MINF

EXECUTIVE COMMITTEE MEETING ON PROPOSED TAX REFORM ACT OF 1986

THURSDAY, APRIL 10, 1986

Committee on Finance

Washington, D.C.

The committee met, pursuant to recess, at 9:35 a.m. in Room SD-215, Dirksen Senate Office Building, the Honorable Bob Packwood (chairman) presiding.

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

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

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

The Chairman. The Committee will come to order, please. Let us continue on on the subject of depreciation. And we had before us the Roth-Baucus et al amendment yesterday. And I would like to continue discussion on that and see if we can possibly dispose of it sooner or later.

Who wants to talk? Or should we simply move its adoption?

Senator Moynihan. Let me talk a little bit. I wonder if I could ask Secretary Darman or Mr. Brockway or whoever would like to answer: We made the point yesterday that one of the aspects of a productivity property designation in the accelerated depreciation schedule is that it tends to take a static photograph of what are export oriented markets at this moment when those markets are very much designed to change.

I think Senator Durenberger made the point yesterday that if you look at this list of goods that are to be given special treatment, you look at the traditional makeup of the Senate Finance Committee. We are from the extractive industries, the states that are sort of primal in their products. Although manufacturer of tobacco and tobacco products, I don't see that fellow around here, but I guess I am wrong about everything.

But the idea that land improvements and manufacture of athletic jewelry -- all this is sort of 19th century industry.

And if there is one big thing this Committee has been moving toward in trade matters is can we not get open trade barriers with respect to something we are newly competitive in, which is service. And we are talking about a GATT round that would bring in services.

And what we specifically leave out here are those aspects of technology which make our service effective. I mean computers, desk computers. And isn't this always the problem of state economic planning? That the planning tends to reflect old realities, not new ones; necessarily rigid.

And there is a word for it. It is called state capitalism. And you pick the winners and losers, and then you bet on the losers because almost always the losers have the largest --

(Laughter)

Senator Moynihan. So you go all over the world and you see this. They say it is -- they call these socialist regimes of the third world. They are mostly state capitalist regimes. The production techniques are owned privately, but the government decides what will be supported by tariffs and subsidies. And pretty soon you get a political interplay which is inevitable.

And does the Treasury really not think this is what we are doing? I mean, Mr. Darman, do you not think we are picking winners and losers here on a most arbitrary basis?

This is, in a sense, an industrial policy written into the depreciation schedule.

Mr. Darman. Senator Moynihan, thank you for that question. It gives me an opportunity to remind you and members of the Committee that Treasury originally favored an extremely neutral approach --

Senator Moynihan. Yes. A market --

Mr. Darman. -- a market tax policy in which we said, as you are suggesting, the market would and should do most of the allocating of resources. We continue to believe that that is the best approach.

However, it has been clear from the day the Treasury 1 was launched -- I was not at the Treasury at the time. I had a more neutral perspective from which to observe. It was clear that there was close to zero practical political support for that approach, even though it has a number of distinguished theorists who favor it.

So we modified Treasury 1 in a direction that began to deviate somewhat from market neutrality, market-oriented neutrality, and made some choices. And we were criticized in the process, but I think they accommodated political and practical reality to some degree.

The House went on to make some further choices. And it was very clear in conversations with the Senate Finance Committee that the Senate Finance Committee intended to make further choices. And I believe you yourself, Senator, were quite eloquent in recognizing that the decisions made by this Committee are inescapably decisions that involved the selective provision of tax benefits in one way or another.

And so I think we have long since passed the issue of pure philosophy. By your way of characterizing this, we have been in the business of state economic planning for as long as we have been in the practical political process.

It seems to me an inescapable fact of political life.

Senator Moynihan. But could I ask you, sir? At this level of detail, isn't this a new level of detail?

Mr. Darman. No, I wouldn't say this is a particularly new level of detail. It is my observation that as we approach the final days of development of the bill in the House where there were a number of advocates of neutrality there were some extraordinarily specific adjustments made in the last several days.

Senator Moynihan. But that was called "boat buying."

Mr. Darman. Well, I didn't characterize it as such, but it seems to me that almost every tax bill over the many years has at one stage or another had some accommodation of particular political interest.

In this case, if I may say, in this case I take it that the authors have in mind an economic principle in the enhancement of U.S. competitiveness through the identification of what is productivity property. And it seems to me that the debate is what is or isn't productivity property, within the framework at least of the amendment as proposed by the sponsors.

Senator Moynihan. My question to you would be simply that we fully understand that, you know, this district or even that state needs something and as a political matter that is how you put together a majority. But this is an economic principle we have here before us.

And I would have thought that you would have found an economic principle that won't work. You cannot figure it out. You can say this should be our principle, but you can't apply it. It is just too elusive.

Mr. Darman. If I could respectfully suggest, Senator Moynihan, that that question ought to be directed to the authors because the --

Senator Moynihan. Well, the authors aren't here, sir.

Mr. Darman. We did not participate in the process that developed the specific discriminations.

Senator Moynihan. Yes.

Mr. Darman. We said we could accept the issue of principle that there would be some discrimination on the basis of a category to be called productivity property. But the specific discrimination that has been made has been worked out among the authors.

Could I add one other point, if I might? On your initial observation with respect to the service sector and U.S. competitiveness, I think your general point about the dynamic nature of technological development and changes in comparative competitiveness is right. But I would note that with respect to the service sector the main impediments to competitiveness have much more to do with investment treatment abroad than they do with domestic tax treatment, in my opinion.

Senator Moynihan. I think this Committee has been dealing with that. I am not trying to harass anyone. I am just trying to say: I think you have made an important point, Mr. Chairman, that this particular schedule does not -- it is not that last minute trading involved. This is an economic principle of sorts we are putting into the tax code, and it is a principle I don't think -- I don't think it will work.

I mean would anybody be able to say -- would Mr. Brockway be able to tell me what proportion of leather and leather products that are manufactured in the United States are exported? Mind you that the degree to which if you are competitive with imports, that is an element too.

Mr. Brockway. I expect we could get that information. I do not have that information right now.

Mr. Darman. Senator Moynihan?

Senator Moynihan. Sir.

Mr. Darman. Excuse me. I know that the authors by and large are not here, and I suggest that I and Treasury have not participated in the process. I do know that at one stage their rationalization was related to the question you are asking. And that is the percent of import and export involvement of the sector. And they were working from what is an available list.

Senator Moynihan. Commerce.

Mr. Darman. Yes, exactly.

And I think there was a relatively high degree of correspondence between those things which they put on the list as being productivity related and those things which had a high degree of export or import sensitivity.

But I just volunteer that on their behalf since they are not here.

Senator Moynihan. I am not trying to monopolize this conversation. I was invisted. The Chairman said anybody want to talk before you two gentlemen came in, the three of you.

Does anybody know what that calculation was? At what point you qualify as a productivity category. Some arithmatical designation, I gather.

Mr. Darman. You may see my eyes wandering around the room looking for one of the authors.

Senator Moynihan. The authors are rather conspicuously absent.

The Chairman. Further comments on the Baucus-Roth et al proposal?

Senator Danforth. I have a question.

Senator Symms. I have a question also, Mr. Chairman, when we get around to it.

Senator Danforth. In calculating revenue effects in this bill on indexing, what is the -- what estimate for inflation do we use?

Mr. Brockway. In the Joint Committee's revenue estimates we assume a four-year -- I mean a four percent level of inflation.

Senator Danforth. You assume four percent level of inflation.

Mr. Brockway. Each year.

Senator Danforth. Each year throughout this five-year period of time.

Mr. Brockway. We take the CBO assumptions where they have them, and after that we straight line it at a four year --

Senator Danforth. I can't hear you.

Mr. Brockway. During the window period, we use CBO assumptions.

Senator Danforth. Yes.

Mr. Brockway. And then after that period for running it, looking at what impact it might have on the long-run basis is something else.

Senator Danforth. I think your sound is on, but it must be turned way down.

Mr. Brockway. We used the numbers the CBO projects during the period, and they are roughly four percent. The impact, basically, is a four percent assumption of inflation.

Senator Danforth. And, Mr. Darman, you just handed me a sheet of paper which I haven't had the opportunity to digest. But does this -- this shows revenue effect of indexing basis for depreciation? Is that right?

Mr. Darman. It shows the effect of -- yes is the short answer. As you can see, it shows the revenue loss or gain associated with the Chairman's package with two point two to eight percent indexing compared with zero to eight percent indexing. And then it makes the same set of comparisons on a fully phased in basis, which -- both of which tables, or the two halves of the table you see before you, are, I think, at least partially responsive to your line of questioning yesterday.

And this morning, as I understand, you were just asking for, in effect, different inflation rates. And we --

Senator Danforth. Well now, what I am asking for is whether in computing revenue estimates on the bill -- we assume a rate of inflation over the next five years, and my question to you is in computing this information did you assume a rate of inflation?

Mr. Darman. Yes. And as you can see, what we did is we have given you three different sets of estimates at three different inflation rate assumptions -- two, four and eight percent inflation rate assumptions. So that you can see what happens with inflation.

And as we were discussing yesterday, it becomes clear that as inflation rises the revenue loss relative to a system in which there were no indexing rises with indexing.

Senator Danforth. Right.

Mr. Darman. But that, of course, as I was trying to suggest yesterday, is a reason to put a cap, if you wish.

Senator Danforth. Yes.

Mr. Darman. But it doesn't, to my way of looking at it, have any relationship to the question of a floor.

And what I think this table suggests -- and we would be happy to go over the back-up detail with you or your staff, if you would like, but this in a summary way suggests that looking just at the depreciation system, only at the depreciation system, excluding the ITC, and, of course, excluding all other provisions of the bill, the Chairman's proposal, in fact, raises revenue by our estimates, and would do so at all inflation rates within the zero to eight percent range or higher. And that if you added -- excuse me, the two to eight percent range. And if you added what we have suggested and what is in the Roth amendment, that is indexing from zero to eight, it would have the effects indicated here, which I would say are rather modest effects. There is certainly no major revenue loss. And there is an enormous favorable affect on the cost of capital, which we had at one stage been led to understand was the principal concern of the Committee.

Senator Danforth. This shows Chairman's package, exclusive of the ITC repeal.

Mr. Darman. Yes.

Senator Danforth. And the Chairman's package with two point two to eight percent indexing and Chairman's package with zero to eight percent indexing as -- I mean these -- in other words, these first two numbers here, this is the Packwood package. This isn't the Roth package.

Mr. Darman. That is right.

Senator Danforth. The only difference between the first two is whether it is two or eight, right?

Mr. Darman. Right.

Senator Danforth. I mean two to eight to zero to eight.

Mr. Darman. Right. This goes only to the question: What is the effect of changing from two to eight percent indexing to zero to eight percent indexing. And it answers that question.

Senator Danforth. Let me ask you this: These numbers here that one picks up 35 and the other 30, that is exclusive of expensing, the 50,000 expensing?

Mr. Darman. That is correct.

Senator Danforth. How much does that lose?

Mr. Darman. Well, the Joint Committee has estimated that, I believe, at about -- I should defer to them. Twenty-two nine.

Mr. Brockway. Twenty-two nine under the proposal, but we have a different set of numbers entirely from these so you just really --

Senator Danforth. You have different numbers. We are going to have to go and vote right now. I would like to see your numbers, too, Dave.

But in other words, there is about -- instead of 30, it should be more like eight for the zero to eight.

Mr. Darman. Except for the fact that -- yes, if you want to include expensing. And if you want to include the ITC, it will be a much larger positive number. We confined it to the depreciation system because indexing only applies to the depreciation system.

Senator Danforth. All right. Well, we are half way through a roll call vote on the floor. So we will be in recess for about five minutes or so.

(Whereupon, at 10:55 a.m., the meeting was recessed.)

AFTER RECESS

(11:06 a.m.)

The Chairman. Let us continue on. Again, let me emphasize the schedule. It would be my hope that we can finish depreciation possibly this morning. I would like to get accounting done this afternoon. And if we cannot move onto the foreign tax proposals this afternoon -- I will have to simply wait and see. But there will be votes through the afternoon.

On Monday afternoon we had initially scheduled a hearing on or a discussion of bonds and we had another morning on bonds, but I have a feeling we may be able to reach a compromise on that and we won't need both Monday afternoon and another morning for discussion. In which case I would use Monday afternoon to continue on with some votes on areas where we may not have otherwise reached an agreement.

And I might even use that afternoon to see if we can finish the employee benefits section. So far, I have received only one amendment. There may be one or two others. But if we had that section and had only a few amendments, we will try to finish that that day.

But at the moment, we have the principal sponsor of depreciation here. And perhaps Senator Roth would like to make some comments.

Senator Roth. Mr. Chairman, I would rather make some comments when we have those here who have raised a number of questions.

Again, I would like to underscore why I think this amendment is desirable. I really feel very strongly that the purpose -- one of the principal purposes of our tax policy must be to help this country become competitive in world markets. And one of the areas that I think the draft proposal, the House proposal in particular, is deficient is with respect to the depreciation of equipment.

Now there is no question of what we have a very strong challenge from abroad in many of these areas that would be impacted by this amendment. And the one chance we have of overtaking our competition and being a leader in these areas is by developing a kind of policy that will help those industries who depend on modern technology and equipment to incorporate them in their facilities. And that, of course, is the basic purpose of this proposal.

Now there has been a lot of talk, a lot of talk, that the proposal is industrial policy. But, ladies and gentlemen, there is just no truth to that charge in any manner whatsoever.

The idea of so-called industrial policy is that government decides, targets, certain industries for growth or phase out. That they play God, so to speak, in those cases.

