EXECUTIVE COMMITTEE MEETING ON PROPOSED TAX REFORM ACT OF 1986

MONDAY, MAY 5, 1986

Committee on Finance

Washington, D.C.

The committee met, pursuant to recess, at 10:08 a.m. in Room SD-215, Dirksen Senate Office Building, the Honorable Bob Packwood (chairman) presiding.

Present: Senators Packwood, Dole, Roth, Danforth, Chafee, Heinz, Durenberger, Armstrong, Long, Matsunaga, Moynihan, Baucus, Boren, Bradley, Mitchell and Pryor.

Also present: Richard Darman, Deputy Secretary of the Treasury; Roger Mentz, Assistant Secretary for Tax Policy, Department of the Treasury.

Also present: Bill Diefenderfer, Chief of Staff; Bill Wilkins, Minority Chief Counsel; John Colvin, Chief Counsel; Majority; David Brockway, Chief of Staff, Joint Committee on Taxation; Randy Weiss, Deputy Chief of Staff, Joint Committee on Taxation; Greg Jenner, Tax Counsel, Majority; Barbara Groves, Trial Counsel, Minority; Susan Taylor, Executive Assistant.

The Chairman. The Committee will come to order, please.

Let me, if I might, briefly explain how I've come to the conclusion I've come to and why the plan that is before us is before us, and I will modify my Chairman's draft as initially proposed with the papers that are now before the Committee and work for that from discussion.

As you will recall, we had 30, I think, 33 days of hearings on this last summer, anyplace from two to six hours a day, thorough hearings, complete hearings. And after those hearings, I met with the various members for about 70 hours in total either in meetings or on telephone calls talking with them about what they wanted in the bill. And in each case, there would be a certain statement, something as follows: Well, gee, I really wish we could get real tax reform, but I know there is no chance of that; it is unfortunate; you know, I would be with you, but there doesn't seem to be any chance.

And each of the members would say something roughly like that. But as I didn't sense even from talking to the members that we could put together a package like that, and maybe at that time we couldn't, what I went ahead and did was the original draft that I put before the Committee based upon the conversations with the members, taking account of some of their very specific interests as related to their states.

And then as we went through the Committee actions on my initial draft, any number of the members came up to me and said they felt a little bit guilty about the way were just en masse voting back in deductions and exemptions. And they would said, well, we know at the end of it we are going to have to come with a clean-up amendment and so it is all right to vote for all of these revenue losers, not unlike we do on the budget process on the Floor of the Senate where we have a clean-up reconciliation vote, and that everything that we have done is, in essence, undone.

During the past year, as I would go around my state, on occasion around the country, I would ask people what was the top maximum rate that they would have to have -- how low would it have to be before they wouldn't really care about deductions; it would lose at least its political grasp as a difficult issue.

And most of them would say about 25 percent, some 20, some 30, but they would say about 25 percent. If you can get the rop rate down to 25 percent, why then the issue of capital gains deductions and charitable deductions and all these others wouldn't matter.

And I thought to myself: I wonder if that was really true. And I came back to the office, this must have been a month ago, maybe only three weeks ago, and I reread, not all of the testimony of the hearings -- I simply reread the witness list. And as I went through it, hundreds of witnesses, I could not find a single interest group in America that was unrepresented.

And I don't use interest group in the pejorative sense. Whether it be charities or universities or labor unions or teachers or banks or farmers, they were all there. And there is not a single group in America that does not have some preference in the tax code.

And what they are afraid of is two things: One, the unknown, the bird in the hand. They know what their preference is, and they are reluctant to lose it because they don't know how they might have to operate in the future if they didn't have the preference. And the other is the fear that they might lose their preference but their competitor might not lose his or her preference, and they would be disadvantaged in the marketplace.

And I thought to myself is it possible they would really go for a tax code, support a tax code, that attempted to remedy all that.

And I've said it before and I will say it again: I take my hat off to Bill Bradley. He grasped this concept a long time ago.

And when a week ago Friday it became obvious that had we continued to vote that day, we would have voted to get rid of another $100 billion or so of savings that were in my initial draft, I adjourned the meeting. And on that day, Bill Diefenderfer and I went to lunch, and we talked over the situation. And we both came to the conclusion that it was worth giving it a try.

And worth giving it a try is the option that you now see before you. It is, indeed, meaningful tax reform. It is significant rate reduction. It is the elimination of many, many preferences. It is an effort, albeit not a full one, but a good one, to attempt to move the tax code toward neutrality among businesses, to attempt to move the tax code away from a whole potpourri of inducements, incentives and to say that savings is best induced, investment is best encouraged, behavior will best result if people do what they think they do well; if they will give to organizations that they believe in because they believe in them rather than inducement from the tax code.

So I think we have an opportunity. And I want to say to all the members on this Committee how appreciative I am of what you have said and done and your comments. It is obvious that all of you in one form or another, I think, are relieved that we did not continue on down the road that we were going.

Whether by the time we are done this tax reform -- and we can truly call it that -- will pass, I don't know. But I do know this: We have an opportunity that is given to very few. To make a significant difference for the betterment of

America for a generation or more.

And I hope we will not lose that opportunity. Because if we march up that hill and fail, it will not pass our way for another decade.

Senator Long.

Senator Long. Mr. Chairman, I want to congratulate you for your good judgment in having foresight to change direction before the ship runs on the rock. And there is no doubt that the bill on which you were proceeding was in trouble and in the prospect of getting into progressively more trouble. And what you have brought to us now, I think, is a better bill. And I believe it has a better chance of success.

I hope we will find time to answer a lot of questions that are being asked in terms of trying to determine precisely what the bill does do to fill in some of the blanks. But as far as I am aware, as I think most Senators are, that there has been resigning applause in the immediate for the bill that has been recommended. And I hope very much that we can make this historic bill one that will not require too much change in the future.

You are going to have from this side of the aisle, and perhaps from your side of the aisle, some Senators urging that we take enough time to be sure that we are on the right track. And we will try to come to terms with you on that to try to meet your desire to report a bill.

But I do think that you have made some very fine suggestions, and I think most of us here would applaud the conciliatory way that you have approached this matter with all members in trying to put together a package that would meet approval of all.

The Chairman. Further comments?

Senator Bradley? Oh, I'm sorry. I thought you had your hand up.

Senator Bradley. Well, Mr. Chairman, if you want me to --

The Chairman. I didn't mean to encourage you.

(Laughter)

Senator Bradley. I mean if you would like me to, I would be glad to make a statement. If not, you want to move on?

The Chairman. Unless others have statements, I would just as soon move on and have the Treasury Secretary and Mr. Brockway and Mr. Colvin and Mr. Wilkins all start to move through. You will find in front of you, Finance Committee members, from the staff, materials for tax reform markup. It pretty much outlines the package. And I think you will recognize most everything in there. Almost all of it in one form or another we touched upon at least tangentially in hearings, and I don't think there are many new subjects.

There are some new things in it that weren't there before, but do you mean are they startlingly new to anything we have ever talked about or considered or had hearings on, they are not.

So, Mr. Brockway, you want to start?

Mr. Brockway. Yes, Mr. Chairman.

The handout starts with a three-paged summary of the overall proposal. Basically, the outline of the proposal is a two-rate system of 15 percent and 27 percent that is designed with break points similar to the original package so that, one, about 80 percent of families would be below, be in the 15 percent bracket or below, also about 6 million of the working poor would be taken off the tax rolls, that the break point for a family of four would end up with a family of four having to earn over $41,000.00 or $42,000.00 before they would even reach the 27 percent rate.

In the package, it would allow home mortage interest deductions, state and local income taxes, state and local real and personal property taxes, charitable deductions.

It goes through the details of the proposal, the overall memo. Page 1, 1 of 13, it outlines modifications, entitled "Spreadsheet Modifications." And these are -- the page numbers at the top will refer to the spreadsheets when the areas are discussed. Also, in certain circumstances, they will refer to the decisions that the Committee has made to date.

The first item, starting on Page 1 of 13-paged memo, is that, as I say, the rate structure would be a 15 percent rate bracket, and then a 27 percent rate bracket. The standard deductions would be $3,000.00 for single, $5,000.00 for joint and $4,200.00 for head of household.

The 27 percent break point would be $17,600.00 of taxable income for singles, $29,300.00 for joint and $23,500.00 for heads of household. So that's taxable income to the taxpayer. Both will get the personal deductions, will get the standard deduction, and then will be taxed at 15 percent on, for example, for a joint return up to $29,300.00.

In addition, the 15 percent break point would be phased out for high-income taxpayers, taxpayers over $75,000.00 when they are joint. And, also, it would be $45,000.00 for singles and $55,000.00 for head of household, keeping the same proportion of distribution between the three filing categories.

Senator Chafee. Mr. Chairman?

The Chairman. Senator Chafee.

Senator Chafee. I just think it is terribly important that anybody studying these sheets understand that when we are talking there under those charts, the $17,600.00 and the $29,000.00, that you are talking taxable income. And people are liable to go out here and talk about somebody earning $29,000.00; that's where he is. That is just not so.

And I just think it is terribly important that that be stressed.

Mr. Brockway. That is correct. I mean looking at that, for example, on a joint --

Senator Moynihan. That translates to approximately $40,000.00.

Senator Chafee. That is right. And, Mr. Chairman, I wonder if at this point he would say what that translates into because people are going to get mixed up and start talking about --

The Chairman. Take the joint return. Most people refer to the family.

Senator Chafee. That is right. Most people talk gross income rather than --

The Chairman. The family of four in terms of taxable versus gross income. The chart shows $29,300.00. To that for a family of four, you want to add $8,000.00 for four exemptions at $2,000.00 each, and a $5,000.00 standard deduction.

So what you were saying is up to $42,300.00 gross income for a family of four. You are going to be in the 15 percent tax bracket.

Mr. Brockway. Assuming that the taxpayer does not itemize.

The Chairman. Yes.

Mr. Brockway. If the taxpayer has larger itemized deductions than that, it will even be higher. But at a minimum, the lowest will be $42,300.00 before you go into 27 percent rate bracket for a family of four.

Senator Chafee. Could he do that for each of them?

The Chairman. Yes.

Senator Chafee. Because the words goes out from this place in the most confused fashion unless we make it absolutely clear.

Mr. Brockway. Well, for a single taxpayer, it would be $22,600.00. You take a standard deduction of $3,000.00, plus a 27 percent in the first bracket would take it 20,000, plus a $2,000.00 personal exemption. And that would take it to $23,600.00.

Senator Durenberger. For illustration, we will have them all. Our single children when they go to work out there will be at a -- at 22,600, they move into the 27 percent bracket; is that it?

Mr. Brockway. If you are single, unmarried and no dependents --

Senator Durenberger. Right.

Mr. Brockway. -- it would be 22,600. And then you --

Senator Durenberger. You move into the top tax bracket at $22,600.00.

Mr. Brockway. At that point, it will be a 27 percent

Senator Durenberger. All right.

Mr. Brockway. A head of household would depend upon how many dependents the family had. If you assume just for comformity with the joint return that there are two dependents, that it would be taking the $23,000.00, add the $4,400.00 to that, takes it to $27,900.00, and then you add $3,000.00 of that would be $33,900.00 in that example.

Senator Chafee. Could you just give the joint one again, the total?

Mr. Brockway. The joint return would be $42,300.00. It would be $5,000.00 standard deduction, $29,300.00 the first bracket, and then $8,000.00 in personal exemptions.

Senator Chafee. These are for non-itemizers?

Mr. Brockway. These are for non-itemizers. Itemizers, the bracket would go up depending upon how large the itemized deductions would be.

Senator Bradley. Mr. Chairman, if we could, as a way of comparison under current law, what would someone making $29,000.00 -- what rate would they be paying? I think they would be paying at least 25 percent and maybe higher, right? It kicks in up to a higher rate. It is around $29,000.00

Mr. Brockway. You mean $29,000.00 --

Senator Bradley. Taxable income. In other words, there is the rate table.

Mr. Brockway. All right. Our comparison isn't going to be quite the same because you are moving standard deductions and personal exemptions.

Let us try and look at a family of four with earnings of $42,000.00.

Senator Bradley. The taxable income, just the rate. That's the only thing I --

Mr. Brockway. Well, I would like to compare adjusted gross income with $42,300.00 so that your matchup will be the same because this proposal gives you a larger standard deduction and larger personal exemptions as well.

A rough look is that it would be the 33 percent bracket.

Senator Bradley. So for the family of four under current law, they would be in the 33 percent bracket, and under this, they would be in the 15 percent bracket.

Mr. Brockway. At that point.

Senator Durenberger. What about the other two categories on that?

Mr. Brockway. At $22,600.00 of AGI, it would be at 26 percent.

And heads of household would be about 32 percent.

Senator Durenberger. Thirty-two percent on --

Mr. Brockway. Earning adjusted gross income of $33,900.00.

Senator Durenberger. Now is that gross income or AGI/

Mr. Brockway. AGI, adjusted gross income.

Senator Durenberger. So that is what we are using as the base throughout all of this -- adjusted gross income.

Senator Heinz. On the C, the phase-out points for the personal exemption, are those faded as taxable income, adjusted gross income?

Mr. Brockway. This is adjusted gross income. It would come in right behind the phase out of the 15 percent bracket; then you would start phasing those out.

Senator Roth. Mr. Brockway?

Mr. Brockway. Yes, sir.

Senator Roth. So the record is complete, can you give what the effect of marginal rate is for the -- because of a phase out under B, and I guess see what that does to the higher?

Mr. Brockway. Well, it is a matter of how you wish to characterize it. What happens in this proposal is that you phase out the advantage of the 15 percent bracket over roughly $70,000.00 of adjusted gross income as it goes up. There is a similar thing that you do on the corporate side, when you phase out the lower --

Senator Roth. Could I ask you this way: If they were treated the same, those in the higher bracket, what would be the marginal rate of tax basis?

Mr. Brockway. Essentially, you can view this phase out as increasing the rates by five percent, and so that you could add that on top if you wished to raise that. But in all these cases, the effective rate of the taxpayer is going to be below 27 percent. If you are phasing up to a 27 percent effective rate -- actually, it would be lower than 27 percent in all cases because you are allowing a variety of itemized deductions. But it is gradually increasing yourself up to that level.

But in that phase-out range, because of your statutory rate of 27 percent, plus you have this phase out, you can view that as a five percent increase in the marginal rate.

Senator Roth. Let me make sure I understand. Effectively, you can say that the 70,000, if they were treated the same, it would be up to 32 percent?

Mr. Brockway. Again, because I have heard that characterized by members both ways, I would be reluctant to state that. Clearly, in all situations, your effective rate is going up in this period, but one way to view that as an increase in the marginal rate is really sort of how you look at any -- just for clarity sake, anytime you have a phase out of any benefits, such as the earned income credit, the lower rates for corporations that you would phase out right now as they go from 100,000 to 300,000, the child care credit, all of that can be viewed as a marginal rate increase. And so that you could state it that way.

Or ordinarily in parlance you don't sort of view those as separate -- you sort of view those as separate items, but certainly you can add those two together.

Senator Danforth. The fact of the matter is that they are being taxed at less than 27 percent.

Mr. Brockway. In all cases, you are moving up towards that.

Senator Danforth. The fact of the matter is that nobody would be taxed at more than 27 percent.

Mr. Brockway. That is correct. You would be less because of itemized deductions.

Senator Danforth. And this whole description of the marginal rate is really a matter of characterizing the phase out.

Mr. Brockway. Exactly.

Senator Roth. But I think it is important that people completely understand that if they were being treated in the higher brackets exactly the same as the 15 percent bracket and the exemptions, that the marginal rate then would go up to, what did you say, five percent?

Mr. Brockway. The phase out has an effect of roughly five percent. If you view it as a marginal rate, that is what is happening; that you are moving yourself up to get, as you go through that phase-out range of 75,000, 150,000, you are getting yourself closer to where you would be above 150,000.

As indicated, the $2,000.00 personal exemption would be retained effective in 1988, and it would be phased out after the phase out of the lower rate bracket is concluded.

The limitation the Chairman has marked, that limited variety of itemized deductions to the first two brackets, would deny it against a 35 percent bracket -- it is deleted from the package. And so that all the itemized deductions that are allowed would be allowed in full, both against the 15 percent bracket and the 27 percent bracket.

On Page 2, the item E, that indexing would be rounded down to the nearest $50.00. And so, therefore, if the indexed number for the standard deduction personal exemption rate brackets was, let us say, 5,125, it would be rounded down to 5,100 for the same item.

Item F, the personal exemption for individuals would be denied.

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus.

Senator Baucus. Mr. Chairman, I just want to ask if the personal exemption presently indexed.

Mr. Brockway. Personal exemption, yes.

Senator Baucus. Thank you.

Mr. Brockway. The personal exemption for individuals who are eligible to be claimed by a dependent would be denied. And so in that situation, the parent would get the $2,000.00, essentially what they get right under present law, but the child also would not be able to get a personal exemption for the same income.

G, the personal property tax deduction would be retained.

H, the current taxation of scholarships and fellowships would be retained rather than changes in the Chairman's proposal and the House bill.

I, the above-line charitable deduction deducted for non-itemizers would be allowed to sunset as scheduled at the end of this year.

J, the deduction, the itemized deduction, for medical expenses right now subject to a five percent of adjusted income floor. That floor will be increased to 10 percent of adjusted gross income.

K, the adoption expense deduction would be repealed.

And, L, the miscellaneous itemized deductions would be repealed. In addition, as under the Chairman's mark and in the House bill, the above the line deduction for unreimbursed employee business expenses would be moved below the line as itemized deduction and subject to a one percent of AGI floor.

On Page 3, the distribution of these changes, of the individual tax changes, is set out. There is an aggregate average cut of 6.2 percent for all taxpayers in 1988.

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus.

Senator Baucus. On that, I see that list here, percentage change and income tax liability 1988 for various income categories broken down into tens of thousands of dollars. Is that table of percentage change in income tax liability, is that for joint taxpayers, single or what?

Mr. Brockway. This is for all taxpayers, Senator. It pulls all of them together in doing these analyses.

Senator Baucus. Could you provide for us what it would be for joint as opposed to what it would be for single income taxpayers in each of those income categories?

Mr. Brockway. I will see what we have on that, whether it can be broken out separately. Ordinarily, the way it comes out is on an aggregate for all taxpayers.

Senator Baucus. I just think if we are going to have a distribution table as this is, some taxpayers are single, some are joint, and they are going to want to know how that affects them. I think they have a right to know how it affects them. And I just think it important for us to have that information broken down.

The Chairman. Let me ask you a further question, Dave. On the income distribution for $200,000.00 and above, this is the percentage change for one year, but it does not yet assume the full phase out of the passive income, which does not finish until three years after the bill, which ought to lower that 4.7 figure, shouldn't it?

Mr. Brockway. It does not include that. And phasing that in will lower that. Whether there are other changes going in the other direction, I am not sure, Mr. Chairman.

But let me look into that, Senator Baucus. That ordinarily when we provide these distributions they have been for all taxpayers. And it is a question, one, of whether they can break it out; and, two, by reducing the sample size, the quality of the numbers is good. But let me look into that and get back to you later today.

Senator Baucus. You mean you haven't broken it up before at any other time?

Mr. Brockway. We generally put these out as overall for all taxpayers.

Senator Baucus. Yes, I hear you saying you generally do, but I am questioning whether it has been done before.

Mr. Brockway. Well, I am reluctant to say that it has never been done before because I will have to check with the economists to see whether we have in the past done it or whether that information is sufficiently broad enough based to give you good distribution. If it is, then I will definitely come back.

I simply don't know. I am reluctant to commit that it can be done.

Senator Baucus. I think it is important to have, frankly.

Senator Pryor. Mr. Chairman, may I ask a question at this point of Mr. Brockway.

The Chairman. Yes.

Senator Pryor. Now these tables indicate an effective date, I understand, of 1/1/88. Is that right?

Mr. Brockway. No. This reflects the change in income tax liability for calendar 1988 for taxpayers. But the effective dates, generally, are the effective dates that are in the Chairman's mark. And that is generally 1/1/87, but a six month delay in the rate change, as has been in the other proposals --

The Chairman. Which is the same provision, only a year later.

Mr. Brockway. Exactly.

The Chairman. That is both in the President's bill and the House bill.

Mr. Brockway. Exactly. But because this is a -- you want to give a full-year effect, which is why we give 1988.

Senator Pryor. Right. But is there a danger in 1987 if the IRA deduction is lost and other itemized interest situations take effect or are lost? Is there a possibility that there would be an increase on some taxpayers in 1987 that we are not seeing here?

Mr. Brockway. There is a possibility. I mean, clearly -- well, two things, just so no one is misled. These are aggregate for all taxpayers. Very definitely that while you have a tax cut here of approximately $100 billion over a five-year period, there will be a number of taxpayers that will have a tax increase, depending upon what their particular profile is. For example, if they had a lot of tax shelters.

In 1987, the net tax cut is smaller under this package as it was in 1986 under the House bill and the Administration proposal because you only have a half-year cut.

The way that works out or at least it did in those others is that up to the middle income -- and I think in this proposal would be about roughly 50,000 where the break point is that -- below that level, there should be a tax cut; above that level, there might be in the aggregate a tax increase in 1987 because the rate cuts are more important to upper income taxpayers.

So there will be income categories in 1987 that have a tax increase, but it will be at the upper end of the income distribution. At the lower ranges, they will have a slight tax cut.

Senator Bradley. Mr. Brockway, would it be fair, just following on what Senator Pryor asked, would it be fair to say that the people who are wage income primarily will end up with a -- clearly will have a tax cut. People who are into tax shelters might have a tax increase in some cases. Those are the people who would have any tax increase, if there were a tax increase.

Mr. Brockway. Clearly, that will be the direction. That the fewer preferences you have under present law, then you are going to have a tax cut even if the tax cut is only a half year's tax cut.

