

1 EXECUTIVE COMMITTEE MEETING ON PROPOSED TAX REFORM ACT OF  
2 1986

3 MONDAY, APRIL 28, 1986

4 Committee on Finance

5 Washington, D.C.

6 The committee met, pursuant to recess, at 10:00 a.m. in  
7 Room SD-215, Dirksen Senate Office Building, the Honorable  
8 Bob Packwood (chairman) presiding.

9 Present: Senators Packwood, Durenberger, and Mitchell.

10 Also present: Roger Mentz, Assistant Secretary for Tax  
11 Policy, Treasury Department; Dennis Ross, Tax Legislative  
12 Counsel, Department of the Treasury; Richard D'Avino, Acting  
13 Deputy Tax Legislative Counsel, Department of the Treasury;  
14 Mr. Parsky, Internal Revenue Service.

15 Also present: Bill Diefenderfer, Chief of Staff; John  
16 Colvin, Chief Counsel; Bill Wilkins, Minority Chief Counsel;  
17 David Brockway, Chief of Staff, Joint Committee on Taxation;  
18 Randy Weiss, Deputy Chief of Staff, Joint Committee on  
19 Taxation; Tom Preson, Joint Committee on Taxation; Barbara  
20 Groves, Tax Counsel, Minority; Greg Jenner, Tax Counsel,  
21 Majority; and Susan Taylor, Executive Assistant.

1 The Chairman. The Committee will come to order.

2 Let's start with the compliance section which we did not  
3 do Friday, because I cancelled the afternoon session, and  
4 then move on to interest and real estate.

5 Mr. Colvin. Mr. Chairman, that begins on Page 33.

6 The Chairman. All right.

7 Mr. Colvin. The first provision on Page 33 raises and  
8 unifies several information return filing penalties. And  
9 the second provision on Page 33 raises penalties for failure  
10 to pay tax to one percent a month after the taxpayer has been  
11 notified that the IRS will levy on the taxpayer's assets.  
12 It also requires a study on the Treasury cost-of-collection  
13 proposal.

14 On Page 34 are changes to the negligence and fraud  
15 penalties. The changes increase the fraud penalty and target  
16 the penalty to the under-payment attributable to fraud and  
17 also makes a couple of changes to the negligence penalties.

18 One is to extend the negligence penalty to all infor-  
19 mation returns, and also to extend the penalty to estate and  
20 excise taxes.

21 Continuing on Page 34, Item B, the interest rate provision  
22 would change how the amount of interest is computed for both  
23 the Treasury and the taxpayer. Under the proposal, the  
24 Treasury would pay interest on over-payments equal to the  
25 three-month Treasury bill rate plus two percent. And a

1 taxpayer would pay based on the three-month Treasury bill  
2 rate plus three percent.

3 The interest would be charged -- on Paragraph Number 2  
4 on Page 34, interest would be charged on under-payments on  
5 accumulated earnings tax from the date the return was  
6 originally to be filed.

7 And, finally, provision number 3 on Page 34, under the  
8 Chairman's proposal, the IRS would be required to pay interest  
9 on tax refunds unless the refund was issued within 45 days  
10 after filing the return.

11 Mr. Persky. Mr. Chairman?

12 The Chairman. Yes.

13 Mr. Davino. Good morning, Mr. Chairman. This is Tom  
14 Persky with the Internal Revenue Service. Roger was  
15 unavoidably detained. He'll be here in a few minutes.

16 The Chairman. Are you related to Jerry?

17 Mr. Persky. No, I am not.

18 The Chairman. Same spelling?

19 Mr. Persky. No. I think he's p-a-r, and I'm p-e-r.

20 The Chairman. Got it.

21 Mr. Persky. Mr. Chairman, I would just like to raise one  
22 item on tax refunds.

23 The Chairman. Talk right into the microphone or people  
24 can't hear you in back.

25 Mr. Persky. The Internal Revenue Service opposes the

1 changes on the payment of interest tax refund. Currently  
2 for individual timely filed income tax returns, we have  
3 until approximately June 1 of each year to process all the  
4 returns. And because we get the returns in sort of a bunched  
5 format -- we get a lot in February and a lot around April the  
6 15th -- this provision permits us to level our workload over  
7 the period. It also reduces the amount of interest that we  
8 pay.

9 The Chairman. Got it.

10 Mr. Colvin. Mr. Chairman, the next provisions are on  
11 Page 35. There are several information reporting provisions  
12 there.