And let me tell you I am very much opposed to an industrial policy for this country. And I would in no way support legislation that was going to push that approach.

And that is not what this amendment does. And let me be very frank with you, Mr. Chairman, and the others. You know as well as I do that this proposal -- I would be the last to claim is perfect, but we think it represents a reasonable compromise, a reasonable compromise that will achieve the goals that I think are necessary.

I see Senator Mitchell is now here, and I guess Senator Chafee was another one that argued the industrial policy.

But what is being overlooked is that this amendment, this proposal, is not targeting particular, specific industries for growth or decline or for whatever the government policy would be.

What our amendment is doing is providing accelerated depreciation to a tremendously broad class of assets. It involves manufacturing. It involves extraction. It involves agriculture. It involves communications and transportation.

It is absolutely ludicrous to try to argue that this approach is picking winners and losers. Now as I mentioned earlier -- may I have the attention of the --

As I mentioned earlier, our definition of productivity property almost directly tracks Section 48(a)(l)(b) of the Internal Revenue Code which defines what property is eligible for the investment tax credit. The list of qualified property is not arbitrary. The ADR class as listed correspond to property that qualifies under the code for the ITC. And people have not been arguing, at least that I am aware of, that ITC was a so-called industrial policy.

Now there are some modifications to this definition. Property used in services does not qualify. And there are several reasons for this exception, one of the most important being that of the impact on revenue. We are trying to minimize the impact. I know that is important to the members of this Committee.

But I would also point out that as far as services are concerned, equipment is a much smaller component in the cost of capital for services. To the contrary, rates are much more important. We are reducing rates so that will be a significant help to the service industry. As a matter of fact, I think it is relevant just to point out that a lot of the service industries were supporting the House bill, which, frankly, I think had very miserable depreciation treatment. They didn't care.

Now another question that has been raised is why are computers not covered. Well, I think it should be pointed out that computers have already been taken care of. They have been moved from the five-year category to the three-year category, so that we felt that that was favorable treatment for them.

Now as I said earlier, this is not a perfect proposal. It is one that we have sought to work out with members of the Committee on both sides of the political aisle, worked out in the sense of being gravely concerned about revenue; tried to minimize the so-called revenue dabbies. Very frankly, I would prefer a much broader approach, but the revenue drain would be large. In fact, I would be very willing to offer my expense program that is part of my reform package, because I think it does a much more effective job of meeting the problems here than the one that we have.

It does equalize effective tax rates across all industries and assets, and it gets the cost of capital down. I think it satisfies the Treasury. But it costs considerable money. However, I would say, Mr. Chairman, that if my good friends, Mr. Chafee, Mr. Mitchell and Mr. Moynihan, would like to offer the Roth-Mitchell-Chafee-Moynihan amendment to incorporate my ECRS plan, I would be happy to do that.

But since it is pretty clear that that is not practical at this stage, I think this amendment is probably the best compromise that can be worked out. It reduces, again, the bias against equipment for a very broad class of assets; lowers the cost of capital for the entire producing sector of this economy. And I would hope that it would be acted favorably.

The Chairman. Further discussion? Senator Mitchell had his hand up first and then Senator Bentsen.

Senator Mitchell. No, you, Senator Bentsen.

The Chairman. All right, Senator Bentsen.

Senator Bentsen. I would rather try to rebut what you say on it.

(Laughter)

Senator Bentsen. Rather than you having a shot at me.

Senator Mitchell. Whatever you say, Mr. Chairman.

(Laughter)

The Chairman. Go ahead, George.

(Laughter)

Senator Mitchell. I would like to ask, Mr. Chairman, if someone, a member of the staff, at the Treasury would explain if this has not already occurred -- and if it has, I apologize because we were all out for a vote -- the document entited "Five-Year Depreciation Revenue Estimates," which has just been distributed. And I assume that -- well, I guess rather than stating an assumption, if it has not been explained, would it be possible to have that done?

The Chairman. Mr. Darman, can you explain that?

Mr. Darman. Senator Mitchell, I believe to some degree it has been explained already before you arrived. But I suppose -- might you have a particular question or would you like me to go over the whole chart?

Senator Mitchell. Well, the top heading says "Five-Year Depreciation Revenue Estimates." Does that five years cover the entire document or is that only the first two figures half way down the page? And does the second category relate to a different period of time?

Mr. Darman. There are basically two charts. The heading of one is "Five-Year Depreciation Revenue Estimate Exclusive of ITC." Those are the two numbers that you see there -- 35.3 and 30.8, under two different assumptions.

Senator Mitchell. And revenues would increase relative to current law over that period?

Mr. Darman. Right. But as I suggested before you arrived, Senator -- and I recognize this may be on your mind -- this does not include treatment of the expensing provision. And, of course, it does not include the ITC, and it does not include all other provisions of the law. It is addressed exclusively to the depreciation system.

Senator Mitchell. Right.

Mr. Darman. And then the second table, in effect, is headed "Fully Phased In Depreciation Revenue Estimates." That is not on a five-year basis. That is on an annual basis, because a number of people have been asking: Well, what is the long-term revenue loss associated with these? Could we please produce numbers with respect to those?

And the way in which we have done that is we have calculated what would be the annual revenue loss associated with these and other provisions assuming that the entire package were fully phased in.

Senator Mitchell. Is there any reason why that was not done on a five-year basis as all other estimates have been done?

Mr. Darman. It is done both ways. It is done on a five-year basis, which is the first table --

Senator Mitchell. No, I meant for the second five-year phase.

Mr. Darman. Oh. Well, the conventional way of estimating fully phased in has not been to go beyond five years and do the sixth year, seventh year, eighth year and ninth year and tenth year because those years -- the particular numbers for those years will vary a lot depending on particular economic assumptions for those years and other variables.

The conventional way of estimating has been, at least at Treasury, has been to say let us take some numbers we know that we have confidence in. The 1986 levels of activity in 1986 economic assumptions. Let us assume that whatever the proposal is had been in effect forever up to this date, and say what then would be the annual revenue loss in 1986 dollars, the year you are in dollars, associated with the proposal if it had been fully phased in forever.

That has been the way of calculating it. And it is, I think, a more accurate indicator of what the steady state effect to the proposal would be than picking any particular year in the future.

Senator Mitchell. You just said that the assumptions as to economic -- you didn't use the word "performance." I think you said "growth." That it would affect the estimate, as is obvious.

I notice that the first footnote is that this assumes four percent real growth. So I gather that what this is based upon is an assumption of four percent real growth indefinitely over a long period of time in each year.

Mr. Darman. That is correct. But if I could add one point here.

In comparing with current law, we have used the same economic assumptions for current law and for any proposal. Now if you change the growth rate, you will have a different effect. But the way we have approached that is always to change it simultaneously for current law and for whatever is being compared with current law to try to control for that uncertainty to some degree.

Senator Mitchell. I understand that. But, of course, you could produce substantial effects with respect to revenue estimates under either alternative, current law or any proposal, by varying the assumption as to real growth.

Mr. Darman. That is right.

Senator Mitchell. And my next question is: To what extent are these estimates influenced by that assumption? And may I perhaps be more specific: If you assumed a two percent real growth, would these figures, particularly this portion of the document entitled "Fully Phased in Depreciation Revenue Estimates" be dramatically altered?

Mr. Darman. These are growth -- I should clarify. Where it says, the footnote: "Assumes four percent real growth." This is four percent real growth in investment. That is a substantially more conservative assumption of growth and investment than the Administration's own assumption.

If we were to use the Administration's higher growth assumption, these numbers would be more favorable.

Senator Mitchell. I see. So that is not real growth in the economy?

Mr. Darman. No. It is real growth in investment.

Senator Mitchell. All right. Mr. Darman, could I -- this may have been asked. Again, I apologize to the members of the Committee if this is repetitious in any way. But I have not heard a response to this question: Does the Administration support this amendment and urge us to vote for it?

Mr. Darman. The short answer would be yes.

Senator Mitchell. Thank you.

Mr. Darman. It merits a longer answer, but I might spare you that.

(Laughter)

Mr. Darman. We have had a certain amount of discussion about the question of productivity property. The other elements we have no problem with whatsoever in the proposal. And we particularly think the indexing portion is important.

The productivity property category involves an issue of principle that relates to deviation from neutrality and having the market do the allocating. And as I suggested before you arrived, Senator, our original position and in a non-political pure world our continuing position would be that we would favor having the market do the allocating purely.

As a matter of practical political reality, we do not think that the Congress or this Committee is going to leave it entirely to the market. There is no evidence to suggest that that is what is going to happen.

So if one is not going to leave it entirely to the market, it seems to us desirable that there be some principles for making discriminations in favor of acceleration. And this Committee has, in effect, suggested that it is interested in a principle that would improve U.S. competitiveness.

It is from that that I understand they have derived the notion of productivity property as a category. And we have said we can accept that principle.

The particular discrimination that has been made in favor of one set of assets or another as to what should be in that category or not, we have not participated in. By and large, we think it is a defensible distribution, but we would have some reservations about particular elements. That is the nature of my footnote.

Senator Mitchell. And would I be unfair to interpret your footnote as saying, well, okay, and we will fix it in conference?

Mr. Darman. Yes, I think that would be unfair.

Senator Mitchell. Then I won't say that.

Thank you, Mr. Chairman.

The Chairman. Further discussion before we vote?

Senator Bentsen. Yes.

The Chairman. Senator Bentsen.

Senator Bentsen. Mr. Chairman, what you have here is, as Secretary Darman is talking about and certainly Senator Mitchell is pointing to, a philosophical different approach, and whether or not the tax system should be used to try to achieve certain economic objectives or not.

And I am motivated a great deal by the fact that we have this $148 billion trade deficit. And I know that we are becoming the principal debtor of the world. And for the balance of this decade and certainly into the 1990's, we are going to finally have to sell more than we import. And I certainly agree with Senator Bradley that the exchange rate is going to be one of the very major causes of whether or not we win or lose in that fight.

And there are quite a number of other factors involved. But one of them is the cost of capital. That is one of the facets of the problem. And it certainly is a controversial matter when you start picking and choosing among assets and deciding if you are going to favor one over the other.

And you do that when you talk about a 200 percent declining balance on depreciation for a particular class that you label as productivity property.

I do think it is helpful in that kind of competition on trade. My good friend from Maine made a point yesterday that a single asset would receive different treatment depending on how it was used. If it was used in manufacturing, it would receive more favorable treatment than if it was used in the service industry.

But what was not pointed out is that same disparity exists right now on a category of property that is labeled "Other Tangible Property."

Now other tangible property is property that is not personal property, nor is it buildings. It would include, for example, a special platform that was built for manufacturing. Under current law, if such a platform is used in manufacturing, production, extraction, or in the furnishing of transportation, communications, electrical energy, gas, all of that, it qualifies for an investment tax credit. But if it is used in the typical service business, then it does not qualify.

There are numerous types of property in the other tangible property classification. An example of that is the roads, bridges, docks, railroad tracks, blast furnaces, pipelines, broadcasting towers for all of these types of property under the current law. The availability of the investment tax credit depends on what type of business the property is used in.

The point is that the current law already makes distinctions not only between types of properties but between the uses of the property.

So we are not talking about a radical change. We are talking, once again, about trying to encourage the productivity in the country to make it more competitive.

It merely means that the line that currently exists between investments and different types of property would be drawn a little more sharply. For example, under current law a dock that was installed by a manufacturer would qualify for the ITC; whereas, a dock that was built for a marina would not qualify.

So this is what we are addressing. It is not a perfect proposal, certainly. And I am sure it will probably be massaged and changed some. But I do think it has a lot to commend it, and I support that proposal.

Senator Chafee. Mr. Chairman.

The Chairman. Just a second.

Senator Bradley was next, and then Senator Danforth, Senator Chafee and Senator Heinz and Senator Baucus.

Senator Bradley. Mr. Chairman, I would like just to ask Treasury on this piece of paper that we received, 1987-1991 revenue change relative to current law. Are you saying that under the Chairman's proposal that the Chairman's proposal would raise an additional $35 billion, and that the Roth proposal would raise an additional $30 billion?

Mr. Darman. No. No, Senator. I am sorry. If I could clarify.

Senator Bradley. Yes.

Mr. Darman. The second alternative there is not the Roth proposal. This piece of paper was intended to respond to Senator Danforth's rather narrow question on indexing, the effects of indexing.

And the first proposal is the Chairman's package. The second one is not the Roth package. It is the Chairman's package modified in the way that the Roth approach modifies indexing. But that is all.

Senator Bradley. All right.

The number that I am looking for is how much more does the Roth proposal cost over the Chairman's proposal.

Do I ask Joint Tax?

Mr. Darman. That is right. You would need an entirely different sheet.

Mr. Brockway. If you are talking about the pending Roth proposal as compared to the Chairman's, it is $14.8 billion over the period, over the five years.

Senator Bradley. Fourteen point eight billion dollars more expensive.

Mr. Brockway. That is correct.

Senator Bradley. Well, I think that that is a number that we should know. We are now spending $14.8 billion more on this depreciation, productivity property, whatever you want to call it, than we were prior to the adoption of this minute. That would put the whole effort of tax reform $14.8 billion further behind the eight ball. We would have to raise $14.8 billion more.

Now let me, if I could -- yesterday, I also asked

Treasury or Joint Tax so that we could make an informed judgment on the exact point that Senator Bentsen raised which is the cost of capital. Could you tell me, if you have gotten the numbers, what is the cost of capital on the assets in the productivity property class under current law, under the Roth-Packwood proposal and in the circumstance in which there was no corporate tax on these assets at all?

