

1 EXECUTIVE COMMITTEE MEETING ON PROPOSED TAX REFORM ACT OF
2 1986
3 TUESDAY, APRIL 22, 1986
4 U.S. Senate
5 Committee on Finance
6 Washington, D.C.

7 The committee met, pursuant to recess, at 2:45 p.m. in
8 Room SD-215, Dirksen Senate Office Building, the Honorable
9 Bob Packwood (chairman) presiding.

10 Present: Senators Packwood, Danforth, Chafee,
11 Durenberger, Symms, Long, Matsunaga, Moynihan, and Bradley.

12 Also present: Roger Mentz, Assistant Secretary for Tax
13 Policy, Department of the Treasury.

14 Also present: Bill Diefenderfer, Chief of Staff; Bill
15 Wilkins, Minority Staff Director; John Colvin, Chief Counsel;
16 David Brockway, Chief of Staff, Joint Committee on Taxation;
17 Randy Weiss, Deputy Chief of Staff, Joint Committee on
18 Taxation; Lindy Paull, Tax Counsel, Majority; Barbara Groves,
19 Tax Counsel, Minority; and Susan Taylor, Executive Assistant.

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1 The Chairman. All right, let us start on page 107,
2 insurance. Mr. Wilkins and Mr. Strella and John, do you want
3 to lead us through it? Somebody will want to change Mr.
4 Santos' nameplate.

5 Ms. Groves. If it is all right, Mr. Chairman, I will
6 begin with it.

7 The Chairman. Oh, yes, I apologize. I forgot that you
8 were going to lead us on this one. That is my fault. I
9 knew that. You were all ready to go the other day, right up
10 to the moment when we changed. I apologize. You have this
11 whole section.

12 Ms. Groves. All right.

13 Beginning on page 107, on insurance product. Your
14 proposal, Mr. Chairman, does not adopt the Administration's
15 recommendation to tax the inside buildup on life insurance.

16 The Chairman. Nor does the House bill.

17 Ms. Groves. Nor does the House bill.

18 Also, your proposal retains current law with respect to
19 the treatment of policyholder loans. It does repeal a small
20 exclusion for life insurance proceeds left on deposit in case
21 of surviving spouses.

22 The Chairman. As did the House bill.

23 Ms. Groves. As did the House bill.

24 Your proposal does not adopt the House bill provision
25 that someone could not claim a casualty loss if they had

1 insurance and failed to file a claim. It retains present law
2 in that regard.

3 Your proposal does adopt the Administration's recom-
4 mendation that alters the treatment of structured settlements,
5 requiring that the full amount of the compensation paid to the
6 assignee be included in the assignee's income, and then the
7 assignee would be given an election of when they wanted to
8 deduct the payments out.

9 Turning to page 109 and the treatment of life insurance
10 companies, your proposal, as did the House bill, does not
11 adopt the Administration's recommendation that life insurance
12 reserve deductions be limited to net surrender value. Rather,
13 it would retain current law where the deduction is the
14 greater of a Federally prescribed computed reserve, or the
15 net surrender value.

16 Your proposal would retain the present law small company
17 deduction for life insurance companies, as would the House
18 bill. However, both your proposal and the House bill would
19 repeal the special life insurance company deduction.

20 Turning to page 110 --

21 Senator Symms. Excuse me. Is that in the issue of
22 consolidation? I don't have my spreadsheet here with me.

23 Ms. Groves. No, I don't believe it would be part of the
24 consolidation issue. The special life insurance company
25 deduction was added in the 1984 Act. It allowed the life

1 insurance company to take a deduction equal to 20 percent of
2 what is called "tentative life insurance taxable income."

3 The purpose of the provision, as I understand it, was to
4 ensure that life insurance companies' effective tax rate
5 would be at 36.8 percent.

6 I don't believe it would get pulled into the consolida-
7 tion issue, Senator.

8 Senator Symms. Thank you.

9 Ms. Groves. Turning to page 110 and the treatment of
10 tax exempt organizations engaged in insurance activity, your
11 proposal, Mr. Chairman, would retain present law in that
12 regard. It would not adopt the House bill provision, which
13 would repeal the tax exemption for organizations if a
14 substantial part of their activities had to do with
15 commercial insurance.

16 Mr. Mentz. Mr. Chairman?

17 The Chairman. Mr. Secretary?

18 Mr. Mentz. Let me just note that the Internal Revenue
19 Service has some reservations whether under current law
20 Blue Cross, Blue Shield, and GIAA CLEFF are tax exempt. That
21 is kind of a continuing issue that is within the IRS. I am
22 not commenting on it, but I am just bringing it to your
23 attention.

24 The Chairman. Are you suggesting that if there is any
25 question and we want to keep them tax exempt, we had better

1 change the law to ensure that?

2 Mr. Mentz. I wouldn't propose to tell you which way to
3 go. But if that is the way you want to go, I think you ought
4 to do it explicitly. Yes, that is exactly what I meant.

5 The Chairman. Thank you.

6 Senator Matsunaga?

7 Senator Matsunaga. Mr. Secretary, you are raising a
8 question of whether or not they are tax exempt under the law
9 as it now reads?

10 Mr. Mentz. Correct.

11 Senator Matsunaga. I see.

12 Mr. Chairman, if this be the proper time, unless she is
13 not finished --

14 The Chairman. No, don't hesitate to interrupt us as we
15 go along, Sparky.

16 Senator Matsunaga. I will be offering an amendment at
17 the appropriate time relative to the treatment of structured
18 settlements, which is item 2B on page 108.

19 The Chairman. Thank you.

20 Ms. Groves. Now, on page 111, Mr. Chairman, your
21 proposal adopts the House bill's provision concerning the
22 use of net operating losses when a company is insolvent or
23 liquidated and had releases from a policyholder surplus
24 account.

25 Turning to page 112 and the treatment of property and

1 casualty insurance companies. As a first matter, Mr. Chairman,
2 your proposal would include annually in income of a property
3 and casualty insurance company an amount equal to 20 percent
4 of the unearned premium reserve. It would take current
5 unearned premium reserve when it goes into effect, and spread
6 that, 20 percent of that amount, ratably income over 10 years.
7 That is similar to the House bill provision; although, as I
8 said, it would have a 10-year spread under the Chairman's
9 proposal and a five-year spread under the House bill.

10 With respect to holdings of tax exempt obligations, the
11 House bill had a provision that property and casualty
12 insurance companies' reserve deductions would be reduced up
13 to a percentage of its tax exempt holdings. Your proposal,
14 Mr. Chairman, does not adopt that provision nor one similar
15 to it.

16 With respect to loss reserves, the House bill only had a
17 study of loss reserves, and in its place put in what I think
18 the industry affectionately called "the hammer." That would
19 basically put a minimum tax beginning in 1988 equal to a
20 percentage of its gain from operations shown on an annual
21 statement.

22 Instead of that, Mr. Chairman, your proposal would adopt
23 a simple discounting provision for loss reserves held by
24 property and casualty insurance companies.

25 Turning to page 113, there is a study, as I said, in the

1 House bill for loss reserves. Since your proposal, Mr.
2 Chairman, actually addresses the loss reserve issue, there is
3 no provision for a study, nor is there a provision for a
4 study of whether there should be a special treatment of
5 policyholder dividends of mutual property and casualty
6 insurance companies as there is in the life insurance area.

7 Mr. Mentz. Mr. Chairman, we are grateful any time you
8 delete a provision requiring the Treasury to make a study.

9 (Laughter)

10 Ms. Groves. Turning to page 114 on the protection
11 against loss accounts, your proposal, Mr. Chairman, would
12 repeal those accounts, as would the House bill.

13 On the treatment of small companies, your proposal,
14 Mr. Chairman, would replace the current law myriad provisions
15 relating to small mutual insurance companies to a single
16 provision that would apply to both stock and mutual companies.

17 Senator Durenberger. Mr. Chairman?

18 The Chairman. Senator Durenberger?

19 Senator Durenberger. Can I inquire as to why your
20 proposal on this issue, the move from the House 500,000
21 threshold down to 350 and from the 2 million threshold to
22 1.2?

23 Ms. Groves. I would imagine, Senator, that it is just a
24 matter of where you draw the line, that if you are treating
25 small companies as being tax exempt, what is the proper level

1 at which you decide that a company should or should not pay
2 tax?

