't think, is something anybody would disagree with. I am told that the cost of this proposal, notwithstanding the fact that there maybe some additional training, is an asterisk, and I would hope we could adopt it.

The Chairman. May I have a comment from staff?

Dr. Weiss. Mr. Chairman, we do understand that CBO believes right now, informally, that it may be a very small cost. I might note that by 1993, when some of the nursing

home reform provisions are fully phased in, there would be a requirement that a nurse be on duty during the course of the day. And consequently, there would be, presumably, someone there who is skilled in administering CPR.

But in the interim, there is potentially that gap. However, there is a cost associated with it. We can't give you a precise number on that cost.

Senator Chafee. Mr. Chairman, could I comment on this?

The Chairman. Yes.

Senator Chafee. It seems to me that we are really getting down to micromanagement here.

The Chairman. That is just what I was thinking, Senator. Incredible.

Senator Chafee. If our system isn't designed that somehow there there aren't people telling nursing homes what to do and not to do, we are in tough shape.

Senator Heinz. The answer is, we are in tough shape, Senator Chafee.

Senator Chafee. I mean, for this Congress to spend time mandating that there is somebody that is going to know CPR on 24 hours a day -- how often are the sheets meant to be changed? Are we going to dictate that?

I think we have to have some confidence that, out there, if there aren't proper regulatory reforms -- we have been through nursing home reform -- and for us to have to have a

law on this I think is just going plain too far. That is my view.

The Chairman. Well, that is one of the complaints we run into with the Governors, the incredible amount of micromanagement that we are exerting.

Senator Symms. Mr. Chairman?

The Chairman. Yes.

Senator Symms. Are we complete on that? I still have one more question to ask staff, but I didn't want to interfere with the other Senator.

Senator Heinz. Mr. Chairman, I don't want to put it this way; but, if people want senior citizens to expire in nursing homes because there is no CPR, they should feel free to vote against my amendment.

(Laughter)

The Chairman. Senator Symms.

Senator Symms. I am sorry, Mr. Chairman. Are we having a vote here?

The Chairman. That, I don't know, either.

(Laughter)

Senator Symms. I apologize, but I still want to come back to my original question on the geographical classifications. I don't think I need an amendment, but I think I need a clarification.

Senator Heinz. Mr. Chairman, would you like to accept

the amendment, or vote on it?

The Chairman. No. I really believe it is micromanaging, and I would urge you to resist the temptation of offering it.

Senator Heinz. I will resist it for the time being, Mr. Chairman.

The Chairman. Good. Thank you. You have done well, Senator.

Senator Heinz. I recognize that, and I hope that that is taken into account in future deliberations.

(Laughter)

The Chairman. Thank you.

Senator Symms. On less of a micromanagement question here, but a question that relates back to the Geographical Classification Review Board -- now, we think that we can take care of, by appeal, the question of going from rural to urban.

Now, the question I have is, where you have a State line that divides two areas -- Moscow, Idaho/Pullman, Washington; Lewiston, Idaho/Clarkson, Washington; Payitt, Idaho/Ontario, Oregon -- Oregon and Washington both have a higher wage base than Idaho. So literally, if the hospital in Moscow, Idaho were moved one and a half to miles from its location, it would lie in the State of Washington. Their Medicare payments would be 20 percent more.

Clarkson and Lewiston are in the same situation, and a the people from Clarkson, Washington all go to Lewiston,

Idaho, for medical treatment, where the hospital is -- it is just across the river -- and they get a lower payment in that hospital.

Does this Geographical Classification Review Board have the authority to address a rural-to-rural formula wage, or whatever, payment basis?

Ms. Anne Weiss. It does, Senator.

Senator Symms. It does?

Ms. Anne Weiss. Yes, it does.

Senator Symms. So we think that is taken care of?

Ms. Anne Weiss. Yes, Senator.

Senator Symms. Okay. Well, I thank you very much. And I want to compliment the staff on much of the cooperation and effort, Mr. Chairman, that they did on this rural question. I think Senator Pryor mentioned it earlier.

But the rural medical delivery system in this country needs rapid attention by Congress, to keep some of those institutions from having to shut their doors and then create a lot of time and distance problems for those people.

So, I thank you.

Thank you.

The Chairman. Senator, what you have seen here in this particular piece of legislation is a major effort to try to assist on those rural problems, and we appreciate your help on that.

Yes, Senator?

Senator Durenberger. I just need to make sure that these two items that we didn't finish up on of mine are finished up on.

I think, on the AAPCC, we agreed on 98 percent next year, 99 percent the year after, and then 100 percent in the third year, and we could finance that --

The Chairman. No, I wasn't aware of any such agreement, unless you have worked something out with staff.

Senator Durenberger. Oh, that is what I meant. I think we have worked it out with staff, haven't we?

Dr. Weiss. We don't know what the money situation is right now, Senator Durenberger, but I will see.

Senator Durenberger. And then there is the other one.

Mr. Chairman, while they are looking at that, on page 3 of the three-page explanation that the Majority Staff handed out, explaining the Rockefeller-Durenberger Physician Payment Reform Proposal, at the very end there is sort of a misleading statement which needs to be corrected.

It says, "In addition, the bill would mandate assignment on claims for all qualified Medicare beneficiaries." What I think they meant to say is --

The Chairman. And Medicaid, probably.

Senator Durenberger. -- these are dually eligible Medicare/Medicaid beneficiaries.

Mr. Olson. Senator, that is correct. I was using a term from the statute.

Senator Durenberger. I think a couple of people have had a concern about that.

Mr. Olson. Yes. It is only the dual-eligible.

Senator Durenberger. All right. Great.

Dr. Weiss. That is the statutory reference to the dually-eligible, Medicare-Medicaid, and that is why it was used.

The Chairman. All right.

Dr. Weiss. Senator Durenberger, I am told by the Congressional Budget Office that they believe that, if you were to go with a 98 percent, 99 percent, 99 percent, 100 percent construct with the two offsetting provisions that you offered earlier, that it looks do-able.

Senator Durenberger. Thank you very much.

The Chairman. Is that acceptable to you, Senator?

Senator Durenberger. It is acceptable. It is one more year than I thought; but if, by starting at 98, I think we accomplish the same goal.

The Chairman. Is there any objection to the Senator's provision?

(No response)

The Chairman. If not, it is accepted.

Senator Durenberger. Thank you, Mr. Chairman.

Now, did we resolve the other, the so-called Humana clarification, on the 50-50? Do you have a problem with that?

Mr. Lauderbaugh I am sorry, Senator? The 50-50?

Senator Durenberger. I can't remember how we left the so-called Humana clarification, of the 50-50.

Mr. Lauderbaugh. Yes. The staff recommended that it be included in the package. We understand that there is another provision that relates to a specific plan, and that is time-limited. And the staff would propose that this be limited in time, also.

Senator Durenberger. All right.

Mr. Chairman, thank you very much. We are in agreement.

The Chairman. All right.

Senator, do you have a comment?

Senator Pryor. Yes, Mr. Chairman, very quickly. I will raise this issue on the tax side, but I am trying right now, Mr. Chairman, to find $38 million so that the SSI programs can go into an outreach mode, I guess, in informing eligible SSI recipients, about 50 percent of that SSI eligible population, of their benefits. Only about 45 percent or 50 percent are now participating.

I will tell you the truth, Mr. Chairman, I have not found that $38 million. I think that I can after a while, but I would just like to raise this right now, to put our colleagues on notice that I will attempt to do this.

The Chairman. All right. Thank you, Senator.

If there is nothing further, we will recess until 8:00. We have to wait until that time, because, in dealing with the tax provisions, they have not completed all of the compilations that are necessary.

Dr. Weiss. Mr. Chairman?

The Chairman. Yes.

Dr. Weiss. Before you break, I wonder if the staff could get some discretion to adjust minor and technical ways to conform to the available money, slide dates, and so forth.

The Chairman. Absolutely. Without objection, so be it.

(Whereupon, at 5:55 p.m., the meeting was recessed, to resume at 8:00 p.m. the same day.)

(Part II will appear on page 105.)

AFTER RECESS

PART II (8:48 p.m.)

The Chairman. Please cease conversation. Please be quiet, so we can all hear.

(Pause)

The Chairman. Now we will turn to the tax side of it. I assume there will be some contention on capital gains tonight, and we will look forward to that debate.

But now I would like to move on to the Chairman's Mark as we presented it and have previously discussed, with some minor changes, covering what the Fiscal 1990 Reconciliation targets happen to be.

It does expand and restore he IRAs to promote savings and investment.

It extends some expiring provisions.

It contains some smaller provisions that members of the committee have suggested to us.

It addresses many of the critical issues facing our nation. It extends the R&D -- the Research and Development -- credit, and the cost allocation rules for those expenses, to try to assist in continuing this nation's leadership in technology.

It extends employee educational assistance, which helps workers continue their education and improve their job skills, to make us more competitive as a nation.

It extends the targeted jobs credit, to assist disadvantaged citizens to find work.

It extends the business energy tax credits, to increase utilization of alternative sources, and to decrease our dependence on foreign oil.

It extends mortgage revenue bonds and improves and extends lower-income housing credits, to address our nation's serious shortage of housing.

It extends small issue manufacturing bonds, to produce local economic development.

It extends group legal service benefits, to ensure that lower income employees get access to legal assistance.

It extends the deduction for health insurance for self-employed people, so they are covered in case of a costly and debilitating illness.

In my discussing yesterday, I talked about extending some of the expiring credits provisions for at least one year. Several members have indicated their support for extending those provisions for a longer period.

In the Chairman's Mark, the lower-income housing credit, the business energy tax credits, mortgage revenue bonds, and the research and development credit are extended permanently. I am proposing a two-year extension for all of the others until the end of 1991.

Finally, this package includes my proposal for the IRAs.

I am convinced that that proposal will improve our nation's flagging personal savings rate. It will give Americans a restored incentive to save. It will assist them in achieving the objectives of educating their children in college, buying their first home, and providing for their retirement. It should help, ultimately, bring interest rates down in this country.

Now, we have been through almost all of these provisions, just as we did previously on the spending provisions. And I would like staff to walk through this package and point out those things that have been changed, and additions made; but the rest of it has been covered and has been distributed to your staffs.

I now defer to Senator Packwood for any comment he might want to make.

Senator Packwood. Mr. Chairman, I appreciate it.

As I have just indicated to the Chairman, we will have a proposal to offer on capital gains later tonight, when we get to the section on IRAs, and we will use a fair portion of the money -- a fair portion, not all of it -- in the IRAs to pay for capital gains. And I will have some questions on the economic distribution of IRAs when we get there, but I think, until that time, Mr. Chairman, I will just withhold my comments.

The Chairman. All right.

Mr. Pearlman?

Mr. Pearlman. Mr. Chairman, I thought we would start by simply bringing to the committee the Technical Corrections package that was distributed to the staffs yesterday. It was also distributed generally yesterday.

Just for the record, it is a document dated October 2, 1989, JCX 56-89. It is as we described to you yesterday, just a compilation of a variety of technical corrections to the last couple of years' tax legislation.

We have no particular comments about them, unless members do, and we are prepared on, unless you have any questions about the technical corrections.

The Chairman. Those have been distributed to the staffs of all of the members.

Senator Armstrong. Mr. Chairman?

The Chairman. Yes.

Senator Armstrong. One question. Are the technicals under item 12, under the so-called "other provisions"?

Mr. Pearlman. Yes. The technical corrections are listed as the very last item on section 12. Yes, sir.

Senator Armstrong. My question is about item M. I believe I understand that. Is that so that hedging income, option income, can be treated as reed income?

Mr. Pearlman. Yes. That is not what I am describing as a technical, Senator. I mean, we will go through all of the

items in 12.

Senator Armstrong. Oh, I see. Thanks.

Mr. Pearlman. Technicals is a separate package.

Senator Armstrong. Forgive me, then. I am in the wrong place in the bill; but, since we are there, that is what that means?

Mr. Pearlman. Yes. And we will get back to you.

Senator Armstrong. Thanks.

The Chairman. All right.

If there are no objections or questions on the technicals --

Senator Heinz. Yes, Mr. Chairman, I do have one.

The Chairman. All right.

Senator Heinz. On page 16, item G, Ron --

Mr. Pearlman. Yes, sir.

Senator Heinz. My understanding is that, when Technical Corrections was presented in the House, they were given two choices on this technical correction. However, in the Senate package there isn't a choice, in our package. The House took the other choice, apparently. Personally, I think the House choice is far superior to the Senate Choice.

You originally gave a choice of one or the other. Why aren't we being given that same choice?

Mr. Pearlman. I will be happy to explain that.

The procedure that we have always followed with technical

corrections, Senator, is to try to reach agreement among the staffs as to what items are appropriate to be presented to the committee as agreed-to technical corrections.

In any instance where there is no agreement, or where there is disagreement -- that is, any staff indicates that it doesn't agree that the technical is appropriate -- then either it is left out of the package or it is presented to the committee in an optional form or as a supplement.

On the House side, there was disagreement by one of the staffs, as to the appropriateness of the technical, the interpretation of the technical. That was not the case on the Finance Committee side. The staffs agreed with the technical correction that is in the package, and it is for that reason it was presented to you that way.

Senator Heinz. That may be. I don't know what my staff did on that, but the problem I've got is that I don't agree with it.

As I understand it, the House option is revenue-neutral, that the one that the House chose is revenue-neutral, and I am wondering if there are any objections to it.

Mr. Pearlman. Well, let me explain first that "technical corrections," by definition, once something is determined to be a technical correction, it has no revenue effect, because it is deemed to have been just a clarification of a prior action of the Congress.

Senator Heinz. Right. Fine.

Mr. Pearlman. I would simply indicate to you that it is our view, as reflected in this document, and the view that we presented to the Ways and Means Committee, that the technical in this document is what we think the accurate decision that the Congress made last year.

So, this item you raise is a question of what did Congress intend last year when it enacted this new special deduction in Section 847.

Senator Heinz. Right.

Mr. Pearlman. So, we have indicated both on this side as well as on the other side that we believe the technical, as it is in this package, is an accurate representation of that legislative intent; but, certainly someone can challenge that.

Senator Heinz. Well, let me ask this of the member staff: Is there any objection to the House solution, the House Technical Correction? Is there any?

Mr. Richter. The intent of the provision last year, as best we can reconstruct, it wasn't intended to go as far as what the House Technical makes it do.

As you point out, it is revenue-neutral, so the consequences of either decision are not significant from a revenue perspective.

Mr. Pearlman. If you will permit me to interrupt you, Norm, I should note, however, that there may well be a

significance from a company's standpoint.

There is no question. As I responded to the Senator earlier, there is no revenue effect from which interpretation is adopted. But there is not agreement among the companies affected by this provision as to the proper interpretation.

Now, we just tried to make the best call we could as to what Congress meant last year, but the members should understand that the companies are not uniform in agreement as to the interpretation. There will be disagreement among the companies, no matte which way you go.

Senator Heinz. Mr. Chairman, I guess the only solution I have got is to ask that the provision be stricken.

The Chairman. What problems result from that?

Mr. Pearlman. Well, I think the problem that would result is that a technical correction, some sort of technical correction, is needed, because the statute, the way it was drafted -- this provision that was enacted last year gives certain insurance companies the right, in effect, to prepay their taxes and, for financial accounting purposes, put themselves in the same position as they would have been had the Congress not changed the rules on discounting of reserves in 1986.

It is a financial-accounting motivated provision that Congress enacted last year. It interacts with a provision that is in the Internal Revenue Code that limits losses in

consolidations, consolidated returns, between like and non-like companies. The interaction of this new provision that was enacted last year and this consolidation rule that has been in the Code for some time doesn't work right, and it needs to be fixed.

So the issue here is, how should it be fixed? I would think that we are not being fair with any of the companies if we drop it simply because it is not going to work. I would think that the consequence would be that the companies will pay more tax than they would have paid had they not gotten the benefit of this provision.

So, I would think that you would want to adopt one or the other. I hope that is responsive to your question.

Senator Heinz. Mr. Chairman, the reason I suggested dropping it is not because I believe Congress shouldn't address the issue. The reason I suggested dropping the provision that we have here is that it is quite different from the provision in the House bill. The House bill provision, like this one, is revenue-neutral; but this particular provision has a very adverse impact on one major employer in my State.

Now, it would be my preference for us to adopt the House provision. There seems to be a lack of willingness to do that, although I haven't really heard a very good reason not to.

So, the only way I know to deal with this problem, to protect against an adverse consequence, is to suggest that we don't address it over here, which will have the effect of us deciding whether we want the House provision or nothing, and I would hope we would take the House provision.

The Chairman. Let me understand, Mr. Pearlman. The House chose another provision?

Mr. Pearlman. That is correct, Senator.

The Chairman. But staff felt this option was the better interpretation?

Mr. Pearlman. Was the more accurate interpretation of legislative history.

But there certainly is nothing wrong, it certainly is not a fatal action, to adopt the House's interpretation. As I said, I think the staffs -- there was a disagreement as to the interpretation on the House side.

The Chairman. But the House chose the other option?

Mr. Pearlman. The House chose the other option, that is correct.

The Chairman. And you did not see any egregious result from this?

Mr. Pearlman. I think I would say that. There is no egregious result that will be produced from adopting the House interpretation. That is correct.

The Chairman. All right.

Would there be objection to adopting the House interpretation on that?

(No response)

The Chairman. Are you moving that?

Senator Heinz. Mr. Chairman, I would move the House provision.

The Chairman. I am trying to determine your feeling.

Senator Heinz. I thank you, Mr. Chairman.

The Chairman. Is there further comment? Questions?

(No response)

The Chairman. If not, all in favor of the motion, make it known by saying aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

The Chairman. We will take the House provision.

Senator Heinz. Thank you, Mr. Chairman.

The Chairman. Now let us move on.

Mr. Oglesby. Senator, there is one further technical correction, that has been cleared on all sides -- Majority, Minority, Treasury, and Joint Tax. At Treasury's suggestion, a technical correction to the S&L Bail-Out Bill, the tax title of the S&L Bail-Out Bill, clarifying Treasury's regulatory authority to provide basis adjustments and other adjustments necessary to prevent double deductions in certain cases.

The Chairman. All right.

Mr. Pearlman. Mr. Chairman, as we proceed through the Reconciliation Package, let me just explain to the committee what documents you have.

The Chairman. Let me ask now if we can get a vote on the Technical Corrections. May we have a motion on that?

Senator Baucus. I so move.

The Chairman. Is there a second?

Senator Pryor. Second.

The Chairman. Is there question?

(No response)

The Chairman. If not, all in favor of that motion, make it known by saying aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

The Chairman. Motion carried.

All right.

Mr. Pearlman. The document that may serve as a convenient summary document is a revenue table. It is dated October 3rd, captioned "Revenue Effects of a Possible Revenue Reconciliation Proposal, JCX 60-89."

This document contains the entire reconciliation package that will be put before you. If you are interested in the total sort of bottom-line revenue effect of this package, and

if you will look at the bottom of page 5 of this revenue table, you will see that in Fiscal Year 1990 you meet your $5.3 billion revenue target -- slightly above that, 5.419 -- and then you will see the 5-year numbers, and then the '90 to '94 total.

Mr. Pearlman. There are also narratives on these various --

The Chairman. So what we are saying is that the package here meets the target, with an extra -- what? Hundred million?

Mr. Pearlman. An extra $119 million, that is correct.

The Chairman. All right.

Mr. Pearlman. And also, I guess, satisfies the requirement that you not be in a deficit position in any of the out-years.

The Chairman. Right.

Mr. Pearlman. I mean, you are positive in all of the years.

The Chairman. Fine.

Let me state to the members that I will oppose any measure that puts us below zero in any of the out-years and puts us subject to a point of order on the floor. And this one takes care of the Byrd Rule and accomplishes the objective.

Mr. Pearlman. All right. Now, because we have had an

opportunity to review with the members and with the staffs most of what is in what is referred to as Roman Numerals I through VIII -- that is, the first two pages of the Revenue Table -- I am going to run through those items very quickly, not describing them but simply noting to you changes or things that we think should be brought to the members' attention.

Obviously, if there are questions about any of these provisions, I will be happy to answer them. And I am going to try to move quickly, because we have got a lot of pages to go through.

The first narrative, if you are interested in the narrative, is captioned "Description of Revenue Reconciliation Proposal, Part I, Revenue-Raising Provisions." It is dated October 3rd, JCX 57-89. It has a table of contents, page numbers in the upper right-hand corner.

Most of the comments I am going to make about this package has to deal with effective dates -- slight expansions of effective dates that I simply want to call to the committee's attention, because they were not described to the committee earlier.

On page 3 of the document, in connection with the high-yield OID, Interest Deferral Rule, beginning at the very bottom of the page you will see a description of a transition rule that is intended to make it clear that, if documents had

been submitted to certain government regulatory agencies that evidence of a transaction was far under way, that they would receive the transition relief.

On page 9, which deals with the Section 351 provision, a portion of this provision is being made effective October 2nd, today, the date that it is being presented to the committee. And that is because it was not provided publicly prior to today.

On page 10, dealing with the built-in gain and loss rule, which was previously described to you, again looking at the effective date, you will see both that there is an October 2; that is, a today-effective date -- and in addition to that, certain reorganizations are given transitional relief under this provision, and the details of that transitional relief for bankruptcy reorganizations is described in the narrative.

On page 23, there are a number of changes: To the ESOP interest exclusion provision, in the effective-date sections. I can just briefly run through it.

Basically, it is a provision that is effective for loans after June 6th, 1989, but there is a binding written contract exception; there is an exception for binding contracts or tender offers registered with the SEC; there is an exception for transactions pursuant to certain collective bargaining agreements, and there is an exception with respect to certain filings with certain agencies of the United States

Government.

In addition, on page 24, certain refinancing loans --

Senator Symms. Excuse me, Mr. Pearlman.

Mr. Pearlman. Yes, sir?

Senator Symms. On that question, is June 6th your date?

Mr. Pearlman. That is correct.

Senator Symms. The House bill had a date of like June 8th, or something?

Mr. Pearlman. The House bill, on this provision, was originally June 6th and was moved to July 10th, if I remember correctly.

Senator Chafee. Mr. Chairman, I would like to ask a quick question.

The Chairman. Yes.

Senator Chafee. Ron, what would be the revenue difference if the 30-percent limitation were in excess of 30 percent were not there?

Mr. Pearlman. I am sorry. Are you saying if you eliminated the 30 percent limit?

Senator Chafee. That's right.

Mr. Pearlman. So that you repealed Section 130 in its entirety? Is that what you are asking?

Senator Chafee. That's right.

Mr. Pearlman. All right. I've got that number, but I am going to have to run it down. So give me just a second.

Senator Chafee. Okay. Well, I don't need it right now.

Mr. Pearlman. Well, we can provide that to you.

Senator Chafee. I mean I might be interested in that revenue later on.

Mr. Pearlman. All right. Well, we've got that; I just don't have it at my fingertips.

Senator Symms. MR. Chairman, I want to go back to this date again. You know, June 6th happens to not be a good date as far as I am concerned, and I just want to know if we can move to June 9th, which would be better. Is there any reason we can't move it?

Mr. Pearlman. That is not for me to decide.

The Chairman. Well, let's get to the point. Who are we talking about? And what are we trying to accomplish here, Senator?

Senator Symms. Well, we have a company in my State that was in the midst of all of its transaction -- had made the loan, and had tendered the offer -- and it just fell in the middle of all of this, and they need to be June 7th. They had done part of this prior to June 6th and part of it after.

Let me get my file out on that.

The Chairman. Who is prepared to discuss that one on staff?

Mr. Oglesby. Senator, the original House action was on June 6th. Subsequent to that, you put in a bill with a June

6th date. A little bit before that, Senator Dole put in a bill with a June 6th date. Before that, the Treasury Department had testified that there were big problems with the ESOP provisions, and especially with the interest exclusion; and this was not a surprise to a lot of people.

Senator Symms. I don't have my file here with me, but Senator Dole, when he introduced his bill, it took care of the constituent I am talking about.

Somebody on the staff has got it there.

Mr. Hardock. Senator Dole's bill had a broader definition of activity before June 6th that dealt with transition relief. The current proposal generally requires some kind of a written, binding commitment, pre-June 6th. Senator Dole's bill, as introduced, basically had a public announcement requirement, that you had to have made some kind of public announcement prior to June 6th.

The Chairman. Well, this is a significant revenue item, if we are doing this.

Senator Symms. Mr. Chairman, if we could just come back to this, I will get my file on it. It can't be that significant of an issue, for one or two days; but there were a number of transactions that closed fairly close to June 6th. People knew that Mr. Rostenkowski would introduce his bill, or was going to introduce his bill, and there were many, many transactions that actually closed on the 6th and some that

spilled over onto the 7th.

Mr. Pearlman. Senator, I think one of the reasons that the June 6th date has held so is because of the revenue consequences of changing it were rather significant. The knowledge that Mr. Rostenkowski was going to introduce a bill got out several days before it was introduced, and there clearly was a rush to market on transactions.

The Chairman. Am I correct in the numbers here of that, if we were to take that extra step in Senator Dole's bill, that that would cost about $110 million in 1990?

Mr. Pearlman. That is correct.

The Chairman. And $510 million over Fiscal Years '90 to '94?

Mr. Pearlman. Yes. sir.

The Chairman. A very major item, I am advised.

Yes, Senator Armstrong.

Senator Armstrong. Mr. Chairman, are you taking amendments at this point? Or do you want to continue the narrative? I have an amendment to this section, but --

The Chairman. I would like to get through the narrative, and then go on back to these, if we could.

Senator Armstrong. Thank you, Mr. Chairman.

The Chairman. All right.

Senator Durenberger. I have a question on this, if I might.

The Chairman. Yes. Sure.

Senator Durenberger. And maybe the language covers this, but I have got a situation with a company back in Minnesota that got caught on the June 6th date, too; but it is a public company that had put its proposal together at the beginning of the year, had made a public offering of its stock way back in February, had bought up a lot of the securities by April -- I mean, long before anybody knew what was going on. And then it just didn't complete the transaction by June 6th, and got trapped there. But, in effect, they had made a public announcement of what they were doing at least three or four months ahead of it, and I am wondering if some language can't be added to cover that kind of a situation.

Mr. Pearlman. Well, if all they did was make a public announcement -- you also said public offering. If they had a registered --

Senator Durenberger. Oh, they bought all the shares.

Mr. Pearlman. Okay.

Senator Durenberger. They actually bought the shares, I think it was four months in advance.

Mr. Hardock. There is another transition rule in Senator Dole's bill, which, to summarize, provides that if the board of directors approved a purchase prior to June 6th and the company then went out and bought stock, that was not yet transferred to the ESOP and did not have an ESOP loan at that

point, that would have been sufficient under Senator Dole's bill.

Preliminary estimates from the Joint Tax Committee were -- well, maybe this has been updated, but I believe in the $300 million range over 5 years, for that piece of the transition.

Mr. Pearlman. That is correct, about 60 percent of that $500 million, that the Chairman mentioned, our estimators tell us they think is attributable to the portion of the Dole Transition Rule that grandfathered or gave transition relief to companies that had adopted board resolutions and made purchases.

We have never viewed these as tax policy issues; this is money. It is just revenue. But that has been the problem in this process. The revenue has been very significant.

Senator Durenberger. Mr. Chairman, may I work to clarify this particular issue with staff, and make sure that it does fall under the Dole Rule?

The Chairman. Well now, if you move to the Dole Rule, which is an expanded one, as I understand it, you are talking about a cost of $110 million, or $510 million through 1994. You are talking about a big-ticket item.

Senator Durenberger. I don't know that I'm talking about a bit-ticket item. I am talking about a situation where they made their public announcement in February, they bought back

their stock in April, they had an S-8 registration statement filed. You know. And then along came June 6th. I mean, everything was done. I don't know whether the board resolution entered into it or not, but --

Mr. Pearlman. Well, let me say this. Obviously we will be happy to talk to Senator Durenberger further. I thought we understood that the transaction Senator Durenberger is talking about would have been protected by a different transition rule. But that, absent it, if the company did not adopt it, that Senator Durenberger's transaction that he is talking about would not be covered, because they did not either complete their ESOP loan -- in other words, they hadn't done the two-prong piece -- or they had not entered into a binding commitment to do so.

Now, we may be wrong about that, and we can talk further about that just to make sure; but we understand it would take the Dole Transition Rule to satisfy the transaction the Senator is talking about.

The Chairman. And if we take that, then these number that I have cited -- because it covers, then, a lot of other companies, in addition to yours -- would be $110 million in 1990 and $510 million over the 5 years.

Senator Durenberger. In the alternative, then, I would propose a more restrictive kind of language, which would say that "the amendment shall not apply to any loan to the extent

that the proceeds are used to require employer securities that were purchased on the market by the employer on or before June 6th, '89, for sale to the ESOP in accordance with a public announcement of the ESOP, and the related buy-back of employer securities, which also was made on or before June 6th of 1989."

The Chairman. I don't know how they can give you numbers as to what something like that would cost.

Mr. Pearlman. I can't. I think that is the question. We can certainly take back anything you want us to; but I can't give you a response to that off the top of my head.

The Chairman. He can't begin to tell you how many companies that applies to, either.

Senator Symms. Mr. Chairman, I would like to make one more inquiry about this. I apologize that I don't have my folder. I thought this had been taken care of, because when Chairman Rostenkowski introduced his bill, my constituent were not aware that he was going to do that or anything, and they were going along in their process. And by coincidence -- there wasn't any rush for them to get to it; they legitimately had gone about the process in a proper way to start an ESOP. They had done part of this transaction on the 5th, and I think they signed the loan on the 7th, if my memory serves me correctly.

So, when Senator Dole introduced his version, he

grandfathered it so that it took care of them. And the Chairman's bill was not introduced until after that.

Now we are coming back in here at the last hour, saying that, if we have to have June 7th as the date, we have to come up with some more money. I just object to that procedure, because I thought this had been taken care of.

These people were just caught out here. They may not have done this transaction had they known that they were going to have a retroactive treatment of their company's policy. There is a substantial, large number of employees who are involved in it, and I just think we ought to be able to accommodate this.

Mr. Pearlman. Well, Senator, I think all we can say to you is that we view transition issues as member issues. I mean, we just give you revenue estimates, and you make the decisions. It is not a tax policy question we are talking about; we are just talking about money. So that we will estimate whatever you want, you know.

Can I give Senator Chafee his numbers? I have them now.

The Chairman. Yes. Fine.

Mr. Pearlman. Okay. I will give you the year by year numbers in writing. You know, I will just hand them to you.

The first year is $1.265 billion, and the total over the 5-year period is $10.996 billion, and I will ask my colleague to give you the year by year numbers. Now, that is for a

total repeal, so that there would be no 30-percent level.

Senator Chafee. Could I ask one quick question? If you have to deduct the 30-percent that we have decided here to get the difference -- in other words --

Mr. Pearlman. That is correct.

Senator Chafee. You are not giving the difference?

Mr. Pearlman. No, I did not give you the difference; I gave you the number for the totals. But we could give you difference. But we could net the two for you. We could do that.

Senator Chafee. That would be helpful. Thank you.

Mr. Pearlman. We will have to be careful to --

The Chairman. Let me interrupt here for a moment, for the benefit of all of the members.

Tomorrow morning we had scheduled an important hearing with Secretary Baker, which would be his first meeting, to discuss Russian-United States economic relations, since his meeting with the Foreign Minister. But we have the Joint Session for President Salines at 11:00. So, the Secretary will be able to come 15 minutes early. He will try to summarize his statement. We will proceed with the meeting, but it will be at 9:45 -- 9:45. So if you will, please be on time, because we will then be going to the Joint Session, at 10:45, I would assume.

All right. If you would proceed.

Mr. Pearlman. All right. The only other item I wanted to mention on the ESOPs is there is a final transition rule -- well, there are actually two more, but one I wanted to mention -- the so-called back-to-back, or mirror loans, are also grandfathered.

The next item has to do with the transfer of excess pension assets. It is described in what might have been given to you as a supplement. If you look at the top right=hand corner, you will see something marked "Part 1, Page 24A and B." If you find that, that is the insert. I guess it goes further than that, A through E. I am going to ask Mr. Hardock to review this one with you.

Mr. Hardock. This is a proposal that is similar to a provision in the Ways and Means Committee bill and in both of the Labor Committees' reconciliation instructions.

In summary, it allows the transfer of excess pension assets into a retiree health account within the pension plan.

The main features are that, in order to protect pension plan participants, the pension plan assets cannot be reduced below 150 percent of termination liability, and all pension plan participants must be vested.

Only retiree health benefits of participants in the pension plan could be funded out of the transfer account.

Employers electing to transfer the assets to the retiree health account would be required to maintain an equal level of

benefits for 5 years for the retirees who are receiving health benefits.

Transfers would be made on an annual basis.

With respect to the retiree health benefits accruing for the next year, there would be a limitation on using this provision for key employees, generally the top officers of a company.

And a general counsel memorandum, which broadened the ability to fund 401(h) accounts would be repealed. That is also in the House Ways and Means' provision.

Mr. Pearlman. And Mr. Chairman, the final item I wanted to mention in this set was the effective date of the proposal to extend the amortization period on franchises, trademarks, and trade names to 20 years. That effective date is October 2, 1989 -- again, today -- and that was a change from what you were advised earlier.

Now, that completes everything in Part I that we had not described to you previously. And if you are looking at the Revenue Table, it completes the first two pages of the Revenue Table.

Senator Pryor. Mr. Chairman, may I raise a question with Mr. Pearlman, please?

The Chairman. Yes, of course.

Senator Pryor. Mr. Pearlman, this is 4(b) on the Farm Provisions. We have talked to your staff about it. There is

one question that I have: Is it the staff's understanding that this provision may be applied retroactively to those losses that might have occurred before July 10, 1989? Is that the understanding? There is some confusion about this.

Mr. Pearlman. Let me describe it as I understand it, without characterizing: If there are losses incurred prior to the effective date, and there was a deconsolidation, then, on a prospective basis, with respect to the future use of those losses, this provision would be affected. It would not literally be retroactive, it wouldn't go back prior to its effective date, but it could affect losses that were incurred prior to the effective date.

Senator Pryor. Mr. Chairman, I don't think there is a major concern here, but there is maybe a little technical amendment that could be drafted for the floor that might clarify this, and if I could just continue working with your staff, I would attempt to do this.

The Chairman. That's fine.

Senator Pryor. Thank you, Mr. Chairman.

Senator Boren. Mr. Chairman, could I just ask a question?

The Chairman. Yes, of course.

Senator Boren. On page 5, on item W-2, which is the farm debt, discharge of indebtedness income question? Looking at the revenue estimate on that, it appeared to be lower than if

we took the bill.

Now, did I understand that we not take the capital gains part of the legislation?

Mr. Pearlman. We haven't actually gone through those items yet, Senator; but the proposal that is on the Revenue Table does not have the capital gains portion in it. I thought I would explain that to you when we got there.

Senator Boren. Oh, I'm sorry. I will defer to that time. But if you could, when we come to that, explain it, that takes care of the problem, do you think, in terms of farm credit?

Mr. Pearlman. We will try to explain to you what we did, and then we can talk about it.

Senator Boren. Thank you very much.

Mr. Pearlman. Let me just make one comment, Senator Pryor, on your point. There could be some very substantial revenue involved with respect to that item. So if that is something that you want to pursue, then we have got to get our revenue estimators busy to do an estimate. So you might want to have your staff give us some language, an amendment or something.

Senator Pryor. Yes. Thank you, Mr. Pearlman.

Mr. Pearlman. Now, Mr. Chairman, at this point we could go on to Part II.

The Chairman. Let's go on to Part II.

Mr. Pearlman. All right.

Mr. Gideon. Mr. Chairman, I would like to make just one point, on item 3(b). Basically, this is the first time we have seen that in full write-up. I think it is similar to the House provision; however, I would simply note that we would like an opportunity at some point to take a little closer look at that and compare its provisions more closely to the House provision.

The Chairman. Mr. Gideon, you had better be taking a look at it, because we are going to try to finish up here tonight, if we can.

Senator Symms. Mr. Chairman?

The Chairman. Yes.

Senator Symms. Mr. Chairman, I don't mean to be obstinate about this, on Section 24, but I want to go back to this to be sure that I understand, entirely, what this is.

On the bottom of page 24 you say, "With respect to the grandfather rule," and so forth, that the legislative history would provide the existence of certain information there. Does that mean that, if this transaction took place over two or three days, that the company I am talking about would be taken care of? Or does it mean it is June 6th, period?

Mr. Pearlman. Well, I think that is factual question. Let me try to explain what I mean.

It is a June 6th date, but because there are multiple

parties involved in these transactions -- the ESOP trustee, the employer, and the lender, and oftentimes others, an investment banker or other financial advisor -- it seemed to us it was not appropriate to have a traditional kind of binding contract, that it would be too tough a rule; that is, if you had to have a contract between two parties, that that rule would be unreasonable in a transaction where we knew that multiple parties were involved.

So, the last paragraph, that you referred to, Senator, on page 24, "attempts to do," is to say you still have to meet the binding contract rule, you still have to prove that you've got a commitment to purchase that stock and to make the loan, but you can prove it by looking at documentation other than simply one contract between to parties.

So, it is a way to permit a taxpayer, or the ESOP, or the bank, in this case, because it would be claiming the interest exclusion, to prove that there were a number of documents that, when put together, would prove that there was a binding agreement. That is what this paragraph means.

But it does not mean that the date changes, or that a requirement for a binding contract changes. It is still required; it is just that you can use a variety of data sources to prove it.

Senator Symms. Well, if the loan was signed on June 7th, then, how is the IRS going to treat that for tax treatment? I

think the stock was tendered on June 5th.

Mr. Pearlman. The bottom line requirements of the provision are that there be a commitment to make the loan, and that there be a commitment to purchase the stock for the ESOP.

Now, maybe your facts do meet that. Again, we would be happy to review your facts with you, but I can't answer you based on what you have told me.

Senator Symms. I will get those facts, Mr. Chairman. Before we complete this, I would like to come back to that.

Mr. Pearlman. Mr. Chairman, there is a Part II. It is a separate document, dated the same day, dated October 3rd, and it is captioned "Expiring Provisions, Child Care Initiative, and IRAs."

Again, since this material was reviewed with both the members and the staff previously, it is not my intention to go through those items, item by item; but what I would like to do is highlight for you a couple of the major things that are different than what you have seen before. And I think, principally, what that means is the lengths of the extensions of the expiring provisions.

What you see -- I am looking at the Revenue Table. It just happens to be easier to look at it.

Senator Roth. Mr. Chairman?

The Chairman. Yes, Senator.

Senator Roth.

Senator Roth. I do have a concern on the first section, on page 36. I don't know whether you would rather I raise that now or later.

The Chairman. What I want to do, Senator, I want to go on through the Chairman's Mark, and them come back and subject it to amendments.

Senator Roth. Thank you, Mr. Chairman.

The Chairman. All right. Let's go on through it.

Mr. Pearlman. All right.

I just think, for purposes of convenience, you might want to look at the Revenue Table on Page 3, and at the top, Roman Numeral IX, you will see all of the expiring provisions listed. And then I will explain to you what we have done on these expirations. I am just going to go down them real quickly:

Educational Assistance and Group Legal Services are extended through 1991. That is the case with the targeted jobs tax credit, as well.

- Research and Development Credit is a permanent extension;

- The R&D 861-8 allocation is a two-year extension;

- Business Energy Credits are permanent;

- Mortgage Revenue Bonds, permanent;

- Small Issue IDBs, through 1991, two years;

- Low-Income Housing, permanent;

- Health Insurance for the Self-Employed, two years, through 1991; and the

- ESOP Withdrawal Tax, two years, through 1991.

We spent some time yesterday discussing with you some details in the R&D credit, the calculation of the credit, particularly the base. I think if you look at the narrative without me going through that, I think those of you who are particularly interested in that will see that what was worked out is confirmed in the document. We can go through that in more detail, if you wish.

Senator Packwood. Could I ask you a question, Ron?

Mr. Pearlman. Yes, sir.

Senator Packwood. What did you do on the low-income housing credit with modifications?

Mr. Pearlman. There are a number of them, and I will be happy to have someone go through them with you. I think they are relatively minor. There is a spreadsheet in your documents that compares present law to the Chairman's Mark. So you can go through each one of those.

If you wish we can go through each one of them with you.

Senator Packwood. I was just wondering were there any changes in the passive-loss rules.

Voice. No, there were not.

Senator Packwood. Thank you.

Mr. Pearlman. All right, now. I think, because there

were no other changes in this section, Mr. Chairman, that completes Part II, unless members have questions.

Senator Symms. I have a question on that, if I could, Mr. Chairman.

Senator Moynihan. Indeed.

The Senator from Idaho.

Senator Symms. On your expiring provisions, what you are saying here is that the $12 billion -- I guess what I am trying to ask is, most of those provisions, the money that is picked up is estimated in the future years, is that not correct?

Mr. Pearlman. Do you mean the revenue losses?

Senator Well, the revenue losses are in the first year or two; but then, as they expire, you start picking up revenue.

Mr. Pearlman. Actually, let me see if I can explain the numbers to you. If you look at the subtotal, you will see revenue losses in each year. For example, 1.7, 2.8, 2.5. That all totals to an overall 5-year loss for the extensions of the expiring provisions of $12.8 billion.

Now, what happens is that, even though you may only extend something for two years, oftentimes there is a revenue loss that flops into the next year. So you just have to look at each one of them.

If you look at Educational Assistance, it shows revenue losses over a 3-year period. If you look at Targeted Jobs

Credit, even though it is a 2-year extension, it shows revenue losses over a 5-year period. That just happens to be the way that the Targeted Jobs Tax Credit operates.

With the Permanent Extensions, obviously there are revenue losses over the 5-year period.

Senator Symms. If you left those extensions in permanently, how much would that number be? Do you have that number?

Mr. Pearlman. We have a total number on extensions, and I will get it for you.

Senator Symms. What I am trying to find is the relationship between the cancelling of these expiring provisions and the cost of the IRAs, as it gets higher.

Mr. Pearlman. Give me just a minute, and I will give you an estimate on the permanent extension of all of the expiring provisions. We do have that number.

(Pause)

The Chairman. Senator Packwood?

Senator Packwood. I just want to ask Mr. Pearlman a question.

Mr. Pearlman. Yes, sir.

Senator Packwood. On item 11, the Individual Retirement Accounts.

Mr. Pearlman. Yes. I am listening.

Senator Packwood. Okay. This is the one that has got

the $12.6 billion loss over the 5 years, right?

Mr. Pearlman. That is correct.

Senator Packwood. Now, I am looking at your Distributional Effective Proposal to Expand the Availability of Individual Retirement Accounts, 50-percent deductible. Is that the chart that relates to this?

Mr. Pearlman. That is correct.

Senator Packwood. Okay, I just want to make sure I read it right.

Of the $12.6 billion that are lost, only 5 percent of that money will go to people with incomes of less than $50,000 a year, is that right?

Mr. Pearlman. Yes, I think that is correct. Let me just --

Senator Packwood. And 95 percent of the benefits go to people making $50,000 or over?

Mr. Pearlman. Yes. Let me say it a different way and see if we are saying the same thing:

This change in the law has less effect for people at the lower income level, because of the current law that allows them 100-percent deductibility. So in other words, the Chairman's Mark does not change current law, that permits employees who are not covered by qualified plans to have full deductibility of their IRAs.

As a consequence, this change in the law has less effect

on them. I think the one important thing to note is the footnote, footnote 1, that "the proposal in the Chairman's Mark to allow penalty-free withdrawals is not reflected in the distribution table." So there is some benefit that goes across the distribution line for withdrawal, and that is not reflected. Otherwise, I think you are right in your comment.

Senator Packwood. And that is a benefit, at the most, of about $1.5 billion, maybe -- the withdrawals?

Mr. Pearlman. Well, I am a little reluctant to confirm that number, because I don't know what it is.

Senator Packwood. Well, don't worry about that. I just want to make sure, again, we understand. I am looking now at the Treasury figures.

Mr. Pearlman. I am told that your number is right.

Senator Packwood. Without categorizing lower-income, middle-income, or upper-income, this will benefit about the upper 5 percent of income earners in the country.

Mr. Pearlman. I am told that above $100,000 of income is about 5 percent of the top earners in the country, that that is sort of the cut-off you can use at 5 percent.

Senator Packwood. Well, I will put it the other way around: This basically benefits people who make above $50,000.

Mr. Pearlman. That is correct.

The Chairman. Well, let me put it another way, as long

as we are getting into this kind of discussion at this point:

Let me state that, for those making less than $75,000, they would get 51 percent of the benefits; that, for the House capital gains provision, those making under $75,000 would get 15 percent of the benefits. For those making less than $100,000, under the Bentsen Ira they would get 69 percent of the benefits; under the House capital gains, they would get 20 percent of the benefits.

Or let us put it another way:

For those, on the Bentsen Ira, that make over $200,000, they would get 7 percent of the benefits; and under the House capital gains, they would get 60 percent of the benefits. As long as we are talking about distribution.

Senator Packwood. I would be happy to get the distribution, so long as we agree that the Joint Committee counts those who make over $200,000, or $100,000 when they sell a capital asset.

You count their capital asset as income in that year, don't you?

Mr. Pearlman. Yes. Our distribution tables include all income -- in fact, it is broader, as you know, Senator -- in the distribution.

Senator Packwood. So, if somebody has worked all their lives and sells their house for $250,000, you list them as having income above $200,000?

Mr. Pearlman. Yes. When we do the kind of distributional table that we have distributed to you, traditionally, we include all income in doing our distributional analysis. That is correct.

Senator Packwood. That's fine. But I just don't want the general public to have the impression that everybody who has the sale of a house at $250,000 should not be categorized as having that kind of income every year. In fact, very few years do they have that kind of income, and probably only once.

The Chairman. Mr. Pearlman, you have some additional information on this. And insofar as the number of sales they make on capital gains, if you would, provide me with that additional information.

Mr. Pearlman. All right. If you don't mind, I am going to ask Mr. Barthold. Rather than relaying it through my head, I am just going to put Mr. Barthold here and let him respond to you.

Mr. Barthold. Senator, we did a look through the 1985 sale of capital assets file, which is the most recent detailed data available from the IRS, and in that we looked at the number of taxpayers reporting transactions on Schedule D, Capital Gains, the number of taxpayers who made one transaction, as opposed to more than one transaction.

The number of taxpayers who made one transaction

accounted for approximately 40 percent of all transactions reported on Schedule D in 1985.

Your question, I believe, though, addressed the dollar value of transactions, and the dollar value of those transactions was approximately 18 percent of all gains claimed by taxpayers in 1985.

Senator Packwood. That is if they made one transaction, right?

Mr. Barthold. That is with the one transaction, that is correct.

Senator Packwood. Well, let me give you one for-instance. If you were to sell a hardware store, you've worked at it all your life, normally when you sell it, how many transactions would you have?

Mr. Pearlman. Well, I think, normally, you would have one transaction.

Senator Packwood. No, I don't think so. You would have a transaction for the sale of the store, and you would have a transaction for the sale of the inventory, and that would count as two transactions, wouldn't it?

Mr. Pearlman. Well, what you are saying is, if you sell assets. If you sell the assets, some of them will be capital assets, and some will not; but I think in terms of reporting on a tax return -- well, I guess you could have more than one asset. Inventory clearly would not show up as a capital

asset.

Frankly, what I was thinking of, Senator, when I responded to you, I was thinking in context of stock. And if you sold the stock of that hardware store, you would have a single sale of stock. If you sold the assets of that store, you would be selling multiple assets, and if there were three capital assets within that category, you would report three assets.

Senator Packwood. Could I ask Mr. Gideon, then, how it is normally reported?

Mr. Gideon. Well, we believe that each entry on the Schedule D, I think, is what has been counted here. For example, if a block of stock -- you own your own company, but you buy it at three different times, so that you have three different holding periods; that probably will be reported as three different transactions for purposes of Schedule D.

Similarly, if you are selling assets -- in other words, you own a farm, and you sell the farm, and it has a tractor, it has a backhoe, it has an irrigation well. Each of those assets would be a capital asset transaction, and we think each one of them would count as an item on Schedule D.

The Chairman. I have sold a few of those, and I have sold the entire farm and all the assets that went with it as one transaction.

Another point I want to bring out is that the average tax

cut under the capital gains proposal is almost $25,000 for those with incomes more than $200,000. Now, that is over 50 times larger than the benefit of the Bentsen Ira Proposal to a comparable taxpayer.

Senator Bradley. Mr. Chairman, could I follow up with Mr. Brown in response to a question by Senator Packwood?

The Chairman. Certainly.

Senator Bradley. Because I didn't quite hear what you said. You said in 1985 the txpayers -- what was that 40-percent figure that you gave?

Mr. Barthold. Of the transactions reported on Schedule D, Senator, about 40 percent of the transactions were counted by taxpayers who reported just one transaction.

Senator Bradley. Right.

Mr. Barthold. Those transactions had a dollar value which was approximately 18 percent of the total dollar value of gains reported in 1985.

Senator Bradley. So, this hypothetical hardware store owner or small businessman who has one sale in one year accounted for 18 percent of the capital gains taken. Is that correct?

Mr. Barthold. That would be correct. One transaction accounted for 18 percent of dollar value.

Senator Bradley. So, 82 percent of the capital gains that were taken were taken by people who had multiple trades

or multiple transactions in one year.

Mr. Barthold. That is correct, according to the 1985 data.

Senator Bradley. Because, you know, there are two things here: One is what are the number of transactions, and the other is what is the dollar value of the transactions? Who is making the money from the transactions?

Senator Packwood. Well, could I ask Mr. Gideon another question, then?

Mr. Gideon, I am looking at your Department of the Treasury Office of Tax Analysis memo: "Distribution of long-term capital gains for returns with long-term capital gains in 1987." Are you familiar with that table?

Mr. Gideon. Yes, I am.

Senator Packwood. If I read it correctly, 46 percent of the gain -- I am talking about the cash gain -- went to people with incomes of under $50,000, is that right?

Mr. Gideon. Of income other than capital gains, yes.

Senator Packwood. That's right.

Mr. Gideon. That is correct.

Senator Packwood. That is why you have to be careful when you are comparing this. You are saying these are people who had income, other than the capital gain. Whereas, when the Joint Committee gives us a figure, it includes the capital gain. So they are totally two different figures, aren't they?

Mr. Gideon. They are two different figures.

Senator Packwood. But 46.7 percent of the total gain, capital gain, goes to people with other income of $50,000 or less.

Mr. Gideon. That is correct.

Senator Packwood. Thank you.

Senator Daschle. Could I ask a question, Mr. Chairman, about that? Because this came up in the hearing, and I am a little confused, myself.

The Chairman. All right.

Senator Daschle. Would someone whose sole income is derived from capital gains -- say, for example, a Donald Trump. I am told that that is his case, although it may not be. But is someone whose sole income is derived from capital gains, would he fit the definition you just described in your answer to Senator Packwood?

Mr. Gideon. I guess, hypothetically, I can conceive of someone like that, Senator, but I think it is very difficult to conceive of someone in the real world who had absolutely no dividend income or interest income.

Senator Daschle. We are not talking about "absolutely" none.

Mr. Gideon. Well, any of those others would score as "other income" -- any of those items.

The Chairman. Let me state, as a further thing on the

point of selling a small business, that we have given particular consideration to that in the Chairman's Mark, because a General Utilities Repeal for Small Business should help them reduce the tax cost of liquidating a small business, by limiting that tax to a single-level tax. So, that provision is in the Chairman's Mark.

Senator Armstrong. Mr. Chairman, could you explain that down at this end of the table? Because we heard "general utility, but we didn't quite understand what you were doing with it.

The Chairman. This calls for the repeal of the General Utilities Provision for Small Business, on a permanent basis.

Senator Armstrong. And how is "small business" defined?

The Chairman. How was that classified?

Mr. Oglesby. Senator, you would reinstate the old General Utilities doctrine for all small businesses with assets of under $5 million, and that would be phased out between $5- and $10 million.

Senator Armstrong. Thank you.

The Chairman. It is a major provision for a small business.

Senator Daschle. Mr. Chairman, could I just ask one follow-up question of Joint Tax on the question I was asking?

The Chairman. Yes.

Senator Daschle. If the Joint Tax could just address the

issue, how many less than zero transactions would be included in the data that we were just discussing? Do you have any of that information?

Mr. Barthold. I don't have the directly comparable data, Senator, because Treasury said they were looking at some 1987 data. But drawing on the 1985 data, about which I described a moment ago, we looked at a number of returns and percentage of gains by an income classified, which was adjusted gross income less net capital gains, so, in other words, non-gain income. And 2.7 percent of the returns in 1985 had non-gain income less than zero. Those returns accounted for 11.6 percent of the total value of gains reported in 1985.

Senator Daschle. That was two-point -- ?

Mr. Barthold. It was 2.7 percent of returns, 11.6 percent of dollar value of gains.

Senator Daschle. Is that representative, in your view, of years before and after?

Mr. Barthold. 1984 had some similar results in SOI data. I don't have that right at my fingertips. Years after, 1986 and 1987, most analysts consider a little bit anomalous because of the fantastic sales volume in 1986, prior to the change in the law that took place in 1987, and then the consequent drop-off in 1987. So I wouldn't want to characterize those years as typical.

Senator Daschle. That is pretty hard to argue with,

don't you think, Mr. Gideon?

Mr. Gideon. Well, we didn't find much difference, frankly, between 1985 and 1987 in terms of the distributions that we are talking about. In other words, the percentages are basically the same for '85 and '87 data.

As to the case that was mentioned, let me simply --

Senator Daschle. They are the same, so you are actually agreeing with Joint Tax, then.

Mr. Gideon. Well, let's talk about that case. Basically, that case is someone who has a loss, and at the same time has a capital gain.

Now, I think Senator Boren is very familiar with that case, a farmer who was in hard times and had a foreclosure, a capital gain, would fit that case precisely.

The Chairman. May we proceed?

Mr. Gideon. Senator, we skipped by item 10, the child care initiative, which is paired with the telephone excise tax.

This adopts some child care provisions that passed the committee, or that passed the Senate, in connection with the permanent extension of the telephone excise tax and some other revenue raisers that were also included in that package as it went to the floor.

With item 11, that completes I think all of the material that is in Part II of a the Joint Tax Committee documents, and

now we would be on Part XII, "Other Provisions."

The Chairman. All right.

Senator Heinz. Mr. Chairman?

The Chairman. Yes.

Senator Heinz. Before we go to "Other Provisions," would it be in order to ask a question about one of these items that we have just gone over?

The Chairman. Yes. Of course.

Senator Heinz. I have a question about item 3(b), "permit limited use of excess pension funds to pay current retiree health benefits."

Am I correct that that is the provision that substantially narrows the amount of excess pension fund money that could be contributed to a 401(h) trust?

Mr. Hardock. One element of the package, Senator, is a provision that overrules a recent General Counsel Memorandum by the IRS General Counsel, which expanded the ability to contribute to 401(h) accounts, retiree health accounts.

Senator Heinz. Now, as I understand 401(h) accounts, they are in effect an account within what you might call a regular ERISA pension fund. Is that right?

Mr. Hardock. That is correct.

Senator Heinz. Now, both pensions and promised retiree health benefits are benefits for retirees, right?

Mr. Hardock. Yes.

Senator Heinz. I am puzzled as to why we would want to restrict the funding or the support of the funding of health benefits from excess funds in a pension plan.

Mr. Hardock. There is no restriction. As a matter of fact, the proposal on the table expands the ability to use the excess funds to fund the retiree health benefit.

Senator Heinz. Expands it beyond --

Mr. Hardock. Beyond current law.

Senator Heinz. -- the General Counsel's Memorandum?

Mr. Hardock. No. Well, currently you cannot use excess pension funds to fund retiree health benefits. The proposal would allow that to occur if certain conditions are met protecting the pension plan participants and the retiree health beneficiaries.

The GCM would have expanded the ability to fund the retiree health account directly by the employer, and have done so in direct contravention to an action taken by the Congress in 1987 to restrict the ability to overfund benefits.

Also, the GCM would allow that funding to occur in a manner that doesn't provide any protections for retirees, in that the benefits be provided for any length of time, or any conditions at all on the benefits.

Senator Heinz. Mr. Gideon, do you want to be heard on this?

Senator Gideon. On this issue, Senator, we have no

disagreement with the action that is being taken.

The Chairman. All right?

Senator Heinz. I just want to express my reservations about it -- not necessarily the entire provision, Mr. Chairman. But, as I understand it, a portion of what is taking place here limits, beyond the GCM, the amount that may be put from an overfunded pension plan into one of these 401(h) accounts. I still haven't heard a good reason for narrowing what the GCM proposed in that area. In the other areas covered by the General Counsel Memorandum maybe there are some legitimate concerns, but I do not understand why this particular subset of that GCM is not good policy.

Mr. Gideon. And I should make clear that my comment refers only to the GCM action. This is the provision as to which, frankly, we are going to have to have more time to study the overall provision to formulate our position.

Senator Heinz. All right.

The Chairman. May we proceed?

Mr. Oglesby. Senator, we are now up to Part XII.

The Chairman. Isn't that listed as "Part III"?

Mr. Oglesby. Senator, you and Senator Packwood have the narrative on Part III. I don't believe anybody else has it. It is on the way over from the Joint Tax Committee.

Mr. Pearlman. It is Part III. It is the hottest off the press. There are two copies, and you have them, and more are

coming. It is the items that are in Roman numeral XII on the table, and we could try to trudge through them or wait until the copies get here.

The Chairman. Let me, then, have action on the Chairman's Mark on Parts I and II.

Senator Moynihan. Mr. Chairman, I move the adoption.

Senator Symms. Mr. Chairman, Mr. Pearlman was getting me an answer here a minute or two ago about the relationship between if those -- and they were looking for the answer. I thought he meant he was going to get it tonight.

Mr. Pearlman. Oh, yes, we are going to get it tonight.

The Chairman. But I would like to move on that, and then we can come back with amendments.

Senator Dole. Mr. Chairman?

The Chairman. Yes.

Senator Dole. I would like to have somebody tell me what is in the child care portion. Is that in Part II, or Part III?

Mr. Pearlman. I am sorry, Senator.

Senator Dole. Child care. Where is that?

Mr. Pearlman. Child care is in Part II. We passed out two sets of documents, and the child care was in the second set of documents.

Senator Dole. Which no one has?

Mr. Pearlman. No, you have those in front of you.

The Chairman. You have had those.

Senator Dole. Well, what is the difference in that and the President's package on child care, and the difference between what we have in here and what was passed by the Senate?

Ms. Malone. Senator, the President's package had a dependent care credit in it, and also an EITC provision, a young child supplement to the earned income tax credit.

What is in this package has the three credits that were passed as part of S.5 by the Senate a couple of months ago. It has the dependent care credit provision; it has the young child supplement to the earned income tax credit provision; and it has the health insurance credit provision.

The health insurance credit provision is the same health insurance credit provision that was passed by this Finance Committee.

Senator Dole. So, everything that we passed in the Senate is in that package, is that correct?

Ms. Malone. All of the pieces are there, Senator, yes.

Senator Dole. Are they all the same?

Ms. Malone. They are not identical to what was passed by the Senate. The health insurance credit is the credit that was approved by the Finance Committee. It has the full 50-percent credit for expenditures for health insurance.

Senator Dole. As opposed to what? The 25 percent?

Ms. Malone. No, as opposed to a phasing in. The bill that was passed by the Senate had a full 50 percent, but it was phased in over a period, I believe, of 3 years. This has 50 percent effective in the first year.

Senator Dole. Any other differences between the Senate bill and this package?

Ms. Malone. There is one other difference, also in the health insurance part. The health insurance provision that was passed by the Senate phased out at an income level of $18,000. This phases out at $21,000.

Senator Dole. What is the cost of that provision?

Ms. Malone. I don't have that.

Senator Dole. It was about $500 million, wasn't it?

Mr. Reishus. The cost of the provision as passed by the Senate would have been $1.8 billion over --

Senator Dole. That was for the whole piece, right?

Mr. Reishus. No, that was for the health insurance credit.

Senator Dole. And how much is this?

Mr. Reishus. The proposal in the Chairman's Mark is $2.8 billion over the 5-year period, compared to $1.8 billion for what was included in the S. 5.

Senator Chafee. Mr. Chairman?

The Chairman. Yes. A question?

Senator Chafee. Mr. Chairman, before we proceed with the

completion of Part I, I wonder if you might turn to page 38, dealing with the Excise Tax for the Coastal Wetlands Trust Fund.

The Chairman. Yes.

Senator Chafee. I would ask that the word "coastal" be deleted from that term of Wetlands Trust Fund, because these funds come from the outer continental shelf, and that is, of course, federal lands, and it is quite different from the drilling that takes place in the three to six mile limit where the Coastal States share in a distinct portion of it, and these monies, I believe, should be used for wetlands throughout the nation, not solely with the definition or the suggestion of "coastal" wetlands. The wetlands problem is a national problem of great concern, and just as we do with the Land and Water Conservation Fund, which uses the outer continental shelf revenues, so I think the suggestion shouldn't be that these funds are solely for "coastal wetlands."

The Chairman. It was my understanding it is not limited to just coastal; it is for wetlands across the country.

Senator Chafee. Well, we don't have legislation yet on this, and I would prefer, and I would suggest and hope, that we could just plain eliminate the word "coastal," so that it is a Wetlands Trust Fund.

The Chairman. I don't see a problem with that. All

right.

Senator Baucus. Mr. Chairman?

The Chairman. Yes.

Senator Baucus. I would echo what the Senator from Rhode Island said; I think it is important to be "wetlands," total, because our wetlands is in addition to the coast.

The Chairman. I don't see any problem with that.

Senator Chafee. Thank you.

The Chairman. So, if there is no objection, all right.

Senator Armstrong. Mr. Chairman?

The Chairman. Senator Armstrong.

Senator Armstrong. Are you ready to take an amendment to these sections?

The Chairman. No. I want to go through it, then I will open it up to amendments. I want to go all the way through.

Senator Armstrong. I thought we had completed the discussion of it.

The Chairman. I want to go through the Chairman's Mark, and then, after we have done that one and see what action the committee wants to make, and then open it up to amendments at any point you want to.

Senator Symms. Mr. Chairman?

The Chairman. Yes.

Senator Symms. It is my understanding that Mr. Pearlman has those numbers that I had asked for, and I would like to

ask him if he could possibly read them into the record.

The question is, what would the revenue loss be in future years if you extended those expiring provisions. How much is computed into this?

Mr. Pearlman. All right. Let me start by giving you a 5-year total. Is that all right?

Senator Symms. Correct.

Mr. Pearlman. A 5-year total, if you were to extend all of the expiring provisions permanently, which I think is what you asked, it would be $20,100,000,000 over 5 years, and that is a $7.3 billion difference between what is in the Chairman's Mark and that $20 billion total. Now, I have the year by year numbers. If you want them, we can provide them to you.

Senator Symms. So we are talking about approximately $12.7 billion difference?

Mr. Pearlman. Well, the expiring provisions as extended in the Chairman's Mark has a 5-year cost of 12.808. It is the last column on page 3 of the Revenue Table. And if you were to extend all of those expiring provisions permanently, then the cost would go up to $20,100,000,000.

Senator Symms. So there is a $7 billion difference.

Mr. Pearlman. A $7.3 billion difference, yes Senator.

Senator Symms. Okay. I thank you very much.

I would just say, again, Mr. Chairman, I think that it is very bad policy for us to continue this one year at a time

extension of important opportunities like investment for R&D credits, and so forth. I think that is the point I am getting at.

The Chairman. We have extended it permanently, or for the three years. What was it?

Mr. Oglesby. The R&D credit is made permanent in the Chairman's Mark.

The Chairman. All right.

Senator Symms. Well, that is a good move. Excuse me. I misunderstood it.

The Chairman. All right. Let's proceed, then.

Mr. Pearlman. Mr. Chairman, first thing, let me apologize for not yet having enough copies of Part III.

The Chairman. Well, let me then proceed on the motion that was made on Parts I and II.

Senator Bradley. Mr. Chairman, I move adoption of Part I and II.

The Chairman. Is there a second?

Senator Daschle. Second.

Senator Packwood. Mr. Chairman?

The Chairman. Yes.

Senator Packwood. By Part I and II, you are including the IRAs, right?

The Chairman. That is correct.

Senator Packwood. In that case, I have an amendment.

The Chairman. Well, we have a motion before us, and I am asking a vote on it.

Senator Packwood. I believe it is open to amendment, Mr. Chairman. Are you suggesting we cannot offer an amendment?

The Chairman. You may offer the amendment.

Senator Packwood. All right. I want to pass out a capital gains amendment.

Senator Armstrong. Mr. Chairman?

Would my colleague yield for a moment?

Obviously, the capital gains versus IRA is the fulcrum of this whole issue, but I am wondering if we couldn't handle the nickel and dime amendments before we get to that.

Senator Packwood. I would be happy to do so. I just don't want to close out Section II.

Senator Armstrong. That is the point I was getting at, Mr. Chairman. I thought you were preparing to adopt this, and I had amendments to the portion that was about to be adopted. I think that is Senator Packwood's point, too. I don't care when we offer them, but I want to be sure we don't get foreclosed, is all.

Senator Bradley. Mr. Chairman, it is my motion that is pending, to adopt the Part I and Part II of the Chairman's Mark.

Senator Packwood. We can't offer any amendments?

Senator Bradley. No, I think that is the Chairman's

call. I am not sure.

Senator Packwood. I can't recall that a member can be precluded from offering an amendment.

Senator Bradley. You wouldn't be precluded from offering an amendment. As I understand it, as the Senator has said to Senator Armstrong, the Chairman's Mark will be open fully to amendments.

Senator Moynihan. Oughtn't we just get through the numbered text, and then come to the main event?

The Chairman. And then we will be happy to get into each of these items.

Senator Packwood. Well, again, I want to make sure, because what we have is a total capital gains and partial IRA substitute for the Chairman's IRA provisions, and I don't want our side to be precluded from offering this amendment.

The Chairman. You will not be precluded from offering it, so let's get adoption before we start.

Senator Symms. Mr. Chairman, I would make a parliamentary inquiry on that. If we adopt the amendment, then if a Senator has another -- as Senator Armstrong calls it -- nickel and dime amendment, but it may have some revenue number, then is the Chairman going to require that we come up with an offset to offer the amendment, after we have adopted the Mark?

The Chairman. If we don't have any money left. But we

do have some money left in the provisions now. That is what I told you before.

Now, we have the motion before us. All in favor of the motion as stated, make it known by --

Senator Chafee. Mr. Chairman, could I have a question? If we wanted to go back and tighten up -- just as a suggestion on the ESOP provision, are we permitted to do that, pick up some money should we want that?

The Chairman. Absolutely. We certainly can go back. But we are trying to get proceeded on the Chairman's Mark, and when we get through this, we will go back and let you try your amendments, wherever they might be.

No, we have the motion before us. All in favor of the motion as stated, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

The Chairman. Motion carried.

All right. Now let us proceed.

Mr. Pearlman. Now, Mr. Chairman, we will move to this last part, which is Roman Numeral II on the Revenue Table. I will go through these items, and hopefully within the next few minutes I will be able to put in front of you the narrative. But I think we have designed the Revenue Table so, hopefully, if you will follow it, will give you at least a description,

and I will try to fill in the blanks.

Senator Packwood. Mr. Chairman, what are you on? What is this "Roman Numeral II"?

Mr. Oglesby. This is Roman Numeral XII.

Senator Packwood. Oh, 12?

Mr. Oglesby. Yes. It would be the Document No. 3. We are getting them --

The Chairman. It is Document No. 3.

Mr. Pearlman. That is correct.

Senator Packwood. Is this Part III, this thing that you and I got?

The Chairman. That's right.

Senator Packwood. All right.

Mr. Pearlman. If you will turn to page 3 of the Revenue Table --

Senator Packwood. Is this the Revenue Table?

Mr. Pearlman. That is correct.

If you look at page 3 of the Revenue Table -- oh, now I think we have the document here, sir.

The Chairman. Yes, we have plenty of them. We are loaded with them, now.

Mr. Pearlman. All right. If you look at the bottom of page 3 of the Revenue Table -- the document is being distributed to you -- you will see a heading captioned "Other Provisions." And what I am going to do, since these are

items that have not been presented to the committee before, I am going to go through these with you, although I am going to try to do it briefly.

If you want to follow the Revenue Table, just follow the items at the bottom of page 3; or, you can follow the narrative which is being distributed to you.

- Number one actually is item A. If you are following the narrative, it begins on page 2, and is the repeal of Section 89. This repeal generally reinstates the rules prior to the enactment of Section 89.

- Number two is a two-year extension of the General Fund Transfers to the Railroad Retirement Tier Two Trust Fund of amounts from taxation of Tier Two benefits.

- The third item is a modification of the full funding limit, and this would, in general, allow employers to elect or apply the present law for a funding limit, without regard to the 150 percent current liability limit, and then it will require the Secretary of the Treasury to adjust the full funding limit in order to make this change a revenue-neutral change.

Mr. Gideon. If we could comment just a moment on this one, we do not object to this provision, Mr. Chairman, but we had made clear over in the House, and we want to make clear here, that this is a provision with winners and losers.

Basically, we are being directed to do something that we

had chosen not to do by regulation. I want to make certain that people understand that as a result of taking this action, which will benefit some companies, we will reduce the full-funding limit for other companies, and as a result you are likely to hear from them after you have done this.

Mr. Pearlman. All right. Mr. Chairman, the next item.

- Number four, or letter D on the Revenue Table, is the treatment of income from personal injury awards for minor children. This provision will treat this income as earned income, and basically it is an exception to what is popularly known as "the kiddie tax."

- The next item will provide tax-exempt status for cooperative service organizations that are established by private foundations or community foundations.

- The next item provides an alternative recapture method for mutual savings banks who change from the reserve method to the specific charge-off method, and for thrift organizations.

The Chairman. Give me page numbers, please.

Mr. Pearlman. I am sorry?

The Chairman. Which page number?

Mr. Pearlman. Oh. Excuse me. All right.

The mutual savings and thrift item is on page 11 of the narrative. If you are working with the narrative, as I flip through it I will give you the page numbers.

The Chairman. Good.

Mr. Pearlman. All right.

- The next page is page 13, and this is a denial of the retroactive certification of so-called WIN tax credits.

- Page 14 has several changes to the estate and gift tax provisions. The first one is a slight change to the so-called Q-tip definition. It reverses the Estate of Howard Case and reinstates some Treasury regulations. The result will be that an income interest would not fail to qualify as a qualified-income interest, merely because the income is for a period that lasts after the last date of distribution.

- The next item is page 15, and would provide that gift exclusions, a $10,000 or less exclusion, would not be included on a taxable estate if made within three years. That is on page 15.

- The next item is on page 16. Again, it is an estate tax item, and it provides that the right of recovery that is currently provided in Section 2207(a) of the Internal Revenue Code would not apply, unless the spouse otherwise directs, in a provision of the rule specifically referring to this provision.

- The next item, on page 17: We proposed a repeal of Sections 2036(c) and 2207(a) of the Internal Revenue Code, the so-called estate freeze provisions.

Senator Bradley. Mr. Chairman?

The Chairman. Yes.

Senator Bradley. May we make inquiries as we go along?

The Chairman. Yes, of course.

Senator Bradley. This one kind of jumps out at me, because I wasn't in the room when this was discussed, but this costs $878 million. I am just curious. What is the a "repeal of estate freeze rules? What were the freeze rules all about, and what specifically does this do? I mean, it is almost a billion dollars.

Mr. Pearlman. These two sections, 2036(c) and 2207(a) were enacted in 1987 as part of the Budget Reconciliation Act in 1987, and they were designed to try to deal with the problem of what is popularly known as "estate freezes," transactions that were structured usually in corporate form, not always in corporate form; but sort of the classic transaction is one where a corporation is capitalized with preferred and common stock. Preferred stock is owned by the elder generation, and the common stock owned by the younger generation. Valuation problems involved in recapitalizing that company and transferring the stock.

This section was intended to try to deal with some of the very difficult valuation issues that were raised by these transactions, in an attempt to eliminate some of what were perceived by the Congress at that point as abuses in those transactions.

Senator Bradley. And what is the complaint with the

existing law?

Mr. Foley. The primary complaint with the existing law is that it is too broad and vague. When the statute was originally drafted, although the preferred stock recap was probably the most common type of estate freeze transaction, the statute was drafted broad enough to apply to a wide range of transactions. There has been a fear that this provision is so broad that it could interfere with some standard intra-family transactions.

Senator Bradley. Well, is there any way this could be addressed, this particular problem, for something less than $878 million? I mean, are there variations on this?

Senator Daschle. Mr. Chairman, if I could respond --

The Chairman. Senator Daschle.

Senator Daschle. There probably would be some variation that ultimately we can address. The problem, as has been stated, is that the legislation that was written in '86 is so broad that it virtually precludes the generational transfer of business right now. It has just stopped it cold.

So our thought was that we would try to come up with a more palatable way to allow for a generational transfer, in small businesses, in particular, but that the only way you can do it at this point is to repeal the '86 provisions, allow us to take a good look at what options we might have available in tax law; but we couldn't do that under the circumstances we

have before us tonight.

So, repeal really does make the most sense from the point of view of dealing with this broad overreaction to the problem that existed in dealing with the abuse in the past. We ought to deal with the abuse, and I think we can, and I want to work with others to see that we address it. But right now we have just virtually stopped generational transfer of small business because of the '86 Act.

Senator Bradley. But the result of this is that there is going to be $878 million less paid in estate taxes. Is that correct?

Mr. Pearlman. The revenue estimate for repeal is $878 million over 5 years.

Mr. Foley. Senator Bradley, one thing you might want to take into consideration, though, is that some of that $875 million might not be directly attributable to an abusive transaction. So, to the extent that it actually applies to a transaction that was not targeted back in 1987, that might be even more of a reason to actually get rid of the law.

Mr. Gideon. Senator, we do not oppose repeal, but we share your concerns. We believe that some of the abusive transactions that led to the enactment of the statute in the first place are likely to reappear, and we would like to see a replacement provision that was narrower and more directly targeted at those, particularly, valuation abuses.

Senator Bradley. But do you have any suggestions now?

Mr. Gideon. We are aware of proposals made by the American Bar Association and others. I think they would probably take a little work, but I would think that it is worthwhile to consider at least what we might do to deal with some of the problems that have arisen in this area.

The Chairman. Senator Boren?

Senator Boren. Mr. Chairman, we had hearings on this matter in the Small Business Committee just a few weeks ago, and I would be happy to share with members of this committee the hearing record. We had a record attendance at that meeting with a number of members expressing concern -- Senator Levin, Senator Baucus gave testimony, and I believe Senator Daschle was involved or at least expressed interest at that hearing. Many of our colleagues on the other side of the aisle, also.

I hope that the members of this committee will take the time to look at the impact of what is happening under current law, because we are literally forcing small businesses to sell out instead of being able to be kept in the family, as have done in the past by the elder generation taking on preferred stock. And it is really a tragic situation.

Witness after witness gave us examples of what it was going to do, whether it was a small grocery store or other kind of small business. And from the point of view of social

policy, what we really were forcing was the sale out of these small independently-owned family units to large chain operations and others.

The Advocate for Small Business at the SBA testified in favor of it very, very strongly. Virtually every small business organization in this country said this was perhaps their top priority in order to maintain the integrity of small business. And as far as I know, every single member of the Small Business Committee in both parties strongly supports this provision.

