

1 EXECUTIVE COMMITTEE MEETING ON PROPOSED TAX REFORM ACT OF
2 1986
3 THURSDAY, APRIL 24, 1986
4 Committee on Finance
5 Washington, D.C.

6 The committee met, pursuant to recess, at 2:33 p.m. in
7 Room SD-215, Dirksen Senate Office Building, the Honorable
8 Bob Packwood (chairman) presiding.

9 Present: Senator Packwood.

10 Also present: Roger Mentz, Assistant Secretary for Tax
11 Policy, Department of the Treasury; Dennis Ross, Tax
12 Legislative Counsel, Department of the Treasury.

13 Also present: Bill Diefenderfer, Chief of Staff; John
14 Colvin, Chief Counsel; Bill Wilkins, Minority Chief Counsel;
15 David Brockway, Chief of Staff, Joint Committee on Taxation;
16 Mel Schwarz, Joint Committee on Taxation; Tom Preston, Paul
17 Strella, Tax Counsel, Majority; Barbara Groves, Jeff Gates,
18 Tax Counsel, Minority; and Susan Taylor, Executive Assistant.

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1 The Chairman. The committee will come to order, please.

2 I don't know how long we are going to be here before
3 votes start, but let's start through the financial
4 institutions and the research and development sections.

5 Who is going to do those? John? Tom?

6 Mr. Colvin. Mr. Chairman, the financial institutions
7 title begins on page 78.

8 The first issue is the bad debt reserve for commercial
9 banks. The chairman's proposal would repeal the reserve
10 methods and require use of the specific charge-off method.

11 The second issue on page 78 is the bad debt reserve for
12 thrift institutions. As the House bill did, the chairman's
13 proposal retains the percent of taxable income reserve
14 method but restricts it significantly over present law.

15 On page 79, the chairman's proposal on the interest on
16 debt used to purchase tax-exempt obligation is like the
17 House bill and the President's proposal and would deny the
18 deduction for interest on debt incurred to buy tax-exempt
19 bonds by financial institutions.

20 That is the general rule now for other businesses, and
21 that general rule would be extended to financial institutions.

22 On page 80, there are three issue relating to
23 reorganization of financially troubled thrift institutions.

24 The President's proposal would have sunset three special
25 rules after five years, and the chairman's proposal sunsets

1 the three special rules after three years.

2 On page 81, the first issue is credit unions; and the
3 chairman's proposal would retain the tax exemption for
4 credit unions.

5 The second issue on page 81 is the special rule for
6 net operating loss carryovers for depository institutions.

7 The chairman's proposal includes a transitional rule
8 for losses for thrifts and commercial banks, for losses that
9 occurred between 1981 and 1985.

10 And under that transitional rule, those losses could be
11 carried forward for eight years rather than five years under
12 present law.

13 Continuing on page 81, the chairman's proposal would
14 retain the present law, which treats losses with respect to
15 a deposit in a financial institution, as short-term capital
16 losses.

17 The House bill would have allowed those losses as a
18 casualty loss.

19 The Chairman. Let me interrupt you. We have a vote.
20 I will announce it to the other committee members who are
21 here. It has to do with revenue sharing, and I want to go
22 over and work the well in a minute and make sure it comes
23 out, hopefully, where it ought to come out.

24 It is good to see you, Mr. Secretary.

25 Secretary Mentz. And you, Mr. Chairman.

1 (Whereupon, at 2:35 p.m., the meeting was recessed.)

2 AFTER RECESS

3 (2:59 p.m.)

4 The Chairman. Are you ready, Mr. Secretary?

5 Secretary Mentz. Ready to go.

6 The Chairman. All right. Let's go on, John, from where
7 we were.

8 Mr. Colvin. Mr. Chairman, we had completed the
9 financial institutions title.

10 The Chairman. Very good. Let's see if we can do the
11 other eight titles this afternoon.

12 Mr. Colvin. The next title on the agenda is research
13 and development, which begins at page 174.

14 The Chairman. All right. Go ahead.

15 Mr. Colvin. The first issue is a restatement of current
16 law that research and development expenses are deductible.

17 The second issue is the research and development tax
18 credit. Under the chairman's proposal the credit is made
19 permanent at a rate of 25 percent.

20 And the definition of research and development is
21 targetted as in the report language in the House bill; but
22 under the chairman's proposal, it would be statutory.

23 The chairman's proposal retains current law on the
24 definition of qualified expenditures and does not exclude
25 leased research equipment from the credit.

1 On page 175, the chairman's proposal includes the House
2 provision under which credits may offset only 75 percent of
3 tax above \$25,000.

4 Under current law, the research and development credit
5 may offset 100 percent of tax above \$25,000.

6 Issue number 3 on page 175 relates to the extra
7 deduction for donations of scientific equipment to colleges
8 and universities.

9 The House proposal would extend that to scientific
10 research organizations, and the Senate bill does not include
11 that provision.

12 The last issue on page 175 is the question of allocation
13 of research expenses to foreign source income.

14 Under the House bill, 50 percent of those expenses could
15 automatically be allocated to domestic income; and under the
16 chairman's proposal, 75 percent could be allocated to
17 domestic income.

18 On page 176, the chairman's proposal includes the
19 personal holding company provision which is sponsored in
20 legislation in the Senate by Senators Danforth and Bentsen.