3 Senator Durenberger. There is no particular policy or
4 reason that would prevent my amendment to adopt the House
5 language at some point, which I intend to do?

6 The Chairman. That is correct.

7 Senator Durenberger. Thank you.

8 The Chairman. That completes the section. You have a
9 very calming effect on this committee; are there any other
10 sections you would like to do?

11 (Laughter)

12 Senator Symms. Mr. Chairman, are we through? I wanted
13 to bring up this question about consolidation and find out
14 how the law treats it, whenever we are ready.

15 The Chairman. In this section right here? Which
16 consolidation are you talking about?

17 Senator Symms. Well, I want to know how an insurance
18 company is treated if they own 80 percent of the stock of
19 another insurance company, and if they can deduct the losses
20 from the gains. Say, a life insurance company owning a
21 property and casualty company, for an example.

22 Ms. Groves. I think what the thing is, that if a life
23 insurance company owns a property and casualty insurance
24 company now, they could file consolidated returns.

25 Some persons have raised concerns that, given the losses

1 in property and casualty insurance companies, that that has
2 allowed an improper use of those losses.

3 I think the Chairman's proposal addresses that issue, not
4 by denying consolidation but by attempting to reach a manner
5 of taxing property and casualty insurance companies that would
6 ensure that their economic income is being taxed, and thus,
7 the consolidation issue would not be any different for that
8 industry than it would be for any other industry.

9 Senator Symms. So, it would be the same in the
10 Chairman's proposal?

11 Ms. Groves. As under current law, yes.

12 Senator Symms. How much more does this increase the
13 taxes on property and casualty companies?

14 Ms. Groves. The revenue that would be raised by it,
15 I believe, is 5.9 billion over the five-year period.

16 Senator Symms. So, it is like a billion a year,
17 approximately? More.

18 Ms. Groves. Yes.

19 Senator Symms. In taxation of property and casualty
20 companies?

21 Ms. Groves. Yes.

22 Senator Symms. And how much were the profits of the
23 property and casualty companies in the last five-year period,
24 say?

25 Ms. Groves. I don't know that figure.

1 Senator Symms. What I am trying to find out is, how
2 big of a hit are they taking in this proposition? That is
3 what I mean.

4 Ms. Groves. Well, on an industrywide basis, as I said,
5 the revenue raising would be 5.9 billion. I imagine the
6 specific effect would be on a company-by-company basis.

7 Senator Symms. Well, how much taxes would they pay under
8 current law, and how much taxes would they pay under the
9 Chairman's proposal. I'll put it that way, then. I know it
10 is 5.9 billion more, but how many dollars are we talking
11 about?

12 Ms. Groves. I don't know. Perhaps the Joint Committee
13 would have those figures.

14 Mr. Weiss. Senator Symms, I don't have it right here,
15 I believe, the projections for the future. We do have some
16 statistics on the 10-year period 1975 to 1984, if that would
17 be helpful to you. Over that period the net gain on a book
18 basis was about \$75 billion, and the net Federal income tax
19 was actually a small refund. So, during that period the
20 companies had a substantial amount of income and essentially
21 did not have a tax liability.

22 Senator Symms. Are you telling me, then, they are going
23 from paying no taxes to paying a billion dollars a year?
24 How many revenue bonds do they own that would be paying local
25 taxes, or so to speak, subsidizing local projects?

1 Mr. Weiss. What I am not sure is, what the particular
2 profit projections we have are for the 1987 to 1991 period,
3 and whether we are projecting zero tax and then \$5.6 billion
4 more, or whether it is going from some small tax to some
5 bigger tax.

6 Senator Durenberger. Could we explore that as a question
7 of history? A couple of years ago we went through life
8 insurance and we gave them a dollar figure, and we let them
9 restructure the Tax Code. Is that what we are doing in
10 property and casualty, Mr. Chairman?

11 The Chairman. That is roughly it. They didn't like what
12 the House did, and the House put in what was called "the
13 hammer." They were frightened to death that we might do
14 exactly what the House did. So, we have more or less reached
15 an agreement with them that comes with a figure which is not
16 far off the House figure, but they like the way we have gone
17 about it much better than the House.

18 Now, if you were to ask them, "Would you rather have
19 neither?" the answer is Yes.

20 Senator Durenberger. But the dollar amount is the same
21 in both the House and the Senate?

22 The Chairman. I am trying to remember; it isn't that
23 far off, is it, in terms of the total?

24 Ms. Groves. Under the House bill, based on the different
25 five-year period, it would be 4.8. And under the Chairman's

1 proposal it is 5.9.

2 The Chairman. Bearing in mind it is one year off. They
3 are both five-year periods, but theirs is a one year prior
4 five-year period.

5 Senator Symms. What you are saying is that 4.9 billion
6 would be paid under current law, and 5.9 billion under the
7 Chairman's?

8 Ms. Groves. No, 4.8 under the House bill, Senator, and
9 5.9 under the Chairman's proposal.

10 Senator Symms. And how about current law?

11 Senator Durenberger. We don't know that.

12 Ms. Groves. That, again, is the question. I don't know
13 exactly what the revenue raised from that industry is under
14 current law.

15 Mr. Weiss. Senator Symms, I believe our projections
16 would show that there would be some net amount of Federal
17 income tax paid, even if the industry as a whole had a loss,
18 because there would be some companies with profits and some
19 companies with losses, and during this period the companies
20 with profits may well pay some tax, while the companies with
21 losses would pay no tax.

22 I am not sure, even if there is a net loss for the
23 industry as a whole. So, it is likely that there would be
24 some tax paid during this period from the subset of companies
25 that have profits.

1 The Chairman. Mr. Secretary?

2 Mr. Mentz. Mr. Chairman, just to give a little perspec-
3 tive to the issue of taxation of property and casualty
4 insurance companies, property and casualty companies were not
5 really affected very much at all by the 1982 or 1984
6 legislation. And under current law they enjoy a very
7 favorable tax regime, in that they are entitled to a full
8 reserve deduction for the anticipated amount of a loss that
9 will occur in the future, undiscounted. In other words, if
10 the loss is going to be \$100, they would take a deduction now
11 for \$100, even though, clearly, you would not need to set
12 aside \$100 because it is going to grow with investment income
13 by the time the loss is payable.

14 That problem has been raised by Treasury; it has been
15 raised by GAO; it is acknowledged by the industry. And as
16 you indicated, the industry basically came forward after the
17 House bill, and the Chairman's package represents a
18 negotiated arrangement with which the industry participated,
19 recognizing that current law was extremely favorable.

20 Senator Symms. Is the issue over the time value of
21 money?

22 Mr. Mentz. The issue is whether the current deductions
23 for the reserve are overstated. And I think it is acknow-
24 ledged that they are. That is the issue.

25 Senator Symms. Thank you.

1 The Chairman. Further discussion on this section?

2 Senator Bentsen?

3 Senator Bentsen. Yes, Mr. Chairman.

4 I have had some people in the title insurance companies
5 approach me saying that in H.R. 3838, where direction was
6 taken to try to see that the fire and casualty companies pay
7 a larger share of taxes, that the feeling apparently on the
8 House side was that they were not paying a proportionate
9 share, but that the legislation was drafted so broadly that
10 it included title insurance companies. And they allege that
11 because of the difference in the business -- and there is a
12 very major difference in the business -- they shouldn't be
13 under the same category, and that in turn that they pay a
14 substantially higher percent of the tax.

15 I would like Ms. Groves to comment on it; I think she is
16 familiar with the issue.

17 Ms. Groves. As I understand it, Senator Bentsen, their
18 primary problem has to do with the provision in the Chairman's
19 proposal concerning the unearned premium reserves, and the
20 20 percent pays. They have recently supplied the staff with
21 quite a few materials explaining the industry, and the staff
22 is in the process of going through those.

23 It appears that their problem might be that, since they
24 put a higher proportion of their premiums and unearned premium
25 reserve than would usually be the case in a property/casualty

1 company, that the 20 percent might overstate the acquisition
2 expense capitalization issue which the unearned premium
3 reserve disallowance piece is aimed at.

4 So, we are currently going through this material and
5 looking at what they have submitted.

6 The Chairman. Any other discussion on this section?

7 Senator Symms. Mr. Chairman, if I could ask one more
8 question, in this discounting is there going to be an interest
9 rate charge on that?