If you have substantial preferences that are being repealed in this bill to pay for the tax cuts, then you may not in 1987 have a tax cut because you are only getting a half-year rate cut. And the way that works out is the lower end -- I know from looking at other packages that in the first year it tends to be the lower end is where you get the net tax cuts, and the upper end is where you have tax increases where you have only a half-year rate cut.

So I would expect that to be the profile here for 1987 as well.

Senator Matsunaga. Mr. Chairman, in terms of dollars now, it seems that 62.2 percent for those between $10,000.00 and $20,000.00 -- now that would sound like a gigantic figure -- but in terms of dollars what is it?

Mr. Brockway. I will try and quantify later. It will not be a substantial amount of money for each taxpayer because each taxpayer does not pay a substantial amount of taxes. Now to them it may be a substantial amount because they only have a relatively small amount of money.

But, clearly, current tax liabilities are fairly significantly progressive. And so that you take these percentages that you have to multiply times the average tax the taxpayer pays. At the lower end, they simply don't pay that much tax. So the average tax cut per taxpayer will be smaller at the low end, and it will get increasingly larger because it will reflect their tax liability.

Senator Matsunaga. Of course, I realize that. But do you have any figure?

Mr. Brockway. I will be able to get that for you later today, Senator.

Senator Matsunaga. And also a figure for $200,000.00 and above?

Mr. Brockway. Be happy to get that figure for you.

Senator Matsunaga. Fine.

Mr. Brockway. The next item covered on the memorandum is the treatment of depreciation, accelerated cost recovery. In the Committee, the Chairman's mark was modified by an amendment of Senator Roth that increased the recovery rate for productivity property 200 percent, declining balance, switching some of the year's digits, and kept at 150 percent declining balance, switching to straight line for non-productivity property.

What this package contemplates is eliminating the distinction between productivity property and non-productivity property, first, by taking the categories that were approved by the Committee in the three-year, five-year class and 10-year class with two changes. One is that there is an amendment that would have moved oil refineries from the 10-year class to the 15-year class. Excuse me. From the 10-year class to the five-year class. This would return to the Chairman's mark on that so that all property with an ADR life of more than 15 years would be in the 10-year class; would get a depreciation over 10 years.

And, also, that R&D property, which under the Chairman's mark and present law would be a three-year category, that would be moved to the five-year category, treated as all other property. Rather than having it three-year straight line, would go to five years double declining balance.

So the categories would be the three-year class, that modification of R&D, five-year class ADR property of less thatn 16 years, 10-year property the same as the Chairman's mark, property with an ADR class of more than 15 years. Fifteen-year class would be utility property and real estate would be given a 30-year straight line recovery.

The recovery rates would be 200 percent declining balance in the 5 and 10-year classes, switching to straight line. So, therefore, whether or not you are productivity property,you get the 200 percent declining balance change under this proposal.

In addition, the $40,000.00 expensing as in the proposal previously approved by Committee would be reduced to a $10,000.00 annual limit rather than $40,000.00 under this proposal.

Senator Armstrong. Mr. Brockway, could you take just a moment and explain the switching mechanism?

Mr. Brockway. The way a declining balance system works is you have --

Senator Armstrong. I understand declining balance, and I understand straight line, but I don't understand the switching.

Mr. Brockway. What you do -- at some point after you have got the acceleration in the first couple of years, the more advantageous to switch off of a declining balance system which has accelerated in earlier years to another method.

Under the amendment, as adopted in the Committee, that you would switch not to straight line depreciation after that optimum point, but to another method some of the year's digits method which, again, is more accelerated than straight line is the way that would work. That would accelerate in the middle years.

What present law does is switch from 150 percent declining balance to straight line at the most favorable point for the taxpayer. And that is what this proposal would do, would switch from 200 percent declining balance. And when you would get at that point, that you would get a more favorable depreciation if you switched on to straight line for the remaining depreciation; it would switch to straight line.

Senator Armstrong. I understand that. Thank you.

The only other question I wanted to ask about that is: is this a prescribed change or is it a taxpayer option?

Mr. Brockway. Generally, it is a precribed change as under present law. I mean I think it would always be advantageous. There are elections that you can take to have slower depreciation generally, and those would be maintained if you wanted to have it.

But, otherwise, taxpayers generally would not want to stay on declining balance on an ongoing basis.

Senator Mitchell. Mr. Chairman.

The Chairman. Senator Mitchell.

Senator Mitchell. Mr. Brockway?

Mr. Brockway. Yes, sir. Sorry.

Senator Mitchell. In this area, I would find it helpful -- I don't know if the other Committee members would -- if you could go down through each of these items, A through G, and describe the relationship between this proposal, current law and the House bill. In other words, what is current law and House bill and how does this proposal differ from either of those.

I don't want to take a long time, but I think it would be very helpful.

The Chairman. Can I ask you a generic question?

Mr. Brockway. Yes, sir.

The Chairman. Would it be fair to say that this depreciation proposal II is certainly more generous than the House bill and somewhat more generous in toto than the present law?

Mr. Brockway. Both statements are true. It clearly is significantly more generous than the House bill, which is less generous than present law. And this is, I believe, about $15 billion more favorable than current law.

The Chairman. Than current law.

Mr. Brockway. I have to check on that, but I think at least for the categories that definitely you get the 200 percent declining balance it is more.

The Chairman. And by and large to the extent that people have asked for some degree of certainty and not great change, for those who are familiar with the ACRS system, this particular proposal will be very familiar to them.

Mr. Brockway. It is based on present law. What it does is provide advantages to property in the three, five and 10-year classes. And then it takes away some advantages from the longer life properties -- utilities, real estate -- is the way it moves from present law essentially.

So for equipment it is going to be a more favorable system than present law.

Senator Pryor. Have these provisions changed over what we talked about last week? For example, A and B, are they changes over what we discussed as late as Thursday or Friday, Mr. Brockway?

Mr. Brockway. Let me go through on that. On Item A, property in a five-year and 10-year class, which is generally most equipment that is used, under present law would have 150 percent declining balance switching to straight line.

Under the earlier amendment adopted by the Committee, some would have 200 percent declining balance switching to some of the years' digits, which is slightly more generous than this. Others would have -- that would be for productivity property. Non-productivity property, however, would only get 150 percent declining balance, which is a straight line under the Committee's amendment, which would have been less generous.

This provides all 200 percent declining balance switching to straight line. And that is, as I say, an increase from the present law of 200 percent declining balance.

The House bill, it really depended upon the length of life of the asset. Some property would have, under that system, a 200 percent declining balance which means straight line system, but the lives there, if your ADR was around five years, you would get the same treatment. But otherwise if it was longer, you would end up with a longer life because that system your depreciation life turned on what your ADR life was so that generally for most equipment this would be a more generous system.

Senator Boren. Where is steel under this?

Mr. Brockway. Under this, the break point is the same as it was in the Chairman's mark -- five year. Steel, I believe, is a 15-year ADR life, so that ends up five years.

Senator Boren. Now on the refineries which we voted on, I believe, by a 10 to 5 vote in this Committee, did I understand that that had been changed? I had been told that we were going to keep exactly the same categories. Have you slipped that back on me again to 10 years even after the Committee had voted by 10 to 5 or is that still five years like we agreed?

Mr. Brockway. Would you like me to say that I slipped it back --

(Laughter)

Senator Boren. Does the vote of the Committee have no weight, since we did vote 10 to 5 on that? Or is the staff overruling the Committee on that?

The Chairman. No, the staff did not overrule. It would be unfair to put the monkey on their back. In redrafting this -- because you will recall in some of the initial proposals we had 15 percent deductions for real property and other taxes as against a 25 as against a 35 percent level.

When I redrafted a new Chairman's draft, there were some significant changes made, including things that I had voted for, that the Committee had voted for, that were taken out. And builder bonds being a good example. I felt very strongly about that, and I put them back into the installment property class with everything else.

Senator Heinz. Mr. Chairman, before we get too much further into this, may I ask one overall question on the individual versus business tax burden shifting here?

What is the amount, as you look at the two proposals, what is the amount of tax burden that we shift from individuals to corporate in what is now before us?

Mr. Brockway. The proposal is roughly a $100 billion corporate increase, a $95 billion, approximately, individual cut, and then you have some revenue loss from certain outlay offsets in the compliance and other areas, and also employment tax offsets that are roughly $5 billion. So that it is about an individual cut of, as I say, $95 billion; corporate, $100 billion, and those others account for the difference.

Senator Heinz. So we have somewhat increased the tax cut for individuals over the weekend?

Mr. Brockway. Depending upon at which point one was at in the discussion of these packages.

The Chairman. But not exactly. We have always been around six percent, give or take 6.3 or 5.7. The difference is that initially there was a presumption of excise taxes. And we had about $70 billion taxes on business, and we presumed about $25 billion in excise taxes. Those are out. There are no excise taxes in here.

And, instead, we are still at about the six percent level. The House was at about a nine percent level, but what they did was hit business for about $145 billion. And the President was about $120 billion.

So instead of the excise taxes, we went from roughly 70 to 100 on business.

Mr. Brockway. The expensing limitation, Senator Mitchell, is $10,000.00. Under the House bill, it is also $10,000.00. Present law, it is $5,000.00, essentially phasing up to $10,000.00. The oil refineries --

Senator Mitchell. When would the 10,000 be reached under current law, Dave?

Mr. Brockway. Either in 1988 or after 1988.

The Chairman. Ten thousand under current law is reached next year, isn't it?

Mr. Brockway. We are checking on that. It is either in 1988, I am pretty sure, or after 1988. I am just not sure which one offhand.

The oil refineries, as discussed earlier, would be put in the 10-year class under this proposal. In the House bill, it is ADR of 16 years, so they would have had a 16-year depreciation rather than 10 years.

Senator Mitchell. Sixteen years.

Senator Durenberger. Mr. Chairman, as I note that, an additional substantiation of what you said earlier, I wasn't here the day we did refineries and food processors have as much claim on the shorter life as do refineries, if we adopt a different theory. So if we are going to stick with 10 years for refineries, than I am giving up $600 million worth of food processors.

The Chairman. Let me emphasize again: As you go through trying to stay at a 17 percent rate, there were many things that many members gave up that they feel very desperately strong about, either from the standpoint of their states or a standpoint of equity of the nation. And it is not unlike a poker game where everybody anted something into the pot in order to make the pot big enough to get the rates where we are.

And I have got to thank the generosity of the members who were willing to do that, swallow hard in some cases. I swallowed hard on builder bonds. But I think we have got a package that will be good for America, if we can get it out.

Senator Boren. Well, Mr. Chairman, were we asked to volunteer these things? Some of us gave them up without really knowing how generous we were apparently.

(Laughter)

Senator Boren. Or I guess some of us were not invited to some of the meetings where the offers were made. But I thought that the votes the Committee has taken in the past -- we were told we would not be changing the depreciation schedule; that at least the authors of the amendment would be consulted.

The authors might be willing to give up all or part of them, but as far as I know, I wasn't consulted. We did have a 10 to 5 vote. If I was consulted, I don't remember it.

The Chairman. David, you were not consulted. And I don't want this blame to be placed on the staff or to be placed on the other Senators. Many of the final decisions I did make, including some of some other members who were working on this where I finally had to make it for them because they weren't around, or I couldn't find them, or they weren't here this weekend.

I make no apologies. There are limitations and eliminations and deductions changed; not significant in the overall sense. We have not made generic changes.

But in order to make this package come out, I had to make some decisions as the Chairman, and I have made them. And we may revote them again, because there are a number of things that the Committee voted for, that I voted for, that we changed.

Senator Mitchell. Could I just ask Mr. Brockway, then, to complete Item C. You have given us what it is under the Chairman's proposal, obviously what it is under House bill. What is it under current law?

Mr. Brockway. Current law, it is five years, 150 percent declining balance, so this is 10 years, 200 percent declining balance. It would be less generous to some extent.

On the expensing -- let me stand corrected on what I said before. In 1988 and 1989, it would be $7,500.00. And 1990 and thereafter it goes to $10,000.00.

Senator Mitchell. Ten thousand, right.

Mr. Brockway. Research and experimental property, present law, it is in a three-year class. Under this proposal, it would go into a five-year class through 1989, and it would revert back to a three-year class thereafter. This four-year move in class is linked up with a four-year sunset on the R&D credit which would be discussed later.

So that under present law, this is in the three-year class. In the House bill -- and the House bill without a special class, it would be -- would fall wherever the property would fall, which generally would be more than the five-year writeoff.

Senator Mitchell. The House bill has fewer classes and attempts to relate depreciation more closely to the useful life of the assets than --

Mr. Brockway. The general design there is to move on ADR basis. I mean this design is trying more or less to stay within the frame work of present law. That is correct.

Item E, place all real estate in a 30-year class. That is the same as the House bill. Present law, there is a 19-year useful life options for taxpayers to take either straight line, 175 percent declining balance.

The Chairman's original markup was 30-year straight line as in this proposal. But there was an amendment that reduced residential property to 25 years. This reverts back to the Chairman's original mark on that item.

Senator Durenberger. Dave, before you turn the page, may I ask you about bond-financed housing? Currently, all real estate is 19 years. Multifamily rental housing also has 19 years. Do you include multifamily housing in the 30-year provision?

Mr. Brockway. If it is bond financed, it goes to the 40-year class.

Senator Durenberger. What is the cost on bringing it back to 30?

Mr. Brockway. We will get an estimate on that for you today. It is not a very large number but --

Senator Durenberger. I have accurately stated the facts so I've an idea that currently they are both at 19, both multifamily and --

Mr. Brockway. That is correct.

Senator Durenberger. Thank you.

Senator Heinz. Dave, one other question.

Mr. Brockway. Yes, sir.

Senator Heinz. Previously, the Committee voted to keep a differential between rental and commercial property. We voted a 25-year life for rental, a 30-year life for commercial.

I gather that that is not retained.

Mr. Brockway. That is correct, Senator.

Senator Heinz. What is the cost of retaining that?

Mr. Brockway. Depending on which question you are asking, you can keep the differential revenue neutral. But the amendment, your amendment, moving it to 25 years, I think, was $400 million.

Senator Heinz. That was $400 million?

Mr. Brockway. I will confirm that, but that is our recollection.

Senator Heinz. That sounds about right.

And to keep it revenue neutral, what options are there?

Mr. Brockway. Well, assuming you wanted to do 25 years, which is a four percent recovery rate, for residential you would go to three precent recovery rate or 33-1/3 years on commercial non-residential.

Senator Heinz. I don't feel strongly whether it needs to be a specific year or not. I just think we have to have a reasonable differential.

Mr. Brockway. That is one differential, Senator -- 25 years and 33-1/3 years or your annual recovery rate being four percent and three percent. You can also just sort of move those together. I think 28 and 31 also works, to my recollection.

Senator Heinz. What would 27 yield? Twenty-seven and 32 or something like that?

Mr. Brockway. It would be a little more than 31, 31-1/2, let's say.

Senator Heinz. Thank you.

Mr. Brockway. On Page 4, continuing on cost recovery, two significant changes. The first is to reduce the investment tax credit on carryover, existing carryovers, and also for transition property by 30 percent to reflect the rate reductions from 46 percent corporate to 33, and the individual rate reductions from 50 to 27. So those credits would be allowed only at 30 percent of the rate that they are right now. Generally, that would be a seven percent. They would be allowed at 70 percent of what you would otherwise get under current rules. Generally, that would be seven percent where you are taking a 10 percent credit.

Also, the mandatory refund of the investment credit, the investment credit buy-back that was discussed in the Committee and in the Chairman's mark would be deleted from the proposal. This proposal would not contain that mandatory buy-back that was in the Chairman's mark.

Senator Durenberger. Mr. Chairman?

The Chairman. Senator Durenberger?

Senator Durenberger. Dave, what is the treatment in here of the ITC as part of the alternative minimum tax?

Mr. Brockway. The ITC would not be allowed against the alternative minimum tax. There would be no credits allowed against alternative minimum tax other than the foreign tax credit and also low-income housing credits.

Senator Durenberger. Do you know what the cost --

Mr. Brockway. Oh, I'm sorry. Even the low-income housing credit would not be. So generally just the foreign tax credit, which is the rule that it is under present law.

Senator Durenberger. What would be the cost of including or not -- of including the ITC carryovers?

Mr. Brockway. My understanding is it is about $4 billion if it is done for all property.

The House bill on that has it only for taxpayers that have net operating losses out of two out of three years which was a smaller number, obviously, than that.

Senator Durenberger. I thank you.

Mr. Brockway. Continuing to the next section, to the accounting changes, and would take the provisions adopted in the spread sheet and as modified by the Committee with various changes.

First, the dollar value LIFO simplification provision for small business would be deleted.

Second, the limitations in the Chairman's proposal on cash accounting would be deleted, retain present law.

Third, the Chairman's proposal on installment sales, borrowing against installment sales, borrowing attributable to installment sales -- the Chairman's proposal did not extend to real estate. Under this proposal, it would extend to real estate. It would cover the builder bond situation.

For bad debt reserves under -- which are repealed for corporations, businesses generally, under the Chairman's mark, the House bill and the Administration proposal would be repealed but not with respect to finance companies. And that coordinates with the facts in the financial institution area discussed later that there is no change for financial institutions to their bad debt reserves. And so that also under this proposal there would be no change for finance companies as well.

The fifth item is an item not in the Chairman's proposal. It deals with accrued income, but unbilled income, of utilities. Present law, certain utilities take the position that they do not have to accrue income until they bill customers for the utility services they provide, even though they are deducting their expenses as they go forward. This would require the utilities to accrue the income as earned rather than waiting until it is billed so you have a shift to the next year.

The next item would conform the taxable years of grandfather partnerships, Subchapter S corporations and personal service corporations, more closely to the taxable years of the owners. Under present law, that in 1972 was changed for new partnerships providing that partnerships had to have a taxable year that ended within the last three months of the calendar year to prevent partnerships from utilizing a device to defer income by setting up with a, for example, January 31 fiscal year -- all the income that the partnership earned between February and December would be reported on the partners' return on January 31 of the following year, so you would have essentially an 11-month delay of all your income on a year-by-year basis. In the partnership, it was changed in 1972. And the regulations, I believe, for new partnerships, this would apply it across the board to new and all partnerships and also Subchapter S corporations and professional service corporations so that you would not have the opportunity to roll income forward an additional year.

Staff. A similar change, Item G, top of Page 5, is a similar ability to defer income for on a one-year basis occurs in mutual funds where you can have a fiscal year mutual fund, and the earnings of the mutual fund will pass through with dividends paid after the end of the owner's, the individual's, taxable year. So it will be earned during the taxable year. Let's say, again, from February to December. And then the dividend paid out at the end of the year, in January 1 of the following year, so you have a one-year delay of the income.

This requires mutual funds to go on a calendar year basis, and it also eliminates an ability they can use in present law to pay dividends right after the close of their year and have that be counted in the subsequent taxable year of the owner's.

This essentially means that income earned by a mutual fund is going to be taxable to the individual owners of the mutual fund the same year it is earned by the mutual fund. It is simply a device under present law to defer income for one year. That would be eliminated.

Senator Durenberger. Mr. Chairman?

The Chairman. Senator Durenberger and then Senator Matsunaga.

Senator Durenberger. Mr. Chairman, two clarifying questions. One on capitalization issue. I think we went part way, didn't we, on that capitalization of inventory?

The Chairman. Five million dollar exemption.

Senator Durenberger. And as I understand, to go all the way would have cost an additional $2.9 billion or something like that.

Mr. Brockway. Are you talking about the provision dealing with wholesaler-retailer?

Senator Durenberger. The wholesalers-retailers, right.

Mr. Brockway. It would be in that neighborhood, yes.

Senator Durenberger. On the installment sales issue, we have a similar problem. I sort of have the impression that that is one of the, at least from the track group, that that is one of those issues that wasn't necessarily great tax policy, but they gave up on their efforts to try to change the taxation of revolving -- I think revolving charge plans and so forth as a tradeoff to get a lower rate of taxation. The dollars involved there, I guess, also were fairly substantial in terms of revenue gain.

The Chairman. The track group, unless it has changed from last week -- and last week we still had the same provisions that we have now on the capitalization of the inventories and installment -- as a package, supported the package.

Senator Durenberger. And my pledge rule that I was going to put in here would cost about $1.2 billion, and I take it they have given up on trying to get that as well.

The Chairman. All I can is that as a package, they supported it. I mean now if we were to start going down the different groups who even support the package but say, well, now wouldn't you like to have A-B in addition -- of course. But you mean would they try to get A-B if it is going to jeopardize the package, no.

Senator Durenberger. I was just trying to delimit the extent of their generosity here.

And there is one small suggestion that -- maybe if we don't have a figure on it we could -- and that is we allowed retailers who have revolving charge plans to use the installment method of reporting -- keep them subject to the Chairman's general debt to assets test for installment sales, but let them use the installment method of reporting income.

Would that be a small-ticket item?

Mr. Brockway. I believe it is 1.6 to apply them to the general rule. Let me confirm that number for you.

Senator Durenberger. All right, thank you.

Thank you, Mr. Chairman.

Senator Matsunaga. The insurance industry does not come within the Title 3?

Mr. Brockway. That is correct, Senator.

Senator Matsunaga. So it is treated under separate --

Mr. Brockway. That is correct. It is later on the document -- the proposal in the document was to retain what is in the Chairman's spread sheet.

Senator Matsunaga. All right. Thank you.

Senator Bradley. Mr. Chairman, on the retail question, that is the industry that benefits enormously from the extra reduction in rates that you gave. I know that -- you know, I have gotten a couple of calls, people singing hallelujah that the rate is down.

The Chairman. If there is any group generically that is happy with the overall bill, it has got to be the retail industry because they are in an effective high tax rate. They were not an industry that was heavy into the use of investment tax credit, so they didn't get all that much benefit. And when we used the investment tax credits to lower the rates, I think had we done nothing else in the whole bill they would have said that is sensational.

Senator Bradley. So it is really kind of shortsighted if that was the big push to get a little bit more and made a problem for the bill. The rate goes to 46 then.

Mr. Brockway. Senator Durenberger, let me confirm that that is $1.6 billion. We checked our letter.

