

EXECUTIVE SESSION

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THURSDAY, SEPTEMBER 21, 1978

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United States Senate,
Committee on Finance,
Washington, D.C.

The Committee met, pursuant to recess, at 10:15 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Byrd, Nelson, Gravel, Bentsen, Matsunaga, Moynihan, Curtis, Hansen, Dole, Packwood, Laxalt, and Danforth.

The Chairman. The Committee will come to order.

Senator Talmadge. Mr. Chairman?

The Chairman. Mr. Talmadge.

Senator Talmadge. I have an amendment which is uncontroversial and I think the Treasury Department supports it with my modification. This is to reduce the employment eligibility requirement to employment for a period in excess of thirty consecutive days on a substantial full-time basis with the credit being effective after this time at the start of the thirty-day period.

Delete all provisions relating to the recovery of the tax credit.

Remove present limitation on amount of the tax credit

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1 available in one year.

2 Expand the existing WIN tax credit to 50 percent of wages and
3 related expenses in the first twelve months of employment,
4 33-1/3 percent in the second twelve months, and 25 percent in the
5 third twelve months. In 1979, the maximum wages per employee
6 eligible for the credit would be \$6,000. The amount would be
7 \$6,500 in 1980 and \$7,000 in 1981, which approximate the increases
8 in minimum wage currently schedule to take effect in those years.
9 The total amount of the credit allowed for any taxpayer when combined
10 with the wage deductions would not exceed 100 percent of the tax
11 benefits of both. The credit would also be applied to non-trade
12 or business employees.

13 Make the welfare tax credit permanent.

14 Make technical and conforming changes if necessary.

15 Mr. Stern. Mr. Chairman, that does raise a question. The
16 increases in the second year does raise a question and the
17 Committe staff does regard it as a subject for a point of order.

18 Since the credit would increase in 1980, it does raise the
19 issue of whether you would want to phase it in on this amendment
20 or not, of whether the Budget Act means you cannot raise the
21 amount of tax in fiscal year 1980.

22 The Chairman. I think that you can. I have indicated
23 there are some amendments where I think that I cannot support, but
24 I would certainly support the Senators' right to offer it -- like
25 the Roth amendment, like the Danforth amendment, for that matter.

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1 Senator Talmadge. If we just struck 1980 and carried it
2 forward, it would not be subject to the budget reservation.

3 Mr. Stern. At some point perhaps you actually want to resolve
4 the issue, but if you want to avoid it here, you could simply have
5 the \$6,000 and then go to \$7,000 in 1981.

6 Senator Talmadge. I so move.

7 The Chairman. That would bypass that particular question?

8 Mr. Stern. Yes, sir.

9 Senator Talmadge. Treasury, I believe, had some minor
10 modification. What is it, Mr. Lubick?

11 Mr. Lubick. Our problem, Senator Talmadge, was both the
12 credit and the reduction would be allowed for the same amount.
13 We had suggested that it would be satisfactory if the deduction
14 were reduced by the amount of the credit.

15 Senator Talmadge. I would be agreeable to that.

16 Mr. Stern. That is quite a substantial change in terms of
17 the value of the credit. You should be aware of that.

18 If a credit is 50 percent and then you give the full deduc-
19 tion of the whole wage, suppose the wage is \$6,000, you would
20 get both the \$3,000 credit and, by being able to deduct the
21 \$6,000, if your marginal rate were 46 percent, that would amount
22 to a total value of 96 percent of the wage in that first year.

23 If you denied the deduction for the 50 percent, that cuts
24 it back to a little bit more than present law. In other words,
25 50 percent credit plus 46 percent of the remaining 50 percent only

1 amounts to a 73 percent credit, something like that.

2 Under present law, since you have full deductibility plus
3 the 20 percent credit, that is already 68 percent, I think. You
4 are not doing very much more in the case of a corporation than
5 present law, if you deny that deductibility.

6 Senator Talmadge. Do you have any suggestions on that,
7 Mr. Galvin?

8 Mr. Galvin. What we are trying to avoid, Senator, is that
9 the high taxpayer can get 120 percent or 130 percent.

10 Senator Talmadge. We do not want that.

11 Mr. Galvin. You do not want that.

12 Mr. Shapiro. We already have that limit here, that says in
13 no case can you get more than 100 percent of the benefits of this
14 provision.

15 The Chairman. With the 100 percent now, that is too much.

16 Mr. Lubick. Mr. Chairman, I might suggest that there be
17 no deduction at all but a credit, be it 75 percent or 80 percent
18 or something like that. It would be all up front and be getting
19 the same benefit, whether it is a small business or a large
20 business.

21 The Chairman. A flat-out credit.

22 Mr. Lubick. No deduction, but determine what dollar amount
23 you want as a credit.

24 Senator Talmadge. What would be wrong with an 80 percent
25 credit?

1 Mr. Lubick. I think that is a judgment that you are going
2 to have to make.

3 Senator Talmadge. Would that be agreeable to Treasury?

4 Mr. Lubick. It seems a little rich, the difference between
5 75 and 80, once we have gotten to 75. I would leave that up to
6 your judgment.

7 The Chairman. It seems to me you should make it 80 or 85,
8 somewhere around in there. 80 or 85.

9 Senator Talmadge. 80 is agreeable to me.

10 Mr. Stern. That would be for the first year; if you are
11 going to have a three-year credit, you would want to figure the
12 percentages for the second and third year.

13 Senator Talmadge. Reduce them.

14 Mr. Stern. 80, 60, 40?

15 Mr. Shapiro. You had 50 percent, 33-1/3, 25 percent. You
16 might want to consider 80, 60, 40.

17 Senator Talmadge. 80, 60, 40.

18 The Chairman. That is a credit --

19 Mr. Shpairo. That would give you a credit of this amount --

20 The Chairman. -- a credit in lieu of a deduction.

21 Mr. Shapiro. And not give a deduction of any of the wages.

22 Mr. Stern. I think you would still get a deduction of the
23 remainder of the wages.

24 The Chairman. No, Mr. Lubick was suggesting that if you
25 want to do better, as an alternative, he suggested -- which was

1 better than what we were talking about a moment ago, you just
2 decide to make it a tax credit and say you cannot deduct it and
3 you do not get the other credit. So if you make it a flat credit,
4 that would be it.

5 Then if you take 80 now and you are not going to have a
6 deduction and you want to go to something like 70 or 60 or some-
7 thing like that, or 75 and then 75.

8 Mr. Lubick. You could figure out what your equivalent was
9 of a third in the second year.

10 The Chairman. Why do you not figure that? Suppose you
11 start out and get your equivalent. Let us say that you have a
12 50 percent rate and a 25 percent rate. So you put the two
13 together, and you get 75. So you move it up, and in the second
14 year, what would it be if you have the same thing?

15 Mr. Stern. One-third with 50 percent would bring you up
16 to 67 percent in the second year.

17 The Chairman. Eight points below that, if you are going
18 to go to 80 and drop eight points you would be to 72. You could
19 make it 70, or round it off to 75, whatever way you wanted.

20 Mr. Galvin is shaking his head. He has something to add.

21 Mr. Galvin. Under the present tax credit, you get a 25
22 percent tax credit, then 48 percent of the wages, which amounts
23 basically to 68 percent for one year.

24 The Chairman. We are talking about the second year.

25 Mr. Galvin. If you have 80 percent, I would say 75 percent

1 for the second year. That would be the only way that there
2 would be an increase over current law.

3 Mr. Stern. Current law is zero for the second year.
4 The Chairman. Mr. Moynihan?
5 Senator Moynihan. Mr. Chairman, I just want to say that

6 we have been talking about a targeted jobs tax credit for welfare
7 recipients generally, and I am a little not entirely prepared to
8 compare our proposal. They are very close, but I would assume that
9 we would want one set of standards for this one group of people.

10 Senator Talmadge. This is a program that has been in effect
11 since '71, Senator Moynihan, and has proved its value during that
12 period of time. They would have to certify the work or the train-

13 ing. You might tell what is happening.
14 The Chairman. What he is saying is correct. You have a
15 jobs credit in the House bill that is very generous. Senator

16 Moynihan is supporting the jobs credit. It is a very generous
17 jobs credit. He is just saying that basically you are talking
18 about the same thing. You are targeting in on these poor people
19 and you are providing a big credit to get them into a job, and
20 he is saying that you really ought to put the rate of the two
21 together.

22 It is about the same thing when you really get down to it.
23 What difference does it make if a person took some training or
24 whether he just came off the welfare rolls into a job. In either
25 event, you want to make it taxwise attractive for the people who

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1 are hiring.

2 Can you tell us what the jobs credit would be on that one?

3 You ought to consider the two of them together.

4 Senator Moynihan. We were proposing almost identical rates,
5 Mr. Chairman -- 50 percent of wages the first year, 35 percent
6 the second, and 20 percent the third.

7 The Chairman. You are also going to have the deductible?

8 Senator Moynihan. Yes, sir.

9 The Chairman. All right. Then you have a limit as to how
10 high the deduction is going to go. I believe you start off with
11 a deductible against the whole thing and you get up around to 90
12 percent.

13 Senator Moynihan. That is right. 30 percent of FUTA wages.

14 The Chairman. Senator Nelson?

15 Senator Nelson. When we raised the discussion the other
16 day, a couple of proposals or three proposals had been made here
17 and some of them cover the whole ball park including the people
18 in the very good program that Senator Talmadge initiated.

19 What I was hoping we would do, no matter what figures we
20 settled on, is that we would adopt the same standard as we approved
21 on the CETA program. We should not really, in the CETA program,
22 we have got it all laid out. We have been using it. We passed
23 it. Now to set another one that has different standards just gives
24 you a ridiculous administrative question.

25 All I am saying is that I think that we ought to get to the

1 question and take it up all at once.

2 The proposal that -- there is a proposal that I have made.
3 Pat named a modification to one that I have made. If the Adminis-
4 tration supports it, I am prepared to modify it.

5 The first year, the unemployed individual described in the
6 Act, 18 to 24, SSI, disabled people and so forth, would get 50 per-
7 cent credit, would get a credit of 50 percent of the first year
8 wages, not to exceed 50 percent of the FUTA wage which, at \$6,000
9 would be \$3,000.

10 The next year, 25 percent, which would be \$1,500. Pat is
11 suggesting 50 percent, 25 percent and going to a third year of
12 20 percent. I do not quarrel about that. None of us know what
13 is best, or what will work.

14 The good thing about this, however, is if it does not work
15 it does not cost anything. If the employer does hire, he is
16 hiring the structurally unemployed that we are trying to help and
17 we are glad to pay the money. If it does not work, it does not
18 cost anything. We are going to take another look at it and see
19 what we have to do to make it work.

20 I would hope we would not come up with a standard here in
21 the CETA program. We do not have a credit like there is here that
22 I think would be better.

23 In the CETA program we provide that the employee hires and
24 then evaluates the job and pays him the cost of training -- absorbs
25 the cost of training an individual. We do not want him going in

1 to hamburger stands that does not take anything to train them.
2 If it takes six months to train them and the cost is X amount,
3 under the CETA bill, that cost would be paid. If you passed this
4 with the credit, the employee would have his option. You could not
5 get both. If you thought it was better to get paid for the train-
6 ing of this individual in a particular job, he could take that.
7 If he thought 50 percent was better, he would take that. My guess
8 is he was more likely to take the 50 percent credit.

9 All I hope is that we would design one that affects all
10 the target groups the same, in CETA and in the Finance Committee.
11 We had agreed that we would try to get together with Herman and
12 see if we could have a credit.

13 The Chairman. Why do we not do this. Why do we not agree
14 to the Talmadge amendment with this understanding, that you talk
15 to the other two Senators and see if it is possible if we can make
16 this have as much consistency as possible and hopefully I know,
17 as far as I am concerned, if you are targeting on these poor
18 people, really the ones who are going to have difficulty getting
19 the job, it ought to be a rather generous tax credit.

20 I think we were talking about making it a 90 percent credit
21 later on. We have had various figures. We have to understand
22 that what we are trying to do here, what Senator Talmadge is
23 trying to do, what Senator Moynihan is trying to do, I think what
24 Senator Nelson is trying to do, we are trying to take these young
25 people and maybe some not so young, these hard-core poverty cases

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1 and these young people are going to have a great difficulty getting
2 a job and we are trying to make it a lot more attractive for an
3 employer to hire them, and if it is going to be a good job, you
4 are going to have to leave out a lot of people who are going to
5 be able to get a job.

6 There has been a lot of criticism of CETA -- I know, I have
7 been reading it. I look down here and see some of the politicians
8 and very well-regarded people doing very well. I am embarrassed
9 to tell you who some of them are. Some of them some of you
10 fellows might know.

11 But the children of their relatives are on the CETA payroll.
12 Those people -- the average state Senator and Judge and people
13 like that, they could find some way to get their youngsters in a
14 job without getting their people to work, without putting them on
15 the CETA. We do not want this program to apply to those young
16 people.

17 Senator Nelson. Let me say, I agree with what you are
18 saying. I think we tightened up that bill so that will not happen.
19 It should be understood that the basic program was established
20 by Senator Talmadge. What would be happening here if you take
21 the targeted jobs credit, you are expanding on the concept. I
22 would like to sit down with Herman and Pat and see what it is
23 about.

24 If you adopt it, a second one for the WIN program and the
25 benefits were less, that would not be equitable. All we are doing

1 is building on the Talmadge concept and I would hope that Herman
2 and Pat and I could get together and see if we could work one out
3 so that we are using the same standard across the board.

4 Senator Talmadge. What I would like to do on the WIN
5 program, it has proved as effective as now over a period of seven
6 years. It has accelerated year after year. How many has it
7 taken off welfare, Bill?

8 Mr. Galvin. Last year, there were 136,000 taken off and
9 135,000 more were employed but still on welfare. They had reduced
10 grants.

11 Senator Talmadge. I have no objection to an expanded,
12 targeted program. I think the staff has a recommendation, staff
13 document, Item C-61, jobs credit. I would prefer to keep the WIN
14 program separate from this other experimental program because it
15 has proved its effectiveness and I have no objection to expanding
16 it on the structurally unemployed.

17 I would expand it up to at least 19, that they would stay
18 in school or go back to school.

19 Senator Nelson. Let's go through it and see if we can work
20 it out.

21 Senator Talmadge. Let's adopt this WIN program and then
22 discuss the other.

23 Senator Nelson. Leave it separate? Fine.

24 Senator Dole. What are we adopting?

25 Mr. Shapiro. One thing I think we should do, one suggestion

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1 that Mike Stern threw out, that Treasury would agree that you
2 should go back to is that you will have a credit and then you
3 will get a deduction for the balance of the wages. For example,
4 you get a credit and a balance with the targeted programs.
5 Whatever you work out, that you are on the same basis, so that
6 if you hire anybody in one of the programs, you can have the same
7 structure.

8 Senator Talmadge. I have no problem with that.

9 The Chairman. May I suggest, you might want to change it
10 upwards or downward, but I believe, if you see what the jobs
11 credit is going to do and you are going to have yours as
12 attractive as the jobs credit that has been discussed already,
13 I think that maybe 85, 80, 70.

14 Senator Packwood. Mr. Chairman?

15 The Chairman. Senator Packwood.

16 Senator Packwood. Are we done with that?

17 The Chairman. Can we vote on it?

18 Mr. Stern. 85, 80 and 75?

19 Senator Nelson. A credit of 85 percent the first year.

20 The Chairman. 85, 80 and then 75, no deduction, just a

21 credit.

22 Mr. Shapiro. What you are saying is a combination of the
23 credit-deduction. You want to get up to these levels, and we will

24 adjust the credit to get to that.

25 Mr. Stern. I think the suggestion was to make it just a

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1 credit, because you do have people with different rates, in the
2 case of corporations, small business and individuals and so forth.
3 So if you are going to have levels like that, that would just be
4 a flat credit.

5 The Chairman. A credit, but no deduction.
6 Senator Nelson. The only thing that I would raise a question
7 about and want to look at is the level of the credit. I think it
8 should be left open for further discussion.

9 The Chairman. That is why I suggested it, because it would
10 bring you closer to what is in the jobs credit.
11 Senator Dole. May I ask a question? Maybe I do not under-
12 stand the program. You start a business and hire ten of these
13 people and the government picks up 85 percent?
14 Senator Nelson. Ours would limit it to 20 percent of

15 payroll.

16 Senator Dole. I am talking about the WIN program.
17 Mr. Stern. Under this proposal, you would take off the
18 limitation that now exists, which is a \$50,000 limit.

19 Mr. Galvin. 50 percent of anything above that. Senator,
20 when you take ten people and hire them, you are taking ten people
21 off the welfare rolls. They no longer get welfare and no longer
22 get food stamps in most states, and they no longer get Medicaid.

23 Senator Talmadge. Assistant Secretary Greene strongly
24 supported it and said that for every \$1 spent in this area, we
25 save two in welfare.

1 Senator Dole. There is no limit on it now?

2 Mr. Stern. There is a limit now.

3 Senator Dole. There will not be any limit if we adopt this?

4 Mr. Stern. Right.

5 Mr. Galvin. The reason that there would be no limit, there
6 is no way to get to the larger companies. The larger companies,
7 in their testimony at the hearings, said that they do not bother
8 with any of these credits. It is too much trouble, and they would
9 hire forty or fifty people at the most -- that would be the maximum
10 credit.

11 Senator Dole. If you take the limit off, it might not
12 be too much trouble.

13 Mr. Galvin. Do not forget, these are the extremely hard
14 to place people. They have reduced the rolls now over the last
15 few years. They are the lowest since October, 1971 -- AFDC.
16 Some of your states are doing very well in that.

17 For example, Nevada is the lowest -- eight years, ten months.
18 Louisiana, eight years five months. Georgia, eight years, two
19 months. Colorado, seven years eleven months. Wyoming, seven
20 years eleven months. New York. --

21 Senator Dole. What is the cost per person, the cost to take
22 them off the rolls? Have you figured that out?

23 Mr. Galvin. There has been a saving to the government every
24 year for the last four or five years.

25 Senator Dole. How much does it cost to do this per person?

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1 Mr. Galvin. On this particular tax feature?

2 Senator Dole. All of these great figures you have showing
3 what it has done, what is the cost?

4 Mr. Galvin. The WIN program has cost approximately \$300
5 million to \$365 million.

6 Senator Nelson. What is the welfare offset? Does that
7 include the welfare offset?

8 Mr. Galvin. The net is a savings for the last four years.
9 I would say roughly \$300 million the last year and a few hundred
10 for the two prior years.

11 Senator Laxalt. Is it a wash?

12 Mr. Galvin. It is a savings for the total government. It
13 is a savings -- the states save the most.

14 The Chairman. The states save more than the Federal govern-
15 ment?

16 Mr. Galvin. They save the most because the WIN program is
17 funded at 90-10.

18 Senator Dole. Say I go out and hire twelve or fourteen or
19 ten of these people; on the average they are going to make \$12,000
20 a year. I start a little business -- maybe a landscape business --
21 and I hire ten of these people and the total payroll is \$120,000.
22 How much --

23 Mr. Stern. The credit only applies to the first \$6,000 of
24 wages under this proposal, so you would get \$3,000 on each
25 employee.

1 Senator Dole. Plus, you get a deduction for the other
2 three.

3 Mr. Stern. I am sorry. I guess I should have said that.
4 It is an 85 percent credit, so it would be 85 percent of \$6,000
5 and no deduction for any of the rest of the first \$6,000.

6 Mr. Galvin. The salaries that you are talking about has
7 not existed since the WIN program has been in effect. They do
8 not get that type of salary. The average salary is about \$3.50
9 to \$4.00. They are put into service industries, basically.

10 The Chairman. Let me point out that since this program has
11 been in effect, between this program and a vigorous child support
12 program, the welfare rolls have been going down rather than up.
13 We have not reduced the welfare rolls by being cruel to people.
14 We have been getting it down on the welfare rolls by making
15 fathers support their children and helping people in their jobs,
16 so that people are better off.

17 The CETA program has helped reduce the welfare rolls. You
18 are helping people get jobs and it tends to reduce the welfare
19 rolls. In terms of numbers, they are down from 10 percent from
20 a high point. While the cash is about the same, if you allow
21 for inflation, I assume that the high point, we are down by 15
22 percent in terms of constant dollars -- not by putting people off
23 the rolls, not by denying them assistance, but by helping them
24 find jobs.

25 If we can keep moving in that direction, we will be making

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1 real progress towards helping people improve their condition.
2 They make more. They are better off. Their lives are on a
3 better basis, so they do not find themselves on the welfare rolls.

4 This has been a major item in moving them that way. I think
5 it is a very good thing.

6 Senator Nelson. Mr. Chairman, I would like to make just
7 one more point. We may want to, after discussing it, let WIN
8 stand absolutely alone and have some different standard on CETA.
9 I am perfectly happy to adopt Herman's, and then talk about it.

10 On the control question, there is a difference in what we
11 are proposing -- credits claimed against wages under the targeted
12 credit could not exceed 20 percent of that employer's payroll,
13 number one. Two, he could not offset more than 90 percent of
14 his tax obligation that year.