Mr. Brockway. On the productivity property under the Roth amendment, under present law, the cost of capital would be five point four.

Under Senator Roth's proposal, it would be six point two.

If you had no federal corporate tax, it would be five point five. In other words, slightly higher than present law.

Senator Bradley. Five point five. So current law essentially is negative?

Mr. Brockway. Very slightly, yes. That is correct. By the estimating assumptions used. That is a combination of the investment credit and depreciation.

Senator Bradley. As I read this -- and I would like to address this question, I guess, to Senator Roth as the sponsor of the amendment and taking as his explanation of the amendment to try to improve our competitiveness -- that you have listed a number of assets that are included in the productivity property class and then you have II, "Property included in productivity property class if used in productive property activity classes." And as I read this, you have general purpose trucks are not included in the productivity property class unless they are engaged in transportation of an approved activity in the first Roman numeral of the productivity property class.

Now what that means, as I read this, is if I have a truck and I use it to transport jewelry or baseball gloves, I can put that truck in productivity property class. But if I have that truck to transport textbooks, I can't.

And since education is a major component of any effort to be competitive, I would like to know what is the rationale for favoring baseball gloves over textbooks.

Senator Moynihan. What if it was a textbook about how to play baseball?

(Laughter)

Senator Bradley. Unfortunately, they wouldn't know how to properly use the gloves that they were being subsidized to purchase.

Senator Moynihan. You underestimate the capacity of our bloated bureaucracy to make decisions?

Senator Bradley. Yes.

(Laughter)

The Chairman. Further discussion?

Senator Bradley. Well, I would like to have the answer to the question.

(Laughter)

Senator Roth. Are you through?

Senator Bradley. No, I am not through. I would like to have the answer to the question.

Mr. Brockway. Senator Bradley, in your example, the use of a truck would depend on whether the user was in one of the categories listed as a productivity property class.

Senator Bradley. Right. It says: "Manufacturer of athletic, jewelry and other goods."

Mr. Brockway. Correct. But also item Asset Guideline Class 27 under the ADR regs includes printing, publishing and allied industries. So a printer or a publisher who had a truck would be treated -- that truck would be treated as productivity property the same way as a manufacturer of jewelry if he had a truck and used it in that business would be productivity property.

If you had a taxpayer who was a, for example, utility or trade or distributive service, that that taxpayer would not be productivity property. It would --

Senator Heinz. Senator Bradley, would you yield for a clarifying question?

Senator Bradley. Sure.

Senator Heinz. What you are saying then, Dave, is that textbooks and baseball gloves and jewelry would be considered productivity property and the truck used to transport them would get the benefit. But if the truck was used to transport hamburger buns to a fast-food outlet from the warehouse, it wouldn't.

Mr. Brockway. If it were the MacDonald's or whatever, their truck, you are correct. That is correct.

Senator Heinz. That sounds like pretty good policy to me.

The Chairman. Fellows, let us be serious. There is no perfect world. If we didn't have anything written in the law and you had each business trying to say what the useful life of each of its assets were, you are going to have arguments. You are going to have arguments when some people say this car is three years and somebody else says it is five years, and you can hassle the IRS, and they finally try to set up uniform regulations which you can then go to court and argue about.

Whether or not we have a -- I know what this compromise is. And I know how hard the principal sponsors on both sides worked to put it together. Is it perfect? No. Was the bill as I drafted it perfect? No. Was Treasury 1 perfect on depreciation? No. These same kind of questions could be raised against any kind of depreciation schedule. At some stage, you have got to have some trust in the administration of the law, and there will be mistakes made in the administration of the law.

But if you are going to wait until you have a perfect world and until you can write a perfect bill, we will write no bills, period, of any kind on depreciation or any other subject.

Senator Danforth.

Senator Danforth. Mr. Chairman, is it appropriate to offer an amendment which would go to either the Roth proposal or the Chairman's proposal?

The Chairman. It is in order.

Senator Danforth. Now, Mr. Chairman, I am going to offer two alternatives with respect to indexing of depreciation. One is to delete indexing of depreciation, and the other is to cap indexing for depreciation at four percent so it will be zero to four instead of either zero to eight or two to eight.

But let me ask this question: Mr. Darman, I have looked at the sheet that you handed out. On the face of the sheet it isn't clear what the cost of indexing for depreciation is. But it looks to me as though it works out to about one and three-quarter billion, roughly, per percent of inflation. I mean that is the -- if you had no indexing versus having indexing, depending on the rate of inflation, it would be in the neighborhood of about one and three-quarter billion, somewhere around there, maybe $2 billion per percentage point.

Mr. Brockway. Yes, that is roughly right.

Senator Danforth. Is it about two? Was that ball park two percent?

Mr. Brockway. I would rather you use one and three-quarter. I liked your first estimate.

Senator Danforth. Is it accurate? I mean I know you like it better, but is it accurate?

Mr. Brockway. The problem is it is not a linear relationship. You would get a different number if you were going from eight to seven than if you were going from five to four, say. But in the range you are talking about, one and three-quarters is the right number.

Senator Danforth. Would it go up or down as the percentage of inflation changes?

Mr. Brockway. We feel you can use one and three-quarters.

Senator Danforth. Straight line, so to speak?

Mr. Brockawy. Yes.

Senator Danforth. All right.

And as time goes on, would it change a little bit?

Mr. Brockway. No.

Senator Danforth. No. I mean for eternity, it would be about 1-3/4 billion per percentage point?

Mr. Brockway. Well --

Senator Danforth. Ten years from now?

Mr. Brockway. That is right. As the whole economy grows, that number is going to grow, but so is the entire revenue base. And as the percentage of the revenue base, it would not change. But the number would grow.

Senator Danforth. I am asking you about the number.

Mr. Brockway. Yes, the number would grow, but so would the whole revenue base.

Senator Danforth. Well, that is nice. I mean that is a supply-side concept.

Mr. Brockway. No, sir. No, sir. If I could respectfully disagree. There is not one trace of supply-side presumption in that comment. It is making an assumption about whatever rate of growth you want to have in the economy, but not any additional growth, thanks to the tax proposal.

Senator Danforth. All right. Well, I am thinking more in terms of inflation growth rather than GNP growth.

But in any event, just for working purposes, the cost is about 1-3/4 billion per percentage point of inflation per year. So, therefore, if we assume a four percent inflation rate, the cost per year of indexing, if we are going to index the basis, the cost per year is about $7 billion, correct?

Mr. Brockway. That is correct.

Senator Danforth. And if our estimate is to -- the cost per year is correct, that means over the five-year period that we are talking about the cost is -- well, it would be less than in the first years, obviously. But over a five-year period it is around $35 billion per year, right, assuming four percent inflation?

Mr. Brockway. Per year?

Senator Danforth. Over a five-year period.

Mr. Brockway. That is right.

Senator Danforth. All right.

And, similarly, if we have an eight percent inflation rate and the indexing is zero to eight, if we have an eight percent inflation rate, then the cost of the program is in the neighborhood of $14 billion each year that it is at eight percent?

Mr. Brockway. That is right.

Senator Danforth. Right.

Mr. Brockway. You're just --

Senator Danforth. Yes. I mean you put down eight percent, assuming hypothetical eight percent inflation, and I am saying if that is correct, you are talking about a cost to the Treasury not just for five years but out into the future of, if it is eight percent inflation, $14 billion a year. If it is four percent inflation, $7 billion a year.

Mr. Brockway. That is right. Relative to what a non-indexed system would produce under the same set of assumptions.

Senator Danforth. Yes.

Mr. Brockway. But it is not a revenue loss relative to the prior year necessarily because with inflation --

Senator Danforth. I understand. I am talking the cost of this indexing scheme. We are talking about if indexing is eight percent, we are looking at $14 billion a year revenue loss.

Mr. Brockway. Senator, you might consider this a semantic quibble, but the same point could be stated instead of a revenue loss as a revenue gain that would have taken place in a non-indexed system which is foregone in the amount you described.

Senator Danforth. Well, all right. But difference in revenue to the Treasury.

Now, Mr. Chairman, I will just make one assertion. I think and I guess that business people making decisions on the purchase of equipment are going to make it on the basis of what they are going to get in the first few years in depreciation probably, and that they are less likely to make the decision on the basis of whether or not the basis is indexed.

I will offer two amendments, assuming I lose on the first.

Maybe I won't lose on the first. The first is to delete for the purposes of both proposals, both the Packwood and the Roth proposal, delete indexing a basis. And if I lose on that, I will offer another one, which would be to cap it at four percent.

Mr. Darman has made an excellent point about the worth of capping. And I say if we are going to have a cap, let us cap it at what we assume inflation is going to be. We assume for all of the purposes of predicting the revenue effects of this bill that inflation was going to be at four percent, but let us assume it for the purpose of this if we have indexing at all.

The Chairman. Motion to eliminate indexing.

Senator Long.

Senator Long. I would just like to say one thing. Mr. Chairman, I am going to support that motion because looking at all the billions of dollars involved, if this were really a good idea to index this thing to inflation, I would have thought -- if it was a great idea, I would have thought I would have hordes of business people come to me and ask me to vote for that indexing. And I just haven't had it. Hardly anybody has asked me to do anything about indexing to inflation.

I think part of that is because, A, they have all got their orders in that those of them that have a lot of major equipment to buy, and they have it where we are going to protect them for the investment tax credit for some time to come; they have got a fast tax write off under the ACRS, and what remains will get a pretty fast tax write off.

In addition to that, as sure as I am talking to you just if experience is anything to go by, the minute we hit a little economic slump somebody is going to come in and say, well, we have got to restore the investment tax credit; we have done it twice already.

And so I just have not seen the kind of support for the indexing it ought to have if it is as good as some people think it is. I am going to vote for the Senator's motion.

The Chairman. Senator Armstrong.

Senator Armstrong. Mr. Chairman, I think there is much merit in what Senator Danforth has said, but I am a little troubled by the sequence in which we are taking these issues.

I personally believe a far better proposal is the proposition which I think Malcolm Wallop will offer to go to 200 percent declining balance for everything. And were that to pass, then I would personally be glad to kick the indexing provision in the creek because exactly what Senator Danforth says, I think, is true. That the business people will look at their early year recovery in making capital outlay decisions. So as a matter of encouraging investment, I think that is the right combination.

It also seems pretty clear to me that it would be cheaper from a revenue standpoint to go to 200 percent declining balance for everything and do away with indexing than to go to 150 percent and leave indexing in.

So I guess I am speaking in encouragement of somebody to get 200 percent declining balance on the table and to consider that issue first. If I am the only one whose vote on the indexing issue would be predicated on that or if there are plenty of votes on one side or another of the issue then it doesn't make any difference. But I think those two are closely related.

The Chairman. Questions on the indexing?

Senator Bradley. Mr. Chairman, how much revenue does the Danforth amendment save?

(CONTINUED ON NEXT PAGE)

Mr. Brockway. The amendment to eliminate indexing entirely would raise $7 billion. In other words, the Roth proposal would have lost $14.8 compared to the chairman's mark.

This would mean, if it were adopted, the Roth proposal would lose $7.8.

Senator Danforth. Seven per year?

Mr. Brockway. Now, Senator Danforth, that is over the five-year period. The numbers that you were discussing with Secretary Darman were the long-run estimates they were using, using current dollars. They are simply not comparable.

Senator Danforth. All right. What I am saying is when you look down the road when the effects of indexing are fully phased in, if it is four percent inflation, it is roughly $7 billion a year; and if it is eight percent inflation, it is roughly $14 billion per year that we would be saving.

The Chairman. Questions on the amendment of the Senator from Missouri? Those in favor will say "aye." The clerk will call the roll.

The Clerk. Mr. Dole?

Senator Dole. Aye.

The Clerk. Mr. Roth?

Senator Roth. Aye.

The Clerk. Mr. Danforth?

Senator Danforth. Aye.

The Clerk. Mr. Chafee?

Senator Chafee. Aye.

The Clerk. Mr. Heinz?

Senator Heinz. Aye.

The Clerk. Mr. Wallop?

Senator Wallop. No.

The Clerk. Mr. Durenberger?

Senator Durenberger. Aye.

The Clerk. Mr. Armstrong?

Senator Armstrong. (No response)

The Clerk. Mr. Symms?

Senator Symms. No.

The Clerk. Mr. Grassley?

Senator Grassley. No.

The Clerk. Mr. Long?

Senator Long. Aye.

The Clerk. Mr. Bentsen?

Senator Bentsen. Aye.

The Clerk. Mr. Matsunaga?

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan?

Senator Moynihan. Aye.

The Clerk. Mr. Baucus?

Senator Baucus. No.

The Clerk. Mr. Boren?

Senator Boren. No.

The Clerk. Mr. Bradley?

Senator Bradley. Aye.

The Clerk. Mr. Mitchell?

Senator Mitchell. Aye.

The Clerk. Mr. Mitchell?

Senator Mitchell. Aye.

The Clerk. Mr. Pryor?

Senator Pryor. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

Senator Armstrong. Mr. Chairman, I vote No.

The Chairman. Senator Armstrong votes no.

The Clerk. Thirteen yeas, seven nays.

The Chairman. The amendment is adopted, and indexing is out of both the Roth-Baucus proposal and the chairman's proposal.

You applied it to both, didn't you, Jack?

Senator Danforth. Yes.

The Chairman. That also applies to my proposal.

Senator Danforth. Yes.

The Chairman. Indexing is out. Senator Dole?

