

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

3 WEDNESDAY, APRIL 9, 1986

4 Committee on Finance

5 Washington, D.C.

6 The committee met, pursuant to recess, at 9:39 a.m. in  
7 Room SD-215, Dirksen Senate Office Building, the Honorable  
8 Bob Packwood (chairman) presiding.

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

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

16 Also present: Bill Diefenderfer, Chief of Staff; David  
17 Brockway, Chief of Staff, Joint Committee on Taxation; Randy  
18 Weiss, Deputy Chief of Staff, Joint Committee on Taxation;  
19 John Colvin, Chief Counsel; Bill Wilkins, Minority Chief  
20 Counsel; Ben Hartley, Mike Livingston, Mary Levontine,  
21 Joint Committee on Taxation; Greg Jenner, Tax Counsel,  
22 Majority; Paul Strella, Tax Counsel, Majority; Randy Hardock,  
23 Tax Counsel, Minority; Susan Taylor, Executive Assistant.

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

2 I have been asked by several members about transitional  
3 rules, and I would like to consider all of those at the  
4 end of the bill, covering any areas, rather than taking  
5 them specifically area by area as we go. We will have a  
6 little bit better idea of where we stand at the end.

7 As you are aware, the House had 68 at least very  
8 specific transitional rules for a whole variety of projects  
9 that barely rise to the definition of a generic. And I  
10 would just as soon consider those at the end of the bill.

11 We are ready to start today on the natural resources  
12 section. I believe some members have some amendments. I  
13 would hope when we are done that this would take care of  
14 the natural resources section except for that caveat I have  
15 indicated before that if we get to the end of the bill and  
16 we are dramatically over on revenue or dramatically short  
17 on revenue that we are clearly going to have to come back  
18 and revisit a lot of areas to try to make the bill come out  
19 at a minimum revenue neutral. Whether we have to come out  
20 more than revenue neutral is a decision we may have to make  
21 depending upon what the Congress does on the budget.

22 The energy section, energy and natural resources  
23 section, is open for amendments. Are there amendments?

24 (No response)

25 The Chairman. No amendments? I know that Senator

1 Bradley had some amendments. He spoke to me about them a  
2 little earlier, and he was here for Secretary Mentz's  
3 hearing.

4 As long as we have a quorum here right now, and we do,  
5 I would like to move that we report out the nomination of  
6 Roger Mentz for Assistant Secretary for Tax Policy. We had  
7 his hearing at 9:00 this morning, but he has been acting  
8 before us in this position for so long and I think quite  
9 well that I hope we could send him out unanimously.

10 Senator Long. I second the motion.

11 The Chairman. Any discussion to report out Roger Mentz?

12 (No response)

13 The Chairman. He has never been confirmed before.

14 Without objection, Mr. Secretary, you are out.

15 (Laughter)

16 The Chairman. Now amendments in the energy and natural  
17 resource section. What page is that?

18 Mr. Colvin. The title begins at Page 64.

19 The Chairman. Sixty-four.

20 Senator Grassley. Do you want the amendments in any  
21 special order, Mr. Chairman?

22 The Chairman. No, no particular order. I am hoping we  
23 can get through this section and the depreciation section  
24 this morning. Do you have an amendment?

25 Senator Grassley. Could I bring up the one that Senator

1 Bentsen and I have talked about. Although it would be a  
2 modification of what the Chairman has in his draft, that  
3 Senator Bentsen had some difficulty with it because it might  
4 affect certain farmers.

5 The Chairman. Is this the bankrupt farmers versus the  
6 bankrupt everybody?

7 Senator Grassley. No. Let me make this clear.  
8 Prepayment of fees.

9 The Chairman. All right.

10 Senator Grassley. Not just prepayment of fee,  
11 prepayment of farming expenses. And Senator Bentsen was  
12 concerned that with a cliff of an automatic and very  
13 drastic cut off of the 50 percent rule that it might  
14 inordinately hurt some farmer that we don't intend to hurt.  
15 And Senator Bentsen said if we would take care of that  
16 problem that then he could go along with it.

17 And it is my understanding that at the staff level we  
18 have taken care of that problem. In other words, we have  
19 eliminated what is referred to as the "cliff problem."

20 The Chairman. Could I have a staff report on that?

21 Senator Bentsen. While the staff is gathering itself  
22 there, Mr. Chairman, let me say that from what I understand  
23 of it, we have resolved the difference. I go along with  
24 Senator Grassley in putting the 50 percent limitation on.

25 My concern was if you had a start-up operation where they

1 had not really settled down on their accounting and they  
2 happen to go over it, they got 51 percent, they lost it all.  
3 And as I understand it, they would get up to that.

4 The Chairman. Mr. Brockway.

5 Mr. Brockway. That is correct. Under the proposal,  
6 it would not be the cliff as the proposal last year, but it  
7 would only be to the extent that the prepayments exceeded  
8 50 percent would there be a denial of the early deduction for  
9 prepayments. The revenue impact would be less than \$50  
10 million.

11 The Chairman. Is there objection?

12 Senator Grassley. Before we go on and a little bit  
13 separate from this issue but still dealing with the language  
14 that was put in the bill in 1984, for those individuals who  
15 are not defined as farmers and under the syndication rule,  
16 we have taken care of people who were prepaying fees as one  
17 example of prepayment of farm expenses that could not be more  
18 than 50 percent of schedule F expenses. In those instances,  
19 those people would have no other schedule F expenses so  
20 50 percent of schedule F expenses was zero. Effectively,  
21 they are prohibited from doing that only up to 90 days,  
22 right? Is that the existing law?

23 Mr. Brockway. That is correct.

24 Senator Grassley. All right.

25 So let me ask staff: You know, some of you were present

1 at the table two years ago when we discussed the same thing  
2 then from the standpoint of the problems we had with the  
3 non-farmer using cattle feeding as an example as a tax  
4 sheltering situation. Then basically what we are doing this  
5 year through this amendment plus what we did last year,  
6 we take care of those problems so that is going to be  
7 discouraged as a tax shelter gimmick, right?

8 Mr. Brockway. That is our belief. That the combination,  
9 particularly of what you did last year, and the amendment,  
10 that would effectively prevent the benefits in the so-called  
11 cattle deals.

12 Senator Grassley. Then not to extend the conversation  
13 any longer, Mr. Chairman, could I just ask would the Finance  
14 staff, Joint Committee take one last look at it? I would  
15 like to know that those things that I have tried to  
16 accomplish in that area, particularly referring to what was  
17 very recently in the Wall Street Journal, dial 800 number  
18 such and such, and you can find out about how to feed cattle  
19 and avoid income tax and all that sort of thing -- you know,  
20 that we are effectively controlling that problem.

21 Mr. Brockway. We will look at that and report back to  
22 you specifically on that.

23 The Chairman. Without objection.

24 Let me announce, if I can, the schedule for the next  
25 few days. And you have received a press release on it. I

1 can't resist looking at the end of it where it says:

2 "As announced in press release number 86-025." We are getting  
3 like the Federal Register. But you are now legally on  
4 notice. We will go this morning through both energy and  
5 hopefully accelerated cost recovery. This afternoon -- and  
6 take votes on it. This afternoon, we will continue the  
7 discussion of pensions and employee benefits, although we  
8 had finished yesterday the bulk of the discussion on pensions.  
9 And I think this afternoon will be mostly discussion on  
10 employee benefits.

11 Tomorrow morning, accounting provisions. And I am hoping  
12 we will have some votes on that. Tomorrow afternoon, foreign  
13 tax provisions, and they are complicated. They are not a  
14 great portion of the bill, but they are complicated. We will  
15 have discussions on it.

16 And then Friday morning the Canadian free trade hearing.  
17 No votes that day and no tax reform that day.

18 Monday, April 14th, we will have, hopefully, a mark up on  
19 the foreign tax provisions. No, that is still discussion.  
20 And a discussion that afternoon on bonds, municipal bonds.

21 And then on Tuesday morning, we will have a discussion  
22 on the individual income tax provisions, but not rates,  
23 personal exemptions, standard deduction or the earned income  
24 credit. Those are such big items that I would like to reserve  
25 them until a slight bit later. The afternoon discussion on

1 the insurance provision, and that will take us through  
2 Tuesday. And you will have more notice before the day is  
3 out as to how we will proceed.

4 And, again, this is all subject to being able to finish  
5 roughly where we are and keep on schedule.

6 Senator Long. Just to be sure, Mr. Chairman, that  
7 April 15, we will not discuss the rates and we will not  
8 discuss the personal exemption as well?

9 The Chairman. That is right. We won't deal there  
10 with --

11 Senator Long. And we won't deal with the standard  
12 deduction or the earned income?

13 The Chairman. That is correct. Those are such big  
14 items that, frankly, they are very major philosophical  
15 items. And an issue like do we want to change to a credit  
16 rather than an exemption that I think those are major issues  
17 to be put off for a more major time.

18 What I am trying to do is to get through most of the  
19 provisions where I think we can reach agreement of if we  
20 don't have agreement where at least we know what the  
21 division is and we can vote.

22 Senator Moynihan. Mr. Chairman?

23 The Chairman. Yes.

24 Senator Moynihan. Could I just ask: There are some,  
25 three of four of us, on the Committee who understand that we



1 are about to be given a major amendment on the depreciation  
2 portion of the bill which will cost \$20 billion. And as of  
3 9:15 last night, it was not ready. And I gather it is being  
4 typed now somewhere. Is that it?

5 The Chairman. It is. It was what the staffs have been  
6 discussing for a fair period of time.

7 Senator Moynihan. Not my staff, Mr. Chairman.

8 The Chairman. I don't think it comes as a surprise at  
9 all. But in any event, it is ready with one minor technical  
10 exception that is being --

11 Senator Moynihan. And we are going to decide that this  
12 morning?

13 The Chairman. Well, we are going to look at it. I don't  
14 think the provisions will surprise anybody. We have discussed  
15 them before. They involve things like cars and trucks.

16 Senator Moynihan. Like what? The productivity property?

17 The Chairman. Yes.

18 Senator Moynihan. Well, thank God Mr. Mentz is  
19 official. He can now give us an official view. Maybe we  
20 should talk about that.

21 The Chairman. Well, we are going to get to that, but  
22 for the moment I want to know if we have any amendments on  
23 natural resources or agriculture.

24 Senator Bentsen. Mr. Chairman, have we disposed of  
25 Senator Grassley's -- the compromise we achieved here?

1 The Chairman. That is correct.

2 Senator Grassley. Except I would like to thank Senator  
3 Bentsen for his cooperation in support of this compromise.

4 Senator Bentsen. Senator Grassley, I appreciate your  
5 comments. And I think we have worked out what results in  
6 equity and fairness and makes the effort feasible.

7 I would like to urge now the further consideration of  
8 the amendment I introduced for Senator Chiles to try to  
9 take care of the replanting of citrus groves that have been  
10 frozen. And that happened not just in Florida. That  
11 happened in Texas. And the very serious problem you have  
12 had is getting additional capital to replant those trees.  
13 And, as you recall, what we have done here is to say that  
14 you would not have a passive partner come in. And the  
15 compromise worked out with the Chairman's staff that you  
16 would have to be participating in the management of the  
17 grove.

18 And this is one that would allow the deduction and  
19 expensing for those new partners to plant, to replant that  
20 grove that had been frozen and lost. And the amount of  
21 taxes involved is minimal. I was amused that they used  
22 this \$50 million threshold. My guess is it would be less  
23 than a million.

24 With the competition of the Brazilians, you are just not  
25 getting a lot of citrus planted in this country.

1 Senator Roth. Is there any further comment on Senator  
2 Bentsen's proposal?

3 Senator Bentsen. The staff might comment. I think we  
4 have worked with the staff, and I believe we have an  
5 agreement on that. So it doesn't open it up to the kinds of  
6 syndications that would be advertised in the Wall Street  
7 Journal, that type of thing.

8 Mr. Brockway. Senator Bentsen, as I understand your  
9 amendment it is that outside active investors with less than  
10 50 percent could come in and qualify for the same treatment  
11 as the current investors. That would be less than \$50  
12 million revenue loss over the period where you have the  
13 freeze destroying the citrus crop.

14 Senator Bentsen. Right.

15 So, Mr. Chairman, we have been discussing that citrus  
16 amendment, and staff, as I understand it, has worked out the  
17 agreement where it doesn't open it up to the syndicate  
18 approach. It requires active participants in the plan.

19 The Chairman. Without objection.

20 Further amendments in the area of agriculture and  
21 natural resources, energy?

22 Senator Grassley. Mr. Chairman?

23 The Chairman. Senator Grassley.

24 Senator Grassley. This deals with a problem that is very  
25 much similar. First of all maybe I ought to say I am offering

9  
1 an amendment on the concept of the concept of an amendment  
2 that would take care of the problem for some debt  
3 forgiveness, like by a bank, under the IRS code to determine  
4 income.

5 And it is not a whole lot different from a problem we  
6 had that this Committee took care of and the President just  
7 signed as part of the reconciliation bill yesterday for the  
8 alternative minimum tax. Certain farmers who were insolvent  
9 because of the capital gains recapture of investment tax  
10 credits were charged with a great big alternative minimum  
11 tax. All right. So we have the problem now not of the  
12 alternative minimum tax but just to the income definition.

13 And I would ask the Joint Tax Committee if they would  
14 explain more thoroughly the problem, if it needs to be  
15 explained. If that doesn't need to be explained, at least  
16 explain how this is a very tightly drawn concept that we have  
17 here where we can help agriculture in this particular  
18 instance with the problem of keeping people who would  
19 otherwise maybe be out of agriculture in agriculture and  
20 over this immediate hump.

21 Could we, Mr. Chairman, have the Joint Tax Committee  
22 respond?

23 The Chairman. Mr. Brockway?

24 Mr. Brockway. Yes, sir. Under present law as a general  
25 rule, if you have cancellation of indebtedness that is income

1 in the amount of the principal debt that is forgiven. There  
2 is an exception, however, where the taxpayer is insolvent.  
3 In that situation, the taxpayer simply does not recognize  
4 the income but reduces the basis of its property as  
5 specified in the code. And then if it is totally -- if the  
6 amount of the debt exceeds the taxpayer's basis and his  
7 assets, then there is no further adjustment above and  
8 beyond that.

9 The problem in this area comes, as I understand it -- it  
10 is the same problem that comes up in connection with the  
11 alternative minimum tax for farmers. That there are a  
12 number of farmers now who are having their indebtedness  
13 written down, and that they would have income included by  
14 virtue of the bank forgiving or the lender forgiving the  
15 debt and so that while they are under financial distress  
16 already, once the loan is forgiven, they would have an  
17 additional burden from the income tax for forgiving the  
18 debt.

19 What the proposal Senator Grassley would provide is that  
20 where a farmer has forgiveness of indebtedness income and the  
21 farmer or this person would be someone with at least 50  
22 percent of their average annual gross receipts for the last  
23 three years from the active business of farming.

24 Then there would be the same treatment for that farmer  
25 as an insolvent taxpayer under present law, provided that the

1 debt to equity ratio of the farmer was at least 70 to 30  
2 before the write-down.

3 Senator Bentsen. Dave, let me ask you about that one.  
4 I understand the thrust of it and what the Senator is trying  
5 to accomplish. And I am sympathetic to that.

6 When you get into the debt equity ratio of 70-30, then  
7 you get into the subjective judgment type thing. How do you  
8 arrive at the criterion to determine that? Do you justify  
9 it by the way the bank had written it up?

10 Mr. Brockway. In the end, you would look at the  
11 taxpayer's balance sheet in trying to decide it. There is  
12 no doubt there would be a factual issue involved in  
13 attempting to determine whether or not you are over the  
14 70-30 limit. I gather that at least in Iowa that that is  
15 the standard they used to determine whether or not you will  
16 qualify for the loan forgiveness program they have there.

17 But, generally, you would be looking at the taxpayer's  
18 balance sheet. It would clearly be a factual issue.  
19 And the intention is to try and limit the relief to  
20 situations where you have a taxpayer who is clearly in some  
21 state of distress.

22 Senator Grassley. Could I add to the 70-30 definition?

23 Senator Bentsen. Yes, I would like to hear it because  
24 whether you are buying or selling, it changes the value of  
25 that land.

1 Senator Grassley. Yes. And this doesn't detract from  
2 anything you have said, but it is also the standard that  
3 is used in the agriculture bill of 1985 that we just passed  
4 before Christmas as well.

5 Senator Bentsen. Still a problem.

6 Senator Grassley. Yes.

7 Senator Chafee. Mr. Chairman?

8 Senator Roth. Senator Chafee.

9 Senator Chafee. I don't understand why this should  
10 solely apply to farmers. Why shouldn't it apply to  
11 everybody? I mean other people are in these jams and get  
12 relieved of their indebtedness. Why not have it apply to  
13 everybody?

14 Mr. Brockway. My understanding of the proposal is that  
15 from the sponsors is this is one area where there is  
16 particular widespread distress, and this is where they wish  
17 to focus their -- the relief of the proposal. And farming  
18 tends to be highly leveraged with little cash flow. That  
19 would possibly be an answer.

20 Senator Chafee. Well, I am sympathetic to the farmers,  
21 and I understand that problem. And I support this. But I  
22 just don't see why it should solely be restricted to a  
23 certain group in our society. What would be the effects if  
24 you would have it apply to everybody?

25 Mr. Brockway. Well, from a revenue standpoint, if you

1 looked at simply in the proposal as limited to individuals as  
2 is and if you looked at individuals in the farming business,  
3 this proposal would be roughly \$100 million over the five-  
4 year window. If you extended to all business activities,  
5 our estimate is about \$400 million over the period.

6 Mr. Mentz. Senator Chafee?

7 Senator Chafee. Well, suppose you had it apply to  
8 fishermen, for example, commercial fishermen?

9 Mr. Brockway. I think commercial fishermen would be a  
10 fairly narrow group of people. It would not have as  
11 significant a revenue effect.

12 Mr. Mentz. Senator Chafee, I wonder if I might add a  
13 little different twist to this.

14 Senator Chafee. Sure.

15 Mr. Mentz. Under current law, a solvent taxpayer who  
16 has cancellation of indebtedness may elect not to have that  
17 treated as income if he reduces the basis in his  
18 depreciable property.

19 Senator Grassley. That is Section 108.

20 Mr. Mentz. That is 108 in current law. So the  
21 fisherman who has got a fishing boat that is a depreciable  
22 asset. To the extent of the basis in that fishing boat, he  
23 can make a 108 election and reduce the basis and thereby not  
24 have income.

25 The problem with farmers is you are talking primarily



1 about land that is non-depreciable. Now as I understand  
2 Senator Grassley's amendment, it would order the reduction  
3 in basis rule so that you reduce basis in depreciable  
4 equipment first. In other words, if I understand it  
5 correctly, Senator --

6 Mr. Brockway. That is correct.

7 Mr. Mentz. -- the regular qualified business indebtedness  
8 comes first and then only when you run out of depreciable  
9 assets do you get down to the farmland. And in that respect  
10 I think it is somewhat unique to farmers.

11 I would just ask one -- or make one suggestion here. I  
12 think in the second to last paragraph the definition relates  
13 to debt incurred to finance the production of agricultural  
14 products or livestock in the United States. That part is  
15 fine. But the final clause: "For debt secured by farmland  
16 or farm machinery and equipment." That is -- that could be  
17 over-broad. You could have a farmer that is incurring debt  
18 for a purpose unrelated to his farm activities, but the bank  
19 takes out a mortgage on his farm.

20 I think the amendment would be better with that part  
21 deleted. I think you are reaching the same result and it is  
22 more appropriately targeted if you drop that last clause.

23 Senator Grassley. How about as an alternative to what  
24 you said if you would limit it for the debt that would be  
25 incurred or the borrowing against farm machinery and

1 equipment related to the agricultural operation?

2 Mr. Mentz. Then that is fine. I think we are  
3 trying to get at the same point. You just don't want it in  
4 an area that is unrelated to the farming business.

5 Senator Grassley. If that satisfies, I am happy to do  
6 that.

7 The Chairman. Senator Danforth.

8 Senator Danforth. I don't have a question, only a  
9 comment, Mr. Chairman. I think this is a very important  
10 amendment. The disaster that has hit agricultural states  
11 has been commented on by many people. It clearly is a  
12 disaster. We have been urging banks to work with farmers.  
13 Obviously, writing off or writing down indebtedness is  
14 something that is going to be absolutely essential. It  
15 would be an absurd situation if farmers who had their  
16 indebtedness written down, written off because they just  
17 couldn't pay and they can't pay would be taxed in the process.

18 I think this is a very important amendment. I would  
19 appreciate being included as a co-sponsor of this amendment.

20 Senator Long. Mr. Chairman?

21 The Chairman. Senator Long.

22 Senator Long. I can vote the amendment but for the life  
23 of me I think it is very unfair to apply this only to  
24 farmers. Now, for example, in the western district of  
25 Louisiana we are -- we don't have a record of how fast people

1 are going bankrupt. Now as far back as our records go,  
2 which don't go back quite that far, we are breaking all the  
3 records month by month down there. People are going  
4 bankrupt, filing bankruptcy. It is burning at the rate of  
5 about 450 a month.

6 Now, of course, I know that we are not dealing with  
7 prejudice here. We are dealing with hatred. A lot of  
8 them are in the oil and gas business. But it is hard for me  
9 to see why when someone is even in the oil and gas business --  
10 he is broke, he is destroyed, wiped out -- why he shouldn't  
11 be given the same treatment as a farmer would receive. Why  
12 must you go after them when they have to foreclose, broke,  
13 gone and bankrupt?