15 And then the other one, we would start off with 50 percent
16 and drop to 25 percent. Pat wants to start at 50, drop to 35
17 and in the third year, 20. I do not think the numbers are of
18 great significance.

19 Mr. Lubick. Under present law, the WIN program has a limit
20 equally 100 percent of tax liability and, in the case of an
21 employer, not in a trade or business limited to \$1,000. I assume
22 you were not intending to change those criteria.

23 The Chairman. \$1,000.

24 Mr. Lubick. \$1,000 credit.

25 The Chairman. Mr. Stern?

1 Mr. Stern. Senator Moynihan's proposal suggests that you
2 do it on a basis of two employees, are translated in those terms,
3 if you are not in a trade or business.

4 The Chairman. Two employees?

5 Mr. Stern. Yes, sir.

6 Senator Nelson. Do we have any breakdown of the description
7 of the jobs that have been taken by people under the WIN program?
8 Do we know how many? Could we get a copy of that?

9 Mr. Galvin. I will give you a copy of the last annual report
10 which shows a breakdown of all the jobs. They range from service
11 to manufacturing certain types of other industries in the manufac-
12 turing field.

13 Senator Nelson. It would be helpful if we could have it.

14 The Chairman. We would not have \$1,000. You could not
15 have more than two employees if you were not in a trade or business.

16 Mr. Stern. Yes, sir. That would be translated into dollar
17 terms.

18 Senator Dole. It does not apply to households, does it?

19 Mr. Stern. That would include household employees.

20 Senator Danforth. This is not refundable now?

21 Mr. Stern. That is correct.

22 Senator Danforth. Has any thought been given to making it
23 refundable?

24 Senator Talmadge. I do not think that we ought to make it
25 refundable.

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1 Senator Danforth. Why?

2 Senator Talmadge. We want people who are in legitimate
3 business paying these people, making employees out of them who
4 will be productive citizens and earn a living for themselves and
5 their families. That is the way it is working now, and it is not
6 refundable.

7 What we are doing is liberalizing it and taking some of the
8 red tape out of it where we think it will be more effective.

9 Senator Danforth. Supposing a hospital were to hire these
10 people and it was a nonprofit hospital. Why would we not want
11 to encourage that?

12 Senator Talmadge. Do you have any answer to that, Mr.
13 Galvin?

14 Mr. Lubick. theoretically, it is a case of wages that are
15 not claimed as a deduction. In the case of a trade or business,
16 you are denying the deduction. Theoretically, you should include
17 in taxable income the wages of the person in the trade or business.

18 The Chairman. Why do we not say if you are not in a trade
19 or business you get a 50 percent tax credit? We start out with a
20 50 percent tax credit and then it would be deductible.

21 If you say it is a 50 percent tax credit, if you are not in
22 a trade or business you get a 50 percent tax credit; if you are
23 in a trade or business, you get an 85 percent tax credit.

24 Senator Talmadge. That sounds all right with me.

25 Senator Dole. Did I understand it right? Maybe I should

1 now. If I found somebody on welfare and hired them to do house-
2 hold work, would I get the credit?

3 Senator Talmadge. 50 percent up to two employees.

4 Senator Dole. I could have a driver and a maid?

5 Senator Talmadge. That is true, under present law.

6 Senator Dole. It is not who gets the benefits, but the fact
7 we take somebody off the welfare rolls.

8 The Chairman. The point is, we want them to hire somebody
9 that you are targeting. You want them to consider hiring somebody
10 who is a hard-core poverty case, and that is hard to get them to
11 hire. Perhaps they have a person with a lot of recommendations and
12 a good work record and all of that on the one hand, but he wants
13 to hire this person who has never has a job and has poor work
14 habits and feels the world is against him, that sort of thing,
15 and you get him to hire that person. You need a tax credit.

16 All in favor, say aye?

17 (A chorus of ayes.)

18 The Chairman. Opposed, no?

19 (No response)

20 Senator Danforth. Mr. Chairman, I would like to ask if
21 any analysis has been made as to either the Treasury consequences
22 or the hiring consequences of making this refundable? It would
23 seem to me that the kind of enterprises that are nonprofit would
24 be exactly the kind that would probably be the most logical
25 ones, the most sensitive, to try to provide jobs for the unemployed.

1 Hospitals, schools, colleges.

2 Senator Nelson. I think that is a good point.

3 Senator Bentsen. I do, too.

4 The Chairman. Here is your point about refundable.

5 Mr. Lubick. I understand that the nonprofit organizations
6 are eligible to receive direct grants from CETA to hire these
7 people.

8 The Chairman. Is that right?

9 What I am concerned about, if we get into this, I am afraid
10 we are going to have this bill referred over to the Appropriations
11 Committee. What I would like to do, what you would like to do --
12 I think we have to go to the Appropriations Committee and get
13 into a big fight with the Budget Committee about this point.

14 I am for it, but if you have the concept, I do not want to
15 get into a budget fight necessarily. If the CETA people would
16 make grants to hire people for the same thing, maybe we ought
17 to rely upon that, rather than to get into the tax credit fight.

18 Senator Nelson. The CETA program would not address itself
19 to personal service of this kind.

20 The Chairman. Even a hospital? Even a nonprofit hospital.

21 Senator Nelson. I do not think so. It would have to be a
22 business. We did not address the nonprofit one. They are not
23 included. It has to be a trade or business, no service, personal
24 service.

25 Mr. Galvin. They are eligible for direct grants, are they

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1 not?

Senator Nelson. No.

2

Mr. Galvin. Under the CETA program, they are eligible for

3

direct grants.

4

Senator Nelson. Not for personal services.

5

The Chairman. Personal service -- a person working in a

6

hospital?

7

Senator Dole. They are talking about maids and chauffeurs.

8

Senator Nelson. Public service.

9

Senator Talmadge. They should not have a grant from the

10

government to hire a maid. That would be absurd.

11

Senator Bentsen. Working in a hospital where they are clean-

12

ing up or something else, that is not called personal service?

13

Senator Nelson. Public service.

14

The Chairman. I think we are in pretty good shape for this.

15

All in favor, say aye.

16

(A chorus of ayes.)

17

The Chairman. Opposed, no?

18

(No response)

19

The Chairman. The ayes have it.

20

Senator Curtis. Mr. Chairman?

21

The Chairman. Let me go by this list.

22

Senator Nelson. It is understood that we will try to get

23

together with Herman and Pat?

24

The Chairman. Yes.

25

1 Senator Talmadge. I am in favor of doing something about
2 the structurally unemployed, but I would like to keep it separate
3 from the WIN program because it has seven years of proven success.
4 I support your targeting.

5 The Chairman. I would hope that we could do business on the
6 basis that I will try to give every Senator a chance to offer
7 something this morning, but I would hope that when I call on a
8 Senator, offer whatever you want to offer, that each Senator can
9 offer an amendment and we will give everybody a chance to get in.
10 Otherwise, I am willing to accomodate somebody who has to leave
11 town and cannot come back. They have offered a shopping list. I
12 would like to give everybody a chance to suggest what he wants.

13 I think you ought to take turns, so if you want to offer an
14 amendment, I will call on someone else. I have Senator Packwood
15 down and Senator Gravel, Senator Hansen, Senator Curtis, Senator
16 Matsunaga, Senator Bentsen, Senator Moynihan and Senator Danforth.

17 Senator Packwood?

18 Senator Packwood. Mr. Chairman, often when we act in haste,
19 there are some consequences of some things that we did not inten-
20 ded. When we adopted that Gravel amendment yesterday relating to
21 hunting lodges, yachts and country club dues, no mention was made
22 of season tickets at coliseums. I do not know about most of the
23 other coliseums, but the one in Portland is municipally owned,
24 and most of the seasons tickets are sold to businesses. They may
25 take them as a business deduction.

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I am not arguing the case for businesses, but the ownership of the coliseum is worried if, indeed, that amendment applies to seasons tickets to boxes or seats, it is going to hurt their revenue. I do not think we intended to apply it to that, but I want to make sure, in the drafting of this, that it does not apply to that kind of situation.

We do not have any of the so-called sky suites. The Chairman. We are losing money in our stadium now. I hope the Committee did not vote to have them lose a lot more?

Mr. Lubick. You did not vote for it anyway. The Chairman. I know, but I hope the Committee did not.

Mr. Lubick. We never viewed that proposal as applying to entertainment of the ticket sort. Whatever the accommodations are, that they are for the purpose of viewing entertainment, that we do not call a facility.

Senator Dole. That covers theatres and stadiums, to take care of New York and the Kansas City Royals?

Mr. Lubick. Right.

Senator Hansen. If we could, before we leave this, Mr. Chairman, let me just make an observation. I agree with Senator Packwood. Sometimes I think we fail to perceive the ramification of some of the actions we have taken. I heard from people in my state of Wyoming who are concerned about the exclusion of country club dues and at this point, it is pretty hard to grow a tree or have a green blade of grass out there, and in many, many little

1 towns in Wyoming, the country club is the one attractive place.
2 I think in big cities, it also provides some open space, and I
3 would hope that if the enforcement is a problem -- I do not object
4 to that, if you want to make a limit on what is a reasonable
5 amount that can be charged off as dues as a business deduction.
6 I would be all for that. But I would hope that we do not just
7 flat out say that you cannot charge a reasonable annual membership
8 fee and dues up to a legitimate business expense because, if that
9 is done, my guess is you are going to wipe out a lot of green,
10 open space through all of America that I would not think is all
11 that good of an idea.

12 I would invite Mr. Lubick to comment, if he would.
13 Mr. Lubick. Senator, I believe that you did include club
14 dues. They are defined as facilities under present law. That
15 was the intention. It was not the intention to apply it to the
16 eating club facility, that which is primarily for eating purposes
17 as opposed to the club that furnishes golf facilities or tennis
18 facilities or the like, and that distinction is already on the
19 books.

20 But I think we indicated in our colloquy with Senator
21 Packwood while the dues are treated as facilities, the expenses
22 of participating in the activities, the cost of the meals, the
23 cost of entertainment charges that are made at the club, remain
24 under present law and it was simply the dues that were referred
25 to, the dues and the initiation fees that were referred to.

1 Senator Packwood. Let me ask you a question -- again, it
2 had not occurred to me yesterday. What do you do with the golf
3 clubs and the sporting clubs that have a dual kind of membership,
4 eating club and social, not using the athletic facilities?

5 Mr. Lubick. Under present law, that sort of club is not
6 eligible. Under present law, it exempts from the facilities
7 provision a club which is just used as an eating club, the theory
8 being that it is like a restaurant and you are paying for your
9 meals partly in advance.

10 Senator Packwood. I understand that. You have many people
11 who belong to country clubs that use them for eating clubs, and
12 they only have basically an eating club membership and paid an
13 eating club dues.

14 Mr. Lubick. It would give me no trouble if you wanted to
15 clarify that and wanted to say, if your membership privileges
16 are confined to eating. The logic, I think, is the same. If all
17 you are paying for is eating, whether you are paying for it
18 upfront or currently, I do not think it should make any differ-
19 ence.

20 Senator Hansen. Mr. Chairman, if we could, I think it
21 might be useful and worthwhile for staff to examine the subject
22 to see what could be done by way of clarification so as to insure
23 that we do not put a lot of clubs out of business. I do belong
24 to one club -- it is an endangered species club. They call it
25 the Capitol Hill Club. Aside from that, I would hope that we did

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1 not put out of business a lot of country clubs throughout all
2 of American which I think make a significant contribution in
3 open space and beautification and in providing an opportunity
4 in smaller towns in Wyoming -- and in many other areas, I am
5 sure -- for people to carry on legitimate business.

6 If staff might look at that and see if there is a reasonable
7 compromise that could be reached, it would be pleasing to me,
8 Mr. Chairman.

9 The Chairman. All right.

10 Mr. Gravel?

11 Senator Gravel. Thank you, Mr. Chairman.

12 Mr. Chairman, I am going to ask my staff to pass out a
13 brochure that we prepared. This is on the GSOP. By preface,
14 there is an outline. I have brought it up before the Committee
15 before. There was some misunderstanding, and we have cleared it
16 up.

17 Senator Dole. Is this what I promised to vote for if you
18 promised to vote for indexing?

19 Senator Gravel. That is exactly right. If you leave the
20 room, just leave your proxy here. I would not want to confuse
21 our arrangement with the facts.

22 Mr. Chairman, this legislation focuses on the capital
23 concentration that exists in our society. The top 1 percent of
24 the American citizenship owns 25 percent of our wealth and 50
25 percent of our corporate stock. These figures come from a study

1 that was done three years ago by the Joint Tax Committee. I
2 think, even before this Committee, which was the first one of its
3 kind, and it has been substantiated by a couple of academic
4 studies.

5 Before it was done, it was really felt in our society there
6 was a great injustice, and we tried to cope with this injustice by
7 pursuing policies which in point of fact hindered economic develop-
8 ment, and those policies were income redistribution. I think that
9 we can have both equity and growth, if we can devise new financing
10 techniques for corporate growth, and the proposal that I have is
11 setting up GSOPs which is a private corporation which would receive
12 special tax treatment.

13 The acronym, GSOP, stands for General Stock Ownership Plans.
14 We talked in terms of expanding the capital -- and I am sure this
15 legislation that is going to come out of this tax committee -- is
16 going to be dealing with the expansion of a great deal of capital.
17 The point should then be asked, who is it expanding it too?

18 I think we have a responsibility to see that it is drafted as
19 broadly as possible.

20 The structure of this corporation we would have, it would
21 be a state-chartered corporation. The shareholders would control
22 the corporation by voting their stock as if it were a private
23 corporation. The corporation would make investments which would
24 be self-amortizing, increasing, as time goes on, the shareholders'
25 equity.

1 In addition to building the equity, the corporation would
2 pay dividends which would increase the income of its shareholders.
3 As this would apply in Alaska, I would have in law that a study
4 be done and reported back to Congress what the impact of this
5 activity would be so that this Committee and the other committees
6 of Congress and the Executive could assess what all is transpiring.
7 Here are the changes that would take place in the tax law.

8 The corporation itself would be tax-exempt, but the share-
9 holders would pay tax on their proportionate share of corporate
10 income, similar to a Subchapter S corporation already in law.
11 The income of the corporation would be computed --

12 Senator Curtis. Do you mean they would be treated as a
13 partnership?

14 Senator Gravel. Similar to a Subchapter S. It is not a
15 partnership, but it would be given the same tax treatment as is
16 given Subchapter S. No difference in that.

17 Senator Curtis. Does that mean that they would be liable
18 for their share of the earnings paid out in dividends, or not?

19 Senator Gravel. That is right. As you see later, it has
20 to be paid out in dividends. They cannot have retained earnings.
21 The income of the corporation would be computed in the normal
22 manner and distributed out to the shareholders annually. That
23 would be mandatory. The net losses of the corporation would not --
24 and I want to stress would not -- be deductible by the shareholder.
25 That would have other features of the tax law which we do not want

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1 to have people sharing in.

2 These losses would be carried over at the corporate level
3 and could be used to reduce the taxable income of the corporation
4 attributable to the shareholders in later years.

5 The major points of this whole proposal are the following
6 three. It is called corporate integration. This is something
7 that was endorsed by the last Administration and the present
8 Administration, under Bill Simon. This proposal was endorsed, and
9 the blueprints for basic tax reform, in January, 1977.

10 It was also endorsed, in concept, by the Carter Administra-
11 tion in its efforts at corporate tax integration that has not come
12 to pass.

13 There are two key things that must be kept in mind because,
14 as I have explained it to most of you privately, the question
15 always comes up, is this a giveaway? Giving something to people,
16 like welfare. It is not a giveaway.

17 The GSOP stock would be issued to all of the citizens of
18 the sponsoring state. No cash investment would be required of the
19 stockholder because the GSOP would borrow the funds necessary for
20 profitable investment. The loan would be secured by the GSOP
21 assets and a state guarantee, if the state chose to give it a
22 guarantee.

23 As the loan is repaid, the citizens of the GSOP would
24 increase their equity. This type of financing is not unique.

25 The rich often borrow money on a nonrecourse basis for investment

1 in profitable enterprises. They use their profits to repay those
2 loans, leaving themselves with an increase in net worth. The GSOP
3 would simply allow the poor and middle classes access to the same
4 credit devices that the wealthy use. So, at the beginning, there
5 is no value to the stock. It is not a giveaway, because the stock
6 has to go earn itself through the investment itself.

7 So that when you are giving a piece of paper, that is all
8 it is -- a piece of paper. It is fully leveraged, and as the
9 debt is repaid, then the paper acquires value. In the beginning,
10 there is no giveaway at all, no more than what you and I do in
11 investments.

12 The key question that is asked, is it state ownership? The
13 stock of the GSOP would be held by the citizens of the state in
14 question. They would vote this stock. They would vote for a
15 board of directors which would have the responsibility to run the
16 GSOP in a profitable manner. The GSOP would be run in the same
17 manner as a typical business corporation. The only -- and I want
18 to underscore this -- the only role of the state in a GSOP would
19 be the chartering of the corporation and, if necessary, if it chose
20 to do it, the guaranteeing of the loans, and that is the extent of
21 the government involvement.

22 The rest of it is just like a normal corporation, arms
23 length from the state.

24 That, essentially, is the concept involved.

25 Senator Curtis. If the Senator would yield for a question?

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1 Senator Gravel. If I could finish one more thought.
 2 Why a GSOP? We are drawing capital from our economy which
 3 could be used to produce wealth and we are transferring this capital
 4 to people who are in need, and what the General Stock Ownership
 5 Plan is is a means of achieving widespread ownership without
 6 confiscating the property of the wealthy and without creating any
 7 monolithic, socialistic state. That is essentially all that this
 8 plan is.

9 I just want to go back to the figures I gave you before,
 10 that is that 1 percent of the people in this country own 25 percent
 11 of the wealth, and they own 50 percent of the stock, and in my
 12 mind, that is a serious indictment of the success of our capital-
 13 istic, free-enterprise system.

14 Senator Curtis. Now may I ask a question?
 15 Senator Gravel. Please.

16 Senator Curtis. Do you have anything in here in reference
 17 to the power to sell a share of stock? I am thinking of the fact
 18 that this goes to every citizen, and you mentioned the AFDC
 19 clients, and I am sure it will go to certain native Americans.

20 During the early years they would not be paying a dividend
 21 and it would have no apparent value.

22 Do you think they ought to be protected from someone going
 23 around and picking up share after share for a nominal sum of
 24 money?

25 Senator Gravel. I agree with you. I think they should, and

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1 I think that it should be done within the corporate charter.
2 Let me tell you where you are at at the present. I cannot speak
3 to the press, to the nation. This is a new idea that was origina-
4 ted -- and I have it focused on Alaska.

5 I went to the state legislature in February and suggested
6 this approach. The state legislature appropriated a quarter of
7 a million dollars. They have now signed a contract with Kelso's
8 firm in San Francisco to design the structure of the corporation
9 what this would permit under Federal tax law. The engineering
10 for that corporation has to now take place, and that is why I
11 would require a study so that we could then see what that is.

12 I agree with you, we should have an alienation clause.
13 Maybe it would be for five years, that you could not alienate
14 the stock. Maybe you can only alienate it if you pass a test that
15 you know about what a corporation is and what stock is and what
16 profit is. Maybe we would have a restriction that one person
17 could now own more than five shares of the stock within the
18 state.

19 You have the difficulty of establishing rolls upon which
20 we can draw on our experience that we learned from the Native
21 Claims Act in Alaska. We set up a roll and made native Americans
22 stockholders in a corporation. People had a very high illiteracy
23 rate. Now they sit at stockholders' meetings in Alaska and deal
24 with their problems.

25 Senator Curtis. Would this only be on state-owned land?

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1 Senator Gravel. No, it would not. The original proposal
2 that we are dealing with in Alaska, and it has an interesting
3 facet -- my first endeavor in Alaska would be to acquire maybe
4 15 percent of the pipeline. I do not think this kind of corpora-
5 tion should not get into majority-owned management. It should be
6 professional.

7 When you get to the breakdown of figures, it shows you that
8 Treasury can probably make close to \$100 million a year off this
9 process. Very simply, if we bought out one of the parties that
10 filed this public data, we would see that they have their income
11 leverage for the next seven to ten years and if we take over that
12 interest, that income will no longer be leverage and the people
13 of Alaska will receive that income and pay taxes on it and that
14 will average out to about 25 percent per person tax.

15 Senator Curtis. If your state charter permits and the
16 state decides that they will have the power of condemnation to
17 acquire assets, does your bill propose they would still get these
18 tax effects?

19 Senator Gravel. I had not thought of state condemnation.
20 I would be opposed to state condemnation to do that.

21 Senator Curtis. Would you object to a proposal that these
22 benefits would not be granted if the property were acquired with-
23 out the consent of the owner?