So, in a sense, it grew out of the joint efforts of everyone, bipartisan, on the Small Business Committee.

I would be happy to work with the Senator from New Jersey and others in the future. If we can come back later and try to target and narrowly craft something, I think it would be fine. Perhaps we could get a report back, with some suggestions back. But I would hope we could go forward, because I would say in this case I think 90 percent of what we are covering under the existing law is something we never intended to cover, and we are doing just tremendous damage out here to the small business community as a result.

Senator Daschle. If the Senator will yield, we haven't mentioned agriculture, but the reason I got into it was actually agriculture. We have some serious problems with regard to transferring farms under the conditions today, too.

So, it is agriculture as well as small business.

Senator Baucus. Mr. Chairman?

The Chairman. All right. Senator Baucus.

Senator Baucus. This is very analogous to Section 89. That is, I think the Congress well intended to govern transfer of certain assets from, say, the older generation to the younger generation; but it is so overly vague, and it is so complicated that most families just don't know when they are in the law and when they are not in the law. It is just a mess.

As a consequence, as Senator Boren said, a lot of these families are forced to sell out. It also has a particularly adverse effect, I know, in smaller business families, and particularly agricultural families. It is just a mess.

So many State tax attorneys have come to me and said, "Max, whatever you do, repeal it. It is just a mess. It is just awful. I don't know what advice to give my clients. It is just a mess." It is like Section 89, and I think it should be repealed and perhaps come up with something much better at a later time.

Senator Bradley. Let me say to all of the Senators who are interested in this, I simply moved my finger down the right side of the sheet, and the number 878 kind of jumps out at you when the others are 6, 8, 30, 40.

I also noticed, though, that the revenue loss in '90 and

'91 is 27 and 72, and then it jumps to 146, 249, and 384. So, if there is a willingness to try to deal with the abuses in the next year or so -- I don't have any detailed information on this.

Mr. Pearlman. Mr. Chairman, we have spent a lot of time with this provision. We do have some very specific suggestions, and we think we can make some recommendations who are interested in dealing with this issue.

The Chairman. All right. If you would proceed.

Mr. Pearlman. All right.

- On page 18 of the document is the next item, and this item would make the existing temporary $2-million exclusion from the generation skipping transfer taxes, the grandchild exemption, a $2 million exemption, permanent, and it would eliminate the existing distribution requirement that is contained in that provision currently.

- The next item is several relatively small items dealing with the foreign marital deduction provisions. I am not going to go through those in detail. Let me just say this, that this was a provision that was enacted last year, designed to limit the marital deduction taken when the spouse is foreign and the assets for which a marital deduction is claimed only will not be taxed in the United States.

That provision needed a lot of work, we discovered after it was enacted. A number of comments were received by people

on the outside. A number of changes were made to that provision as purely technical corrections. A number of changes we believe need to be made to that provision which cannot properly be characterized as technical corrections, and so they are described on pages 19 through 21.

- On page 22 is the next item, dealing with adoption expenses. This provision would allow an exclusion of up to $3,000 for adoption expenses in connection with so-called special-needs children.

- On page 23, the next item is a proposal that would restore income averaging as it was in effect before the '86 Act for so-called qualified farmers.

- The next item, on page 24, would provide that disaster relief payments received under the 1989 Disaster Assistance Act would be treated the same as the payments received under both the 1949 and 1988 Acts, essentially saying that that income would be deferred. It is a deferral mechanism.

Congress did that, with respect to the '88 Act, but has not done that for the '89 Act, and so that is what this provision would do.

- Page 25 is a proposal which deals with wholesale distributors of diesel fuel and would allow a person who qualifies as a wholesale distributor to be treated as having been such a distributor during the period April 1 through

December 1, 1988.

Now, the effect of this provision would be during the period of time when the new collection mechanism was put into place, after the '87 Act. It would permit these people to claim refunds on taxes that they really shouldn't have paid because they were collected from someone else.

- The next item is on page 26. On this provision I think I got a question -- I can't remember who from, either Senator Heinz or Senator Armstrong. This one on rates. It is the one that was on the Revenue Table that you asked about. What it would do is extend the current interest rate swap or cap agreement provisions to so-called four rate agreements and futures contracts, and similar arrangements.

- The next item, on page 27, would adopt recommendation that was provided by the Treasury Department -- well, that is probably inaccurate to call it a "recommendation. It would adopt a classification that was done by the Treasury Department that rental tuxedos be assigned a class life of 2 years. That was done pursuant to a study by the Treasury Department, and this codifies that.

Senator Heinz. Mr. Chairman, would an editorial comment be in order?

(Laughter)

The Chairman. No, no.

Mr. Pearlman. The next item, on page 28, would expand

the definition of "qualified architectural and transportation barrier removal expenses," and would do so on a revenue-neutral basis by adjusting the current dollar threshold from $35,000 to $25,000.

- The next item is on page 29 and would permit tax-exempt employers to maintain so-called cash or deferred arrangements or 401(k) plans.

- The next item, on page 30, would modify the integration rules, would clarify that the Secretary of the Treasury, when he seeks to coordinate prior law and the '86 Act rules, could provide the plans that had a frozen defined benefit, effective because of the '86 Act, to calculate that benefit based on final average pay in accordance with the benefit in effect on that Act.

It is trying to respond to the enactment of the integration rules in 1986 and give frozen defined benefit pension plans a mechanism for calculating their benefits after those rules were changed.

- On page 31 is a provision that would clarify that the current-law rule with respect to VEBAs, that requires that they have a geographic locale, permit that they be in a geographic area of more than one State.

The notion here is to slightly expand that so it could be no more than three contiguous States. It is just to expand the area over which a VEBA can operate.

- The next item -- again, I am not going to go into great detail here but simply to indicate that some of the employee leasing rules that were contained in the committee's bill on Section 89, that tried to give some clarification of the current-law leasing rules, but which are dropped out when the Section 89 repeal is adopted, or reinstated here -- I think you will find that these are rules that employers will look at favorably because they clarify some fairly complicated rules currently; and, second, to clarify the dependent care assistance discrimination rules that would otherwise come into effect with the repeal of Section 89.

- The next item, on page 34, is one of several tax-exempt bond rules. This one would permit, in certain circumstances, for private activity bonds to include State housing agency bonds. There are some bells and whistles in here in terms of what kinds of bonds they have to be, certain targeting provisions, and that is described on page 34.

- Page 36 has a provision that will permit the current refunding by qualified issuers of certain existing outstanding bonds, subject to some conditions that, again, are described in the explanation on page 36.

If any of these require further explanation, you've got the --

Senator Durenberger. Mr. Chairman?

The Chairman. Yes.

Senator Durenberger. Ron, may I ask you a question on 34, on the State housing agency tax-exempt bonds?

Is the cap issue involved here at all? I mean, is this subject to the cap?

Mr. Hardock. These bonds would be subject to the volume cap.

Senator Durenberger. Thanks.

Mr. Pearlman. All right. I am at page 37, unless there is a question.

Senator Symms. Does that speak to the question of private colleges with revenue bonds? You know, there is a ruling that public institutions can sell them; but what about private institutions?

Mr. Pearlman. If you look at page 37, Senator --

Senator Symms. That is taken care of. That's it.

Mr. Pearlman. That provision, which I was just about to mention, is one that would repeal the provision that was enacted in 1986 and treat bonds issued by 501(c)(3) organizations, which would include colleges and universities in the same manner as present law treats governmental units.

Mr. Gideon. We would like to note our opposition to this provision, Mr. Chairman.

The Chairman. So noted.

Mr. Pearlman. The next item is on page 38 and deals with mortgage credit certificates. What this item does is deal

with a 1988 technical correction. There was a defect in the 1986 Act. It had to be fixed by a 1988 technical correction. Because the correction didn't get enacted until two years after the '86 Act was enacted, it affected some transactions in the meantime. There were some transactions that needed the '88 Act technical correction.

Well, in the meantime, the two-year time period that is contained in the mortgage credit certificate provision expired, so these people who would have otherwise been eligible to issue MCCs within this two-year time period and would have been all right, well, they got hit by this '88 Act technical corrections. So what this does is simply give them the two years they otherwise would have had.

- On page 39, this provision would provide sports stadiums -- it would classify them as exempt facilities, and therefore it would permit them to be financed on a tax-exempt bond basis, subject to the State private-activity volume cap.

- Page 40 has some direction. It is actually committee report language that will direct the Treasury Department in how it can exercise the regulatory authority it was given last year in connection with so-called immediate annuity contracts.

I think I can summarily say this report language is intended to clarify what we think Congress intended by that regulatory delegation of last year.

Mr. Gideon. It might be appropriate to state, though,

that we do not understand the technical to preclude us from dealing with a situation where two annuities considered together basically give you the same characteristics as a bond.

Mr. Hardock. Senator, the provision expressly states that there is no inference with respect to Treasury's authority to deal with that issue, based on other regulatory authority that is available.

- The next item is on page 41. It is a proposal that would reduce the occupational tax on certain retail establishments that sell alcoholic beverages from $250 to $150 per year. You will note, if you look at the narrative, that it only applies to relatively small establishments; that is, ones with annual gross receipts from the sale of alcoholic beverages of less than $250,000. There is another condition, but that is the principle one.

- Page 42 is a provision that would impose a statute of limitations from 1985 as a period in which the Bureau of Alcohol, Tobacco, and Firearms can go and collect back taxes, interest and penalties on some taxes that were imposed on establishments selling alcoholic beverages but that was never collected, as a practical matter, for years was never collected; and then in 1987 when Congress changed the collector from the IRS to BATF, BATF went out and collected these very old taxes. And what this provision would do is say

they can't go back any further than 1985.

- The next item is on page 43. It would increase on a permanent basis the current 15-percent excise tax on pension reversions to 20 percent.

Mr. Hardock. We oppose this provision, as well.

Mr. Pearlman. The next item is on page 44. This proposal would amend the expenditure for purposes of the Airport and Airway Trust Fund to include the so-called Essential Air Services Program, which is authorized already in Section 419 of the Federal Aviation Act of 1989.

Senator Dole. How much is that going to cost? I think you oppose this, too.

Mr. Gideon. Yes. I wanted to note that the Office of Management and Budget had advised us that the Administration opposes this provision.

Mr. Pearlman. Senator, there is no revenue effect, we understand, because there is authorizing legislation that is required.

Senator Danforth. Mr. Chairman?

The Chairman. Yes.

Senator Danforth. On this point, the point was raised yesterday when we met on the subject that this could be a matter that was within the jurisdiction of the Commerce Committee. I wonder if that point was pursued with Chairman Hollings. I think it is within the jurisdiction of the

Commerce Committee, but --

The Chairman. I thought we had cleared this point.

Mr. Sessions. We don't believe that this is within the jurisdiction of the Commerce Committee. I believe the Commerce Committee would have jurisdiction over this if it did not require authorization and appropriation.

This simply says that the Airport/Airway taxes collected can be used for trust fund purposes, but it still has to go through the authorization and appropriations process.

Mr. Pearlman. So the Commerce Committee will still have to act to do the authorization.

The Chairman. They still have the authorization.

Senator Dole. Well, can they limit the amount of subsidy? I mean, in a case in my State, there was a $300-a-passenger subsidy. They finally cancelled the flights.

Senator Baucus. Mr. Chairman, I think I can answer that question. Essentially, this provision does not address authorization, nor does it address appropriation of an essential air service program. That is up to the authorizing committee, and it is up to the Appropriations Committee.

This proposal only says that whatever is authorized and appropriated for essential air service comes out of the trust fund, not out of general revenue.

Senator Dole. They do have a 45-mile provision that we passed on the floor was 100 miles; so you have already started

to write in the legislative, taking that away from the authorizing committee. Why do you have the 45-mile provision? It is the greatest racket in the country.

Mr. Pearlman. I am advised that that is in the Federal Aviation Act. I am not familiar with it, but it is not in this proposal. I am told it is in the Federal Aviation Act.

Senator Danforth. Mr. Chairman?

The Chairman. Senator Danforth.

Senator Danforth. I would hope that this matter would be raised with the Chairman of the Commerce Committee before it is included, because a decision that whatever is spent for essential air services is going to come out of the airport trust fund does have significant consequences. I mean, it is to say that if we are going to spend anything at all for essential air services, it has to go out of a special fund that heretofore has been used for airport improvements and runways, and so on. Clearly, the capital needs of airports are going to be absolutely staggering in the foreseeable future. Maybe this is a good idea, and maybe it isn't; but I think that at least the Commerce Committee could be consulted.

There are a number of members of this committee on the Commerce Committee, and the point was raised during the Commerce Committee meeting on reconciliation that certain ideas that they had were infringements on Finance Committee's

jurisdiction.

The Chairman. Senator Danforth, I totally agree. You know, the last thing I want to do is to get into their jurisdiction, or want them into hours. And we worked together to try to eliminate those problems.

I brought that to the attention of staff and said, "I want you to be sure that we are staying within our jurisdiction on this one."

Mr. Sessions. Commerce had a concern, as we understand it, about an earlier version of this proposal, which would not have subjected amounts that would be spent on the Essential Air Services program to the authorization and appropriations process, but we don't think it would have a jurisdictional concern about this proposal, or that they have a valid jurisdictional argument about this proposal.

It is my understanding that the Finance Committee has traditionally added -- this is a Code provision, it is in the Internal Revenue Code, and traditionally it has been within the jurisdiction of this committee to add to the trust funds within the Internal Revenue Code the programs. That is this committee's jurisdiction.

The Chairman. I want to stress to you, Senator, and I stressed to them, repeatedly, that I feel very strongly about the jurisdiction of this committee, and I have to defend it from to time. But we did not do it, and staff felt very

confident after they changed it some that it did not.

Senator Danforth. Mr. Chairman, I wonder if your coming motion to approve this subsection of the Chairman's Mark might exclude this provision until the question is put to Senator Hollings. If he is not concerned, I am not concerned; but I just wanted to at least give him that opportunity. and if we could wait, I would appreciate it.

The Chairman. Is there further comment?

Senator Dole. This doesn't mandate any spending, does it?

Mr. Sessions. That is correct.

Senator Dole. But it still has to go through the process.

Mr. Sessions. That is correct.

Senator Dole. And we are going to give these $300 subsidies per passenger in my State -- which I think is ridiculous -- we will have a chance to vote on that, right?

Mr. Sessions. That is correct.

Senator Dole. This makes Amtrak look like --

Mr. Sessions. I want to say we have had repeated conversations with the Commerce Committee staff, and they have never raised a jurisdictional objection about the revision as it is presented in this package.

The Chairman. I don't believe it does.

Senator Baucus. Mr. Chairman, on that basis I think we

should keep it in. I mean, if they raised the question with the Commerce Committee staff repeatedly, and they only objected to an earlier version but not this one, I suggest we keep it in.

Senator Danforth. Well, I am not on the Commerce Committee staff, so I can't speak for them.

(Laughter)

Senator Danforth. But I think that at least the Chairman should be consulted. I raised the question about it, and I would hope that we could not make a decision on it.

I mean, if any of this is going to be left past tonight, I would hope that this item would just be put on the back burner.

Senator Baucus. Mr. Chairman, if I might?

The Chairman. All right.

Senator Baucus. It just seems to me that, given the Chairman's desire not to intrude in jurisdictions, we keep it in the bill. And if for some reason the Chairman of the Commerce Committee objects, I would guess that either the Chairman of the Commerce Committee would raise a point of order or seek some conversation, and I think, in good faith, if it is a legitimate jurisdictional question, that probably we would agree to take it out. But since that has not arisen yet at this point, we should keep it in.

Senator Danforth. Can you just give me 10 minutes,

please, Mr. Chairman?

The Chairman. Well, let us move on meanwhile. We will put that aside, then, Senator.

Senator Chafee. Mr. Chairman? Could I ask a question about the previous one?

The Chairman. Yes.

Senator Chafee. Treasury objected to no. 20 and just said they objected. Could you tell us why?

Mr. Gideon. It is simply an increase in the reversion tax. We don't know of any basis of doing that.

Senator Symms. Explain that a little more, please.

Mr. Gideon. In other words, when a pension plan terminates, there is presently a 15-percent excise tax, and this provision simply raises it to 20.

Senator Symms. How much money is it?

Senator Chafee. Seventeen million. This is on page 43. It raises $17 million over 5 years.

(Pause)

The Chairman. Are there further comments on it? I was diverted here.

(No response)

Mr. Pearlman. Do you want me to proceed now, Mr. Chairman?

The Chairman. Unless there are further questions.

All right.

Mr. Pearlman. We are on page 45, the foreign tax provisions.

- The first one, 22(a), provide rules under which certain leasehold interest in assets would be treated for certain circumstances as an asset held by a foreign corporation for the purposes of the PEFIC rules.

Mr. Gideon. We would like to work with the staff to flesh this one out a little more, Mr.Chairman. We don't have any inherent objections to it, but the description is a little vague, and we would like to have a chance to add a little more meat to the bones in the drafting process.

The Chairman. Well, we would be happy to consider your suggestions.

All right.

Mr. Pearlman. The next one -- actually there are two with an error in the effective dates that I need to point out to you.

- Page 46, which is a modification of the definition of a passive foreign investment company for export trade corporations, should say, if you look at the bottom of the page --

What this provision does is it excludes from the definition of passive income the income of an export trade corporation, which is a term of art under the Internal Revenue Code., and the narrative says, "For taxable years beginning

after December 31, 1989" - it should say "December 31, 1988."

- The next time is on page 47. This is a provision that deals with the taxation of certain scholarships or fellowship grants to non-resident aliens of so-called Fullbright scholarships and other grants by tax-exempt organizations.

And again, this effective date is incorrect. It should say "Taxable years beginning after December 31, 1988.)

Mr. Gideon. Mr. Chairman, if we could be heard on this issue.

We have no objection to this proposal insofar as it applies to grants by Federal Government entities, because this is essentially a budgetary issue. However, we are concerned about the extension of the proposal to things that would not be on budget.

And, particularly what this does, by granting this form of unilateral relief in the United States, it deprives us of what we consider to be a very valuable treaty-negotiating right in bilaterals in dealing with other countries.

In other words, frequently recriprocal relief is granted in tax treaties; however, if we grant that relief on our own, basically our bargaining position is not particularly strong in the bilateral negotiations to achieve the same sort of results for students in the United States.

Therefore, while we certainly do not oppose it with respect to Fullbrights and other sorts of Federal Government provisions, we would ask that the provision be narrowed to

Federal Government-sponsored scholarships.

Senator Pryor. Mr. Chairman, just one moment, if I might.

The Chairman. Yes.

Senator Pryor. Do any other foreign governments tax the students that we send to their countries?

Mr. Gideon. Yes, they do, unless we have obtained treaty relief for them.

Senator Pryor. Well, how would a Fullbright Scholar, then -- how would you draft such a language to make certain that the Fullbright Scholars, if they came here, did not have to pay taxes? How would you do this?

Mr. Gideon. I think that all that's necessary is to do exactly what you have here, and simply remove the provisions that relate to people other than the Federal Government.

Senator Pryor. Well, all we are trying to do is make this an even playing field. That is the attempt, and I hope that legislative intent will be carried out.

The Chairman. Well, let me understand, then. Are you saying that you don't see a problem with what the Administration's position is?

Mr. Gideon. We believe we covered the Fullbrights.

Senator Pryor. What about a Rotary scholarship?

Mr. Gideon. Unless they were from a country that had specific treaty relief, they wouldn't be granted relief. But frankly, we feel that granting that sort of relief

unilaterally, Mr. Pryor, is the sort of thing that would cause us to lose our bargaining power, with France or Germany, or whatever, with respect to these same issues.

Senator Pryor. Mr. Chairman, I just can't buy that "bargaining power." I really think we are just struggling over a very, very minor issue that is very major, I know, to the Fullbright program, perhaps to the Rotary International program, and to other private programs. We are simply trying to put these scholars on the same footing.

The Chairman. Let's move on, then, and we will return to this if someone wants to offer an amendment on it.

Mr. Pearlman. All right.

I mentioned a moment ago that I had an effective date change, and I mentioned it in connection with page 46. I said there was also an effective date change on page 48, and I was wrong about that. The only change is the one I mentioned on page 46, which was taxable years beginning after December 31, 1988.

- Moving to page 49, accounting provisions, the first item treats so-called safe harbor leases by member organizations, treats the income and the rental expenses -- matches. It requires the netting of the income and expense from sale/lease-back transactions by membership organizations.

- Page 50, discharge of indebtedness income. I think this is the one Senator Dole mentioned a moment ago. This is

the provision that is intended to try to fix the rules now with respect to discharge of indebtedness income for certain farmers. The proposal would provide relief from discharge-of-indebtedness income for farmers who are not bankrupt, because bankrupt farmers get that relief under the current law, and makes --

Senator Dole. This is what we thought we corrected in technical corrections last year?

Mr. Pearlman. Well, this, clearly, is different than what was done in technical corrections last year. I think what it does, Senator, is it makes the rules with respect to a farmer who goes into bankruptcy and the rules with respect to a farmer who is insolvent but is not bankrupt, makes them the same, which we think is what Congress intended in 1986.

Now, you will note, if you look at the explanation, that it puts some restrictions on that. There is a $350,000 limit on how much discharge of indebtedness gets the benefit of this rule. It has some income limits.

We can go into the details of that, but the theory of this provision is to say that the farmer who goes into bankruptcy and the farmer who is insolvent but not in bankruptcy are on a level playing field. Neither is benefitted over the other, they both are treated the same, and we think that was the intention of the Congress in 1986. In fact, there are specific congressional legislative history,

by Senator Kassebaum, who said that specifically. That is what she intended to do.

Senator Dole. I know we tried to correct something last year in technical corrections, and then we get a different interpretation after the corrections bill passed from the IRS that disadvantages farmers. I just wondered if maybe Ken knows whether that is --

Are you in favor of this provision?

Mr. Gideon. Well, we actually wrote a letter in opposition to this provision in its current form. I will say we are very sympathetic to the problem, however, as we noted then. And indeed, given the opportunity to work a little further on this provision, we would not oppose it.

Our concerns have to do with basically the qualifying standards. We don't have any objection to giving relief in a genuine distress, informal reorganization situation; we are just concerned that there might be a few people who get through the net who really aren't in that situation and as a result are getting a fairly significant benefit.

The Chairman. Let's see if we can make some progress in trying to work out the differences.

Senator Dole. Fine.

Mr. Pearlman. The next item, Mr. Chairman, page 52, deals with contributions in aid of construction received in connection with certain funds provided by governmental

agencies.

Just because I think it is easier to describe it this way, the staff have all been referring to this as the "superfund provision." It is described as a contribution in aid of construction provision, but really what it deals with is how do local water utilities treat payments they receive, principally from the Federal but also from State and local superfund grants. What this provision says is, if they get a grant from a governmental agency, a Federal, State or governmental agency, then that grant will not be treated as income if it is for these very specific environmental purposes.

Senator Symms. Mr. Pearlman, just on this point -- and I understand this is not the appropriate time, Mr. Chairman, to offer an amendment on it, but on this point; this is an issue we discussed yesterday -- you are talking about the narrow version that we discussed? Is that what this is?

Mr. Pearlman. Yes. This is a very narrow provision that deals only with grants that are received from governmental agencies that are used for environmental or health purposes, yes.

Senator Symms. I would just like to comment that this problem is bigger than this narrow issue, though, for some of these private utilities. I will have an amendment at the appropriate time, along with others on this committee on both

sides of the aisle, to speak to that, because this passes the cost on to some real small water companies, to a tremendous cost, per home, that they service, if they get a grant that is donated to them -- a construction contribution, I mean -- and then it is charged as taxable income to them.

So I think there was a mistake in the 1986 law, is what I am saying, and we want to address that. I think you had some numbers on that. There is a cost to it that is a little --

Mr. Pearlman. Yes. We can provide those.

Senator Symms. I think you have those. But I will bring that up at the appropriate time.

The Chairman. All right.

If you would proceed.

Mr. Pearlman. Mr. Chairman, the next item is on page 53, and it has two items with respect to the percentage of completion method of accounting.

- The first one would permit a taxpayer to elect not to recognize income under a long-term contract until it recognizes at least 15 percent of the total estimated cost of the contract. That is an elective provision.

- The second item would require the Treasury Department to undertake a study of the proper treatment of long-term contracts and report to the tax-writing committees of the Congress by February 28, 1990, in connection with that matter.

- Page 55. This proposal will modify the material participation standards for timber property owned by individuals. The Treasury Department promulgated a regulation that automatically classified any amount of time with I think under 100 hours as failing the material-participation test, and this proposal would remove that automatic disqualification of that time and permit that individual timber owner on a facts and circumstances test to determine whether in fact that timber owner materially participated for passive loss purposes.

- Page 57, the next item, would permit any corporation, or certain qualified partnerships, that prior to January 1, 1987 -- that is, prior to the effective date of the 1986 Act -- that could use the accrual method of accounting with respect to certain farm activities, certain crops, wold be permitted to continue to use that method on a prospective basis.

- The next item is on page 58, and it would do two things.

Mr. Gideon. Excuse me just a second. That one got by me there. I apologize.

We don't have any objection to the provision on page 57, provided it is made clear that it is for the benefit of pineapples and bananas, which I think are the intent of the people who offered it. The current provision is limited to

sugar.

As we understand the proposal, it is now written generically; and, while we would not oppose it if it simply adds the two crops that were intended to be benefited, we would not like to see a generic rule put in place that we don't know what the effects of might be.

The Chairman. Is that the intent?

Mr. Oglesby. Senator, I believe that was the intent all along, and that this was a technical --

The Chairman. You are saying you think it was?

Mr. Oglesby. Yes, sir.

Mr. Pearlman. All right. The next item is on page 58. As I mentioned, it would do two things in connection with the installment sales treatment of certain sales of time share units and residential lots by so-called "C" or taxable corporations. The first would be to adjust the interest rate, the calculation of the interest rate; and then, the second would be to permit those corporations, as a result of adjusting that interest rate, to use the installment sale method in calculating their alternative minimum tax.

The next item is on page 60, and this provision does three things, three modifications to the non-conventional fuels credit, the production credit, the current credit. The first thing is to make the production of gas from tight sands formations eligible for the credit; the second would be to

make the credit available for gas from wells drilled after December 31, 1989; and the third would extend the production credit for non-conventional fuels to wells drilled or for facilities placed in service before January 1, 1993, instead of the current January 1, 1991.

Senator Dole. What page is that?

Mr. Pearlman. That is page 60.

- The next item is on page 61. This would provide a tolerance range, a fairly small tolerance range, for meeting the gasohol blending requirement of current law. This is something, frankly, that we think BATF wants. I guess it is impossible to meet an exact 10-percent alcohol blend tolerance in gasohol. Everyone loses -- it is either a little higher or a little lower. So, BATF has suggested to us that maybe a slight tolerance will make their lives and the taxpayers' lives a bit easier.

- The next item, on page 62, would allow crop dusters to purchase a tax-free gasoline for off-highway farm use without first having to receive a waiver from the farmer.

- The next item, on page 63, would provide that the entire amount of the corporate alternative minimum tax, rather than only an amount attributable to timing differences, could be taken into account in considering the credit available for future years. This provision was include din the House bill, so-called credit-sharing for --

Senator Dole. On page 62, does the Administration support that?

Mr. Gideon. Yes, we do.

Senator Dole. You are not worried about the waiver, then?

Mr. Gideon. Excuse me. Which provision are you talking about?

Senator Dole. It is the one to allow crop-dusters -- I mean, I support it, but I want to make certain that you can collect the tax you are going to have to collect.

Mr. Gideon. We believe that what happens now is that the crop-duster has to get the certificate directly from the farmer.

Senator Dole. Right.

Mr. Gideon. This would simply allow him to certify it himself. We think that is going to be equivalently auditable. I mean, this is not a provision we sought, but we don't oppose it. I was referring to 63, when I thought that.

Mr. Pearlman. All right. We are at page 64, and the provision on 64 would reinstate or make permanent the 1986 Act relief for so-called small corporations from General Utilities repeal. It is in the form of a transitional rule now, but it would be made permanent under this proposal.

Mr. Gideon. This is a provision that we have opposed, as well.

Mr. Pearlman. The next item is a multi-page description of a package of changes that are popularly called "a penalty-reform package." I am not going to go through all of the details in this package. If you have questions, or if you wish us to, we will have someone do that.

But that comprises everything, I think, through page 82.

Mr. Gideon. If I could request, on item BB, what page is that, Mr. Pearlman? Eighty-three? Are you to that yet?

Mr. Pearlman. I had not yet gotten to 83. Is that what you are referring to?

Mr. Gideon. That's right.

Senator Dole. Is the Administration for the other?

Mr. Gideon. On the penalty bill, yes, Senator Dole. We have worked with the House in the development of that. We have had some discussions with Senator Pryor on his provisions. We think that penalty reform is a good thing and that the provisions here are an outstanding beginning.

Mr. Pearlman. The next item is on page 83. This deals with two items that grew out of a failure on the part of the Internal Revenue Service to notify taxpayers of certain refunds they were entitled to on their returns.

This does two things. Number one, it provides that the Service has to report those overpayments to taxpayers if the refundable amount -- it is a withheld amount -- exceeds $5.00.

And the second would permit taxpayers, whose statute of

limitations have closed, the opportunity to amend a return in order to get a refund of any taxes that they would have due to them. As long as they file them by next year, April 15, 1990, they can go back to 1985.

Mr. Gideon. We have no opposition to this proposal, but we have requested a higher tolerance amount than the $5.00 -- ideally, $25 would be better; but, other than that, that is our only concern.

Senator Symms. Mr. Chairman, could I ask a question on this entire package, both to Mr. Gideon and to Mr. Pearlman?

Going back on page 67, this entire last two items you have named are all dealing with penalty reform?

Mr. Pearlman. Well, pages 66 through 82 are what we have been referring to as "the penalty reform package." And then 83 is a separate item.

Senator Symms. Just in a general sense, is this going to make the IRS less popular or more popular with the public? What are we doing here?

(Laughter)

Mr. Pearlman. I think everyone who has worked on this, including --

Senator Symms. Is this part of Senator Pryor's efforts?

Mr. Pearlman. Yes. Senator Pryor has been heavily involved, as you know, in efforts involving administrative provisions with the Internal Revenue Code.

Senator Pryor. Mr. Chairman, if Senator Symms would cosponsor this with me, he will be more popular with the public in Idaho, I promise you that.

(Laughter)

Senator Symms. That is the answer. I want to compliment you for doing that, if that is what is happening here, because I think we've got a problem in tax collection, and this is a way to gear part of it.

Senator Pryor. Mr. Chairman, on this point -- if the Senator would yield to me.

Senator Symms. I will yield.

Senator Pryor. We have had a problem getting a revenue estimate; I don't think there is any secret there. I want to applaud these staff for diligently working days and days to get this, and I hope you will bear with us just a little bit longer to get those estimates. I am very appreciate of your efforts.

Mr. Pearlman. Thank you, Senator. We are working on it.

All right. Page 83, we did.

- On page 84, which is the last page you have, I have one other item that, with all these pages, we failed to put in. We blew one, but the last one here increases the Joint Committee refund threshold from $200,000 to $1 million.

This is provision where the staff of the Joint Committee recommended to the members of the Joint Committee that the

refund threshold at which we review cases be raised, because it is just out of date. It hasn't been raised for a number of years. So we have recommended that it be raised from $200,000 to a million dollars.

Now, I mentioned that we left one out. We made an error. There is another provision in the Chairman's Mark, and it deals with the refund-offset provisions that have been enacted over the last several years by the committee.

The proposal would provide that the refund-offset provisions that empower the IRS to pay over tax refunds to other agencies of government would not apply to certain obligations owed in connection with black lung advances. As I indicated, that was just an oversight on our part, for which we apologize.

Finally, Mr. Chairman, let me just mention that in the package of written materials that you got, part one of the written materials, there was a narrative that was omitted. It is in the Revenue Table, but we just discovered that the narrative was omitted.

So you will receive a page 40(a), "Modify Collection Period for Air Passenger Tax," page 40(a), that you should simply add to your Part One.

Parts One, Two, and Three, which you now have in front of you comprises the narratives on the entire Chairman's Mark, and that completes a walk-through of those items, Mr.

Chairman.

The Chairman. That completes all of those items on the Chairman's Mark?

Mr. Pearlman. Yes.

Mr. Oglesby. Mr. Chairman, the Administration has a handful of items.

The Chairman. I understand that, but I am talking about the Chairman's Mark now.

Yes?

Senator Packwood. I just want to ask one question, Ron, before we get to this capital gains issue.

Take a look at this sheet. Roman numeral VIII(a), "Other Revenue-Raising Provisions That Tax Pre-Contribution Gain in Certain In-Kind Partnership Distributions," and what not. The effective date on that is now July 10, 1989. What would be the difference in your revenue estimate if it was December 31st?

Mr. Pearlman. I just can't answer right now. Obviously it will be some revenue effect. I would think it would be relatively small, but we will have to look at that. I just don't know.

I mean, if you make it December 31, obviously you do leave a window. And when you leave windows on these transactions, revenue tends to evaporate. But we can check that for you, if you wish.

Senator Packwood. Would you, please?

Mr. Pearlman. Sure.

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, we seem to have completed Part Three, and I accordingly move the adoption of the Chairman's Mark of Part Three.

The Chairman. Is there a second?

Senator Pryor. Second.

Senator Chafee. Mr. Chairman?

The Chairman. Yes.

Senator Chafee. I would like to ask a quick question, if I might.

The Chairman. Well, let me dispose of the motion, please.

Senator Danforth. Mr. Chairman, I would like to amend the motion by deleting the section here relating to essential air services.

Whether or not this is technically within the jurisdiction of the Commerce Committee is debatable. However, it has such a major effect on the policy relating to the construction of airports that I really think the Commerce Committee should have a chance to look at it. And since it produces no revenue, there are no revenue consequences, I would move that it be deleted.

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus.

Senator Baucus. I understand the Senator's concern, because he is on the Commerce Committee. I think it is an excessive concern because, in effect, what we are doing here is giving up jurisdiction, not taking away jurisdiction, and this is the reason why:

This provision authorizes --

The Chairman. Senator, I would like to just go ahead and get this adopted, and then we will open it up to your amendment.

Senator Baucus. Well, that's fine with me, if that is the Chairman's wish.

The Chairman. Could we do that?

Senator Baucus. Sure.

The Chairman. All right. The motion has been made and seconded. All in favor of the motion as stated, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

The Chairman. The Ayes have it.

Senator Danforth. Now, Mr. Chairman, is my amendment in order?

The Chairman. Yes, it is.

Senator Danforth. Thank you. I offer my amendment to

delete paragraph "U".

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus.

Senator Baucus. Again, just so I stop belaboring the point, in effect the purpose of the provision in the bill is to help make it easier for the authorizing committee, the Commerce Committee, to provide for essential air service, if it so chooses, either out of general revenue or out of the trust fund.

Currently, the authorizing committee, the Commerce Committee, can provide for essential air service out of general revenue, but, as I understand the law, not out of the trust fund.

The net effect, then, of the Chairman's Mark, when it becomes enacted, is that the authorizing committee, the Commerce Committee, will have further jurisdictional power; because, not only will the authorizing committee be able to authorize the program out of general revenue; but, if it so chooses, either way, out of also the trust fund.

So, frankly, I just think we should keep it in. We should resist this amendment. And if, at a later date, the Chairman of the Commerce Committee so decides that he has a problem with it, then we can handle it in a fair, expeditious way.

But again, the net effect of the amendment is to give up

Finance Committee jurisdiction, in the sense of giving the Commerce Committee more jurisdiction than it already has.

So, that is why I think the Senator's concern is excessive and just doesn't have the effect the Senator thinks.

The Chairman. Senator I forewarned the staff and told them to make a diligent search, satisfy themselves on this position, and they did, and they had some communication with staff at the Commerce, I would further state.

So I would hope that we would not do something that might diminish the jurisdiction of our own committee. After talking it over with Senator Hollings, if I become convinced that we have invaded his jurisdiction, I will sure do what I can to delete the amendment.

But with that, I hope that we will not approve the amendment.

Do you want to move your amendment?

Senator Danforth. Yes, Mr. Chairman.

The Chairman. The Senator moves his amendment. All in favor of the Senator's amendment, let it be known by saying Aye.

(Chorus of Ayes.)

The Chairman. Opposed?

(Chorus of Noes.)

The Chairman. Do you want us to pull out proxies, or is that sufficient?

Senator Danforth. I think that the Noes have it, Mr. Chairman.

The Chairman. All right. Thank you.

Senator Chafee. Mr. Chairman, may I ask a question of the committee staff here?

The Chairman. Yes, of course.

Senator Chafee. I would like to refer, if I might, to that last proposal that you mentioned, the black lung proposal.

If I understand this correctly, black lung payments are paid to an individual. The company or the government appeals. The payments are disallowed. Subsequently, if, in the event that the minor or the individual has a tax refund coming to him, under current law the Government can withhold the amount of that tax refund to the extent that the black lung payments have been made in excess of that which he was entitled to. Is that correct?

Mr. Richter. That would be the effect of the amendment.

Senator Chafee. No. The amendment would say that Government could not withhold on the tax refund.

Mr. Richter. That is correct.

Senator Chafee. Now, first of all, is there any other case where we make an exception like this, regardless of whatever type of payment is made?

Mr. Humphreys. We do not use this mechanism, the IRS tax

refund-offset mechanism, for example, to collect Social Security overpayments. So there are other --

It is available not for anything that is owed to the Government but only for specified --

Senator Chafee. And is black lung one of the few instances where there is this collection process?

Mr. Humphreys. No. There are a number of things. The biggest item is overdue student loans.

Senator Chafee. What about revenue effect? It seems to me the number of people who have their black lung claims disallowed must be tiny, and the number of those who have tax refunds must be tiny. Are we talking any sizable revenue here?

Mr. Pearlman. Senator, that is a CBO number, and we are waiting for that. It is not a tax revenue number; it is an outlay offset number, and we have not received a number from CBO. I would think it would be tiny, but I don't know that.

Senator Dole. "Tiny." How do we determine that? A hundred million?

Senator Chafee. Well, Mr. Chairman, it doesn't seem to me to be right that somebody gets a benefit and subsequently is declared not to be entitled to it, and then, in addition, gets a refund from the Federal Government. I think we ought to follow the existing law. And I would so move.

The Chairman. Senator, do you have a comment on it?

(Continued on page 214)

Senator Rockefeller. Yes, I certainly do.

We have been through this in previous discussion in the other room. The Finance Committee has jurisdiction over only a certain part of this matter. Other jurisdiction is held by the Government Operations Committee.

The argument that coal miners are getting a fair shake on this I think is absurd, in that the Government goes back to people who are in their seventies and their eighties and tries to take back money which was given to them, which is obviously already spent.

The Finance Committee is honorably and properly addressing only that part which it can, and doing so in an equitable manner, in my judgment. And if the Senator insists on putting this to a vote, I would strongly oppose his amendment.

Senator Chafee. Well, I would be willing to hear a voice vote on it, Mr. Chairman.

The Chairman. All right.

All in favor of the motion as stated, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(Chorus of Noes)

The Chairman. The Noes have it.

Senator Bradley. Mr. Chairman?

The Chairman. Yes, Senator Bradley.

Senator Bradley. Yesterday when we were discussing, in the other room, the issues that various Senators had to raise, I raised the earned income tax credit and the disregard on public housing.

It was asserted at that point that the only objection was that there was a committee jurisdiction problem. I now have a letter from the distinguished Senator, Senator Riegle, to the Chairman of the Banking Committee, and also, on the House side, saying there is no jurisdictional problem.

So, for purposes of determining eligibility for public housing and subsidized housing, I wonder if we could provide the same kind of treatment with the EITC as we do for eligibility for Medicaid, Welfare, and Food Stamps, and that is not count the EITC toward eligibility.

The Chairman. What was the cost question on that?

Senator Bradley. It is $10 million in the first year, $15 million in the second year and the third year.

The Chairman. Are there comments?

Mr. Pearlman. That, too, is a CBO number. So we think that is right, but we don't have access to that number.

The Chairman. Are there questions concerning it?

(No response)

The Chairman. Is there further discussion of it?

(No response)

Senator Bradley. I move the amendment.

The Chairman. The amendment has been moved. All in favor of the amendment as stated, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(No response)

The Chairman. Amendment carried.

Senator Packwood. Mr. Chairman?

The Chairman. You say you have got the --

Senator Packwood. Capital gains. Yes.

Lindy, do you want to pass out those capital gains provisions?

(Pause)

Senator Packwood. Mr. Chairman, while she is passing these out, I will explain what it is, so that those who are here in the audience can at least know what it is we are suggesting.

As far as individuals are concerned, they will be given a sliding scale basis for capital gains differential, depending upon the length of holding period. If they hold it one year, their individual top rate would be 26.6 percnet. It slides on down to six years, where the rate would be 19.6 percent. And in addition, there would be a provision for indexing cost basis for inflation.

For corporations themselves, corporations would be given

a lower rate. It would be 27.9 percent on capital gains on assets owned for more -- and here we put in a plug figure, 8 to 10 years. It will be in that range, depending upon the final estimates. We do not have them yet.

Third, the final provision would repeal the Internal Revenue Service General Counsel's Memorandum requiring timber growers to capitalize their fertilizer expenses. We argued this in 1986. There was an argument about capitalization versus expensing. The IRS lost it. They didn't like it. We said that they could expense it, but they were trying to make them capitalize their fertilizer expenses. This would be changed.

And we would pay for this by replacing, Mr. Chairman, your IRA proposal, which has a $12.7 billion revenue loss in it, replacing it totally, and it would leave about $2.5 billion left over, which would be used for indexing and a modified IRA Plus plan, not unlike that offered by Senator Roth, which is the back-loaded provision that you do not pay taxes on the inside build-up when you take it out.

It is a very clear alternative. We can get into the arguments if we want to, as to whether we need to at the moment or not, on incidence of income and who is favored, but I think everyone is familiar with capital gains versus the IRAs.

This is both corporate and individual. For the

individuals, they have both indexing and a differential. Corporations have a fixed rate for assets held a rater lengthy period of time.

The Chairman. Further comments?

Senator Symms. Would the Senator yield for a question?

Senator Packwood, when we had our earlier meeting with the Party group, it was never discussed, to my memory, of what all is included in terms of assets.

Senator Packwood. All assets except collectibles.

Senator Symms. I might just say, is there any particular reason why collectibles are left out?

Senator Packwood. Revenue.

Senator Symms. But is it actually? In the figures I have seen, it is not a revenue loss. We are going to drive all of this art business offshore, is what is going to happen. They will just take the painting to London and sell it.

Senator Packwood. Frankly, we left it out because it has not appeared in anybody else's. The Administration had left it out. The House left it out.

Senator Symms. How about with gold and silver coins. That would not be considered collectibles? You are just talking about art objects?

Senator Packwood. I would have to turn to the Treasury on that one.

Senator Symms. Treasury, how would that be ruled?

Mr. Gideon. It would depend. Gold and silver coins that are in collections I believe probably would be covered by the provision, Senator. Basically, to be candid with you, I think it is there because some people feel that it simply shouldn't be in this sort of proposal, and that was important to some folks over on the House side.

Senator Bradley. If gold and silver coins -- you know, they sell them at these coin stores. They are not collectibles?

Mr. Gideon. No, I said that I thought they would be collectibles.

Senator Bradley. Oh, they would be collectibles. I see.

Senator Symms. How about U.S. Treasury coin-of-the-realm $20 gold pieces? You know, the Golden Eagles and the Silver Eagles that are sold daily down at Treasury.

Mr. Gideon. Well, again, I don't know that we have fully fleshed out the concept of "collectible." But I believe, in general, it is intended to refer to things like stamp collections, antiques, paintings, that sort of asset.

Senator Symms. All right. Thank you very much, Mr. Chairman. I think it is a little late in the evening to get into this. We can get into this later on the floor.

Senator Packwood. I might say, before we have further discussion and vote on this, for those who want capital gains, if we put it in the bill now, and we put it in with a majority

vote here, if we have to wait until the floor, we are going to have to have 60 votes to either overcome a point of order or a budget point of order.

So, for those who want capital gains, and especially this provision that includes corporate capital gains for long-held assets, this may be the last chance to get it.

The Chairman. Let me speak to the point of the IRAs and what has been offered as an alternative to what the Chairman has proposed.

That is a back-loaded IRA. I think that what Secretary Brady said in the meeting is quite apropos. This is what he said in the hearing last Friday:

"I think all of the evidence that I have seen is that IRAs that are back-loaded cost the same as ones that are front-loaded. It is just that different generations pay for them." And that is what that one does. It passes on the cost to the next generation.

Now, what I have proposed in the IRA is one that has been expanded to provide for the purchase of that first home, which is becoming more difficult and more difficult for that young couple to achieve. It means they continue to live with mom and dad, when they really want to be out on their own. This helps those parents help those children achieve that, and it helps those young people do that.

It does the same thing when you are talking about trying

to send your children to college. And once again, as we have seen, the cost of education escalate. That is a dream that is becoming more illusive, more difficult to attain. But this helps them do that.

Now, under the other proposal that has been offered as an alternative, you have to wait five years to start drawing it out.

Now, let me make another point. The question is the incentive that is taking place, that is going to encourage those savings. The fact that you have it where you have no tax on it as you bring it out, if that really works, then why don't we do that for all pension programs and put them in there?

The idea that you are going to take your hit now, you are going to pay for it now, under that proposal, that means that you have to decide what the government is going to do 10, 20, 30 years from now on taxes.

This is 1989, and look what we have done to the tax laws in the last five years. Do you think you can really bet on what the government is going to do, when they see that kind of a tax-free build-up having taken place, and decide that's where they can raise some revenue? Or try to discount that to present value. I don't really think that is the kind of incentive that is going to take care of you.

So, what they want, and what you want, I think is when

you get ready to sign that check to the government, and say, "Well, rather than sending that amount to the government, I would like to save on at least half it and take that off my check to the government, and put that into my IRA account," as proposed by the Chairman.

Now, do IRAs do a job, and can they under those kinds of provisions? Of course, they can.

There used to be a lot of debate about whether IRAs really increased savings in this country, or whether it was just a shift of savings. But we heard the testimony, in the committee, as they talked about the change in attitude by so many economists. In the studies that we're showing, as little as 20 percent of that was actually a shift in savings, that some 30 percent of it was attributable to the tax savings, and that the estimate was that 50 percent of it was a net increase in savings.

Now, the other part of the problem you have in this country is that you have to increase savings. Today, we are saving around 5 percent. The Japanese? Around 16 percent. If we are going to get the cost of capital down in this country, we have to increase the amount of savings that are available.

If you are trying to compete with the Japanese or the West Germans, who have an 8.5 percent prime rate, while we have a 10.5 prime rate, and the Japanese have a 4.8 percent

prime rate, you are at a tremendous disadvantage, as you borrow the money, sell the bonds, try to build that new plant, whether you are building widgets or anything else. That is why it is important that we bring our interest rates down.

If we look at what we are paying on the national debt today, just the interest on that takes all of the personal income taxes of everyone west of the Mississippi.

So, what we are trying to do is turn the situation around and truly encourage savings in our country.

We discussed earlier some of the distribution between where the money went on capital gains cuts and where it went on the IRA. The IRA is available to people that are making some money, yes. But the incentives we have now phase out on the individual at $24,000, and on the couple they start phasing out at $40,000 and phase out at $50,000.

And some of them say, "Well, those are wealthy people." But you talk to a couple where both of them are working, each of them making $25,000. They sure don't think they're rich. And those are the kind of folks that are in a squeeze, and so we are trying to help them buy that home, provide that education, and provide for their own retirement.

I think it does much more than what you see in capital gains cuts. I don't have the numbers on Senator Packwood's particular provision, but I did look at the numbers on the Administration's proposal, and I did look at the numbers on

what happened in the House. We went through those before, but to repeat it again:

Those provisions showed, on the IRA, that for people making less than $75,000, 51 percent of the benefits went there. On the House capital gains, 15 percent went there.

And if we went to the other extreme, and looked at people making $200,000, on the IRAs, 7 percent of the funds went there; but under the House capital gains, 60 percent went there.

If you are talking about an average tax cut, under the capital gains proposal in the House, 25,000 of that money went for those with incomes over $200,000, over 50 times larger than the benefit of the Bentsen IRA proposal to a comparable taxpayer. Those are the things we are looking at in trying to decide.

I am a fellow who has worked for a reduction in capital gains. I did it for years, ever since I have been in the Senate. But I will tell you, I was so much stronger for it when I saw the income tax rate at 90 percent, then 70 percent, then 50 percent. But now I see the top rate at 33, or, for the wealthiest, at 28 percent, one of the lowest top rates in any industrial nation in the world.

So I think it is important for us to put the emphasis in trying to encourage these savings accounts. I believe that the IRA that I have proposed helps accomplish that fact.

Senator Roth. Mr. Chairman?

The Chairman. Senator Roth.

Senator Roth. Mr. Chairman, first I would like to congratulate Senator Packwood for bringing together a package that I think helps meet the most critical need of this country: greater capital resources, greater savings.

By his approach, we do not have to choose between capital gains and IRA, but we can have both, and both are essential for the future growth and soundness of the United States economy.

The most important problem this country faces is becoming competitive in these emerging global economies. A nd the fact is, whether we like it or not, that we have neither the savings nor the low capital rates that are essential to make American industry competitive with that of the Japanese and others. Japan not only saves more than us, but Japan also has none or very little capital gains tax.

So what we are proposing here is a giant step forward in meeting the needs of this country.

I congratulate the Chairman for proposing an IRA, because I strongly agree with him that an IRA is essential, both for this country and for the American family. Our savings rate has not been satisfactory. But studies have been made that show that the IRA, which was in effect for several years, did result in substantial new savings.

I want to say to the Chairman, I join hands with him, and believe him, that IRAs are critically important if we are going to do anything about the private savings rate of this nation.

Let me address briefly this question of whether it helps the rich or the affluent, and just point out that I don't think the typical American that I know is interested in class warfare. I find that most people, if they aren't making much money, either anticipate that they ultimately will or that their children will. And I think they look upon savings through the IRA to be a very sound advance for the American family.

I agree with the Chairman when he talked about the importance of the IRA from the standpoint of helping educate their children, from the standpoint of buying that first house, and I would also add that I would provide, as we do in my IRA, that withdrawals could also be made for purposes of catastrophic health costs.

As far as the first five years are concerned, I doubt that there is enough in the IRA account of a typical family that it would be very substantial; so I don't think the fact that we don't allow withdrawals for the first five years to be very significant.

But, Mr. Chairman, I think there is great appeal to the IRA I have proposed. Studies have been made by various

organizations such as Merrill Lynch, which has shown that many consumers felt that back-ended IRAs make sense, since it enables an account-holder to get more earning potential for their investment due to the tax-free withdrawal at retirement. Consumers felt that, since they wouldn't have to share their retirement investments with the government, there would be more money for them.

Seven out of 10 participants in this particular study said they would be interested in a back-ended IRA.

But the essential point I want to make is that this is not a choice of capital gains or IRA. The fact is, we can have both. The fact is, we need both. The fact is that, by promoting savings, we will be resulting in increased growth and productivity of this nation, which ultimately will be more income for the government as well as for the family.

So, Mr. Chairman, I would urge support for the Packwood proposal. I might like to ultimately strengthen the IRA proposals; but, what I feel is particularly sound about this proposal is that it enables us to move forward, both with respect to capital gains and personal savings which are essential for this country's welfare.

The Chairman. Thank you, Senator Roth.

Other comments?

Senator Armstrong. Mr. Chairman?

The Chairman. Senator Armstrong.

Senator Armstrong. Mr. Chairman, I think there is a reasonable area for debate over what level of rates are appropriate for capital gains transactions. My own conviction is that the suggestions which Senator Packwood has incorporated in his proposal make sense, although I note that, even after five years, the capital gains rates would be higher than they were prior to the Tax Reform Act of 1986. So, we are not talking about drastic reductions in the capital gains rates.

I think, however, the particular provision that I want to draw attention to is the indexing portion of this proposal.

Whether a person thinks that the right rate for taxation of gains is 26 percent, or 19 percent, or 43 percent, or whatever it is, the threshold question is: What are we taxing? And at the present time we are taxing something in many cases, in most cases, which are not really gains, because they result purely as the result of inflation.

The reality for most taxpayers is that, if they hold an asset for a while, most of them don't do much better than inflation; or, at least, only a little better. So, when they sell their business or the farm, or whatever it might be, any asset that is subject to capital gains taxation, what they really end up paying tax on, at whatever rate we set, is not on a gain but actually a levy on capital, because they find that the value of the asset has doubled in nominal terms, or

maybe tripled, if they hold it long enough, and yet, in the meantime, the price of everything that is an everyday living expense -- bread, and automobiles, and housing, and what not -- has doubled or tripled, too, so they end off worse than they were years or even decades earlier.

It is obvious I wanted to emphasize the point that this is a fundamental matter of justice to individual taxpayers.

It has, secondarily, I think, some very beneficial macroeconomic effects. I am for this mostly because of the issue of justice for taxpayers; but a lot of economists have come to recognize that the lack of indexing in the basis locks people into sub-optimum investments, and that means our economy operates less efficiently.

I won't do it today, but when I file views, I intend to submit for the record the observations of a number of economists who have looked at this issue, and others, who have concluded that this is a very desirable provision, and I am grateful that Senator Packwood has included it.

The Chairman. Further comments?

Senator Riegle. Mr. Chairman?

The Chairman. Senator Riegle.

Senator Riegle. Mr. Chairman, I would like to ask the appropriate staff persons who are here if we have a meaningful estimate. If you take the Bentsen plan, in the financial assumptions, how many people are we assuming would

invest in IRAs prospectively? What is built in is just the total numbers of individuals who, on the margin, would make IRA investments that otherwise would not, or we would presume would not?

Mr. Pearlman. I am advised, Senator Riegle, that we project approximately 7 million additional taxpayers.

Senator Riegle. Seven million.

Now, with respect to the capital gains approach in the Packwood package, do we have any way of making an estimate as to how many additional taxpayers would be engaging in capital gains activity, or seeking to, as a result of this being out there, in a sense, as an incentive to seek capital gains, or to make the types of investments that could lead to capital gains? In other words, the incremental increase. What is projected there, in terms of the number of people? I am not getting into the question of transactional size of activity; I am talking the number of players.

Mr. Pearlman. When we have done our capital gains estimates, we have looked at volumes of transactions, and I think that has been the traditional way of estimating the consequences of capital gains. In the aggregate, what are the levels of capital gain realizations that the economy will reflect, and it is not in terms of numbers of taxpayers.

I am not aware that we have any projections on number of taxpayers who would have capital gains transactions that

didn't before as a result of any of the capital gains proposals.

Senator Riegle. Well, let me try to suggest an answer to that second question, myself. My hunch is that, in terms of enticing new investors into capital gains type activity or, in other words, seeking to generate capital gains by making investments that otherwise they might not make, rather than people who now make them and who might make more of them, I suspect that it probably does not entice vast numbers of people into making investments simply on the basis of adding the dimension of the more favorable tax treatment to them if they go that route.

I don't know what the number would be, but my hunch would it would be substantially less than the increment of 7 million, that is the figure that you are using in terms of the IRAs.

Now, I make that point separate and apart from the question of the aggregate volumes of additional investment that might take place, because I think one of the important aspects of the IRA is it tries to promote -- as the Chairman has said, and as Senator Roth has said, and as others of us believe -- it promotes a concrete incremental saving action by a very substantial number of people.

And so, you not only have the sheer volume of savings generated by those additional savers or people whose behavior

has changed, but in fact you foster a kind of savings ethic and a kind of investment ethic in a much broader part of your national population. And I think that is a very important thing for us to accomplish.

There is the whole equity question, as to whether or not you are making this available to a greater number, and I think it is preferable on that ground, as well; but in terms of a country with an abysmal savings rate, and where people have to, in effect, sacrifice, I think for people to squeeze out the additional money to put into an IRA, they probably have to forego something else. Probably a lot of it is current consumption, that otherwise would occur in one form or another. And the tilt that we have to get back in our national savings performance and investment performance is exactly that kind of an adjustment.

So it seems to me that anything that reaches out and persuades a vast number -- and I would call 7 million a vast number on the margin -- of Americans to stretch in order to become savers on the margin, beyond what they otherwise would do, is a very healthy thing for the country. I think it is precisely the kind of thing that needs to happen, and I think it has an effect of growing, over time, because I think it catches on.

Those people to talk to other people, they become examples to other people. I think it then causes those

institutions that specialize in IRA investments to do more advertising. The data that we have shows that the advertisements that run in a burst as we approach tax time generate a lot of IRA decision activity by people, and I think locking up those long-term savings pools, which IRAs do, albeit here with the case of people being able to withdraw for educational or first-home investments, I think is exactly the route we need to go.

So, I am very much hopeful that we will do that, and I think the bulk of the people of the country are reflecting that. They are reflecting that in the polling data that is coming back.

People aren't stupid. They have a chance to see this, and they would like to have an opportunity to participate in a material way in increasing the savings pool and getting a little something for it, not just seeing it flow right past them to somebody who is already in a very financially advantaged situation.

So, I think it is a chance to let the rank and file person get into the game, where they ought to be, and we need to have them.

The Chairman. Let me say that it is near midnight. I don't want to cut off any debate, but I have a hunch that every person on this committee has made up his mind and knows how he is going to vote. But, whomsoever would like to talk.

I think Senator Dole had asked me, earlier.

Senator Dole. Mr. Chairman, I want to commend Senator Packwood. I think we have a better package here than the House provision, and I know what the vote is going to be, unless I miscounted. It is going to be a tie, and then we are going to have the play-offs on the Senate floor, and that is where the action will be, hopefully.

I don't understand -- 7 million -- how many people may be eligible. Is that how many are eligible, or how many are going to buy the IRA?

Mr. Pearlman. We project that that would be the number of new contributors to the IRA proposal, 7 million new contributors.

Senator Dole. We did a quick survey in my State and found only 3 to 5 percent were even eligible under the Bentsen plan.

But I want to make the point that this matter was discussed at length in the Presidential election last year. The last time I checked, and I checked fairly carefully, George Bush won.

(Laughter)

The Chairman. I don't know. With as many as have come up to me, Senator, and said they voted for me, I may ask for a recount.

(Laughter)

Senator Dole. Well, I have had the same experience.

(Laughter)

Senator Dole. You are lucky you didn't have my pollster.

(Laughter)

Senator Dole. So this comes as no surprise. I mean, President Bush campaigned on it; he asked for a reduction of 15 percent. The American people overwhelmingly supported President Bush. I said nice things about the Chairman, publicly. That is not the point. But the issue has been out there, and the American people have had a chance to look at it, whatever their income category may be.

So it seems to me that we ought to consider the present proposal. The class warfare argument got beaten badly on the House side, and we've got another class warfare argument from the Senator from Michigan.

Just a true story that happened just last night:

I was fortunate enough to go up to New York to raise money for one of my colleagues -- really a treat -- and we were at this hotel where a lot of rather well-to-do people were, contributing to this outstanding Republican Senator. I won't name any names, but I can say that they probably can do without IRAs or the capital gains reduction.

But a funny thing happened as I prepared to leave. The waiter said to me -- the waiter -- "I hope you get that capital gains reduction, sir, I want to sell my home."

So, you can talk all you want about who will benefit, but it is going to benefit a lot of people, and a lot of people are out there working so they can get in the position to receive the capital gains reduction.

Now, somebody reminded me later that waiters at the Pierre Hotel make more than we do.

(Laughter)

Senator Dole. I didn't ask for his income tax returns.

So, this is an opportunity I think to vote on a better provision than we had in the House, and I think Senator Packwood deserves credit, and I hope all my colleagues on this side the same way I do and at least two on the other side would see it that way. I don't think that will happen, but if I lived in any State where they raised timber, and I looked at this particular provision, particularly with reference to corporations, I would look very carefully at it before voting against it.

Senator Danforth. Mr. Chairman?

The Chairman. Senator Danforth.

Senator Danforth. Well, Mr. Chairman, I am on the team, and I think that by and large it is a pretty good provision. I think all of us could have offered changes to it.

As I understand it, the sheet that I have in front of me -- and I would like to ask Senator Packwood this -- the Packwood amendment, which is a kind of capital-formation

amendment, is comprised of three parts: One is capital gains, the second is Individual Retirement Accounts, and the third is fertilizer expenses for growing timber.

Now, I don't want to ask about this fertilizer expenses for growing timber part, but the capital gains for corporations -- it is my understanding that the holding period is -- what is it?

Senator Packwood. It will be between eight and 10 years, when we run the figures.

Senator Danforth. Well, does an asset leap to your mind for that holding period? Is this somehow related to the fertilizer expenses?

(Laughter)

Senator Danforth. If more fertilizer is used, might the asset in question mature before the 10-year period?

(Laughter)

Senator Packwood. I would let Senator Heinz speak for coal, or Senator Armstrong for other minerals. I can assure you that corporate timber companies hold their timber for longer than 8 or 9 or 10 years. And this is probably the best provision they are likely to see in the House, or the Senate, or the Senate floor.

Yes, the answer is.

The Chairman. Are there further comments?

Senator Chafee. Mr. Chairman, I would just like to say

that I think this is vastly superior to the House provision, and I want to join the praise for Senator Packwood for this.

Also, he encourages the longer holdings, which I think is so important, on the individuals. And indeed, as I understand it, it would apply to already-existing holdings. In other words, you don't have to wait for the six years to pass for it to apply to those. And as is mentioned, it applies to corporations; although I can't think of a single corporation in my State that could much advantage out of it, since we grow precious little timber.

But I think, overall, it is a very, very good provision.

The Chairman. Thank you.

Let me state, on those income tax levels I was speaking of earlier, the top rate paid by those people earning the most money: The tax rate in Japan is 76 percent, in Sweden it is 75, in The Netherlands it is 70, in Denmark it is 68, in the United Kingdom it is 60; Italy, 60; France, 57; Germany, 53; Australia, 49; Canada, 45; and the United States, 28.

So my enthusiasm for capital gains has lessened some over the years, as I have watched us come down from 90, to 70, to 50, and then to 28. And I think the emphasis should be on trying to boost the savings of our country and getting the interest rates down, and that is what that IRA does.

Senator Mitchell. Mr. Chairman?

The Chairman. Yes.

Senator Mitchell. May I merely ask a question of the staff?

The Chairman. Of course.

Senator Mitchell. This document which Senator Packwood has distributed explaining his amendment has, on the second page, revenue effect in millions.

Mr. Pearlman, are these the estimates of the committee? When you say "revenue effects," whose estimates are these? Are these yours?

Mr. Pearlman. Well, if I read this correctly, I think what Senator Packwood is doing is setting revenue targets for is provisions, and we would presumably be expected, then, to give him the necessary rate and holding periods that will meet these revenue targets.

Senator Packwood. That is correct.

Mr. Pearlman. And, incidentally, we have told him we can do that. We can fill in those blanks. We think we can meet those targets if he gives us the flexibility on either the holding period or the rates.

Senator Mitchell. That explains it. The question I was going to ask is, how is it possible to determine an aggregate amount before you have determined the individual sums that will make up the aggregate amount?

Senator Packwood. That is why you have, at the moment, in brackets, on the corporate rate, 8 to 10 years. It will be

someplace in that area, and that will make it come out to the revenue figure that we have in the right-hand column.

Senator Mitchell. I see. So you will adjust the provisions to meet the revenue figure.

May I just ask one further question? Has any consideration been given to the effect on the deficit beyond 1994?

Mr. Pearlman. We have done some work in connection with the House consideration of both capital gains and IRAs on post-budget window projections. They are difficult projections to make, but we did release 10-year projections for a variety of capital gains proposals and a variety of IRA proposals.

To my knowledge, we have not done that on the Senate side. Now, I may be wrong about that, but I don't think we have. But we can do that. We are prepared to do that.

They are in a sense arbitrary, because CBO does not give us any baseline numbers beyond 1994; so what we essentially do is try to look at the trendline on various revenue items, and then apply an inflation factor based on the CBO's growth in the outer years. And that was the methodology we used in projecting those 10-year estimates for various House proposals, and that is what we would do if we were asked to do it with any proposals under consideration in the Senate.

Senator Mitchell. Well, I thank you, Mr. Pearlman.

Mr. Chairman, I don't wish to prolong this. I think you are right, everybody has made up their minds.

I would merely add, in addition to all that has been said and the views that have long been expressed on this subject, that we consider the effect of our actions on the deficit. We may, in the very near future, in the Congress repeal the Catastrophic Health Act, enact a capital gains tax cut, enact an IRA provision, and then, within just a few days thereafter, have an automatic sequester because we have been unable to meet the budget targets under Gramm-Rudman. And I think all of those events are not unrelated.

I merely raise the question for consideration by my colleagues of whether the course we are pursuing is the proper one with respect to the deficit and its effect on our economic future. I think that is something that has troubled all of us.

I don't believe there is a Member of the United States Senate who has not given perhaps a hundred speeches on the deficit, describing it as the most serious problem we face in our country to our future economic growth; and yet, virtually every step that we have considered taking, at least the four major ones that I have described, will admittedly have the effect of exacerbating the deficit at least over some period of time. I think that is a very serious matter that we all have the responsibility to consider in this matter.

Mr. Chairman, I thank you.

The Chairman. Thank you, Senator.

I think we have developed the subject pretty well, if you are ready to vote. We have other amendments yet to consider tonight.

You have a motion before us, do you not?

Senator Packwood. Yes.

The Chairman. The motion has been made, and seconded, I assume.

I assume you will want a roll call.

Senator Packwood. Please, Mr. Chairman.

The Chairman. The roll call has been called for.

All in favor of the motion, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed, No.

(Chorus of Noes)

The Chairman. And by roll call.

Clerk. Mr. Matsunaga?

The Chairman. No, by proxy.

The Clerk. Mr. Moynihan.?

Senator Moynihan. No.

The Clerk. Mr. Baucus?

Senator Baucus. No.

The Clerk. Mr. Boren?

Senator Boren. Aye.

The Clerk. Mr. Bradley?

Senator Bradley. No.

The Clerk. Mr. Mitchell?

Senator Mitchell. No.

The Clerk. Mr. Pryor?

Senator Pryor. No.

The Clerk. Mr. Riegle?

Senator Riegle. No.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. No.

The Clerk. Mr. Daschle?

Senator Daschle. No.

The Clerk. Mr. Packwood?

Senator Packwood. Aye.

The Clerk. Mr. Dole?

Senator Dole. Aye.

The Clerk. Mr. Roth?

Senator Roth. Aye.

The Clerk. Mr. Danforth?

Senator Danforth. Aye.

The Clerk. Mr. Chafee?

Senator Chafee. Aye.

The Clerk. Mr. Heinz?

Senator Heinz. Aye.

The Clerk. Mr. Durenberger?

Senator Durenberger. Aye.

The Clerk. Mr. Armstrong?

Senator Armstrong. Aye.

The Clerk. Mr. Symms?

Senator Symms. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. There are 10 Senators in favor, 10 Senators opposed.

The Chairman. And the amendment fails.

Senator Dole. It is a tie, isn't it? Yes.

(Laughter)

The Chairman. Yes.

Senator Armstrong?

Senator Armstrong. Mr. Chairman, are you ready for other amendments?

The Chairman. Yes, of course.

Senator Armstrong. Mr. Chairman, I would like to offer an amendment that touches the bill in two places and, in fact, conceptually, is two amendments, but I offer them together because one gains revenue and one loses revenue. Or maybe that is not necessary. Have we got some -- ?

The Chairman. I don't think we have much left. I don't know what the number is now.

Would you bring us up to date on what we have? Do I

have any room left?

Mr. Pearlman. Hang on.

The Chairman. Considering what the Majority Leader said, we don't have to spend it all, you know.

Mr. Pearlman. We are at $5.409 billion, and we know that we need a CBO number on the black lung, which we do not have. So, we are 5.409, subject to that one item.

The Chairman. So that means we have what?

Mr. Pearlman. Well, at a 5.3 target, we have $109 million.

The Chairman. I see. That we could apply to the deficit?

(Laughter)

Senator Armstrong. Mr. Chairman, I will offer them jointly or separately, as you wish, but the two issues that I want to address are, first, the question of the life of franchises.

As I understand, the proposal as it is now before us increases from 10 to 20 years the term for depreciating these franchises. So far as I am aware, the 10 years was arbitrary, and the 20-year proposal is arbitrary.

The desire originally was to avoid having to go through and litigate a large number of these. My conviction, just from talking to people who were affected, is that 20 years is an awful big increase from 10 years.

I have tried to think that, rather than just arbitrarily take it to 15 years, or let's take it to 18 years, or let's take it to 12 years, if there is any proposal that could be made that would actually have some economic justification -- I would like to share with you where I came out.

The Chairman. You know, if they can prove a lesser period of time, they have that option.

Senator Armstrong. Yes, sir, I am aware of that. But the problem with all of that is that it leads to an enormous amount of litigation, which is costly both to the people who are seeking to prove the case and also for the IRS.

So my proposal is going to be for 13 years. That is a 30-percent increase over where they are, but my justification for it is this:

Even if one assumed that a franchise is of perpetual value, it would not be unreasonable, even for a perpetuity, to say that they ought to be able to take off each year an amount more or less equivalent to the carrying costs, to the interest cost. If you take today's interest rates and discount it back, that would come out to about a 13 or a 14 year life.

Mr. Chairman, the other amendment which I want to offer -- and I guess I will offer them together, though they can be voted on separately.

I think what I have just suggested would cost somewhere less than $50 million.

The Chairman. Do you have a number on that?

Mr. Pearlman. No, sir. I don't think we have been asked to estimate this.

Senator Armstrong. Well, Mr. Chairman, I said I think it costs that, and I am prepared to say that the exact amount could be adjusted. We have submitted requests for a number of estimates and, just due to the press of events, they haven't come back.

But in any case, my desire is to arrive at something that is in some way grounded in economic reality and isn't such a big increase in this group of taxpayers.

The Chairman. Senator, if your two amendments are coupled, one essential to the other, then, yes. But if they are not, let someone else move in on another amendment.

Senator Armstrong. That is fine. The only reason to offer the other amendment is that it pays for the one I have just suggested.

The Chairman. Well, then they are coupled. All right.

Senator Armstrong. They are not conceptually coupled in any way. Would you rather take them separately?

The Chairman. Well, I think you might want to consider both of them, because that gives you a better chance.

Senator Armstrong. It seemed to me that they were well taken together.

I can pay for this, Mr. Chairman, with an amendment which

not only picks up approximately -- and I say approximately -- $50 million in revenue. That is based on a revenue estimate we received last year for an identical proposal. But the real reason for the other half of it is not to pick up the revenue but as a matter of justice. This is the question of these pension fund assets.

We have got millions of people in this country whose main economic asset is invested in a pension fund, in a defined benefit plan, which is supervised and guaranteed by the Pension Benefit Guaranty Corporation and is subject to some regulations as to its prudent investment, and so on.

Increasingly, these assets are being taken out of these government-guaranteed and protected pension funds and put into ESOPs. I have no objection to that, but it does seem to me that when employers or others -- outside entrepreneurs, people who are buying out corporations -- are liquidating company pension plans and putting the money into an ESOP, which in a number of cases is also being used to finance the acquisition of the company, that the people who are unprotected are the employees whose pensions are in the pension fund.

So, all my amendment says is that they have the right, if this happens, to decline to have their portion of the pension fund transferred. In other words, they retain the option to just say, "No, if you are going to liquidate the plan and take the money and put it in an ESOP, I don't want that to happen

to mine." It just seems to me they ought to have the right to refuse that kind of a transfer, and that is what my amendment does.

The Chairman. How does that pick up the 50 million? I don't quite understand that.

Senator Armstrong. Let me see if I can explain it. Can staff help me with that? Why does that result in a saving?

(Pause)

Senator Armstrong. Mr. Chairman, I am advised that at the time that we priced this, last year, we were not given an explanation; that is just the number that was furnished to us.

Mr. Pearlman. Frankly, I don't remember the number. We gave it a long time ago. But I think the reason is because we assumed that it will have a depressing effect on the creation of ESOPs. I think that is the reason that it was deemed to have raised some money.

Senator Armstrong. Oh. And so there would be proportionately less tax deduction for the ESOPs?

Mr. Pearlman. Correct.

Senator Armstrong. Mr. Chairman, let me stress that while it does pick up some revenue, my interest is in protecting the rights of the employees involved.

I also want to make it absolutely clear this is not a theoretical concern; this was brought to my attention in a very urgent way by a number of employees who are concerned

that, after paying into a pension fund for 10-15-20 years, they are going to see it invested, perhaps unwisely, in an ESOP.

Now, the specific case that is the biggest example of this that I know of is United Airlines. I don't have any idea whether or not that is a good ESOP or a good takeover or not, and I don't take any position on it; but I really do think that the employees involved ought to have a right to decide for themselves whether or not they want that to happen to their pension fund, rather than just having it happen to them without any control on their part.

So that is my amendment, Mr. Chairman.

The Chairman. Does staff have a comment on this?

Mr. Foley. I would just like to clarify that in our proposal, if the value of the transaction is less than $100,000, they would still be allowed to use current law.

So, you were concerned about the fact that there is a big jump between the 10 years and the 20 years, but I would like to point out that if $100,000 or less is allocated to the intangible, they would still be allowed to use the 10-year figure.

Senator Armstrong. I am aware of that, but we are talking about, in many cases, large dollar volume transactions.

Mr. Foley. That is correct, Senator.

Mr. Hardock. Senator, can I get a point of clarification on the defined benefit proposal?

Senator Armstrong. Yes, sir.

Mr. Hardock. Is it only the excess assets in the pension plan that would be affected? Because I think the other assets could never be transferred to the ESOP; they are required to pay the benefits of the participants that have accrued to date.

Senator Armstrong. No, I don't think so. As I understand it, what happens is that employers terminate the plan or use the assets of the plan to buy shares in the ESOP.

Mr. Hardock. I don't actually know what happened in United, but as I understand the --

Senator Armstrong. Well, it hasn't actually happened, it is proposed to happen.

Mr. Hardock. Okay. If they have a pension plan that they consider terminating, they would have had to use most of the pension plan assets to buy annuities from an insurance company, with respect to all benefits accrued to date. At that point the company could, under current law, take the money, pay ordinary income tax, pay a 15 percent excise tax, and walk with it. Or they can pay ordinary income tax, pay a 15-percent excise tax, and put the money in an ESOP, which is then allocated to the accounts of the ESOP participants.

Senator Armstrong. Yes. But my point is that, if they

transfer into the ESOP, the individual employees don't get consulted about it. They don't have the option.

Mr. Hardock. That is correct.

Senator Armstrong. That is the point, that this is the biggest economic asset these people have, and it happens they don't get consulted. They may get asked about it, but they don't get to vote on it.

All I am saying is that each of them ought to have the option of whether they want to go into the ESOP or stay where they are.

The Chairman. Mr. Pearlman, do I understand that we don't have any numbers from Joint Tax on this? Is that correct?

Mr. Pearlman. That is correct. We have not been asked to estimate the 13 years, and we have not updated a last-year estimate. So we do not have revenue estimates on this.