Senator Chafee. I don't want to give the impression, Mr. Chairman, that the hallelujah chorus was unanimous. There were some who didn't sing.

Mr. Brockway. The next area, Page 5, capital gains. Two changes from the spread sheet. First, repeal capital gains exclusion, taxing at the same rate structure as other income. This is for individuals. That is a 15 percent and then 27 percent brackets. Additionally, the provision dealing with small business participating debentures would be deleted from the package.

Senator Heinz. On that, that is to say capital gains will not be included in income. They will be taxed separately on their own separate rate schedule? Are they going to be included in income?

It sounds like you are not including them in income.

Mr. Brockway. I am sorry, Senator.

Senator Heinz. It is the way that you have described it that it doesn't sound like you are simply including capital gains in income. I have reason to believe that you are including capital gains as income. But as you have described it, it sounds like they are subjected to a separate parallel rate structure.

(Pause)

Senator Heinz. Mr. Chairman, I apologize for the delay.

Mr. Brockway. I am not sure what the purpose is of the words you are questioning, which is --

(Laughter)

Mr. Colvin. Senator Heinz, your understanding is correct. The effective --

Senator Heinz. I just asked a question. I didn't have an understanding.

The Chairman. Let me tell you, Dave, what I intended, because I remember talking to some of the members about it. I left in, at least in my mind -- I intended to leave in capital gains at a separate rate, although it would be identical. So that anybody ever moved to increase the rate, there would have to be another vote on increasing the capital gains rate. That the two of them would not go up automatically in one vote.

Mr. Colvin. And that is the intent of this language.

Senator Matsunaga. So that in the calculation, then, capital gains will not be included as income, which means that --

Senator Heinz. It is unclear.

Senator Matsunaga. Because that could determine what rate you are in.

The Chairman. No. It is includable as income.

Senator Matsunaga. Yes. But then if you include it in income, you may reach the higher bracket.

Senator Heinz. Mr. Chairman, would this be an accurate description of what you have decided to do? For the purposes of computing the tax on capital gains, you have a separate schedule -- 15 percent and 27 percent -- and what you do is, step one, you calculate your tax on your normal income; then, step two, you go over to this other schedule, you put in your capital gains, then you put in your taxable income that you pay taxes on; you add that up; you figure up how much tax you owe on that; and subtract the tax you paid on column A from column B; take the difference, which we will call C, and add it back to your tax back in column A.

The Chairman. That is exactly what we intended.

(Laughter)

The Chairman. I have got to confess that in terms of the columns I had not thought it through completely in my mind. I was thinking of the philosophy of the vote, because there will be an amendment on the floor to attempt to raise the tax on the higher income levels. And I just -- the entire key to any agreement on this, if an agreement can be reached, about the elimination of the capital gains is a rate no higher than 27 percent. At 28 percent, two members of this group drop out. I drop out at 28 percent. And if that vote is coming on the floor -- and I think it is going to be offered -- I want to make jolly well make sure that everyone understands that the capital gains rate is separated, and if somebody wants to make a motion to raise the capital gains rate, they can do so. But it is going to be a separate vote.

Senator Danforth. Mr. Chairman, the people who are in the transitional area, the phase-out area, for the standard deduction, personal exemption, it would turn out to be higher than 27 percent, wouldn't it? Or would it?

I mean is it our intention, in other words, even in that phase out to have the capital gains tax at 27 percent or is it our intention to have it taxed as though it is just ordinary income?

Senator Bradley. If I could -- are you waiting for them?

Senator Heinz. Just one quick question.

Did I describe -- I wasn't sure whether the Chairman was being facetious or not about my explanation.

The Chairman. I had not thought through the technicalities of which columns. I just wanted to make sure we didn't get the capital gains rate dragged up in --

Senator Heinz. Did you really understand what I was describing?

The Chairman. I understood in what you described. In talking with the staff and saying I want to make sure of these two distinctions, I had not thought through. I understand what you have said. I have simply not thought through in my mind technically where it would be on the columns.

Senator Heinz. But you think I have described technically where you would have to come out or not?

Mr. Colvin. No, Senator Heinz, it would be one pot of money and capital gains would go in on top of what we think of as regular income. And it would not be a separate pot as you described.

This language was meant to reflect the explanation that the Chairman gave to it. If in the future there was an increase on regular income above 27 percent, it would require a separate amendment to raise the rate on capital gains above 27 percent.

Senator Heinz. I don't quite know how you do that if you add capital gains income to ordinary income for tax purposes. I don't think you can do it that way. I understand your intent, and I think I support your intent, but what you have just described, I do not think will accomplish your purposes.

Senator Mitchell. Well, Mr. Chairman, as a person who will author the amendment and offer it on the floor, I intend to make a distinction. If that is what you are seeking here, you --

The Chairman. Senator Mitchell has been very good and indicated on the floor he will offer a higher amendment; not in Committee, and I appreciate that. And I didn't even think about that, George. And you have been very decent this whole time. And I am glad to know it, but I wasn't aiming that at you.

Mr. Brockway. Mr. Chairman, if I may restate where I believe things are and what we are carrying -- is that this is a change, basically a drafting change, in how the statute, the bill, will read, so that it requires a separate amendment.

The substance of the rule, the effect on taxpayers, will be that when the provisions are effective, that capital gains would be taxed at the ordinary income rates. That is what we have done in the estimates and the proposals.

So the rates will be the same. It is just added into your income. Now how the statute is drafted will work that out in drafting to make it difficult to amend -- but the substance will be it is taxable at ordinary income combined with your other ordinary income.

Senator Heinz. I am just interested in what happens if somebody comes along and says, well, let us increase the 27 percent rate for people over $200,000.00 to something else. Then you will have to have a separate schedule.

Mr. Brockway. We will have to in drafting figure out the best way to do it to make the amendment hard to accomplish the result, to accomplish the technical parliamentary objectives, but --

Senator Mitchell. And after you do that, what are you going to do when I come and ask you to help me draft the amendment?

Mr. Brockway. Then I am going to figure out how to draft that amendment.

(Laughter)

Senator Heinz. I want to thank Mr. Brockway for a clear explanation of how to handle that technically.

Mr. Brockway. But, substantively, you will get the same result in terms of the taxpayer as if you are just taxing capital gains at the ordinary income rates combining with your other income.

Senator Heinz. I think the answer is they are working on it.

Senator Matsunaga. What about those who pay a 15 percent rate?

Mr. Brockway. They will pay 15 percent on the capital gains.

Senator Matsunaga. Capital gains. I see.

Mr. Brockway. Hopefully, that clears that up.

(Laughter)

Mr. Brockway. The next area is compliance. Generally following the provisions in the Chairman's spread sheet, the major change here is providing for increased funding for the IRS agents' audits and modernization of the IRS compliance systems. That would be funded through the penalties and taxes. The IRS budget generally would be funded through penalities on taxes collected.

This would contemplate roughly a $700 million increase in spending on agents, and it would net, when you aggregate both the corporate and individual side, approximately $17 billion of revenue increase from the increase in agents and audits.

Senator Chafee. Mr. Chairman.

The Chairman. Senator Chafee.

Senator Chafee. Wouldn't it also be safe to say that there is a fringe benefit resulting from the elimination of the special treatment of capital gains in that a very substantial portion of your agents' time now must be spent in trying to audit returns, arguing over the difference between capital gains and ordinary income? If that differential is eliminated, it would seem to me a sizable number of agents that are currently delving in that -- and this isn't going to happen immediately obviously -- but in the course of time, they will be freed up to enforce compliance with the code.

Mr. Brockway. It is clear -- at least many commentators on the issue have said -- that that is one area. The fighting after audits of whether or not it is ordinary income or capital gain would be eliminated if the rate structure is the same. Also, a lot of the effort in designing a structure to accomplish that result would be taken out for the taxpayers attempting to convert ordinary income to capital gains. You come up with a fairly complex transaction that even if it worked would take a long time to audit to see whether, in fact, it works.

Senator Chafee. I have heard, Mr. Chairman -- whether they are accurate or not -- that 50 percent of agents' time, the IRS force, is devoted to trying to fathom whether transactions are capital gain or ordinary income. That may be hard, but if it is anything close to that, you are going to have a lot of agents available that you didn't have before.

Mr. Brockway. Yes. I think 50 percent would also include other shelter activities. And there there is a very heavy devotion of IRS resources, particularly in recent years to shelters and other investment activities that are designed to reduce taxes. And capital gains is a --

The Chairman. And many of those shelters we are trimming in this bill.

Mr. Brockway. Oh, very definitely.

Also, this would delete the provisions that would require the IRS to pay interest on delayed refunds that is in the Chairman's proposal.

Senator Baucus. Mr. Chairman, back on the compliance section, Section 5(b), I am going to be offering an amendment to boost up the voluntary disclosure. It is not quite the amnesty provision that I had mentioned earlier. What it is is a compromise between the two. According to, I think, the Joint Tax Committee estimates, it helps you out.

The Chairman. Any revenue raisers are welcome.

Senator Baucus. One point four billion.

(CONTINUED ON NEXT PAGE)

Mr. Brockway. Page 6 of the memo, corporate taxation.

Senator Heinz. Mr. Chairman, before we leave capital gains, just one last question.

Would it be accurate to say that anybody with an adjusted gross income between $75,000 and $185,000--that includes the two phase-out brackets for the 15 percent rate and the personal exemptions--would, in fact, be paying if they had capital gains in that rate? They would be paying a marginal rate of about 30 percent of their capital gains?

Mr. Brockway. Again, this is the same discussion we had with Senator Roth, and you can characterize it either way of saying you have that additional marginal rate by virtue of the phase-out or not characterizing it that way.

The answer is the same as with Senator Roth.

Senator Heinz. I am sorry. I was distracted. I apologize for going over that again.

Mr. Brockway. You can view this phase-out, within that phase-out range, as increasing the marginal rate, as happens with any phase-out you have in the tax law here.

The lower bracket for earned income credit, corporation credit, child care credit, etcetera; you can add that on to the margin rate generally and view that phase-out as a marginal tax increase, or you can just simply view this as increasing people's effective rate of tax on a gradual basis up to the top rate of 27 percent.

Senator Heinz. But in effect, whether it is capital gains or any kind of income, we are hitting people who are between $70,000 and $180,000 harder than we are hitting people who have more than $180,000.

Mr. Brockway. Well, harder or softer really depends upon how you want to look at it.

When you add the two at the margin, you can say their average effective rates are always going to be less; and just going up, for every dollar you make, you will end up paying more average tax.

Your effective rate goes up. So, for somebody making over that range, they are still paying a higher effective rate on all their capital gains, for example, and all their income.

But it is the same answer whether it is capital gains or ordinary income.

Senator Bradley. But in no case will the effective tax rate go above 27 percent?

Mr. Brockway. That is correct.

Senator Bradley. The effective tax rate?

Mr. Brockway. Your effective tax rate, assuming no itemized --

Senator Heinz. Average tax rate?

Senator Moynihan. And we put into the Code an incentive to make more than $180,000 a year?

Mr. Brockway. Well, I think even there, unfortunately, the more money you make, the higher your average tax will be in the aggregate for taxpayers as a result of this phase out because that will apply to everybody who is above that level; and you can just sort of look at it either way.

The Chairman. For those interested in capital gains, and we all are, there is one thing that hasn't been mentioned.

Isn't it true that short-term capital gains will now have a significant rate reduction from the present rate on short-term capital gains?

Mr. Brockway. That is correct. I should have recalled this in talking to Senator Chafee. Much of the concern right now is whether something is short-term or long-term capital gains or trying to convert the two; and they will both meet the same rate so you won't have a six-month and one-year separation between the two, depending upon your holding period.

Corporate taxation on page 6 deletes a number of the items on the corporate tax changes. They were discussed in the spreadsheet. Retaining only the items listed here.

First, under the spreadsheet, the corporate rate would have been reduced to 35 percent.

This proposal will reduce the corporate rate to 33 percent from current 46 percent.

In addition, it retains the provision that reduces the intercorporate received deduction from the current 85 percent to 80 percent to have the same effective rate of tax on an intercorporate dividend, reflecting the general corporate tax reduction.

It retains the provision in the chairman's markup repealing the $200.00 exclusion for individuals on dividends.

It retains the stock redemption expense, the so-called "green mail" repeal--the deduction for green mail.

It retains the provisions dealing with net operating loss carryovers.

It retains the provision allowing 60-month amortization for bus operating rights.

It also retains the 75 percent limitation on business credits.

Importantly then, the items that are deleted here would be the general utilities repeal and all the associated changes to the so-called Subchapter C report, and changes to corporate business taxation would not be as a part of this proposal, as well as a variety of amortization repeals, capital construction funds, contribution to aid construction, and a variety of other minor items.

Senator Durenberger. Mr. Chairman?

The Chairman. Senator Durenberger?

Mr. Brockway. Also, let me comment that one extraordinary major change is that the deductibility of excise taxes, which was covered in this area in the spreadsheet, is deleted from the proposal.

Senator Durenberger. Mr. Chairman, I want to clarify. There were two infrastructure items in here that I cared about in particular.

I think Dave referred to one of them, that is, the contributions in aid of construction. I take it we maintain current law on that?

Mr. Brockway. Correct.

Senator Durenberger. And the other is the 60-month amortization of pollution control equipment. Is that maintained as in current law?

Mr. Brockway. Current law again.

Senator Durenberger. Thank you, Mr. Chairman.

The Chairman. Senator Danforth?

Senator Danforth. Mr. Chairman, now that the individual tax rates will be lower than the corporate tax rates, I wonder if there is any reason for retaining the personal holding company tax?

The personal holding company tax is a very complicated area in the Tax Code; and I am wondering if, in the name of reform, we could simply delete from the Code the personal holding company tax?

Mr. Brockway. Senator, if I can respond later today on that? It intuitively seems like that is something that should be possible.

There are problems, one, with have the first bracket differential between the two.

There are other reasons why you might want to retain it. Even in present law, the difference between the individual 50 percent and corporate 46--I don't think simply that difference is the reason you have the personal holding company tax.

But let me talk to members of the staff who work in the area so that we can lay out the trade-offs involved.

It may be that, with this structure, it might be possible or, in any event, to cut it back.

Senator Danforth. All right. I wonder, Mr. Mentz, would this be a desirable thing to do or not?

Secretary Mentz. Senator Danforth, I think it would be desirable to explore the possibility of repealing or at least modifying both the personal holding company provisions and the accumulated earnings tax provisions, which do have their basis in the differential between the personal and the corporate rates.

There may be other factors to consider, including the differentiation between the passive loss rule that applies at the individual level but not at the corporate level.

We would have to factor that into our thinking; but it seems to me that this type of a structure that the chairman is proposing permits the opportunity for this kind of major corporate simplification, at least for an examination of it that we really haven't had before.

Senator Danforth. I know the chairman wants to press on with the bill, and I encourage him to do that.

Do you think it would be timely during this markup? I mean, I guess we are going to try to finish it within the next day or two.

Would it be timely to resolve this question during this markup, or don't we have enough time to look at that?

Secretary Mentz. I think it would take a little more time than that. As you indicated, the personal holding company provisions are very complex; but we can do it in the relatively short term--certainly before the bill gets to the floor.

Senator Danforth. And would it be revenue neutral, do you think?

Secretary Mentz. I think it would have to be.

Senator Danforth. But obviously, it would have to be; but would it be?

Secretary Mentz. We would craft it with that as a requirement. Sure.

Senator Matsunaga. Mr. Chairman?

The Chairman. Senator Matsunaga?

Senator Matsunaga. How is the CCF, the capital construction fund, treated under --

Mr. Brockway. That would be present law, Senator.

Senator Matsunaga. Existing law?

Mr. Brockway. Correct.

The next area, page 7 of the memo: energy, natural resources, agriculture include items discussed in the spreadsheet as modified by the committee, with the exception that the extension of the residential and business energy tax credits would be deleted from the package.

The next area: excise and employment taxes, would --

Senator Matsunaga. Mr. Chairman?

The Chairman. Senator Matsunaga?

Senator Matsunaga. Are we pursuing the separate item with the House to continue existing --

The Chairman. The House has them in their bill, and that's the reason I left them out. It saved us about $1 billion, and we are going to go to conference with the House; and they have got that. On the energy credits?

Senator Matsunaga. Yes.

The Chairman. Yes. They have them all in their bill, including the extensions.

Senator Matsunaga. But we are not taking any position?

The Chairman. No. I figured as long as it was in the House bill, and I was looking for ways that we could keep this bill revenue neutral, that this is one thing we can leave out, knowing full well that I think they are going to be in, in a final package, because they have broad support.

Senator Matsunaga. I don't think the House bill covers all of the alternative sources that your original package covered, which means that I may be offering an amendment to this part.

The Chairman. All right. Senator Mitchell?

Senator Mitchell. Mr. Chairman, if I may on that score, I am also interested in the same point that Senator Matsunaga made. I think biomass is not in there.

The Chairman. You spoke to me about biomass.

Senator Mitchell. Yes.

Mr. Brockway. The next area is excise --

Senator Moynihan. Mr. Chairman, could I just say that hydroelectric is an interest to me.

The Chairman. Small-scale hydroelectric?

Senator Moynihan. Yes, small scale.

Mr. Brockway. The next area is in excise and employment taxes. It would retain current law with two changes. So, importantly there, the increases in excise taxes and the adjustment to reflect the price changes are deleted from the package as potential revenue raisers.

The two changes from present law are, first, to include the provision that would increase the quarterly payroll threshold for agricultural wages from $20,000 to $40,000 in the aggregate.

So, if the aggregate farm wages for your farm employees is less than $20,000, right now there is no requirement for withholding the employment taxes. This would increase that level to $40,000.

In addition, the threshold for the accelerated eight times a month payroll tax deposits of present law, which is $3,000 if you have more than $3,000 of payroll deposits you have to make a month, you have to do it on an eight times a month basis. That would increase to $5,000.

The Chairman. That was taken from an amendment on the floor that Senator Baucus and Senator Armstrong proposed a couple years ago. Bill? And passed 96 to nothing.

Senator Bradley. It was dropped in conference.

The Chairman. It was dropped in conference, so I sensed that the committee might have some support for it.

Mr. Brockway. It is an item, to my understanding, that is important to small business groups.

The next area, financial institutions, would be retain current law.

The next area, the foreign provisions, would include the provisions on the spreadsheet, as modified by the committee, with the exception that in the foreign investment in U.S. real property--that the chairman's markup would have expanded that to include other types of investments--that current law would be retained, neither expanded nor contracted.

In addition, the issue that was raised about reinsurance industry because of the excise tax on foreign insurers being waived in certain tax treaties, particularly in the United Kingdom tax treaty, this would provide a study of whether the situation that foreign insurers under the treaty structure and certain circumstances can avoid payment in the U.S. tax--whether that creates a significant competitive advantage for the U.S. companies.

And to the extent that there are such significant competitive advantages, or disadvantages for the U.S. industry, that it would instruct Treasury to renegotiate those treaties to try and put the U.S. companies on the same footing as foreign companies.

The next item, in page 8, is the area of insurance; and that would include the provisions that are in the spreadsheet, dealing with both life insurance and property and casualty, etcetera.

Senator Mitchell. Mr. Chairman, may I ask a question on that?

The Chairman. Senator Mitchell?

Senator Mitchell. Senator Armstrong had raised at an earlier meeting the question of the discount rate that is used with respect to property and casualty; and I know there were to be some further staff discussions.

I believe there were to be some further staff discussions on that. Has that occurred? And has there been an appropriate rule worked out on discounting?

Mr. Brockway. There have been certain discussions, but there has been no change from the chairman's markup in this proposal.

So, the concerns that Senator Armstrong raised continue to exist.

Senator Armstrong. What page is this, Mr. Brockway?

Mr. Brockway. This is on page 8. Oh, I am sorry. On the spreadsheet, it is on pages 107 to 114. That covers insurance.

And then, you had raised the question about the discount rate, and this retains the description as in the chairman's markup, which is the area of concern that you had raised.

Senator Mitchell. I share that concern. I wonder, Mr. Chairman, if it might be possible for us to pursue further discussions with the staff while we are going forward with the rest of this explanation?

The Chairman. All right. Senator Durenberger?

Senator Durenberger. Mr. Chairman, while we are on page 114 of our spreadsheets, let me ask about the special exemptions, rates, and deductions of small mutual property and casualty companies.

Largely, I think that is an interest that John Heinz and others here have expressed earlier, particularly on behalf of farmer mutual companies.

The House has, in terms of the taxation of these small stock or mutual insurance companies, a provision that exempts from taxation those with net written premiums of less than $500,000; and then between $500,000 and $2 million gives them an option to be taxed, I think, on investment income.

What would be the cost of going from where we are to that? Or have we already gone to that?

Mr. Brockway. You are discussing the House provision?

Senator Durenberger. Yes.

Mr. Brockway. That would be about $100 million.

Senator Durenberger. About $100 million?

Mr. Brockway. Yes.

Senator Matsunaga. On the inside bill that we retain the present law?

Mr. Brockway. Correct.

The next area is interest expense. It would include the provisions in the chairman's markup with the following modifications: that the interest limitation would be reduced from the $1,000 single, $2,000 joint that is in the chairman's proposal to zero.

So, the consumer interest generally would not be allowed any more as an itemized deduction, and investment interest expense would be limited to investment income.

Also, under the chairman's proposal, that provision phased in over a five-year period. This would phase it in over a three-year period in conjunction with the phase-in of the passive loss limitation that will come up in a subsequent part of the memo.

The next area deals with the minimum tax. Essentially, it includes the minimum taxes as provided in the chairman's spreadsheet, with the exception that the passive loss preference only applied at the 50 percent level in 1987. This would apply it fully in 1987.

And also, the inclusion of tax-exempt bond interest as an enumerated preference in the minimum tax would be deleted from the proposal.

Also, the amortization of pollution control equipment would be retained as a preference in conformity with allowing retaining the amortization of that in the regular tax system.

Senator Durenberger. Mr. Chairman?