24 Senator Gravel. The difficulty would be --

25 Senator Curtis. Conceivably, this could be put in the hands

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1 of somebody fifteen or twenty years from now that decided to
2 nationalize all of your industry in Alaska.
3 Senator Gravel. First of all, it is not nationalization,
4 it is not state ownership, one. Two, this has a sunset provision.
5 This only goes for five years.
6 I, myself, recognize that it is a pioneering effort and am
7 concerned, so it has a sunset provision. It will come back to us
8 within five years. You will have studies about what happens in
9 Alaska and you could put a restriction on condemnation.
10 I think if you put a restriction, like on the pipeline, if
11 you had such a restriction, you could say that maybe somebody
12 owns 1 percent of the pipeline and does not want to see the people
13 of Alaska own 15 percent of it and would exercise, saying, no
14 we do not want them as partners.

15 Senator Curtis. I am talking about the owner of the property
16 that your GSOP project acquires.
17 Senator Gravel. If the owner does not want to sell, I do
18 not know how we could buy it. If you have a condemnation restric-
19 tion --

20 Senator Curtis. Why do not you condition these tax benefits?
21 Senator Gravel. To a condemnation? I would go for that.
22 Senator Curtis. To properly acquire, other than by condemna-
23 tion, any involuntary method.
24 Senator Gravel. Very much so. I think the condemnation
25 would be for this kind of trial period, a five-year period. I

1 accept that, and it is a good suggestion.

2 Senator Hansen. Just one question. I do not know what
3 the laws governing residency are in the state of Alaska. There
4 has been a considerable change with the election reform, and now
5 in order to vote in many states, all you have to do is be in the
6 state maybe ten days or declare your intention. Do you envisage
7 any problems in trying to determine who are Alaskans?

8 Senator Gravel. Very much so. It would be a little differ-
9 ent. With the Native Claims, we took people of one-fourth blood
10 and then they became automatic stockholders. In this case, we
11 would have to develop a different definition. That is what this
12 engineering is that would have to be done.

13 I can give you off the top of my head one of my suggestions
14 of how we would do it. We would say as of a date certain -- last
15 January 1st, for example -- that anybody who was a resident of
16 Alaska -- and you define resident, birth, a person who has had a
17 job for X period of time, pays a telephone bill X period of time
18 or has a residence for X period of time -- he is a resident.
19 Then you would close the rolls.

20 Every one of those individuals would be issued a share of
21 stock. If the person shows -- with time, the stock will acquire
22 value. Supposing a person -- which is customary in our state,
23 because retired people cannot afford to stay in Alaska; it costs
24 too much, so they have to leave. So they go -ack and they are
25 required to go to the GSOP and say look, I am leaving Alaska, I am

1 65, 70 years old. I want to go down to Palm Springs, buy back
 2 my stock. They would have to buy back the stock. It would then
 3 become Treasury stock.

4 The people who would be coming into Alaska, the first thing
 5 they would do would be to pass by the GSOP office, sign up and
 6 say, okay, I am now a resident of Alaska, here I am, here is my
 7 address and put me on your list. Just as we have a list here on
 8 a first-come, first-served basis, they could then acquire the
 9 GSOP stock in the same way it would be issued to them, and they
 10 would not put up any money, but through the repayment, it would
 11 then acquire equity.

12 Maybe five years later or three years later you would open
 13 up the rolls again to the new base of population with the new
 14 projects you would go into, so maybe over a 50-year period a
 15 person who was there five years who would own Class A stock a
 16 person of ten years would own Class A and Class B; a person
 17 for fifteen, Class A, Class B, Class C. The longer you stayed,
 18 the wealthier you would become.

19 Also, I passed out a sheet showing the savings from welfare
 20 that we could receive -- \$1.5 million. As we distribute these
 21 dividends, if we expect to get the dividends that are here for
 22 this one particular case, they will not be receiving a welfare
 23 check because this income would be deducted from their welfare
 24 proposal.

25 The Chairman. I would suggest, Senator, that you limit

1 your proposal to the production, transportation and processing
2 of mineral resources, if that is what you have in mind. Do you
3 have mineral resources in mind, produced within the state? You
4 are talking about having an equity interest in the processing
5 and transporting of that, do you not?

6 Senator Gravel. We do, Mr. Chairman. That did start out
7 as my first idea. In talking to other interested parties in
8 Alaska -- one, a large communications concern which is always
9 interfacing with government, and they may be interested in
10 possible involvement.

11 For this five-year study period, I would hope that we could
12 leave as many openings as possible to try various things and
13 then report back to the Congress our success or failure and have
14 a better evaluation, so we would know how to go forward. To limit
15 it to energy if that were necessary to get it passed, fine.
16 But I would hope that we would recognize that it is a prototyping,
17 and in a prototyping, you want to see how the plane can fly up
18 on its side or upside down and every which-way and then give it
19 the evaluation.

20 I would hope that we could just leave it.

21 The Chairman. As I understand it, the Treasury is more
22 receptive to this proposal than it was to the previous proposal.

23 Mr. Lubick. We have worked with Senator Gravel to try and
24 make the idea fit the framework of the general principles that
25 exist in the tax law, and I think that, in every respect, except the

1 one he is talking about, I think that he has accommodated the
2 arrangement to the existing tax laws so that it can all be done
3 without any amendment. The one deviation that requires tax
4 legislation is to, as the Senator points out, integrate the
5 corporate tax with the underlying shareholders and, in that
6 regard, we used the analogy of the taxation of cooperatives,
7 the regulated investment companies or Subchapter S companies that,
8 in effect, you have a single level of taxation of the current
9 income of the corporation, you do not have any deferral, you do
10 not have any exemption. The income is all taxed currently, but
11 it is taxed once at the shareholder level.

12 The result of this is to have a tax at the shareholder
13 level on the excess of the amortization of the principal of the
14 loan over current depreciation, if there is any.

15 Other than that, since it is contemplated that current
16 earnings are going to be distributed anyway to the shareholders,
17 the only problem that they can have, there may be some amortiza-
18 tion of principal not received in the form of current distribut-
19 tion on which they would have to pay tax.

20 Presumably, the distribution of the balance of the earnings
21 would be more than adequate to finance any tax liabilities that
22 there would be on this, and since there is to be broad ownership,
23 presumably most of the persons may indeed be in very low brackets
24 or indeed, not taxable anyway.

25 Within that concept, we think Senator Gravel has brought his

1 proposal primarily within the range of existing tax law and,
2 with respect to that one deviation, he is within principles that
3 already have been enacted in other areas of the tax law, so that
4 we think that it is certainly supportable on that basis.

5 It is our understanding that during the experimental program
6 that the eligibility would be limited to corporations that have
7 the characteristics which Senator Gravel has described -- broad
8 stock ownership, some limitation on alienation, some limitations
9 on acquisition, and I think that those will have to be worked out
10 some way, but I think that those should be conditioning limitations
11 on the corporation, which is eligible, so that we do have a some-
12 what unique creature and one that we can view on this experimental
13 testing basis.

14 Senator Gravel. Mr. Chairman, we will be working in the
15 structural design of this corporation very closely with Treasury,
16 because it would serve our purposes very nil to have something of
17 an experimental nature that they were opposed to going into, if
18 we want the thing to work, to see what could happen, what could be
19 done to broaden and make more capitalists in this country. The
20 study would be tied in with a university, something like Wharton,
21 Harvard Business School or Stanford Business School and, rather
22 than creating a model, actually use the state of Alaska, which
23 has some 400,000 people isolated to measure inflation, measure
24 impact on work habits, impact on savings, impact on knowledge
25 acquisition, and make an annual report to the President and to the

1 Congress, and hopefully to try to analyze it through the
2 performance.

3 Senator Danforth. Mr. Chairman, I do not understand
4 Treasury's response, Mr. Lubick's response. Does the Administra-
5 tion support this concept?

6 Mr. Lubick. Yes, Senator. I think Senator Gravel has
7 changed the proposal very considerably from what it was originally
8 and the only tax change that he is asking is to fashion this type
9 of corporation on the model of a cooperative or regulated invest-
10 ment company or Subchapter S corporation.

11 Senator Danforth. Does the Administration support the
12 policies served by this?

13 Mr. Lubick. Well, I think that is really not something we
14 have addressed ourselves to. Basically we are concerned whether
15 to accomplish this purpose has been able to do so within the
16 framework or sound principles of tax policy, and I think that
17 test has been satisfied.

18 The question as to whether the state ought to broaden the
19 ownership of resources within the states, among all of its
20 residents, is not a question, certainly, that we at Treasury have
21 addressed ourselves, or have particular confidence to do.

22 I think I have a lot of sympathy with the objective, which
23 is to encourage broad ownership and a feeling of many persons
24 to have a stake in property in the state in which they reside.
25 I think it is rather hard to quarrel with that objective. But I

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1 think as a question of official Administration policy, I do not
2 think that is for us to make a pronouncement.

3 The Chairman. It seems to me it can become a philosophical
4 matter. The state has a lot of resources. The people up there,
5 I would think, if they could, would like to see in developing those
6 resources that the people wind up with some equity interest in
7 their resources. Down in Louisiana, we used to have this type
8 of thing before the days of big conservation practices. Companies
9 would come through and cut all the timber and they would pull
10 the timber up to the mill and rip up all of the landscape, so it
11 tore up all of the underbrush.

12 By the time they got through, you had something that looked
13 like a plowed field with no growth at all. You did not have
14 any trees there for another 30 years. By the time they got
15 through harvesting all of those resources, we are saying, they
16 would pick up and leave and say goodbye, my honey, I am gone.
17 And there the people would be left with the denuded land, no
18 resources, nothing to live on.

19 Of course, that is the old way of doing business. The
20 Senator is seeking to try to move towards a situation where his
21 people would have a small equity interest in the development and
22 transportation and sale of their own resources. It does not do
23 any violence to Federal law. I do not think he is seeking any
24 more than what we are already doing for the REA, except the
25 REA is borrowing money with rates from the Federal government.

1 Those farmers with those poles -- you put those poles in
2 the ground, extend the line and grandpapa, over his lifetime,
3 when he dies, some of these REA's have a policy of sending
4 grandpa a check for his share of equity in the distribution
5 money. This is a parallel to that.

6 The state buys something there, something for sale -- and I
7 go along with Senator Curtis. The last thing I want to do is
8 put pressure on and make them sell, but if they have an equity and
9 they want to sell and the state buys it and lets the citizens help
10 buy it, that then, because the average citizen has a much lower
11 tax rate, if he can have the benefit of the Subchapter S corpora-
12 tion, in effect they have a better tax treatment than the persons
13 to whom they are buying it.

14 And hopefully, it would be a good deal. It would not be
15 taking people in if it was not a good deal for them.

16 Is this correct? It does not cost the Treasury anything
17 to do that?

18 Mr. Lubick. I think that is correct, Senator Long. I
19 think that we would like to see it limited in the areas that Senator
20 Gravel has been talking about, at least for the time being.

21 We, of course, would not like to see a situation where you
22 have an undue competitive advantage. If you are talking about a
23 retail business of some kind, I do not think you would want this
24 type of business extended to that, where you have integration with
25 a corporate tax for one kind of ownership and not for the

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1 competitor. I do not think you have that problem in the pipeline
2 situation, and in the situations where you do not have a normal
3 competitive situation. I think that one of the lessons that
4 Senator Gravel's proposal would attempt to teach is whether
5 indeed we can work out integration, whether or not it works in
6 this particular area.

7 This is why I think it must be narrowly confined for the
8 construction period.

9 The Chairman. To see how it works.

10 Senator Curtis brought this point up, and I agree with him
11 about that. We have a provision in the ESOP law that says you
12 cannot divest yourself for a certain time. Is that five years?

13 Mr. Shapiro. I think five years is right, Senator.

14 Senator Gravel. I would be happy with that, too.

15 The Chairman. You see, during the trial period, there
16 would be a lot of people who are likely to sell it. Give me a
17 dollar for it, something that later on would be worth something
18 to them. I think there should be a provision like stock. You
19 cannot sell it for a certain period of time.

20 Would five years be all right?

21 Senator Gravel. I accept that.

22 Mr. Shapiro. ESOP is seven years.

23 The Chairman. ESOP is seven.

24 Senator Gravel. Five years would be acceptable.

25 The Chairman. You have a five-year experiment, so five years,

1 you could sell it if you want to.

2 Mr. Lubick. I think that there is also a limited class of
3 transferees. I think Senator Gravel has suggested putting a limit
4 on the number of shares that any individual could acquire that
5 we would not have all this bought up by a very few persons.

6 The Chairman. Is that in there?

7 Mr. Lubick. I think that was the intention.

8 The Chairman. Do you have it in there, the limit to the
9 number of shares that that particular person can hold?

10 Senator Gravel. My thought was to do that. I was reserving
11 that for the corporation to decide, but if you want to do that,
12 too.

13 Mr. Lubick. I think that is significant. I do not know
14 if you want to confine ownership to residents of Alaska.

15 Senator Gravel. We would have a difficult time today to
16 find a resident. Why not limit it to ten shares.

17 Senator Curtis. Could nonresidents buy those shares?

18 Senator Gravel. No, I think there would be a restriction
19 on that.

20 Senator Curtis. Do you have any concern -- I am speaking
21 to Treasury -- that if Alaska elects to guarantee these loans
22 that that would have any adverse effect on other borrowers to
23 develop similar resources?

24 Mr. Lubick. Other borrowers? I am not quite sure what you
25 mean.

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Senator Curtis. If the state of Alaska would guarantee the loans that they made to develop these projects, there would be no such guarantee for a private company in developing similar resources.

Do you anticipate that that would cause any problems in available capital?

Senator Gravel. If I could answer that, first off, it would not have any tax effect. State government can guarantee any private loan it wants in any state within its jurisdiction. We have a request from the gas line to have some of their loans guaranteed by the state. The only thing that happens in the marketplace, you probably would get a more favorable interest rate.

Mr. Lubick can answer.

Mr. Lubick. The only problem that I saw, Senator Curtis, was the problem the state of Alaska may face. they may incur liabilities. I think the problem may have an effect on its credit standing but not on others.

The Chairman. If you are worried about that, I would think that the state legislature would have more flexibility, ordinarily, than the Congress of the United States. The state might pass a law when it sells somebody a lease and sells the corporation a lease and let the corporation pledge the lease against it, if it is a good lease.

That would be enough equity to back up the loan, but it seems

1 to me, though, that if you put in the provisions we are talking
2 about, you would have enough protection, unless you want to have
3 a dollar limit on how big a deal they could make it, how big it
4 could be.

5 Senator Gravel. I think five years; that would be the
6 structural limit.

7 Senator Bentsen. Mr. Chairman, it seems to me, if we go
8 into great deal trying to define this thing, we are really cramp-
9 ing some of the things that the state legislature would be inter-
10 ested in doing and quite capable of doing and better adapted to
11 their local traditions than we are.

12 The Chairman. I do not think that the governor or the
13 legislature is going to jump out there and pledge their credit and
14 pre-empt their credit, you might say, by getting into something
15 where they might regret it.

16 Down in the Louisiana legislature, every time they bring up
17 some deal that sounds like a great idea for somebody, they say,
18 let's hold on a minute, fellows. States learn pretty fast about
19 that type of thing.

20 With those modifications, as far as I am concerned, I am
21 agreeable.

22 Senator Curtis. Mr. Chairman?

23 The Chairman. Senator Curtis?

24 Senator Curtis. Am I next?

25 The Chairman. Shall we vote on this?

1 All in favor, say aye.

2 (A chorus of ayes.)

3 Mr. Shapiro.. One thing that we want to say is that there
4 are some conformity changes that are necessary to be worked out
5 and they will be worked out with Senator Gravel.

6 The Chairman. Without objection, agreed, then.

7 All in favor, say aye.

8 (A chorus of ayes.)

9 The Chairman. Opposed, no?

10 (A chorus of nays.)

11 The Chairman. The ayes appear to have it. The ayes have
12 it.

13 Senator Hansen is next, then Senator Curtis.

14 Senator Hansen. I will try to be brief. There has been a
15 series of hearings chaired by Senator Byrd on the capital gains
16 changes in the Tax Code. As they have been presented and been
17 discussed, we have had a number of economists and leaders testify,
18 including such persons as Martin Feldstein who was under a grant
19 from the Treasury. We have had various econometric models set
20 up by Data Resources, Merrill Lynch, et cetera, and
21 Arthur Leverett; Arthur Burns, former Chairman of the Federal Reserve
22 Board had a long article in Business Week. Secretary Blumenthal
23 and Chairman Arthur Miller have conceded that a reduction would
24 do some good and would generate revenue.

25 In addition to that, a number of important groups -- the

1 Association of American Railroads, the Machinery Allied Products,
2 the Association of Wholesale Distributors, the National Taxpayers
3 Union, the Chamber of Commerce of the United States, the Associa-
4 tion of Textile Manufacturers and the Business Roundtable, to
5 mention a few, I think have come down in support of the idea of
6 reducing capital gains.

7 There is no agreement as to the effect that it will have
8 in the creation of jobs, how much venture capital will flow into
9 the kind of job-creating activities, how much it may help the
10 economy, how much it will help our competitive position with other
11 nations around the world. But there is almost included in this
12 list of persons and organizations to which I referred an agreement
13 that it is on the positive side.

14 Without belaboring the issue, I would like to move that 30
15 percent of the profit in a capital gains transaction be subject to
16 regular tax rates. In other words, what I am saying is that 70
17 percent of the capital gains profits would not be subjected to that
18 tax. I would be, as I understand and have followed the discus-
19 sions, subject to two alternative minimum taxes, to assure -- as
20 you have said repeatedly -- that no significant income receiver
21 escapes taxation.

22 I think that we would be giving the kind of signal to the
23 business world that could result in the generation of considerable
24 activity. It would have a favorable effect on the economy.

25 I think also -- which I have not mentioned before -- that it

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1 would give a renewed surge of confidence to this country that our
2 military position would not be further impaired because of the
3 exploitation of American technology.

4 Let me point out that we have had visits, we have had some
5 testimony from military people that it is the consensus. One of
6 the ways that America has kept on top has been to encourage
7 bright minds to work on new concepts and then to insure that this
8 spin-off from this kind of activity accrues first to the United
9 States.

10 Just in less than a few of the ten years, there have been
11 some new electronics organizations that have come into being in
12 California. They were unable, because of the changes in tax law,
13 to get the venture capital necessary to finance their operation.
14 As a consequence, they had to go abroad to Japan and West Germany,
15 each of which companies got exclusive selling rights on ideas
16 that unfortunately will be shared with the rest of the world and
17 not give us the edge that would have been available to us had
18 we been able to get people to put cash in venture risk operations
19 that admittedly are risky and have to have better tax treatment
20 than is now available to them before they take that chance.

21 Senator Curtis. I think that it is very, very imperative
22 that we have capital gains tax relief. I want to commend the
23 distinguished Senator from Wyoming and the distinguished Senator
24 from the Committee for the foresight in that regard, and I am
25 happy to see that there appears that they are pretty much together

1 on their proposal and I hope that it can be adopted.

2 The Chairman. Senator Byrd?

3 Senator Byrd. Mr. Chairman, I want to commend my colleague,
4 the Senator from Wyoming, Mr. Hansen, for the leadership that he
5 has taken in this vitally important matter of bringing about a
6 more equitable tax on capital gains.

7 Senator Hansen almost single-handedly accumulated the
8 signatures of 62 members of the Senate to reduce the capital
9 gains rate to a maximum of 25 percent, and that was a tremendous
10 job that Senator Hansen did. And I want to congratulate him.
11 I want to congratulate him as a Senator and also congratulate him
12 as a fellow citizen for the work that he has done for that.

13 I want to express just a slightly different viewpoint. I
14 am not in opposition to what Senator Hansen proposes, but a
15 slightly different viewpoint.

16 Senator Hansen, as I understand it, proposes to tax 30
17 percent of any gains that there might be which would mean a maximum
18 tax of 21 percent. I feel that this Committee made a mistake --
19 and I joined in with the mistake -- in 1969. It was compounded
20 in 1976 when the Committee put the capital gains maximum rate up
21 to 49 percent, and it is vitally important that it be reduced.

22 I personally feel that reducing it below 25 percent is going
23 perhaps too far in the other direction. My own preference would
24 be to tax 50 percent of the capital gains and then subject the
25 other 50 percent to an alternate tax rather than taxing only

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1 30 percent. I do not quarrel with Senator Hansen's proposal. I
2 feel it is going a little further than I would like to go. I
3 think there should be a reasonable tax on capital gains, and I
4 think a maximum tax of 25 percent is an appropriate figure.

5 The Chairman. If I may just make one point about what you
6 are saying here, no one should count their chickens before they
7 are hatched. If we vote for Senator Hansen's proposal here, we
8 are going to have to compromise with the House in conference.
9 The House has a reduction in capital gains, but the House has
10 what amounts to a 35 percent tax on capital gains.

11 So if we vote for this amendment, we are going to have to
12 think in terms of coming down somewhere between the 21 percent and
13 the 35 percent. I want to make it clear that what I have supported
14 my view -- I would have to withdraw my support and have to vote
15 to move for a substitute of some sort in the event that we are not
16 able to work out some other aspects of the bill.