Senator Dole. Mr. Chairman, I wonder if based on the action taken on the Danforth amendment, as I understand, the limitation on rental cars was imposed and returned for indexing basis without a two percent floor.

And I am wondering now if there is any reason for the distinction between rental cars and other cars such as a fleet of company cars, and how much it would cost to remove the limitation? Dave, do you have anything on that?

Mr. Brockway. I will have that in a second, Senator. I think that part of the rationale was that rental cars are heavy use vehicles. That is why they had a three-year straight line rather than five years, 200 percent declining balance.

The Chairman. Excuse me. I didn't hear the answer.

Senator Roth. I would be willing to go along with the suggestion of Senator Dole.

Senator Moynihan. Are they a productivity property? Rental cars?

Senator Roth. Yes.

Mr. Brockway. It would depend upon how the property was used: what taxpayer used the property, what activity.

Senator Symms. Could I ask a question? How is the interpretation of an automobile that a person uses to conduct his business, say a salesman, and drives it, say, 40,000 miles a year? I don't see how we can fairly put that in a five-year classification. How would that be interpreted?

Mr. Brockway. A car that the salesman used would be five years under the proposal. It would be five years, 150 percent declining balance under the proposal.

If you switched autos to five years, 200 percent--excuse me--to three years straight line, that would be roughly $2 billion.

The Chairman. $2 billion more?

Mr. Brockway. $2 billion --

The Chairman. Over the three years for rental cars and light trucks?

Mr. Brockway. Correct. In other words, treating all autos the same way as rental autos and light trucks.

The Chairman. Are you making that as a motion?

Senator Dole. Yes.

The Chairman. Discussion on the motion?

Senator Symms. Now, is the motion, Mr. Chairman, so that all business-owned and used automobiles and light trucks will be going to three years?

The Chairman. That is the motion.

Senator Symms. I could support that.

The Chairman. Discussion? Senator Heinz?

Senator Heinz. Just a parliamentary question. Is this to the Roth proposal?

The Chairman. It is to the Roth proposal.

Senator Heinz. Thank you.

The Chairman. Which I assume at some stage we are going to vote on in its totality, one way or the other.

Further discussion?

Senator Matsunaga. Does that mean, Mr. Chairman, that you will go back to the present law, taking the Roth amendment to the present law?

The Chairman. That is correct. All those in favor of the amendment --

Senator Long. That is not quite it. You are talking about three years straight line, aren't you?

Mr. Brockway. That is correct.

Senator Long. Right now, they are getting three years with 150 percent declining balance, don't they?

Mr. Brockway. That is correct.

Senator Heinz. And what is the revenue cost of this proposal?

Mr. Brockway. Senator Dole's amendment would be approximately $2 billion.

Senator Matsunaga. $2 billion?

Mr. Brockway. That is correct. Over the five-year period.

Senator Bradley. So, in the previous amendment, we gained $7 billion over five years, and now we are giving $2 to $3 of that back with this amendment. Is that correct?

Mr. Brockway. That is correct. Right now, Senator Roth's proposal would lose, from the chairman's proposal, roughly $7.8 billion. This would take it up to $9.8 billion, or $10.

Senator Bradley. $10?

Mr. Brockway. $10.

The Chairman. You have heard the motion. All those in favor of the motion will say "aye."

(Chorus of ayes)

The Chairman. Opposed, no?

(Chorus of noes)

The Chairman. Let's call the roll.

The Clerk. Mr. Dole?

Senator Dole. Aye.

The Clerk. Mr. Roth?

Senator Roth. Aye.

The Clerk. Mr. Danforth?

Senator Danforth. Aye.

The Clerk. Mr. Chafee?

Senator Chafee. No.

The Clerk. Mr. Heinz?

Senator Heinz. Aye.

The Clerk. Mr. Wallop?

Senator Wallop. Aye.

The Clerk. Mr. Durenberger?

Senator Durenberger. Aye.

The Clerk. Mr. Armstrong?

Senator Durenberger. Aye.

The Clerk. Mr. Symms?

Senator Symms. Aye.

The Clerk. Mr. Grassley?

Senator Grassley. Aye.

The Clerk. Mr. Long?

Senator Long. Aye.

The Clerk. Mr. Bentsen?

Senator Bentsen. (No response)

The Clerk. Mr. Matsunaga?

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan?

Senator Moynihan. No.

The Clerk. Mr. Baucus?

Senator Baucus. No.

The Clerk. Mr. Boren?

Senator Boren. Aye.

The Clerk. Mr. Bradley?

Senator Bradley. No.

The Clerk. Mr. Mitchell?

Senator Mitchell. No.

The Clerk. Mr. Pryor?

Senator Pryor. (No response)

The Clerk. Mr. Chairman?

The Chairman. Aye.

The Clerk. Fifteen yeas, five nays.

The Chairman. While I have everybody here, let me announce again the schedule for the benefit of the members.

As I have indicated, we will have no votes on Friday afternoons or Monday mornings, but we will use those times under normal circumstances to continue discussion on the bill.

Tomorrow, however, we are on to the Canadian-American Free Trade hearing in the morning. There is no afternoon hearing.

On Monday afternoon, we had initially scheduled a discussion on bonds and then we would reserve another morning for bonds. This is not, however, the issue of the minimum tax and municipal bonds.

We will get to that on the minimum tax debate.

But I think we may be near an agreement on bonds, and I don't think we will need both Monday afternoon and I think it was Wednesday morning, but I wouldn't swear to when we had that other discussion on bonds. When was it, John? Wednesday or Thursday? Never mind; don't worry about it.

We had two times set aside for discussion. I don't think we will need both. So, Monday afternoon, I would like to use for further votes, if we have not finished on depreciation or on accounting or on employee benefits.

And I would ask again for all of the members that have amendments to have them in. You have been very good so far about turning them in, and I appreciate it very much. Senator Pryor?

Senator Pryor. Mr. Chairman, at the hearing tomorrow on the Canadian-American Free Trade Agrement, at that session will we be faced with a proposition of either approving or disapproving? We won't be faced with that question?

The Chairman. Not tomorrow, but what I may be inclined to do if there is enough-- And I have to confess that a fair number of members have spoken to me about wanting to vote "no." They don't want to give the President the authority to go ahead.

Understand the implications. I mean, the President can negotiate anything he wants. However, if he submits to us the proposition that he wants to negotiate and we turn it down and he then negotiates a treaty, he does not get the fast-track method.

And I have had a fair number of people on this committee to say they would like to say "no." They don't want to get themselves into a bind on fast track and let the President go ahead and we will then consider it.

So, we will not vote tomorrow; but I think there will be enough members on this committee that want to register a vote at some stage that, before the deadline, on one of these hearings or one of these mark-ups that we are having, I will give you notice and we will have that issue for a vote.

Senator Chafee? Excuse me. Senator Chafee and then Senator Moynihan.

Senator Chafee. All right. What I would like is the figures-- The next vote will be on the Roth proposal, will it not?

The Chairman. There may be some more amendments, but the Roth proposal is before us.

Senator Chafee. All right. What I would like from Mr. Brockway here is what is the cost of the Roth amendment with the revisions that have taken place for Senator Danforth's proposal? That is, over present law--changes from present law. What is it going to cost?

Senator Bradley. Do you mean present law or the Packwood proposal?

Senator Chafee. My next question is: What is the cost of the Packwood proposal over present law.

In other words, up or down, what is it costing us?

Mr. Brockway. Senator Packwood's proosal is minus $4.3 compared to present law --

Senator Chafee. With the changes now?

Mr. Brockway. With the changes, it would be roughly an additional $10 billion; so, it would be $14.3.

Senator Chafee. That is the Roth?

Mr. Brockway. The Senator Roth proposal, as amended, is now, as compared to the chairman's proposal, an additional revenue loss of roughly $10 billion, over the five-year period.

Senator Chafee. $10 billion over five years?

Mr. Chairman, it seems that now is the time to address the Roth proposal, as we have been. It seems to me that if we adopt the Roth proposal with $10 billion over your proposal, which was revenue neutral, that means there is just $10 billion more we have got to struggle to pick up somewhere.

If we are going to have tax reform, if we are going to have lower rates, the objective of the exercise as I see it is to get lower rates. And this puts the chances of receiving lower rates further out of sight.

And I think every time we pass these substantial measures, and by substantial I consider $10 billion loss of revenue or increased money we have got to make up somewhere, a blow to the chances of having successful passage of this measure in a revenue neutral fashion.

And I consider that a severe detriment to the Roth proposal. It has got some attractiveness in it unquestionably, but it all costs money; and so, for that reason, I would vote against it.

Senator Moynihan. Mr. Chairman?

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, Senator Chafee spoke about the cost of the proposal to adopt a new category of economic goods called productivity property. And the Joint Committee has given us a very good chart that shows the quite striking difference in the cost of capital for productivity property as against property generally.

In our bill, for example, the cost of capital goes from eight percent to 6.8, a very real division.

I would like to read a very brief statement on the theory and practice of State capitalism.

"State capitalism is a melding of the most prominent features of capitalism and socialism. Although economically ruinous, it has shown adaptive qualities that make it attractive to emerging or declining industrial economies.

"The principal feature of State capitalism is that the means of production remain in private ownership, but the State is the arbiter of which enterprises will prosper and which will not.

"Generally speaking, the State economic planners pick winners and losers in the economy. Then the politicians back the losers. The reason for this is that the losers are typically old, declining sectors where more workers and owners are found and therefore more political support.

"This is generally speaking economically counterproductive. On the other hand, it has occasionally improved a source of political stability to nations that have weak sectors and need to accumulate as much political influence on the periphery as possible.

"The concept of defining some form of manufacture as productivity property is an example of State capitalism. Such economies are continuously preoccupied with export drives and typically are seeking to sell abroad manufactures which have long since gone through the trade cycle in which, first the technology, then the actual production systems have moved abroad.

"These export drives rarely succeed, but they give the central government the appearance of enterprise and are a source of contributions at election time."

The Chairman. Who is the source?

Senator Moynihan. The export drives. They give to central government, of course.

The Chairman. Senator Wallop?

Voice: Who is the source?

Senator Moynihan. Oh, Daniel Patrick Moynihan, Honorary Fellow, London School of Economics --

(Laughter)

The Chairman. Did I what?

Senator Heinz. Did you lose my name on your list there?

The Chairman. No. I didn't have it on the list.

Senator Heinz. You had me after Senator Chafee the last time you read it.

The Chairman. I apolotize. Let me recognize Senator Wallop, and then I will recognize you next.

Senator Heinz. All right.

Senator Wallop. Mr. Chairman, I think it is time that we reminded ourselves what the objectives of tax reform were, and they were not solely lower rates.

That is a fixation that seems to come back in here, but one of the other things was simplicity, and one of the other legs of that stool was economic vitality.

And we are losing sight of that--the very reason the Senator from Texas spoke yesterday and the Senator from Delaware. That is, the cost of capital, with all respect to my learned and professorial friend from New York, that few people in universities were ever able to contribute much to the productive capacity of the nation.

They contribute a great deal to the intellectual capacity of it, but the point of fact is that capital in productive equipment does make a nation competitive.

I doubt seriously if productive capacity of equipment does contribute to campaign funds. I think that is an unfair interjection into what we are trying to accomplish here.

What we are trying to see is whether or not this nation can have a cost of capital that is competitive with those with whom we trade, not only abroad but domestically in our own markets.

We can build apartment houses or other things here, probably better than the Japanese can build apartment houses or other things like that here.

But we can't build a great deal of the rest of what this nation must have, both for its national defenses and for the employment of its people. Not all of us can hold hammers and saws. Not all of us can work on ends of computers.

Now, what I would ask the Treasury Department here is: What has just happened to the cost of capital by the adoption of the Danforth amendments on productive property?

Mr. Darman. Senator Wallop, as I suggested earlier, the most efficient--revenue efficient--way to reduce the cost of capital is to adopt the indexing provision. Having eliminated it, the Senate Finance Committee has raised the cost of capital on the Roth proposal probably to something in excess of seven percent on productivity property and overall something in excess of eight percent.

It has, of course, dones that for the chairman's proposal as well.

Senator Wallop. Well, I must say that my friends at-- Under present law, according to this sheet that is here, productive property, capital expenses, 5.4 percent, and overall 8.2 percent. It defies logic to understand how we have improved any of this nation's requirements for tax reform by adopting that amendment.

Now, what we have is something that is worse than the present law, worse than where we were before. And we are still a nation, I think and hope, that tries to compete abroad.

With that in mind, Mr. Chairman, I would like to offer that we go to the straight 200 percent declining balance without indexing on all property.

That will level the playing field. That will not distinguish between classes, but it certainly will do something about the productive capacity of this country and lower the cost of capital.

The Chairman. Is that a motion, Malcolm?

Senator Wallop. I want to hear from Treasury first.

Mr. Darman. Senator, do you want a revenue estimate?

I think Joint Tax has a revenue estimate of that, but our own is approximately --

Mr. Brockway. Senator Wallop, if you are discussing property in the five, ten, fifteen year class under present law, taking that to 200 percent, overall that would have been a $40 billion revenue loss; but Senator Roth's amendment would have net a $30 billion revenue loss compared to where we are right now. Actually, it is $27; excuse me.

Senator Wallop. That is the most mystical answer I have ever heard.

(Laughter)

Mr. Darman. The answer, I think, Senator, on their numbers is: If your amendment were to the Packwood proposal, it would cost $40 billion. If it were to the Roth proposal, it would cost $30. Is that right?

Mr. Brockway. Correct.

Mr. Darman. Our own estimate is slightly lower than that. Our own estimate is, respectively, $34 billion and $24 billion; but they are in the same range.