10 Ms. Groves. Yes. The way the discounting proposal would
11 work, it would begin generally for all lines of business of a
12 property/casualty insurance company and would start with the
13 gross amount. Then it would be discounted, based on an
14 interest rate, a payout period, and a time period.

15 The Chairman's proposal states that it would be a five
16 percent rate adjusted to an appropriate rate. What is
17 envisioned by that is beginning --

18 Senator Symms. A five percent based on a what?

19 Ms. Groves. Five percent. Beginning at five percent.

20 Senator Symms. For how long?

21 Ms. Groves. What is envisioned is that in 1987, which
22 would be the first year in effect, it would be at five percent.
23 For 1988 it would move to a number which is a percentage of
24 the AFR. That percentage would be the ratio which five
25 percent bears to the AFR at January 1, 1987. If you use the

1 current mid-term AFR which just came out in the last few days,
2 at 7.43, that would put the 1988 interest rate used in
3 discounting at 67, approximately 67 percent of the AFR.

4 Then, for 1989 it would move up to a higher percentage
5 of the AFR, somewhere between the 1988 level and 100 percent.
6 Then at 1990 it would go at 100 percent of the AFR, the
7 rationale being that the AFR, being a conservative investment
8 rate, that a company could always invest its assets at at
9 least that rate, and that that would be the discount rate that
10 should be used, because they could always get at least that
11 much money on their assets.

12 The Chairman. Further questions?

13 (No response)

14 The Chairman. If not, good job. Thank you.

15 Let us move on to the capital gain section, one of the
16 relatively simpler sections, and hope we can move through it
17 relatively fast.

18 Mr. Colvin. That begins on page 30, Mr. Chairman.

19 The Chairman. Page what, John?

20 Mr. Colvin. Page 30.

21 The Chairman. Thank you.

22 Mr. Colvin. On page 30, the Chairman's proposal would
23 retain the top capital gains rate of 20 percent for
24 individuals and 28 percent for corporations. And at the
25 bottom of page 30, the Chairman's proposal with respect to

1 incentive stock options would repeal the sequencing rule. It
2 changes the \$100,000 limit from application to grants to
3 exercise, and also limits incentive stock options to companies
4 with gross profits of \$100 million or less.

5 On page 31, the Chairman's proposal includes the small
6 business participating debenture proposal, which has been
7 reflected in legislation introduced over the last several
8 years by Senator Weicker and many other Senators.

9 The proposal would create a hybrid investment instrument
10 for small business, under which the business could deduct
11 interest paid on the small business participating debenture,
12 the lender would report as income the interest up to a
13 guaranteed level that would treat as capital gains interest
14 above the guaranteed level. The purpose of the proposal is
15 to help small business raise capital.

16 On page 32, the proposal includes a provision relating
17 to straddles, and would treat as short-term capital gain
18 received under tax straddles, and as a result the applicable
19 highest rate would be 35 percent; whereas, under current
20 law the highest rate would be 32 percent, and under the
21 workings of the House bill the highest rate would be 28.4
22 percent.

23 Senator Symms. Hold on that point, John.

24 Now, you call it "straddles," but aren't you talking
25 about commodities?

1 Mr. Colvin. That is correct.

2 Senator Symms. But is there any other place in the Tax
3 Code where we tax somebody for unrealized gain, other than
4 this?

5 Mr. Colvin. The market-to-market system is limited to
6 these rules.

7 Senator Symms. But see, I thought there had been an
8 agreement made in 1981 that, since the market-to-market
9 taxation is an exception to ordinary tax law, whereas, people
10 are taxed on unrealized gain -- in other words, they may
11 close out the transaction and lose money on the transaction,
12 but at year end they are taxed on what their basis was,
13 whether ahead or behind. And we are talking about raising
14 them, is that it?

15 Mr. Colvin. The effect of the proposal would be to
16 raise them from the 32 to 38, under the theory that they are
17 more in the nature of short-term capital gains. If there
18 were no provision, the effect would be --

19 Senator Symms. Thirty-two to 38? Or 35?

20 Mr. Mentz. We are not up to 38 yet.

21 Mr. Colvin. From 32 to 35. I apologize.

22 Senator Symms. Thirty-five. Well, what about if a
23 person had commodity trades and was not in the income bracket
24 to be at the 35 percentile? Would they then be at 15?

25 Mr. Colvin. That is just the maximum rate, and so lower

1 rates would apply in those cases.

2 For shorthand purposes I was giving the highest
3 applicable rate, but if they were in the 15 or 25 percent
4 bracket those would be the rates that would apply.

5 Senator Symms. I guess what I was trying to get at is,
6 by having gone to mark-to-market where this is a very high
7 risk enterprise anyway, and we have the 32 percent rate, is
8 there any reason to think that that isn't working fairly well
9 now at that rate?

10 Mr. Colvin. If there were no provision in the Chairman's
11 bill, the effect of the top capital gains rate of 20 percent
12 and the top individual rate for ordinary income of 35 percent
13 would be to reduce this figure to 26 percent. So, that would
14 be the effect if there were no provision.

15 Senator Symms. And if there is no provision -- now, say
16 that again.

17 Mr. Colvin. You see, the House had no provision. If
18 the Chairman had also had no provision, the effect would be
19 the top tax rate would be 26 percent. That is simply the
20 interaction between the 20 percent and the 35 percent top
21 rate.

22 Senator Symms. The 60-40 rule?

23 Mr. Colvin. That is right, that is how the 60-40 rule
24 would apply.

25 Senator Symms. I would like to explore that a little bit

1 more, Mr. Chairman, at some point, as to whether I totally
2 understand why it is we are changing this.

3 What would it take to get it back, just to keep it the
4 way it is?

5 Mr. Colvin. It would take a different rule than 60-40.
6 I don't have the percents. You would have to modify that
7 formula.

8 Senator Symms. What I am trying to get at is, why
9 single out one industry and essentially give them a tax rate
10 increase? Why not apply the 60-40 rule like we have. If we
11 think it is fair and equitable to have the 20 percent on
12 capital gains rate and 35 percent top rate, it would seem
13 logical what they did in the House.

14 Mr. Colvin. I guess it is a question of what you think
15 the nature of these transactions is. And the theory of the
16 Chairman's proposal is that the 20 percent capital gains
17 rate should be retained, but that, with respect to this type
18 of transaction, the 35 percent rate is more appropriate.

19 Senator Symms. So they would actually end up getting a
20 3 percent tax increase on what they are doing right now?

21 Mr. Colvin. That is right.

22 Senator Symms. See, the concern that I think the
23 committee needs to consider is that, because of the applica-
24 tion of mark to market rules, sometime along in the middle of
25 December or earlier a lot of traders start slowing down on

1 their trading and closing out for the year, because they don't
2 want to end up with a position that shows a profit at year
3 end and then come back over a long weekend of New Years and
4 find out that they have lost a lot of money on it and are
5 still liable for a 32-percent tax rate against that position.

6 What this does to the farmers and lumbermen and miners,
7 and so forth, that use the commodity markets for price
8 discovery is, it makes the market awfully thin, because
9 people stop trading; it takes all those traders in there,
10 the ones that make the market.

11 What my concern is, if you raised their rates, you
12 are going to compound that year-end problem, which has
13 happened; but I think they have learned to adjust to the
14 mark-to-market system. But that is the only place in our
15 Tax Code where we tax people for unrealized gains -- which
16 I personally think is a poor policy, but it is the law. But
17 that is neither here nor there, what my opinion of it is,

18 It is a fact that those people who are engaged in making
19 those commodity or options transactions that are taxed on a
20 mark-to-market basis stand the possibility to lose a lot of
21 the profits that they had if they hold a position through
22 their year-end. Maybe the way to offset that would be to
23 get them to all stagger their end-of-year, so that you would
24 have all the traders having a year-end at the end of a
25 different month, based on the alphabet or something, so that

1 they don't all come up on a calendar year; but it forces those
2 markets to get very thin at the end of the year, which can be
3 very detrimental to the industries that are producing and
4 using those markets.

5 So I just throw that out. I don't have a solution, but
6 if you can come up with something on that. What I would
7 think would be more fair would be to at least not raise their
8 rate, maybe going to 26 percent is more than the committee
9 wants to do; but I don't see why they should have their rate
10 raised to compound this problem.