17 For example, it is crucial to me that the bill be a balanced
18 bill. For example, that we do not run afoul of the criticism that
19 the President made when he brought up the subject of the minimum
20 tax and he was pointing out that there would be some people who
21 would escape taxes.

22 We would have to work out a good minimum tax and I hope an
23 improvement on the present minimum tax.

24 In some cases, there are people paying a minimum tax who
25 are already paying a substantial amount of taxes already. It

1 would be a substitute or an alternative tax rather than an add-on
2 tax, but that there would be a tax that would raise a substantial
3 amount of revenue -- not as much as the present one, but at least
4 it approaches that figure. But it would be better to target on
5 the people that are getting by without paying what they ought to
6 pay.

7 Also, if we can have a balanced bill that when we get through
8 considering things like the earned income credit and things of
9 that sort, we have a bill where people in all shapes up and down
10 the ladder are being treated fairly.

11 I would vote for it with the understanding, Senator, that I
12 would have to reconsider my position if you cannot work out the
13 matter of the minimum tax and the earned income credit and the
14 middle income things that would give us a balance.

15 Senator Bentsen?

16 Senator Bentsen. Mr. Chairman, I echo that, and I want to
17 say that I am going to vote for Senator Hansen's amendment which
18 I think is a good one and that will free up capital and keep
19 the mobility of capital and its better economic utilization and
20 put our capital gains tax somewhat more in relationship to what
21 the capital gains tax is in other western nations throughout the
22 world.

23 Ours generally has been substantially higher, and you have
24 seen it other places.

25 But I share with Senator Long the feeling that I do this

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1 only with the understanding that we get tax in the alternative,
2 that sees that people do not escape taxation and you do not have
3 people living off cash-flow in this country of several hundred
4 thousand dollars and paying no taxes. That destroys the confidence
5 in the tax system. You can never adequately explain it to the
6 fellow who is making \$15,000 or \$20,000 a year, and therefore,
7 we must not allow it to happen.

8 I think that the Chairman is working on a tax in the alter-
9 native where you put all the preference items in and then you add
10 them back to your taxable income and you put a rate on that.
11 That would see that you pay a reasonable tax, whatever it would
12 be, the higher of two. I congratulate him on that. I tried to
13 get a tax in the alternative in in '76 and was not successful for
14 that.

15 I also want to congratulate Senator Hansen on his leadership
16 in capital gains and I am sure when we get all through that this
17 one is not going to be the final product, that you are going to
18 have a compromise between what the Senate version is and what the
19 House version is.

20 And I am delighted that we are moving in the direction of
21 the targeted unemployment, the tax credit here, to try to see
22 that we get to the structurally unemployed. I think we are going
23 to see some major things in this tax bill that are going to help
24 move our society forward and try to get some of these people who
25 have not been a part of the economic scene where they think they

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1 are in the economic mainstream of our economy.

2 Senator Moynihan. I would like to join in congratulating
3 Senator Hansen.

4 Senator Gravel. Briefly, speaking philosophically, in our
5 economic peer group, which would be Western Europe and Japan, I
6 think West Germany is the only one that has a slight capital gains
7 tax. The others do not, and we do not come out very well in those
8 comparisons and I would be happy that we are moving in that direc-
9 tion because I think that would cause a readjustment in our
10 productivity.

11 Senator Nelson. Mr. Chairman, before I would want to vote
12 in favor of any proposal, I would like to see Senator Hansen's
13 or anybody else's -- the Chairman's plan, and what the others
14 are proposing laid out and let us see what the actual impact was
15 and I thought we were going to ask the staff to develop some models
16 to look at to see what the consequences of a proposal with an
17 alternative tax, with various brackets.

18 So as of now, I would vote against any proposal until I
19 see on paper what the impact is.

20 The Chairman. Could we do this? Could we vote on this with
21 the understanding that this is contingent on us agreeing on the
22 minimum tax?

23 Senator Hansen. Yes, sir.

24 Mr. Chairman, I tried to imply earlier that I thought that
25 it was generally agreed here that there would be, rather than the

1 present add-on minimum tax that really hits small taxpayers
2 extraordinarily hard, I have talked to a number of accountants
3 that says that under the present law, the effect of that has been
4 to wipe a lot of small taxpayers out when they get caught in the
5 regular brackets under the expanded income concept.

6 They be earning only \$15,000 or \$20,000 a year or less and
7 if they sell an asset that they have, a business or a piece of
8 land or something, and they take an add-on tax the way it is now
9 and what the House did, of course, was wipe that out and put on
10 is what I think is a very commendable substitute and an alterna-
11 tive tax.

12 It was with that concept in mind, rather than trying to spell
13 out all of the specifics, I thought that it made sense to propose,
14 as I have done this morning, making it applicable to the present
15 tax rates, 30 percent to the capital gains.

16 Now, if a person is in the lower brackets, in a 14 percent or
17 20 percent bracket, he would pay less, obviously, than would
18 someone else who conceivably, under my proposal, the top would
19 be 21 percent.

20 I think it should not go unobserved that, while no two
21 economists, as nearly as I know, agree precisely on the impact
22 that it will have on the Treasury, I think there is wide consensus
23 that this is not a static situation. Given this change in the law,
24 there will be a very decided movement of assets that have been
25 held pretty much in a frozen state because of the impact that the

1 present tax schedules have.

2 With these observations, if this is helpful, I do offer it,
3 recognizing that there are other things that are going to have to
4 be worked out, but I think that if we take it a step at a time
5 that we could proceed in a more orderly fashion.

6 Senator Byrd. Should we not include a motion on an alter-
7 nate tax of such and such a percentage?

8 Senator Hansen. I would be happy to have a recommendation
9 from my friend from Virginia, if he has a specific number. There
10 are some complications, because under the law, a number of
11 preference tax items come in, all of which, or some of which,
12 could be included in this alternate minimum tax.

13 The Chairman. Let me just get an estimate from the staff.

14 In terms of the minimum tax that we are talking about, we would
15 think that the last time that we were looking at it in terms of
16 the various suggestions by Senator Byrd and others, we were talk-
17 ing about a minimum tax on a graduated basis, and about how
18 much money were we thinking about that tax raising?

19 Mr. Shapiro. In the neighborhood of \$1.2 billion with a
20 70 percent exclusion.

21 Senator Byrd. What would be the alternate tax rate?

22 Mr. Shapiro. The alternate tax rate was to have a schedule
23 of 10 percent of the first \$40,000 with a 20 percent exemption
24 and a 20 percent rate on the next \$40,000 and then a 25 percent
25 on everything above \$80,000. It goes from 10, 20, 25.

1 Senator Bentsen. That is with all of the preference items
2 added in on top of your taxable income?

3 Mr. Shapiro. Yes. Only one exception in present law is
4 the one Senator Byrd had reference to and which was discussed. It
5 takes out state taxes from being included in the alternative.

6 Senator Byrd. State and local taxes.

7 Mr. Shapiro. State and local taxes.

8 Senator Byrd. In that connection, I am wondering if we
9 should not eliminate charitable contributions. Charitable
10 contributions are in no way a tax shelter. Money is paid out by
11 the individual; the individual gets no benefit from it.

12 Mr. Shapiro. The purpose of the provision including this
13 was to say there are some voluntary expenditures. If they gave
14 more than 65 percent of their income, they would pay some minimum
15 tax on it, so that those voluntary contributions are voluntary
16 minimums would not make them tax exempt so that they would be on
17 the list of those that pay no taxes.

18 If you were to take out some additional items, you would
19 be left with the only item that you would be taxing, in effect,
20 would be interest.

21 I should make one other comment --

22 Senator Byrd. Interest is the only preference item?

23 Mr. Shapiro. In the excess itemized deductions. When you
24 are talking about itemized deductions, you are taking out medical,
25 casualty and taxes.

1 Senator Byrd. Medical and casualty are already taken out.
2 That is not considered a part of the preference anymore?

3 Mr. Shapiro. That is correct.

4 What the proposal has added is an exemption that you sugges-
5 ted to the Committee.

6 The Chairman. When we first had this conversation, and the
7 talk about the so-called taxpayer revolts and all of that, we had
8 some Treasury studies back at that time that showed, back in the
9 1950's, people who made over \$1 million had managed to escape
10 without paying any tax would be mainly because of the unlimited
11 charitable contribution. Is that right?

12 Mr. Lubick. That is correct, Senator.

13 The Chairman. The way we closed that loophole was to say
14 that you could only deduct, that you could not claim the charita-
15 ble deduction for more than, I think, 50 percent of the income.
16 Is that right?

17 Mr. Lubick. Later on, as the tax shelters began to grow,
18 Larry Woodworth came up with this idea to see that people, when
19 they got through with their tax planning would not avoid all
20 taxes saying that they could not reduce, for the purposes of the
21 minimum tax, they could not reduce their adjusted gross income
22 subject to tax by itemized deductions down to more than 60 percent.
23 The itemized deductions to a person with the minimum tax could not
24 exceed 50 percent.

25 From that we agreed that that would not include medical

1 and casualty. We included that right at the beginning.

2 And Senator Byrd suggests -- and I think he is right about
3 it -- that it should not include taxes. That, then, gets you to
4 just this one point -- how much can you avoid paying the minimum
5 tax with a charitable contribution? You have charity and interest.
6 Those would be the two main items.

7 I imagine at this point we are just talking about the final
8 catch-all and you get to the point where they have done enough
9 tax planning, they have gotten around everything else that you
10 wanted them to pay, they got to the point, can they escape that
11 minimum tax by the final charity, the final contribution, if it
12 is charitable.

13 We have already said that the charitable contribution, you
14 cannot deduct more than half of it, and for purposes of the
15 minimum, I would think if you say, well, you cannot reduce the
16 part that would be subject to a minimum tax by more than a certain
17 percent, if the charitable contribution is doing it, it seems to
18 me you ought to have some limitation on it. Just as you say you
19 cannot give more than 50 percent or something like that -- you
20 just have the charity and interest. You cannot reduce it more
21 than the 60 percent.

22 You can make it, if you want to, that you cannot reduce
23 it by more than 70.

24 Is there much revenue involved in that?

25 Mr. Shapiro. Not much revenue, Senator. The particular

1 point in that one, the statistics show that the individuals
2 not covered under the 1969 changes, in most cases, were because
3 of itemized deductions and the statistics that you wanted to deal
4 with was to be sure that those individuals would pay some minimum
5 tax so they would not show as a nontaxpayer.

6 Senator Byrd. I notice that this tax proposal statement
7 given to the Committee, it does not include charitable contribu-
8 tions as a part of the preferences.

9 The Chairman. It is not a preference.

10 Mr. Shapiro. The way it includes it, the next to the last
11 sentence in the second paragraph where it says, "Excess itemized
12 deductions would equal itemized deductions other than medical,
13 casualty or tax deductions in excess of 60 percent of adjusted
14 gross income." The effect of that would be that you would look
15 at all of the itemized deductions except for medical, casualty and
16 taxes which has the effect of including the charity and interest.

17 Senator Byrd. It seems to me, number one, when a person
18 makes a charitable contribution, it costs him money. It does not
19 save him money. There is no way you can save money by making a
20 charitable contribution. If you include it in the minimum tax,
21 then you are making it easier for the charitable organizations to
22 obtain their resources.

23 Mr. Shapiro. The charitable contribution alone would not
24 make it a preference item because, as Senator Long pointed out,
25 there is presently a 50 percent limit on charitable contributions.

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1 You cannot give more than 50 percent.

2 This means that if you had more than 15 percent of other
3 itemized deductions, but not including medical or casualty or
4 taxes, that the interaction of the charitable plus the interest
5 or others -- if someone just had the charitable contributions,
6 that would not be taxed. It would be the charitable plus inter-
7 est, and then the interaction of those would potentially make it
8 a preference item.

9 Senator Byrd. The charitable organizations are very much
10 concerned now and want to get a change in the law, so the
11 standard deduction people could get a double deduction for chari-
12 table contributions. If we include the charitable contributions
13 in the minimum tax it is going to make it even more difficult
14 for them.

15 Senator Bentsen. Does that not mean only if the itemized
16 deductions exceed 60 percent of their adjusted gross income and
17 then if you have charitable deductions as a part of that excess of
18 itemized deductions?

19 Mr. Shapiro. That is correct.

20 The Chairman. If you will write a few figures down, Harry,
21 I think this will help. You will see the picture.

22 Let us assume that the person had \$100,000 of adjusted gross
23 income and then he has, from that, let's say \$20,000 worth of
24 state and local taxes, and then he has, let's say, about \$40,000
25 casualty loss and then let's say that he has got an investment --

1 let's say a charitable contribution of \$40,000. And the he has
2 an interest expense -- wait a minute. I am going too far.
3 A charitable contribution of \$30,000.

4 Senator Packwood. How much?

5 The Chairman. \$30,000, and he has interest expense of
6 \$10,000. You had better leave the charitable out. Let's start
7 all over again.

8 \$20,000 in taxes, \$30,000 in charitable, and let's say
9 that you have the other \$50,000 in interest.

10 Senator Hansen. No casualty loss?

11 The Chairman. Leave out the casualty. The casualty is out
12 already.

13 He has a lot of itemized deductions before he reaches the
14 adjusted gross income point, but those itemized deductions would
15 fall in the sheltered area. The minimum tax could apply to those.
16 But if the minimum tax would not catch him, because those are not
17 the preference items, so the minimum tax would not apply to him.

18 But then you get down to the taxes, charitable and interest.
19 \$20,000 in taxes, \$30,000 in charitable and \$50,000 in interest.
20 You would get it down to zero except for Larry Woodworth's amend-
21 ment, and Larry Woodworth's amendment was to say that the \$100,000
22 of adjusted gross income could not be reduced by more than 60
23 percent because of these three items, so he would still have
24 \$40,000 that would be subject to the minimum tax that would apply
25 15 percent, and he would pay \$6,000 in taxes. Is that right?

1 Mr. Shapiro. Under present law, that is correct.

2 Senator Packwood. Under present law that is how it would
3 work. You might call it the Long amendment -- actually, it was
4 the Harry Byrd amendment. It said, we will not count these
5 taxes.

6 That being the case, I suppose you would reduce this \$100,000
7 to \$80,000 and then you are looking at an \$80,000 deduction --
8 \$30,000 charity and \$50,000 interest.

9 If you said, all right, 60 percent of that, 60 percent of
10 the 80 -- that would be 48. Subtract that from the other, and
11 that gives you \$32,000.

12 Mr. Shapiro. 60 percent of the \$100,000. 60 percent of the
13 \$100,000 in your example. For purposes of this write-off, what
14 you would say is you take 60 percent of \$100,000.

15 The Chairman. You should reduce that \$100,000 to \$20,000
16 in taxes.

17 Mr. Shapiro. It can be done that way. That was not contem-
18 plated.

19 The Chairman. I would suggest that that is the kind of thing
20 that I would have in mind. You would reduce it, reduce the
21 \$100,000 by \$20,000 in taxes he paid. That would give you \$80,000
22 to look at.

23 Of the \$80,000 he has \$80,000 of deductions. Now you want
24 to give some tax. Basically, we are just trying to get some
25 nominal amount of tax so that this fellow does not completely get by

1 without paying something.

2 So you would say, well, all right, what Larry suggested was
3 60 percent. That means he pays tax on 40 percent, \$32,000 to
4 pay taxes on, and under existing law, you have a 15 percent tax,
5 right, so you would have --

6 Mr. Shapiro. The present law has a \$10,000 exemption you
7 have. They would get a \$10,000 exemption off the top. In his
8 type of situation, there would be no tax under present law.

9 The Chairman. Under present law.

10 Mr. Shapiro. Every taxpayer gets an exemption of \$10,000.
11 You either can deduct one-half of your regular taxes or \$10,000
12 whichever is greater.

13 The Chairman. Can he deduct \$10,000, even with this prefer-
14 ence?

15 Mr. Shapiro. An exemption of \$10,000, therefore, in this
16 particular case, he would pay no minimum tax.

17 The Chairman. It seems to me that we ought to have the
18 thing drafted so he should have to pay some tax. That is all I
19 am saying, down to where he would pay something.

20 Senator Byrd. He was talking about present law versus the
21 proposal. He said under present law he would pay no tax.

22 Mr. Shapiro. Under present law in the example that you are
23 discussing, present law would not impose any tax. It would have
24 been \$6,000 if you did not have the exemption, but present law
25 has the \$10,000 exemption in this proposal; although there is a

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1 \$20,000 exemption, we are talking about an expanded income. What
2 you are doing is adding the preferences on top. Even in this
3 proposal they would not be owing any taxes in this particular
4 case.

5 Senator Bentsen. You have to be sure that the fellow is
6 making some money for you.

7 The Chairman. I always thought \$100,000 was money.

8 Senator Bentsen. That is right.

9 Senator Curtis. Is this for an income credit item, this
10 sheet passed around? Is that something new? This foreign income
11 item, is that something new?

12 Senator Bentsen. A foreign tax credit, as I understand it.

13 Mr. Shapiro. Senator, that is the same way that it presently
14 provides. It is to your advantage.

15 Senator Bentsen. You can get an offset on it now?

16 Mr. Shapiro. Let me point out, the way you have revised the
17 deduction for taxes, there would be a minimum tax under the
18 proposal, if you subtracted the taxes from your adjusted gross
19 income for purposes of the 60 percent, so in the way that you have
20 modified it with respect to the application of the excess itemized
21 deductions, there would be a minimum tax.

22 The Chairman. The way we modified it?

23 Mr. Shapiro. The way you modified it.

24 The Chairman. It seems that they should pay something.
25 How much tax would there be?

1 Mr. Shapiro. \$1,200.

2 The Chairman. \$1,200.

3 Senator Packwood. How did you get \$1,200?

4 Mr. Shapiro. Senator Long said, you take \$100,000 adjusted
5 gross income, subtract the \$20,000 in taxes and you have \$80,000.
6 Then you take your 60 percent, which is based on that \$80,000,
7 which means \$48,000 and you take your excess itemized deductions
8 of \$48,000.

9 Senator Packwood. You take your excess itemized deductions?

10 Mr. Shapiro. Which are \$80,000, the charitable and the
11 interest, subtract that from \$48,000 and you have \$32,000 and
12 you have \$20,000 out. You have \$12,000.

13 Senator Packwood. You levy your 15 percent.

14 Mr. Shapiro. The first rate is 10 percent on the first
15 \$20,000.

16 Senator Packwood. This presumes we knock off the present
17 exclusion in the law.

18 Mr. Shapiro. You are changing present law. You are elimina-
19 ting the present law minimum tax and you are going to an alter-
20 native which would have a \$20,000 exclusion.

21 Senator Bentsen. Let me ask you about your investment
22 interest expense. Has that been deducted or not? I am talking
23 about investment interest expense. Is that above the line or
24 below the line, under the present system.

25 Mr. Shapiro. In the present system, it is below the line.

1 It is included as a part of the interest.

2 Senator Bentsen. That is right. What you have done, you
3 see, on his investment, interest expense, that is the expense, but
4 you do not charge it against his adjusted gross income, so there
5 is no deduction there. So if you go to your \$80,000 you have
6 not removed the investment interest expense.

7 Now, you turn around on the other side and you say that is
8 an excess deduction, but he never got it.

9 The Chairman. Look, you see, in these tax situations, when
10 that guy has the \$50,000 as interest expense, he typically had
11 a piece of real estate that appreciated \$2,000 in value that
12 year, or \$100,000. He is not paying a tax on that. At some
13 point he will, but he is not paying it now. That is the same
14 thing you are talking about, people living out of that cash flow.

15 Senator Bentsen. If that happens.

16 The Chairman. Here is the point we are talking about. We
17 are not arguing about the interest. The part we are talking about
18 are the charitable contributions, and my point is that he cannot
19 afford to pay Uncle Sam \$1,200 in taxes, how on this green earth
20 can he afford to give away \$35,000 to charity? He is not really
21 giving it to a public charity, he is giving that to his private
22 foundation. He is trying to put it from Pocket A to Pocket B,
23 in some cases.

24 Senator Byrd. Not necessarily. Most people give to the
25 recognized charities. Some give to the foundations.

1 The Chairman. More often than not.

2 Senator Byrd. That is a red herring, Mr. Chairman.

3 The Chairman. You will find the kind of guy who presents
4 you with the situation where he cannot afford to make a charitable
5 contribution, theoretically cannot afford to pay any taxes, that
6 being the case, logically you think he cannot afford to make the
7 charitable contribution. He gives away \$30,000. He cannot afford
8 to pay us any taxes therefore, to give away \$30,000, it seems to
9 me in a case like that, we should pass a little something.

10 I do not care to defend this fellow, especially if that
11 is a donation to his own private foundation. I do not care to
12 defend his getting by without paying any tax.

13 Senator Hansen. Mr. Chairman, if I could, let me say that I
14 do not argue with you at all in the example that you have given us
15 here. I think that it should be observed that it may not be a
16 typical example.