Mr. Brockway. Actually, Senator Wallop, I gave you a number that would have assumed $50,000 expensing or $40,000 expensing. It would be $37 billion as against the chairman's package, $27 billion against Senator Roth. So, I think that--

Senator Wallop. Yes. And I am contemplating, of course, keeping the real estate provision as something different than this. Is that what your estimate contemplates?

Mr. Brockway. Yes, that is correct.

Senator Wallop. Senator Bradley?

The Chairman. Are you making a motion yet?

Senator Wallop. I am trying to get to the point, but I think Senator Bradley has a question, Mr. Chairman.

Senator Bradley. Mr. Chairman, as I understand the revenue numbers and also the motivation for Senator from Wyoming's offering the amendment was the passage of Senator Danforth's elimination of indexing, which over five years costs $7 billion. He picks up $7 billion because he has eliminated indexing.

And you are now proposing an amendment that will lose a minimum of $27 billion. I would say that that goes a little bit beyond making up for Senator Danforth's pickup of $7 billion.

Senator Wallop. I have a mystical time with this concept of cost, anyway. Nothing is costing that you haven't yet got. We are still trying to achieve an overall package here.

What has happened is unacceptable, I think, and what is even more unacceptable is that, as you go down the line on this thing and play with it, that the old nemesis of the minimum tax re-enters in here; and you are going to put more and more people subject to it, which I think is counterproductive.

Senator Chafee. Could I ask a question? Would your proposal apply to real property?

Senator Wallop. No.

Senator Chafee. You exempted real property. And did you know that when you gave your figure here?

Senator Wallop. I have a hard time accepting the figures but we have, once again, no choice.

Senator Symms. Would you say again what the suggestion is or the proposal?

The Chairman. A 200 percent declining balance but not on real estate is what he is suggesting.

Senator Symms. On five years or on three years?

The Chairman. You are talking about all properties, aren't you, other than real estate?

Senator Symms. On a five-year, 200 percent declining --

Senator Wallop. Yes.

The Chairman. You are talking about properties on longer than five years also?

Senator Wallop. Yes, that is correct.

Mr. Brockway. Senator Wallop, just for clarification. The numbers I gave you were on the assumption that you did not split up the five-year class of property, retain present law ACRS categories?

Senator Wallop. That is true.

Mr. Brockway. Okay. So, there are two things going on in that proposal then. One is taking property under the Roth amendment would be treated as nonproductive property giving it 150 declining balance. You would give that 200 percent declining balance plus property under the Roth amendment where the ADR life was more than 15 years, which under the Roth amendment and the chairman's proposal is treated as 10-year property, you would treat that as five-year property as in the present law?

Senator Wallop. That is correct.

Mr. Brockway. And also, there are certain changes in utility property as well, and you would again retain present law under your amendment.

So, it was all those changes that aggregated the net $27 billion number.

Senator Wallop. Now, Mr. Chairman, I won't offer the amendment, but I would just tell you that we have now arrived at the point where tax reform, as made in the name of tax reform, we have waged an assault on the productivity of America; and that is a very curious thing to do with the great claims for creativity on the part of this committee.

I just don't think that that is what we were asked to do and what we set out to do. There were three legs on that stool. We have chopped off two of them in the name of trying to make it stand on one leg, lower rates. I think it is idiotic.

The Chairman. Senator Heinz?

Senator Heinz. Thank you, Mr. Chairman.

I want to ask a question regarding the Roth amendment, as modified by the Danforth amendment, versus current law as to what the increase in revenues is from what I will call changes in capital cost recovery.

Capital cost recovery would include the investment tax credit and changes in depreciation, ACRS being current law.

My question is: If we were to adopt the Roth amendment, as modified, how much revenue increase would there be compared to current law?

Mr. Brockway. Under the chairman's package, you have looked at all the provisions and this is on the list we handed out to the committee generally of changes including depreciation changes, expensing changes, changes to the investment tax credit.

Those provisions in the aggregate would have raised $143.9 billion over the five-year period.

With Senator Roth's amendment, then, that aggregate package would raise $133.9 billion.

Senator Heinz. So, in either event, we are increasing the tax burden on the business sector over the five-year period?

Mr. Brockway. Insofar as you are discussing the cost recovery --

Senator Heinz. Just in terms of capital cost recovery, to the tune of either $133.9 if we adopt Roth, $143.9 if we don't.

Mr. Darman. Senator, could I just interject: And assuming, as I know Dave Brockway would himself wish to add, assuming no corporate tax rate reduction.

Senator Heinz. I understand that; but we have been talking about how much does Roth add, how much does it subtract; and I just wanted to put that in that perspective.

Now, as I understand some of the concern about Senator Roth's amendment, some of the people who have spoken say that this distinction between productivity property and other property is an artificial one.

I would associate myself not only with Bill Roth's comments but with those of Senator Baucus that it is important and it is legitimate and it is, indeed, necessary to take into account the fact that productivity property, as it is defined here, is in fact property that is used to produce products that are almost the subject of foreign competition.

And there is no sense in putting our industries that are subject to that kind of competition at a disadvantage, vis-a-vis our tax code compared to somebody else's tax code.

Now, somebody said that these categories are kind of totally new and arbitrary. My understanding is that categories of this kind are indeed quite well known. They have been quite precisely defined in the ADR categories that we have been using for some 15 years.

Would you care to comment on that, Mr. Brockway?

Mr. Brockway. Essentially, the dividing line between productivity property and nonproductivity property is derived from a dividing line you have in present law for tangible property other than personal property, which if it is used in certain activities--manufacturing, extraction, production, and a variety of other activities--qualifies for investment credit, and it is treated as --

Senator Heinz. And current law really is based on the asset depreciation range that was in effect prior to that. Is that not so?

Mr. Brockway. Well, two things are going on. One is that you have current law, categories of assets, whether for example you fall in the three-year class, the five-year class or the ten-year class under present law, under ACRS, are in turn where you were categorized under ADR, which is a similar structure as under this proposal it would be.

In addition, under present law and under prior law, you had a differentiation between property-- Investment credit would be allowed for all tangible personal property, movable property; and then real property would also qualify for the investment credit under present law, depending upon whether it is in certain described activities: manufacturing, production, extraction, communications, etcetera.

It is from that second list where the basic dividing line between productivity and nonproductivity property was derived for this proposal. It was basically picking it up from present law.

Senator Heinz. So, the philosophical concept is not new. Its application is not new; and much of the classifications are quite similar and have been made going back, in some cases, as many as 15 years.

Mr. Brockway. Basically, they would have gone back to 1962. Yes, the classifications are somewhat different and for different purposes, but it is similar --

Senator Heinz. Now, it is my understanding that the Bradley-Gephardt bill uses the accelerated depreciation range in its distinctions.

Mr. Brockway. It would assign property to classes, as would this proposal and as would the House bill and as present law, depending on what their ADR category was.

Senator Heinz. So, Senator Bradley and Congressman Gephardt have made the same kinds of distinctions that we have been making since 1962 and upon which the productivity classes, broadly speaking, are based?

Mr. Brockway. I am somewhat hesitant to characterize it that way. They used ADR mid-point life, what ADR system is used in the property, how long it would be used, for deciding whether it was going to be in various classes of depreciation.

They did not have a split between property that was productivity property and not productivity property.

Now, the same process is used for drawing those lines.

Senator Heinz. Now, clearly, what Senator Roth is trying to do in his proposal is to keep as much of the revenue gain of $143.9 billion as he responsibly can, and he has only modified that revenue gain and knocked it down by $10 billion to $133.9, looking at just those items. Is that accurate?

Mr. Brockway. That is my understanding of his purpose.

Senator Heinz. Mr. Chairman, I obviously am arguing in favor of the Roth amendment. I wanted to put it into a perspective where we might understand that, while the categories that are used here are used perhaps more stringently than heretofore, they are not new either philosophically or in their application; and that the reason they are used is to be fiscally responsible and to try and keep tax reform alive.

There is no doubt in my mind that it certainly is possible to pile up so much straw on the back of the camel in the way of amendments that we can break the back of tax reform.

Senator Roth, I think, is trying to treat the camel in a humane way and keep tax reform alive.

My own view is that unless we adopt something like the Roth amendment or maybe even something better than it, we will kill tax reform because the capital formation provisions in the chairman's draft--at least while they are an improvement in some ways for small business--they are not as good, I think, as they need to be.

So, I hope the Roth amendment --

The Chairman. I would like, if we could, to put the Roth amendment to a vote.

Senator Bradley. Mr. Chairman?

The Chairman. Senator Bradley?

Senator Bradley. Let me just get one number correct because I think it was gone over rather quickly in the course of the questioning.

The Roth amendment versus current law is more generous or less generous than current law, or about the same?

Mr. Brockway. With respect to depreciation itself, it is more generous if we take into account all the things we list as depreciation on that table.

That includes the expensing provision. If you take into account all of the capital cost recovery provisions, including investment credit, it is less generous than present law.

Senator Bradley. But the point to be made is that the depreciation schedules and the benefits will accrue to the particular category of assets in the Roth amendment plus they would get a lower rate of tax?

Mr. Brockway. The numbers I gave about saying depreciation is more generous, as I say, includes the expensing provision in that package; but yes, in the aggregate for depreciation including expensing that the recovery would be more generous under the package.

In the aggregate, there would be a lower rate, but taxpayers would lose the investment credit; so that as to how their particular tax liabilities would go, they might go up or down.

Senator Bradley. Right.

The Chairman. Senator Moynihan?

Senator Moynihan. Mr. Chairman, I don't want to prolong and will not, but I would make the gentle point that none of us were in-- There are those of us on the committee that were not part of the discussions that led to the amendment before us, and so it came new to us yesterday about mid-day, and we are just trying to learn it.

I would like to ask first Secretary Darman and then Mr. Brockway; or perhaps it should be Mr. Brockway. It is about the Joint Committee on Taxation table you just handed out.

It says that if there were no corporate Federal tax, the corporate tax of productivity capital, the special class we are now creating, would be 5.5 percent.

Mr. Brockway. That is correct.

Senator Moynihan. With the present law, we have 5.4 percent; so in effect that is a negative rate.

Mr. Brockway. That is correct.

Senator Moynihan. You get the tax advantage in doing all of this; and yet, under the Roth amendment, it goes up from present law from 5.4 percent to 6.2. So, they are raising the cost of capital here, while at the same time we are giving away a lot of revenue.

Mr. Brockway. Senator Moynihan, I think that as a general matter, if you look at overall property of a taxpayer rather than the productivity property, you will have a different picture than present law.

But if you look just at equipment, the combination of investment credit and depreciation under present law is, under the discount rates we are assuming, more generous in expensing so that any proposal that involved the repeal of the investment credit is likely to have an increased cost of capital.

Senator Moynihan. I would just make the point to my colleagues that we think we have some great malaise in terms of the productivity property, but we are raising the capital cost above present law.

And in present law, you know, you are rewarded by the tax system for investment. So, I don't know how the tax system is holding us back.

And inevitably, we will remove that present incentive, will we not?

Senator Matsunaga. Mr. Chairman, I have one fast question of the offerer of the amendment.

While you do away with the investment tax credit, this has no bearing at all on the energy business tax credit?

Senator Roth. That is correct.

The Chairman. Clerk, call the roll on the Roth amendment.

The Clerk. Mr. Dole?

Senator Dole. (Aye by proxy)

The Clerk. Mr. Roth?

Senator Roth. Aye.

The Clerk. Mr. Danforth?

Senator Danforth. Aye.

The Clerk. Mr. Chafee?

Senator Chafee. (No response)

The Clerk. Mr. Heinz?

Senator Heinz. Aye.

The Clerk. Mr. Wallop?

Senator Wallop. No.

The Clerk. Mr. Durenberger?

Senator Durenberger. No.

The Clerk. Mr. Armstrong?

Senator Armstrong. (No response)

The Clerk. Mr. Symms?

Senator Symms. Aye.

The Clerk. Mr. Grassley?

Senator Grassley. Aye.

The Clerk. Mr. Long?

Senator Long. Aye.

The Clerk. Mr. Bentsen?

Senator Bentsen. (Aye by proxy)

The Clerk. Mr. Matsunaga?

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan?

Senator Moynihan. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Boren?

Senator Boren. Aye.

The Clerk. Mr. Bradley?

Senator Bradley. No.

The Clerk. Mr. Mitchell?

Senator Mitchell. No.

The Clerk. Mr. Pryor?

Senator Pryor. No.

The Clerk. Mr. Chairman?

The Chairman. Aye. And Mr. Armstrong "no" by proxy. Senator Chafee?

Senator Chafee. No.

The Chairman. Senator Chafee "no."

The Clerk. Twelve yeas, eight nays.

The Chairman. The amendment is adopted. Let's break and come down at 2:00 and see if we can finish depreciation this afternoon. Yes?

Senator Heinz. All right. Let me lay down an amendment for 2:00, if I may, which is that I have an amendment to reduce the depreciation life of residential real estate to a 25-year straight line depreciation.

The Chairman. Come back at 2:00.

(Whereupon, at 12:29 p.m., the meeting was recessed, to reconvene the same day, Thursday, April 10, 1986, at 2:00 p.m.)

AFTERNOON SESSION

(2:10 p.m.)

The Chairman. The committee will come to order.

Senator Chafee? Have you got any amendments, Senator?

Senator Chafee. Let's see.

The Chairman. We are still on depreciation. We are waiting for Senator Heinz to come, who is going to move a 25-year I think he said "residential life."

Senator Chafee. That is right.