Senator Armstrong. Well, Mr. Chairman, the reason why the 13 years is subject to adjustment -- and I would condition my amendment this way -- is that whatever the ultimate number is, and I believe it will be about $50 million, would provide whatever it takes to bring it down from 20. Maybe that will bring it to 14 years, I don't know. Maybe it will bring it to 12, maybe it will bring it to 15. But I am trying to make the package revenue-neutral, because here are two amendments that seem to have a sense of justice about them, and that makes

them revenue-neutral. I don't care whether we end up at 13 or 14, or exactly which it is.

The Chairman. Senator, what are you proposing now? Both amendments? One amendment?

Senator Armstrong. No. As you have suggested, Mr. Chairman, I am proposing them together, in a way that makes them revenue-neutral. The exact number of years, going from 20 to what I would estimate, around 13 to 14 years, dependent on the final analysis of what the revenue pickup is in the pension amendment.

The Chairman. All right. Are we ready for a vote?

Senator Symms. Mr. Chairman, could I ask Senator Armstrong a question?

Is this amendment the same as your bill S. 1078?

Senator Armstrong. Yes, it is.

Senator Symms. See, I like the first part of your amendment. I am a little skeptical of the second amendment, to be honest with you.

Senator Armstrong. Why are you skeptical of it, Steve?

Senator Symms. Well, just from what happened in the committee. I understand there were over 50 statements that were received in opposition to the bill.

Senator Armstrong. Of course there were, because that was not a hearing; those were just statements that were submitted.

I believe what is going to happen is, if the issue is surfaced, you are going to hear from every flight attendant in the country and a lot of other employees. That is not who you heard from on that list.

The Chairman. Gentlemen, we have a lot more amendments, I think, that are coming. Can we go to a vote?

Senator Armstrong. Mr. Chairman, I think we have aired the issue. This is a question of whether or not the people ought to get a chance to speak for themselves as to whether they want to go into the ESOP or whether they ought to get the right to stay where they are.

The Chairman. All right. You have had the two amendments.

Yes, Senator; did you have a question?

Senator Rockefeller. Mr. Chairman, ESOPs are something which have developed fragilly in recent years. They are generally considered to be very good. They are considered by me to be very good. It would seem to me the Senator's amendment would slow the development of ESOPs. Employees do have an opportunity to make that choice when they vote their plans, and I consider his amendment nothing more than an effort to weaken the development of ESOPs, which I do not consider to the in the interest of our people.

Senator Armstrong. Jay, did you mean to say that the employees have a right to make that determination? That isn't

right. That is the point.

All I am saying is that when it is proposed to take pension fund assets and put them in an ESOP, that the employee ought to have a right to say, "Yes, that's okay. Go ahead," or, "No, don't do that with my portion of it; keep it where it is." And the difference is that the ESOP -- it may be very, very good; I am not saying they are bad. But it is inherently a much more risky investment than the government-supervised, government guaranteed pension fund kind of an investment under present law. I am just saying they ought to have the right to choose.

The Chairman. Can we have a vote.

Senator Rockefeller. I understand what the Senator is saying, but I haven't changed my position.

The Chairman. The motion has been made. All in favor of the motion, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(Chorus of Noes)

Senator Armstrong. Mr. Chairman, I would like to have a roll call.

The Chairman. How about a show of hands because of the time? Would that be fair enough?

Senator Armstrong. Sure. That's fine.

The Chairman. All right. All in favor, please raise

your hand.

(Show of hands)

The Chairman. Opposed?

(Show of hands)

The Chairman. All right. Thank you. The motion fails.

Senator Boren. Mr. Chairman?

The Chairman. Yes.

Senator Boren. Mr. Chairman, I would like to offer an amendment, the same form as Senate Bill 1273, which has 25 cosponsors including several members of this committee. Senator Durenberger is the principal sponsor, and Senators Dole, Daschle, Danforth, Baucus, Pryor, Symms, and Matsunaga.

This amendment has been submitted to Joint Tax. They have given an estimate that it would cost $40 million over 5 years. It deals with farm cooperative income.

Under the previous practice, when farm cooperatives sold assets that were used in patronage activities, membership activities and membership earnings, and in the past it was always treated as patronage income. The IRS has challenged that and has said it should be considered as non-patronage income. Some co-ops do elect to use it that way.

Under this bill, it would allow a co-op that wished to treat assets which are used inherently in the production of patronage services, and provision of the service to the members, could be treated as a patronage income if the co-op

so elected, or it could be treated as non-patronage income for those that had been treated that way in the past.

I simply think that we need to have certainty in this matter. The co-ops have been very confused about it. There has been a great amount of litigation about it.

Let me read the definition again, to make it very, very clear, that "non-exempt farmer co-operatives who elect to use ordinary as patronage source treatment for gain of loss realized on the sale or disposition of assets used in patronage operations, to provide patronage services" -- not something that is unrelated to what they do for their members, not some totally separate business enterprise, but the assets used in membership services.

I think it is pretty straightforward. I have a letter I believe from Mr. Pearlman that was written in response to a letter from Mr. Dorgun on the House side. This is the exact same bill as H.R. 2353. And that was a revenue estimate we had, dated September 12.

Mr. Wooton. Mr. Chairman?

The Chairman. Yes

Mr. Wooton. We do have a revenue estimate on this proposal, which is $40 million over the 5 years, $18 million in the first year.

We would also have comments on the substance of the provision, if we may.

We agree there is a problem in this area. However, this bill, as we see it, has two aspects that are questionable from a policy perspective.

First of all, the bill is elective, which lets the co-ops choose which way they want to treat these gains, depending on whether they have gains or losses.

The Chairman. Do you mean they can be retroactive?

Mr. Wooton. Well, the second issue is that the bill is retroactive, and in order to benefit the particular taxpayer who we understand has been most interested in this provision, the bill would have to be retroactive.

The Chairman. How often can they change?

Mr. Wooton. Under the bill, the taxpayer can make election I think every three years.

The problem as we understand it is that the industry is divided on whether or not they would rather have one rule or the other, and therefore the proposal has been to make it elective and let the people who would benefit from treating these assets one way choose to treat them that way, and let other people choose the other way.

If a consistent, logical proposal could be worked out, we think that Treasury could improve the current situation. But they haven't been able to do that on a consistent basis.

The Chairman. Does the Administration have a comment on this, Mr. Gideon?

Mr. Gideon. On this provision? I don't believe that we do.

Senator Boren. Mr. Chairman, in rebuttal, I understand exactly what has been said here, and it has been difficult to reach a solution, because there has been some division of opinion; but I would point out that you don't offer an election to them on all assets. You only offer them the right to elect it patronage source income for those assets that are used in patronage services, for membership services, assets that have that use, and that seems to me only fair.

As I say, we have 25 members of the Senate that have sponsored this proposal. It is something that has broad support in the agricultural sector. It is important to these institutions. And I would simply urge its adoption.

Senator Durenberger. Mr. Chairman?

The Chairman. Yes.

Senator Durenberger. If I might just add a brief comment, this is a problem that has been around a long time. I remember, back in the days when I represented rural electric co-ops, problems like this arose all of the time. I think most recently, though, it has been a problem in which, no matter which choice the co-op made, they ended up in litigation.

I think what we have been trying to do, over time, is to clarify the route that they will take and back it up, as the

Senator from Oklahoma says, by patronage sourcing the assets involved.

So I would strongly recommend that we support this amendment.

Senator Dole. Mr. Chairman, I would just say I support the amendment. I think I could live without the election, but I can't live without the retroactivity. That is critical.

Senator Boren. I move its adoption, Mr. Chairman.

The Chairman. All right.

The motion has been made. All in favor of the motion as stated, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(Chorus of Noes)

The Chairman. Motion carried.

Senator Heinz. Mr. Chairman?

The Chairman. Yes?

Senator Heinz. Mr. Chairman, I would like to bring up the issue of the alternative minimum tax problem of small life insurance companies, which is an $8 million item in the first year.

The problem, as people may know, is that if you are a small life insurance company that is growing fast -- and I know the Chairman knows this backwards and forwards and will correct me if I misstate it.

Now that we have an alternative minimum tax, the small life insurance company basically gets taxed on profits that it never receives, and therefore is not able to make the payments to the required reserves under State law that is almost inevitably necessary.

As a result, if we don't address this problem, any small life insurance company that is growing 5 percent or more isn't going to be able to grow 5 percent or more. That simply means that the people who are in the life insurance business now and who are big are going to be protected against competition. People who want to start a business, people who want to grow a business, will not be able to do it.

I don't think that was the intention of this committee when we adopted the alternative minimum tax; but because of the nature of the requirement that we capitalize, under the alternative minimum tax, the acquisition costs, or, if you will, the commissions, over several years, the life of the life insurance policy, that nonetheless is the effect.

So the amendment that I am offering simply says that if a small life insurance company, as defined under present law, has an increase in premium value of at least 5 percent over the prior year, then acquisition costs will not be required to be capitalized for purposes of the alternative minimum tax.

Senator Moynihan. I wonder if I could ask the hum in the back of the room to quiet down? The Senator has a right to be

heard.

Senator Heinz?

Senator Heinz. I thank the Gentleman from New York. I have completed my explanation.

Senator Moynihan. Could I then ask the Treasury's view in this matter?

Mr. Gideon. Senator Moynihan, we have reviewed this provision. We were concerned about it originally; but in light of the fact that it has a restriction that will reduce the revenue loss involved, we will not object to it at this time.

Senator Moynihan. Is the revenue loss established, Mr. Pearlman?

Mr. Pearlman. The revenue on this proposal is minus-$8 million in 1990 and minus-$84 million over the 5 year period.

Senator Moynihan. May I ask, sir, does that bring us to the end of our small little reserve we had a moment ago?

Senator Heinz. Mr. Chairman, I think now. The $100-plus million reserve was for the Fiscal '90 year.

Mr. Pearlman. No, we would still be positive by $91 million-minus. So we would be positive by $83 million if this were to be passed.

Senator Moynihan. Thank you. Is there any further comment?

Mr. Pearlman. Let me indicate, Senator Moynihan, I hate

to disagree with the Treasury Department, but we think this is not good tax policy.

The tax system generally requires taxpayers to amortize costs over a multi-period. Buildings are depreciated over a multi-period even though they earn income. I mean, that is the way our tax system operates. And the whole purpose of the minimum tax was to try to get to a more accurate measurement of economic income.

Life insurance companies get a special benefit through their reserve additions that other taxpayers don't get, and it is the special benefits that were made part of the Alternative Minimum Tax in 1986. As a consequence, we see no reason here to take a certain class of taxpayers, with a certain kind of amortizable asset, and say they are not subject to the minimum tax, where thousands of other taxpayers are.

Senator Moynihan. Mr. Pearlman, you should never hesitate to disagree with the Treasury Department. Please feel free in that regard.

Does the committee have any further comment? We have a rather strong statement from the Joint Tax Committee.

Senator Heinz. Mr. Chairman, I would like to respond to the Joint Tax Committee.

Senator Moynihan. Yes, of course, Mr. Heinz.

Senator Heinz. The reserving requirements are set under State law. They are very stringent, and they are very strict.

I would only ask the Joint Committee the following:

Is it not the case that a combination of State law requirements and the capitalization of commission costs, which are very, very high the first year, will have the effect, due to the Alternative Minimum Tax, of having insurance companies pay taxes at a very high rate? Is that true or false?

Mr. Pearlman. Senator Heinz, I don't think I can answer it as true or false. Insurance companies are required for regulatory reasons to have reserves. Banks are required to have reserves, savings and loans are required to have reserves, and obviously that means they have to set cash aside. Some companies have to go out and buy buildings or equipment, and they have to set cash aside for those. And they can't deduct all of those expenses in year-one. That is not the way either financial accounting or tax accounting operates.

So, yes, it is true that an insurance company has some expenses that have to be capitalized and can't be deducted all in one year. That is the way our tax system works. I would emphasize here that, for financial accounting purposes, these companies have to do exactly the same thing.

Senator Heinz. Well, Mr. Pearlman, let me ask you this: You indicated banks have reserves, and that is true, but banks do not have a high selling cost; but they do have a component called salaries. We don't require them to capitalize

salaries, because it is an expense. Commissions are people costs, the cost of people going out and selling. And under the Alternative Minimum Tax we do require, rightly or wrongly, that that be capitalized. That is the problem.

If you are saying that banks are being treated the same, I would disagree with you. They are able to expense an item that is somewhat -- I won't say it is exact, of course it is not -- somewhat equivalent to the cost that an insurance company bears.

Let me ask you this: Do you dispute the notion that a small insurance company that doesn't have a large pot of established reserves and thereby does have to put up the cash, and has to pay the extra taxes, and has to lay out the money for commissions -- those are all cash expenses -- that those add up to more than 100 percent of the cash the company is going to have? Do we at least agree on that?

Mr. Pearlman. More than 100 percent of the cash? It would certainly be likely to add up to more than 100 percent of the income it might earn in a particular year. I doubt it would end up more than 100 percent of the cash.

The Chairman. Senator, could we bring this to a vote?

Senator Heinz. Yes, Mr. Chairman, I move the vote.

The Chairman. All right. All in favor of the motion, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(Chorus of Noes)

Senator Heinz. Mr. Chairman, can I have a show of hands?

The Chairman. Yes.

A show of hands. Those voting Aye?

(Showing of hands)

Senator Heinz. I may have to ask for a roll call.

The Chairman. Opposed?

(Showing of hands)

The Chairman. All right. The amendment fails.

Senator Pryor?

Senator Pryor. Mr. Chairman, earlier today I raised the SSI Outreach Program. We have been struggling for some hours now to find the revenues to pay.

First, we would ask the SSI to communicate in outreach efforts to reach those people. About 50 percent of the eligible SSI recipients are not even aware that there are such programs that would benefit them. We think that now we are on the verge of locating the revenues to do this, and I would propose such amendment.

I think Mr. Pearlman is ready; I am not certain.

Mr. Pearlman. I apologize that I am not. Just tell me again. I am sorry, Senator.

Senator Pryor. Yes. Mr. Pearlman, this is the SSI Outreach Program.

Mr. Pearlman. Okay. Yes, this is Mr. Humphreys' issue, not ours.

Senator Pryor. Right. Mr. Humphreys, I think, has been working with our staff on this.

Mr. Humphreys. I think the issue, though, is a question of the revenues available.

Senator Pryor. I think in 1990 it is zero in the first year.

Mr. Pearlman. Excuse me. I am confused.

Senator Pryor. I don't know how you kept up so well tonight. I really admire how you have done this.

Mr. Pearlman. You asked us for some offsetting revenue raisers, and we did those. We do have those estimates. Do you want me to describe your proposals? I am not sure what you want from me.

Senator Pryor. I think the proposal has been described.

Mr. Pearlman. You asked us for two options.

Senator Pryor. For 1991 and 1992, if you would just give us a revenue number there.

Mr. Pearlman. Sir, I am not sure what proposal you have before the committee. I am sorry; you asked us for two, and that is why I am confused.

(Pause)

The Chairman. Are we dealing with this amendment?

Senator Pryor. Let me just say that I would like to

dispose the possibility of this one, Mr. Chairman, if I could, before another amendment is offered.

Mr. Pearlman. Senator, I think now I can respond to you.

Senator Pryor. Thank you sir. I am sorry I did not communicate that well.

Mr. Pearlman. I am sorry that I was a little slow.

We have $91 million available in Fiscal Year 1990. That is the year where we have to be really careful. And we have $1.6 billion available in 1991. Are those the two years you asked about?

Senator Pryor. I understand 1990 is no revenue cost for this program, this amendment.

Mr. Pearlman. That, I can't comment on.

Senator Pryor. And roughly $60 million for the second year, 1991.

Mr. Humphreys. On a policy basis, the proposal is I think unobjectionable. So it is just a matter of whether the committee wants to spend these funds.

The basis of the amendment is to have the Social Security Administration go out and find people who are eligible for SSI.

Senator Pryor. Who have not been made aware of it.

Mr. Humphreys. So this would have no cost in 1990; they would have a $60 million in 1991 --

Senator Pryor. That's the figures we have.

Mr. Humphreys. -- $80 million in 1992, and $90 million in 1993; $95 million in 1994. So it rises from nothing in the first year, $60 million in the second, rising up to about $100 a year, which is mainly cost of additional people becoming eligible for the SSI program.

The Chairman. Does the Administration have a position on this?

Mr. Gideon. Senator, I am not familiar with this issue, and I really couldn't advise you.

Senator Heinz. Mr. Chairman, may I be heard on the amendment?

The Chairman. On this issue?

Senator Heinz. Yes, but briefly.

The Chairman. Yes, of course.

Senator Heinz. Mr. Chairman, I would like to support Senator Pryor's amendment.

The people who are most often overlooked by the SSI program are those who are hardest to find or who are least informed. They are typically the poorest, they are typically the most desperate, and they are the people who would benefit most from this affirmative action program, with a small "a", to go out and reach to them, to find them, and to help them. They are the people who most need the help.

Senator Pryor. Thank you.

The Chairman. Are there further comments on this amendment?

Senator Dole. The total cost is about what? Four hundred million dollars? Why didn't we consider this in income security earlier today?

Senator Pryor. Well, we tried to earlier, but we could not exactly put the revenue figures to find the way to pay for it, Senator Dole. Now it is a zero cost estimate in '90 and $60 million in '91. I understand that there may be an offset here. I think the staff may have found that offset.

Senator Dole. What is the offset?

Mr. Pearlman. I am just not aware of an offset.

Senator Pryor. Pardon me, that there is existing revenue still available.

Mr. Pearlman. In the package that the committee has approved, there is still some existing revenue available. That is correct.

Senator Pryor. Well, that is the revenue I would like to use.

Senator Dole. Does anybody else have any amendments? Because this will take all of it, right?

Senator Chafee. No, it is not taking it all.

Senator Dole. It must take all but about 30 million or 32.

The Chairman. How much money is left, Mr. Pearlman?

Mr. Pearlman. We've got $86 million left in the first year. We have $1.6 billion in '91. I think the year you have to be careful of is '92, where it is $286 million. For example, this number is 80 million in '92.

So, say you have got 86 in '90 and 286 in '92. Those are the two numbers you sort of have to monitor.

Senator Dole. What does it take in '90?

Mr. Humphreys. It has no cost in '90

Senator Pryor. Zero.

The Chairman. All right.

Are there further questions about the amendment?

Senator Bradley. Could someone restate the amendment, just so that we know what it is?

The Chairman. Would you restate the amendment, Mr. Humphreys?

Mr. Humphreys. What the amendment would do would be to direct the Social Security Administration to undertake an outreach program targeted toward certain categories of aged, blind, and disabled individuals who might be eligible for SSI.

The result of this program is that they would find some, and the estimates are that the additional benefit costs would be zero in 1990, because the program wouldn't have had its impact then; $60 million in 1991, $80 million in '92, $90 million in '93, and $94 million in '95. And these costs would reduce the amount of deficit reduction that is now left

available in the package for those years.

The Chairman. All right.

If there is no further discussion, do you move the amendment?

Senator Pryor. I move the adoption, Mr. Chairman.

The Chairman. All in favor of the amendment, make it known by saying Aye.

(Chorus of Ayes)

The Chairman. Opposed?

(Chorus of Noes)

The Chairman. Can we have a show of hands?

All in favor, please raise your hand.

(Showing of hands)

The Chairman. Opposed?

(Showing of hands)

The Chairman. The amendment carries.

All right.

Senator Pryor. Mr. Chairman, thank you.

Senator Dole. Mr. Chairman?

The Chairman. Senator Dole.

Senator Dole. Mr. Chairman, I have two amendments. I don't think they are any revenue cost; or, if they are, they are very small. And they have both been discussed with staff, but let me designate.

One amendment would provide transition relief to public

charities, which temporarily become classified as private foundations to avoid disrupting established business relationships which do not involve substantial contributors.

I think we have had a discussion with staff on that. Mr. Oglesby?

Mr. Oglesby. Yes, sir. That is one that our staff and your staff have worked on, Senator. When a charity switches into private foundation status, it would not immediately taint all the contracts that the directors had before it was a private foundation. It would say, "Well, that is an unusual case," and so they would have 5 years to get out of that arrangement. This would be a generic rule on an ongoing, prospective basis.

The Chairman. I don't see any problem with that one. Does anyone?

(No response)

The Chairman. Without objection, we will accept that one.

Senator Dole. The other technical one: Page 24 of Part 1, Revenue-Raising Provisions. The last paragraph there, with respect to the grandfather rule for certain loans, who has that? Ron, or Randy?

Mr. Hardock. We talked to your staff about it, Senator.

The Chairman. Do you have the information on it?

Senator Dole. He has the information.

Here is a company that complies with all of the requirements of that last paragraph. It has announced its intent to form an ESOP in January 1988, effective for 1989, and solicited the loan commitment documentation revision, except that after the modification occurred they got a lower interest rate, which I think would probably reduce the cost. I just wonder of this can be accommodated.

Mr. Hardock. I think it is consistent with the provision that is here if they have a written binding commitment pre-June 6th.

The Chairman. We have no cost involved in that one, do we?

Senator Dole. The only change they had in the modification was they lowered the interest rates.

Mr. Humphreys. It should not be a significant cost.

The Chairman. I would not think so.

Mr. Pearlman. It sounds like it meets the Refinancing Rule, from what I hear. It sounds all right.

The Chairman. All right.

Is there any objection to it?

(No response)

The Chairman. If there is no objection, we will adopt it.

Now, didn't we have some non-controversial amendments by the Administration that were presented to me earlier?

Mr. Gideon. Yes, we do, Senator.

Mr. Oglesby. Yes, sir, Senator, and Mr. Gideon can run through those.

The Chairman. Let's get those done.

Mr. Gideon. Three of these are already in the House bill, Senator.

The first is to reauthorize the tax-exempt status of the Overseas Private Investment Corporation. That corporation came up for reauthorization in the appropriate jurisdiction committee, but you have to approve the tax exemption.

The Chairman. Is there any question about it?

(No response)

The Chairman. If not, without objection it is adopted.

All right.

Mr. Gideon. The second is to expand Section 912 to certain Defense Department personnel. This has to do with the kinds of tax treatments that are extended to U. S. employees abroad. Again, this is the same as the House provision.

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The Chairman. Is there objection to it?

(No response)

The Chairman. If not, it will be approved.

Mr. Gideon. The third item also on the House bill is a deferral of recognition of gains for property required to be divested by Federal ethics requirements.

Mr. Oglesby. There is not clearance on that one at the staff level I would point out.

Mr. Gideon. There is not?

Mr. Oglesby. No, sir.

Mr. Gideon. Oh, okay.

The Chairman. No. There is an objection to that one. All right?

Mr. Gideon. One that was not in the House bill but I do believe there is staff clearance on is a revision to the TEFRA partnership procedures to deal with a situation that has arisen as a result of a Tax Court case, Monroe versus Commissioner. This would provide a new procedure that would allow the IRS in certain circumstances as defined by that case to treat partnership items as nonpartnership items.

Mr. Oglesby. Ken, I can't say that we are familiar enough with that one to send up. We had the OPEC tax exemption, the DOD and Defense Intelligence Agency employee rules and the IRS undercover agent.

Mr. Gideon. All right.

The undercover rule basically would extend a rule that presently allows the Service to essentially take money from undercover

operations and continue to use it in undercover operations rather than having to go through the recycling process. This rule already exists; however, it was to cease to apply. This would simply extend it for two additional years.

The Chairman. Any problem with that on Joint Tax?

Mr. Richter. No, sir.

The Chairman. If there are no objections that will be accepted.

Senator Moynihan. Mr. Chairman, I will be brief, and I think a measure which I believe we can also pay for. I believe Senator Armstrong is interested in this matter. It has to do with employees who receive benefits from their employers for van pooling or mass transit.

The present law is that you may receive up to $15.00 tax free for using mass transit, using van pooling. That is a situation where packing benefits are completely tax free. But there is a catch. If you get the $15.00, but if the employer gives you $16.00 then the tax free nature of the $15.00 disappears. It is somewhat of an unusual thing and obviously not very useful. I don't know if we want to encourage this kind of transportation.

We propose to pay for it, Mr. Chairman--it is not expensive; $7 million the first year.

The Chairman. How much?

Senator Moynihan. $7 million the first year. We propose to pay for it--and now I don't want to pretend to know more than I do--by offsetting a loophole closing proposals that would deny amortization of life estates to related party joint purchases. Ron Pearlman, take it from

there.

(Laughter)

Mr. Pearlman. This is a proposal that was in the House bill, and it deals with a transaction where two related parties go out and buy an asset. Well they split the interest between them. One of them takes the remainder interest and one takes a life term of years and then it is normally the elder who takes the life interest and then they amortize it usually over a term of years or actuarial life expentancy. And without amortizing that asset, the income, the conventional asset is not taxed.

The conclusion in the House was that when those transactions are related party transactions that the tax credit doesn't work right. But if it is an unrelated party, I buy a life estate, and I don't own another interest in it, and no on that is related to me does, it is appropriate that I would amortize it. But if the property is owned within a related party, that splitting of the asset into pieces doesn't seem to produce the right result.

So the House proposal would preclude an amortization deduction in every instance where there is a related party purchase of the same or essentially the same property. And then there is that provision that makes sure that you don't lose the tax basis. I am not going to get into that detail, but it is designed in a way so that the tax basis that otherwise would be deductible will be preserved, so it is available if the asset is ever sold. Now that is the provision.

It raises about $15 million in 1990, about $35 million over the

5-year period.

Senator Moynihan. So it is about what we estimate this would cost?

Mr. Pearlman. Yes, sir.

Your proivision I think is like 29 million over the period. I think that is right.

The Chairman. Are there further questions about it?

Senator Armstrong. Mr. Chairman?

The Chairman. Yes. Senator Armstrong.

Senator Armstrong. I would just like to express my approval of this. Senator Moynihan and I have been interested in this for a long time both for tax reasons but also for air pollution reasons. We are trying to do something to get people out of their cars and into vans and this is a modest but very worthwhile step.

The Chairman. Are there other questions?

(No response)

The Chairman. If not, all in favor make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(No response)

The Chairman. The motion is carried.

Senator Chafee. Mr. Chairman, I will be very brief.

In the 1986 Tax Reform bill we did something that, in retrospect, seems bizarre and terribly unfortunate, and that was we provided that appreciated property caused the taxpayer to become subject to the

alternative minimum tax. And the result has been a dramatic decline of those particular appreciated properties to museums, universities, hospitals and any of the charitable institutions.

I can just cite some statistics from Yale that I am somewhat familiar with. Others are even more familiar with it here. In 1989, the gifts are running 56 percent below 1985. And they have got other statistics that clearly show it was not due to the stock market crash in 1987. It clearly is traceable to the appreciated property problem. And the same applies to the museums in the country. And so what I am proposing, Mr. Chairman, is that we try for a year going back to not requiring them to be under the tax preference for the alternative minimum tax. And that would cost, according to Mr. Pearlman, $13 million in 1990. So I hope we can do this. And, frankly, in retrospect, I don't know why we ever did what we did. On one hand, we try to encourage these institutions, encourage private giving; on the other hand, we say but if you are ultra generous we are going to tax you for it.

The Chairman. All right. Let me have a comment out of Joint Tax on this one.

Mr. Pearlman. The revenue is, as Senator Chafee indicated, is $13 million for one year if it is done on a 1-year basis. I can explain the reason it was done in 1986, since at least I had some involvement in that. And that is, again, I think you have to go back to the purpose of the Alternative Minimum Tax. The theory of the Alternative Minimum Tax was to try to make sure that people with

economic income paid at least some level of tax. The combination cannot do it alone. It takes more than just a contribution of appreciated property. But the combination of the contribution of appreciated property and other tax benefits can put someone in a zero tax position.

So I guess what I would say to the Committee in response to your question, Mr. Chairman, is I think the Committee will just have to be aware of that. Maybe the argument that Senator Chafee makes about the reduction in contributions of this kind of property outweights that, but I think you do have to be aware that part of the thing that drove the AMT in 1986 and got a lot of attention, as you know, was that there were taxpayers who could be identified as not paying any tax. And this is an area where it is quite possible that there will be some high income individuals who will end up paying no Federal income tax. And the Committee should just be aware of that.

Senator Chafee. Well they would have to also make very substantial contributions.

Mr. Pearlman. There is a limite. They cannot make a contribution that exceeds 50 percent of their adjusted gross income. So it is really in relationship to their adjusted gross income. But yes, if they are a high income taxpayer they obviously have to make a sizeable charitable contribution. That is correct.

The Chairman. What is the Administration's position on this?

Mr. Gideon. We agree with Mr. Pearlman's analysis and we oppose the provision.

Senator Moynihan. Mr. Chairman, can I ask a question?

The Chairman. Yes.

Senator Moynihan. Mr. Pearlman, is it the case that merely the gift of appreciated property would never take your income tax down to zero? Is that it?

Mr. Pearlman. That is correct. That was the point I was making before.

Senator Moynihan. You have to have other things.

Mr. Pearlman. Yes.

It is te contribution plus other things. That is right. You cannot do it alone. And that was the reason I tried to make that clear a moment ago.

Senator Moynihan. Yes. Thank you.

Senator Packwood. Could I make a statement, Mr. Chairman?

The Chairman. Yes, of course.

Senator Packwood. Contributions to museums are not down. Contributions to universities are not down. They are up. Contributions of appreciated property, which we found whether they were an extraordinary tax dodge or just quite an occasional tax dodge, is hard to tell. But I do remember the situation when we debated it. And the reason they are not giving appreciated property--and I want to emphasize this, museums are getting money and universities are getting money--is because people cannot use this as a tax dodge any more. And it gets back to what we tried to do, and that is everybody that has some income is going to pay some tax. No matter what the merits of what their

deduction might be, we just said you have got to pay some tax. And this is an invasion of it that I hope we would not adopt.

Senator Danforth. Mr. Chairman, one thing that happened in 1980 taxes that we began I think for the first time to call gifts to charities tax dodges. Now that is the new lingo. I don't think a person should be taxed for giving monei to charity or giving assets to charity.

The fact is that this has had a dramatic effect on our museums and on our universities. We had a meeting last spring I think. It was Benoschmidt, the President of Yale, was there, together with the presidents of a variety of universities, public and private, church related and independent, and they made it very clear that this had a dramatic effect on what was going on in their universities. It is hurting them. There is no question about it.

If we believe that charitable contributions are tax dodges, and if we believe that in the name of tax equity somehow we have to follow policies that are going to hurt universities, hurt art museums, and hurt symphonies and so on, then we should keep the current law. But I think for $13 million, let's at least see what effect it has. For $13 million we can test it for a year. And if Senator Packwood is correct, that it doesn't have any effect, then we can go back to where we are right now.

Senator Chafee. Well I am not quite sure what Senator Packwood is saying. I mean the statistics clearly show that gifts of appreciated property have dramatically declined. Now you can brush that off and

say that that is not important. But as a percentage of the total that universities receive, it is very dramatic. Now it may well be that the universities have still been able to increase their donations. That is not the case in the ones I am familiar with. I don't know what you are quoting for statistics, but the ones I am familiar with, both museums and universities, they are giving a decline. And clearly, their giving of the big gifts, which they count on, has declined.

Senator Packwood. I will make you a deal. If contributions to universities are up--total contributions--will you drop the amendment?

Senator Chafee. Total contributions.

Senator Packwood. People are not donating the appreciated property any more. They are making regular donations. They love to donate the appreciated property because it got them down into a zero tax status. They are still contributing; they are just not contributing their appreciated property.

But if you mean are contributions to universities down year over year, or even on an adjusted basis for inflation, they are not. Are contributions to museums down on an adjusted basis for inflation, the are not. They are up. But you are singling out appreciated property. Those are down, because the tremendous tax incentive to give them is no longer there.

Senator Bradley. Would the Senator yield?

Senator Chafee. I am not quite sure I want to walk this plank.

(Laughter)

Senator Bradley. The action was also responsive to a couple of IRS

studies, and maybe Mr. Gideon has some of the numbers at his fingertips or Mr. Pearlman. But as I recall in the area of the gifts of appreciated propertyl when the property was art, it was something like 75 percent of the gifts were overvalued upon reevaluation by 1,000 percent. In other words, if I have this, and I say this is a work of art, and you are a willing recipient, we both agree this is worth $10,000.00. You have just raised $10,000.00 for your charity and I have just deducted $10,000.00 from my income taxes for this work of art. That is the kind of thing that is a kind of abuse that led the Treasury and others to say we have got to control this. Now maybe we went a little too far. Maybe there are problems with it. But we shouldn't think that because some gifts of appreciated property have declined that we should reinstitute the full appreciated property.

Senator Chafee. No one will argue with that position.

The Chairman. Gentlemen, let Senator Boren speak here. He has been trying to speak for some time.

Senator Boren. Mr. Chairman, let me just -- I have here some information that comes from the Association of American Universities and the National Association of State Universities and Land Grant Colleagues prepared by their counsel for tax relations. And I just want to quote the figures because they run a survey. I think this answers some of the questions that have been made.

"The Association of Art Museum Directors found that from 1987 to 1988 the dollar value of donations decreased 28.8 percent as the purchase price of art increased by 20.4 percent. The Council for

Aid to Education found a 10.6 percent decline in property given to schools and a 16 percent decline in property given to colleges and universities between academic years 1987 and 1988. These declines in property"--now this is the important point because it has been arised--"these declines in property giving occurred during the same year that all giving to higher education--all giving, not just the giving of appreciated property--all given to higher education declined for the first time since 1975, which was only the third decline instance of a decline in 25 years.

"Furthermore, schools, colleges and universities report a chilling effect on leadership gifts of appreciated property necessary to begin fund raising campaigns."

So we have, according to the AAU and the National Association of State University and Land Grant Colleges, experienced both a very significatn decline in appreciated property giving and a total decline in all giving to colleges and universities.

I think this is very serious. We have pushed on to the private sector, particularly during the previous eight years. The Administration said we are going to quit doing a lot of things at the government level. We are going to ask private citizens to take up the slack and meet these responsibilities. And I think it is very important that we do something like what Senator Chafee is here proposing.

The Chairman. Are we prepared for a vote?

Senator Symms. Mr. Chairman, I just would like to second that.

And I received a call today from the president of a small private college in Idaho that I am on the board of, and this has already had an impact on them because they have, in their effort to try to start an endowment, which some of the other more wealthy schools have already developed, they are receiving some stock certificates from some of their big donors that are appreciated and they are not giving them because of this.

The Chairman. All right.

Senator Symms. And I think we ought to take the Chafee amendment.

The Chairman. Can we get the vote, gentlemen? We have a lot more amendments left.

Senator Heinz. Mr. Chairman, I understand that, but Senator Bradley brought up a point; if it's a serious point still ought to be discussed on the question of the overevaluation of art.

Senator Bradley. I am not sure it is a needed point if I can count.

Mr. Pearlman. In 1984, there were some valuation rules adopted, very strict ones, and indeed many think that is what has caused the down turn in a contribution of a lot of this property.

Senator Bradley. Oh, the valuation rules.

Mr. Pearlman. Valuation rules that were adopted in the 984 Act, yes.

The Chairman. All right. Is the motion made?

Senator Moynihan. So moved.

The Chairman. All right. All in favor of the motion as stated make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(Chorus of "nays")

The Chairman. The "ayes" have it.

Senator Baucus. Mr. Chairman.

The Chairman. Senator Baucus.

Senator Baucus. Thank you, Mr. Chairman.

I have a similar amendment. I don't know the degree to which the Committee wants to pursue it. Essentially it refers to a given received deduction as it applies to the Alternative Minimum Tax. Currently, the more a corporatin owns a stock in a company that it receives dividends from the more it is able to take advantage of a dividends received deduction. And that provision, however, does not apply to Alternative Minimum Tax. The consequences is that it puts actually United States Corporations to a disadvantage with foreign corporations with a similar situation. The amendment would be to, as I said earlier, apply the same dividends received deduction treatment to AMT as they currently applies to the corporate income tax law generally. The revenue estimates are over five years, it is $90 million. Fifteen the first year, 1990.

The Chairman. Let's have some comments on it, Mr. Pearlman.

Mr. Pearlman. Mr. Chairman, that is correct. That was included in the House bill, and from the Joint Committee Staff's standpoint we have

no problem with this amendment.

The Chairman. How about the Administration?

(Pause)

Mr. Pearlman. Can I just clarify?

The Chairman. All right.

Mr. Pearlman. I assume that you are talking about allowing the dividend received deduction for adjusted current earnings purposes for stock ownership between 80 and 20 percent. That is what cost $15 million in 1990 and $90 million over the period.

Senator Baucus. Yes, that's right.

Mr. Pearlman. Is that correct?

Senator Baucus. Is that the first interpretation on the sheet you have there? Maybe we have different sheets. It is the same as in the House bill.

Mr. Pearlman. All right. We are all right.

Senator Baucus. All right. Fine.

The Chairman. Does the Administration have a position on this?

Mr. Gideon. I am sorry, Senator. I missed this point.

The Chairman. Are there further comments?

Mr. Gideon. Yes. We favor this one.

The Chairman. All right.

Do you move the amendment?

Senator Baucus. I move it.

The Chairman. All in favor of the amendment make it known by saying "aye."

(Chorus of "ayes)

The Chairman. Opposed?

(No response)

The Chairman. The amendment carries.

Senator Roth.

Senator Roth. Mr. Chairman, I will be very brief. There is an excise tax on ozone depleting chemicals, both a tax and indexing over the 1990 to 1994. The industry would prefer that the revenue raised by this means be fixed, in other words, that they do away with the indexing, that you add those figures into the base rate so there would be no loss of income.

The Chairman. Can I get a comment out of the staff on that one?

Mr. Richter. The amendment is to change the CSC proposal so that the rate would reflect the inflation assumption.

Senator Roth. Both a base rate and an indexing.

Mr. Richter. Right.

Senator Roth. And the base rate goes up.

Mr. Richter. So the rates would be changed to reflect the inflation assumptions I think the estimators are making as I understand --

Senator Roth. That is correct.

Mr. Richter. -- correctly.

Mr. Gideon. If I could just ask a question. In other words, what is going to happen under tbis is that the rates will go up and the indexing proposal will come out and preserve the revenue stream. Is that what you are saying?

The Chairman. That is correct. The same amount of revenue.

Senator Roth. Keep the same amount of revenue.

Mr. Gideon. All right.

The Chairman. Is there any problem?

Mr. Gideon. No. As long as the revenue string is preserved.

The Chairman. Any objection?

(No response)

Senator Roth. So moved, Mr. Chairman.

The Chairman. The amendment is proposed. All in favor make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed a similar sign.

(No response)

The Chairman. All right.

Senator Durenberger. Mr. Chairman, can I ask a question on that one before it gets voted in?

The Chairman. Oh, yes. Of course.

Senator Durenberger. What was the purpose of the index in the first place?

Senator Bradley. Too much money.

Mr. Richter. The purpose I believe was to -- it's an environmental policy concern, and that is if you index -- if you don't index the rate it is possible that prices of competitive products would go up, and that the tax which is designed to discourage the use of these products would have less of an effect in that respect than it otherwise would. So it

depends on whether the inflation assumptions are accurate or not whether that rationale is well founded.

The Chairman. All right. Senator Daschle.

Senator Daschle. Thank you, Mr. Chairman.

This amendment has been discussed before. It is the amendment that I discussed yesterday which would clarify that ethanol which is used in the manufacture of ethyl tertiary butal ether, so-called ETBE, is eligible for the alcohol fuels tax credit. It does ot create a new tax credit. It only clarifies that this product, which was only developed in 1982, be allowed to be used under the alcohol fuels tax credit that will expire in three years. It sunsets in three years.

There is probably no product on the market that has come about in the last several years that has more environmental as well as octane boosting qualities as an additive to gasolene than ETBE. It is widely acknowledge as that. Many of the oil companies support it. The auto manufacturers support it as a product that ought to be included in gasolene. And it is critical that if we are going to be able to use this in environmental impacted areas that we allow it to be commercially viable. And I am told that the only way we can test its commercial viability in the next couple of years is to allow it to fall under the alcohol fuels tax credit.

I emphasize here it will expire in three years. So we will have to review this whole issue again. But in the three years that we have, it will give us an opportunity to check the commercial viability of it and give us a real opportunity to decide whether or not this is something

that should be extended.

The Chairman. What is the cost on the provision?

Mr. Pearlman. This one loses $18 million in 1990 and $547 million over the 5-year period.

The Chairman. Does the Administration have a position on this?

Mr. Gideon. Yes, Senator, we do. We believe this is an area where, as Senator Daschle has stated, we could reach this result by regulation. However, we would welcome the action of this committee today in the manner proposed which would resolve the matter with congressional concurrence.

Senator Heinz. Mr. Chairman.

The Chairman. Yes, Senator Heinz.

Senator Heinz. I want to register my very strong objections to the proposal and I don't know quite what Treasury is so favorable on this. This is a proposal that would give an alcohol fuel credit to ETBE as I understand it. And one of the problems is that there is a limited supply of a chemical needed to make both ETBE and its competitor, the one that is derived through methanol, and that particular chemical, Ithobutulene, is in short supply. What we are going to do is nutty. We are going to subsidize the production of a particular kind of chemical that cost more to make but uses a limited input and the taxpayer is going to pay for it. We are not going to get any more of either ETBE or MTBE except if we can import more if the limitations on the Ithobutulene are as they are represented.

So I would hope that we would not agree to this amendment.

The Chairman. Are there further comments?

Senator Daschle. Mr. Chairman, if I could respond to that because it is a very important point. The GAO is doing a study. They have just given us a preliminary briefing as well as the draft of the report. And they contradict what the Senator from Pennsylvania has said flatly. There is no limit on the amount of that chemical. The availability is plentiful and that is not a factor on this issue at all.

The Chairman. Senator Rockefeller.

Senator Rockefeller. Mr. Chairman, for reasons that I will not go over now but which I have discussed in meetings we have had behind that door before, I cannot vote for this amendment because of its effect, as I see it, on methanol. But I have to compliment the Senator from South Dakota because I think we are all running away from the issue of alternative fuels. We have passed bills on it; nothing is happening about it. The President has spoken about it; nothing is happening about it. And both ethanol and methanol are going to be part of our futures, and we are going to have to face up to it, or we are going to have no national energy security at all.

The Chairman. Are there further comments?

Senator Bradley. Mr. Chairman, I would like a recorded vote on this amendment. This is a $500 million amendment. It is widening a tax expenditure, a tax expenditure I think that is dubious a value anyway, the benefits of which go to very few, very few companies. And I would personally like to have a roll call vote on the amendment.

Senator Dole. It doesn't last five years. It is only three years,

isn't it? What is a 3-year cost, Ron? It expires in three years.

Mr. Pearlman. I'm sorry. You want --

Senator Dole. Well, you gave us the 5-year cost.

Mr. Pearlman. I gave you the 5-year cost.

Senator Dole. It expires in 1992. What is it for three years?

Mr. Pearlman. Well, I --

Senator Daschle. The 3-year cost, according to the figures I have been given, is $172 million: $18 million this year, $50 million in 1991, and $104 million in 1992.

Senator Dole. It is a lot less.

The Chairman. Are there further comments?

Senator Baucus. Mr. Chairman.

The Chairman. Yes.

Senator Baucus. Mr. Chairman, just briefly. Many cities in this country are in carbon monoxide non-attainment, and one of the solutions, in addition to increased tail pipe standards, is more oxygenated fuels. This is an additional additive to help oxygenate fuels. The more that happens the more carbon monoxide -- the more there is less carbon monoxide, as additional oxygen burns it more cleanly. This will help cities reach carbon monoxide non-attainment.

The Chairman. All right.

Senator Armstrong. Mr. Chairman, I didn't hear how we would pay for it. I want to vote for the amendment, but I don't want to put us in a deficit on reconciliation.

Senator Dole. It is $18 million the first year.

Senator Daschle. $18 million the first year, that's correct.

Senator Dole. There is still plenty left.

Senator Armstrong. Is that within what we have got left?

Mr. Pearlman. There is sufficient money left in both 1990 and 1992, which are the two critical years to pay for Senator Daschle's amendment.

Senator Bradley. Mr. Chairman.

The Chairman. Senator Bradley.

Senator Bradley. I think it should be noted that the existing Section 40, about two-thirds of the benefit goes to one company. And we can go ahead and do this if we want, but I would like to have a roll call vote on it.

The Chairman. All right. A roll call vote has been requested. You moved the amendment.

Senator Daschle. I move the amendment.

The Chairman. All right.

Senator Chafee. How much is this subsidy per gallon?

Senator Durenberger. I think it is 60 cents, isn't it?

Senator Daschle. It is 60 cents.

The Chairman. Let's proceed with the roll call.

The Clerk. Mr. Matsunaga?

Senator Daschle. I have Mr. Matsunaga's proxy and I vote him "aye."

The Clerk. Mr.Moynihan?

Senator Moynihan. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Boren?

Senator Boren. Aye.

The Clerk. Mr. Bradley?

Senator Bradley. No.

The Clerk. Mr. Mitchell?

Senator Mitchell. Aye.

The Clerk. Mr. Pryor?

Senator Pryor. Aye.

The Clerk. Mr. Riegle?

Senator Riegle. Aye.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. No.

The Clerk. Mr. Dashcle?

Senator Daschle. Aye.

The Clerk. Mr. Packwood?

Senator Packwood. No.

The Clerk. Mr. Dole?

Senator Dole. Aye.

The Clerk. Mr. Roth?

Senator Roth. No.

The Clerk. Mr. Danforth?

Senator Danforth. Aye.

The Clerk. Mr. Chafee?

Senator Chafee. No.

The Clerk. Mr. Heinz?

Senator Heinz. No.

The Clerk. Mr. Durenberger?

Senator Durenberger. Aye.

The Clerk. Mr. Armstrong?

Senator Armstrong. Aye.

The Clerk. Mr. Symms?

Senator Symms. Aye.

The Clerk. Mr. Chairman.

The Chairman. No.

The Clerk. There are 12 Senators in favor, eight opposed.

The Chairman. The amendment is carried.

Senator Danforth. Mr. Chairman, I have an amendment, depending on how much money is left.

(Laughter)

Mr. Pearlman. Mr. Chairman, we have $34 million left in 1990, and in 1992 we have $75 million left.

Senator Danforth. How about 1991?

Mr. Pearlman. We have got plenty of money left in 1991.

The Chairman. Lots of money.

Senator Danforth. All right. Mr. Chairman, that is good news. Mr. Chairman, this amendment is really Senator Mitchell's amendment, and I offer it on behalf of Senator Mitchell, the Majority Leader, and myself. I guess a year or a year and a half ago Senator Mitchell and I established a task force of, really a blue ribbon task force, to examine

the problems of the low income housing tax credit, and to make proposals for making that tax credit more effective. And the Committee came back with some specific recommendations which related both to the low income housing tax credit and to the rehab credit. And one of the recommendations dealt with the application of the passive loss rule.

The proposal that we offer now, the amendment that we offer, is included in the House bill. And under the proposal, taxpayers, regardless of their adjusted gross income, would be able to utilize at least $7,000.00 of low income and rehab tax credits annually.

Again, this is one of the proposals of the blue ribbon group that we convened. They believe it would be particularly important now with respect to the rehab credit, but also it would provide additional sources of capital for the low income housing tax credit in the future.

Senator Dole. What is the limit now? It is $200,000,00, isn't it?

Senator Danforth. That is correct.

Senator Dole. If we take the cap off?

Senator Danforth. Yes.

Senator Dole. The rich get richer.

Senator Packwood. Is this the one where we had the evidence yesterday that it would not do any good because the States are at their limit anyway?

Senator Danforth. It would certainly do good with respect to the rehab credit because there is no such thing as a cap on the rehab credit. And, for example, in both St. Louis and Kansas City, which have some good old housing stock, that rehab credit pretty much is dried

up. It just has not been utilized. It is down to I think about 30 percent of what it was before we passed the 1986 Tax Act, and that was the principal source of creating new housing.

Now we attempted to create an offset to the passive loss rules by the low income housing tax credit in addition to the rehab credit. The Committee that we appointed said that there were some real problems, and this is one of the suggestions that they make to fix it.

Obviously, there is no revenue loss if it does not help housing.

Senator Mitchell. Mr. Chairman, if I could just press my support for the amendment. The purpose of this change is to expand the maximum possible market of investors. That market is now constricted by the cap, making it more difficult to find investors, thereby increasing the marketing cost. And it requires that investors be offered a higher rate of return to invest in low income housing.

Senator Packwood was quite correct that because the low income housing tax credits are being fully utilized in most States, and there is a cap on them, there will not be a direct and immediate benefit. It will be primarily in the rehabilitation credit. But by increasing the maximum available pool of investors, we hope, when we get the credit improved, as we are attempting to do through other legislation, that the combined effect will be to encourage investment in low income housing.

I recognize that it goes contrary to many of the principals that we adopted in the 1986 Act, but, as we know, the manufacture and operation of low income housing is simply not something that is sufficiently economically viable to induce investment. And the only way to get it

done is either through direct Government subsidy or in the form of credits of this type.

The Chairman. Are there further comments?

(No response)

The Chairman. Is the motion made? Do you so move, Senator?

Senator Danforth. Yes.

The Chairman. All right. Any questions?

(No response)

The Chairman. All in favor of the motion as stated make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(No response)

The Chairman. The motion is carried.

All right. Senator Riegle.

Senator Riegle. Mr. Chairman, I will be very brief on this one. This is a subject, termination reserves on minimum premium plans. And I want to put a question to the Treasury in a moment on this, but the proposed amendment would address an issue that has arisen concerning the deductibility of reserves maintained by insurance companies to cover their liability for claims under certain accident and health policies employing so-called minimum premium plans. The proposed amendment simply makes it clear that insurance companies are entitled to deduct from income the portions of premiums that they receive. They are set aside in reserves required by State law for future claims

payment. And if my information is correct, the Treasury has looked at this, and if what I am told is right, has no objection to it. But I put that question to them.

Mr. Gideon. We do not object to it. It is a matter that is in litigation. And after reviewing the matter with our staff, our position is that we would not oppose the amendment.

The Chairman. Does Joint Tax have any comment on it?

Mr. Pearlman. Well let me first give you the estimate. We estimate it having a relatively small loss, $5 million over the 5-year period. Clearly, there is something that needs to be done with this issue subsequently. I think the concern we have is the concern that the Treasury Department expressed, and that is this is a case that is in litigation. And it is difficult for the staff to recommend to members to legislate on something that is pending in litigation.

The Chairman. All right.

Do you move the amendment?

Senator Riegle. I do indeed.

The Chairman. Are there questions?

(No response)

The Chairman. If not, all in favor of the amendment make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(No response)

The Chairman. The amendment carries.

Senator Riegle. Thank you, Mr. Chairman.

The Chairman. Senator Symms.

Senator Symms. Thank you, Mr. Chairman.

Mr. Chairman, I have two items I want to bring up. I don't think an amendment will be necessary in either one and I think we can settle it now. But if I cquld have the Joint Tax Committee's -- I want to go back to that issue on the grandfathering on the ESOPs.

Number one, this company, first off, they made the decision in the early spring of 1989 to move into an ESOP. They negotiated the loan with the lender, which is evidenced by the lender's written offer to the borrower; orally accepted the lender's loan terms. The lender notified the secondary lenders in writing, filed with the SEC the ESOP plan description, which includes a recitation of the loan terms, made a public offering, and accomplished all that prior to, you know, completed it all by June 6.

They did not sign the loan terms with the company satisfying the grandfather transition relief rules even though it has not accepted in writing the lender's terms and even though the lender has not formally and in writing approved the loan. They did everything that I stated, except the actual officially signing the dotted line, which they signed on the 7th of June, the actual loan.

Mr. Richter. Senator, I think the question relates to language on page 24. If you read it, I think the intent is to say you look at all the facts and circumstances to see if the bank in that case was bound prior to June 6. It seems like they have a very good case. Not knowing

everything, it is, of course, difficult. I do not think that this list was intended to be a list of everything that had to be done, and that every little check list had to be met. To the contrary, these are factors that one would look at to determine if there was enough documentation to constitute a binding contract.

The fact pattern you have laid out, in particular the pre-June 6 letter from a bank, offer from the bank, to make a loan at a specified rate, and then the acceptance of that offer, even though that piece was verbal, might well constitute a binding commitment under this rule.

Senator Symms. Well I don't know whether that is good enough or not or whether we are going to have to reopen this, Mr. Chairman, on the floor. But my point is that there were two major pieces of legislation dealing with ESOPs in this town, and which I happen to be opposed to both of them as far as I was concerned. But one of them was by Senator Dole, one by Chairman Rostenkowski. And Senator Dole's package had different dates in it, which would have taken care of this particular problem. Now we come back and find out that this date is June 6, and I just want to say that we have got to resolve this one way or the other.

Mr. Pearlman. Senator, I would suggest that we get some very careful written description of these facts so that we can take a look at them, and consult with Treasury, and then come back and give you a response because these are very factual fact intensive, and it would be irresponsible to say that your transaction is good or not based on this discussion. I think it would not serve you to do it. I mean that is

the only thing I think we can do to respond to you.

I mean it is not a transaction we are familiar with, so we cannot respond based on a background.

Senator Simms. All right.

The Chairman. Well get the information to us.

Senator Symms. Thank you, Mr. Chairman.

Mr. Chairman, the other question I wanted to direct to Mr. Gideon, and what it deals with, Mr. Gideon, is the so-called empty seat rule for valuing flights on business aircraft. And the issue is that whether or not the company has to fill the plane up with passengers who are flying for business reasons when, in fact, if they fly the airplane somewhere with one person for business reasons, why is there an issue about who is in the other seats? Now you can do this by regulation.

Mr. Gideon. This issue has been raised with us, Senator, and we have looked carefully into it. It turns out that there was a very explicit letter on this subject from Mr. Pearlman when he was in my position to Senator Dole. That was included as part of the record. In light of that letter, and in view of the fact that the current regulations are consistent with the letter, I am reluctant to conclude that we ought to do this without at least some expression by the Congress; that this is in fact what you want to do.

Specifically the issue here is under the terms of the letter right now, the way the empty seat rule works is that you have to have a majority, or 50 percent or more,of the people in the seating capacity of

the plane going on business so that other people can ride essentially for free.

The proposed change would say that if 50 percent or more of the occupied seats are going on business then if that 50 percent test is met, even though that might be two people in the plane that seated nine, the test would still be met as long as it is primarily -- you have met the primarily for business standard.

The Chairman. Is that the proposal that you have?

Senator Symms. I take that proposal, yes.

The Chairman. It sounds all right to me.

Senator Symms. I so move.

The Chairman. All right. Is there any objection to that?

Mr. Pearlman. Senator, if you are going to do that legislatively I just want to caution you we have no idea what the revenue effects of that will be. And that is subject to looking at the revenues. If you are going to take a Committee action, we are going to have to score it.

Senator Symms. My information is it is a zero cost.

(Laughter)

The Chairman. Well, of course, I have to defer to the cost question.

Mr. Pearlman. Well if a law is being changed now--and I don't know whether it is--but if it is, and if you act, then obviously we are going to have to score it.

Senator Symms. Well I would just say this, Ron. It cannot cost the Treasury any money. The company could fly the airplane with one person

in it. And if it is a mechanic, and they have got to take him to Challis, Idaho from Boise, for example, they can take the plane with one guy in it. It is totally business deduction. If they want to put somebody else in the plane on a one for one basis, there will be no cost to Treasury because they can send the airplane with one person.

Mr. Pearlman. Well, all right. Again, I am not saying it cost money. All I am saying is if you take action, we are not in a position now to tell youwhether there is a revenue effect. You can take the action with the understanding we will report to the Chairman if there is a problem. And we are not trying to cause you a problem, we are just trying to caution you.

Senator Symms. All right.

The Chairman. All right. Let's do it that way. Any problems?

Senator Symms. No.

The Chairman. All right. Then we will accept it.

Senator Symms. I so move the amendment.

The Chairman. All right. Unless there is objection we will accept it that way with that proviso.

Senator Chafee. Are we reaching an end here, Mr. Chairman?

The Chairman. Well let me find out what we are facing here, gentlemen. It is 20 minutes of 2:00 and we would like to wrap this thing up. So the staff has a tremendous job to accomplish to get us ready for the floor. What are we looking at insofar as amendments?

Senator Symms. I have got five.

The Chairman. Oh, come on. Five?

Senator Symms. Five issues I need to bring up, yes, Mr. Chairman. I just discussed three of them, and two amendments possibly.

The Chairman. How many are we looking at over here? Who has the most expensive one?

(Laughter)

Senator Durenberger. Mine is zero.

Senator Heinz. Mine are all cheap.

Senator Danforth. Mine is expensive.

Senator Dole. We just took one of yours, yes.

Senator Danforth. This is the Grassley one about student loans, but he pays for it.

Senator Heinz. Let them do it last.

The Chairman. Senator Packwood.

Senator Symms. Mr. Chairman, if I could make a suggestion. I think that there is a package of these amendments that we could put together. I don't know what the Chair's pleasure is, but the Senator from Oklahoma and I were working on a package earlier this evening. There is potential to put several of these in one package and pay for them and pass it. And I would be willing to cooperate with the Chairman and do that.

The Chairman. No, I don't think we want to.

Senator Packwood. Ron, I just wanted your attention on this amendment. This is again back to the tax free contribution gain in certain in kind partnership distributions. Under Roman numeral VIII(a) I want to change the effective date from 12/31/89 to tonight. And the

revenue loss, according to your estimator, is $2 million, $1 million, $1 million and then zero, zero.

Mr. Pearlman. You said 12/31/89.

Senator Packwood. It is July 10, 1989, and I am changing it to tonight. And the revenue loss is $4 million over three years.

The Chairman. What are we changing?

Mr. Pearlman. Yes, that is correct. October 3rd, 1989. That is what you said.

Senator Packwood. Yes.

Mr. Pearlman. I just wanted to know.

Senator Packwood. You said you didn't want to create a perceptive date because you had --

Mr. Pearlman. I just wanted to make sure I knew what it --

Senator Packwood. It was all right until tonight.

Mr. Pearlman. And you are correct. It is $2 million in 1990 and $1 million in each of the other two years.

The Chairman. Effectiveness of what amendment?

Mr. Pearlman. This is the partnership in kind distribution provision. And if I understand Senator Packwood's amendment, he would move the effective date to tomorrow.

Senator Packwood. Well, you can do it tonight.

Mr. Pearlman. Actually that is the better way to do it.

The Chairman. All right.

Mr. Pearlman. The better way to do it is today.

The Chairman. Is there objection to that?

(No response)

The Chairman. If not, it is approved.

Senator Packwood. Thank you, Mr. Chairman.

Mr. Pearlman. Is it tomorrow or tonight? That could be very important.

Senator Packwood. Today is tomorrow. It is the 3rd of October.

Mr. Pearlman. It is the 3rd. All right.

Senator Durenberger. Mr. Chairman.

The Chairman. All right. Senator Durenberger.

Senator Durenberger. Mr. Chairman, yesterday Bob Packwood raised an amendment for me concerning an extension of the foreign tax credit to carry forward a period from five to 15 years. And what the amendment would do is conform the foreign tax credit to carry forward rule with the carry forward rule that is allowed for all other business credits at net operating losses. And I understand over this 5-year budget period it is revenue neutral.

The Chairman. May we have staff comment on it?

Mr. Pearlman. Mr. Chairman, we have no policy problem with the amendment. Senator Durenberger is right, there is no revenue during the period. But the Committee should understand that there is revenue outside the budget window and it is not insignificant. Our estimators are saying 50 to 100 million dollars per year and growing each year for some period, whatever that means. But from a policy standpoint, we do not object to the amendment.

The Chairman. What does it do? It allows foreign tax credits to be

carried back for two years? Is that it?

Mr. Pearlman. Carry forward.

The Chairman. Four and five?

Mr. Pearlman. Currently it is a 5-year carry forward period and it extends it to 15 years.

The Chairman. It would allow it 15 years carry forward.

Senator Bradley. Which means you could get to year eight and suddenly you would lose a lot of money. You could get to year eight, year nine, and suddenly somebody would come in what this amendment contemplates and you would lose a lot of money.

Mr. Gideon. We have concerns on that point.

The Chairman. Do you support it, oppose it?

Mr. Gideon. I would associate myself with Mr. Pearlman's statement. I mean it is hard to oppose this kind of time limit on a policy basis. It is really for your decision. On the other hand, there will be revenue cost in the out years.

The Chairman. Any further comments on it?

(No response)

The Chairman. Do you move the amendment?

Senator Durenberger. Yes, I do, Mr. Chairman.

The Chairman. All right. All in favor of the amendment as stated make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Oppoosed?

(Chorus of "nays")

The Chairman. A show of hands.

(A show of hands.)

The Chairman. The nos have it. The amendment fails. All right.

Senator Dole. Mr. Chairman, the other amendments I offered I think were neutral, but this is an amendment that I am offering on behalf of myself, Senator Exon, Senator Carey and Senator Kasenbaum. It has been raised in a letter addressed to -- a letter signed by the four of us, and I think Senator Exon received a reply. Let me explain what happened.

This involves the 1986 Act, provided an suspense account for taxpayers forced from cash to accrual accounting under the family farm rules. This relief was intended to be more generous than the traditional 10-year spread of the cash accrual adjustment typically allowed the taxpayers forced to change their accounting method. I think this was adopted to help chicken producers in Arkansas and other States.

But because of the timing of the business cycle, the cattle producers could not use the 1986 suspense account. And what this amendment would do is permit the taxpayers forced to switch to accrual accounting under the 1986 rules to elect a 10-year spread in lieu of the suspense if they so choose. It affects a number of cattle producers. It happens to affect cattle producers in the States of Kansas and Nebraska. I am certain other may be included. It does have a 1990 cost, according to I think Ron Pearlman's shop, of 32 -- is someone familiar with this?

Mr. Pearlman. $18 million in the first year and $80 million over

the period.

Senator Dole. Right.

Mr. Pearlman. We are within $1 million, so we can cover this amendment in 1990.

Senator Dole. Well I want to present it. I am not certain the others want to cover it, but it is an amendment that I am offering for myself and additional Senators. And it seems to me -- I don't remember taking this provision up in 1986, but I think we did it. It was supposed to be a generous rule, and it turned out fine for those who produced chickens but not those who were in the cattle business as I understand it.

Mr. Pearlman. Senator, let me ask you a question. Would you have any objection if your amendment, if we understood your amendment to mean that there would be some time limit when the election would have to be made, like within a year?

Senator Dole. Oh, yes.

Mr. Pearlman. Just so it does not go indefinitely?

Senator Dole. No problem.

Mr. Pearlman. All right.

The Chairman. Are there further comments on it?

Senator Bradley. It just gives to cattlemen what we gave to chicken farmers in 1986?

Mr. Richter. What it does, it was in 1987 that the change was made to the cash accounting rules which forced some companies to go on accrual accounting. At that time the deferred taxes were covered by a

suspense account. And this would say that those taxpayers who were forced to changes of that change in 1987 could instead of using this suspense account have a 10-year spread of the deferral at their election.

Senator Dole. It may be limited, as Ron says, to the year.

Mr. Richter. It does not put them back on cash accounting. It simply deals with the change.

Senator Bradley. You said limit the benefits for 10 years?

Mr. Richter. That's right. It would allow them to spread it over 10 years rather than the suspense account.

The Chairman. Are there further questions?

(No response)

The Chairman. Do you move the amendment?

Senator Dole. So moved.

The Chairman. The amendment is moved. All in favor say "aye."

(Chorus of "ayes")

The Chairman. Opposed?

Senator Bradley. No.

The Chairman. The amendment is carried. All right, Senator Moynihan.

Senator Moynihan. Mr. Chairman --

Mr. Pearlman. Mr. Chairman, we have $1 million left in 1990, so we are close. One million.

Senator Moynihan. Mr. Chairman, in the 1986 legislation there was a generic rule set up by Section 833 which established the tax status of

Blue Cross and Blue Shield organizations by name. There is a large and old established organization in New York, The Group Health Insurance, which does exactly the same thing, but they are not clear that they can receive this tax treatment because it is provided by name in the statute. They feel in litigation they could probably win, but they would like to get it settled in statute. And at this hour, it only would cost $1 million. What I really would like to ask is if we could have a study of the situation to see if as a matter of generic tax policy this shouldn't be corrected.

The Chairman. Is there any objection to the study?

(No response)

The Chairman. If not it will be done.

Senator Moynihan. Mr. Pearlman, you understand the case, do you?

Mr. Pearlman. I do understand it, Senator.

The Chairman. All right. Are there further amendments.

Senator Moynihan. Thank you, Mr. Chairman.

The Chairman. Senator Danforth.

Senator Danforth. Mr. Chairman, this is again Senator Grassley's amendment,and it has to do with the deductibility of student loans. In 1986--studnet loans are no longer deductible--we phased out the deduction for personal interest, so that this year it is 20 percent and in 1990 it is 10 percent, and then in 1991 it is zero.

Senator Grassley's proposal is that we restore the interest deduction for student loans and for educational expenses for a 2-year period of time, and that we pay for that 2-year student loan

deduction by reducing the personal interest deduction from 10 percent to such amount as is necessary to fund the student loan proposal. We think it would be in the neighborhood of 8 percent.

Now again, the personal deduction is going out anyhow. It is being phased out. It is going from 20 to 10 percent. Senator Grassley's amendment would have it go from 20 to something, a little less than 10, in order to fund a 2-year restoration of the student loan deduction.

The Chairman. May I have comments from staff?

Mr. Pearlman. Mr. Chairman, let us alert you that in the form it is offered I think it could be changed, but in the form it is offered it will put us in a negative position for 1992 because of the fiscal year split. There is a loss of $142 million on the deductibility side and there is no pick up from the phase out of the consumer interest deduction in 1992. So we will be in a negative for 1992 if we do it on a 2-year basis.

The Chairman. As I stated at the beginning, I will oppose any amendment that puts us in a negative position that makes it subject to a point of order.

Senator Danforth. No, we won't do that. Just you design it.

Mr. Pearlman. Well we could do it for a year. I mean we could do it for a shorter period of time.

Senator Danforth. Then I think Senator Grassley would take the year.

Mr. Pearlman. Well I mean I think at this point we have got $30

million left in 1992.

Senator Danforth. But see, Ron, what I am saying is --

Mr. Pearlman. And it looks to me like the only thing we can do is do it for a year.

Senator Danforth. But he would say we want to pick up more revenue. And the way we pick up additional revenue is by reducing the personal interest deduction from 10 percent, which is going to be at next year, down to 9, 8, or whatever, so that you pick up -- in other words, he has a true offset. His offset is to say that we are going to have a little less personal deduction to provide for restoration of the student loan --

The Chairman. What does the Administration have to say onthat?

Senator Danforth. -- for such period as we can.

Mr. Gideon. We have concerns about both pieces of the amendment, but particularly the offset. In other words, this is the 4-year phase out rule by which these amounts were phased out in tax reform. While the amounts on any given return will be small, it will affect a large number of people. And we really don't think you ought to open transitions of that sort again. We expressed that reservation in the House, we express it here.

The Chairman. Does that mean you oppose the amendment?

Mr. Gideon. Yes.

The Chairman. Are there other comments on it?

Senator Chafee. Mr. Chairman, it does seem that not only are you favoring the student loans by giving, I assume, a 100 percent

deduction for them, but you are putting the other people who borrowed, whether for a car or whether for a new appliance, in an even worst position than they originally anticipated to be in. So it seems to me it is a double whammy against the other folks.

And also one of the provisions that we tried to do in 1986 was to bring down the rate so that these deductions would not mean so much.

The Chairman. Well I share you viewpoint with it.

Are there further comments on this one?

Mr. Pearlman. Mr. Chairman, just before you vote so we understand what the proposal is. Let me just direct it to Senator Danforth again. We think that if you used the phase out of the consumer interest deduction, which goes from 10 percent to zero, okay, there is nothing left at the end of 1991. I mean that picks up revenue in 1991, but it picks up no revenue in 1992, and it can't; it's gone. That if you do a 2-year deductibility you will lose money in 1992 and put us in a negative.

Now I think I missed something in your discussion.

Senator Danforth. What I am saying is that you could make some money available by reducing the personal interest deduction from 10 percent to something less than 10.

Mr. Pearlman. My suggestion to you, Senator, simply to get you out of this box would be to propose it for one year rather than two, because, otherwise, you are going to run into this revenue problem.

Senator Danforth. All right. I propose to do it for one year.

The Chairman. Do we have further comments on it?

(No response)

The Chairman. Do you move the amendment?

Senator Danforth. Yes.

The Chairman. All in favor of the amendment make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(Chorus of "nays")

The Chairman. The amendment fails. All right.

Senator Heinz. Mr. Chairman, I have two items that I think have been cleared. One is the amendment to provide better coordination between the foreign tax rules governing controlled foreign corporations and passive foreign investment companies and the rules forbidding a U.S. owned foreign life insurance company to take a reserve deduction for investment income held on its reserves.

My understanding is that this amendment has been gone over by staff and they do not have problems with it.

Mr. Pearlman. That is true, assuming that everyone is on board. Let me just read a sentence, and if everyone is in agreement with that we are in agreement. And that is we are going to do some stuff in the legislative history, and what we are basically saying is that the Treasury Department may promulgate some regulations to deal with the particular thing you are concerned with, but that the Committee is not telling the Treasury Department they have to decide the issue one way or another. Or if the Treasury decides to not issue the regulations, that

that would not be inconsistent with the Committee's intent. If that is your understanding, then yes, I think there is agreement.

Senator Heinz. That is our understanding.

Mr. Pearlman. Yes, sir. Then we do have agreement, yes.

Senator Heinz. All right.

The Chairman. All right.

Senator Heinz. The second one, Mr. Chairman, has to do with an issue that has arisen concerning the deductibility of reserves maintained by insurance companies to cover their liability for claims under certain accident and health policies employing so-called minimum premium plans. And what this amendment--it also technically does--is to simply make clear that insurance companies are entitled to deduct from income the portions of premiums that they receive that are set aside. Has it been done?

Mr. Pearlman. I think this one has already been done.

Senator Heinz. Well as I said, I have a second amendment, Mr. Chairman. The last one. I'll shut up if you just give me the look.

The Chairman. Let someone else have one, Senator. You have gone through a couple of them now.

Senator Symms. Mr. Chairman.

The Chairman. Yes.

Senator Symms. The next amendment I want to bring up is one that I thought was going to be taken care of earlier and paid for with this so-called private line telephone tax. But I guess that deal is off.

But there are 26 sponsors for this amendment. And it speaks to the issue of investor-owned utilities and the CIC, contribution in aid of construction. And what I would ask Treasury and Joint Tax, I think we ought to establish that if we cannot pay for this--I believe this amendments costs a total of $14 million the first year. And did you say we have $1 million left?

Mr. Pearlman. Yes. We could not pay for it. That's right.

Senator Symms. What is that?

Mr. Pearlman. We could not pay for it with what we have left. Right.

Senator Symms. Well what I would like to do is to pass the concept on a sliding scale --

(Laughter)

Senator Symms. -- where you start each year raise up the amount that it allows for, because what we have got here -- I hear my colleague laughting -- but what we have here is we are having an enormous cost passed on to the development of these subdivisions and other housing properties. And I think it was a poor thing we did in the tax law, in the 1986 tax law, and we ought to correct it. And we fixed part of it with what Senator Bradley brought up, but a very narrow part of it, yesterday. But it is in the Chairman's mark. And I just would like to have Joint Tax figure this out. There has got to be a way to establish this. Maybe it took zero percent the first year. You go to 25 percent the second year, 50 percent the third year and so forth so we could phase it in and restablish the principal.

Mr. Pearlman. Clearly, we could design it in a way that it tracks what available revenue there is.

The Chairman. Does the Senator move his amendment?

Senator Symms. Well, Mr. Chairman --

The Chairman. I will have to oppose the amendment, Senator, but you go ahead and move it if you like.

Senator Symms. I guess that maybe what I might do is just say that I can count that this amendment is going to be -- I move the amendment. If it is defeated I intend to bring this up on the floor with a method to pay for it. And I have got several other amendments.

The Chairman. Do you move the amendment?

Senator Symms. I move the amendment.

The Chairman. The amendment is moved. All in favor say "aye."

Senator Symms. Aye.

The Chairman. Opposed?

(Chorus of "nays")

The Chairman. The amendment fails.

Senator Boren. Mr. Chairman.

The Chairman. All right. Senator Boren.

Senator Boren. Mr. Chairman, this amendment I offer on behalf of myself and Senator Dole. This amendment deals with marginal oil production which I think as we all understand is low production, few numbers of barrels and high cost production.

And this is a proposal that the Treasury has proposed I think on several occasions and packages that have come from the Administration.

Though a very odd situation, this Committee has always understood the difficulty with the marginal wells, trying to keep them in production especially during the low cost periods we have had. And we have inadvertently done something which has taken away the benefit of a lot of our incentives. We allow percentage depletion and other kinds of deductions for marginal wells, but we do not allow for other kinds of production. It keeps them from being prematurely plugged.

But there is another provision of the law which says that you cannot take these deductions beyond 50 percent of the income from a particular lease. It doesn't even talk about the income of a taxpayer. And the problem is if you have a strip release, a marginal oil lease, you have to be losing money on that lease. That is the very reason why you need to have the deduction, to keep from plugging the well.

So you lose your deduction for the marginal well on the very lease that is losing money because you cannot get a deduction unless you are receiving net income from that particular lease.

Now what this proposal would do is simply repeal that limitation by lease. There is still a limitation by the taxpayer. I still cannot take deductions against more than 65 percent of my income as a taxpayer. But it just does not make sense the way the law is now. And it is bad conservation practice and it causes a waste of a lot of resources.

I would yield to Senator Dole. We would have to start this in 1991, given the constraints we have.

Senator Dole. 1991.

Senator Boren. And I think the estimate was $60 million the first year and $19 million the second and $21 million the third. We would just have to slide that estimate down and start it in 1991 in order to meet your available revenues I think.

Senator Dole. I would just add I know sometime you mention oil in this room everybody runs. But we are talking about marginal production. We are talking about 15 barrel less in oil and 90,000 cubic feet for gas. So that is marginal production. We had 1800 wells abandoned last year and most of those were in this category. We had the lowest production in the lower 48 last year than we had in the past 30 years. We have reached that peril point. The Chairman, who supported the amendment on the peril point, we lost by a few votes.

And it seems to me that by making it effective in 1991 we avoid any revenue problem. This is just one, I might add, of about five provisions that is in a bill sponsored by 25 or 30 Senators. I don't believe the Treasury has any problem with this. In fact, I think they would welcome some incentives because we are becoming more and more dependent on foreign oil. And I would hope we could adopt this amendment even thought we cannot make it effective until 1991.

The Chairman. Well I would say I understand the problem because these are marginal, and they are marginal in production and marginal in profit. And once you plug them that is the end of them. You don't go back and reopen them because you cannot afford that cost.

We are approaching the 50 percent on imports, so what we can hang onto I think we should and I would support it. But you do have it

tkaen care of now insofar as revenue?

Senator Dole. By making it effective in 1991.

The Chairman. 1991.

Mr. Pearlman. I just want to make sure that we are because I have got two numbers in front of me. I just want to make sure we know exactly what your proposal is. You are proposing the increase in the 50 percent net income limit for percentage completion to 100 percent?

Senator Dole. That's right. Repeal of the 50 percent.

Mr. Pearlman. Well, all right. On marginal wells. But your definition of "marginal wells" is different than current law. Is that correct?

Senator Dole. That's right. Fifteen barrels per day for oil and 90,000 cubic feet for gas.