13 Number one requires real estate brokers to file information  
14 returns on real estate transactions.

15 Provision number two requires federal agencies to file  
16 an information return on each person with which the agency  
17 enters into a contract.

18 Provision number three in the Chairman's proposal would  
19 require a reporting of income tax payments to state and local  
20 governments. This is somewhat similar to the House bill, but  
21 the House bill had also included real and personal property  
22 taxes.

23 The fourth provision on that page, the Chairman's  
24 proposal does not include the House provision which would  
25 require reporting of tax-exempt bond interest.

1 On Page 36 --

2 The Chairman. I am curious about something. In the  
3 House provision on the tax-exempt interest where you report it,  
4 all you do is report it, don't you?

5 Mr. Colvin. That is right.

6 The Chairman. I have got a gain of \$50 million or less  
7 than \$50 million in the House. How do you gain any money  
8 by reporting tax-exempt income?

9 Mr. Colvin. It may have some minor effect on some areas  
10 of the tax code where minimum tax can affect your tax  
11 liability, such as the payment of tax on some Social Security  
12 payments; another might be the denial of the interest  
13 deduction.

14 The Chairman. Got it.

15 Mr. Colvin. When you have loans to purchase  
16 tax-exempt bonds.

17 On Page 36, provision D in the Chairman's proposal would  
18 toll the statute of limitations for tax returns during the  
19 time required to obtain third-party records.

20 And Item number E on Page 36 is the proposed tax shelter  
21 user's fee. The purpose of the proposed fee would be to  
22 compensate the IRS for its estimated \$165 million cost of  
23 its tax shelter audit program. That has had a significantly  
24 adverse effect on IRS compliance efforts in other areas. And  
25 the proposal would compensate the IRS for those costs.

1 Mr. Persky. Mr. Chairman?

2 The Chairman. Right.

3 Mr. Persky. As unusual as it might seem, the Internal  
4 Revenue Service and the Treasury Department do not support  
5 this increase in a penalty.

6 Our view is that this would be an extremely difficult  
7 provision for us to administer, number one. And, number two,  
8 it would affect a lot of businesses that would not meet sort  
9 of a common sense test of what is a tax shelter.

10 And as we try to determine more and more carefully what  
11 a tax shelter is, the provision would probably become more and  
12 more difficult to administer, and the revenue would probably  
13 go down.

14 So we currently don't support this provision.

15 Mr. Colvin. The definition of tax shelter for the  
16 proposal is taken from existing definitions of tax shelters  
17 in the Internal Revenue Code.

18 On Page 37 are several additional tax shelter proposals.  
19 Paragraph number 2 would modify the calculation of credits  
20 for tax shelter definition purposes to conform to the tax  
21 rate cuts.

22 Provision number 3 would increase the penalty for  
23 failure to register a tax shelter.

24 And provision number 4 would raise the penalty on a  
25 taxpayer for failure to report the tax shelter identification

1 number on his or her return.

2 Continuing tax shelter provisions on Page 38. Provision  
3 number 5 would increase the penalty on tax shelters for  
4 failure to maintain lists of investors.

5 Number 6 in the Chairman's proposal would raise the  
6 interest rate on under-payments, which are part of tax  
7 motivated transactions.

8 And then a different subject, paragraph number F on Page  
9 38, would require estimated tax payments for individuals  
10 equal to 90 percent of current-year tax liability. And as in  
11 the House bill, the Chairman's proposal retains the  
12 alternative test of 100 percent of last year's tax liability,  
13 if less than the 90 percent.

14 Page 39, the Chairman's proposal includes the legislation  
15 sponsored by Senators Baucus and Grassley to provide for the  
16 award of attorney's fees in tax cases. And the provision  
17 here is almost identical to that contained in the  
18 reconciliation bill approved by the Finance Committee in  
19 1985. It would make the attorney's fees provision permanent,  
20 and it would change the burden and standard of proof. And it  
21 changes the limits on attorney's fees allowable.

22 The Chairman. And I assume Treasury and the IRS don't  
23 like that.

24 Mr. Persky. That is correct.

25 The Chairman. All right. It is not a change of position.

1 That has been your position for 10 years.

2 Mr. Persky. That is correct, Mr. Chairman.

3 Mr. Colvin. At the bottom of Page 39, the Chairman's  
4 proposal does not include a House bill provision which would  
5 impose personal liability or allow the court to impose  
6 personal liability on IRS employees for some of the attorney's  
7 fees payments.