The Chairman. And yesterday he had indicated he was going to do it, but he would have a method of paying for it; although, I am not sure.

Senator Chafee. Does Mr. Brockway have a figure on that?

Mr. Brockway. If you took Senator Heinz' proposal as he articulated it before he left, of simply taking residential property and giving it a 25-year life, that would lose .4 over the period, $400 million over the period.

The Chairman. Senator Mitchell?

Senator Mitchell. Thank you, Mr. Chairman.

Mr. Chairman, much of the discussion this morning revolved around the question of revenue estimates, the effect that the various proposals we were debating and subsequently voted on would have on revenues.

I would like to ask if we are maintaining any kind of a running total that can tell us at any given moment where we are from some base line, which I would assume would be your proposal.

The Chairman. I would just as soon start from the Chairman's draft, which hopefully is revenue neutral, but it is revenue neutral because of the limitation of the excise tax deductions. So we start there with $62 billion. I don't know how the members are going to finally come out, but just keep that in the back of your mind.

I would ask the staff as we go along on amendments if you want to indicate where we are from the Chairman's draft, just from time to time reminding us of the $62 billion but for the moment presume it is there and let us know how far off from the draft we are.

Senator Mitchell. Does anybody have any estimate of that now?

Mr. Brockway. Well, the Chairman's original package was revenue neutral within a couple of billion dollars. I think it was slightly up, raises a slight bit of revenue, but we are sort of refining the fine points. It was basically revenue neutral.

If you remember, this morning, we don't have a final estimate but it was roughly $10 billion, the Roth amendment as modified.

So the package would be down $10 billion at the moment.

Senator Mitchell. As the result of this morning's action. Are there any other actions which we have previously taken that would have produced a cumulative effect?

Mr. Brockway. Yesterday you had some very minor revenue items, less than $50 million, or I think one of them might have been $100 million. So, it is $10 billion down.

Senator Mitchell. So, now we are at about $10 billion down?

Mr. Brockway. That is correct.

Senator Mitchell. All right.

Mr. Chairman, before the noon break Senator Heinz laid down an amendment.

The Chairman. The 25-year residential.

Senator Mitchell. Yes.

As you know from our prior discussion, I had intended to offer that amendment, and as soon as he comes I would hope we could proceed on that.

The Chairman. Why don't you go ahead and talk on it. Just before you got in they estimated about a $400 million loss on it.

Senator Mitchell. That's right.

The Chairman. But why don't you talk, and we'll keep going as far as we can.

Senator Mitchell. All right. Well, I don't want to do anything to which Senator Heinz might object. I would be happy to do that, but I merely want to speak now in support of the amendment which he has previously indicated would be laid down.

I would like to make some comments on it, because I did say some rather strong words yesterday regarding our attempt to influence market decisions.

I think we are all agreed at least in principle that an objective ought to be to group assets on the basis of equivalent economic depreciation. That would provide for more uniform tax treatment of assets, so that market forces could then determine where investment funds flow.

For any given level of investment, the improved deficiency of investment flows should produce a higher level of output. That principle is, of course, applicable to real estate, and it is true that the economic depreciation of residential property is comparable to the economic depreciation of commercial property.

But if we place residential and commercial in the same asset class, with the same depreciation rate, factors in the market will tend to cause investment dollars to flow to commercial over residential real estate, until the market adjusts through higher residential rents.

The market would ultimately work, but in the interim it would produce higher rents, and of course people who have to pay them would pay for that.

Now, that is not and has not been our nation's policy.

For at least the last half-century it has been a policy of the Federal Government to encourage the availability of afforadable and decent housing.

I know, Mr. Chairman, you spoke very forcefully on this in another context earlier regarding another provision of this legislation.

And through direct spending programs and, indirectly, through the Tax Code, the government has given a high policy priority to housing.

This committee is concerned that the real estate industry has enjoyed tax benefits that sometime bear no relationship to economic depreciation. You, Mr. Chairman, have proposed that the value of those benefits be moderated somewhat in some areas.

I think all of us are concerned that in some cases investment dollars have been wasted in commercial real estate in recent years, as evidenced by the many office buildings that now stand vacant, and which were constructed for tax considerations as opposed to economic considerations.

A similar problem does not exist with regard to residential real estate. The amendment would deal with the problem in which most areas of the country in fact face a shortage of housing, not a surplus; and at very little cost it simply tries to maintain a differential between residential real estate and commercial real estate.

While I acknowledge that this does represent some effort to moderate pure market forces, I think it does so in a manner that is consistent both with national policy over the last half-century and with meeting what is an essential need in our society.

So, Mr. Chairman, I commend Senator Heinz for his amendment and urge the committee's support of it.

Senator Heinz. Mr. Chairman?

The Chairman. Senator Heinz?

Senator Heinz. Mr. Chairman, I want to thank Senator Mitchell for his support. I know he had an interest that I discovered in another amendment, and it might have been the Mitchell Amendment just as easily as it happens to be the Heinz Amendment.

But I just want to make the following observations on this amendment. The first is that, I suppose to the extent anybody argues against it, to argue against it because the revenue loss might be as much as $400 million over five years, I would remind our colleagues that in repealing indexing from these proposals we saved in excess of $7 billion. And indeed, even though the committee I think spent about $2 billion of it within 60 seconds thereafter on Senator Dole's motion on automobiles, that still leaves a balance of some $5 billion that in a sense we are ahead.

The Chairman. I understand we are already $10 billion behind. It is all relative, that we are not $15 billion behind.

Senator Chafee. Yes. We adopted the Roth Amendment, which consumed what the Dole Amendment didn't. So, we gobbled up that so-called "saving" pretty quickly.

Senator Heinz. Well, if you want to look at it that way, you are entitled to do so.

(Laughter)

Senator Chafee. You are the one who is looking at it that way.

Senator Heinz. Let's look, though, at what the amendment does before we all blindly rush in and say, you know, "We are unwilling to give a mild preference to residential rental real estate."

If there is general agreement among the membership of this committee, and I think there is, and I do share it, that it was bad policy to have 15 or subsequently 18 or 19 years on commercial and residential real estate, it seems to me that we need to recognize that we did, even under the various manifestations of what is called "current law," have a preference for residential rental real estate.

We did that, treating recapture differently. And the reason we did that was that we recognized that rental property serves the social purpose of providing housing for those who can't afford to purchase a home. And of the 30 million rental households in America, 55 percent of them have incomes under $15,000.

Now, there is a good reason, if we want to ensure that residential rental real estate is not at a disadvantage versus commercial real estate, to treat them differently.

Were we to treat them the same, someone might say, "Well, 30 years on both, why aren't they being treated equally? How is that disadvantaging rental residential real estate?" And the answer is: The structure of that industry disadvantages residential rental property in several ways:

Rental housing property involves much more intensive and costly management than commercial real estate. It is inhabited all day and all night long. Commercial real estate isn't. There is a much wider variation and variety in the tenants: the tenants are a lot less wealthy than the tenants of commercial real estate, on the whole.

And in housing, the nature of the tenants is such that they don't sign up for 15 and 20 year leases. Typically, rental residential real estate people, people are renting on an annual basis, sometimes on a monthly basis, and in relatively few cases on a multi-year basis, compared to commercial real estate where people are renting on very long-term leases, and indeed many commercial structures are actually pre-leased. You could never find a residential rental property that was pre-leased.

As a result, residential property cannot avoid the heavy start-up costs that commercial property is often able to get around because of the nature of the clients -- business firms tend to be better off than renters.

As a result, it is my firm conviction -- Senator Mitchell's and my firm conviction -- that residential rental property needs some degree of favorable treatment under the Tax Code if we want to have any of it; otherwise, there will be, in effect, a preference given to the construction of commercial real estate.

So I hope, Mr. Chairman, that we look at what that so-called "revenue loss" of $400 million will buy us.

But let me just ask this of staff: Taking into account the fact that we are moving from 18 or 19 years out to in this instance 25 years, versus current law, are we gaining revenue or losing revenue in this provision that I would promote?

Mr. Brockway. Well, I think, with the same qualification as this morning, if you look solely at depreciation, that changing from 19 years to 25 for residential would be a revenue raiser in the aggregate. Looking also at the rate cut, residential real estate may be better off than it is under present law with the combination of --

Senator Heinz. Is there any evidence to suggest that it would be better off than under present law? Looking at everything?

Mr. Brockway. If you are looking at everything, and fully equity-financed.

Senator Heinz. Looking at all of the changes that we are making, including the accounting changes.

Mr. Brockway. Well, if you look at the proposal, looking at cost of capital in the aggregate, just at structures, it would have been 9.2 under present law and 9.0 under the Chairman's proposal with 30 year straight line for both.

Now, these numbers, again, are just equity financed.

Senator Heinz. And is that both residential and commercial?

Mr. Brockway. That is residential and commercial. So even at 30 years it is slightly better, and at 25 years it would even be additionally better, if you look at it from that standpoint.

Senator Heinz. Does your calculation of the cost of capital under current law take into account the advantages that commercial real estate has under current law to deduct many construction period expenses?

Mr. Brockway. Those changes wouldn't be reflected in these numbers.

Senator Heinz. I think we ought to recognize, if you want to really look at this correctly, that there are very substantial advantages under current law for building commercial office buildings. That is why we have built so many of them.

We have not exactly gone on a building spree on residential rental property -- to the contrary. And the reason is that the cost of capital for building commercial property isn't anything like 9.2 percent; it is substantially lower than that average figure. And for residential rental property it is substantially higher.

So, thank you.

The Chairman. Senator Chafee?

Senator Chafee. Thank you, Mr. Chairman.

First of all, I would call attention to page 18 of the spreadsheets here, where in item D under 1, on the definition of low-income housing, I can only presume that the Chairman's proposal will have something forthcoming in connection with low-income housing. Is that correct?

Mr. Colvin. Those provisions are contained in the real estate title in the spreadsheets, Senator Chafee.

Senator Chafee. Say that again, please.

Mr. Colvin. The provisions affecting low-income housing are contained in the real estate title in the spreadsheets.

Senator Chafee. Oh, I see. In any event, they are there, some provisions which in effect make special provisions for low-income housing?

Mr. Colvin. Yes, sir.

Senator Chafee. To encourage the building of that.

Mr. Colvin. It is on page 180 in the spreadsheets.

Senator Chafee. Yes. So we have not neglected that area in our efforts here today, or the efforts under the Chairman's proposal.

Mr. Colvin. That is correct. That will come up when you turn to the real estate title.

Senator Chafee. All right.

Now, the second question is of the Treasury Department. Senator Heinz was indicating that there is a bias in favor of investment in commercial as opposed to residential real estate. Is that so? Is there a more rapid wear-out of residential real estate because it is used 24 hours a day? Is there any justification for that assertion?

Mr. Brockway. Senator Chafee, there is some information under the revenue procedures that applied before 1981, before you went to a fixed life for real estate, that did have different average useful lives for property, different types of real estate. And apartment buildings were somewhat less than other types of buildings, office buildings.

For example, under the revenue procedure that applied, apartment buildings would have had a 40-year useful life, and office buildings a 45-year useful life, a retail store, a 50-year useful life, a warehouse, 60 years.

Senator Chafee. I see.

Mr. Brockway. And that type of pattern also was reflected in the average useful lives claimed by taxpayers. Taxpayers were not required to use these useful lives and typically did not; they claimed a shorter life. But generally that type of pattern, where apartment buildings were depreciated on a somewhat faster rate than other types of real estate.

Mr. Mentz. Although Senator, to answer the question you asked of Treasury, we are not aware of any empirical data that suggests that commercial office buildings, for instance, would wear out faster than a commercial apartment house.

It is true that they are treated differently, have been treated differently in the past under ADR, but --

Senator Heinz. Is there any evidence the other way around?

Mr. Mentz. Not that I am aware of, Senator.

Senator Heinz. No evidence either way?

Mr. Mentz. That is right.

Senator Chafee. Let me ask another question of Treasury or of Mr. Brockway: Who will principally receive the benefits of this? Will this be multi-family housing or single-family housing?

Mr. Brockway. This would be multi-family housing, I'm quite sure.

The Chairman. Do you mean the benefits would go to those people who build apartment houses?

Mr. Brockway. It would apply to both, but I think the investment largely would be in multi-family when you are talking about depreciable rental property.

Senator Heinz. I don't think there are many rental single-family units being built these days.

Senator Chafee. No.

This isn't necessarily oriented entirely toward, clearly not toward, middle-income or lower-income -- it could be any income?

Mr. Brockway. That is correct.

Senator Chafee. Is Trump Towers going to get something out of this?

Mr. Brockway. Well, if it were resold -- some probably placed in service like Trump Tower.

The Chairman. But you could built a Trump Tower and get 25 years?

Mr. Brockway. Sure. Correct. Or Trump Tower if it were sold. This would apply to used property as well.

Senator Chafee. And that wouldn't fall into either middle-income or low-income housing, I suspect.

Mr. Brockway. Not most of the units there.

(Laughter)

Senator Chafee. Now, Mr. Chairman, I have some problems with this. All through here we have done quite a bit for housing. I don't know how I am going to vote, but I would point out to everyone that you have a provision here dealing with builders' bonds, which you explained the other day was oriented --

The Chairman. Single-family housing, basically.

Senator Chafee. That's right. But the purpose of it was to encourage building of residential property.

The Chairman. That is correct.

Senator Chafee. For single-family homes we've got the ability to deduct the interest expense on both the first and the second home. Again we get into the problem -- did I miss something? Senator Heinz, did you propose a way of paying for this?