The Chairman. Senator Durenberger?

Senator Durenberger. Mr. Chairman, I appreciate the fact that we have deleted tax exempt bond interest as a preference; but when we are still using the 50 percent book income, and I take it we are catching some companies with interest income from tax-exempt bonds.

Mr. Brockway. If their structure was such that essentially their book income exceeded their alternative minimum taxable income in the expanded definition of taxable income, then one-half of that excess--

Since book income does include tax exempt bonds, it would be picked up in that regard, in that situation.

The Chairman. Bill Armstrong?

Senator Armstrong. Mr. Chairman, on the passive loss issue, as I understand the markup document we have this morning, you have gone back to the spreadsheet formula.

So, passive losses arising from an actively managed business may be netted against income from any source. Is that correct? Without becoming subject to the minimum tax?

Mr. Brockway. That is correct, other than the rental activity area, but where rental activities--long-term rentals--are treated as passive; but other than that, that is correct.

The active basket proposal was deleted.

The Chairman. I want to make sure that I understood your question. Ask it again, will you, Bill?

Senator Armstrong. Well, during our seances last week, there was a notion that even if it was an actively managed business--the famous flower shop example that we kicked around last week--

The Chairman. Yes.

Senator Armstrong. That you could lose money in a flash. You could have a husband working at one job, and a wife running a flower shop; and the losses from the flower shop could not be netted against his --

The Chairman. So, long as it is active business, total losses can be deducted against any other total income.

Senator Armstrong. Against anything. What I would like to just pin down--and then I want to move to one other related question--is that there is in the law someplace a definition of an actively managed business.

At least, that is what I think I heard discussed last week.

Mr. Brockway. This would pick up material participation which is a concept used in the employment tax area.

There are a variety of places where this type of concept shows up, but this would pick up-- Material participation is essentially the dividing line between whether you have self-employment income or not for SICA purposes.

Senator Moynihan. Mr. Chairman?

Senator Armstrong. We don't have to do it now, but would you just refer me at some point to a section of the law that I could read on that?

And I would like to ask a related question. As it now reads, going back to the spreadsheet on page 119, with respect to other kinds of passive losses, they may not be netted against passive income.

In other words, literally you can have somebody who had income, say, from portfolio investments--bond interest, dividends from stocks--and you can't net that against the losses.

Mr. Brockway. There is a sort of terminology difficulty here. These losses are situations where there is a business investment activity that is ongoing where you are, for example, not participating in the management or, let's say, a net lease situation or where you are a limited partner, but there is business activity going on.

Those cannot be used against your portfolio investment income, which is not in this basket at all. That would be portfolio dividends and interest, capital gains, royalties, that type of thing, where you are simply a portfolio investor.

Senator Armstrong. Mr. Chairman, I don't want to drag this out because we have had an extended discussion of this behind closed doors, but I just want to note for those who are hearing it on the record for the first time that I think this is a very mischievous provision.

I understand the reason for it, but I think it is unjust. I think it is illogical; and I am not sure what its economic consequences are.

And I hope that somebody is going to come forward and tell us that. If the economic consequences of it are not particularly burdensome, then the fact that it seems to me to be illogical and somewhat unjust ins't all that important.

My sense is that the economic consequences of this little provision are simply stupendous, and I hope somebody will come forward to explain it.

Last, Mr. Chairman, on this point, I don't see it in the markup material; but I did read in the paper that there is some move to phase this provision in. Is that --

The Chairman. The passive provision?

Senator Armstrong. Yes.

The Chairman. Three years.

Mr. Brockway. And in the proposal, the minimum tax is effective immediately; but the proposal--the regular tax--is phased in over three years rather than immediately as in the original.

So, for the regular tax, you get a deferral of the provision.

Senator Armstrong. Thank you.

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, Senator Armstrong has made a point; and when we get to XVI on tax shelters, I think it would be helpful if Mr. Brockway and Secretary Mentz explained this basket concept with respect to active and passive incomes, and explain some of the adjustments.

The flower shop has been saved, and things like that; but it is a new idea and it needs to be explained, which I am sure it will be.

Mr. Brockway. The next area is changes dealing with pensions, which would include the proposals in the spreadsheet as amended by the committee, with several exceptions.

The first is that IRAs you would revert to essentially pre-1981 law where you would not be allowed the deduction for a contribution to an IRA unless you did not participate in an employer's retirement arrangement.

It would not go all the way back to prior law in that the adjustments that increased that prior law was $1,500. You would be allowed a $2,000 IRA, and the other changes in that area would also be picked up.

But IRAS again would be limited just to those who did not also participate in an employer's retirement arrangement.

The Chairman. Senator Roth?

Senator Roth. Mr. Chairman, I would just like to go publicly on record that, while I applaud very much this initiative, one area that I am concerned about is that we don't do more to promote savings.

I do agree that by reducing the rates that that is a very significant move in that direction; but it bothers me, as least for one, that we are very much backing off of an IRA which I think has been a worthy initiative and should be continued.

So, at appropriate time or times, I will undoubtedly offer amendments in this area.

Senator Chafee. Mr. Chairman?

The Chairman. Senator Chafee?

Senator Chafee. I would like to ask Mr. Brockway a question. You say you are precluded from having an IRA if you are participating in an employer's retirement arrangement?

Suppose you weren't vested yet? Would that have anything to do with it? In other words, if you are in the first couple of years.

Mr. Brockway. It is the same rule as prior law, so that, if you are covered by the plan, even if you are not vested, you are not entitled to an IRA deduction.

Senator Chafee. Thank you. Mr. Chairman, as you know, I have expressed many times my concerns about the IRAs. And also, I was hopeful that we could work out something at least to have a nondeductible IRA to permit people to use them, and at least get the benefit of the inside buildup tax-free.

I understand that was-- Do you have a figure on that?

The Chairman. About $3 billion.

Senator Chafee. $3 billion.

Senator Bradley. What could you get if you cut down the 401(k) even further?

Senator Chafee. Do you have a figure, Mr. Brockway?

The Chairman. Below $7,000?

Senator Chafee. A figure on how much you pick up per $1,000 decline on a 401(k)? I suppose you get much more when you get down lower?

Mr. Brockway. Correct. It is not linear whatsoever, that going to $12,000 was not a significant pickup. I don't remember, but going from $12,000 to $7,000 was about $1 billion, and then you start picking up rapidly as you go further on down the line.

So, I don't know what a $1,000 change there would be.

Senator Bradley. Would it be ballpark to say that the $3 billion you could pick up by reducing the 401(k) to $5,000?

Mr. Brockway. That is a collective hunch here.

Senator Bradley. Possible? So, you could keep the buildup in interest of an IRA on a tax-free basis if you were able to squeeze down a little bit more on the 401(k)s?

Mr. Brockway. Certainly there is a level. We will try to run something that has the same revenue pickup from a 401(k) limited adjustment as allowing a nondeductible IRA.

Senator Chafee. Thank you.

Senator Heinz. Mr. Chairman?

The Chairman. Senator Heinz, and then Senator Chafee.

Mr. Brockway. One thing also. With the existing IRAs, you continue the inside buildup on that. We are talking about just new contributions, whether you would allow a structure of a new nondeductible IRA system.

Senator Heinz. Mr. Chairman, like Senator Chafee, I, too, would like to find a way to permit the establishment of new IRAs, not necessarily--since I suspect it is too expensive--by permitting their deductibility, but to at least allow them the advantage on the inside buildup.

And John, I would like to work with you on a way to pay for that, if we can.

I also would like to know: When we considered the pension provisions in the committee, one of the elements was that we permitted the lump sum distribution from a pension plan where the worker invested in the pension and was leaving, to be rolled over into an IRA.

Is that still permitted under this proposal?

Mr. Brockway. It is still permitted to have the rollover.

Senator Heinz. All right. Finally, on Item C, we are making a fairly major change in what we are doing with defined benefit plans.

Now, my concern is really threefold. One, I would like to know the extent to which we are going to affect participants in existing defined benefit plans, with the emphasis on participants.

Second, I would like to know to what extent this applies to existing defined benefit plans and whether all those plans, as a result of this proposal, are going to have to be changed.

And thirdly, since, as I understand it, the proposal will basically substantially change what we had achieved in the way of parity of treatment between defined benefit and defined contribution plans, having basically a four-to-one ratio between benefits and contributions permitted.

I would like to know whether this in fact is likely to militate against the establishment of more defined benefit plans and will make the establishment of defined contribution plans a lot more attractive, and therefore, in a sense, undercut the establishment of defined benefit plans in the future.

Mr. Brockway. If you will give me an opportunity to respond to that later so we can go over those, with a little more time to get a complete response to those questions.

Senator Heinz. How much money are we saving in this section here? On page 9?

The Chairman. It is about $5 to $7 billion as I recall.

Senator Heinz. I am sorry, Mr. Chairman. What did you say?

Mr. Brockway. It is in that order of magnitude.

The Chairman. $5 to $7 billion.

Senator Heinz. Mr. Chairman, I have some real reservations about what we are doing to the very good work we otherwise did in pensions.

Obviously, somebody decided you needed some money from someplace to make all this work. I do fear this subject needs some more information from the staff. I do feel that this is a fairly major change in what we have previously attempted to achieve.

Does Treasury have any comments on this? Mr. Darman, do you think this change is a good policy change? Mr. Mentz?

Secretary Mentz. This is a change in basically a funding--it is the pace at which a defined benefit plan gets funded.

To take into account changes in expected retirement ages. We view it as a reasonable part of the overall package. We do not see it as a major threat to the fundamentals of our defined benefit pension plan system.

Senator Heinz. That is an odd way of putting it. You don't see it as a major threat. What do you see it as?

Secretary Mentz. We don't see it as a threat at all. We see it as a reasonable proposal.

Senator Heinz. You like it? You are in favor of it?

Secretary Mentz. Yes.

Senator Heinz. All right. Thank you.

Senator Matsunaga. Mr. Chairman?

The Chairman. Senator Matsunaga?

Senator Matsunaga. On Item E.

The Chairman. E, on pensions?

Senator Matsunaga. Yes. On page 10. Under limitation of contributions, that is the cap on Section 401(k), elective contributions.

Under the Heinz-Packwood proposal, what was the limitation, if any?

Mr. Brockway. Under the Heinz-Packwood, I believe it was $7,000, and there was an amendment by Senator Grassley that took it to $12,000.

Senator Matsunaga. And the amendment was adopted?

Mr. Brockway. The amendment was adopted.

Senator Matsunaga. I see. So, you are reducing it from $12,000 to $7,000 here.

Mr. Brockway. This would reduce it from $12,000 to $7,000.

Senator Matsunaga. And you are in toto adopting the Heinz-Packwood amendment?

Mr. Brockway. Well, what I might do is go through it. There are these five changes, from where the committee was after the Heinz-Packwood amendment, as modified.

There was a modification on the 401(k) limit by Senator Grassley. Also, Senator Pryor had an amendment dealing with 403(b), which also would be preserved in this.

These are the changes from where the committee was that are on the sheet.

Senator Matsunaga. Can we have a copy of the amendment as amended?

Mr. Brockway. Definitely. I mean, it will be the spreadsheet that has the proposal as such, and then there should be a press release that will outline all the changes that were made in committee when we discussed it.

And then, these changes here, some of which are modifying what was done and some of which are new provisions.

Senator Matsunaga. Mr. Chairman, I may have an amendment to this section. I am not all together clear until I see what the actual language of the amendment as amended is.

The Chairman. Senator Durenberger?

Senator Durenberger. Mr. Chairman, may I ask that on Item D, Dave, dropping the extenstion of 401(k)s to State and local employees. Was that done for some policy reason, or to save money? And if the latter, how much did it save?

Mr. Brockway. This is an approximately $3 billion item.

Senator Durenberger. What is that?

Mr. Brockway. It is about a $3 billion item. So, clearly, that was one of the concerns.

Senator Durenberger. That is why I am the only one that cares, I guess.

Senator Pryor. Dave, what section is that? Excuse me.

Mr. Brockway. This is State and local government employees to drop a provision that would have extended 401(k)s to those employees.

Rather, this would leave State and local employees with the 457 plans.

Senator Pryor. Oh, all right.

The Chairman. Again, Dave, I don't want the blame to be placed on the staff on this. It is $7 billion total. And as we went through it, I was looking to squeeze and trying to keep us at 27 percent.

Senator Durenberger. I just didn't realize it was that big.

Senator Mitchell. Excuse me. Could I just ask a question? Someone said $3 billion. Did you just say $7 billion?

The Chairman. Had we kept the law as it is, $7 billion, this compromise reduces that to about $3 billion.

Senator Mitchell. I see. The compromise being the grandfathering of existing plans?

The Chairman. Oh, no. I thought you were on B.

Mr. Brockway. Yes.

Senator Mitchell. Oh, no. D.

The Chairman. Oh, excuse me. I am still talking about B. I am sorry.

Senator Mitchell. All right.

Mr. Brockway. Yes. Item D as considered by the committee would have extended 401(k) plans to State and local governments and other tax exempt employers.

This would revert to present law.

Senator Mitchell. That is $3 billion. So, the chairman's reference to $7 billion doesn't have anything to do with that?

Mr. Brockway. Let me go back through the list, just to correct one thing. The numbers we are discussing generally about the revenue here do not mean to include in there the changes dealing with IRAs, which is a separate item on the $5 to $10 billion increase.

But Item B is the three-year basis recovery rule that the chairman's markup would have repealed that.

Under the committee's amendment, there was an amendment that would have retained present law. This provides a three year phase-out of the provision so that in 1988, the taxpayer would retain present law.

In 1989, there would be half the benefit of present law. And in 1990, the provision would be deleted and these annuities would be treated the same as all other annuities, that the income would come out on a pro rata basis.

Senator Mitchell. So, that is the Federal --

Mr. Brockway. Correct. It essentially affects Federal employees.

Senator Mitchell. And what you are doing is phasing it out over three years at 0, 50, 100?

Mr. Brockway. Correct.

Senator Mitchell. Over three years?

Mr. Brockway. Correct.

Senator Chafee. Mr. Chairman?

The Chairman. Senator Chafee?

Senator Chafee. Mr. Chairman, this was an item that I was deeply involved in and concerned about, as you know, and we had the vote here. And it turned out to be expensive.

I think that we have made a lot of progress and this, indeed, was a very substantial change, going to the 0, 50, 100.

And when we couple that with the fact that we have gotten the vast reduction in rates, I think--although I am not going away happy--I --

If you will remember Herman Hickman,

Senator Bradley. Herman who?

Senator Chafee. Herman Hickman, who was the coach of the Yale football team and --

Senator Bradley. Oh. Oh, yeah, Herman.

(Laughter)

Senator Chafee. He said he tried to keep the alumni sullen but not rebellious.

Senator Bradley. Yes.

Senator Chafee. You have about kept me that way, Mr. Chairman, on this item. And at least, we have made a lot of progress and particularly when we consider the reduction in the rates.

Could you give me the dates again now? I thought it was zero for 1987, Dave. You said zero for 1988.

Mr. Brockway. I slipped all the years one date. You are correct.

Senator Chafee. You made it more enticing than it actually is. It is zero for 1987.

Mr. Brockway. Unfortunately, more expensive, but in 1987 --

Senator Chafee. I would be glad to take what you described.

(Laughter)

Mr. Brockway. That was not intended as an offer.

Senator Chafee. That would improve both my sullenness and my rebelliousness.

(Laughter)

Mr. Brockway. Yes. I am sorry. I did slip all the dates. In 1987, it would be zero; 1988, 50 percent; in 1989 and thereafter, the same as other annuities. It would be phased out entirely.

Senator Chafee. And when we do realize, Mr. Chairman, that you started with 50 right off, it would be 50 in 1987 and 100 in 1988. That was the original chairman's proposal, or the chairman's original proposal.

Then, there was some discussion of going over a five-year period to a 20/20/20--20 percent each year. This is a vast improvement over that, a vast improvement, and particularly, as I mention once again, the reduction of rates.

Senator Durenberger. John, would you yield on the definition of "vast"?

I found one of the reasons you proposed this was that we were going to drive a lot of people out of Federal service. And it seems to me we are going to stay in an extra year and then get driven out.

What have you accomplished? I don't fully understand this; but if it is a vast improvement, maybe you could explain to the rest of us what you mean by that.

The Chairman. One, if you assume that the vast majority of Federal employees make under $40,000 a year as a family --and they do. I understand the Schedule C's and the others, but the vast majority are going to be at the 15 percent rate to begin with.

Secondly, with this kind of a phase-out, if a 15 percent rate is going to be the difference on taxation that is going to be levelled out over the years, anyway, I will be surprised that that will be the factor that, for the vast majority of Federal employees, will cause them to leave.

Senator Chafee. You are right that one of my original deep concerns was the loss of the Federal employees going out, but one of the factors that was continually mentioned to me was the unexpectedness of this and the inability to do any planning.

And although we are not giving them all the world to plan here--all the time in the world to plan--at least it is a substantial improvement over what was originally proposed.

And indeed, if you look at the House of Representatives bill, they have it go into effect on July 1, 1986. So, they are getting -- We have made a real effort here to --

The Chairman. They had it in effect fully on July 1, 1986.

Senator Chafee. Yes, fully. No 50 percent or 100 percent. It was 100 percent --

Senator Durenberger. After conference, it might end up July 1988 or 1987 or something like that. Is that what we are looking at?

Senator Chafee. I think you are going to find us quite strong on this matter in conference.

So, everything that goes up to conference isn't up for bargaining; at least this is an exception.

The Chairman. Oh, I am sorry. Senator Danforth?

Senator Danforth. I have another question on pensions, but it is not related to this issue.

The Chairman. Go ahead.

Senator Danforth. All right. Earlier, when we were at the early stages of markup, the question was raised as to the regressive nature of the penalty for withdrawal from pension plans.

And it was my understanding that the staff was to look at that, and I wonder if the staff has looked at that and has any suggestions.

Mr. Brockway. We are still looking at it. I don't have a response right now. Obviously, in the next 24 hours, we will get back to you with a response on that.

Senator Danforth. Thank you.

Mr. Brockway. Item C is increasing the retirement ages for qualified plan retirement purposes, requiring plans to use age 65, the Social Security retirement age of 65, and then that will go up when the Social Security retirement age goes up.

This is not a change in the plan allowed maximum amount of pensions, but it is simply a change to reduce the funding to prevent overfunding of pension plans where you can accelerate your deductions.

But it will not change the ratio between defined benefit and defined contribution plans of how much taxpayers can provide the 415 limits.

And then, there is Item D, the repeal--excuse me, not the repeal--but the elimination of the provision extending 401(k) plans to State and local governments.

And Item E, reducing 401(k) plans elective contribution limit to $7,000.

The next subject matter area, research and development, would pick up the provisions in the spreadsheet, with the exception that the 25 percent incremental credit would be extended for four years through December 31, 1989, rather than a permanent extension.

The next area is tax shelters and real estate. Again, picking up the provisions in the spreadsheet, and the major change here is the tax shelter limitation of passive loss limitation in the proposal.

And the way that would work is that individuals and personal service corporations would be subject to limitation of the amount by which they could take losses from their investment activities and offset unrelated income.

You would look at all the investment income the taxpayer had from business investments where he does not materially participate.

That might be, for example, a limited partnership interest. It might be interest in a trust or a Subchapter S corporation where it was not involved in the management.

It could be a net lease arrangement where the taxpayer essentially has no active participation. Also, it could be other investments, such as let's say, an absentee landlord on a farm; that type of arrangement where there is no material participation in the venture by the taxpayer.

In addition, the limitation would also apply to rental activities, whether or not the taxpayer materially participated in the activity.

The rule, then, you would look at the taxpayer's net losses out of the passive income basket--the so-called passive income basket. You could offset losses arising from that activity against incomes in that activity; but other than that, you could not use it to shelter other income, whether the taxpayer has earned income, personal services income, or taxpayer's portfolio investment income could not be sheltered by losses coming out of these investments.

The losses would, however, be carried forward to be used in subsequent years; essentially the same treatment you get under present law on a capital loss, where the capital loss --the net capital loss--of the taxpayer is allowed.

I believe it is $3,000 deduction; but other than that, you are required to carry it forward until it subsequently has capital gain income. This would work the same way.

It is just simply a carry forward. The net interest limitation works the same way.

In the case of rental activities, there is however an exception. It allows taxpayers earning under $100,000, where they have a rental activity that they materially participate in, such as if the taxpayer had a house or apartment building where they were actively managing that property, they would be allowed to use up to $25,000 of losses against their other income.

The Chairman. This also takes care of the problem that many members raised about the one couple and they've worked all their lives and they have a small beach cabin or a mountain cabin.

And indeed, they rent it out and they have losses on it, but it would be a very unusual situation where their losses would be $25,000 or over that.

Or they may decide to retire to the beach cabin and keep the place in town and rent that out. And many members thought that was unfair. And we can make that exception without having an extraordinary carve-out for commercial real estate.

Mr. Brockway. Correct. And this limitation would phase out between $100,00 and $150,000 that exception.

Under this package, the rules would phase in over a three-year period.

The Chairman. Senator Baucus?

Senator Baucus. I am wondering. Senator Armstrong got at the point of asking about the definition. As I understood Dave Brockway's response, there are various provisions in the Code which address this, and I am just wondering if we are getting in a situation where we have different definitions instead of one definition for the purpose, at least of this provision.

I wonder if it would make sense for us to know what the definition is for "materially participate" so that we know what we are getting into here.

What does "materially participate" mean?

Is there one provision, or are there several provisions? If there are several, are they the same provisions, or are they different provisions?

Mr. Brockway. There are several provisions that have similar concepts. This concept would be basically the same concept as used for determining whether you are self-employed for employment tax purposes.

It is a similar concept that is used for special use valuation for agricultural property that I believe is a more liberal definition.

There is a concept-- Offhand, I don't recall of any others in present law. In the chairman's markup and the House bill, there were such ideas.

But let me get back to you with the specific analogs. I think the place to look is where the material participation notion has been used is the self-employment tax, whether or not you say you are self-employed and you ought to pay Social Security taxes on your income.