Mr. Pearlman. All right. We understand that. And by moving the date, you could do --

Senator Boren. You start at 60 in the first year of 1991.

Mr. Pearlman. That's correct.

You will not go below in 1992. That's correct.

The Chairman. All right. Are there other questions about it?

(No response)

The Chairman. Any objections?

(No response)

The Chairman. Do you move the amendment?

Senator Baucus. I so move.

The Chairman. All in favor make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(Chorus of "nays")

The Chairman. The motion carried. All right.

Senator Dole. I just have one for clarification. I know there has been a cost given to this particular problem, but let me explain what it is. It refers to Section 351 where you have a binding contract. In this particular case, the binding conract I think was signed on July 10th or sometime before July 11th. And it happened that the directors who were also on the board had to go through the pro forma ratification, but they were also engaged in the contract negotiations. The problem wasthey didn't have a board meeting until August 3rd. And nothing was changed at the board meeting, the contract was approved.

And I cannot understand why there is a revenue loss attributed--a total over four years or five years--of $80 million. And obviously if that is the case, the amendment cannot be accepted. But it seems to me there should not be any revenue loss at all. And I would take issue with the Tax Committee.

Mr. Pearlman. Well, Senator, clearly, we are familiar with this transaction. And, frankly, the transaction is not troublesome. I mean, it is, again, just like all these transition rules. Those are not tax policy issues.

It wasn't the transaction that caused an $80 million revenue loss, but rather the language that was suggested, that was necessary in order to cover all board resolutions, our estimators believe would bring a

sizeable number of transactions within the transition relief and just, therefore, has a large revenue effect.

It wasn't just this transaction.

The Chairman. Well with that in mind, the Chair would have to oppose the amendment.

Senator Dole. Right. I understand that. So I just wondered if there were -- how many transactions are there out there?

Mr. Pearlman. I cannot answer that question. And that is always a judgment call by the estimator when you change the law. But we know there is clearly more than one transaction in which conditions are put on a contract like a board. It is not unusual for contracts to have conditions like board approvals, and that is what caused them to determine there were other transactions that would be affected.

Senator Dole. But in this particular case, the board members were also those who were involved in negotiations and signed the binding contract before the July 11 date.

Mr. Pearlman. Yes.

Senator Dole. I don't know how many situations you have like that. I can see we might have a couple of lawyers working on a contract. Somebody signs it and then a month later you have a board meeting. But that is not the case in this particular instance.

Mr. Pearlman. Yes. As I said --

Senator Dole. I would just ask the Chairman that he might take another look at it, and maybe Treasury take a look at it, and see i- those revenue figures hold up. Obviously, it is not going to be

accepted.

Mr. Pearlman. Well we will certainly look at the revenue figures.

The Chairman. I would rather do that, certainly, Senator Dole. All right. Is that it?

Senator Pryor. I recognize that Ron Pearlman has been sitting here now for almost seven hours, he and his staff, and I think they and the Treasury people and all the other tax persons should be voted a little vote of thanks.

The Chairman. That is a point well made.

(Applause)

(continued on following page)

Senator Dole. There are a lot of public citizens out there too.

(Laughter)

The Chairman. I hope so.

Senator Heinz. Mr. Chairman, if there is $175,000 left I have got a use for it.

(Laughter)

Senator Heinz. Mr. Chairman, I would like to propose an amendment that excludes what is known as inactivated polio vaccine from the definition of polio vaccine for the purposes of the excise tax on vaccines that funds the National Vaccine Injuries Compensations Program. The reason for this is that inactivated vaccine does not cause any of the adverse reactions now for injury that other kinds of vaccines do. In fact, ITD as it is known, is commonly used for immuno compromised indivduals and their family, namely, those who are at risk from adverse reaction. We have got a $100 million surplus in this fund. There are only something like five cases yet to be adjudicated, and yet we are still taxing this--I guess we will tax forever--this kind of polio vaccine which should never have been taxed in the first place. My amendment is not retroactive. It is just prospective. And I would hope that we could stop taxing some people who should not be taxed or should not have been taxed in the first place.

The Chairman. May I get a comment from staff?

Mr. Pearlman. Senator, I am sort of embarrassed to say we are not sure what -- we know what was done in the House bill. In the House bill they eliminated the excise tax but they conditioned it on the action

on another committee. Now I don't know whether that is necessary here or not, but is that part of your amendment?

Senator Heinz. I hadn't planned on making that a part of the amendment, but if that is what it takes --

Mr. Pearlman. Well I don't know whether it does or not.

Senator Heinz. If that is what it takes to pass it then I am willing.

Mr. Pearlman. The other thing that I should note is that it was made clear in the House bill that compensation from the fund also was not available for this vaccine. The theory was if they were not going to pay the tax on the vaccine then the funds expenditures would not be used to pay claimants that claimed something with respect to that vaccine.

I think maybe, Senator, if you would condition yours on whatever action is necessary by another committee that will eliminate a potential jurisdictional problem.

Senator Heinz. That's fine.

The Chairman. Now let me understand. We don't have a revenue problem on this one.

Mr. Pearlman. There is not a revenue problem. That's correct.

The Chairman. All right. Fine.

Is there any objection to the amendment?

(No response)

The Chairman. If not, we will accept it.

Senator Dole. Mr. Chairman, I just want to submit report language

that you can look at, Ron, on that last memo I talked about.

Mr. Pearlman. All right.

The Chairman. All right.

Senator Moynihan. Mr. Chairman, would you like to take an offer?

The Chairman. Well I would like to give the staff authority to make such adjustments that have to be made--we went through that on the spending side--in order to be sure that we do not go below the line and have a deficit here.

Mr. Oglesby. Senator, we also have a request from the Veterans Committee that Norm can tell about.

The Chairman. Well let me first get this one. Is there any objection to that?

(No respponse)

The Chairman. If not, staff has that authority. All right.

Mr. Richter. The Veterans Administration and the Veterans Committee has asked us to enact a bill that they have moved through their committee but needs a tax vehicle. It essentially would permit the sharing of tax data with the VA to allow them to police some of their programs that depend upon beneficiaries having income below certain levels. It would allow access only to third party information, like W-2s, except in the case of self-employment returns.

The Chairman. All right. Do we see any problem with the amendment? There is no cost to our granting it.

(No respponse)

The Chairman. There is no objection to it?

Senator Bradley. The IRS would share information with the Veterans Administration?

Mr. Richter. That's right.

Mr. Oglesby. Yes, Senator.

Senator Bradley. Does the IRS share information with many other agencies?

Mr. Richter. In the Tax Code a number of agencies are specified for tax data sharing. This would add the VA to the list. Social Security Administration. I think some of the AFDC programs.

Mr. Pearlman. A lot of the agencies which administer entitlement programs where there is a sharing of information in a protected way that can be used to determine eligibility on income thresholds, other entitlements. And the Veteran's proposal has, the Code has an elaborate system to protect that information. And the Veteran's proposal has been made subject to those.

The Chairman. I assume the Administration has no objection in reporting this.

Mr. Gideon. No objection.

The Chairman. Yes.

Mr. Richter. This would realize too an outlay savings of $639 million over five years to the Veterans Administration.

The Chairman. Wonderful.

Senator Bradley. Mr. Chairman, I would just like to state for the record that I did give you my word and I will vote to report the bill out of the committee. The bill, as it has progressed, has become

increasingly more troubling. And I hope that we will be able to deal with some aspects of the bill on the floor so that the bill out of the Senate is worthy of support.

The Chairman. Thank you for your comments.

Senator Bradley. There are many, many aspects of the bill now that are of real concern.,

The Chairman. All right.

Senator Bradley. We have raised $37 billion to meet a $5.4 billion reconciliation number.

Senator Moynihan. Mr. Chairman, if there is no further comment I would move that we report the Chairman's bill as amended.

The Chairman. Is there a second?

Senator Pryor. Second.

The Chairman. All in favor of the motion as stated make it known by saying "aye."

(Chorus of "ayes")

The Chairman. Opposed?

(No response)

The Chairman. The motion carried. Thank you, gentlemen.

(Whereupon, at 2:18 a.m., Wednesday, October 4, 1989, the meeting was concluded.)

C E R T I F I C A T E

This is to certify that the proceedings of an Executive Committee Meeting of the United States Senate Finance Committee, held on October 3-4, 1989, were transcribed as herein a-pears and that this is the original transcript thereof.

WILLIAM J. MOFFITT
Official Court Reporter

My Commission expires April 14, 1994.

Printers

UNITED STATES SENATE
COMMITTEE ON FINANCE

Executive Session

Tuesday, October 3, 1989 - *3:00 PM*
SD-215 Dirksen Senate Office Building

A G E N D A

To consider legislation providing for budget reconciliation.

DESCRIPTION OF TECHNICAL CORRECTIONS

PROPOSED TO THE

TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988,

THE REVENUE ACT OF 1987, AND

CERTAIN OTHER TAX LEGISLATION

For Consideration

By the

SENATE COMMITTEE ON FINANCE

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 2, 1989

JCX-56-89

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary description of proposed technical corrections to recent tax legislation. No description is provided for clerical or conforming changes.

Part I of the document describes proposed technical corrections to the Technical and Miscellaneous Revenue Act of 1988 (1988 Act). Part II describes proposed technical corrections to the Revenue Act of 1987 (1987 Act). Part III describes proposed pension technical corrections relating to the Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1986, and the Omnibus Budget Reconciliation Act of 1987 (including the Pension Protection Act). Part IV is a description of an additional technical provision relating to Code section 274.

Effective dates.--Unless otherwise specified in the description, the proposed technical correction provisions are effective as if included in the Act to which the correction is being made.

Revenue effect.--The technical corrections provisions described in this document involve no revenue impact.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Technical Corrections Proposed to the Technical and Miscellaneous Revenue Act of 1988, The Revenue Act of 1987, and Certain Other Tax Legislation (JCX-56-89), October 2, 1989.

I. AMENDMENTS TO THE TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

A. Corporate Provisions

1. Method of computing net unrealized built-in gain or loss

For purposes of sections 382, 384, and 1374 the method of computing the amount of net unrealized built-in gain or loss is clarified. Items of income or loss that would be treated as built-in gain or loss if recognized within the recognition period are included in the computation of net unrealized built-in gain or loss, without regard to when or whether such items are actually recognized within the recognition period.

2. Modification of conforming amendment relating to S corporations engaged in banking operations

Prior to the Tax Reform Act of 1986, a corporation could not be an S corporation if the corporation's deductions for bad debts could be taken under the reserve method as a bank (under Code sec. 585) or as a thrift institution (under sec. 593) (Code sec. 1371(b)(2)(B)). The Tax Reform Act of 1986 disallowed the use of the reserve method for bad debts for large banks (Sec. 901(a)(1) of the Tax Reform Act of 1986). As a conforming amendment, the 1986 Act provided that a corporation could not be an S corporation if the corporation was a bank or thrift institution, regardless of whether or not that corporation claimed any deduction for bad debts under the reserve method (Sec. 901(d)(4)(G) of the Tax Reform Act of 1986).

The provision modifies the conforming amendment in the 1986 Act such that corporations would not be eligible to be an S corporation if the corporation could have claimed a deduction for bad debts under the reserve method as a bank if it were a small bank.

3. Reduction in S corporation income taxed to shareholders by the amount of built-in gains tax paid

The provision clarifies that the amount of any built-in gains tax paid by an S corporation reduces the amount of S corporation income that is taxed to the S corporation shareholders.

4. Reduction in built-in gains tax by minimum tax credit carryovers

The provision provides that any minimum tax credit carryover of an S corporation arising from a year the corporation was a C corporation may reduce the built-in gains tax of the S corporation.

5. Determination of tax basis of property transferred to Alaska Native Corporations

The 1988 Act states that no provision in any law (whether enacted before, on, or after the date of enactment of the 1988 Act) shall affect the date on which a transfer to an Alaska Native Corporation is made for purposes of determining basis for Federal tax purposes. The amendment removes any retroactive effect of this provision in the 1988 Act with respect to determining the tax basis of property transferred to an Alaska Native Corporation. No inference is intended regarding the interpretation of such prior law.

B. Minimum Tax Provisions

1. Tax benefit rule

The Tax Reform Act of 1986 provided that the Treasury Department may prescribe regulations providing proper adjustments where the taxpayer will not receive a tax benefit from an item for any taxable year. The provision clarifies that this rule applies whether the tax benefit will result in the current year or in another year.

The provision also provides that the prior law add-on minimum tax rule requiring the Treasury Department to issue tax benefit regulations (sec. 58(h)) was not repealed by the Tax Reform Act of 1986 in so far as it relates to carryovers to taxable years beginning after December 31, 1986.

2. Minimum tax credit

The provision clarifies that the minimum tax credit includes any minimum tax imposed in prior years by reason of the 90-percent limitation on the use of the alternative minimum tax foreign tax credit. This position is consistent with the position taken by the Internal Revenue Service in its forms and accompanying instructions. (Under present law, the minimum tax credit includes any minimum tax previously paid because of the 90-percent limitation on the use of net operating loss deductions.)

3. Treatment of disqualifying dispositions of certain stock

The provision clarifies that the minimum tax rules applicable to a disqualifying disposition of stock acquired pursuant to the exercise of an incentive stock option where the amount realized is less than the value at the time of exercise follows the regular tax rules of section 422A(c)(2) where the stock is disposed of in the same taxable year the income is taken into account for minimum tax purposes. Thus, the amount included in alternative minimum taxable income will not exceed the amount realized on the sale or exchange of the stock over the adjusted basis of the stock.

4. Treatment of acquisition expenses of life insurance companies

In determining adjusted current earnings under the alternative minimum tax, acquisition expenses of life insurance companies are required to be capitalized and amortized in accordance with the treatment required under generally accepted accounting principles, as if such treatment was required for all prior taxable years. The committee report to the bill would clarify that to the extent that life insurance reserves are relevant in determining the

amortization schedule under generally acceptable accounting principles, tax reserves instead of reserves determined under generally acceptable accounting principles are to be used.

C. Accounting Provisions

1. Long-term contracts

a. Percentage of completion method.--In general, a portion (generally, 90 percent) of the items with respect to certain long-term contracts must be taken into account under the percentage of completion method. Under the percentage of completion method, as presently drafted, it is unclear whether all of the income under the contract must be taken into account over the contract term if not all of the total estimated contract costs are actually incurred as of the end of the taxable year in which the contract is completed. The provision clarifies that, except for purposes of applying the look-back method, all of the income under the contract must be taken into account no later than one year after the taxable year in which the contract is completed.

b. Treatment of costs attributable to the installation of integral components to real property.--Present law provides an exception to the long-term contract rules for home construction contracts and more generous treatment for residential construction contracts. The provision clarifies that the cost of installing any integral component to real property (e.g., a heating or air conditioning system) is to be considered a qualifying cost for purposes of the definition of home construction contract and residential construction contract.

c. Exception for certain construction contracts.--Present law provides an exception to the long-term contract rules for certain construction contracts of taxpayers whose average annual gross receipts for the prior three taxable years do not exceed $10 million. The provision clarifies that the gross receipts of any predecessor of the taxpayer (and certain related persons) are to be taken into account in determining whether this exception applies.

d. Treatment of interest under the look-back method.--Upon the completion of a long-term contract, a taxpayer must pay interest under the look-back method to the extent that taxes in a prior contract year were underpaid due to the use of estimated contract price and costs rather than the actual contract price and costs. The provision clarifies that such interest is to be treated as an increase in tax for purposes of subtitle F of the Code (other than the estimated tax provisions).

e. Application of the lookback method to amounts taken into account after completion of the contract.--Present law provides that the lookback method applies if amounts are received or accrued after completion of a long-term contract. In addition, under the lookback method, amounts that are

received or accrued after the completion of a contract are to be taken into account by discounting such amounts to their present value as of the completion of the contract. A taxpayer may elect with respect to any contract not to discount amounts received or accrued after the completion of the contract. The provision clarifies that the lookback method applies if costs are taken into account after the completion of a contract and that costs under a contract are to be discounted in the same manner as items of income.

f. Treatment of certain home construction contracts for purposes of the adjusted current earnings provision of the alternative minimum tax.--In determining alternative minimum taxable income, the amount of income derived from certain home construction contracts by certain small taxpayers is not required to be determined under the percentage of completion method of accounting. The provision clarifies that, in determining adjusted current earnings under the alternative minimum tax, the amount of income derived from such contracts by such taxpayers is not required to be determined under the percentage of completion method of accounting.

g. Application of regulatory authority to certain ship contracts.--The provision clarifies that the regulatory authority granted to the Secretary of the Treasury to prevent the avoidance of section 460 applies to qualified ship contracts.

2. Uniform cost capitalization rules

a. Application of section 189.--Section 189, before its repeal by the 1986 Act, required the capitalization of certain construction period interest and taxes. Such capitalized costs were generally amortized over a 10-year period. Costs were not subject to the rules of section 189 if they were capitalized under section 266. Section 263A, as enacted by the 1986 Act, also requires the capitalization of certain interest and taxes. Under section 263A(f), interest may be capitalized pursuant to a formula that takes into account all prior capitalized costs (the avoided cost method). The provision clarifies that the costs that would have been taken into account for purposes of sections 189 and 266 before the effective date of the 1986 Act will be taken into account for purposes of section 263A(f) after the effective date of the 1986 Act.

In addition, the provision clarifies that certain property that was provided transition relief under the 1986 Act is subject to the capitalization rules of section 189 (as effective before its repeal) with respect to interest and is subject to the capitalization rules of section 263A with respect to other costs, including taxes.

b. Exception for free-lance authors, photographers, and

artists.--The 1988 Act exempted certain free-lance authors, photographers, and artists from the uniform capitalization rules of section 263A. The provision clarifies that the exemption also applies to certain expenses incurred by certain corporations owned by such persons.

c. Exception for certain producers of animals.--Prior to the 1988 Act, producers of certain plants and animals were subject to the uniform capitalization rules unless an election was made to forego the use of accelerated depreciation. The 1988 Act exempted certain producers of animals from the uniform capitalization rules and allowed the revocation of prior elections to forego the use of accelerated depreciation. The provision clarifies that only producers of animals may revoke prior elections.

3. Installment sales

Treatment of sales of personal use property by individuals.--Present law provides that certain installment sales by nondealers are subject to special interest-charge and pledging rules. The provision clarifies that the sale of personal use property by an individual is not subject to these special interest-charge and pledging rules.

D. Foreign Tax Provisions

1. Source rules: Special rules for transportation income

a. The provision exempts from U.S. income tax gross income from the international operation of ships or aircraft derived by an individual resident of a possession, or a corporation organized in a possession, if such possession grants an equivalent exemption to U.S. individuals or corporations. In the case of any possession on the mirror code, the provision clarifies that such reciprocal exemptions exist.

b. The provision clarifies that a foreign corporation may be exempt from U.S. tax on its income from the international operation of ships or aircraft, even if the equivalent tax exemption of the country where the foreign corporation was organized does not extend to dual resident companies that are both incorporated in the United States and also treated as residents of that country under its tax laws.

c. Under the provision, failure to have substantially all of a taxpayer's U.S. source gross transportation income attributable to regularly scheduled transportation (or, in the case of income from the leasing of a vessel or aircraft, attributable to a fixed place of business in the United States) would not automatically prevent transportation income other than U.S. source gross transportation income from being treated as effectively connected with the conduct of a trade or business in the United States if the general rules would treat such other transportation income as so effectively connected.

2. U.S. taxation of income earned through foreign corporations

a. Exceptions for same-country interest, rents, and royalties.--The provision clarifies that the exceptions from treatment as foreign personal holding company income for certain interest received from a related person that is organized in the same country as the recipient, and for certain rents and royalties received from a related person with respect to property within the country of the recipient, apply only to payments received from a related person that is a corporation.

b. Losses of foreign corporations electing to be taxed as domestic insurance companies.--The provision clarifies that any loss of a foreign corporation that makes an election to be treated as a domestic insurance company cannot reduce the taxable income of any other member of its affiliated group.

3. Treatment of foreign taxpayers

a. Partnership withholding.--

i. For purposes of determining the adjusted basis of an interest in a partnership, the provision generally treats withholding tax paid by a partnership on behalf of a foreign partner as a deemed distribution to such partner on the earlier of (1) the date such tax is paid to the Internal Revenue Service, or (2) the last day of the partnership's taxable year for which the tax is paid.

ii. The provision subjects a partnership to an underpayment of estimated tax penalty similar to that applicable to corporations if the partnership fails to properly pay quarterly installments of withholding tax with respect to foreign partners.

b. Excise tax on insurance premiums paid to foreign persons.--The provision conforms the exemption from the excise tax for premiums on life, sickness, and accident insurance policies and annuity contracts with the existing exemption from the tax for premiums on casualty insurance policies and on all reinsurance policies.

4. Foreign currency gain and loss

The provision clarifies that the character of any foreign currency gain or loss is determined under the rules of section 988 notwithstanding other gain and loss characterization rules (e.g., the rule characterizing gain and loss from trading section 1256 contracts) in the Code.

5. Tax-exempt shareholders of DISCs

The provision clarifies that all tax-exempt DISC shareholders that are generally subject to the unrelated business income tax are equally subject to unrelated business income tax on income with respect to DISC stock.

E. Estate and Gift Tax Provisions

1. Rates and unified credit

Phaseout of unified credit for nonresident alien decedents.--The 5-percent phaseout of the unified credit would apply to the estate of an nonresident alien only to the extent that the estate qualified for the credit.

2. Gift tax

a. Marital deduction for gifts made by nonresident alien.--For gift tax purposes, a nonresident alien would receive the same marital deduction allowed a resident alien.

b. Annual exclusion for transfers to alien spouse.--The $100,000 annual exclusion for gifts made to an alien spouse would be allowed only for transfers of nonterminable interests. The provision would be effective for gifts made after date of committee action.

3. Amounts includible in gross estate

Amount included in gross estate when creation of joint tenancy constituted completed gift.--If the creation of a joint tenancy between citizen and noncitizen spouses resulted in a gift prior to July 14, 1988, only a portion of the joint tenancy property would be included in the decedent spouse's estate.

4. Estate tax marital deduction

a. Treatment of survivor annuity as QTIP.--A survivor annuity would be treated as qualifying terminable interest property for purposes of the marital deduction only if includible in the gross estate of the decedent as an annuity.

b. Availability of marital deduction for nonresident alien.--The statute would be clarified to allow property passing from a nonresident alien to an alien spouse to qualify for the marital deduction if passing to a qualified domestic trust (QDT).

c. Availability of marital deduction for property transferred to qualified domestic trust (QDT) before filing of the estate tax return.--Probate property passing to an alien spouse would qualify for the marital deduction if such property is transferred or irrevocably assigned to a QDT before the estate tax return is filed. Estates of decedents dying before the date of enactment would be allowed one year to make such a transfer or assignment.

5. Credit to estates of alien spouses for estate tax paid by estate of decedent spouse

a. Availability of credit to nonresident alien.--The credit for estate tax previously paid by the decedent spouse would be allowed to a surviving spouse who is a nonresident alien.

b. Credit for taxes imposed on qualified domestic trust (QDT) not reduced by amount qualifying for marital deduction.--The credit for the estate tax imposed on property in a QDT would not be reduced to reflect that such property qualified for the marital deduction.

6. Estate tax on qualified domestic trust (QDT)

a. Definition of distribution.--The payment of the estate tax on a QDT itself would be a distribution subject to the estate tax.

b. Multiple QDTs.--If there is more than one qualified domestic trust, the tax rate on each trust would be the highest estate tax rate in effect at the date of the decedent's death unless there is one U.S. citizen or domestic trustee responsible for filing the returns and paying the tax on all qualified domestic trusts.

c. Interest on tentative tax.--The tentative tax refunded upon final determination of estate tax on a QDT would bear interest.

d . Basis for estate tax on lifetime distributions.--The basis of property distributed as corpus from a QDT would be increased by the portion of estate tax attributable to appreciation in such property paid by the trust.

e. Due date for tax on deathtime transfers.--The return for the estate tax imposed on a QDT by reason of the death of the surviving spouse would be due on the same date as the estate tax return for that spouse.

7. Generation-skipping transfer tax

a. Basis adjustment.--The total basis adjustment for property subject to the generation-skipping transfer tax would be limited to its fair market value.

b. Double deduction of expenses.--Administrative expenses would not be simultaneously deductible against both the generation-skipping transfer tax and the income tax.

c. Valuation date for transfers for which gift tax

return not required.--Generation skipping transfers would be valued as of the date of transfer if an allocation of exemption is made on a gift tax return that would be timely filed if such a return were required.

8. Estimated taxes of trusts and estates

Exception from estimated taxes for two years following decedent's death.--If no will is admitted to probate, a grantor trust with primary responsibility for paying taxes, debts and administrative expenses of a decedent would not be required to pay estimated taxes for taxable years ending within two years of the decedent's death.

9. Treaty interaction with estate and gift tax marital deductions

Under the provision, certain estate and gift tax marital deductions available pursuant to treaties to nonresident aliens transferring U.S. property would apply notwithstanding inconsistent 1988 Act provisions.

F. Application of 2-Percent Floor on Itemized Miscellaneous Deductions to Indirect Deductions Through Pass-Through Entities

1. 2-percent floor and pass-through entities

Under present law, the Secretary of the Treasury is required to prescribe regulations prohibiting the indirect deduction through pass-through entities of amounts that would not be deductible under the 2-percent floor on miscellaneous itemized expenses if paid or incurred directly by an individual. In the 1988 Act, Congress intended to exclude a shareholder's share of expenses of publicly-offered mutual funds from the 2-percent floor until December 31, 1989. Instead, the 1988 Act inadvertently sunset the entire prohibition for taxable years beginning after that date. Under the correction, the prohibition on indirect deduction through pass-through entities would be made permanent. The exclusion for shareholder expenses of publicly-offered mutual funds would remain permanent.

G. Insurance Provisions

1. Treatment of modified endowment contracts

a. Treatment of qualified additional benefits.--The provision clarifies that an increase in the charge for a qualified additional benefit is not a material change in the benefits under a contract, and, consequently, the 7-pay test is not to be reapplied at such time. An addition of, or an increase in, a qualified additional benefit, however, is to be considered a material change in the benefits under the contract and requires a reapplication of the 7-pay test.

b. Increase in benefits based on cost-of-living index.--The provision clarifies that, to the extent provided in regulations, a material change does not include any cost-of-living increase based on an established broad-based index if the increase is funded ratably over the remaining period during which premiums are required to be paid under the contract (rather than over the remaining life of the contract).

c. Treatment of contracts with a negative 7-pay premium.--The committee report to the bill would clarify that a contract which is materially changed is not to be considered a modified endowment contract if the calculation of the 7-pay premium after the material change is a negative amount provided that no additional premiums are paid during the first 7 years after the material change.

d. Timing of death benefit increases under the material change rules.--The committee report to the bill would clarify that a death benefit increase that occurs before the payment of a premium that is not necessary to fund the lowest death benefit payable during the first 7 contract years may be considered a material change in the benefits provided under a contract, and, in such case, the material change would be considered as occurring on the date that such premium is paid.

e. Aggregation rules for modified endowment contracts and annuity contracts.--The provision clarifies that contracts under qualified pension plans are not subject to the aggregation rules which generally apply to modified endowment contracts and annuity contracts. In addition, the provision clarifies that the aggregation rules are to apply only to contracts issued by the same company (or related companies) to the same policyholder during any calendar year.

f. Special effective date provision where death benefit increases by more than $150,000.--The committee report to the bill would clarify that if the death benefit under a contract increases by more than $150,000 over the death benefit under

the contract as of October 20, 1988, then the contract would be subject to the material change rules as of the date that the death benefit exceeds the threshold. In addition, the committee report would provide that in determining whether the death benefit increase constitutes a material change, the death benefit payable under the contract as of October 20, 1988, increased by $150,000 is to be taken into account rather than the lowest death benefit payable during the first 7 contract years.

g. Exception to special effective date provision where death benefit increases by more than $150,000.--The provision clarifies that the exception to the $150,000 death benefit increase provision applies to any contract that, as of June 21, 1988, required at least 7 level annual premium payments and under which the policyholder makes at least 7 level annual premium payments.

h. Treatment of contracts that are considered entered into on or after the effective date.--The committee report to the bill would clarify the treatment of an insurance contract that is entered into before June 21, 1988, and that is exchanged on or after such date for another contract or that is otherwise treated under the effective date provisions as entered into on or after such date. The committee report would provide that the 7-pay premium for such a contract is to be reduced by the cash surrender value of the contract in the same manner as a contract that is materially changed.

2. Treatment of certain workers' compensation funds

The provision clarifies that if, for the first taxable year beginning on or after January 1, 1987, a qualified group self-insurers' fund changes its treatment of policyholder dividends to take into account such dividends no earlier than the date that the State regulatory authority determines the amount of the policyholder dividend that may be paid, then such change is to be treated as a change in method of accounting and no section 481(a) adjustment is to be made with respect to such change in method of accounting.

3. Special estimated tax payments

a. Deduction allowed only if tax benefit results.--The provision clarifies that a deduction is allowed for unreversed discount only to the extent that the deduction results in a tax benefit for the taxable year of the deduction or a prior carryback year.

b. Due date of special estimated tax payments.--The provision clarifies that special estimated tax payments are to be made on or before the due date (determined without regard to extensions) for filing the return for the taxable year for which the deduction is allowed.

c. Special loss discount account.--The provision clarifies that any amount added to the special loss discount account must be subtracted from such account and included in gross income no later than the 15th year after the year for which the amount was added to the account.

d. Treasury regulatory authority.--The provision clarifies that the authority granted to the Secretary of the Treasury to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 847 shall include the authority to prescribe rules that apply in cases where the deduction allowed for any year is less than the unreversed discount as of the close of such year.

e. Effective date.--The provision clarifies that the amount of the deduction for unreversed discount is to be determined by considering losses incurred in taxable years beginning December 31, 1986, rather than losses incurred after December 31, 1986.

f. Earnings and profits.--The provision clarifies that the earnings and profits of any corporation is not to be reduced by the deduction allowed under section 847 for unreversed discount or increased by inclusions required under section 847. For purposes of the alternative minimum tax, however, the adjusted current earnings of a corporation is to be reduced by the deduction allowed under section 847 and increased by the inclusions required under section 847.

g. Section 1503(c) limitation.--The section 847 deduction would be subject to the section 1503(c) limits on losses in consolidation, and the amount of the special estimated tax payments would be determined by taking into account the section 1503(c) limits in consolidation.

H. Pension Provisions

1. Treatment of churches under certain deferred compensation programs

The provision clarifies the exemption from the application of section 457 for church plans. Under the provision, churches would be exempt from the definition of eligible employer.

2. One-time election with respect to elective deferrals

The provision clarifies the regulatory authority in the exception to the definition of elective deferrals (sec. 402(g)(3)) to provide that a contribution is not treated as an elective deferral if, under the salary reduction agreement, the contribution is made pursuant to (1) a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement or (2) a similar arrangement involving a one-time irrevocable election specified in regulations.

3. Effective date with respect to deductibility of certain contributions by self-employed individuals

The provision clarifies that the effective date of the 1988 Act rule relating to the deduction rules for self-employed individuals is effective as if included in the Tax Reform Act of 1986, rather than as if included in the Pension Protection Act of 1987.

4. Deduction for payments relating to standard terminations

The deduction rule relating to employer liability payments treated as contributions to qualified plans is amended to clarify that the rule applies in the case of standard terminations, effective for payments made after January 1, 1986, in taxable years ending after that date.

5. Tax treatment of transfers of interests in individual retirement accounts and qualified governmental plans incident to divorce

Present law permits a transfer of an interest in an individual retirement account (IRA) to be treated as a nontaxable transfer if the transfer is to a former spouse pursuant to a divorce decree. Special tax rules apply under present law to the transfer of an interest in a qualified plan pursuant to a qualified domestic relations order (QDRO). These tax rules do not apply to the transfer of interests in governmental plans and church plans because the QDRO rules do not apply to such plans.

The provision amends the rules relating transfers of interests in an IRA incident to a divorce to conform to the treatment generally of such transfers under the Retirement Equity Act of 1984. The provision permits a transfer of an interest in an IRA to be treated as a nontaxable transfer if the transfer is to a spouse or former spouse under a divorce or separation decree.

The provision applies the same tax rules applicable to transfers pursuant to a QDRO to transfers of interests in a governmental plan or a church plan if the transfer is made pursuant to a domestic relations order as defined in section 414(p)(1) (without regard to sec. 414(p)(1)(A).

The provisions are effective for transfers after the date of enactment in taxable years ending after the date of enactment.

6. Definition of compensation for purposes of IRA deduction limit

Under present law, the maximum deduction limit for contributions to an individual retirement account (IRA) is the lesser of $2,000 or 100 percent of compensation. The provision provides that compensation for this purpose includes the earned income and wages of individuals who are not subject to FICA or SECA taxes because of their religious beliefs. The provision is effective for contributions after the date of enactment.

I. Excise Tax Provision: Undenatured Distilled Spirits

The provision corrects the exemption for educational institutions from the distilled spirits occupational tax to apply to procuring less than 25 gallons of distilled spirits free of tax, instead of specially denatured distilled spirits.

J. Tax-Exempt Bond Provisions

1. Disregard of certain financings in determination of qualification for small-issue exception

The provision amends Code section 148(f)(4)(C)(ii)(II) as enacted by section 6183 of the 1988 Act to clarify that bonds issued by a governmental unit "to make loans to," rather than "on behalf of," other qualifying governmental units do not count in the determination of whether the issuing governmental unit has exceeded $5 million in total annual bond issuance.

2. Application of future legislation to transitioned bonds

The provision clarifies that in the case of any bond to which the amendments made by section 1301 of the Tax Reform Act of 1986 do not apply by reason of any provision of the Tax Reform Act of 1986, any amendment of the 1986 Code (and any other provision applicable to such Code) included in any law enacted after the date of enactment of the Tax Reform Act of 1986 generally, shall be treated as included in section 103 and section 103A (as appropriate) of the 1954 Code with respect to such bond. Exceptions are provided (1) if such law expressly provides that such amendment (or other provision) shall not apply to such bond, or (2) if such amendment (or other provision) applies to a provision of the 1986 Code for which there is no corresponding provision in section 103 and 103A (as appropriate) of the 1954 Code and which is not otherwise treated as included in such sections 103 and 103A with respect to such bond.

The provision is effective as if included in the Tax Reform Act of 1986.

3. Treatment of certain property subject to use restrictions due to financing with qualified 501(c)(3) bonds

The provision clarifies property acquired with the proceeds of qualified 501(c)(3) bonds will be treated as new property for purposes of section 145(d)(2)(A) and, thereby, not subject to the income targeting requirements of section 142(d) in the following two circumstances.

(1) Where the housing is financed by sources other than tax-exempt debt and is later re-financed with tax-exempt debt, the facility is not considered "existing" housing for purposes of section 145(d) if there was a reasonable expectation that the facility would be re-financed with tax-exempt debt and the re-financing with tax-exempt debt occurred within a reasonable period of time thereafter; and

(2) Where the initial financing was with taxable debt because at the time of the taxable financing, State law prohibited tax-exempt financing for the property so financed, then the property will be treated as new property for purposes of a subsequent financing with tax-exempt debt.

K. Research Tax Credit Provision: Election of Reduced Credit

Present law, as amended by the 1988 Act, provides that the section 174 deduction is reduced by 50 percent of the research tax credit determined for the year. Present law permits a taxpayer to avoid a reduction of the section 174 deduction for a taxable year by electing to forgo entirely its section 41 credit for the year. The provision would permit a taxpayer to avoid a reduction of the section 174 deduction by electing to reduce its section 41 credit by the amount of tax saved (assuming the taxpayer is in the highest corporate tax bracket) by not making a reduction of its section 174 deduction. An election by a taxpayer to have this provision apply to a taxable year shall be irrevocable and may be made not later than the time for filing the taxpayer's return for such year (including extensions), except that if the taxpayer's return for a taxable year must be filed before 75 days after the date of enactment of this provision, then the election under this provision may be made at any time before 75 days after such enactment.

L. Low-Income Housing Tax Credit

1. The provision clarifies that students in governmentally supported job training programs, including the Job Partnership Training Act and similar Federal, State or local programs, are deemed to be eligible tenants for purposes of the credit.

2. The operation of the credit in the case of trusts and estates is clarified to provide that the amount of credit and any penalty with respect to the credit is apportioned between beneficiaries and a trust or estate on the basis of the income allocable to each.

3. The provision clarifies that, in the case of a disposition of an ownership interest during the course of a calendar year, the credit is to be allocated pro rata between the seller and purchaser according to the number of days of ownership.

4. In order to carry out legislative intent, the provision authorizes the Treasury Department to issue regulations permitting housing credit agencies to correct administrative errors and omissions with respect to allocations of the credit.

5. The provision clarifies that a person purchasing an interest in a building (including an interest in a partnership owning credit property) steps into the shoes of the previous owner of such interest for purposes of the credit. This provision does not alter the application of the recapture and bond posting requirements as in effect under present law.

These provisions would be effective as if included in the Tax Reform Act of 1986.

II. AMENDMENTS TO THE REVENUE ACT OF 1987

A. Accounting Provisions

1. Installment sales

Present law provides an interest charge on certain deferred tax liabilities arising from certain installment sales. The provision clarifies that such interest is not to be treated as a payment of regular tax for purposes of determining whether the alternative minimum tax applies. Another provision clarifies that the interest charge described in section 453A(c) (relating to nondealer sales) shall be treated as interest for purposes of computing the deductions allowable to a taxpayer.

2. Required payments for certain entities

Partnerships and S corporations may elect a taxable year other than a required taxable year if certain required payments are made. The amount of the required payments generally is phased-in over a 4-year period. The provision clarifies that the phase-in rule is not to apply for taxable years beginning after 1988 unless more than 50 percent of the net income of the partnership or S corporation for the short taxable year that otherwise would have resulted had the election not been made is allocable to partners or shareholders who would have been eligible to include such income over a 4-year period.

B. Corporate Provision:

Adjustments to Earnings and Profits and to Basis of Stock of a Subsidiary

The provision clarifies that the rules requiring certain adjustments to earnings and profits and to the basis of stock of a subsidiary, for purposes of determining gain or loss on disposition of such stock, apply where the corporation disposing of the stock of a former member of an affiliated group is itself a former member of the group. The provision is not intended to apply to the extent such adjustments have already been made with respect to a prior disposition.

C. Vaccine Injury Compensation Trust Fund

The provision would allow funds (not to exceed $6 million annually) from the Vaccine Injury Compensation Trust Fund to be available, as provided in appropriations Acts, for payment of administrative expenses of the National Vaccine Injury Compensation Program.

III. AMENDMENTS RELATED TO OTHER PENSION PROVISIONS

Section 207 of S. 2238, introduced in the 100th Congress by Senators Bentsen and Packwood on March 31, 1988, and reported by the Senate Committee on Finance on August 1, 1988, contains pension-related technical corrections previously approved by the Committee.[2] The technical corrections amend Titles I and IV of the Employee Retirement Income Security Act of 1974 (ERISA) and corresponding provisions of the Internal Revenue Code and the Public Health Services Act. Section 207 of S. 2238 made technical changes to the Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1986, and the Pension Protection Act of 1987.

The proposal would adopt the provisions of section 207 of S. 2238, as previously approved by the Senate Finance Committee with the following modifications and additional provisions.

A. Amendments Related to the Tax Reform Act of 1986

1. Class-year vesting

The Reform Act repealed class-year vesting. The previously-approved technical corrections include a special vesting rule for plans that had class-year vesting so that the elimination of class-year vesting does not adversely affect the vesting status of plan participants. Under the provision, compliance with this special vesting rule would not result in the maintenance of a separate benefit structure for purposes of the minimum participation rule (sec. 401(a)(26)).

2. Time for plan amendments

The Reform Act provided a delayed date for making plan amendments to comply with the provisions of the Act. The previously-approved technicals extend this rule to amendments required by the technical corrections. The provision extends the remedial amendment period to the end of the first plan year beginning after December 31, 1989. As under the original provision, the plan must in any event be operated in compliance with applicable rules.

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[2] For a description of the provisions, see Sen. Rep. No. 100-445, "Technical Corrections Act of 1988", Report of the Committee on Finance, United States Senate, to accompany S. 2238. The pension-related technical provisions were not included in the Technical and Miscellaneous Revenue Act of 1988 as enacted.

3. Health care continuation rules

a. Effective dates.--Certain of the previously-approved technical corrections are effective for plan years beginning after December 31, 1988. At the time the technical corrections were first introduced, this would have been a prospective effective date. Under the provision, December 31, 1988, would generally be changed to December 31, 1989. The effective date for the technical correction relating to termination of continuation coverage in the case of coverage under another group health plan would generally be qualifying events occurring after December 31, 1989. In addition, the provision would apply to individuals who elected continuation coverage in 1989 and who pay for such coverage in accordance with the continuation health care rules.

b. Continuation coverage in the case of Medicare entitlement.--The provision provides that, in the case of a covered employee who becomes entitled to Medicare coverage and continues to be covered by a group health plan, but then terminates employment or suffers a reduction in hours within 18 months following becoming entitled to Medicare, the duration of continuation coverage for the employee's spouse and dependent children is 36 months from the date the beneficiary first became entitled to Medicare coverage. This provision is effective for plan years beginning after December 31, 1989.

The provision would also clarify the present-law rule that if a covered employee has a qualifying event that results in 18 months of continuation coverage, and the covered employee becomes entitled to Medicare coverage before the expiration of the 18 months, any qualified beneficiary who is at that time covered under the group health plan is entitled to continuation coverage for a total of 36 months from the date of the original qualifying event.

B. Amendments Related to the Omnibus Budget Reconciliation Act of 1987 (including the Pension Protection Act)

1. Effective dates of changes relating to amortization periods

The previously-approved technicals provide that the change in the amortization period for experience gains and losses applies to gains and losses established in years beginning after December 31, 1987, and provides a special transition rule for any experience gain or loss determined by a valuation occurring as of January 1, 1988. In Notice 89-52, the Internal Revenue Service provided transitional relief with respect to the effective date of the change in such amortization period. Under the provision, the employer may elect to amortize gains and losses (1) in accordance with the general effective date without regard to the special rule

for valuations occurring as of January 1, 1989, (2) in accordance with the special rule, or (3) in accordance with the IRS notice.

C. Miscellaneous

The proposal makes certain clerical changes to the previously-approved technicals, such as correcting incorrect citations and cross references.

IV. ADDITIONAL TECHNICAL: CODE SECTION 274

Under present law, the amount allowable as a deduction for certain expenses for food, beverages, and entertainment is limited to 80 percent of the expense. This 80-percent limitation does not apply to expenses for food or beverages required by Federal law to be provided to crew members of a commercial vessel. The provision would clarify that this exception applies to food or beverages required by any Federal law to be provided to crew members of a commercial vessel.

DESCRIPTION OF REVENUE RECONCILIATION PROPOSAL

PART ONE: REVENUE-RAISING PROVISIONS

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on October 3, 1989

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 3, 1989

JCX-57-89

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of Part One of a revenue reconciliation proposal for consideration by the Senate Committee on Finance at a markup scheduled for October 3, 1989.[2] Part One describes revenue-raising provisions.

A separate document provides estimated budget effects of the specific provisions.

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[1] This document may be cited as follows: Description of Revenue Reconciliation Proposal: Part One (Revenue-Raising Provisions) (JCX-57-89), October 3, 1989.

[2] Part Two of the revenue reconciliation proposal is in a separate document, which includes expiring provisions, child care initiative (from S. 5), individual retirement accounts (IRAs), and other provisions.

Also, see separate document (JCX-56-89) for a description of technical corrections provisions.

DESCRIPTION OF REVENUE RECONCILIATION PROPOSAL

PART ONE: REVENUE-RAISING PROVISIONS[1]

A. Repeal of Special Rules Applicable to Financially Troubled Financial Institutions in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (P.L. 101-73)

Prior Law

Under prior law, special rules provided as follows:

(1) certain mergers involving financially troubled thrift institutions and financially troubled banks could qualify as tax-free reorganizations, without regard to the continuity of interest requirement;

(2) relaxed rules applied to the carryforward of net operating losses, built-in losses, and excess credits in the case of tax-free reorganizations involving financially troubled thrift institutions and financially troubled banks;

(3) gross income did not include assistance payments from the Federal Savings and Loan Insurance Corporation in the case of thrift institutions, or the Federal Deposit Insurance Corporation in the case of banks, and no basis reduction was required on account of such payments although there may have been a reduction in certain tax attributes.

These provisions were scheduled to expire after December 31, 1989.

Explanation of Present Law

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (P.L. 101-73), enacted on August 9, 1989, repealed these special rules.

Effective Date

The repeal is effective for transactions on or after May 10, 1989.

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[1] See also separate document for Part Two: Expiring Provisions, Child Care Initiative, IRAs, and Other Provisions.

B. Corporate Provisions

1. Defer interest deduction on certain high-yield original issue discount (OID) obligations until interest is paid

Present Law

Original issue discount (OID) is the excess of the stated redemption price at maturity over the issue price of a debt instrument. The issuer of a debt instrument with OID generally accrues and deducts the discount, as interest, over the life of the obligation even though the amount of such interest is not paid until the debt matures. The holder of such a debt instrument also generally includes the OID in income as interest on an accrual basis.

Explanation of Proposal

The interest deduction for OID with respect to certain instruments, including instruments allowing for the payment of interest with additional instruments of the issuer (e.g., so-called "payment-in-kind (PIK)" bonds), would be deferred until actually paid. The holder, however, would continue to include such discount, as interest, in income as it accrues.

The provision would apply to OID on any debt instrument issued by a C corporation that has a term of more than five years, significant OID, and a yield in excess of 5 percentage points over the applicable Federal rate. An instrument has significant OID if in any accrual period ending more than five years after issuance, the aggregate taxable income with respect to the instrument exceeds (1) the aggregate cash interest to be paid under the instrument plus (2) the yield on the instrument in the first year.

The Secretary of the Treasury would be granted authority to prescribe regulations appropriate to carry out the purpose of the provision and to prevent its avoidance, including regulations governing the treatment of complex instruments.

Effective Date

The provision would be effective for instruments issued after July 10, 1989. The provision would not apply to an instrument issued after July 10, 1989, in connection with an acquisition completed (or for which there was a commitment to complete) before July 11, 1989, so long as the significant terms of such instrument were determined before July 11, 1989, in a written document transmitted to a government regulatory agency or prospective party to the issuance or acquisition. The provision also would not apply to an instrument issued after July 10, 1989, so long as the significant terms of the instrument do not exceed the terms

contained in the last bankruptcy reorganization plan filed before that date. For these purposes, a maturity date not otherwise determined is considered determined so long as the actual term of the instrument does not exceed ten years.

In addition, the provision would not apply to instruments issued as interest payments on a grandfathered instrument. Finally, a grandfathered instrument could be refinanced without being subject to the provision so long as its term, issue price, and redemption price are not increased (and periodic interest payments not reduced) by the refinancing.

2. Limit dividends received deduction with respect to certain nontaxed income of consolidated subsidiaries

Present Law

A distribution to a shareholder is generally treated as a dividend to the extent of the distributing corporation's current or accumulated earnings and profits. Corporate recipients of dividends generally are entitled to a dividends received deduction equal to at least 70 percent of the dividend. (An 80-percent or 100-percent deduction is permitted if the recipient has sufficient ownership of the stock of the distributing corporation.) The dividends received deduction serves to reduce substantially or eliminate multiple taxation with respect to income earned and corporate-level tax paid by distributing corporations on distributions to corporate shareholders.

If a group of corporations files a consolidated return, taxable income is determined by reference to the income and deductions of all members of the group and is, in substance, computed as if the group operated as a single corporation. No income is separately attributed to minority owners of a subsidiary that joins in filing a consolidated return. Thus, for example, income of a subsidiary bears no corporate-level tax if its parent corporation or other members of the group have losses sufficient to offset that income, even though the subsidiary may have taxable income economically attributable to minority ownership. If the minority owner and the parent or other group members had been joint venturers with respect to the subsidiary's business, then the income attributable to minority ownership could not be sheltered by losses of other members of the group but would be fully taxed to the minority owners.

In order to be eligible to file a consolidated return, a subsidiary generally must be related to the rest of the group through the group's ownership of at least 80 percent of the vote and value of all classes of subsidiary stock. However, stock described in section 1504(a)(4) (generally, nonvoting preferred stock that does not participate in corporate growth to any significant extent) is not counted for this purpose. Thus, minority shareholders holding nonvoting preferred stock may be entitled to virtually all the subsidiary's earnings without preventing consolidation. In this situation, the earnings to which the preferred shareholders are entitled can be sheltered by the losses of other members of the group without limitation. The subsidiary can pay these non-taxed earnings to the minority corporate shareholders as dividends eligible for the 70-percent dividends received deduction. Such earnings thus bear no corporate-level tax to the distributing corporation and bear a maximum tax to the recipient corporation of only 10.2 percent (34 percent of the

30 percent that is taxable after the dividends received deduction).

Explanation of Proposal

The dividends received deduction would not be allowed for a portion of dividends paid out of current earnings and profits with respect to stock described in section 1504(a)(4) (generally, nonvoting preferred stock) in certain circumstances.

The provision would apply only to dividends paid from a subsidiary of a group filing a consolidated return.

The portion of dividends received deduction disallowed would be calculated as a fraction, the numerator of which is the amount of consolidated losses (other than those of the distributing corporation) and the deduction equivalent of consolidated credits (other than foreign tax credits) attributable to other members of the group that reduce the distributing corporation's separately computed taxable income, and the denominator of which is the distributing corporation's separately computed taxable income. The amount of distributions limited with respect to the dividends received deduction shall not exceed the amount of the consolidated losses and the deduction equivalent of consolidated credits attributable to other members of the group that are treated as reducing the distributing corporation's separately computed taxable income.

The Treasury Department would be authorized to exempt taxpayers from the limitation to the extent they can establish that the distributions in question were made out of earnings that were taxed to the distributing corporation or the consolidated group of which it is a member.

The Treasury Department would also be authorized to provide antiabuse rules. It is expected that regulations would prevent avoidance of the rules through the contribution of built-in loss assets or other direction of losses to the subsidiary by other members of the group. It is also expected that regulations would prevent avoidance of the rules through delaying distributions until later years or through the use of tiered subsidiaries or similar devices.

Effective Date

The provision is generally effective for distributions after October 2, 1989. However, it does not apply to distributions with respect to subsidiary stock issued on or before that date, or issued after that date pursuant to a binding written contract in effect on that date and at all

times thereafter before such stock is issued, so long as the subsidiary is not transferred outside the group of which it was a member on October 2, 1989.

Auction rate preferred stock is treated for this purpose as issued when the contract requiring the auction became binding and is not considered issued at the time of each auction conducted pursuant to such commitment.

3. Repeal nonrecognition treatment when securities are received in section 351 transactions

Present Law

No gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control of the corporation (sec. 351). Accordingly, a transferor may transfer appreciated property to a controlled corporation in exchange for stock and a debt obligation of the corporation that is a security, without recognition of gain.

Different rules apply for debt obligations that are not considered to be "securities" under section 351. Such other debt obligations are treated as "boot." A transferor who receives boot is taxed on the lesser of the amount of the boot or the gain realized on the exchange generally as if the transferred property had been sold.

Under the corporate reorganization provisions, a taxpayer who transfers property in a reorganization and who receives securities with a principal amount in excess of any securities surrendered is taxable on the excess as "boot."

The receipt of any debt obligation constituting boot generally qualifies for installment sale treatment. Under the installment sale rules, taxpayers generally report gain on the installment method but must pay interest on the deferred tax liability in certain circumstances. However, the installment method is not available in certain circumstances (for example, if the property transferred is stock or securities traded on an established market, or in the case of certain transfers between related parties). In addition, in certain circumstances, a taxpayer will accelerate gain if the installment note is pledged as security for an indebtedness (sec. 453A).

Explanation of Proposal

Securities received in a section 351 transaction would be treated as boot. The provision would not apply, however, to: (1) any exchange that is pursuant to a plan of reorganization in which the securities are subject to section 354(a); or (2) any exchange where the stock or securities received in the exchange are distributed as part of a section 355 transaction and are subject to section 355(a)(3).

The provision is not intended to alter the ability of the Internal Revenue Service to recharacterize transactions to which the provision does not apply.

Effective Date

The provision would apply to transfers made by corporations after July 11, 1989 (other than transfers made by S corporations, and other than transfers where the corporate transferor, immediately after the transfer, owns stock in the transferee that meets the 80-percent vote and value test of section 1504(a)(2)), unless the transfer was pursuant to a written binding contract in effect on July 11, 1989 and at all times thereafter before such transfer.

The provision would apply to transfers made by individuals, other noncorporate entities, corporations (but only where the corporate transferor, immediately after the transfer, owns stock in the transferee that meets the 80-percent vote and value test of section 1504(a)(2)), and S corporations after October 2, 1989, unless the transfer was pursuant to a written binding contract in effect on that date and at all times thereafter before such transfer.

4. Reduce built-in gain or loss threshold for sections 382 and 384

Present Law

Sections 382 and 384 of the Code restrict the use of built-in losses and built-in gains of a corporation when there are certain changes in the control of the corporation. These rules apply only if the net unrealized built-in loss or built-in gain exceeds 25 percent of the fair market value of the assets of the company.

The consolidated return regulations also contain rules that restrict the use of built-in losses of a corporation in certain circumstances. These rules apply only if a 15 percent threshold is exceeded.

Under the minimum tax adjusted current earnings regime, if there is a change of ownership under section 382, all built-in losses are limited without a threshold.

Explanation of Proposal

The restrictions in Code sections 382 and 384 on the use of built-in gains and built-in losses of a corporation would apply if the built-in loss or built-in gain exceeds the lesser of (1) 15 percent of the fair market value of the assets of the company or (2) $25 million.

A corresponding threshold would be provided under the minimum tax adjusted current earnings regime.

Effective Date

The proposal generally would be effective for changes in control of a corporation subject to section 382 or 384 after October 2, 1989, unless pursuant to a binding written contract in effect on or before October 2, 1989 and at all times thereafter. However, in the case of a reorganization described in subparagraph (G) of section 368(a)(1) of the Internal Revenue Code of 1986, as amended, or an exchange of debt for stock in a title 11 or similar case, as defined in section 368(a)(3) of such Code, the provision would not apply to any ownership change resulting from such a reorganization or proceeding if a petition in such case was filed with the court before October 3, 1989.

5. Require basis reduction for nontaxed portion of dividends on self-liquidating stock

Present Law

In general, corporations are entitled to a deduction equal to 70 percent of the dividends received from a domestic corporation. An 80-percent dividends received deduction is allowable if the corporate shareholder owns 20 percent or more of the stock of the domestic corporation and a 100-percent dividends received deduction is allowable if the corporate shareholder owns at least 80 percent of the stock of the domestic corporation.

A corporate shareholder's basis in stock is reduced by the portion of a dividend eligible for the dividends received deduction if the dividend is "extraordinary." In general, a dividend is extraordinary if the amount of the dividend equals or exceeds 10 percent (5 percent in the case of preferred stock) of the shareholder's adjusted basis in the stock and the shareholder has not held the stock, subject to a risk of loss, for at least 2 years prior to the date the amount or payment of the dividend is declared, announced, or agreed to, whichever is the earliest (sec. 1059).

Explanation of Proposal

Dividends with respect to certain preferred stock would be treated as extraordinary dividends under section 1059 (regardless of holding period), thus requiring reduction in stock basis. The provision would apply to dividends with respect to preferred stock if (1) when issued, such stock has a dividend rate which declines (or reasonably can be expected to decline) in the future, (2) the issue price of such stock exceeds its liquidation rights or its stated redemption price, or (3) such stock is otherwise structured to enable corporate shareholders to reduce tax through a combination of dividend received deductions and loss on the disposition of the stock. The provision would not apply to dividends on preferred stock whose dividend rate declines due to an unforeseen economic downturn in the issuer's business.

The Secretary of the Treasury would be authorized to prescribe regulations that would apply the provision to dividends with respect to stock other than preferred stock in appropriate cases.

Effective Date

The provision would apply to stock issued after July 10, 1989, unless issued pursuant to a written binding contract in effect on July 10, 1989, and at all times thereafter before the stock is issued.

6. Modify excess loss account recapture rules to prevent prevent shifting of basis to debt

Present Law

Under consolidated return regulations, in general, a parent corporation must reduce its basis in the stock of a subsidiary with which it files a consolidated return by the amount of distributions the parent receives from the subsidiary and the amount of any deficit in earnings and profits of the subsidiary. The parent increases its basis in the stock of a subsidiary by the amount of contributions to the subsidiary and earnings and profits of the subsidiary. In general, when distributions and losses from the subsidiary exceed the contributions to and earnings of the subsidiary, an "excess loss account" is created. This amount is generally recaptured by the parent on certain dispositions of the stock of the subsidiary.

Under the present consolidated return regulations, a parent corporation that has an excess loss account in the stock of the subsidiary can defer recapture of such excess loss account on dispositions of the subsidiary's stock by electing to apply the excess loss account to reduce the basis of other stock or debt held by the parent in the subsidiary.

Explanation of Proposal

The proposal would modify the excess loss account recapture rules to prevent the reallocation of the excess loss account to reduce the basis of subsidiary debt held by the parent. Thus, on disposition of the stock of a subsidiary, gain attributable to an excess loss account would be required to be recognized rather than deferred through a reduction in the basis of debt held by the parent corporation.

The Treasury Department would be directed to reexamine the rules permitting reallocation of the excess loss account to reduce the basis of the other stock held in the subsidiary.

Effective Date

The provision would be effective for dispositions after July 10, 1989, unless pursuant to a binding written contract in effect on that date and at all times thereafter.

7. Clarify Treasury regulation authority relating to debt/equity (section 385)

Present Law

The characterization of an investment in a corporation as debt or equity for Federal income tax purposes generally is determined by reference to numerous factors that are deemed to reflect aspects of the economic substance of the investor's interest in the corporation. There presently is no definition in the Internal Revenue Code or the income tax regulations which can be used to determine whether an interest in a corporation constitutes debt or equity for Federal income tax purposes. Such a determination is made under principles developed in case law. Courts have approached the issue of distinguishing debt and equity by analyzing and weighing the relevant facts and circumstances of each case.

In 1969, Congress granted the Secretary of the Treasury the authority to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated as stock or as indebtedness for Federal income tax purposes (sec. 385). The regulations were to prescribe factors to be taken into account in determining, with respect to particular factual situations, whether a debtor-creditor relationship or a corporation-shareholder relationship existed. Proposed regulations under section 385 were issued in 1980 and 1981, although they were withdrawn in 1983. To date, no additional regulations have been issued.

Explanation of Proposal

Section 385 would be amended to allow the Treasury Department to characterize an instrument having significant debt and equity characteristics as part debt and part equity. In addition, the Treasury Department would continue to be authorized, although not required, to issue comprehensive debt-equity regulations under section 385. However, the Treasury Department would be directed to increase the issuance of IRS published rulings on debt-equity issues.

No inference is intended that the Internal Revenue Service could not characterize an instrument as part debt and part equity under present law.

Effective Date

The Treasury Department's regulatory authority to characterize an instrument as part debt and part equity would apply only on a prospective basis. Such authority could be exercised only with respect to instruments issued after public guidance is published, whether by regulation, ruling,

or otherwise, stating the position of the Treasury Department with respect to the characterization of such instruments.

8. Require reporting to IRS of acquisitions and recapitalizations

Present Law

There is no requirement under present law that the parties to an acquisition or recapitalization transaction report information to the Treasury Department or the Internal Revenue Service with respect to such transaction, except as incident to the filing of Federal income tax returns.

Explanation of Proposal

The Treasury Department would be directed to require reporting with respect to corporate acquisition and recapitalization transactions. The information to be reported would include the identity of the parties to the transaction, the fees involved, and the change in the capital structure of the corporation. Penalties would apply for non-compliance with these reporting rules.

Effective Date

The proposal would be effective on date of enactment for transactions after March 31, 1990.

9. Require Treasury study of "debt vs. equity" and integration issues

Present Law

Interest on debt is generally deductible by the issuer and is includible in the income of the holder. However, in the case of tax exempt or foreign holders, the interest is not taxable with the result that neither the issuer nor the holders pay any tax on amounts distributed as interest.

The U.S. income tax system is not integrated, i.e., corporations and their shareholders are generally separate taxable entities. Thus, income earned by a corporation and distributed to shareholders may be taxed twice: once at the corporate level and again at the shareholder level when such income is distributed to shareholders.

Explanation of Proposal

The Treasury Department would be required to study whether the present-law distinctions between debt and equity are meaningful and whether there are cases in which it would be appropriate to limit interest deductions.

The Treasury Department would also be required to study the policy and revenue implications of proposals which would integrate the corporate and individual income tax systems, including a deduction for dividends paid by a corporation and a shareholder credit or exclusion for such dividends.

In addition, the Treasury Department would be directed to consider the policy and revenue implications of the tax treatment of corporate distributions with respect to debt and equity held by tax-exempt entities and foreign persons.

The Treasury Department would be required to report its findings and recommendations to the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation no later than one year following the date of enactment of this proposal.

Effective Date

The provision would be effective on the date of enactment.

10. Restrict ability of C corporations to carry back certain net operating losses

Present Law

A corporation that incurs net operating losses (NOLs) generally can carry the NOLs back 3 taxable years and forward 15 taxable years. Carrying the NOLs back against prior taxable income allows a corporation to recognize currently the benefit of those losses by obtaining a refund.

Explanation of Proposal

The ability of C corporations to carry back NOLs would be limited in cases where the NOLs were created by interest deductions allocable to certain corporate equity-reducing transactions (CERTs). A CERT would be either a major stock acquisition (of at least 50 percent of the vote or value of another corporation) or an excess distribution (defined generally as the excess of the aggregate distributions and redemptions made by a corporation with respect to its stock over 150 percent of the average of such distributions for the previous 3 years).

The portion of the NOL carryback that would be limited would be the lesser of (1) the corporation's interest expense that is allocable to the CERT, or (2) the excess of the corporation's interest expense in the loss limitation year over the average of the corporation's interest expense for the 3 taxable years prior to the taxable year in which the CERT occurred. The provision would not apply if the lesser of these two amounts was less than $1 million.

Effective Date

The proposal generally would apply to CERTs occurring after August 2, 1989, in taxable years ending after that date.

In determining whether a CERT has occurred after August 2, 1989, the following would not be taken into account: (1) acquisitions or redemptions of stock, or distributions with respect to stock, occurring on or before August 2, 1989; (2) acquisitions or redemptions of stock after August 2, 1989, pursuant to a written binding contract (or tender offer filed with the SEC) in effect on August 2, 1989, and at all times thereafter before such acquisition or redemption; or (3) any distribution with respect to stock after August 2, 1989, which was declared on or before August 2, 1989.

11. Require mutual funds to distribute 98 percent of ordinary income

Present Law

In order to avoid a penalty excise tax, regulated investment companies, commonly called "mutual funds," must distribute before January 1 of any year at least 97 percent of their ordinary income earned during the prior calendar year and 98 percent of their capital gain net income for the twelve month period ending on October 31 of that year.

Explanation of Proposal

The distribution required to avoid the penalty excise tax would be increased to 98 percent of ordinary income.

Effective Date

The provision would be effective for taxable years ending after July 10, 1989.

12. Require continued capitalization of mutual fund load charges in the case of certain switches within a family of funds

Present Law

A shareholder's basis in shares purchased in a regulated investment company (mutual fund) is the cost of acquiring the shares. This cost includes expenses incurred in connection with the purchase. Upon sale or exchange of the shares, the shareholder's gain is reduced, or loss is increased, by the amount of such expenses.

Some mutual fund sponsors impose an advance charge for sales fees (load charge) upon purchase of shares. Sometimes, a load charge is imposed when shares of a fund are purchased but is waived if the shares are received in exchange for those of another fund within a family of funds. Under present law, a shareholder can purchase shares of a fund, immediately exchange them for shares of a fund for which the load charge is waived, and increase loss or reduce gain by an amount equal to the load charge.

Explanation of Proposal

A load charge would not be taken into account in determining a shareholder's basis in mutual fund shares which are sold or exchanged within six months in a transaction that does not terminate the shareholder's reinvestment right. A reinvestment right is the right to reinvest the proceeds from the sale or exchange of the shares at a reduced charge in one or more mutual funds.

Effective Date

The provision would apply to load charges incurred after October 3, 1989, in taxable years ending after such date.

13. Require mutual funds to include dividend income on the ex-dividend date

Present Law

Dividends from stock owned by a regulated investment company (RIC), commonly called a "mutual fund," are includible in the company's income when received.

Explanation of Proposal

Dividends received by a mutual fund would be includible in income when the stock becomes ex-dividend with respect to the dividend. If a mutual fund receiving a dividend did not own the stock when the stock became ex-dividend, the dividend is includible in income on the date the fund acquired the stock.

Effective Date

The provision is effective for dividends on stock becoming ex-dividend after date of enactment.

C. Employee Benefit Provisions

1. Provisions relating to employee stock ownership plans (ESOPs)

Present Law

ESOPs in general

An employee stock ownership plan (ESOP) is a qualified stock bonus plan or a combination of a stock bonus plan and money purchase pension plan that meets certain requirements and under which employer securities are held for the benefit of employees. Present law generally prohibits loans between a qualified plan and a disqualified person (sec. 4975). An exception to this rule is provided in the case of an ESOP.

If employer securities are acquired by an ESOP with loan proceeds, the ESOP is referred to as a leveraged ESOP. The ESOP may borrow directly from a financial institution (typically with a guarantee from the employer), or the employer may borrow from a financial institution and in turn lend the funds to the ESOP which then uses them to acquire employer securities. The employer securities are typically pledged as security for the loan. The employer makes contributions to the ESOP which are then used to repay the acquisition loan. Shares that are acquired with an acquisition loan are allocated to the accounts of ESOP participants as the loan is repaid.

In general, the type of employer securities that may be held by an ESOP are (1) common stock of the employer that is readily tradable on an established securities market, or (2) if there is no such common stock, common stock issued by the employer having a combination of voting power and dividend rights at least equal to that class of common having the greatest voting power and that class of common having the greatest dividend power. Noncallable preferred stock is treated as employer securities if such stock is convertible into stock that meets the requirements of (1) or (2), whichever is applicable.

ESOPs are required to pass through to plan participants certain voting rights with respect to employer securities. If the employer has a registration-type class of securities, the ESOP is required to permit each participant to direct the plan as to the manner in which employer securities allocated to the account of the participant are entitled to vote. If the employer does not have a registration-type class of securities, the plan is required to permit each particpant to direct the plan as to the manner in which voting rights are to be exercised only with respect to certain enumerated corporate issues, such as the approval or disapproval of any corporate merger or consolidation, recapitalization,

reclassification, and similar transactions as prescribed by the Secretary.

Partial interest exclusion for ESOP loans

A bank, an insurance company, a corporation actively engaged in the business of lending money, or a regulated investment company may exclude from gross income 50 percent of the interest received with respect to a "securities acquisition loan" used to acquire employer securities for an ESOP (sec. 133). A "securities acquisition loan" is generally defined as (1) a loan to a corporation or to an ESOP to the extent that the proceeds are used to acquire employer securities for the ESOP, or (2) a loan to a corporation to the extent that the corporation transfers an equivalent amount of employer securities to the ESOP and such securities are allocable to accounts of ESOP participants within 1 year of the date of the loan (an "immediate allocation loan").

Explanation of Proposal

The proposal limits the circumstances in which the partial interest exclusion applies. In general under the proposal, the partial interest exclusion does not apply to a securities acquisition loan unless (1) immediately after the acquisition of the securities acquired with the loan the ESOP owns at least 30 percent of each class of outstanding stock of the corporation issuing the employer securities or 30 percent of the total value of all outstanding stock of the corporation, (2) the term of the loan does not exceed 15 years, and (3) each participant is entitled to direct the plan as to the manner in which shares allocated to the participant's account that were acquired with a section 133 loan are to be voted. These requirements apply to transfers of stock with respect to an immediate allocation loan as well as other types of securities acquisition loans.

The 30-percent requirement is designed to ensure that the ESOP holds a substantial percentage of the company's stock. After the sale of the stock to the ESOP, the ESOP must generally hold the employer securities for at least 3 years. An excise tax is imposed on the employer sponsoring the ESOP if, within 3 years after the acquisition of the employer securities with a loan to which section 133 applies, the ESOP disposes of employer securities and the total number of employer securities held by the ESOP is less than the total number held after the acquisition or the value of the employer securities held by the plan after the disposition is less than 30 percent of the value of the outstanding securities. The excise tax does not apply to certain distributions, such as distributions to plan participants and distributions with respect to certain corporate

reorganizations.

An excise tax is also imposed if the ESOP disposes of the employer securities before the securities are allocated to accounts of participants and the proceeds from such disposition are not so allocated.

The amount of each excise tax is 10 percent of the amount realized on the disposition. The excise tax rules are similar to those that apply in situations where there has been a sale of stock to an ESOP that entitles the seller to defer recognition of gain on the sale (sec. 1042) or an estate tax deduction (sec. 2057).

The voting requirements of the proposal apply to all shares acquired with the loan to which the partial interest exclusion applies. This requirement applies to all issues and applies regardless of whether the employer has a registration-type class of securities. In addition, if the shares are convertible preferred stock, the participants must be entitled to direct the voting of such stock as if the preferred stock had the voting rights of the common stock of the employer having the greatest voting power.

Effective Date

The proposal would generally be effective with respect to loans made after June 6, 1989, including (except as provided below) loans made after June 6, 1989, to refinance loans made on or before June 6, 1989. The proposal would not apply to any loan (1) pursuant to a binding written commitment to make a securities acquisition loan in effect on June 6, 1989, and at all times thereafter before the loan is made, (2) the proceeds of which are use to acquire employer securities pursuant to a written binding contract (or tender offer registered with the Securities and Exchange Commission) in effect on June 6, 1989, and at all times thereafter before such securities are acquired, (3) to the extent made to finance the acquisition of employer securities by an ESOP pursuant to a collective bargaining agreement between employee representatives and one or more employers ratified on or before June 6, 1989, or agreed to on or before such date and ratified within a reasonable period of time after such agreement and which agreement which sets forth the material terms of the ESOP, or (4) with respect to which a filing was made with an agency of the United States on or before June 6, 1989, which specified the aggregate principal amount of the loan or debt obligations, and (a) such filing specifies that the loan is intended to be a securities acquisition loan (as defined in sec. 133) and is for registration required to permit the offering of such loan, or (b) such filing is for approval required in order for the ESOP to acquire more than a certain percentage of the stock of the employer. The grandfather in item (4) relates only to

governmental filings required in order for the ESOP debt to be issued or the employer securities to be acquired by the ESOP and, thus, for example, does not apply to requests for a determination letter from the Internal Revenue Service that the ESOP is a qualified plan.

In addition, the proposal would not apply to loans made after June 6, 1989, to refinance loans made on or before such date (or to refinance loans described in the preceding paragraph), if (1) such refinanced loan meets the requirements of section 133 (as in effect before the amendments made by the proposal), (2) the outstanding principal amount of the loan is not increased, and (3) the term of such loan does not extend beyond the later of (a) the last day of the term of the original securities acquisition loan, or (b) the last day of the 7-year period beginning on the date the original securities acquisition loan was made.

It is intended that the refinancing rules described above also apply in the case of a securities acquisition loan that consists of a loan to the employer with a corresponding loan to the ESOP (a "back-to-back" or "mirror" loan) (see sec. 133(b)(3)), if the loan is restructured so that the loan is directly from the financial institution to the ESOP with a guarantee from the employer rather than a loan from the employer.

With respect to the grandfather rule for certain loans made after June 6, 1989, the legislative history would provide that the existence of a written binding loan commitment can be demonstrated, for example, by a combination of documentation by the lender, written communications by the borrower or the borrower's agent (e.g., an investment banker or a broker), and documentation of the borrower showing that the loan was approved by the lender and that the offer to make the loan was received by the borrower. Such documentation would have to include the principal terms of the loan, such as the principal amount, interest rate or spread or formula pursuant to which the interest rate will be set, and maturity of the loan. The binding contract rules apply to all types of securities acquisition loans, including immediate allocation loans.

D. Foreign Provisions

1. Conform tax years of certain controlled foreign corporations and foreign personal holding companies to tax years of certain U.S. shareholders

Present Law

A controlled foreign corporation is deemed to distribute certain earnings and profits to its U.S. shareholders on the last day of the controlled foreign corporation's taxable year. Similar rules apply to a foreign personal holding company. There is no requirement that the taxable year end of such foreign corporations conform to the taxable year end of their U.S. shareholders. By contrast, the ability of taxpayers to defer income inclusions by manipulating the taxable years of other pass-through entities was significantly curtailed by the 1986 Act.

Explanation of Proposal

The proposal would generally require the taxable year of a controlled foreign corporation to conform to the taxable year of any U.S. shareholder that directly, indirectly, or by attribution owns more than fifty percent of the outstanding stock of the controlled foreign corporation. Alternatively, the controlled foreign corporation would be allowed to use a taxable year end which provides no more than one month of income deferral to such majority U.S. shareholder. For example, if the majority U.S. shareholder has a taxable year end of December 31, then under the proposal, the controlled foreign corporation would be permitted to use either November 30 or December 31 as its year end. If, as a result of attribution of stock ownership, more than one such majority U.S. shareholder exists (or there is a U.S. shareholder that is not a majority U.S. shareholder but that owns stock in the controlled foreign corporation, and that stock is regarded as owned by a majority U.S. shareholder), then the controlled foreign corporation would generally be required to use the year which results in the least aggregate amount of deferral of income to such U.S. shareholders as its taxable year.

In the case of a foreign personal holding company that is not also a controlled foreign corporation, the proposal would require the company to adopt the taxable year of its shareholder who is a U.S. person and who directly, indirectly, or by attribution owns more than fifty percent of the outstanding stock of the foreign personal holding company. If, by attribution, there is more than one such majority U.S. shareholder (or there is a U.S. shareholder that is not a majority U.S. shareholder but that owns stock in the foreign personal holding company, and that stock is regarded as owned by a majority U.S. shareholder), then the foreign personal holding company would generally be required

to use as its taxable year the year which results in the least aggregate amount of deferral to such U.S. shareholders.

The proposal to require taxable year conformity would not apply to a controlled foreign corporation or a foreign personal holding company that does not have a U.S. shareholder who is considered to own under applicable ownership attribution rules more than fifty percent of the value of the outstanding stock of such corporation.

The proposal additionally would allow a foreign personal holding company two and one-half months beyond the close of its taxable year to distribute its undistributed foreign personal holding company income for such year. The distribution would be treated as paid during such year and would be required to be included in the income of the recipient U.S. shareholder (under the principles of section 551(f)) for its taxable year in which the taxable year of the foreign personal holding company ends.

Effective Date

The proposal would be effective for taxable years beginning after July 10, 1989. In the case of a controlled foreign corporation or foreign personal holding company that would be required by this proposal to change its taxable year for its first taxable year beginning after July 10, 1989, each shareholder that would otherwise be required to include income from more than one taxable year of such corporation in any one of its taxable years would take into account the income for the short taxable year of the corporation ratably over a period not to exceed four years, beginning with its taxable year with which or within which the short taxable year of the corporation ends.