Senator Heinz. Yes, with the repealed indexing.

Senator Chafee. I think we are going to ride that indexing horse a lot. We are going to get a lot of rides out of that.

(Laughter)

Senator Heinz. The horse is fresh so far. This is only the second rider on the horse.

The Chairman. This is a race to the courthouse. Senator Danforth wasn't here when we started to spend his savings.

(Laughter)

The Chairman. Coming right behind, we are going to have soon a recommendation for 5-year lives on oil refineries and 5-year lives on food producing, all of which I think is going to come out of your savings, on the argument that we have now saved -- what is it? -- seven billion?

I am going to vote against this provision of the Senator from Pennsylvania, because I don't want to start down the road now of, "Well, it's only $500 million, only $600 million, only $800 million, and we'll take it all out of Senator Danforth's savings." All that is going to do is make this bill tougher and tougher and tougher at the end, bearing in mind that it's revenue neutral -- only neutral -- only because it has $62 billion in revenues from the elimination of the deduction of excise taxes, and we are $10 billion off of neutrality now. I think we are better off to say, "Does this add to the $10 billion?" rather than to say, "We are now simply spending some of the Danforth savings."

Senator Chafee. Well, let's get that Danforth saving thing straightened out once and for all, can we, Mr. Chairman? We gobbled up those savings this morning.

The Chairman. Well, we gobbled up about $2 billion of them on the three-year cars.

Senator Chafee. Oh, that went quickly; that was the Dole Amendment.

The Chairman. Yes.

Senator Chafee. But you also remember we had an amendment -- not "we had," "there was" -- an amendment here, the Roth Amendment, that passed 12 to 8.

Now, you can correct me, Mr. Brockway, but as I recall that took all the balance of the Danforth Amendment savings, didn't it?

Mr. Brockway. My understanding was that the Danforth Amendment was an amendment to the Roth Amendment.

The Chairman. Yes. Put it the other way around: it made the Roth Amendment not as expensive as it otherwise would have been but for the Danforth Amendment.

Senator Chafee. Very well phrased.

(Laughter)

Senator Chafee. But when we get to the bottom line, as they say, the combination of Roth-Danforth-Dole added how much?

The Chairman. We are $10 billion off.

Senator Chafee. So, I don't want Senator Heinz to disregard that $10 billion. That horse has already been ridden hard and is back in the barn, exhausted.

(Laughter)

The Chairman. Well, I am prepared to put the motion to a vote.

Senator Mitchell. Mr. Chairman, I would just like to make one point, because Senator Chafee commented on it and you also spoke on it.

If you want to do something for housing, and the choice is between this and the builder bonds, in my judgment, with all due respect, I think this is far more effective at far less cost.

The Chairman. Well, I would disagree with you, in this sense: If you want to do more for single family housing, this isn't going to do it at all.

We have tailored this bill to low-income housing, and we have worked with the low-income people. I think between what we have here and what we will have in the bond proposal, the low-income housing people, multi-family or otherwise, are going to be satisfied. The ones that want a little more are those who are building multi-family middle- and upper-income housing. But in no event, I think, should the builder bonds be compared with this, because builder bonds are basically single-family residences, and most of them are houses of $90,000 or less.

Senator Mitchell. Not to prolong it, Mr. Chairman, I would just note that the Coalition for Low and Moderate Income Housing and the Council for Rural Housing Development support this amendment.

I really feel it is very difficult to make the argument that the builder bond provision will result in more construction of homes, particularly when compared to this. And the cost of this is far lower than that of the builder bond provision. The benefits of that are much more narrowly focused, and there is a very considerable dispute on whether they flow through the builders ultimately to home builders.

But in any event, I would hope that the committee would approve the amendment.

The Chairman. Is the committee ready to vote?

Do you want a rollcall?

Senator Heinz. Yes.

The Chairman. Rollcall. Clerk, call the roll.

The Clerk. Mr. Dole?

(No response)

The Clerk. Mr. Roth?

(No response)

The Clerk. Mr. Danforth?

Senator Danforth. No.

The Clerk. Mr. Chafee?

Senator Chafee. No.

The Clerk. Mr. Heinz?

Senator Heinz. Aye.

The Clerk. Mr. Wallop?

(No response)

The Clerk. Mr. Durenberger?

(No response)

The Clerk. Mr. Armstrong?

(No response)

The Clerk. Mr. Symms?

(No response)

The Clerk. Mr. Grassley?

(No response)

The Clerk. Mr. Long?

Senator Long. No.

The Clerk. Mr. Bentsen?

Senator Bentsen. Aye.

The Clerk. Mr. Matsunaga?

(No response)

The Clerk. Mr. Moynihan?

(No response)

The Clerk. Mr. Baucus?

(No response)

The Clerk. Mr. Boren?

(No response)

The Clerk. Mr. Bradley?

(No response)

The Clerk. Mr. Mitchell?

Senator Mitchell. Aye.

The Clerk. Mr. Pryor?

Senator Pryor. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

Senator Heinz. Mr. Chairman, Senator Symms votes Aye by proxy.

The Chairman. And Senator Grassley votes Aye by proxy.

Senator Moynihan votes Aye.

The Clerk. Seven Yeas, four Nays.

The Chairman. The amendment is adopted.

Are there amendments to the depreciation section? I told Senators Durenberger and Boren if there were no more amendments we would move on to another section until they got here, because they have two amendments to present and they are at an Intelligence Committee confirmation hearing right now.

Senator Heinz. Mr. Chairman, excuse me. Are you about to leave this section?

The Chairman. The depreciation section. It depends. If there are other amendments to be offered now -- if not, I am going to move off it and go on to accounting, until Senators Boren and Durenberger get here.

Senator Heinz. Mr. Chairman, I have a minor amendment to this section. I would like to come back. It has to do with rental tuxedos.

The Chairman. Rental tuxedos?

Senator Heinz. Yes, Mr. Chairman. They currently get a 5-year life, and if you want to rent a five-year-old rental tuxedo, well, you are welcome to do so; but the market for five-year-old rental tuxedos is modest.

Senator Moynihan. Are these a productivity property?

(Laughter)

Senator Heinz. They are manufactured in New York.

Senator Moynihan. Even though the Japanese can sell them things that they have to wear?

Senator Pryor. May I ask the Senator, is this a productive or a non-productive item that you are talking about?

Senator Heinz. Well, in all fairness, I don't want to get into that dispute. I think what happened was, in 1981 we made a mistake -- I guess we'd better do it.

Mr. Chairman, if I may?

The Chairman. Yes.

Senator Heinz. In 1981, the fact is we made a mistake. There was one group of people, believe it or not, that we shafted.

(Laughter)

Senator Heinz. It's hard to believe that there was actually somebody who didn't get a good deal in that 1981 tax bill. But we put rental tuxedos into this 5-year category, and they just don't last five years. So, what I would like to do is put them into the 3-year category.

The Chairman. Do you want to so move?

Senator Heinz. I so move.

Senator Moynihan. Depreciation ideally should be just a question of fact. What does the Treasury have -- I have to say I have seen Mr. Darman in a tuxedo which is clearly more than five years old.

(Laughter)

Senator Heinz. While they are trying to figure out what their position is --

Senator Bentsen. What I want to know is, was it rented?

(Laughter)

Senator Heinz. We decided even before the Dole Amendment that rental cars should have three years. Then Senator Dole came along and said all cars should get three years.

You know, tuxedos are not quite made out of the kind of steel that cars are made out of. They may wear like iron, but they are not made out of steel.

Mr. Brockway. Senator Heinz, just a point of information: Would that be three years straight-line, as the cars are, or three years 150-percent declining balance?

Senator Heinz. Three years straight line.

Mr. Brockway. The revenue effect of that would be less than $100 million.

The Chairman. A hundred million?

Senator Heinz. Less than.

The Chairman. A lot less than a hundred million?

Mr. Brockway. Well, it depends. I first thought that it would have been a lot less, because I thought that most everybody in this business would be expensing these. And when it came up when we were in markup a week ago, I so indicated. I have since gotten a letter castigating me from someone who said that they had far more than $50,000 worth of tuxedos that they rent out each year. Evidently renting tuxedos is a large business, and other clothing.

The Chairman. Well, only in this town and in New York, I guess, could this be an issue.

(Laughter)

Senator Heinz. Oh, good God, wait a minute.

The Chairman. There are some things that we do to make ourselves look foolish, and then some things that make us look really foolish.

(Laughter)

Senator Heinz. Mr. Chairman, I object to that characterization.

The Chairman. Well, I don't know.

Senator Heinz. You clearly never were a haberdasher. I want to refer you to Harry Truman.

The Chairman. Yes. He went bankrupt because he didn't have three years depreciation.

(Laughter)

Senator Heinz. I am glad you understand the situation.

The Chairman. Now let me rethink this. Do you mean if he had had five years he might have been successful and not gone into politics?

(Laughter)

The Chairman. Productive property, I understand the debate on it. But gee whiz, this seems outrageous.

But anyway, you put the motion -- three years.

Senator Long. Couldn't we ask Treasury? The Treasury ought to know something about this to advise us. I mean, somebody ought to know something besides the sponsor of the amendment. What can the Treasury advise us on how long those tuxedos wear, according to the Treasury? How long do you think they will last?

Mr. Darman. Senator, I am sorry to report we do not have any definitive data on the use of rental tuxedos or their lives. I can say that Senator Moynihan kindly referred to my own tuxedo, and he is correct about it's appearance. But it is over 17 years old.

Senator Long. Well, I have a full dress suit that is over 30 years old. But I only wear it once a year -- that's if I get invited to the Gridiron Club.

(Laughter)

Senator Heinz. A good argument for renting.

Senator Long. I have rented tuxedos many times, and may I say they have developed a new technique? They have developed a suit-type thing where you can have a waist 50 inches or you can have one 20 inches, and the same thing will fit either way.

(Laughter)

Senator Long. They have done some fantastic things about making them adjustable. If you haven't found that out, I have.

Senator Danforth. They figured out the R&D tax credit.

(Laughter)

Senator Heinz. Senator Long, will you yield?

Senator Long. Yes, sir.

Senator Heinz. In Texas they not only clean quail in the rental cars, they do it in tuxedos as well.

(Laughter)

Senator Long. I am dismayed that the Treasury can't tell us anything about it; I thought the Treasury knew something about anything.

(Laughter)

Mr. Mentz. We can usually make it up.

(Laughter)

The Chairman. Is the committee ready to vote?

Senator Chafee. Mr. Chairman, does this apply to all rental clothing -- graduation gowns and things like that?

The Chairman. Rental tuxedos is what he said.

Senator Chafee. Just tuxedos?

Senator Heinz. A good question. I only phrased it for tuxedos, but --

The Chairman. The revenue loss has to be way up if it includes wedding gowns and --

Mr. Brockway. I think our assumption was it was all rental clothing. That is the way I heard it proposed before.

Senator Moynihan. Let us say all rental clothing.

Mr. Brockway. Retail rental clothing.

Senator Long. How much is that going to cost now? Wait a minute. Maybe we shouldn't have even discussed the matter; now it is for all rental clothing, I am told. Is that right? How much will that cost, Treasury?

Senator Heinz. I want to apologize. The correct term I meant to use was "formal wear" which covers tuxedos and graduation gowns.

Senator Long. How about any gown?

Senator Heinz. No. I apologize to my colleagues; I was inaccurate.

Senator Moynihan. "Tuxedo" is from Tuxedo Park, New York.

Senator Heinz. It is "formal wear," for formal occasions such as a graduation or --

The Chairman. Is the committee ready to vote? The Clerk will call the roll.

The Clerk. Mr. Dole?

(No response)

The Clerk. Mr. Roth?

(No response)

The Clerk. Mr. Danforth?

Senator Danforth. No.

The Clerk. Mr. Chafee?

Senator Chafee. Aye.

The Clerk. Mr. Heinz?

Senator Heinz. Aye.

The Clerk. Mr. Wallop?

(No response)

The Clerk. Mr. Durenberger?

(No response)

The Clerk. Mr. Armstrong?

(No response)

The Clerk. Mr. Symms?

Senator Heinz. Aye, by proxy.

The Clerk. Mr. Grassley?

Senator Heinz. Aye, by proxy.

The Clerk. Mr. Long?

Senator Long. No.

The Clerk. Mr. Bentsen?

(No response)

The Clerk. Mr. Matsunaga?

(No response)

The Clerk. Mr. Moynihan?

Senator Moynihan. No.

The Clerk. Mr. Baucus?

(No response)

The Clerk. Mr. Boren?

(No response)

The Clerk. Mr. Bradley?

(No response)

The Clerk. Mr. Mitchell?

Senator Mitchell. No.

The Clerk. Mr. Pryor?

Senator Pryor. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

Senator Mitchell. Senator Baucus votes No by proxy.

The Clerk. Five Yeas, six Nays.

The Chairman. Defeated.

Are there other amendments to the depreciation section other than those that Senators Boren and Durenberger will be bringing when they come from the Intelligence Committee?

Mr. Mentz. Mr. Chairman?

The Chairman. Mr. Secretary?

Mr. Mentz. I wonder if I might just seek a clarification on a couple of points in the Roth-Heinz depreciation proposal? Well, Mr. Heinz has just left, so maybe I am not going to be able to get clarification.

The one issue in particular that I would like to raise is the treatment of leased property, whether leased property qualifies as "productivity property" if the lessee uses it in an activity that would qualify it were the lessee to be the owner.

The Chairman. I can't answer your question.

Mr. Brockway. The revenue estimtes assumed that it would apply depending upon the user, the same way the present investment credit rules turn on whether the user of the property is using it in manufacturing or extraction industry on the one hand or a retail hand on the other. The same concept would apply.