14 And I must say I think it is unfair just to do this for  
15 farmers and not do it for other people who are also  
16 bankrupt, wiped out.

17 Senator Grassley. Mr. Chairman, besides Senator Danforth  
18 as a co-sponsor, Senator Dole is a co-sponsor as well. We  
19 worked with his staff. And, also, there has been an interest  
20 by a member outside of this Committee, Senator Kassebaum,  
21 who presently has some amendment dealing in this area. Maybe  
22 it is not quite as defined as we have here, but it is on a  
23 bank bill that is pending now to deal with the problems of  
24 agricultural banks. So I want to give Senator Dole and  
25 Senator Kassebaum credit for this as well.

1           Senator Long. Why should people who have the same  
2 plight who don't happen to be farmers be treated differently?

3           The Chairman. Further discussion on the amendment?

4           Senator Baucus. Mr. Chairman?

5           The Chairman. Senator Baucus.

6           Senator Baucus. Mr. Chairman, I want to congratulate the  
7 Senator for offering this. I think it is a good amendment  
8 too. Not only for the reasons that he has outlined but  
9 a lot of the livestock -- because of the dairy buy-out  
10 program, they are in tougher shape than otherwise would be  
11 the case. I think it is a good amendment. And I would like  
12 to be added as a co-sponsor too.

13          The Chairman. If there is no objection --

14          Senator Wallop. Mr. Chairman?

15          The Chairman. Senator Wallop.

16          Senator Wallop. I have no objection.

17          The Chairman. If there is no objection, adopted.

18          Further amendments?

19          Senator Wallop. Well, I didn't know you were going to  
20 call for questions on the amendment. I do believe that  
21 Senator Long is entitled to an answer. I mean I appreciate  
22 and am very much supportive of the thrust of this amendment,  
23 but we have threads in our constituency that goes beyond  
24 agriculture which are in desperate, desperate trouble today  
25 as well. And I think that there ought to be an answer. I

1 don't necessarily suppose that it will change this amendment,  
2 but I think that he is entitled to an answer.

3 The Chairman. Does the sponsor want to respond? I am  
4 not sure we have to have an answer to vote on it, but I am  
5 not the prime sponsor of the amendment. But in that case,  
6 why limit it to oil and agriculture? Why not spread it  
7 out to --

8 Senator Wallop. I didn't say a word about oil. I  
9 didn't mention it.

10 (Laughter)

11 Senator Wallop. I mean there are people whose businesses  
12 are directly related to agriculture who are not farmers and  
13 ranchers, who are implement dealers, who are collapsing  
14 because the agricultural community is collapsing. Are they  
15 not important to our community?

16 Senator Grassley. We did already discuss the small  
17 businesses that have an election under Section 106 of  
18 depreciation. And there is the problem or the unique thing  
19 about agriculture particularly because of inflation that we  
20 had there was such a high amount of investment in non-  
21 depreciable assets. The land itself does not qualify, and  
22 so we are trying to take care of that problem. It is a  
23 problem which is unique to farming.

24 The Chairman. Further discussion?

25 (No response)

1           The Chairman. No further discussion, those in favor of  
2 the amendment, say aye.

3           (Chorus of ayes)

4           The Chairman. Opposed?

5           (No response)

6           The Chairman. Are there further amendments to the  
7 agriculture, energy, natural resources section?

8           Senator Wallop. Mr. Chairman?

9           The Chairman. Let us take Senator Bradley first. He  
10 has had his hand up for a bit. Go ahead.

11          Senator Bradley. Mr. Chairman, I have a series of  
12 amendments that I would like to offer. We can debate them  
13 now or separately, if you would like.

14          The thrust of my amendments will be to reinforce the  
15 market as the allocator of resources in the energy sector.  
16 I think that if we are going to compete in a growing world  
17 economy that we are going to be able to do that best if we  
18 have the market allocate resources. And we have in the  
19 energy area a great many production subsidies and various  
20 tax credits that are nothing more than subsidies, and that  
21 I think ultimately impede the functioning of the market.

22          And I think also since we are in a world where we have  
23 a giant budget deficit and we are making decisions on cutting  
24 spending in a variety of areas that it is important to know  
25 who benefits from the various production subsidies that are

1 in the code relating to energy development.

2 And so, Mr. Chairman, I would like to offer a series of  
3 amendments on the oil depletion allowance, on intangible  
4 drilling costs and on business and energy tax credits,  
5 treating all of these subsidies basically in the same way.  
6 And I would like to do that whenever you feel appropriate.

7 The Chairman. Why don't we do them now?

8 Senator Bradley. Good.

9 The first amendment I would offer, Mr. Chairman, deals  
10 with the oil depletion allowance, percentage depletion. I  
11 think it would help the Committee to focus a little bit on  
12 the history of the oil depletion allowance. The oil  
13 depletion allowance was first proposed in 1918, and the  
14 rationale for the proposal was that it would help us win  
15 World War I. We needed oil to win World War I.

16 It was passed in 1919 after World War I was over. And  
17 in subsequent years when that provision of the code was  
18 scrutinized, it was found, I think, wanting, but instead of  
19 eliminating it, we simply added many more minerals and  
20 other substances to the category of depletable assets. So  
21 that now we are not only having depletion, percentage  
22 depletion on oil, but we also have it on coal, gravel,  
23 lignite, peat, pumice, sand, shale, sodium chloride, stone,  
24 antimony, asbestos, asphalt, bauxite, barillium, borax,  
25 cadmium, chromite, cobalt, copper, feldspar, mollusk shells,

1 oyster and clam shells, quartz, sulphur, tytanium and  
2 so forth. It is a very long list.

3 So, Mr. Chairman, I also believe that the effect of  
4 percentage depletion is not to stimulate or to provide an  
5 incentive to go out and search for new oil, but it happens  
6 to be a very lucrative benefit to those wells that would be  
7 highly productive and are highly productive and would more  
8 than likely be drilled anyway. It is an added benefit.

9 And so what I would finally say about depletion is: Who  
10 does benefit from depletion? It so happens that 50 percent  
11 of the benefits from the depletion allowance go to 90,000  
12 people in this country with adjusted gross income of  
13 \$75,000.00. And the average subsidy is \$6,500.00 per tax-  
14 payer.

15 So, Mr. Chairman, what I would move is that we adopt the  
16 provision that would phase out depletion over a three-year  
17 period. That is similar to the provision that the President  
18 suggested in his original proposal, although he suggested  
19 we phase out percentage depletion over a five-year period.

20 The House passed a provision that would phase it out over  
21 three years, and that is the provision that I would ask the  
22 Committee to adopt at this time.

23 The Chairman. Discussion on the amendment? Any  
24 discussion?

25 (No response)



1 The Chairman. If not, those in favor --

2 Senator Bradley. Mr. Chairman, I would like to have  
3 a roll call vote on the amendment.

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

5 Senator Long. I just want to say one word on it, Mr.  
6 Chairman. Before we had the free-fall in the price of oil,  
7 I talked to people who rather consistently invested money in  
8 the -- in trying to develop oil and gas. Well, some of those  
9 that did have had some success in it. And what most of them  
10 told me was that if the Administration's proposal became law,  
11 they had drilled their last well. I think I recall one young  
12 man, a lawyer, who represented quite a few people in business  
13 and he annually invested in several wells. He said, right  
14 now, I have money invested in five wells that are being  
15 drilled; but if that becomes law, I have invested in my last  
16 well.

17 Now since that time, you have had the price go down to  
18 about a third of what it was. So you don't need to worry  
19 about getting that man to drill anymore. He has been  
20 cured anyway.

21 But it would be great news down there -- they are being  
22 wiped out and going bankrupt at a record rate -- to be told,  
23 well, now just in case you do make some money sometimes, we  
24 have a nice big tax increase for you. This will be something  
25 to knock out their favorable treatment on intangible drilling

1 expense.

2 And I just think to take someone who is suffering and  
3 who has suffered before and then just in case the situation  
4 does get better -- don't you worry, you have got people  
5 working on you up there in Washington so you will have a great  
6 big tax increase waiting for you. I think that is just  
7 going too far.

8 The Chairman. Further discussion?

9 (No response)

10 The Chairman. If not, the Clerk call the roll.

11 The Clerk. Mr. Dole?

12 (No response)

13 The Clerk. Mr. Roth?

14 Senator Roth. No.

15 The Clerk. Mr. Danforth?

16 Senator Danforth. No.

17 The Clerk. Mr. Chafee?

18 Senator Chafee. Aye.

19 The Clerk. Mr. Heinz?

20 (No response)

21 The Clerk. Mr. Wallop?

22 Senator Wallop. No.

23 The Clerk. Mr. Durenberger?

24 (No response)

25 The Clerk. Mr. Armstrong?

1 (No response)

2 The Clerk. Mr. Symms?

3 Senator Wallop. No, by proxy.

4 The Clerk. Mr. Grassley?

5 Senator Grassley. No.

6 The Clerk. Mr. Long?

7 Senator Long. No.

8 The Clerk. Mr. Bentsen?

9 Senator Bentsen. No.

10 The Clerk. Mr. Matsunaga?

11 (No response)

12 The Clerk. Mr. Moynihan?

13 (No response)

14 The Clerk. Mr. Baucus?

15 Senator Baucus. No.

16 The Clerk. Mr. Boren?

17 Senator Long. No, by proxy.

18 The Clerk. Mr. Bradley?

19 Senator Bradley. Aye.

20 The Clerk. Mr. Mitchell?

21 Senator Mitchell. Aye.

22 The Clerk. Mr. Pryor?

23 Senator Pryor. No.

24 The Clerk. Mr. Chairman?

25 The Chairman. No.

1 The Clerk. Three yeahs, 11 nays.

2 The Chairman. The amendment is defeated.

3 Bill, do you want to go onto your second one?

4 Senator Bradley. Thank you very much, Mr. Chairman.

5 I would like to point out not that this argument would  
6 have been decisive in the last vote, but it would have  
7 raised \$3 billion.

8 The Chairman. Senator Heinz would like to be recorded  
9 as no on the last vote.

10 Senator Bradley. The next amendment deals with  
11 intangible drilling costs. Intangible drilling costs, as  
12 you know, is another special benefit for the production of  
13 oil. The same argument that I made for depletion would  
14 apply to intangible drilling costs. I believe the market  
15 should allocate the resources, and we should not have  
16 excessive subsidies for the production of energy, but we  
17 should allow the energy source that can compete in the  
18 marketplace to be produced and to be purchased and to  
19 prosper, and those that can't should not be overly subsidized.

20 In the intangible drilling cost area, Mr. Chairman, we  
21 are asking the question as to who benefits. And intangible  
22 drilling costs, 50 percent of the benefits go to just 31,000  
23 Americans with adjusted gross income of over \$100,000.00. And  
24 that is an average subsidy per taxpayer there of \$28,000.00  
25 per taxpayer. So at a time where we are trying to get tax

1 rates down for middle income people and that is the real  
2 thrust of tax reform, to reduce tax rates for middle income  
3 people, I think it would be appropriate to, if not eliminate  
4 intangible drilling costs, at least make them a more  
5 reasonable reflection of the length of -- how long the  
6 expenditures last.

7 And so what I would propose to do is to amortize  
8 intangible drilling costs over a 26-month period. That is  
9 the provision that is in the House bill. It would raise  
10 \$1.2 billion.

11 The Chairman. Discussion on the amendment?

12 Senator Bentsen. Yes, Mr. Chairman.

13 The Chairman. Senator Bentsen.

14 Senator Bentsen. I couldn't think of a worse time to  
15 do this. You have got a situation where this country at  
16 the time of the 1973-74 embargo was importing 47 percent of  
17 the oil that it used in this country. And we saw the OPEC  
18 countries really put it to us. We saw the long gas lines.  
19 We seem to have forgotten that.

20 What we were able to do with conservation in this  
21 country and continuing to drill, we were able to cut the  
22 dependency on foreign oil down to 31 percent. That is a  
23 great stride forward.

24 You actually saw in 1984 with all the problems of  
25 depleting reserves that we had more reserves of oil in 1984

1 than we did in 1949. Ninety percent of the real exploratory  
2 wells are done by the independents. You have seen a real  
3 hit taken in this industry with the precipitous price in  
4 the drop of oil which is helpful to a great part of the  
5 country and very detrimental to the producing states.

6 You have seen a situation where we are capping wells.  
7 The most active part of the oil business today is the  
8 undertaker part of that business. That is plugging wells.

9 I had a fellow in Odessa tell me the other day that he  
10 had been getting calls of one to two a day previously to  
11 plug wells. Now he is getting 12 to 20. What happens when  
12 you plug a well? In most instances, you have lost that  
13 reserve from now on. Oil would have to go to \$40.00 or  
14 \$50.00 a barrel at least before you would try to open that  
15 well again. And you would never get it back to where it  
16 was because you would never get the water flow and the oil  
17 flow working at the rate it did before.

18 You have seen the number of rigs that drill, that use  
19 this incentive, go down from a top in the past of about  
20 4,500 rigs down to less than 1,100. By the end of this  
21 year, the estimate is that the production in this country  
22 which was at 8.9 million barrels will drop by a million  
23 barrels. And you will see a substantial amount of our  
24 reserves lost forever. And you are going to see an increase  
25 in oil usage in this country. And instead of 31 percent

1 dependency on foreign oil, it is going to be substantially  
2 more, and it is going to climb.

3 And we are headed back to where we were in 1973 and 1974.  
4 We don't seem to learn.

5 And now there is talk about further curtailing the  
6 capital flow. Now, see, this fellow finally pays the taxes  
7 anyway. The question is giving him credit early so he has  
8 some capital flow, some cash flow, so he can go out and  
9 drill another well. It is the nature of this guy. He  
10 always thinks he is going to hit the big one. Few of them  
11 do.

12 To turn around and try to curtail that at a time like  
13 this I don't think helps either the national security of  
14 this country or the economy of this country. We sit here  
15 with \$148 million trade deficit, and then take away the  
16 incentives for domestic production.

17 There might have been an argument once upon a time  
18 although I don't think it had substance then. But the  
19 timing now is, horrendous to try to have this kind of  
20 amendment. I would urge the defeat of the amendment.

21 The Chairman. Further discussion?

22 Senator Wallop. Mr. Chairman, let me say that I agree  
23 with Senator Bentsen, and I also would say that this is one  
24 of the problems that we have with writing tax legislation.  
25 The figure as to how much it would raise is on its face

1 absurd in today's climate. You cannot possibly raise that  
2 kind of money given the fact that there is not that kind of  
3 drilling.

4 But aside from anything else and all the arguments that  
5 deal directly with the energy industry and its state of  
6 economic disrepair right at the moment, this is but another  
7 means of declaring what everybody else in every other form  
8 of business in America does and that is expense their cost  
9 of developing the product which they ultimately produce.

10 It is really not different than a newspaper writing off  
11 the cost of ink to produce the paper that ultimately is the  
12 thing which gives them the profit.

13 And so I would hope for just tax reasons as well as the  
14 economic reasons that Senator Bentsen mentioned that we  
15 defeat this amendment.

16 The Chairman. Could I ask the Clerk to record Senator  
17 Dole as no on the last amendment?

18 Further discussion?

19 (No response)

20 The Chairman. You want a roll call on this one?

21 Senator Bradley. Yes, I would like a roll call.

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

23 The Clerk. Mr. Dole?

24 (No response)

25 The Clerk. Mr. Roth?



1 Senator Roth. No.  
2 The Clerk. Mr. Danforth?  
3 Senator Danforth. No.  
4 The Clerk. Mr. Chafee?  
5 Senator Chafee. Aye.  
6 The Clerk. Mr. Heinz?  
7 (No response)  
8 The Clerk. Mr. Wallop?  
9 Senator Wallop. No.  
10 The Clerk. Mr. Durenberger?  
11 The Chairman. No, by proxy.  
12 The Clerk. Mr. Armstrong?  
13 (No response)  
14 The Clerk. Mr. Symms?  
15 Senator Wallop. No, by proxy.  
16 The Clerk. Mr. Grassley?  
17 Senator Grassley. No.  
18 The Clerk. Mr. Long?  
19 Senator Long. No.  
20 The Clerk. Mr. Bentsen?  
21 Senator Bentsen. No.  
22 The Clerk. Mr. Matsunaga?  
23 (No response)  
24 The Clerk. Mr. Moynihan?  
25 Senator Moynihan. No.

1 The Clerk. Mr. Baucus?

2 Senator Baucus. No.

3 The Clerk. Mr. Boren?

4 Senator Long. No, by proxy.

5 The Clerk. Mr. Bradley?

6 Senator Bradley. Aye.

7 The Clerk. Mr. Mitchell?

8 Senator Mitchell. No.

9 The Clerk. Mr. Pryor?

10 Senator Pryor. No.

11 The Clerk. Mr. Chairman?

12 The Chairman. No. And Senator Heinz wants to be  
13 recorded as no.

14 Senator Bradley. Mr. Chairman?

15 The Chairman. Senator Bradley.

16 The Clerk. Two yeahs, 14 nays.

17 The Chairman. The amehdment is defeated.

18 Senator Bradley.

19 Senator Bradley. Mr. Chairman, thank you very much. I  
20 seem to have lost ground in the last amendment. And that  
21 must have been because of the persuasive case made by the  
22 Senator from Texas and the Senator from Louisiana as to this  
23 was the wrong time in which to eliminate this particular  
24 production subsidy, notwithstanding that 50 percent of it  
25 goes to individuals who make more than \$100,000.00, and that

1 it impedes the functioning of the market. And, therefore,  
2 responding to their comments about this being the wrong  
3 time, the third amendment that I would offer would deal with  
4 intangible drilling costs, but it would read: "When the  
5 price of oil shall have exceeded \$25.00 per barrel for two  
6 consecutive quarters, then intangible drilling costs incurred  
7 at or subsequent to the casing point or to be amortized over  
8 a 26-month period."

9 Senator Bentsen. Mr. Chairman, let me say to the  
10 Senator I did not state just as a matter of timing. I was  
11 very careful to state that I had opposed this all along  
12 and felt that this added to the problem, the timing. I  
13 wasn't going to let myself walk into that one.

14 (Laughter)

15 The Chairman. Further discussion on the Senator's  
16 amendment?

17 (No response)

18 The Chairman. Want a roll call?

19 Senator Bradley. Yes, I would, Mr. Chairman. Again,  
20 let me state that this would phase out the intangible  
21 drilling cost subsidy only if the price of oil goes above  
22 \$25.00 a barrel.

23 The Chairman. Clerk, call the roll.

24 The Clerk. Mr. Dole?

25 (No response)

1 The Clerk. Mr. Roth?  
2 (No response)  
3 The Clerk. Mr. Danforth?  
4 Senator Danforth. No.  
5 The Clerk. Mr. Chafee?  
6 Senator Chafee. Aye.  
7 The Clerk. Mr. Heinz?  
8 (No response)  
9 The Clerk. Mr. Wallop?  
10 Senator Wallop. No.  
11 The Clerk. Mr. Durenberger?  
12 (No response)  
13 The Clerk. Mr. Armstrong?  
14 (No response)  
15 The Clerk. Mr. Symms?  
16 Senator Wallop. No, by proxy.  
17 The Clerk. Mr. Grassley?  
18 Senator Grassley. No.  
19 The Clerk. Mr. Long?  
20 Senator Long. No.  
21 The Clerk. Mr. Bentsen?  
22 Senator Bentsen. No.  
23 The Clerk. Mr. Matsunaga?  
24 (No response)  
25 The Clerk. Mr. Moynihan?

1 Senator Moynihan. Yes.

2 The Clerk. Mr. Baucus?

3 Senator Baucus. No.

4 The Clerk. Mr. Boren?

5 Senator Long. No, by proxy.

6 The Clerk. Mr. Bradley?

7 Senator Bradley. Aye.

8 The Clerk. Mr. Mitchell?

9 Senator Mitchell. No.

10 The Clerk. Mr. Pryor?

11 Senator Pryor. No.

12 The Clerk. Mr. Chairman?

13 The Chairman. No. And Senators Dole, Heinz and

14 Durenberger no.

15 The Clerk. Three yeas, 14 nays.

16 The Chairman. The amendment fails.

17 Senator Bradley.

18 Senator Bradley. Thank you very much, Mr. Chairman.

19 My next amendment would deal with the energy related  
20 tax credit, the so-called residential energy tax credits and  
21 the business energy tax credits and the credit for fuels  
22 from non-conventional sources and alcohol fuels credit and  
23 tax exemption.

24 Mr. Chairman, again, consistent with the general approach  
25 that the market should allocate the resources and that

1 various forms of energy sources should not be subsidized  
2 at varying levels because of the political process. This  
3 would move to eliminate all of those tax credits and  
4 special production subsidies.

5 I understand why many of those were put into the code.  
6 They were put into the code in the wake of the oil crisis  
7 of 1979 when everyone thought that we should have this  
8 source or that source of energy instead of high-priced oil.  
9 And so we ultimately guaranteed a floor under many sources  
10 of energy even though the price of oil now has dropped under  
11 that floor and that the market would dictate greater  
12 purchases of oil. We are now in some cases subsidizing  
13 other exotic forms of energy at much higher than what the  
14 market would bear.

15 Mr. Chairman, this would -- by elimination of these tax  
16 credits, we would raise \$1.2 billion. And I would move that  
17 we eliminate the tax credit.

18 The Chairman. Discussion on the amendment?

19 Senator Chafee. Mr. Chairman?

20 The Chairman. Senator Chafee.

21 Senator Chafee. If the prior amendments had been  
22 carried, I would be more enthusiastic for this group being  
23 eliminated. The prior amendments not having carried, I am  
24 not enthusiastic for the Senator's proposal.