8 On Page 40, item number 2, the Chairman's proposal does  
9 not include a House provision which would authorize the tax  
10 court to impose a \$120.00 penalty if a taxpayer fails to  
11 exhaust administrative remedies at the IRS.

12 At the bottom of Page 40 begins a number of --

13 The Chairman. Mr. Wilkins, come here a second. Let me  
14 ask you a question.

15 Go ahead, John.

16 Mr. Colvin. At the bottom of Page 40 begin a number of  
17 provisions relating to the tax courts. Item A authorizes  
18 a registration fee for attorneys. Item B provides the tax  
19 court with jurisdiction over late payment penalties. Item C  
20 authorizes U.S. marshalls to be available to the tax courts.  
21 Item D provides for salary and travel expenses of special  
22 trial judges.

23 On Page 41, Item E allows retirement pay for tax court  
24 judges under the same circumstances as for district court  
25 judges.



1 And that is the conclusion of the provisions relating  
2 to the tax courts.

3 Item H on Page 41 allows rescision of a 90-day letter or  
4 a statutory notice of deficiency.

5 Item 2 on Page 41 would give the IRS authority to abate  
6 interest charges if the delay was attributable to the IRS.

7 On Page 42, item number 3 is a pro-taxpayer provision  
8 suspending the compounding of interest in certain circum-  
9 stances.

10 Item 4 would in the Chairman's proposal and in the House  
11 bill exempt service-connected disability pay from IRS levy.

12 Item number 5 retains current law and does not include  
13 the House provision. Raising from \$2,500.00 to \$100,000.00  
14 the amount the IRS may sell administratively in collecting  
15 taxes.

16 Mr. Persky. Mr. Chairman?

17 The Chairman. Yes.

18 Mr. Persky. May I just make one comment about that?

19 The Chairman. Yes.

20 Mr. Persky. The House bill changes the IRS authority  
21 from \$2,500.00 to \$100,000.00. It basically brings it in line  
22 with the current Customs authority and DEA authority for  
23 administrative forfeitures.

24 The Chairman. And you support that?

25 Mr. Persky. Yes, sir.

1 Mr. Colvin. Continuing on Page 42, item number 6, the  
2 Chairman's proposal does not include the House bill provision  
3 exempting IRS special agents from the automobile record-  
4 keeping regulations.

5 Mr. Persky. Again, Mr. Chairman, it is our view that a  
6 law enforcement officer is a law enforcement officer. In our  
7 criminal investigation agents who are involved in basic  
8 law enforcement activities carry firearms and act as other law  
9 enforcement officers should be treated the same.

10 The Chairman. Thank you.

11 Mr. Colvin. On Page 43, item number I, simply indicates  
12 that the withholding tables for individuals would be conformed  
13 to the tax changes made by the bill.

14 Item J would pick up the House provision, which requires  
15 a report on the return-free tax system.

16 On Page 44, item number K, is a provision that would cut  
17 tax deferral available to trusts to three months, and also  
18 require estimated tax payments for trusts.

19 Item number L applies to income tax payments by estates.  
20 And it ends the right to defer taxes by making four quarterly  
21 payments after the year the income is earned, which is  
22 available under current law. And also requires the states  
23 to make estimated tax payments.

24 Mr. Chairman, that completes the compliance provision.

25 The Chairman. All right. Let us move on to interest.

1 Mr. Colvin. Interest begins at Page 115.

2 Item A(1) imposes limitations on the deduction of interest  
3 by individuals to interest relating to debt on the principal  
4 residence plus a second residence, an amount equal to invest-  
5 ment income plus \$1,000.00 for singles and \$2,000.00 for joint  
6 returns.

7 Item number 2 treats limited partnership interest as an  
8 investment; not as a trade or business. And the effect of  
9 that is to limit the interest deduction available to debt  
10 incurred to purchase limited partnership interests.

11 Paragraph number 3 on Page 115 also affects tax shelter  
12 investments and requires more complete accounting of  
13 investment expenses for purposes of figuring investment  
14 income.

15 Item number 4 is a provision which allows services  
16 performed by a property owner to count as expenses for  
17 purposes of figuring whether the 15 percent rental income  
18 limit is met for the net lease rule.

19 On Page 116, item number 5, has the effect of treating  
20 vacation homes as an investment; not as a trade or business;  
21 thus, subjecting interest payments in connection with buying  
22 vacation homes to stricter deductibility limits.