17 As far as I know, I would think that the overwhelming number
18 of charitable contributions that are made are not made to founda-
19 tions. I live in a little town where we used to have a private
20 hospital. By gosh, we financed the building of a new hospital
21 there by charitable contributions. There was not a single dime
22 of that that went to any foundation. It went to St. John's
23 Hospital.

24 I know people who give to the university and to libraries
25 and that sort of thing, so I am not arguing with you. I am just

1 saying that if this is the situation, I would agree with you, but
2 I do not think it is a typical situation that you have spelled
3 out here.

4 I would agree that if a person can afford to give \$30,000
5 to charity, he can afford to pay \$1,200 in taxes. I would not
6 want to be a party to any machination that would let such a
7 situation evolve.

8 I do not think --

9 The Chairman. I am trying to protect this Committee and,
10 being Chairman, I am trying to protect myself from being labelled
11 the guy who lets these people get away without paying any taxes.

12 Mr. Lubick. Mr. Chairman, you might be aware that many of
13 the charitable contributions are made with appreciated property
14 on which, therefore, the gain is not realized, which is a part of
15 our policy. I think part of that was behind Larry's thinking in
16 the design of this excess deduction tax.

17 Senator Byrd did mention that the man is out of pocket for
18 the charitable contribution. There are illustrations where you
19 can be better off by giving the property away under the law today
20 than you are by selling it. You can charge off on a very low
21 basis, or no basis, and you give it to charity and you have a
22 full deduction against 70 percent of income.

23 You can indeed be better off than if you sell the property
24 and pay a 35 percent tax. There would be more proceeds left
25 from giving it away than through selling it.

1 Senator Packwood. Mr. Chairman, I do not think any of
2 us quarrel with the idea that everyone should pay a minimum tax.
3 We have learned our lesson that. Whether or not it raises much
4 revenue, it is necessary psychologically to make people assume
5 that everybody is paying their full share.

6 By and large, we support what you are trying to do. My
7 misgiving is that we be sure we know what we are doing and what
8 the effect is.

9 What I would suggest is that the staff give us six or
10 seven examples, preferably in round numbers divisible by ten
11 rather than some of the examples that we get, by different aspects
12 of what you are proposing so we can grasp them from a practical
13 standpoint.

14 Are we going to meet tomorrow, by the way?

15 The Chairman. If we have a quorum here, yes.

16 Senator Packwood. I would suggest this, that they give
17 them to us preferably before the start of the meeting in the
18 morning. If we are meeting this afternoon, that we go on to a
19 variety of other items that different Senators have and see if
20 we can dispose of a good many of those and come back and plug
21 away at this tomorrow morning with enough examples so that we can
22 all understand, hopefully, what the effect would be.

23 The Chairman. I would be willing to put it on this basis.
24 As far as I am concerned, if we can agree just on these principles:
25 one, the minimum tax is now raising \$1.8 billion.

1 Mr. Shapiro. \$1.4 billion.

2 The Chairman. You are talking about a proposal that raises
3 about \$1.2 billion, is that right?

4 Mr. Shapiro. That is right.

5 The Chairman. It seems to me that we are talking about a
6 major reduction in capital gains, and if we could say, in doing
7 that, we will have a minimum tax at a rate that will raise
8 \$1.2 billion in that area, reserving the specifics -- because
9 you can pick up some by moving your figures up and down -- just
10 exactly where you are going to put your brackets and where you
11 put your rates can determine where you put them.

12 If we could agree we will shoot at \$1.2 billion -- that is
13 the type of thing we are talking about -- you can make some
14 changes in how you want to do it.

15 Basically we are talking about a minimum tax based on the
16 one that we have in the law at the present time but better
17 targeted on people who, under the present law, are paying less
18 than 5 percent. That is the group we are talking about.

19 Those people who pay more -- people who are paying 10 percent
20 and over, that we are not targeting on them. We are targeting
21 on those who are paying, let's say, 10 percent or less in terms
22 of what their economic income was.

23 Now, if we can think in those terms, that satisfies me.

24 Senator Bentsen. Mr. Chairman, I would like to vote on
25 Senator Hansen's amendment, where you stated over and over that it

1 is a tentative decision and some of us have stated subject to
2 coming up with determining an alternative tax that satisfies us.

3 The Chairman. Could we be a little more definite and say
4 that we are talking about a minimum tax in excess of \$1 billion?

5 Senator Bentsen. That is fine.

6 Senator Curtis. We can still discuss it in detail?

7 The Chairman. Any details. I just do not want people around
8 the country to think they are going to get this big cut in capital
9 gains without a minimum tax and a substantial minimum tax. On
10 that basis, that is fine with me.

11 Senator Byrd. I think there should be a minimum tax. I
12 favor a minimum tax. I am not opposing a minimum tax. I am
13 just throwing out the suggestion as to whether or not you want
14 to include charitable contributions in preference items. That is
15 all.

16 I favor the minimum tax. I want to make that clear.

17 The Chairman. Let me make it clear the minimum tax does
18 kick out what we call preference items. The charitable contribu-
19 tion is not one that we regard as a preference item. We do not
20 put a tax on, the minimum tax on, charitable contributions as a
21 preference items.

22 As we come back with a final wrap-up, if they duck is in
23 every other way, then we look at their itemized deductions. At
24 that point, we are looking at what we regard as legitimate
25 deductions, but we are not going to let them deduct enough of it

1 where they wind up paying no tax at all.

2 And so we will let them deduct enough medical expenses
3 about which we feel that they have no choice, enough casualty
4 expenses about which we feel they have no choice but to pay,
5 enough taxes where they have no choice about that. But in chari-
6 table and interest, they have, there is an area of decision where
7 they have some say about how much they are going to take in those
8 areas -- the investment interest and the charitable in those
9 areas. We just do not want them to reduce it down to a point
10 where they do not owe us anything. That is the point.

11 Senator Curtis. Mr. Chairman, I would like to call up a
12 matter --

13 Senator Byrd. Can we vote on this?

14 Senator Curtis. I thought we did.

15 Senator Hansen. Let's have a roll call.

16 The Chairman. With the understanding that subject to the
17 general agreement, that we are going to have a minimum tax.

18 Mr. Stern. Mr. Talmadge?

19 Senator Talmadge. Aye.

20 Mr. Stern. Mr. Ribicoff?

21 (No response)

22 Mr. Stern. Mr. Byrd?

23 Senator Byrd. Aye.

24 Mr. Stern. Mr. Nelson?

25 Senator Byrd. No, by proxy.

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1 Mr. Stern. Mr. Gravel?
2 Senator Gravel. Aye.
3 Mr. Stern. Mr. Bentsen?
4 Senator Bentsen. Aye.
5 Mr. Stern. Mr. Hathaway?
6 (No response)
7 Mr. Stern. Mr. Haskell?
8 (No response)
9 Mr. Stern. Mr. Matsunaga?
10 Senator Matsunaga. Aye.
11 Mr. Stern. Mr. Moynihan?
12 Senator Moynihan. Aye.
13 Mr. Stern. Mr. Curtis?
14 Senator Curtis. Aye.
15 Mr. Stern. Mr. Hansen?
16 Senator Hansen. Aye.
17 Mr. Stern. Mr. Dole?
18 Senator Hansen. Aye, by proxy.
19 Mr. Stern. Mr. Packwood?
20 Seantor Packwood. Aye.
21 Mr. Stern. Mr. Roth?
22 (No response)
23 Mr. Stern. Mr. Laxalt?
24 Senator Laxalt. Aye.
25 Mr. Stern. Mr. Danforth?

1 Senator Danforth. Aye.

2 Mr. Stern. Mr. Chairman?

3 The Chairman. Aye.

4 Thirteen yeas and one nay.

5 Senator Packwood. What time are we going to start this
6 afternoon?

7 The Chairman. Let me look at my schedule. How about
8 2:00 o'clock.

9 Senator Talmadge. To meet here, or meet on the Senate
10 Floor?

11 Mr. Stern. We were unable to get a room, Mr. Chairman.

12 Senator Curtis. Mr. Chairman, I will be as brief as I can.
13 This is a matter relating to industrial revenue bonds. It has
14 been approved by this Committee. Here is what it is.

15 These bonds -- and some people believe in the system and
16 some do not and it is there -- are located by localities to build
17 plants to provide employment. Under the procedure over a number
18 of years, when those projects that had to be refunded, they were
19 refunded with a tax exempt privilege.

20 Effective as of November 4th of last year, the Treasury
21 ruled that the refunding of the bonds would not be subject to the
22 tax exempt status. That existed for some time.

23 There were some of us who felt that such a change should
24 be made in the Congress, but we are not contesting that now.

25 This is not a proposal to enlarge the scope of industrial

1 revenue bonds. It is not a proposal to repeal what the Treasury
2 did by regulation. It merely calls for a transition rule for
3 those projects and there are over twenty of them, affecting 15
4 states where those projects were in the process of being refunded
5 when, on November 4th, the end of the business day, they were out.

6 The language on writing a phase-out rule or a transition
7 rule has been submitted to the staff and, in the main, it has
8 already been approved at this time.

9 Now, transition rules are customary. In amending this
10 Section 103, the Internal Revenue Service itself, by regulation,
11 provided a transition rule in 1972. In 1975, 1976, 1977, 1978.

12 The Congress provided the transition rule in 1968 on this
13 very section. Had the Treasury not ruled under the past existing
14 law, there would have been no revenue effect on the rule.

15 Consequently, a transition rule will not affect the budget
16 at this time, because it is money that was before the action that
17 would not be counted. I think it is a matter of justice. It is
18 a matter that there is precedent for, both in the action of
19 Congress and we have approved it before.

20 Many of these companies were created in rural areas to
21 provide employment and, relying on existing law, they had proceeded
22 with their refunding process. We had approved it before. It is
23 germane here. We have already amended the industrial revenue
24 bonds section. I would like to have it approved.

25 The Chairman. Mr. Lubick?

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1 Mr. Lubick. Mr. Chairman, I would like to state the
2 Treasury's opposition to what I agree with Senator Curtis -- it
3 is fair that when a longstanding rule or position of the Revenue
4 Service is changed that it should generally be done on a prospec-
5 tive basis and, indeed, that that is the normal situation to which
6 we adhere.

7 I think, in this particular situation, we have something that
8 is somewhat unique. I think that what we have here is a situation
9 where the Congress, in 1968, moved with due regard to nonretroac-
10 tivity in saying that those private corporations which were using
11 industrial development financing for their private construction,
12 issued the bonds before 1968, that they would be protected there-
13 after. I think Congress made a judgment that there would be no
14 further industrial bond finance except for the exceptions in the
15 law.

16 The objective of the corporations involved at this particular
17 time was to, in effect, put out new industrial development bonds
18 financing that was prohibited by the '68 action by refunding the
19 obligations that were outstanding before 1968, and by so doing,
20 they were enabled to get to a competitive financing advantage
21 that other corporations were not able to get.

22 The Treasury, in its regulations before this date, had not
23 enjoined the devise of extending and permitting new issues to the
24 advance refunding technique.

25 Some time in May, before the regulation was proposed in

1 November, a regulation project was opened under this section,
2 that they generally became aware that the Internal Revenue Service
3 was going to change its position on this problem.

4 They then got word during the last three weeks, during the
5 November issuance date, that all of the corporations around the
6 country that were eligible to participate with this device were
7 attempting to get issues very quickly so that they could beat the
8 change in the rules, which they all knew was coming.

9 So that, on November 5th, I believe it was, we issued a
10 news release in the proposed regulation saying that it would
11 apply, that the new rules would apply to bonds issued after that
12 date. In some instances, where we had changed regulations before,
13 we had the bond issue rule and, in one instance, we did because
14 it was necessary to prevent this rush to market.

15 We then talked with all of the corporations involved to see
16 whether there was an appropriate transition rule. Indeed, we did
17 relax the rule to permit certain housing obligations that had been
18 underway for over a year and obviously had not been moving in
19 contemplation of a change in the rules.

20 But basically, after exploring the situation with regard
21 to the other corporations, we found that, by and large, they
22 were all acting with notice, with suspicion if not notice, of what
23 the change was.

24 Senator Curtis. Mr. Chairman, I cannot accept that. This
25 item has been opposed by such innuendoes and by challenging the

1 ethics and integrity of some of the people involved.

2 I have investigated these things; here is one of them.
3 They started their first action in April, 1976. Here is another
4 one, August 5, 1976. Here is one that started their preparation
5 for their refunding June 21, 1976.

6 And not at one time did the Treasury support a transition
7 rule in this case, and the idea that these were not legitimate
8 transactions that had been in for months, I just feel compelled,
9 in fairness to a great many fine people, to speak up and oppose
10 it.

11 Mr. Lubick. I want to agree with you on that. I am not
12 challenging the ethics or the legitimacy --

13 Senator Curtis. It has been thrown around here.

14 Mr. Lubick. Basically, as a lawyer, I too would try to
15 advise my client to move as quickly as possible. There is nothing
16 illegitimate.

17 Senator Curtis. I am citing dates that were months before
18 there was any guess there was anything in the air.

19 Mr. Lubick. There were some, perhaps. Basically, when we
20 met with these people, you may have had a meeting between an
21 underwriter and a board of directors, but they were not taking
22 any substantial action until October --

23 Senator Curtis. I am talking about the community involved
24 that built this plant to provide employment.

25 That before the transactions appear on paper, they

1 make the provision to refund. If they inquire what the law is,
2 they went ahead.

3 The only way you can measure what was on their minds and
4 how long they planned it are some of these actions in writing.
5 I do not want to shut Treasury off. I understand they are opposed
6 to it. They were opposed to what was brought up before. At one
7 time they favored it, and so stated it, a transition rule in
8 this particular case.

9 I do not think that there is a great amount of evidence or
10 revenue involved. I think it is a matter of justice, and it is
11 certainly in accord with the precedents in the Treasury in issuing
12 regulations and with Congress.

13 The Chairman. Let me get one thing straight in my mind.
14 If you assume for a moment that the industrial revenue bonds were
15 tax-exempt at the beginning, what logic would keep it from being
16 taxed to the extent that we are just refunding? Why would that
17 be the case?

18 Senator Curtis. That has been the law that has followed
19 all through the times.

20 The Chairman. Mr. Lubick?

21 Mr. Lubick. Basically, Mr. Chairman, the bonds are exempt
22 if they were issued before 1968 and the refunding, in effect, is
23 a new issue and in effect, you have two issues outstanding, so
24 it really doubles or triples the value of tax-exempt securities.
25 But the refunding is a device whereby they are, in effect, putting

1 an amendment in, or an extension of the maturity date of the bonds
2 that were issued before '68. Congress knew that nobody new could
3 come in after 1968 and changing the maturity from ten years out
4 to twenty years out gives you extra years of financing, the
5 same as if you had put out a second issue that ran for another
6 ten years.

7 So, in effect, it is a way to circumvent the 1968 cut-off.
8 There is no new financing involved here, no new construction
9 involved here, no new benefits to any communities. It is simply
10 allowing the corporations that had the benefit of the low interest
11 rate tax-exempt financing to get a new financing for a longer
12 period.

13 Senator Moynihan. I would just like to say, Mr. Chairman,
14 that there is a difference of opinion here between, you know,
15 transparently on this about what the merits are, but I have had
16 Senator Curtis show me the list of projects involved -- a limited
17 number -- and he made his case to me, and I found it very persua-
18 sive.

19 This is a bill in relief of what seems to have been an action
20 of government that could be questioned; without any way questioning
21 the responsible statements of the Treasury, I think that Senator
22 Curtis has made a good case, at least to this member of the
23 Committee.

24 Senator Talmadge. We have some situations in my state that
25 were involved and, as I recall, I went with several Senators

1 protesting to Treasury, in writing.

2 Senator Curtis. I think Treasury is getting off very
3 easily if they are allowed to change the law by regulation. We
4 are not challenging that at this time.

5 The Chairman. Let me ask you, is this a case where the
6 Treasury is, in effect, changing? I know you would not do it if
7 you did not think you were right, but is this a case where the
8 Treasury has, in effect, changed the law by changing regulations?

9 Mr. Lubick. Senator, I believe that this is a very clear
10 case of interpretation of what Congress enacted in 1968. It
11 seems to me very clear that if one is not permitted to put out a
12 new issue of an industrial development bond after 1968, to say
13 that you can add ten years on to an existing issue is the equivalent
14 of a new issue, which is prohibited.

15 I think that is not only a reasonable construction but a
16 construction that is fairly close to being beyond a reasonable
17 doubt.

18 The Chairman. I will be glad to take another look at it.
19 You might want to get out the law and show it, but I have had an
20 awful lot of experience around here in situations where Treasury
21 felt that somebody should pay more taxes and therefore they wanted
22 to change a regulation or change a law to get them. I know
23 usually if they came up here and they wanted to get them, they
24 would usually say well, we will let those who up to this point
25 have gone thus far up to a certain point, we have their application

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1 in already. They can receive consideration. But any of those
2 who have not -- and oftentimes, sometimes they made those things
3 effective the very day the Committee acted -- but we can put
4 dates all kinds of ways about what the effective date would be
5 without any particular rhyme or reason except looking at what
6 all of the facts were and who all was involved in it, you try to
7 put the date at some point, and you pick a future point, or at
8 least a present or future point.

9 Mr. Lubick. Basically, we have a situation here where I
10 think the regulations, at best, were silent on it, but a ruling,
11 as Senator Curtis indicated, was issued by somebody at the Internal
12 Revenue Service and it was that ruling that was the source of the
13 difficulty. The private ruling was unreviewed, and somebody in
14 the Revenue Service let the ruling out and the ruling was gener-
15 ally circulated in the bond community, which is a relatively small
16 community, and word travels fast, so many people thought that this
17 would be, as I would have, this would be a good thing to do.

18 Senator Curtis. Mr. Lubick, the communities signed on the
19 dotted line to pay for these bonds. They came to that conclusion
20 long before that. This is not like going out and selling a life
21 insurance policy to drum up a customer. This was a necessity
22 that they had to have for the refund.

23 Furthermore, if someone is hurt a bit, they are in the same
24 position as someone who sells something in December because he
25 feels that in his particular tax bracket it is going to be better

1 han in January. I do not think we can, in the tax law, judge
2 the motives of people.

3 The Treasury at one time agreed on a transition rule in this
4 particular case.

5 Mr. Lubick. We do agree that any bonds that were issued
6 before the November 5 date continue to get the benefits of the
7 tax-exempt basis.

8 Senator Curtis. Now, I have been filibustered out of
9 court. The Committee is gone.

10 We know that the Treasury is against us. They have reversed
11 their position. They were for a transition rule in this very
12 case.

13 Mr. Chairman, I do not know what to do.

14 The Chairman. We will come back here and vote after we
15 get a quorum at 2:00 o'clock.

16 Senator Curtis. Could it be the first order of business,
17 to have a roll call on this?

18 The Chairman. Yes.

19 (Thereupon, at 12:40 p.m., the Committee recessed, to
20 reconvene at 2:00 p.m. this same day.)

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EXECUTIVE SESSION

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THURSDAY, SEPTEMBER 21, 1978

- - -

United States Senate,
Committee on Finance,
Washington, D.C.

The Committee met, pursuant to recess, at 2:20 p.m.
in room 2221, Dirksen Senate Office Building, Hon. Russell B.
Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Byrd, Nelson, Gravel,
Bentsen, Matsunaga, Moynihan, Curtis, Hansen, Dole, Packwood,
Laxalt and Danforth.

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AFTER RECESS

(2:20 p.m.)

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2
3 The Chairman. Gentlemen, as far as I am concerned, I heard
4 the debate on the Curtis amendment. I think that we voted on it
5 before.

6 What is the revenue impact of the Curtis amendment, Mr.
7 Shapiro?

8 Mr. Shapiro. The revenue impact we have now would be less
9 than \$10 million:

10 The Chairman. Less than \$10 million revenue. Is that a
11 year?

12 Mr. Shapiro. Yes.

13 As long as these are exempt, if you assume that they would
14 have otherwise been issued as taxable, it would be each year.

15 Mr. Lubick. I was going to say what he said. They would
16 be outstanding for twenty or thirty years, so it is \$800 million
17 worth of bonds. In addition, the impact of bringing these bonds
18 to market will, of course, raise the general cost of borrowing for
19 all state and local governments.

20 At the time that our regulations were put out, interest rates
21 were rising, but the announcement of the regulations drove down
22 the interest rate of state and local obligations, so I think there
23 is a cost beyond the cost attributable to these bonds. It will
24 raise generally the cost of financing for state and local govern-
25 ments.

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1 The Chairman. Here is the thing that occurs to me about
2 this. You can read present accounts that it looks like some
3 bonding company is going to get this. The way I understand this,
4 that the people who will get the benefit of it -- I guess you pay
5 a lawyer to represent you, or you pay a bonding house or somebody
6 to sell the bonds, to put them on the market for you, but the way
7 I read this type of thing is that it is the communities that bene-
8 fit, the individual taxpayers that buy the bonds up.