25 The Chairman. Further discussion?

1 Senator Pryor. Mr. Chairman, could the record just  
2 show that Senator Chafee when he talked about the prior  
3 amendments --

4 (Laughter)

5 Senator Pryor. -- that is p-r-i-o-r. I just want to --

6 (Laughter)

7 The Chairman. The record will show that he means the  
8 preceding amendments.

9 Clerk, call the roll on the amendments.

10 The Clerk. Mr. Dole?

11 The Chairman. No.

12 The Clerk. Mr. Roth?

13 (No response)

14 The Clerk. Mr. Danforth?

15 Senator Danforth. No.

16 The Clerk. Mr. Chafee?

17 Senator Chafee. No.

18 The Clerk. Mr. Heinz?

19 The Chairman. No.

20 The Clerk. Mr. Wallop?

21 Senator Wallop. No.

22 The Clerk. Mr. Durenberger?

23 The Chairman. No.

24 The Clerk. Mr. Armstrong?

25 (No response)

1 The Clerk. Mr. Symms?  
2 Senator Wallop. No, by proxy.  
3 The Clerk. Mr. Grassley?  
4 Senator Grassley. No.  
5 The Clerk. Mr. Long?  
6 Senator Long. No.  
7 The Clerk. Mr. Bentsen?  
8 Senator Bentsen. No.  
9 The Clerk. Mr. Matsunaga?  
10 Senator Long. No, by proxy.  
11 The Clerk. Mr. Moynihan?  
12 Senator Moynihan. No.  
13 The Clerk. Mr. Baucus?  
14 Senator Baucus. No.  
15 The Clerk. Mr. Boren?  
16 Senator Long. No, by proxy.  
17 The Clerk. Mr. Bradley?  
18 Senator Bradley. Aye.  
19 The Clerk. Mr. Mitchell?  
20 Senator Mitchell. No.  
21 The Clerk. Mr. Pryor?  
22 Senator Pryor. No.  
23 The Clerk. Mr. Chairman?  
24 The Chairman. No.  
25 The Clerk. One yeah, 17 nays.



1 The Chairman. The amendment fails.

2 Senator Bradley.

3 Senator Bradley. Thank you very much, Mr. Chairman.

4 It is getting lonelier and lonelier, Mr. Chairman.

5 (Laughter)

6 Senator Bradley. And I have saved the last amendment  
7 because I don't think I could get any lonelier than the  
8 previous amendment.

9 The next amendment does not deal with energy, but it  
10 deals with timber.

11 (Laughter)

12 The Chairman. I think the amendment is out of order.

13 (Laughter)

14 Senator Bradley. Well, you haven't heard me make my  
15 case.

16 A brief history of the issue of capital gains treatment  
17 for timber. Mr. Chairman, there was a time when the capital  
18 gains treatment for timber applied only to people who held  
19 trees for investments. Any other company that was involved  
20 in the business of growing trees, cutting trees, selling  
21 trees, so forth, their income was treated as ordinary income.  
22 Then came World War II when tax rates were generally about  
23 90 percent, and the timber industry came to Congress and  
24 basically said they weren't going to cut any timber if the  
25 rates were 90 percent.

1           And at that time because we were in the war effort they  
2 proposed this particular kind of treatment for the cutting  
3 of timber. And they also applied that to so-called contract  
4 loggers who were entitled they argued or should be to  
5 capital gains treatment even though the timber they cut was  
6 owned by other people, in many cases owned by the Federal  
7 Government and the Forest Service.

8           The Congress, a little reminiscent of the oil depletion  
9 allowance in 1919, responded to this powerful national  
10 security argument and allowed capital gains treatment for  
11 timber. When the Congress passed it, the President at that  
12 time, Franklin Roosevelt, vetoed the break and said that this  
13 is relief not for the needy but for the greedy, which is a  
14 phrase I have heard subsequent to his coining it back in  
15 1944.

16           Needless to say, even though the President of the United  
17 States vetoed this particular tax break, the Congress  
18 overrode the veto and then expanded capital gains treatment  
19 to include Christmas trees in 1954, which as we all know  
20 are essential to our nation's national security.

21           And that brief history, I think, would demonstrate that  
22 the political process was more instrumental in providing  
23 this benefit than was either the market or any kind of  
24 rational economics.

25           Now I don't intend to take on this whole provision in the

1 amendment that I would offer. I would take on only capital  
2 gains treatment for timber on federal land. And the reason  
3 I do that is that in the course of our hearings we have  
4 heard a number of people come before the Committee and  
5 petition us as well outside the Committee that they believe  
6 that if we didn't have the capital gains treatment for  
7 timber that how could they get the money to plant the forests  
8 and have the next generation of trees that our nation so  
9 desperately needs.

10 So my amendment would only deal with the timber cut on  
11 federal lands because it is the federal lands area where  
12 there is a double subsidy, because it is the Forest Service  
13 that will replant those lands. And it is the taxpayer that  
14 will pay for the replanting of those lands; not the companies.  
15 And, secondly, it will -- the taxpayer will be hit by the  
16 capital gains treatment for the timber that is cut on the  
17 land.

18 So, Mr. Chairman, I would move to repeal capital gains  
19 treatment for timber on federal lands effective January 1,  
20 1987.

21 The Chairman. I would respond as follows:

22 Senator Bradley. I am surprised, Mr. Chairman.

23 (Laughter)

24 The Chairman. One, this very clearly aims at a very  
25 specific group of smaller timber operators for the following

1 reasons: Weirhauser is our biggest timber company in the  
2 United States, although they are only about five percent of  
3 the market, but they are the biggest. They grow most of  
4 their own timber. They have a few occasional purchases  
5 from public land, but they are by and large self-sufficient.  
6 And they get a capital gains treatment, depending upon when  
7 they grew, and they get expensing for their reforestation.  
8 And it is expensing that is more critical for reforestation.  
9 And the capital gains is between the two.

10 So what you are saying to the small timber operators in  
11 Oregon, Washington, Northern California and elsewhere: You  
12 buy your trees from public land, you have three years to cut  
13 them, you get no capital gains. You are going to go up  
14 against both Weirhauser and the others who have their own.  
15 They will get capital gains. You are going to go up against  
16 those who purchase from private lands in the South, they  
17 will get capital gains. But not those small mills. And the  
18 bulk of timber production in the northwest is from small  
19 mills.

20 They will not get the same treatment. And I think it is  
21 discriminatory. I think it is unfair to single them out  
22 and say only you will not get it. And I would hope that  
23 the Committee would defeat the amendment.

24 Senator Baucus. Mr. Chairman?

25 The Chairman. Senator Baucus.

1           Senator Baucus. Mr. Chairman, I don't think we want to  
2 prolong this. I think your arguments are pretty well known.

3           In addition to the arguments you make, which I very  
4 heartily subscribe to, one problem with this amendment, and  
5 frankly some of the others that preceded it, is they don't  
6 take into consideration our international competitive  
7 position.

8           Canada, for example, very heavily subsidizes its timber.  
9 Thirty percent of our softwood consumption in America today  
10 is Canadian imports. This amendment would have the effect  
11 of increasing that to above 30 percent and the more that it  
12 hurts the U.S. industry compared with the Canadians.

13           There are a lot of other examples I could go into, but  
14 the main point is that in addition to discriminating against  
15 the smaller producers, which is very true -- and the point  
16 you make is very, very valid -- smaller operators buy most  
17 of their timber from Forest Service land. They don't get  
18 near as much timber from the private land.

19           In addition to that is the international competitive  
20 angle. And the fact of the matter is whether we like it or  
21 not as Americans, we are facing the international  
22 competition. We are facing competition overseas that is  
23 subsidized much more heavily than is the U.S. And, in fact,  
24 the Canadian's tax treatment of timber compared with the U.S.  
25 tax treatment of timber according to the International Trade

1 Commission is a wash. The U.S. tax treatment of timber does  
2 not subsidize the American timber compared to the Canadian  
3 timber. It is a wash on the tax side only.

4 But in addition to the tax consequences, Canada does  
5 subsidize its stumpage very, very heavily. Stumpage  
6 prices in Canada are roughly a tenth what they are in the  
7 U.S. on public lands.

8 So I just think for all these reasons that this is not a  
9 good idea. And I urge the Committee to oppose it.

10 The Chairman. Further discussion?

11 Senator Bradley. Mr. Chairman?

12 The Chairman. Senator Bradley.

13 Senator Bradley. If I could, I think that the comment  
14 made by the Senator from Montana is a precursor to the whole  
15 discussion on depreciation and a variety of other issues.

16 If we attempt to solve our international competitiveness  
17 problems through the tax system as opposed to paying closer  
18 attention to exchange rates and interest rates and fiscal  
19 policy, I think we are going to load even a greater burden  
20 on the tax system than presently exists with our crazy  
21 quilt set of distorted incentives.

22 And I appreciate that argument, but I don't think that  
23 it is appropriate here.

24 And I might also say that for the small loggers who go  
25 out and essentially have contracts to cut on federal land,

1 the argument has been made and again today that, you know,  
2 they are facing a big risk when they go out, and, therefore,  
3 they deserve to have the capital gains treatment.

4 I would point out only to you that when the value of  
5 those logging contracts collapsed in 1982 what happened was  
6 Congress came in and bailed them out with a direct subsidy  
7 that could end up costing the taxpayer about half a billion  
8 dollars.

9 So, Mr. Chairman, I simply wanted to make the points,  
10 and state to the Committee that this is one of those  
11 provisions where the taxpayer gets hits twice. And instead  
12 of cutting middle income people's tax rates, we are giving  
13 the benefit to a particular segment of the industry and then  
14 we are forcing the taxpayer to pay more in taxes to  
15 reforest the area that has been cut.

16 The Chairman. Let me make just one correction to the  
17 Senator's last statement. All of the timber from the  
18 public, from the Forest Service, from the Bureau of Land  
19 Management land, sold on a competitive bid on any of what we  
20 would call the productive forest mostly in the West, they  
21 more than pay their own way. All of those forests make  
22 money for the Federal Government. Just because we do not  
23 have a specific U.S. Forest Service trust fund for  
24 reforestation, although we do have a minor one that was  
25 passed in legislation in 1980, you should not be confused with

1 who is paying the money to do the reforestation. It is all  
2 put into the bid price, and the bid price is competitive, and  
3 the bid price is high.

4 And after reforestation, and after the roads and  
5 after everything else is done, the Forest Service still  
6 realizes a profit on the sale of the trees.

7 Senator Moynihan.

8 Senator Moynihan. Mr. Chairman, I am not going to  
9 support Senator Bradley's amendment mainly because of the  
10 geography of public lands. I mean there is forestry in most  
11 parts of the country, save the Great Plains. There are  
12 forest product industries in New York state.

13 But it is only in the northwest that you find that huge  
14 concentration of federal land, which I think is the  
15 Chairman's point about the disadvantage of the operators  
16 using the federal lands as against those using the private  
17 lands. I think it is a fair one and accepted.

18 But let me agree with the Senator about the question of --  
19 and respectfully disagree with my friend from Montana -- about  
20 solving our international trade problems with our tax code.  
21 I mean the first thing I said when we began this markup, and  
22 I will say it again and I hope Mr. Darman will hear me and  
23 I hope Mr. Mentz hears me -- five years ago in this Committee  
24 we passed a revenue neutral tax bill which produced the most  
25 disastrous fiscal policy in the history of the nation, a



1 protracted deficit, a decade of prices not over --  
2 extrapolation under Gramm-Rudman, we might get to a  
3 balanced budget in the next decade. A decade of disastrous  
4 fiscal policy because we misinformed ourselves and deluded  
5 ourselves and at some point I have to say misrepresented  
6 things.

7 And if we do that again it is not to be abided by. This  
8 is my tenth year in this Committee. I understand something  
9 about this Committee. This Committee is a mark of the early  
10 republic. It represents the great expanses of new land,  
11 extractive industries, exploitive industries, perfectly  
12 good ones. That is how we got out of growing corn and beans.

13 And when we need an excerpt, Senator, from the oil pack,  
14 we expand the size of the Committee and make sure it is  
15 there. And they are always here. And it is meant to be.  
16 And that is why I am the first New York Democrat in a  
17 century to serve in finance because the main forces of the  
18 economic productivity of this country have not needed the  
19 tax code and haven't got much from it.

20 That is all very well, and that is the reality and that  
21 is the republic. But to add a trillion dollars to the  
22 national debt in five years because of our tax bill is not  
23 all right. And if we are going to -- and that is what  
24 happened to the exchange rate between the United States and  
25 Canada.

1 I have not come to this Committee to ask relief for the  
2 onions that are pouring in from Quebec, but they are. We  
3 happen to grow onions in New York. We have got a few  
4 patches of deep, 17 foot muck that is some geological  
5 holdover. It is sold by the square foot. And they are good  
6 onions. I don't know how much different onions are one from  
7 the other. Some people probably do. I don't.

8 But they are good onions. And they grow. You drop the  
9 seed in little patches. There are about five of them in  
10 New York state. And up comes the onion, and down it goes  
11 to the Boston market. No more. They come from Quebec. Why?  
12 Because for \$.60 it will get you a dollar's worth of onions  
13 in Quebec, and that is happening in this Finance Committee.  
14 And it is happening to your stumpage.

15 The Chairman. Further discussion?

16 (Laughter)

17 Senator Moynihan. If we are going to give away another  
18 \$100 billion in structural deficit under the heading of a  
19 nominally revenue neutral tax bill, well, I don't think we  
20 will have served the nation well. And we certainly will have  
21 repeated an event that in one decade has no right.

22 The Chairman. Senator Chafee.

23 Senator Chafee. Mr. Chairman, various members of the  
24 Committee have speeches that are given on occasion, and they  
25 are all good ones. Sometimes there is not a reply. I

1 wouldn't want silence to be indicated either agreement or  
2 assent or approval of Senator Moynihan's excellent speech.  
3 Excellent delivery, weak in content.

4 (Laughter)

5 Senator Chafee. So rather than prolonging the matter, I  
6 would just say that no one should assume that by our not  
7 engaging him in verbal battle here we are agreeing in any  
8 fashion with what he has said.

9 The Chairman. Clerk, call the roll.

10 Senator Bradley. Mr. Chairman?

11 The Chairman. Senator Bradley.

12 Senator Moynihan. I would be interested in your reply.  
13 Did we create a deficit or did we not? Have we not raised  
14 the cost of the dollar internationally or have we not?

15 The Chairman. I would rather not rehash the 1981 tax  
16 bill, if we can avoid rehashing it, while we have got major  
17 work still ahead of us.

18 Senator Moynihan. We have been at this a long time, and  
19 I have only made the speech twice.

20 (Laughter)

21 Senator Chafee. Twice in two days, though. That is a  
22 high average.

23 (Laughter)

24 The Chairman. Senator Bradley.

25 Senator Bradley. Mr. Chairman, just let the record

1 reflect that Senator Moynihan ably represented the interest  
2 of Carmen Vacillio, that former welter weight champion  
3 onion grower from Schenectady, New York.

4 The Chairman. The Clerk will call the roll.

5 The Clerk. Mr. Dole?

6 The Chairman. No.

7 The Clerk. Mr. Roth?

8 (No response)

9 The Clerk. Mr. Danforth?

10 Senator Danforth. No.

11 The Clerk. Mr. Chafee?

12 Senator Chafee. No.

13 The Clerk. Mr. Heinz.

14 The Chairman. No.

15 The Clerk. Mr. Wallop?

16 Senator Wallop. No.

17 The Clerk. Mr. Durenberger?

18 The Chairman. No.

19 The Clerk. Mr. Armstrong?

20 (No response)

21 The Clerk. Mr. Symms?

22 Senator Symms. No.

23 The Clerk. Mr. Grassley?

24 Senator Grassley. No.

25 The Clerk. Mr. Long?

1 Senator Long. No.

2 The Clerk. Mr. Bentsen?

3 Senator Bentsen. No.

4 The Clerk. Mr. Matsunaga?

5 (No response)

6 The Clerk. Mr. Moynihan?

7 Senator Moynihan. No.

8 The Clerk. Mr. Baucus?

9 Senator Baucus. No.

10 The Clerk. Mr. Boren?

11 Senator Long. No, by proxy.

12 The Clerk. Mr. Bradley?

13 Senator Bradley. Aye.

14 The Clerk. Mr. Mitchell?

15 Senator Mitchell. No.

16 The Clerk. Mr. Pryor?

17 Senator Pryor. No.

18 The Clerk. Mr. Chairman?

19 The Chairman. No.

20 The Clerk. One yeah, 16 nays.

21 Senator Bradley. Mr. Chairman, I will not offer another  
22 amendment.

23 (Laughter)

24 Senator Bradley. But I would like the record to reflect  
25 that if we had adopted these amendments that we would have

1 raised \$5.6 billion that could have gone to rate reduction  
2 for middle and low income people. And I hope that as we  
3 proceed through the bill that we are able to make the choices  
4 that will continue to keep those rates down and their tax  
5 burden down.

6 The Chairman. Further amendments on the energy,  
7 natural resources, agriculture section?

8 Senator Wallop. Mr. Chairman, I would just like to make  
9 an observation that those revenue figures are again ones  
10 which are produced as only they can be produced by Joint  
11 Tax or by Treasury on static projections based on a market  
12 that no longer exists. I mean it is just a dandy way of  
13 producing a level of this information of what might have  
14 happened, because I believe the Senator would agree with me  
15 that they couldn't possibly raise that kind of revenue given  
16 the market that is in existence today in either of the  
17 industries of which we have just been dealing.

18 Senator Bradley. If I could just respond. As we  
19 proceed through writing tax reform legislation, to do it in  
20 any kind of coherent way, we have to decide if we eliminate  
21 tax expenditure X; how much revenue will it raise. That is  
22 the way that we get to a revenue neutral tax reform bill.

23 Just as you would look at the depletion in the hard  
24 mineral industry or you would look at capital gains or you  
25 would look at any of the tax expenditures, you have to put a

1 revenue number on it.

2 Now I can understand the Senator's view that this whole  
3 process is something that he can't support, but I am sure  
4 that he would want to if we were going to proceed through it  
5 to do it in the most rational way possible. And the only  
6 number that I raised was the number that is provided by the  
7 Joint Tax Committee.

8 Senator Wallop. Well, I don't quarrel with a number that  
9 was raised and that being the source. But I do quarrel with  
10 the idea that it can't be hinged to some kind of reality,  
11 you know. Frankly, this just isn't hinged to any kind of  
12 reality.

13 Senator Moynihan. How should we do that?

14 The Chairman. Secretary Mentz, do you have a comment?

15 Mr. Mentz. Yes. Before we broke for recess, you asked,  
16 Senator Wallop, for an estimate of the depletion numbers  
17 based on different oil prices. Treasury has estimated those,  
18 and I can just give them to you now, if you like.

19 At a \$20.00 a barrel oil price, the total revenue  
20 involved is \$2,463,000,000.00.

21 Senator Wallop. For the five years?

22 Mr. Mentz. For the five years.

23 At \$15.00, it goes down to \$1,745,000,000.00 And at  
24 \$10.00, it is \$1,70,000,000.00. So it drops by a third from  
25 the estimate at the Administration estimate.

1 I don't have those, Senator Bentsen. I would expect  
2 they would be --

3 The Chairman. Comparable.

4 Mr. Mentz. -- a similar pattern though.

5 Senator Wallop. Actually, the IDCs would probably be  
6 a little bigger. The IDCs would probably represent a  
7 larger loss of revenue than --

8 Senator Long. I would just want to fix the credit to  
9 a \$10.00 figure. For \$10.00 you are looking at one big  
10 zero deduction compared to \$3 billion or, say, a figure  
11 of 2.4. So that if it is a \$10.00 figure, it is only about  
12 40 percent of what it would be if it would be a \$20.00  
13 figure.

14 Mr. Mentz. That is right.

15 Senator Long. And now the high point on rigs with only  
16 a few years to go, when you had about four and a half,  
17 4,500 rigs or in that vicinity working, and now that figure  
18 is about, what, one point three, something like that? That  
19 is 1,100. So 75 percent of all the rigs have been  
20 immobilized, and that would mean, I would take it, it would  
21 be down by about 75 percent. Is that correct? If you lay  
22 off 75 percent of the rigs, you have got your drilling down  
23 75 percent on the average, I would think. And if that is  
24 the case, then that figure has to be cut to about one-  
25 quarter or one-third of what the Senator is estimating.



1 Mr. Mentz. It certainly has got to be in that ball  
2 park, Senator.

3 The Chairman. Further amendments in this section?

4 Senator Danforth.

5 Senator Danforth. Mr. Chairman, this section includes  
6 agriculture as well as minerals, correct?

7 The Chairman. Agriculture and natural resources.

8 Senator Danforth. This is a subject that Senator  
9 Grassley, I know, is interested in and others have taken an  
10 interest in it. Basically, the issue has to do with trying  
11 to discourage people from getting into farming purely for  
12 tax shelter purposes. With tremendous problems in  
13 agriculture, in over production in agriculture, there is  
14 great concern that the tax code not encourage people who  
15 really are not in the farming business other than to  
16 generate losses from getting into the farming business.

17 Senator Abdnor introduced a bill some time ago which  
18 would limit the deduction of farming losses to farming  
19 itself so that a person couldn't get into the farming  
20 business, generate losses, and use it against other income.

21 I don't have the amendment prepared right now, but I  
22 wonder if Treasury has looked at this proposal and whether  
23 there is any interest in it.