23 Item 6 is the effective date and provides a five-year  
24 phasein for the interest limits.

25 And the last item on Page 116, item B, eliminates the

1 deduction for money borrowed to deposit in an individual  
2 retirement account.

3 That completes the interest provisions, Mr. Chairman. The  
4 next title scheduled for discussion is real estate  
5 beginning on Page 177.

6 The Chairman. All right. Let us conclude with real  
7 estate.

8 Mr. Colvin. On Page 177, item A, the at-risk rule, the  
9 Chairman's proposal includes the House provision which would  
10 apply at risk to real estate with an exception for third-  
11 party, non-recourse debt.

12 Item B on Page 177, rehabilitation credits, the Chairman's  
13 proposal includes the House provision which cuts the  
14 rehabilitation credits from either 15 or 20 percent to 10  
15 percent and limits them to property placed in service before  
16 1936. In addition, the proposal drops the rule allowing  
17 eligibility for the rehabilitation credit if 75 percent of  
18 external walls are kept. And, as a result, under the  
19 alternative test now provided in the law, 75 percent of the  
20 internal structure, internal structural frame work, would be  
21 required to be kept.

22 On Page 178, the credit for certified historic structures,  
23 the Chairman's proposal includes the provision from the House  
24 bill which cuts the credit from 25 percent to 20 percent, and  
25 raises the basis adjustment from a one-half basis adjustment

1 to a full basis adjustment.

2 And, finally, the provision would drop the external walls  
3 requirement because the Department of the Interior approves  
4 these rehabilitations and it would give the Department of  
5 the Interior more flexibility in approving historic structure  
6 projects.

7 The remainder of Page 178 describes the transitional  
8 rules for the rehabilitation credits.

9 Mr. Chairman, I would like to take the next two real  
10 estate provisions in reverse order, and pass over low-income  
11 housing for a moment and go to the real estate investment  
12 trust provisions which begin on Page 182.

13 The Chairman. All right.

14 Mr. Colvin. Those provisions cover Page 182 through 185,  
15 and they make several technical reforms to the real estate  
16 investment trust rules to enable those rules to work more  
17 effectively.

18 There are numerous changes there, and I don't believe  
19 we need to describe them specifically.

20 Now back to low-income housing on Page 179. The Chairman's  
21 proposal combines the various low-income housing incentives  
22 that are now scattered throughout the code into one targeted  
23 credit. And the proposal either repeals or allows to sunset  
24 the other -- the low-income incentives that are now in the  
25 code.

1 As originally described in the spread sheet on Page 180,  
2 the provision would be available as an alternative to tax-  
3 exempt bond financing for multifamily housing bonds, which  
4 were originally intended to be placed in the volume cap by  
5 the Chairman's proposal. That has now been taken out of the  
6 volume cap, and we are working with staffs of other senators  
7 to make some modifications in this proposal as a result of  
8 that.

9 That completes the real estate title.

10 The Chairman. Well, I would like to go on to other  
11 sections, but I think having announced them for this  
12 afternoon, we had better wait.

13 Let me ask you, John. When we finish this afternoon  
14 with minimum tax and the ITC refund, that just leaves us  
15 then the excise issues and then technical transitional and  
16 miscellaneous.

17 Mr. Colvin. That is correct.

18 The Chairman. All right. We will go back then into our  
19 private sessions tomorrow morning. And my hunch would be  
20 that we will be in private sessions most of the rest of this  
21 week.

22 Mr. Colvin. Mr. Chairman, one other issue you have not  
23 discussed is the tax rates for corporations and individuals.

24 The Chairman. Didn't we discuss that? Oh, that is right.  
25 Well, if we reach some conclusions in our private meetings,

1 what is in the Chairman's draft may be slightly changed.

2 That will conclude, then, our meeting this morning. We  
3 will come back at 2:00 this afternoon.

4 (Whereupon, at 10:23 a.m., the meeting was recessed.)  
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AFTERNOON SESSION

(2:09 p.m.)

1  
2  
3 The Chairman. Let's start. And John, I wonder if we  
4 might go in reverse order.

5 Let's take the Mandatory ITC Refund and discuss the  
6 ITC a bit until some other members get here because, if we  
7 have to replot and reexplain that ground, it isn't that  
8 complicated.

9 Then, we can move on to the minimum tax when we get a  
10 few people here.

11 Mr. Colvin. Mr. Chairman, the Mandatory Refund of the  
12 ITC is on page 23 on the spreadsheets.

13 The Chairman. What page?

14 Mr. Colvin. Page 23.

15 The Chairman. Thank you.

16 Mr. Colvin. The proposal would require a refund on  
17 the investment tax credit carryover at a 70 percent rate;  
18 and it is set at a 70 percent rate to be approximately  
19 revenue neutral.

