

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

3 THURSDAY, APRIL 17, 1986

4 Committee on Finance

5 Washington, D.C.

6 The committee met, pursuant to recess, at 9:45 a.m. in  
7 Room SD-215, Dirksen Senate Office Building, the Honorable  
8 Bob Packwood (chairman) presiding.

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

13 Also present: Senators Exon and Zorinsky.

14 Also present: Roger Mentz, Assistant Secretary for Tax  
15 Policy, Department of the Treasury; Steve Shay, International  
16 Trade Counsel, Dennis Ross, Tax Legislative Counsel,  
17 Department of the Treasury.

18 Also present: Bill Diefenderfer, Chief of Staff; David  
19 Brockway, Chief of Staff, Joint Committee on Taxation; Randy  
20 Weiss, Deputy Chief of Staff, Joint Committee on Taxation;  
21 John Colvin, Chief Counsel; Bill Wilkins, Minority Chief  
22 Counsel; Benjamin Hartley, Joint Committee on Taxation; Mary  
23 Frances Pearson, Tax Counsel, Majority; Barbara Groves,  
24 Randy Hardock, Tax Counsel, Minority; and Susan Taylor,  
25 Executive Assistant.

1 The Chairman. The Committee will come to order.

2 I wonder if we might start with two things. If I could ask  
3 the Joint Committee for revenue estimates on the amendment  
4 that the members have submitted to us. And let me ask if the  
5 members have copies of those amendments.

6 Mary Frances, do you know?

7 Mr. Colvin. No, Mr. Chairman. We just -- we have a list  
8 of amendments that legislative assistants mentioned yesterday  
9 afternoon. And we gave that list to Joint Tax to produce  
10 revenue estimates.

11 The Chairman. All right.

12 Mr. Hartley.

13 Mr. Hartley. The first amendment that was discussed  
14 yesterday afternoon, Mr. Chairman --

15 The Chairman. A little louder. We can't hear you.

16 Mr. Hartley. The first amendment that was discussed  
17 yesterday afternoon deals with the circumstances under which  
18 a solid waste disposal facility may be exempted from the  
19 volume cap.

20 The Chairman's package requires governmental involvement  
21 on a continuing basis and rate setting as a condition of  
22 coming out the volume cap. If the facility were operated  
23 pursuant to a long-term contract where rates were contracted  
24 up front with no continuing involvement, the package requires  
25 those bonds to be issued under the volume cap.

1 A number of the assistants yesterday afternoon wanted to  
2 delete that requirement to allow governmentally owned  
3 facility to the outside of the volume cap, even though the  
4 terms of the contract were established in an initial  
5 negotiation and were not continually reviewed by the  
6 government.

7 The Chairman. How much?

8 Mr. Hartley. The revenue estimate on that was a \$200  
9 million loss.

10 The Chairman. All right.

11 Mr. Hartley. The second two amendments dealt with  
12 advance refundings, liberalizing the number of advance  
13 refunding bonds that could be issued. The revenue estimate  
14 on that is \$100 million loss.

15 Another modification on that would cover cost of  
16 issuance and allow arbitrage profits to be used to pay the  
17 cost of issuance, including bond counsel fees and investment  
18 counsel fees. The cost on that would be \$200 million.

19 The Chairman. Let me ask just a quick question. That  
20 would, in essence, undo the arbitrage provisions we have. And  
21 so you could use the arbitrage profits to pay your bond  
22 counsel fees and lawyers.

23 Mr. Hartley. That is correct.

24 The Chairman. Earmarked for that purpose, in essence.

25 Mr. Hartley. It would only be allowed for those cost of

1 issuance, yes.

2 The Chairman. All right.

3 Mr. Hartley. The third amendment deals with the  
4 limitation on the amount of the outstanding bonds that a  
5 section 501(c)(3) organization can have other than hospital  
6 bonds. The first amendment that was mentioned on that would  
7 delete this requirement for Section 501(c)(3) organizations.

8 The second amendment would, if the requirement is  
9 retained, expand the exception for hospitals to all health  
10 care facilities.

11 The Chairman. How much?

12 Mr. Hartley. The revenue on the first amendment was  
13 \$100 million. The second will be less than \$50 million.

14 Senator Moynihan. Mr. Chairman, I am sorry. Is this in  
15 writing? Are we hearing proposals that you are making?

16 The Chairman. No. These are different amendments that  
17 the members have handed in. I just wanted him to go through  
18 and give an idea of the cost, and then we start with the  
19 sheet that you have got, Pat, entitled "Possible  
20 Modifications to the Tax Exempt Bond Provisions."

21 Those, in fairness, are basically many of Dave  
22 Durenberger's principles. Dave Durenberger's suggestions and  
23 some others. But we will start when we have finished with  
24 these revenue estimates on this sheet.

25 Senator Moynihan. How will we get back to the sheet

1 that --

2 The Chairman. Those are amendments that the members have  
3 suggested, and we will start going down one at a time. And  
4 when we come to your amendment you will -- maybe some of  
5 the members are not going to offer their amendments now. I  
6 don't know.

7 But why don't you just go ahead through?

8 Mr. Hartley. All right. The next amendment deals with  
9 mass commuting facilities that are industrial development  
10 bonds. Those are not allowed under the Chairman's package.  
11 The amendment would allow those bonds to be issued under the  
12 state volume cap, and the cost is \$400 million.

13 The next amendment deals with small issue IDBs for  
14 agricultural equipment. And it would limit the amount of  
15 IDBs that could be used for depreciable property used in  
16 farming to no more than \$1 million per person. This is  
17 similar to a bill that Senator Kasten has introduced dealing  
18 with the dairy program with which he may be familiar. The  
19 cost would be less -- a gain of under \$50 million.

20 The next proposal that was mentioned was a deletion of  
21 the sunset on small issue IDBs. Under the Chairman's package,  
22 they would sunset at the end of 1988. The volume cap  
23 schedule to drop to 100 per capita would be retained. The  
24 cost on that is \$500 million.

25 The next amendment deals with the requirement that

1 arbitrage be rebated in the case of pooled financings where  
2 many organizations join together in a common pool and take  
3 loans out of the pool. It would allow an exception from the  
4 rebate in certain cases and would also require an exception  
5 from the federal guarantee rules that were enacted in 1984.  
6 The cost on that is estimated at \$100 million.

7 The next amendment deals with allowing the New York  
8 Power Authority to issue tax-exempt bonds on the same basis  
9 as public power agencies. The cost estimate on that is  
10 \$150 million.

11 Multi-family housing bonds under the Chairman's package,  
12 the project's finance of these bonds has to continuously  
13 comply with the low-income set-aside requirement.

14 The amendment that was suggested would be that in  
15 certain high-cost areas where there is deep targeting in the  
16 set-aside unit a rule that allows income of low-income  
17 tenants to rise up to 120 percent of the low-income amount  
18 would be increased to 150 percent of the low-income amount  
19 before you had to bring in new low-income tenants.

20 The cost on that is \$100 million.

21 The Chairman. The others that were on the list, I think,  
22 have been incorporated in the package.

23 Ms. Pearson. That is right, Mr. Chairman.

24 Mr. Hartley. I think that is correct.

25 The Chairman. Are you ready, Dave?

1 Senator Durenberger. Certainly, Mr. Chairman.

2 The Chairman. If we could turn our attention to the  
3 possible modification to the tax-exempt bond provisions.  
4 And I have indicated again any number of members were  
5 involved in this, but Dave Durenberger deserves principal  
6 credit for making what I think were good suggested changes.  
7 And I would like to -- it is four pages -- and I would like  
8 the members to take a look at it. And, hopefully, we can  
9 adopt this package as it is. It doesn't preclude other  
10 amendments, but could adopt this package as it is.

11 Dave?

12 Senator Durenberger. Mr. Chairman, thank you very much.

13 And let me just say that most of us were all in this  
14 together, and a lot of the changes that are in the modifica-  
15 tion that we are proposing today were contained either in  
16 the Chairman's bill or in S. 2166, which some members of this  
17 Committee and about 24 other members of the Senate who are  
18 not part of this Committee were co-sponsors of. And it is  
19 just a large effort to try to rescue state and local govern-  
20 ments' traditional tax-exempt, long-term debt financing  
21 rights and responsibilities from an effort on the House side,  
22 I think, in particular to disadvantage certain states, certain  
23 communities and certain public purposes by putting an  
24 artificial cap on the per capita cap on the dollar amount of  
25 authority for tax-exempt bond financing in any state.

1 In a number of states in this country, a volume cap  
2 wouldn't make a lot of difference. I think about 13 states.  
3 But in 37 states, it makes a lot of difference, because it  
4 puts important purposes in competition with each other to  
5 the detriment of needs that are in that particular state.

6 So all of this is not an effort to try to go back to the  
7 old days where every purpose became a public purpose. The  
8 Chairman is fond of reciting a little story that happened  
9 here last fall which was very real life when an industrial  
10 development person from, I think, the State of New Jersey  
11 was in here and testifying on behalf of all tax-exempt bond  
12 financing. And the Chairman asked him about public purpose.

13 And he said, well, shouldn't these have a public purpose.  
14 And the witness said, of course; they all do have public  
15 purposes.

16 And the Chairman: Well, is job creation a public purpose?  
17 And he said, of course; job creation is a public purpose.

18 That has just been built into our psyche here over  
19 the last 10 years or so that as unemployment has increased  
20 and as the nature of work in America has changed, states have  
21 come in competition with each other to create jobs. And  
22 Lloyd's state gets all these Minnesotans who are flocking  
23 down there because they like the climate or the political  
24 representation or something. I don't know what it is.

25 But we come to think about job creation. We stayed here



1 until Christmas of 1982 after my reelection, I remember,  
2 creating jobs with the gasoline tax which didn't actually  
3 put out any money until last summer. But we were desperate  
4 with 11 percent unemployment.

5 The Chairman. You know, the fellow from New Jersey was  
6 really marvelous, because I was quizzing him about the  
7 Saturn plant. The location had not been decided yet. And  
8 I asked him was he willing to use industrial development  
9 bonds, although he could only do a small issue, to attract  
10 the Saturn plant. Oh, yes, that was perfectly all right.

11 And I said, you mean you are going to take these tax-  
12 exempt bonds and, in essence, give them to General Motors  
13 to locate -- oh, yes, that was perfectly all right.

14 At that stage, I asked him what was not a public purpose.  
15 And I don't think he had an answer. And he was a good  
16 witness. I thought he was fine. Bill knows him.

17 But I guess there is nothing that is not a public purpose.

18 Senator Durenberger. Well, Mr. Chairman, that, I think,  
19 best illustrates our frustration here in trying to take the  
20 nation's notion of tax exemption for state and local issue  
21 back to where it once was, which was the important fiscal  
22 tool available to state and local government.

23 It is even more important today, because in the last  
24 20 years, we have found wonderful ways to meet people's needs  
25 by coming to Washington and using the inflated income tax as

1 a way to solve the problems. Now we are getting out of that  
2 business, but the responsibilities are still there.

3 So this is an effort on the part of the Chairman and me  
4 and most of the members of this Committee, as far as I can  
5 tell, to try to come to grips with a redefinition of public  
6 purpose, rather than putting just the artificial cap as a  
7 way to get them disciplined into the system.

8 We are trying to redefine public purpose. I suspect we  
9 haven't found the perfect answer, but I think we have come a  
10 long way in this process.

11 So the agreement that at least we have worked out is  
12 before everyone. And I don't know whether Mary Frances or  
13 John wants to explain it in any detail.

14 I think as far as I am concerned we have agreement on  
15 everything except there is some question in my mind about,  
16 what is it, special low-income family housing? Is there one  
17 area that we have a little bit of -- we are not so sure  
18 about?

19 Mr. Colvin. Yes. Senator Durenberger, there is inter-  
20 action between the depreciation that would be available for  
21 multi-family housing projects --

22 Senator Durenberger. Multi-family, yes.

23 Mr. Colvin. -- and the low-income credit, which is  
24 contained in the real estate title in this bill. And we  
25 wanted to take a little more time working with your staff and

1 with staffs of other Senators to make sure that this proposal  
2 works as intended.

3 And so this proposal keeps that issue open.

4 Senator Durenberger. All right. The Treasury also  
5 expressed some concerns about the rebate rule. Is it my  
6 understanding that staff and Treasury have clarified the  
7 rebate rule to everyone satisfactorily?

8 Ms. Pearson. That is right, Senator.

9 Senator Durenberger. How about the definition of the  
10 loan? Where are we on that issue? The private loan bond  
11 provision. Do we have an agreement on that?

12 Ms. Pearson. Yes, we do.

13 Mr. Hartley. The Treasury Department supplied us with  
14 some clarifying language on loans yesterday afternoon. They  
15 might want to respond more directly to it.

16 Basically, it deals with a loan when you shift the  
17 economic benefits of ownership. And if you did not shift  
18 the benefits of ownership, it would not be a loan, but it  
19 might well be a use under the IDB test.