24 Senator Bentsen. I would like to speak to it as soon  
25 as Treasury has responded.

1 Mr. Mentz. Well, Senator Danforth, there is a provision  
2 similar to that in the minimum tax, in the Chairman's  
3 minimum tax proposal, limiting the farm loss so that it  
4 can't be used against other forms of income.

5 But I think in the regular tax the Administration or at  
6 least the Treasury has always been reluctant to put barriers  
7 around different kinds of businesses to constrain a business-  
8 man from being in one business and being in another business  
9 and having the legitimate business expenses of one offset  
10 income of another.

11 I think that is kind of opposite to the free market way  
12 that our tax system should operate. It does seem to  
13 Treasury that it is appropriate in the minimum tax -- there  
14 is a specific farm provision in the minimum tax on that point.

15 But on the regular tax, I have not studied exactly what  
16 Senator Abdnor is proposing, but I would say our general  
17 philosophy is that that is probably not the direction to go.

18 Senator Bentsen. Senator, if I might further comment.  
19 Let me tell you what my concern is with it. You do have  
20 provisions in there to stop the fellow that does it just as  
21 a hobby. He has to show a profit on it over a period of  
22 time in that regard.

23 But what concerns me the most is the problem that we  
24 have got so many questionable farm loans today in the banks.  
25 And you see a drop in value of those farms and the collateral.

1 You see the examiners really riding tough on them, and you  
2 are seeing a lot of agricultural banks, in effect, going  
3 broke.

4 Now if you add this provision and you begin to segregate  
5 a business and say you can't go into that one as an  
6 additional business, which would be unique in the tax law,  
7 and, frankly, I think, bad tax law -- but in addition to that  
8 then you get further farms put on the market.

9 And as you do that, you accelerate the decline in farm  
10 values. And I think that your collateral goes down. And  
11 I think the examiners put more loans in question. And I  
12 think that you add to the problem, and farms will go down  
13 more in value. And I think you will have more foreclosures.  
14 And I think farmers themselves get hurt in the process. That  
15 is what concerns me with that kind of an approach.

16 Senator Baucus. Mr. Chairman?

17 The Chairman. Senator Baucus.

18 Senator Baucus. Mr. Chairman, I understand what  
19 Senator Danforth is striving for, and I think it is a  
20 laudable goal. Your package moves very much in that  
21 direction already. It includes the anti-sod busting  
22 provision, for example, which is very helpful. Second, it  
23 also has a tighter individual minimum provision to help do  
24 some of this sheltering of non-farm income. I think it goes  
25 very far in that direction.

1           However, I am afraid that the Abdnor idea perhaps goes  
2 a little too far. There are a lot of farmers and ranchers  
3 who definitely do farm and ranch very legitimately. But in  
4 order to stay alive, they also have some outside income.  
5 And there are countless examples of that. And I am afraid  
6 that the Abdnor idea, although it is laudable on the surface,  
7 would tend to undercut and undermine too many farms and  
8 ranches in this country who are striving to stay alive by  
9 supplementing some of their outside income.

10           The fact is, I think some of the future in farming not  
11 only depends upon expanded export markets and much more  
12 vigorous moves in that direction but also depends to some degree  
13 on some outside income.

14           I am not going to hold Japan up as an example, but in  
15 Japan 70 percent of all farm income in Japan is non-farm  
16 income. I visited an agricultural co-op in Japan last year.  
17 It was the most profitable in Japan. It was a cattle co-op.  
18 And even though it was the most profitable cattle co-op,  
19 50 percent of their income was non-farm income. The fact  
20 that they see the writing on the wall, they see more deep  
21 imports into Japan, they are growing flowers as an  
22 alternate, which I am sure is still farm income. But,  
23 nevertheless, they are diversifying.

24           I think part of the answer to American agriculture will  
25 include some diversification in addition to stronger, more

1 aggressive farm programs. So I think this goes too far.

2 Senator Danforth. I think that is a very good point. I  
3 mean there are a lot of farmers who are able to keep their  
4 heads above water simply because there is a community some-  
5 where nearby and they are able to go to work during the day  
6 and keep their farms. And I wouldn't in any way want to  
7 impair that.

8 On the other hand, there are also a lot of people who  
9 have gotten into farming purely for tax shelter purposes.  
10 I would doubt that the tightening of the minimum tax is  
11 going to get at that problem, and I know that -- what is it,  
12 two years out of seven you have to realize a profit? Is  
13 that it, Roger?

14 Mr. Colvin. It is two out of five under current law.

15 Mr. Brockway. Two out of five.

16 Senator Danforth. Two out of five.

17 Mr. Mentz. Unless it is race horses.

18 Mr. Colvin. Three out of five under the Chairman's  
19 proposal.

20 Senator Danforth. Three out of five that you have to  
21 have a profit?

22 Mr. Mentz. Well, if you meet that test, you are clearly  
23 not a hobby. But if you don't meet that test, it doesn't  
24 mean that you are out. So it is just a --

25 Senator Bentsen. Let me tell you a lot of 100 percent

1 farmers would like to meet that test today.

2 Senator Danforth. That is right. I mean I think of  
3 most people in farming now, people really in the business of  
4 farming, are far from meeting the test. I think the problem  
5 is somebody who is, you know, doing anything, practicing  
6 law or a doctor or whatever and they decide, well, I am  
7 going to pick up a farm; it looks good; it is, you know, a  
8 nice thing to have; I can spend my weekends there. And  
9 while I am spending my weekends there if I can earn a  
10 profit two years out of five, those other three years are  
11 going to be used for shelter.

12 As I said, I am not proposing this at this time. Mr.  
13 Chairman, I know you don't want to keep these various areas  
14 of the bill open forever, but I wonder if I could at least  
15 reserve the possibly of some time of developing something  
16 in this area.

17 The Chairman. Without objection.

18 Are there other amendments in this area? I would like  
19 to move on to depreciation when we can.

20 Senator Chafee.

21 Senator Chafee. Mr. Chairman, Senator Grassley had an  
22 amendment which we all support and I thought was a good one  
23 previously. And the only question was whether that amendment  
24 should apply to other than farming.

25 What I would like to do, Mr. Chairman, is just look into

1 it a little more, and perhaps come back with a broadening of  
2 that amendment.

3 And I think Treasury gave us a -- Mr. Brockway gave us a  
4 revenue estimate. I am just not sure what to do about  
5 that. Senator Long spoke about it.

6 The Chairman. Why don't you reserve it and see what you  
7 can come up with.

8 Senator Chafee. I would. I would like to. Thank you.

9 The Chairman. Senator Grassley, do you have an  
10 amendment?

11 Senator Grassley. I don't have an amendment, but I  
12 want to say something about what Senator Danforth talked  
13 about.

14 I am glad that he spoke up on that this morning. I am  
15 glad he observed some rights in that area. My thinking is  
16 along the line of Senator Danforth and to be supportive of  
17 something in the vein of Senator Abdnor. Wait until we  
18 get near the end of the tax bill because the impact of some  
19 the changes we make like extending depreciation, some  
20 agricultural things and any other provisions -- both the  
21 alternative minimum tax -- would make some difference in that  
22 area.

23 But I think that when you think in terms of two and  
24 four-tenths billion dollars that would come in under Abdnor's  
25 amendment and then presumably if we made some modification

1 in tax sheltering anyway then that would be a smaller number  
2 if we would go with it now. It is still a sizable amount  
3 of money.

4 And then it seems to me like there has got to be some  
5 umbrella because we aren't going to take care of all things.  
6 And I think that it is perfectly legitimate to discriminate --  
7 or not to discriminate -- to discourage some of this in an  
8 industry that is already over-capitalized. That is one of  
9 the major problems in agriculture today. We have had such  
10 favorable tax policy, we have invited so much capital into  
11 agriculture. That is one of our major problems.

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1           Senator Grassley (continuing). And in comment to  
2 Senator Baucus's concerns, very legitimate concerns, about  
3 some people maybe not being in farming, without some of this  
4 outside income -- like either one of the spouses working --  
5 the fact that it is average household income, the rule that  
6 Senator Abnor uses in his bill, I think takes care of an  
7 overwhelming percentage of the problem. And yet, I would have  
8 to confess that going with Abnor in the purest form has caused  
9 some doubt in my mind that maybe it would affect some people  
10 negatively in agriculture. But I think we ought to try it.

11           Senator Wallop. Mr. Chairman, I would like to make an  
12 observation there. Before we go too far on all of these  
13 things, one thing that the American farmer does not need  
14 today is a lower price for his land. And you may be wandering  
15 into a thicket that creates just that circumstance and begins  
16 to diminish a market which is already pretty tragically  
17 depressed.

18           Senator Baucus. Mr. Chairman?

19           The Chairman. I would like to move on to depreciation,  
20 if we can, because we have a large group here.

21           Senator Baucus. I understand. Just 60 seconds.

22           Addressed to the Senator from Iowa: I would hope that  
23 we could look at the minimum tax provision that is already in  
24 this package. It very much increases the amount of non-farm  
25 income which is included as a tax preference. And I think if

1 we crank out the numbers of that, you will see that it begins  
2 to address the bulk of the problem that you and I are both  
3 addressing. Perhaps modification of Abnor might be necessary  
4 later on but, if you look at the provision in the present  
5 package, I think you will find that it goes a long way in the  
6 direction that you want to go.

7 Senator Grassley. I could be convinced that that would  
8 take care of it, but I think you would want to wait until the  
9 tail end to make that decision.

10 The Chairman. Let us move on to depreciation, because we  
11 have a major proposal which Senators Roth and Baucus spear-  
12 headed in putting together, and it is also co-sponsored by  
13 Senators Heinz, Dole, Bentsen, Grassley, and Wallop.

14 The sheet has been passed out, and I think a good many  
15 members have been involved in addition to the sponsors in the  
16 negotiations on this. I will call upon Senators Roth and  
17 Baucus for the amendment.

18 Senator Roth. Thank you, Mr. Chairman.

19 As you have already indicated, this amendment is offered  
20 on behalf of a large number of Senators from both the  
21 Democratic and Republican side.

22 I think it is important. I think it is important to  
23 understand that our staffs have been meeting over a period of  
24 several weeks, so that I think the development of this  
25 specific proposal has been widely disseminated to members of

1 this committee.

2 Let me start out by saying that many of us, Mr. Chairman,  
3 have been concerned about the House bill as well as the  
4 Senate Finance Committee draft, as to what impact it has  
5 on growth.

6 In many ways it seemed to me that some of the earlier  
7 proposals are what I would call "anti-growth and anti-jobs."  
8 It seems to me that one of the most important goals in tax  
9 reform is to create the kind of tax environment that will  
10 help us to become competitive in world markets.

11 Certainly a key factor in modernization is the cost of  
12 capital for equipment. How much money must be generated to  
13 produce the necessary rate of return is a key factor in the  
14 businessman's or business woman's decision, and what has  
15 concerned us about both the House proposal and the Finance  
16 Committee draft is that they have raised the cost of capital  
17 for equipment so that, in turn, I think they tend to be  
18 anti-competitive.

19 For example, in the case of the House bill, it is  
20 estimated that the cost of capital for equipment is 30 percent  
21 higher. Now, it is my feeling that that is the wrong way to  
22 go, that if we are going to meet the challenge of competition  
23 from abroad, then we have to have a tax code that is going to  
24 encourage investment. And that is exactly what we are seeking  
25 to do here in our tax proposal.

1           Now Mr. Chairman, essentially what we have done, we have  
2 used your amendment as the starting point. We have thought to  
3 build on it. As you know, the Senate proposal keeps ACRS for  
4 equipment, but it eliminates the ITC. And the method of  
5 depreciation used in the Senate draft is 150-percent declining  
6 balance. Some long-lived property is moved from the 5- to  
7 the 10- and 15-year class. The system is indexed for infla-  
8 tion in excess of 2 percent; and autos and light trucks were  
9 put in the 5-year category.

10           Now, what we propose to do is to amend that proposal as  
11 follows:

12           First, we would set up a class of productivity property  
13 for the 5-, 10-, and 15-year property that are used in  
14 manufacturing, transportation, agriculture, communications,  
15 extraction industries, and research.

16           The 3-year property would not be included in this  
17 class of productivity.

18           It is also provided that utilities, since they benefit  
19 under other provisions, would not be "productivity property,"  
20 with the exception of telephone.

21           And Mr. Chairman, we have attached a list that define  
22 productivity properties.

23           Now, I might point out for the benefit of the committee,  
24 that the productivity property is in the law already; this is  
25 not a new concept. So, we aren't redefining or introducing

1 something new and novel.

2 As I said, the definition of "productivity property" is  
3 very broad; it includes all equipment used in production,  
4 extraction, transportation, communications, and agriculture.

5 Now, services do not qualify under the definition of  
6 "productivity" because these industries are primarily  
7 concerned with rate reduction, and the rate reductions in the  
8 Chairman's proposal have lowered their cost of investment  
9 dramatically to current law -- as I said, the cost of equip-  
10 ment that has risen dramatically in the various proposals,  
11 and that is what we are seeking to address.

12 Again, I would point out that the plan is administerable.  
13 The productivity class is based on existing definition under  
14 the Asset Depreciation Range, better known as ADR; a list of  
15 ADR categories for equipment can be read into statutory  
16 language. And as I said, anything on the list would get  
17 200-percent declining balance, while anything not on the list  
18 gets 150-percent declining balance as proposed under the  
19 Chairman's amendment.

20 We would permit a switch at the optimum time to the sum  
21 of digits.

22 Now, Mr. Chairman, other changes: We would eliminate the  
23 2-percent floor on indexing; thus, the entire system would be  
24 fully indexed. We would move autos and light trucks into the  
25 3-year class using straight-line deduction. And we find that

1 this proposal roughly is equivalent to current law.

2 Mr. Chairman, I think this is an extremely important  
3 proposal. I think it is particularly important if this  
4 country is to have a chance of becoming competitive in world  
5 markets.

6 I don't know how you feel -- I am tired of seeing this  
7 country play catch-up. I think it is about time that we lead  
8 instead of following our competitors. That means that, if we  
9 are going to succeed, that our industrial facilities have  
10 to have the most modern equipment available, not only for this  
11 year but for every year following, because I think change,  
12 innovation, new technology is the order of the day.

13 So, we propose this as a step to help this country  
14 continue to be the industrial leader, and, most importantly,  
15 I think it is important that if we are to provide jobs, jobs  
16 for the unemployed and jobs for the under-employed, jobs for  
17 the young, then it is important that we have the best  
18 industrial facilities in the world.

19 I would propose and urge the adoption of this amendment,  
20 about which I want to pay my special congratulations to others  
21 and particularly Senator Baucus and the many other co-sponsors  
22 who have played a key role in developing this amendment.

23 The Chairman. Senator Baucus?

24 Senator Baucus. Mr. Chairman, I want to thank the  
25 Senator for his statement and explanation of the proposal.

1           Essentially, the goal here is to redress what some of us  
2 perceived as an imbalance in the original Chairman's package  
3 as it affects the cost of capital.

4           All of us here for a long time this morning, and on  
5 subsequent days, can debate the degree to which U.S. cost of  
6 capital is higher than overseas cost of capital, and the  
7 ways in which we address our competitive position. There are  
8 no hard facts there, it is hard to analyze that, but I think  
9 we all will agree that, to a general degree, U.S. capital  
10 costs are higher than are capital costs overseas and that  
11 that very much directly affects our competitive position, and  
12 it will to a greater degree in the future. And therefore, it  
13 must be at least addressed.

14           Now, the difficulty we face here, among others, is that  
15 the original package did reduce the capital costs in various  
16 categories but not for machinery and equipment; that is,  
17 inventory capital costs because of lower rates in the package,  
18 land costs -- again, because of lower rates. They both have  
19 experienced some reduction compared to current law.

20           But because of the repeal of the ITC, machinery and  
21 equipment capital costs under the original package were  
22 increased.

23           The problem here is that that is the part of American  
24 investment which most directly is adversely affected by  
25 international trade. It is therefore our thought that we

1 address that and try to do so with this compromise, this  
2 package that we are presenting to the committee.

3 It is designed to do that, to redress that balance, so  
4 that machinery and equipment capital costs are not increased.  
5 If we do anything here, I think we should not increase  
6 capital costs. We can debate the degree to which we should  
7 decrease, but we certainly should not increase.

8 I am also particularly interested in one sector of  
9 American industry, and that is the semiconductor industry.  
10 This package includes semiconductor processing equipment in  
11 the 3-year category. I think that is an important improvement.

12 More fundamentally is the small business expense  
13 provision -- that is, the \$40,000 expensing provision. I  
14 think it is important for us to realize the degree to which  
15 the House bill helps big business basically at the expense of  
16 small business. Big business rates are lowered under the  
17 House bill; small business rates are not lowered.

18 ITC repeal applies to both big business and small  
19 business; consequently, comparatively, big business gets a  
20 better break under the House bill than does small business.

21 It is our attempt here in this package, with the \$40,000  
22 small business expensing provision, to help redress that  
23 imbalance, so that small business is treated in a fair way,  
24 certainly compared with big business.

25 The small business provision, too, only applies to an



1 investment which is used in the active trade or business, so  
2 that that provision is not abused.-- it is hopefully not  
3 abused. And then, second, I think there is a \$200,000 capital  
4 expense limitation, so it would apply only to truly a small  
5 business, and the \$40,000 expensing would not be as available  
6 to big business.

7 I think it is a good compromise. It attempts to address  
8 of lot of the problems earlier, as we saw, and I urge the  
9 committee to adopt it.

10 The Chairman. Senator Grassley, and then Senator  
11 Danforth.

12 Senator Grassley. I just wanted to clarify with  
13 Senator Roth that his portion here in his explanation, where  
14 he talks about "special purpose agriculture structures" --  
15 momentarily, that is not a part of your amendment, because we  
16 are going to work on a compromise on that, right?

17 Senator Roth. That is correct.

18 Senator Grassley. So, would you make clear, then, to  
19 the committee that that part of it will come up in a few hours  
20 or days later? Right?

21 Senator Roth. Yes. I have discussed with the Chairman  
22 the desires of Senators Pryor and Danforth. And I would say  
23 to the good Senator that, as I indicated to him earlier, we  
24 are hoping that he and Senator Pryor and Senator Danforth and  
25 myself can look at this problem of the single-purpose

1 agriculture building -- and, Senator Heinz, I think this is  
2 a matter of interest to you, as well -- and we can work out  
3 a reasonable compromise. So, that will come up at a later  
4 time.

5 The Chairman. There is the following order; Danforth,  
6 Bentsen, Chafee and Mitchell.

7 I would just like to add ont point on this: I am very  
8 reluctant to drop off of the \$50,000 expensing for small  
9 business. That is perhaps the most attractive part of this  
10 bill to small business, and the House has a \$10,000 limit in  
11 their bill. Every dollar we move down here is going to make  
12 our position in terms of a conference a bit weaker on that  
13 subject.

14 Senator Danforth?

15 Senator Danforth. Mr. Chairman, first I have a couple of  
16 questions to ask. I am sorry, I was distracted when Senator  
17 Grassley asked his question, but is it my understanding that  
18 this proposal does not deal at all with the single-purpose  
19 agricultural structure? Or does it deal with it? Or does it  
20 deal with it, and then we leave it open for the future? What  
21 is the situation?

22 Senator Roth. Well, specifically, Senator Danforth, it  
23 would be my understanding that we would deal specifically  
24 with that problem in the future; assuming this amendment is  
25 adopted we would work from it. But that the question of

1 single-purpose agriculture buildings is totally open for  
2 further discussion.

3 Senator Danforth. Totally open, and this doesn't deal  
4 with it at all?

5 The Chairman. But it deals with it -- doesn't it? --  
6 generically, in the sense as it would with other productive  
7 property.

8 Senator Roth. Oh, yes.

9 The Chairman. But it doesn't distinguish it in any other  
10 way.

11 Senator Roth. Yes, it would generally deal with it. But  
12 we would expect to deal further with it.

13 Senator Danforth. Right. So, if we adopt this, this  
14 doesn't represent a taking of a position one way or another  
15 with respect to the single-purpose agricultural structures?

16 Senator Roth. No. We would expect that to come up  
17 separately.

18 Senator Danforth. Now, another question. I have three  
19 points to make, Mr. Chairman, and that was one. The second  
20 question is this: As I understand it, this proposal does  
21 deal with the expensing, correct? The \$40,000? It reduces  
22 the 50 to 40?

23 The Chairman. It reduces the 50 to 40, which I have  
24 misgivings about.

25 Senator Danforth. And it also says that the expensing

1 would be available if the assets were used "in accu-trader  
2 business, and would be limited" -- and this is the key --  
3 "would be limited to taxable income derived from the trade  
4 or business in which the asset were used."

5 The Chairman. That eliminates it from tax-shelter area.

6 Senator Danforth. Right. This is designed to get at the  
7 shelter problem, and I think this is a very important  
8 provision.

9 I have a question about how it works. The question is  
10 this: If a business is generating losses, and if the business  
11 has both deductions and then this expensing provision, when  
12 it is calculated, what comes first?

13 The reason I say that is that, if you add up the  
14 deductions, if the expensing is added up first and then the  
15 other deductions are added, and there is an overage, then that  
16 overage could be used against another business; whereas, if  
17 the other deductions were computed first and then the  
18 expensing were computed, were the last thing added to the  
19 list, then that would not be used as an offset to the other  
20 business.

21 Mr. Brockway. The way the proposal would work, Senator  
22 Danforth, is you would compute your income without regard to  
23 the expensing first, so if your other deductions created a  
24 loss you wouldn't get the expensing this year, you would get  
25 it next year when that trade or business had some income, or

1 some subsequent year when you had the income.

2 Senator Danforth. All right. So, in other words, that  
3 expensing is not to be used against another trade or  
4 business.