2. Resourcing income to prevent avoidance of foreign tax credit limitation rules relating to foreign losses

Present Law

Members of an affiliated group of corporations may file (or be required to file) consolidated returns. To be a member of an affiliated group for this purpose, a corporation must be an "includible corporation," and a controlling percentage of the stock of the corporation (unless it is the common parent) must be owned by an "includible corporation." Under section 1504(b), foreign corporations and certain other types of corporations do not qualify as includible corporations.

Each foreign tax credit limitation to which a consolidated group is subject varies directly with the ratio of (1) the foreign source taxable income of the group subject to that limitation, to (2) the entire taxable income of the group. Under foreign tax credit limitation rules relating to foreign losses, a net loss in a separate foreign tax credit limitation category, or in the general limitation category, reduces positive foreign source taxable income in each of the other categories.

Explanation of Proposal

The proposal gives the Treasury authority to resource the income of any member of an affiliated group of corporations (defined to include certain groups that would otherwise not be treated as affiliated because stock of includible corporations is owned indirectly, rather than directly, by other includible corporations), or to modify the consolidated return regulations, to the extent such resourcing or modification is necessary to prevent avoidance of the purposes of the foreign tax credit limitation rules relating to foreign losses. For example, where an includible corporation indirectly controls another includible corporation through a corporation that is not includible, the Treasury would be authorized to recharacterize by regulation foreign source income of the includible corporations as U.S. source income, so that the aggregate U.S. tax liability of those corporations is no less than the tax that that would be imposed if, for foreign tax credit purposes, the includible corporations had joined in filing a consolidated return.

Effective Date

The provision would be effective for taxable years beginning after July 10, 1989.

3. Improve information reporting by U.S. subsidiaries and branches of foreign corporations

Present Law

The Treasury is authorized to distribute, apportion or allocate gross income, deductions, credits, or allowances between or among commonly controlled organizations, trades, or businesses as necessary to prevent the evasion of taxes or to clearly reflect income (sec. 482). Any corporation (U.S. or foreign) that conducts a trade or business in the United States and that is controlled by a foreign person must file an information return reporting all transactions with related foreign persons (sec. 6038A). Failure to comply with this reporting requirement carries a monetary penalty that can reach a maximum of $25,000. "Control" for purposes of section 6038A requires 50-percent ownership by a single foreign person (including ownership attributed to that person).

The IRS is authorized to summon certain persons to produce books, papers, records, and other data that may be relevant to the examination of any return (sec. 7602). However, such summonses may not be practically or legally enforceable in all appropriate cases, especially where summoned materials are in the possession of a foreign person.

Explanation of Proposals

Requirements imposed on taxpayers

1. Apply the reporting requirements of section 6038A to corporations that are owned by 25-percent foreign shareholders, and to transactions involving such shareholders.

2. Require certain books, papers, records and other data (generally as specified in Treasury regulations) that are necessary to determine the tax liability of a corporation that is subject to the reporting requirements of section 6038A ("reporting corporation") to be maintained in the United States for each transaction that is required to be reported under section 6038A ("reportable transaction"). Treasury would be authorized to limit the categories of records required to be maintained in the United States. Translation of any such documents into English, where necessary to determine the tax liability of the reporting corporation, will not be required until the time specified in Treasury regulations. Treasury would be authorized to modify the generally applicable requirements that it prescribes under this provision in appropriate specific cases, including by entering into record-retention agreements that accomplish the purposes of this provision.

3. Require any foreign person that is a related party of any reporting corporation to designate such corporation as its agent to accept service of process in connection with IRS summonses related to any reportable transaction, solely for the purpose of determining the tax liability of the reporting corporation. It is contemplated that where records of the related party are obtainable on a timely and efficient basis under a procedure in a treaty, the Service would make use of that procedure before issuing a summons to the designated agent.

Penalties for noncompliance

1. Increase the existing $1,000 penalty for failure to meet the requirements of section 6038A (as expanded by the proposal) to $10,000, and remove the current $24,000 ceiling on additions to that penalty.

2. Authorize the Secretary to (1) reduce or disallow deductions claimed by the reporting corporation for amounts paid or incurred to the related party in connection with reportable transactions, and (2) reduce or eliminate the cost (including all components of the cost of goods sold) to the reporting corporation of property acquired from or transferred to the related party in connection with a reportable transaction, in the event that the reporting corporation and the related party fail to satisfy information availability requirements specified by this provision. Failures that the Secretary may take into account include (a) the failure by a related party to designate a reporting corporation as its agent to accept service of summonses related to reportable transactions (for purposes of determining the tax liability of the reporting corporation), and (b) the failure by a reporting corporation or a foreign person related thereto to produce books, papers, records, or other data that are properly required by the IRS in the examination of a reportable transaction. Treasury would be authorized to disregard certain de minimis failures.

Report to Congress

Require the IRS to report to Congress on its efforts to audit U.S. subsidiaries and branches of foreign-based multinationals.

Effective Date

The provisions would apply to taxable years beginning after July 10, 1989.

E. Excise Tax Provisions

1. Repeal Airport and Airway Trust Fund tax reduction trigger

Present Law

The tax rates of certain of the excise taxes which fund the Airport and Airway Trust Fund (AATF) generally will be reduced by 50 percent as of January 1, 1990, because AATF appropriations for fiscal years 1989 and 1990 for airport improvement, facilities and equipment, and research, engineering and development programs were 79 percent, instead of at least 85 percent, of the amounts authorized for those fiscal years. The tax rate reductions are required under provisions of the Airport and Airway Revenue Act of 1987, because of the expressed concern by the Congress that the trust fund programs cited above were not being funded adequately.

The present levels of AATF excise taxes are scheduled to expire after December 31, 1990.

The AATF excise tax rates which will be reduced by 50 percent are: (1) 8 percent tax on air passenger transportation; (2) 5 percent tax on air freight; and (3) 14 cents-per-gallon tax on jet fuel used in noncommercial aviation. The 3 cents-per-gallon additional tax on gasoline used in noncommercial aviation (in addition to the basic 9 cents-per-gallon tax under section 4081) would be eliminated and 3 cents of the 9 cents-per-gallon gasoline tax would be refunded or credited to ultimate purchasers using the gasoline in noncommercial aviation. The $3 per person international departure tax would not be reduced.

Explanation of Proposal

The 1990 reduction in AATF excise tax rates would be repealed. Present law excise tax rates relating to air passenger transportation, air freight transportation, and gasoline and other fuels used in noncommercial aviation would remain unchanged.

Administration position

The Administration proposed, in its budget recommendations, that the trigger be repealed. It also indicated, in a letter to the Chairman of the Committee on Ways and Means of the House of Representatives, its support for increased spending for the airport improvement program, with concern for capacity and security projects. The Committee on Finance understands that the Administration continues to endorse that position.

Effective Date

The proposal would be effective beginning on January 1, 1990.

2. Increase international air passenger departure tax

Present Law

The international air passenger departure tax is $3 per person. The tax is imposed when the air passenger ticket is purchased.

Revenues from this tax are deposited in the Airport and Airway Trust Fund. The tax is scheduled to expire after December 31, 1990.

Explanation of Proposal

The departure tax on international air passenger transportation would be increased by $3 per person to $6 per person.

Effective Date

The proposal would become effective on January 1, 1990, with respect to international departures on and after that date.

3. Ship passengers international departure tax

Present Law

There are no Federal taxes or fees currently imposed on cruise ship passengers. Cruise ships using U.S. ports are subject to a .04 percent excise tax on the value of commercial cargo and passenger fares (sec. 4461). Revenues from this tax are deposited in the Harbor Maintenance Trust Fund.

Under special rules, no harbor maintenance tax applies to cruise ships loading or unloading with respect to cruises to or from Alaska, Hawaii, or a U.S. possession, unless the Alaska, Hawaii, or U.S. possession port is only a stopover to a foreign destination.

Explanation of Proposal

There would be imposed a tax of $3 per passenger on a covered voyage on a passenger vessel having berth or stateroom accommodations for more than 16 passengers that embarks from a United States port on a voyage that extends over one or more nights. The tax also would be imposed on a vessel transporting passengers engaged in gambling aboard the vessel beyond the territorial sea of the United States. The tax would be assessed only once for each passenger on a covered voyage, either when a passenger first embarks or disembarks in the U.S.

The tax would not be imposed on a vessel on a voyage of less than 12 hours between two points in the United States, or a vessel owned and operated by a State or a political subdivision of a State.

Effective Date

The proposal would be effective on January 1, 1990.

4. Petroleum Excise Tax for Oil Spill Liability Trust Fund

Present Law

Present law (Code sec. 4611) establishes an excise tax at the rate of 1.3 cents per barrel on domestic crude oil and imported petroleum products (including imported crude oil) for the purpose of funding the Oil Spill Liability Trust Fund. However, the tax will not be imposed until the enactment of qualified authorizing legislation.[1] Although the tax itself was enacted in 1986, qualified authorizing legislation has not yet been enacted. Consequently, this tax has never been collected.

The tax on domestic crude oil would be imposed on the operator of any United States refinery receiving such crude oil, while the tax on imported petroleum products would be imposed on the person entering the product into the United States for consumption, use, or warehousing. If domestic crude oil were used in, or exported from, the United States before imposition of the tax on the operator of a refinery, the tax would be imposed on the user or exporter of the oil.

Repayable advances could be made to the Trust Fund from the general fund of the Treasury in a maximum outstanding amount of $500 million. The maximum amount which could be paid from the Trust Fund for any single incident is $500 million, no more than $250 million of which could be used to pay for natural resource damage claims (sec. 9509(c)). Certain costs incurred by the Federal Government for oil spill removal are authorized by the Federal Water Pollution Control Act and the Intervention on the High Seas Act and are permissible Trust Fund expenditure purposes which, although subject to appropriation, do not require the enactment of the qualified authorizing legislation which is necessary to commence collection of the 1.3-cents-per-barrel excise tax.

The Oil Spill Liability Trust Fund excise tax is scheduled to expire on December 31, 1991. The tax will terminate earlier than that date if the Secretary of the Treasury determines that $300 million has been credited to the Trust Fund before January 1, 1992.

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[1] The Code (sec. 4611(f)) requires that the authorizing legislation must be substantially identical to subtitle E of title VI, or subtitle D of title VIII, of H.R. 5300 of the 99th Congress as passed the House of Representatives.

Explanation of Proposal

The proposal would modify present law to impose the tax at a rate of 3 cents per barrel and to commence collection of the tax for the Trust Fund expenditure purposes which under present law do not require the enactment of qualified authorizing legislation. Upon the enactment of qualified authorizing legislation, Trust Fund amounts could be available for additional expenditure purposes. The proposal specifies that qualified authorizing legislation includes S. 686, "The Oil Pollution Liability and Compensation Act of 1989" as passed by the Senate August 4, 1989, for this purpose. As under present law, collection of the tax would cease December 31, 1991, or earlier if $300 million had been credited to the Trust Fund.

Effective Date

The provision would require the collection of the tax to commence on January 1, 1990.

5. Excise tax on ozone-depleting chemicals

Present Law

The use or manufacture of chemicals which deplete the ozone layer is not subject to Federal tax under present law.

Explanation of Proposal

The proposal would assess an excise tax on the sale or use by a manufacturer of certain ozone-depleting chemicals and on the import into the United States of such chemicals or products containing such chemicals. Ozone-depleting chemicals include: chlorofluorocarbons ("CFCs") (which generally are used as refrigerants, foam blowing agents, and solvents) and halons. Those chemicals subject to tax would be those chemicals subject to production and consumption restrictions under the Montreal protocol.

The amount of tax would be determined by multiplying a base tax amount by an "ozone-depleting factor." The ozone-depleting factor would reflect the potential ozone depletion which would result from one kilogram of a given chemical compared to the ozone depletion which results from one kilogram of CFC-11 (trichlorofluoromethane).[1]

For the period beginning January 1, 1990, and ending December 31, 1990, the provision would not apply in the case of the manufacture or sale of halons or the sale or use by a manufacturer of ozone-depleting chemicals for the purpose of manufacturing or selling rigid foam insulation, or the import into the United States of chemicals or products containing such chemicals for such purposes. For calendar years 1991, 1992, and 1993, a credit against the excise tax would be provided for halons and rigid foam insulation in a credit percentage that equates the tax per pound of qualifying chemical to a net tax of 25 cents per pound of ozone-depleting chemical, prior to any adjustment for inflation indexing.

The base tax rate on ozone-depleting chemicals would be $1.10 per pound for 1990 and 1991, $1.60 per pound for 1992, and $3.10 per pound for 1993 and beyond. The base tax amount would be indexed for inflation which occurs after 1989.

Effective Date

The provision would be effective for ozone-depleting chemicals produced in or imported into the United States after December 31, 1989. In addition, a floor stocks tax

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[1] CFC-11 is assigned an ozone depleting factor of 1.0.

would be imposed on ozone-depleting chemicals held by a dealer for sale on January 1, 1990, and on every subsequent January when the tax rate on taxed chemicals changes. For 1990, collection of the tax would not begin until April 1, 1990.

6. Excise tax for Coastal Wetlands Trust Fund

Present Law

Excise taxes are imposed under present law with respect to certain substances, such as crude oil, feedstock chemicals, and chemical derivatives. Receipts from these excise taxes are appropriated to trust funds to pay costs incurred in the cleanup of hazardous wastes, oil spills, and leaking underground storage facilities.

Internal Revenue Code section 4611 establishes an excise tax of 1.3 cents per barrel on domestic crude oil and imported petroleum products (including imported crude oil) for the purpose of funding the Oil Spill Liability Trust Fund (the "Oil Spill Fund"). However, under present law, the tax will not be imposed until qualified authorizing legislation is enacted. Oil Spill Fund expenditure purposes would include payment of removal costs of an oil spill and certain otherwise uncompensated claims. In addition, funds would be available to carry out specific provisions of other legislation relating to oil discharges and pollution. The Oil Spill Fund excise tax currently is scheduled to expire on December 31, 1991, or on an earlier date if the Secretary of the Treasury estimates that $300,000,000 will be credited to the Fund before January 1, 1992.

The Offshore Oil Pollution Compensation Fund (the "Offshore Pollution Fund") is established by Title 43 U.S.C. section 1812. The Offshore Pollution Fund is financed by a fee not to exceed 3 cents per barrel on oil obtained from the Outer Continental Shelf, which is imposed on the owner of the oil when it is produced, and by monies recovered by the Fund in actions against polluters. The Offshore Pollution Fund is available to pay for offshore (and adjoining shoreline) cleanups and for damages resulting from an oil spill where the owner or operator of a vessel or offshore facility is incapable of meeting its obligation. The 3-cent-per-barrel fee authorized by 43 U.S.C. section 1812 terminates when the amount in the Offshore Pollution Fund reaches $200,000,000.

Explanation of Proposal

An excise tax of 3 cents per barrel would be imposed on oil obtained from the Outer Continental Shelf (i.e., from offshore drilling) for the purpose of financing a Coastal Wetlands Trust Fund ("wetlands fund") to be used for the preservation and restoration of wetlands. In addition, an excise tax of 2 cents per thousand cubic feet would be imposed on natural gas obtained from the Outer Continental Shelf, also for the purpose of financing the wetlands fund. The excise taxes would be imposed on the owner of such oil or natural gas at the time it is produced.

Expenditures from the wetlands fund of receipts collected from excise taxes imposed on oil or natural gas obtained from the Outer Continental Shelf would be contingent upon the enactment of qualified authorizing legislation. The excise taxes provided for by this proposal would expire on December 31, 1994.

Effective Date

Imposition of the excise taxes provided for by the proposal would commence January 1, 1990.

7. Accelerate payment schedule for the gasoline excise tax

Present Law

Deposits of gasoline excise tax liability are made monthly or semi-monthly, depending on the amount of tax to be deposited.

Taxpayers must make monthly deposits of tax for any month in which they are liable for more than $100 of taxes, and the monthly deposits are due by the last day of the following month. Taxpayers liable for more than $2,000 of excise taxes for any month of a calendar quarter must make semi-monthly deposits in the following quarter 9 days after the end of a semi-monthly period which ends on the 15th or last day of a month. Taxpayers who deposit by electronic wire transfers to a government depositary have until 14 days after the end of a semi-monthly period to make the transfer.

Explanation of Proposal

Taxpayers which have more than $100 in any month of a calendar quarter of gasoline excise tax liability would make tax deposits four times in a month.

Nine day and 14 day depositors would make tax deposits at those same intervals after the end of the tax period, but there would be four tax periods in each month. The tax periods would end on the 7th, 14th, 21st, and last days of the month. Nine day taxpayers would deposit tax liabilities, with respect to the weekly tax periods on the 16th, 23rd, 30th days, respectively, of the same month and on the 9th day of the succeeding month. For the same tax periods, 14 day taxpayers would make their deposits on the 21st and 28th days, respectively, of the current month and on the 7th and 14th days of the succeeding month.

The table also sets forth the proposed payment schedules.

Days in tax period	9 day payers		14 day payers	
1st - 7th	16th day	current month	21st day	current month
8th - 14th	23rd "	" "	28th "	" "
15th - 21st	30th "	" "	7th "	" "
22nd - last	9th "	next "	14th "	next "

Effective Date

The proposal would be effective on January 1, 1990.

F. Accounting Provisions

1. Repeal of the completed contract method of accounting for long-term contracts

Present Law

Taxpayers engaged in the production of property under a long-term contract generally must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. However, exceptions to these required accounting methods are provided for certain construction contracts of small businesses and certain home construction contracts.

Under the percentage of completion-capitalized cost method, a taxpayer generally must take into account 90 percent of the items under the contract under the percentage of completion method. The remaining 10 percent of the items under the contract must be taken into account under the taxpayer's normal method of accounting (e.g., the completed contract method of accounting). Exceptions to the 90/10 requirement are provided for certain ship construction contracts (40 percent under the percentage of completion method and 60 percent under the taxpayer's normal method of accounting) and certain residential construction contracts other than home construction contracts (70 percent under the percentage of completion method and 30 percent under the taxpayer's normal method of accounting).

Explanation of Proposal

The percentage of completion-capitalized cost method of accounting for long-term contracts would be repealed. The present-law special rules and exceptions for certain construction contracts of small businesses, qualified ship contracts, home construction contracts and residential construction contracts would be retained.

Effective Date

The proposal would apply to contracts entered into on or after July 11, 1989. However, the proposal would not apply to any contract entered into pursuant to a written bid or proposal submitted by a taxpayer to the other party to the contract before July 11, 1989, if the bid or proposal could not have been revoked or amended by the taxpayer at any time during the period after July 10, 1989, and ending on the date that the contract was entered into.

2. Treatment of amounts paid on account of the transfer of a franchise, trademark or trade name

Present Law

A taxpayer that purchases an intangible asset (such as a patent, know-how, or a contract right) is generally allowed a deduction for the purchase price over a period no shorter than the useful life of the asset. If the useful life is not determinable or is perpetual, no deduction is generally permitted. The useful life of an asset is a question of fact.

A taxpayer that leases an asset and pays continuing rents or royalties (e.g., a recurring annual percentage of sales) is generally allowed a deduction as the rent or royalties are paid. If the lessee makes a payment of an initial fixed sum at the start of the lease, a deduction is generally allowed for the payment over the life of the lease. The life of a lease is a question of fact.

Section 1253(d) of the Code provides exceptions to these rules in the case of certain payments made on account of the transfer of a franchise, trademark or trade name. For example, in the case of a single payment made in discharge of a fixed-sum amount where the transferor is required to treat the payment as ordinary income rather than as capital gain, section 1253(d) provides that the payment is to be deducted ratably over a period of no more than 10 taxable years, regardless of the useful life of the franchise, trademark or trade name. In addition, section 1253(d) provides that any amount paid or incurred on account of the transfer of a franchise, trademark or trade name which is contingent on the productivity, use, or disposition of the asset transferred is allowed as an ordinary and necessary business expense deduction.

Explanation of Proposal

The special rules applicable to the deduction of fixed-sum payments and contingent payments that are made on account of the transfer of a franchise, trademark or trade name would be modified. First, the proposal would repeal the special treatment accorded fixed-sum payments where the total fixed-sum amount for any transaction exceeds $100,000. Second, contingent payments would not be allowed as a deduction for the taxable year in which paid or incurred unless (1) the payments are made at least annually throughout the period that the use of the franchise, trademark or trade name will occur, and (2) the payments are substantially equal in amount or payable pursuant to a fixed formula. Third, fixed-sum and contingent payments that are no longer deductible under the proposal would be chargeable to capital account and would be amortized over the actual useful of the

franchise, trademark or trade name to the extent otherwise allowed under present law. Alternatively, a taxpayer would be allowed to elect to amortize over a 20-year period all fixed-sum payments and contingent payments (other than those deductible for the taxable year in which paid or incurred) that are part of the same transaction (or a series of related transactions).

The proposal would also repeal a provision of present law that prohibits a deduction for costs of acquiring trademarks and trade names and would provide that deductions for certain payments are to be recaptured on the disposition of the franchise, trademark or trade name.

Effective Date

The proposal would apply to transfers that occur after October 2, 1989, unless pursuant to a binding written contract in effect on that date and at all times thereafter until the transfer occurs.

G. Employment Tax Provisions

1. Income tax withholding on the wages of certain agricultural workers

Present Law

In general, wages paid by an employer to an employee are subject to income tax withholding. Wages paid for agricultural labor are, however, exempt from income tax withholding (sec. 3401(a)(2)).

Certain cash wages paid for agricultural labor are subject to withholding for Federal Insurance Contributions Act (FICA) taxes (sec. 3121(a)(8)). In general, agricultural workers are subject to FICA withholding if they earn at least $150 in annual cash remuneration or are covered because of the employer FICA withholding test. The employer FICA withholding test generally subjects employee wages to FICA withholding if the employer pays more than $2,500 during the year to all employees. Certain employees who are hand harvest laborers, are paid on a piece rate basis, commute daily to the farm from their permanent residence, and were employed in agriculture less than 13 weeks during the prior year, are exempt from FICA withholding.

Explanation of Proposal

If an agricultural worker's cash wages are subject to FICA withholding, the agricultural worker's cash wages also would be subject to income tax withholding. In addition, crew leader rules parallel to those utilized for FICA withholding purposes are to apply for income tax purposes (these rules specify who is the employer of certain agricultural workers).

Effective Date

The proposal would be effective for wages paid after December 31, 1989.

H. Other Revenue-Raising Provisions

1. Tax pre-contribution gain on certain in-kind partnership distributions

Present Law

Under present law, income, gain, loss and deduction with respect to property contributed to a partnership by a partner is required to be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time when it was contributed (sec. 704(c)). If appreciated property that was contributed to a partnership is sold, the partnership's gain generally is required to be allocated to the contributing partner, to the extent that the partner has not theretofore recognized pre-contribution appreciation in the property.

Present law does not provide the same result in the case of a distribution (rather than sale) of the contributed property, however. In general, gain is recognized upon a distribution from a partnership only to the extent that cash is distributed in excess of the partner's basis in his partnership interest. Thus, under present law, the pre-contribution gain may not be recognized by the contributing partner if the contributed property is distributed to another partner instead of sold by the partnership.

Explanation of Proposal

In the case of a distribution of contributed property, the contributing partner would be treated as recognizing pre-contribution gain or loss. The amount of gain or loss recognized by the contributing partner would be the amount that he would have been required to take into account if the partnership had sold the property at its fair market value at the time of the distribution, to the extent he had not previously taken into account the pre-contribution gain or loss. Gain or loss recognition would not be required, however, to the extent property is distributed back to the partner or partners who contributed the property. In addition, gain or loss recognition would not be required when a distribution of contributed property (to a partner other than the contributor) is accompanied within six months by a distribution of section 1031 like-kind property to the contributing partner.

The legislative history would provide that a constructive termination of the partnership would not change the application of section 704(c) (as modified by the proposal) to pre-contribution gain or loss with respect to

previously contributed property, and that a constructive termination would not cause gain or loss recognition under the proposal.

The provision would apply to distributions of contributed property within the three year period following the contribution of the property.

Effective Date

The provision would be effective for contributions of property to a partnership after July 10, 1989, in taxable years ending after such date.

2. Restrict basis shifting techniques between related parties in like-kind exchanges

Present Law

An exchange of property, like a sale, generally is a taxable transaction. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like-kind" which is to be held for productive use in a trade or business or for investment (sec. 1031).

If related parties engage in a like-kind exchange that qualifies for nonrecognition treatment under section 1031, a subsequent disposition of the property by the transferee generally will not affect the nonrecognition treatment of the original exchange. In contrast, present law prevents the use of related party sales to avoid current recognition of gain in the case of installment sales. Under section 453 (relating to the installment method of reporting gain), if an installment sale between related parties is followed by certain dispositions of the property by the transferee, the gain reportable by the original seller will be accelerated.

Explanation of Provision

If a taxpayer exchanges property with a related party (as defined for purposes of sec. 267) and the taxpayer would otherwise be eligible for nonrecognition treatment with respect to the exchange of such property under section 1031, and within two years of the date of the last transfer which was part of the exchange, either the related party disposes of such property or the taxpayer disposes of the like-kind property received in the exchange from the related party, then the original exchange would not qualify for nonrecognition under section 1031. Any gain or loss not recognized by the taxpayer as of the date of the original exchange would, subject to the loss limitation rules of section 267, be recognized as of the date of the subsequent disposition. A disposition of the property would not invalidate the nonrecognition treatment of the original exchange if such disposition is due to the death of either party or the involuntary conversion of the property, or if it is established to the satisfaction of the Secretary of the Treasury that neither the exchange nor the disposition had as one of its principal purposes the avoidance of Federal income tax. It is intended that the non-tax avoidance exception generally would apply to: (i) a transaction involving an exchange of undivided interests in different properties that results in each taxpayer holding the entire interest in a single property; and (ii) dispositions of property in nonrecognition transactions.

Nonrecognition would not be accorded to any exchange

which is part of a transaction or series of transactions structured to avoid the purposes of this provision. For example, if a taxpayer, pursuant to a prearranged plan, transfers property to an unrelated party who then exchanges the property with a party related to the taxpayer within two years of the previous transfer in a transaction otherwise qualifying under section 1031, the related party would not be entitled to nonrecognition treatment under section 1031.

The running of the two-year holding period would be suspended during any period with respect to which a party's risk of loss with respect to the property is substantially diminished.

Effective Date

The provision would apply to transfers after July 10, 1989, other than transfers pursuant to a written binding contract in effect on July 10, 1989 and at all times thereafter before the transfer. For this purpose, a written contract which, on July 10, 1989, and at all times thereafter before the transfer, obligates the taxpayer to transfer the property to another party would not fail to qualify as a binding contract solely because it provides in the alternative for an exchange or a sale, or solely because the property to be received in the exchange was not identified on or before July 10, 1989.

DESCRIPTION OF REVENUE RECONCILIATION PROPOSAL

PART TWO: EXPIRING PROVISIONS, CHILD CARE INITIATIVE, AND IRAs

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Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on October 3, 1989

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 3, 1989

JCX-58-89

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of Part Two of a revenue reconciliation proposal for consideration by the Senate Committee on Finance at a markup scheduled for October 3, 1989. This part describes expiring provisions, child care initiative and individual retirement accounts (IRAs).

Part One (separate JCX-57-89) describes revenue-raising provisions of the revenue reconciliation proposal.[2]

Part Three (separate JCX-59-89) describes other, miscellaneous tax provisions of the revenue reconciliation proposal.

A separate document provides estimated budget effects of the specific revenue provisions.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Revenue Reconciliation Proposal: Part Two (Expiring Provisions, Child Care Initiative, and IRAs (JCX-58-89), October 3, 1989.

[2] Also, see separate document (JCX-56-89) for a description of technical corrections provisions.

H. Extensions of Expiring Tax Provisions

1. Exclusion for employer-provided educational assistance

Present Law

Under present law, an employee is required to include in income, for income and employment tax purposes, the value of educational assistance provided by an employer to the employee, unless the cost of such assistance qualifies as a deductible job-related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continuing employment in the same job.

Under prior law, an employee's gross income for income and employment tax purposes also did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). The exclusion was limited to $5,250 of educational assistance with respect to an individual during a calendar year.

For years prior to 1988, educational assistance included assistance related to graduate-level course work. However, for years beginning in 1988, the exclusion did not apply to any payment for, or the provision of any benefits with respect to, any graduate-level courses.

The Deficit Reduction Act of 1984 required that employers file information returns with respect to educational assistance plans under section 127 (sec. 6039D). The purpose of this requirement was to collect data with respect to the use of such plans so as to provide Congress with a means to evaluate the effectiveness of the exclusion.

The educational assistance exclusion expired for taxable years beginning after December 31, 1988.

Explanation of Proposal

The exclusion for employer-provided educational assistance would be retroactively reinstated and extended so that it expires for taxable years beginning after December 31, 1991. The provision would clarify that, to the extent employer-provided educational assistance is not excludable under section 127 because it exceeds the maximum dollar limitation or because of the limitation on graduate-level courses, it may be excludable from income as a working

condition fringe benefit (sec. 132(d)), provided the requirements of that section are otherwise satisfied (e.g., the education is job-related as defined under section 162). Educational assistance may not be excluded under any other provision of section 132.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1988.

2. Exclusion for employer-provided group legal services

Present Law

Under present law, amounts contributed by an employer to a group legal services plan on behalf of an employee generally are includible in the employee's gross income.

Under prior law, amounts contributed by an employer to a qualified group legal services plan for an employee (or the employee's spouses or dependents) were excluded from the employee's gross income for income and employment tax purposes (up to $70 per year) (sec. 120). The exclusion also applied to any services received by an employee or any amounts paid to an employee under such a plan as reimbursement for the cost of legal services for the employee (or the employee's spouse or dependents). In order to be a qualified plan under which employees were entitled to tax-favored benefits, a group legal services plan was required to fulfill certain requirements. The exclusion for group legal services benefits expired for taxable years ending after December 31, 1988.

In addition, under prior law, an organization, the exclusive function of which was to provide legal services or indemnification against costs of legal services as part of a qualified group legal services plan, was entitled to tax-exempt status (sec. 501(c)(20)). The tax exemption for such an organization expired for years ending after December 31, 1988.

The Deficit Reduction Act of 1984 required that employers file information returns with respect to qualified group legal services plans (sec. 6039D). The purpose of this requirement was to collect data with respect to the use of such plans so as to provide Congress with a means to evaluate the effectiveness of the exclusion.

Explanation of Proposal

The exclusion for employer-provided group legal services and the tax exemption for group legal services organizations would be retroactively reinstated and extended so that it would expire for taxable years beginning after December 31, 1991.

Effective Date

The provision would be effective for group legal services provided in taxable years ending after December 31, 1988, or taxable years of group legal services organizations ending after December 31, 1988.

3. Targeted jobs tax credit

Present Law

Tax credit provisions

A tax credit is available on an elective basis to employees of individuals from one or more of nine targeted groups. The nine groups consist of individuals who are either recipients of payments under a means-tested transfer program, economically disadvantaged (as measured by family income), or disabled.

The credit generally is equal to 40 percent of the first $6,000 of qualified first year wages. The employer's deduction for wages must be reduced by the amount of the credit.

The credit shall not apply to any amount paid or incurred to an individual who begins work for the employer after December 31, 1989.

Authorization of appropriations

Present law also authorizes appropriations for administrative and publicity expenses relating to the credit through September 30, 1989. These moneys are to be used by the IRS and Department of Labor to inform employers of the credit program.

Explanation of Proposal

Under the proposal, the credit would be extended for two years, with one modification.

The modification requires that employers specifically identify the categories (not to exceed two) for which an individual is believed to be eligible when requesting certification of individual eligibility for individuals who have not received a preliminary determination of eligibility from the designated local agency. In addition, the employer must include a statement on the certification request that a good faith effort was made to determine that the individual may be eligible for the credit.

The authorization for appropriation would also be extended for two years.

Effective Date

The proposal would extend the credit to amounts paid or incurred to a targeted-group individual who begins work for the employer after December 31, 1989, and before January 1, 1992. The credit does not apply with respect to individuals

who begin work for the employer after December 31, 1991.

The proposal would also provide that the authorization for appropriations for the period October 1, 1989, through September 30, 1991 (fiscal years 1990 and 1991).

4. Research and experimentation tax credit

Present Law

Incremental credit

General rule.-- A 20-percent tax credit is allowed for qualified research expenditures incurred by a taxpayer in carrying on a trade or business. Except for certain university basic research payments, the credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed the average amount of the taxpayer's yearly qualified research expenditures in the "base period," meaning the preceding three taxable years.

The credit is scheduled to expire after December 31, 1989.

Base limitation.--The amount of base-period research expenditures is treated as equal to at least 50 percent of the taxpayer's qualified research expenditures for the current year.

Trade or business limitation.--Research expenditures of a taxpayer are eligible for the credit only if paid or incurred in a particular trade or business already being carried on by the taxpayer.

Eligible expenditures.--Research expenditures eligible for the 20-percent incremental credit consist of (1) "in-house" expenditures by the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf.

Expenditures attributable to research which is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

Aggregation rules and changes in business ownership.--To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related persons, research expenditures of the taxpayer are aggregated with research expenditures of certain related persons for purposes of computing any allowable credit.

Special rules apply for computing the credit when a

business changes hands, under which qualified research expenditures for periods prior to the change of ownership generally are treated as transferred with the trade or business which gave rise to those expenditures.

University basic research credit

In addition to the 20-percent incremental credit, there is a 20-percent tax credit for certain corporate expenditures for university basic research. This credit applies to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research over (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

This credit also is scheduled to expire after December 31, 1989.

Relation of credit to section 174 deduction

For taxable years beginning after 1988, the amount of any deduction allowable to a taxpayer under section 174 or any other provision for qualified research expenditures is reduced by an amount equal to 50 percent of the taxpayer's research credit determined for that year.

Explanation of Proposal

Incremental credit: sales ratio R&E tax credit

General rule

A 20-percent tax credit would be allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit would be made permanent.

The base amount for the current year would be computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years.

Fixed-base percentage

Existing firms.--If a taxpayer both incurred qualified R&E expenses and had gross receipts[1] during each of at least

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(Footnote continued)

three years from 1984 to 1988, then its "fixed-base percentage" would be the ratio that its total qualified R&E expenses for the 1984-88 period bears to its total gross receipts for this period (subject to a maximum ratio of .16, as described below).

Start-up companies.--If a taxpayer did not both incur qualified R&E expenses and have gross receipts during each of at least three years between 1984-1988, then for each of its first five taxable years after 1989 in which it incurs qualified R&E expenditures, the taxpayer would be assigned a fixed-base percentage of .03.

After its first five taxable years after 1989 in which it incurs qualified R&E expenses, a start-up firm's fixed-base percentage would be computed as follows: (1) for the firm's sixth year, its fixed-base percentage would be equal to one-sixth of its research-to-gross receipts ratio for its fourth and fifth years; (2) for the firm's seventh year, its fixed-base percentage would be one-third of its ratio for its fifth and sixth years; (3) for the firm's eighth year, its fixed-base percentage would be one-half of its ratio for its fifth through seventh years; (4) for the firm's ninth year, its fixed-base percentage would be two-thirds of its ratio for its fifth through eighth years; (5) for the firm's tenth year, its fixed-base percentage would be five-sixths of its ratio for its fifth through ninth years; and (6) after a firm's tenth year, its fixed-base percentage would be its actual research-to-gross receipts ratio for five years selected by the firm from its fifth through tenth years.

Maximum fixed-base percentage.--A taxpayer's fixed-base percentage would not exceed .16.

Base limitation

As under current law, a taxpayer's base could not be less than a certain percentage of current-year qualified R&E expenditures. The base limitation percentage for all firms would be 50 percent for taxable years beginning in 1990; 55 percent for taxable years beginning in 1991; 60 percent for taxable years beginning in 1992; 65 percent for taxable years beginning in 1993; 70 percent for taxable years beginning in 1994; and 75 percent for taxable years beginning in 1995 or later.

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[1](continued)
[1] The Treasury Department would be authorized to prescribe regulations providing that de minimis amounts of qualified R&E expenses and gross receipts may be disregarded (including under the start-up company rules described infra).

Trade or business limitation

A taxpayer would be treated as meeting the trade or business requirement with respect to in-house research expenses if, at the time such in-house research expenses are incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business of the taxpayer or certain related taxpayers.

Consistent treatment of R&E expenses

Qualified research expenses taken into account in computing a taxpayer's fixed-base percentage are to be treated on a basis which is consistent with the determination of qualified research expenses for the current year.[2]

Treasury Department study

The Trerasury Department would be required to conduct a study during each 5-year period beginning on January 1, 1990, to determine whether revenue losses from the credit are consistent with the projections, to evaluate whether the rules for computing the base for start-up firms are appropriate in view of actual trends in qualified research expenditures and gross receipts of those firms, and to analyze the effectiveness of the credit in promoting research.

Eligible expenditures

The eligible expenditures for the credit would be the same as under present law.

Aggregation rules and changes in business ~~o~~wnership

The rules relating to aggregation of related persons and changes in business ownership would be the same as under present law, with the modification that when a business changes hands, qualified research expenses and gross receipts for periods prior to the change of ownership would be treated as transferred with the trade or business which gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage.

In addition, a foreign affiliate's gross receipts which

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[2] The Treasury Department would be granted authority to prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts due to a change in accounting methods used by the taxpayer between the current year and a year taken into account in computing the taxpayer's fixed-base percentage.

are not effectively connected with the conduct of a trade or business in the United States would not enter into the computation of the credit.

University basic research credit

The university basic research credit would be permently extended.

Relation of credit to section 174 deduction

The amount of any deduction allowable to a taxpayer under section 174 or any other provision for qualified research expenditures would be reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

The proposal would clarify that research expenses would be deductible under section 174 only to the extent that they are reasonable under the circumstances.

Effective Date

The proposal would be effective after December 31, 1989.

5. Allocation and apportionment of research expenses

Present Law

Computation of the foreign tax credit requires the taxpayer to distinguish between taxable income from U.S. sources and taxable income from foreign sources, and thus to allocate and apportion deductions among items of U.S.-source and foreign-source gross income. Treasury regulations prescribe detailed methods for allocating and apportioning research and experimental (R&D) expenses.

The R&D allocation regulation was suspended in part by a succession of statutes, effective for taxable years beginning after August 13, 1981, and on or before August 1, 1987, as well as for each taxpayer's first taxable year beginning after August 1, 1987. In taxable years beginning after August 13, 1981 and on or before August 1, 1986, all U.S.-incurred R&D expenses were allocated to U.S.-source income. In taxable years beginning after August 1, 1986 and on or before August 1, 1987, 50 percent of such expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographic source) were allocated to U.S.-source income, with the remainder allocated and apportioned either on the basis of sales or gross income.

Expenses incurred during a taxpayer's first taxable year beginning after August 1, 1987 were given bifurcated treatment. Generally, for one third of the year's R&D expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source), 64 percent of U.S.-incurred R&D expenses was allocated to U.S.-source income, 64 percent of foreign-incurred R&D expenses was allocated to foreign-source income, and the remainder of R&D expenses was allocated and apportioned either on the basis of sales or gross income, but subject to the condition that if income-based apportionment was used, the amount apportioned to foreign-source income could be no less than 30 percent of the amount that would have been apportioned to foreign-source income had the sales method been used. Generally, for the other two thirds of the year's R&D expenses, the R&D allocation regulation applied.

Explanation of Proposal

Under the proposal, taxpayers would allocate 64 percent of expenses for R&D conducted in the United States to U.S.-source income, and would allocate 64 percent of expenses for R&D conducted outside the United States to foreign-source income. The remainder of such expenses would be apportioned on the basis of either sales or gross income, but subject to the condition that if income-based apportionment is used, the amount apportioned to foreign-source income can be no less

than 30 percent of the amount that would be apportioned to foreign-source income if the sales method is used.

Effective Date

The provision would be effective for taxable years beginning after August 1, 1989, and on or before August 1, 1991.

6. Business energy tax credits

Present Law

Three nonrefundable business energy tax credits are allowed for certain types of energy property; these tax credits are scheduled to expire after December 31, 1989. The credits (the rates and the property to which they pertain) are:

(1) Business solar--10% credit;
(2) Geothermal--10%; and
(3) Ocean thermal--15%.

Under section 38, these (and other) tax credits may not be used to offset more than 25 percent of regular tax liability above $25,000 or the tentative minimum tax for the taxable year.

The expiration date for these credits was extended for one additional year, i.e., from December 31, 1988, to December 31, 1989, in the Technical and Miscellaneous Revenue Act of 1988. Earlier, these tax credit rates were extended through 1988 in the Tax Reform Act of 1986.

Explanation of Proposal

The energy tax credits for solar energy, geothermal, and ocean thermal property would be extended permanently.

Effective Date

The proposal would be effective on January 1, 1990.

7. Qualified mortgage bonds and mortgage credit certificate program

Present Law

Qualified mortgage bonds

In general

Mortgage revenue bonds qualifying for tax-exemption under section 103 of the Code ("qualified mortgage bonds") are bonds the net proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied homes located within the jurisdiction of the issuer of the bonds.

Eligible purchasers

In general, eligible purchasers must have not owned a residence within the three prior years and must have incomes below 115 percent of the median income for the area or State where the residence is located. For families consisting of less than three persons, the income limitation is 100 percent of the area or State median income.

Purchase price limitations

The acquisition cost of a residence financed with qualified mortgage bonds may not exceed 90 percent (110 percent in targeted areas) of the average area purchase price applicable to the residence.

Recapture

All or part of the subsidy provided by qualified mortgage revenue bond financing or mortgage credit certificates (described below) is recaptured on dispositions of assisted housing which occur within 10 years of purchase by mortgagors whose incomes increased substantially since purchase of their homes. The maximum amount recaptured is 1.25 percent of the original balance of the loan for each year the loan is outstanding, or 50 percent of the gain realized on the disposition, whichever is less. For sales in years six through 10, the 1.25 percent per year is phased out. This recapture provision only applies to loans originated, and mortgage credit certificates issued, after December 31, 1990.

Limitations on volume, arbitrage and unspent proceeds

Mortgage revenue bonds are subject to the general per capita volume limitation on private purpose obligations. Issuers of mortgage subsidy bonds generally must issue mortgages at rates that cannot exceed the rate of interest on

the bonds by more than 1.125 percentage points. In general, bond proceeds not used to make mortgages and mortgage principal payments must be used to redeem outstanding bonds.

Sunset

The authority of State and local governments to issue tax-exempt mortgage subsidy bonds is scheduled to terminate on December 31, 1989.

Mortgage credit certificates

In general

Qualified governmental units may elect to exchange qualified mortgage bond authority for authority to issue mortgage credit certificates (MCCs) (sec. 25). MCCs entitle homebuyers to nonrefundable income tax credits (not to exceed $2,000 per year) for a specified percentage of interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the residence being financed continues to be the certificate-recipient's principal residence. MCCs are generally subject to the same eligibility and targeted area requirements as qualified mortgage bonds.

Sunset

Mortgage credit certificates are scheduled to sunset with respect to nonissued mortgage subsidy bonds elected after December 31, 1989

Explanation of Proposal

The proposal would permanently extend the authority to issue qualified mortgage revenue bonds and to elect to trade-in bond volume authority to issue mortgage credit certificates (MCCs).

Effective Date

The proposal would be effective for bonds issued, and mortgage credit certificates issued pursuant to elections to trade-in State bond volume limitation, after December 31, 1989.

8. Qualified small-issue manufacturing bonds

Present Law

Interest on certain small issues of private activity bonds is exempt from tax if at least 95 percent of the net proceeds of the bonds is to be used to finance manufacturing facilities or certain land or property for first-time farmers ("qualified small-issue bonds").

Qualified small issue-bonds are issues having an aggregate authorized face amount (including certain outstanding prior issues) of $1 million or less. Alternatively, the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the 6-year period beginning three years before the date of the issue and ending three years after that date, may not exceed $10 million. In determining whether an issue meets the requirements of the small-issue exception, certain previous small issues (and in the case of the $10-million limitation, capital expenditures during a 6-year period) are taken into account.

Interest on qualified small-issue bonds is taxable if the aggregate face amount of all outstanding tax-exempt private activity bonds (including exempt-facility bonds, qualified redevelopment bonds, and qualified small-issue bonds) that would be allocated to any beneficiary (other than a section 501(c)(3) organization) of the qualified small-issue bonds exceeds $40 million.

The aggregate amount of qualified small-issue bond financing for first-time farmers for all types of depreciable farm property (including both new and used property) is limited to $250,000 for any person or related persons. The $250,000 is a lifetime limit.

To issue a qualified bond, the issuer must receive an allocation from the State private activity volume cap. Authority to issue qualified small-issue bonds expires December 31, 1989.

Explanation of Proposal

The authority to issue small-issue bonds would be extended for two years (through December 31, 1991).

Effective Date

The proposal would be effective on the date of enactment.

9. Low-income housing tax credit

ITEM	PRESENT LAW	CHAIRMAN'S MARK
1. **Extension of credit**	Authority to allocate low-income housing tax credits expires December 31, 1989.	Provides for a permanent extension of the low-income housing credit.
2. **Carryover of credit authority**	Unused credit authority may not be carried forward, nor may one State's credit authority be made available for projects in another State.	Allows a one-year carryforward of unused credit authority by allocating agencies. Any unused authority after such carryforward is reallocated to other States through a national pool of unused authority. Such carryover must be allocated in the year received.
3. Payment of credit	The owner of a qualifying property receives the credit over 10 years but must maintain compliance with low-income restrictions for 15 years.	Retains present law.
4. Credit recapture	Accelerated portion of credit is recaptured if the qualified basis is reduced or if the property is disposed of without posting bond satisfactory to Treasury.	Retains present law.
5. Extended low-income use and options to purchase	A building for which the owner receives a credit allocation is subject to a 15-year compliance period during which that part of the buildirg for which the credits are claimed must be rented to low-income tenants at restricted rents.	Makes the existence of a 30-year extended low-income use agreement a requirement for credit eligibility. If the taxpayer is unable to transfer property at the end of the initial compliance period for continued low-income use, the allocating agency is allowed one year (beginning at the end of the 14th year of compliance period) to find an eligible buyer at a specified price based on outstanding indebtedness and investor equity contributions. If no such buyer is located, the property may be converted to market rate use with the qualification that existing low-income tenants may not be

ITEM	PRESENT LAW	CHAIRMAN'S MARK
		evicted. The determination of ownership of a qualified low income building is made without regard to options held by qualified nonprofit organizations that did not provide financing during the compliance period.
6. Allowance of credit for acquisition of existing property and substantial rehabilitation	A 70-percent present value credit may be claimed for the taxpayer's basis in both (i) new construction and (ii) qualified substantial rehabilitation expenditures; provides, in each case, that the property is not federally subsidized. A 30-percent present value credit may be claimed for the taxpayer's basis in both qualified acquisition property. To qualify for the acquisition credit, substantial rehabilitation need not be undertaken. To qualify as substantial rehabilitation, qualifying expenditures must average at least $2,000 per low-income unit, but need not be made on the low-income units. Expenses may be incurred over a 24-month period.	Permits the acquisition credit only if substantial rehabilitation is done and increases the minimum qualifying expenditure for substantial rehabilitation from $2,000 to $3,000 average per low-income unit.
7. Passive loss exception	A taxpayer otherwise subject to the passive loss rules is allowed up to a $25,000 deduction-equivalent amount (i.e., credit of up to $7,000) of low-income housing credits, regardless of whether the taxpayer "actively participates" in the activity. This allowance is subject to a phaseout ratably as the taxpayer's adjusted gross income increases from $200,000 to $250,000. No amount of the credit is allowed under the	Retain present law.

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	special $25,000 allowance for individuals with adjusted gross income over $250,000.	
8. Federally subsidized property: Eligibility for 70-percent Credit	In general, the qualified basis of newly constructed buildings or low substantial rehabilitation expenditure which are not federally-subsidized which are not federally subsidized is eligible for a 70-percent present value credit. However, the qualified basis of existing buildings and newly constructed buildings, or substantial rehabilitation expenditures, or substantial rehabilitation expenditures which are federally-subsidized is eligible for a 30-percent present value credit. Alternatively, federally-subsidized property is eligible for the 70-percent present value credit if the federal subsidy is excluded from the eligible basis. A federally-subsidized building is any building for which there was outstanding during the taxable year or any prior year a tax-exempt bond or below market Federal loan, the proceeds of which were used to finance the building or its operation. The qualified basis of a qualified low-income building for any taxable year is determined by multiplying the eligible basis of the building by the lesser of (i) the ratio of number of low-income units to all units in the building, or (ii) the ratio of the floor space of low-income units to floor space of all units.	Retains present law, except as to definition of "substantial rehabilitation".
9. Tax-exempt bond financed property: Annual credit limitation	When 70 percent or more of the aggregate basis of a building and the land on which	Retains present law

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	it is located is financed with the proceeds of tax-exempt bonds which are subject to the State's bond volume cap the owner may claim the 30-percent present value credit for the entire eligible basis of the building without receiving an allocation under the State's annual credit cap.	
10. High-cost areas	A maximum 70-percent present value credit is available for new construction and substantial rehabilitation expenditures..	Increases the maximum credit available to buildings in certain high-cost and very poor areas (up to a 91 percent present value credit).
11. 10-year rule	Generally, properties placed in service within the last 10 years are ineligible for the credit. Exceptions are provided for buildings transferred in which the new owner retains the basis of the previous owner. When the transferor is a qualified tax-exempt organization or a governmental entity, the 10-year rule is applied by looking to the placed in service date of the most recent taxable owner. In addition, exceptions to the 10-year rule are provided (sec. 42(d)) for certain properties, a default on which would result in a Federal Government budget outlay.	Grants a new exception from the 10-year rule for: 1) for certain buildings acquired from failed financial institutions; 2) certain properties which would convert to market use and which are owned by HUD or the Farmers Home Administration or where HUD holds the mortgage loan on the building; and 3) low-income buildings the mortgages on which are subject to prepayment if the exception is necessary to avert conversion of the properties to market rate use. Also, expands definition of "federally-assisted building" to include building with four or more units with mortgages originated by or insured or guaranteed by the Federal Government.
12. Credit and HUD section 8 programs	The credit is available to qualifying properties which also receive direct Federal	Provides that the credit is not available to property receiving assistance under the

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	assistance under HUD Section 8 programs.	HUD Section 8 mod rehab program.
13. Single room occupancy units	A single room occupancy unit is eligible for the credit if the unit is subject to a six-month lease.	Provides that month-to-month leases do not disqualify single room occupancy units for the credit.
14. Four-unit, owner-occupied structures	Owner-occupied buildings with four or fewer units are ineligible for the credit.	Expands eligibility for the credit to owner-occupied buildings having four or fewer units. The expansion only applies to acquisition and rehabilitation of buildings pursuant to a development plan sponsored by a State or local government or qualified nonprofit.
15. Special needs services	Non-housing services may be provided to tenants in rent-restricted units on an optional basis. If such services are mandatory and paid for by the tenant, charges for them are added to rental charges and subject to the 30-percent gross rent restriction.	Expands eligibility of the credit for certain special needs housing and increases current rent restrictions by 20 percent in the case of certain fees paid to owners by governmental units for "supportive services".
16. Scattered site projects	All units in a project must be located on contiguous geographic sites.	Treats scattered site housing as one project if 100 percent of dwelling units are qualified low-income units and there is common plan of financing.
17. Credits allocated to projects	Credits are allocated to buildings, although compliance is determined on a project basis.	Allows an allocation of credit on a project, rather than a building basis.
18. Determination of eligible basis	For the new construction credit, eligible basis is determined at the placed-in-service date. For the acquisition and substantial rehabilitation credits eligible basis is determined at the end of the first taxable year of the credit period. This determination will be made before depreciation is taken into account.	Provides that the determination of eligible basis for all credits is made at the end of the first taxable year of the credit period. This determination will be made before depreciation is taken into account.

ITEM	PRESENT LAW	CHAIRMAN'S MARK
19. Determination of rent for rent-restricted units	Maximum allowable rents for rent-restricted units are determined by 30 percent of qualifying income limitation adjusted for family size.	Uses apartment size rather than family size of occupants as the basis for gross rent limitation. Uses actual family size as basis for qualifying low-income tenant.
20. Rent floors	For rent-restricted units, the rent is determined by taking 30 percent of the qualifying income limitation. Annually, as the qualifying income limitation changes, the allowable rent may change.	Retains present law.
21. Rents for previously qualifying tenants whose incomes now exceed the qualifying income limitations	A tenant who qualified for a rent-restricted unit may continue to be deemed to qualify even if his/her income grows to as much as 140 percent of the qualifying income limitation. The maximum allowable rent is still determined by 30 percent of the qualifying income limitation.	Retains present law.
22. Deep rent skewing	To qualify under the deep rent skewing exception, at least 15 percent of the low-income units must be occupied by tenants whose incomes do not exceed 40 percent of area median income, the rents must be restricted to 30 percent of the qualifying income limitation, and rents on the market rate units must be at least 300 percent of rents charged on comparable rent restricted units.	Liberalizes the deep rent skewing rules by changing 300 percent to 200 percent.
23. At-risk rule for qualified nonprofit organizations	Treats as an amount at risk certain nonrecourse financing provided by a qualified nonprofit organization, provided that certain requirements are met including that the financing is repaid within 90 days after the end of the 15-year compliance period.	Expands the present law at-risk rules for property financed by qualified nonprofit organizations by delaying the deadline for full repayment of such financing to conform to extended use period.
24. State plans	Credits are allocated by	Mandates the development of a

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	State allocating agencies.	plan of allocation by State allocating agencies. Among the location criteria are inclusion of local charities and encouragement of mixed use housing.
25. Allocation of only necessary credits	For new or substantially rehabilitated property, allocating agencies may allocate up to a 70-percent present value credit. For acquisition property and Federally-subsidized property, the allocating agency may allocate up to a 30-percent present value credit.	Mandates that credit allocations to a building not exceed the level necessary for the financial feasibility of the project.
26. Project evaluation	Allocating agencies may use any guidelines they choose to allocate credits to eligible properties.	Mandates State allocating agency evaluation of each credit project according to pre-established criteria.
27. Semiannual determination of credit percentage	Credit percentages are determined monthly by the Secretary.	Retains present law.
28. Credit claimed for buildings placed in service in later years.	Generally credit may be claimed only for property placed in service in the year the credit allocation is received. An exception exists for newly constructed or substantially rehabilitated property which is not substantially financed with tax-exempt bonds. This exception permits credits to be claimed for property placed in service within two years after a credit allocation was received, if 10 percent of estimated project costs were incurred in the year in which the allocation was made.	Provides that newly constructed or substantially rehabilitated property which is substantially financed with tax-exempt bonds may claim the credit for buildings placed in service within two years after the bonds were issued, if at least 10 percent of estimated project costs were incurred by the close of the calendar year in which the bonds were issued.
29. Administrative provisions	Requires that credit forms be filed within 90 days after the end each taxable year in the credit period.	Allows the taxpayer to file credit forms on the same day as required for filing tax returns.
30. Effective date	The credit is scheduled to	The proposal is generally

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	expire after December 31, 1989.	effective for determinations made under section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

10. Health insurance deduction for self-employed individuals

Present Law

Under present law, self-employed individuals are entitled to deduct 25 percent of the amount paid for health insurance for the individual and the individual's spouse and dependents (sec. 162(l)). This deduction expires for taxable years beginning after December 31, 1989.

Under present law, more than 2-percent shareholders of S corporations are generally treated as partners in a partnership for purposes of the employee fringe benefit provisions of the Code (sec. 1372).

Explanation of Proposal

The proposal would extend the 25-percent deduction so that it expires for taxable years beginning after December 31, 1991. The proposal would also provide that the 25-percent deduction applies to a more than 2-percent shareholder (as defined under sec. 1372). For purposes of the 25-percent deduction, such an individual's earned income is determined exclusively by reference to the individual's wages (as defined in sec. 3121) from the S corporation. The Secretary is authorized to prescribe additional adjustments relating to application of the deduction in the case of S corporation shareholders.

Effective Date

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

11. ESOP exception to additional tax on early withdrawals

Present Law

Under present law, an additional 10-percent income tax applies to early withdrawals from a qualified retirement plan. However, certain distributions from an employee stock ownership plan (ESOP) or a tax credit ESOP are exempt from the additional income tax to the extent that the distribution is attributable to assets that have been invested, at all times, in employer securities (as defined in sec. 409(l)) that satisfy the applicable requirements of sections 409 and 401(a)(28) for the 5-year period immediately preceding the plan year in which the distribution occurs (sec. 72(t)(2)(C)). The ESOP exception does not apply to distributions made after December 31, 1989.

Explanation of Proposal

Under the proposal, the exception to the early withdrawal tax for certain distributions from an ESOP would be extended for 2 years so that it applies to distributions made before January 1, 1992.

Effective Date

The proposal would be effective for distributions after December 31, 1989.

I. Child Care Initiative and Telephone Excise Tax[1]

1. Dependent care tax credit; credit for health insurance premiums; supplemental earned income tax credit for families with young children

Present Law

Dependent care credit

Under present law, an individual may be entitled to a nonrefundable tax credit equal to a percentage of the employment-related child or dependent care expenses paid by the individual for the taxable year to enable the individual to work (sec. 21). The maximum amount of the credit is 30 percent of allowable employment-related expenses. This 30 percent is reduced by one percentage point for each $2,000 (or fraction thereof) of the taxpayer's adjusted gross income (AGI) between $10,000 and $28,000. The credit rate is 20 percent for taxpayers with AGI in excess of $28,000.

The maximum amount of expenses that may be taken into account in calculating the credit is limited to $2,400 per year in the case of one qualifying individual and $4,800 in the case of more than one qualifying individual. In addition, the maximum amount of expenses taken into account cannot exceed the individual's earned income or, in the case of married taxpayers, the lesser of the individual's earned income or the earned income of his or her spouse.

A "qualifying individual" is (1) a dependent of the taxpayer who is under the age of 13 and with respect to whom the taxpayer is entitled to claim a dependent exemption, (2) a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself, or (3) the spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for himself or herself.

Tax provisions relating to individual health insurance

Present law generally does not provide tax benefits specifically designed to encourage the purchase of health insurance by individuals; however, present law does provide certain tax benefits for health insurance in particular circumstances. Under present law, health insurance that is paid by an employer is generally excluded from an employee's gross income. In addition, self-employed individuals are

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[1] The provisions in this part are equivalent to those included in S.5, as passed by the Senate, or as previously approved by the Finance Committee with an effective date modification.

entitled to deduct 25 percent of the amount paid for medical insurance for the individual or his or her spouse or dependents; this provision is scheduled to expire for taxable years beginning after December 31, 1989.

Taxpayers who itemize deductions may deduct expenses for medical care (not compensated by insurance or otherwise) of the taxpayer or his or her spouse or dependents to the extent such expenses exceed 7.5 percent of the taxpayer's adjusted gross income. Premiums paid for health insurance qualify for the deduction.

Earned income tax credit

The earned income tax credit (EITC) provides an advanced refundable tax credit to taxpayers who maintain a household for one or more children. In 1989, the credit is equal to 14 percent of the first $6,500 of earned income. The credit is phased out at a rate of 10 percent of the amount of adjusted gross income (or, if greater, the earned income) that, in 1989, exceeds $10,240. The $6,500 and $10,240 amounts are adjusted annually for inflation, so that the maximum credit amount and the maximum amount of income eligible for the credit increase with inflation.

Explanation of Proposals

Dependent care credit

The proposal would make the present-law dependent care credit partially refundable and available through advance payments. That is, taxpayers who do not have sufficient taxable income to offset the credit would be entitled to receive 90 percent of the credit that is not offset against tax liability in cash. Refundable amounts may be received through the year as advance payments from the employer. However, under the proposal, taxpayers with adjusted gross income (AGI) in excess of $28,000 would not be entitled to claim the refundable credit, but instead would be eligible for the nonrefundable dependent care credit as under present law.

Health insurance credit

The proposal would amend the dependent care credit to add a new advance refundable credit for health insurance expenses. The proposal would provide that an individual who maintains a household containing one or more qualifying individuals is entitled to a credit equal to 50 percent of the individual's qualified health insurance expenses that do not exceed $1,000. The 50 percent credit percentage is reduced by 5 percentage points for each $1,000 (or fraction thereof) by which the taxpayer's adjusted gross income (AGI)

exceeds $12,000. Thus, the credit is zero for taxpayers with AGI in excess of $21,000.

Qualified health insurance expenses would be amounts paid during the taxable year for health insurance that includes coverage for one or more qualifying individuals. For purposes of this credit, a qualifying individual would be a dependent of the taxpayer who is under age 19 and with respect to whom the taxpayer can claim a dependent exemption.

Supplemental earned income credit

A supplemental credit of 7 percent of the first $6,500 of earned income (as adjusted for inflation), but not to exceed $500, would be provided for families with one qualifying child. The percentage for families with two or more qualifying children would be 10 percent and the credit could not exceed $750. A qualifying child would be one for whom the taxpayer maintains a household and has not attained the age of four. The supplemental credit would be phased out at a rate of 15 percent (10 percent for a taxpayer with only one qualifying child) of the amount of adjusted gross income (or, if greater, the earned income) that exceeds the lesser of $10,000 (as adjusted for inflation), or $12,000.

Child health demonstration projects

The proposal would authorize the appropriation of $25 million for each of the fiscal years 1990 through 1994 to enable the Secretary of Health and Human Services to conduct demonstration projects to evaluate and extend health insurance to children under age 19 who are not covered by other public or private health programs.

GAO study

The General Accounting Office (GAO), in consultation with the Internal Revenue Service (IRS), would be required to conduct a study to determine (1) the effectiveness of the advance payment system and (2) how to implement such a system to avoid administrative complexity for small business and report its recommendations within one year after enactment.

Effective Dates

In general, the proposals would be effective for taxable years beginning after December 31, 1990. Advance refundability of the dependent care credit and the health insurance credit would be effective for tax years beginning after December 31, 1991.

2. Estimated tax payment for certain subchapter S income

Present Law

In general, an S corporation is not subject to tax on its taxable income. Rather, taxable income of an S corporation flows through to its shareholders in a manner similar to a partnership. However, there are limited instances when an S corporation is subject to tax. These instances include: (1) the recognition of a built-in gain within 10 years of the date that a former C corporation elected S corporation status (sec. 1374(a)); (2) the receipt of passive investment income in excess of 25 percent of total annual gross receipts if the corporation has earnings and profits from a year in which it was not an S corporation (sec. 1375(a)); and (3) the recapture of investment tax credits claimed during a taxable year in which the corporation was not an S corporation (sec. 1371(d)).

Although situations exist for which an S corporation is liable for income tax, present law does not require the corporation to make estimated tax payments. Instead, the tax must be paid no later than the unextended due date of the S corporation tax return.

Explanation of Proposal

The proposal provides that an S corporation would be required to make estimated tax payments if it has tax attributable to: (1) the recognition of built-in gains under section 1374(a);[1] (2) the receipt of excess passive investment income under section 1375(a); or (3) the recapture of investment tax credits pursuant to section 1371(d).[2] The rules contained in section 6655 for estimated tax payments by corporations would generally apply.

For purposes of the portion of required estimated tax payments attributable to built-in gains and investment tax credit recapture, an S corporation would not be able to utilize the exceptions which allow estimated tax payments to be based on the corporation's prior year tax (secs. 6655(d)(1)(B)(ii) and 6655(d)(2)(B)). The prior year's tax exception would be available to all S corporations (including "large" S corporations) with respect to the portion of

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[1] The proposal would also apply to tax that is attributable to certain capital gains of S corporations pursuant to sec. 1374 as effective before the changes made by the Tax Reform Act of 1986.

[2] No inference would be intended as to the proper estimated tax treatment for any item for any prior year or for any item for any taxpayer other than an S corporation.

required estimated tax payments attributable to excess passive income (even if there was no tax attributable to excess passive income in the prior year). In all situations, an S corporation would be able to use the annualization exception (sec. 6655(e)).

Effective Date

The proposal would be effective for estimated tax payments due for taxable years beginning after December 31, 1989.

3. Extension of the telephone excise tax; modification of tax collection period

Present Law

Imposition of tax

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service (sec. 4251). The tax is collected by the provider of the service from the consumer (business and personal service). The tax is scheduled to expire after December 31, 1990.

The 3-percent telephone excise tax was last extended for 3 years (1988-1990) in the Omnibus Budget Reconciliation Act of 1987. The 3-percent tax was previously extended for 2 years (1986-1987) in the Deficit Reduction Act of 1984.

Collection of tax

Under present law, the telephone tax billed to the customer in a semi-monthly period is considered to be collected from the customer during the second following semi-monthly period. Such tax must be deposited in a Federal Reserve Bank or other authorized depository within 3 banking days after the end of the semi-monthly period for which the tax is considered collected. (Rev. Proc. 76-45, 1976-2 C.B. 668).

Explanation of Proposal

Extension of tax

The 3-percent telephone excise tax would be made permanent. The Administration's budget proposal recommended making the tax permanent.

Modification of collection period

Under the proposal, the tax for a semi-monthly period would be considered collected during the first week of the second following semi-monthly period. The tax would be required to be deposited within 3 banking days after the end of the week for which such tax is considered to be collected.

Effective Date

The proposal to extend the telephone excise tax would be effective on January 1, 1991. The proposal with respect to the time the tax is considered collected would be effective with respect to taxes considered collected for semi-monthly periods beginning after June 30, 1990.

J. Individual Retirement Accounts (IRAs)

Present Law

Under present law, the maximum deductible contribution that can be made to an individual retirement account (IRA) is generally the lesser of $2,000 or 100 percent of an individual's compensation. Individuals who are not active participants in an employer-sponsored retirement plan, single taxpayers with adjusted gross income (AGI) of less than $25,000, and married taxpayers with AGI of less than $40,000, may make the maximum deductible contribution. For taxpayers who are active participants in employer-sponsored retirement plans, the IRA deduction is phased out for single taxpayers with AGI between $25,000 and $35,000, and for married taxpayers with AGI between $40,000 and $50,000.

Taxpayers who are not entitled to the maximum IRA deduction may make nondeductible contributions to IRAs. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions accumulate on a tax-deferred basis.

Amounts withdrawn from IRAs (other than nondeductible contributions) are includible in income when withdrawn. Early withdrawals, e.g., withdrawals prior to age 59-1/2, death, or disability, are generally subject to an additional 10-percent income tax (sec. 72(t)).

Explanation of Proposal[1]

In general

The deductibility of an individual's contributions to an IRA is expanded under the proposal. Generally, the proposal permits a deduction of one-half of the otherwise nondeductible portion of the contribution made by an individual. The proposal also allows withdrawals from an IRA without imposition of the additional 10-percent tax to the extent the amount withdrawn is used for either the purchase of a first home or for certain education expenses.

Expansion of present-law deduction rules

Under the proposal, an individual who contributes to an IRA may deduct the amount of the contribution that is deductible under present law, plus 50 percent of the contribution that is not deductible under present law. This

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[1] This proposal is substantially the same as the provisions of S. 1678, The Savings and Investment Incentive Act of 1989, which was introduced on September 27, 1989, by Senator Bentsen and others.

additional 50-percent deduction is only allowed with respect to contributions that would otherwise have been deductible but for the active participant rule. The present-law maximum dollar limitation ($2,000) and other limitations relating to deductibility (e.g., the requirement that the IRA owner be under the age of 70-1/2) continue to apply.

The proposal also provides that interest on loans the proceeds of which are directly traceable to an IRA contribution is nondeductible.

Withdrawals by first-time home buyers

Under the proposal, withdrawals by first-time homebuyers that are used within 60 days to acquire, construct, or reconstruct the taxpayer's principal residence are not subject to the 10-percent additional tax. A first-time homebuyer is an individual who has not had an ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which the withdrawal relates. The date of acquisition is the date the individual enters into a contract to purchase a principal residence or begins construction or reconstruction of such a residence. The proposal requires that the spouse of the taxpayer also meet this requirement as of the date of acquisition. Principal residence is defined as under the provisions relating to the rollover of gain on the sale of a principal residence (sec. 1034).

Under the proposal, any amount withdrawn from an IRA for the purchase of a principal residence is to be used within 60 days of the date of withdrawal. The 10-percent additional income tax is imposed with respect to any amount not so used. However, if the 60-day rule cannot be satisfied due to a delay in the acquisition of the residence, the taxpayer may recontribute to an IRA all or part of the amount withdrawn prior to end of the 60-day period. Any amount recontributed is generally treated as a rollover contribution (sec. 408(d)), except that the frequency limitation on rollovers between IRAs does not apply.

Rules relating to expenses for education

Under the proposal, withdrawals used by a taxpayer during the year for qualified higher education expenses are not subject to the 10-percent additional tax. Qualified higher education expenses are tuition, fees, books, supplies, and equipment required for courses at an eligible educational institution. Amounts withdrawn may be used for the education of the taxpayer, or the taxpayer's spouse, dependents, or grandchildren.

The amount that may be withdrawn for educational expenses for a taxable year without imposition of the

10-percent tax is reduced by any amount that is excludable from the taxable income of the taxpayer under the provisions relating to educational savings bonds.

Effective Date

The expansion of the deduction provisions would be effective for taxable years beginning after December 31, 1990. The provisions relating to the exceptions to the 10-percent additional income tax would apply to distributions after December 31, 1989. The provision relating to interest on funds borrowed to make IRA contributions would be effective for debt incurred after the date of enactment.

DESCRIPTION OF REVENUE RECONCILIATION PROPOSAL

PART THREE: MISCELLANEOUS TAX PROVISIONS

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on October 3, 1989

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 3, 1989

JCX-59-89

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of Part Three of a revenue reconciliation proposal (miscellaneous tax provisions) scheduled for consideration by the Senate Committee on Finance on October 3, 1989.

Part One (JCX-57-89) describes revenue-raising provisions of the revenue reconciliation proposal, and Part Two (JCX-58-89) describes expiring provisions, child care initiative and individual retirement accounts (IRAs).[2]

A separate document provides estimated budget effects of the specific revenue provisions.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Revenue Reconciliation Proposal: Part Three (Miscellaneous Tax Provisions) (JCX-59-89), October 3, 1989.

[2] Also, see separate document (JCX-56-89) for a description of technical corrections provisions.

K. Other Provisions

1. Repeal of section 89 nondiscrimination rules

Present Law

Under present law, section 89 of the Code imposes nondiscrimination rules on employer-provided health benefits and group-term life insurance plans. In addition, section 89 requires that certain types of employee benefit plans meet minimum qualification requirements (e.g., that the plan be in writing and that plan participants be notified of plan provisions). Prior to the enactment of section 89 in the Tax Reform Act of 1986, prior law applied other nondiscrimination rules to group-term life insurance plans, cafeteria plans, and self-insured health plans.

Explanation of Proposal

The proposal would repeal present-law section 89, and generally reinstate the rules applicable before its enactment.

Effective Date

The provision would be effective as if included in the Tax Reform Act of 1986.

2. Two-year extension of general fund transfers to Railroad Retirement Tier II Trust Fund of amounts from taxation of Tier II benefits

Present Law

The railroad retirement program consists of a Tier I benefit structure which is generally equivalent in benefits and financing to the social security program, and a separately financed Tier II benefit structure, which is similar to private-sector pension plans. The Tier II benefits are financed primarily by payroll taxes. Tier II benefits are generally includible in income for tax purposes in the same manner as benefits received under any employer-maintained qualified pension plan. The Railroad Retirement Solvency Act of 1983 provides for the transfer from the general fund to the Railroad Retirement Trust Fund of an amount equal to revenues received from the taxation of Tier II benefits. This transfer to the Railroad Retirement Trust Fund applies only to benefits that are received prior to October 1, 1989.

Explanation of Proposal

The transfer of proceeds from the taxation of railroad retirement Tier II benefits from the general fund of the Treasury to the Railroad Retirement Trust Fund would be extended for two additional years, to October 1, 1991.

Effective Date

The proposal would be effective for benefits received prior to October 1, 1991.

3. Modification of full funding limitation

Present Law

Under present law, subject to certain limitations, an employer may make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets (sec. 412(c)(7)). For plan years beginning before January 1, 1988, the 150 percent of current liability limitation does not apply.

The Secretary may, under regulations, adjust the 150-percent figure in the full funding limitation to take into account the average age (and length of service, if appropriate) of the participants in the plan (weighted by the value of their benefits under the plan). In addition, the Secretary is authorized to prescribe regulations that apply, in lieu of the 150 percent of current liability limitation, a different full funding limitation based on factors other than current liability. The Secretary may exercise this authority only in a manner so that in the aggregate, the effect on Federal budget receipts is substantially identical to the effect of the 150-percent full funding limitation.

Explanation of Proposal

In general

The proposal would allow certain employers to elect to apply the present-law full funding limitation without regard to the 150 percent of current liability limitation. The Secretary is required under the proposal to adjust the full funding limitation for all plans (other than those subject to such an election) in response to employer elections under the proposal so that the proposal has a negligible effect on Federal budget receipts.

Employers eligible to elect alternative full funding limitation

An employer may elect to use the alternative full funding limitation if (1) as of the first day of the plan year in which the election is made the accrued liability of participants accruing benefits under all defined pension benefit plans of the employer (and controlled group members) is at least 90 percent of the aggregate total accrued liability under all such plans; (2) no defined benefit pension plan maintained by the employer (or by any controlled group member) is a top-heavy plan (within the meaning of

section 416(g)) for the plan year in which such election is made and the immediately preceding 2 plan years; and (3) the plan has more than 100 participants at all times during the plan year in which the election is made and the immediately preceding 2 plan years.

If the accrued liability ratio described above falls below 90 percent for any plan year for which the election is in effect, the alternative full funding limitation is phased out for the remainder of the period for which the election is in effect under rules to be prescribed by the Secretary. If a plan becomes a top-heavy plan or fails to meet the 100-participant requirement during any plan year in the period for which the election is in effect, the alternative full funding limitation ceases to apply. In addition, if the 90-percent requirement, top-heavy restriction, or 100-participant restriction is violated during the election period, the employer is precluded from making a subsequent election to use the alternative full funding limitation for 10 plan years following the election period.

Requirements with respect to election of alternative limitation

The election to use the modified full funding limitation would be subject to the following requirements:

(1) the election is to apply for a 5-plan year period beginning with the first plan year for which the election is effective;

(2) the election is to be made by application to the Secretary filed 60 days prior to the first day of the plan year immediately preceding the first plan year for which the election is effective;

(3) the election application is to include actuarial information (for each plan to be covered by the election) indicating the full funding limitation that will apply under each year of the period for which the election is in effect, and the full funding limitation that would apply in each of the years covered by the period in the absence of an election (in each case, based on reasonable estimates) as well as such other information as may be required by the Secretary; and

(4) the election is to be made for all defined benefit pension plans maintained by the controlled group of which the employer is a part.

An election may be made for successive 5-plan year periods upon application to the Secretary in accordance with the above criteria. If the employer does not choose to make a subsequent election after the expiration of any 5-plan year period, the employer may not make an election under the

provision until 10 plan years after the expiration of such 5-plan year period.

An employer that makes an election may not be granted a minimum funding waiver for the period beginning after the election is made and ending at the expiration of the 5-plan year period. The Secretary may prescribe additional rules and requirements with respect to whether an employer is eligible to make an election.