11 The Chairman. Further discussion?

12 Senator Moynihan. Mr. Chairman?

13 The Chairman. Senator Moynihan.

14 Senator Moynihan. Are we on the straddles?

15 The Chairman. Just on it, right now.

16 Senator Moynihan. You know, this is something that I
17 was much involved with in the first place. I have never heard
18 that the industry liked the arrangement that we made, that
19 mix of 60-40, when we put it to the commodity straddle
20 arrangements. I guess I should say I have never heard it
21 until this morning. Now, I gather there are some people who
22 don't consider it an unfriendly act, that we took.

23 I guess as much as any one person, I wrote this pro-
24 vision. I always thought they were very angry with us, and
25 me. Could I reserve just the opportunity to consult, then

1 return to the subject at a convenient time?

2 The Chairman. Absolutely. All we are doing is
3 discussing it, Pat.

4 Senator Moynihan. Yes, I know that. I just would like
5 to learn whether they are still as mad as they said they
6 were. I think things turned out better than they thought.
7 I don't know.

8 Senator Symms. Would the Senator yield for a moment?

9 Senator Moynihan. Yes.

10 Senator Symms. I would just like to say that, coming
11 from a state where we produce silver and lumber and grain and
12 livestock, and all of these commodities that are traded on
13 the exchanges, under the old law -- and I am not sure how the
14 traders like the mark-to-market system, but under the old
15 law -- there was a preference, a tax preference, slightly
16 tilted in favor of the long positions, the bulls.

17 Senator Moynihan. Yes.

18 Senator Symms. So, the big fortunes that were often
19 made in the commodity markets were made in the hands of the
20 people that were in a long position. That was beneficial to
21 the same guy that is mining silver or selling lumber or
22 producing lumber, producing grain, livestock, and so forth.

23 And when we changed to mark-to-market, that was
24 basically my opposition to it. You took all the bias out of
25 it; you might as well be short as long.

1 In the old says, if you were short you would get hit
2 at the higher tax rate; if you were long, you would have --

3 Well, what has happened is, we have taken the bias out
4 of it, so there is no benefit for anybody to be either long
5 or short.

6 Senator Moynihan. That was our object, but they didn't
7 really like it.

8 Senator Symms. Well, that was to the disadvantage, from
9 my point of view, of the producing state, because it tended
10 to remove people's willingness to try to buy more rather than
11 to be selling more.

12 But still, we have to face the fact that even though it
13 isn't -- everybody is not involved in the commodity industry.
14 But anybody who holds a position at the year end is liable for
15 a tax on that position, if it shows a profit. And that is
16 my objection to raising the rates on them. It is the only
17 place in our Tax Code where we tax people for unrealized
18 gains. And it is a very high risk business.

19 It just appears to me that it is a mistake, I would say
20 to my colleague, to raise the rates.

21 Senator Moynihan. I would be very happy to talk with
22 him and with the Chairman. It is just that there was such
23 unshirted hell raised when we did make these changes that I
24 assume maybe their people don't like them. Maybe they can
25 make that case. If they do like them -- and I think Senator

1 Symms was absolutely right: there was this bias in favor of
2 the long. We tried to make it neutral.

3 But, if the Chairman would be kind enough, as he is, we
4 will return to the subject when we get to the point where we
5 are getting --

6 The Chairman. Absolutely.

7 Senator Moynihan. Thank you, Mr. Chairman.

8 The Chairman. Let us go on to corporate, if we might.

9 Mr. Colvin. That begins on page 45.

10 The Chairman. Senator Bentsen has requested if we could
11 start with general utilities, page 50, I think.

12 Senator Bentsen. That is correct.

13 Mr. Colvin. That begins on page 50.

14 Senator Bentsen. Mr. Chairman, if I might, this
15 particular provision is one that does not have widely-held
16 recognition of its provisions. But I think it can get us in
17 a lot of trouble if we repeal the General Utilities Doctrine.
18 That is a 50-year-old rule, and if you repeal it I think you
19 move the corporate tax system in completely the wrong
20 direction.

21 Let me tell my colleagues what the General Utilities
22 provision is. That is a rule that simply says that when you
23 liquidate a corporation you pay one tax, instead of paying
24 two, that you do not get into the situation where you would
25 pay first the corporate tax and then the stockholders would

1 pay an additional tax.

2 Now, insofar as Europe is concerned, they have gone
3 pretty far in the way of integrating the corporate and the
4 individual tax system. This is the only provision that we
5 have that really does that, that I can think of. And it seems
6 to me a serious mistake to move away from it.

7 Now let me give you an example. Let us suppose I start
8 a business, and I have in it a piece of land that is worth
9 \$100,000 that I buy. And then as time goes on and the
10 business progresses, the property goes up in value. Let us
11 say it goes up to \$200,000. Then I decide to sell the
12 business in liquidation.

13 Under the General Utilities provision I would pay one
14 tax. Without that, I would pay one at the corporate level,
15 then I would turn around and pay another one at the share-
16 holder level. And they are on exactly the same appreciation.
17 I would pay it twice.

18 I think that that puts a substantial penalty on putting
19 things in corporate solution, and I think you would put a
20 great deterrent on people doing that, and obviously you would
21 treat them differently than you would in a partnership or a
22 single proprietorship.

23 I don't think you want to do that, in getting
24 entrepreneurs started in the business. I don't think you
25 particularly would want to do that at a time when our tort

1 law is having some very serious problems on liability
2 questions.

3 Mr. Chairman, I would like it if Treasury would comment
4 on their point of view on that particular piece of
5 legislation, if Secretary Mentz would.

6 Mr. Mentz. Well, Mr. Chairman, the issue of General
7 Utilities or the repeal of General Utilities is a difficult
8 issue. As Senator Bentsen ably explained it, General
9 Utilities does provide a measure of integration at the end
10 of the period of corporate existence; whether by liquidation
11 and sale of assets or sale of assets followed by liquidation,
12 the rule provides one level of tax -- a tax at the share-
13 holder level, not at the corporate level.

14 The other side of that is that the purchaser of,
15 typically, appreciated assets, maybe even inventory,
16 assuming it is a corporate purchaser, will get a fair-market-
17 value basis for those assets purchased.

18 The way General Utilities works -- and we really should
19 not be calling it "General Utilities"; it is not a case, it
20 is a series of Code sections. The way sections 336 and
21 337 work, the way the Internal Revenue works under present
22 law, a corporation can sell its business, including its
23 inventory, to one purchaser, and the purchaser would have a
24 full step up in basis, he would take a fair market value for
25 the inventory, and thus the appreciation in the inventory

1 in the inventory would effectively escape corporate-level tax.
2 There would be shareholder tax on the gain realized by the
3 shareholders, but no corporate level tax, as Senator Bentsen
4 has explained.

5 I would say, in terms of the professional legal
6 community, there is a split right now as to whether there
7 should be a corporate level tax in all cases or in all
8 transactions, or whether this sale in liquidation should be
9 exempt from corporate tax. I think it is a fair represen-
10 tation that bar associations differ on this. And indeed, able
11 and well-recognized tax lawyers have different points of
12 view.

13 I would say that, were we not in a fundamental tax
14 reform mode, you just asked the question what should be done
15 with General Utilities independent of tax reform, which was
16 a question that came up in the early Eighties. I believe
17 there was a hearing on it. I think the question in that
18 context really is a question of do you want to impose a
19 second level of tax and raise revenue.

20 There is a significant revenue impact on this -- I
21 believe the Joint Committee estimated it as \$2.6 billion over
22 the budget period. I think that the Treasury has never, to
23 my knowledge, said that, "Yes, that is a good idea; you
24 ought to do that; go ahead and repeal these Code sections
25 that provide for a double level of -- relief of one level of

1 tax so that there is only one level of tax."

2 I think the question really that is framed here is,
3 is the answer different in tax reform? And is it different
4 when we are doing other things -- fundamental changes,
5 reducing rates, changing, base broadening, trying to basically
6 totally restructure the Code? In other words, the question
7 is almost, "If you wanted to start fresh, would you or would
8 you not have a corporate level tax that would apply to all
9 transactions?"