20 Senator Durenberger. Can you give us an example?

21 Mr. Mentz. It is just a basic tax ownership rule,

22 Senator Durenberger. In other words, if you have a lease  
23 that really shifts tax ownership because the leasee, in  
24 effect, takes the burdens and benefits of the property, that  
25 would effectively convert it into a mortgage loan and would be

1 caught under the --

2 Senator Durenberger. If we do something simple like  
3 repaving a street or building a new street or something out  
4 in front of a residential development and, thus, raise the  
5 assessed value of property adjacent to that street, that  
6 doesn't automatically violate the private loan bond provision,  
7 does it?

8 Mr. Mentz. That is correct.

9 Senator Durenberger. Mr. Chairman, I don't know if --  
10 The Chairman. Discussion on the package?

11 What I would like to do is limit for the moment our  
12 discussion to our package, hopefully adopt it, and then go  
13 through the dozen amendments or so the different members have  
14 to offer.

15 Mr. Mentz. Mr. Chairman?

16 The Chairman. Who seeks recognition? Mr. Secretary.

17 Mr. Mentz. Let me just observe that the role of tax-  
18 exempt bonds in tax reform is one that has sort of evolved  
19 over time from the provisions of Treasury 1 and, indeed,  
20 Treasury 2, which would have pretty much eliminated all  
21 private-purpose municipal financing.

22 It has evolved, as it inevitably does everytime the  
23 legislative process attempts to tackle tax-exempt bonds -- we  
24 wind up with a sort of a mixed bag of provisions, some of  
25 them policywise beneficial and some of them, perhaps, going

1 in the wrong direction.

2 I would just suggest to you that where the Treasury  
3 basically comes from philosophically is that tax-exempt  
4 financing is appropriate for municipal facilities. It is  
5 appropriate for schools, roads, building a new court house,  
6 what have you.

7 It should be very strictly limited to the extent that it  
8 becomes a substitute for corporate finance. If a corporation  
9 wishes to finance a property that is privately owned and  
10 operated, it ought to do that outside the tax-exempt sphere.

11 And that kind of distinction has been sort of driving,  
12 at least where we come from on the policy end. To some extent,  
13 Senator Durenberger has gone in that direction. And  
14 certainly provisions such as the arbitrage rebate rule, for  
15 example, is, we believe, a constructive improvement, and we  
16 support. And we support much of this package.

17 But let me just call your attention to a couple that do  
18 give us problems. And these are more from the administrative  
19 standpoint that I would like to raise.

20 First of all, on the rebate, the penalty for bailing  
21 through rebate arbitrage, if I understand it correctly,  
22 Senator Durenberger, this does not come into play until the  
23 IRS gives notice that the issuer has failed to appropriately  
24 rebate. Is that right?

25 Senator Durenberger. Yes, that is correct.

1 Mr. Mentz. All right. Well, under current circumstances,  
2 that presents the IRS with a pretty impossible situation  
3 since we don't ordinarily have information or returns on  
4 issuance of bonds, particularly by municipalities, states,  
5 typical governmental issue.

6 I suppose that rule would require some form of information  
7 reporting. It would only be through that process that the  
8 IRS would know which bonds were issued and which ones to  
9 audit and issue a notice on.

10 So do I understand correctly that your proposal envisions  
11 or contemplates that kind of a process?

12 Senator Durenberger. Yes. But it was written -- the  
13 reason we got into this is we were trying to find a  
14 realistic penalty. We are not against penalties. We were  
15 trying to find a realistic penalty. We wanted one that would  
16 not raise the cost of the borrowing by having the penalty out  
17 there on the person that bought the bond, and he didn't know  
18 whether or not some issuer was going to violate the law.

19 So we are just looking for a realistic penalty. I am  
20 informed that sometime last night, "Treasury," whatever that  
21 means, said this would work.

22 Ms. Pearson. Senator Durenberger, I would like Stan  
23 Hartley to clarify what the Treasury and staff agreed to.

24 Senator Durenberger. All right. That is much better than  
25 my trying to do it.

1 Mr. Mentz. They can clarify for the staff. I can  
2 clarify for the Treasury, thank you very much, Mary Frances.

3 Ms. Pearson. No.

4 Mr. Hartley. Senator, what was discussed last night was  
5 whether the penalty would be self-assessing, because there is  
6 no way the IRS could track issuance of every bond and notify  
7 one on the date on which rebate was due.

8 And the language was changed to provide that the penalty  
9 and the interest that would accrue on a late payment of  
10 rebate would be self-assessing.

11 Once the IRS was notified there was an error or if there  
12 was a willful disregard, the IRS would notify the issuer, and  
13 at that point the bonds would become taxable.

14 Senator Durenberger. Now that makes sense. Maybe as  
15 we go through this, why don't we have Mr. Hartley respond  
16 rather than the Senator respond until we get to one that I  
17 may understand better than he. How is that?

18 Mr. Mentz. All right. That is fine. And that is an  
19 improvement. I think we are still going to need some  
20 modest information reporting so that this can be monitored.

21 And I want to say the Treasury is supportive. We do not  
22 want to have a result where you have a tax exemption on  
23 bonds disallowed because particularly of an inadvertent,  
24 harmless error on something like an arbitrage rebate. So  
25 certainly we are coming from the same position there, Senator.

1 Senator Durenberger. I appreciate that.

2 Mr. Mentz. The other one I just want to direct the  
3 Committee's attention to is Number 7 that would require that  
4 Treasury's SLGS program to be modified and in place by  
5 January 1, 1987.

6 The present SLGS program, which is a state and local  
7 government series of obligations that are issued by the  
8 Treasury for restricted yield portions of the proceeds of  
9 bonds -- these are obligations issued by the Treasury at  
10 rates below current market rates that permit the issuer to  
11 comply with the present arbitrage regulations.

12 The SLGS program does not work perfectly. We have had  
13 some comments and, I think, very constructive criticisms of  
14 it, particularly from the National League of Cities. I had  
15 a meeting with them just this morning.

16 I think we can improve that program. I think that if we  
17 go or if we are required to go in the direction of  
18 effectively a money market SLGS program with no notice so  
19 that a bond issuer can just come in and say here is my  
20 billion dollars, give me my SLGS, and it is on a money market  
21 kind of a system, that, I am told, is going to cause  
22 significant disruption in the Treasury's ability to manage  
23 its cash flows and in the Federal Reserve's ability to  
24 effect and control and manage money supply.

25 So I think the Treasury -- not so much tax policy, but the



1 Treasury as a whole -- is going to have problems with a  
2 complete sort of money market open window arrangement. That  
3 is particularly a problem when we are bumping up against the  
4 debt limit.

5 Now maybe that will never happen again, but on the  
6 off chance that it will --

7 (Laughter)

8 Mr. Mentz. -- I think we need to bear in mind that a  
9 broadening of the SLGS program, particularly with no notice  
10 and this money market kind of a concept, which would apply  
11 not just to restricted but unrestricted yields as well, will  
12 cause Treasury serious problems.

13 Senator Durenberger. I wonder if John or Mary Frances  
14 can respond to this.

15 Ms. Pearson. Our main comment from taxpayers who were  
16 at -- that the SLGS program wasn't working. That they had  
17 to have a certain amount of money, and they had to give  
18 notice.

19 It has basically tied taxpayers' hands, and they would  
20 have to go into all the complicated procedures of figuring  
21 arbitrage and the yield restriction. And it was putting an  
22 administrative burden on the backs of the taxpayers that we  
23 thought could be better administered by the Treasury  
24 Department.

25 What we were envisioning was a program on demand where

1 taxpayers could issue bonds, place it in the SLGS program  
2 and be free of concern about earning arbitrage. If they  
3 didn't want to earn arbitrage, then they just put it in the  
4 SLGS program.

5 It is something -- if we are going to require rebate and  
6 the tightened arbitrage rules and all the things that we need  
7 to protect our revenues, I think we ought to give the tax-  
8 payers something that, especially small issuers, something  
9 that they can rely on without having to worry about the  
10 complexity.

11 Mr. Mentz. Well, that may be, but I don't think you found  
12 it in this SLGS amendment, because I am telling you it is not  
13 going to work.

14 Ms. Pearson. Now, Mr. Chairman --

15 The Chairman. Mary Frances.

16 Ms. Pearson. I am afraid I found a mistake on Page 1 of  
17 the handout, Number 4. The willful disregard is to apply to  
18 the retroactivity of the bonds; not to the penalty. The  
19 penalty will apply on the rebate. If the taxpayer willfully  
20 disregards the rebate requirement, then he fails to secure,  
21 and the IRS shows it is willful disregard, then it becomes  
22 taxable.

23 And the reason we put that in there was to make sure  
24 that the issues don't become taxable unless it is just  
25 loudly willful disregard.

1 Mr. Mentz. Just one last point on SLGS. If you open  
2 up the Treasury to investments in just all the bond proceeds,  
3 not just the restricted portion, you will, in effect, drain  
4 away deposits from local banks where amounts are invested  
5 under current law.

6 And I think that is clearly an undesirable consequence.  
7 I am sympathetic to working out an investment mechanism to  
8 simplify the arbitrage rebate rules. I understand that is  
9 the purpose that we are trying to reach. And I am just saying  
10 I don't think we are quite there yet.

11 The Chairman. John Chafee.

12 Senator Chafee. The Treasury might have touched on this  
13 before. I have two questions. The first is: Taking the  
14 Durenberger-Chairman's proposal, how much tightening does  
15 that do over existing law? Is it a revenue pickup? And  
16 what are the principal features that tighten up over  
17 existing law?

18 Mr. Mentz. It is not a revenue pickup. It is a revenue  
19 loss of, what is it, then, 4.5?

20 Mr. Hartley. The package would be minus 4.8 over present  
21 law. That is including \$300 million in depreciation that  
22 is in this package that you received this morning.

23 Mr. Mentz. I think though, Senator Chafee, there are,  
24 in fairness, some extensions of expiring provisions. For  
25 instance, the exempt small issue and mortgage revenue bonds

1 would be continued, although they would expire under current  
2 law. And that is a substantial revenue loss.

3 We don't support their extension. We would like to see  
4 them expire. But I don't know whether there has ever been a  
5 bond provision that has expired by its terms, at least not to  
6 my knowledge. So maybe that is an inevitable extension, in  
7 which case it tends to tip the revenue negative.

8 Senator Chafee. And the next question was: As I  
9 understood originally when this proposal came out, there was  
10 some language qualifying limited equity housing co-operatives  
11 for the multi-family tax exemption. And that was -- I think  
12 the argument against that was so-called double-dipping.

13 If the -- and the double-dipping being the combination of  
14 the low interest rate and the homeowners' tax benefits. If  
15 the homeowners' tax benefits were taken out, would that --  
16 well, obviously that would eliminate the double-dipping.  
17 What is Treasury's reaction to that proposal?

18 And I guess I would ask the Chairman, too.

19 Mr. Mentz. It is a version of owner-occupied housing.  
20 It is a mortgage subsidy bond. We are not real happy with  
21 mortgage subsidy bonds in total.

22 Senator Chafee. Well, does this aggravate your  
23 unhappiness?

24 Mr. Mentz. Sure. No question. I am quite aggravated,  
25 Senator.

1 (Laughter)

2 Senator Chafee. It is kind of a modest thing. Not  
3 minor, but modest.

4 What does Mr. Brockway say about all that? Are you  
5 familiar with this?

6 Mr. Brockway. No.

7 Senator Chafee. Ms. Pearson?

8 Ms. Pearson. No.

9 Senator Chafee. No.

10 Mr. Mentz. I guess, Senator, we would be less aggravated,  
11 as you put it, if they -- they are really single family,  
12 similar to single family.

13 Senator Chafee. They are multi-family, though. They are  
14 multi-family.

15 Mr. Mentz. But you are talking about co-ops, aren't you?

16 Senator Chafee. Yes.

17 Mr. Mentz. So, really, they are individual owners. It  
18 is really very much like single family. And if you put them  
19 under a single family cap, it would be a step in the right  
20 direction.

21 The Chairman. Senator Armstrong.

22 Senator Armstrong. Mr. Chairman, I join this discussion  
23 somewhat belatedly and with a degree of uncertainty about  
24 where we are. But as I understand it, the pending business  
25 is a motion by Senator Durenberger and yourself to amend what

1 is in the book starting on Page 186 for this package that  
2 has been passed out.

3 The Chairman. That is correct.

4 Senator Armstrong. My question: What is the justifica-  
5 tion of placing multi-family housing bonds outside the  
6 IDB volume cap. I understand they would like to be outside  
7 the cap, but then so would everybody else. What is the  
8 reason for doing it?

9 Senator Durenberger. I am the proponent of that. And  
10 the reason is to make rental in communities that have  
11 shortages of rental affordable, that is, market rate, below  
12 market rate rental, for low and moderate income persons to  
13 enable them to be able to build those kinds of facilities.

14 Senator Armstrong. What do you mean "below market  
15 rate rental?" And what do you mean "cities that have a lack  
16 of such housing?"