In determining whether the accrued liability with respect to a participant may be aggregated with the accrued liability of other participants in order to meet the 90-percent requirement (i.e., whether the participant is accruing benefits under the plan), only active employees who have accrued benefits in the current year may be considered. Specifically, the Secretary is to issue guidance with respect to determining when a participant has accrued a benefit in the current year. Under such guidance, for example, for purposes of this provision, a participant in a plan where the employer has frozen accruals will not be considered to accrue benefits in the current year. In addition, a participant is not considered to accrue benefits solely because the participant's accrued benefit is increased by reason of a cost-of-living increase or similar feature in the plan.

It is intended that the Secretary limit the availability of this provision where one or more plans of the employer have been terminated or amended in a manner that significantly increases the likelihood that the employer will be eligible to make an election under this provision (e.g., where a plan has undergone a termination/re-establishment or a spin-off/termination within the preceding 10 plan years).

Required adjustment of full funding limitation

The proposal requires the Secretary to adjust the full funding limitation applicable to other defined benefit pension plans on an annual basis in response to the elections under this provision so that the provision has a negligible affect on net Federal budget receipts.

Any adjustment to the full funding limitation required to be made under the proposal is to be made with respect to all plans (other than those subject to the alternative limitation) and by reducing the full funding limitation with respect to participants who are not accruing benefits under the plan. This modification is made by substituting, with respect to these participants, a percentage between 140 percent and 150 percent for "150 percent" in the 150-percent full funding limitation. Thus, the full funding limit will be applied to the plan by multiplying the current liability attributable to active participants accruing benefits by 150 percent and by multiplying the current liability attributable

to other participants by a percentage between 140 and 150 percent as determined by the Secretary.

To the extent that net Federal budget receipts require additional adjustments to the full funding limitation, the full funding limitation is to be adjusted by multiplying the accrued liability of the plan (sec. 412(c)(7)(A)(i)(II)) for all participants in the plan by a percentage less than 100 percent, but in no event by reducing this liability below 140 percent of current liability.

Effective Date

The proposal would be effective on the date of enactment.

4. Treatment of income from personal injury awards for minor children

Present Law

As a result of the Tax Reform Act of 1986, the unearned income of a child under 14 generally is taxed at the top marginal rate of his or her parents.

Explanation of Proposal

Income attributable to lump sum damages received on account of personal injuries or sickness would be taxed at the child's rate if such income accrues in a custodial account and is prohibited from being used to satisfy an obligation of support.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1986.

5. Tax-exempt status for cooperative service organizations for private foundations and community foundations

Present Law

Present-law section 501(c)(3) requires that an organization be organized and operated exclusively for an exempt purpose in order to qualify for tax-exempt status under that section.

Section 501(f) provides that an organization shall be treated as organized and operated exclusively for charitable purposes if it is comprised solely of members that are educational institutions and is organized and operated to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) in stocks and securities, the moneys, contributed thereto by the members, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members.

Explanation of Proposal

The proposal would grant tax-exempt status to certain cooperative service organizations comprised solely of members which are tax-exempt private foundations or community foundations within the meaning of section 170(b)(1)(A)(vi). Such a cooperative service organization would be tax-exempt if: (1) it has at least 20 members; (2) no one member holds more than 10 percent (by value) of the interests in the organization; (3) no one member, by itself, controls the organization or controls any other member; (4) the members are permitted to dismiss the organization's investment adviser upon a vote of members holding a majority of interest in the organization; and (5) the organization is organized and operated solely to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) in stocks and securities, the moneys contributed by the members, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members.

The cooperative service organization would be subject to the present-law excise tax provisions applicable to private foundations (e.g., sec. 4941 rules governing self-dealing arrangements), other than sections 4940 and 4942. The proportionate share (whether or not distributed) of the net income of the cooperative service organization (including capital gains) of each member (other than certain exempt operating foundations) for any taxable year of the cooperative service organization would, for purposes of the excise tax imposed under present-law section 4940, be treated as net investment income of the member for the taxable year of such member in which the taxable year of the cooperative service organization ends.

Effective Date

The proposal would apply to taxable years beginning after December 31, 1989.

6. Alternative recapture method for mutual savings banks changing from the reserve method to the specific charge-off method for bad debts

Present Law

Under present law, a thrift institution (i.e., a building and loan association, mutual savings bank, or cooperative bank) is permitted a deduction for a reasonable addition to a reserve for bad debts if at least 60 percent of its assets are invested in qualified assets (including home mortgages). The reasonable addition to the reserve for bad debts for a thrift institution is an amount computed under the experience method or an amount equal to 8 percent of its otherwise taxable income. The amount of bad debt reserves are recaptured if the thrift institution is liquidated in a taxable transaction or makes dividend distributions in excess of post-1951 earnings (Code sec. 593(e)).

A commercial bank whose average adjusted bases of all assets does not exceed $500 million (i.e., a "small bank") also is allowed a deduction for a reasonable addition to a reserve for bad debts. The reasonable addition to the reserve is an amount computed under the experience method. A bank whose average adjusted bases of all assets exceeds $500 million (i.e., "big banks") is not permitted any deduction for an addition to a reserve for bad debts. In addition, big banks are required to recapture their existing bad debt reserves under one of two methods. Under the first method (called the "4-year recapture method"), the balance of the reserve generally is recaptured at the following rates: 10 percent in the first year, 20 percent in the second year, 30 percent in the third year, and 40 percent in the fourth year. Under the second method (called the "cut-off method"), specific bad debts on loans made before the change in method are charged to the reserve. Then, the balance of the reserve is recaptured as the reserve balance exceeds the amount of pre-change loans that remain outstanding.

Explanation of Proposal

Under the proposal, a mutual savings bank or a savings and loan association that changes from the reserve method of accounting for bad debts to the specific charge-off method would be allowed to elect to recapture only the so-called "experience portion" of their bad debt reserves under the "4-year recapture method" applicable to commercial banks. The experience portion of the bad debt reserve is based on the average of the institution's actual bad debts as a percentage of its loans outstanding. However, if the sum of the specific bad debts at the end of any year on loans held by the taxpayer before the accounting method change exceed the cumulative amount of reserves required to recaptured by the end of that year, the excess would not be deducted, but

would be charged to the unrecaptured portion of the bad debt reserves (similar to the "cut-off method"). In addition, any remaining bad debt reserves would be recaptured when excessive dividends are paid by the savings bank or upon partial or complete liquidation of the savings bank (under the rules of Code sec. 593(e)).

Mutual savings banks that make an election under this provision would not be permitted to use the reserve method of accounting for bad debts in any subsequent year.

Effective Date

The proposal would be effective for taxable years ending after the date of enactment.

7. Denial of retroactive certifications for work incentive (WIN) tax credit

Present Law

Under prior law, the work incentive (WIN) credit provided a tax credit to employers for the employment of certain qualified individuals. Prior to the Economic Recovery Tax Act of 1981 (ERTA), the WIN credit did not specifically require certification of an employee as a qualified individual prior to the date of employment. In 1981, ERTA modified the WIN credit by merging it with the targeted jobs credit. ERTA also required that certification of an individual as a member of a targeted group must be obtained or requested before the date an individual begins work. This change was made generally effective on July 23, 1981, to avoid the potential for substantial revenue losses.

The law is unclear as to whether the requirement that the request for certification be made contemporaneously with employment applies only to the new targeted jobs credit or to the prior separate WIN credit. The Internal Revenue Service took the position that retroactive certifications under the prior-law WIN credit are not valid.[1] The Tax Court recently held that retroactive certifications are valid for purposes of claiming the prior-law WIN credit.[2]

Explanation of Proposal

The proposal clarifies that certifications for the WIN credit (sec. 50B(h)(1) of the Code as in effect for taxable years beginning before January 1, 1982) must be made on or before the day the individual begins work.

Effective Date

The proposal would be effective for WIN credits first claimed after March 11, 1987.

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[1] General Council Memorandum 39604, 2/26/87.

[2] Lucky Stores Inc. v. Commissioner, No. 35251-86, 92 T.C. No. 75, 5/3/89.

8. Estate and gift tax provisions

a. Definition of qualified terminable interest property

Present Law

Since December 31, 1981, a marital deduction has been allowed for qualified terminable interest property (QTIP). In order to qualify as qualified terminable interest property, the surviving spouse must have a qualifying income interest for life, which in turn requires that the spouse be entitled to all of the income from the trust, payable annually or at more frequent intervals. Property qualifying under the QTIP rule generally is includible in the gross estate of the surviving spouse for Federal estate tax purposes.

Under proposed regulations, an income interest will not fail to constitute a qualifying income interest for life solely because income between the last distribution date and the date of the surviving spouse's death is not required to be distributed to the surviving spouse or the surviving spouse's estate. See Prop. Reg. secs. 20.2056(b)-7(c)(1), 25.2523(f)-1(b). Contrary to the regulations, the United States Tax Court has held that in order to satisfy the QTIP requirements, income accumulated by the trust between the last date of distribution and the date of the spouse's death must be paid to the spouse's estate or be subject to a power of appointment held by the spouse. See Estate of Howard v. Commissioner, 91 T.C. 329, 338 (1988).

Explanation of Proposal

An income interest would not fail to qualify as qualified income interest for life solely because income for the period after the last distribution date and on or before the date of the surviving spouse's death is not required to be distributed to the surviving spouse. The income for such period, however, would be includible in the gross estate of the surviving spouse for Federal estate tax purposes.

Effective Date

The proposal would apply to decedents dying, and gifts made, after October 3, 1989. The proposal would not require the inclusion in the surviving spouse's gross estate of property for which no marital deduction was claimed.

b. Inclusion in gross estate of gifts made within three years of death

Present Law

The first $10,000 of gifts of present interests to each donee during any one calendar year are excluded from Federal gift tax.

If an interest that is includible under sections 2036, 2037, 2038 or 2042 (or would have been includible had such interest been retained by the decedent on the date of his death) is transferred within three years of the decedent's death, the value of the gross estate includes the value of the property so transferred. This rate applies even if the transfer is of less than $10,000.

Explanation of Proposal

Gifts of less than $10,000 would not be included in the gross estate even if such gifts were made within three years of death and would have been included under sections 2036, 2037, 2038, or 2042 had the transferred interest been retained by the decedent at death. In addition, the statutory provision making the adjustment for gifts made within three years of death would be clarified without substantive change.

Effective Date

The proposal would be effective for decedents dying after the date of enactment.

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c. Waiver of right of recovery for certain marital deduction property

Present Law

For estate and gift tax purposes, a marital deduction is allowed for qualified terminable interest property (QTIP). Such property generally is includible in the gross estate of the surviving spouse for Federal estate tax purposes. The surviving spouse's estate is entitled to recover a portion of the Federal estate tax attributable to the inclusion in the surviving spouse's gross estate of the qualified terminable interest property (Code sec. 2207A), unless the spouse directs otherwise by will. Thus, a will requiring that all taxes be paid from probate property may have the effect of waiving the right to recovery.

Explanation of Provision

The right of recovery with respect to qualified terminable interest property would not apply unless the spouse otherwise directs in a provision of the will specifically referring to the statutory provision, i.e., a specific reference to section 2207A.

Effective Date

The provision would be effective for decedents dying after the date of enactment.

d. Estate tax inclusion related to valuation freezes

Present Law

If a person holds a substantial interest in an enterprise and in effect transfers property having a disproportionately large share of the potential appreciation in such person's interest in the income of, or rights in, the enterprise, then the transferred property is includible in such person's gross estate (sec. 2036(c)). The estate is entitled to recover from the person receiving the property a portion of the estate tax attributable to the inclusion (sec. 2207A).

The estate and gift tax is imposed on the value of property passing by gift or bequest. This value is the price at which the property would change hands between a willing buyer and willing seller. The statute of limitations for the gift tax is three years.

Explanation of Proposal

Code sections 2036(c) and 2207A would be repealed.

Effective Date

The repeal of section 2036(c) and 2207B would be retroactive from their date of enactment.

e. Exclusion from generation-skipping transfer tax for transfers to grandchildren

Present Law

The Tax Reform Act of 1986 imposed a generation-skipping transfer tax on direct transfers to grandchildren. However, a person may make direct skip transfers of up to $2 million to a grandchild prior to January 1, 1990, without incurring this tax (the "$2 million exclusion"). A transfer to a trust will qualify for the $2 million exclusion only if certain requirements are met, including annual distribution of trust income to (or for the benefit of) the grandchild after age 21 (the "distribution requirement").

Explanation of Proposal

The $2 million exclusion would be made permanent. The distribution requirement would be eliminated.

Effective Date

The proposal would be effective for transfers made after date of committee action.

f. Marital deduction for property passing to noncitizen spouses

Present Law

In general

A deduction generally is allowed for Federal estate and gift tax purposes for the value of property passing to a spouse. Except in specified situations, no deduction is allowed if the interest passing to the spouse is terminable (i.e., the property cannot pass to another person on termination of the spouse's interest) (Code secs. 2056(b), 2523(b)).

Marital deduction for property passing to noncitizen spouse

The marital deduction generally is disallowed for the value of property passing to noncitizen spouse. Property passing at death to a noncitizen spouse may, however, qualify for the marital deduction so long as it satisfies the normal requirements for a marital deduction (sec. 2056(b)) and the property passes in a qualified domestic trust (QDT).

Definition of qualified domestic trust (QDT)

In order to be a QDT, a trust must meet four conditions. First, the trust instrument must require that all trustees be U.S. citizens or domestic corporations. Second, the surviving spouse must be entitled to all the income from the property in the trust, payable annually or at more frequent intervals. Third, the trust must meet the requirements of Treasury regulations prescribed to ensure collection of the estate tax imposed upon the trust. Finally, the executor must elect to treat the trust as a QDT.

Estate tax on QDT

An estate tax is imposed upon distributions from a QDT made prior to the surviving spouse's death and upon the value of property remaining in a QDT upon that spouse's death. The tax, however, is not imposed on distributions of income, as defined under local law. The tax is also imposed upon the trust property if a person other than a U.S. citizen or domestic corporation becomes a trustee of the trust or if the trust ceases to meet the requirements of Treasury regulations prescribed to ensure collection of the estate tax.

Explanation of Provisions

Marital deduction for bequests to noncitizen spouse

Spouse becomes citizen.--The marital deduction would be allowed for property passing to an alien spouse if the spouse

becomes a U.S. citizen before the date the estate tax return of the decedent spouse is filed, so long as the surviving spouse was a U.S. resident at the date of the decedent's death and at all times before becoming a U.S. citizen.

Trustees.--The rule that all the trustees of a QDT must be U.S. citizens or domestic corporations would be modified to require only that one trustee be a U.S. citizen or domestic corporation, so long as no distribution could be made from the trust without the approval of that trustee.

Income.--A trust could be treated as a QDT even if the surviving alien spouse did not have an income interest in the trust. However, in order to qualify for the marital deduction, the interest passing to the spouse would continue to be subject to requirements applicable to property passing to U.S. citizen spouses. To meet these requirements in particular situations, a spouse may need to have an income interest in the trust.

Reformation to meet QDT requirements.--A trust would meet the requirements for a QDT if it is reformed to meet those requirements before the filing of the return or in a suit initiated before that time.

Estate tax on qualified domestic trust (QDT)

Definition of "income".--The Secretary of the Treasury would be granted regulatory authority to modify the definition of "income" in order to insure that trust distributions do not deplete trust corpus.

No tax when surviving spouse becomes U.S. citizen.--The estate tax on a QDT would no longer be imposed if the surviving spouse subsequently becomes a U.S. citizen if either (1) the spouse was a U.S. resident at the date of the decedents death and at all times before becoming a U.S. citizen, or (2) the spouse elects to reduce his unified credit and amounts subject to lower transfer tax brackets by the amount of prior taxable distributions made from the trust.

Availability of estate tax benefits.--The charitable and marital deductions, capital gains treatment of redemptions of stock to pay estate tax, alternate valuation, special use valuation, and extension of time to pay estate tax would be allowed against the estate tax on QDTs if allowable to the estate of the surviving spouse.

Distribution for hardship.--The tax would not be imposed on distributions made to a spouse if such distribution is made in order to alleviate hardship.

Regulatory authority

The Secretary of the Treasury would be directed to prescribe regulations necessary or appropriate to carry out the purposes of the provisions, including regulations treating an annuity includible in decedent's gross estate as a QDT.

Effective Date

The provisions would be effective for decedents dying after November 10, 1988.

9. Adoption expense deduction

Present Law

The Tax Reform Act of 1986 (the "1986 Act") repealed the deduction for adoption expenses associated with special needs children, effective for taxable years beginning on or after January 1, 1987. Under prior law, a deduction of up to $1,500 of expenses associated with the adoption of special needs children was allowed. The 1986 Act provided for a new outlay program under the existing Adoption Assistance Program to reimburse expenses associated with the adoption process of these children. The group of children covered under the outlay program is somewhat broader than the group covered by the prior deduction. Aid to Families with Dependent Children (AFDC) and Title IV-E Foster Care assistance outlay program provides assistance for adoption expenses for these special needs children as well as special needs children in private and State-only programs.

One component of the Adoption Assistance Program requires States to reimburse certain costs incurred for special needs children. The Federal government shares 50 percent of these costs up to a maximum Federal share of $1,000 per child. Reimbursable expenses include those associated directly with the adoption process such as legal costs, social service review, and transportation costs.

Explanation of Proposal

The proposal would allow a taxpayer to exclude from adjusted gross income (AGI) up to $3,000 of expenses incurred in the course of the adoption of a child with special needs. This exclusion would be an "above-the-line" deduction. A child with special needs means any child who, as determined by a State, cannot or should not be returned to the home of the birth parents and cannot be placed with adoptive parents without providing adoption assistance.

Eligible adoption expenses would be limited to those: (1) directly associated with the adoption process and (2) that are of a type eligible for reimbursement under the Adoption Assistance Program. These include reasonable and necessary court costs, legal expenses, and other expenses directly related to the legal adoption of a child.

Effective Date

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

10. Restoration of income averaging for farmers

Present Law

Prior to the enactment of the Tax Reform Act of 1986, certain individuals could elect to compute their income tax liability for the current year based on a formula that took into account their income for the current year and their average income of the prior three years. This election was repealed by the Tax Reform Act of 1986, effective for tax years beginning after December 31, 1986.

Explanation of Proposal

The proposal would restore the income averaging rules that were repealed by the Tax Reform Act of 1986 for certain qualified farmers. Qualified farmers would mean those individuals (1) who materially participate (within the meaning of sec. 469(h)) in the trade or business of farming (within the meaning of sec. 2032A(e)(4) and (5) of the Code), for each year of the averaging period; and (2) whose total annual gross receipts (including nonfarm gross receipts) for the preceding three taxable years does not exceed $5 million for each of such years.

Effective Date

The proposal would be effective for taxable years of individuals beginning December 31, 1989.

11. Treatment of certain payments received as a result of crop losses due to drought conditions

Present Law

A cash method taxpayer who receives insurance proceeds as a result of the destruction of, or damage to, crops may elect to include the proceeds in income for the taxable year following the year in which the destruction or damage occurs if, under the taxpayer's practice, income from such crops would have been included for a year following the year in which the destruction or damage occurred. For this purpose, payments received under the Agricultural Act of 1949, as amended, or Title II of the Disaster Assistance Act of 1988, as a result of the destruction of, or damage to, crops caused by drought, flood, or other natural disaster or the inability to plant crops because of such natural disaster are treated as insurance proceeds received as a result of the destruction of, or damage to, crops.

Explanation of Proposal

Payments received under the Disaster Assistance Act of 1989 (P.L. 101-82) would be treated in the same manner as payments received under the Agricultural Act of 1949 or Title II of the Disaster Assistance Act of 1988.

Effective Date

The proposal would apply to payments received before, on, or after the date of enactment.

12. Definition of wholesale distributors of diesel fuel

Present Law

The excise tax on diesel and special fuels was imposed at the producer or importer level under the Omnibus Budget Reconciliation Act of 1987 (OBRA), beginning on April 1, 1988. As a result, retail distributors would not be able to purchase the fuels tax-free, and off-highway users of the fuels (e.g., business, farmers, State and local governments, and airlines) would purchase the fuels tax-paid and apply for refunds.

Congress amended the locus of tax imposition in the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), and restored the ability of off-highway fuels users to purchase fuels tax-free. The wholesale distributor was allowed to file for the refund, in effect stepping into the shoes of the retail purchasers eligible for tax-free purchases.

Under TAMRA, the definition of a wholesale distributor was revised to include distributors who sell taxable fuels in bulk quantities. Under regulations, the Internal Revenue Service provided that a person who sells 70 percent or more of its fuel to tax-exempt users also would qualify as a wholesale distributor who would be entitled to purchase and sell fuel tax free.

In the course of the legislative process in 1988, several distributors of diesel and special fuels, then classed as retail distributors, anticipated that Congress would revise how exempt diesel fuel users could purchase tax-free fuel and that the imposition of tax would be changed from OBRA 1987. Consequently, they did not collect the excise tax on sales to exempt or off-highway purchasers. Although those distributors now may qualify as wholesale distributors, they still could be made liable for excise taxes which were not collected between April 1, and December 31, 1988.

Explanation of Proposal

The proposal would allow a person who qualifies as a wholesale distributor under present tax regulations to be treated as having been a wholesale distributor during the period of April 1, through December 31, 1988.

Effective Date

The proposal would be effective as if included in the Omnibus Budget Reconciliation Act of 1987.

13. Real estate investment trusts (REITs) holding a residual interest in a real estate mortgage investment conduit (REMIC)

Present Law

In order for an entity to qualify as a real estate investment trust ("REIT"), at least 95 percent of its gross income generally must be derived from certain passive sources, and from real estate assets (the "95-percent test"). Also, with certain exceptions, less than 30 percent of the gross income of a REIT must be derived from the sale or exchange of certain assets, including real property held for less than four years (the "30-percent test").

The Code provides rules governing the treatment of interest rate swap or cap agreements for REIT qualification purposes, i.e., agreements that protect the REIT from interest rate fluctuations on variable debt incurred to acquire or carry real estate assets. Such agreements are treated as securities under the 30-percent test and payments under them are treated as qualifying under the 95-percent test.

Explanation of Proposal

The present-law treatment of interest rate swap or cap agreements would be extended to similar arrangements, such as forward rate agreements and futures contracts. In addition, in determining whether an agreement hedges variable rate indebtedness, a REIT holding a residual interest in a real estate mortgage investment conduit (REMIC) would be treated as holding a proportionate share of the REMIC's assets and a proportionate share of the regular interests of the REMIC would be treated as direct indebtedness of the REIT.

Effective Date

The provision would be effective with respect to taxable years beginning after the date of enactment.

14. Cost Recovery Provisions

a. Treatment of tuxedos held for rental

Present Law

Tuxedos held for rental are assigned a class life of 9 years, and, consequently, the applicable recovery period under the accelerated cost recovery system as modified by the Tax Reform Act of 1986 is 5 years.

Explanation of Proposal

Tuxedos held for rental would be assigned a class life of 2 years. Consequently, the cost of rental tuxedos would be recovered either over a 3-year period using the 200-percent declining balance method or, under the alternative depreciation system, over a 2-year period by using the straight-line method.

Effective Date

The proposal would apply to rental tuxedos placed in service after December 31, 1989.

b. Treatment of certain capital expenditures incurred in order to assist the disabled

Present Law

A taxpayer may elect to deduct qualified architectural and transportation barrier removal expenses that are paid or incurred during any taxable year in lieu of capitalizing such expenses and recovering the expenses over the useful life of the property to which the expenses relate. The deduction allowed under this provision for any taxable year is limited to $35,000. For this purpose, a architectural and transportation barrier removal expense is any expenditure for the purpose of making any facility, or public transportation vehicle, owned or leased by the taxpayer for use in connection with a trade or business of the taxpayer more accessible to, and usable by, handicapped and elderly individuals. A qualified architectural and transportation barrier removal expense generally is any architectural and transportation barrier removal expense that satisfies standards contained in Treasury regulations.

Explanation of Proposal

The definition of qualified architectural and transportation barrier removal expense would be expanded to include capital expenditures incurred in connection with a trade or business to provide auxiliary aids and services (as defined in section 3(1) of the Americans with Disabilities Act of 1989) or reasonable accommodations (as defined in section 3(8) of the Americans with Disabilities Act of 1989) to individuals with disabilities. In addition, the annual limitation on the deduction allowed for qualified architectural and transportation barrier removal expenses would be reduced to $25,000.

Effective Date

The proposal would apply to taxable years beginning after December 31, 1989.

15. Employee Benefit Provisions

a. Repeal of limitation on ability of tax-exempt employers to maintain cash or deferred arrangements

Present Law

Under present law, if a tax qualified profit-sharing or stock bonus plan meets certain requirements, then an employee is not required to include in income any employer contributions to the plan merely because the employee could have elected to receive the amount contributed in cash (sec. 401(k)). Tax-exempt organizations are generally prohibited from establishing qualified cash or deferred arrangements, except for certain plans in existence on July 2, 1986.

Explanation of Proposal

The proposal would allow tax-exempt organizations to maintain cash or deferred arrangements for their employees. As under present law, the limitations on the amount that may be deferred by an individual participating in both a cash and deferred arrangement and a tax-sheltered annuity would apply.

Effective Date

The proposal would be effective with respect to plans established after December 31, 1989.

b. Modification of integration rules applicable to certain defined benefit pension plans

Present Law

Under present and prior law, benefits and contributions under a qualified plan may not discriminate in favor of highly compensated employees. Under prior law, a plan was not considered discriminatory merely because an employee's benefits under the plan were reduced in accordance with certain requirements to take into account the employee's social security benefits (sec. 401(l)).

The Tax Reform Act of 1986 (the 1986 Act) modified the integration rules to limit the permitted disparity between benefits for highly and nonhighly compensated employees. The 1986 Act rules are generally effective for plan years beginning after December 31, 1988. The 1986 Act contemplated that the Secretary would prescribe rules coordinating the benefits provided under the rules of prior law and the 1986 Act. In the case of a final pay defined benefit pension plan that is frozen as of January 1, 1989, and that was integrated in accordance with prior law, proposed Treasury regulations generally have the effect of precluding benefits from being calculated based on the final average pay of the participant when the participant retires (rather than the date the plan was frozen).

Explanation of Proposal

The proposal would clarify that, in coordinating the prior law and 1986 Act rules, the Secretary is to provide rules that permit a frozen defined benefit pension plan to calculate benefits based on final average pay in accordance with a benefit formula in existence on the effective date of the 1986 Act integration rules if appropriate conditions, as prescribed by the Secretary, are satisfied. It is intended that among the conditions to be imposed, the Secretary will include a requirement that the employer maintains a nonintegrated plan in years after 1989 that provides a minimum benefit level (i.e., 1 percent of compensation), and that the benefit formula in effect prior to 1988 would satisfy the 50 percent offset requirement in present law.

c. Modify geographic local limitation on voluntary employees' beneficiary associations

Present Law

A voluntary employees' beneficiary association ("VEBA") that provides for the payment of life, sick, accident or other similar benefits to its members, their dependents or designated beneficiaries may qualify for exemption from income taxation if certain requirements are met (sec. 501(c)(9)). Among these requirements is that the members have an employment-related common bond determined by reference to objective standards.

Under Treasury regulations, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to have an employment-related bond. The Internal Revenue Service has taken the position that the geographic locale requirement may not be met by a VEBA established by a nationally-based trade association for its membership.

Explanation of Proposal

The proposal would clarify that the geographic locale requirement may be met by a VEBA that provides benefits to the employees of its members in a clearly defined geographic region that may include more than one state. Subject to such restrictions as may be imposed by the Secretary to ensure that the VEBA operates in a limited area, a VEBA will meet the geographic locale requirement if it provides benefits to the employees who are located in no more than three contiguous states. Thus, the proposal adopts the position of the Internal Revenue Service that an exempt VEBA may not provide benefits to employees over a wide geographic area.

Effective Date

The provision would be effective for years beginning on or after the date of committee action. No inference is intended with respect to the application of the geographic locale restriction under present law.

d. Modification of rules relating to employee leasing and dependent care assistance programs

Present Law

For purposes of specified pension requirements, a leased employee is treated as the employee of the person for whom the leased employee performs services (the "recipient"). A leased employee is generally defined as any person who is not an employee of the recipient if (1) such services are provided to the recipient under an agreement between the recipient and the organization providing the person's services (the "leasing organization"), (2) the person performs such services for the recipient (or for the recipient and related persons) on a substantially full-time basis for at least 1 year, and (3) such services are of a type historically performed, in the business field of the recipient, by employees.

In addition, under present law, an employee may exclude certain benefits received under an employer-provided dependent care assistance program provided certain requirements are satisfied (sec. 129).

Explanation of Proposal

Under the proposal, the present-law historically performed test is repealed and replaced with a new rule defining who must be considered a leased employee. This change is made because the proposed regulations under the leased employee rules (sec. 414(n)) are overly broad in defining who may be a leased employee. Under the proposal, the proposed regulations are no longer valid.

Under the proposal, an individual would not be considered a leased employee unless the individual is under the control of the recipient organization. The determination of whether an individual is controlled by the employer would be based on all the facts and circumstances. Among the factors that would be relevant in this determination are whether the recipient organization: (1) prescribes the individual's work methods; (2) supervises the individual; (3) sets the individual's working hours; and (4) sets the individual's level of compensation. Other factors that may be considered include those that are relevant for determining whether the employer is responsible for employment taxes on the compensation paid to the individual. The Secretary may designate other relevant factors. It would not be necessary that all these factors indicate that the individual is under the control of the employer in order to find that such individual is a leased employee. Nor would it be necessary that the recipient organization be responsible for employment taxes in order to find that the individual is a leased employee because, if the recipient organization is liable for

employment taxes, the individual is an employee of the organization who generally must be taken into The proposal would not alter the definition of a common-law employee, nor the rules that such employees are to be taken into account unless specifically excluded.

The proposal would clarify present law in that support staff of professionals would continue to be treated as leased employees (to the extent they are not already considered employees because they are common-law employees). In general, professionals would include those individuals defined as such under Treasury regulations relating to the minimum participation requirements (sec. 401(a)(26)) and the minimum coverage requirements (sec. 410). This clarification with respect to the support staff of professionals is not intended to create an inference with respect to the support staff of nonprofessionals.

Under the proposal, persons who perform services incidental to the sale of goods or equipment or incidental to the construction of a facility are generally not leased employees. This rule does not extend to the operation (including supervision over such operation) of the goods, equipment, or completed facility.

In addition, under the proposal, the nondiscrimination rules under section 129(d) as that section was amended by the Tax Reform Act of 1986 would continue to apply to dependent care assistance plans but are modified in the following respects. First, if a plan fails to meet the requirements of section 129(d), only highly compensated employees must include benefits under the program in gross income. Second, if a dependent care assistance program fails the 55-percent benefits test, then the highly compensated employee must include in gross income only that amount of benefit in excess of that level of benefit that would meet the benefits test. Finally, under the proposal, the 55-percent benefits test can be applied on a line of business basis (sec. 414(r)).

Effective Date

Under the proposal, the revised definition of leased employee would be effective for years beginning after December 31, 1983.

With respect to dependent care assistance programs, the proposal is effective for years beginning after December 31, 1988.

16. Tax-Exempt Bonds

a. Tax-Exempt Debt of State Housing Agencies

Present Law

In general, interest on qualified private activity bonds is tax-exempt. Bonds, the proceeds of which are used directly or indirectly to make or finance loans to persons other than government units are private activity bonds. Categories of qualified private activity bond include: (1)an exempt facility bonds; (2) qualified mortgage bonds; (3) qualified small issue bonds; (4) qualified student loan bonds; (5) qualified redevelopment bonds; and (6) qualified 501(c)(3) bonds.

State and local bonds issued to purchase single family residences or residential rental real estate are generally (non-qualified) private activity bonds. State and local bonds issued to finance the disposition of single family residences owned by a State Housing Agency are not qualified private activity bonds unless all provisions of Code Section 143 relating to Qualified Mortgage Revenue Bonds are met. State and local bonds issued to finance the disposition of residential rental projects owned by a State Housing Agency to a private business user are not qualified private activity bonds.

Explanation of Proposal

The proposal would expand the definition of private activity bonds to include certain State Housing Agency Bonds. Qualified bond issues must spend at least 95 percent of the proceeds to: (1) acquire single family residences or residential rental projects from the Resolution Trust Corporation, the Federal Deposit Insurance Corporation, the Federal Housing Authority, the Veterans' Administration, or other agencies of the United States Government; (2) finance the disposition of single family residences owned by the above agencies to purchasers who meet the owner-occupancy requirements, the purchase price restrictions, and the family income restrictions of Code Section 143 (related to qualified mortgage bonds); or (3) finance the disposition of residential rental projects owned by the above agencies to private owners who would comply with the low-income targeting requirements of Code section 142(d). In all cases, all the dwellings must be located within the jurisdiction of the State Housing Agency purchasing the mortgage related assets.

The arbitrage restrictions of Code section 148 would apply to bonds issued pursuant to this exception. Moreover, the bonds described in this proposal would be subject to the annual state volume cap for qualified private activity bonds.

Effective Date

The proposal would be effective on the date of enactment.

b. Refinancings of certain bond issues

Present Law

A bond (including refunding bonds) is a private activity bond if an amount exceeding the lesser of five percent or $5 million of bond proceeds is to be used (directly or indirectly) to make or finance loans to any person other than a governmental unit.

Explanation of Proposal

The proposal would allow a current refunding on a tax-exempt basis to qualified issuers if the following restrictions are satisfied: (1) the amount of the refunding issue may not exceed the outstanding amount of the refunded bonds; and (2) the final maturity date of the refunding issue may not be extended later than July 1, 1995. A qualified issuer must have issued the bonds to be refunded to provide financial assistance to another issurer, which is a separate political subdivision, that has defaulted on its financial obligations and meet other restrictions.

Effective Date

The proposal would be effective on the date of enactment.

c. Conform treatment of 501(c)(3) bonds to governmental bonds

Present Law

Present law permits tax-exemption for interest on bonds to benefit section 501(c)(3) organizations (qualified 501(c)(3) bonds). Qualified 501(c)(3) bonds are defined as bonds which would not be private activity bonds if section 501(c)(3) organizations were treated as governmental units with respect to their exempt activities (sec. 145). Qualified 501(c)(3) bonds are classified as private activity bonds and such bonds are generally subject to several of the limitations on qualifying private activity bonds. In addition, no more than $150 million of qualified 501(c)(3) bonds (other than hospital bonds) may be outstanding with respect to any section 501(c)(3) organization at any time.

Explanation of Proposal

The proposal would repeal section 145 and generally treat bonds issued by 501(c)(3) organizations in the same manner in which present law treats bonds issued by governmental units. The proposal thereby would: (1) repeal the $150 million limitation on outstanding tax-exempt indebtedness of 501(c)(3) organizations; (2) repeal the two percent limitation on the financing of costs of issuance with bond proceeds; and (3) other changes.

Effective Dates

The proposal would generally be effective for bonds issued after December 31, 1989. The proposal would not apply to certain bonds issued after December 31, 1989, if such bonds are subject to any transition rule under subtitle B of title XIII of the Tax Reform Act of 1986.

d. Mortgage credit certificates time limit suspension

Present Law

Generally, a qualified issuer may either issue Mortgage Revenue Bonds (MRBs) or exchange MRB authority for authority to issue Mortgage Credit Certificates (MCCs). After it has exchanged the authority the issuer can proceed with the actual issuance of the MCCs. The Tax Reform Act of 1986 imposed new restrictions, including tighter targeting, on MRBs and MCCs. The statutory language made these restrictions effective for MCCs issued after August 15, 1986. The Conference Committee Report, on the other hand, provided that these restrictions were effective with respect to bond authority exchanged for authority to issue MCCs after August 15, 1986. The "Bluebook" General Explanation noted that a technical correction would be necessary to correct the statutory language to conform to the legislative intent. This technical correction to apply the 1986 Act restrictions to exchanges of bond authority and not issuances of MCCs after August 15, 1986 was enacted in the Technical and Miscellaneous Revenue Act of 1988.

Code section 25(e)(3)(B) renders a MCC invalid unless the mortgagor incurs debt by the close of the second calendar year after the exchange the authority. The time limit under this section was not suspended by the 1986 Act.

Explanation of Proposal

The proposal would provide that the two-year time period allowed in Code section 25(e)(3)(B) commences running on the date of enactment of this technical for bond authority exchanged before August 15, 1986, but not issued as of that date.

Effective Date

The proposal would be effective on the date of enactment.

e. Sports stadium bonds

Present Law

The Tax Reform Act of 1986 restricted the availability of private activity tax-exempt bond financing. Specifically, the volume limitation applies to (1) exempt-facility bonds (other than bonds for airports, docks and wharves, and certain governmentally owned solid waste disposal facilities), (2) qualified mortgage bonds, (3) small-issue bonds, (4) qualified student loan bonds, and (5) qualified redevelopment bonds. Certain other private activity bonds for which tax-exemption specifically is provided in non-Code provisions also are subject to the new private activity bond volume limitations. While sports stadiums and convention facilities could be financed as qualified Industrial Development Bonds (IDBs) under prior law, they no longer fall within any category of exempt-facility bonds eligible for tax-exemption under present law.

Explanation of Proposal

The proposal would provide that sports stadiums are an exempt facility and can be financed using tax-exempt bonds subject to the State private activity bond limitation.

Effective Date

The proposal would be effective for bonds issued after December 31, 1989.

17. Treatment of immediate annuity contracts

Present Law

In order to curtail the marketing of serial contracts that are designed to avoid the distribution rules applicable to annuity contracts, the Technical and Miscellaneous Revenue Act of 1988 provided that all annuity contracts issued by the same insurer (or affiliates) to the same policyholder during any 12-month period are to be aggregated for purposes of determining the amount of any distribution that is includible in gross income under section 72(e) of the Internal Revenue Code. In addition, the Treasury Department was provided regulatory authority to prevent the avoidance of the distribution rules contained in section 72(e) through the serial purchase of contracts or otherwise.

Explanation of Proposal

The committee report to the bill would clarify that the present-law aggregation rules for determining the portion of any distribution from an annuity contract that is includible in gross income would not apply to an immediate annuity. In addition, the committee report would clarify that Congress did not intend to address the treatment of "combination" or "split" annuities in providing the Treasury Department with the authority to provide regulations that are necessary or appropriate to prevent avoidance of the distribution rules. The committee report would also provide that no inference is intended with respect to whether the Treasury Department may treat combination or split annuities as a single contract under its general authority to prescribe such rules and regulations as may be necessary to enforce the income tax laws.

Effective Date

The proposal would be effective as if included in the Technical and Miscellaneous Revenue Act of 1988.

18. Occupational tax on retail alcoholic beverage distributors

Present Law

The occupational tax on retail establishments which sell alcoholic beverages is $250 per year. The occupational tax was increased from $54 per year in the Omnibus Budget Reconciliation Act of 1987, and became effective on January 1, 1988.

Explanation of Proposal

The proposal would reduce the occupational tax on certain retail establishments which sell alcoholic beverages from $250 to $150 per year. The reduction would apply to establishments with annual gross receipts from the sale of alcoholic beverages less than $250,000 and in which at least one-third of the alcoholic beverages sold are consumed on the premises of the establishment.

Effective Date

The proposal for a reduced occupational tax would be effective on and after January 1, 1990.

19. Apply statute of limitations to uncollected occupational taxes for retail alcoholic beverage establishments

Present Law

The occupational tax on retail establishments which sell alcoholic beverages is $250 per year. The occupational tax was increased from $54 per year in the Omnibus Budget Reconciliation Act of 1987, and became effective on January 1, 1980.

Since the increase in the occupational tax and transfer of responsibility for administration of alcohol taxes to the Bureau of Alcohol, Tobacco and Firearms (BATF), enforcement activities have been intensified in a systematic manner. As a result, some taxpayers were located who had not paid occupational taxes for a number of years, some for a large number of years. Many taxpayers accused of tax delinquency claim to have not been aware of the existence of the occupational tax. Nevertheless, they have been assessed for back taxes plus interest and penalties on the back taxes.

Explanation of Proposal

The proposal would establish a statute of limitations from 1985 in order to limit the period for which back taxes, interest, and penalties may be assessed.

Effective Date

The proposal would be effective on the date of enactment.

20. Excise tax on reversions of qualified plan assets

Present Law

A nondeductible 15-percent excise tax is imposed on employer reversions from qualified plans (sec. 4980). The tax is designed to recapture the tax benefit received by the employer from the deferral of tax on pension fund earnings.

Explanation of Proposal

The proposal would increase the 15-percent excise tax to 20 percent.

Effective Date

The proposal would generally apply to reversions received after the date of committee action, other than reversions with respect to which a notice of intent to terminate was provided on or before such date.

21. Include essential air services among Airport and Airway Trust Fund expenditure purposes

Present Law

Excise tax receipts appropriated to the Airport and Airway Trust Fund (AATF) may be spent only for statutory purposes specified in section 9502 of the Internal Revenue Code. Generally, these purposes are (1) airport improvement, which includes airport development and planning, noise abatement at airports, and enhancing airport capacity; (2) airway systems improvement, which includes air navigation and communications facilities and equipment, and instrument landing systems; (3) portions of administrative expenses which are attributable to activities under points (1) and (2); and (4) research, engineering and development, and demonstrations, which include projects relating to such activities as air traffic control, air navigation, aviation weather, aviation medicine, aircraft safety, environmental problems, and human factors.

Section 419 of the Federal Aviation Act of 1958, as amended, provides for subsidization of essential air services to an eligible point which is more than 45 highway miles from an airport hub and which has lost what is determined by the Secretary of Transportation to be essential air service. The Secretary is authorized to provide a reasonable amount of compensation to an air carrier which is selected to provide air services to an eligible point. Guidelines for determining compensation are to "include expense elements based upon representative costs of air carriers providing scheduled air transportation of persons, property, and mail, using aircraft of the type determined by the Secretary to be appropriate for providing such service."

Explanation of Proposal

The proposal would amend the expenditure purposes of the Airport and Airway Trust Fund to include the essential air services program which is authorized in section 419 of the Federal Aviation Act of 1959, as amended.

Effective Date

The proposal would apply to obligations incurred in fiscal years after September 30, 1989.

22. Foreign Provisions

a. Consider certain leased assets for purposes of the passive foreign investment company asset test

Present Law

A foreign corporation is treated as a passive foreign investment company (PFIC) if it satisfies either an income test or an asset test. To satisfy the income test, at least 75 percent of the corporation's gross income for the taxable year must be passive income. The asset test is met if the average percentage of assets (based on either fair market value or adjusted basis) held by the corporation during the taxable year which produce, or are held for the production of, passive income is at least 50 percent.

Explanation of Proposal

The proposal would provide rules under which certain leasehold interests in certain assets would be treated in certain circumstances and to some extent as an asset held by a foreign corporation for purposes of applying the PFIC asset test to that corporation.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1988.

b. Modify definition of passive foreign investment company with regard to certain income of export trade corporations

Present Law

Certain income derived by an export trade corporation (ETC) from certain export activities is exempt from current taxation under subpart F (sec. 970). Under this exemption, the subpart F income of an ETC is reduced by certain amounts that constitute export trade income (as defined in section 971). No foreign corporation may qualify as an ETC unless it has so qualified generally since 1971 (sec. 971(a)(3)).

The income of any passive foreign investment company (PFIC) is generally subject to current U.S taxation (sec. 1291-1297). A PFIC is defined by section 1296 generally as any foreign corporation if either (1) 75 percent or more of its gross income for the taxable year is passive income, or (2) 50 percent or more, on average, of the assets held by such corporation during the taxable year produce passive income or are held for the production of passive income. For this purpose, passive income generally is defined by reference to section 954(c). Amounts that are passive income for this purpose may also constitute export trade income under section 971.

Explanation of Proposal

The proposal would exclude from the definition of passive income, solely for the purpose of determining whether a foreign corporation is a PFIC, any export trade income of an ETC to the extent that the subpart F income of such ETC is reduced under section 970 by such income.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1989, for which a foreign corporation is treated as an export trade corporation. An ETC that is a PFIC under present law but would not be a PFIC under the proposal would be treated as making distributions out of earnings that were accumulated in years during which the ETC was a PFIC, which distributions would be subject to the rules of section 1291, only after the distribution of all other accumulated earnings and profits.

c. Treatment of certain scholarship or fellowship grants to nonresident aliens

Present Law

Generally under the Code, the United States imposes tax, at ordinary rates, on the taxable income of a nonresident alien individual that is effectively connected with the conduct of a trade or business in the United States. However, in computing taxable income, a nonresident alien cannot use the standard deduction and is in some cases entitled to only one personal exemption in cases where (because of rules for spouses and dependents) a U.S. resident or citizen would be entitled to multiple personal exemptions. Under the Code, a nonresident alien is generally subject to a 30 percent tax on gross amounts of fixed or determinable, annual or periodical income from U.S. sources that is not effectively connected with the conduct of a trade or business in the United States. The payor of income subject to this gross-basis tax is generally required to collect the tax by withholding at the full 30 percent rate.

U.S. source amounts that are received by a nonresident alien individual who is temporarily present in the United States under an F, J or M visa, and that are either (1) incident to a qualified scholarship to which section 117(a) applies (but are includible in gross income), or (2) a scholarship or fellowship for study, training, or research in the United States and received from a government, a 501(c)(3) organization, or certain types of international, binational, or multinational organizations, are treated as effectively connected with the conduct of a trade or business within the United States and eligible for withholding at a 14 percent rate.

Explanation of Proposal

In the case of a nonresident alien individual who is temporarily present in the United States under an F, J or M visa, the proposal would permit that individual the benefits of the standard deduction and the personal exemptions to which the individual would be entitled for the year if he or she (and his or her spouse, if any) were U.S. citizens, to the extent that deduction and those exemptions do not exceed the amounts which are granted to the individual during the taxable year by a federal, state, or local government agency, or a tax-exempt U.S. organization described in section 501(c)(3), as a scholarship or fellowship for study, training, teaching, research or career development in the United States, and which are included in the individual's gross income. Withholding would be reduced to account for the reduction in tax liability.

Effective Date

23. Accounting Provisions

a. Treatment of safe-harbor leases of membership organizations

Present Law

Present law provides that, in the case of a membership organization (such a cooperative), losses from transactions with members cannot be used to offset income from transactions with nonmembers. The Internal Revenue Service has taken the position that the interest income derived from a safe-harbor sale-leaseback transaction is income not derived from transactions with members while the rental expense from such a sale-leaseback transaction must be allocated between income derived from members and nonmembers.

Explanation of Proposal

Under the proposal, the interest income and rental expense from the sale and leaseback of the property under a safe-harbor lease are to be first netted and the difference allocated between members and nonmembers in proportion to the business done with each group.

Effective Date

The proposal would be effective for all open taxable years.

The proposal would apply to taxable years beginning after December 31, 1989.

b. Modify treatment of discharge of farm indebtedness for certain farmers

Present Law

Gross income generally includes income from the discharge of indebtedness (sec. 61(a)(12)). If an insolvent taxpayer realizes income from discharge of indebtedness, however, the income is excluded and certain tax attributes of the taxpayer (including items such as net operating loss carryovers and basis in property) generally are reduced by the excluded amount. The exclusion is limited to the amount by which the taxpayer is insolvent. If the taxpayer's discharge of indebtedness income (not in excess of the amount by which the taxpayer is insolvent) exceeds these tax attributes, the excess is forgiven, i.e., is not includible in income (sec. 108).

The Tax Reform Act of 1986 provided that, in the case of a solvent taxpayer who realizes income from the discharge by a "qualified person" of "qualified farm indebtedness," the discharge is treated in a manner similar to a discharge incurred by an insolvent taxpayer (sec. 108(g)). Qualified farm indebtedness is indebtedness incurred directly in connection with the operation of a farming business by a taxpayer who satisfies a specified gross receipts test. A qualified person is one regularly engaged in the business of lending money and meeting certain other requirements. The Technical and Miscellaneous Revenue Act of 1988 provided that the amount excluded under this provision generally may not exceed the sum of the taxpayer's loss and credit carryovers and the taxpayer's basis in property held for use in a trade or business or for the production of income. Thus, if there is any remaining discharge of indebtedness income after the taxpayer has reduced these tax attributes, income will be recognized.

Explanation of Proposal

Farmers meeting certain requirements could exclude income from discharge of qualified farm indebtedness, but not in excess of $350,000. This provision would apply to a taxpayer that meets all of the following requirements: (1) the taxpayer's adjusted gross income (with certain modifications) is less than the national median adjusted gross income; (2) more than 50 percent of the taxpayer's gross receipts for 6 of the 10 taxable years preceding the year of transfer is attributable to the farming business, the sale or lease of assets used in farming, or both; (3) the taxpayer materially participates in the farming business; (4) the amount of equity in all property held by the taxpayer after the discharge is less than the greater of (a) $25,000 or (b) 150 percent of the excess of the tax that would be due if section 108 of the Code did not apply, over the tax that

would be due if section 108 did apply; (5) the taxpayer's indebtedness both before and after the discharge is equal to 70 percent or more of the equity in all property held by the taxpayer; and (6) the taxpayer transfers only farm property to discharge the qualified farm indebtedness.

The $350,000 limit would be reduced by prior year exclusions of discharge of qualified farm indebtedness income under this provision.

With respect to farmers that do not satisfy the requirements described above but who otherwise realize income from the discharge of qualified farm indebtedness, the present-law rule that generally limits the exclusion of such income to the sum of the taxpayer's loss and credit carryovers and the taxpayer's basis in certain property, would not be changed by this provision.

Effective Date

The provision would apply to discharges of indebtedness occurring after December 31, 1986, in taxable years ending after such date.

c. Contributions in aid of construction of alternative water supplies

Present Law

Contributions in aid of construction received by a public utility are treated as gross income of the utility and not as a contribution to the capital of the utility. Consequently, a utility is required to include in gross income the value of any property (including money) that it receives to provide, or to encourage it to provide, services to, or for the benefit of, any person transferring property to the utility. A utility is considered as having received property to encourage the provision of services if the receipt of the property is a prerequisite to the provision of services, if the receipt of the property results in the provision of services earlier than would have been the case had the property not been received, or if the receipt of the property otherwise causes the transferor to be favored in any manner.

Explanation of Proposal

A contribution of money or other property by a Federal, State or local government (or a political subdivision thereof) to a regulated public utility that provides water or sewage disposal services would be treated as a contribution to capital and not as an item of gross income if the contribution is in aid of construction of property that will be used predominantly in furnishing alternative water supplies for purposes of remedying environmental contamination or protecting the health of individuals threatened by environmental contamination. This treatment would apply only if the contribution (or any property acquired or constructed with the contribution) is not included in the utility's rate base for ratemaking purposes. In addition, no deduction or credit would be allowed with respect to any expenditure that constitutes a contribution to capital and the adjusted basis of any property acquired by such an expenditure would be zero.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986.

d. Modification of the percentage of completion method of accounting for long-term contracts and study of the treatment of long-term contracts

Present Law

Taxpayers engaged in the production of property under a long-term contract must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. Exceptions to these required accounting methods are provided for certain construction contracts of small businesses and certain home construction contracts.

Under the percentage of completion method, a taxpayer must include in gross income for any taxable year an amount that is based on the product of (1) the gross contract price and (2) the percentage of the contract completed as of the end of the taxable year. The percentage of the contract completed as of the end of a taxable year is determined by comparing costs incurred with respect to the contract as of the end of the year with the estimated total contract costs. In addition, under the percentage of completion method, costs allocable to the contract are taken into account for the taxable year in which incurred.

Explanation of Proposal

Modification of the percentage of completion method of accounting for long-term contracts

A taxpayer would be allowed to elect not to recognize income under a long-term contract or take into account any costs allocable to such long-term contract for any taxable year if as of the end of the taxable year less than 15 percent of the estimated total contract costs have been incurred. For the taxable year in which the 15-percent threshold is satisfied, all costs that have been incurred as of the end of the taxable year would be taken into account in determining the percentage of the contract that has been completed and in determining the amount of allowable deductions under the contract.

The election would also apply for purposes of the lookback method, in determining alternative minimum taxable income, and in determining adjusted current earnings under the alternative minimum tax. The election would be required to be made with respect to all long-term contracts of a taxpayer and would be treated as a method of accounting.

Study of the treatment of long-term contracts

The Treasury Department would be required to study the proper treatment of long-term contracts for Federal income

tax purposes and report the results of the study to the House Ways and Means Committee and the Senate Finance Committee by February 28, 1990.

Effective Date

The proposal would apply to long-term contracts that are entered into after December 31, 1989.

e. Modify material participation for certain timber activities of individuals under the passive loss rules

Present Law

Present law, as amended by the 1986 Act, provides that deductions from passive trade or business activities, to the extent they exceed income from all such passive activities (exclusive of portfolio income), generally may not be deducted against other income. Suspended losses are carried forward and treated as deductions from passive activities in the next year. Suspended losses are allowed in full when the taxpayer disposes of his entire interest in the activity to an unrelated party in a transaction in which all realized gain or loss is recognized. The provision applies to individuals, estates, trusts, and personal service corporations. A special rule limits the use of passive activity losses and credits against portfolio income and tax attributable to portfolio income in the case of closely held corporations.

An activity generally is treated as passive if it is a rental activity, or if the taxpayer does not materially participate in it, i.e., the taxpayer is not involved in the operations of the activity on a basis which is regular, continuous, and substantial.

Under temporary and proposed Treasury regulations, a taxpayer may meet any of several tests for material participation, including a test based on all of the facts and circumstances. If an individual participates in an activity for 100 hours or less during the taxable year, the regulations provide that such individual shall not be treated as materially participating under the facts and circumstances test.

The regulations further provide that an individual's services performed in the management of an activity shall not be taken into account in determining whether such individual is treated as materially participating under the facts and circumstances test, unless, for such taxable year, (i) no person (other than such individual) who performs services in connection with the management of the activity receives compensation that is earned income in consideration for such services; and (ii) no individual performs services in connection with the management of the activity that exceed (by hours) the amount of such services performed by such individual.

Explanation of Proposal

Under the proposal, in the case of qualified timber property held by a natural person, material participation could be determined under the facts and circumstances test in

the regulations even though the person participates in the activity for 100 hours or less during the taxable year.

Qualified timber property for this purpose would mean a woodlot or other site located in the United States that will contain trees in significant commercial quantities and that is held by the taxpayer for the planting, cultivating, caring for, and cutting of trees for sale or use in the commercial production of timber products.

Effective Date

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

f. Treatment of certain crops under the annual accrual method of accounting

Present Law

Present law provides an exception to the uniform cost capitalization rules for certain corporations and qualified partnerships that are permitted to use the annual accrual method of accounting with respect to the trade or business of farming sugar cane. Under the annual accrual method of accounting, revenues, costs, and expenses are determined under an accrual method of accounting and the preproductive period expenses incurred during any taxable year are charged to harvested crops or are deducted in determining taxable income for such years.

Explanation of Proposal

A corporation or qualified partnership that, for its last taxable year ending before January 1, 1987, was allowed to use, and actually used, the annual accrual method of accounting with respect to any crop would be allowed to continue to use such method of accounting with respect to such crop.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986.

g. Installment sales treatment of timeshares and residential lots sold by C corporations

Present Law

A taxpayer who disposes of a timeshare or a residential lot on the installment plan generally may report income derived from such a disposition on the installment method if the taxpayer elects to pay interest on the amount of deferred tax that is attributable to the use of the installment method. Under this election, interest is required to be paid for any taxable year that payments are received under the installment obligation (other than the taxable year in which the sale occurs). The interest is imposed for the period that begins on the date of the sale of the timeshare or the residential lot and ends on the date that each payment is received. The interest rate used for this purpose is the applicable Federal rate (compounded semiannually) in effect at the time of the sale for debt instruments with the same maturity as the installment obligation.

A taxpayer who elects to pay interest with respect to an installment sale of a timeshare or a residential lot may use the installment method in determining alternative minimum taxable income. However, for purposes of the adjusted current earnings provision of the alternative minimum tax, the installment method may not be used in determining income derived from an installment sale (including a nondealer installment sale of property) even though interest is required to be paid with respect to all or a portion of the deferred tax that is attributable to the use of the installment method. The adjusted current earnings provision of the alternative minimum tax applies to C corporations for taxable years beginning after December 31, 1989.

Explanation of Proposal

The proposal would modify the amount of interest that is payable by a C corporation that elects to use the installment method with respect to an installment sale of a timeshare or a residential lot. The interest would be determined for all outstanding installment obligations with respect to which an election was made by multiplying the total net deferred tax with respect to all such obligations by the underpayment rate in effect for the month with or within which the taxable year ends.

For any taxable year, the deferred tax for such obligations would equal (1) the amount of gain under the obligations that has not been recognized as of the close of the taxable year reduced by the excess (if any) of the total allowable deductions for such year over the total income for such year, multiplied by (2) the maximum rate of tax in effect for such taxable year for C corporations. The net

deferred tax for such obligations would equal the deferred tax reduced by the excess (if any) of the amount of income tax credits for such year over the amount of income tax for such year before reduction by credits. Alternatively, a C corporation would be allowed to elect to determine the net deferred tax by multiplying (1) the amount of gain under the obligations that has not been recognized as of the close of the taxable year, by (2) the maximum rate of tax in effect for such taxable year for C corporations.

Any interest determined under the proposal would be treated as a tax imposed for the taxable year following the year in which the interest was determined. The portion of the interest, however, that is allocable to installment obligations that have not been outstanding for a two-year period as of the close of the taxable year or that are in default as of the close of the taxable year would not result in an increase in tax for such taxable year. Instead, if such installment obligations are not in default at the close of any taxable year after the end of the two-year period, the amount of interest that was determined under the proposal but was not added to tax would be added to tax for the first taxable year following such year (together with additional interest compounded at the underpayment rate for each year that the original interest has not been added to tax).

The proposal would also clarify that the interest determined under the proposal is to be treated as tax for purposes of the estimated tax provisions applicable to corporations.

A C corporation that elects to pay interest under the proposal with respect to an installment sale of a timeshare or a residential lot would be allowed to use the installment method for purposes of the adjusted current earnings provision of the alternative minimum tax. In addition, for purposes of the adjusted current earnings provision of the alternative minimum tax, a taxpayer that is required to pay interest with respect to a nondealer disposition of property would be allowed to use the installment method for the portion of the gain with respect to which interest is required to be paid.

Effective Date

The proposal would apply to dispositions occurring in taxable years beginning after December 31, 1989.

24. Energy/Excise Tax Provisions

a. Modifications to production credit for nonconventional fuels

Present Law

Nonconventional fuels are eligible for a production credit which is equal to $3 per barrel of BTU oil barrel equivalent. Those fuels which are eligible must be produced from a well drilled, or a facility placed in service, before January 1, 1991. Qualified fuels are eligible for the production credit through December 31, 2000.

Gas from a tight sands formation was eligible for the production credit as long as natural gas was subject to price controls, under sec. 107 of the Natural Gas Policy Act of 1978.

Explanation of Proposal

(1) Production of gas from a tight sands formation would be eligible for the production credit even though the price of natural gas no longer is subject to price control.

(2) The production credit for gas produced from a tight sands formation would be available for gas from wells drilled after December 31, 1989.

(3) The production credit for nonconventional fuels would be extended to apply to wells drilled or facilities placed in service before January 1, 1993, instead of before January 1, 1991.

Effective Date

The proposal would be effective on January 1, 1990.

b. Proving tolerance limits for blending of gasohol

Present Law

Gasohol blenders which produce a blend containing 10 percent alcohol and 90 percent gasoline may receive a credit or refund of 6 cents per gallon of the 9 cents per gallon gasoline excise tax which is dedicated to the Highway Trust Fund.

Blenders have found in practise that it is difficult to achieve precisely the 10 percent alcohol content in a gasohol blend because of (1) mechanical imprecision in metering alcohol into a tankload of gasoline which can occur because the calibration of dispensing equipment may have become inexact during usage and (2) cut-off valves which do not respond instantaneously to mechanical or electronic signals to cease dispensing.

Explanation of Proposal

A range of tolerance of plus-or-minus one-tenth of one percent (+/- 0.1%) would be considered as meeting the requirements of a gasohol blend of 10 percent alcohol, so long as over a reasonable period of time the average ratio of alcohol to gasoline is 10.0 percent. The Secretary would be instructed to provide regulations governing the administration of this provision.

Effective Date

The proposal would be effective on January 1, 1990.

c. Allow crop dusters to apply for waivers from gasoline tax

Present Law

Crop dusters, who make aerial applications to farmers' crops, do not have to pay the excise tax on gasoline because the gasoline is not used on highways. In order to avoid payment of the gasoline tax, however, crop dusters must obtain a waiver from the farmer which provides that the farmer does not want the excise tax exemption and that the crop duster may claim it, even though the off-highway use took place on the farmer's land.

Crop dusters have found this procedure to be both burdensome and cumbersome, and have sought relief in favor of a process which allows them to claim an exemption for off-highway gasoline use directly without having to involve farmers in the process.

Explanation of Proposal

The proposal would allow crop dusters to purchase tax-free gasoline for off-highway farm use without having first to receive a waiver from a farmer.

Effective Date

The proposal would be effective on January 1, 1990.

25. Provide minimum tax credit for exclusionary items of corporations

Present Law

When a corporation pays the alternative minimum tax, the amount of the tax paid (to the extent attributable to timing differences with the regular tax), is allowed as a credit against the regular tax as a credit in future years. The credit (known as the minimum tax credit) cannot be used to reduce tax below the tentative minimum tax in subsequent years.

Explanation of Proposal

The proposal would provide that the entire amount of the corporate alternative minimum tax (rather than only the amount of tax attributable to timing differences) may be taken into account in computing the amount of the alternative minimum tax credit available in future years.

Effective Date

The proposal would allow the entire alternative minimum tax arising in taxable years beginning after December 31, 1989 to be allowable as a credit for subsequent years.

26. Small business exemption from recognition of gain or loss on liquidating sales or distributions (exemption from repeal of the General Utilities doctrine)

Present Law

Gain or loss is generally recognized by a corporation on a liquidating sale or distribution (including a deemed sale occurring when a corporation is acquired and an election is made to treat the transaction as an asset sale). This rule was added to the Code by the Tax Reform Act of 1986. Prior to the 1986 Act, gain was generally recognized in the case of nonliquidating sales or distributions but not in the case of liquidating sales (including sales involving the acquisition of the corporation). However, certain nonliquidating distributions to long-term individual shareholders were not taxed prior to the 1986 Act. The 1986 Act generally conformed the treatment of gain in liquidating sales and distributions to the treatment that resulted in the absense of a liquidation or an acquisition by requiring gain recognition in all cases.

The 1986 Act provided transition relief for certain small corporations. Corporations eligible for this relief were granted two additional years, until December 31, 1988, in which they could distribute assets, liquidate, or convert to subchapter S status without becoming subject to the 1986 Act provision except in the case of ordinary income assets or capital assets held less than six months, or in the case of certain conduit transactions with ineligible corporations.

Eligible corporations were those in existence on August 1, 1986, and whose value on the later of that date or the date of adoption of a plan of liquidation did not exceed $10 million, provided that on August 1, 1986 and at all times thereafter, more than 50 percent (by value) of the stock of such corporation was owned by a qualified group. This was a group of 10 of fewer individuals who at all times during the five year period ending on the date of adoption of the plan of liquidation (or during the life of the corporation, if shorter) owned more than 50 percent of the value of the corporate stock. Corporations whose value exceed $5 million were eligible only for partial relief and the relief was phased out entirely at a size of $10 million.

Explanation of Proposal

The 1986 Act relief from gain recognition for small corporations that expired at the end of 1988 would be reinstated. The relief would apply to corporations more than 50 percent of the stock of which is held by qualified shareholders each of whom has held his or her stock for at least 5 years. As under the 1986 Act transition rule, ordinary income property and short term capital gain property

would not be eligible for relief. Conforming changes would be made to the definition of short term capital gain property to reflect changes in the definition that have occurred since 1986.

Effective Date

The provision would be effective for distributions or sales occurring after December 31, 1988.

27. Civil penalty reform

a. Information reporting penalties

Present Law

In general

Any person that fails to file an information return with the Internal Revenue Service on or before the prescribed filing date is subject to a $50 penalty for each failure, with a maximum penalty of $100,000 per calendar year. Information returns relating to interest and dividends are subject to this $50 penalty for each failure, but without any cap on the total amount of penalty that may be imposed. In addition, any person that fails to provide a copy of an information return (a "payee statement") to a taxpayer on or before the prescribed due date is subject to a penalty of $50 for each failure, with a maximum penalty of $100,000 per calendar year. If a person fails to include all of the information required to be shown on an information return or a payee statement or includes incorrect information, then a penalty of $5 may be imposed with respect to each such failure, with a maximum penalty of $20,000 per calendar year. Stricter penalty provisions apply in the case of interest and dividend returns and in the case of intentional failures to comply with the information return requirements.

A penalty may also be imposed for each failure to include a correct taxpayer identification number on a return or statement and for each failure to furnish a correct taxpayer identification number to another person. The amount of the penalty that may be imposed is either $5 or $50 for each failure, depending on the nature of the failure.

Foreign provisions

Income of foreign persons subject to withholding

Persons having control, receipt, custody, disposal, or payment of certain types of U.S. income of foreign persons are required to deduct and withhold U.S. tax from such income under chapter 3 of the Code's income tax provisions (secs. 1441-1464). Generally, any person required to serve as a withholding agent under chapter 3 must provide each income recipient an annual withholding statement (Form 1042S) and must file all required Forms 1042S with the IRS accompanied by a return (Form 1042) summarizing the information on the Forms 1042S (Reg. sec. 1.1461-2). As described above, the Code generally provides penalties for each failure to file a required information return with the IRS and each failure to provide a required payee statement. These penalties do not apply, however, to each failure with respect to Forms 1042S.

Information reporting

Generally, every U.S. person is required to report certain information concerning any foreign corporation that such person controls and information relating to transactions between the corporation and certain specified persons. Failure to provide such information subjects the U.S. person to a monetary penalty plus a denial of foreign tax credits (sec. 6038). These information reporting requirements and this penalty do not specifically refer to all types of information needed to determine tax liabilities with respect to controlled foreign corporations.

Explanation of Proposal

Overview

The proposal would modify the information return penalties provided under present law in order to encourage persons to file correct information returns even though such returns are filed after the prescribed filing date. The proposal would establish a three-tier penalty structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. This structure would give taxpayers an incentive to correct their errors as rapidly as possible. Taxpayers would be permitted correct a de minimis number of errors and avoid penalties entirely. Uniform reporting requirements would be made applicable to magnetic media. A study of service bureaus, which file information documents on behalf of other persons, would be required.

Failure to file correct information returns

Any person that fails to file a correct information return with the Internal Revenue Service on or before the prescribed filing date would be subject to a penalty that varies based on when, if at all, the correct information return is filed. If a person files a correct information return after the prescribed filing date but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty would be $15 per return, with a maximum penalty of $75,000 per calendar year. If a person files a correct information return after the date that is after 30 days after the prescribed filing date but on or before August 1, the amount of the penalty would be $30 per return, with a maximum penalty of $150,000 per calendar year. If a correct information return is not filed on or before August 1 of any year, the amount of the penalty would be $50 per return, with a maximum penalty of $250,000 per calendar year.

The proposal would also provide a special rule for de minimis failures to include the required, correct information. This exception would apply to incorrect

information returns that are corrected on or before August 1. Under the exception, if an information return is originally filed without all of the required information or with incorrect information and the return is corrected on or before August 1, then the original return would be treated as having been filed with all of the correct required information. The number of information returns that may qualify for this exception for any calendar year would be limited to the greater of (1) 10 returns or (2) one-half of one percent of the total number of information returns that are required to be filed by the person during the calendar year.

The use of 10 returns for this purpose effectively provides a special small-business rule in this penalty. According to IRS statistics, approximately 84 percent of payors who file information returns with the IRS file 10 or fewer forms. Thus, these payors will have until August 1 to correct without penalty errors of omission or commission on information returns that were originally timely-filed with the IRS. If the total number of returns corrected by the taxpayer exceeds the de minimis threshold, only the number exceeding the threshold is subject to penalty. This specific de minimis rule in no way restricts the ability of the IRS or the courts to grant a waiver based on reasonable cause (discussed below). The reasonable cause waiver is applied before the de minimis threshold is applied.

In addition, the proposal would provide special, lower maximum levels for this penalty for small businesses. Small businesses would be defined as firms having average annual gross receipts for the most recent 3 taxable years that do not exceed $5 million. The maximum penalties for small businesses would be: $25,000 (instead of $75,000) if the failures are corrected on or before 30 days after the prescribed filing date; $50,000 (instead of $150,000) if the failures are corrected on or before August 1; and $100,000 (instead of $250,000) if the failures are not corrected on or

The proposal would also incorporate into this general structure the penalty for failure to provide information reports to the IRS or statements to payees relating to pension payments.

Failure to furnish correct payee statements

Any person that fails to furnish a correct payee statement to a taxpayer on or before the prescribed due date would be subject to a penalty (as under present law) of $50 per statement, with a maximum penalty of $100,000 per calendar year. If the failure to furnish a correct payee statement to a taxpayer is due to intentional disregard of the requirement, the proposal generally provides a penalty of $100 per statement or, if greater, 10 percent of the amount

required to be shown on the statement, with no limitation on the maximum penalty per calendar year.

Failure to comply with other information reporting requirements

Any person that fails to comply with other specified information reporting requirements on or before the prescribed date would be subject to a penalty of $50 for each failure, with a maximum penalty of $100,000 per calendar year. The information reporting requirements specified for this purpose would include any requirement to include a correct taxpayer identification number on a return or statement and any requirement to furnish a correct taxpayer identification number to another person. The proposal would coordinate this penalty with the penalty for failure to file correct information returns and the penalty for failure to file correct payee statements by making this penalty inapplicable to failures penalized under those provisions.

Waiver, definitions, and special rules

The proposal would consolidate the waiver standards relating to information reporting into one provision. Thus, any of the information reporting penalties may be waived if it is shown that the failure to comply is due to reasonable cause and not to willful neglect. For this purpose, reasonable cause exists if significant mitigating factors are present, such as the fact that a person has an established history of complying with the information reporting requirements. If a payor correctly reports information that the payor received from a payee, the payor is not subject to penalty for errors that the payee made in reporting the information to the payor. The separate, higher waiver standard under present law for interest and dividends is repealed. Interest and dividend returns and statements are consequently subject to this general waiver standard.

Foreign provisions

Penalties for failure to file withholding statements

The proposal would integrate the penalty for failure to file Form 1042S and failure to provide Form 1042S to the payee into the general penalty structure. Thus, the proposal would treat each Form 1042S required to be filed with the IRS and provided to a payee as an information return and as a payee statement, respectively, as those terms are defined in section 6724. Accordingly, each failure to file any required Form 1042S will be subject to a separate penalty under

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[1] Five percent for several types of statements.

section 6721, and each failure to provide a payee any required Form 1042S will be subject to a separate penalty under section 6722.

Penalties for failure to report information with respect to certain foreign corporations

The proposal would clarify the reporting requirements and penalties imposed by section 6038 by expressly applying those provisions to failures to provide certain information with respect to related parties, such as controlled foreign corporations of which the person subject to the requirements is a U.S. shareholder.

Uniform requirements for returns on magnetic media

The proposal would provide that uniform magnetic media requirements apply to all information returns filed during any calendar year. The proposal would accomplish this by making statutory the requirement currently contained in IRS regulations that persons filing more than 250 information returns file those returns on magnetic media. The proposal would make this requirement applicable to all types of information returns. Thus, the proposal would repeal the provision of present law that requires persons filing more than 50 information returns relating to payments of interest, dividends, and patronage dividends to file all such returns on magnetic media. The proposal would provide that the penalty for failing to file information returns on magnetic media when required to do so applies only to the number required to be so filed that exceeds 250. The penalties for failure to file on a timely basis correct information returns would apply to the first 250 returns.

Study of procedures to prevent mismatching

The proposal would require the General Accounting Office, in consultation with the Treasury Department, to conduct a study on whether, if the name and taxpayer identification number of any person that is set forth on an information return do not correspond to the name and taxpayer identification number of such person contained on the records of the IRS, the IRS should be permitted to disclose to the person that has filed such information return such information as may be necessary to determine the correct name and taxpayer identification number. A report on the study, together with any recommendations, is to be submitted to the tax-writing committees of the Congress by June 1, 1990.

Study of service bureaus

The proposal would require the General Accounting Office, in consultation with the Treasury Department, to conduct a study of whether service bureaus engaged in the

business of transmitting information returns or other documents to the IRS on behalf of other persons should be subject to registration or other regulation. A report on the study, together with any recommendations, is to be submitted to the tax-writing committees of the Congress not later than July 1, 1990.

Effective Dates

The information reporting provisions of the proposal would generally apply to information returns and payee statements the due date for which (determined without regard to extensions) is after December 31, 1989.

b. Accuracy penalties

Present Law

Negligence penalty

If any part of an underpayment of tax required to be shown on a return is due to negligence or disregard of rules or regulations, a penalty may be imposed equal to 5 percent of the total amount of the underpayment. An underpayment of tax that is attributable to a failure to include on an income tax return an amount shown on an information return is treated as subject to the negligence penalty absent clear and convincing evidence to the contrary.

Fraud penalty

If any part of an underpayment of tax required to be shown on a return is due to fraud, a penalty may be imposed equal to 75 percent of the portion of the underpayment that is attributable to fraud.

Substantial understatement penalty

If the correct income tax liability of a taxpayer for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations), then a substantial understatement exists and a penalty may be imposed equal to 25 percent of the underpayment of tax attributable to the understatement. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return. Special rules apply to tax shelters.

Valuation penalties

If an individual, personal service corporation, or closely held corporation underpays income tax for any taxable year by $1,000 or more as a result of a valuation overstatement, then a penalty may be imposed with respect to the amount of the underpayment that is attributable to the valuation overstatement. A valuation overstatement exists if the valuation or adjusted basis of any property claimed on a return is 150 percent or more of the correct value or adjusted basis. The amount of the penalty that may be imposed increases from 10 to 20 to 30 percent of the underpayment attributable to the valuation overstatement as the percentage by which the valuation claimed exceeds the correct valuation increases. Similar penalties may be imposed with respect to (1) an underpayment of income tax that is attributable to an overstatement of pension liabilities and (2) an underpayment of estate or gift tax that is attributable to a valuation understatement.

Explanation of Proposal

Overview

The proposal would consolidate into one part of the Internal Revenue Code all of the generally applicable penalties relating to the accuracy of tax returns. The penalties that would be consolidated are the negligence penalty, the substantial understatement penalty, and the valuation penalties. These consolidated penalties would also be coordinated with the fraud penalty. The proposal would repeal the present-law versions of these penalties. The proposal would reorganize the accuracy penalties into a new structure that operates to eliminate any stacking of the penalties. The proposal would be effective for returns the due date for which is after December 31, 1989.

Accuracy-related penalty

The accuracy-related penalty, which would be imposed at a rate of 20 percent, would apply to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation overstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement.

(1) Negligence

If an underpayment of tax is attributable to negligence, the negligence penalty would apply only to the portion of the underpayment that is attributable to negligence rather than, as under present law, to the entire underpayment of tax. This is a significant change from present law. Under present law, if any portion of an underpayment is attributable to negligence, the negligence penalty applies to the entire

underpayment (both the portion attributable to negligence and the portion not attributable to negligence).