10 I think that a case can be made that, if a satisfactory
11 corporate regime is in place, which would involve something
12 along the lines of the Senate Finance staff proposals, that
13 in effect provide an escape hatch from General Utilities, a
14 way of purchasing assets from a corporation with a carryover
15 basis, so that there would be no corporate level tax, and
16 therefore the seller could avoid the corporate tax and be
17 in a position of having only one tax, in that case and if
18 that set of corporate rules were in place I think that the
19 revenue raised by the Chairman's proposal on this is worth
20 the effort and worth changing these rules.

21 You may want to consider very hard how those rules in
22 the Senate Finance staff action apply, Senator Bentsen; but
23 to limit my answer and to finalize my answer in the context
24 of tax reform, if we can do it, if it can be done in a way that
25 provides that escape hatch that Senate Finance staff have

1 worked out, Treasury would not object to it.

2 Senator Bentsen. That is a pretty long answer,
3 Mr. Secretary. Let me read you a much shorter answer. This
4 one says, "I am troubled by the staff's proposal to impose
5 a full corporate level tax on all gain realized in the sale
6 of assets by a corporation pursuant to a liquidation that is
7 governed by section 337 of present law, or on the complete
8 liquidation of a corporation that is presently governed by
9 section 336." It then goes on to make some of the same
10 arguments I did. Of course, this one is dated October 27,
11 1983, and it is signed by a Mr. Roger Mentz.

12 I would say, Mr. Secretary, that this Administration has
13 worked to try to get integration of the corporate and the
14 individual tax, and I think that is the proper approach and
15 the proper direction.

16 I think if we pass this and repeal the General Utilities
17 provision, you are not going to hear much about it at this
18 point, I don't believe. But you are sure going to hear about
19 it in the next year or two as people suddenly find out what
20 has happened to them. Then you are going to get a great
21 deterrent on the use of putting assets in corporate solution.
22 It is, frankly, I think, at least a bad tax law.

23 Now, if we can find some way to accomplish the objective
24 otherwise, I am certainly prepared to look at it. But it is
25 certainly moving away of what we have seen happening in

1 Europe.

2 Mr. Mentz. Well, Senator Bentsen, I hope that my answer
3 did indicate that it is a troublesome issue. It is trouble-
4 some to me. Obviously I am well aware of the letter that I
5 wrote. I think if you read the letter all the way through
6 you will probably agree with the point of view expressed; it
7 raises some pretty fundamental problems that a change of law
8 of this nature would entail.

9 Senator Bentsen. Sure. There are all kinds of other
10 things that you are going to have to change in addition, if
11 you change this.

12 Mr. Mentz. That is right. And in order to make it work
13 you would have to make fundamental changes so that, in the
14 case of a purchase of assets -- frequently an acquisition
15 cannot involve the purchase of stock. A buyer doesn't always
16 want to buy stock, as you well know. He may have liabilities
17 associated with the company, or whatever. So, an asset
18 purchased is mostly the more common way of doing a purchase,
19 particularly in the smaller business setting. And in that
20 context it is essential to have the ability to buy assets
21 without involving the double tax. That would require going to
22 a very different scheme of corporate taxation for corporate
23 transactions than we presently have.

24 The issue of going in that direction was raised at a
25 committee hearing last Fall, I believe. Assistant Secretary

1 Pearlman testified, and his recommendation was that that is
2 a very complicated area and it might be better to leave that
3 one to a time when we have more time to study it and not try
4 to take it up as a part of tax reform.

5 I guess what I am saying now is, if you want to go in the
6 direction of repealing General Utilities, I think you have to
7 take it up now, because it is essential to allow that escape
8 hatch. The real question is, when you get all through with
9 General Utilities and whatever exceptions or modifications
10 you want to make to it, can you raise the \$2.6 billion or
11 something very close to it? And what do you think of the
12 package? I think you have to go down the road a bit before
13 you can make that judgment.

14 Senator Bentsen. Well, of course there is one other
15 point that you touched on very quickly in the beginning, and
16 I think there is perhaps some grounds there for some change
17 to stop abuses, and that is on inventory. I think something
18 might be done there.

19 But on the other hand, insofar as depreciation of
20 property, the rules there override General Utilities, and you
21 get a recapture on depreciation. So I don't have a problem
22 there.

23 But I think that you get in a situation where, if you
24 start saying to an entrepreneur, "If you go into corporate
25 solution you are going to end up paying a double tax," I

1 really think you make it much more difficult for the entre-
2 preneur to start new businesses, and that is where a great
3 many of our jobs come from these days.

4 Then you look at the tort law today, look at some of
5 these awards and that type of thing, and the problem of trying
6 to obtain liability insurance, and you go into business as an
7 individual and can't get appropriate liability insurance.
8 I just looked at one where the premium -- the premium -- for
9 one year's million dollar liability was over \$700,000. That
10 was the premium. Now, why would they do that? Because they
11 are in the trucking business, and to get their certificate
12 they have to have liability insurance. So, that is what they
13 are up against today, and that is why, if you deny them the
14 corporate route and give them the double tax, I just think it
15 is a bad way to go.

16 The Chairman. Senator Symms and then Senator Moynihan.

17 Senator Symms. Mr. Chairman, I think Senator Bentsen
18 has hit a very, very important point in this sector. After
19 hearing your answer, what Senator Bentsen is really saying is,
20 if there is anybody out there in America and is incorporated,
21 in, say, a small family business, a farm or what have you,
22 they had better sell before we change the law, because after-
23 wards it is going to cost them more money.

24 Just to give you an example, let us say that if a family
25 farmer had gotten a hold of a farm in 1920 and had been on it

1 since, and his cost of the farm was \$10,000, and he sold the
2 farm for \$500,000, with a gain of \$490,000, and the tax added
3 at a 28-percent rate, the corporate level, which would leave
4 you \$362,800, and then you would have to tax the shareholders
5 at the 20 percent rate if you go the route that the Chairman
6 is talking about, for another \$72,000, the net to the share-
7 holders would be \$290,240.

8 Under current law, the same proposition, you would not
9 tax it at the corporate level if you liquidated the company
10 and distributed it to the shareholders, and they would pay a
11 20-percent rate, which would be \$98,000, it would be
12 \$392,000 left over for the shareholders. It would be a
13 \$100,000 difference. It is a big tax increase.

14 Ms. Paull. Senator Symms, I would like to point out that
15 the Chairman's proposal does have a relief from the share-
16 holder level tax in that type of situation, where the value
17 of the corporation is \$5 million or less. And the gain on the
18 sale of a long-held asset such as that farm property would be
19 taxed at the corporate level, but the shareholder would
20 receive a basis adjustment which would, in essence, preclude
21 taxing it again at a second time at the shareholder level.

22 So, for a smaller corporation, a mom and pop type
23 corporation, with \$5 million in stock value, we do have
24 shareholder level relief.

25 Senator Symms. That is well and good, but a lot of this

1 gain is because of that printing press down there on 14th and
2 Independence Avenue, and we have been printing money for
3 years and years and years. So, a lot of that appreciation in
4 value may have just come about because of a long-time 24-
5 hour-a-day shift of the printing press.

6 I think that is well and good, but in the case Senator
7 Bentsen is talking about, about the company, say, that needs
8 to reorganize or change or wants to quit because of high
9 liability insurance, what about them? We have to recognize
10 it is an extraordinarily big tax increase. We are talking
11 about paying 100 percent more -- well, not quite 100 percent
12 more.

13 Ms. Paull. We do have, though a two-tier level of tax,
14 and this has tended to be a very inefficient way to provide
15 that integration because of the abuses that have occurred.

16 Congress has had to cut back on the General Utilities
17 rules over successive years. So, it has been a troublesome
18 aspect of the two-tier tax system.

19 Turning back to page 45, the --

20 The Chairman. Wait.

21 Did you have a question, Pat?

22 Senator Moynihan. This is for Secretary Mentz.

23 This was not in Treasury-I or Treasury-II.

24 Mr. Mentz. That is right.

25 Senator Moynihan. I guess you are by now familiar that

1 such provisions, where they are kind of intricate, raise in
2 our minds the suspicion that they are at least as much
3 revenue-driven as they are doctrinal or otherwise.

4 Aren't we, Mr. Chairman, undertaking a general review
5 of Subchapter C, of which this would necessarily would be a
6 part?