21 And the chairman's proposal also includes the basic
22 research credit contained in the House bill.

23 That is the completion of the research and development
24 title.

25 The Chairman. Any questions from the committee?

1 (Laughter)

2 The Chairman. Any questions from the desk?

3 (Laughter)

4 The Chairman. Mr. Secretary, any comments?

5 Secretary Mentz. I think that was a beautiful job, Mr.
6 Colvin.

7 (Laughter)

8 The Chairman. Let's see. We can go to Monday morning
9 on interest and real estate.

10 Let's go a moment on compliance.

11 Mr. Colvin. The compliance title begins on page --

12 The Chairman. Wait a minute. I don't have my compliance
13 book. It begins on what page? I think I can remember it
14 from memory.

15 Mr. Colvin. Page 33.

16 The Chairman. Go ahead, and I will try to stop you where
17 I don't recall.

18 Mr. Colvin. The chairman's proposal contains a number
19 of penalty provisions which were also contained in the House
20 bill.

21 The first issue on page 33 are information return and
22 penalties. The provision generally consolidates and increases
23 a number of those penalties.

24 The second issue on page 33 is the penalty for failure
25 to pay taxes.

1 The chairman's proposal follows the House bill and
2 raises the penalty to one percent per month after the
3 taxpayer has been notified that the IRS will levy assets to
4 collect tax.

5 That is intended to be an approximation of the cost of
6 collection charge proposal the Administration had offered.

7 The chairman's proposal also asks Treasury to report to
8 Congress how to implement the cost of collection proposal.

9 Secretary Mentz. Mr. Chairman, let me just ask Mr.
10 Colvin: Is it still staff's view that a report is necessary
11 in view of 2(a) above?

12 Mr. Colvin. The staff view was that the cost of
13 collection charge proposal had significant potential and
14 that we felt that the members of the committee would want
15 more information about the collection charges would be
16 determined.

17 Secretary Mentz. I see.

18 Mr. Colvin. So, that was the purpose of the report.

19 Secretary Mentz. All right. So, the point is to come
20 up with a report as to how a cost of collection charge would
21 be implemented. Is that it?

22 Mr. Colvin. That is right.

23 Secretary Mentz. Yes.

24 Mr. Colvin. On page 34, the first issue is the negligence
25 and fraud penalties.

1 The chairman's proposal includes provisions from the
2 House bill that broaden and increase the negligence and fraud
3 penalties in several respects.

4 The fraud penalty is increased from 50 to 75 percent.
5 The negligence penalty is extended to all information returns,
6 and the negligence penalty is also extended to excise taxes
7 and the estate tax.

8 The next issue on page 34 is the interest rate issue.

9 Secretary Mentz. Mr. Chairman?

10 The Chairman. Mr. Secretary?

11 Secretary Mentz. Before you go on to that, I would just
12 like to register on behalf of the IRS an objection to 3(d).

13 The Chairman. Excuse me. 3(d)?

14 Secretary Mentz. 3(d). The obligation of the
15 negligence penalty only to the portion of the underpayment
16 attributable to negligence is a severe administrative
17 problem.

18 It tends to make the negligence penalty very difficult
19 to administer.

20 Typically, a negligence case involves somebody who is
21 not keeping adequate books and records, or an issue that is
22 very feasible to apply the penalty across the board to
23 whatever the --

24 I didn't know they felt that strongly.

25 (Laughter)

1 It is easy to apply the penalty across the board to
2 whatever the deficiency is; but if you have to pick out
3 particular items of negligence, it is just a lot more
4 difficult.

5 Mr. Colvin. This was included in the proposal to
6 parallel the change relating to the fraud penalty.

7 Under current law, the negligence penalty would relate
8 to all of the underpayment of tax. And what this does is
9 it increases the penalty, but targets it to the underpayment
10 relating to the negligence.

11 The Chairman. All right.

12 Mr. Colvin. The interest rate provision would drop the
13 current interest rate rules applicable to both overpayments
14 and underpayments and substitute a system, as was used in
15 the House bill, where for overpayments of tax, Treasury
16 would pay the three-month Treasury bill rate plus two percent.

17 But for underpayments of tax, the taxpayer would pay
18 the three-month Treasury bill rate plus three percent; and
19 it would be adjusted quarterly.

20 The next issue on that page: The chairman's proposal
21 includes the House provision, which would charge interest
22 on underpayments of the accumulated earnings tax from the
23 date the return was originally due to be filed.

24 The Chairman. Let me stop you, John. We have got
25 another vote now, and I think there is going to be another

1 one, back to back.

2 I am not sure there is any point in going on for the
3 remainder of the afternoon because I think the bulk of the
4 committee is going to stay on the floor.

5 Let's adjourn now. Mr. Secretary, I need to talk with
6 you a minute about another matter.

7 We will adjourn, and we may or may not come back tomorrow
8 afternoon. If all we have is individual rates tomorrow,
9 maybe we can kind of move those over to Monday morning and
10 finish up compliance at the same time.

11 (Whereupon, at 3:10 p.m., the meeting was recessed,
12 to be reconvened on Monday, April 28, 1986, at 10:30 a.m.)

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This is to certify that the foregoing proceedings of an Executive Session of the Committee on Finance, held on April 24, 1986, in re: Tax Reform, were held as herein appears and that this is the original transcript thereof.

William J. Moffitt
WILLIAM J. MOFFITT
Official Court Reporter

My Commission expires April 14, 1989.