Negligence would include any careless, reckless, or intentional disregard of rules or regulations, as well as any failure to make a reasonable attempt to comply with the provisions of the Code. In addition, the proposal would repeal the present-law presumption under which an underpayment is treated as attributable to negligence if the underpayment is due to a failure to include on an income tax return an amount shown on an information return.

(2) Substantial understatement of income tax

The accuracy-related penalty that would apply to the portion of an underpayment that is attributable to a substantial understatement of income tax would be the same as the substantial understatement penalty provided under present law with three principal modifications. First, the rate would be lowered to 20 percent. Second, the proposal would expand the list of authorities upon which taxpayers may rely (currently contained in Treasury regulations) to include proposed regulations, private letter rulings, technical advice memoranda, actions on decisions, general counsel memoranda, information or press releases, notices, and any other similar documents published by the IRS in the Internal Revenue Bulletin. In addition, the list of authorities would include General Explanations of tax legislation prepared by the Joint Committee on Taxation (the "Blue Book"). Third, the proposal would require the IRS to publish not less frequently than annually a list of positions for which the IRS believes there is no substantial authority and which affect a significant number of taxpayers. The purpose of this list would be to assist taxpayers in determining whether a position should be disclosed in order to avoid the substantial understatement penalty. Thus, if a taxpayer takes a position that is enumerated on this list, the taxpayer could choose to disclose that position to avoid imposition of the substantial understatement component of the accuracy-related penalty. However, inclusion of a position on this list is not conclusive as to whether or not substantial authority exists with respect to that position. If, however, there is litigation as to whether there is substantial authority, and the court concludes that the IRS is correct in the belief that there is not substantial authority for the position, then this penalty would apply.

(3) Substantial valuation overstatement

The penalty that would apply to the portion of an underpayment that is attributable to a substantial valuation overstatement would generally be the same as the valuation overstatement penalty provided under present law with five principal modifications. First, the proposal would extend

the penalty to all taxpayers. Second, a substantial valuation overstatement would exist if the value or adjusted basis of any property claimed on a return is 200 percent or more of the correct value or adjusted basis. Third, the penalty would apply only if the amount of the underpayment attributable to a valuation overstatement exceeds $5,000 ($10,000 in the case of most corporations). This would increase five-fold the threshold below which the penalty does not apply to individuals. Fourth, the amount of the penalty for a substantial valuation overstatement would be 20 percent of the amount of the underpayment if the value or adjusted basis claimed is 200 percent or more but less than 400 percent of the correct value or adjusted basis. Fifth, as explained below, the proposal would provide that the rate of this penalty is doubled if the value or adjusted basis claimed is 400 percent or more of the correct value or adjusted basis.

(4) Substantial overstatement of pension liabilities

The accuracy-related penalty would also apply to substantial overstatements of pension liabilities. This penalty would be derived from the present-law penalty in section 6659A. The proposal would, however, modify the present-law penalty by providing that the taxpayer is subject to this component of the accuracy-related penalty only if the actuarial determination of pension liabilities is 200 percent or more of the amount determined to be correct (under present law, the penalty applies to claims 150 percent or more in excess of the amount determined to be correct). As under present law, this penalty would apply only if the underpayment attributable to the valuation overstatement exceeds $1,000.

(5) Substantial estate or gift tax valuation understatement

The accuracy-related penalty also would apply to substantial estate or gift tax valuation understatements. This penalty would be derived from the present-law penalty in section 6660. The proposal would, however, modify the present-law penalty by providing that the taxpayer is subject to this penalty only if the value of any property claimed on an estate or gift tax return is 50 percent or less of the amount determined to be correct. (Under present law, the penalty applies to claims that are 66 2/3 percent or less of the amount determined to be correct.) In addition, the proposal would modify the present-law penalty by increasing five-fold the threshold below which the penalty does not apply, from $1,000 to $5,000.

(6) Gross valuation misstatements

The proposal would provide that the rate of the general

accuracy penalty is to be doubled (to 40 percent) in the case of gross valuation misstatements. There would be three types of gross valuation misstatements. The first would be the same as the substantial valuation overstatement component of the accuracy-related penalty, except that the doubling would apply only to valuation overstatements claimed on a return that are 400 percent or more of the amount determined to be the correct amount. The second would be the same as the substantial overstatement of pension liabilities component of the accuracy-related penalty, except that the doubling would apply only to overstatements of pension liabilities that are 400 percent or more of the amount determined to be the correct amount. The third would be the same as the substantial estate or gift tax valuation understatement component of the accuracy-related penalty, except that the doubling would apply only to valuations claimed on the estate or gift tax return that are 25 percent or less of the amount determined to be the correct amount.

Fraud penalty

The fraud penalty, which would be imposed at a rate of 75 percent, would apply to the portion of any underpayment that is attributable to fraud.

Under the proposal, the accuracy-related penalty would not apply to any portion of an underpayment on which the fraud penalty is imposed. (Under present law, the fraud penalty is coordinated in this manner with the negligence penalty, but not with the other components of the accuracy-related penalty.) However, the accuracy-related penalty may be applied to any portion of the underpayment that is not attributable to fraud.

Definitions and special rules

The proposal would provide special rules that apply to each of the penalties imposed under the new structure. First, the proposal would provide standardized exception criteria for all of these accuracy-related penalties. No penalty is to be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith. This standardized exception criterion is designed to permit the courts to review the assertion of penalties under the same standards that apply in reviewing additional tax that the Internal Revenue Service asserts is due.

Second, the proposal would provide that an accuracy-related or fraud penalty is to be imposed only if a return has been filed. This is intended to improve the coordination between the accuracy-related penalties and the failure to file penalties.

Third, the proposal would provide a standard definition of underpayment for all of the accuracy-related penalties.

Repeal of present-law penalties

The proposal would repeal the present-law penalties for negligence and fraud, substantial understatements of liability, valuation overstatements, and valuation understatements for purposes of estate or gift taxes. The proposal would also repeal the special negligence rules applicable to straddles and to amounts shown on information returns. Finally, the proposal would repeal the higher interest rate that applies to substantial underpayments that are attributable to tax-motivated transactions.

Effective Date

The accuracy provisions of the proposal would generally apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989.

c. Preparer, promoter, and protester penalties

Present Law

Return preparer penalties

An income tax return preparer is subject to a penalty of $25 for each failure to (1) furnish a copy of a return or claim for refund to the taxpayer; (2) sign the return or claim for refund; or (3) furnish his or her identifying number.

Penalty for promoting abusive tax shelters

Any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, is subject to a penalty if in connection with such activity the person makes or furnishes a false or fraudulent statement or a gross valuation overstatement. The amount of the penalty equals the greater of $1,000 or 20 percent of the gross income derived or to be derived by the person from the activity. It is unclear under present law whether the term "activity" refers to each sale of an interest in a tax shelter or whether it refers to the overall activity of promoting an abusive tax shelter.

Penalty for aiding and abetting the understatement of tax liability

Any person who aids, assists in, procures, or advises with respect to the preparation or presentation of any

portion of a return or other document under the tax laws which (1) the person knows will be used in connection with any material matter arising under the tax laws, and (2) the person knows will (if so used) result in an understatement of the tax liability of another person is subject to a penalty equal to $1,000 for each return or other document ($10,000 in the case of returns and documents relating to the tax of a corporation).

Frivolous income tax return penalty

Any individual who files a frivolous income tax return is subject to a penalty of $500.

Sanctions and costs awarded by courts

If it appears to the Tax Court that (1) proceedings before it have been instituted or maintained primarily for delay, (2) the taxpayer's position is frivolous, or (3) the taxpayer has unreasonably failed to pursue administrative remedies, the Court may award damages not to exceed $5,000 to the United States.

Authority to counterclaim for balance of penalty in partial refund suits

Taxpayers may pay a portion of the penalties for failure to collect and pay over tax, for understatement of a taxpayer's liability by an income tax return preparer, for promoting abusive tax shelters, and for aiding and abetting the understatement of tax liability. By doing so, they may obtain judicial review of the imposition of these penalties. Present law may prohibit the Federal Government from counterclaiming for the balance of the penalty in the same lawsuit.

Bonding requirement

Return preparers may post a bond, thereby preventing any proceeding by the Federal Government under section 7407 seeking to enjoin a return preparer from engaging in prohibited conduct.

Disclosure of certain information by return preparers

In general, return preparers are subject to penalty for disclosing tax return information that is furnished to the return preparer in connection with the preparation of tax returns. The IRS may by regulation provide exceptions to this general prohibition.

Explanation of Proposal

Return preparer penalties

The return preparer penalties that apply to each failure to (1) furnish a copy of a return or claim for refund to the taxpayer, (2) sign the return or claim for refund, (3) furnish his or her identifying number, and (4) file a correct information return, would be made uniform. The penalty would be $50 for each failure; the total penalties imposed for any single type of failure for any calendar year would be limited to $25,000.

Penalty for promoting abusive tax shelters

Under the proposal, the amount of the penalty imposed for promoting abusive tax shelters would equal $1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). In calculating the amount of the penalty, the organizing of an entity, plan or arrangement and the sale of each interest in an entity, plan, or arrangement would constitute separate activities. These modifications would be made because the courts have differed in their interpretations of the provisions of present law. The proposal would also provide a six-year statute of limitations for this penalty.

The proposal also would clarify that, under present law, "investment plan or arrangement" and "other plan or arrangement," as those terms are used in section 6700 of the Code, include obligations issued by or on behalf of State or local governments which are represented to be described in section 103(a) of the Code ("bonds").

Penalty for aiding and abetting the understatement of tax liability

The proposal would amend the penalty for aiding and abetting the understatement of tax liability by imposing the penalty in cases where the person aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document if (1) the person knows or has reason to believe that the return or other document will be used in connection with any material matter arising under the tax laws, and (2) the person knows that if the portion of the return or other document were so used, an understatement of the tax liability of another person would result. In addition, the proposal would provide that a penalty for promoting abusive tax shelters is not to be imposed on any person with respect to any document if an aiding and abetting penalty is imposed on such person with respect to the same document. The proposal would also provide a six-year statute of limitations for this penalty.

Frivolous income tax return penalty

The proposal would delete the special provision in

present law permitting taxpayers who contest the imposition of this penalty to pay 15 percent of the penalty, which halts further collection proceedings until final judicial resolution of the dispute. Thus, taxpayers who wish to contest imposition of this penalty would be required to pay the full penalty before seeking judicial review of imposition of the penalty. Repealing this special 15-percent rule would place taxpayers who contest this penalty by way of a refund action in the same position as taxpayers who contest the assertion that they owe additional tax to the IRS.

Sanctions and costs awarded by courts

The proposal would authorize the Tax Court to impose a penalty not to exceed $25,000 if a taxpayer (1) institutes or maintains a proceeding primarily for delay, (2) takes a position that is frivolous, or (3) unreasonably fails to pursue available administrative remedies.

The proposal would also authorize the Tax Court to require any attorney or other person permitted to practice before the Court to pay excess costs, expenses, and attorney's fees that are incurred because the attorney or other person unreasonably and vexatiously multiplied any proceeding before the Court. If the attorney is appearing on behalf of the Commissioner of Internal Revenue, the United States would pay these costs in the same manner as an award of these costs by a district court.

Authority to counterclaim for balance of penalty in partial refund suits

The proposal would clarify that, where taxpayers utilize the provisions of present law (other than with respect to frivolous income tax returns) that permit partial (rather than full) payment of certain penalties to obtain judicial review of the imposition of these penalties, the United States may counterclaim as part of the same lawsuit for the remainder of the penalty. Present law may prohibit a counterclaim of this nature; thus, an additional lawsuit must be brought even if the taxpayer loses the case brought after partial payment of the tax.

Repeal of bonding requirement

The proposal would repeal the provision permitting return preparers to post a bond and thereby prevent any proceeding by the Federal Government under section 7407 seeking to enjoin a return preparer from engaging in prohibited conduct.

Disclosure of certain information by return preparers

The proposal would provide that the IRS regulations

relating to the use of tax information by return preparers are to provide that a return preparer may disclose tax information to another return preparer solely for purposes of quality or peer reviews. This would enable a return preparer to obtain the benefits of having another return preparer review the first preparer's work.

Effective Dates

The modifications to the return preparer penalties would apply to documents prepared after December 31, 1989. The modifications to the penalty for promoting abusive tax shelters and the aiding and abetting penalty would apply to activities after December 31, 1989. The modification to the frivolous income tax return penalty would apply to returns filed after December 31, 1989. The modifications to the court-awarded sanctions would apply to proceedings pending on, or commenced after, December 31, 1989. The provision relating to counterclaims would be effective on the date of enactment. The provision repealing the bonding requirement for return preparers would be effective for actions or proceedings commenced after December 31, 1989. The provision relating to disclosures by return preparers would be effective on the date of enactment.

d. Delinquency penalties

Present Law

Failure to file

A taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to 5 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 5 months or 25 percent. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.

Failure to make timely deposits of tax

If any person who is required to deposit taxes imposed by the Internal Revenue Code with a government depositary fails to deposit such taxes on or before the prescribed date, a penalty may be imposed equal to 10 percent of the amount of the underpayment, unless it is shown that such failure is due to reasonable cause and not willful neglect. The amount of the underpayment for this purpose is the excess of the amount of the tax required to be deposited over the amount of the tax, if any, deposited on or before the prescribed date.

Failure to withhold on income of foreign persons

As described above, persons having control, receipt, custody, disposal, or payment of certain types of U.S. income of foreign persons are required to deduct and withhold U.S. tax from such income under chapter 3 of the Code's income tax provisions (secs. 1441-1464). The amount withheld is credited against the U.S. tax liability of the foreign income recipient.

Where a tax on the U.S. income of a foreign recipient was required to be withheld but the withholding agent failed to do so, and instead the tax is paid by the income recipient, a penalty may be imposed on the recipient or the withholding agent for failure to pay the tax only if the failure was fraudulent and for the purpose of evading payment (sec. 1463). By contrast, where a U.S. employer fails to withhold income tax from an employee's wages but the employee pays the tax due, the employer remains liable for any penalties and additions to tax otherwise applicable (sec. 3402(d)).

Explanation of Proposal

Failure to file

The proposal would modify present law by providing that the fraud and negligence penalties are not to apply in the case of a negligent or fraudulent failure to file a return. Rather, in the case of a fraudulent failure to file a return, the failure to file penalty would be increased to 15 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 5 months or 75 percent. This modification would improve the coordination of the failure to file penalty with the accuracy-related penalties.

Failure to make timely deposits of tax

The proposal would also modify the penalty for the failure to make timely deposits of tax in order to encourage depositors to correct their failures. The proposal would establish a four-tiered penalty structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. A depositor would be subject to a penalty equal to 2 percent of the amount of the underpayment if the failure is corrected on or before the date that is 5 days after the prescribed due date. A depositor would be subject to a penalty equal to 5 percent of the amount of the underpayment if the failure is corrected after the date that is 5 days after the prescribed due date but on or before the date that is 15 days after the prescribed due date. A depositor would be subject to a penalty equal to 10 percent of the amount of the underpayment if the failure is corrected after the date that is 15 days after the due date but on or before the date that is 10 days after the date of the first delinquency notice to the

taxpayer (under sec. 6303). Finally, a depositor would be subject to a penalty equal to 15 percent of the amount of the underpayment if the failure is not corrected on or before the date that is 10 days after the date of the first delinquency notice to the taxpayer (under sec. 6303). This would mean that, on average, a taxpayer will generally have approximately 40 days from the due date of the quarterly return that reconciles liability with amounts deposited to make up any shortfall in deposits before the rate of the penalty increases from 10 to 15 percent. This time period could be significantly shorter in cases of jeopardy. In cases of jeopardy, the 15-percent rate would apply if the taxes are not deposited on or before the date on which notice and demand for immediate payment is given under section 6861, section 6862, or the last sentence of section 6331(a). This penalty structure is designed to give the taxpayer an incentive to correct any underpayments before the IRS discovers the underpayment and demands payment. As under present law, no penalty is to be imposed if the failure to make a timely deposit is due to reasonable cause and not willful neglect.

Failure to withhold on income of foreign persons

The proposal would provide that in cases where a tax on the U.S. income of a foreign person was required to be withheld under chapter 3 but was not in fact withheld, and the person who would have been entitled to a credit for any withholding tax paid instead satisfies its own proper tax liability, the withholding agent would remain liable for any penalties and additions to tax otherwise applicable for failure to withhold. Thus, these withholding agents would be subject to the same general approach applicable to U.S. employers who withhold income taxes from employees' wages.

Effective Dates

The modification to the failure to file penalty would apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989. The modification to the penalty for the failure to make timely deposits of tax would apply to deposits that are required to be made after December 31, 1989. The modification to the rules on liabilities of withholding agents would apply to failures to deduct and withhold taxes after December 31, 1989.

28. IRS notice to taxpayers of underreporting of amounts withheld

Present Law

Under procedures in effect for taxable years beginning before 1987, the Internal Revenue Service did not notify taxpayers or make adjustments on income tax returns when it was determined that the amount reported as withheld on an income tax return was less than the amount reported on an information return. On March 22, 1989, the Internal Revenue Service announced revisions in its procedures for the 1987 taxable year and thereafter. Under these revised procedures, discrepancies involving amounts reported as withheld on information returns will be adjusted in the same manner as discrepancies in amounts reported as withheld on Forms W-2 or W-2P. Such an adjustment may involve a correction of the return where information has been reported on the wrong part of the return. In other cases, the Internal Revenue Service's procedures require that the IRS contact the taxpayer to inform the taxpayer of the discrepancy.

Explanation of Proposal

If, in connection with one or more information return matching programs, the Internal Revenue Service determines that the amount of tax shown on information returns as withheld for any taxable year exceeds by $5 or more the amount of tax shown on the income tax return as withheld for that taxable year, then the Internal Revenue Service would be required to notify the taxpayer of such excess. (This would be identical to S. 811, introduced by Senator Bentsen.)

In addition, the proposal would provide that a taxpayer may file an amended return until April 15, 1990, for the taxable year ending December 31, 1985, if the amended return relates to an overpayment of tax attributable to the taxpayer's failure to take proper credit for amounts of tax withheld by a payor from any income included in the taxpayer's gross income for that taxable year. (This would be identical to S. 753, introduced by Senator Gore, Senator Pryor, and Senator Harkin.)

Effective Date

The proposal would apply to all information return matching that occurs after the date of enactment.

29. Increase in Joint Committee refund review threshold

Present Law

No refund or credit in excess of $200,000 of any income tax, estate or gift tax, or certain other specified taxes, may be made until 30 days after the date a report on the refund is given to the Joint Committee on Taxation (sec. 6405). A report is also required in the case of certain tentative refunds. Additionally, the Joint Committee staff conducts post-audit reviews of large deficiency cases and other select issues.

Explanation of Proposal

The threshold above which refunds must be submitted to the Joint Committee for review would be increased from $200,000 to $1,000,000. This increase would speed the issuance of refunds between $200,000 and $1,000,000 to the taxpayers involved. In addition, this increase would free up significant resources of both the Internal Revenue Service and the Joint Committee staff, without materially impairing the Joint Committee's ability to monitor problems in the administration of the tax laws.

In addition, the legislative history would state that the Joint Committee staff would be expected to continue to exercise its existing statutory authority to conduct a program of expanded post-audit reviews of large deficiency cases and other select issues. The legislative history would also indicate that the IRS would be expected to fully cooperate in this expanded program.

Effective Date

The proposal would be effective on the date of enactment, except that the higher threshold would not apply to a refund or credit with respect to which a report was made before the date of enactment.

Joint Committee on Taxation
October 3, 1989
JCX-60-89

- Senate Finance Committee -
REVENUE EFFECTS OF A POSSIBLE REVENUE RECONCILIATION PROPOSAL

Fiscal Years 1990-1994
[Millions of Dollars]

Item	Effective	1990	1991	1992	1993	1994	1990-94
I. REPEAL FINANCIAL INSTITUTION (FSLIC & FDIC) TAX BENEFITS							
(P.L. 101-73) (1)	5/10/89	568	31	351	310	213	1,473
II. CORPORATE PROVISIONS							
A. Defer interest deduction on certain high-yield original issue discount (OID) obligations until interest is paid	*	18	44	86	120	141	409
B. Limit dividends received deduction with respect to certain nontaxed income of consolidated subsidiaries (effective for stock issued after date of introduction)	Intro.	45	92	154	209	271	771
C. Repeal nonrecognition treatment when securities are received in a section 351 transaction	(2)	164	288	289	316	359	1,416
D. Reduce built-in gain or loss threshold of sections 382 and 384 to lesser of 15% or $25 million	Intro.	12	18	17	18	19	84
E. Require basis reduction for nontaxed portion of dividends on self-liquidating ("wasting") stock	*	6	10	11	12	13	52
F. Modify consolidated return excess loss account recapture rules to prevent shifting of basis to debt	*	54	69	61	52	42	278
G. Clarify Treasury regulation authority relating to bifurcation of an instrument into debt and equity portions (section 385)	*	(3)	(3)	(3)	(3)	(3)	(3)
H. Require reporting to IRS of acquisitions and recapitalizations	D/o/E	(3)	(3)	(3)	(3)	(3)	(3)
I. Require Treasury study of "debt versus equity" and integration issues	D/o/E	--	--	--	--	--	---
J. Limit net operating loss carrybacks attributable to interest expense in certain circumstances (S. 1506)	ty/e/a: 8/ 2/89	226	406	420	384	343	1,779
K. Require regulated investment companies (mutual funds) to distribute 98% of ordinary income to their shareholders	ty/e/a: 7/10/89	50	5	5	5	5	70
L. Adjust basis for mutual fund load charge only if shareholder holds shares for more than six months	10/ 3/89	28	46	22	7	5	108
M. Include dividends in income of regulated investment companies on ex-dividend date (effective for ex-dividend dates after D/o/E)	D/o/E	110	20	20	20	20	190
Subtotals:		713	998	1,085	1,143	1,218	5,157
III. EMPLOYEE BENEFIT PROVISIONS							
A. Repeal partial exclusion for interest paid on ESOP loans if ESOP owns less than 30% of the employer's stock (section 133)	Generally: 6/ 7/89	1,101	1,400	1,774	2,123	2,488	8,886
B. Permit limited use of excess pension funds to pay current retiree health benefits	1/ 1/89	585	417	380	345	321	2,048
Subtotals:		1,686	1,817	2,154	2,468	2,809	10,934

Item	Effective	1990	1991	1992	1993	1994	1990-94
IV. FOREIGN PROVISIONS							
A. Conform tax years of certain controlled foreign corporations and foreign personal holding companies to the tax years of certain U.S. shareholders (with one-month exception)	ty/b/a: 7/10/89	48	71	71	71	36	297
B. Change the sourcing of income of certain corporations in commonly-controlled groups	ty/b/a: 7/10/89	20	37	41	45	49	192
C. Improve information reporting by U.S. subsidiaries and branches of foreign corporations	ty/b/a: 7/10/89	55	75	80	85	90	385
Subtotals:		123	183	192	201	175	874
V. EXCISE TAX PROVISIONS							
A. Repeal Airport and Airway Trust Fund tax reduction trigger	1/ 1/90	851	1,505	1,630	1,762	1,907	7,655
B. Increase international air passenger departure tax from $3.00 to $6.00 per person	1/ 1/90	51	89	94	100	106	440
C. Impose $3.00-per-passenger tax on international departures by commercial ships	1/ 1/90	5	7	8	8	8	36
D. Impose Oil Spill Liability Trust Fund petroleum tax at $0.03/barrel (cap at $300 million)	1/ 1/90	43	114	60	8	--	225
E. Impose tax on ozone-depleting chemicals subject to the Montreal Protocol	1/ 1/90	384	560	753	1,171	1,442	4,310
F. Impose Coastal Wetlands Trust Fund tax on oil and gas produced offshore at $0.03/barrel of oil and $0.02/thousand cubic feet of natural gas	1/ 1/90	47	80	83	85	88	383
G. Change collection of gasoline excise from semi-monthly to weekly deposits	1/ 1/90	111	4	1	2	4	122
H. Modify collection period for airline ticket tax (taxes billed after 6/30/90)	--	110	6	6	7	7	136
Subtotals:		1,602	2,365	2,635	3,143	3,562	13,307
VI. ACCOUNTING PROVISIONS							
A. Repeal remaining portion of completed contract method of accounting	*	171	390	262	116	28	967
B. Modify treatment of cost of acquiring franchises, trademarks, and trade names (20-year amortization election for fixed and contingent payments)	10/ 3/89	51	108	144	157	185	645
Subtotals:		222	498	406	273	213	1,612
VII. EMPLOYMENT TAX PROVISIONS							
A. Impose income tax withholding on the wages of certain agricultural workers	1/ 1/90	270	68	21	22	23	404
B. Payroll tax speedup ($250,000 threshold; next-day deposit in 1990, third-day deposit in 1991 and 1992, and next-day deposit thereafter)	6/30/90	2,366	-694	100	106	1,108	2,986
Subtotals:		2,636	-626	121	128	1,131	3,390
VIII. OTHER REVENUE-RAISING PROVISIONS							
A. Tax pre-contribution gain on certain in-kind partnership distributions made within three years of contribution	*	7	14	18	19	20	78
B. Restrict like-kind exchange basis shifting techniques between related parties, reverse 401(h) letter ruling	7/ 10/89	100	120	130	140	151	641
Subtotals:		107	134	148	159	171	719

Item	Code Section	Current-Law Expiration	Effective	1990	1991	1992	1993	1994	1990-94
IX. EXPIRING PROVISIONS									
A. Employer-provided education assistance (through 1991)	Sec. 127	12/3/188	1/ 1/89	-439	-316	-96	--	--	-851
B. Group legal services (through 1991)	Sec. 120	12/31/88	1/ 1/89	-127	-82	-29	--	--	-238
C. Targeted jobs tax credit (through 1991)	Sec. 51	12/31/89	1/ 1/90	-47	-134	-144	-80	-37	-442
D. Research and experimentation credit (with modifications) (Permanent)	Sec. 41	12/31/89	1/ 1/90	-398	-782	-968	-1,063	-1,194	-4,405
E. Research and experimentation cost allocation rules (64% allocation) (for 2 years)	Sec. 861	+	ty/b/a: 8/ 1/89	-335	-625	-275	--	--	-1,235
F. Business energy credits (solar, geothermal, and ocean thermal) (Permanent)	Sec. 46	12/31/89	1/ 1/90	-56	-81	-51	-38	-40	-266
G. Mortgage revenue bonds (Permanent)	Sec. 143	12/31/89	1/ 1/90	-11	-55	-128	-205	-269	-668
H. Small-issue manufacturing bonds (through 1991)	Sec. 144	12/31/89	1/ 1/90	-7	-39	-58	-78	-76	-258
I. Low-income housing credit (with modifications) (Permanent)	Sec. 42	12/31/89	1/ 1/90	-79	-333	-681	-1,058	-1,448	-3,599
J. Health insurance for self-employed (through 1991)	Sec. 162	12/31/89	1/ 1/90	-244	-411	-151	--	--	-806
K. Waiver of early withdrawal tax for ESOPs (through 1991)	Sec. 72(t)	12/31/89	1/ 1/90	-10	-20	-10	--	--	-40
Subtotals:				-1,753	-2,878	-2,591	-2,522	-3,064	-12,808
X. CHILD CARE INITIATIVE AND TELEPHONE EXCISE TAX									
A. Child care initiative:									
1. Dependent care credit, refundable, present law; Advanced refundable 1/1/92; 90% refundability limit			1/ 1/91	--	-51	-1,090	-1,130	-1,229	-3,500
2. Health insurance credit; Rate: 50%; Phaseout: $12,000 - $21,000			1/ 1/91	--	-46	-964	-903	-882	-2,795
3. EITC supplemental for children under 4 years old; Rates: 7% for 1 child, 10% for 2+ children; Phaseout rates: 10%, 15%; Phaseout income levels: $10,000 - $15,000 indexed			1/ 1/91	--	-63	-632	-681	-732	-2,108
B. Require corporate estimated tax payments on tax liability for certain Subchapter S income			1/ 1/90	25	(3)	(3)	(3)	(3)	25
C. Telephone excise tax			1/ 1/91	--	1,612	2,732	2,930	3,143	10,417
1. Permanent extension			6/30/90	102	5	5	6	6	124
2. Modify collection period (100% speedup, effective for taxes billed by service providers after 6/30/90)									
Subtotals:				127	1,457	51	222	306	2,163
XI. INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)									
Provide for 50% Deductibility of Contributions (effective 1/1/91), and Allow Penalty-Free Withdrawals for First-Time Homes and Higher Education Expenses (effective 1/1/90)			1/ 1/91 and 1/ 1/90	-192	-1,560	-3,265	-3,613	-4,055	-12,685
XII. OTHER PROVISIONS									
A. Repeal section 89			1/ 1/89	-154	-156	-170	-185	-202	-867
B. Continue temporary rules concerning allocation of taxes for Railroad Retirement Trust Fund			10/ 1/89	--	--	--	--	--	--

Item	Effective	1990	1991	1992	1993	1994	1990-94
C. Require exercise of Treasury regulatory authority with respect to full-funding limitation on a revenue-neutral basis	D/o/E	--	--	--	--	--	---
D. Treat income from personal injury awards to children as earned income	1/ 1/87	(3)	(3)	(3)	(3)	(3)	(5)
E. Permit private foundations to use common investment funds	1/ 1/90	-1	-4	-8	-11	-15	-39
F. Modify rules concerning recapture of bad-debt reserves of mutual savings banks and thrifts	D/o/E	1	3	10	13	20	47
G. Deny retroactive certification of WIN credit	(7)	38	28	12	--	--	78
H. Estate and gift tax provisions:							
2. Estate tax marital deduction--Overrule Howard Estate	Cmte Actn	(6)	(6)	(6)	(6)	(6)	(6)
2. Exclude annual exclusion gifts under section 2035	D/o/E	-1	-2	-2	-3	-3	-11
3. Allow waiver of right of contribution (section 2207A) in limited circumstances	D/o/E	(6)	(6)	(6)	(6)	(6)	(6)
4. Repeal estate freeze rules (section 2036(c))	12/31/87	-27	-72	-146	-249	-384	-878
5. Generation-skipping transfer tax	Cmte Actn	-1	-15	-23	-31	-42	-112
6. Denial of marital deduction to foreigners; eliminate income requirement and other minor changes	11/10/88	(6)	-2	-2	-2	-2	-8
7. Trustee discretion to make distributions to surviving spouse in case of need (effective for decedents after 11/10/88)	11/10/88	-4	-2	-2	-3	-3	-14
I. Allow deduction for certain adoption expenses	1/ 1/90	-2	-3	-3	-3	-3	-14
J. Income averaging for farmers	1/ 1/90	-5	-65	-70	-75	-80	-295
K. Drought deferral extension (effective for all open years)	--	-12	--	--	--	--	-12
L. Small diesel fuel tax relief	12/22/87	-(6)	-1	-1	+(6)	+(6)	-2
M. Treatment of hedging transactions by REITs	D/o/E	(8)	(8)	(8)	(8)	(8)	(8)
N. Cost recovery:							
1. Recovery period for rental tuxedos	1/ 1/90	-2	-7	-8	-7	-5	-29
2. Revenue-neutral change to deduction for expenditures incurred to assist disabled	1/ 1/90	--	--	--	--	--	---
O. Employee benefit provisions							
1. Section 401(k) plans for tax-exempt organizations	1/ 1/90	-15	-32	-38	-42	-56	-183
2. Change in integration rules	1/ 1/89	(9)	(9)	(9)	(9)	(9)	(9)
3. Modifiy geographic limitation on VEBAs	Cmte Actn	-5	-9	-13	-17	-20	-64
4. Leased employees and dependent care	--	(9)	(9)	(9)	(9)	(9)	(9)
P. Tax-exempt bonds							
1. State Housing Agency bonds	D/o/E	-1	-4	-7	-11	-16	-39
2. Refunding bonds	D/o/E	-1	-4	-6	-9	-11	-31
3. Modify rules concerning tax-exempt bonds issued by 501(c)(3) organizations	1/ 1/90	-4	-9	-15	-22	-29	-79
4. Mortgage Credit Certificate (MCC)	D/o/E	(6)	(6)	(6)	(6)	(6)	(6)
5. Sports facilities	1/ 1/90	-2	-6	-11	-16	-23	-58
Q. Insurance: Treatment of split annuities	10/21/88	(6)	(6)	(6)	(6)	(6)	(6)
R. Reduce BATF occupation tax for small retail dealers	1/ 1/90	-5	-5	-5	-6	-6	-27
S. Provide statute of limitations for occupational taxes	D/o/E	-2	-2	-2	-2	-2	-10
T. Permanent increase in excise tax on pension reversions to 20%	Cmte Actn	9	4	2	1	1	17
U. Essential air service--Add authorization to Airport & Airway Trust Fund.	D/o/E	--	--	--	--	--	---
V. Foreign provisions							
1. Consider certain leased assets for purposes of the passive foreign investment company asset test	ty/b/a: 12/31/88	-6	-5	-5	-5	-5	-26
2. Provide exception from passive foreign investment company rules for export trade corporations	ty/b/a: 1/ 1/90	-6	-4	-4	-4	-4	-22
3. Modify treatment of certain scholarships and fellowships received by nonresident aliens	1/ 1/90	-2	-4	-4	-4	-4	-18

Item	Effective	1990	1991	1992	1993	1994	1990-94
W. Accounting provisions							
1. Rural electric coops--Safe-harbor leasing	(10)	-12	-7	-7	-7	-6	-39
2. Farm debt--Discharge of indebtedness income	1/ 1/87	-45	-18	-20	-23	-26	-132
3. Contributions for facilities to replace contaminated water supplies	1/ 1/89	-1	-1	-2	-2	-2	-8
4. Percentage of completion method of accounting--Adopt (15% of costs) rule	1/ 1/90	-83	-119	-57	-35	-22	-316
5. Timber passive loss material participation exception	ty/b/a: 12/31/89	-8	-26	-30	-36	-40	-140
6. Annual accrual method of accounting not limited to sugar cane	1/ 1/87	-8	-8	-3	-3	-3	-25
7. Installment sales of residential lots and timeshares by C corporations (regular and minimum tax)	1/ 1/90	-13	-17	-12	-7	-6	-55
X. Energy/excise tax provisions							
1. Extend section 29 credit through 12/31/92 and include production from tight sands	1/ 1/90	-40	-99	-168	-198	-180	-685
2. Ethanol--Compliance related proposals	1/ 1/90	(6)	(6)	(6)	(6)	(6)	(6)
3. Facilitate tax-free purchase of fuels by crop dusters	1/ 1/90	-3	-4	-4	-4	-4	-19
Y. Alternative minimum tax credit and exclusion items	1/ 1/90	--	-24	-61	-92	-119	-296
Z. Small business exemption from recognition of gain or loss on liquidating sales or distributions (exemption from repeal of General Utilities doctrine)	1/ 1/89	3	1	-5	-11	-15	-27
AA. Penalty reform	1/ 1/90	--	-51	-82	-58	-25	-216
BB. IRS notice to taxpayers concerning withholding per S. 811 and S. 753	D/o/E	--	--	--	--	--	---
CC. Increase Joint Committee on Taxation refund review threshold to $1 million	D/o/E	--	--	--	--	--	---
DD. Technical corrections	--	--	--	--	--	--	---
Subtotals:		-420	-751	-972	-1,169	-1,342	-4,654

SUMMARY

I. REPEAL FSLIC & FDIC TAX BENEFITS (1)	568	31	351	310	213	1,473
II. CORPORATE PROVISIONS	713	998	1,085	1,143	1,218	5,157
III. EMPLOYEE BENEFIT PROVISIONS	1,686	1,817	2,154	2,468	2,809	10,934
IV. FOREIGN PROVISIONS	123	183	192	201	175	874
V. EXCISE TAX PROVISIONS	1,602	2,365	2,635	3,143	3,562	13,307
VI. ACCOUNTING PROVISIONS	222	498	406	273	213	1,612
VII. EMPLOYMENT TAX PROVISIONS	2,636	-626	121	128	1,131	3,390
VIII. OTHER REVENUE-RAISING PROVISIONS	107	134	148	159	171	719
Subtotals: REVENUE-RAISING PROVISIONS (I-VIII)	7,657	5,400	7,092	7,825	9,492	37,466
IX. EXPIRING PROVISIONS	-1,753	-2,878	-2,591	-2,522	-3,064	-12,808
X. CHILD CARE INITIATIVE AND TELEPHONE EXCISE TAX	127	1,457	51	222	306	2,163
XI. INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)	-192	-1,560	-3,265	-3,613	-4,055	-12,685
XII. OTHER PROVISIONS	-420	-751	-972	-1,169	-1,342	-4,654
GRAND TOTALS	**5,419**	**1,668**	**315**	**743**	**1,337**	**9,482**

|Footnotes for table appear on following page.|

Joint Committee on Taxation

NOTES: In "Effective" column-- D/o/E denotes provision effective on date of enactment.
ty/b/a denotes "taxable years beginning after" effective date given.
ty/e/a denotes "taxable years ending after" effective date given.
* denotes provision is effective for transactions after 7/10/89, unless otherwise noted.

\+ Rules expire 4 months after start of a firm's first tax year beginning after 8/1/87.
(1) Estimate reflects net budget effects, including outlay effects, as estimated by the Congressional Budget Office.
(2) Provision generally would apply to transfers made by corporations after 7/11/89 and to transfers made by all other persons after the date of introduction of proposal.
(3) Gain of less than $5 million.
(4) Gain of less than $500,000.
(5) Total is not available for estimates represented by footnotes.
(6) Negligible amount.
(7) Credits first claimed after March 11, 1987.
(8) Loss of less than $5 million.
(9) Loss of less than $500,000.
(10) Open year returns as of date of enactment.

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SOCIAL SECURITY

Social Security as an Independent Agency

Present law. - Responsibility for administering the Old-Age, Survivors, and Disability Insurance (OASDI) program is vested in the Secretary of Health and Human Services. The program is administered by the Social Security Administration, which is headed by a Commissioner appointed by the President. SSA also administers the Supplemental Security Income (SSI) program.

Proposed change. - The proposal would establish the Social Security Administration as an independent agency with responsibility for the Old Age, Survivors, and Disability Insurance program, and for the Supplemental Security Income program.

There would be a 9-member part-time Advisory Board appointed for 6-year terms as follows: 5 appointed by the President (no more than 3 from the same political party), 2 each (no more than 1 from the same political party) by the Speaker of the House (in consultation with the Chairman and Ranking Minority Member of the Committee on Ways and Means) and the President pro tempore of the Senate (in consultation with the Chairman and Ranking Minority Member of the Committee on Finance). Presidential appointees would be subject to Senate confirmation. They would serve staggered terms. The chairman would be appointed by the President.

The Board would generally be responsible for giving advice on policies and operational issues. It would have authority to hire its own staff.

Specific functions of the Board would include: making recommendations as to the most effective methods of providing economic security through social security and supplemental security income; making recommendations relating to the coordination of such programs with other programs providing economic and health security; making an independent assessment of the annual report of the Board of Trustees and advising the President and the Congress on the implications of the assessment; recommending to the President names to consider in selecting his nominee for the positions of Social Security Commissioner and Deputy Commissioner; reviewing and assessing the quality of service that the agency provides to the public; assessing annually the state of the agency's computer technology; reviewing and assessing the agency's progress in developing needed management improvements; increasing public understanding of the social security system; reviewing the development and implementation of a long-range research and program evaluation plan for the

agency; reviewing and assessing any major studies of social security; and conducting such other reviews and assessments as may be appropriate.

The agency would be headed by a Commissioner appointed by the President for a 4-year term coinciding with the term of the President, and subject to confirmation by the Senate. The Commissioner would be compensated at the rate for level I of the Executive Schedule (equivalent to Cabinet officer pay). The Commissioner would be selected on the basis of proven competence as a manager, and would be responsible for the exercise of all powers and the discharge of all duties of the Social Security Administration, have authority and control over all personnel and activities of the agency, and serve as a member of the Board of Trustees.

The President would also appoint a Deputy Commissioner, who would be subject to Senate confirmation.

Other positions established within the agency (and appointed by the Commissioner) include: a Beneficiary Ombudsman to sponsor and support beneficiary interests, a Solicitor of Social Security to provide legal advice to the Commissioner and to manage the agency's litigation workload, and Chief Administrative Law Judge. An independent panel would nominate candidates for the position of Chief Administrative Law Judge. In addition, there would be an Inspector General appointed in accordance with the Inspector General Act.

The Commissioner (jointly with the Director of the Office of Personnel Management and the Administrator of General Services, as appropriate) would be directed to carry out demonstration projects under which the Commissioner would be able to appoint computer specialists and other professional and technical specialists without regard to the civil service classification system; perform functions relating to recruitment and examination programs for entry level employees and classification and pay ranges for pay ranges for identified job categories; establish higher compensation levels for geographic areas where there is difficulty in recruiting and retaining qualified employees; exercise authority relating to the acquisition, operation, and maintenance of facilities; and exercise authority relating to leasing, purchasing, or maintaining automated data processing equipment. The demonstration projects would last for a period of six years.

The Director of OPM would be directed to authorize for the Social Security Administration a substantially greater number of Senior Executive Service positions than were authorized on the date of enactment.

Appropriations requests for staffing and personnel of the Administration would be based upon a comprehensive work force plan, as determined by the Commissioner.

The Social Security Commissioner would be directed consult on an on-going basis with the Secretary of Health and Human Services to assure (1) the coordination of the Social Security and Medicare programs and (2) that adequate information concerning Medicare benefits will be available to the public.

Rules, regulations, determinations, contracts, collective bargaining agreements, recognitions of labor organizations, and licenses in effect under the authority of the Secretary of Health and Human Services would continue under the authority of the independent agency until modified or terminated in accordance with law. Report language would be added directing SSA to consult with supervisors and managers in the field on a regular basis.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-1	-1	-1	-1

Increase the Retirement Test

Present law. - The primary purpose of the social security program is to provide an income for older individuals who are retired. As a way of determining whether an individual is retired, the program looks at the individual's age and earnings. Those age 70 or above are automatically considered retired and get full benefits without regard to earnings. Those under age 70 are considered retired and eligible for full benefits only if their earnings are lower than a specified exemption level. In 1990, the exemption level for retirees age 65 to 69 will be $9,360. Above that level, individuals will have their social security benefits phased out on the basis of a $1 reduction in benefits for every $3 of earnings. (Under current law, the reduction rate goes down from 50 percent to 33 1/3 percent starting in 1990.)

Proposed change. - The proposal would increase the amount of earnings totally exempt from reduction under the retirement test for individuals age 65 to 69 to $11,700 in a990 and to $14,520 in 1991--an increase of roughly $5,000

over present law. In addition, starting in 1991, the proposal would lower the rate of reduction on earnings for an additional $5,000 above that exempt amount. For earnings between $14,520 and $19,520, the reduction rate under the retirement test would be 25 percent in place of the current law rate of 33 1/3 percent which would continue to apply to earnings above that level.

Budget impact (in millions):

1990	1991	1992	1993	1994
-380	-860	-1020	-1070	-1120

Treatment of Deferred Compensation

Present law. - The "contribution and benefit base" is the amount of annual earnings for each individual that is subject to social security taxes and countable towards benefit eligibility. Each year, this base is indexed to take into account the growth in wages covered by the social security system. This indexing factor also is applied to increasing several benefit determination factors, and in particular the so-called bend points of the formula for determining initial benefit eligibility. For the past several years, however, certain types of deferred compensation (e.g. 401(k) contributions) have not been included in measuring wage growth because of the way in which these items are reported on W-2 forms even though these wage payment are in fact subject to social security tax and therefore a part of "covered wages". This exclusion has slowed the growth of the wage indexing series used to increase the base.

Proposed change. - Effective for the 1990 determination of the tax and benefit base, the amount of that base would be increased by an additional 2% ($900) to take into account the past failure to include the deferred compensation payments. For subsequent years, deferred compensation would be factored into the indexing for both the base and the various affected benefit elements. The 1990 increase would not be used to raise the benefit factors; instead the funds generated would be used to offset the retirement test increase described above.

Budget impact (in millions):

1990	1991	1992	1993	1994
400	1095	1087	1083	1069

Annual Earnings and Benefit Statements

Present law. - There is no statutory requirement that the Social Security Administration provide individuals with earnings and benefit statements. Upon request, SSA currently will provide an individual with such a statement.

Proposed change. - When fully effective in 1999, the proposal would require that annual earnings and benefit statements be sent to all those who have paid social security taxes. These statements would show what they have contributed to the social security program, estimate their future benefits at retirement (or at least describe those benefits in the case of persons under age 50), and describe the benefits that will be provided by Medicare. In the short run, the proposal would require that such statements be provided when requested and, starting in 1995, that they be provided to all individuals age 60 and above.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Child Adopted After Parent's Entitlement to Benefits

Present law. - Minor and disabled children of individuals who had paid social security taxes can qualify for benefits when those individuals die, become disabled, or retire in old age. In the case of natural children, these benefits are paid without regard to whether the child was born before or after the individual retired or became disabled. In the case of adoptive children, however, the law requires that the child must have been adopted before the individual became eligible for disability or retirement benefits (or, at least, must have been dependent on the individual at that time.)

Proposed change. - A minor child adopted after a worker becomes entitled to retirement or disability benefits would be eligible for child's insurance benefits regardless of whether he or she was living with and dependent on the worker prior to the worker's entitlement.

Budget impact (in millions):

1990	1991	1992	1993	1994
-5	-12	-16	-21	-22

Continuation of Disability Benefits Pending Appeal

Present law. - A disability insurance beneficiary who is determined to be no longer disabled may appeal the determination through three levels of appeal: a reconsideration by the State Disability Determination Service; a hearing before an SSA administrative law judge (ALJ); and a review by the Appeals Council.

The beneficiary has the option of requesting that benefits be continued through the ALJ level of appeal. If the earlier unfavorable determinations are upheld by the ALJ, the benefits paid during the period of appeal are considered overpayments and are subject to recovery by the agency. (If an appeal is made in good faith, benefit repayment may be waived.) Medicare eligibility also continues, but Medicare benefits are not subject to recovery.

This option was originally enacted in 1984, and was accompanied by a requirement that the Secretary of HHS conduct a study of its impact on the OASDI trust funds and on appeals to ALJs. This report has not yet been completed. The Congress has extended the option several times, most recently in the Technical and Miscellaneous Revenue Act of 1988. The latest extension authorized the payment of benefits pending appeal of termination decisions made on or before December 31, 1989. Payments may continue through June 30, 1990.

Proposed change.- The period in which disability benefits may be paid, and medicare eligibility continued, while an appeal is pending (through the ALJ level) would be extended for one additional year. Upon application by the beneficiary, benefits would be paid while an appeal is in progress with respect to unfavorable determinations made on or before December 31, 1990, and would be continued through June 1991 (i.e., through the July 1991 check).

Budget impact (in millions):

1990	1991	1992	1993	1994
-8	-27	-6	-9	-10

Consolidation of Old Computation Methods

Present law. - The rules for computing the initial benefit amount payable to social security claimants have been changed many times since the program was enacted in the 1930's. In adopting new computation rules, Congress

frequently allowed continued use of the old rules for individuals who would benefit from them. There are now a number of computation methods, particularly those that were established before 1965, that continue to apply to very small numbers of people. These computations have largely phased out for workers coming on the rolls, and new claims are from the relatively few remaining eligible survivors. These old computation methods currently require manual computation.

Proposed change. - All of the remaining initial computation methods that currently require manual intervention would be eliminated and consolidated. Any retired workers whose benefits are computed under one of these old computation methods and who are still working would have their benefits recomputed under a newer computation method.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Limitation on New Entitlement to Special Age-72 Payments

Present law. - Special age 72 benefits (so-called "Prouty benefits" after Senator Winston Prouty of Vermont) were enacted in 1966 to provide some payment to individuals who, when the program began or when coverage was extended to their jobs, were too old to earn enough quarters of coverage to become fully insured. When enacted in 1966, it was expected that new entitlement under this provision would not be possible for anyone reaching age 72 after 1971. This is because individuals age 72 after 1971 who met the quarters-of-coverage requirements for Prouty benefits also would have enough quarters of coverage to be fully insured, and because the amount of the Prouty benefits was less than the amount of the minimum benefit payable at age 62. However, due to subsequent changes in the law, it is now theoretically possible for certain people who will reach age 72 after 1990 and who receive the frozen minimum benefit (due to a change in the law in 1977) or who receive less than the minimum benefit (due to its elimination in 1982) to become newly eligible for Prouty benefits.

Proposed change. - The proposal would preclude the unintended payment of Prouty benefits (due to the interaction of the Prouty benefit provision with subsequent changes in the law affecting the minimum benefit) by providing that Prouty benefits would not be payable to any individual reaching age 72 after 1971. This change would not affect any current beneficiaries.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	*	*	*	*

Extension of Authority to Prescribe Magnetic Media Reporting Requirements Applicable to Payroll Agents

Present law. - Section 6011(e)(1) of the Internal Revenue Code directs the Secretary of Treasury to prescribe regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form. Pursuant to this authority, the Secretary has issued regulations that require employers having 250 or more employees to file returns on magnetic media. The Secretary's regulatory authority does not extend to payroll agents who are engaged in the business of preparing payroll data or filing returns for employers. As a result, high volume payroll agents need not file on magnetic media returns prepared on behalf of employers eligible for the low volume exception.

Proposed change. - The Secretary's authority to set magnetic media reporting standards would be extended to payroll agents of employers.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	0	0	0	0

Elimination of Advanced Crediting to the Trust Funds of Social Security Payroll Taxes

Present law. - The Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund are credited by the Treasury Department on an advance basis at the beginning of each month with estimated revenues from social security payroll taxes for the entire month. This advance crediting provision was enacted as part of the Social Security Amendments of 1983, and was designed to help address the problem of the solvency of the trust funds which at that time had very low reserves. Combined trust fund assets at the end of 1989 are projected to be equivalent to 66 percent of 1990 outgo, and this "contingency ratio" is projected to grow rapidly in future years.

Proposed change. - Social security taxes would be

credited to the trust funds periodically during a month as they are received.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	0	0	0	0

Trial Work Period During Rolling 5-Year Period for All Disabled Beneficiaries

Present law. - Under present law, disability beneficiaries who are still disabled but who want to return to work despite their disabling condition are entitled to a 9-month trial work period. (The months need not be consecutive.) During this period disabled beneficiaries may test their ability to work without affecting their entitlement to disability benefits. Any work and earnings are disregarded in determining whether the beneficiary's disability has ceased.

Only one trial work period is allowed in any one period of disability. In addition, an individual who is entitled to disabled worker's benefits for which he has qualified without serving a waiting period (i.e., the worker was previously entitled to disabled worker's benefits within 5 years before the month he again becomes disabled), is not entitled to a trial work period.

Proposed change. - All beneficiaries would be given an opportunity to test their capacity to engage in substantial gainful activity over a sustained period of time before their benefits would be stopped by providing that a disabled beneficiary would exhaust his 9-month trial work period only if he performed services in any 9 months within a rolling 60-month period, and repealing the provision which precludes a reentitled disabled worker from being eligible for a trial work period.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-1	-1	-1	-1

Extension of Disability Insurance Program Demonstration Project Authority

Present law. - Section 505(a) of the Social Security Disability Amendments of 1980 (P.L. 96-265), as extended by the Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272), authorizes the Secretary to waive compliance

with the benefit requirements of titles II and XVIII for the purpose of conducting work incentive demonstration projects to encourage beneficiaries to return to work. This authority will expire June 10, 1990.

Proposed change. - The work incentive demonstration project authority would be extended for three years, through June 10, 1993.

Budget impact (in millions):

1990	1991	1992	1993	1994
-1	-6	-6	-6	-*

Suspension of Auxiliary Benefits When the Worker is in an Extended Period of Eligibility

Present law. - Present law provides a 36-month extended period of eligibility to an individual entitled to disability benefits who completes a 9-month trial work period but who continues to have a disabling impairment. During this period, a disabled worker who engages in substantial gainful activity in any month (i.e., earns $300 or more, or, beginning January 1990, $500 or more) retains eligibility for medicare benefits, but no cash benefits are payable for that month.

Proposed change. - Language would be added to clarify that no monthly cash benefits are payable to auxiliary beneficiaries in any month in which the disabled individual is in an extended period of eligibility and does not receive benefits because he is performing substantial gainful activity. This is current administration practice.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	0	0	0	0

Authority to Amend Wage Records After Expiration of Time Limitation

Present law. - The Secretary is required to establish and maintain records of workers' wages and self-employment income. Errors in these records may be corrected at any time up to 3 years, 3 months, and 15 days after the year in which the earnings occurred. After this time, various revisions

may be made including ones in which an employer neglected to report covered wages. However, no revision is permitted where an employer misreported the amount of the earnings.

Proposed change. - The current list of revisions to earnings records that may be made after 3 years, 3 months, and 15 days from the year of the earnings would be expanded to permit the record to be changed where an entry for an employer is present but incorrect.

Budget impact (in millions):

Administrative costs are not charged to the Finance Committee.

	1990	1991	1992	1993	1994
Benefits	-*	-*	-1	-2	-3
Administration	-1	-1	-1	-1	-1

Representative Payee Reforms

Present law. - When it appears to the Secretary that the interest of an applicant entitled to social security benefits would be served thereby, the Secretary may certify payment either to the individual or to a relative or some other person (representative payee). If certification of payment is made to a person other than the individual entitled to the payment, such certification must be made on the basis of an investigation, carried out either prior to such certification or within 45 days after certification, and on the basis of adequate evidence that the certification is in the interest of the individual. The Secretary is required to ensure that all such certifications are adequately reviewed.

The Secretary is also required to establish a system of accountability monitoring in cases involving a representative payee whereby the representative payee reports not less often than annually with respect to the use of the payments. The Secretary is required to establish and implement statistically valid procedures for reviewing these reports in order to identify instances in which representative payees are not properly using the payments. The requirement for annual reporting does not apply to a parent or spouse who lives in the same household as the beneficiary.

Similar provisions apply with respect to individuals who apply for SSI benefits.

An individual or entity convicted of a felony under sections 208 or 1632 of the Social Security Act may not be certified as representative payee.

Proposed change. - Present law requirements relating to representative payees would be expanded and modified as follows.

The Secretary's determination that it is in the interest of a beneficiary to have payments made to a representative payee would have to be in writing.

The present law requirement that certification for payment to a representative payee be made on the basis of adequate evidence that the certification is in the interest of the individual would be modified to require substantial evidence, with the additional stipulation that priority be given to the immediate needs of the individual. In addition, the Secretary would be required to promulgate regulations to encourage, where appropriate, face-to-face contact with the representative payee and the beneficiary. The Secretary

would also be required to develop and promulgate, through regulations, procedures to implement the investigation including (1) verification of the identity, including at least the social security account number, of any individual who applies to be a representative payee; (2) a determination insofar as feasible of whether the individual has been convicted of a felony under the Social Security Act or under any other Federal or State law; and (3) a determination, based on the Secretary's records, of whether the services of the individual as a representative payee have previously been terminated or suspended.

The amendment would prohibit the payment of large lump-sum retroactive benefits to a new representative payee until the investigation of the payee has been completed.

Effective March 1, 1991, the amendment would also require the Secretary to have in place a centralized, current file of the address and social security account number of each representative payee, the address and social security account number of each beneficiary for whom a representative payee is providing services, and the name and social security account number of each person who has been convicted of a felony under the Social Security Act or whose services have been previously terminated by the Secretary. On a demonstration basis, the Secretary would be required to correlate information in the file to determine whether multiple beneficiaries reside at the same address and, if so, upon request, would transmit this information to the agency or agencies of a State which are primarily responsible for regulating care facilities, providing for protective services, or serving as long-term care ombudsmen.

The Secretary would be required to provide to each beneficiary (other than a child living with his parents), and each person authorized to act on behalf of an individual who is legally incompetent or is a minor, a formal notice of the initial determination of the need for a representative payee. This notice must be provided in advance of any benefits being paid to a representative payee.

An individual who is a creditor of a beneficiary would be precluded from serving as the beneficiary's representative payee except under certain conditions.

The Secretary would be required to make good faith efforts to locate a suitable representative payee for each beneficiary for whom a suitable payee cannot readily be found. All local social security offices must have available a current list of local public and nonprofit community-based social services agencies that provide services as a representative payee.

If an individual (who has not been adjudged legally incompetent) is being paid benefits directly, the Secretary must continue to make direct payments until he completes his determination concerning the ability of the beneficiary to manage his benefits, and concerning the selection of the representative payee.

If an individual is newly eligible for benefits and it is determined that a representative payee is necessary, the Secretary must pay the individual directly until he has completed his investigation of and has selected the representative payee, or until such time as the individual has exhausted appeal rights. This requirement does not apply in the case of lump sum payments, or to a beneficiary who is likely to suffer substantial harm if payments are made directly, or who is eligible on the basis of disability and is medically determined to be a drug addict or alcoholic.

A representative payee must be terminated or suspended if the Secretary or a court of law determines that the payee acted in violation of representative payee requirements or has otherwise not acted in the best interest of the beneficiary for whom he was authorized to perform such services, or has misused an individual's benefits.

Failure of the Secretary to investigate or monitor a representative payee that results in misused benefits would constitute an underpayment of benefits and the Secretary would be required to make repayment to the beneficiary.

In addition, in the case of termination of representative payee services based on misuse of benefits by a representative payee, the Secretary would be required to make a good faith effort to obtain restitution of misused funds.

Present law requirements with respect to monitoring representative payees would be amended to require the Secretary to provide for increased monitoring for certain categories of high-risk representative payees.

SSA would be directed to prescribe by regulation reasonable maximum fees which may be charged to an individual by a qualified organization for expenses incurred in providing services performed by the organization as the individual's representative payee. The GAO would be directed to conduct a study of the advantages and disadvantages of allowing qualified organizations that charge fees to serve as representative payee services to individual who receive social security and SSI benefits, and to report its findings

to the Ways and Means Committee in the House and the Committee on Finance in the Senate no later than January 1, 1992.

Budget impact (in millions):

Costs are subject to appropriation and therefore not charged to the Finance Committee.

1990	1991	1992	1993	1994
-10	-10	-4	-5	-5

Continuation of Benefits on Account of Participation in a Non-State Vocational Rehabilitation Program

Present law. - Social Security or supplemental security income benefits based on disability or blindness to a beneficiary who has medically recovered may not be terminated or suspended because the disability or blindness has ceased if (1) the individual is participating in an approved State vocational rehabilitation program, and (2) the Commissioner of Social Security determines that completion of the program, or its continuation for a specified period of time, will increase the likelihood that the individual may be permanently removed from the disability or blindness benefit rolls. The Disability Advisory Council has recommended that the same benefit continuation provisions should be extended to beneficiaries who medically recover while participating in other approved vocational rehabilitation programs.

Proposed change. - The proposal would adopt the recommendation of the Disability Advisory Council to provide that those DI or SSI beneficiaries who medically recover while participating in an approved non-State vocational rehabilitation program would have the same benefit continuation rights as those who medically recover while participating in a State vocational rehabilitation program.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Demonstration Projects Relating to Accountability for Telephone Service Center Communications

Present law. - SSA currently operates 37 teleservice centers (TSCs) that respond to inquiries from the public. In

addition to providing general program information, these TSCs can schedule appointments at local offices and provide individual service, including discussing an individual's eligibility and taking specific actions regarding the individual's benefits. In recent years SSA has attempted to increase the amount of services and actions handled over the telephone by implementing a toll-free 800 number and reallocating staff resources to telephone service workstations, and by promoting its telephone service abilities with the public. Approximately 60 percent of the beneficiary population is currently covered by the new 800 number system. As the other 40 percent--who now use telephone service directly to local offices--are phased into the new nationwide system, local office numbers will no longer be listed in phone books and calls through them will be diverted to the 800 number system. In addition, non-listed local office numbers will be changed or dropped in the future thereby curtailing or eliminating other telephone channels the public has with local offices.

Proposed change. - The Secretary would be required to carry out demonstration projects testing a set of accountability procedures in at least 3 teleservice centers. Callers who provide adequate identifying information would be provided with written confirmation of the date and nature of their calls, including the name of the employee with whom they spoke, a description of any action the employee said would be taken, and any advice the caller was given. Routine communications would be excluded.

The Secretary would be required to report to the Committees on Ways and Means and Finance on these demonstrations, including costs and benefits, difficulties encountered, and an assessment of the feasibility of implementing the procedures nationally.

Budget impact (in millions):

Costs are administrative costs subject to appropriation and therefore not charged to the Finance Committee.

1990	1991	1992	1993	1994
-1	-3	-1	-*	-*

Standards Applicable in Certain Determinations of Good Cause, Fault, and Good Faith

Present law. -

Good cause. - A Social Security beneficiary who (i) works for more than 45 hours during a month in noncovered

employment outside the U.S., (ii) ceases to have a child in care, or (iii) has earnings in excess of the annual exempt amount under the earnings test, is subject to a penalty for failure to report these facts to SSA. However, if the individual can demonstrate to the satisfaction of the Secretary that he or she has good cause for failing to make a timely report, the penalty is waived. In addition, disability benefits are terminated when a beneficiary fails, without good cause, to cooperate with the Secretary in reviewing his or her entitlement or in following a treatment which is expected to restore his or her ability to work.

Fault. - The Secretary may waive overpayments to beneficiaries in cases where the individual is without fault and recovery would defeat the purposes of the program or would be against "equity and good conscience". SSA regulations state that in determining whether an individual was without fault, consideration will be given to the individual's age, intelligence, education, and physical and mental capabilities.

Good faith. - A beneficiary receiving benefits based on disability whom the Secretary determines is no longer disabled has the option of having his or her benefits continued through a hearing before an Administrative Law Judge (ALJ). Benefits paid during this period are considered overpayments if the beneficiary loses the appeal. However, if the beneficiary acted in good faith in pursuing the appeal, repayment can be waived. SSA regulations establish a presumption that appeals are made in good faith unless the beneficiary fails to cooperate with the agency during the appeal.

Proposed change. - In making specified determinations of good cause, fault and good faith, the Secretary would be required to take into account any physical, mental, educational, or linguistic limitations that the individual has. This requirement would apply to the following situations: (1) when an individual is without fault in causing an overpayment; (2) when an individual has acted in good faith in appealing a termination of his disability benefits; (3) when there is good cause for failing to timely report certain information affecting eligibility for benefits; and (4) when there is good cause for failure to participate in a reassessment of an individual's disability entitlement or in a treatment program.

Budget impact (in millions):

Costs are administrative costs subject to appropriation and therefore not charged to the Finance Committee.

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Assistance to the Homeless

Present law. - SSA has participated in projects designed to assist the homeless in qualifying for Social Security or SSI benefits. No provision exists expressly delineating responsibilities for SSA with regard to enrolling potentially eligible homeless people.

Proposed change. - The Secretary would be required to establish a program to identify homeless individuals who may be eligible for Social Security or SSI benefits and to provide reasonable assistance to them in making application. The Secretary's program would include efforts (coordinated with State or local government or nonprofit organizations) to facilitate and encourage application by homeless individuals for Social Security and Supplemental Security Income benefits.

Budget impact (in millions):

Costs are administrative costs subject to appropriation and therefore not charged to the Finance Committee. CBO also believes that there are likely to be some benefit costs but cannot provide a specific estimate.

1990	1991	1992	1993	1994
-5	-10	-10	-10	-10

Notice Requirements

Present law. - The Secretary must use understandable language in notifying individuals of a denial of disability benefits. The law is silent regarding the language of other notices.

Blind SSI applicants and recipients may opt to be informed by telephone of a decision or action affecting them within 5 days of the mailing of written notices of such action, to have such notices sent by certified mail, or to receive them through some other means established by the

Secretary. These options are not available to blind Social Security applicants and recipients.

Proposed change. - With regard to notices about Social Security and SSI benefits, the Secretary would be required to use clear and simple language and to include information on how to contact the appropriate local social security office (including providing a telephone number) in notices generated by local and central SSA offices.

With regard to the blind, the notification options currently available to SSI applicants and recipients would be extended to Social Security applicants and recipients.

Budget impact (in millions):

Costs are administrative costs subject to appropriation and therefore not charged to the Finance Committee.

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Representation of Claimants

Present law. - Social Security and SSI claimants and beneficiaries may use attorneys and legal assistance representatives in pursuit of their claims and in taking other action before the agency. The Secretary, however, is not required to advise them of options regarding their possible use of attorneys and legal aid representatives. When a claimant or beneficiary decides to use one, SSA requires the individual to sign a form designating an attorney or other person as his or her representative. The hard copy form then becomes the record of authorization for all subsequent dealings between the agency and the representative. SSA is under no legal requirement to maintain an automated list of attorneys and legal aid representatives who have this written authorization to assist claimants and beneficiaries with their cases before the agency.

Proposed change. - The Secretary would be required to maintain an up-to-date electronic record, accessible to SSA field offices through the agency's computer system, of the identities of legal representatives of all Social Security and SSI claimants. In addition, the Secretary would be required to include in benefit denial notices information on options for obtaining attorneys to represent the individual's interests before the agency. Such notices also would include information about the availability of legal services organizations that provide assistance free of charge to

qualified claimants.

Budget impact (in millions):

Costs are administrative costs subject to appropriation and therefore not charged to the Finance Committee.

1990	1991	1992	1993	1994
-*	-*	-*	-1	-1

Applicability of Administrative Res Judicata; Related Notice Requirements

Present law. - If a claimant for Social Security or SSI disability benefits successfully appeals an adverse determination by the Secretary, benefits may be paid retroactively for up to 12 months prior to the date of the original application. If, however, instead of appealing, the claimant reapplies and is subsequently found to be disabled as of the date originally alleged, there are circumstances where retroactive benefits would be limited to 12 months from the date of the subsequent application (rather than the date of the first). This occurs when SSA determines that it cannot reopen the original decision under its "reopening rules". (SSA's administrative policy permits a case to be reopened within 12 months of an initial determination for any reason; and within 4 years (2 years for SSI claims) if there is new and material evidence or the original evidence clearly shows on its face that an error was made in the original decision.

A reapplication in lieu of an appeal also could result in an outright denial of Social Security benefits without even considering an individual's medical evidence. This occurs when (i) the claimant's insured status ran out before the date of the original denial or the recency of work test cannot be satisfied since then, and (ii) there is no new and material evidence and no facts or issues that were not considered in making the prior decision. In this situation, SSA applies the legal principle of res judicata to deny the subsequent claim. Under this principle--the use of which is prescribed by SSA regulations--SSA will not consider the same claim over and over again.

Prior to May, 1989, SSA's standard denial notice informed claimants that they could reapply at any time, but did not explain the potential adverse consequences of reapplying versus appealing a denial. A May, 1989 modification to notices informs claimants that reapplying may result in a loss of benefits, but does not mention the possibility of their becoming totally ineligible.

Proposed change. - When an individual can demonstrate that he or she failed to appeal an adverse decision because of reliance on incorrect, incomplete, or misleading information provided by SSA, his or her failure to appeal could not serve as the basis for denial by the Secretary of a second application for such benefits for any period. The Secretary also would be required to include in all notices of denial, a clear, simple description of the effect on possible entitlement to benefits of reapplying rather than making an appeal. This provision will apply to adverse decisions made on or after September 1, 1990.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Authority for Secretary to Take Into Account Misinformation Provided to Applicant in Determining Date of Application

Present law. - By regulation, if an individual expresses his intention to file for Social Security or SSI benefits in a telephone call to SSA, the SSA representative is required to establish a "protective application" at the time of the call. This procedure enables an applicant to establish the date of the call as the filing date if the applicant subsequently qualifies for benefits. If the individual does not express his or her intention to file for benefits, a "protective filing date" is not assigned, even if failure to express such interest is caused by misinformation communicated in the call by the SSA representative.

Proposed change. - When an individual can demonstrate to the Secretary's satisfaction that he or she failed to file for Social Security benefits as a result of misinformation provided after December 1982 concerning eligibility provided by SSA, the individual would be deemed to have applied on the later of (i) the date the incorrect information was provided, or (ii) the date the individual met all the requirements for entitlement. The amendment would apply with respect to benefits for months after December 1982 based on written requests filed on or after the date of enactment. A similar provision would apply to SSI benefits on a prospective basis.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Same Day Personal Interviews at SSA Field Office

Present law. - Nothing in current law requires SSA offices to respond promptly to individuals who visit them on matters of personal urgency or under time deadlines imposed by the agency.

Proposed change. - When an individual visits a field office during normal business hours, SSA would be directed, whenever possible, to provide the individual with a face-to-face interview with an SSA employee before the close of the business day. In the case of an individual who visits an office in response to a time-limited notice for action sent by SSA or because his or her Social Security or SSI check was lost, stolen, or not received, the Secretary would be required to assure that the individual receives a face-to-face interview with an SSA employee before the close of the business day.

Budget impact (in millions):

Administrative costs are not charged to the Finance Committee.

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Social Security Attorneys' Fees

Present law. - When social security recipients are represented by an attorney in pursuing an appeal of an unfavorable decision before the agency, the attorney must have his fee approved by the Social Security Administration. If the fee is approved, the agency directly makes payment to the attorney out of any past due benefits (but not more than 25 percent of the past due benefits).

Proposed change. - Under the proposal there would be no review by the Social Security Administration of attorneys' fees agreed upon by the attorney and the claimant which do not exceed 25 percent of past due (or interim) benefits unless the fee totals more than $3,000 or a review is requested by the claimant or the administrative law judge who heard the appeal on the basis that the claimant was inadequately represented or that the fee is excessive in light of the services rendered. Attorneys could also ask for a review if they believe a higher fee should be set. The Secretary would have authority to increase the $3,000 limit.

In addition, the amendment would provide that a fee would be calculated without applying an offset for SSI interim assistance benefits otherwise payable to States if this is necessary to pay the amount of the fee in full. Reimbursement for travel expenses of individuals who represent claimants could not exceed the maximum amount that would be payable for travel to the site of the reconsideration interview or proceeding before an ALJ from a point within the geographical area served by the office having jurisdiction over the interview or proceeding.

Budget impact (in millions):

Savings represent reduced administrative costs.

1990	1991	1992	1993	1994
2	4	4	4	4

SUPPLEMENTAL SECURITY INCOME

Commission on Child Disability

Present law. - The Social Security Act definition requires that in order to qualify for Disability Insurance benefits an individual must be unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that has lasted, or is expected to last, at least 12 months, or is expected to result in death. The determination must be made on the basis of medically acceptable clinical and laboratory diagnostic techniques.

In establishing the Supplemental Security Income program for needy aged, blind, and disabled individuals in 1972, the Congress agreed to use the same definition of disability under that program that is used for the Disability Insurance program. However, since the SSI program provides eligibility on the basis of disability without regard to age, the statute recognizes that ability to engage in substantial gainful activity may be an inappropriate or impossible test to apply to infants and children. For an applicant under age 18, the law provides that the child will be found to be disabled if he suffers from any medically determinable physical or mental impairment of comparable severity to what would be considered disabling in the case of an adult recipient.

Regulations require that a child must have an impairment(s) that meets or equals in severity an impairment in the Listing of Impairments. If the severity of an adult's impairment does not meet or equal the severity of an impairment in the listings, he can still be found disabled if his impairment prevents him from doing any substantial gainful work that exists in the national economy, considering his vocational factors (age, education, and work experience). This test (or a similar test of functional capacity) is not applied to children.

Questions have been raised about the appropriateness of the standards that are being used for determining disability in children. It has been alleged that the existing system inappropriately excludes some children who are clearly suffering from very severe disabilities. There has also been a Circuit Court decision holding that the present methods for determining disability do not adequately consider the functional limitations which some medical conditions impose upon children.

Proposed change. - The Secretary of Health and Human Services would be required to establish a 15 member commission to conduct a study, in consultation with the National Academy of Sciences, of the definition of disability for determining whether a child is eligible for disability benefits under the Supplemental Security Income program, including the appropriateness of the present definition and the method of assessment that is used in making the determination. In its study and recommendations the Commission shall also address (1) whether it is appropriate to use an individualized functional assessment in determining whether a child is disabled, and if it is appropriate, what criteria should apply to such assessment; (2) the validity of a presumption of disability for children under age four who have a genetic, congenital, or perinatal disorder; and (3) how the Childhood Listing of Impairments should be revised, including the degree to which age-appropriate medical and functional criteria can validly be included in the listing.

The 15 members of the Commission must include representatives from the field of medicine who are expert in the evaluation and treatment of disability in children, the study of congenital, genetic, or perinatal disorders in children, or the measurement of developmental milestones and developmental deficits in children. Other members of the Commission shall be representative of the fields of psychology, education and rehabilitation, law, insurance, administration of disability programs, or such other fields of expertise as the Secretary determines is appropriate.

The Commission must be appointed within 90 days after enactment, and must report by September 1, 1991.

Report language would state that the Committee does not intend that this and other amendments relating to childhood disability approved by the Committee should be interpreted by the courts as either supporting or not supporting the concept that an individualized functional assessment must be used in determining whether a child meets the definition of disability.

Budget impact (in millions):

1990	1991	1992	1993	1994
*	*	0	0	0

Preeffectuation Review Requirement for Disabled Children

Present law. - The Social Security Administration has

recently issued preliminary findings from a childhood disability study requested last year by the Committee on Finance. The study involved a review of 927 title XVI childhood disability claims that were denied in 1987. The preliminary findings from this study indicate that there are unacceptably high numbers of errors in decision-making that result in denial of SSI benefits to disabled children. For example, the study showed that 42 percent of denials were made in error in the case of the "Growth Impairment" listing; 29 percent of denials were in error in the case of the "Cardiovascular System" listing; 13 percent of denials were in error in the case of the "Digestive System" listing; and more than 10 percent of denials were in error in the case of "Mental and Emotional Disorders." These errors involve both clear decisional errors and documentation deficiencies. The study also indicates that certain types of impairments are significantly more prone to error than others.

Proposed change. - Beginning January 1990, the Social Security Administration would be required to review 50 percent of all childhood disability denials made by State Disability Determination Services. Beginning as soon as is feasible, but no later than September 1990, SSA would be required to review 50 percent of all decisions (with a larger percentage of denials than of allowances) before they become effective. The review would apply to decisions on initial claims, reconsiderations, and continuing disability investigations. SSA would be directed to target its review on those determinations which it identifies as most likely to be incorrect. This requirement for review shall apply to determinations made prior to the beginning of fiscal year 1993.

In addition, SSA would be directed to develop a schedule for updating and revising the medical listings that are now being used in determining childhood disability and to submit that schedule to the Committee on Finance and the Committee on Ways and Means.

Finally, report language would direct SSA to improve its procedures for gathering evidence of a child's daily activities and the effect of the physical and/or mental impairment on the child's ability to function.

Budget impact (in millions):

	1990	1991	1992	1993	1994
Benefits	-2	-10	-20	-20	-20
Administration	(-5)	(-10)	(-10)	0	0

Outreach Program for Disabled Children

Present law. - There is no statutory requirement that the Social Security Administration conduct ongoing outreach activities to identify children who may be eligible for disability under the Supplemental Security Income program and encourage their participation in the program.

Proposed change. - The Secretary of Health and Human Services would be directed to conduct an ongoing program of outreach to children who are potentially eligible for SSI on the basis of disability.