Senator Baucus. I wonder if you could tell us what the definition of "materially participating" is.

Mr. Brockway. Yes. Basically, it is an attempt to define different situations where, for you, while it is a business and somebody else is running it, your interest is essentially as an investor, where you wouldn't see yourself as earning earned income where you are required to pay Social Security tax or anything like that.

Senator Baucus. I understand that. I understand your intent. I was looking for what the actual definition is. And you are going to come back later with that definition?

Mr. Brockway. Yes.

Senator Baucus. Thank you.

The Chairman. Senator Roth and then Senator Moynihan.

Senator Roth. I wonder how much you save by phasing out this $25,000 between $100,000 and $150,000?

Mr. Brockway. In dollar terms, Senator, I am not sure of that. As long as you kept the $25,000, I am not saying exactly what substantial is. I don't know how significant it is.

I think a more important concern is the distributional aspect because, obviously, the principal effect of that would be-- The only effect would be for taxpayers over $100,000 and particularly over $200,000; and the over $200,000 is where you have a concern on your distribution.

So, we would have to look at that from both respects; one of the revenue and one of the distribution, but we will try to do a run on that, Senator.

Senator Roth. Yes. I think that could be helpful because, if we don't make much savings, I don't think it should be continued.

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, I wonder if we could, in fact, pause just a minute at this proposal. It is very new to our Tax Code, and it may be the saving of it, in the view of many of us.

The dimension of the matter is perhaps the dimension of the problem. Earlier on, our handout notes that by closing corporate loopholes and the special tax privileges, we hope to pick up $100 billion.

Now, there is less of a bite on corporate incomes than either the President proposed or the House. The President proposed $120 billion, and the House proposed $140 billion.

And we have not had to do that to the corporate side of this ledger because, on this individual side, we are going to be picking up--as the chairman says by eliminating the ability of individuals to avoid paying taxes by using the tax shelters--we are going to pick up $50 billion.

Now, that is what is most distinctive in the money transfers in this legislation. We have always had to have money transfers in order to be revenue neutral.

The biggest thing that the chairman's package is different in is it picks up $50 billion by--according to The Washington Post this morning--tearing the roof off most tax shelters by forbidding the use of their paper losses to shelter ordinary income.

The Chairman. You know, a perfect example was that Wall Street Journal story that you read the other day, on Friday, where it said this particular proposal--my particular proposal--would have an effect on real estate shelters and cattle feeding operations and whatnot--and right next to the story was an advertisement to invest in a cattle feeding operation.

Senator Moynihan. Is the tax bite too big?

The Chairman. Yes. The tax bite is too big. Do you want to shelter some of your income? Invest in Amarillo or someplace like that--by somebody who obviously wouldn't know a cow from a pig, probably, and shelter your income in it, at a time when we don't need any more cattle feeding lots, anyway.

And that is exactly the kind of thing that we are trying to shut down.

Senator Moynihan. I would just like to make the point that what you have brought into this computation is $50 billion in tax shelters. And the fact of making a simple distinction between active and passive income, that it can pick up $50 billion, is a measure of what is going on.

Senator Danforth. Mr. Chairman?

The Chairman. Senator Danforth? Then Senator Bradley.

Senator Danforth. Mr. Chairman, first Senator Moynihan is exactly right. I mean, I guess the most basic question is: Do we want to have a tax system which pays for the existence of tax shelters with relatively high rates?

Or instead, do we want to reduce rates and do away with the tax shelters?

I would like to make a couple of additional arguments.

The first is that I met about a month ago with a very well-known businessman. This person is in the high reaches of the American business establishment.

Obviously, he is very well paid for his work, and he travels in circles of people who are very well paid for their work.

He said to me: You know, I pay my fair share of taxes. I pay a lot of taxes. But he said: I don't know anyone else who pays any taxes. I don't know anyone who pays any taxes.

Now, we are talking about the distribution of the Federal tax load. The fact of the matter is that, with these shelters, we have a situation where very high income people can pay nothing, and it is just plain wrong.

And on the corporate side, we have a situation in which some corporations can pay in the 40 percent range and other corporations can pay nothing. And that is just plain wrong.

But I think one additional point that should be made with respect to these tax shelters is that, not only do they raise questions of equity, but in addition to that, they can have extremely perverse effects on major sectors of our economy.

For example, in the Midwest, the inland waterway system is a major part of our economy. The inland waterway system --the barge industry--is in a depression. It is caused by a number of reasons; but one of the reasons is that in the late 1970s, it seemed that every dentist in the country owned a piece of a barge.

I mean, we in the Congress had subsidized, by the way we wrote the Tax Code, the investment of money by people who had no interest whatever in the barge industry in barges.

And we created a glut on the market. And the same thing existed with respect to boxcars.

Now, those of us from the Midwest, concerned about the depression in American agriculture, that, too, has a number of causes.

But it seems to me that one of the things that we do not want to do is to have a Tax Code which encourages people to go into the business of farming for tax shelter purposes.

When we are creating surpluses in American agriculture, when we have people who are in family farming who are losing their farms, for us to have a tax law which says that it is a tax advantage to people who read the Wall Street Journal to go into cattle feeding operations or whatever, it is just plain perverse. It is wrong.

It has the wrong economic consequences.

So, I would simply embellish on the very accurate comments made by Senator Moynihan to say that I think that the effect of what we are doing here is to remove the bias in the Tax Code which goes against the interests of a lot of people who are being hurt today.

The Chairman. Senator Bradley? Then Senator Moynihan.

Senator Bradley. Mr. Chairman, if I could just follow on to what both Senator Moynihan and Senator Danforth said, it is our willingness to eliminate the tax shelters and get $50 billion out of that.

It is our willingness to do that, a primary benefit of which will be a more efficiently functioning economy. It won't be diversion of resources, as Senator Danforth said, into investment that wouldn't otherwise be made.

But what we really gain from being willing to do that is a benefit to individual taxpayers--low income people--six million off the rolls. They don't have to pay taxes any more.

That will be, I believe, combined with the 15 percent rate for those individuals up to a family of four, $42,000; that will be the most significant piece of legislation to benefit low and middle income people in this country passed in the last 20 years.

It will be taking six million people off the rolls, and you will be giving that middle income family with both spouses working in some cases--in some cases with one spouse making $20,000 to $25,000--you will be giving them the benefit of that lower rate.

And most of those people believe that they have not only been paying the freight for Government in the last 25 years, but they have been doing it without much being given back to them.

And what we are saying is: Look, we are going to reward you for the work, and for what you have done in the last 25 to 30 years.

I mean, they are literally the backbone of the country; and with a lower rate, they know that if their other spouse goes to take a job and they earn another $8,000 or $10,000, they are going to keep more of that money.

Mr. Chairman, I might also say that, for somebody who is a big hitter, there are enough of them that have told me: My God, I would rather not spend my time figuring out how to lose money in order to pay less tax. Give me a rate that is reasonable--and I think your 27 percent is the lowest around--and I will give up those shelters.

But the point that we have to remember is we don't get all those benefits for low income people, for working Americans, for well-compensated Americans unless we are willing to give up the shelters.

Otherwise, we can't make the argument in here that we have lower rates and it is a fairer bill. It is almost a precondition to get to where we want to get that we are willing to take on the distortions in the economy that cover the term "tax shelters."

So, I think that everybody wants to cut the rates; but now we are in a situation where, in order to cut the rates, we have got to be willing to take on some of the entrenched interests.

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, I just would perhaps restate the point that Senator Danforth so ably made, that we have distorted the economy through these provisions.

And I just wonder--without knowing--if you remember back in 1981, we had to deal with the question of the commodities straddles, which in my own city of New York, people would say had the potential of zeroing out the tax system.

Well, we did that; but then, I think we may have shifted that activity into barges and boxcars and feedlots.

Surely, there is the question of distortion of the economy.

Secondly, Senator Bradley makes the point of just plain equity. Some people pay their taxes; some don't. But we have a question of perception here, and I think Secretary

Mentz could help us.

It would appear that bringing the tax rate down to 27 percent might mean a very great advantage to persons with incomes, say, over $200,000 a year.

But isn't it the case, Mr. Secretary, that for a very large percentage of those high income people, a 27 percent rate will mean--if they have to pay it--a tax increase?

Isn't that what your research finds? Or Mr. Darman?

Secretary Mentz. It is a substantial number. It certainly will mean a tax increase for those who are presently sheltering most or all of their income.

And I think there is a kind of a fundamental tax policy point there that a person's wages or his professional income and his investment income is the backbone of the personal income tax system.

And to the extent that we permit it to be eroded by investments in tax shelters, you are eroding that base and making people who don't have the means to make those types of investments, they are forced to effectively bear a higher burden.

Senator Moynihan. And in your research, the IRS analyses do show a very poor proportion of people above six figure incomes with tax rates down, ranging from 0 to 20 percent.

Secretary Mentz. I think Senator Bradley's point is right, that there are many high income people who say: Give me a low enough rate, and I won't worry about how to put my money in tax shelters.

And the people who are designing tax shelters, instead of trying to design an investment that will shelter taxes, they will design an investment that will produce economic --that will be the most desirable economic investments; and that is where your investments will go.

Senator Moynihan. And that is how we would like to optimize it. Thank you very much, and thank you, Mr. Chairman.

The Chairman. Senator Mitchell? Then Senator Chafee; then Senator Heinz.

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

I would like to express some support for the concept, but also to raise two notes of caution.

First, to confirm what Senator Moynihan has suggested. I believe the most recent years for which such data are available is 1983; and in that year, over 30,000 taxpayers filed returns reporting incomes in excess of a quarter of a million dollars and paid none or virtually no taxes.

Ten percent of them, or in excess of 3,000--I believe the number is about 3,100--filed returns reporting incomes in excess of $1 million that year and paid none or virtually no taxes.

I believe every member of this committee has been exposed to thousands of members of the public in our own States and across the country. My experience is, I believe, typical in that what troubles Americans most about the tax system is not that they have to pay taxes--although no one likes to pay taxes.

It is the knowledge that a citizen who pays taxes fairly and fully feels used because he or she knows that there are many others in similar circumstances who don't do so; and more importantly, many others in much better circumstances who don't do so.

It is this knowledge that tens of thousands of Americans earn several hundred thousand dollars a year and don't pay any taxes that most troubles the factory worker who makes $18,000 a year and who does pay taxes.

The white collar worker who makes $22,000 or $25,000 a year and who pays taxes. The teacher--the people whom Senator Bradley has described as the backbone of our country.

So, I think it is important that we move forward to see to it that everyone pays their fair share of taxes. That, I think, is the most essential element of the proposal we are about.

I must express two concerns. We want to reduce their income taxes, and Senator Bradley suggested correctly that, for 80 percent of American taxpayers with family incomes of

$42,000 or less, they would experience a reduction. But we have to keep this in the context of overall taxation.

And the tax policy which has been pursued in this country for the past five years has been to steadily reduce that tax based on the ability to pay, while increasing all other taxes.

We reduced in the income tax in 1981 over a three-year period significantly, but before that was fully in effect, in 1982, 1983, or 1984, we raised virtually every other Federal tax: the gasoline tax, the payroll tax, and excise taxes.

And the net effect of those actions has been to dramatically shift the burden of taxation in our society down the income scale, primarily upon the working and middle classes.

Mr. Chairman, I am pleased that this proposal does not include an excise tax increase for precisely that reason, which I have suggested on many occasions.

We don't do much for working Americans if we give them a nominal decrease in their income tax and, in the meantime, raise their excise taxes. And that, of course, is what has been happening over the past year.

So, I hope that the concept introduced here, that is, of tax relief for middle income Americans, will carry forward, not only in connection with this legislation, but in all tax matters that we consider.

I have two notes of caution, Mr. Chairman.

The first is--and I won't be long because all the members, I am sure, are tired of hearing me say it--while I favor lower rates, I also favor retaining the progressive nature of the Federal income tax.

I believe it is a well established and fundamentally fair principle that the burden of taxation should be related in part to ability to pay.

And while I will vote for this proposal, ultimately it is my intention to offer an amendment on the floor to preserve a higher rate for higher income taxpayers, because I don't believe it is right for a family of four with an overall income of $40,000, or a taxable income of $28,000--however you want to describe it--pays the same rate as a family of four with an overall income of $400,000 or $4 million.

I think that we are going too far in eliminating progressivity from our Federal income tax by adopting a two rate schedule at merely 15 and 27 percent.

I understand the political situation, Mr. Chairman, that there are many people, including yourself, who don't want to go above 27. I know that my views are certainly a minority on this committee.

I hope not in the Senate as a whole. At the same time, while I agree on the necessity for eliminating the shelters, I think we have to recognize that these investments were made in reliance on a law that was passed by the Congress to induce people to engage in certain activity.

While I don't think we had in mind the cattle feeding shelter that you referred to, we certainly when we passed that law had in mind low income housing.

We have recognized in this country for a long time that the free market will not provide low income housing because it is not an economically sound investment.

We, as a society, have through the means of Government attempted in a variety of ways to deal with that. Given the present Administration and prevailing philosophy in opposition to direct Federal expenditure for such purposes, we have adopted a system in which we attempted to induce people to invest in low income housing.

And it was a classic purpose of matching a higher motive with a less noble means, that is, if enough people could be induced to put their money so as to avoid paying taxes, then low income housing would be built.

I think what we need to do, therefore, Mr. Chairman, is to make this change over time in a manner that permits people who have made investments in good faith, acting in reliance on inducements created by the Congress; and I intend to include that as part of my amendment, that is, the additional revenue to be raised from having a higher bracket--which I view as essential to fairness--would be used to provide a more realistic transition for people caught in that circumstance.

On balance though, I express my strong commendation for you. I know at the beginning of this, everybody commended you, and you were a little bit concerned about it.

I suppose we might as well end as we began, and I would say that I intend to support this in committee to enable it to go to the floor; but I feel very strongly about the two provisions I mentioned.

And I do intend to make an effort with as much vigor as I can on the floor to make those changes.

The Chairman. Your having been a trial judge, you know what I mean when I say I am always---I clerked for a year on the Oregon Supreme Court--and I was always fearful of the trial judge.

When the court started out, the learned trial judge was very wise.

Senator Mitchell. Right.

The Chairman. And then--but--and he overruled. So, I appreciate the commendation. I would sooner have the brickbats in the bill than the commendation and no bill.

Senator Chafee and then Senator Heinz.

Senator Chafee. Mr. Chairman, the dentists have taken a tough time here today, but I want to say that they are not alone. The lawyers and the doctors and the tinker and tailor all are professionals who have been in on this tax shelter business.

And truly, it has been an outrage. The amount of time and energy that has been devoted to ferreting out these tax shelters so that they could shield some of their income and come with a rate that is far below what we are proposing here.

I think the encouraging factor is about this bill, which I strongly support--the proposal we are working on--is that the people who are making $1 million indeed are going to be paying 27 percent--$270,000. And there may be higher brackets now, but nobody is paying them.

And that is the distortion. It is not just the distortion; it is insanity, the way the system is currently working.

Now, we are not going to take care of everything before us; and one of the things that remains excluded is tax exempt bonded interests.

And I feel that is unfortunate. I see all the problems involved. I see that we don't want to open up a -- nest of trying to deal with that. Somehow, I wish we could at least make it a figure to be computed in ascertaining the base for the minimum tax.

But that doesn't seem to be the sentiment of the majority here, at least those that I have spoken to individually.

I think the key thing to remember is that, despite Senator Mitchell's concern for a higher rate, the people are going to be paying 20 percent when we finish under this legislation.

So, that is a major step forward, and I think we should get considerable satisfaction out of that, Mr. Chairman.

The Chairman. Senator Heinz?

Senator Heinz. Mr. Chairman, I think that you and the committee have done a remarkable job, considering where we have come in the last week.

And I think you are very close--maybe you are over the mark--in getting a bill that a majority of the committee will support. I think it is important to have a bill.

And I myself am very close to supporting this legislation, and I can enumerate, as probably any member of this committee can, any number of problems that I would like to find a way to address.

And maybe I will be able to find a way to address some of the concerns I have on how hard we are going to get depreciation under the alternative minimum tax or I expressed reservations about what we are doing to defined benefit plans, and so forth.

George Mitchell makes the point about he would like a slower phase-in on the elimination of tax shelters, and I can sympathize, I suppose, for all his rich constituents that he is concerned about.

But I think we all recognize that there is going to have to be some give and take. I don't expect that I am going to be able to solve all my problems, and I am going to have to come to a conclusion as to whether this is sufficiently, on balance, good legislation.

And I am sure that there are going to be things in here I don't like at all; and I would just as soon almost say, well, to heck with it.

But I think that we are--speaking for myself, I am quite close to being able to say this is good legislation, that the committee can and should go forward and ahead with.

The Chairman. Thank you very much.

Dave, let's go through and finish up the remaining pages.

Mr. Brockway. The next item, Mr. Chairman, on page 11, is Item B. It is the low income housing credit.

The proposal would essentially retain the proposal for the low income housing credit that was in your markup with modifications reflecting discussions with low income housing groups.

The first change is that multifamily housing is not under the bond cap. There is no need for the provisions that dealt with a trade-in and bond authority and also governmental units allocating the credit.

So, those items are out, and there is no volume cap on the tax credit.

Second, under the proposal, there is a five percent annual credit for individuals with income of less than 50 percent of the area median income, and that was over a 15-year period.

The proposal would change that to an eight percent credit but over 10 years. So, it increased the value of the credit but shortened the period for which taxpayers could get it.

In addition, at the top of page 12, there is also allowed a four percent credit--half the regular credit--for units where the median income is between 50 and 70 percent of the area median income.

That would be allowed, though only up to a maximum of 30 percent of the units in the project.

In addition, this credit--the low income housing credit--would not be subject to passive loss limitations.

Also, the credit would not be allowed where there are Government subsidies in the form of Section 8 financing, for example, or subsidized mortgages.

Item C would be the provisions dealing with mortgage backed certificates, raised by Senator Chafee, with certain modifications, that I think in the past has been referred to as the Timms proposal.

It has gone through several modifications and included within the package.

The next subject matter area is the tax exempt bond area.

Senator Mitchell. Mr. Chairman, may I ask a question on this section?

The Chairman. Senator Mitchell?

Senator Mitchell. Dave, you referred to Item 5 as an anti-double-dipping rule, and I would like to ask a couple of specific questions about that.

Would this prohibition apply to the Section 515 loan program under the Farmers Home Administration?

Mr. Brockway. Yes.

Senator Mitchell. What effect do you think that would have on the 515 program? Are you able to judge that? Or estimate that?

Mr. Brockway. I would like to get back to that. I don't know which they would choose. Essentially, in the situation, it would fit one or the other.

Senator Mitchell. All right, but does it apply to low income rental housing projects previously subsidized under Section 236 or Section 221?

In other words, would current owners have to pay off mortgages for those projects in order to take advantage of the credit for a transfer of these properties?

Mr. Brockway. It wouldn't really be available for existing properties. You would have to go through a substantial rehab or a new property, and there you would have to decide which you would prefer.

Senator Mitchell. In effect, you would have to choose?

Mr. Brockway. Yes.

Senator Mitchell. Yes, and do you know whether this would apply to low interest loans provided by local governments or State governments through programs such as the Community Development Block Grants?

Mr. Brockway. This just applies to Federal subsidies. You wouldn't have multiple Federal subsidies, but if the State decided or the local government decided that it wished to provide the benefit, that would be allowed.

Senator Mitchell. Federal subsidies denominated as such. For example, supposing a State gets a Community Development Block Grant, and then uses it for purposes of a specific housing subsidy?

Mr. Brockway. Under the current rules, you would have to trace that under the reporting. That would be treated as a Federal subsidy.

Senator Mitchell. That would be treated as a Federal subsidy?

Mr. Brockway. Yes.

Senator Mitchell. So, it would have an effect there. Mr. Chairman, that does concern me; and as with the other area on low income housing, the lack of which concerns me, and the prospective lack of which ought to be of real concern.

I would like to work further on this provision.

Mr. Brockway. The next general subject matter area is the tax exempt bond provisions, and the proposal would include the provisions in the spreadsheet as modified by the committee, except that mortgage revenue bonds and small issue IDBs would sunset as under current law rather than being extended.

The conforming change, the IDB volume cap, would be allowed to reduce $100.00 from the $150.00, and also mass transit industrial development bonds would be eliminated.

The next general area is --

Senator Heinz. Mr. Chairman, on that, I assume that is the issue we voted on in the committee?

Mr. Brockway. That is correct.

Senator Heinz. Would you restate the revenue cost of that?

Mr. Brockway. That was $500 million from eliminating mass transit and industrial development bonds.

Senator Heinz. And was there any reason to eliminate it, other than money?

Mr. Brockway. Obviously, money is a major consideration and this is an area that the Administration would have repealed basically on the viewpoint that it should be provided without a tax subsidy.

Senator Heinz. You are saying the Administration. May I ask the Administration, now that they are here?

Roger, what was the rationale for treating mass transit differently from ports and other similar kinds of infrastructures?

Secretary Mentz. I am sorry. Are you addressing your question to ports?

Senator Heinz. Well, yes. Under the committee spreadsheet, Mr. Brockway just said that basically the Administration felt that mass transit and IDB should be handled differently here.

And under what we are doing, if I can find it in the spreadsheets--if you will bear with me--we are retaining IDBs for airports and docks and wharves, if the bond financed property were governmentally owned.

But for some reason, we are not doing that with mass transit.

Secretary Mentz. Senator Heinz, the Administration position was not to retain the exemption for any of those provisions.

Senator Heinz. Oh, all right.

Secretary Mentz. We would have just --

Senator Heinz. All right. Let's go back to Mr. Brockway or -- Well, they just said it was your idea.

Secretary Mentz. It was your idea, wasn't it, Dave?

(Laughter)

Mr. Brockway. I am engaged in another discussion.