20 The Chairman. Now, here I want to ask something because  
21 I have noted some errors in reporting on this in terms of  
22 cost.

23 And I will ask Treasury to comment on this, Mr.  
24 Secretary, if you will.

25 If we follow the procedure in the House bill of letting



1 the credits play out, it costs roughly what our 70 percent  
2 refund costs. Is that correct?

3 Mr. Colvin. Do you mean that for Treasury?

4 The Chairman. If Treasury knows, because I want to  
5 make sure that people understand.

6 Secretary Mentz. I think that is basically correct,  
7 although the way the 70 percent was developed was taking  
8 the existing investment credits that were carried over to  
9 1986 and, on a statistical basis, figuring out how many of  
10 them would be used, using current law, and then developing  
11 a percentage that would bring you out to revenue neutrality

12 Now, if you cut the rate from 46 to 36 or 33 or 35,  
13 you may have--it depends--you may have less tax, you may  
14 have more tax, depending upon the taxpayer involved.

15 If you have less tax, there would be less investment  
16 credit used and your 70 percent would be a revenue winner.

17 The Chairman. Now, say that again.

18 Secretary Mentz. Well, it depends on the taxpayer; but  
19 if a particular taxpayer is a high-bracket taxpayer--the  
20 company that pays tax at the 46 percent level--if the rates  
21 go down to 35, that corporation is going to have less tax  
22 liability.

23 And if they have less tax liability, therefore, less  
24 credits.

25 The Chairman. So, the lower the corporate tax rate, the

1 more likely the buy-back is a better revenue deal for the  
2 Treasury than the straight play-out over five years?

3 Secretary Mentz. That is right, but it of course also  
4 depends upon accounting changes and all the other changes  
5 that are in the corporate package.

6 The Chairman. Now, is it a fair statement--and anybody  
7 can answer this that knows--if you have the straight play-out  
8 of them over the five years, companies that will get the  
9 advantage of them are those companies that are genuinely  
10 profitable that have something to offset the credits against?

11 And the companies that cannot use them are the companies  
12 that simply have no tax obligation and, therefore, have  
13 nothing to use the credits against?

14 Secretary Mentz. That would be right under current law.

15 The Chairman. Yes.

16 Secretary Mentz. And under the House bill, it is a  
17 little trickier because a lot of companies would be under  
18 the minimum tax.

19 If you are under the minimum tax in the House bill,  
20 you can only use credits if you have net operating losses  
21 in two out of three years.

22 The Chairman. Right.

23 Secretary Mentz. So, in some cases, companies would  
24 be simply not able to use their carryovers at all if they  
25 are in that situation.

1 So, for those companies, they are much better off with  
2 a buy-back.

3 The Chairman. All right. John, go ahead.

4 Mr. Colvin. That completes that item.

5 The Chairman. Let me ask you a question. You told me  
6 earlier today, and I want to make sure that I understand it.

7 We could have both the buy-back of the investment tax  
8 credit and, in addition, use it to reduce the corporate  
9 rate in future years; and if we applied all of the ITC to  
10 that reduction, we could reduce the corporate rate to about  
11 33 percent?

12 Mr. Colvin. That is correct.

13 The Chairman. We can do both.

14 Mr. Colvin. That is correct because the ITC revenue  
15 you are using to reduce the corporate rate is for future  
16 ITC's that will not become available if it is repealed, and  
17 the ITC's that are being cashed in were earned previously.

18 The Chairman. All right.

19 Mr. Colvin. The next subject is the minimum tax, which  
20 begins at page 117.

21 The Chairman. All right. Go ahead.

22 Mr. Colvin. The first issue is the tax rate, which  
23 under the chairman's proposal would be 20 percent compared  
24 to 25 percent in the House bill.

25 The exemption amount would be retained as in current law,

1 except it would be phased out for persons with taxable  
2 incomes above \$150,000.

3 Preferences for the individual minimum tax: first, the  
4 dividend exclusion is repealed for regular tax purposes; so,  
5 it is irrelevant for minimum tax.

6 Accelerated depreciation on real property would become  
7 a tax preference to the extent the deduction exceeds a  
8 40 year deduction computed on a straight-line basis.

9 For personal property, accelerated depreciation would  
10 be a preference to the extent it exceeds depreciation deducted  
11 on a straight-line basis over the ADR life.