17 Senator Durenberger. I will have to defer to an expert  
18 as to the definition of below market.

19 Senator Armstrong. I would be glad to hear that. But  
20 really what I want to know is what you mean, what the  
21 Chairman means.

22 Senator Durenberger. Well, what I mean is -- and it would  
23 be a lot better if I could give you a specific statistic.  
24 The reality is that not a lot of people in this country in  
25 the low and moderate income categories can afford to own their

1 own home. They are by circumstances required to rent.

2 The question is: What is an affordable rent, depending  
3 on your income? Right now it is averaging something like  
4 44 percent of income in the low-moderate income category as  
5 being devoted to housing.

6 Senator Armstrong. How many units of subsidized housing  
7 do we have in this country today?

8 Senator Durenberger. I can't answer that question.

9 Senator Armstrong. Is it 2 million? Three million?  
10 Five million pretty close?

11 Mr. Hartley. Senator, I don't know a number of units,  
12 but --

13 Senator Armstrong. Well, Mr. Chairman, I think that is  
14 exactly the problem. We don't know. I know the number. It  
15 is about 5 million units. And I am pretty well convinced  
16 that there's enough units to subsidize housing in this  
17 country to take care of people who need help.

18 Now they are not well distributed. Most of the units  
19 of subsidized housing in this country are distributed to  
20 people who are not by any reasonable standard or definition  
21 needy. That is the problem.

22 And the point that concerns me, and the reason why I  
23 would urge that this item be taken out of the package at least  
24 for the time being, is that we don't know. We don't know how  
25 many units of subsidized housing we have got. There is a

1 general feeling that maybe it is tough to get affordable  
2 housing in some places, and yet as far as I can tell this  
3 amendment is not directed to that.

4 I mean it doesn't say that these bonds can only be  
5 issued in cities where there is a dearth of such housing.  
6 There are not standards in it.

7 I would like to know, among other things, what the  
8 qualifications are for people living there. Is there a percentage  
9 of these units that must be occupied by persons of low  
10 income, and how is low income defined?

11 Mr. Hartley. There is a set-aside requirement over a  
12 15-year period in these projects. Low income is defined in  
13 an alternate of two ways under the Chairman's package.  
14 Either 25 percent of the units occupied by persons below  
15 80 percent of the area median income, or 20 percent of the  
16 units occupied by persons below 70 percent of area median  
17 income.

18 Senator Armstrong. All right. Now that is exactly the  
19 point I wanted to elicit.

20 Mr. Chairman, if we are serious about this, to suggest  
21 that we issue tax-exempt bonds for housing projects where  
22 only 25 percent of the units must be for low-income people,  
23 particularly in areas where that low income is generously  
24 defined, really skirts the problems and creates an abuse.

25 I happen to be familiar with some of these. And if you



1 will look right around the outer perimeter of the Beltway,  
2 you will find some pretty luxurious housing developments which  
3 are financed with this kind of financing which are occupied  
4 75 percent by people who don't meet any test. And the  
5 balance of them by people who meet the test based on the  
6 Washington metropolitan area median income, which is how  
7 much?

8 Mr. Hartley. It would be around high 20s, I think.

9 Senator Armstrong. And what is the test that they have  
10 to be? What fraction of the median income?

11 Mr. Hartley. Present law is 80 percent. The bill would  
12 give an 80 percent or a 70 percent option, depending on the  
13 number of set-aside units.

14 Senator Armstrong. So what we are talking about here, Mr.  
15 Chairman, is that 75 percent of the units in a project  
16 financed by this kind of bond can be rented to people of  
17 any income -- \$50,000.00, \$100,000.00, \$200,000.00, no limit  
18 whatsoever. And 25 percent must be set aside, though not  
19 necessarily rented, for people whose is, say, somewhere  
20 around \$18,000.00 or less.

21 Senator Durenberger. If you would yield and let me make  
22 a couple of -- are you through with your argument?

23 Senator Armstrong. No. But I will be glad to yield and  
24 pick up later.

25 I just want to urge that we take this one and set it aside

1 and come back to it another time. I just don't think it fits  
2 naturally in the rest of the package.

3 Senator Durenberger. Well, I am going to oppose. We are  
4 going to either do tax-exempt bonds or we are not going to do  
5 tax-exempt bonds.

6 It seems to me if you look around your Denver area, you  
7 are going to find a host of excess of commitments made in  
8 real estate and a variety of areas. And you would be the  
9 expert on it more than I. I have just seen the statistics.

10 But you would probably find that that is not attributable  
11 to tax-exempt bond financing, as much as it is attributable  
12 to our generosity with respect to ACRS. In 1981, our  
13 generosity with regard to overlooking limited partnerships  
14 and the effectiveness of limited partnerships and bringing  
15 financing into the property area.

16 But regardless of that, the point is, Bill, that there  
17 are millions of Americans who cannot afford to rent housing.

18 Senator Armstrong. Fine. Let's take care of them. That  
19 is not what this amendment does. If you want to limit this  
20 to some reasonable definition of metropolitan areas where  
21 such housing is in short supply, I have got no problem. If  
22 you want to limit it to people who are by some reasonable  
23 standard or definition -- and I am flexible on what that is --  
24 people who are unable to afford housing, I have got no problem  
25 with that. You want to talk about the Denver metropolitan

1 area, let me tell you about that.

2 In one neighborhood that I am familiar with because it  
3 is right at my front door, one of the largest -- in fact, I  
4 believe, the largest -- commercial real estate development  
5 company in the world is developing 700 units of rental  
6 housing with bonds, tax-exempt bonds, financed by the city  
7 of Englewood.

8 Now I have got nothing against the Trammel Crow Company.  
9 They are a great company. But there is a huge surplus of  
10 apartment buildings in Denver, Colorado and environs, and it  
11 is senseless for the Federal Government to subsidize these  
12 bonds to build more rental housing. If Trammel Crow or  
13 somebody thinks they want to build apartment units there,  
14 fine, let them build them. But I just don't think that the  
15 taxpayers ought to subsidize it.

16 So my proposal, Mr. Chairman, is this:

17 Senator Durenberger. Would you yield just a minute before  
18 you make your proposal?

19 Senator Armstrong. Yes, sure.

20 Senator Durenberger. I am interested in exploring your  
21 proposal. If you will expand it to take on all of housing,  
22 and you agree that owned housing in America will operate with  
23 the same degree of subsidy as it relates to income as rental  
24 housing, and you want to take that on as a subject, I will  
25 agree with you. Because we have a setup in this country where

1 you can use the interest deduction on owner-occupied housing,  
2 whether it is your first home, your second home, your third  
3 home, your fourth home, your fifth home --

4 The Chairman. We finally limited it to only two homes  
5 in this bill.

6 Senator Durenberger. Well, that is great, good fortune,  
7 but one of them can be a \$5 million home and the other one  
8 can be a \$4 million home, and the subsidies are incredible  
9 compared to the fact that we have a lot of communities in  
10 this country in which people can't afford housing.

11 So the argument is not that this is an efficient subsidy.  
12 My God, none of these are efficient subsidies.

13 The argument is that we are living in a period of time  
14 when people cannot afford housing in America because we have  
15 driven the prices up. And you can make the efficiency  
16 argument with respect to this subsidy, but I will make it  
17 in spades with regard to owned housing.

18 The Chairman. Bill, let me ask you this: I sense the  
19 argument is pretty well made. You want to make a motion to  
20 eliminate this provision from the package, and let us vote  
21 on it.

22 Senator Armstrong. Well, Mr. Chairman, I think a better  
23 proposal -- I would be glad to make that. I don't care.

24 The Chairman. But I am receptive to a better proposal.

25 Senator Armstrong. A better proposal would be to modify

1 this amendment to say that the bonds which are beyond the  
2 cap -- in other words, anything that is under the cap, that is  
3 fine. But bonds that go beyond the cap should be only those  
4 which are limited either geographically to areas where a  
5 shortage of such housing has been shown to exist and where  
6 at least half of the housing in the units which are to be  
7 financed -- half of the units would seem to me to be a  
8 reasonable test -- are for persons of low income.

9 It seems to me that that fulfills the need which Senator  
10 Durenberger raises, which I think is legitimate.

11 In other words, I say let's take care of the poor people,  
12 but let us not have a big windfall for everybody else involved.

13 The Chairman. I am not quite sure what your specific  
14 motion is that we ought to put right now. Do you want to  
15 think a minute and draft --

16 Senator Armstrong. Can the staff suggest a standard  
17 for either geography or -- well, can staff suggest a  
18 standard by which areas are presently classified to the  
19 availability of rental housing?

20 Mr. Hartley. There are some studies, not governmental  
21 studies, that are current that deal with vacancy rates. There  
22 are other studies that deal with the cost of housing in  
23 comparison to area median income. You could key to either one  
24 of those studies. We would have to explore how it would work  
25 for you, but there is information there.

1           Senator Armstrong. Mr. Chairman, just to get a test of  
2 sentiment of the Committee, rather than focusing on the  
3 availability of housing, which seems to me to be a reasonable  
4 approach to it, I would appeal to the sponsors of this measure  
5 to make the test for placing housing bonds outside the IDB  
6 volume cap; that at least 50 percent of the units be occupied  
7 by persons in the low-income group as it is presently defined,  
8 however that may be.

9           The Chairman. You heard the motion. And I think on this  
10 one we ought to have a roll call.

11           Bill, I am going to restate the motion for Jack Danforth's  
12 standpoint. On housing that is above the volume cap, right?

13           Senator Armstrong. Yes. Only applies to bonds that  
14 finance housing above the volume cap.

15           The Chairman. That at least 50 percent of the units must be  
16 available to low-income people as presently defined. Do I  
17 phrase it roughly right?

18           Senator Heinz. Mr. Chairman, what is that definition?

19           Senator Armstrong. We were told that it is 80 percent of  
20 the median income.

21           The Chairman. In any particular area.

22           Senator Armstrong. Any particular area. So that it  
23 could be in a high-income area, as much as \$20,000.00 a year  
24 or more, and a low-income area to be less.

25           Senator Heinz. Mr. Chairman?

1           The Chairman. Yes.

2           Senator Heinz. I sympathize very much with what my  
3 colleague from Colorado is trying to do. But I am going to  
4 have to oppose him, and for this reason: If one of the  
5 objectives is to build low-income housing in low-income  
6 areas, as well as other areas, it seems to me that by having  
7 a test wherein you are drawing the line at 80 percent of the  
8 median income in a particular area, what you will get is  
9 low-income housing built in moderate and upper income areas,  
10 exclusively.

11           Now I am not opposed to low-income housing being built  
12 wherever people want to build it. But it seems to me that  
13 we will preclude under this definition low-income housing  
14 being built every place except in relatively low-income areas  
15 simply because that is the way the market will push people.

16           Senator Armstrong. John, I think you misunderstand.  
17 Either you misunderstand or I do.

18           The income test is applied across the metropolitan  
19 area; not by neighborhood.

20           Senator Heinz. I understand that. And what I am saying  
21 is there will be areas of the United States, metropolitan  
22 areas, which are relatively low income, and they will not be  
23 able to support, it is my best judgment --

24           Senator Armstrong. That is the test at the present time.

25           Senator Heinz. I understand that. And I liked your other

1 test, which was housing availability, better.

2 So, as I say, I think you are on the right track. I just  
3 don't think this is the specific cure I would like to  
4 support.

5 Senator Armstrong. Well, I would be glad to defer action  
6 on this until we have a chance to work it out.

7 One of the things that is plainly obvious is that we  
8 don't really have a clear understanding of what we are doing.  
9 I certainly am not wedded to my proposal. In fact, I didn't  
10 know when I came here this was even going to be before us.

11 But, Mr. Chairman, the one thing that is really clear  
12 from anybody who has looked carefully at the pattern of  
13 subsidized housing in this country is that we have not been  
14 very successful in helping the needy people who are unable to  
15 afford housing, and that we have had a lot of people that have  
16 made vast fortunes out of government subsidies for housing.

17 And a lot of the people who have done it, frankly, are  
18 good friends of mine. And I have said, boys, I don't object  
19 to your making a fortune out of this, but you have already  
20 made one, and I think it is time to put a stop to it.

21 I don't think we ought to have a whole new crop of  
22 multimillionaires out of subsidized housing. And, honestly,  
23 that is who we have helped with all this subsidized housing.  
24 The Section 8 program and the 235 program, the guys who are  
25 benefitting from this are not the poor by any reasonable



1 degree. It is primarily the developers, the middle income  
2 and the well-off elderly who have benefited from this.

3 So could I ask two more questions? And then I think in  
4 light of what Senator Heinz has said, I would just like to ask  
5 that we defer this for 24 hours or 48 hours until we get back  
6 to it and take it up after we have had a chance to staff up  
7 on it.

8 My two questions are: What did the House do with this  
9 provision? And what is the position of the Treasury  
10 Department?

11 Mr. Mentz. Well, Senator Armstrong, the House, I believe,  
12 has multi-family under the volume cap. And the Treasury  
13 supports that. And let me tell you why.