7 The Chairman. That is correct. It is a part of the
8 study that the committee has been doing off and on. We had
9 a report last May, and we had some hearings on it in the Fall,
10 as I recall.

11 Senator Moynihan. Yes.

12 I have one point to make and then an inquiry. I know
13 that the provision as you have submitted it has some
14 complementary provisions that go into effect on January 1,
15 1988. Isn't that right?

16 Ms. Paull. That is right.

17 Senator Moynihan. But the change in the existing law
18 goes in March 1 of 1986. Is there a reason for this gap?
19 Oughtn't they to be sort of simultaneous -- if there is an
20 "ought," I mean. I am just asking for information.

21 Ms. Paull. The March 1 date for General Utilities was
22 used because of a fear of a great revenue loss from a rush to
23 the market. The January 1, 1988, date was used for the
24 balance of the Subchapter C report, to give further time for
25 the tax bar to learn the rules. And that was what was in our

1 mind at the time.

2 Senator Moynihan. Could I ask you, Mr. Secretary, I take
3 it your point that -- there is a lovely line of G. K.
4 Chesterton in which he says, "The question is much too wide
5 and much too deep and much too hollow. And learned men on
6 either side use arguments I cannot follow."

7 I think you were saying there could be a case for doing
8 the Subchapter C all at once. I mean, this is not something
9 on which there is a professional consensus, at this point.

10 Mr. Mentz. That is right. And my own view, Treasury's
11 view, is that you need the Subchapter C proposals to implement
12 General Utilities; they go together.

13 Senator Moynihan. You need Subchapter C to implement?

14 Mr. Mentz. I think so.

15 Senator Moynihan. I do not claim to understand that,
16 but I know what you mean.

17 Mr. Mentz. The reason I say that, Senator, is that one
18 possible transaction, which would be a common transaction,
19 would be a sale of assets followed by a liquidation. And if
20 you have the Subchapter C proposals in place, you could have
21 the selling corporation avoid corporate-level tax. The assets
22 would take a carryover basis; there would not be any step-up
23 in basis, but there would be no corporate level tax, a single
24 tax, at the shareholder level.

25 Senator Moynihan. So, you would have solved this problem

1 of double taxation?

2 Mr. Mentz. Well, I don't think Senator Bentsen would
3 agree that it would be solved, but it would be ameliorated
4 significantly, and that is the reason I suggested that they
5 really ought to be done as one package.

6 Senator Moynihan. All right. May I suggest that you,
7 Mr. Secretary, get with the Chairman and solve this one?

8 The Chairman. We will take care of it.

9 Mr. Mentz. All right.

10 The Chairman. Now let us start through, Lindy.

11 Ms. Paull. All right.

12 Senator Symms. Mr. Chairman, I have one more question
13 to ask back to Ms. Paull, if I could.

14 You say the \$5 million size company, the point I
15 expressed is taken care of.

16 Ms. Paull. Yes.

17 Senator Symms. Well, let us say it is a \$50 million
18 company and you have a lot of small stockholders. What is
19 the answer on that one?

20 Ms. Paull. If the value of the stock is over \$10 million
21 on a liquidating distribution there would be tax both at the
22 corporate level and at the shareholder level.

23 Senator Symms. If it is over \$10 million?

24 Ms. Paull. Right. But what we do is provide a full
25 amount of relief on long-held assets for corporations with

1 \$5 million in value or less, and then we phase out that
2 relief between \$5 million and \$10 million.

3 Senator Symms. Well, I think somebody who had a company
4 that size would be considered a fairly substantial person,
5 possibly; but, what about the little old lady in tennis shoes
6 that just owns \$25,000 worth of this stock? We are going to
7 give her a double hit under this plan, then?

8 Ms. Paull. She would have to pay a shareholder level
9 tax. The corporation itself would have to.

10 Senator Symms. But the successful individual who has
11 held the farm for all of these years and has a big personal
12 financial statement, they would get out of the double
13 taxation under this plan?

14 Ms. Paull. Well, they would be eligible for relief at
15 the shareholder level.

16 Senator Symms. Well, do you see what my point is?

17 Ms. Paull. Yes.

18 Senator Symms. In my view, this is either a right
19 policy or a wrong policy, and it sounds to me like what we
20 are trying to do is tax people twice.

21 Ms. Paull. Well, when the staff was developing the
22 proposal there was a lot of concern expressed about mom and
23 pop type corporations.

24 Senator Symms. But what about mom and pop who own stock
25 in a bigger corporation that liquidates? And they may even

1 of a lesser financial worth than the mom and pop that we are
2 protecting with this break in the bill?

3 Ms. Paull. Right. Well, the larger corporation would
4 not be afforded the same type of protection.

5 Senator Symms. But who owns that? That is my whole
6 point. There could be thousands of stockholders who all own
7 just a little bit.

8 Thank you.

9 The Chairman. Go ahead, Lindy.

10 Ms. Paull. All right. On page 45 we are skipping over
11 the first item, which is the corporate tax rates. The second
12 item is the corporate dividends paid deduction. Under
13 current law corporations are not allowed the deductions for
14 dividends paid to their shareholders. The Chairman's proposal
15 would change this treatment.

16 Turning to page 46, spreadsheet item 3, the Chairman's
17 proposal reduces the 85 percent dividends-received deduction
18 for corporate shareholders to 80 percent.

19 Item 4 on page 46, the Chairman's proposal repeals the
20 \$100 or \$200, in the case of a joint return, dividend
21 exclusion for individual shareholders.

22 On that same page, item 5, the Chairman's proposal
23 provides that a corporation cannot deduct payments made in
24 connection with the redemption of its stock, including so-
25 called "green mail payments" in a hostile takeover situation.

1 Item number 6, which begins on page 50 and goes through
2 page 52, provides new rules for limiting the use of net
3 operating loss carryovers when there is a change in ownership
4 of the loss company. The new rules are modelled after the
5 rules that were in a recent bill introduced by Senators
6 Danforth and Chafee.

7 We have previously discussed item 7, which is the
8 General Utilities Rule, and that carries on through page 52
9 with the related provisions.

10 Turning to page 53, items 8 as well as items 9 are the
11 new rules that are contained in the Subchapter C revision
12 report of the Finance Committee staff. These are the new
13 rules that are a result of over two years' work by the
14 Finance Committee and the Joint Committee staff, in close
15 connection and with cooperation of the Tax Bar. They are
16 based on a report that was published last May by the staff,
17 and they provide new rules for mergers and our positions in
18 related Subchapter C issues.

19 On page 58, item 10, dealing with extraordinary dividends
20 received by corporate shareholders, the Chairman's proposal
21 tightens, basically, an anti-abuse provision that was enacted
22 in 1984.

23 Mr. Mentz. Mr. Chairman, when it comes up I think
24 Treasury will suggest that that maybe is a little too tight.

25 The Chairman. Are you serious, too tight?

1 Mr. Mentz. A little too tight.

2 The Chairman. I want to make a star -- which page is
3 that?

4 Ms. Paull. That is page 58.

5 The Chairman. Treasury says, "Too tight." All right.

6 Ms. Paull. On that same page, item 11, the Chairman's
7 proposal also tightens the related-party rules for
8 determining when related party transactions will result in
9 ordinary income treatment. In essence, the 80-percent
10 ownership rules are changed to a 50-percent ownership
11 requirement, and attribution of ownership between parents and
12 children would also be proposed.

13 On page 59, item 12, it places further restrictions on
14 the dividends-received deduction that corporate shareholders
15 are entitled to take. This is intended to prevent corporate
16 shareholders from creating an artificial loss by purchasing
17 their stock during a period where a dividend is reflected in
18 the purchase price of the stock. Also, it is intended to
19 prevent corporate shareholders from obtaining a dividends-
20 received deduction without bearing the economic risk of
21 holding the stock that pays the dividend.

22 Mr. Mentz. Mr. Chairman, could I inquire whether the
23 last sentence in 12 is meant to be a reference to section
24 1092, the "substantially diminished" language?

25 Ms. Paull. No. It is intended to be a reference to

1 section 246(c), is what it is derived from.

2 Mr. Mentz. Thank you.

3 Ms. Paull. Yes.

4 Also on page 59, item 13 clarifies current law as to when
5 a company would recognize bond premium in a carryover basis
6 type transaction. This is a clarification of an existing
7 statute that began to be interpreted differently after the
8 1984 Act, when we expanded the definition of "issue price
9 for OID purposes."