12 On page 118, intangible drilling costs would remain a  
13 preference for individuals as in current law.

14 Item (e), pollution control facilities. The five-year  
15 amortization is repealed for regular tax purposes; and so,  
16 it is dropped from the minimum tax.

17 Expensing of mining exploration and development costs  
18 would remain a preference as in current law.

19 Circulation expenses are kept as a preference for  
20 individuals as in current law.

21 Research and development is kept as a preference for  
22 individuals as in current law.

23 Percentage depletion is kept as a preference as in  
24 current law.

25 The capital gains deduction is kept as a preference

1 and the language here relating to insolvent farmers has  
2 substantially been enacted in the reconciliation bill; and  
3 so, it is no longer contained in this spreadsheet.

4 Incentive stock options are kept as a preference as in  
5 current law.

6 Tax-exempt interest with respect to bonds issued after  
7 January 1, 1987 remains as a part of the spreadsheets.

8 Income excludable under Section 911 by U.S. citizens  
9 living abroad would be made a preference under the chairman's  
10 proposal.

11 That is also as in the House bill. Unlike the House  
12 bill, however, the chairman's proposal does not reduce the  
13 exclusion.

14 The Chairman. Hold on just a second, please.

15 (Pause)

16 The Chairman. Go ahead.

17 Secretary Mentz. Mr. Chairman?

18 The Chairman. Mr. Secretary?

19 Secretary Mentz. Let me just say that the  
20 Administration has some concern about making the exclusion  
21 of earnings earned abroad a preference for the minimum tax.

22 It hits hardest at the level of income of \$75,000 to  
23 \$125,000; and basically, it will in most cases result in  
24 a tax equalization payment by the corporation that is  
25 employing the individual.

1           The net result is that it makes it more expensive to  
2 have that individual employed overseas; and so, Americans  
3 get displaced by Europeans or people from other nationalities.

4           It just tends to weaken our competitive position. So,  
5 I just simply want to note that for the record.

6           The Chairman. I am curious. The Treasury must have  
7 more objections than that because you raise \$1.6 billion  
8 and we raise \$24.9 billion out of the individual minimum tax;  
9 and the difference is not solely income earned abroad.

10          Secretary Mentz. We applaud the direction in which you  
11 are going.

12          The Chairman. Thank you. I am glad to hear that.

13          Any other sections we can cover today? Go ahead, John.

14          Mr. Colvin. On page 119, the use of the completed  
15 contract method of accounting would become a preference;  
16 and it would be measured by a comparison to percentage of  
17 completion method.

18          The installment method of accounting would become a  
19 preference under the chairman's proposal.

20          An exception would be provided for consignment sales  
21 by manufacturer to a dealer if the amount of installment  
22 obligations exceeds the manufacturer's net worth.

23          The last two items on page 119 are the preference for  
24 passive investment activities in general and the passive  
25 loss from farming activities preference.

1 The chairman's proposal has substantially the same  
2 rules for both of those preferences.

3 Under the House bill, the preferences would have been  
4 effective January 1, 1986.

5 Under the chairman's proposal, they are not effective  
6 at all in 1986; they take half-effect in 1987 and they are  
7 fully effective in 1988.

8 The chairman's proposal provides an insolvency exception  
9 for both farm and nonfarm passive loss preference purposes.

10 The chairman's proposal retains the activity-by-activity  
11 rule for purposes of farming activities, but allows  
12 aggregation for purposes of the general passive loss other  
13 than farms.

14 The definition of passive investment is the same in  
15 both proposals, that is, it applies to a trade or business  
16 activity in which the taxpayer did not materially participate  
17 in the management.

18 With respect to cash-basis offset, the chairman's  
19 proposal does not allow an offset based on cash basis.

20 The House bill had allowed an offset of twice basis  
21 for farm passive losses and basis up to \$50,000 for nonfarm  
22 passive losses.

23 On page 120, the chairman's proposal treats interest  
24 from limited business interests as a minimum tax itemized  
25 deduction and does not include charitable contributions of

1 appreciated property as a preference.

2 Item number 6 on page 120. The chairman's proposal is  
3 the same as present law, which allows the taxpayer to have  
4 minimum tax rules for a preference applied for regular tax  
5 purposes. This is sometimes called the "Normative Tax  
6 Election."

7 Item number 7 is an adjustment for deferral preferences  
8 for the minimum tax.

9 Under item number 8, the chairman's proposal is the  
10 same as present law in that it would not allow incentive  
11 credits to offset minimum tax.