5 Mr. Brockway. Right.

6 Senator Danforth. Period.

7 Mr. Brockway. Correct.

8 Senator Danforth. All right.

9 Now, the final question, which is a broader one: Mr.  
10 Chairman, when we have been talking about this tax bill, we  
11 have been talking about revenue losses, revenue gains in a  
12 5-year period of time. We have not attempted to project after  
13 that 5-year period of time.

14 We have been told that it is not possible to do so with  
15 any degree of accuracy. But I would raise the question with  
16 respect to the indexing of basis for depreciation.

17 If we are to get into that, if we are to index the basis  
18 for the purpose of depreciation, then in the outyears we are  
19 necessarily creating a very large revenue loss. I wonder if  
20 we want to do that, because what I think we are doing is to  
21 finance rate reductions now by revenue losses in the future.  
22 And I question that.

23 I know the Chairman proposed a somewhat different  
24 restriction on the availability of indexing of basis. And  
25 frankly, the Chairman's proposal, the 2-percent, 8-percent,

1 had more appeal to me than allowing indexing from zero to  
2 eight.

3 But I have to say that the whole idea of indexing is  
4 one that I think is fraught with peril, and that we are going  
5 to see a major loss of revenue in outyears. Three or four of  
6 five years from now, or beyond five years from now, we are  
7 going to be back in this committee trying to figure out what  
8 we are going to do about revenue, and how we are going to  
9 increase some tax revenue in order to offset this flood that  
10 we are losing by virtue of the indexing of basis.

11 I am going to offer an amendment. I want to sort of get  
12 the lay of the land before I offer it. At the very least, I  
13 would go back to the Chairman's proposal, of the 2-percent/  
14 8-percent. But if there is any sentiment for it, I would like  
15 to wipe it out altogether.

16 The Chairman. Does Treasury want to respond to the  
17 outyear-loss argument?

18 Mr. Darman. Senator Danforth, on the question of  
19 indexing generally and estimating the long-term revenue  
20 effects, that is calculable. I believe you suggested that  
21 some may have said it is not. We believe it is calculable,  
22 and we have done a long-run estimate for our own proposal, and  
23 we contend that it is revenue-neutral over the long term.

24 Senator Danforth. How could it be? How could that  
25 possibly be?

1 Mr. Darman. Because there are offsetting long-term  
2 back-loaded revenue gainers. There is a long list of such  
3 gainers that I would be happy to provide you with.

4 That is, you are correct that the pattern of indexing  
5 will be one which has rising revenue losses in the outyears,  
6 but the pattern of some other provisions is that there will  
7 be rising revenue gains in the outyears to offset that.

8 Senator Danforth. Well, I would like to see that  
9 analysis, because that is not my impression of the bill  
10 itself. But certainly, with the provision that is before us  
11 now, it clearly is not the case.

12 Mr. Darman. Senator Danforth, we haven't completed the  
13 same analysis for the Chairman's proposal; but, we are getting  
14 close on that and would be happy to provide those numbers.

15 But I would certainly agree with you that those numbers  
16 are relevant. But I am also suggesting they are calculable  
17 and that we would be happy to provide them and discuss them  
18 with you.

19 Senator Danforth. I would very much like to see it.

20 Mr. Darman. Your presumption is correct, that indexing  
21 itself will have a rising revenue-loss pattern. It was my  
22 understanding that the committee wanted to cap that, because  
23 there is an uncertainty as to what that revenue loss might  
24 be if we were to return to some unknown double-digit  
25 inflation amount.

1           So, it was on that basis that the Chairman put in an  
2 8-percent cap. And as I understand it, that remains in the  
3 proposal here.

4           Senator Danforth. Well, that is compounded, correct? I  
5 mean, you can get eight percent inflation a year, and so the  
6 basis is adjusted up to eight percent every year?

7           Mr. Darman. Right. Only, of course, if inflation is at  
8 that rate or higher. You don't get any such thing if  
9 inflation is at three percent or four percent.

10          Senator Danforth. And if it is at three or four percent  
11 you get three or four percent?

12          Mr. Darman. Correct.

13          The problem, in terms of the revenue loss that I think  
14 you are worried about, is there would be some very large  
15 revenue loss if inflation would have returned to double  
16 digits; but this proposal says that, "To protect against that  
17 possible large unknown revenue loss, if we were to return to  
18 some double-digit inflation, the committee would put a cap  
19 of eight percent."

20          And have said that, while we don't favor that as a matter  
21 of policy, we can understand that as a way of dealing with the  
22 long-term uncertainty about the revenue, and can support that.

23          What we have not been able to understand is the decision  
24 to put an arbitrary floor, as well, of two percent.

25          Senator Danforth. To me it is perfectly understandable:



1 if indexing is a bad idea, if it is fraught with peril in the  
2 future, if it is going to create revenue losses in the future,  
3 then it is better to subtract two percent per year from  
4 whatever the indexing is going to be than give the whole thing.

5 The Chairman. We have five other members on the list.

6 Senator Danforth. Well, I am going to offer an amendment.

7 The Chairman. Can the others talk first?

8 Senator Danforth. Sure.

9 The Chairman. Senator Bentsen?

10 Senator Bentsen. Thank you very much, Mr. Chairman.

11 Mr. Chairman, what we are seeing here is something that  
12 is pretty basic in the way of a difference in philosophy that  
13 is expressed on this committee when we are talking about this  
14 provision that is being offered, and that is whether or not  
15 you use the tax system to try to accomplish certain economic  
16 goals for your country.

17 I just spent the last week meeting with the President of  
18 Mexico and individual members of his cabinet, looking at a  
19 country that has \$97 billion worth of external debt -- really  
20 in tough shape, trying to figure out how they are going to  
21 service that debt.

22 I got to thinking that it wasn't going to be very long  
23 before we are going to say to Mexico and to Poland and to  
24 Brazil, "Move aside, fellows, you are pikers. We are the  
25 number-one debtor of the world." And we ought to be trying to

1 anticipate that and turn that thing around.

2 Last year we had a \$148 billion trade deficit. Last year  
3 some of us were talking -- early last year -- about having  
4 this country intervene in currency exchange rates and to meet  
5 with the financial markets of other countries around the  
6 world.

7 I remember when we tried that, pushing that, that the  
8 Administration responded and said this was a sign of the  
9 strength of our economy, what the dollar was. The  
10 Administration has made a 180-degree turn on that one, and  
11 Secretary Baker has helped lead the way, and I congratulate  
12 him on it, and we have seen the dollar go down 31 percent  
13 against the yen. And we have seen other measures helping.

14 Senator Bradley very well makes the point that that is  
15 really one of the keys as to whether we are competitive. And  
16 what happens to interest rates in this country, too?

17 But it is a many-faceted problem, and we ought to attack  
18 it on every front we can. The cost of capital is one of  
19 those fronts.

20 That is why I believe that we have to have a contro-  
21 versial proposal like this one. This is no easy political  
22 proposal that is being made, because you have winners and  
23 losers in it; this is saying that manufacturing a product that  
24 is in competition in world trade, that we give that an extra  
25 incentive over a shopping center, that we walk right into that

1 kind of a fight as we make this kind of a proposal.

2 But I believe that the cost of capital is one of the many  
3 facets of a decision as you make the investment that is  
4 necessary in those things in which we are in competition on  
5 world trade.

6 And I am pleased to support this proposal. Obviously it  
7 is a compromise, as these things often are; but I think it is  
8 a step in the right direction, and I support it.

9 The Chairman. Senator Chafee, then Senator Mitchell.

10 Senator Chafee. Thank you, Mr. Chairman.

11 Mr. Chairman, previously we had the objective, when we  
12 started this exercise, of having simplicity, and that has been  
13 junked. Certainly this latest proposal sounds the death knell  
14 of simplicity; this is incredibly complicated.

15 Secondly, Mr. Chairman, I thought the purpose of our  
16 exercise in connection with depreciation schedules was to  
17 depreciate property at its rate of life. And indeed, in  
18 Treasury's handout here they talk about: If depreciation  
19 allowance is "understate real economic depreciation of a  
20 particular asset, income from the investment is over taxed,  
21 and a tax disincentive is created which impairs capital  
22 formation. Similarly, if depreciation allowances exceed real  
23 economic depreciation, incentives are created for investment  
24 in depreciable property." And they conclude, "A more neutral  
25 cost-recovery system would preserve investment incentives while

1 equalizing effective tax rates."

2 In other words, we weren't out to choose winners or  
3 losers, we were to depreciate property at its life. And  
4 clearly, the ACRS distorted that to a considerable extent,  
5 and we are trying to back away from that to depreciate all  
6 property, as I say, for its rate of life.

7 Now, there has been considerable discussion on the cost  
8 of capital, and the cost of capital is a factor. But cost of  
9 capital is not a major factor in our international competitive  
10 position; the cost of money is a far more important factor --  
11 the interest rates. And clearly, if we can get the deficits  
12 of the country down, the interest rates will come down. That  
13 will mean much more than the cost of capital.

14 Furthermore, here we have a complicated list of what is  
15 productive and what is not. For some reason, desktop  
16 computers are not productive; and yet, every office in  
17 America that you go into has desktop computers -- whether it  
18 is an insurance company, or whatever it is.

19 Photocopiers aren't productive, word processors aren't  
20 productive. To me, that just doesn't make sense. Who has  
21 chosen the winners or losers, as I see this list?

22 Fourth, Mr. Chairman, I agree with Senator Danforth: I  
23 think indexing is bad. Now, the Administration put in  
24 indexing, but they put in indexing when the President's  
25 proposal had no capital gains. And this is an entirely

1 different ballgame we are involved in now; we have restored  
2 capital gains.

3 I couldn't agree more with what Senator Danforth said  
4 about the outyears.

5 Finally, Mr. Chairman, I think every one of us in this  
6 room knows that the proposal for the excise tax which you  
7 have in here, which is to pay for this program, isn't going  
8 to fly. And that is, as I recall, a \$63 billion item.

9 Now, therefore, we are going to need every nickel we can  
10 to make this program revenue neutral, or we are not going to  
11 have a revenue-neutral tax bill, and if we don't have a  
12 revenue-neutral tax bill I for one am not going to vote for  
13 it.

14 Therefore, I don't think we should be using up those  
15 primary targets for helping to balance this program, one of  
16 them being the increase in expensing that you gave small  
17 business, from \$10,000 to \$50,000, which in itself is a  
18 \$21 billion item.

19 And in this proposal they use up a good portion of that  
20 -- well, they use up a quarter of it, of the increase. As  
21 I understand the increase -- correct me if I am wrong,  
22 Mr. Colvin -- the increased cost of the added expensing for  
23 small business is \$21 billion. Is that right?

24 Mr. Colvin. That is correct.

25 Senator Chafee. All right. And that goes to \$50,000,

1 so you go from 10 to 50. They have already used up a quarter  
2 of that, or, to balance this proposal right here, Senator  
3 Roth's proposal, they use up \$10,000 of that by dropping it  
4 from 50 to 40. Right?

5 Mr. Colvin. That is correct.

6 Senator Chafee. Therefore, you are using up a quarter  
7 of the increase.

8 Why are you shaking your head, Mr. Jenner? You don't  
9 agree?

10 Mr. Jenner. I believe, Senator, with the tighteners  
11 limiting it to an active-trader business, that would save  
12 approximately \$8 billion over the Chairman's proposal. There  
13 is a disproportionate savings.

14 Senator Bradley. What would save?

15 Senator Chafee. Explain that.

16 Senator Bradley. What would save?

17 Mr. Jenner. The proposal as written would limit the  
18 use of expensing to use in an active-trader business, and  
19 limit the --

20 Senator Moynihan. Say that again, sir. Active?

21 Mr. Jenner; Active.

22 Senator Danforth. It would do more than that; it would  
23 limit it to the business against which it is taken.

24 Mr. Jenner. That is correct, Senator.

25 So, those limits on that proposal, together with the

1 drop from 50 to 40, would save approximately \$8 billion.

2 Senator Bradley. Over five years?

3 Mr. Jenner. Over five years. Rather than a propor-  
4 portionate 25 percent drop, as Senator Chafee was indicating.

5 Senator Chafee. Well, I hear him talking, but I don't  
6 understand him.

7 (Laughter)

8 Senator Chafee. All I am saying is --

9 Senator Long. Why don't you just tell us what that  
10 means? Frankly, that leaves me very much in a cloud, when  
11 you say "active-trader business." Who would get it, and who  
12 wouldn't get it? That is what I want to know.

13 Mr. Jenner. People who use the assets in their  
14 business would be allowed the expensing. Tax shelters would  
15 not be allowed the expensing.

16 Senator Long. Could you just give us a few illus-  
17 trations? I must say, I am still in a cloud.

18 Mr. Jenner. A small manufacturer who buys a piece of  
19 equipment and places that equipment into his trade or  
20 business would be allowed the expensing, to the extent that  
21 they did not exceed \$200,000 in purchases of assets in that  
22 year.

23 A person who buys the asset and then turns around and  
24 leases it to a business -- in other words, to shelter that  
25 person's other income by the use of leasing -- would not be

1 allowed to claim the expensing. That would be a distinction.

2 Senator Chafee. I guess we are still on my time,  
3 Mr. Chairman. Let me say that we are using up part of those  
4 savings, regardless of how you slice it. And if we are going  
5 to have a tax-reform measure out of this committee, we are  
6 going to need to seize upon potential areas for money;  
7 because, as I say, that excise tax, if everybody's mail is  
8 running like mine, isn't going to prevail here.

9 So, Mr. Chairman, I have great difficulty with the  
10 proposed amendment. I am not sure what your time schedule is,  
11 if you are planning to vote on it this morning, since we  
12 just received it; but I have deep concerns with it.

13 Thank you.

14 The Chairman. It depends on how far we go. We are  
15 going to have to quit at about five after 12 today because of  
16 a meeting that a number of other people have to go to.

17 Senator Mitchell?

18 Senator Mitchell. Mr. Chairman, when we began this  
19 markup on March 19, I devoted my opening statement to my  
20 concern about the revenue effects of what we were doing in the  
21 5-year period of 1991 to 1996.

22 As you may recall, I asked you and the committee and the  
23 Treasury to provide revenue estimates for the second 5-year  
24 period for the provisions in the measure then presented to us.  
25 To date, I have not received any response. I hope that I will



1 at some point, and I think that this provision dramatically  
2 illustrates the importance of doing that.

3 I think Senator Danforth has forcefully pointed out the  
4 problem, and I won't repeat it; but I believe it would be  
5 irresponsible for this committee to act on this provision  
6 before we have some indication of the effect on revenues in  
7 the 5-year period from 1991 to 1996. I think we will see that  
8 there will be a substantial decline. I think we would be  
9 setting a stage for a repetition of the occurrence in the  
10 first five years of this decade, in which we have been plagued  
11 by enormous rising deficits which, in their ultimate effect,  
12 have a far greater impact on the competitiveness of American  
13 industry than what we are trying to do here through the Tax  
14 Code.

15 I think this is a very unwise provision because it  
16 continues a situation where effective tax rates on different  
17 assets vary widely, thus creating artificial, unproductive  
18 incentives to invest in assets that would not otherwise be  
19 supported by a free market.

20 I think it is ironic, Mr. Chairman, that what we are  
21 doing here is really the very antithesis of the principle of  
22 a free enterprise system. Here, the United States Government  
23 is defining what equipment is productive and what is not.  
24 Indeed, at this stage it is 20 American politicians who are  
25 defining what assets are productive and what are not. At

1 least in the Soviet Union they use economists for that.

2 (Laughter)

3 Senator Mitchell. And we can see how well they are doing.

4 I submit, Mr. Chairman and members of this committee,  
5 that there is no group of 20 Americans, of whatever knowledge  
6 or ability, that can define what equipment is productive and  
7 what is not -- that is what the free market system is for,  
8 and that is what we all say we believe in.

9 There is not a member of this committee who hasn't given  
10 numerous speeches defining the values, indeed the glories, of  
11 the free enterprise system. And yet what we are doing here  
12 is saying that we don't have faith in the free enterprise  
13 system; it is incapable of determining which assets are  
14 productive and thus worthy of investment in this country, and  
15 it is up to the government to decide that.

16 And so we, here, 20 middle-aged white male American  
17 politicians, are going to make a decision that will have an  
18 enormous effect for years into the future, and for which I  
19 say we are not qualified. I don't think any group of  
20 Americans is qualified to do it.

21 And if we have the slightest faith in the free enterprise  
22 system, and in a free market economy, which we so routinely  
23 praise, I think we ought to leave that to the free market  
24 system, and what we should be doing is trying to create a  
25 system in which there is relative neutrality in the taxation

1 of business assets, and economic decisions can once again in  
2 this country be made on economic grounds.

3 Now, we have heard a lot of talk about the cost of  
4 capital, and I won't try to repeat all of that, because I  
5 would like to just supplement what has been said and not be  
6 repetitious.

7 It embraces more than just equipment. It embraces the  
8 cost of land, the cost of structures, the cost of inventory.  
9 The proposal that Senator Packwood presented to us in fact  
10 reduced the cost of capital overall, when all of those  
11 factors are considered. This amendment says that the only  
12 thing that counts is the cost of equipment. That is just not  
13 true, and there is no economic rationale or economic basis  
14 for that determination.

15 This would also produce some very anomalous results. If  
16 a plumber who is in a service industry purchases a pipe-  
17 threading machine, would that qualify as "productive property"  
18 under this amendment? My understanding is that it would not.

19 On the other hand, if a pipe manufacturer purchases a  
20 pipe-threading machine, that would, under this amendment, be  
21 deemed to be "productive property." And that would be true  
22 even if the pipe-threading machine that the plumber purchased  
23 was made in America, and the pipe-threading machine that the  
24 manufacturer purchased was made in Japan.

25 I submit to you that this is one of an unlimited number

1 of implications that no one has thought through, no one has  
2 seriously considered. And here we are now with a proposal  
3 presented to us which, I repeat, could have profound revenue  
4 effects in the next decade and is the antithesis of the free  
5 market system in which we believe, and which has implications  
6 which not one member of this committee can possibly have  
7 foreseen, because it is fairly new to us.

8 I strongly recommend, Mr. Chairman, that we not take  
9 action on this, at the very least until we get some revenue  
10 figures. And at that point I hope we defeat it.

11 Senator Matsunaga. Will the Senator yield, just for a  
12 question?

13 I take it that the Senator was colorblind when he  
14 referred to "20 white Americans."

15 (Laughter)

16 The Chairman. In the following order: Senator Heinz,  
17 Senator Wallop, Senator Moynihan.

18 Senator Heinz. Mr. Chairman, thank you.

19 Listening to my friend George Mitchell, I came to the  
20 conclusion, listening to him, that rather than have 20  
21 politicians do anything having to do with tax reform, we  
22 should have 20 economists do it. There will be about 150  
23 volunteers right outside the room -- maybe that many in the  
24 room.

25 Senator Mitchell. No, I wasn't suggesting that.

1 Senator Heinz. Oh. All right.

2 Mr. Chairman, I have some questions about this proposal,  
3 because there had been modifications in it right up to the  
4 last moment.

5 Bill, you indicated that you were going to work out  
6 something with Senator Grassley on single-purpose agricultural  
7 structures; is that right?

8 Senator Roth. That is correct.

9 Senator Heinz. And that will be included in here?

10 The Chairman. It may or may not be included in here; it  
11 is going to be addressed separately.

12 Senator Roth. It will be addressed separately; that is  
13 correct.

14 Senator Heinz. What is the status of the quarterly  
15 convention? Is that in here, or not?

16 Mr. Brockway. It is not in this proposal. It retains it  
17 in the proposal as in the Chairman's proposal.

18 Senator Heinz. Is there any cost to adding the  
19 quarterly convention?

20 Mr. Brockway. If you put a mid-quarter in, it would be  
21 about \$100 million revenue loss.

22 Senator Heinz. And the practical result is that -- the  
23 way the quarterly convention works is, if you place an asset  
24 in service --

25 Senator Moynihan. John, you have to help us. Is this a

1 quarterly convention of the Kiwanis, or -- ?

2 (Laughter)

3 Senator Heinz. An idea.

4 (Laughter)

5 Senator Heinz. I will explain what the quarterly  
6 convention is if you will explain what "current law" is as  
7 the Chairman's proposes it.

8 The quarterly convention, were we to adopt it, would  
9 permit somebody who places an asset in service in the first  
10 quarter of the year to take a deduction for the first 12  
11 months of the year. If he placed it in service in the second  
12 quarter, he would get a deduction equivalent to nine-twelfths,  
13 and so forth.

14 It is a question of how you relate the timing of the  
15 placing in service to the amount of depreciation taken on the  
16 asset.

17 Senator Durenberger. Actually, if you will yield, it is  
18 mid-quarter convention, I think. So, it goes to the middle  
19 of the quarter.

20 Mr. Brockway. That is correct.

21 Senator Heinz. Correct. Excuse me. I stand corrected,

22 Senator Durenberger. Right. So, you are getting one and  
23 a half, plus.

24 Mr. Brockway. Under present law we have a mid-year  
25 convention. That assumes that, no matter when you acquire your

1 property during the year, place it into service in effect, on  
2 July 1, it sort of averages it all; so you get the first  
3 year of putting property in service, you get a half-year's  
4 depreciation rather than a full year's depreciation, as  
5 some of it might have been bought in the first part of the  
6 year and some at the end of the year.