10 On page 60, the next three items -- actually, beginning
11 on page 60 and going on to the top of page 61 -- repeals some
12 special amortization rules for trademarks, trade names,
13 pollution control facilities, railroad grading, and tunnel
14 bores.

15 Senator Durenberger. Mr. Chairman?

16 The Chairman. Senator Durenberger?

17 Senator Durenberger. Mr. Chairman, let me suggest that
18 we consider going back to current law in item number 2, the
19 five-year amortization of pollution control facilities.

20 We discussed this matter when we were working out our
21 agreement on tax-exempt bond financing, and this provision
22 applies to the installation of pollution control facilities
23 on plants that were in operation before January 1 of 1976.
24 There are not too many of these left, and I think that is
25 reflected in the fact that there is quite a disparity in the

1 Joint Committee's estimate of the savings here, \$50 million,
2 and the House report estimate which is \$25 million. Either
3 one indicates that there isn't much left to be picked up here.

4 For a variety of reasons, including the fact that this
5 is not productive property, it puts our plants at a disad-
6 vantage with others, these installations are all mandated, I
7 would recommend that we go back to current law, and I don't
8 think we are losing much money in the process.

9 Mr. Chairman, could I also -- because I have a couple
10 of people waiting out there -- could I also make a brief
11 comment on item 3 on page 63, which I know you will get
12 to fairly quickly, which is the issue of contributions in
13 aid of construction?

14 The Chairman. Yes.

15 Senator Durenberger. Let me just call your attention
16 by way of reference to the report or the comments of the
17 Committee on Taxation of the Bar Association of the City of
18 New York. On pages 92 and 93 they cover this particular
19 area, and I will recommend here again that we stay with
20 current law.

21 The New York City Bar Association criticizes your
22 provision, or really it is the House provision incorporated
23 into your draft, saying that the utility is required to
24 report income in an early year and will incur related
25 deductions over the life the assets are in question, but that

1 the utility that construct the facilities without contri-
2 butions in aid of construction do so with borrowed funds, and
3 the cost of the facility is thus built into the utility's
4 rate base; whereas, in this case it doesn't get built into
5 the rate base, they do not get depreciation or other tax
6 benefits. So at the appropriate time I am going to recommend
7 we go back. That is a big ticket item because it includes
8 gas, energy, electric, sewage, et cetera, in addition to just
9 water, which is one of the principal things I care about.
10 But it is for reasons of fairness and equity that I will
11 propose it.

12 Senator Bradley. Would the Treasury know the revenue
13 effect of that? I think the principle -- I think it is a good
14 idea.

15 Mr. Weiss. It is a \$600 million item.

16 The Chairman. The House's was 500; ours is 600.

17 Go ahead, Lindy, you only have a couple to finish up.

18 Ms. Paull. Back to page 61, item 4 at the bottom of that
19 page, the Chairman's proposal would allow a five-year writeoff
20 for bus operating rights that were, in essence, made worthless
21 as a result of Federal deregulation.

22 Page 62 we will skip and leave that for another day.

23 The Chairman. That is just a small item, \$62 billion.

24 On page 63, the Chairman's proposal tightens the rules
25 for capital construction funds by subjecting nonqualified

1 withdrawals to a 50-percent excise tax, only on those
2 withdrawals, though, that have been in the fund for more than
3 15 years. I believe, also, nonqualifying withdrawals will be
4 subject to the maximum rate of tax applicable at that time.

5 Item 2 on page 63, the limitation on business tax
6 credits, the limitation on 85 percent of your tax liability
7 would be reduced to 75 percent of your tax liability under
8 the Chairman's proposal.

9 And then on item 3, which was just discussed by
10 Senator Durenberger, the election to treat contributions in
11 aids of construction as not taxable would be repealed under
12 the Chairman's proposal.

13 The Chairman. Any other comments?

14 (No response)

15 The Chairman. If not, we will be back on Canda-America
16 Free Trade at 9:30 in the morning.

17 (Whereupon, at 3:59 p.m., the meeting was recessed, to
18 reconvene at 9:30 a.m., Wednesday, April 23, 1986.)

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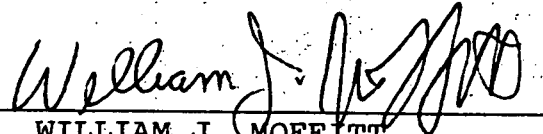
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C E R T I F I C A T E

This is to certify that an Executive Committee meeting of the Senate Committee on Finance, held on Tuesday, April 22, 1986, was as herein appears, and that this is the original transcript thereof.



WILLIAM J. MOFFITT
Official Court Reporter

My Commission expires April 14, 1989.

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United States Senate

COMMITTEE ON FINANCE
WASHINGTON, DC 20510

WILLIAM DIFENDERFER, CHIEF OF STAFF
WILLIAM J. WILKINS, MINORITY CHIEF COUNSEL

April 17, 1986

TO: SENATE FINANCE COMMITTEE MEMBERS
FROM: FINANCE COMMITTEE STAFF
SUBJECT: EXECUTIVE SESSION -- TUESDAY, APRIL 22, 1986

On Tuesday, April 22, at 9:30 a.m., the Committee will meet in Executive Session to vote on a resolution disapproving U.S.-Canada Free Trade negotiations.

RESOLUTION OF THE COMMITTEE ON FINANCE
OF THE UNITED STATES SENATE

Whereas, on December 10, 1985, the President notified the Committee on Finance of his desire to enter trade negotiations with Canada with the purpose of reaching a bilateral trade agreement;

Whereas, if the Committee on Finance or the Committee on Ways and Means of the House of Representatives fails to disapprove of the negotiation of such agreement before the close of 60 days after the above-mentioned notification, the Senate would be required to approve or disapprove of any final negotiated agreement under expedited procedures of section 151 of the Trade Act of 1974 which limit debate and amendment; and

Whereas, disapproval of the negotiation of an agreement eligible for the expedited legislative procedures of section 151 of the Trade Act of 1974 does not preclude the President from conducting a bilateral trade negotiation with Canada on his own authority or from resubmitting a request for negotiating authority pursuant to the procedures of section 102 of the Trade Act of 1974.

THEREFORE, IT IS RESOLVED:

That the Committee disapproves the negotiation of a bilateral agreement with Canada the implementation of which is accomplished pursuant to the expedited legislative procedures of the Trade Act of 1974.

RESOLUTION OF THE COMMITTEE ON FINANCE
OF THE UNITED STATES SENATE

Whereas, on December 10, 1985, the President notified the Committee on Finance of his desire to enter trade negotiations with Canada with the purpose of reaching a bilateral trade agreement;

Whereas, if the Committee on Finance or the Committee on Ways and Means of the House of Representatives fails to ~~disapprove of the negotiation of such agreement before the close of 60 days after the above-mentioned notification, the Senate would be required to approve or disapprove of any~~ final negotiated agreement under expedited procedures of Section 151 of the Trade Act of 1974 which limit debate and amendment;

Whereas, the legislative history of Section 102(b)(4) of the Trade Act of 1974 makes it clear that the Committee on Finance was given authority to disapprove of trade negotiations in order to ensure that the Senate played a significant role in such negotiations;

Whereas, the Committee on Finance has a responsibility to the full Senate not to forfeit this authority, but instead should play a central role in guiding the course of any bilateral trade negotiations with Canada;

Whereas, disapproval of the negotiation of an agreement eligible for the expedited legislative procedures of Section 151 of the Trade Act of 1974 does not preclude the President from conducting a bilateral trade negotiation with Canada by his own authority, or from resubmitting a request for negotiating authority pursuant to the procedures of Section 102 of the Trade Act of 1974;

Whereas, the Committee does not yet have a sufficient basis to conclude that the Administration has generated adequate Congressional and private sector support for trade negotiations with Canada, or that several outstanding trade problems with Canada will be resolved; and

Whereas, the Administration's relationship with Congress on trade matters has brought into question the relative roles of Congress and the Executive in the conduct of U. S. trade policy; but

Whereas, the Committee attaches great importance and value to the negotiation of a free trade agreement with Canada;

THEREFORE, IT IS RESOLVED:

That the Committee disapproves at this time the negotiation of a bilateral agreement with Canada, the implementation of which is accomplished pursuant to the expedited legislative procedures of the Trade Act of 1974.