12 Item number 9 is a change from present law in that the  
13 foreign tax credit could not offset more than 90 percent of  
14 minimum tax.

15 Item number 10 --

16 Secretary Mentz. Mr. Chairman, I would just note  
17 Treasury concern about or objection to number 9, just because  
18 it is a departure from the basic rule of using foreign tax  
19 credit to relieve international double taxation.

20 Mr. Colvin. As in the proposal, the intent was not  
21 to undermine the foreign tax credit, but rather to prevent  
22 its use to entirely offset minimum tax payments.

23 Item number 10, net operating losses. The chairman's  
24 proposal is the same as present law. Net operating losses  
25 would be allowed against minimum tax.



1 Page 121, the corporate minimum tax. As proposed by  
2 the President, the structure of the tax would be changed  
3 from an add-on minimum tax to an alternative minimum tax.

4 The rate would be 20 percent compared to 25 percent  
5 in the House bill.

6 The exempt amount would be increased from \$10,000 to  
7 \$40,000 and phased out for larger corporations.

8 The preferences for the corporate minimum tax. The  
9 first accelerated depreciation on real property would be  
10 a preference measured against 40-year depreciation on a  
11 straight-line basis.

12 Item B, capital gains, would remain a preference.

13 Item C, five-year amortization for pollution control  
14 is repealed for regular tax purposes; so it need not be  
15 retained as a preference.

16 Item D, bad debt reserve. It would be retained as a  
17 preference for financial institutions.

18 Item E, percentage depletion, would be retained as a  
19 preference as in current law.

20 Item F, accelerated depreciation for personal property,  
21 would be a preference for all corporations to the extent  
22 that the accelerated depreciation deduction exceeds a  
23 straight-line deduction computed over the ADR life.

24 Item G, mining exploration expenses, would remain a  
25 preference, and it would be extended to all corporations.

1 On page 122, the first issue is intangible drilling  
2 costs.

3 Intangible drilling costs would remain as a preference  
4 under the chairman's proposal, and the definition in current  
5 law would be retained; but it would be extended to all  
6 corporations.

7 Item I, circulation expenses, would remain as a  
8 preference as in current law.

9 Item J, research and development expenses would not be  
10 a preference for the corporate minimum tax.

11 Item K, tax-exempt interest. The applicability of this  
12 to bonds issued after January 1, 1987 remains an issue in  
13 the spreadsheet.

14 Senator Durenberger. Mr. Chairman, we will revisit  
15 that issue at some point, won't we?

16 The Chairman. That is correct. All we did, as you  
17 will recall, is say that we would not have it retroactive.

18 And when we came to the issue of whether we would have  
19 it at all if we had it, it would be prospective; but we  
20 didn't even vote as to whether we would have it.

21 Mr. Colvin. Item L, foreign sales corporations.  
22 Foreign sales corporations would not be a preference under  
23 the chairman's proposal.

24 Completed contract method of accounting would be a  
25 preference to the extent it exceeds the percentage of

1 completion method.

2 Charitable contributions and appreciated property would  
3 not be a preference under the chairman's proposal.

4 The installment method of accounting for dealers would  
5 be a preference as in the individual minimum tax; and also,  
6 as in the individual minimum tax, there would be an exception  
7 for consignment sales by a manufacturer to a dealer if the  
8 amount of the installment obligation exceeds the  
9 manufacturer's net worth.

10 Capital construction funds would become a preference  
11 under the chairman's proposal.

12 Item Q. This is usually called the "book preference."  
13 A new preference would be created equal to 50 percent of  
14 profits reported to shareholders or to creditors or to  
15 regulatory agencies to the extent not included in the  
16 minimum tax base but for that preference.

17 On page 123, the first issue is the normative election.  
18 Under that provision, the chairman's proposal includes a  
19 provision from the House bill which allows the taxpayer to  
20 have the minimum tax rules for a preference apply for  
21 regular tax purposes.

22 Item number 6 allows minimum tax liability arising from  
23 a deferral preference as a carry-forward credit against  
24 regular tax.

25 Item number 7, incentive credits. As in present law,

1 incentive credits would not be allowed to offset minimum  
2 tax.

3 Item number 8, the foreign tax credit. This is the same  
4 as the point we mentioned earlier on the individual minimum  
5 tax.