9 Mr. Lubick. These bonds are already out and issued. The
10 projects that they were financing have already been built. It is
11 simply permitting those corporations that benefit from the tax-
12 exempt financing to have another 20 or 30 years of financing.
13 Nothing new will be built. No state or local government will get
14 any benefit from this whatsoever and, in point of fact, it should
15 increase the borrowing costs of state and local governments.

16 Senator Curtis. Now, just a minute. We have discussed this
17 once before this Committee. These bonds were issued to provide
18 employment in these localities and if, before they get the bonds
19 paid off, it comes to an end that the community does suffer -- Mr.
20 Chairman, I just call for regular order.

21 The Chairman. Call the roll.

22 Mr. Stern. Mr. Talmadge?

23 Senator Talmadge. Aye.

24 Mr. Stern. Mr. Ribicoff?

25 (No response)

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Mr. Stern. Mr. Byrd?

Senator Byrd. Aye.

Mr. Stern. Mr. Nelson?

Senator Nelson. Mr. Chairman, I was not here for the discussion. I do not have a judgment on it. I will just withhold my vote.

Mr. Stern. Mr. Gravel?

(No response)

Mr. Stern. Mr. Bentsen?

Senator Bentsen. Aye.

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

[No response]

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. Aye.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. Aye.

Mr. Stern. Mr. Curtis?

Senator Curtis. Aye.

Mr. Stern. Mr. Hansen?

Senator Hansen. Aye.

Mr. Stern. Mr. Dole?

Senator Dole. Aye.

Mr. Stern. Mr. Packwood?

1 Senator Packwood. Aye.

2 Mr. Stern. Mr. Roth?

3 (No response)

4 Mr. Stern. Mr. Laxalt?

5 Senator Laxalt. Aye.

6 Mr. Stern. Mr. Danforth?

7 Senator Danforth. I will vote present.

8 Mr. Stern. Mr. Chairman?

9 The Chairman. Aye.

10 Eleven aye, one present.

11 Now we will hear from Mr. Matsunaga.

12 Senator Matsunaga. Thank you, Mr. Chairman.

13 Mr. Chairman and members of the Committee, you will recall
14 that on last Tuesday I offered an amendment to shorten the qualify-
15 ing life period for investment tax credit from seven years to
16 three years, and the Treasury Department indicated its approval
17 of my proposal provided that the basis is reduced by the credit.

18 I believe that just as the Chairman in this Committee conclu-
19 ded in 1964 that such an adjustment would be really troublesome
20 for taxpayers, it would create bookkeeping complications and it
21 would restrict the tax credit incentive, if the basis has to be
22 reduced by the amount of the credit, all property now receiving
23 the full 10 percent credit will have the depreciation basis
24 reduced by the credit.

25 In effect, the basis adjustment proposed by the Treasury

1 would become a tax increase on business which is certainly not
2 our intent, by my amendment.

3 To balance this tax increase which would be a result of the
4 adjustment, we would need to increase the credit to 12 percent or
5 14 percent which would result in a bigger revenue loss in 1979
6 than my initial proposal.

7 Mr. Chairman, I believe that the basis adjustment would
8 be troublesome and that this Committee wisely repealed it in
9 1964. We can all agree that any tax proposal must be based in
10 equity.

11 My amendment proposes to eliminate an inequity, the farmers,
12 small businessmen and users of short-lived assets now used. I am
13 concerned about the budget impact of my proposal and wish to amend
14 the proposal I presented last Tuesday with a three-year phase-in
15 to soften the revenue loss in the initial years, but the credit
16 would be extended gradually to short-lived assets over a three-
17 year period and, in 1979, the first year's revenue loss would be
18 only \$100 million instead of the \$700 million which my initial
19 proposal would have cost.

20 Treasury states that such a phase-in creates problems because
21 it only postpones revenue loss. I can see, however, no difference
22 between my proposal and the gradual increase of the tax credit
23 limitation from 50 percent to 90 percent over the next four years.
24 This increase of the credit limitation was passed by the House
25 and is in the present bill and the phase-in that I am proposing

1 I am sure causes no more problems.

2 I repeat what I said last Tuesday, Mr. Chairman. This
3 amendment would extend the full 10 percent credit on assets to
4 computers, office machinery, trucks, oil and gas, drilling equip-
5 ment, construction equipment, textile equipment logging machinery,
6 machine tools such as dyes, jigs, molds used by manufacturers
7 as well as communication equipment.

8 Today, under the present law, they are subjected to inequi-
9 ties because the equipment, the life of these tools and equipment
10 do not extend beyond the seven year minimum and I see no reason
11 why this inequity should be continued.

12 Senator Dole. Does that apply to breeding animals? You
13 mentioned farmers.

14 Senator Matsunaga. Farmers, they have certain kinds of
15 equipment, like tractor.

16 Senator Dole. And breeding stock.

17 Senator Matsunaga. And breeding stock.

18 Senator Dole. There is one inequity. It does not include
19 breeding horses.

20 Mr. Shapiro. The present law does not apply to horses.
21 What you have reference to is whether it would include horses.
22 The way Senator Matsunaga's amendment is proposed is to take
23 existing qualifying property. If you wanted to expand it to
24 cover a property that was not presently covered, that would have
25 to be amended.

1 It covers all animals that are presently covered, but the
2 present law does not cover horses.

3 Senator Dole. At the present time, I would like to amend
4 that. I think you are aware of that problem -- not race horses
5 or show horses, but breeding horses. Somehow they were left out.

6 Senator Matsunaga. My proposal would merely be reducing
7 the number of years from the seven to the three for qualified
8 things. If presently any asset that is not qualified, you would
9 have to add.

10 The Chairman. Let's talk about a couple of things. Let's
11 talk about the revenue impact. When this is in full operation,
12 what would be the revenue impact?

13 Mr. Shapiro. You would have to make a couple of assump-
14 tions. The proposal that Senator Matsunaga has assumes no changes
15 like this involved. He indicated what he meant by that.

16 The House bill adopted what was proposed by the Administra-
17 tion, the amount that you can take against present taxes, and
18 present law -- you can offset 100 percent of the investment tax
19 credit against taxes up to your tax liability, or \$25,000. If
20 you owe taxes above \$25,000 you can only offset the credit against
21 one-half of your tax liability over \$25,000.

22 The Administration proposed, and the House adopted, the
23 provision that would increase the 50 percent limitation up to
24 90 percent over a phased-in period, 10 percent each year, so that
25 when it is fully implemented, instead of being limited to 50

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1 present of taxes paid by the company, you can offset up to 90
2 percent of your tax paid.

3 Senator Matsunaga's estimate are on his sheet that he has
4 here. If you assume that 50 percent of that is under present law,
5 and if that is not changed, you can see that the phase-in starts
6 at \$200 million in fiscal year '79 and by 1983 it goes up to
7 \$1.7 billion and we agree with that, based on existing law.

8 If the Finance Committee were to adopt the House provision
9 which would phase in the 50 percent offset up to 90 percent then,
10 by 1983, that \$1.7 billion would go to \$3.1 billion. In the
11 first two years, '79 and '80, it would be approximately the same.

12 Just to complete it, let me go to 1981, where Senator
13 Matsunaga has \$1.3 billion, under the 90 percent rule, it would
14 be \$1.8 billion. In 1982, where Senator Matsunaga's proposal
15 has \$1.6 billion it would be \$2.7 billion.

16 Senator Matsunaga is saying in his proposal that it is just
17 changing present law with respect to this change, and if the
18 Committee should increase that offset subsequently, then that
19 would have an additional effect on that. But this proposal is
20 looked at without that factor.

21 The Chairman. In terms of revenue impact, I have contended
22 that what we want to do on capital gains would have a great deal
23 of feedback and that it would not cost anything. I do not think
24 it would cost us anything. That is debatable.

25 But, if it did, I do not think -- I would hardly think that

1 it would cost as much as this would.

2 What is your thought about that, Mr. Lubick, in terms of
3 the adjustment of cost and when you include the feedback? There
4 has to be feedback in this.

5 Mr. Lubick. We think that this has a very substantial
6 revenue impact and, in point of fact, I think it does violate
7 the principle that I was concerned about yesterday that we not
8 mortgage the out-years.

9 However, the figures that we have indicate a revenue impact
10 as Bobby indicated, rising to about \$3 billion in 1981, that
11 is if there is no basis adjustment.

12 Senator Hansen. I am sorry, if there is no basis?

13 Mr. Lubick. Assuming that we do not have the basis adjust-
14 ment which includes some of the revenue, I think that it also
15 gives us some very serious problems on getting a bias towards
16 investments of short-lived assets, and I would like to ask, with
17 your permission, to have Mr. Sunley give some explanation of just
18 how the investment credit, without a basis for adjustment, applies
19 on a uniform basis or assets with a life of three years or up.

20 The Chairman. Could you put that on a chart on the blackboard
21 so we could see it?

22 Senator Matsunaga. Mr. Chairman, I hope that the Treasury
23 and staff will have taken into consideration the feedback which
24 generally occurs from the investment tax credit.

25 The Chairman. Maybe Mr. Stern can write it on the board.

1 If you could put it up there so we can see it, what the problems
2 are, as you understand it, in terms of what you contend to be
3 a bias in favor of -- in terms of a short-term equipment proposal,
4 we could better understand the problem.

5 Mr. Sunley. I think to understand the difference between
6 short-lived and long-lived property, we have to think mentally
7 about how the investment credit influences the investment decision.
8 Let us assume, these are hypothetical numbers that we would be
9 using, let us assume that we have a choice between investing in a
10 short-lived asset, a three-year asset, and a longer-lived asset,
11 possibly a ten-year asset.

12 The Chairman. Can you give us an example, some illustra-
13 tion of what that might be?

14 Mr. Sunley. A short-lived asset might be a truck, for
15 example. A longer-lived asset may be a railroad car or an air-
16 plane which has longer lives under the existing depreciation system
17 than trucks.

18 Let us assume before we have any investment credit that
19 both of these investments would yield an after-tax return of 10
20 percent, but it may be that investors are unwilling to make
21 investors if they can only get a 10 percent after-tax return given
22 the riskiness of making investments. So we provide an investment
23 credit. This has an initial effect of increasing the after-tax
24 rate of return.

25 Under current law, for example, the after-tax rate of return

1 for the three-year asset might be increased from 10 percent to
2 16 percent approximately by our current investment credit, whereas
3 the ten-year asset, the after-tax rate of return may be increased
4 from 10 percent to 12.9 percent in this hypothetical example.

5 The effect that is pointed out in this chart which Mike
6 has been kind enough to put on the blackboard is that the current
7 investment credit has the effect of increasing the after-tax rate
8 of return for short-lived assets more than for long-lived assets
9 and I think that the Committee in 1962, when the Committee put in
10 a limitation on short-lived property, they recognized this problem
11 and, at that time, the Committee pointed out that a person might
12 invest in a nine-year asset or a three-year asset. If he invests
13 in a three-year asset, he gets the credit three times over a
14 nine-year period, whereas if he invests in the nine-year asset,
15 he gets it only once, and that seemed to mean that the investment
16 credit would tend to favor the short-lived assets because you get
17 it more often.

18 If you remove the short-term property limitation, you will
19 accentuate the bias against the very short-lived assets by increas-
20 ing the rate of return on short-lived assets much more than you
21 do for long-lived assets.

22 Let me try to give an intuitive notion of what is going on
23 here. In the case of the short-lived assets-- well, let me put
24 it this way, if I may. Suppose, when President Nixon proposed
25 the investment credit to be reinstated in 1971 he had said, I am

1 not going to use the investment credit. Instead, I am going to
2 freeze all prices, which he did at that time in August of 1971,
3 and then I am going to order an across-the-board 8 or 10 percent
4 reduction in the price of all machinery and equipment to encourage
5 investment in machinery and equipment.

6 Investors would then go out and find that their initial cost
7 of purchasing machinery and equipment, the initial cash that they
8 would need would be 10 percent less. They would also find that
9 their depreciation deductions would be reduced by 10 percent,
10 since their basis on their property would be only 90 percent of
11 what it was before that fateful day, August 15, 1971.

12 Under our current credit, we do not make that basis adjust-
13 ment so, instead, our investment credit is not equivalent to a
14 10 percent price reduction, it is equivalent to something better
15 than that. Not only is your initial outlay reduced by 10 percent,
16 but your future depreciation deduction are not reduced by 10
17 percent. You get to take the depreciation deductions as though
18 you pay 100 percent of the cost of the asset.

19 This additoinal amount of depreciation is worth more to you
20 the sooner you get it. You get it sooner if you have a short-lived
21 asset. So that that is the source of the bias, in the current
22 investment credit that favors the short-lived asset because we do
23 not have that basis adjustment.

24 Congress offset that bias in the earlier legislation by
25 reducing the amount of the credit for the short-lived assets so

1 the short-lived assets would not be unduly favored relative to
2 long-lived assets.

3 Senator Dole. If you had an asset that cost \$1,000, how
4 would it work on each one of those?

5 Mr. Sunley. If you have an assets -- you have a choice
6 between two assets, each costs \$1,000 and you are asking now, if
7 I make this investment, given what I think the operating costs are
8 going to be of the assets in the future, what kind of after-tax
9 rate of return will I get on these two assets. Suppose they are
10 equal; 10 percent. Neither one may be an attractive investment.
11 As a businessman, you may require a 12 percent return before you
12 want to undertake the investment.

13 It seems that one reasonable approach to providing an invest-
14 ment incentive is to increase the after-tax rate of return in the
15 same amount for both assets. We do not want to provide an artifi-
16 cial incentive that will increase the after-tax rate of return
17 much more for the long-lived asset than for the short-lived asset.
18 The current investment credit avoids that by reducing the rate of
19 the credit for the short-lived assets.

20 The Chairman. Here is what concerns me. I an Chairman of
21 the Service Transportation Subcommittee and one of the big prob-
22 lems we had, that so many railroads are going broke. I am trying
23 to help Pat Moynihan with the Delaware and Hudson right now, but
24 it will not do them a big of good to give them a tax reduction --
25 they are not paying any taxes. They are tottering on bankruptcy.

1 That is one reason I have been saying that we ought to make
2 it a refundable tax credit so when you are trying to help some
3 of these concerns, you can help them even if they are not showing
4 that much profit.

5 One of the things you ought to do in this country is try to
6 get the railroads rehabilitated, modernize their tracks, take an
7 investment tax credit on the rails. The rails get an investment
8 tax credit. I assume that is plant and equipment, is it not?

9 Mr. Lubick. They do.

10 The Chairman. That has a long life, does it not?

11 Senator Matsunaga. A long life.

12 The Chairman. Locomotives have a long life, box cars have
13 a long life.

14 Mr. Sunley. A fairly short life.

15 The Chairman. Locomotives, long life?

16 Mr. Sunley. Railroad cars and locomotives, if they are used
17 by nonrailroads, they have a 15-year asset guideline period, with
18 the lower limit being 12 years.

19 The Chairman. How does that compare to a truck?

20 Mr. Sunley. Trucks currently have a five-year lower level,
21 heavy general purpose trucks. Light general purpose trucks have
22 a three-year depreciation period.

23 The Chairman. I am concerned about the fact that there is
24 a lot of heavy cargo moving on the highways. I know down my way
25 it seems to me the trucks -- I think they are overloading those

1 trucks, because some of those new highways, they are just torn
2 up something awful and they have been for a year, and in bad
3 shape. . Somebody must be letting those trucks have permits they
4 should not be getting, or the state legislature raised the weight
5 limit too high, because it is doing tremendous destructive damage.
6 A lot of those things moving on the highways should be moving on
7 the rails.

8 The railroads have tough time. I am not aware that the
9 trucking industry has any trouble, and generally speaking, there
10 would not be much in there that would benefit the rail industry.
11 A ten-year life is at the bottom of the chart. The three-year
12 life is at the top of the chart.

13 It costs a lot of money to do that. But the question is,
14 if we do that, are we doing that for the industry that is saying
15 we do not need it.

16 What industries, if you are thinking in terms of helping
17 short-lived equipment at the expense of short-lived equipment,
18 how much can we afford to do? What are the industries that would
19 have the short-lived as compared to the long-lived equipment
20 generally?

21 Mr. Sunley. Some of the longer-lived assets are the utility
22 industry; heavy manufacturing tends to have longer lived assets.
23 The steel industry has a fifteen-year life at the lower limit of
24 the ADR range.

25 The Chairman. What industries have a short life?

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1 Mr. Sunley. Some of the short lifes are contract construc-
2 tion. That has a four-year life. Manufacturing of food and
3 beverages has a three-year life at the lower limit. Manufacturing
4 of knitted goods, a six-year useful life.

5 The cutting of timber, a five-year useful life. Special
6 tools, of course, in the automobile industry and rubber products
7 have a three-year useful life.

8 The Chairman. You brought up the matter about the so-called
9 Long amendment. I did not know what you were talking about yester-
10 day. I recall very well what you are talking about now.

11 When we started out with the investment tax credit, my amend-
12 ment would say that you could not depreciation something that you
13 did not pay for, so that if you have a 7 percent investment tax
14 credit, you could not depreciate it any more than the other 93
15 points.

16 After awhile, I gave up on that and went along with the
17 idea that they could depreciate the whole thing on the idea of
18 the subsidy. In so far as you are depreciating something that
19 you did not pay for, this amendment would also give a much greater
20 advantage to short-lived equipment and depreciating something they
21 had not paid for and depreciating it quicker, would it not?

22 Mr. Sunley. Mr. Chairman, another way of seeing this, if
23 you have a 10 percent credit on a ten-year-life asset, you get
24 a percentage point a year, you might think of it. If you have a
25 three-year-life, you are getting 3-1/3 investment credit per

1 year.

2 Senator Matsunaga. Mr. Chairman, that is not entirely
3 correct. To begin with, that chart there, I think, presumes that
4 you get a greater return on short-lived equipment which is not
5 necessarily true. I think that if we use actual dollar figures
6 of normally a three-year-lived equipment, it would be cheaper --
7 \$1,000, let us say -- then you have this seven-year-lived equip-
8 ment which will be \$2,000 so that, under present law, the one
9 purchasing the seven or more year lived equipment would be getting
10 10 percent. It would be \$200 in the case of \$2,000 equipment.
11 You can multiply it by ten, if you wish to get into bigger
12 machinery. The one buying three-year lived equipment would be
13 getting only \$1,000.

14 The Chairman. Let's put it in these terms. Let us assume
15 that you have \$100,000 worth of equipment, and let us assume that
16 you can write it off in three years and, if you have enough
17 income, write it off again.

18 If that is the case --

19 Senator Matsunaga. That means you buy new equipment and
20 that is what the investment tax credit is all about, to stimulate
21 the manufacture of new equipment.

22 The Chairman. I understand that. Let us look at how it
23 works out.

24 Let us assume, if I understand correctly, this is the way
25 it has been explained to me, that that is three-year lived

1 equipment. You deduct it against taxes and as you earn your
2 money, you take the deductions and you write the equipment off
3 and, in three years, you ought to have your \$100,000 back. You
4 have deducted enough to earn your \$100,000 back.

5 In addition, you made an average of \$3,300 a year. You
6 put your \$100,000 into buying some more short-lived equipment at
7 that point and you replace the equipment and you have written that
8 off in another three years, then you have made your money back
9 and you have made another \$3,300 a year.

10 As that equipment is written off, assume you are retired and
11 you bring more in, you write that off, then you have made another
12 \$3,300. So, by the time you get through with the ten years, you
13 have made \$10,000 by buying short-term equipment. That is a
14 subsidy that the government has paid you. The government has
15 only paid you -- during the same period of time, the government
16 has only paid you \$3,300 subsidy, you might say, tax subsidy,
17 to buy the long-term equipment. It is a matter of favoring one
18 type of equipment over another type of equipment and the Treasury
19 had that very much in mind when they said at the beginning that
20 it has got to be seven year equipment.

21 Is that not right?

22 Mr. Lubick. Originally it was four, six and eight. It has
23 been reduced somewhat since.

24 Senator Matsunaga. Mr. Chairman, I think that your example
25 is not altogether correct, because we are calling for only a 10

1 percent credit in the phase-in after three years. In the initial
2 year, it will not be as much as 10 percent. Assuming we go to
3 the full credit, it would be 10 percent and assuming that we have
4 arrived at the full credit, which has allowed long-lived equipment,
5 it is still 10 percent per year. So that over a three-year period
6 it would be 30 percent-- not 100 percent right off, 30 percent --
7 and the seven year lived equipment would have 70 percent at the
8 end of the useful life of the equipment.

9 Ten year equipment life would have a full 100 percent. But
10 we are talking about merely reducing from seven years to three
11 years and then, with 30 percent in the case of a truck for example,
12 in the trucking business, you have -- the newer the truck, the
13 more efficient the truck, the greater the earnings because they
14 operate more efficiently and have, let's say, energy savings when
15 they use new equipment.

16 And, after three years they buy the new trucks, they have
17 used up only 30 percent of the credit, the full 30 percent, and
18 then the additional three years of new equipment, again they start
19 off with a full 10 percent, so after using two new trucks over a
20 six year period it still amounts to only 60 percent which would
21 not be equivalent to using equipment seven- years or more life for
22 six years.