Mr. Mentz. All right. So, an equipment lessor that leases property that is used in a manufacturing activity will qualify as productivity property, as I understand it. Is that right?

Mr. Brockway. That is correct.

Mr. Mentz. And how about for the new expensing rule, the $40,000 expensing rule, where there is a limitation on trade or business? Is a lessor who leases equipment entitled to take that $40,000 deduction against any other income from that same trade or business?

(Pause)

The Chairman. I don't know if they are huddling on an answer to your question or not. Are you?

Mr. Colvin. Yes, Mr. Chairman.

If the business is an active trade or business, it would be eligible for expensing.

Mr. Mentz. All right. So, in other words, if the lessor is in effect himself in an active business -- in other words, he is not passive; he is managing the equipment -- and he is a full-time lessor, he would be eligible for the $40,000 expensing?

Mr. Colvin. That is correct.

Mr. Mentz. All right.

Mr. Wilkins. I assume that is if the lessor is himself a small business, within the definition of how much he could place in service?

Mr. Mentz. Yes. My question assumed that.

What about assets that are not in listed ADR activities? I assume they are not productivity property; is that correct, Mr. Colvin?

Mr. Brockway. This is an exclusive list. So, it is.

Mr. Mentz. It is an exclusive list, yes. That was my understanding.

Is it correct that research facilities can be productivity property if used in a listed ADR activity?

Mr. Brockway. Do you mean the 3-year straight line?

Mr. Mentz. Well, let us assume -- if it is 3-year straight line, it can't be productivity property, right? That's right. So, it has to be 5-year. But if you have some 5-year property that is a research facility?

Mr. Brockway. If it is 5-year property, and it is used in the appropriate categories, then the treatment would follow, if I understand the question.

Mr. Mentz. Yes. That was my assumption; I just wanted to make sure that was clear.

I assume Senator Durenberger is going to pursue his amendment on food processing. Is that right?

The Chairman. He indicated he is, yes.

Mr. Mentz. Well, all right.

The Chairman. He will be here later this afternoon to present it, and Senator Boren on a 5-year life on oil refineries.

Mr. Mentz. Thanks, Mr. Chairman.

The Chairman. Are there other amendments on the depreciation section? Senator Grassley?

Senator Grassley. No, I don't think so.

The Chairman. All right. Let's move on, then, to the accounting section, and we will move back to this section when either Senators Boren or Durenberger get here.

(Pause)

The Chairman. I am advised also that Senator Wallop will have an amendment on the depreciation of pipelines.

Now let's see if there are amendments to be offered, because if I recall we have been through this section, John, in terms of discussion, haven't we?

Mr. Colvin. That is correct.

The Chairman. Are there amendments to the accounting section?

(No response)

The Chairman. Let me say this: I actually know of some. There are at least four. I might ask the committee if they have any knowledge of any amendments in this area at all -- and I will tell you which pages in your book it is on. Start on page 24.

On the simplified LIFO for small business, I have had no requests for any amendments to it at all. And I think it is generall accepted. Treasury supports it.

On page 28, on the repeal for bad debt reserves other than for banks and thrifts, we get to that at another time. I have had no interest or suggestion of amendments.

On page 28, the retained special rule for the magazines, paperbacks, and records, I had no interest or requests.

And lastly, also on page 29, where we repeal the special rule for qualified discount coupons, I had no expressed interest.

Senator Grassley. Mr. Chairman, I just heard that you mentioned banks, and this isn't the time to bring this up now; but just to protect myself, just in case I would be absent sometime when that would come up, there is this treatment for banks but another treatment for finance companies.

The Chairman. That is correct.

Senator Grassley. And I want to raise a point about the equity of that. You don't have to answer that now; in fact, it would probably be more appropriate later.

The Chairman. We have adopted the Administration's position on the banks, correct, Mr. Secretary? The bad debt reserve?

Mr. Mentz. That's right.

The Chairman. But you are right, it is different than the Finance Committee's.

Senator Grassley. All right. And I want to raise that issue at that time.

The Chairman. Now, are there amendments to the accounting section?

Senator Long. Mr. Chairman, what is the page number in section 2?

The Chairman. Page 26, section 2.

Senator Long. There is a provision there. I did not anticipate any objection, but I have heard from electric utilities in my state and apparently they are just coming alerted to the fact that apparently this would create a problem that they did not anticipate.

They maintain that a portion of construction carrying costs, if they were spun out of equity rather than debt because of a regulatory requirement, should not fall under these capitalization rules. This is a very complicated area, and I am not prepared at this point to say whether they are right or not, but I would like to reserve the right to reopen this matter.

The Chairman. What I am going to try to do is to go as far as we can on this today. And then -- again, emphasizing -- on Monday morning we will discuss but have no votes on the foreign tax provisions. But Monday afternoon I would expect we would have votes, and I would like to finish up if we can the accounting section, the depreciation section, and the employee benefits section, so that we have those behind us. I think we can do that in a good three hour stretch on Monday afternoon.

Senator Pryor. Mr. Chairman?

Senator Chafee. Mr. Chairman?

The Chairman. Senator Pryor, then Senator Chafee.

Senator Pryor. I would be glad to yield.

Senator Chafee. My question was just a timing one. I missed the first part of your remarks, which were that you are going to keep going for a while this afternoon on accounting.

The Chairman. I will even come back to depreciation, if any of the members come back who indicated they had depreciation amendments.

Senator Chafee. Yes. But on Monday afternoon did you say that we would be voting on -- we can come back to the accounting on Monday afternoon?

The Chairman. We can come back to it, although I am trying to encourage any members who have amendments to be here now and offer them. But I would like to wrap up those three topics that afternoon -- depreciation, accounting, and employee benefits.

Senator Chafee. So, in other words, even though we don't bring up an accounting amendment today, we have another shot at it Monday afternoon?

The Chairman. Yes. You are not precluded, but I would like to get as many done today as we can. And again, I would like to have notice if you have a new one that I don't know about on Monday.

Senator Pryor. Mr. Chairman, I thought that I would be ready at this time to move forward with an amendment relative to installment sales on land. And to be honest, we have given it to the staff and there may be some problems, but in fact I don't think they are insurmountable. I think if we can have until Monday, we may be able to work out something, hopefully where it would be acceptable.

So, if I could, I would like to reserve that option until Monday to move forward in this area.

The Chairman. Without objection.

Senator Pryor. Thank you.

Senator Danforth. As I understand it, Senator Pryor's suggestion would raise revenue. Is that right?

Senator Pryor. It could very well raise revenues in the long run.

(Laughter)

Mr. Mentz. In the long run, we are all dead.

Senator Danforth. I think, Mr. Chairman, that any Senator who has a revenue-saver and who puts a horse in the stable should be able to ride his own horse. That is a major tool.

The Chairman. Any member who has a revenue-saver gets a priority, gets to come on any day at any time.

(Laughter)

Senator Chafee. Yes, I think we ought to have ownership of the savings, and we should have to get permission from the fellow who garnered the savings before it can be used up.

Senator Pryor, were you indicating you were going to have something on the builder bond?

Senator Pryor. No, it is not a builder-bond issue; it is the installment sales of land. Really, our particular problem in our part of the country is in the retirement areas, where people are moving down and they don't even in fact move to the area; they sell a lot or a piece of land, say for a small percentage down. The question is: At what point is it taxable?

It is not quite like the completed contract, either, that Senator Danforth has mentioned, but somewhat about a third cousin to it.

The Chairman. Senator Mitchell?

Senator Mitchell. Thank you, Mr. Chairman. If you would like me to do so, I am prepared to offer an amendment now to the inventory section on behalf of myself and Senator Baucus, who is necessarily on the floor at this time. I will be glad to speak to it and then afford Senator Baucus the opportunity later.

The Chairman. Go right ahead.

Senator Mitchell. This amendment would exempt wholesalers and retailers with less than $5 million in average annual gross receipts over the prior three years from the new inventory capitalization rules.

The Chairman. I would be prepared to accept that amendment if you didn't speak any further on it.

Senator Mitchell. One time, Mr. Chairman, when I was a Federal Judge, I was hearing an argument. I had read in great detail the briefs the night before and had made up my mind which way to rule. The lawyer in whose behalf I decided to rule got up and started speaking. After about 30 minutes, I was waivering.

(Laughter)

Senator Mitchell. So, I called him up to the bench, and I said, "Listen, I have already decided to rule in your favor, but if you keep going, I said, "I think I am going to go the other way." He walked back to the table and said, "Your Honor, I rest."

(Laughter)

Senator Mitchell. So therefore, Mr. Chairman, with those words, I rest.

The Chairman. I think it is a fair provision for this $5 million exemption, and I hope, if we grant it, the committee would stick there and not attempt to expand it to companies bigger than that. But I think in fairness to companies that size it is a good provision.

Senator Mitchell. Thank you, Mr. Chairman.

Senator Grassley. Mr. Chairman, I have been working with Senator Wallop on an amendment that deals with depreciation and administrative and general expenses.

The Chairman. Excuse me -- of what?

Senator Grassley. Well, not in the area he was talking about.

The Chairman. No, I understand that; but I didn't hear what you said at the end.

Senator Grassley. For depreciation and administrative expenses in this area. But he is not here, and I don't want to go ahead without his taking the lead on that.

The Chairman. Do it on Monday.

Senator Grassley. All right.

The Chairman. Other amendments to be considered today?

Senator Grassley. And I also want to ask Treasury's judgment. If on page 27, under the Chairman's proposal, item 3, long-term contracts, if the $10 million figure was $25 million, can you give us some judgment of what that would cost?

The Chairman. Are you asking on the 10 million or two years?

Senator Grassley. Yes.

The Chairman. It is similar, I think, to the Pryor Amendment. David, is he on the same amendment you are?

Senator Pryor. Mr. Chairman, I don't think it is the same.

The Chairman. It is not the same?

Senator Pryor. No.

Senator Grassley. It is not the same. And I am not proposing an amendment, Mr. Chairman; I just want to know what it is going to cost.

Mr. Brockway. You are keeping the two years?

Senator Grassley. Keeping the two years.

Mr. Brockway. But raising it from 10 to 25? That would be .2, $200 million.

Senator Grassley. Two hundred million, over five years?

Mr. Brockway. That is correct.

The Chairman. Further amendments?

Senator Chafee. Mr. Chairman, I have trouble with item B on page 24. Under the House bill -- and the Chairman's proposal is the same as the House bill, essentially, in the matter I am concerned with -- exceptions are made for the cash method of accounting for farming business.-- I can understand that -- to qualified personal-service corporations, and then these "with an annual gross receipts of $5 million or less."

The outfit I am concerned with is a service corporation, a personal-service corporation, but it is publicly-owned. Now, in this instance it would not qualify under the so-called "qualified personal service corporations." Is that right? To be a qualified personal service corporation, it must be owned by the employees? What, X-percent?

Mrs. Paull. Yes, sir.

Mr. Brockway. There is no stated percent, but it is substantially all. So it would be the typical incorporated law firm or accounting firm.

Senator Chafee. Well, listen to this: My problem is I have got a small corporation with about $12 million of gross, which is -- excuse me, what was that figure, the percentage?

Mr. Brockway. It is not listed as a particular percentage, but it is substantially all the stock which is owned by the employees.

Senator Chafee. This is not substantially owned; it is 40-percent owned.

Now, in order for the company I am interested in to come into this, because the fact that they cannot use the cash accounting method is severe to them, what I would like to do is to look at the cost of increasing the average gross receipts to something like, say, 15.

They have gotten approval from the IRS to use the cash accounting. Does that make sense, that that would be a form of restriction?

Mr. Brockway. Well, I think, of the total 3.4 that you raise from putting corporations on to the accrual method from the cash method, in most of those situations probably the taxpayer has gotten approval. It is clearly a permissable method. Right now under present law, if you start out using the cash method, you can continue to use it, under present law.

Senator Chafee. Well, in other words, the IRS currently exerts some restraint, I presume, on this. Don't they?

Mr. Brockway. Well, the general problem in the area is that cash method for a business without inventories is a permissable method under present law; the only time you get IRS approval is if you are going to switch from another method -- let's say if you are on accrual and you want to switch to cash, then you would have to get IRS permission to do that. And in the past they have resisted that; where a taxpayer was already on a hybrid method on the accrual and wanted to switch to cash, they have resisted that, even though another taxpayer in a similar business who started out in cash could continue to use cash.

Senator Chafee. Well, Mr. Chairman, I don't want to take the committee's time. I will be talking with Mr. Brockway and seeing if there is a possibility of doing something here. Then I might possibly have an amendment Monday.

The Chairman. Are there other amendments? Other amendments to consider today?

(No response)

The Chairman. If not, let me remind the committee again of our schedule:

Tomorrow, Canadian-American Free Trade. Monday morning, a discussion of the foreign tax provisions in the bill. Monday afternoon -- and let us start at 1:30 on Monday afternoon if we could -- votes on depreciation, accounting, and employee benefits, and try to wrap up those three sections that afternoon.

To the extent that any of you need information from the Joint Committee or Treasury, if you could get to them this afternoon and tomorrow and Monday morning, I am sure they are willing to work over the weekend. It would be helpful.

Adjourned.

(Whereupon, at 3:10 p.m, the meeting was recessed, to be reconvened Monday, April 14, at 9:30 a.m.)

C E R T I F I C A T E

This is to certify that the foregoing proceedings of an Executive Committee meeting of the Senate Finance Committee held on April 10, 1986, was 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.