6 The foreign tax credit would not be allowed to offset  
7 more than 90 percent of minimum tax.

8 Secretary Mentz. The same objection from the  
9 Administration.

10 Mr. Colvin. Net operating losses would be allowed  
11 against minimum tax.

12 Item number 10, estimated tax payments. The House bill  
13 and the chairman's proposal would require estimated tax  
14 payments for the minimum tax.

15 And that completes the minimum tax provisions.

16 The Chairman. I want to ask Treasury a question.

17 Mr. Secretary, apart from your objection on the foreign  
18 tax credit, both individual and corporate, you did not raise  
19 any other objections.

20 In the President's proposal, there was on corporate  
21 \$10.4 billion raised. The House cut the corporate minimum  
22 tax to \$5.8; we raise \$20.9 on corporate.

23 Do you think we are heading in the right direction on  
24 the corporate minimum tax?

25 Secretary Mentz. Yes, I think you are. I think that

1 when you get a more complete discussion, there will be these  
2 various pieces pulled apart and discussed and negotiated;  
3 but your general question--do I think you are heading in  
4 the right direction?--the answer is yes.

5 I think under current law it is possible for corporate  
6 taxpayers to zero out fairly easily, and indeed, the  
7 President's proposal did not have a very tough minimum tax.  
8 That is very clear.

9 The Chairman. And also, on the minimum side, the  
10 President's proposal raises \$1.6, ours raises \$24.9; and  
11 I know you raised an objection on the credit.

12 But for several weeks, people were critical of the  
13 committee losing money, losing money, losing money.

14 Here are two areas where we have got very tough minimum  
15 taxes. I think on the corporate one it would be impossible  
16 on a book-value basis for a profit-making public corporation  
17 to escape paying tax. I don't care what their other  
18 preferences are.

19 Secretary Mentz. I think that is right.

20 The Chairman. We will see the end of those stories of  
21 profit-making corporations not paying tax, and the minimum  
22 one is tough.

23 Because we haven't yet made the decision on municipal  
24 interest and because of the decision to allow appreciated  
25 value deduction at the full value of the appreciated value,

1 there is still some possibility of some individuals escaping,  
2 although not many.

3 But indeed, if there is any place where we have been  
4 tougher than the President and tougher than the House, it  
5 is in these two areas.

6 Senator Mitchell?

7 Senator Mitchell. No questions, Mr. Chairman. I just  
8 thought I would come up and keep you company for a while.

9 The Chairman. Well, you got here just in time to  
10 adjourn.

11 Senator Mitchell. Oh, did I?

12 The Chairman. Yes. Let me just tell you very quickly  
13 what we discussed on the investment tax credit because there  
14 has been some criticism of the so-called buy-back provision.

15 Roughly, the buy-back at 70 percent of their value,  
16 it figured at present corporate tax rates would cost about  
17 as much as letting it play out over five years and letting  
18 the unused credit be used up over the next five years.

19 But Secretary Mentz called to our attention that if we  
20 cut the corporate rate, the buy-back is actually a revenue  
21 producer, vis-a-vis letting them take it back at the lower  
22 corporate rates.

23 It is a shift in the incidence of taxation. If you allow  
24 the play-out over five years, the companies that take it are  
25 the profitable companies who have taxes against which to

1 take credits.

2 The companies that don't take it are those that don't  
3 have any profits and therefore no taxes; therefore, nothing  
4 to take a credit against, but that was the principal  
5 difference on it.

6 And then, as John Colvin assured me--because I know the  
7 members when we met last week were stunned that we could lower  
8 the corporate tax rate to 33 percent with solely the use of  
9 the investment tax credit proceeds--John Colvin assures me  
10 that we could do both the buy-back, which are past credits,  
11 and reduce the corporate rate to 33 percent using just the  
12 investment tax credit.

13 There is no other discussion?

14 (No response)

15 The Chairman. We are adjourned.

16 (Whereupon, at 2:32 p.m., the meeting was recessed to  
17 reconvene at 9:30 a.m. on Tuesday, April 29, 1986.)

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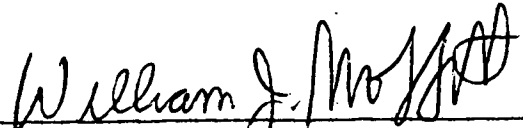
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This is to certify that the foregoing proceedings of an Executive Session of the Committee on Finance, held on April 28, 1986, in re: Tax Reform, were held as herein appears and that this is the original transcript thereof.

  
WILLIAM J. MOFFITT  
Official Court Reporter

My Commission expires April 14, 1989.