23 Senator Curtis. May I ask a question? Maybe the staff could
24 answer it.

25 The effect on the revenue, changing it from a longer period

1 to a shorter period comes about by reason of the recapture clause.

2 Mr. Shapiro. No, Senator. It comes about because under
3 present law there is a 10 percent investment credit. You get that
4 full 10 percent only if that asset has a useful life of more than
5 seven years. If that asset has a useful life, for example, of
6 less than three years, you get no investment credit. It has to
7 have a minimum of three years and then if it has only three or
8 four years, you get only one-third of that investment tax credit.

9 Senator Curtis. You do not know that when you buy it?

10 Mr. Shapiro. You will know when you buy it, the useful life
11 I will get to recapture. You know, when you buy that asset the
12 useful life of it. The asset has a three-year useful life, so
13 you can take a 3-1/3 tax credit.

14 Under Senator Matsunaga's proposal, that asset would be
15 eligible to receive a 10 percent credit. The revenue cost is the
16 difference between 3-1/3 percent and 10 percent.

17 The recapture provision we give reference to is where an
18 asset, for example, has a seven-year useful life and you take a
19 full 10 percent credit. Then after three years, you sell that
20 asset. The Federal government lets you recapture two-thirds
21 because you did not keep it for the full term.

22 Senator Curtis. Thank you. Now I recall.

23 The Chairman. Let us go vote. We will come back.

24 (A brief recess was taken.)

25 The Chairman. Gentlemen, we have debated the Matsunaga

1 amendment. I had thought that we could just vote on it.

2 I am going to have to vote against it. Senator Matsunaga
3 made a good argument and each person should vote their own
4 conscience.

5 If it is all right, call the roll.

6 Senator Matsunaga. Mr. Chairman, I really do not know what
7 the sentiment will be as indicated by the votes, but in view of
8 the representations made by the Treasury that they do intend to
9 look into this matter, that it has merit, that they will report
10 back early next year - -

11 Mr. Lubick. We had hoped to do that, a general review.
12 As I indicated, we were already pursuing your idea before.

13 Senator Matsunaga. In view of that representation made by
14 the Treasury, Mr. Chairman, I withdraw my amendment.

15 The Chairman. I thank the Senator. I would like to help
16 him with the amendment, especially if we can work it out, something
17 that Treasury can live with.

18 Senator Hansen made a point, I think we should settle it.
19 He says that he thinks the effective date of the Hansen amendment
20 should be November 1, 1978. I believe that is correct. Otherwise
21 you are going to have people withholding transactions and it will
22 tend to hold up commerce until the effective date of that bill.

23 If people want to sell something, they will not sign the
24 contract or conclude that deal. It will freeze up the economy,
25 people waiting for a law to go into effect.

1 If there is no objection, we will make November 1 the
2 effective date of the Hansen amendment.

3 Senator Nelson. What happens to them if they make their
4 sales and the President vetoes it?

5 The Chairman. They will know by that time.

6 Mr. Shapiro. We will know by November 1.

7 The Chairman. By that time, I hope they will know.

8 I had a list here. Mr. Bentsen?

9 Senator Bentsen. Mr. Chairman, I would like to bring up
10 what was put into the law in '77 and a limitation was put on it
11 that the preference tax would apply to all income from oil and
12 gas property, intangible drilling deduction would be on all income
13 from oil and gas property.

14 Let me get it right. The excess of intangible drilling
15 costs above oil and gas income property, that would be a tax, and
16 be subject to a preference tax. The reason for that was put on
17 to stop the wealthy lawyer, the wealthy doctor, whatever it might
18 be, who is really not in the business, to use that as a tax
19 shelter.

20 In the alternative tax that I was looking at awhile ago,
21 apparently they were also considering putting it on there. All
22 I am asking is that we . put it on on a permanent basis. Other-
23 wise, you are going to see a substantial curtailment in drilling
24 in this country, and at the present time it prejudices against
25 the independent operator because the corporation does not have

1 that kind of limitation on it. It puts him in a position where
2 he is discriminated against.

3 The Chairman. Does Treasury support that?

4 Mr. Lubick. That was a description of the Administration's
5 proposal, Mr. Chairman. We had hoped it would be enacted as a
6 part of the energy bill, but it was the Administration's proposal.

7 The Chairman. It might become law in the energy bill. If
8 so, so much the better. Since the Administration favors it and
9 it is appropriate on a tax bill, I do not know of any objection.

10 Senator Hansen. I join with the distinguished Senator from
11 Texas. I think as we understand the thrust of the amendment tax
12 now, it will insure that an appropriate tax will be levied and
13 I think the earlier provision would certainly be redundant and
14 would discourage the very kind of activity we hope so much not
15 to encourage.

16 Senator Bentsen. I move that it be made permanent.

17 The Chairman. All in favor, say aye.

18 (A chorus of ayes.)

19 The Chairman. Opposed, no.

20 (No response)

21 The Chairman. The ayes have it.

22 Mr. Shapiro. Let me clarify the way that would work,
23 Senator Bentsen. I think in the 1977 act they adopted this
24 provision in 1977.

25 Senator Bentsen. That is correct.

1 Mr. Shapiro. The energy tax bill adopted it permanently,
2 in both versions, the House and Senate, effective in 1977,
3 beginning in '78. The alternative minimum tax would apply
4 beginning next year.

5 Senator Bentsen. That is why I need it now, and I am
6 asking for it to start.

7 Mr. Shapiro. That is what I am clarifying for the record.

8 Your amendment would amend the existing minimum tax to
9 apply for 1978, to apply this rule. Presumably it would continue
10 the same way in the alternative minimum tax as suggested.

11 Senator Bentsen. I am asking that it be amended permanently
12 and if they come up with an alternative tax, that is fine.

13 The Chairman. Senator Moynihan, then Senator Danforth,
14 then Senator Packwood.

15 Senator Moynihan. Mr. Chairman, this may not be the correct
16 time to raise it, or it may be. I would like to ask Senator
17 Hansen and the Chair to decide. As they know, I wish to propose
18 that there be a corresponding reduction in the capital gains tax
19 on corporations to match the prospective decrease in the income
20 tax on corporations.

21 We have dealt with capital gains today and we have yet to
22 deal with the other matter, but this has to do with capital
23 gains, although it relates to the other matter.

24 Why do I not just put the proposition? I think there is
25 general agreement to it. I do not know. You can decide whether

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1 you want to vote when you hear the proposition, which is that
2 there are a significant number of corporations in rather defined
3 kinds of activities -- lumber, paper, petroleum, equipment, real
4 estate, insurance and investment companies, cattle producers,
5 whose income is very heavily derived from capital gains. They
6 are a rather distinct kind of company, although they are
7 corporations, and if we are going to reduce the corporate income
8 tax to maintain the present relationships and not to have unin-
9 tended effects that no one seems to desire, it is suggested that
10 there be a two-point drop in the capital gains tax for corpora-
11 tions.

12 This revenue loss is approximately \$65 million, as I under-
13 stand. It would be about a \$130 million loss here. It has to
14 do with, really, symmetry.

15 Senator Hansen. Mr. Chairman, if I may respond to my
16 distinguished friend from New York, I agree with him completely.
17 I think it is important to maintain the relative comparability
18 between the maximum corporate tax rate and the capital gains rate
19 with corporations, and I do agree with him. I support his amend-
20 ment. I hope that it might be adopted.

21 Senator Packwood. Mr. Chairman, I echo that, especially
22 speaking for timber. We had a long debate two years ago on the
23 Floor of the Senate on the taxation of capital gains in timber
24 because of the unique requirement of holding timber for 60, 70,
25 80 or 90 years before it is sold. If we did not have the capital

1 gains, most properties could not be in business at all. They
2 would cut and leave. They could not afford to reforest. I hope
3 we maintain this.

4 The Chairman. Let us hear from Treasury.

5 Mr. Lubick. Mr. Chairman, everyone is aware -- although we
6 did not articulate it this morning, we do find the reduction
7 in the capital gains rate of the magnitude that you voted this
8 morning somewhat -- that the Administration strongly opposes, both
9 for distributional reasons and for revenue reasons, and I think
10 again that we think that the corporate change in the capital gains
11 rate is subject to some of the same objections.

12 Basically, the corporate capital gains are not subject to
13 many of the same problems that individuals are subject to. The
14 corporate capital gains rate, even at the present rate of 30
15 percent, is a very favorable rate and many of the items which
16 benefit from the capital gains rate are, strictly speaking, not
17 capital gains in the sense of being investments.

18 They would normally be treated as inventory items and subject
19 to ordinary income tax, and they have a preferential rate --
20 capital gains rate -- simply because that is the other rate that
21 is provided in the Code.

22 We would think that it would be appropriate to judge the
23 corporate situation on its own merits and that those persons who
24 are beneficiaries of the capital gains rates already have a
25 sufficient differential from the ordinary corporate rate, and it

1 ought not to be extended.

2 Mr. Sunley. I would like to say one more thing about the
3 special tax treatment of the timber industry and remind the
4 Committee of how the rules now work.

5 The treatment of that industry, which would get half of
6 the benefit from this amendment, is especially favorable. Not
7 only do they receive capital gains treatment for the gain repre-
8 senting the increase in the value of their standing timber, but
9 the cost of growing that timber, except for the planting cost,
10 generally is deductible against their other income.

11 So that, in a sense, they are getting better than capital
12 gains treatment. If they go out and spray their trees, put roads
13 in, pest control, many of their costs get put against other
14 income although, in an accrual sense, that is a cost of growing
15 timber and ought to be capitalized if you are not going to recog-
16 nize any income from timber until you later cut the trees.

17 This is an amendment for one industry. About half of the
18 benefit would go to the timber industry, which is especially
19 favorably treated.

20 The Chairman. Let me ask this question. Why not just say
21 that you cut the capital gains rates two points, but not on
22 capital gains on timber. Leave capital gains on timber.

23 Senator Packwood. Wait a minute here. This whole arrange-
24 ment will fall apart. Of all of the industries that can justify
25 capital gains, it is timber. When Mr. Sunley talks about spraying

1 trees, these are expense items. They can spray every year. If
2 you want to capitalize those, you want to go to an entirely differ-
3 ent tax -reatment on timber, on that basis.

4 The Chairman. We could give you a tax credit for spraying.

5 Senator Moynihan. Mr. Chairman, I would like to just say
6 that what Mr. Sunley said is clearly the case in the sense that
7 this is the situation. But what has been the consequence of the
8 situation? The United States -- the one thing we can sell the
9 Japanese is lumber.

10 Senator Packwood. The consequences --

11 Senator Moynihan. We have the best forests, the best
12 technology. This is a great resource and it is in front of our
13 eyes a depleted country in timber.

14 Senator Packwood. When you look at the private timber
15 holdings in the Northwest, private industry is doing substantially
16 better than the government in 44 states because they have made
17 a commitment to be in this business forever and they cannot be
18 in it, they will not be in it, but for the capital gains treatment
19 of timber. They cannot afford to hold an asset that long.

20 Senator Hansen. Mr. Chairman?

21 The Chairman. Yes, sir.

22 Senator Hansen. It occurs to me that the examples that
23 we are talking about -- I did not argue with the conclusions that
24 Treasury may have reached. I think that we ought not to lose
25 sight of an opportunity that we may be denying ourselves in

1 permitting corporations to branch out and to create new satellite
2 corporations where there is high-risk and where new technology
3 is involved and where the greatest opportunity for the creation of
4 new jobs and establishing a higher competitiveness in so far as
5 American companies are concerned, versus foreign countries, are
6 at stake.

7 It would occur to me that we, indeed, may be missing an
8 opportunity to expand the activities of established corporations
9 if this balance is brought into some disproportion as I feel would
10 result if we did not look closely at changing the capital gains
11 rates for corporations. We may expect a further concentration in
12 established lines of endeavor and tend to discourage the branching
13 out.

14 I would ask Mr. Lubick if there is any validity to my feeling
15 on that.

16 Mr. Lubick. Senator, I would assure you that any opinion
17 you have has validity. I think that we differ that the incentive
18 that we are talking about is essential. I think basically there
19 already is a very favorable rate for corporate capital gains and
20 where one draws the line, I think, is the question where reason-
21 able men may differ, and you and I do, and we are certainly in
22 that category.

23 Senator Hansen. Thank you, sir.

24 The Chairman. Well, I just wanted to point out, gentlemen,
25 there is a lot of appeal to the amendment, and when I was asked

1 about the capital gains tax rate, I said I have not focused on
2 it, I have not heard the pros and cons. I do not know any reason
3 why we should not cut the corporate capital gains tax than on
4 individuals.

5 In that this falls in the first fiscal year we will have
6 to reduce these tax cuts to individuals by that amount. Is that
7 not right, Mr. Shapiro? For budgetary reasons, we will have to?

8 Mr. Shapiro. This particular one would not have a signifi-
9 cant revenue impact this fiscal year. It depends on when you
10 make it effective, because any changes that do not have an
11 immediate effect, it is not reflected.

12 But your general statement is correct, which is to the
13 extent that the Committee enacts amendment which have revenue cost
14 in this fiscal year it will have to have the effect of reducing
15 something in the bill to come out and meet the Budget Resolution
16 that has been imposed.

17 The Chairman. Would you be willing to modify that by saying
18 that this will start effective January 1, have that effective
19 January 1?

20 Senator Moynihan. Yes, sir.

21 The Chairman. That meets the budget problem.

22 All in favor, say aye.

23 (A chorus of ayes.)

24 The Chairman. Opposed, no?

25 (No response)

1 The Chairman. The ayes have it.

2 Senator Moynihan. Mr. Chairman, one last thing. Senator
3 Packwood and I have an amendment on charitable contributions that
4 you know about. May I ask permission that it be distributed to
5 the Committee at this point?

6 The Chairman. I do not want to take it up.

7 Senator Moynihan. Not to be taken up, just to be on the
8 table.

9 The Chairman. Pass it around then.

10 I neglected to call on Senator Talmadge when his turn came.
11 I recognize the Senator from Georgia.

12 Senator Talmadge. Thank you, Mr. Chairman.

13 This amendment relates to S. 3433 which I introduced.

14 Mr. Chairman, in 1971, when we restored the investment tax
15 credit, we provided that a building that was designed for a special
16 purpose -- agricultural structures and enclosures for raising and
17 feeding of poultry and horticultural products, for producing eggs,
18 that the machinery would be entitled to the investment tax credit.
19 This is what we had in the Senate Finance Committee report.

20 To illustrate the type of structure which should be eligible
21 for the credit, the Committee gave the following example of a
22 unitarian hog-raising facility. One example of the type of struc-
23 ture closely related to poultry houses, called to the attention
24 of Congress was the unitary system for raising hogs, which includes
25 automatic feed systems, special air units, slatted flooring, pens

1 partitions. The structure which can be added to, according
2 to the number of hogs raised, is no more than a cover and way
3 of tying together the specially designed pens, automatic feed
4 systems, and so forth. There is no other practical use for the
5 structure and it can therefore be expected to be used only so long
6 as the equipment it houses is used. Such a structure would be
7 eligible for an investment credit.

8 It was the intention of Congress to make clear that the
9 investment credit as restored would apply to structures for raising
10 poultry and hogs, despite reference to certain revenue rulings to
11 the contrary. Despite the clear statement in the 1971 Committee
12 Report, the Internal Revenue Service nevertheless in numerous cases
13 has denied the credit to special purpose agricultural structures
14 or enclosures for raising poultry, livestock, horticultural
15 products or for producing eggs.

16 These structures have uses and physical attributes that are
17 very similar to the unitary system for raising hogs described in
18 the Finance Committee report and the U.S. Tax Court has ruled
19 that structures raising chickens and hogs, aging liquor and
20 greenhouses qualify for the credit.

21 For example, the Ninth Circuit Court of Appeals in 1974
22 in the district court of the Western District of Missouri, August
23 10, 1978, ruled that a greenhouse eligible for the credit in the
24 Ninth Circuit Court held a functional test, rather than the
25 appearance test, is the proper test to determine whether a structure

1 constitutes a building.

2 The Court concluded, and I quote: "Under the functional
3 test, greenhouses do not function as buildings as the term is
4 employed in Section 48. The greenhouses supply the controlled
5 environment that is essential to the commercial production of more
6 and finer flowers."

7 That is what the amendment does. It clarifies what we
8 thought we did in 1971.

9 I yield to the Senator from Kansas.

10 Senator Dole. Mr. Chairman, Senator Talmadge, I certainly
11 support the amendment. I am just wondering -- Senator Nelson and
12 I have some interest in extending the investment tax credits to
13 cooperatives. Would you have any objection to adding that to
14 your amendment?

15 Senator Talmadge. No.

16 Senator Dole. It is number 55 on the list. I think the
17 staff is aware of it. I know Senator Nelson and others have
18 expressed an interest in extending -- they do not have access now
19 to the investment tax credit.

20 Is that right, Gaylord?

21 Senator Nelson. Yes. I think Senator Curtis is also a
22 sponsor of that amendment.

23 Mr. Lubick. Right now, Senator Dole, I think the coopera-
24 tives have a scaled down investment credit. They do not get the
25 full investment credit.

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1 Senator Dole. Right.

2 Senator Bentsen. What is the reason for that, Mr. Lubick?

3 Mr. Lubick. Well, the Congress stated that because, in
4 1962, because the cooperatives had a special tax credit as
5 opposed to conventional corporations, they thought it was inap-
6 propriate to give them the full investment credit, so they tried
7 to proportion the tax credit in proportion to the special benefit
8 received, so it was going to be reduced in the same proportion
9 that their taxable income is reduced.

10 To the extent that the cooperative itself was nontaxable
11 by dividends, Congress provided for scale-down of the allowable
12 credit. That was the 1962 rationale.

13 Senator Dole. I think that has been changed.

14 Mr. Lubick. Since that time, I think there has been a
15 scale-down in connection --

16 Senator Dole. They changed the tax treatment since that
17 time.

18 Mr. Lubick. The regulated investment companies and invest-
19 ment trusts get scaled down as well, and the savings and loan
20 associations. It is a part of that whole package by which those
21 corporations which were treated somewhat differently from conven-
22 tional corporations had their credit scaled down.

23 I do not know, Senator Dole, whether your bill deals also
24 with the pass-throughs of the credit to the patrons.

25 Senator Dole. Right.

1 Mr. Lubick. That part is much more troublesome to us than
2 the liberalization of the credit itself, because the pass-through
3 presents some very difficult problems of handling -- for example,
4 if we have a recapture of the credit, I do not think that there
5 is any feasible way that the property is disposed of to go back
6 to the patrons and calculate the recapture of the credit.

7 I think, in addition, we have problems of distinguishing
8 between patrons and cooperatives that have a lot of the non-
9 patronage income as well.

10 So that, while we have serious objections to the pass-
11 through of the credit as far as the patrons are concerned, a
12 reasonable argument can be made for giving the cooperatives the
13 incentive at the cooperative level with respect to their invest-
14 ment.

15 Senator Dole. I do not think that the type of property the
16 cooperatives buy is disposed of, in any event. I am trying to
17 think of the cooperatives I am familiar with.

18 Senator Talmadge. They increase the assets.

19 Mr. Lubick. The investment credit is applicable to a desk
20 or a typewriter or anything like that. You would have some very
21 difficult calculations, if you were concerned with the pass-through
22 of the credit to some cooperatives that may have 100,000 patrons.
23 I think that the technical problems are very difficult.

24 The Chairman. Can you not figure out a way for Treasury or
25 somebody to give -- you could deal with a refundable tax credit, but

1 if you can find a way against taxes -- after all, the investment
2 tax credit is a subsidy, a subsidy for buying equipment. I do
3 not like to see the cooperatives lose the benefit of it.

4 If you are going to give a 10 percent subsidy to those
5 they are competing with, it seems as though the cooperatives ought
6 to have the same thing.

7 Mr. Lubick. They can get the benefit of it at the coopera-
8 tive level.

9 Senator Dole. We are talking about a total revenue loss
10 of \$29 million.

11 The Chairman. Why do we not just give them the benefit of
12 the credit against other taxes that they paid.

13 Mr. Lubick. That is what we would do at the cooperative
14 level.

15 The Chairman. For example, you can give him a credit against
16 the Social Security tax that they pay, payroll taxes, unemployment
17 taxes.

18 Mr. Lubick. I think what you are doing --

19 The Chairman. Gasoline taxes.

20 Mr. Lubick. You are making the credit, in that case, a
21 refundable credit.

22 The Chairman. Refundable credit? What are you talking
23 about? This is for taxes that they paid, against the Social
24 Security taxes that corporations paid.

25 Mr. Lubick. I think most of the cooperatives are paying some

1 regular tax and, since the House bill raises the amount of the
2 offset to 90 percent, I think that perhaps your suggestion is not
3 necessary.

4 The Chairman. I do not want to ask for something that is
5 not necessary, but if it is necessary, then I would suggest that
6 we do that.

7 I just think we ought to put them on the same basis.

8 Senator Dole. I think we can vote on it.

9 The Chairman. All in favor, say aye.

10 (A chorus of ayes.)