14 I think the points that you make about multi-family  
15 housing tax-exempt bonds tend to get used, you know, sometimes  
16 to build housing that really is not benefitting the poor.  
17 That is a very real problem, but maybe the better way to  
18 solve it is to force the states and the localities to choose  
19 where they want to spend their limitation on tax-exempt  
20 financing.

21 Let it be done not so much at the federal level with an  
22 arbitrary 50 percent or 25 percent rule or whatever, but let  
23 the people who are closer to the problem make their own  
24 decision.

25 Senator Durenberger. That is precisely what is going on

1 now. And perhaps you have the data, Roger, that would  
2 substantiate the argument made by Bill that nobody in the  
3 low and moderate income category is being housed in America,  
4 but only the rich are being enriched by this program. Do you  
5 have that data available?

6 You said it creates a problem. What is the problem  
7 precisely that is created?

8 Mr. Mentz. I am agreeing with Senator Armstrong that  
9 multi-family housing exempt bonds are not targeted to low-  
10 income families and people.

11 Senator Durenberger. Well, of course, they are targeted  
12 to it. You have to serve low and moderate income persons or  
13 you can't have access to --

14 Mr. Mentz. But I think, Senator Armstrong's example is  
15 a good one. And, you know, the housing outside the Beltway  
16 demonstrates that pretty well.

17 All I am saying --

18 Senator Durenberger. Tell us how it illustrates it.  
19 You are operating on the presumption there is some large  
20 rip-off because the Senator from Colorado claims there is a  
21 rip-off. There is no evidence of it except in his own  
22 analysis of his neighborhood.

23 Senator Armstrong. Oh, no. There is an extensive body  
24 of statistical evidence.

25 Senator Durenberger. Well, where is it? Where is the

1 evidence?

2 Senator Armstrong. It is in the keeping of the Senate  
3 Banking Committee where for a couple of years I was chairman  
4 of the Housing Committee. And we compiled all this stuff.

5 And it is very clear, if you look at the 5 million units  
6 of subsidized housing we have got in this country, that a  
7 high proportion, roughly half, are for the benefit of persons  
8 who are not by any reasonable definition needy.

9 And it was as a result of those studies and the testimony  
10 we had that the Senate and in due course the House agreed to  
11 raise the test from 20 percent to 50 percent for the  
12 proportion of Section 8 units that must be occupied by needy  
13 people.

14 Senator Durenberger. I understand that.

15 Senator Armstrong. I don't know if that is the best  
16 way to handle this. I am perfectly willing to accommodate  
17 what Senator Heinz is saying.

18 But I think, Mr. Chairman, the better approach, since it  
19 is clear that there are some things we ought to know perhaps,  
20 is to simply say that let us defer this section, and pass it  
21 over, and we will try and work something out.

22 And, by the way, although I am concerned about this  
23 problem, I don't think that Senator Durenberger is wrong in  
24 his basic insight. I am just trying to find a more sufficient  
25 way to get the money to the people who need it.

1 Mr. Mentz. There is a GAO study, and I will get it for  
2 you, Senator.

3 The Chairman. The motion, then, is to defer this  
4 section. Correct, Bill?

5 Senator Armstrong. Yes. Well, the question of  
6 multi-housing bonds outside the --

7 The Chairman. Yes. I understand.

8 Senator Chafee. Mr. Chairman?

9 The Chairman. Senator Chafee.

10 Senator Chafee. Mr. Chairman, I would hope that the  
11 Armstrong amendment would not be accepted. I think we should  
12 move ahead with this. Certainly in the area I represent,  
13 we have a distinct shortage of housing for low-income people,  
14 and we have the facility set up through our mortgage and  
15 finance corporation, housing and mortgage corporation, a  
16 state-run organization, to properly care for those under this  
17 provision.

18 I think he is quite right in saying there have been  
19 abuses in the past; that the rich got richer out of programs  
20 that then existed. That is the Section 8 and others. That  
21 is why we ended those programs. They don't exist anymore.

22 And something has to take its place. If after passing  
23 this we can come forward with some kind of a more restrictive  
24 measure that we have all fought through and looked at  
25 carefully, I would be amenable to adding that. But I just

1 think we have got to proceed along here. We have got this  
2 before us, and I hope we will reject the amendment.

3 The Chairman. One of the things that the rules say is  
4 that the Chairman has a prerogative to put a vote if he  
5 thinks there has been enough discussion, unless the majority  
6 of the Committee wants to overrule him.

7 And I think there has been enough discussion. I think  
8 we understand the issue, and so I would like to put the vote  
9 on the motion of Senator Armstrong.

10 Senator Heinz. Mr. Chairman, would you yield that I  
11 might ask one question of staff? Would you be so --

12 The Chairman. One itsy-bitsy-teensy-weeny question?

13 Senator Heinz. Teeny itsy bitsy.

14 The Chairman. You are going to ask an itsy-bitsy-teeny-  
15 weeny question?

16 Senator Heinz. Well, that is my interpretation.

17 The Chairman. All right.

18 (Laughter)

19 Senator Heinz. Would the staff enumerate for all of us  
20 very quickly those items that are under the volume cap in  
21 the bill? Just name more than half a dozen items.

22 Mr. Hartley. Student loan bonds, small issue bonds,  
23 tax increment financing bonds or redeveloping bonds, local  
24 furnishing of electric and gas and privately owned sewage  
25 solid waste and water.

1           Senator Heinz. Mr. Chairman, the reason I asked for that  
2 list is almost all those bonds affect a lot of people when  
3 they are issued for either an electric or gas item, energy  
4 furnishing item, or general development, or student loans, and  
5 the key thing here is that housing is very specific. And in  
6 a contest with all those relatively -- those other kinds of  
7 broad-based project which spread their benefits around rather  
8 broadly, housing or a specific set of units of housing, a  
9 project, almost always loses.

10           That is why I congratulate Senator Durenberger on his  
11 proposal.

12           The Chairman. Clerk will call the roll on the Armstrong  
13 amendment. That is of this particular section; not of the  
14 whole package. Just this particular section.

15           Senator Symms. Mr. Chairman, could I just make one  
16 question to the Senator from Colorado before we vote on this?

17           I hear his argument and as usual he is very articulate  
18 and makes a very difficult argument to be opposed to, except  
19 by the imposition of this set of standards, I have always  
20 had the feeling that tax-free municipal bond financing is  
21 a way to let the market and the efficiency of the market  
22 and the private sector do things rather than having a big  
23 government bureaucracy.

24           Who is going to go out and impose all these standards on  
25 who gets to rent these houses, and how much is that going to

1 cost the taxpayers to try to have compliance?

2 Senator Armstrong. Steve, the answer to your question is  
3 that the present law says that 25 percent of the people who  
4 live in these units must meet the income test. The question  
5 is whether or not we ought to be issuing tax-exempt bonds  
6 to build projects in which only 25 percent of the people are  
7 by some standard which already exists needy.

8 Mr. Chairman, let us vote on it. Let us have a voice  
9 vote or show of hands.

10 The Chairman. Well, we will have a voice vote unless  
11 anyone commands a roll call.

12 All those in favor of the Armstrong amendment say aye?

13 (Chorus of ayes)

14 The Chairman. Opposed, no.

15 (Chorus of nos)

16 The Chairman. The nos have it.

17 Senator Armstrong. I am sure glad we had a voice vote,  
18 Mr. Chairman.

19 (Laughter)

20 The Chairman. Now we are on the --

21 Senator Armstrong. But having said so, let me just say  
22 that you are sweeping the problem under the rug. And we ought  
23 to come back to it at some point because this is a ripoff.  
24 It is enriching the largest companies in America unjustly.  
25 It is depleting the revenues of the Treasury, and it is not

1 helping the needy.

2 Senator Bentsen. Mr. Chairman, let me say to my friend  
3 from Colorado that I think we have deferred something that  
4 needs further study and swept it under the rug so to speak.  
5 I do hope he will come back and give us time to study it and  
6 evaluate it at some point in the future.

7 The Chairman. Now further discussion on the Durenberger-  
8 Chairman package?

9 Senator Pryor. Mr. Chairman, if I could, I just have a  
10 statement, short statement, I would like to insert in the  
11 record.

12 The Chairman. Absolutely.

13 (The prepared statement of Senator Pryor follows:  
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April 17

40  
Pryor

TALKING POINTS AND MEMO ON TAX-EXEMPT BOND PROVISIONS

MR. CHAIRMAN, I THINK THE PACKAGE YOU AND SENATOR DURENBERGER HAVE PREPARED IS FAR SUPERIOR TO THAT OF THE HOUSE.

~~I HAVE A FEW QUESTIONS ON THIS TITLE, AND AT AN APPROPRIATE TIME, I WOULD LIKE TO ASK THEM.~~ I KNOW IN MANY AREAS THE HOUSE SIMPLY WENT TOO FAR, AND YOUR PROPOSAL REMOVES THESE VERY SERIOUS PROBLEMS CREATED BY THE HOUSE BILL.

ONE NOTABLE EXAMPLE, IS THE HOUSE RESTRICTION<sup>on</sup> EARLY ISSUANCE. ALTHOUGH THERE ARE NO SET TIME PERIODS UNDER PRESENT LAW, THE HOUSE INSERTED A PROVISION THAT WOULD HAVE REQUIRED STATE AND LOCAL GOVERNMENTS TO SPEND 5% OF THE BOND PROCEEDS WITHIN 30 DAYS AFTER THE BONDS WERE ISSUED. IN MANY INSTANCES, I HEARD FROM OFFICIALS IN THE STATE OF ARKANSAS THAT THIS WOULD HAVE BEEN AN IMPOSSIBLE REQUIREMENT TO MEET. ALSO, WHILE YOU HAVEN'T RETAINED PRESENT LAW IN THE AREA OF ADVANCE REFUNDINGS, YOU HAVE PROVIDED SOME MUCH-NEEDED RELIEF OVER THE HOUSE PROVISIONS.

I HAVE A FEW QUESTIONS ON THIS TITLE, AND AT AN APPROPRIATE TIME, I WOULD LIKE TO ASK THEM.

1 The Chairman. Further discussion on the package?

2 Without objection.

3 Senator Danforth. After we adopt the package, if we adopt  
4 the package, Mr. Chairman, it would be open for further  
5 amendments?

6 The Chairman. Oh, yes. There are about a dozen amend-  
7 ments the members have indicated they have.

8 All those in favor of the package will say aye?

9 (Chorus of ayes)

10 The Chairman. Opposed, no.

11 (No response)

12 The Chairman. Adopted.

13 Let me make one announcement. The final passage of the  
14 relicensing, hydro relicensing bill, which was set at  
15 11:30 has been moved to 12:00.

16 Secondly, I have been asked by a number of people about  
17 the Canadian-American fast track. We will take it up on  
18 Tuesday morning at 9:30. I don't know how much discussion  
19 there will be. But to alleviate anybody's fears, it is my  
20 intention to put it to a vote because if we drag it past the  
21 23rd and do nothing, which is Wednesday, the approval would  
22 go into effect automatically. And I don't intend to deny  
23 this Committee the right to vote on that issue. And so it  
24 would be my intention after appropriate discussion to  
25 simply exercise the prerogative of the Chair to suggest we

1 vote. And I don't intend to drag it out past the effective  
2 date for our action.

3 Senator Pryor. Mr. Chairman, may I ask a question about  
4 Monday's hearing on the excise tax?

5 The Chairman. Yes.

6 Senator Pryor. Mr. Chairman, do we now have a list of  
7 those witnesses that will come before the Committee?

8 The Chairman. I am not sure.

9 Bill, do we have a list? Who knows? John?

10 Mr. Colvin. Mr. Chairman, I believe the witnesses have  
11 all been notified of those that the Committee has been able  
12 to schedule. There were a very, very large number of  
13 requests, and I believe they have all been notified.

14 The Chairman. As usual, we had infinitely more requests  
15 than -- I think we are going to meet all day on Monday on  
16 this subject. And there are immense panels, and lots of  
17 panels.

18 Senator Pryor. I would appreciate it as soon as it is  
19 available for us to be able to see those, Mr. Chairman.

20 The Chairman. All right.

21 Now we are open for further amendments on the bond  
22 section.

23 Senator Danforth.

24 Senator Danforth. Mr. Chairman, Senator Moynihan and I  
25 do have an amendment which was mentioned a couple of days ago

1 when we discussed the bond section. And that is to delete  
2 the \$150 million volume cap on 501(c)(3) organizations.

3 Mr. Chairman, it is true that this would cost some  
4 revenue. I think it is about \$200 million over the five --

5 Mr. Hartley. One hundred million.

6 Senator Danforth. One hundred million dollars over the  
7 five-year period of time by deleting this volume cap. But I  
8 think that it is also important to recognize that the  
9 \$100 million would fall exclusively, exclusively on about  
10 20 institutions. Maybe a few more, but around 20 institutions.  
11 Most of them are major universities, particularly our major  
12 research universities.