I think the general argument here, as with all industrial bond financing, is that if it is an activity that is being undertaken by the private sector, that it is better to treat it the same way as any other nonsubsidized undertaking--not taxed subsidized undertaking --unless there is a substantial policy reason to do so.

Senator Heinz. Now, aren't we talking about governmentally owned facilities here? You kept saying private sector.

Mr. Brockway. Well, if it is governmentally owned and private sector operated.

Where it is governmentally owned and governmentally operated, that would be--a GO would still qualify.

The situation comes up where there is a private operator of the undertaking and you have the tax exempt bond financing to--

But it is simply a policy choice as to whether this is an area where the committee would wish to continue the advantages of tax exempt financing or not, that it is a -- drawing exercise that exists in present law and will continue in this bill.

Senator Heinz. If the cost of mass transit here is $500 million, what is the cost of bonds for airports separately? What is the cost of bonds for docks and wharves?

Mr. Brockway. I will have to get back to you on that, Senator Heinz. I don't have that now. It is clearly a significant revenue item.

Senator Heinz. All right.

Mr. Brockway. The next general area is the trust and estate provisions which would pick up in the spreadsheets as modified.

The rates for trusts, now that you have only a two-rate structure, would have to conform to this proposal; and also, the amendment adopted by the committee--Senator Bentsen's amendment, I believe--for indexing estate tax and gift tax brackets would be deleted.

The next general area is miscellaneous provisions. It would delete the various provisions--miscellaneous provisions--in the spreadsheet with three exceptions.

One is architectural barriers. Two is the Vietnam MIA provision. And three is the provision dealing with title holding companies.

That completes the description of the package.

Senator Moynihan. Mr. Chairman?

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, that completes the description, but it is a record of extraordinary work by

David Brockway and the Joint Committee on Taxation.

The Chairman. I have to confess, in watching them work over the last two weeks where we say now if we change the percent from 26 to 27, what does it do?; and of course, what it does is change everything all along, in terms of what are the revenue losses, what are the revenue gains, and they have to run their computers.

I forgot what it was that you told me that you had to rerequest when we started this bill for allocation of computer time. It was in the magnitude of $30,000 to $100,000 a month?

And every time a member says: Can't you run that off for me? I am just taking a guess; that is probably $5,000 to run it off that the Joint Committee pays to whoever it pays for its computer runs.

Mr. Brockway. Actually, we pay the Treasury Department, and Dick just reminded me that we still owe them quite a bundle.

(Laughter)

Senator Bradley. Mr. Chairman?

Senator Durenberger. Mr. Chairman?

The Chairman. Senator Bradley and then Senator Durenberger, and then Senator Mitchell.

Senator Bradley. Since we are in the business now of commenting about Joint Tax, I, too, want to thank them for their effort and also tell them that I think I--and I think the whole committee--appreciates, even when the news is bad.

You know, you figure out one thing, and you say how about this? And they come back and say, well, I'am sorry; that won't work for the following two reasons.

I think that accountability and integrity in the process is absolutely essential when we do this kind of bill, and I appreciate all their hard work, as well as that integrity.

The Chairman. Senator Durenberger?

Senator Durenberger. Four brief questions, Mr. Chairman.

One is on adoption expenses, the adoption deduction K on page 2 of 13. And I am sorry; I either wasn't here or I missed that.

If that covers the adoption of children with special needs, I want to raise a question about it. I see we are doing a trade-off for explicit dollar, and I don't see that we are going to appropriate those dollars.

What is the money that is involved in this one?

Mr. Brockway. The number is very small. This does not contemplate the spending program in this. The House proposal had a spending program.

The Administration said repeal; come up with a spending program. The House bill had one. This simply was one of the itemized deductions that was deleted; but because it is a very narrow group, I don't recall offhand what the number was, but it was small.

Senator Durenberger. This is an incredibly important area. And I don't know whether the tax approach is better than some other approach, but I would at least like the opportunity, Mr. Chairman, to make a case for retaining present law on that one.

The second question is about the targetted jobs tax credit.

Mr. Brockway. It may be we will have to check the way the structure was in the House, that it was set up as an entitlement program so that the appropriations wouldn't be the direct issue; but I will have to check on that.

Senator Durenberger. All right. The targetted jobs tax credit.

Mr. Brockway. That is not in the proposal.

The Chairman. Dave, that is another one. That is about $1 billion, as I recall. And I have editorials that want to keep it desperately.

As you know, when you get down to the end on this, it is not unlike my days as a labor negotiator. Even things that cost $200 or $300 million become consequential when you are trying to reach the end; and that costs $1 billion, and I left it out.

Senator Durenberger. The other two questions are on revenue estimates. Moving the medical deduction from five percent of AGI to 10 percent of AGI. That raises how much?

Mr. Brockway. I will get you the number on that. I don't have that right now.

Senator Durenberger. And the elimination of the sales tax deduction is how much?

Mr. Brockway. That was --

The Chairman. About $18 to $19 billion.

Senator Durenberger. $18 to $19 billion?

Mr. Brockway. Could I say that is over five years?

Senator Durenberger. And you will get me the figure on the medical?

Senator Moynihan. David?

Mr. Brockway. Yes, sir?

Senator Moynihan. Could I just say to you that I will offer an amendment that you might want to join on the sales tax.

The Chairman. But a revenue neutral amendment?

Senator Moynihan. Revenue neutral. Yes.

The Chairman. Senator Mitchell?

Senator Mitchell. Mr. Chairman, I would like to ask about an area that was not discussed this morning. It has to do with structured settlements of court suits.

I don't know how familiar you and the other members of the committee are with that.

Under current law, a defendant found liable can be required to pay the sum in full upon rendering of judgment or to structure it in a way that pays it over time.

As you may know, in connection with the current so-called insurance crisis, there have been many proposals at the State level not only to permit but to mandate so-called structured settlements over time.

One of the ways in which they are facilitated is that ordinarily the defendant is insured, and the insurance company can invest that money and the income is not taxed so long as it goes to the purpose of paying out the sum over some period of time.

I believe the revenue effect is less than $50 million, as I have been advised. I raise it for purposes of whether or not something that is relatively minor insofar as we are concerned, we are moving in a direction counter to that which our society seems to be moving and appropriately so as part of a different problem in another context.

The Chairman. I can't answer your question. Can you, Dave, on the structured settlements?

I can't remember what we did.

Mr. Brockway. The proposal here is the Administration proposal which was adopted. In terms of response, let me --

The Chairman. Can we get him an answer by late this afternoon?

Mr. Brockway. Yes.

The Chairman. All right. Any other questions?

(No response)

The Chairman. If not, we will stand in recess until 5:00 in this room. And I would expect we will meet on into the evening.

(Whereupon, at 1:05 p.m., the meeting was recessed, to be reconvened this same day, Monday, May 5, 1986, at 5:00 p.m.)

EVENING SESSION

(7:43 p.m.)

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

Senator Danforth?

Senator Danforth. Mr. Chairman, it is my understanding that, whereas, in the past, when we have had tax bills, we have amended the Internal Revenue Code of 1954, the House purports to pass an entirely new tax bill creating an Internal Revenue Code of 1986, and reenacting even those portions of the Code that we don't even touch.

Is that correct, Mr. Brockway?

Mr. Brockway. That is correct.

Senator Danforth. Well, my understanding of the law, Mr. Chairman, is that if we reenact the Internal Revenue Code from scratch, even those sections that we are not amending or changing, the effect of that is to open up the entire Tax Code for new legislative history.

I believe the courts have held that the only time legislative history can be made with respect to tax legislation is if we are enacting a section or reenacting a section.

My concern is that if we follow the path that has been embarked on by the House, the effect of that is that we will open the door for all kinds of mischief on the Senate floor, in that people can attempt to stick into the Congressional

Record what they believe is legislative history.

I think it is also clear, and anybody who has practiced tax law knows, that the Congressional Record and hearings and committee reports are pored over by tax lawyers and by judges to try to determine what the legislative history is.

The problem is that a lot of the things that could be put in the committee report, a lot of the things that could be put in the Congressional Record, have not really been focused on by members of this committee.

So my concern is that, if we do attempt to reenact the entire Tax Code, we have created a tremendous uncertainty on matters that have since 1954 enjoyed a great deal of analysis and adjudication, revenue rulings, and so forth. So it would be my hope that what we are doing here is amending the Code of 1954 and not enacting a new Internal Revenue Code of 1986.

Mr. Brockway. As a general matter, Senator, you are correct, that legislative history be taken into account in interpreting the meaning of statute, only if you amend the provision. There is some ambiguity if you simply reenact the same statutory language and then attempt to modify what interpretation has been given by the courts, and whether or not that will be taken into account.

If you do reenact the Code as a part of this process, you may wish to make a clear statement in the committee report that it is your intention not to change the interpretation of any provision in existing law that isn't specifically amended by this, and that the reenactment is not intended to give any opportunity for a reinterpretation of what the meaning of the statute is, through floor colloquies or otherwise.

Senator Danforth. Well, it is my understanding from having raised this matter to members of the Finance Committee that it is not our intention to open up existing provisions of the Code to new legislative history.

It would be my hope that this would either be expressly an amendment of the 1954 Code or that we could make it abundantly clear that there is no intention on the part of the Congress to open the door to a whole new legislative history.

Mr. Brockway. I think it is very useful to resolve that question. Doing either would clarify the situation.

Senator Danforth. I would think the most straightforward and absolutely the clearest would be to have this bill be an amendment to the Code of 1954.

The Chairman. We are going to do it in whatever fashion is necessary to make sure that we cause as few ripples as possible with those areas of the law we are not touching at all.

Senator Baucus?

Senator Baucus. Mr. Chairman, in an earlier stage of of this bill, when we were in open session, I offered an amendment with respect to the Section 911 exclusion.

Essentially, under current law, Americans living and working abroad, under Section 911, are entitled currently to an $80,000 exclusion in the calculation of their income.

The whole purpose of Section 911 is to encourage trade, encourage commerce with various countries, particularly encourage Americans to live abroad so that American companies can export goods abroad and services abroad.

Since enactment of that Section, however, there have been various Executive Orders, where the President has issued an Executive Order basically stating that it is a violation of that Order for persons to engage in economic activity in certain countries. Those orders presently apply to North Korea, Vietnam, Cuba, Cambodia, Iran, and since February 1 of this year the country of Libya.

It is my view that the Section 911 exclusion should not be available to Americans residing in those countries in contravention of an Executive Order.

When I first brought this up, there was some concern that perhaps the State Department might have an objection. It is my understanding, after consulting with the State Department and I think also with Treasury, that both the State Department and Treasury do not have objections to this particular provision.

I might add, also, that my amendment would not cover certain Americans who, by that Executive Order, are not covered under the exclusion -- namely, journalists and some others, too.

So I think it is a fair amendment.

The Chairman. Is there objection to the amendment?

Senator Durenberger. Mr. Chairman, can I ask a question that I think I raised last time this issue came up?

What is the tax treatment, particularly the foreign tax credit treatment, for American companies that are currently doing business in Libya? Do they still qualify?

Mr. Brockway. They would qualify under the generally applicable rules.

Senator Durenberger. They would?

Mr. Brockway. Yes.

Senator Durenberger. Would you be willing to expand your amendment to --

The Chairman. Let me ask Treasury's judgment. I know that they had approved of the amendment as Max had introduced it.

Mr. Mentz. We do approve of Senator Baucus's amendment, but I think we would have problems in denying the foreign tax credits for business transacted in pure fiction.

Senator Durenberger. I wonder, Mr. Chairman, if we could explain the rationale for that? I mean, we have an economic boycott, as I understand it, in Libya. This nation obviously has just gotten through spending several tens of millions of dollars bombing the heck out of various parts of Libya. I can't understand why we should continue to support American businesses -- if we are not going to support individuals, why support American businesses through the Tax Code?

Mr. Brockway. If I understand it, Senator Durenberger, your proposal would be essentially to deny a foreign tax credit and give a deduction, something like the treatment that is provided in the present?

Senator Durenberger. Well, I am not sure I favor what Max has proposed. It seems to me we are sort of going in willy-nilly and changing tax laws.

Now, if there is a foundation for his, then I argue there is a foundation for my suggestion, that is all. If Treasury has found or the State Department has found a legal foundation to deny individuals the tax treatment, then the same thing ought to apply to corporations.

Mr. Mentz. I think the issue you have raised is a difficult one and one that would need to be carefully studied.

Senator Durenberger. That is why I raised it a couple of weeks ago. Right. So it would get the same careful study that Max's got. I am sorry if I didn't make it clear.

Mr. Mentz. I'm sorry, we did not hear that part of the question.

The Chairman. I wonder if I might suggest this:

My hunch is, this is the kind of an amendment that if offered on the floor would pass 96-to-nothing, or 100-to-nothing, if everybody is there.

Why don't you withhold it, Dave, a bit. Ask Treasury. It will be about a month before we are on the floor, at least and, with or without their support, my hunch it would pass 100-to-nothing on the floor.

Is there objection to the Baucus amendment?

(No response)

The Chairman. Without objection, then.

As long as we are on 911, can I go to Senator Chafee?

Senator Chafee. Mr. Chairman, under 911, as you know, it was indexed; so, it is currently at $80,000. The House set it at $75,000. It is my understanding that if we remove this amount from the minimum tax, $70,000 would make it revenue neutral. Is that accurate?

Mr. Brockway. That is correct, if you kept it at $70,000.

Senator Chafee. Well, Mr. Chairman, I would move that these amounts under 911 not count toward the minimum tax, but that the maximum be at $70,000.

The Chairman. Is there objection?

Senator Mitchell. Could we just have an explanation of why? Why do you want to do it? What is the purpose of the amendment?

Senator Chafee. The purpose of the amendment is to get it excluded from the minimum tax, the amount. And in order to make it revenue neutral, I had to get the money from somewhere. So I brought it down from the $80,000 to $70,000.

Mr. Brockway. Senator Mitchell, discussions that we have had with some taxpayer representatives, obviously they would rather have it not be a preference and keep the level where it is under present law.

But as between the two, they would rather have the preference come down somewhat and then not have it be a preference in the minimum tax, because that requires them to go through both systems, and many people would be on the minimum tax. So, to solve the complexity, they would simply rather lower the exclusion and also allow the exclusion under the minimum tax.

Senator Mitchell. The reason for my question, John, is that I understood one of our purposes to be to try to ensure that everyone who doesn't pay taxes and is able to do so does pay taxes.

I don't have any major objection to your amendment, but it seems to me that it goes in the opposite direction. How many people are involved, who would otherwise be paying tax under the minimum tax, who will be now able to avoid paying ttaxes under this amendment?

Mr. Brockway. We could look into that for you. It is is not clear to me -- that would be really just an impirical question -- whether this would end up taking more people off the tax rolls than vice versa, because you just have the two different systems, and this will mean more people will be on the regular tax, and obviously less people will be on the minimum tax.

The other way around, there might be a lot of people who were on neither tax system but will be caught up as a result of this amendment under the regular tax.

So, I am not sure what the trade-off is that way, in terms of numbers of taxpayers.

I think the argument for doing it is largely one of complexity for people filing their returns -- they would rather just deal with one system.

Either system you have is a very low rate system, so anybody in the country who has any significant level of tax will not be paying any U.S. tax, in any event.

Senator Chafee. Well, yes. And it seems to me the theory for exempting them from the minimum tax is the very reason we went into the whole program in the beginning, and that is our competitive position, that other countries do not levy their income taxes on their nationals who work abroad; and therefore, we are in the unfortunate situation where U.S. companies, with being able to hire abroad and seeking engineers to handle the jobs they were dealing with, sought engineers from Canada and Great Britain and other places where they were not required to pay -- those people were not required to pay -- an income tax while they served overseas under these limited conditions. What is it, at least 330 days abroad. And so, Americans were losing out on the jobs because the contractors would have to pay the Americans not only their salary but above their salaries in order to compensate for their U.S. income taxes.

So, we made a very conscious decision that we wanted these people to be exempt from all tax abroad.

I was very actively involved in that when we did it, several years ago, and I think the same rationale applies today.

Therefore, it seems to me we would be losing the whole purpose that we sought under 911 if we had these people fall under a minimum tax.

I personally would like to see it kept. Orginally we started at $75,000, I believe, Mr. Brockway, didn't we?

Mr. Brockway. It would start at $75,000, and phased up.

Senator Senator Chafee. Yes.

Mr. Brockway. I think what happens here is, with 911 being a preference under the minimum tax, then the tax entry point would be $30,000-single, $40,000-joint. At that level, and then at a lower rate, those people, by this amendment, would be taken off the tax rolls, assuming they didn't have foreign tax credits.

But what would be brought on would be people who, let's say, were having $90,000 of income, who under current law in a couple of years wouldn't pay any regular tax, and this would bring the tax entry point down there.

I think that the trade-off is, without looking at numbers, that the amendment will tend to increase taxes on high-earning employees overseas with relatively low foreign tax credits, versus people earning between the entry point of the minimum tax, $40,000 or so, up to $100,000. At some point you get a crossover of which is more important.

The Chairman. Further discussion?

Senator Chafee. I move the amendment.

The Chairman. Those in favor of the amendment say Aye.

(Chorus of Ayes)

The Chairman. Opposed, No.

(No response)

The Chairman. The amendment is adopted.

Senator Long?

Senator Long. Mr. Chairman, I would like to --

The Chairman. Could I interrupt you a second?

Senator Long. Yes.

The Chairman. This afternoon when the members were meeting privately, they were -- to the man -- absolutely wonderful in saying that all of the amendments they were going to offer would be revenue neutral or would pick up revenue; there was not a member that suggested an amendment that would not be revenue neutral in one way or another.

I appreciated it very much, and I think it is going to enable us to move in pretty expeditious fashion.

Senator Long?

Senator Long. Mr. Chairman, I would like to offer an ESOP proposal -- there are four facets of it -- and then one to pay for it, that would, as a matter of fact, raise almost twice as much money as the amendment would cost.

But first I would like to ask Mr. Gates a question. First, it is something that we passed before, I believe in 1984, when we said there would be a deduction for ESOP dividends, and extend the dividends used to repay ESOP loans. That is what it would be for, to extend the dividends to pay ESOP loans?

Mr. Gates. That is correct.

Senator Long. That was passed in 1984.

Second, the state tax exclusion. This would allow an exclusion from an estate for 50 percent of the proceeds realized on an estate sale of stock to an ESOP. We passed that in 1984.

The first would cost $100 million over a five-year period; the other would cost $300 million.

Then I would suggest, regarding the ESOP loans, that we extend the interest exclusion -- which we presently have, but we would extend it -- for the loans matched by contributions of stock to an ESOP, and extend the exclusion to loans by mutual funds. At the present time it says that mutual funds cannot make such a loan, even though a bank can.

Also, we have our rules with regard to early withdrawals which are really intended for pension plans, and it should not apply to ESOP plans; because the ESOP plans are situations where people want to separate themselves and withdraw from the program. So, this would exempt ESOPs from the excise tax on early withdrawals from pension plans.

That never would have happened except that it falls in the same part of the Code as pension plans.

Then we would pay for this by providing for an early termination of the tax break for ESOPS. We would extend the expiration date from December 31, 1987, to -- what is that? June --

Mr. Gates. June 31, 1987.

Senator Long. June 31, 1987. That would pick up --

Mr. Brockway: May? Or June?

The Chairman. May 31.

Mr. Brockway. I have May 31 on the draft here, or June 30. One or the other it would have to be.

Senator Long. Well, by moving the date to make it an earlier expiration, that would save $1.3 billion. So, the total over the five-year period would be a $600 million pickup.

The Chairman. I think it is a good amendment; it picks up $600 million. It is also meritorious.

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus, then Senator Moynihan.

Senator Baucus. Mr. Chairman, I think this is a very good idea and a very good amendment. I note that most members of the committee at one time or another have adopted most of the provisions in this package.

I think it is good because it obviously increases efficiency, increases worker productivity, it is better relationships with management, saves money, all the right reasons.

I am wondering if the Senator might agree to adding to that an amendment I offered earlier with respect to ESOPs that would raise the amount that an employer or employee could contribute to $2500 on top of the $7,000 limit on the 401(k)s, so long as the additional $2500 is used by the employee to buy stock under an employee stock ownership plan?

That costs about $300 million. It is within the limit of the amount of money raised by the Senator's amendment; so, I think there is still about $300 million left over.

Senator Long. I would leave that up to the committee, Mr. Chairman.

The Chairman. Discussion? Senator Bradley?

Senator Bradley. Mr. Chairman, is the suggestion that an employee be able to use an additional $2500 to purchase ESOP stock only after the $7000 of the 401(k) have been utilized?

Senator Baucus. No.

Senator Bradley. No? I'm sorry, that is how I understood it.

Mr. Gates. Senator Bradley, as I understand it, it would be first dollar. Of the first dollar of the $7000, you could purchase ESOP stock, if you had up to $2500; or you could go to $7000 and then $2500 on top of that. But the amendment would anticipate that, in order for this to qualify, every employee would have to be allowed to participate, and his first dollar could be designated for employer stock.

The Chairman. Further discussion?

Mr. Brockway?

Mr. Brockway. Mr. Chairman, I am trying to find out whether I have an estimate on Senator Baucus's proposal.

Have I sent you an estimate? Unfortunately, I have a letter that doesn't have that proposal on it.

Mr. Baucus. For the earlier version that Senator Long and I were looking at, with respect to this provision alone, the estimate I have is $300 million.

The Chairman. Secretary Mentz has a comment, too. Why don't we let him make it, and then come back to your estimate?

Mr. Brockway. Could I clarify just one thing?

Senator Long, is it June 30, or May 31st?

Mr. Gates. Oh, June 30. That is my mistake. It is June 30, the expiration date for the ESOP.

The Chairman. If it is June 30, it doesn't quite pick up that much money, does it?

Mr. Gates. No, that's the correct amount.

The Chairman. All right. Then, it is June 30.

Mr. Gates. Yes. It is the wrong date, but the correct amount.

The Chairman. Secretary Mentz?

Secretary Mentz. Thank you, Mr. Chairman.