11 The Chairman. Opposed, no?

12 (No response)

13 The Chairman. The ayes have it.

14 Mr. Shapiro. Does that include both the Talmadge amendment
15 and the Dole amendment?

16 The Chairman. I would like to know a little more about
17 the Talmadge amendment that we started off with.

18 Would you tell us what the cost is, Mr. Shapiro?

19 Mr. Shapiro. The cost of that on a calendar year basis
20 is \$62 million, but the \$62 million includes a retroactive feature.

21 As Senator Talmadge indicated when he explained the amend-
22 ment, in 1971 Congress reinstated a 10 percent investment tax
23 credit. The Senate Finance Committee specifically covered this
24 in its Committee Report. The Internal Revenue Service has taken
25 a position, however, that the Committee Report does not bind them,

1 that the law does not specifically cover this because it is a
2 structure, and they are saying the investment tax credit is not
3 available for structures.

4 The Senate Finance Committee, in its report, indicated that
5 these special purpose structures should be eligible for the
6 investment tax credit. Since the law specifically did not say
7 that, the Internal Revenue Service has been disallowing the
8 investment tax credit in these cases.

9 Senator Talmadge. Going to Court, and losing.

10 Mr. Shapiro. As a result, Senator Talmadge's amendment is
11 retroactive to the August 15, 1971 effective date that the
12 Congress reinstated the investment tax credit to put in the
13 legislation what the Finance Committee had put in its Committee
14 Report. It is a feature that has a larger revenue cost the first
15 year to make it clear that it is covered for those years.

16 The Chairman. Is Senator Talmadge right when he says that
17 the Treasury has been contending a position at odds with what
18 the Senate Finance Committee did and going to Court and losing in
19 Court?

20 Mr. Shapiro. That is correct.

21 The Chairman. From their point of view, that does not cost
22 us anything. It seems to me if Treasury cannot win a lawsuit,
23 they are hard put to say the law is other than what the Judge says
24 it is. Mind you, it is one thing for Treasury to say that the
25 law is not what the Congress says it is but when they tell us that

1 the law is not what the Judge says it is -- I know when you lose
2 in Court that that is the end of it, you have lost.

3 Mr. Lubick. Senator Long, in fairness, the Service has
4 won some of the cases. It is still a ballgame. I do not think
5 it is a whitewash.

6 Mr. Shapiro. There is a split-up of authority and we have
7 to show the revenue effect that is involved.

8 The Chairman. It seems to me that we have a right to say
9 that the Judge is saying it our way. That is what we said to begin
10 with.

11 Senator Hansen. You said that this was the last half of
12 the ninth and we are up to that and we are ahead.

13 The Chairman. What it seems to me, the Committee started
14 out by saying here is what we intend. This is what we mean by
15 this, and then most of the courts apparently agree with that, but
16 apparently some of the courts have agreed with the Trasury and
17 said that the law does not mean what we thought we meant.

18 Mr. Lubick. The problem, Senator, there are many different
19 types of structures, and I think that you get into some very
20 difficult, sticky, factual situations. I think as far as the
21 Treasury is concerned, this matter ought to be settled by legisla-
22 tion, because it is a very stick standard.

23 As far as the greenhouses are concerned, it does seem to
24 us that the policy is correct, that they are essentially a piece
25 of machinery.

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1 Senator Talmadge. You cannot use it for any other purpose
2 except for the production of pigs or milk.

3 Mr. Lubick. I think that what the Service is concerned
4 with is that some of the structures could be used -- they are not
5 times that are coterminus in the useful life of the machinery.
6 That is a question that we agree that it is a matter of policy
7 where the life of the structure is coterminus with the machinery
8 that it houses and ought to be treated as a part of that machinery.

9 Then you get into the question as to whether you want to
10 allow -- how you differentiate the special purpose agricultural
11 structure from a general agricultural structure, or from struc-
12 tures generally used in the manufacturing or production, and the
13 lines are very difficult to draw.

14 The Chairman. Why do you not just say that if they quit
15 using it for the purpose they had in mind that you would have a
16 recapture.

17 Senator Talmadge. To be eligible for the credit under the
18 bill, it has to be specifically designed, used solely for, the
19 production of poultry, eggs, beef, pork or plants. General purpose
20 structures, such as barns, therefore would not be eligible.

21 The Chairman. It seems to me, Mr. Lubick --

22 Mr. Lubick. I think we are in accord as far as the purpose
23 is concerned. We are not quite clear whether the language does
24 it.

25 The Chairman. Why do you not talk with staff and work out

1 the technical amendments. It seems to me if all we are arguing
2 about is getting together, and you have the same purpose, I do
3 not see why you cannot get together on language.

4 Mr. Lubick. Would you give us a little discussion to work
5 on the language of the amendment?

6 Senator Talmadge. Special purpose buildings.

7 The Chairman. Without objection, you will work with the
8 staff and bring us back to us and tell us what you did. It seems
9 to me that if what we are voting for in this Committee is that
10 the law intended what we intended for it to mean all the time and
11 if got our share of the courts, at least half the courts, on our
12 side, I will be darned if I see why we have to put a revenue
13 estimate on something where all we are saying is that the law
14 meant what we intended it to be all the time and what the courts
15 have said.

16 If we have at least half the courts on our side, I will be
17 darned if we have to say the courts are wrong.

18 Mr. Shapiro. You have 75 percent of them on your side.

19 Senator Talmadge. Here is the difficulty. These farmers,
20 many of whom are going bankrupt, you have heard from them all
21 last winter, howling through the halls of Congress. They are not
22 able to hire a lawyer and litigate with the United States of
23 America, yet that is the only way they win a case. They do not
24 have the resources. They have no one to rely on but us.

25 The Chairman. They have a good Senator looking after them.

1 All in favor, signify by saying aye.

2 (A chorus of ayes.)

3 The Chairman. Opposed, no?

4 (No response)

5 The Chairman. The ayes have it.

6 Next, we will hear from Mr. Danforth.

7 Senator Danforth. Mr. Chairman, it is my understanding that
8 Senator Packwood is going to be leaving fairly soon and he has
9 a very short noncontroversial amendment. Would it be all right --

10 Senator Packwood. Mr. Chairman, I told him if it was contro-
11 versial, I would defer. It has to do with geothermal energy,
12 the identical amendment, and you have a chart in front of you, a
13 sheet in front of you, entitled, "Geothermal Energy Amendment."

14 It was in our '77 energy bill and is almost identical to
15 the amendment that we had in the 1976 Tax Reform Act in the
16 energy package which we dropped in conference because of the
17 cost.

18 The reason I offer this is that geothermal energy is rather
19 significant and becoming more significant in Oregon. The provi-
20 sions are the same, as I say, as were in the energy bill -- a
21 30 percent tax deduction up to \$2,000 for residential geothermal
22 expenditures and 20 percent for the next \$8,000; 15 percent for
23 businesses.

24 The depletion drilling is the same if it is for geothermal
25 liquid, the same is for oil and if it is geothermal gas, it is

1 the same as for methane, which is, as I recall, was the Chairman's
2 amendment of 10 percent. The same at risk provisions, the same
3 minimum tax provisions provided as we had, and I would not change
4 any of that.

5 If there are any questions, I would be happy to answer
6 them. We have gone over and over this subject. I do not think
7 it was controversial before.

8 The Chairman. The only thing that bothers me about it is
9 that I am afraid the Press is saying we are having more and more
10 amendments off the energy bill. I hope we can bring those
11 conferees out sometime soon and bring the Conference Report on
12 back in here. As soon as we get the gas bill behind us --

13 Senator Packwood. Right after the tuition tax credit
14 conference?

15 The Chairman. Incidentally, we are going to have a tuition
16 tax credit conference. I have asked to name the conferees, and
17 I have asked that Mr. Shapiro get together with Mr. Ullman and
18 see what Committee --

19 Mr. Shapiro. We have anticipated that as soon as you
20 finish these matters there will be a conference on the tuition
21 tax credit.

22 Senator Packwood. In that case, I will defer. I reserve
23 the right to, when we get to the Floor, if we have not retaken up
24 our energy tax conference, I will offer it on the Floor. I do
25 not think it is controversial.

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1 I will withdraw that now, and go back to Mr. Danforth's
2 amendment.

3 The Chairman. Mr. Danforth?

4 Senator Danforth. Mr. Chairman, last month Senators
5 Bellmon, Proxmire and I introduced S. 3416, which was entitled
6 the Excess Government Spending Surtax Act of 1978.

7 I would like to offer that bill as an amendment to this bill.
8 The point of this bill, in substance, would be to provide an
9 automatic surcharge on the income tax in the amount by which out-
10 lays in Federal spending in a year exceeded a real growth rate of
11 2 percent. That is, that would set a target growth rate for
12 Federal spending of inflation plus 2 percent.

13 It would impose an automatic surcharge on the income tax
14 in the event in which we exceeded that target.

15 The surcharge would kick out -- would not be applicable --
16 in terms of high unemployment, when unemployment rates exceeded
17 7.5 percent, thereby preserving the possibility of counter-cyclical
18 increases in Federal spending.

19 It seems to me that the whole concept of Proposition 13 has
20 not been so much a quarrel by the American people with respect to
21 taxes. It is a quarrel with respect to the very rapid increase
22 in the size and in the cost of the Federal government. And while
23 we are addressing the tax relief part to a greater or to a lesser
24 extent in the bill that is now before us, we should also be
25 addressing the Federal spending problem.

1 It is so easy for those of us in politics to say yes to
2 everybody who comes along with some spending program, and yet
3 when people complain about why are you costing so much, it is
4 easier to raise the deficit and to finance our spending increases
5 with what you have called printing press money.

6 It seems to me that there should be some political disincen-
7 tive to rapid increases in Federal spending, and if politicians
8 would have to go back to their constituents and explain to them
9 not only how they got them a new bridge or why they got them a
10 new highway and all of the wonderful things they have done, but
11 also explain to them why this separate item is on their income
12 tax return denominated as an excess government spending tax,
13 it might provide some cause for us to think about why we are
14 increasing the rate of Federal spending so rapidly.

15 That is the theory behind this amendment, Mr. Chairman.

16 The Chairman. It seems to me it is nice to have somebody
17 offer an amendment that will get us some revenue for a change,
18 but if you want to offer this, you ought to be a little more
19 direct with this. You ought to have a separate form that people
20 have to fill out, starting off with the names and pictures of
21 all the members of Congress who voted for excess spending, so
22 everybody can look on there and see if it was his Senator or his
23 Congressman who voted for this. Let them know who is responsible
24 for all of this so that when they pay it, they will know about
25 it.

1 I think also, just to be sure that they give credit where
2 credit is due, they should have a full-page picture on whose idea
3 it was from the beginning so everybody can get aboard and we can
4 have all credit for our good work and for our bad work, and cer-
5 tainly can get credit for passing this bill to cut government
6 spending and to make clear how that went.

7 I recall one time when Uncle Earl was campaigning for office
8 he sent out a circular showing all of these people running for
9 office on that ticket, what all they were running for. On the
10 other side was a picture of Uncle Earl.. His picture was bigger
11 than the rest of all of those.

12 It seems to me this ought to be accompanied by a picture of
13 all of these who voted for the excess spending and a picture of
14 the man whose idea it was to expose all of those people.

15 Senator Danforth. Mr. Chairman, I think that it sounds like
16 a gimmick, but I think it is the kind of thing that my constitu-
17 ents pretty well understand. I think they have realized something
18 that maybe we in Washington have not realized, namely that there
19 is not any free lunch.

20 The Chairman. It is a very interesting suggestion. Does
21 Treasury support the amendment?

22 Mr. Lubick. Mr. Sunley has analyzed it and I think he has
23 some interesting views to present.

24 Mr. Sunley. I once made a comment before this Committee on
25 the tax treatment of Americans living abroad and it was just a

1 mark-up on something totally unrelated. Some newspaper picked up
2 my picture that day and put it in the European edition and a
3 friend of mine sent me a note saying you had better not travel
4 to Europe under your regular name.

5 I think the goal that Senator Danforth's proposal is aimed
6 at is one that we all share -- that is, how do you get control
7 over government spending. I think Congress made a major step in
8 that direction with the Budget Act, which is an attempt to get
9 control over the level of spending and the level of revenues.
10 I think we all look for additional ways that would move us in this
11 direction.

12 We really have not had a chance to fully examine all of
13 the ramifications of this amendment. It did seem to me, just
14 looking at it, that the 7.5 percent figure has an escape valve if
15 the unemployment rate gets above 7.5 percent.

16 I notice in late 1974 when we were clearly going into a
17 recession, at a time when we probably would have liked a tax cut,
18 we could not have a tax cut at that time because we would not
19 have hit the escape valve. We did not get to 7.5 unemployment
20 until the beginning of the third month of '75 and then three
21 months of it.

22 It is true that the previous Administration did recommend
23 a tax increase when we went into that recession, but in retrospect
24 we know that was a mistake.

25 It is also clear that the proposal, in its own

1 rather insensitive to national emergencies other than recessions.
2 We have a provision that it kicks out if you have unemployment
3 over 7.5 percent. I think I could conceive of other circumstances
4 where you might want a major increase in government expenditures
5 and you would be constrained -- you would be required to have a
6 surtax at that very moment when the increase was really appropri-
7 ate for other reasons than just a recession.

8 The Chairman. Such as?

9 Mr. Sunley. War.

10 Senator Danforth. Mr. Chairman, that is exactly the point.
11 I think the people would be willing to pay for that. I think
12 that people would be willing and would understand -- in fact,
13 there is precedent in times of war, I believe in times of the war
14 in Vietnam for a surtax to help pay for the war in Vietnam. The
15 people, even with a very unpopular war, most people understood
16 why that was so.

17 But the problem here is that every year we have a deficit.
18 Every year we have a very large deficit, and in the Budget Act --
19 we say, is that not a wonderful thing to try to control the
20 deficit? It has not controlled the deficit.

21 The deficit has been larger under the Budget Act than it
22 was before the Budget Act came into existence.

23 First of all, you can increase outlays by the rate of
24 inflation.

25 Secondly, over and above that, there can be a 2 percent

1 increase without anything being triggered into that. But, to
2 the extent that outlays exceed that 2 percent growth rate, there
3 will be a surtax.

4 Let us suppose, then, that there was a \$10 billion overage,
5 that we have inflation plus 2 percent, plus \$10 billion. What
6 that means is that a taxpayer who has an income of \$20,000 would
7 have an extra \$87 item on his income tax.

8 It seems to me that that is the least we can do.

9 Basically, I think, that the question that is before the
10 the Congress in this tax bill is the relative share of the nation's
11 wealth that is going to be spent by government and the relative
12 share that is going to be spent by the people. And if Congress
13 was restrained by a provision such as this, if there were a
14 sufficient political restraint to keep the budget down to a
15 2 percent growth rate, then according to the projections I have
16 seen in the Gross National Product, we would get Federal spending
17 as a percent of GNP down in five years to about 20 percent of
18 GNP.

19 I think that is a goal that we should be shooting for.

20 The Chairman. If you have a war on your hands, you should
21 not call it excess spending. You should call it a war tax.
22 I hate to think that you would economize to the extent that you
23 are losing the war, especially if you are being invaded.

24 It seems to me, at a minimum, that you should amend the thing
25 somewhere so that you would call it a war tax.

1 Senator Danforth. I would be happy to accept that amendment.

2 Senator Hansen. Mr. Chairman, I move to observe that I
3 think Senator Curtis in times past has offered a similar amendment
4 and, if I recall correctly -- and I would ask Treasury if they may
5 recall, if they can help refresh my memory -- his proposal did
6 make allowances for an emergency such as war.

7 Would anybody know if that is right?

8 Mr. Lubick. I do not recall.

9 Senator Hansen. I think that is right.

10 Mr. Pritts. That is true.

11 Senator Talmadge. In his constitutional amendment, yes, it
12 does.

13 Senator Danforth. I would be happy to accept that.

14 The Chairman. Then you should have an employment trigger.
15 It should not always be 7 percent rather than 7.5 percent. You
16 have 7.5 percent; it ought to be 7.

17 Senator Danforth. Fine.

18 Also, this would only last for four years, Mr. Chairman.
19 It would not go on in perpetuity, but if it went on for four
20 years it is our projection and we do not exceed the 2 percent
21 limit that we would get spending down to 20 percent of GNP which
22 is the goal that I think a lot of people have been shooting for.

23 It is interesting that there is a wave going on at the
24 state level to amend the Constitution in order to prevent deficit
25 spending, or limit deficit spending. I am told that something

1 like 22 states have enacted resolutions petitioning the Congress
2 to convene a Constitutional convention for this purpose.

3 I do not think that a Constituional amendment is very
4 desirable myself. It seems to me to be inflexible.

5 It seems also to me that if we want to stave off that kind
6 of thing, we cannot just ignore a national wave, but we have
7 to be responsive to the same concern that is shared by a lot of
8 people in this country and the concern is that spending as a
9 percentage of gross national product has increased over the past
10 two decades and it is accelerating very rapidly now, and I think
11 that is what is annoying the people of this country.

12 I think this is a very moderate way to get out of it. It
13 does not forbid Congress from spending in excess of the limit.
14 All it does is to say that we are not going to finance all of
15 that excess spending out of a deficit and out of inflation, which
16 is a much more regressive tax, I might point out, than doing it
17 out of the income tax.

18 Senator Nelson. May I ask a question, Mr. Chairman?

19 The Chairman. Yes.

20 Senator Nelson. This applies to the corporate income tax?

21 Senator Danforth. Yes.

22 Senator Nelson. As to your second point, I also notice
23 that 22 states have proposed a constitutional amendment to be
24 sure that the Federal government budget keeps in balance. We
25 can avoid that whole thing, too, by just cutting out all that

1 general sharing of taxes and all of the stuff that we are sending
2 back to the states that balances their budget and unbalances ours
3 and we would have a surplus.

4 Senator Hansen. I am with you.

5 The Chairman. Let's not go hog wild about this.

6 We have a proposal. Do you want to vote on it now?

7 Call the roll.

8 Mr. Stern. Mr. Talmadge?

9 Senator Talmadge. No.

10 Mr. Stern. Mr. Ribicoff?

11 (No response)

12 Mr. Stern. Mr. Byrd?

13 Senator Byrd. Aye.

14 Mr. Stern. Mr. Nelson.

15 Senator Nelson. Aye.

16 Mr. Stern. Mr. Gravel?

17 (No response)

18 Mr. Stern. Mr. Bentsen?

19 (No response)

20 Mr. Stern. Mr. Hathaway?

21 (No response)

22 Mr. Stern. Mr. Haskell?

23 (No response)

24 Mr. Stern. Mr. Matsunaga?

25 Senator Matsunaga. No.

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1 Mr. Stern. Mr. Moynihan?

2 (No response)

3 Mr. Stern. Mr. Curtis?

4 Senator Hansen. Aye, by proxy.

5 Mr. Stern. Mr. Hansen?

6 Senator Hansen. Aye.

7 Mr. Stern. Mr. Dole?

8 Senator Dole. Aye.

9 Mr. Stern. Mr. Packwood?

10 Senator Danforth. Aye.

11 Mr. Stern. Mr. Roth?

12 (No response)

13 Mr. Stern. Mr. Laxalt?

14 Senator Danforth. Aye.

15 Mr. Stern. Mr. Danforth?

16 Senator Danforth. Aye.

17 Mr. Stern. Mr. Chairman.

18 The Chairman. I would like to withhold my vote right now.

19 I will probably vote for it, but I would like to wait until

20 tomorrow.

21 Eight yeas and two nays and one present. My inclination

22 would be to vote for it but I would like to think about it.

23 Now, Senators, I had planned to stay here until 4:00

24 o'clock and I would hope that we would come back and meet at

25 11:00 o'clock tomorrow. The reason I say 11:00, I hope to have a

1 meeting with some of the Democrats before coming in here, maybe
2 some of the Republicans before coming in also.

3 I would hope at 11:00 we could come in and discuss some
4 of these suggestions and make a lot of progress tomorrow.

5 Senator Dole. Along those lines, there are a number of us
6 who submitted to the Chairman and every member an alternate plan
7 that may or may not have merit, but at least it is something that
8 you might look at.

9 Do I understand we will start off with the same, sort of
10 take terms? I have a little amendment that the Treasury agrees
11 with that I could take up tomorrow morning, then. That is the
12 one that allows the participant in a tax-qualified plan to deduct
13 amounts contributed up to \$1,000.

14 I think if we phase that in over a four-year period
15 Treasury might agree to it. I do not know.

16 The Chairman. We will talk about it tomorrow. Meanwhile,
17 I think it is a good idea to start thinking somewhat in terms of
18 a package approach to take care of some of the things that various
19 Senators have placed in the highest priority and also, I suspect,
20 before we are through we would also have to squeeze out some of
21 the things that we would like to do, but may not find enough
22 money.

23 So we will meet at 11:00 tomorrow.

24 (Thereupon, at 4:15 p.m. the Committee recessed to reconvene
25 at 11:00 a.m. on Friday, September 22, 1978.)