13 There are about 20 colleges and universities that are  
14 already at or about the \$150 million volume cap. And they  
15 include everything you could think of by way of a major  
16 research university in this country -- Harvard, Yale,  
17 Princeton, Stanford and MIT and so on.

18 I think really the question, Mr. Chairman, is whether we  
19 want to single out these major universities at this time. If  
20 we do so, if we impose a volume cap on them, that would mean  
21 that we would be treating differently state universities,  
22 which would be free to issue bonds in any amount, and also  
23 whether we would be treating separately small colleges and  
24 universities that are nowhere close to the volume cap.

25 So if you had, for example, this volume cap, it would mean

1 that, for example, Yale University would not be in the  
2 business of issuing tax-exempt bonds anymore; whereas,  
3 Albertus Magnus College located up the road from Yale would,  
4 if it wanted to, be able to issue such bonds.

5 So I think that if one of our objectives in this country  
6 is to encourage high-quality research, and if we recognize  
7 the fact that much of this high-quality research goes on at  
8 precisely these institutions, then it would seem to me that  
9 we would not want to create to what amounts to a special  
10 rule precluding the issuance of these bonds or making them  
11 unavailable to these institutions.

12 The Chairman. Discussion?

13 Senator Moynihan.

14 Senator Moynihan. Just to add very briefly to the point  
15 that has been excellently made by Senator Danforth. I would  
16 hope the Committee would think about this in the large terms  
17 of the issue of public and private institutions.

18 We are blessed in this country with a mixture of public  
19 and private institutions in almost everything we do, and no-  
20 where more conspicuously than in higher education. The  
21 research universities, the major research -- it is split just  
22 about exactly even. About half are private like Stanford,  
23 about half are public like the University of California.  
24 Half are University of Texas, half are Southern Methodist  
25 University.

1           And the one thing we would never want to do, I am sure,  
2 is to introduce a distinction in the tax code that favors the  
3 public sectors against the private sectors. It just can't be  
4 in our interest to do that.

5           The second point I would make is that the amounts of  
6 money here are not large. And to the degree that this  
7 research cannot be done and maintained privately, inevitably  
8 the public -- they will be coming to this Committee for it.

9           Senator Danforth. And we are cutting the budget.

10          Senator Moynihan. And we are now cutting that very  
11 research budget. I mean it doesn't cost money to run a law  
12 school. It costs money to do high energy physics.

13          The Chairman. Further discussion?

14          Senator Heinz. Mr. Chairman?

15          The Chairman. Senator Heinz and then Senator Baucus.

16          Senator Heinz. First, Mr. Chairman, I would ask Senator  
17 Danforth and Senator Moynihan to add me as a co-sponsor to  
18 their amendment.

19          Senator Danforth. Happy to do so. And also Senator  
20 Roth has indicated that he would like to be a co-sponsor.

21          Senator Moynihan. Senator Bentsen would like to also.

22          The Chairman. Let me ask the Committee if there is  
23 anyone who doesn't want to be listed as a co-sponsor to this  
24 amendment.

25          (Laughter)

1 Senator Heinz. Would you like to co-sponsor it, Mr.  
2 Chairman?

3 The Chairman. I don't co-sponsor amendments that come  
4 before the Committee.

5 (Laughter)

6 Senator Heinz. The last amendment was the Chairman-  
7 Durenberger amendment, not the Packwood-Durenberger amendment.

8 The Chairman. It was the Chairman's draft.

9 Senator Heinz. I see.

10 Mr. Chairman, in my state of Pennsylvania, we have four  
11 very fine research universities, and we have other smaller  
12 ones. The University of Pennsylvania, Temple University,  
13 University of Pittsburgh and Penn State University --

14 Senator Danforth. And Carnegie Mellon.

15 Senator Heinz. And Carnegie Mellon as well.

16 (Laughter)

17 Senator Heinz. How am I going to explain that to the  
18 man who gave me a job in teaching, Dick Cier, the President  
19 of Carnegie Mellon University?

20 I didn't want a conflict of interest to be lodged against  
21 me.

22 In any event, of those five universities that I have now  
23 mentioned, four of them will be under this cap. And one of  
24 them will not be affected at all. The Penn State University,  
25 which is a fine university, will, in effect, be able to achieve

1 a monopoly status on research. And I am not against Penn  
2 State University, except when they play the University of  
3 Pittsburgh and then I have to watch it.

4 The fact is that we will be discriminating unless we  
5 adopt the Danforth-Moynihan amendment against these  
6 independent, private, non-profit research centers. And that  
7 is wrong-headed, bad policy.

8 The Chairman. Senator Baucus.

9 Senator Baucus. No discussion, Mr. Chairman.

10 The Chairman. Further discussion on this amendment?

11 Senator Durenberger. Mr. Chairman, just very briefly.

12 The Chairman. Are you sure?

13 Senator Durenberger. Oh, yes. I am not a co-sponsor.

14 Not that I am going to oppose it. But we carefully  
15 considered this when we put S. 2166 together, and I will just  
16 say to my colleagues on this Committee that 24 people outside  
17 this Committee signed up to limit in some way this. And we  
18 did it for some very good reasons.

19 If you look at the 40 colleges and universities reporting  
20 the largest endowment funds, you will see that Harvard  
21 University has an endowment of \$2,487,419,000.00, which, of  
22 course, earns them a substantial profit each year while they  
23 are going to be accessed under this amendment to tax-exempt  
24 bond financing without limit.

25 The Chairman. I think what we are doing is, in essence,



1 taking the very richest colleges in the country and letting  
2 them arbitrage government bonds.

3 Senator Durenberger. Of course, we are. And I know that  
4 one of the weaknesses in this approach is the public-private.  
5 And yet I don't think the public-private becomes a problem  
6 if we use the \$150 million limitation on both. But I am not  
7 going to oppose this because obviously in this Committee it  
8 has strong support.

9 I just wanted to put the other side of the rationale.  
10 That for many universities this is a wasted subsidy.

11 The Chairman. Further discussion?

12 (No response)

13 The Chairman. Those in favor of the amendment will say  
14 aye.

15 (Chorus of ayes)

16 The Chairman. Opposed, no.

17 Senator Moynihan. Mr. Chairman, if Mr. Boren had been  
18 present he would have voted aye.

19 Senator Chafee. Could we have a roll call?

20 The Chairman. Sure. Clerk, call the roll.

21 The Clerk. Mr. Dole?

22 Senator Heinz. Senator Dole votes aye by proxy.

23 The Clerk. Mr. Roth?

24 Senator Roth. Aye.

25 The Clerk. Mr. Danforth?

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

1 The Clerk. Mr. Boren?

2 Senator Boren. Aye.

3 The Clerk. Mr. Bradley?

4 Senator Bradley. Aye.

5 The Clerk. Mr. Mitchell?

6 Senator Mitchell. Aye.

7 The Clerk. Mr. Pryor?

8 Senator Pryor. Aye.

9 The Clerk. Mr. Chairman?

10 The Chairman. Aye. The amendment is adopted.

11 Senator Armstrong. Mr. Chairman, I'd like to vote no.

12 The Chairman. Armstrong no.

13 Senator Symms?

14 Senator Symms. I voted aye.

15 The Chairman. Oh, excuse me. I thought you were waiting  
16 to be recorded.

17 Senator Symms. I wanted to ask a question of the staff.

18 The Chairman. The absentees, when it doesn't change the  
19 outcome, can record themselves.

20 The amendment is adopted.

21 Senator Bradley. Mr. Chairman?

22 The Chairman. Senator Bradley.

23 Senator Bradley. Mr. Chairman, I am not sure that I will  
24 need to offer an amendment, but I do need a clarification.

25 And I guess I would direct the question to the staff. It

1 pertains to certain bonds that are not subject to the volume  
2 limitation cap. And it relates specifically to the solid  
3 waste disposal bonds and the conditions under which they are  
4 not subject to the cap.

5 On Page 203, Section 3(b), it says that "bonds for  
6 solid waste disposal, public sewage water facilities, et  
7 cetera, will not be subject to the volume cap if the rates  
8 for the service are established or approved by a state or  
9 political subdivision thereof."

10 Now what I would like clarification of is are bonds  
11 qualified for solid waste disposal in terms of being approved  
12 if a government body -- let me say what I would like to do  
13 is not offer an amendment, but I am prepared to offer an  
14 amendment that will say a government body will be deemed to  
15 have approved the rates of service if there is an existing  
16 management contract, and if that contract sets out the  
17 terms and conditions and their service fees under the terms  
18 and conditions, and that there are also established operating  
19 conditions in which the operator can be penalized if he does  
20 not perform the services under the contract, and that the  
21 contract can be cancelled for non-performance.

22 Essentially, the question is: Will a government entity  
23 that has a management contract still be outside the volume  
24 cap under the provision as it is now written?

25 Mr. Hartley. Senator Bradley, the management contract

1 could be outside of the cap only if the rates were subject  
2 to review on a recurring basis by the governmental unit.

3 The description that you gave would have the rates  
4 established at the time the contract was negotiated. Those  
5 bonds would be under the cap under the package.

6 Senator Bradley. All right. Well, this gets to the  
7 question of whether if you have a local government, and they  
8 build a solid waste disposal facility, and they don't have the  
9 expertise to run that facility, and they enter into a manage-  
10 ment contract with a company to run the facility. Some do it  
11 for 10 years; some do it for 20 years.

12 And what this amendment would require is that there be --  
13 that a contract to operate could not be longer than one year  
14 because there would be a review.

15 And it seems to me that that is kind of arbitrary, to say  
16 the least. And that you ought to provide the flexibility  
17 for local government to make its arrangements in the disposal  
18 of solid waste with people who have expertise through a  
19 management contract.

20 The Chairman. I thought you were going to have an  
21 amendment to that effect, which I was prepared to accept.

22 Senator Bradley. I am prepared to offer the amendment.

23 (Laughter)

24 The Chairman. I am prepared to accept the amendment.

25 Senator Bradley. Thank you.

1           The Chairman.    What the amendment does is simply strike  
2 down the provision that the local government be involved on a  
3 continuing basis on rate setting, which I think is an improve-  
4 ment.

5           Senator Bradley.   Exactly.

6           Senator Bentsen.   I think Senator Bradley makes a very  
7 good point.

8           The Chairman.    Is there further discussion on the  
9 Bradley amendment?

10          Senator Durenberger. This is just an observation that  
11 Bill is correct. The question of whether the -- the issue  
12 is the rates. Whether the rates are predetermined or they  
13 are subject to renegotiation really shouldn't make any  
14 difference, and I think Bill clarified that.

15          The Chairman.    Those in favor of the amendment say aye.

16          (Chorus of ayes)

17          The Chairman.    Opposed, no.

18          (No response)

19          The Chairman.    Adopted.

20          Further amendments?

21          Senator Bentsen?

22          Senator Bentsen.   Mr. Chairman, I brought up a couple of  
23 minor ones yesterday. And one of them was one that was  
24 raised by MCA -- owning a foreign subsidiary which in turn  
25 owned a company back in the United States not getting credit

1 for the 85 percent credit on the payments upstream. In  
2 effect, paying a double tax.

3 And my understanding from the Secretary yesterday that  
4 that is true but certainly not equity. And that there was  
5 support for correction of it.

6 And I would like to propose it at this time.

7 The Chairman. All right with Treasury?

8 Mr. Mentz. Yes. It is not exactly a bond amendment, but  
9 it is all right with Treasury.

10 Senator Bentsen. Oh, I'm sorry. I beg your pardon.

11 The Chairman. He mentioned this to me today, and I  
12 understand it is cleared on all sides. Had there been any  
13 controversy, we wouldn't have brought it up now.

14 Senator Bentsen. I apologize, Mr. Chairman.

15 The Chairman. Joint Committee is okay?

16 Ms. Pearson. Yes. We adopted language to that effect  
17 last night.

18 The Chairman. I know it.

19 Ms. Pearson. We assumed that was your amendment.

20 Senator Bentsen. I didn't know we were voting last --

21 Ms. Pearson. Not voting.

22 Senator Bentsen. Oh, but you adopted.

23 The Chairman. Is there objection to the Bentsen  
24 amendment?

25 Senator Bentsen. That is the best way to do it.

1 (No response)

2 The Chairman. Without objection.

3 Further amendments?

4 Senator Moynihan.

5 Senator Moynihan. I would like to raise something but  
6 we have already had our crack. Does anyone else want one?

7 The Chairman. Any other amendments? Senator Heinz?

8 Senator Heinz. Mr. Chairman, first, there was a  
9 discussion earlier about the depreciation problem for small  
10 issues that we had with your staff. And I understood -- and  
11 I want to be sure about this -- that we have agreed to leave  
12 open the issue of depreciation as it affects small issue  
13 IDBs until later in our deliberations.

14 I am asking that we do that for these small issues.

15 The Chairman. Excuse me, John, I didn't get the point  
16 you were driving at. Say it again.

17 Senator Heinz. If you go back to the depreciation section,  
18 we have changed the depreciation schedule for IDBs, for  
19 facilities financed by IDBs, and I recollect we stretched  
20 them out from 30 to 40 years. Is that right?