Senator Long and I agree on many issues, but the old saying is that "if you and I agree on everything, then one of us is superfluous," and I am afraid I know which one would be superfluous in that situation.

Let me just raise the Treasury's objections to these amendments. They are somewhat outside the ordinary scheme of taxation, the idea of a deduction for dividends is a little out of the ordinary.

I appreciate what is in the 1984 Act, but nevertheless, taking it beyond the 1984 Act is something that I must do.

The same is true for the other deductions and the amendment by Senator Baucus. I sense that my objections will not carry too many votes.

I would make one suggestion to you, however, and that is that the tax credit, ESOP, should be repealed back to 12-31-86. This is the action that was done in the House, and you would actually pick up a little more money, which you may need before this exercise is over.

Senator Long. You haven't offered me much of a trade if you want to push the repeal date back to January 1, and then not accept my amendment.

(Laughter)

Senator Long. Thank you, Mr. Chairman.

The Chairman. Further discussion?

Senator Dole. Is there going to be any left over when this is all done?

The Chairman. Yes, but I am recognizing Sparky next.

Senator Dole. Oh, oh.

(Laughter)

Mr. Brockway. Mr. Chairman, it is correct, $300 million. If I understand, this is the $2500 additional?

Senator Baucus. That's right.

Mr. Brockway. That is correct.

The Chairman. Further discussion?

(No response)

The Chairman. Is there objection to the amendment?

(No response)

The Chairman. Senator Matsunaga?

Senator Chafee. Mr. Chairman, I wonder if Mr. Mentz could get a mike that works. We have a long evening here, and his mike just plain isn't working.

(Laughter)

Secretary Mentz. Is that better?

Senator Chafee. That is much better.

(Laughter)

The Chairman. Senator Matsunaga?

Senator Matsunaga. Mr. Chairman, I have an amendment to offer, to reinstate the credits for the alternative energy production, of business energy.

I passed out a sheet. That is, the solar energy credit would be extended. The 15-percent tax credit would be extended to 1986, 12 percent for 1987, 12 percent for 1988, eight percent for 1989, and eight percent for 1990.

And the geothermal: 15 percent for 1986, 10 percent for 1987, 10 percent for 1988, 10 percent for 1989, and 10 percent for 1990.

My amendment would also reinstate and extend the business energy tax credit for wind and biomass and provide an affirmative commitments provision, as follows:

Wind, 15 percent in 1986, 10 percent in 1987, and then in 1988, 1989, and 1990, provide an affirmative commitment provision for a qualifying project.

Biomass: 15 percent in 1986, 10 percent in 1987; and 1988, 1989, and 1890, an affirmative commitments provision for qualifying projects.

Thirdly, to reinstate and extend the residential solar credit, as provided in the House-passed bill, that is, 30 percent in 1986, 20 percent in 1987 and 1988, with a limit of $5000.

This, as I understand it, is revenue neutral, and it will be paid for by Senator Long's amendment.

The Chairman. I wonder if I might make a suggestion, Sparky?

Senator Matsunaga. Yes.

The Chairman. Because I know that you were planning to use the remainder of Russell's money for this. But you would have to cut it off at 1987, sunset it at 1987, and you would fit within and you would be revenue neutral.

If you go beyond that, you are going to be a little off on money, I think.

Mr. Brockway. A little bit more, if I understand. You are also extending residential solar in this amendment?

Senator Matsunaga. Well, we can cut that portion out. I am not too concerned about residential. My prime concern is the business energy tax credits.

Mr. Brockway. Yes. The proposal as you described it would be, just on the business side, .6 over the period.

Senator Long's amendment, as modified by Senator Baucus, would net up .3; and so you would have to move that date back a couple of months to pick up the revenue.

The Chairman. What if you cut the credits off after 1987?

Mr. Brockway. A six-month advance? That would be $1.2 billion, roughly. It is about $200 million a month. Yes, that is correct.

The Chairman. I am confused.

Mr. Brockway. Oh, I'm sorry. I was talking about the ESOP credit.

The Chairman. No, no. No, no, no, no. I am talking about if we were to -- because, we are going to be going into conference with the House -- if we were to sunset these after 1987, how much would Senator Matsunaga's amendment cost?

(Pause)

Mr. Brockway. It would not save probably more than $100 million, Mr. Chairman; since, in the wind and biomass, that is basically the rule, in any event, and that is where the revenue is.

The Chairman. That is basically what?

Mr. Brockway. Where the revenue is, and that is where it is cutting off. In any event, would we go to .3 if we give it another year?

Senator Matsunaga. A hundred million, I believe, will come from Senator Moynihan's amendment, easily.

The Chairman. Which amendment?

Well, Sparky, you know, we are going to put these credits back in. If we don't, they are going to come in in conference. They are good amendments, and we all have interest in these amendments. I am trying to find out a way to pay for them now so we can have them in the bill, rather than having to hassle with the House about them. But we have kind of tried to agree we would keep the amendments revenue neutral.

Senator Matsunaga. So that, where is the cut-off?

Mr. Brockway. If you give us a few minutes, we can come up with something that is a $300 million figure, if that is what you are looking for.

Senator Matsunaga. Well, I had $400 million, until Max Baucus beat me to the --

(Laughter)

The Chairman. Well, can we agree that you have dibs on $300 million, and they will see if they can --

(Laughter)

Senator Heinz. Sir, I've got a low-income housing amendment that will cost about $200 million, Mr. Chairman.

(Laughter)

Senator Dole. Borrow a couple of months from Russell.

The Chairman. What did you come up with?

Mr. Brockway. On Senator Matsunaga's amendment?

The Chairman. If we could go on to another area and then come back to that, we could get on the phone and come up with some answers.

The Chairman. Let us take Senator Moynihan's amendment, Sparky. We will come back to you after we do Pat's.

Senator Dole. This doesn't include number three, then, residential?

The Chairman. Correct. He took out residential.

Senator Dole. All right. That's some improvement.

The Chairman. Pat?

Senator Moynihan. Mr. Chairman, Senator Matsunaga is the authority for the proposition that this amendment will bring in $100 million in revenue. It may or it may not. It surely will cost nothing, and it clearly has the prospects of raising money.

In 1984 we amended the Code to permit the Inernal Revenue Service to share tax information with political subdivisions other than the states and the possessions, which is now the case. We did this in response, openly, to a request from the City of New York, which has the fourth largest public budget in the nation, for what interest that has for anybody.

The thought is simply that, as the IRS shares information with state governments, it would be free to do that with cities of two million and more.

The City of New York certainly estimates it would raise money from this sharing, and it thinks the IRS would do well.

There are concerns about confidentiality and strictures which are legitimate on the part of the IRS, and the city is willing to accommodate any of them; and I am sure the other cities, with reference to the income taxes, would do the same.

I know that Secretary Mentz has thought about the subject, and I would ask his view on it, reminding him and our colleagues that the Senate has passed this bill before we lost it in conference in 1984.

Secretary Mentz. Senator Moynihan, you have identified the two principal issues involved in your proposed amendment. The one is the confidentiality of taxpayer information. It is, of course, essential that information provided to the Internal Revenue Service retain its confidentiality.

We presently have a system of sharing with the states; but, at present, by statute, it does not go beyond the states.

There are criminal and civil sanctions in the Internal Revenue Code for a violation of that confidentiality; but, nevertheless, it is a very important policy concern of the

Internal Revenue Service --

Senator Moynihan. And should be.

Secretary Mentz. -- and should be, that that information be tightly guarded.

The second concern is that, while I believe the Internal Revenue Service and the Treasury have concluded that there could be some advantages of sharing information with New York City, considering the size of its tax compliance operation itself, there would be certainly a concern that if the Internal Revenue Code permitted the sharing with smaller cities and towns, the ability to preserve the confidentiality would be perhaps lost.

Senator Moynihan. This proposal is for cities of two million or more.

Secretary Mentz. I understand that, and that is why I am responding in the way that I am, which is that the Treasury Department would look favorably upon that limited amendment, with the clear understanding that we are going to have to be very, very careful and watch to make sure that the taxpayer information retains its confidentiality.

Senator Moynihan. Mr. Chairman, I would like to make this suggestion, in response to Secretary Mentz's very forthcoming proposition: that the Treasury write the understanding, and that it emphasize the criminal penalities for any violation. But there is the potential for increased revenues to both jurisdictions.

This is the fourth largest public budget in the nation. If we share it with 50 states and the possessions, why not share it with the City of New York?

Secretary Mentz. Senator, I think, as you indicated, that Treasury would sort of set the conditions, and one of the conditions might be that we would operate on a trial basis for a while and see how it works.

Senator Moynihan. Whatever condition the Treasury thinks is best.

Secretary Mentz. I thought that was your understanding.

Mr. Brockway. Mr. Chairman, on this, I think the one important issue is that it be done under the same terms and conditions that it is done for the states.

I understand earlier that was some trouble for New York; but, now they find that to be an agreeable relationship arrangement.

Senator Moynihan. Exactly so.

The Chairman. Is there objection?

(No response)

The Chairman. Now, Mr. Brockway, have you got an estimate on Senator Matsunaga's amendment?

Mr. Brockway. They are still on the phone, Mr. Chairman.

The Chairman. Then can we go to Senator Chafee?

You have a stock option amendment?

Senator Chafee. Mr. Chairman, my stock option amendment is as follows:

We presently permit, under your mark, stock options to corporations whose sales are less than $100 million. I just could not understand the rationale for that.

I know one of the thoughts is that stock options should be available for start-up companies, but I think $100 million is hardly a start-up company.

The Chairman. Well, we cut it off at $100 million. I suppose if you owned a start-up company, you ought to say $100,000, or a million, or five million, or something like that.

The theory was that they didn't need it beyond that. I am not going to argue hard one way or the other; it actually probably picks up a little money if we eliminate it. Most of the stock options that we have actually pick up money.

Senator Chafee. Mr. Chairman, it seems to me that stock options are employed by established companies as well as start-up companies. They are an incentive, an incentive to keep good people in established high-tech companies, and it is not a revenue loser.

The Chairman. That is true.

Senator Chafee. It is the system we have currently. So, I just don't get the rationale for restricting it. My amendment would be not to have that limitation.

The Chairman. Is there objection?

(No response)

The Chairman. Without objection.

Now, Senator Heinz, I believe you have an amendment. Or do you not?

Senator Heinz. Well, I have quite a few; which one did you have in mind?

The Chairman. Well, I haven't got all of them on a list.

Senator Heinz. I am still waiting for some final revenue estimates from the staff. I could make inquiry to find out if they have made any progress on that.

Does the staff yet have a revenue estimate on the corporate minimum tax amendment? Or the minimum tax amendment I should say.

Mr. Brockway. I am trying to sort through which ones.

Going to straight line over ACRS --

Senator Heinz. With the carry-forward.

Mr. Brockway. That one piece by itself is a 3.6 revenue loss.

Senator Heinz. Well, there are three elements.

Mr. Brockway. That one piece has a 3.6 revenue loss.

Senator Heinz. Which would be 3.6?

Mr. Brockway. This is going to straight-line ACRS as your minimum tax depreciation base, rather than straight-line ADR midpoint.

It is between three and four billion to allow the investment credit against the alternative minimum tax, depending upon the level you set it at. I am trying to get that number right now. But increasing the corporate rate by one point is roughly $10 billion. So, you would net up roughly $2 billion in this package -- two-plus, depending upon how those numbers come out. So, in the aggregate, it would be a revenue raiser of more than $2 billion.

Senator Heinz. All right, I will be back to you shortly.

The Chairman. I might also indicate that I did announce to Bill Armstrong and some others who had previous commitments tonight that, if we had major controversial amendments, we would try to put them off until morning.

With many of the amendments we are adopting here, we have adopted because we met this afternoon in private session and were able to harmonize a good many of these amendments. Over the night, I think we will be able to harmonize a good many more.

But to the extent that any of them come that are big or severe or controversial, I would appreciate it as a matter of commodity to some of the members that we wait until the morning.

We are on pretty good track. I think all of the members that had amendments mentioned them in our session, and we have them all down and are ticking them off on a chart. I think we are getting down pretty close to the last 10 or 15, or at the outside 20, amendments that we may have to consider.

Senator Durenberger?

Senator Durenberger. Mr. Chairman, I have -- one of the things that we ticked off and you put on a chart was the so-called quarterly convention. I guess that is in the estimating process someplace, the alternatives on that?

Mr. Brockway. That is correct.

Senator Durenberger. I have an alternative to that that we might get an estimate on. As I understand the Chairman's proposal, it would require a taxpayer to use the mid-month convention for all assets placed in service during the year if more than 40 percent of its assets are placed in service in the last quarter. If we change that to 50 percent of its assets placed in service in the last quarter, could we get an estimate on that, in case my first proposal is a little bit too high?

The Chairman. Are you saying Yes to Dave, or are you looking for an estimate?

Mr. Brockway. On going to a quarterly convention, that if you place it in service in the first quarter you would get -- I guess the assumption there is that it would be put in service on February 15; the second quarter, half way in the middle of that quarter; and so on and so forth. That was about .1. Now your proposal here is --

Senator Durenberger. Well, the second one. The one I did this afternoon you characterized as a semiannual.

Mr. Brockway. Semiannually, and we have that.

Senator Durenberger. And the third one is to change the 40 percent of its assets test to 50 percent of its assets placed in service in the last quarter.

Otherwise, taxpayers could use the happier convention, which assumes that all property is placed in service on June 30.

Mr. Brockway. I see. All right.

The Chairman. Senator Mitchell?

Senator Mitchell. Mr. Chairman, this afternoon I raised the question of continuing current law with respect to the treatment of structured settlements and tort awards.

As you know, under existing law the amount can be set aside in an account, which can be used only for the purposes of paying out awards over a period of time. The investment can only be made in an annuity or in Treasury bonds. And the buildup is tax free.

Since the inside buildup of life insurance is not now going to be taxed, and since I think there is a separate policy issue involved in encouraging the payment of these tort awards over a long period of time, a direction in which many states are moving, I think it makes sense to continue current law in that regard.

The Chairman. I would appreciate it if we could withhold on that. It is in the House bill, and frankly I would look favorably on it; but I would like to have some things, when we negotiate with the House, that we can say, "Okay, we will give in."

I would prefer not to have that in our bill, just for the sake of going to conference and having the difference.

Senator Mitchell. Well, wholly apart from the question of our saying that in public, how much leverage you have --

(Laughter)

Senator Mitchell. But since we are already in the water, I would like to get your assurance that you will fight hard to give in to the House on that.

(Laughter)

The Chairman. The Majority Leader says he is ready to look very kindly on the House provision.

Senator Mitchell. He does? All right. Well, with that expression of assurance, Mr. Chairman, I won't offer the amendment.

The Chairman. I thank my good friend.

Senator Heinz. Mr. Chairman?

The Chairman. Senator Heinz?

Senator Heinz. Might I inquire of the staff if they have had a chance to cost out the investment tax credit carryback proposal that I propounded earlier today?

Mr. Brockway. No, we have had some difficulty to figure out a way to structure that in a way that would be revenue neutral. In fact, I think if it is done on an elective basis, it will not be possible to structure that by itself as a revenue neutral amendment.

You will either have to make it a mandatory cutdown on the credit, one way or another, or have some additional piece that raises revenue.

But I think that, going through it, we could not figure out a way that would have it work on elective basis that would raise revenue, because presumably anybody who would elect this would elect it because it was more favorable for them, so that you would lose money.

Requiring it as part of the trade-off for taxpayers, which is straight line, would raise revenue from the provision if they were to be taxable. But unfortunately, many of the people or most of the people who would elect this aren't going to be taxable in the next five years in any event, so the penalty that is being imposed on them that presumably would raise revenue in fact won't raise revenue because it wouldn't have tax liability. And other taxpayers that would be hurt by that election simply wouldn't make the election.

So it is very difficult to come up with a structure that would raise revenue, net.

Senator Heinz. As the proposal stands now, have you any estimate as to how much revenue it would lose?

Mr. Brockway. We do not have that. It would be fairly significant -- I am just guessing, mind you, based on where the ITC catch-up proposal was. But it could be in the order of $20 billion -- no, strike that completely.

Senator Heinz. I was falling over on that.

Mr. Brockway. Let me find out. I simply don't have that answer right now. I was thinking of something else.

Senator Heinz. All right.

I don't think I am ready to offer that amendment.

(Laughter)

The Chairman. As soon as he says $20 billion, you want to withdraw it immediately.

(Laughter)

Senator Heinz. Well, he did say he was thinking of something else.

The Chairman. Senator Chafee?

Senator Chafee. Mr. Chairman, in 1982 we passed legislation here in the Senate and in the House, and it was signed by the President, which was probably the most significant environmental law that has been passed in a good long while, and that dealt with the protection of the coastal barrier islands and beaches.

What we did was, we instructed the Secretary of Interior to survey the beaches on the Atlantic and the Gulf Coast, the beaches and islands, that were defined ecologically to be fragile, and to take those that were not yet developed. And the law that we passed said that in those areas that were not developed, which constituted about one-third of the total beaches -- one-third was already developed, one-third was under protection of some type, usually a state or a national park, and the third was still undeveloped.

We passed this very significant legislation that said no Federal funds would be used for the development of those beaches -- such as the building of roads, the building of sewage plants -- and indeed we withdrew the Federal Flood Insurance for construction on those beaches.

Now, Mr. Chairman, what I propose this evening is that we go one step further, and that we really complete the loop toward the preservation of those fragile islands and beaches, and we say that the national policy will be extended so that no tax benefits can be taken for development on those beaches, that you can't have accelerated depreciation or IDBs, or ITCs, or depletion allowance, or deduction for land clearing, or intangible oil well drilling, or whatever it is.

The Chairman. Home mortgage interest, also?

Senator Chafee. Home mortgage interest.

I know that that excites some people; but, Mr. Chairman, I just think if we are serious about protecting these beaches, if we had enough money the Federal Government would clearly buy them. But we don't.

So, we made these restrictions to some 188 units along the Atlantic and Gulf Coasts -- some are in my State, some are in everybody's state here. I think everybody voted for that legislation.

We took care of problems; Senator Long had some particular problems in his state, which were dealt with with the Corps of Engineers -- they were not exempt, and they wouldn't be under this legilsation.

We took care of a problem that cam up in South Padre Island in Texas, and that legislation received tremendous support.

Mr. Chairman, I feel strongly that we should take this next step.

Now, we had hearings on a far broader bill, but this bill was strictly restricted to those barrier islands and beaches. None in the West Coast -- we are not involved there. So, I think it is something that anybody from Oregon could enthusiastically support.

Well, there you have it, Mr. Chairman. I would hope the committee would support it.

The Chairman. Discussion?

(No response)

The Chairman. We really are going in uncharted waters here. You talked to me about this yesterday and today. My hesitancy is anything that is going to frighten people on the home mortgage interest deduction; but the merits of your amendment, on the surface, strike me. I just am reluctant to jump into something I don't know anything about.

Mr. Secretary?

Secretary Mentz. Mr. Chairman, Senator Chafee reminded me that there was a hearing on, as you say, a far broader bill. Treasury testified in opposition to that bill, the basis being that these types of certainly worthy governmental protection should not be done through the Tax Code but rather through a more direct approach. And for that reason, I would speak in objection to the Senator's proposal.

I would note that the testimony also included testimony on TIMS, where we supported you, Senator.

Senator Chafee. Well, Mr. Chairman, let me say this: If we followed Treasury's rationale, we wouldn't have passed that legislation in the beginning.

Treasury says we shouldn't get involved. I suppose what you are saying, that go out and buy them. That is about what you are saying, isn't it?

Secretary Mentz. Well, I am saying that you shouldn't buy the tax law, create a protection for the islands or whatever it is, that you ought to do it directly.

Senator Chafee. Well, what we are trying to do, Mr. Chairman, is be neutral here. The Code has encouragement for development. These are very precious, fragile islands. They are defined. It isn't just that somebody goes out with some rough piece of chalk and says, "Let's take here, and let's take there"; we had a team in the Treasury Department, indeed under Secretary Watt, who no one will accuse of being prejudiced toward fragile islands, and we came up with a definition and a delineation of sections of this very, very important coastline that was approved -- I don't know whether it was unanimously, but darned near -- by the Congress.

It seems to me that what we want to do is get the Code out of encouraging this kind of development. So, we are not asking for any special advantage; we are just asking for the Federal Government to be neutral in these areas that we have already determined should be preserved.

The Chairman. Further discussion?

Senator Durenberger. Mr. Chairman, I wonder if I might just ask John: This amendment applies specifically to the barrier islands, is that correct?

Senator Chafee. Right. Solely.

Senator Durenberger. Do we have comparable situations when we get into some of the wild and scenic rivers kinds of situations, where we take scenic easements or some other less-than-fee situations that might still permit some development within certain kinds of parameters set up by whoever is responsible for applying the easement?

In other words, I am certainly sympathetic to what you are trying to accomplish, but where does this stop once we start into it with the barrier islands?

Senator Chafee. Well, don't make me argue for something else that isn't before us here. That is not before us. We never have taken the major step that we took two years go, or in 1982, in connection with no bridges, no Federal development at all, except in the case of the Louisiana situation where we permitted the Corps of Engineers -- for very specific reasons, because of the oil policy that they had there.

I think it would be unfair to draw me into saying, "Well, this is the camel getting his nose under the tent," and so forth. Congress can consider wild and scenic rivers or easements on that type of land adjacent to Federal parks, or whatever it is, when the time comes. We could consider that.

But this bill doesn't touch that, my proposal doesn't; it solely deals with those barrier islands that we have dealt with before.

I think it is an outstanding amendment, oddly enough.

(Laughter)

Senator Chafee. And I would like to see us pass it.

Senator Long. Mr. Chairman, I would hate to see us agree with this tonight, because, on the barrier island matter, when we acted on it we worked out agreements so that everybody was satisfied by the time we got it worked out.

But I don't think anybody in Louisiana, for instance, knows that the amendment is pending. So, they wouldn't be in a position to advise me whether it should be modified, or whether we have an interest to protect, or what.