7 For real estate, since it is such a major investment and  
8 you can more easily time that for the end of the year,  
9 present law has a mid-month convention. So, you look at the  
10 particular month that you put the real estate in service, and  
11 then, if it is in the first month of the year, you get  
12 eleven and a half months of --

13 Senator Moynihan. Stop! Stop! Stop!

14 Mr. Brockway. Okay.

15 (Laughter)

16 The Chairman. Do you have any more questions,  
17 Senator Moynihan?

18 (Laughter)

19 Senator Heinz. As I was saying, and in the thirteenth  
20 month -- well, Mr. Chairman, on that I won't at this point  
21 propose an amendment to this proposal. Maybe it is, maybe it  
22 isn't best to amend it here; but I hope we can include the  
23 quarterly convention.

24 I want to ask a question also on the alternative proposal  
25 about real estate, which is item number 6. Under this

1 proposal, were we to adopt it as is, we would retain current  
2 recapture laws, and real property would get a 30-year life.  
3 Is that correct?

4 Mr. Brockway. That is correct.

5 Senator Heinz. And that would apply to either rental  
6 or commercial real estate?

7 Mr. Brockway. That is correct.

8 Senator Heinz. Now, under current law we give a mild  
9 preference to rental real estate. Is that correct?

10 Mr. Brockway. You give it in the form of recapture  
11 under present law.

12 Senator Heinz. And if we retain the recapture rules  
13 as is, will there still be a mild preference for rental  
14 real estate?

15 Mr. Brockway. No, there will not, because in present  
16 law the way the benefit works is you can either take a  
17 19-year straight line, in which event there is capital gain  
18 recapture rather than ordinary income recapture when you sell  
19 the property, or, if you elect to take accelerated deprecia-  
20 tion, 175 percent declining balance, if you wish to, for  
21 residential property you only have to recapture as ordinary  
22 income the excess of that accelerated depreciation over  
23 straight line. For commercial, you have to recapture the  
24 entire amount as ordinary income.

25 Under this proposal, however, all property, residential



1 or commercial, would not have the accelerated depreciation  
2 option of 175 percent. So, it would all be at straight line.  
3 So it wouldn't make any difference; it would all be capital  
4 gain, regardless.

5 Senator Heinz. Everybody, I suppose, can come to their  
6 own conclusion about it. My preference is that I would like  
7 to have some kind of mild preference for rental real estate.  
8 And I am not quite sure of the best way to go about that. I  
9 don't mind doing it in a revenue-neutral way, if it means  
10 going, you know, from 30 to 31 years on commercial, and take  
11 one away and do it for 29 years on rental. But I would like  
12 to structure something that is more or less equivalent to  
13 current law.

14 I am not quite sure how to do that. Has the staff  
15 examined any options on that?

16 Senator Mitchell. If the Senator would yield, I have an  
17 amendment that I intend to offer on that when we get to that  
18 part of the proceedings.

19 The Chairman. Do you mean residential?

20 Senator Heinz. My understanding is that you intend to  
21 vote against the entire proposal -- against this amendment.

22 Senator Mitchell. Against this amendment. Then we are  
23 going to get to real estate.

24 The Chairman. When you talk about "rental," do you mean  
25 residential?

1           Senator Heinz. Residential, yes, as opposed to  
2 commercial. Excuse me, I misspoke.

3           And I would hope -- do you have any options on that,  
4 Dave?

5           Mr. Brockway. Well, I haven't prepared one, but  
6 obviously you could do something along the lines you were  
7 suggesting, of having different lives for commercial property  
8 and for residential property, and you could set them so you  
9 would end up with a revenue-neutral amendment.

10          Senator Heinz. To get an idea of how much money is  
11 involved in this -- and I am not making this as a proposal;  
12 I might, but I am not intending to right now -- if you  
13 reduced the life of residential real estate from 30 to 25,  
14 what would be the revenue loss on that?

15          Mr. Brockway. I think it is around .4.

16          Senator Heinz. Four hundred million dollars over five  
17 years?

18          Mr. Brockway. That is correct.

19          Senator Heinz. All right, thank you.

20          Senator Danforth. Mr. Chairman?

21          The Chairman. I have Senator Wallop next, then  
22 Senator Moynihan.

23          Senator Wallop. Mr. Chairman, let me suggest that I  
24 compliment Senator Roth and his cosponsors. I have been  
25 working with him on this, as well.

1           This is not as good as present law in terms of cost of  
2 capital, but it goes a long way back toward restoring some  
3 level of credibility in that whole area. I think if we are  
4 going to be a competitive country, that is one area.

5           I am amused by what happens to us as we talk in this  
6 thing. My friend from Maine said that he wished very much  
7 that we would have something whereby economic decisions could  
8 be made on economic grounds, and then he suggests that he has  
9 a mild preference for rentals coming up. All of us fall into  
10 this hole, and the reason we do is because none of us are  
11 committed to tax reform.

12           We threw that out in the very beginning when we decided  
13 it would be embarrassing to have a lower tax rate than  
14 30 percent in a country like this, which you could have done  
15 by tossing out this whole level of things called "preferences"  
16 and made some real economic neutrality in the decision  
17 process. But we abandoned that a long time ago. We are  
18 not going to retrieve it in this tax-reform process.

19           So, what we have here is a step in the right direction  
20 towards keeping us a competitive nation in the area of cost  
21 of capital, and I salute them for it.

22           I want to suggest that I will try to visit, in the  
23 transportation area of productive property, the interstate  
24 portion of gas pipelines. I think they should be treated the  
25 same as other transportation mechanisms. We have to look and

1 see what the costs are going to be, but the problem is, I  
2 think they may be treated as utility property, and they are  
3 probably not utility property until they are in the distri-  
4 bution system; they are probably genuine transportation  
5 until they get to that area.

6 The Chairman. I was asked my intentions. We are going  
7 to take Senator Moynihan, then I fear we are going to have  
8 to break. We will come back at 2:00, but there has been an  
9 objection raised to the committee meeting on the unanimous-  
10 consent request, which means that we would not be able to  
11 have votes this afternoon. But it does not preclude us from  
12 continuing an informal discussion of the employee benefits  
13 provisions. So at least we can talk about it and get it  
14 out of the way, and I would presume we would come back to this  
15 subject tomorrow morning.

16 Unfortunately, the meeting will not start until 10:30  
17 tomorrow morning. Where did Senator Moynihan go?

18 Senator Danforth. Mr. Chairman, can I ask a question while  
19 we are waiting for Senator Moynihan?

20 The Chairman. Yes.

21 Senator Danforth. Mr. Darman said that the Administra-  
22 tion had some numbers on the outyear costs. I think it is  
23 very important that we get those numbers, particularly before  
24 deciding the indexing question for depreciating.

25 The Chairman. It would help if we had those this

1 afternoon; if by chance the unanimous consent request is  
2 approved we could vote this afternoon. If not, we could not  
3 vote until tomorrow. But if we are going to vote, I would  
4 like to have the numbers.

5 Senator Boren. Mr. Chairman, could I ask a question of  
6 Senator Roth on this proposal?

7 The Chairman. Yes.

8 Senator Boren. As I understand it, under current law  
9 refineries are in a 5-year category, and they were moved to a  
10 10-year under the draft proposal. Are they at 10 or 5 in  
11 your proposal now?

12 Senator Roth. They are at 10.

13 Senator Boren. They would still be at 10?

14 Senator Roth. That is correct.

15 Senator Boren. I would hope you might consider -- I am  
16 sympathetic to this package, but I hop you might consider  
17 moving it back to current law, because we have had a loss of  
18 about 25 to 30 percent of our domestic refining capacity, and  
19 I think we are now down to dangerously low levels in terms of  
20 national security interests. I hope that would be an area  
21 where we might be able to retain current-law status.

22 Senator Roth. I would have to say to the distinguished  
23 Senator, I think that would be somewhat controversial. I  
24 think there are those who feel that 10 years is adequate in  
25 light of the other conditions. But we would be happy to

1 discuss it further with you.

2 The Chairman. Senator Moynihan? Senator Bradley?

3 Senator Bradley. Mr. Chairman, I would just like to  
4 follow up with Senator Ross in just a quick question:

5 On the expensing provision, even though it is reduced,  
6 would that mean a doctor could expense his Mercedes?

7 Senator Roth. No.

8 Senator Bradley. Even if it is in his business, he uses  
9 it in his business?

10 Senator Roth. No, that was not part of our proposal.

11 Mr. Brockway. Senator Bradley, one of the things, if you  
12 are talking about an auto, I believe under the proposal it  
13 would be subject to the luxury-car limitations in the present  
14 law, even with the expensing. So, I am not sure what the  
15 numbers in the proposal are, but it would be like \$3000 a year  
16 for the auto.

17 Senator Bradley. So that if a small businessman went on  
18 and made calls, really was a salesman, he wouldn't be able to  
19 get expensing for his automobile?

20 Mr. Brockway. They would be subject to the limitations  
21 that were adopted in 1984 and are in this proposal under the  
22 luxury auto. Automobiles as a separate class would be  
23 limited to -- I don't know the precise number, but it is  
24 \$3-4000 a year.

25 Senator Bradley. I only raised this to point out that

1 this is a real nest of problems here. The more we micro-  
2 manage this, the greater the problems will be. And I hope  
3 this afternoon we will be able to get into this at some  
4 greater depth, so we know clearly what the proposal is.

5 The Chairman. Senator Moynihan?

6 Senator Moynihan. Well, just in that spirit and in the  
7 spirit that Senator Chafee spoke earlier, Mr. Chairman, you  
8 know I have been saying -- and I hope I haven't been dis-  
9 agreeable about it -- that we have to produce a revenue-  
10 neutral bill or we have done ourselves a real disservice to  
11 the country.

12 So, we need to know what this is going to cost. I guess  
13 I would also like, in the spirit of Senator Mitchell, the  
14 judgment of what is a "productivity property" and what is not.  
15 All of that has got to be a complicated decision.

16 I wonder simply this: One, could we hear what the  
17 Treasury thinks? Maybe you have just seen it, as many of  
18 us has just seen it. What do you think about this?

19 And, two, could you give us a list of properties that  
20 are not productivity properties? You are going to have to.  
21 Isn't the IRS going to have to say "this is, that's not"?

22 I don't want to have you answer right now, but perhaps  
23 Secretary Mentz or Secretary Darman might have an early  
24 response.

25 Secretary Mentz. Sure.

1 Senator Moynihan. One, do we know what this will cost?  
2 And, two, how do you feel about distinguishing between  
3 "productivity" and "non-productivity"? And how do we get a  
4 list, for example of what is a non-productivity property?

5 The Chairman. I would wager they could have an answer  
6 by 2:00 today.

7 Senator Moynihan. Sure. I would wager they would have a  
8 response; whether they would have an answer -- negative.

9 (Laughter)

10 The Chairman. Senator Matsunaga wanted to make a  
11 comment on the votes.

12 Senator Matsunaga. Mr. Chairman, I ask unanimous  
13 consent that I be recorded as having voted No on the votes  
14 taken previously, inasmuch as the outcome will not be altered  
15 in any way.

16 The Chairman. Without objection.

17 Senator Moynihan. And could I make the same for the  
18 first vote, Mr. Chairman?

19 The Chairman. Senator Moynihan can be recorded as No on  
20 the first vote.

21 We will stand in adjournment until 2:00.

22 (Whereupon, at 12:07 p.m., the meeting was recessed.)  
23  
24  
25



AFTER RECESS

(2:05 p.m.)

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The Chairman. The committee will come to order, please. Because we are going to have a vote in a few minutes, I would like to switch over and start down the walk-through on the employee benefits section starting on page 155 of the worksheet.

Mr. Colvin, if you want to start down those, we will get back to depreciation later this afternoon, but we are going to have a vote soon.

Mr. Colvin. Mr. Chairman, on page 155, the only issues are the proposal would make permanent the exclusion for prepaid legal services and would allow the vanpooling exclusion to sunset.

On page 156, the first issue is the exclusion of pre-judicial assistance would be made permanent and the \$5,000 annual limit would be indexed.

The Chairman. Here we have a situation where the President's proposal eliminated the cap. Right?

Mr. Colvin. That is correct.

The Chairman. And we are putting on, not an index cap, but tying it to the Social Security wage base.

Mr. Colvin. That is correct. And item (b), self-employed individuals, the chairman's proposal would allow a 50 percent deduction for self-employed persons for the cost of health insurance.

The Chairman. I think in fairness that ought to be

1 called the Grassley proposal. This is the self-employed  
2 proposal. It is not everything we wanted, but it is half.

3 And I don't know if you found the same thing I have,  
4 but this issue and expensing have meant more to small  
5 business than everything else we have in this bill.

6 And it has been Senator Grassley that for the last  
7 several years has been pushing this, pursuing this, asking  
8 about it.

9 I even went to Iowa to speak one time, and one of his  
10 constituents came up and knew that he was pushing it and  
11 asked me to laud him and thank him.

12 So, that should be called the Grassley proposal  
13 henceforth.

14 Senator Grassley. Thank you.

15 Mr. Mentz. The Treasury congratulates Senator Grassley.

16 (Laughter)

17 Mr. Colvin. Page 157 is a summary page. The issues  
18 are all referred to in greater detail on the following pages.

19 Page 158 --

20 Mr. Mentz. Mr. Chairman, just one quick point on 157.  
21 You may remember when we had hearings, I guess it was last  
22 year, on health plans, it was pointed out that there were  
23 no nondiscrimination rules applicable to insured health plans  
24 maintained by companies; and this proposal would change that.

25 And it has really been a pretty major omission in the law

1 that is fortunately about to be corrected.

2 The Chairman. I don't know if this is the appropriate  
3 time to show these colored charts that have been made because  
4 I am not sure all the members have them; but I had the staff  
5 prepare different definitions of key employees in terms of  
6 trying to figure nondiscrimination.

7 And I will hold the chart up and you will see a bunch  
8 of colors that look like a semifour flag key. These are all  
9 the different kinds of definitions, and each one is different  
10 depending upon whether you are talking about a legal plan or  
11 an ESOP or any other kind of plan.

12 Then, although you can't see this, I will hold these up  
13 and you will find that three or four of the definitions are  
14 applied simultaneously to a particular plan.

15 And over on the right-hand side of the page are the  
16 proposals I have where there are only three definitions of  
17 key employees for all plans.

18 And if anybody is talking about tax simplification, this  
19 is certainly a step in the direction of simplification.

20 Mr. Colvin. That is the issue on page 158. I would  
21 like to clarify that at the bottom of page 158, there is a  
22 list of nine areas to which the standard rules would apply.  
23 Insured health insurance also should be on that list.

24 The Chariman. By insured health insurance, do you mean  
25 self-insured or what?

1 Mr. Colvin. Self-insured is item number 2.

2 The Chairman. Right.

3 Mr. Colvin. But the list should also include insured  
4 health plans.

5 The Chairman. Where you are contracting out on the  
6 insurance then? Is that what you mean?

7 Mr. Colvin. That is right.

8 The Chairman. All right.

9 Mr. Colvin. On page 159 are rules --

10 The Chairman. Let me interrupt just a moment and  
11 indicate what I am doing. I thought, George and Chuck, we  
12 would start down the employee provisions because we are going  
13 to have a vote at about 2:10; and I expect the other members  
14 will not be coming.

15 We will get back to depreciation, but I thought we might  
16 as well walk through these, which are subjects reasonably  
17 familiar to most of the committee and see how much of it we  
18 can finish before the vote.

19 Senator Mitchell. A vote on the floor, you mean?

20 The Chairman. A vote on the floor--and I don't want to  
21 call any vote perfunctory--but I think it is one of those  
22 100 to nothing votes.

23 Senator Mitchell. Yes. You still will not have any  
24 votes here this afternoon?

25 The Chairman. I don't expect any votes. There has been

1 an objection to our meeting; and indeed, any votes we have  
2 might be tainted.

3 Senator Mitchell. Yes.

4 Mr. Colvin. On page 159, the issue is the question of  
5 what categories of employees are excludable for purposes of  
6 the nondiscrimination rules.

7 And the chairman's proposal includes a list very much  
8 like the House bill. It requires inclusion of employees for  
9 purposes of health plans after six months and for other  
10 benefits after one year.

11 Mr. Mentz. Mr. Chairman?

12 The Chairman. Mr. Secretary?

13 Mr. Mentz. Let me just interject one small point here.

14 There is an exclusion in your proposal for employees who  
15 work less than half-time. They would not be considered in  
16 the discrimination test.

17 The House bill has more of a bright-line test. It is  
18 employees who work less than 20 hours per week.

19 We have received comments--in fact, I have a submission  
20 from the National Retail Merchants Association, expressing  
21 a preference for the 20 hour rule, as a bright-line rule.  
22 This may be preferable than a rather vague or more vague  
23 standard.

24 The Chairman. I think the point is probably well taken  
25 in terms of certainty.

1 Mr. Mentz. Yes, exactly.

2 Mr. Colvin. There are some situations where the regular  
3 work week might be 35 hours, and that is why we used the  
4 one-half test; but it is not a major difference.

5 Page 160 and page 161 are the nondiscrimination rules  
6 for health insurance that Mr. Mentz referred to a moment ago.

7 The proposal would extend nondiscrimination rules to  
8 insured health plans, and the eligibility test is similar to  
9 that for pensions. The plan would have to benefit 80 percent  
10 of all employees or a reasonable classification of employees.

11 And as in the pension area, there is a line-of-business  
12 safe harbor with respect to establishing a reasonable  
13 classification.

14 161 goes with 160. It is a completion of the same area.

15 On page 162, the principal issue is the application of  
16 these rules to life insurance plans, and the proposal provides  
17 rules standardized with the health insurance rules--the 80  
18 percent or reasonable classification standard and also the  
19 line-of-business safe harbor.

20 On page 163, the concentration test for plans other than  
21 health plans. The provision extends the concentration test  
22 rules to life insurance, but provides an equal benefit  
23 exception which would be beneficial to small business.

24 On page 164, the issue of sanctions for discrimination.  
25 Under the proposal, if a plan is discriminatory, the taxability

1 of the benefits would apply only to the highly compensated  
2 employees. That is because presumably the highly compensated  
3 employees would not have been responsible for the design of  
4 the plan.

5 On page 165, the cafeteria plan rules. The only change  
6 is to apply the standard highly compensated definition to  
7 cafeteria plans.

8 The prizes and awards provision at the bottom of page  
9 165 picks up the President's proposal to make prizes and  
10 awards taxable.

11 Page 166, the accrued vacation pay provision also  
12 includes the House provision to allow advance vacation pay  
13 accrual up to only eight and a half months.

14 The faculty housing provision is as was approved by the  
15 Senate Finance Committee in the Reconciliation Bill, but was  
16 not included in the final reconciliation legislation.

17 Mr. Mentz. I would register Treasury's support for that  
18 provision.

19 The Chairman. Thank you.

20 Mr. Colvin. Page 167, parents of airline employees --

21 The Chairman. Oh, not again.

22 Mr. Colvin. That is correct, Mr. Chairman. That is in  
23 the Reconciliation Bill, and so that is moot.

24 The Chairman. All right.

25 (Laughter)

1 Mr. Colvin. Page 16--

2 Senator Mitchell. I didn't understand what he said.

3 The Chairman. It is in the Reconciliation Bill; so, it  
4 is moot.

5 Senator Mitchell. Oh, okay.

6 Mr. Colvin. Page 168, health benefits for retirees.

7 These provisions have to do with financing of health benefits  
8 for retirees. The provision is intended to allow a deduction  
9 for these costs, which is realistic in light of the eventual  
10 cost that will occur.

11 And paragraph (b) on page 168 would extend the due date  
12 of a Treasury study relating to welfare benefit plans.

13 The Chairman. Refresh my memory as to what happened to  
14 the proposal. Was it in reconciliation to mandate retirement  
15 benefits or spouse benefits on health? I can't recall.  
16 Or was that dropped out of reconciliation?

17 Mr. Weiss. Mr. Chairman, that proposal was enacted.  
18 There was a conference agreement reached, and that has been  
19 enacted.

20 The Chairman. All right, but this is just retirees here,  
21 not widows?

22 Mr. Weiss. And it just deals with funding.

23 The Chairman. Right.

24 Mr. Weiss. It doesn't deal with actual coverage.

25 The Chairman. Yes, it permits a set-aside of a certain



1 amount of funds.

2 Mr. Weiss. Right.

3 Mr. Colvin. The remainder of the title are the employee  
4 stock ownership provisions, and the proposal retains current  
5 law.

6 The Chairman. I would normally call on Senator Long to  
7 speak to this proposal, but I think all of us have heard him  
8 often enough.

9 I support it strongly, and I hope we keep it.

10 I might say to the committee members --

11 Mr. Wilkins. Mr. Chairman?

12 The Chairman. Yes?

13 Mr. Wilkins. I think it is possible that Senator Long  
14 may have some comments and minor amendments in this area.

15 The Chairman. That is fine. They are welcome.

16 I might say to the committee members, in this particular  
17 section, the entire employee benefits section, we have had  
18 relatively few members suggest that they are going to offer  
19 any amendments.

20 And that is why I hoped we could go through it in a  
21 relatively expeditious fashion; unless more members start to  
22 offer amendments than have, we will be able to take it up and,  
23 I think, dispose of it very soon in the future and get it  
24 behind us. Questions?

25 (No response)

1 The Chairman. In that case, we are through that section.  
2 Let me just check now. Could I ask the staff to check  
3 on what the vote situation is? I thought we would be voting  
4 about 2:10.

5 If we are not going to, I would expect the other committee  
6 members will be coming, and we would go back to depreciation.

7 Senator Grassley?

8 Senator Grassley. Did you announce that there weren't  
9 going to be any votes this afternoon?

10 The Chairman. There has been an objection to our  
11 meeting. We can meet, but I think any votes we might take  
12 would be tainted; and I think it would be unwise, therefore,  
13 to take any votes.