21 Mr. Hartley. Multi-family is the only bond depreciation  
22 that was left open in the package.

23 (CONTINUED ON NEXT PAGE)

24

25



1           Senator Heinz. Mr. Chairman, what I am saying is -- and  
2 I apologize I wasn't here at 9:30; I was precluded by another  
3 responsibility with a number of my colleagues -- my under-  
4 standing that certain issues involving depreciation were  
5 agreed to be left open, and my understanding is that small  
6 issue IDBs were not included in that understanding. I would  
7 like to get them included in that understanding, so that we  
8 can look at all of the issues together when we get back to  
9 depreciation.

10           The Chairman. I have to confess this is news to me.

11           Ms. Pearson. Senator Packwood, our understanding was  
12 everything was straight line over ADR, and Senator  
13 Durenberger's package only made exception to solid waste and  
14 left multi-family open.

15           Senator Heinz. Then I apologize to you and my colleagues.

16           Senator Durenberger. I think, Mr. Chairman, as explained  
17 to me, it is only a matter of trying to get some information  
18 out of Treasury at this point. That is as I understand it.  
19 And I think to help conclude this deal, we might leave this  
20 issue open. I don't think the Senator is trying to seek an  
21 advantage that we weren't willing to give.

22           The Chairman. Well, John, you can always offer an  
23 amendment. I would like to conclude the rest of the section,  
24 if I can, and maybe we can work it out.

25           Senator Heinz. I have no objection to that, Mr. Chairman.

1 I apologize for my confusion. It was occasioned by my  
2 inability to have been here the first half hour.

3 I do have another amendment, Mr. Chairman.

4 The Chairman. Your other amendment, then Senator Boren.

5 Senator Heinz. Mr. Chairman, on page 203 of the spread-  
6 sheet, which is IDBs, et cetera, not subject to volume  
7 limitations, the committee print -- and I don't think  
8 Senator Durenberger significantly changed this -- is we do  
9 not subject to volume limitations bonds for airports and docks  
10 and wharves, if the bond-financed property were governmentally  
11 owned, determined generally by reference to federal income  
12 tax concepts of ownership.

13 I would like to propose that mass transit be included.  
14 It is just as important a public transportation purpose as  
15 airports or docks or wharves, and it seems to me that there is  
16 no good reason for excluding mass transit.

17 So I would like to propose that we include mass transit  
18 at that point.

19 The Chairman. Discussion on the amendment? It costs  
20 what? Three to four hundred million dollars?

21 Mr. Hartley. Four hundred million under the cap, Mr.  
22 Chairman. We haven't estimated it outside the cap, because  
23 our understanding was the amendment will be to place it under  
24 the cap as an IDB category.

25 The Chairman. I didn't hear you.

1 Mr. Hartley. We estimated that adding back mass transit  
2 IDBs as a category under the volume cap, and that was  
3 \$400 million. We have not estimated what it would cost to  
4 take them out of the volume cap. It would be more than  
5 \$400 million, however.

6 The Chairman. I had to understand, John, that your  
7 amendment was going to be to keep them under the cap but  
8 allow the issuance. Are you suggesting now to take them out  
9 from under the cap, also?

10 Senator Heinz. Mr. Chairman, I simply want them to be  
11 treated the same as other transportation facilities. It  
12 appears that other transportation facilities are not put under  
13 a volume cap, as I read the plain language of section 203; but  
14 there may be a reference back to an earlier page.

15 Does anyone want to explain whether or not airports and  
16 docks and wharves are under a cap?

17 Ms. Pearson. They are under a cap unless they are  
18 governmentally owned and elect out and don't take depre-  
19 ciation. There is an election procedure.

20 Senator Heinz. And mass transit facilities, typically,  
21 are governmentally owned.

22 Mr. Hartley. At the present time, yes.

23 The Chairman. Well, I would have to oppose this amend-  
24 ment if they are going to be out from under the cap. I would  
25 support it if they were left under the cap; but if you are

1 going to pursue it on outside, I would strongly urge --

2 Senator Heinz. Mr. Chairman, may I just clarify one  
3 other point that the staff has made? They made a point that  
4 if this were adopted it would cost \$400 million or more. I  
5 am puzzled by that, because I have a March 1st estimate of  
6 federal tax expenditures for Fiscal Years '87 through '91  
7 prepared by the Joint Tax Committee, and in Table One under  
8 "Tax Expenditures Estimated by Budget Function for the Five-  
9 Year Period," the exclusion of interest on state and local  
10 government mass transit bonds is estimated to cost a total  
11 of \$200 million. So, I am rather confused by where the  
12 \$400-plus million comes from.

13 Mr. Hartley. There are two things there, Senator Heinz.  
14 First, the Administration has a shift in policy going on in  
15 the mass transit area. In the past, most mass transit has  
16 been financed with what would be governmental bonds, because  
17 it was governmentally owned and operated.

18 As UMTA money has dried up, people have started moving  
19 into what would be IDBs for mass transit. So you would have  
20 more bonds being issued than was projected until the  
21 Administration started decreasing and eliminating UMTA money.

22 Senator Heinz. Is the assumption that the government  
23 isn't going to spend the one cent on the gas tax, that when we  
24 passed it in this committee for discretionary capital, that  
25 that is not going to be spent? Is that the assumption?

1 Mr. Hartley: My understanding is, that is being spent  
2 largely in three to four cities around the country rather than  
3 being spread out, and operating subsidies and other UMTA  
4 monies have been eliminated or are proposed to be eliminated  
5 from the budget.

6 Senator Heinz. Mr. Chairman, I must say, if the  
7 estimate that he is giving us is based hypothetically on an  
8 Administration proposal that has been rejected three years  
9 in a row by the Congress, in terms of what they expect us to  
10 do on section 3 and section 9 of Mass Transit, I must  
11 register my strong objections to that kind of loaded  
12 estimating.

13 Mr. Hartley. Senator Heinz, they have notified cities  
14 around the country that they will not be receiving money, and  
15 the money they have in the UMTA account has been committed to  
16 those cities. So that's the reason you see other cities going  
17 into IDBs where they have not gone in the past.

18 Senator Heinz. Mr. Chairman, I just want to note that  
19 the Banking, Housing, and Urban Affairs Committee on which I  
20 serve has just completed two days of hearings. The consensus  
21 both among the witnesses and among the members of that  
22 committee is that we will reauthorize the Mass Transit  
23 Authority very much as it is today. It will not obviously be  
24 reauthorized by unanimous vote of everybody on that committee,  
25 but I think it is fair to say that we are not going to

1 restructure the Act again this year, as proposed by the  
2 Administration.

3 But in any event, I hope we can adopt the amendment.

4 The Chairman. Dave Durenberger?

5 Senator Durenberger. Mr. Chairman, I am not sure what  
6 conclusion I would come to, other than that I have already  
7 drawn a conclusion that excludes it, as has the Chairman, and  
8 maybe for different reasons in light of what you said.

9 If it is outside the cap, then the issue is whether it  
10 is \$200 million, \$300 million, \$400 million or something else.  
11 If it is inside the cap, that's another problem, because in  
12 our agreement we reduced the per capita cap per state by  
13 \$25 per capita, as I recall, because certain purposes were  
14 outside of the cap.

15 Now, you bring this, particularly this one, the large  
16 urban mass transit facilities, which is principally what is  
17 going to happen here, you bring that inside the cap and you  
18 then have mass transit competing with student loans, with  
19 single-family housing, it becomes an urban versus a rural  
20 problem in states with a large metropolitan area and large  
21 population and small rural communities. So it gets to be a  
22 tough issue if you bring this one under the cap, because of the  
23 competitive nature of the purposes under the cap.

24 The Chairman. Further discussion? Senator Pryor?

25 Senator Pryor. I think, on this point, I would like to

1 get a little information, Mr. Chairman, maybe from Mr. Hartley?

2 What would be the revenue effect of removing the sunset  
3 date that is proposed, December 31, 1988, but leaving the  
4 volume cap reduction to \$100 per resident? And then what  
5 would it be moving it to \$125 per resident?

6 The Chairman. Are you talking now about the IDB cap, in  
7 the sunset?

8 Senator Pryor. Yes. I don't know if that is the  
9 appropriate place to raise it.

10 The Chairman. I would hope, when we get to that, we  
11 would keep the sunset. I would like to have some negotiating  
12 room with the House.

13 Senator Pryor. I would just like to get an idea of the  
14 revenue, what we are talking about here.

15 Mr. Hartley. Senator Pryor, extending the small issue  
16 sunset and making that exception permanent, but leaving the  
17 drop in the cap scheduled as under the package on January 1,  
18 1989, to 100 per capita, which is a deferral of two years from  
19 present law, would reduce revenues \$500 million. I don't know  
20 how much would result from leaving the cap at a higher amount  
21 than \$100 per capita.

22 Senator Pryor. We don't have a figure, then, say for  
23 \$125?

24 Mr. Hartley. No, sir. We can get that figure for you.

25 Senator Pryor. I would like that, for the record. Thank

1 you, Mr. Hartley.

2 The Chairman. Further discussion on the Heinz Amendment,  
3 to include mass transit outside the cap?

4 Senator Chafee. Well, Mr. Chairman, I have missed a beat  
5 here. Is mass transit now allowed at all, even under the  
6 cap?

7 Mr. Hartley. Senator Chafee, mass transit is permitted  
8 under the cap if privately owned. They have the same election  
9 that airports and ports have under present law to come out of  
10 the volume cap.

11 Senator Chafee. If they are out of the volume cap?

12 Mr. Hartley. If they are governmentally owned, they  
13 are out of the volume cap under present law.

14 Senator Heinz. Under present law.

15 Mr. Hartley. Under present law.

16 Senator Heinz. What about in Senator Packwood's bill?

17 Senator Chafee. This proposal would continue to allow  
18 bonds, docks, wharves to be out of the cap, but not mass  
19 transit?

20 Mr. Hartley. That is correct. The Packwood package  
21 eliminates mass transit IDBs altogether. They could not be  
22 issued under the cap or out of the cap.

23 Senator Chafee. Well, that was my question originally.  
24 Now, what is the rationale for that?

25 The Chairman. Trying to put some kind of limitations on



1 anything at all -- which apparently we are not going to do --  
2 that if you are going to tighten down at all on government  
3 issue bonds of some kind, you have to start some place.

4 Senator Chafee. Yes, but it is so odd to do it here.  
5 It seemed to me airports -- I don't get the difference between  
6 airports and mass transit.

7 Mr. Hartley. Senator Chafee, one difference is that  
8 historically many mass transit systems have been owned and  
9 operated by governments. They would continue to be allowed  
10 because they are governmental bonds, outside of the cap, not  
11 IDBs.

12 Airports, because of the special relationships of the  
13 airlines to the facilities, are IDBs, and you would not have  
14 an airport operated as a governmental facility in the sense  
15 that you can operate mass transit as a governmental facility.

16 Mr. Mentz. Senator Chafee, there is another rationale  
17 for not including the airports and docks and wharves in the  
18 volume cap, and that is, an airport frequently serves more  
19 than one state. So you get into real difficulty in trying to  
20 figure out whose volume cap is used up with those bonds. And  
21 that is generally not a problem with mass transit.

22 Senator Moynihan. Mr. Chairman?

23 The Chairman. Senator Moynihan?

24 Senator Moynihan. Could I say, on behalf of Senator  
25 Heinz's proposal, that again it is one of these

1 public-private things.

2 Mass transit is clearly an activity imbued with a public  
3 interest, and in the older parts of the country it has  
4 typically -- you know, it began as a private enterprise and  
5 when it ceased to be profitable became a government enter-  
6 prise. And it is an aspect of making possible certain kinds  
7 of densely populated urban places which are economically  
8 productive in the large.

9 And in some cities such as New York the government --  
10 indeed mass transit, is publicly owned. In others, it is not.  
11 And yet it has a public purpose in both places, and I think  
12 Senator Heinz is right.

13 The Chairman. Mary Frances, currently, present law and  
14 the draft, what is the situation involving publicly owned  
15 mass transit?

16 Ms. Pearson. You can issue as many bonds as you want  
17 outside the volume cap for publicly owned mass transit. Let  
18 me give you an example.

19 The Chairman. Now wait. Under the Chairman's proposal  
20 and under the present law?

21 Ms. Pearson. Yes.

22 Senator Moynihan. My point is, my particular state has  
23 no problem at all. But in another situation a perfectly  
24 identical activity would have a problem.

25 Ms. Pearson. May I give one example? Assume you have a

1 subway system in D.C., and you want to build the Connecticut  
2 connection. The only thing the Chairman's proposal limits is  
3 that you can only use 25 percent of the bond proceeds to build  
4 the Connecticut connection. Nothing is limited to the tracks  
5 and the cars; those are governmental bonds. So that is where  
6 the private use and --

7 The Chairman. You had better define what a "Connecticut  
8 connection" is.

9 Ms. Pearson. On Connecticut and K, connected to the  
10 subway system there is a Mandy's and a Cookie's, Cookie  
11 Boutique, and all sorts of private shops that are used for the  
12 benefit of travelers. So it is connected to the mass transit  
13 system, but it is not essential to the functioning and the  
14 running of it.