That the Committee believes that the President should initiate negotiations with Canada toward a trade agreement pending intensive consultations between the Executive and the Legislature to address outstanding concerns expressed by Members.

That the Committee recommends that the President immediately resubmit a renewed request for negotiating authority pursuant to the procedure of Section 102 of the Trade Act of 1974, except that such request shall be considered by the Committee within a 30-day period instead of the 60-day period which the statute provides.

RESOLUTION

To express the sense of the Senate relating to the negotiation of a trade agreement with Canada.

Whereas, the Senate wishes to fully exercise its constitutional role in the formulation and implementation of United States trade policy;

Whereas, the Committee on Finance has authorized the President to initiate negotiation of a trade agreement with Canada which is eligible for the expedited legislative procedures of Section 151 of the Trade Act of 1974; and

Whereas, the Senate wishes to ensure that any trade agreement which may be negotiated with Canada advances the trading interests of the United States and satisfactorily resolves outstanding trade disputes with Canada.

NOW, THEREFORE, BE IT RESOLVED,

1. That it is the sense of the Senate that no trade agreement with Canada should be submitted to the Congress for review pursuant to the expedited legislative procedures of the Trade Act of 1974 until such agreement:
 - a. Eliminates or reduces to the maximum extent possible Canadian tariffs on United States exports and ensures that such Canadian tariffs are, on a trade-weighted basis, no higher than United States tariffs on Canadian exports.
 - b. Reduces substantially Canadian government subsidies and support to Canadian industries which are engaged in trade with the United States or compete with United States industries in Canada.
 - c. Provides enhanced access for United States service exports to Canada and advances non-discriminatory treatment by Canada of United States suppliers of such services.
 - d. Provides full and effective protection for intellectual property rights in Canada comparable to the protection

afforded such rights in the United States.

- e. Provides substantially increased access to Canadian procurement, both federal and provincial, for United States suppliers.
- f. Ensures that United States persons retain full access to United States trade remedies affecting imports from Canada.
- g. Provides effective protection against the problems of transshipment of third country goods.
- h. Reflects a commitment of the Canadian provincial governments to implement the relevant terms of the agreement.
- i. Provides for the treatment of United States investment in Canada which is no less favorable than is afforded to Canadian investment in the United States.

2. The President should cooperate with the Congress in developing trade legislation which addresses the need to obtain greater access to foreign markets, combat unfair trade practices and provide industries injured by imports an effective means of adjusting to foreign competition.

Chuck Grassley

STATEMENT ON U.S./CANADA FREE TRADE AGREEMENT
BY SENATOR CHARLES E. GRASSLEY

MR. CHAIRMAN:

LAST WEEK, TWELVE MEMBERS OF THIS COMMITTEE SUBMITTED A LETTER TO THE PRESIDENT URGING HIM TO WITHDRAW THE "FAST TRACK" PROPOSAL FOR A U.S./CANADA FREE TRADE AGREEMENT. THE INTENT OF THE LETTER WAS NOT TO IMPEDE ONGOING TALKS WITH CANADA, NOR TO PREVENT RESUBMISSION AT SOME LATER DATE. RATHER, I BELIEVE, IT WAS IN HOPES OF HAVING SUFFICIENT TIME TO DISCUSS SPECIFIC CONCERNS OF INDIVIDUAL MEMBERS, AND TO ADDRESS THE MUCH BROADER ISSUE OF WHERE OUR TRADE POLICY, OR LACK OF IT, IS TAKING THIS COUNTRY.

YESTERDAY, AS A SIGNATORY OF THE LETTER TO THE WHITE HOUSE, I RECEIVED THE OFFICIAL RESPONSE FROM THE PRESIDENT. THIS RESPONSE WAS THREE PAGES IN LENGTH, WHICH IN ITSELF GIVES CREDIBILITY TO THE IMPORTANCE THE ADMINISTRATION PLACES ON THIS ISSUE. BUT I WOULD LIKE TO QUOTE THE SECTION OF THE LETTER WHICH STATES:

" I AM CONCERNED, HOWEVER, BY YOUR REQUEST THAT I WITHDRAW THE PROPOSAL FOR THE USE OF ACCELERATED IMPLEMENTING AUTHORITY, AND I CANNOT ACCEDE TO YOUR REQUEST. AS PRIME MINISTER MULRONEY MADE ABUNDANTLY CLEAR, CANADA WILL NOT ENTER THESE NEGOTIATIONS WITHOUT THE FAST TRACK NEGOTIATING AUTHORITY."

MR. CHAIRMAN, I REGRET THAT THE PRESIDENT HAS NOT ACCEPTED THE REQUEST OF THIS COMMITTEE TO WITHDRAW THE PROPOSAL FOR THE TIME BEING, AND THAT PRIME MINISTER MULRONEY HAS TAKEN SUCH A STRONG STAND AGAINST ENTERING INTO ANY NEGOTIATIONS UNLESS THEY ARE ON THE FAST TRACK. FOR, MR. CHAIRMAN, I BELIEVE THAT EVERY MEMBER OF THIS COMMITTEE POSSESSES A STRONG DESIRE TO SEE A HEALTHY AND VIGOROUS WORKING RELATIONSHIP WITH OUR GOOD CANADIAN NEIGHBORS. I AM AS EQUALLY CONVINCED THAT NOT ONE MEMBER OF THIS COMMITTEE IS WILLING TO SACRIFICE HIS PARTICULAR CONCERNS ON SPECIFIC ISSUES IN THIS NEGOTIATING PROCESS. THE ISSUE BEFORE US TODAY, HOWEVER, TAKES ON A MUCH BROADER CONCERN: IS THIS COMMITTEE GOING TO BE ACTIVELY PARTICIPATING IN TRADE POLICY, AND IN FACT, IS IT NOT TIME WE ESTABLISH A NATIONAL TRADE POLICY TO HALT THE ERODING EFFECT OF THE TRADE DEFICIT WE ARE CURRENTLY EXPERIENCING.

LIKE MANY OF MY COLLEAGUES, I HAVE SPECIFIC CONCERNS ABOUT THE CANADIAN MARKET BARRIERS ON THE U.S. EXPORTS OF TELECOMMUNICATIONS, APPLIANCES, AND AGRICULTURAL EQUIPMENT. AS YOU MIGHT IMAGINE, COMING FROM AN AGRICULTURAL STATE, I AM EXTREMELY CONCERNED WITH THE QUARANTINE PLACED ON HOG EXPORTS AND SUBSIDIZATION OF CANADIAN HOG IMPORTS. NEVERTHELESS, I DO NOT BELIEVE ANY OF US ARE HOLDING THIS PROPOSAL HOSTAGE DUE TO PERSONAL BIAS. WHILE EACH OF US WOULD LIKE TO SEE OUR SPECIFIC ISSUES RESOLVED, OUR CONCERNS GO BEYOND THESE SPECIFIC ISSUES TO THE WHOLE TRADE PICTURE.

IT WOULD BE MY SINCERE HOPE THAT WE CAN CONTINUE NEGOTIATIONS WITH OUR CANADIAN FRIENDS ON MATTERS OF MUTUAL INTEREST TO OUR TWO COUNTRIES, EVEN THOUGH THEY ARE NOT ON A FAST TRACK BASIS. TO DO LESS WOULD BE A DISSERVICE TO BOTH OF OUR COUNTRIES.

RESOLUTION

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Whereas, the Senate wishes to ensure that any trade agreement which may be negotiated with Canada advances the trading interests of the United States and satisfactorily resolves outstanding trade disputes with Canada.

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- e. Provides substantially increased access to Canadian procurement, both federal and provincial, for United States suppliers.
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 - g. Provides effective protection against the problems of transshipment of third country goods.
 - h. Reflects a commitment of the Canadian provincial governments to implement the relevant terms of the agreement.
 - i. Provides for the treatment of United States investment in Canada which is no less favorable than is afforded to Canadian investment in the United States.
2. The President should cooperate with the Congress in developing trade legislation which addresses the need to obtain greater access to foreign markets, combat unfair trade practices and provide industries injured by imports an effective means of adjusting to foreign competition.