14 But we can literally go on talking about depreciation.  
15 We could ask for a show of hands, and I could get a sense  
16 of where people are; and we would ratify it, vote some other  
17 time when we are permitted to meet.

18 Why don't we do this? Senator Bradley, do you have  
19 anything to bring up now? The reason I ask is that the vote  
20 is going to come within five minutes, and if it is, I was  
21 going to adjourn the committee until the vote was over.

22 Senator Bradley. No, Mr. Chairman.

23 The Chairman. All right. We will stand in recess until  
24 the vote is over, and then we will come back.

25 (Whereupon, at 2:18 p.m., the meeting was recessed.)

1 AFTER RECESS

2 (2:46 p.m.)

3 The Chairman. Let's get started on depreciation. The  
4 one person who had objected to our meeting is no longer  
5 objecting. His provisions are back in the bill.

6 No, it is not a member of this committee. There is no  
7 longer an objection to our meeting. As the committee is  
8 aware, it does require a unanimous consent to meet. That  
9 unanimous consent will be offered, and we will see if there  
10 are some other objections.

11 But in any event, even if there is objection, we can  
12 continue to sit in session and go through the proposals in  
13 the hopes of voting for them or against them tomorrow morning.

14 Senator Moynihan. Mr. Chairman?

15 The Chairman. Senator Moynihan?

16 Senator Moynihan. Would it be impolitic to ask what  
17 provisions are back in the bill?

18 The Chairman. No. I was only jesting. The objection  
19 did not come from a member of the committee.

20 Senator Moynihan. Well, for heaven's sake, don't make  
21 the suggestion.

22 (Laughter)

23 The Chairman. No. I think I know what the problem with  
24 the member was. Basically, it was just someone who doesn't  
25 want a bill at all, under any circumstances; and so any delay

1 is good.

2 Now, let's go back to depreciation. When we left this  
3 morning, we have requested of the Treasury some estimates;  
4 but I would be curious if Treasury could comment on the  
5 general direction we are going on depreciation, including  
6 the investment tax credit because it seems to me whether  
7 we are going on a straight line down or not or whether we  
8 are weaving, the direction is certainly in the right  
9 direction.

10 Mr. Darman. Mr. Chairman, I think we would agree with  
11 you completely. There is an important point to be made  
12 that I assume you are suggesting.

13 It is in the right direction in two senses I would think.  
14 There is an understandable interest in the committee to focus  
15 on what might otherwise be problems for U.S. competitiveness,  
16 and that represents one direction in which the pattern of  
17 changes is moving, which is constructive relative to the  
18 House bill.

19 By the same token, we are all--or many of us at least--  
20 interested in tax reform as measured by something that would  
21 seem in some respects to be inconsistent with that; and that  
22 is the degree of neutrality in the system.

23 And I think it is worth pointing out that by eliminating  
24 the investment tax credit, one makes a major contribution to  
25 the general principle of greater neutrality.

1           And by lowering the corporate rate, one makes a  
2 substantial contribution in the direction of greater  
3 neutrality, even with these disparities in degrees of  
4 acceleration for different types of assets because the value  
5 of the depreciation is reduced as the corporate rate is  
6 reduced; and so the degree of difference is reduced as the  
7 corporate rate is reduced.

8           So, in these various respects, I would say it is moving  
9 in the right direction.

10          The Chairman. Dave? Were you waving for recognition?

11          Senator Durenberger. No.

12          The Chairman. Oh, all right.

13          (Laughter)

14          The Chairman. Comments on the Roth-Baucus-Heinz-Dole-  
15 Grassley-Wallop-Bentsen proposal?

16          Senator Durenberger. Yes, Mr. Chairman?

17          The Chairman. Yes?

18          Senator Durenberger. I am sorry. I was carrying on  
19 another conversation.

20          I have a couple of comments. One, I am not sure I know  
21 what the process is to suggest that some of us have changes  
22 that we would like to see made in here.

23          I agree with some suggestions that have been made earlier  
24 in the day about the mid-quarter convention on placed in  
25 service property.

1 I don't know if anyone has raised the issue of auto  
2 depreciation, but I think I have addressed that subject  
3 before; and if the Senator from Louisiana doesn't have an  
4 amendment, I have an amendment in that regard.

5 The Chairman. You will notice what this provision did:  
6 it had rental automobiles and light trucks at three years,  
7 straight line, and other autos at five years.

8 Senator Durenberger. Right, and I think that part of  
9 it is fine. My concerns are relative to straight-line  
10 depreciation or 150 percent; and I don't know what the dollar  
11 difference is between the two of them.

12 Does anybody know about the dollar difference between  
13 rental automobiles and trucks--the dollar difference--between  
14 150 percent and straight line?

15 Mr. Brockway. We don't have that number right now,  
16 Senator Durenberger. We will have to get back to you on  
17 that.

18 Senator Durenberger. Right.

19 Mr. Brockway. You are referring to the rental  
20 automobiles and light trucks right here, the difference  
21 between 150 percent and straight line, defining balance?

22 Senator Durenberger. Yes. Right.

23 Mr. Brockway. I don't have a number right now. I will  
24 try and get one for you.

25 Senator Durenberger. The second issue deals with--and I

1 assume this is an issue that has been discussed at the staff  
2 level--and that is the depreciation for food processing --

3 The Chairman. For what?

4 Senator Durenberger. Food processing equipment. It  
5 is grain milling equipment, margarine processing equipment,  
6 and corn oil processing equipment, which is currently in  
7 the five-year category and is moved to the ten-year category  
8 which, in effect, creates a discrimination, and I will give  
9 you some examples between flour processing equipment and  
10 bakery equipment which stays in the five-year category,  
11 breakfast cereal in the ten-year category, breakfast sausage  
12 equipment in the five-year category, margarine processing  
13 is in ten-year.

14 Butter processing is in five--just a variety of  
15 inconsistencies which, I think, come from the history of  
16 the classifications based on ADR mid-point life, and I  
17 think that is where some of that comes from; but I will at  
18 the appropriate time make an argument that all food processing  
19 equipment, specifically grain milling, margarine processing,  
20 and corn oil, ought to have a five-year rather than a ten-year  
21 category.

22 The Chairman. What is the normal ADR on that kind of  
23 equipment?

24 Mr. Brockway. It is 17 and 18 years.

25 The Chairman. 17 and 18 years?

1 Mr. Brockway. On those.

2 The Chairman. What we tried to do in drafting this, I  
3 think there are none where we are probably over the ADR on  
4 depreciation, are there?

5 Mr. Colvin. That is right.

6 Mr. Brockway. That is correct.

7 The Chairman. What we tried to do, Dave, is in sum  
8 where the asset depreciation range was really out of line  
9 with the classification, we changed the classification.

10 That is one of the reasons, frankly, we brought computers  
11 down from five to three. They didn't have a life that long.

12 Are there mistakes in classification? I suppose there  
13 can be. Would we have been better off to have gone back to  
14 where the law was 20 years ago and we didn't have any  
15 statutory classification, and everybody simply tried to  
16 figure out what their useful life was, and you argued with  
17 the IRS as to what the useful life was?

18 I think, to those who want certainty, there is some  
19 value in classification--statutory classification--so you  
20 know where you are; but the reason we went to ten years is  
21 because their life was even significantly longer than ten.

22 Senator Durenberger. I suppose. I don't possess all  
23 the information on this. My information is that all of this  
24 started back in the 1950s with ADR, and the ADR was being  
25 updated; but in this area, it was not updated when we went



1 to ACRS. So, I don't know whether we are working off of  
2 real lives or not any more, and I can't understand why this  
3 difference between margarine processing, butter processing,  
4 the ones I gave you as an example.

5 I don't understand that. I am not seeking an advantage  
6 for somebody who has a real life of 17 years, but I assume --

7 Mr. Brockway. Those differences would have simply come  
8 out of the pre-1981 system where that actually went back  
9 30 or 40 years--that type of classification that was used.

10 The one that existed pre-ADR was largely used to  
11 construct ADR as well, looking at average lives of assets  
12 in these industries.

13 So, if there are those differences, that is sort of  
14 reflected by the way things stood at that time. Treasury,  
15 from time to time, would adjust items--the classification  
16 of certain types of assets.

17 That remains in this package as well, where Treasury  
18 would be obligated to look to see whether the classification  
19 was correct and see whether similar types of assets are being  
20 treated differently.

21 Senator Durenberger. Is somebody going to go back and  
22 compare all of these for me so that I can find the --

23 Mr. Brockway. We can give you a list of the ADR  
24 guideline classes which are used for assigning property under  
25 this proposal.

1           Actually, they are used right now for ACRS. There is  
2 just, as you pointed out, much less importance as most  
3 equipment--non-utility equipment--is in the five-year class  
4 under ACRS; so it is all put in one category.

5           But it would be the ADR classifications, the mid-points,  
6 that would govern whether it was a five-year or a ten-year  
7 asset under this proposal.

8           Senator Durenberger. At the appropriate time, Mr.  
9 Chairman, I will move to increase--or decrease the number  
10 of years involved to five years.

11           Senator Moynihan. Mr. Chairman?

12           The Chairman. Senator Moynihan?

13           Senator Moynihan. I think Senator --

14           The Chairman. I apologize.

15           Senator Durenberger. That is all right. I was just  
16 going to make another observation. Those are the specifics,  
17 but another observation on our colleagues' amendment that  
18 had been made earlier on the matter of indexing.

19           Because the 1981 legislation has been criticized most  
20 for underestimating revenue foregone, I share the concern  
21 about 1991 and beyond in terms of the effect of indexing.

22           Also, even though I shouldn't be concerned about it,  
23 given the value in my State, I do have a concern about the  
24 definition of productivity.

25           The Chariman. About productivity?

1 Senator Durenberger. Of productivity included in this  
2 amendment and how we are going to come to grips with what is  
3 productive use and what is not

4 The Chairman. Senator Armstrong?

5 Senator Armstrong. I think Senator Moynihan is next.

6 Senator Moynihan. Mr. Chairman, could I first thank  
7 Secretary Darman and Secretary Mentz and their associates for  
8 producing a table in the last two hours of what are the  
9 nonproductivity properties that are not going to get in the  
10 new depreciation schedule, or the new rate schedule.

11 And in response to Senator Durenberger, if I could ask  
12 for his attention for just a minute --

13 The Chairman. Is that a table only you have or did  
14 Treasury make it available?

15 Senator Moynihan. Only I have it. I asked for it, and  
16 I am the only one that has it.

17 (Laughter)

18 Senator Moynihan. I think the answer is that there is  
19 no definition of productivity excepting what State you came  
20 from, if you were part of the group that put the thing  
21 together.

22 I don't mean to be difficult, but I think this is the  
23 kind of distinction that no economist would want to make.  
24 They wouldn't know how to make it because they don't know  
25 --unless we are prepared to change the rules every two years

1 as we have been doing. You don't know what turns up. The  
2 market can only make those decisions.

3 Senator Mitchell was saying this morning that here we  
4 are picking out winners and losers. Senator Armstrong  
5 doesn't seem to think so, but I think we are.

6 Senator Armstrong. No. Mr. Chairman, if the Senator  
7 will yield, I think he is absolutely right. I wasn't here  
8 this morning, but I heard what Senator Mitchell said; and  
9 from the account of it I agree with it and with what Senator  
10 Chafee said.

11 I think this is nuts for us to sit around trying to  
12 decide which are productive assets to give one kind of  
13 depreciation and which are not.

14 And worse than being intellectually foolish, which I  
15 believe it to be, I think it fosters the worst kind of  
16 cynicism about our tax policy.

17 So, I wasn't shaking my head to dispute your point;  
18 but in fact, just shaking my head, to see if my brains would  
19 rattle.

20 (Laughter)

21 Senator Moynihan. When we see the table, I asked that  
22 we could get a look at the specifics; and we find land  
23 improvements are productivity related; but computers are not.

24 That is a thought. If you try to increase pick and  
25 shovel work or something. I don't know. I mean, is

1 international trade our concern? Well, then, why are food  
2 products involved?

3 Certainly, most of the food products we produce in the  
4 United States are consumed by, I expect, 98 percent.

5 I mean, just suddenly we depart from principles to such  
6 an extraordinary degree, to politicize the document in such  
7 a way--a way that we don't even know.

8 We do know that these are largely political choices.  
9 They cannot-- They represent legitimate political interests;  
10 but what does it have to do with taxes?

11 Senator Durenberger. It appears that the commonalities  
12 for most of them, with the exception of athletic, jewelry,  
13 and other goods, is that it has either a natural resource  
14 phase or a transportation of some kind.

15 There are few exceptions to that, but if you look  
16 through it, which is why I was reluctant to raise the issue--

17 It has agriculture, mining, manufacturing, food products,  
18 tobacco, tobacco products, timber, paper --

19 Senator Moynihan. Yes, tobacco products. How much  
20 are tobacco products going to support as manufactured  
21 products --

22 I just wonder. I have said what I have to say.

23 Senator Bradley. If the Senator would yield? I think  
24 that the point has been made and will be made again and again  
25 that what is in this class of the productivity class is purely

1 arbitrary; and the irony is that we are discussing this in  
2 terms of international competitiveness.

3 And if you look at, say, the provision on computers,  
4 if you have a computer that is a part of a central system,  
5 that gets a more favorable treatment than if you have the  
6 way in which most computers are used in the country, which  
7 is in office and data systems.

8 So, essentially, what this is saying is that the whole  
9 service industry, or anything that uses a free-standing type  
10 computer and a data processing system, has a less favorable  
11 treatment than chicken coops or pigpens, which get the faster  
12 treatment, or jewelry.

13 And it doesn't make any sense because what we have done  
14 is to move away from the basic concept of depreciation which  
15 is economic depreciation, which is when your assets wears out,  
16 you should have saved enough money to buy another asset to  
17 replace it, to a more generous form of depreciation which  
18 has been accomplished, I think, heavily for political motives  
19 as opposed to any economic motives.

20 Senator Moynihan. I would like to ask my friend if he  
21 wouldn't recognize two things? First of all, there is a  
22 name for this in economics. It is called State capitalism.

23 And there are many regimes around the world which can  
24 be defined as State capitalism. The enterprises are mainly  
25 in private hands, but they are in those private hands that the

1 State determines it desires them to be; and it has corruption  
2 and inefficiencies involved, but it is a recognizable form  
3 of government.

4 It is not one I have associated with the Reagan  
5 Administration, but there you are.

6 And there is a second thing. It seems to me the worst  
7 thing we could do is to build into the Tax Code a fixed  
8 static notion of international trade.

9 There is something which economists fool around with,  
10 one little fellow figured out, called the trade cycle; and  
11 he described it from the history of manufacturing and  
12 exporting countries, and he was thinking specifically of  
13 our country.

14 A product is invented in this country and developed in  
15 this country and becomes successful. Then, it starts being  
16 exported abroad and is purchased abroad and is an export item.

17 Then, it begins to be manufactured abroad under license  
18 and is a capital return; and then it begins to be imported  
19 from its foreign manufacturers and is an import item.

20 And what you hope for is that in the process, in the  
21 meantime, something else is being thought up and developed  
22 and exported and so forth; and that is how a dynamic system  
23 moves.

24 We are taking a photograph of what it is we are doing  
25 today and assuming we are going to be doing it for 20 years.

1 That is a formula for stagnation. And I don't know that  
2 there is anything more I have to say.

3 The Chairman. Senator Mitchell?

4 Senator Mitchell. Mr. Chairman, I have a few questions  
5 in this area that I would like to ask of either Mr. Mentz  
6 or somebody from the staff who is down here. These deal  
7 with the pending proposal by Senator Roth.

8 I would like to ask how would alternative energy property  
9 be treated, for example, a biomass boiler? Would the  
10 depreciation treatment be different if the boiler were  
11 operated by a private manufacturing company, a regulated  
12 utility, a non-regulated utility, or a private company  
13 marketing power produced by a public utility?

14 Mr. Brockway. Are you aware of whether it has an ADR  
15 Life, Senator Mitchell?

16 Senator Mitchell. Pardon me?

17 Mr. Brockway. Are you aware whether this product has  
18 an ADR Life?

19 Senator Mitchell. No.

20 Mr. Chairman, maybe to save time, you could get the  
21 answer and get back to me.

22 Mr. Brockway. Yes, that would be a better way to do it.

23 Senator Mitchell. All right. Then, I have a few other  
24 similar questions, and I would like to ask them; and then  
25 perhaps you could get the answers to these as well.

(The prepared information follows:)

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1           Senator Mitchell. I would like to know how this  
2 proposal would work for taxpayers who are in both the  
3 manufacturing and distributive services business. If  
4 manufacturing property is productivity property and property  
5 that is involved in distribution and services is not  
6 productivity, what would you do with assets that were used  
7 in both?

8           For example, what if you have a truck that both delivers  
9 product inputs to the manufacturing facilities and then  
10 distributes the manufactured product to customers?

11           Mr. Brockway. Senator Mitchell, it would work on an  
12 activity-by-activity basis. So, you would split it up.

13           Essentially, a similar question rises under present law  
14 where this concept was derived from, from investment credit  
15 rules where certain property--

16           Generally investment credit is only for personal  
17 property, but it was also allowed for real property that was  
18 used in certain specified areas, including manufacturing and  
19 distribution.

20           That is where this list came from, and I think you would  
21 have the same issue.

22           Senator Mitchell. So, in other words, the drivers of  
23 the vehicle would have to keep track of the miles that were  
24 used for one purpose, that is delivering product input to  
25 the manufacturing facility, and also for the miles

1 distributing the materials and the proportion of whether or  
2 not it is productivity property would be that proportion of  
3 the former. Is that what you are saying?

4 Let me ask another question while you are thinking about  
5 that one. What about a car driven by the chief executive  
6 officer of a company that has subsidiaries, some of which  
7 are engaged in what are defined as productivity activities  
8 and some of which are not?

9 Mr. Brockway. My assumption is that there would be an  
10 allocation between the two activities.

11 Senator Mitchell. All right.

12 Mr. Brockway. But I think with items like this, it  
13 would be a matter of looking at these issues and drafting  
14 and coming up with a resolution of how you would treat  
15 that particular type of property where it is a type of  
16 property that might be used in two separate activities,  
17 such as an automobile.

18 Senator Mitchell. I know it is difficult to answer. I  
19 am just trying to make a point regarding this that we really  
20 haven't explored it. And I would like to ask just a couple  
21 more questions, and maybe you could respond later after you  
22 have a chance to consider them.

23 Mr. Brockway. All right.

24 Senator Mitchell. With respect to vehicles, rental  
25 automobiles are placed in the three-year class for straight

1 line depreciation. Is that limited to rental cars?

2 Secondly, on page 3, there is a reference to a class of  
3 automobiles and taxis that would be treated as productivity  
4 property. Over what time period is that?

5 And what I am really asking is: How many different  
6 classes would there be for cars? As I read it, you could  
7 have leased cars, rental cars, cars owned by the taxpayer.  
8 And maybe if you could clarify that at a later time--maybe  
9 tomorrow or something.

10 Mr. Brockway. All right.

11 Senator Mitchell. Next, what about a computer that  
12 performs both research activity and regular data processing?

13 Mr. Brockway. On that issue, we can clarify that now.  
14 It would be three years straight line regardless of where  
15 the computer was used.

16 The computer, regardless of what business it is in or  
17 what activity it is in, will be entitled to a three-year  
18 straight line depreciation under the proposal.

19 Senator Mitchell. All right. Now, if a manufacturer  
20 has equipment that is considered to fall within the definition  
21 of productivity property, if he builds a structure to house  
22 that, is the structure considered productivity property?

23 Again, you can answer that at an appropriate later time.

24 Mr. Brockway. All right.

25 The Chairman. Senator Danforth?

1 Senator Danforth. First, Mr. Darman, when can we get  
2 the revenue loss projections for the out-years for the  
3 indexing?

4 Mr. Darman. For the indexing alone?

5 Senator Danforth. Pardon me?

6 Mr. Darman. For the indexing alone?

7 Senator Danforth. The indexing of the basis for  
8 depreciation. Remember, we talked about this this morning.  
9 I think it is really important before we vote.

10 Mr. Darman. I thought we talked about something slightly  
11 different, but in any case, just a minute.

12 Senator Danforth. Well, I would like anything you have.

13 I thought you had it for depreciation and you also had  
14 the out-year projections for the rest of the bill as well.

15 Mr. Darman. The problem, Senator, is what I said is  
16 we have them for the President's proposal. We have those  
17 already.

18 That is not terribly relevant at the moment since that  
19 is not what you are debating. The proposal that we are  
20 debating at the moment is one we received at the same time  
21 you did this morning.

22 Senator Danforth. You had an indexing proposal in the  
23 President's bill.

24 Mr. Darman. Right. It is affected by the rest of the  
25 system with which it is associated though. In any case, we

1 can get you the numbers.

2 Senator Danforth. Just whatever you have, I mean, just  
3 to give us the best indication we can come up with.

4 Mr. Darman. Our preliminary estimate--and we can probably  
5 get you a refined paper on this by late tomorrow--but our  
6 preliminary estimate is that the Packwood depreciation  
7 system--not the one right on the table, but the chairman's  
8 proposal--actually raises revenue on a fully phased-in basis,  
9 about \$6 or \$7 billion a year, the whole depreciation system,  
10 the cost recovery system.

11 If you changed it from the 2 to 8 percent indexing  
12 provision to the 0 to 8 percent indexing system, it would  
13 end up being approximately revenue neutral in its own frame,  
14 within the framework of depreciation and ITC itself.