15 And the Chairman's proposal allows that up to 25 percent.

16 Senator Matsunaga. Mr. Chairman?

17 The Chairman. Senator Matsunaga?

18 Senator Matsunaga. The Heinz Amendment will place into  
19 the same category as public transportation privately-owned  
20 mass transportation? Is that the proposal?

21 Mr. Hartley. It would place publicly-owned but privately  
22 operated mass transit facilities outside of the volume cap.

23 Senator Matsunaga. But it still would be publicly owned?

24 Mr. Hartley. That is correct.

25 The Chairman. Further discussion?

1 (No response)

2 The Chairman. Those in favor of the Heinz Amendment will  
3 say Aye.

4 Senator Heinz. Could we have a rollcall on that?

5 The Chairman. Oh, yes. Clerk, call the roll on the  
6 Heinz Amendment.

7 The Clerk. Mr. Dole?

8 (No response)

9 The Clerk. Mr. Roth?

10 Senator Roth. No.

11 The Clerk. Mr. Danforth?

12 Senator Danforth. No.

13 The Clerk. Mr. Chafee?

14 Senator Chafee. Aye.

15 The Clerk. Mr. Heinz?

16 Senator Heinz. Aye.

17 The Clerk. Mr. Wallop?

18 (No response)

19 The Clerk. Mr. Durenberger?

20 Senator Durenberger. Aye.

21 The Clerk. Mr. Armstrong?

22 (No response)

23 The Clerk. Mr. Symms?

24 (No response)

25 The Clerk. Mr. Grassley?

1 Senator Grassley. Aye.  
2 The Clerk. Mr. Long?  
3 Senator Long. No.  
4 The Clerk. Mr. Bentsen?  
5 Senator Bentsen. Aye.  
6 The Clerk. Mr. Matsunaga?  
7 Senator Matsunaga. Aye.  
8 The Clerk. Mr. Moynihan?  
9 Senator Moynihan. Aye.  
10 The Clerk. Mr. Baucus?  
11 Senator Baucus. No.  
12 The Clerk. Mr. Boren?  
13 Senator Boren. Aye.  
14 The Clerk. Mr. Bradley?  
15 Senator Bradley. Aye.  
16 The Clerk. Mr. Mitchell?  
17 Senator Mitchell. No.  
18 The Clerk. Mr. Pryor?  
19 (No response)  
20 The Clerk. Mr. Chairman?  
21 The Chairman. No.  
22 (Pause)  
23 The Clerk. Nine Yeas, six Nays.  
24 The Chairman. The amendment is adopted.  
25 Senator Boren?

1           Senator Boren. Mr. Chairman, I want to raise an amend-  
2 ment in regard to the question of advanced refunding of bond  
3 issues.

4           In many parts of the country, particularly those that are  
5 undergoing economic stress right now, and those that have  
6 cyclical economic conditions as many have experienced.-- we  
7 are experiencing those in the southwestern states right now;  
8 other parts of the country have had the same experiences  
9 during the past decade.-- what often happens is that sales  
10 tax revenues and other revenues that are pledged to service  
11 bonds suffer immense declines.

12           I just looked at the communities around the part of  
13 Oklahoma where I live right now, and the sales tax revenues  
14 have been declining from last year on a range of from 13 to  
15 18 percent decline.

16           We have used, for example, in one community in our state  
17 that has financed its hospital and pledged sales tax revenues  
18 to the bond issue, now, with falling occupancy rates in  
19 hospitals plus plunging sales tax receipts.-- they are having  
20 a real problem.

21           With the interest rates now lower, of course, one of the  
22 ways that they can ease that problem is with advance refunding.  
23 And Senator Durenberger in his proposal has gone some  
24 direction in solving this problem: he has put a limitation,  
25 an advanced limitation, prospectively I believe, on

1 outstanding bonds of two issuances during the life of a bond  
2 issue.

3 I would like to propose in my amendment that we increase  
4 that to three, in terms of a prospective limit on outstanding  
5 obligations, because, again, with the kinds of cycles -- and  
6 I think we are probably apt to go through them in all parts  
7 of the country with some restructuring of our economy -- we  
8 will have pockets from time to time in different areas where  
9 this needs to be done.

10 If you have a 30-year period on a bond, I think it is not  
11 unreasonable to think that you might have a situation in which  
12 you might have to have three instances.

13 The second part of the amendment would be to change the  
14 limitation in terms of cost of issuance that can be included  
15 in the refunding. I think Senator Durenberger, as I under-  
16 stand it, caps it at the credit-enhancement part of the  
17 expenses. But that is not the only expense that the  
18 community, state government, or local government is apt to  
19 be out. There are all sorts of additional fees: there are  
20 marketing fees, there are printing fees, there are legal fees,  
21 there are other costs of issuance in addition to the direct  
22 credit enhancement part that is a cost to the municipality.

23 So I would propose that we would include, as Senator  
24 Durenberger has proposed, the credit enhancement costs, but  
25 that we also say additional, actual costs up to three-quarters

1 of one percent maximum cap, so that the communities would have  
2 the opportunity to also not lose or not be out of pocket  
3 the additional costs that they are going to have to be paying.

4 We are in a situation in the southwest in particular,  
5 and it also afflicts the midwestern farming states, the  
6 entire farm belt, really, from Canada down to the Gulf, where  
7 we are credit-poor right now. We simply do not have --

8 As I mentioned before in this committee, in our state  
9 the bank loans outstanding have actually been contracting  
10 three years in a row now. That means you have a constriction  
11 of credit available. That is very, very tough. We are  
12 capital starved, we have a lot of pressing needs, and we have  
13 communities with falling revenues.

14 The revenue collection under our existing tax structure  
15 in our state has fallen by almost 45 percent. The actual  
16 collections, under the very same identical law, is about 45  
17 percent in three years. So, you can imagine the impact that  
18 that is having not only on state government but on municipal  
19 governments as well, and this would be a mechanism in terms  
20 of allowing refunding, flexibility in refunding, that would  
21 help us make up for some of that loss.

22 The Chairman. Let me address myself to this. The first  
23 part of it, whether you want to go to two or three advanced  
24 refunding bonds, I am going to call on Treasury.

25 The second part of it is simply beyond the pale. He



1 talked about issuing costs. The issuing costs are not  
2 printing the bonds; that is a relatively minor cost.

3 What we are going to do is allow the arbitrage profits  
4 to pay off the handful of brokerage houses and legal firms  
5 in this country that approve these bonds. And I cannot  
6 accept us subsidizing at federal expense the richest law  
7 firms and brokerage houses in this country. That is  
8 outrageous.

9 Senator Durenberger. A strong statement to follow.

10 (Laughter)

11 The Chairman. I mean, it is right out of the pockets  
12 of everybody into the hands of some of the richest people.  
13 Worse than the housing provision you referred to.

14 (Laughter)

15 Senator Boren. Mr. Chairman, I see you are in doubt on  
16 this proposal.

17 (Laughter)

18 The Chairman. Senator Durenberger?

19 Senator Boren. I think that what I had better do,  
20 considering this, I had better split this amendment into  
21 two parts.

22 (Laughter)

23 Senator Boren. Having, I think, heard your endorsement  
24 on the first part or at least acquiescence.

25 (Laughter)

1           The Chairman. Treasury may even want to address itself  
2 to the first part.

3           Senator Boren. Mr. Chairman, let me just make the point:  
4 It is not my design to try to -- I think we all know that  
5 the legal fees on these matters have traditionally run as  
6 high as one percent by themselves; you have in addition to  
7 that certain banking costs; you have trustee fees; you have  
8 remarketing fees; you do have printing costs. I am not  
9 interested in preserving any rate, whether it is one percent  
10 or something else. Maybe the cap should be one-half a  
11 percent or something lower.

12           But I do think that there are some additional out-of-  
13 pocket expenses that are incurred that the cities and towns,  
14 for example, are going to have to be paying. And I think in  
15 a time in which it is a necessity for some of these commun-  
16 ities to have to go into refunding, that there should be  
17 some fair mechanism of their achieving at least their  
18 reasonable out-of-pocket expenses.

19           Now, if we want to put some cap on it that is lower than  
20 what I just said, I am certainly willing to do that; but I  
21 think there should be some ability.

22           The credit-enhancement costs are not the full costs to a  
23 community in terms of an advanced refunding proposal. And I  
24 agree with you. I think some of these fees are excessive.  
25 I think there should be a cap. But I don't think that we

1 should not allow a community to cover its reasonable out-of-  
2 pocket expenses.

3 The Chairman. You indicated that you are willing to  
4 split the amendment for the moment and put them into two, but  
5 I know Treasury wants to address itself probably to both of  
6 them. But go ahead with the advanced refunding one first.

7 Mr. Mentz. All right. They are really both advanced  
8 refunding proposals.

9 First of all, let us understand what an "advanced  
10 refunding" is. You have got a issue of bonds outstanding  
11 that were used to finance a school or a road or what have you,  
12 and for one reason or another -- maybe to get a lower interest  
13 rate, or maybe to get out from a burdensom covenant -- it is  
14 desirable to refinance that issue.

15 But, because of the terms of the issue it cannot be  
16 called. And so what actually happens is, the issuer goes out  
17 and issues another set of bonds. So, you have a doubling  
18 up: you have two issues of bonds, basically, outstanding at  
19 the same time and for a continuing period of time, that are  
20 used basically to finance the same underlying project.

21 Now, with respect to the two amendments, taking the  
22 cost of issuance first --

23 The Chairman. Let me ask if I understand.

24 Mr. Mentz. Sure.

25 The Chairman. You sell some bonds at 10 percent. The

1 interest rates fall. You still have a 10-year obligation  
2 and you can't call the bonds in, so you issue a new set at  
3 8 percent.

4 Mr. Mentz. Right.

5 The Chairman. And that's the going rate. You now use  
6 those proceeds to pay off the first bonds, and you've got  
7 two sets of tax-exempt bonds outstanding.

8 Mr. Mentz. Yes. You can't pay them off. That's right.  
9 You invest them in SLGs. You can't pay off the original bond  
10 because it is not callable, so you effectively escrow the --

11 The Chairman. You mean, you can't buy it out.

12 Mr. Mentz. You can't buy it out, that's right. So you  
13 escrow the proceeds.

14 Senator Boren. Now, the SLGs, one point on that is that  
15 your rate of interest on what you pay on those is generally  
16 below the market. So, in some sense you are resubsidizing  
17 the federal government, in that you are required, when you  
18 refinance, to put it back into bonds at below market.

19 But what we were talking about is the rate of interest  
20 at which the community can receive a return on that second  
21 issuance. Isn't that correct? What costs you can include?

22 Mr. Mentz. Yes, that's right. Believe me, there is no  
23 subsidy of the federal government in anything to do with  
24 tax-exempt bonds; it is all going the other way.

25 Senator Symms. Is that really what your opposition to it

1 is? That you don't want people to have tax-exempt bonds? Is  
2 that the basis?

3 Mr. Mentz. Steve, I have two basic opposition points to  
4 each of Senator Boren's proposals.

5 Taking it in reverse order, on the question of whether  
6 cost of issuance expenses get figured in in determining what  
7 kind of a yield you can get, they are figured in under current  
8 law, and that makes possible refunding transactions where  
9 there can be a tiny benefit to the issuer that is refunding.  
10 And the real benefit is to the lawyers and the underwriters  
11 who are doing the transactions.

12 If I had the opportunity to state the argument before to  
13 the Chairman, I probably would have said the same thing only  
14 perhaps in somewhat stronger terms.

15 I want to strongly agree with him that those costs of  
16 issuance, by allowing arbitrage, if you will, to be used to  
17 pay for those costs, you are providing an incentive to do  
18 refundings where the benefit to the issuer can be paper-thin.

19 And all that Senator Durenberger and the Chairman are  
20 proposing is, if you are going to a refinancing, make it so  
21 that it makes economic sense. It is just like if you are a  
22 homeowner and you want to refinance your mortgage; you are  
23 not going to refinance it if you have to pay points and other  
24 expenses and you wind up losing money out of pocket. We are  
25 saying the same rule should apply on tax-exempt bonds when

1 they are refinanced.

2 And on the question of advanced refundings, how many  
3 should you have, I guess the fewer the better. Two is the  
4 Chairman's proposal; Senator Boren would raise it to three.  
5 Certainly Treasury would prefer to leave it at two.

6 But let me ask you one question: When you say "starting  
7 over," do you mean that if an issuer has had two advanced  
8 refundings already so that he has done three, he is stopped?  
9 Or can he do three more? I don't quite understand.

10 Senator Boren. No, he could do an additional one. In  
11 other words, he would not have more than three outstanding at  
12 one time.