I would certainly hope if we are going to vote on this that the people would have notice of it, so that they could make their feelings heard about it.

I just haven't heard from anyone in Louisiana where we would be affected, because nobody knew the amendment was coming up. I would hope that we wouldn't vote on this tonight or at least we wouldn't agree to it tonight.

It may be that there would be no one to object to it, but I think they ought to have the chance to object if they wanted to.

The Chairman. In fairness, I think I have to agree with Senator Long. I am hesitant. Something tells me, just don't quite do this. I don't know what is out there; I don't know what we are affecting; I don't know who we are affecting; I don't know if it is fair. I think I like it, but I would hope that the Senator from Rhode Island wouldn't pursue it tonight.

Senator Long. Let us say, for the sake of argument, that here is some Frenchman in Louisiana out trapping muskrats down there, who is living in a little houseboat, who would like to build a little house for his wife. I've visited some of them in the houseboats, but I'm not sure anyone would want to build a little house on stilts, or something.

And being in no position to know what is likely to happen down there, I am sure that this fellow would be very dismayed that he thought he was trapping those muskrats and not doing anyone any harm, and all of a sudden Congress passes a law to say, "You can't build a little house on your island."

Senator Chafee. Well, we have already said, unfortunately, that his mortgage interest is not deductible on his houseboat. I think that is one of the --

Senator Long. Well, I am not asking any consideration for his houseboat; that is not what you are trying to tax. You are trying to tax his home, when he builds one. And I just ghink when we had this thing before, we had a chance to find out about it. We explained what our problem was, the amendments were worked out, the Senator agreed to them, as I understand it, and so it's fine; we don't complain about that.

But in this case, we have had no chance to see whether we need to have an amendment to the Senator's amendment, or whether it would create any problem.

I would suggest that the Senator withhold it and offer it later on, after we have had a chance to see if anybody objects to it down our way.

How do we know if they are going to object or not? Some of them don't even know Congress is meeting, Senator.

(Laughter)

Senator Long. And here we are proposing to say you can't build a little home for a man and his wife and child.

Senator Chafee. Well, I am a thorough gentleman all the way. What do you say we put it off, and we'll vote on it tomorrow? How about that?

Senator Long. Well, we aren't going to be able to find out about that; the people I need to reach probably don't have a phone.

(Laughter)

The Chairman. John, what you could do is, again, you could offer this on the floor, because I think it has got to be a revenue pickup. I can't picture it as a revenue lower, somehow.

Senator Chafee. Well, it sure is not a revenue loser. Furthermore, I think it would make everybody feel good.

(Laughter)

Senator Chafee. It has got a lot of plusses to it.

The Chairman. Well, in that case, why not make the whole Senate floor feel good, instead of just the Finance Committee?

Senator Chafee. Well, I have a limitation on how many people I want to make feel good.

(Laughter)

Senator Chafee. Well, we will let it simmer for a while.

The Chairman. I appreciate that.

Senator Long. Thank you, Senator.

The Chairman. Are you ready, Senator Matsunaga, or not?

Senator Mitchell. Mr. Chairman, may I ask a question on an unrelated matter?

The Chairman. Yes.

Senator Mitchell. Mr. Brockway?

Mr. Brockway. Yes?

Senator Mitchell. I wanted to inquire regarding a figure that was used earlier today, and I want to see if my recollection is correct on that.

Under the pension section -- this is the handout of earlier today, the fundamental tax reform -- on page 10, item D, "Do not extend 401(k) plans to state and local governments. This provision would not apply to plans adopted before March 1, 1986."

It is my recollection that, in response to a question I think from Senator Chafee -- I am not sure, either Senator Chafee or myself -- regarding the revenue involved in that, you used the figure $3 billion.

My question is: Was that based on the earlier limit of 12,000, or is that based on the current figure, which is of course in the next sentence, item E, reducing it to 7000?

The Chairman. My hunch would be that it wouldn't be much different; you wouldn't have many state employees over $7000 or $12,000, would you?

Mr. Brockway. I believe you are correct about that, Mr. Chairman. Also, I think that that number may have been done against the Chairman's mark, which was $7000. But either way, I would be surprised if there is much difference. I can check on that for you.

Senator Mitchell. Well, would you check?

Mr. Brockway. It was done at $7000, I am informed.

Senator Mitchell. Those who are interested in pursuing this -- and, of course, they are state and local groups -- have apparently provided their estimates to the committee, which are in the range of $1 billion, and that is such a wide disparity. Obviously they have an interest.

Mr. Brockway. It is sort of a typical disparity, actually.

Senator Mitchell. Oh, is it really? A 300-percent disparity?

Mr. Brockway. Not for them, but just generally.

Senator Mitchell. In general, do you mean?

Mr. Brockway. Yes. That tends to happen.

Senator Mitchell. Well, if we could look at that.

Mr. Brockway. We could look at that information and check it over the night, and we will be able to respond to you tomorrow morning.

Senator Mitchell. If you would do that, I would appreciate it.

Thank you, Mr. Chairman.

The Chairman. Senator Matsunaga?

Senator Matsunaga. Mr. Chairman, Senator Long is willing to change his earlier amendment, modify his earlier amendment, so that it would give an additional $200 million, and that should cover my amendment.

The Chairman. That takes an extra month off the ESOP/ PASOP. But that covers your amendment through 1990? Or through 1987?

Mr. Brockway. I guess I will have to make 100-percent sure what we are talking about now in terms of the amendment.

Senator Long's amendment as modified by Senator Baucus has a $300 million reserve. And then if you moved it a month, that would get you roughly $500 million.

Senator Matsunaga. That is right. That will save, initially --

Mr. Brockway. If your initial amendment, without going to residential solar, would have been $600 million -- you have one, two, and three on that sheet. The first is business energy credits for solar, geothermal and otec. That would be --

Senator Matsunaga. We will cancel out number three.

Mr. Brockway. Cancelling out number three would leave it at $600 million?

The Chairman. No, $600 million with number three.

Senator Matsunaga. So, take number three out.

The Chairman. Take number three out, and you have $500 million. How far does it go? And do we have to sunset it before 1990 in order to make it come within the 500?

Senator Matsunaga. And since Senator Baucus's amendment took $300 million of the $600 million, we have $300 million. And then by moving the date from June 30 to May 31, 1987, the ESOP amendment offered by Senator Long would save another $200 million, giving a total of $500 million, which should cover my amendment, one and two.

Mr. Brockway. Senator Matsunaga, if we could sit down with you and your staff and work out a package, either a $300-million package or a $500-million package, I think we can in a few minutes do that. I am just not sure where you want to go, and which is the item that you think is more important -- whether the solar, geothermal, and otec, or wind and biomass, or they are both equally important -- so that we can try to design that.

The Chairman. Or consider sunsetting them earlier than 1990.

Mr. Brockway. I think we certainly find a place where we could sunset it and come with either a $300-million or a $500-million package.

The Chairman. Why don't we do this, Sparky: why don't we agree to sunset it for one and two at the end of 1987, and see how much money that costs; then if there is a slight amount left, extend it out?

Senator Matsunaga. Well, as I understand it, if we sunset it after 1988, in item number one, that is, solar, geothermal and otec --

Mr. Brockway. In the House?

The Chairman. In the House?

Senator Matsunaga. No, if we do it now, here.

The Chairman. Oh.

Senator Matsunaga. And sunset wind and biomass after 1987, then that would come to about $500 million.

The Chairman. Then you would be bound to be within it.

Mr. Brockway. You might be a little bit above $500 million.

Senator Matsunaga. And cancel out number three, now.

Mr. Brockway. No, no, cancelling out number three, and also dropping the affirmative commitment provisions. Is that what you are suggesting?

Senator Matsunaga. Yes, that is correct. Cross out affirmative commitment.

Mr. Brockway. I think that, in any event, the order of magnitude will be approximately $500 million if you sunset both at the end of 1987.

The Chairman. Have you got it, Sparky?

Senator Matsunaga. Well, I will agree to that, provided that if we find more funds --

(Laughter)

The Chairman. No, I think we have to pass them around.

Senator Matsunaga. So, it is three years in item one and two in item two?

Mr. Brockway. No. I am saying both sunset at the end of 1987. Alternatively, you would have to sunset, I think, item two a little bit earlier, or drop the 1987 number below, from 10 percent somewhat lower. Either one.

Senator Matsunaga. Well, there are some of us who are more interested in item two than in item one.

Mr. Brockway. Yes. In that case, I would think that both at the end of 1987 is best.

The Chairman. Sparky, why don't we do that? Because the House has got 1988, and we will be in conference with them.

I know that biomass is very important to George.

Mr. Brockway. Or, alternatively, you can drop percentages in both to hit the correct number, phase them both down.

Senator Matsunaga. Well, if you could give me another month --

(Laughter)

The Chairman. All right; 1987, Sparky?

Senator Matsunaga. Yes, we will go into conference with that.

The Chairman. All right, 1987.

Are there other amendments?

Senator Moynihan, Senator Danforth, Senator Durenberger?

Senator Matsunaga. I have one very simple one, Mr. Chairman.

The Chairman. Go ahead, Pat.

Senator Moynihan. Mr. Chairman, this is a measure I offer at the request of Senator Thurmond and on my own behest. It has to do with the exemption of Internal Revenue Service special agents from the requirements of auto recordkeeping which we adopted in 1984.

I believe Secretary Mentz will wish to see this happen.

In 1984, we passed those recordkeeping amendments for automobile use. We exempted law enforcement agents. But by a quirk of that law, we did not include special agents of the Internal Revenue Service.

The Chairman. Where they are using their car on Service duty?

Senator Moynihan. On Service duty. These are in every sense law enforcement officers, Mr. Chairman; they carry weapons, wear badges, are involved in criminal investigations of a very high order and often a very dangerous order.

The House has now amended the law to include them, and I believe the Treasury would like them included; Senator Thurmond asked that they be; the revenue involved is negligible, and the exclusion is unseemly.

The Chairman. Does Treasury have a view?

Secretary Mentz. Yes. We strongly support that amendment, Mr. Chairman.

Senator Moynihan, just one point of clarification. The effective date -- would you be willing to make it January 1, 1985, which was basically the date that the provisions apply to every other law enforcement officer?

Senator Moynihan. As you wish, Mr. Secretary. Yes.

The Chairman. Is there objection?

(No response)

The Chairman. Adopted.

Senator Danforth?

Senator Danforth. Mr. Chairman, this is an issue which I regret to say I did not raise this afternoon. I raise it now under a de minimus rule; but, if it isn't de minimus, I will withdraw it until there is a chance to study it.

The bill now, the Finance Committee bill, incorporates a bill that Senator Bentsen and I introduced relating to the exclusion of computer software royalty income earned from the sale or license of computer software by companies that created the software -- to exclude that from the personal holding companies, the personal holding company income.

Now, that is in the bill. The question is the effective date of that. Treasury indicated to the industries that it would work with the Internal Revenue Service to try to make sure that the provisions in the bill applied retroactively to all open years.

Apparently, Treasury and the IRS could not work this out; but it was my understanding that the Treasury's position was that it would support retroactivity of this provision for all open years. That is what I would like to accomplish in the bill, to make sure that the effective date is retroactive.

My guess is that the revenue cost is close to aero.

The Chairman. Mr. Brockway?

Mr. Brockway. Senator, if we could have until tomorrow to check with the IRS, to see how many cases are in audit and the order of magnitude, we can get back to you on that issue.

Senator Danforth. Yes.

The Chairman. Senator Durenberger?

Senator Durenberger. Mr. Chairman, I think this is de minimus, and I gave you a brief description. This is page 35 on the spreadsheets, number 3, information reporting on state and local taxes. I gave you a little sheet on that this afternoon.

The Chairman. Oh, yes, where we have asked them to report on the income taxes.

Senator Durenberger. Well, yes. We have asked the income tax, the House wants it in the report on income, real property, personal property tax. I think the notion was about that people are cheating on their income taxes at the state level, or something.

But the information that I have is that we could possibly raise $50 million with this amendment; but the states tell me it is going to cost us $37 million as a minimum for them to report all this information to the taxpayer and to the IRS. And I really wonder why we are doing it. I would like to propose we get rid of it.

Senator Bradley. Mr. Chairman, I also have an interest in this and have heard from my state on the same issue.

The Chairman. I am curious. Did you hear before we limited it just to the income tax? A lot of us did on that, and then I didn't hear much after we limited it just to the income tax.

Senator Durenberger. Mr. Chairman, one other item: the $50-million estimate was over five years; the $37 million we heard from them was per year.

Mr. Brockway. I think, in part, it depends on whether you are doing all taxes or just income taxes. With just income taxes, as in the proposal, it is $50 million over the period.

Senator Durenberger. They tell me, Mr. Chairman, that postage is the biggest component. And I will raise the question: Why are we doing it? For $50 million over five years, why bother the states? It is good for the Postal Service, I guess, but whose idea is this?

Mr. Brockway. The general notion on all this information reporting is just simply where you can get actual information reporting on deductions claimed, you end up having better compliance.

State and local income tax is better compliance than, for example, real property. Real property was not included in this mark, simply because that is imposed at a local level and you have too many points; the cost was there.

There are certain problems for the states because of the timing of when state and local taxes are paid and whether they can get it into the --

Senator Durenberger. Mr. Chairman, I move we delete the requirement.

Senator Bradley. I would second that motion.

Secretary Mentz. Senator Durenberger, one other alternative would be to have the states report only to the Internal Revenue Service, not send all the copies to all of the taxpayers. That would cut out the postage problem.

Senator Durenberger. I move to delete it entirely, The Chairman. Dave, could we do this? Could you hold on this until tomorrow, and let me see if we can find $50 million; because I don't want to start the precedent of non-revenue-neutral amendments. And between now and tomorrow we will find $50 million somehow, some way.

Senator Durenberger. All right.

Could I ask you one other thing, to get an estimate on a different matter?

The Chairman. Yes.

Senator Durenberger. On the installment method of accounting issue: as I understand, the current proposal would deny use of the installment method for a portion of sales of dealers in property that bears the same ratio to the total installment sales that the taxpayer's outstanding debt bears to the adjusted basis of the taxpayer's assets.

This is the possible proposal, to see if there is any room overnight for some agreement on this: "For all installment sales, disallow a deferral of 30 percent on sales with payments of over six months, effective in taxable years beginning January 1987" -- a 30-percent deferral, over six months.

Mr. Brockway. All right. We will try to get an answer by tomorrow on that, and we should be able to.

Senator Durenberger. Thank you very much.

The Chairman. Senator Matsunaga?

Senator Matsunaga. Mr. Chairman, I brought up in the afternoon private session the matter of trade shows, and I indicated that when the law was passed earlier, in 1976, the colloquoy on the floor of the Senate between Senator Talmadge and Senator Long indicates that organizations such as the Red Cross and the Girl Scouts, and the National Association of Secondary School Principals, et cetera, would be exempt from the income from trade shows.

I don't know whether to call this a "clarification amendment." The amount involved is minimal, and that total amount is $1 million a year.

Do you think this is the proper time to offer it?

The Chairman. Well again, if you have five million, I don't think Russell wants to give any more days off of his.

I really do, Sparky, want to -- you know, a million dollars over five years or less is one thing; that is de minimus. I realize five million is not much, but I would like to hold to a principle of stickign to revenue neutrality.

Senator Brockway. Mr. Chairman, I don't think it is a million dollars; I think it is roughly .1 over the period, if I understand the proposal.

The Chairman. That's $100 million?

Mr. Brockway. That is my understanding. But it would be very useful if we could confirm this. I think what happened in 1986 was that there was an assumption that that was what the size of the revenue was. And then after looking at that, and the experiences, they have come to the conclusion that there is substantial more activity involved.

Senator Matsunaga. We are exempting only those organizations which fall within section 501(c)(3) and (4) -- (c)(3) and (4).

The Chairman. Why don't you hold on that, Sparky, until they get a chance to check; because, there are a lot of organizations that have trade shows in those two categories, and I know the kind of income they are talking about. This is from the exhibitors' boothes. I think we would be better off to wait until they get an estimate.

Senator Matsunaga. I am talking about the educational trade shows, now.

Mr. Brockway. That is correct, but if I understand, it would really go to pretty much all charitable groups such as the AMA, but also all civic organizations. It could be a fairly large group.

But if we could have some time to discuss it with your staff, we could make sure we understand.

Senator Matsunaga. All right.

The Chairman. Senator Heinz?

Senator Heinz. Mr. Chairman, when the committee was marking up several weeks ago, I offered an amendment to give residential rental property a preference compared to commercial rental property.

When that amendment was adopted, it basically created a 30-year life for commercial property, and a 25-year life for residential rental property.

That amendment was a revenue loser, and I would like to try to stay with revenue neutrality. I have a number of options, one of which is to go to 26 years on residential rental and 32 years on commercial. I understand that that is revenue neutral but it is probably a little higher on commercial than I would like to go. That is a six-year spread between the two, which is probably more spread than is absolutely necessary.

Could the staff tell me if 27 years for residential rental and 31 years for commercial would be roughly revenue neutral or not?

Mr. Brockway. That lose maybe $50 million; 28 and 31 is neutral, and 26 and 32 is neutral.

Senator Heinz. My problem with 28 and 31 is that that is such a small differential it won't accomplish my policy goal.

Mr. Brockway. If you are willing to entertain half-years I think we might be able to.

Senator Heinz. As long as I am not the person who has to do the accounting problems.

Mr. Brockway. In the end -- see, the numbers you are going to use are not going to be round numbers in any event, because the depreciation they will take, in the 26 years class -- I would have to devide that into 100. So, whatever that is.

Senator Heinz. It is going to be an odd number, in any event?

Mr. Brockway. It will be unless you went 20, 25, 33, something that divides into 100.

Senator Heinz. If I went 26.5 and 31.5, that would be revenue neutral, and wouldn't, oddly enough, introduce any additional complexity?

Mr. Brockway. It would be fairly close to neutral, and I think the numbers would not change appreciably for the taxpayer.

Senator Heinz. In terms of the complexity? I don't want to mess everybody's accounting up any more than we have already messed them up.

All right, Mr. Chairman, assuming that this is revenue neutral, could I ask if there is any objection to it in the committee?

The Chairman. I don't know if there is objection or not. Is this 27-31?

Senator Heinz. No, it would be -- what did we decide?

Mr. Brockway. I think it was 26.5/31.5 that would be pretty close.

Senator Durenberger. Mr. Chairman?

The Chairman. Senator Durenberger?

Senator Durenberger. I would just ask John to consider incorporating in here somewhere, as long as we are figuring the numbers, the issue that I raised this morning or this afternoon on tax-exempt bond-financed principally multifamily housing, which in here is at 40 or life but traditionally has had the same life as other real estate. If we could incorporate that.

Senator Heinz. I would be very amenable to doing that.

Mr. Brockway. We would have to change the years a bit to do that; that is about a .1, I believe. You could come up with a proposal, obviously, mixing both the lives of residential and the lives of nonresidential, and changing the bonds. But that, by itself, is additional loss of .1.

Senator Durenberger. Which adds what part of a year?

Senator Heinz. Mr. Chairman, let me withdraw my amendment and see if Senator Durenberger and I can work something out.

The Chairman. I think that is a good idea.

Senator Chafee?

Senator Chafee. Mr. Chairman, I have been working with the staff on clarifying that certain disability-related expenses are deductible as medical expenses. I would like to see the language we come up with, in order to make sure that the amendment to the statute is not necessary.

What I am particularly thinking about is the removal of architectural barriers in houses. This is particularly important, Mr. Chairman, since we are going up now from five percent to 10 percent on the medical deductions.

Now, it is my understanding with the staff that this can be worked out with the committee report language; but, if not, I just want to give notice that I would be bringing up an amendment to this statute.

But, Mr. Weiss, I think that probably won't be necessary -- is it? -- to have the removal of the architectural barriers to be included as medical expenses. You think we can work that out?

Mr. Weiss. Senator Chafee, I think that is correct, that we could put language in the committee report that would clarify that in these sorts of situations, that those expenditures are eligible for the medical deduction.

Senator Chafee. All right.

The next one, Mr. Chairman, is to permit limited equity co-ops to be eligible for tax-exempt bond financing.

The Chairman. Limited what?

Senator Chafee. Limited equity co-ops, which would be eligible for tax-exempt bond financing if they met the following requirements: that the bonds would be included in the volume cap for single-family mortgage revenue bonds. Who is the expert on this. Is that you, Dave?

Mr. Brockway. I am not sure that anyone is exactly an expert.

The Chairman. Is this one you floated by us before?

Senator Chafee. Yes. I believe the staff is aware of it. It is revenue neutral.

Mr. Brockway. Is this the situation where they are giving up the mortgage interest deduction?

Senator Chafee. They could not take the mortgage interest deduction. They had to meet the targeting of the multifamily bonds, and the bonds had to be under the cap for single-family mortgage revenue bonds.

Mr. Brockway. In that structure, then as I understand it, it would be revenue neutral, if they are giving up the mortgage interest deduction.

Senator Chafee. That is right.

The Chairman. Does anybody know the merits of it, apart from revenue neutrality? It sounds all right to me, but I am not really familiar with it.

Senator Chafee. Well, for some reason in our state they are using it. It falls under all the caps.

The Chairman. Mr. Secretary, do you have any views on this?

Secretary Mentz. I wanted to say, Mr. Chairman, that we have looked at it, and we have no objection to it.

The Chairman. Fine. Is there any objection from anyone in the committee?

(No response)

The Chairman. Without objection.

Further amendments?

(No response)

The Chairman. If there are no further amendments, we will stand in adjournment until 10:00 in the morning, and I hope then we can start facing some of the major amendments that I know are coming.

(Whereupon, at 9:12 p.m., the meeting was recessed, to resume the following day, May 6, 1986, at 10:00 a.m.)

C E R T I F I C A T E

This is to certify that the foregoing proceedings of an Executive Session on Tax Reform of the Senate Committee on Finance, held on May 5, 1986, were 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.