15 That is our preliminary estimate. We will have a little  
16 paper for you.

17 Senator Danforth. In other words, you are saying that  
18 from, say, the period five years--say the period from 1991  
19 to 1996--that period of time--the Packwood proposal would  
20 be revenue neutral?

21 Mr. Darman. Well, we haven't broken it out --

22 Senator Danforth. For indexing?

23 Mr. Darman. The analysis isn't done that way. It is  
24 done on a first five-year basis, and then what is called a  
25 fully phased in basis; and it isn't broken out year by year

1 in between, for every single year in between.

2 Senator Danforth. Let me ask you this: --

3 Mr. Darman. It would appear, preliminarily at least,  
4 that the depreciation system itself is a slight revenue  
5 raiser.

6 The Chairman. In the first five years.

7 Senator Danforth. That is not my question. My question  
8 has to do with indexing.

9 Mr. Darman. And that is including a 2 to 8 percent  
10 indexing provision. If you changed it to a 0 to 8 percent  
11 indexing provision, it would appear that it would become  
12 revenue neutral.

13 It would go from being a slight revenue raiser to being  
14 revenue neutral.

15 Senator Danforth. Dick, let me just ask you this:  
16 Isn't it true that what occurs when you index and you attempt  
17 to reduce the cost of capital by indexing, what you do is  
18 you shift the cost of the program to future years?

19 Mr. Darman. Right.

20 Senator Danforth. Therefore, just looking at the  
21 indexing concept, that doesn't cost anything right off the  
22 bat, does it?

23 Mr. Darman. No, sir. Well, it does. It costs a few  
24 billion right off the bat. In the first five years, the  
25 change that we would seek from the 2 percent floor to a

1 0 percent floor would cost probably about \$4.5 billion in  
2 the first five years.

3 Senator Danforth. All right.

4 Mr. Darman. That rises slowly over time.

5 Senator Danforth. If you provide like 200 percent  
6 declining balance depreciation, that front end loads the  
7 revenue loss. Therefore, if we are trying to project what  
8 are the revenue effects of what we are doing, we get a  
9 clear view. We bite the bullet early.

10 We face up to reality; and we say, okay, we are going  
11 to incur this kind of revenue loss early and then hope to  
12 have a more productive country, whereas when we use the  
13 indexing method, what we are doing is to say that we are  
14 going to make the revenue situation look better in the  
15 early years; but looking down the road five years or ten  
16 years, down into the future, we are going to have a situation  
17 in which the longer the life of the property, the more the  
18 impact is going to be.

19 Mr. Darman. Senator, what I am trying to say is that,  
20 even taking that into account, it is our estimate that the  
21 depreciation system as a whole would be revenue neutral and  
22 the package as a whole would be revenue neutral.

23 Senator Danforth. Does that factor in the elimination  
24 of the investment tax credit?

25 Mr. Darman. No, that is without-- For the depreciation

1 system, that is without factoring in the elimination of the  
2 investment tax credit.

3 If you included the elimination of the investment tax  
4 credit, it would be a major revenue raiser; but of course,  
5 that is --

6 Senator Danforth. I think I had better see that on  
7 paper.

8 Mr. Darman. All right.

9 Senator Danforth. Because that really taxes my belief.  
10 I mean, I am not questioning your credibility; I am just --

11 Mr. Darman. Well, I said preliminarily, and I want to  
12 underline it. So, let me get you the paper, and we will  
13 discuss it further then.

14 Senator Danforth. All right. Let me ask one other  
15 question, if I can, Mr. Chairman?

16 The Chairman. All right.

17 Senator Danforth. Is there a problem that is created  
18 by the new concept productivity property? Is there a problem  
19 in that it would invite a kind of abuse?

20 Some years ago, various accounting firms were running  
21 around the country drumming up business for themselves by  
22 offering to go into a company, look at its business, and  
23 determine whether or not it was properly characterizing its  
24 property in order to take advantage of the investment tax  
25 credit.



1           And there was a case on this involving the Ernst and  
2           Whinney accounting firm. Is it possible that we are creating  
3           a kind of a new industry of accounting where accounting  
4           firms will be traveling the country persuading clients to  
5           engage in descriptive devices of property in order to bring  
6           the property within the category of productivity property?

7           Mr. Brockway. Senator, by and large, that should not  
8           be a potential risk here, compared to what it is right now  
9           with the investment credit, which is what that case you  
10          referred to involved because most of the distinction between  
11          productivity and nonproductivity looks to your particular  
12          ADR class for that industry.

13          So, if you are in one of these manufacturing industries,  
14          all your property will be in it. And if you are in one of  
15          the various categories of activities--let's say a utility--  
16          all your property will be nonproductivity property.

17          So, it won't be a matter of your going out and trying  
18          to characterize some of your property one way or another.  
19          All your property will be basically the same situation as  
20          you have right now in determining what life you use for  
21          your depreciation, or what you had before 1981, right now.

22          Senator Armstrong. Except, Mr. Brockway, in the case  
23          that Senator Mitchell brought up.

24          Mr. Brockway. I think that those were the cases, for  
25          example, where automobiles, which is property that may be

1 productivity or may not be productivity property, depending  
2 on who the user is or where you have two separate types of  
3 activities in the same taxpayer's group.

4 But even right now, for example, or pre-1981, if you  
5 had two separate activities, you would have had to look at  
6 those for your ADR classification as well.

7 I mean, clearly, at the edges there will be a problem,  
8 but it should not be larger than the one you are dealing  
9 with under past systems.

10 Senator Danforth. Do you agree with that, Mr. Mentz?  
11 I don't know if you were in on this subject.

12 Mr. Mentz. I was still trying to figure out your last  
13 question, Senator.

14 Senator Danforth. Oh, good.

15 (Laughter)

16 Senator Danforth. The question was whether their  
17 accountants would engage themselves in a whole new field  
18 of creative description of property for the purpose of  
19 bamboozling the IRS by describing certain property as  
20 productivity property.

21 Mr. Brockways says no because the distinction isn't  
22 made according to the description of the property but the  
23 description of the business.

24 Mr. Mentz. I think any time that you are describing,  
25 drawing lines that differentiate between a better tax benefit

1 and a lesser tax benefit, you are going to have taxpayers.  
2 close to the line wanting to be on one side rather than the  
3 other.

4 Senator Danforth. Do you know this Ernst and Whinney  
5 case?

6 Mr. Mentz. Yes, I am familiar with the Ernst and  
7 Whinney case. I think the Ernst and Whinney case is a  
8 pretty aggrievous example.

9 I don't know that there is any way of stopping that  
10 type of gross mislabeling.

11 Senator Danforth. Are we asking for that kind of  
12 labeling in this proposal?

13 Mr. Mentz. I don't think you are asking for it any more  
14 in this area than you are in lots of other areas that we  
15 are dealing with.

16 I think reforming the tax law naturally involves drawing  
17 a lot of new lines that you are going to have some aggressive  
18 taxpayers taking advantage of.

19 I think it depends on how clearly the statute is written  
20 and how well the regulations are written, frankly.

21 Senator Danforth. You don't view this as a serious  
22 problem then?

23 Mr. Mentz. The definition of productivity property?

24 Senator Danforth. Yes.

25 Mr. Mentz. I don't think so. It is reminiscent of the

1 problems that have come up with the investment credit.

2 And there will be cases, without a doubt, but I don't  
3 think it is a serious problem that would be strong enough to  
4 wipe out the proposal.

5 The Chairman. Senator Chafee?

6 Senator Chafee. Thank you, Mr. Chairman.

7 Mr. Mentz, I might have missed a prior comment that you  
8 made. I am curious. What does Treasury think of this?

9 To me, I have been persuaded by the arguments presented  
10 here today, that it is not a very good proposal and that we  
11 are indeed trying to pick winners and losers.

12 We are having an industrial policy, if you would. We  
13 are saying what is productive and what is nonproductive, and  
14 I went through those lists.

15 If somebody can tell me why something is listed as  
16 productive versus nonproductive--what your rationale is--  
17 well, not yours, but the offerers of this provision--I don't  
18 see it.

19 And in your material that you presented in fostering  
20 your capital cost recovery system, you talk a great deal  
21 about a more neutral cost recovery system that would preserve  
22 investment incentives while equalizing effective tax rates  
23 across assets.

24 Now, what is your answer? Are you for it, or "agin" it  
25 or wishy-washy?

1 Mr. Mentz. Let me answer it not immediately yes or  
2 no. I may come to a yes or no, but let me --

3 Senator Chafee. Now, there is a third category I gave.  
4 Are you going to fall into that?

5 Mr. Mentz. I am not going to characterize my answer  
6 just yet.

7 Senator Chafee. All right.

8 Senator Mentz. But let me respond. In 1981, Congress  
9 went to an ACRS system and retained the investment credit.  
10 Investment credit is inherently nonneutral because it is the  
11 same 10 percent whether you have a long-lived or short-lived  
12 asset.

13 ACRS lumps assets into categories, three years, mostly  
14 five years, a little bit of ten years, and 15 years; and by  
15 putting assets with very different lives in the same class,  
16 ACRS itself is nonneutral among assets.

17 Now, I think there is a defense--a good defense--for  
18 the Economic Recovery Tax Act and what was done in 1981; and  
19 I think that I don't happen to share Senator Moynihan's  
20 view of the present state of the economy.

21 I think the economy is pretty healthy, and I think the  
22 Economic Recovery Tax Act and the Administration's economic  
23 philosophy in general has been supportive and helpful in  
24 getting us to where we are today.

25 But in terms of neutrality, the Economic Recovery Tax

1 Act is not neutral among asset categories.

2 Now, when the President's proposal came along, we were  
3 trying to get to a more neutral system. You get there in a  
4 number of ways.

5 One is you eliminate the investment credit. That is a  
6 big step in the right direction.

7 Another is you try to break up the categories. You  
8 don't have the 3-5-15, but you try to select assets more  
9 in line with their useful lives.

10 Now, the President's proposal didn't--it is not pure  
11 economic depreciation, but the idea of it is to have some  
12 incentive, but basically a level incentive, so that we are  
13 trying to keep it as neutral as possible.

14 Senator Chafee. That is right. And they didn't choose  
15 whether a computer will get ACRS and a roller coaster will  
16 not.

17 Mr. Mentz. That is right. And there are choices.  
18 There are always choices in depreciation; and indeed, that  
19 is what we are involved in right now.

20 The choices made in the President's proposal were guided  
21 by that philosophy. Moving to the chairman's proposal, the  
22 chairman's proposal --

23 Senator Chafee. No, let's not move to the chairman's  
24 proposal. Let's stick with this.

25 Mr. Mentz. I was trying to take them in order because

1 I think there is a kind of a progression.

2 Senator Chafee. All right.

3 Mr. Mentz. The philosophy in the chairman's proposal  
4 is, number one, get rid of the investment credit which does  
5 a lot for neutrality. Lower the rates; I forgot to mention  
6 lower the rates.

7 Lowering the rates improves neutrality no matter what  
8 your system because it reduces the value of the deductions;  
9 but in addition, the chairman opted for simplicity, which is  
10 a maintenance of a somewhat revised ACRS system.

11 We have heard a lot from companies who say for God's  
12 sakes, don't give us another depreciation system; we have  
13 too many of them already. Stick with ACRS and modify it  
14 where you think necessary.

15 That is what the chairman did; and I think on the whole  
16 the Treasury feels--as Secretary Baker said--quite comfortable  
17 with the chairman's proposal, and he would have liked to have  
18 seen it indexed from 0 to 8 rather than 2 to 8, but the  
19 chairman's proposal is not very different from Treasury II.

20 This proposal has its differences, and the major  
21 difference is isolating a type of property called productivity  
22 property that is given special treatment.

23 And that is a feature that is inconsistent with where  
24 the President was. That is a deliberate intention to provide  
25 incentive for certain assets.

1 We did not try to reach that resolve. We are trying to  
2 make it as neutral as possible, but even under the President's  
3 proposal there are choices made.

4 Senator Chafee. We recognize that. Everything is a  
5 matter of degrees.

6 Mr. Mentz. That is right.

7 Senator Chafee. But this proposal we have before us  
8 this morning--that was submitted this morning--is clearly  
9 going way beyond the shades that were in the President's  
10 proposal and in the chairman's proposal.

11 I feel you are getting right up to the edge of the cliff  
12 by saying it is not good, but you are not willing to jump.

13 Mr. Mentz. You are right. I am not going to jump.

14 Senator Chafee. Well, we look for your views here.

15 I mean, you are influential in our deliberations, and  
16 particularly you represent The White House, who has a big  
17 hand in this proposal when we finish up. I would like to  
18 hear you --

19 Mr. Mentz. Senator, I guess how I would conclude is:  
20 When you get down to the final decisions on depreciation,  
21 whether you put a particular asset, whether it is computers  
22 and peripheral equipment or telephone switching equipment,  
23 in the three years or five years, whether it is automobile  
24 tools, whether that goes into three years or five years and  
25 whether it is rental cars for straight-line three-year



1 depreciation or five years, accelerated depreciation, are  
2 matters of judgment.

3 And they are matters of how much incentive do you  
4 want to give to a particular asset. And I don't think that  
5 it is possible to--

6 At some point, you just kind of have to make those  
7 choices. We made them, and this is another attempt at  
8 making them.

9 Senator Chafee. Yes, but it goes much further than  
10 just making a choice. I mean, it is putting certain  
11 categories of property into production and certain categories  
12 into nonproduction.

13 I mean, that is a major difference. Don't you agree  
14 with that?

15 Mr. Mentz. It is a difference.

16 Senator Chafee. Oh, come on. It is more than just a  
17 difference. It is a big difference.

18 Well, I will put you down in that third category.

19 (Laughter)

20 Mr. Mentz. I would say that is the correct  
21 categorization.

22 The Chairman. Are there further comments? We have a  
23 vote; we can go about another eight to ten minutes maybe,  
24 and then I think we probably will adjourn for the afternoon.

25 Senator Bradley?

1 Senator Bradley. Mr. Chairman, I have a number of other  
2 comments, but what I would like to do is to ask Treasury or  
3 Joint Tax if they could produce a figure for me.

4 What I am interested in is the cost of capital on the  
5 assets in this class productivity property. Under current  
6 law, then under the Roth proposal, and then, if there was  
7 no corporate tax on these assets.

8 In other words, I would like the cost of capital for  
9 these assets under three circumstances: current law, the  
10 Roth proposal, and then basically exempting those assets  
11 from any tax.

12 Mr. Brockway. We will provide that in the morning.

13 Senator Bradley. And I will only make one other-- No,  
14 I don't think I will even make the other point, if we are  
15 going to adjourn.

16 I will make the other point. The cost of capital  
17 question. When we held the hearings on the cost of capital,  
18 it was related to the House bill; and a number of witnesses  
19 said that the amount that the House bill hurt our cost of  
20 capital relative to current law could be offset by a 5 percent  
21 decline in the value of the dollar.

22 And if that is correct and that is what they said, in  
23 the last four months the dollar has depreciated 5 percent,  
24 so that essentially the House bill is now in a position  
25 where the cost of capital is no worse than what current law

1 would have been four months ago.

2 And I make that point only to illustrate that the tax  
3 component of cost of capital is a very small amount when  
4 you consider the other aspects: interest, exchange rates,  
5 and so forth.

6 I have no other comment to make at this time.

7 The Chairman. Further comments?

8 (No response)

9 The Chairman. The roll call is on a Triple motion to  
10 table the Lautenberg Amendment to the airport bill. Got  
11 that?

12 Could I ask if the members are going to have any  
13 amendments on either the employee benefits section or the  
14 ESOP section, to get them to us. So far, I have had no  
15 members suggest any, and it was my impression there were  
16 one or two. I know there are not a lot, but I would like  
17 to get them.

18 If there are not many amendments, that is a section we  
19 can move into and hopefully close up early and get it behind  
20 us.

21 Senator Durenberger. Mr. Chairman, I think that either  
22 John Heinz or I will have an amendment on the mid-quarter  
23 convention.

24 The Chairman. Right.

25 Senator Durenberger. And I am going to have one --

1 The Chairman. That is in the depreciation section,  
2 though.

3 Senator Durenberger. Oh, I am sorry.

4 The Chairman. Yes. I am talking about just the employee  
5 benefits section.

6 For the members that weren't here, we went through it  
7 and the explanation of it from about 2:00 to 2:20 or 2:25  
8 before we had the vote and walked through it.

9 I know it is a section that most of the members are  
10 familiar with, and I know that they all know my views.

11 I thought there were some amendments, and there may be;  
12 but there aren't many amendments that I know of. And to the  
13 extent that I can get them ahead of time, I think it is a  
14 section we can close up relatively early.

15 Senator Long. Mr. Chairman, I have been working on  
16 some suggestions in the way of an add-on to the ESOP proposals,  
17 and I am not sure whether I will offer it, but I would like  
18 to reserve the right.

19 The Chairman. Senator Chafee?

20 Senator Chafee. Mr. Chairman, I will have one on employee  
21 awards and possibly another on fringe benefits. I don't know  
22 whether I will or not; but I will certainly have one on  
23 employee awards.

24 The Chairman. I appreciate it.

25 Senator Chafee. What would you like in connection with

1 that? One, you would like us to get it to you. Two, for  
2 our own benefit, get it to the other members. Right?

3 The Chairman. That is up to you, if you want to get  
4 it to the other members. I would think in terms of selling  
5 it, it would help if you got it to them.

6 But the reason it helps me, if your staff can run it  
7 past John or somebody else, is that we have a reasonable  
8 idea of planning.

9 If we have a section that the committee basically agrees  
10 on, and there are one or two amendments, that is easier for  
11 planning than if we have 35 or 40 amendments on a very  
12 controversial section.

13 Senator Heinz?

14 Senator Heinz. I will have another amendment, I guess,  
15 on what you would call employee benefits regarding watches.

16 The Chairman. Watches?

17 Senator Heinz. Watches that are given for retirement --

18 The Chairman. Are these awards?

19 Senator Heinz. Awards, yes.

20 The Chairman. Is that the same one, John, that you have  
21 or close to it?

22 Senator Chafee. I am not sure.

23 The Chairman. All right.

24 Senator Long. Mr. Chairman, Senator Matsunaga might have  
25 another one. There is one on fringe benefits that he is

1 thinking about offering.

2 Mr. Wilkins. Senator Matsunaga's amendment deals with  
3 the pension part of that title.

4 Senator Long. So, it would be in this area?

5 The Chairman. It is mentioned --

6 Mr. Wilkins. Not in this area.

7 The Chairman. He has quite a line of amendments on the  
8 pensions.

9 Senator Durenberger. Mr. Chairman, for purposes of  
10 deciding whether I have one on capping the tax-free nature  
11 of the health insurance benefits, I wonder if we could  
12 get up-to-date estimates from the Treasury on a \$75.00 and  
13 \$175.00 cap or, in the alternative, \$100.00 single individual  
14 and \$250.00 group or family plan cap?

15 The Chairman. Treasury could probably provide that.  
16 They at one time suggested that terrible idea and had estimates  
17 at that time.

18 (Laughter)

19 Senator Durenberger. Since your idea disappeared, I  
20 thought maybe this one had new life breathed into it.

21 Senator Bradley. Mr. Chairman, I think Senator  
22 Durenberger wants to follow in my footsteps.

23 (Laughter)

24 The Chairman. We will be adjourned until 10:30 a.m.  
25 in the morning.

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(Whereupon, at 3:38 p.m., the meeting was recessed, to  
be reconvened on Thursday, April 10, 1986, at 10:30 a.m.)

C E R T I F I C A T E

1

2 This is to certify that the foregoing proceedings of

3 an Executive Committée Session of the Committee on Finance,

4 held on April 9, 1986, in re: Tax Reform, were held as

5 herein appears and that this is the original transcript

6 thereof.

7

8

9 *William J. Moffitt*

10 WILLIAM J. MOFFITT

11 Official Court Reporter

12

13

14 My Commission expires April 14, 1989.

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5-Year Depreciation Revenue Estimate  
(Exclusive of ITC)

1987-1991  
Revenue Change  
Relative to Current Law  
(\$ billions)

Chairman's package with 2-8% indexing of equipment:	35.3
Chairman's package with alternative 0-8% indexing of equipment as in Roth, Dole, Heinz, Baucus:	30.8

Fully Phased-in Depreciation Revenue Estimates <sup>1/</sup>  
(Exclusive of ITC)

	Hypothetical Annual Inflation	Annual Revenue Change Relative to Current Law (\$ billions)
Chairman's package with 2-8% indexing of equipment:	2%	10.6
	4%	7.1
	8%	0.1
Chairman's package with alternative 0-8% indexing of equipment as in Roth, Dole, Heinz, Baucus:	2%	6.1
	4%	2.6
	8%	-4.1 <sup>2/</sup>

U.S. Department of the Treasury  
Office of Tax Analysis

April 10, 1986

<sup>1/</sup> Assumes 4 percent real growth.

<sup>2/</sup> This decrease is relative to a non-indexed system. Nominal revenues would, in fact, be increasing at the inflation rate--but no more.

Note: Revenue increases relative to current law are accounted for primarily by the lengthening of depreciation lives for many current 5-year assets and all current 19-year assets.

### Corporate Cost of Capital

	<u>No Federal Corporate Tax</u>	<u>Present Law</u>	<u>CCRS</u>	<u>House Bill</u>	<u>SFC</u>	<u>Roth</u>
Total	5.9	8.2	7.5	8.6	8.0	7.7
Productiv- ity Property	5.5	5.4	6.5	8.0	6.8	6.2

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Joint Committee on Taxation,  
April 10, 1986