Budget effect (in millions):

1990	1991	1992	1993	1994
-4	-5	-7	-8	-10

$30 Monthly SSI Payment for Certain Disabled Children Without Regard to Parents' Income

Present Law.--When disabled children are institutionalized, their parents' income is not taken into account for determining eligibility for Supplemental Security Income. Consequently, they can receive the $30 monthly personal needs allowance provided by SSI to eligible individuals who are in medicaid institutions regardless of the level of their parents' income. In the case of a disabled child living at home, however, the parents' income is counted in determining whether the child qualifies for SSI benefits. For purposes of medicaid eligibility, States are permitted to provide eligibility without regard to parents' income to certain disabled children living at home who would otherwise be institutionalized. Such "home care" children, however, do not qualify for SSI payments.

Proposal. - Children who are now ineligible for SSI but who get medicaid coverage under State home care provisions would be allowed to receive the $30 SSI personal needs allowance that would be payable to them if they were in an institution. This will be payable regardless of the amount of their parents' income.

Budget impact: (in millions)

FY90	FY91	FY92	FY93	FY94
-2	-2	-2	-2	-2

SSI Benefits for Disabled Children of Service Personnel Abroad

Present law. - SSI eligibility is limited to individuals who are physically present inside the United States. A member of the armed services who has a disabled child may, if the family income is low enough, qualify for SSI benefits on behalf of the child. If the service member is assigned overseas, however, the child will lose eligibility as long as the child remains out of the country.

Proposal. - The proposed change would allow continued SSI eligibility for a disabled child residing with a parent who is assigned outside of the United States while on active military service.

Budget impact: (in millions)

FY90	FY91	FY92	FY93	FY94
-*	-*	-*	-*	-*

Treat Royalties as Earned Income

Present law. - In determining SSI eligibility and benefit amounts, income received in the form of royalties and honoraria are considered unearned income. This results in a dollar-for-dollar loss of SSI benefits.

Proposed change. - Any royalty which is earned in connection with the publication of an individual's work, or any honorarium which is received for services rendered would be treated as earned income for purposes of SSI eligibility and benefit determination. This would mean that income from these sources would be disregarded to the same extent that income from other types of earnings is disregarded (i.e., the first $65 of monthly earnings plus 50 percent of additional earnings).

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Special SSI Benefits for Individuals Who Lose Disability Insurance Benefits

Present law. - A basic test used in determining whether an individual is disabled for purposes of Social Security Disability Insurance (SSDI) or for SSI benefits is whether

the individual has earnings that constitute performance of "substantial gainful activity" (SGA). If he does, he cannot qualify for benefits. The Secretary of HHS has defined SGA as earnings of $300 a month. New regulations provide for increasing the SGA limit to $500 a month beginning in January.

In order to allow disabled SSI recipients to return to work without facing a severe disincentive, the Congress enacted legislation creating "special status" benefits under section 1619 of the Social Security Act. Section 1619 allows SSI recipients who continue to be disabled, but who, despite their impairments, begin to work at earnings above the SGA level, to continue to receive "special" SSI cash benefits. The benefit amount is reduced as earnings rise. Medicaid benefits are also continued.

Different rules apply with respect to Social Security disability beneficiaries who return to work at earnings above the SGA level. In the DI program, an individual may work without having his earnings affect his benefits during a 9-month trial work period. After the trial work period, disability benefits stop if the individual engages in SGA. However, the individual is entitled to receive a social security benefit for any month in which he does not perform SGA in the 36-month period that begins after the month in which the trial work period ends.

A Social Security disability insurance beneficiary who loses SSDI benefits because his earnings exceed the SGA level cannot subsequently qualify for regular SSI benefits (because he does not meet the basic disability definition). He therefor also cannot qualify for "special status" benefits under section 1619 which are available only to individuals who first qualify for regular SSI benefits.

Proposed change. - The amendment would permit an individual whose Social Security disability benefits cease because of work activity and who could be eligible for SSI but for the fact that he continues to engage in substantial gainful activity and, therefore, cannot establish initial eligibility for SSI disability benefits, to become eligible for cash and Medicaid benefits under section 1619. The individual would be deemed to have been eligible for SSI in the month prior to the month that Social Security disability benefits are not payable because of work activity, and his application would be deemed to have been filed in that prior month, provided that he files an SSI application during the 12-month period beginning with the first month in any period of months that a Social Security disability benefit was not payable because of work activity.

Budget impact (in millions):

1990	1991	1992	1993	1994
-2	-6	-8	-11	-13

Treatment of Impairment-Related Work Expenses

Present law. - Impairment-related work expenses of a disabled individual are excluded from earnings for purposes of determining (1) whether earnings for any month constitute substantial gainful activity, (2) the monthly benefit amount, and (3) continuing eligibility.

Proposed change. - Impairment-related work expenses would also be excluded in determining initial eligibility and reeligibility for SSI benefits and State supplementary payments.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Reimbursement for Vocational Rehabilitation Services Furnished During Certain Months of Nonpayment of Supplemental Security Income Benefits

Present law. - The Secretary is required to refer blind and disabled individuals who are receiving SSI benefits to State vocational rehabilitation agencies and is authorized to reimburse these agencies for the reasonable and necessary costs of the vocational rehabilitation services that are provided to recipients under certain specified conditions. Reimbursement is not allowable with respect to services provided to individuals who are not receiving cash benefits but who are eligible for medicaid benefits because they are in "special status" under 1619(b), are in suspended benefit status, or are receiving Federally-administered State supplementary payments but not Federal SSI benefits.

Proposed change. - The proposed change would implement a recommendation of the Disability Advisory Council to authorize reimbursement for vocational rehabilitation services provided to individuals who are not currently receiving Federal SSI benefits but who are in "special status" under section 1619(b), are in suspended benefit status, or are receiving Federally-administered State supplementary payments.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Gifts of Transportation Tickets

Present law. - A domestic commercial transportation ticket received as a gift by an SSI recipient is not counted as income if it is not convertible to cash (e.g., if it is charged on the donor's credit card). However, if a ticket is convertible to cash it is counted as unearned income and reduces the individual's SSI benefit on a dollar-for-dollar basis.

Proposed change. - The value of gifts of domestic commercial transportation tickets given to an individual or eligible spouse would be disregarded if they are used by the individual or spouse and not converted to cash.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Exclusion of Interest on Burial Spaces

Present law. - A burial fund with a value of up to $1,500, including interest on the fund, is excluded in determining whether an individual meets the SSI resources test. Burial spaces are also excluded, but interest on the spaces is not excluded.

Proposed change. - In determining resources for purposes of SSI eligibility, interest and other accruals on burial spaces would be excluded.

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Reduce Time During Which Income and Resources of Separated Couples Must be Treated as Jointly Available

Present law. - A husband and wife who are both eligible for SSI benefits and who have not been living apart for more than 6 months are treated as an eligible couple rather than as 2 individuals. The benefit for which they are eligible is 150 percent of the benefit for an individual. If they

separate, they are considered to be a couple until they have lived apart for more than 6 months, at which time they are each eligible for individual benefits.

Proposed change. - A married couple would be treated as separate individuals for purposes of SSI eligibility and benefit determination beginning with the first month following the month of separation.

Budget impact (in millions):

1990	1991	1992	1993	1994
-0	-2	-2	-2	-2

Concurrent SSI/Food Stamp Applications

Present law. - P. L. 99-570 (the Anti-Drug Abuse Act of 1986) amended the Social Security Act to require the Secretaries of HHS and Agriculture to develop a procedure to allow institutionalized individuals who are about to be released to make a single application for both SSI and food stamp benefits.

Proposed change. - The proposal would allow SSA to take concurrent applications for the SSI and food stamp programs, but would not require that the applications be on a single form.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	0	0	0	0

Valuation of Certain In-Kind Support and Maintenance

Present law. - Under present law, SSI benefit payments are computed under a system which determines the amount payable for any month on the basis of income received in the second preceding month. This applies not only to actual income of the recipient but also to certain types of in-kind income (such as the value of housing provided without charge) which are computed as a percentage of the basic SSI payment rate. When SSI benefits are increased in January of each year, this rule creates an anomaly in which for two months (January and February) the presumed income is determined by applying the percentage to a benefit rate which is no longer payable (the benefit rate for November and December). The result is that beneficiaries see their net

SSI payment go up by slightly more than the cost-of-living percentage in January and then have their checks cut back to the actual cost-of-living adjustment in March.

Proposed change. - The proposal would provide that any rule which is used to determine the countable value of in-kind income as a percentage of the SSI benefit rate would make this computation on the basis of the SSI benefit rate in effect for the month of eligibility rather than the rate in effect for the second preceding month.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	4	4	4	4

Exclusion of Agent Orange Settlements In Determining Eligibility for Needs Tested Programs

Present Law. - Under Supplemental Security Income and other needs tested programs, all forms of income generally count against eligibility for benefits unless there is a statutory provision under which the income can be disregarded. Individuals who were awarded benefits under the Agent Orange litigation could, therefore, find that the Agent Orange awards result in their losing eligibility under SSI or other programs.

Proposed change. - Agent Orange settlement payments would be excluded from income and resources under these Finance Committee programs: SSI, AFDC, Medicaid, title XX social services and several other programs. This amendment was previously passed by the Senate as a free-standing bill--S. 892--but no action has been taken by the House.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

AID TO FAMILIES WITH DEPENDENT CHILDREN

Emergency Assistance and AFDC Special Needs

Present law. - States may operate an emergency assistance program for needy families with children (whether or not eligible for AFDC) if the assistance is necessary in order to avoid the destitution of the child or to provide living arrangements in a home for the child. The statute authorizes 50 percent Federal matching for emergency assistance furnished for a period not in excess of 30 days in any 12-month period. Regulations state that Federal matching is available for emergency assistance authorized by the State during one period of 30 consecutive days in any 12 consecutive months, including payments which are to meet needs which arose before the 30-day period or are for such needs as rent which extend beyond the 30-day period.

In addition, AFDC regulations allow States to include in their State standards of need provision for meeting "special needs" of AFDC applicants and recipients. The State plan must specify the circumstances under which payments will be made for special needs.

The Department of HHS published proposed rules on December 14, 1987 to amend the emergency assistance regulations to limit assistance and services under the emergency assistance program to those provided during 30 consecutive days of need in any period of 12 consecutive months. The Department also proposed changes to prohibit States from providing, as basic or special needs, multiple shelter allowances based on the type of housing occupied. The proposed regulations would have the effect of prohibiting States from using emergency assistance or special needs funds to pay for maintaining families in welfare hotels or similar housing arrangements.

An amendment to the Omnibus Reconciliation Act of 1987 imposed a moratorium on publication of final rules through September 1988. The moratorium was extended through September 1989 by an amendment to the Stewart B. McKinney Homeless Assistance Amendments Act of 1988.

Proposed change. - The Secretary of HHS would be directed not to implement the proposed regulations published December 14, 1987 with respect to the use of emergency assistance or special needs funds, but would be allowed to issue revised proposed regulations with respect to the use of emergency assistance funds that reflect the recommendations included in a report entitled "Use of the Emergency Assistance and AFDC Programs to Provide Shelter to Families" transmitted by the Secretary to the Congress on July 3, 1989.

The Secretary would be prohibited from establishing an effective date for any final regulations relating to emergency assistance, or otherwise modifying current policy regarding the use of emergency assistance or special needs funds without specific legislative authority, prior to April 1, 1991. Effective with the calendar quarter beginning January 1, 1990, States would be required to identify in their financial reports any emergency assistance or AFDC special needs funds that are used to pay for housing in welfare hotels or similar housing arrangements.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Minnesota Welfare Reform Demonstration

Present law. - There is no statutory authority designed to enable States to undertake welfare reform demonstration projects that involve several Federal welfare programs.

Proposed change. - The State of Minnesota would be allowed to undertake a welfare reform demonstration project in selected counties, operated in accordance with Minnesota State law. The program will involve the AFDC, Medicaid and food stamp programs.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Penalty for Failure to Implement the JOBS Program

Present law. - The Family Support Act of 1988 provided for the establishment of a new education and training program (JOBS) to serve recipients of Aid to Families with Dependent Children. The statute gives States the option of implementing the new program beginning July 1, 1989. All States must have a JOBS program in effect by October 1, 1990. If they do not, the Secretary of HHS may find that their program is not in substantial compliance with AFDC law, and the Secretary may withhold all or part of the State's AFDC matching funds.

Proposed change. - The Secretary of HHS would be required to withhold all Federal matching for Aid to Families

with Dependent Children for a State that does not implement the new JOBS program by the required date (October 1, 1990).

Budget impact: None

CHILD WELFARE/FOSTER CARE

Foster Care Administrative Costs

Present law. - Concern has been expressed by both the Administration and Congress over the recent rate of increase in administrative costs for the Title IV-E foster care program. States received $118 million in Federal matching funds (50% Federal/50% State) for foster care administration in fiscal year 1983. Federal matching costs rose to $294 million in 1987. (Over this same period of time foster care maintenance payments grew from $276 million in 1983 to $422 million in 1987.) According to Administration projections, if current trends continue, administrative costs will exceed maintenance costs by 1992. Administrative costs already exceed maintenance costs in a number of States.

Various explanations have been given for the increases that have been occurring. Some of the reasons that have been put forward are: in the past some States were underclaiming for administrative costs, and only recently began to file claims for legitimate activities authorized under the law; major child welfare reforms enacted in 1980 (and regulations issued pursuant to that law) allow States to claim for activities that are far more labor intensive (involving development of case plans, preparing for and participating in judicial proceedings, assessment of the child and family's condition, etc.) than the kinds of activities that qualify for Federal matching under the AFDC, Medicaid, or food stamp programs; Federal cost matching definitions are unclear and extremely broad, as are cost allocation rules (e.g., certain costs for non-title IV-E-related activities are being charged to the IV-E program); and States are transferring costs to the Federal government that they themselves should be paying.

A report by the Office of Inspector General, dated October 1987, found that the Office of Human Development Services has not documented that States are systematically transferring ineligible costs to the Federal government, and that there was no evidence in the IG's studies to demonstrate patterns of abuse by the States.

In the last several years the Administration has put forward several proposals that would have the effect of putting a cap on Federal matching for foster care administrative costs. These proposals have not been agreed to by the Congress.

Proposed change. - The Office of Inspector General in HHS would be required to conduct a study of State administrative costs under the Title IV-E foster care program, including the following matters: (1) the kinds of activities that are being funded with IV-E matching funds,

(2) the extent to which the activities that are being funded reflect requirements imposed on the States by section 427 of the Social Security Act, (3) the extent to which States have received reimbursement for claims to which they are not entitled, (4) the reasons why State administrative costs have increased in recent years, including an explanation of why the rates of increase have varied from State to State, (5) the extent to which States have claimed and the extent to which they have received Federal reimbursement under the IV-E program for activities that serve children other than IV-E children (e.g., reimbursement for recruitment of foster care parents regardless of whether they serve IV-E children or non-IV-E children), and (6) the extent to which States are providing in-kind rather than cash payments to match Federal funds.

In addition, the General Accounting Office would be directed to study the effects of the imposition of alternative caps on Federal matching of administrative costs (including a cap that would limit Federal matching for administrative costs to no more than a specified percentage of maintenance costs) on (1) the quality and availability of services to children receiving maintenance payments under the title IV-E program, and (2) the costs to States and to the Federal government.

A State maintenance of effort provision would be added which would limit Federal matching for title IV-E administrative costs to no more than the State received in the prior year unless the State maintains its prior year level of expenditures for child welfare services. For purposes of this provision, child welfare services would be defined to include child welfare services expenditures under title XX and title IV-B of the Social Security Act, and child welfare expenditures made by State and local agencies that participate in the administration of the child welfare, foster care, and adoption assistance programs.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	0	0	0

Child Welfare Services Authorization

Present law. - The annual limit on funding for the child welfare services program (Title IV-B of the Social Security Act) is $266 million. This has been the amount authorized for the program since 1982. The appropriation for fiscal year 1989 was $247 million. Under the child welfare services program, States may provide a wide range of services to

children. There is no Federal income test for these services.

Proposed change. - The authorization for the Title IV-B child welfare services program would be increased from the current level of $266 million a year to $325 million.

Budget impact (in millions - authorization not charged against Finance Committee):

1990	1991	1992	1993	1994
-43	-58	-59	-59	-59

Authority to Transfer Foster Care Funds

Present law. - The Adoption Assistance and Child Welfare Act of 1980 (P. L. 96-272) allows States to transfer unused foster care funds (authorized under title IV-E of the Social Security Act) to use for child welfare services under title IV-B. The transfer mechanism works as follows:

There is a mandatory ceiling on Federal AFDC foster care payments to States if appropriations for the child welfare services program reach a specified level ($266 million a year for years after 1982). With the mandatory ceiling States that meet certain conditions may transfer any unused foster care funds to be used to provide child welfare services under title IV-B. In years in which appropriations do not reach the trigger amount, States may choose to operate under a voluntary ceiling and transfer a certain proportion of unused foster care funds to their child welfare services program.

A State's ceiling is based on the greater of: (1) the fiscal year 1978 AFDC foster care funding for the State with annual increases equal to the lesser of 10 percent or twice the increase in the consumer price index, or (2) a share of $100 million based on the State's under-18 population. In a year in which the title IV-B trigger amount has been appropriated, a State may choose to have its ceiling based on one of two options: the higher of (1) or (2) above; or (3) the 1978 funding level increased by the AFDC foster care caseload increase since fiscal year 1978 if the State's caseload (relative to its total child population) was lower than the 1978 national average foster care caseload (until the caseload equals or exceeds the 1978 national average.)

When operating under the mandatory ceiling, States - except those choosing to calculate the ceiling amount under the alternative formula (No. 3 above) - can use matching foster care funds for the title IV-B child welfare services

at the IV-B Federal matching rate of 75 percent. Although the technical matching rate is 75 percent, States are allowed to use their general foster care costs to meet the non-Federal matching requirement. (Effectively, this means that the receipt of new Federal funds does not require any increase in State matching funds.) These funds cannot exceed the State's share of $141 million under the IV-B allocation formula unless certain preplacement preventive services are implemented. If the IV-B appropriations are $266 million for two consecutive years, a State cannot transfer funds from IV-E to IV-B unless all the foster care procedures and protections required for receipt of additional IV-B child welfare services funds, including preplacement preventive services, are implemented. The mandatory ceiling has been in operation only one year, 1981.

In the years when a State chooses to use a voluntary ceiling, it can transfer an amount, which together with its IV-B allocation, does not exceed what it would have received if the IV-B appropriation had been adequate to trigger the ceiling. In addition, the amount transferred, when added to its IV-B allocation, cannot exceed its share of $141 million under the IV-B allocation formula unless certain of the foster care procedures and protections specified in the 1980 legislation are implemented. If the amount of money transferred plus direct IV-B funds for any two fiscal years equal the State's share of $266 million under the IV-B allocation formula, the State cannot transfer funds unless it has implemented all the foster care procedures and protections specified in the 1980 legislation for the receipt of additional child welfare services funds, including preplacement preventive services.

States have had the option of choosing a voluntary ceiling each year since 1982. Under the voluntary ceiling, States transferred a total of $33 million in 1983, $20 million in 1985, $11 million in 1987, and $7 million in 1989 (estimate).

Proposed change. - The current law authority (which expires September 30, 1989) that establishes ceilings on Federal matching for State foster care maintenance payments and allows a State to transfer its unused foster care funds to the child welfare services program would be extended for three years (through fiscal year 1992).

Budget impact (in millions):

1990	1991	1992	1993	1994
-4	-5	-5	-1	0

Federal Matching for Training Foster Care and Adoptive Parents

Present law. - Federal regulations allow States to use Federal administrative matching funds for short term training for foster and adoptive parents. Matching is at a 50 percent rate, and is limited to travel and per diem.

Proposed change. - States would be eligible to receive 75 percent Federal matching for the costs of training foster care and adoptive parents for fiscal years 1990, 1991, and 1992. States would be required to identify funds used for this purpose in their fiscal reports.

Budget impact (in millions):

1990	1991	1992	1993	1994
-1	-1	-1	-*	0

Health and Education Records for Foster Care Children

Present law. - There is no requirement under present law that States include in their case plans for foster care children any record of the child's educational and health status.

Proposed change. - A case plan for a child receiving foster care maintenance payments under the responsibility of the State must include, at the time of placement, a record of the child's educational and health status. The record must be reviewed and updated at the time each placement is made.

Budget impact (in millions):

1990	1991	1992	1993	1994
-2	-2	-2	-2	-2

Authorization for the Independent Living Program

Present law. - The purpose of the foster care independent living program is to help title IV-E foster care children age 16 and over prepare for independent living. States are entitled to receive their share of $45 million allocated on the basis of each State's relative number of children receiving title IV-E foster care maintenance payments in 1984. There is no State matching requirement. The independent living program was originally authorized for two years, 1987 and 1988. It has been extended for one

additional year.

Proposed change. - The authorization for the independent living program would be extended for three years, through September 30, 1992. The present level of entitlement funding would be increased from $45 million to $60 million. States would be required to provide 50 percent matching for any Federal funding claimed that exceeds the present $45 million funding level. Funds could be used for services to youths for up to one year after they become ineligible for foster care payments (instead of for 6 months as under current law). The GAO would be required to evaluate the effectiveness of the program, including a comparison of outcomes for youth participating in the program with similar youths who did not.

Budget impact (in millions):

1990	1991	1992	1993	1994
-45	-60	-60	-15	0

Data Collection

Present law. - An amendment to the Omnibus Budget Reconciliation Act of 1986 (P. L. 99-509) required the Secretary of Health and Human Services to establish an advisory committee to recommend (by October 1, 1987) a method of establishing, administering, and financing a system for the collection of data with respect to adoption and foster care in the United States. Based on the recommendations, the Secretary was required to submit a report to the Congress (by July 1, 1988) including his recommendations for an adoption and foster care information system. Final regulations for the implementation of the system were required to be promulgated by December 31, 1988, and the system is to be implemented not later than October 1, 1991.

The October 1987 advisory committee report recommended that the data collection system cover all legalized adoptions, including relative and non-relative adoptions, as well as adoptions under private and public auspices. With respect to foster care, the report called for data on all children within the purview of section 427 of the Social Security Act (relating to foster care protections), including children placed under the auspices of public child welfare agencies, children placed by private agencies under contract to the public agency, and children placed privately by licensed private agencies.

The report issued by the Secretary in May of this year

recommended limiting the scope of the system for adoption to only those adoptions in which the State child welfare agency is involved. With respect to foster care, it did not include the advisory committee's recommendation that the system require reporting for children placed privately by licensed private facilities.

Proposed change. - In proposing regulations to establish the foster care and adoption assistance data collection system required by section 479 of the Social Security Act, the Secretary would be required to provide for collection of (and Federal matching for) the kinds of data recommended by the Secretary's advisory committee, as follows: (1) with respect to foster care, data on all children within the purview of section 427 of the Social Security Act, including children placed under the auspices of the public child welfare agency and those placed by private agencies under contract to the public agency, and, to the extent feasible, children who are placed privately by licensed private agencies; (2) with respect to adoption assistance, all legalized adoptions, including relative and non-relative adoptions, as well as adoptions under private and public auspices. The regulations must provide for implementation of the system no later than October 1, 1992. These regulations must be proposed by March 1, 1990, with final regulations issued no later than September 1, 1990. The Secretary must provide technical assistance to the States in implementing the information systems. States could claim Federal matching for the costs of the data collection system as foster care administrative costs (title IV-E) or as part of their child welfare services program (title IV-B).

Budget impact (in millions):

1990	1991	1992	1993	1994
-1	-3	-7	-7	-7

CHILD SUPPORT ENFORCEMENT

Extend IRS Authority to Collect Child Support Arrearages From Tax Refunds

Present law. - Under the Social Security Act, States have permanent authority to request the IRS to collect child support arrearages due to AFDC families by withholding income tax refunds due to the noncustodial parent. States have similar authority to use the IRS income tax offset mechanism with respect to families who are not receiving AFDC. However, this authority applies only to refunds payable before January 1, 1991.

Proposed change. - The current authority to collect child support arrearages on behalf of non-welfare families would be extended for five years. In addition, the current provision of law that restricts use of the IRS income tax offset procedure to collections on behalf of a non-AFDC child who is a minor would be modified to allow collections on behalf of a child of any age if the child is disabled, as determined under the DI or SSI programs.

Budget impact (in millions):

1990	1991	1992	1993	1994
0	-2	-2	-2	-2

Allow States to Use IRS Offset for Non-AFDC Families When Arrearage is Under $500

Present law. - The child support statute now provides that States may use the IRS income tax offset procedure to collect child support arrearages on behalf of non-AFDC families only where the State determines that the amount of past-due support that is owed equals or exceeds $500. However, regulations allow States to use the IRS procedure on behalf of AFDC families where the amount of past-due support that is owed equals or exceeds $150.

Proposed change. - The $500 minimum threshold for collecting non-AFDC child support arrearages using the IRS income tax offset procedure would be removed. States would have discretion to use the same threshold amount that applies to AFDC families.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Allow IRS Offset for Spousal Support When Spousal Support and Child Support are Combined in the Same Order

Present law. - With respect to AFDC families, the IRS may withhold tax refunds to collect past-due support owed to a minor child and the parent with whom the child is living. However, with respect to non-AFDC families, withholding can occur only on behalf of a minor child. Withholding is not allowed on behalf of the child's parent, even if spousal support and child support are combined in the same court order.

Proposed change. - The IRS income tax offset procedure could be used for spousal support, as well as child support, when spousal and child support are included in the same order.

Budget impact (in millions):

1990	1991	1992	1993	1994
-*	-*	-*	-*	-*

Technical Amendment to Allow Good Cause Exception

Present law. - Under current law, as a condition of eligibility for AFDC, a parent must cooperate with the child support enforcement (IV-D) agency in establishing paternity, and in obtaining and enforcing a support order unless there is "good cause" for refusal. "Good cause" includes such factors as reasonable belief that cooperation could result in physical or emotional harm to the child or caretaker relative, and other factors established by regulation. The 1988 Family Support Act established a similar requirement for cooperation with the IV-D agency in order for a family to be eligible to receive child care transition benefits. However, the "good cause" exception was omitted.

Proposed change. - The good cause exception from cooperating with the IV-D agency would be made applicable to transitional child care benefits to make it consistent with the exception that applies to AFDC cash benefits.

Budget impact (in millions):

None.

Self-Employment Demonstration Projects

Present Law.--The 1987 budget reconciliation act included a provision authorizing 3 States to undertake demonstration projects under which payments would be made from the Unemployment Trust Fund to individuals otherwise eligible for unemployment compensation to enable them to undertake self-employment activities. A part of this legislation requires the States involved to repay the Trust Fund, from State general funds, the amount of any costs incurred which exceed the unemployment benefits that would have been paid in the absence of the demonstration projects.

Proposed change. - The requirement that States repay the excess costs to the Trust Fund would be eliminated to the extent that such costs do not exceed $600,000 in the case of any State over the duration of the project.

Budget impact: (in millions)

1990	1991	1992	1993	1994
-*	-*	-*	-*	0

Withholding Unemployment Benefits to Recoup Unpaid Unemployment Taxes

Present Law.--Under the Federal-State system of unemployment compensation, State unemployment benefits are paid from State accounts in the Federal Unemployment Trust funds. These accounts are funded from State-imposed payroll taxes on employers in each State. Federal law requires that amounts in these State accounts may be expended only for the purpose of paying unemployment benefits. In 1987, the State of Minnesota passed a law under which individuals who, as employers, failed to pay State unemployment taxes into the fund would be subject to a withholding of any subsequent unemployment benefits for which they might become eligible so as to recoup their unpaid taxes. The Department of Labor held that this withholding of unemployment benefits to recoup unpaid unemployment taxes constituted an improper use of the funds in the State unemployment account; that is, the Department held that the funds were not being used for the sole legal purpose--the payment of benefits to unemployed individuals.

Proposed change. -- The Federal rules governing allowable uses of funds in the State accounts of the Unemployment Trust would be modified to deduct from the unemployment benefits otherwise payable to an individual any amounts the individual owes to the fund as unpaid unemployment taxes.

Budget impact: (in millions)

1990	1991	1992	1993	1994

INCOME SECURITY PACKAGE

SOCIAL SECURITY 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Create Independent Agency	-*	-1	-1	-1	-1	-4
Increase Retirement Test	-380	-860	-1020	-1070	-1120	-4450
Include Deferred Compensation for Indexing of Tax/Benefit Base	400	1095	1087	1083	1069	4734
Annual Earnings and Benefit Statements	-*	-*	-*	-*	-*	-*
Adoption After Benefit Entitlement	-5	-12	-16	-21	-22	-76
Continuation of Disability Benefits Pending Appeal	-8	-27	-6	-9	-10	-60
Consolidation of Old Computation Methods	-*	-*	-*	-*	-*	-*
Limit on New Entitlement to Age-72 Payments	0	*	*	*	*	*
Authority to Prescribe Magnetic Media Reporting Requirements	0	0	0	0	0	0
Eliminate Advance Crediting of Payroll Taxes	0	0	0	0	0	0
Trial Work Period for All Disabled Beneficiaries	-*	-1	-1	-1	-1	-4
Extend Disability Demonstration Project Authority	-1	-6	-6	-6	-*	-19
Treatment of Auxiliary Benefits	0	0	0	0	0	0
Authority to Amend Wage Records	-1	-1	-2	-3	-4	-11
	5	187	35	-28	-89	111

* Less than $500,000

1/ Preliminary. Minus indicates an increase in outlays.

SOCIAL SECURITY AND SUPPLEMENTAL SECURITY INCOME 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Representative Payee Reforms 2/	(-10)	(-10)	(-4)	(-5)	(-5)	(-34)
Benefits for Participants in Non-State Vocational Rehabilitation Programs	-*	-*	-*	-*	-*	-*
Demonstrations for Teleservice Centers 2/	(-1)	(-3)	(-1)	(-*)	(-*)	(-5)
Set Standards Used in Making Certain Determinations 2/	(-*)	(-*)	(-*)	(-*)	(-*)	(-*)
Assistance to Homeless 2/ 3/	(-5)	(-10)	(-10)	(-10)	(-10)	(-45)
Improve Notices 2/	(-*)	(-*)	(-*)	(-*)	(-*)	(-*)
Representation of Claimants 2/	(-*)	(-*)	(-*)	(-1)	(-1)	(-2)
Administrative Res Judicata; Notice Requirements	-*	-*	-*	-*	-*	-*
Misinformation Provided to Applicants	-*	-*	-*	-*	-*	-*
Require Same Day Interviews 2/	(-*)	(-*)	(-*)	(-*)	(-*)	(-*)
Attorney Fees 2/	(2)	(4)	(4)	(4)	(4)	(18)
Total	-*	-*	-*	-*	-*	-*

* Less than $500,000.

1/ Preliminary. Minus indicates an increase in outlays.

2/ Administrative costs subject to appropriation and therefore not charged to the Finance Committee.

3/ CBO also estimates that there are likely to be some benefit costs but is unable to provide a specific estimate.

SUPPLEMENTAL SECURITY INCOME 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Commission on Child Disability 2/	(-*)	(-*)	0	0	0	(-*)
Preeffectuation Review Requirement for Disabled Children						
Benefits/Medicaid	-2	-10	-20	-20	-20	-72
Administration 2/	(-5)	(-10)	(-10)	0	0	(-25)
Outreach Program for Disabled Children						
Benefits	-4	-5	-7	-8	-10	-34
Administration 2/	(-1)	(-*)	(-*)	(-*)	(-*)	(-1)
Personal Needs Allowance for Children at Home	-2	-2	-2	-2	-2	-10
Benefits for Children of Military Stationed Abroad	-*	-*	-*	-*	-*	-*
SSI Benefits for Individuals Who Lose SSDI	-2	-6	-8	-11	-13	-40
Treat Royalties as Earned Income	-*	-*	-*	-*	-*	-*
Exclude Impairment-Related Work Expenses at Eligibility	-*	-*	-*	-*	-*	-*
Reimburse for Vocational Rehabilitation During Nonpayment of SSI Benefits 2/	(-*)	(-*)	(-*)	(-*)	(-*)	(-*)
Exclude Gifts of Transportation Tickets	-*	-*	-*	-*	-*	-*
Exclude Interest on Burial Spaces	-*	-*	-*	-*	-*	-*
Reduce Time During Which Resources of Separated Couples Treated as Jointly Available	-0	-2	-2	-2	-2	-8
Allow Concurrent SSI/Food Stamp Applications	0	0	0	0	0	0
Valuation of In-Kind Support	0	4	4	4	4	16
Total	-10	-21	-35	-39	-43	-148

* Less than $500,000.

1/ Preliminary. Minus indicates an increase in outlays.

2/ Administrative costs subject to appropriation and therefore not charged to the Finance Committee.

AID TO FAMILIES WITH DEPENDENT CHILDREN 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Emergency Assistance and AFDC Special Needs	-*	-*	-*	-*	-*	-1
Minnesota Welfare Reform Demonstration	-*	-*	-*	-*	-*	-*
Penalty for Failure to Implement the JOBS Program	0	0	0	0	0	0

* Less than $500,000.

1/ Preliminary. Minus indicates an increase in outlays.

CHILD WELFARE/FOSTER CARE 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Foster Care Administrative Costs	-*	-*	0	0	0	-*
Increase Child Welfare Services Authorization 2/	(-43)	(-58)	(-59)	(-59)	(-59)	(-278)
Extend Authority to Transfer Foster Care Funds	-4	-5	-5	-1	0	-15
Federal Matching for Training Foster Care & Adoptive Parents	-1	-1	-1	-*	0	-3
Health and Education Records for Foster Care Children	-2	-2	-2	-2	-2	-10
Authorization for Independent Living Program	-45	-60	-60	-15	0	-180
Data Collection	-1	-3	-7	-7	-7	-25
	-53	-71	-75	-25	-9	-233

* Less than $500,000.

1/ Preliminary. Minus indicates an increase in outlays.

2/ Increase in authorization subject to appropriation and therefore not charged to the Finance Committee.

CHILD SUPPORT ENFORCEMENT 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Extend IRS Authority to Collect Child Support from Tax Refunds	0	-2	-2	-2	-2	-8
Eliminate $500 Minimum for Tax Refund Offset	-*	-*	-*	-*	-*	-*
Allow Tax Refund Offset for Child and Spousal Support When Combined in Court Order	-*	-*	-*	-*	-*	-*
Good Cause Exemption	0	0	0	0	0	0
	0	-2	-2	-2	-2	-8

* Less than $500,000

1/ Preliminary. Minus indicates an increase in outlays.

UNEMPLOYMENT COMPENSATION 1/

(Budget impact in millions)

	1990	1991	1992	1993	1994	Total 5-year
Self-employment Demonstration Projects	-*	-*	-*	-*	0	-1
Withholding Unemployment Benefits to Recoup Unpaid Unemployment Taxes	0	0	0	0	0	0

* Less than $500,000

1/ Preliminary. Minus indicates an increase in outlays.

PAYMENTS FOR NURSE PRACTITIONERS IN NURSING HOMES

CURRENT LAW: OBRA'86 authorizes physician assistants to be reimbursed for services that would otherwise be reimbursed if provided by a physician in a hospital, nursing home, physician's office in an underserved area, and as an assistant-at-surgery. Payments are on an assignment basis and set at a percentage of the amount that would otherwise be paid to physicians: 65 percent for assistant-at-surgery; 75 percent for hospital services; 85 percent for all other services.

PROPOSAL: Authorize payments, effective 1/1/90, for services performed by nurse practitioners in nursing homes under the under the same requirements as physician assistants. Payments would be made through the physician provider with whom a nurse practitioner collaborates and not directly to to nurse practitioner. Incentives for continued physician involvement would be provided by permitting payments for nurse practitioner or physician assistant services when performed as part of a member of a provider team, where "team" is defined to include the attending physician and includes a physician assistant working under the supervision of the physician or a nurse practitioner working in collaboration with the physician. Payment mechanisms would be designed to permit and limit routine payments involving teams to up to 1.5 visits per nursing home resident per month and to protect against duplicate payment. At least one demonstration would also be required to test an alternative approach or approaches to setting the limitation on the number of visits per resident per month.

RATIONALE: A HCFA demonstration based in Massachusetts and completed in February, 1989, examined the costs, quality of care and provider (nursing home) satisfaction of using nurse practitioners (NPs) and physician assistants (PAs) teamed with physicians in the provision of primary medical care to intermediate and skilled nursing home residents. Evaluations of demonstration findings by RAND Corporation, the University of Minnesota, and Boston University showed the following: Costs - the use of NPs and PAs was budget neutral and could, over time, result in savings through reduced hospital re-admissions; Quality - quality of care was equivalent or exceeded that provided by physicians in control groups; Satisfaction - nursing directors and nursing home administrators were highly satisfied with the team approach and found that residents received more medical attention, that NPs and PAs had a positive impact on nursing staff and their practices, and that medical response time was faster than when physicians operate alone. This proposal builds on the Massachusetts experience, on the legislative precedent set by OBRA'86 with respect to PAs in nursing homes, and on the role NPs have continued to play in augmenting the skills and availability of physicians. The proposal also maintains the active involvement of physicians as the point of accountability for patient care and Medicare reimbursement and has the potential for improving the quality of care through the team approach.

FINANCIAL IMPACT: CBO estimate pending. Massachusetts results support budget neutrality if not savings. Demonstration would be minor cost.

Deemed Status under Medicaid

Alternative method of qualifying for Medicaid program participation.

Voluntary Contributions

Rule permitting voluntary donations within certain limits. Extension of moratorium on final regulations with respect to provider-specific taxes.

Review of reimbursement for intraocular lenses

Establishes review mechanism for new technology IOLs.

Clarify Bed and Board

Allows payment of room and board for live-in personal attendant.

Prevocational services

Allows payment of prevocational services for persons who have not resided in an institution.

Residents of terminated ICF/MRs

Makes residents of decertified or terminated ICF/MRs eligible for waiver services.

Extend option for correction reduction

Permanently authorizes option for States to submit correction and reduction plan for ICF/MRs facing funding cutoff.

Retroactive coverage of QMSs

Permits States to pay Medicare cost sharing retroactively due to slow implementation of QMB program.

Long-term care insurance demo

Would establish long-term care waiver demo in New York State; Secretarial approval contingent upon budget neutrality.

DISCUSSION DRAFT

BUDGET RECONCILIATION SUMMARY	FY90	FY91	FY92	FY93	FY94	TOTAL
Deficit Reduction Package	3642	3795	3690	3725	3830	18682
Spending Initiatives						
Health	-780	-1327	-1098	-893	-527	-4625
Income Security	-63	-92	-110	-64	-52	-381
Net Effect on Deficit	2799	2376	2482	2768	3251	13676
GRH Target	2768					
(Medicare Target)	2300					

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DEFICIT REDUCTION PACKAGE

	Staff Estimates					
	FY90	FY91	FY92	FY93	FY94	Total
MEDICARE PART A						
1) Indirect Medical Education at 6.6%	300	370	410	450	490	2020
2) Inpatient Capital: 20% reduction; exempt high disproportionate share hospitals and sole community hospitals	615	90	0	0	0	705
3) PPS Update Large Urbans: Market basket - 1.25 Other Urbans: Market basket - 2 Rurals: Market basket + 2 Exempts: Market basket	430	540	600	660	720	2950
Bar reduction in DRG weights	0	0	0	0	0	0

MEDICARE PARTS A & B	FY90	FY91	FY92	FY93	FY94	Total
4) Medicare Secondary Payer (IRS Enforcement)	342	780	680	420	110	2332
5) Payment Cycle (2 days)	470	70	80	80	90	790

MEDICARE PART B	FY90	FY91	FY92	FY93	FY94	Total
6) Freeze physicians 1/1-4/1; full MEI for primary care on 4/1; continue freeze for other	655	640	720	810	910	3735
7) Overpriced Procedures: Reduce by 1/3 of difference with RBRVS; 15% max	150	235	270	305	340	1300
8) Reduce radiology 4%; modify time unit calculation for anesthesiology	90	110	130	145	160	635
9) Limit durable medical equipment update to 2%; reduce selected DME items	30	85	95	110	195	515
10) Cap clinical lab fee schedule at 95%; limit update to 2%	85	145	180	205	245	860
11) Outpatient Hospital Capital (conforms to #2)	25	20	0	0	0	45
12) Hospital Outpatient Payments 2% across the board reduction	85	80	15	0	0	180

13) New physician customary charges	25	150	0	0	0	175
14) Extend 25% Part B premium one year	340	480	510	540	570	2440
TOTAL	3642	3795	3690	3725	3830	18682

Possible Additional Reduction: Ways & Means delay payments
an additional five days yields $2 billion in FY90

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DISCUSSION DRAFT
SPENDING INITIATIVES

		1990	1991	1992	1993	1994	Total
	Other Income Security	-63	-92	-110	-64	-52	-381
	Infant and Child Health	-196	-469	-546	-588	-617	-2416
	Rural Health	-162	-205	-177	-182	-197	-923
	Physician Payment Reform	0	-20	335	675	1155	2145
	Miscellaneous Health Provisions						
1	Cancer Hospitals	-12	-3	-3	-3	-4	-25
2	Hemophilia Clotting Factor	-2	-14	-17	0	0	-33
3	Medicare Hospice	-20	-25	-30	-35	-40	-150
4	Corrected Determinations	-30	-15	-15	-20	-20	-100
5	Eliminate mental health cap	-20	-45	-60	-75	-95	-295
6	Psychologists	-17	-31	-40	-52	-55	-195
7	Clinical Social Workers	-17	-31	-40	-52	-55	-195
8	Disabled Enrollment Period	*	*	*	*	*	*
9	Claims process-physician payment reform	-36	-160	-175	-190	-210	-771
10	Religious Orders	-12	-15	-20	-20	-25	-92
11	Home Health Advisory Committee	*	0	0	0	0	0
12	Base Year Cost for Medical Education	*	*	*	*	*	*
13	Home Health Wage Index	*	0	0	0	0	*
14	Hospital-Based Nursing Schools	-100	**	**	**	**	**
15	Medicare Secondary Payer Coinsurance	*	*	*	*	*	*
16	CRNA Fee Schedule	-70	-185	-205	-230	-235	-925
17	Power Driven Wheelchairs	1	2	2	2	2	9
18	Interventional Radiologists	*	*	0	0	0	*
19	Portable Xrays	-1	-1	-2	-2	-2	-8
20	Coverage of EPO (drug) (change date)	-10	-30	-30	-30	-35	-135
21	Buyin for Working Disabled	*	-4	-11	-19	-28	-62
22	Part A Buyin for QMBs	*	*	*	*	*	*
23	AAPCC	-25	**	**	**	**	-25
24	Medicare Secondary Payer Drug Claims	*	*	*	*	*	*
25	Personal Care Services Demonstration	-2	-2	-2	-1	0	-7
26	Medicaid Transition for AFDC families	-8	-10	-10	-10	-10	-48
27	Therapeutic Shoes	*	*	*	*	*	0
28	Nurse midwives	*	*	*	*	*	*
29	Nuclear Medicine	-3	-3	-1	0	0	-7
30	Respite Demo	**	**	**	**	**	**
31	Oregon Waiver	-3	-10	-10	-10	-10	-43

32	Qualified Substate Entities	*	-1	-1	-1	-1	-4
33	Institutions for Mental Disease	-5	-10	0	0	0	-15
34	COLA disregard for QMBs	-2	-5	-5	-5	-5	-22
35	Veterans' Pension Disregard	-25	-30	-30	-35	-30	-150
36	Medicaid Hospice	-3	-5	-5	-10	-10	-33
	TOTAL	-843	-1419	-1208	-957	-579	-4906
	Social Security	5	187	35	-28	-89	110

(Separate floor amendment; not included in Reconciliation totals)

* Minimal Cost
** Cost estimate unavailable

COST ITEMS

1. Cancer Hospitals

Exempts hospitals from prospective payment system, from capital reductions, and restores periodic interim payments.

2. Hemophilia Clotting Factor

Provides time-limited additional payment to hospitals for inpatient use of factor, while study is completed of ways to compensate hospitals for added costs since factor must now be tested for HIV virus.

3. Medicare Hospice

Increases payment rates 20% (the rates have been frozen for several years) and indexes them to inflation in the future. Clarifies relationship between hospice benefit and "Mitchell drug" benefits, and studies high-cost care. Allows temporary verbal certification by physician of need for hospice care, as long as written certification follows within a limited period of time.

4. Corrected Determinations

Directs HHS to correct payment errors made in computing area wage indices.

5. Eliminate Mental Health Cap

Eliminate Medicare's $1100 annual limit on outpatient mental health, maintaining current 50% beneficiary coinsurance.

6. Psychologists

Provide for direct Medicare reimbursement for the services of qualified psychologists, consistent with State law.

7. Clinical Social Workers

Provide for direct Medicare reimbursement for the services of licensed clinical social workers, consistent with State law.

8. Disabled Enrollment Period

Allow disabled beneficiaries to enroll in Medicare at any time penalty if they have been covered by private insurance, as is currently the case for aged beneficiaries.

9. Claims submission, physician payment reform.

Require physicians to submit unassigned claims.

10. Religious Orders

Clarifies that religious orders are not treated as employers for purposes of Medicare secondary payer.

11. Home Health Advisory Committee

Extends the Committee's authority one year and requires an evalution of the implementation of its recommendations.

12. Base Year Costs for Medical Education

Allow the use of a different base year in computing graduate medical education limits if the Secretary of HHS determines the institution has upgraded its commitment to medical education.

13. Home Health Wage Index

Directs the Secretary of HHS to continue using the wage index in effect from July 1988-July 1989 for an additional year.

14. Hospital-Based Schools

15. Medicare Secondary Payer Coinsurance

Allows payments by other primary insurers to count toward beneficiary liability for coinsurance and deductibles, as is currently the case for group health plans.

16. CRNA fee schedule

Set national rates at $19, $21; cap at anesthesiology rate.

17. Power Driven Wheelchairs.

Relassifies as frequently purchased, with discretion to the Secretary to provide for payment as customized.

18. Interventional Radiologists.

Permits MDs currently "split billing" to continue for 1 year.

19. Portable X-rays.

Exempts portable X-ray services from 4% reduction in radiology fee schedule.

20. Coverage of EPO.

Permits self-administration at home.

21. Buy in for Working Disabled.

Payment of part A premium for individuals losing SSDI entitlement due to work.

22. Part A Buy in for QMBs.

Waives normal part A enrollment limitations for QMBs.

23. HMO: AAPCC

Phased in increase to 100 percent of AAPCC.

24. Medicare Secondary Payer: Drugs

Permits Secretary to delay application of MSP to drug claims.

25. Personal Care Services Demonstration.

Extends for 3 years a waiver to provide personal care services to elderly and disabled individuals.

26. Medicaid transition for AFCD families.

Makes permanent a provision providing transitional medicaid benefits for families losing AFDC eligibility due to increased child support enforcement collections.

27. Therapuetic shoes.

Flexibility under existing demo.

28. Nurse midwives.

To clarify that coverage of services is not limited to Medicare disabled population.

29. Nuclear medicine.
Exempts services commonly performed by nuclear physicians from radiology fee schedule for one year. Budget neutral implementation.

30. Respite Demo Extension.

Extends Medicaid demo for New Jersy due to delay in start up.

31. Oregon Medicaid Waiver.

Waives certain Medicaid requirements in order to permit the State of Oregon to cover larger poulation and to prioritize services.

32. Qualified substate networks.

Allows States to finance services through substate government agencies.

33. Institutions for Mental Disease.

Bars reclassification of certain facilities pending report.

34. COLA disregard for QMBs.

Corrects problem of coordination between COLAs and update of poverty guidelines.

35. Veterans pension disregard.

Corrects defect in income methodology.

36. Medicaid Hospice

Allows Medicaid hospice beneficiaries to continue receiving certain services, and modifies payment for hospice beneficiaries in nursing homes.

RURAL CONSENSUS PACKAGE

Eliminate urban-rural payment differential

Sole Community Hospitals

Rural Referral Centers

Geographical Classification Review Board

Rural Health Transition Grants

Rural Health Clinics

Rural Health Medical Education Grants

Telecommunications Demonstration

Essential Community Hospitals

Interim Protection for Medicare-Dependent Hospitals (Chairman, Pryor)

PROPAC Representation

Nurse Practitioners in Rural Areas

Rural Disproportionate Share Hospitals

Rural Wage Index Study

Office of Rural Health

Social Workers in Rural Health Clinics

DRAFT SENATE FINANCE COMMITTEE RURAL CONSENSUS PACKAGE
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	1990	1991	1992	1993	1994	Total
Single National Rate	0	0	0	0	0	0
Sole Community Hospitals	90	130	140	155	165	680
Regional Referral Centers	15	0	0	0	0	15
Geographic Classification Review Board	0	0	0	0	0	0
Rural Health Transition Grants *	10	25	25	0	0	60
Rural Health Clinics	*	1	1	2	2	6
Rural Health Medical Education *	*	*	*	*	*	0
Telecommunications Demonstration *	*	1	1	1	0	3
Essential Community Hospitals *	*	1	1	1	1	4
Interim Protection (60% dependent)	37	54	11	0	0	102
PROPAC Representation	0	0	0	0	0	0
Nurse Practitioners	20	20	25	25	30	120
Disproportionate Share Hospitals	***	***	***	***	***	0
Rural Wage Index Study	0	0	0	0	0	0
Office of Rural Health *	17	17	17	0	0	51
Social Workers in Rural Health Clinics	0	0	0	0	0	0
Total	189	249	221	184	198	1041
Amount Subject to Appropriation	27	44	44	2	1	118
Total, Senate Finance	162	205	177	182	197	923

*/ Subject to appropriations; costs are not scored against Finance Committee
*** Not yet available

SUMMARY OF PHYSICIAN PAYMENT REFORM PROPOSAL

o Physician fees would be determined on the basis of a national fee schedule, rather than on the basis of the "reasonable charge" payment method, which reflects historical charges for a service in an area.

o The amount to be paid for a particular service under the fee schedule would be determined by multiplying a budget-neutral "conversion factor" by the number of relative value units assigned to the procedure.

o The number of relative value units for a service would reflect the physician work required for that service, as well as the overhead and malpractice costs attributable to that service.

o The overhead and malpractice components of the fee schedule amount (approximately 46 percent) would be adjusted for geographic variations in these costs. The physician work component would not be adjusted for geographic differences in a physician's cost of living.

o Initially, the geographic units used for this adjustment would be the payment localities currently used by part B carriers. The Secretary would be permitted to apply different geographical units after conducting a study to determine the appropriateness of alternative approaches.

o The transition to a fee schedule would begin in 1991, when the Secretary would eliminate customary charge limits, as well as specialty differentials. The Secretary would be required to adjust prevailing charge limits in order to assure that these changes do not increase or decrease total payments for physicians' services.

o From 1992 through 1995, actual payment amounts would equal a blend of the adjusted prevailing charge and the fee schedule amount. The percentage of payment based upon the old payment system would decline from 80 percent to 20 percent during that period, while the percentage derived from the new fee schedule would increase from 20 percent to 80 percent. In 1996, payment for a service would be based upon 100 percent of the fee schedule amount.

o The current 5 percent differential between participating and nonparticipating physicians would be retained.

o A 10 percent bonus payment would be implemented for all services provided in a health manpower shortage area (HMSA).

o The current limits on actual charges of nonparticipating physicians would be replaced with limits based upon a specified percentage of the fee schedule amount. This percentage would decline from 125 percent in 1992 to 115 percent in 1995 and thereafter.

o Physician fees would be updated annually in accordance with the update enacted by Congress, or in the absence of Congressional action, by the MEI percentage increase minus 2 percentage points.

o A volume performance standard would be set by Congress annually. In the absence of Congressional action, it would equal actual expenditures for the preceding year, increased by sum of the increase in the MEI, the increase in the number of part B enrollees, and the 5-year average increase in services per beneficiary, reduced by 2 percentage points.

o In determining an appropriate update for a year, Congress would consider whether actual expenditures for a preceding year exceeded the expenditure target for that preceding year, taking into account the Secretary's recommmendations.

o In addition to providing for reform of the physician payment system, the bill would also:

oo mandate assignment on claims for all qualified Medicare beneficiaries; and

oo provide enhanced funding for outcomes research and the development of practice guidelines for use in the Medicare program.

PHYSICIAN SELF REFERRAL

1. Require providers to disclose names of physician investors.

2. Require that all part B claims contain the name and physician provider number or identifier of the referring or ordering physician.

3. Require organizations paying Medicare claims to monitor the part B ancillary services for which physician investors refer their patients in order to detect patterns that may indicate overutilization.

4. Prohibit "shell" labs.

HMO CONSENSUS PACKAGE

1. 3-Year phase in of 100 percent of the capitated rate (AAPCC), contingent upon Secretarial certification that certains conditions have been met.

2. Require Secretary to disclose assumtions and methodology for determining capitated rate.

3. Require Secretary to certify that the capitated rate is actuarially equivalent with amount that would be paid on fee for service basis.

4. 3-year waiver of 50:50 requirement for organizations that are able to demonstrate sound finances and that agree to provide additional benefits for their elderly enrollees.

5. Limit prohibition of physician incentive payments to cases in which there is a direct relationship between the payment and reduction of services for an identifiable enrollee.

6. Make permanent the authority for an HMO to establish a benefit stabilization fund.

7. Extend Medicaid HMO waiver for Tennessee Primary Care Network.

8. Extend Medicare HMO waiver for Watts Health Foundation.

CHILD HEALTH PACKAGE

Coverage of pregnant women, infants and children through the sixth birthday to 133% of poverty

Optional coverage of children up to 100% of poverty through the 19th birthday

Demonstration of buy-in for uninsured families

Continuous eligibility for pregnant women, infants and children through the 3rd birthday

Continuous coverage of children until redetermination completed

Coverage of all children receiving SSI

Development of model Medicaid application

Hospital payment protections for all infants and for children under the age of 6 in childrens' or disproportionate share hospitals

Payment protections for children in out-of-state childrens' hospitals

Codify requirements for adequate payment

Secretarial report on adequacy and timeliness of provider payment

Direct reimbursement for certified and family nurse practitioners

Expanded participation in home and community based services waivers

Optional coverage of home and community based services for children with AIDS and ventilator-dependent children

Optional coverage of home visiting for medically fragile infants

Codification of Early and Periodic Screening, Diagnosis and Treatment requirements, with required interperiodic screening and coverage of conditions discovere dduring screen

Health Care Improvements for children in Federally-financed foster care

Require HHS coordination with Governors and Secretary of Agriculture

Require coordination of State Medicaid plan with WIC; improved WIC information for Medicaid applicants

Modify timetable for calculating Medicaid matching rate

HHS annual report on health status of children

Model definitions of high risk pregnancy, high risk children, and medically uninsurable children

Development of model health benefit package for pregnant women and children

Increase authorization for Maternal and Child Health Block Grant

Improve MCH planning and reporting, creation of advisory boards, State development of "one stop shopping" programs

Require information networks for chronically ill children

Demonstration of alternative approaches to health insurance and promotion of community services for children with special health care needs

Optional State outreach services

Demonstration of provider payment (authorization)

Authorization for handbook for pregnant women

Medicaid coverage of community health clinic services

DRAFT CHILD HEALTH PACKAGE

	1990	1991	1992	1993	1994	Total
Pregnant Women/Infants 130% 7/1/90	30	130	155	180	195	690
Children to 6th Birthday 130% 7/1/90	20	105	125	150	160	560
Option for Children to Age 19 100% 7/1/90	10	60	70	85	90	315
Buy-in Demonstration (7/1)	15	50	60	10	0	135
Continuous Eligibility Pregnant Women/Infants	15	20	25	25	25	110
Continuous Eligibility under 3 for Children	10	10	10	15	15	60
Clarify Continuity	2	5	5	10	10	32
Cover all SSI children	2	3	4	4	4	17
Model application	1	0	0	0	0	1
Hospital Payment Protections:						
All infants, all hospitals	*	*	*	*	*	*
Under 6 in certain hospitals	5	5	5	10	10	35
No dollar limits on infants	4	4	4	5	5	22
Out of State hospitals	*	*	*	*	*	*
Codify Adeqaute Payment	0	0	0	0	0	0
Secretary's Report	1	0	0	0	0	1
Nurse Practitioners	*	*	1	1	2	4
Home & Community Based Services:						
350 slots	5	5	5	10	10	35
AIDS & ventilators	8	9	9	10	11	47
Home Visitors (medically fragile infants)	3	3	3	3	5	17
EPSDT Expansions	20	25	25	30	30	130
Foster Care	*	0	0	0	0	0
Medicaid-WIC Coordination	1	2	2	2	2	9
Secretary Consults	1	1	1	1	1	5

on Coordination						
Modify FMAP	35	0	0	0	0	35
Optional Outreach (7/1)	6	30	35	35	40	146
Provider Payment Demo (authorization)	10	10	10	0	0	30
MCH Handbook (authoriz)	0	1	1	1	0	3
Annual Report	2	2	2	2	2	10
Definitions of high-risk, uninsurable & model benefits	*	*	*	*	*	0
MCH Block Grant (authorization)	150	150	150	150	150	750
SUBTOTAL	356	630	707	739	767	3199
Subject to Appropriations	160	161	161	151	150	783
TOTAL	196	469	546	588	617	2416

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NON-BUDGET ITEMS

Budget Neutrality in Updating Wage Index

Requires HHS, in updating prospective payment system wage index, to do so in a way that does not affect aggregate Medicare spending

Study of Inpatient Mental Health Benefit

HHS to study advisability of modifying Medicare's 190-day lifetime limit on inpatient care in psychiatric hospitals in favor of an annual limit.

Annual Wage Index Update

Requires HHS to update hospital prospective payment system wage index annually beginning in FY92.

Assignment of Receivables

Clarifies that Medicare and Medicaid providers may use Medicare and Medicaid receivables as collateral for loans. (Report language only)

Dentists as Medical Staff Directors

Allows hospitals to have dentists serve as medical staff directors.

Wage Index Codes and Requirements

Requires HHS Secretary, to the extent feasible, to take into account State codes and requirements in determining the area wage index used in Medicare hospital payment.

Exceptions & Adjustments for PPS-Exempt Hospitals

Authorizes the HHS Secretary to use a different base year as a mechanism for making adjustments to Medicare payment limits for these hospitals. Requires publication of instructions regarding application for exceptions and adjustments.

Finger Lakes Waiver extension

Modify test used to measure cost effectiveness of this waiver until October 1, 1991. Require GAO to study whether the test should be permanently extended and report by October 1, 1990.

Hospital Payments for Bad Debt Public Hospitals

Clarifies in report language that hospitals' debt collection, indigence determination and documentation methodology may not be subject to change under the moratorium imposed by Section 4008(c) of the Omnibus Budget Reconciliation Act of 1987 if the fiscal intermediary had accepted that methodology prior to August 1, 1987, and that recoupment or disallowance based on statistical sampling rather than a case-by-case analysis is also prohibited.

OTA Study of Closed Captioning

Directs the Office of Technology Assessment to study the advisability of requiring hospitals and nursing homes to make available closed captioning television for hearing-impaired individuals.

PROPAC Study of Hospital Outpatient Costs

Directs PROPAC to study the sources of growth in outpatient spending under Medicare and cost differences between services provided in the outpatient department and in other settings.

Municipal Health Services Waiver

Extends the waiver until 6 months after an evaluation of the program is submitted by HHS to Congress.

GAO Study of Beneficiary Protections in Medicare Secondary Payer

Directs GAO to study whether additional statutory provisions are required for beneficiaries against whom recoveries are made under Medicare secondary payer rules.

GAO Study of Home Health Paperwork

Requires GAO to study Medicare paperwork requirements for home health agencies.

Amendments for Childrens Commission & Pepper Commission

Extends the reporting dates for these Commissions, allows the Childrens' commission to raise private funds, and changes the name of the Pepper commission in law.

Certification & Recertification by Nurses

Allows nurse practitioners and clinical nurse specialists who have neither an direct nor an indirect employment relationship with the facility to certify a patient's continuing need for skilled nursing care, on a budget-neutral basis.

Cape Cod Hospital

In report language, direct the Secretary of HHS, in computing payments to sole community hospitals, to recognize the special needs of sole community hospitals which are also designated as rural referral centers and which have entered into merger agreements with additional sole community hospitals.

High Medicare Hospitals *

Directs PROPAC to study and report to Congress on the financial status of hospitals with a large share of Medicare patients.

GME Study

Directs PROPAC and PHYSPRC to report to Congress on recommended reforms in Medicare financing of graduate medical education to encourage priority practice areas and practice locations.

HCFA Personnel Study

Direct the National Academy of Public Administration to study personnel issues related to the Health Care Financing Administration.

Liens on Liability

In report language, indicate that the Committee has taken no position on whether hospitals can seek imposition of liens against liability rewards in excess of Medicare payments due to pending litigation.

SNF cost limits

Study of differential limits for hospital-based and freestanding SNFs

Report language on timely update of cost limits.

Nursing home reform technicals:

Delay in regs
State approval of nurse aide training programs
Elimination of grace period for certain nurse aides
Nurse aide training requirements: transition rules
Nurse aide training programs
Incentives to States for nurse aide training
Nurse aide registry
Right to examine medical record
Regulatory standards for certain services
Enforcement for dually certified facilities
Right to refuse transfer
Nurse staffing requirements
Implementation of PASARR requirements
Scope of PASARR review
Responsibility for PASARR screening

Intermediate sanctions for pyschiatric hospitals

Intermediate sanctions under Medicare and Medicaid paralleling SNF sanctions.

Study of RNs as Assistants at Surgery

Requires study of financial incentives created by differing reimbursement of PAs and RNs.

Home Health Items

Technical correction re: coverage of disposable items under DME fee schedule. Budget neutral implementation.

ESRD Composite rate moratorium; ProPAC study

Two-year moratorium on reductions, with study of appropriate rates.

Moratorium on clin lab competitive bidding demo

One year extension; publication of methodology.

CRNA fee schedule

Set national rates at $19, $21; cap at anesthesiology rate.

Physician office labs

Technical; elimination of conflicting requirements.

PRO quality denials

Hearing for practitioner or provider before notice to beneficiary

Involvement of nonphysician professionals in PROs

Requires PROs to involve nonphysician professionals.

ESRD Network Funding

Allows limited reallocation of funds to underfunded networks.

ESRD medical review protections

Treatment parallel to PROs re liability,confidentiality.

Day habilitation services

Prohibits disallownces until regulations are clarified.

Study of reimbursement for independent rural labs under RBRVS

Would require PPRC to study appropriate reimbursement for lab services billed under RBRVS.

Trip fee for rural labs.

Technical corrections; budget neutral implementation.

Minnesota Prepaid Demo Extension

Extension of capitated care demonstration project.

Medicaid disproportionate share.

Flexibility for State in meeting statutory reqts.

2. Transfer of excess pension plan assets to pay current retiree health benefits

Present Law

Under present law, pension plan assets may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Any assets that revert to the employer upon such termination are included in the gross income of the employer and are subject to a 15-percent excise tax (sec. 4980).

Subject to certain limitations, an employer may under present law make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan or (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets. Special deduction rules apply in the case of contributions to plans established before January 1, 1954, as a result of an agreement between employee representatives and the Government of the United States during a period of Government operation of a major part of the productive facilities of the industry in which such employer is engaged (sec. 404(c)).

Under present law, a pension plan may provide medical benefits to retirees through a section 401(h) account. These medical benefits, when added to any life insurance protection provided under the plan, are required to be incidental or subordinate to the retirement benefits provided under the plan. Under Treasury regulations, the medical benefits are considered incidental or subordinate to the retirement benefits if, at all times, the aggregate of employer contributions (made after the date on which the plan first includes such medical benefits) to provide such medical benefits and any life insurance protection does not exceed 25 percent of the aggregate contributions made after such date, other than contributions to fund past service credits.

The assets of a pension plan may not be transferred to a section 401(h) account without disqualifying the pension plan and subjecting the amounts transferred to income tax and the 15-percent excise tax.

Explanation of Proposal

Permitted transfer of certain excess assets

Under the proposal, a transfer of certain assets is permitted from the pension assets in a defined benefit pension plan to the section 401(h) account that is a part of

such plan. The assets transferred are not includible in the gross income of the employer and are not subject to the 15-percent excise tax on reversions. The defined benefit pension plan does not fail to satisfy the qualification requirements (sec. 401(a)) solely on account of the transfer and does not violate the present-law requirement that medical benefits under a section 401(h) account be subordinate to the retirement benefits under the plan.

The transfer of assets to a section 401(h) account may be made only once in any taxable year of the employer. Transfers may be made in taxable years beginning after December 31, 1989, and before December 31, 1994.

Under the proposal, accrued retirement benefits under the plan must be nonforfeitable (i.e., vested).

The amount of excess pension assets that may be transferred and used for retiree health benefits is limited to the amount reasonably estimated to be the amount the employer will pay for qualified current retiree health liabilities. "Excess pension assets" are those assets in excess of those necessary to meet the full funding limitation. That is, excess pension assets are those in excess of the lesser of (1) 150 percent of the plan's current liability, or (2) the accrued liability (including normal cost) under the plan (as determined under sec. 412(c)(7)).

The amount transferred under this proposal is generally treated as a contribution except that no deduction is available with respect to the transfer. Under the proposal, for purposes of determining the maximum deductible contribution to the defined benefit pension plan, the amounts held in the section 401(h) account are considered in determining whether the plan is at the full funding limitation.

Qualified current retiree health liabilities are defined as the amount of retiree health benefits (including administrative expenses) expended by the employer or reasonably estimated to be paid by the employer during the employer's taxable year in which such transfer occurs and with respect to those employees who have retired on or before the date of the transfer. In determining the amount that may be transferred, the employer is to consider earnings that will be attributable to such assets subsequent to the transfer. The amount of qualified current retiree health liabilities is also reduced to the extent that the employer has previously made a contribution to a section 401(h) account or a welfare benefit fund (e.g., voluntary employees' beneficiary association (VEBA)) relating to the same liabilities. No deduction is allowed with respect to amounts expended by the employer and subsequently reimbursed from the section 401(h) account.

The retired employees who may be taken into account in calculating qualified current retiree health liabilities are limited to those who are eligible for retirement benefits under the defined pension benefit plan containing the separate account. Retiree health benefits of key employees (sec. 416(i)(1)) may not be paid out of transferred assets. Transferred amounts are generally required to benefit all participants in the pension plan who are entitled upon retirement to receive retiree medical benefits (other than key employees) through the section 401(h) account.

A special rule applies with respect to an employer's taxable year beginning in 1989. Under this rule, an employer may transfer to a section 401(h) account the amount expended by the employer for qualified retiree health benefits during the employer's 1989 taxable year. The transfer may be made after the end of the 1989 taxable year and before the time for filing the employer's tax return for such year (including extensions). The employer may make a single transfer for both 1989 and 1990 qualified current retiree health benefits. Alternatively, an employer may make 2 transfers in an employer's 1990 taxable year, if one of the transfers is made to reimburse 1989 liabilities.

An employer that makes a transfer to a section 401(h) account under the proposal is to maintain employer-provided retiree health expenditures for covered employees at a minimum dollar level for the year of the transfer and the following 4 years. The minimum level is equal to the highest average employer cost per employee for retiree health benefits for the pension plan participants in the 2 years preceding the year of the transfer.

The amounts transferred to the section 401(h) account are required to be paid out for qualified current retiree health liabilities. Amounts that are not expended within the taxable year of the employer in which the transfer occurs are to be returned at the end of such year to the general assets of the plan.

The employer is not entitled to a deduction when amounts are transferred into the section 401(h) account or when such amounts (or income on such amounts) are used to pay retiree health benefits. No deduction or contribution is allowed the employer for the provision of retiree health benefits (whether directly, through a 401(h) account, or a welfare benefit fund) except to the extent that the total of such payments for qualified current retiree health liabilities exceed the amount transferred to the section 401(h) account (including any income thereon).

Special rule for certain negotiated plans

The proposal would provide that surplus assets in

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certain retirement plans may be transferred to retiree health benefit plans. Assets so transferred would not be includible in the income of the employer, nor would they be subject to the 15-percent excise tax. A plan qualifies as a transferor plan under the proposal if it is a plan described in section 404(c) or a continuation of such a plan and participation in the plan is substantially limited to individuals who retired before January, 1976. A plan qualifies as a transferee plan under the proposal if it is a plan described in section 404(c) or a continuation of such a plan and it provides health benefits to retirees and beneficiaries of the industry that maintained the transferor plan.

In addition, the proposal would provide that any employer that had an obligation to contribute to a plan that qualifies as a transferee plan under the proposal as of January 1, 1988, (including a contingent obligation to contribute) shall have a continuing obligation to contribute to the plan.

Requirement that medical benefits be incidental or subordinate

Under the proposal, the medical benefits described in section 401(h) are considered subordinate to the retirement benefits only if the aggregate of actual contributions (made after the date on which the plan first includes such medical benefits) to provide such medical benefits and any life insurance protection does not exceed 25 percent of the aggregate contributions actually made after such date (rather than the cost related to benefit accruals) other than contributions to fund past service credits. This rule does not apply to a transfer of excess assets permitted under the temporary rule described above.

Under this rule, for example, if a section 401(h) retiree medical benefits plan was established at a time when the plan was fully funded (as determined under section 412), the employer is precluded from making contributions to fund the section 401(h) account unless and until the plan falls below the full funding limit. This is because the permissible level of contributions is measured by actual contributions to the pension plan after the date the medical benefit is established.

Internal Revenue Service General Counsel Memorandum, 39785, issued on April 3, 1989, is rejected to the extent it concludes that contributions to a section 401(h) account may be based on plan costs rather than actual contributions to the plan. No inference is intended as to whether a contribution to a section 401(h) account prior to the effective date of this proposal met the requirement that the medical benefits be subordinate to the retirement benefits of the plan where the determination as to whether such

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requirement was met was based on plan costs rather than on actual contributions to the plan.

Effective Date

The proposal would generally apply to years beginning after December 31, 1989. However, no transfer under the general rule would be allowed with respect to any year beginning after December 31, 1994.

The special rule applicable to certain negotiated plans would be effective on the date of enactment, except that the continuing obligation to contribute would be effective as of January 1, 1988.

The proposal relating to the subordination requirement (i.e., the 25-percent rule) for purposes of determining the permissible contribution to a section 401(h) account would be effective with respect to contributions after the date of committee action.

8. Modify collection period for air passenger tax

Present Law

An 8 percent excise tax is imposed on the value of air passenger transportation. Revenues collected under this and other aviation taxes are deposited in the Airport and Airway Trust Fund. This tax is effective through December 31, 1990.

The air passenger tax is billed to the customer with the charge for air transportation and is considered to be collected from the customer during the second following semi-monthly period. The tax is collected by the air carrier (or its agent) which provides the transportation. The tax must be deposited in a Federal Reserve Bank or other authorized depositary within 3 banking days after the end of the semi-monthly period for which the tax is considered to be collected.

Explanation of Proposal

The air passenger tax collected during a semi-monthly period would be considered as collected during the first week of the second following semi-monthly period. It would be required that the tax be deposited within 3 banking days after the end of the week for which such tax is considered to be collected.

Effective Date

The proposal would be effective with respect to taxes considered collected for semi-monthly periods beginning after January 1, 1990.

2. Payroll tax deposit speedup

Present Law

Treasury regulations have established the system under which employers deposit income taxes withheld from employees' wages and FICA taxes. The frequency with which these taxes must be deposited increases as the amount required to be deposited increases. Employers are required to deposit these taxes as frequently as eight times per month, provided that the amount to be deposited equals or exceeds $3,000. These deposits must be made within three banking days after the end of the eighth-monthly period.

Explanation of Proposal

Employers who are on the eighth-monthly system would be required to deposit income taxes withheld from employees' wages and FICA taxes by the close of the next banking day (instead of by the close of the third banking day) after any day on which the business has an amount to be deposited equal to or greater than $250,000 (regardless of whether that day is the last day of an eighth-monthly period).

Effective Date

The proposal would be effective for amounts required to be deposited after July 31, 1990. A special rule would be effective for 1991 and 1992. For 1991 and 1992, amounts required to be deposited under this provision must be deposited by the close of the third banking day (instead of the next banking day). The Treasury Department is given authority to issue regulations for 1995 and succeeding years to provide for similar modifications to the date by which deposits must be made in order to minimize unevenness in the receipts effects of the provision.

PACKWOOD AMENDMENT

DESCRIPTION OF AMENDMENT

1. Capital Gains

Exclusion for Individuals.--Individuals would be allowed an exclusion of up to 30 percent of the net capital gain from sales or exchanges of assets (except for collectibles) which are disposed of after October 1, 1989. The allowable exclusion is:

Assets held over:	Exclusion:	Individual Top Rate:
1 year	5%	26.6%
2 years	10%	25.2%
3 years	15%	23.8%
4 years	20%	22.4%
5 years	25%	21.0%
6 years	30%	19.6%

Index cost basis.--Individuals would be permitted to index cost basis for inflation (details to be determined).

Alternative Rate for Corporations.--Corporations would be permitted to compute their tax on capital gains from sales or exchanges of assets (except collectibles) which disposed of after October 1, 1989, using an alternative rate 27.9 percent for assets owned more than [8-10] years (an 18% rate reduction).

Minimum Tax.--No capital gain exclusion would be allowed in computing the alternative minimum tax.

Depreciation Recapture.--The entire amount of depreciation deductions taken with respect to all property would be recaptured as ordinary income.

2. Individual Retirement Accounts

Tax-Free Build-up.--Taxpayers would be permitted to elect to establish a modified version of the IRA-Plus account contained in S. 1256 introduced by Senator Roth.

Mark-Up Proposal.--The IRA proposal in the Chairman's mark would be deleted.

3. Fertilizer Expenses for Growing Timber

An IRS general counsel's memorandum (GCM 39791) requiring the capitalization of fertilizer expenses in connection with the growing of timber would be repealed.

PACKWOOD AMENDMENT ON CAPITAL GAINS

REVENUE EFFECT ($ IN MILLIONS)

	1990	1991	1992	1993	1994	1990-94
1. Capital Gains-Individuals	500	500	-1,900	-2,200	-2,400	-5,500
2. Capital Gains-Corporations	[To be determined]					-4,700
3. Indexing and modified IRA-Plus	[To be determined]					-2,500
Totals						-12,700
Bentsen IRA	**-192**	**-1,560**	**-3,265**	**-3,613**	**-4,055**	**-12,685**

DANFORTH

AMENDMENT TO RESTORE THE DEDUCTION FOR INTEREST ON STUDENT LOANS OFFERED BY SENATOR DANFORTH

THE AMENDMENT IS BASED ON S. 656 INTRODUCED BY SENATORS GRASSLEY AND DANFORTH, WHICH HAS 16 OTHER COSPONSORS. THE AMENDMENT WOULD RESTORE THE INTEREST DEDUCTION ON STUDENT LOANS FOR EDUCATIONAL EXPENSES FOR TWO YEARS. THIS DEDUCTION WILL BE PHASED OUT AFTER 1991 ~~ALONG WITH ALL OTHER PERSONAL INTEREST DEDUCTIONS.~~

REVENUE ESTIMATE- APPROXIMATELY $150 MILLION OVER 2 YEARS.

OFFSET- UNDER CURRENT LAW (SEC. 163), THE PERSONAL INTEREST DEDUCTION WILL BE AT 10% FOR 1990 (WORTH $1.2 BILLION). WE WOULD REDUCE THIS TO JUST ABOVE 8% TO PAY FOR THE $150 MILLION COST OF THE AMENDMENT.