13 Senator Durenberger. Including the original issue? Is  
14 that your proposal?

15 Senator Boren. Yes, including the original issue.

16 Mr. Mentz. But you do count issues that have been  
17 refunded prior to the effective date. So let's say you did  
18 three refundings before 1-1-87. Under your proposal there  
19 would be no more ability to advance refund, is that right?

20 Senator Boren. Well, I thought we would count the  
21 original issue but not count any others. Right now there are  
22 no limitations on how many refundings you can do, isn't that  
23 correct, under current law?

24 Mr. Mentz. Yes, for non-IDBs. IDBs are restricted. You  
25 can't advance IDBs under present law.

1 Senator Boren. No, but we are talking here in terms of  
2 municipal projects and that sort of thing.

3 Mr. Mentz. That's right.

4 Senator Boren. So it was my intention to count the  
5 original issuance but to allow you from this day forward to  
6 have a maximum of three. I think you allow a maximum of two  
7 from this day forward. How does the operation of your --

8 Senator Durenberger. Two sets of bonds including the  
9 original bond.

10 Senator Boren. Including the original. Yes, I would  
11 include the original. And what I am saying is three.

12 Mr. Mentz. So, if there had been an advanced refunding  
13 prior to the effective date, would you allow another?

14 Senator Boren. No. You see, what I would do is allow  
15 one additional, because we are in a situation in many cases  
16 in which -- and I think we have to seriously think about this.  
17 I don't think if you change this three -- we'll separate the  
18 points here for just a minute and come back to the other one  
19 in a second, because I would like your guidance in terms of  
20 what you think is fair.

21 But on this first point we actually have many situations.  
22 We are going to have defaults, I promise you, in many areas of  
23 the country on some municipal obligations, for example, if we  
24 do not allow those municipalities to go through a refunding  
25 process now. And many of them have perhaps refunded once

1 already; so therefore, the original issue plus one other time,  
2 they are now under this cap.

3 If that is wise policy, that is a decision the committee  
4 has to make. I don't think it is. And I would point out I  
5 don't think that this is a prevential matter, because who can  
6 look down the road over the next 30 years? Our part of the  
7 country is suffering now. I hope the one thing we have all  
8 learn, and I hope we have learned it -- it has been a good  
9 lesson for me -- that times can change and times can turn.

10 We have had the upper midwestern industrial part of this  
11 country suffer earlier. So, who knows where the next area is  
12 going to be that suffers?

13 But I think we do not want to deprive our state and  
14 local governments. And we are not talking about broad, we  
15 are talking about very narrowly defined legitimate governmental  
16 projects. I think we want to allow them the flexibility if  
17 it is to their advantage, and if it means they can meet their  
18 obligation under bond issues by refunding in times of  
19 imminent economic crisis to them, where they have had a great  
20 loss of revenues, I think we should allow them that  
21 flexibility. And I think that is going to benefit everyone  
22 sitting around this table in the course of 30 years, I would  
23 predict.

24 Senator Symms. Would the Senator yield?

25 The Chairman. Mr. Secretary first.



1 Mr. Mentz. Well, let me say obviously this is a  
2 judgment call that you all have to make. Treasury's view  
3 is that if an issue has been refunded prior to 1-1-87, at  
4 least if it has been refunded twice, I would count both of  
5 those refundings and would not allow another two more  
6 refundings, which is what I understand your proposal would  
7 do, Senator Boren. I think that is going really too far.

8 I have problems with your basis "is it two or is it  
9 three?" But for gosh sakes, whatever you do, don't disregard  
10 the refundings that you have already got on the books, because  
11 you could have an issue that has been refunded five times,  
12 and you could allow two more. It seems to me that you are  
13 going way past the bounds of fairness.

14 Senator Bentsen. Mr. Secretary?

15 The Chairman. Senator Bentsen, then Senator Mitchell.

16 Senator Bentsen. Educate me a little here, Mr.  
17 Secretary. You can get a very major drop in interest rates.  
18 I don't want to penalize a city or whatever public entity in  
19 trying to take advantage of those, if they have a clause or  
20 a covenant where they can't call the other bonds.

21 And yet, I ceratinly want to avoid the churning of these  
22 issues just for attorneys' fees. That gets outrageous.

23 But if you get away from the situation where it is just  
24 a sliver of differential in the way of interest rate, I can  
25 recall buying a company that had some Los Angeles municipals

1 maturing in the year 2001 that were one percent. I don't  
2 anticipate that happening again, but you could have a  
3 substantial drop. Can't you control this by the utilization  
4 of the arbitrage in the tax matters in which that is handled?

5 Mr. Mentz. Well, I think the second amendment of  
6 Senator Boren, on whether you count the lawyers and invest-  
7 ment bankers' fees in the cost of issuance, that is how you  
8 control the arbitrage. If you make the issuer in effect  
9 pay for those not out of arbitrage, then you are controlling  
10 the arbitrage, and it is much less of a problem.

11 For that reason, I think that the second amendment is  
12 more troublesome than the first.

13 I agree with you about there has to be some flexibility;  
14 so that when you do have a lowering of interest rates, as  
15 we are in right now, it would be most unfortunate if a city  
16 or a municipality were unable to refinance its debt.

17 I do think, Senator Bentsen, that at some point you  
18 really do have to draw the line and say enough is enough, and  
19 I think that is where the Chairman's --

20 The Chairman. Thank you, Mr. Chairman. I have several  
21 questions.

22 The first is, and I might direct my question to  
23 Senator Boren: It is unclear to me how the municipality would  
24 stave off default if you passed just the first part of your  
25 amendment, when the very reason that you suggest is that they

1 can't, they are subject to the dates in the initial issue.  
2 Unless they can get some benefit from the second issue through  
3 arbitrage or some economic benefit, then what is the value of  
4 it to them?

5 Senator Boren. Oh, it is an economic benefit. For  
6 example, let us say that the interest rate has fallen three  
7 or four percentage points, or there is some covenant that they  
8 might be able to get out from under. But probably the  
9 principal thing driving it, the interest rates are much lower  
10 now than they were earlier.

11 So in other words, it is just like refinancing your  
12 house; it is the same thing. If you had a 17-percent  
13 mortgage on your house right now, you would be going and  
14 making arrangements to pay off that loan, a mechanism of  
15 doing it, so that you could get a new interest at 11 or 12  
16 percent.

17 Senator Mitchell. But no, the analogy is not apt,  
18 because you only do that when you can pay off the first  
19 mortgage with the proceeds of the second mortgage. You are  
20 describing a situation where you, by very definition, cannot  
21 pay off the first mortgage. So you are issuing a second  
22 mortgage for the sole purpose of reinvesting the funds at a  
23 rate higher than the amount that has been issued, and  
24 benefitting from that.

25 Senator Boren. Senator Mitchell, I will defer to

1 Mr. Mentz about this, but the effect of it is the same as  
2 what I have described. The mechanism that you go through is  
3 a more convoluted mechanism in that under the covenant of the  
4 bonds they are not callable at that point as it would be  
5 paying off the mortgage all at once under the example I gave  
6 with the house.

7 But the mechanism is, the city does get the interest  
8 rate benefit.

9 Senator Mitchell. That is only because they can benefit  
10 from the arbitrage.

11 Mr. Mentz. No.

12 Senator Mitchell. That's right.

13 Mr. Mentz. They get the benefit, but they get the  
14 benefit only after the original set of bonds actually do get  
15 paid off.

16 Senator Mitchell. That's right. In the interim, the  
17 only economic benefit is the arbitrage. That's why it's done.

18 Mr. Mentz. That's right.

19 Senator Mitchell. And that's what's wrong with it.

20 The Chairman. That's correct.

21 Mr. Mentz. The arbitrage is used to pay the expenses of  
22 the issue.

23 Senator Mitchell. But the first part of the amendment  
24 doesn't do anything unless you can get the benefit of the  
25 arbitrage. And that's what's wrong. The whole purpose of

1 this is to enable municipalities to get money at a low rate  
2 and reinvest it at a higher rate, and use the proceeds for  
3 their economic benefit.

4 Mr. Mentz. That is correct.

5 Senator Mitchell. And that's what's wrong with this  
6 whole system.

7 The Chairman. And can you think of a greater inducement  
8 for a bond counsel to come to the city than to say, "Listen,  
9 you can include our fees as part of your reissuance."

10 Senator Mitchell. That's right. This is one of the  
11 greatest growth industries in the country. Will somebody tell  
12 us the volume of bonds issued 10 years ago, five years ago,  
13 and last year?

14 Mr. Hartley. In 1975, approximately \$30.5 billion of  
15 long-term bonds were issued. In 1984, that had grown to  
16 \$114.3 billion. Preliminary estimates for 1985 show it around  
17 \$230 billion.

18 Senator Mitchell. And we have all seen the articles in  
19 the magazines about these municipalities -- that's how they  
20 conduct their operations. They, in effect, extract a subsidy  
21 from the taxpayers and other municipalities who don't issue  
22 these bonds, by issuing them, reinvesting the money, and  
23 therefore they can keep the property tax rate down, they can  
24 keep all of their other expenses down, and they use this for  
25 this purpose. That is clearly the only economic benefit that

1 can be derived from this proposal, and therefore, it seems  
2 to me, it doesn't make any sense at all in terms of the  
3 overall national interest.

4 The Chairman. Senator Symms?

5 Senator Symms. Mr. Chairman, I just had the Mayor of  
6 Idaho Falls in my office yesterday morning, and they have this  
7 exact problem. They are supporting what Senator Boren is  
8 trying to do. And if I understand it correctly -- and I want  
9 to direct this question to Mr. Mentz and the Treasury -- they  
10 take any surplus funds and invest it in Treasury Bonds. Isn't  
11 that correct?

12 Mr. Mentz. In state and local government series, that's  
13 right.

14 Senator Symms. Or in U.S. Treasury Bonds.

15 Mr. Mentz. Well, that is U.S. Treasury.

16 Senator Symms. Well, why wouldn't that be a benefit to  
17 the Treasury? It helps you finance your debt at a lower cost.

18 Mr. Mentz. Well, the use of arbitrage here, Senator  
19 Symms, is in paying the financing costs, and underwriters and  
20 lawyers and so forth, of doing the transaction. That is where  
21 the arbitrage comes in.

22 If you accept the Chairman's recommendation and  
23 Senator Durenberger's recommendation and change that rule,  
24 then you basically eliminate the benefit of arbitrage with  
25 respect to an advanced refunding, but the issuer does not

1 achieve the interest savings until the first set of bonds  
2 gets paid off.

3 Senator Symms. Doesn't it still help Treasury, though,  
4 to have a --

5 Mr. Brockway. It is a wash for Treasury.

6 Senator Symms. -- to have a pool of funds, though, to --

7 Mr. Brockway. Sorry, it is not a wash. Effectively,  
8 it is the same thing as if the government issued a tax-exempt  
9 bond, the Federal Government did. The government would lose  
10 more money from tax revenues than it gained from the lowering  
11 of the interest rate on issuing tax-exempt bonds, which is  
12 why the Federal Government does not issue tax-exempt bonds.

13 The Chairman. Further discussion?

14 Senator Chafee, and Senator Bradley.

15 Senator Boren. Mr. Chairman, I think that, after hearing  
16 this discussion -- and I have been discussing it with  
17 Senator Durenberger as well -- I do not want to confuse the  
18 issue about allowing the municipalities to have the right to  
19 advance refund, and some of whom, when there was no cap, some  
20 of whom have already refunded. I don't think it is fair then  
21 to say, "All right, you have had your chance, if you had an  
22 original issuance and a refunding." Now, they can't go again,  
23 even though they might be in a very desperate situation.

24 It is not my purpose to assist anyone to make large fees  
25 off this matter; it is my purpose to allow some relief to the

1 municipalities.

2 So I think the simplest thing is simply to delete the  
3 second part of my amendment completely so there is no  
4 confusion about that question. I still think there are some  
5 out-of-pocket expenses, legitimate ones, that are not  
6 covered. But I can live with what Senator Durenberger has  
7 provided, in terms of the direct -- I believe you call it  
8 the "credit enhancement costs" -- and simply move one part of  
9 the amendment that would allow a ceiling of three instead of  
10 two.

11 I would say this: They are not going to be a lot of  
12 people do this. If we have a ceiling of three, they are not  
13 going to do this for a sliver of gain. If they know that  
14 they are only going to be able to do this one more time, if  
15 they have already done it once they are only going to be able  
16 to do it one more time probably in the life of a 30-year  
17 bond, they are not going to do that lightly. There is going  
18 to have to be some significant economic gain.

19 I seriously think with the cycles in our economy we want  
20 to allow that.

21 The Chairman. Senator Bradley, then Senator Durenberger,  
22 and then let's vote.

23 Senator Bradley. Mr. Chairman, I have two points. The  
24 first point is actually a question to Senator Durenberger:

25 The idea of the number of refinancings. The fact is that



1 you find some systems, some hospital systems, that are  
2 municipally owned, that find changes in federal law, federal  
3 reulgation, going to the DRGs, et cetera, that impose  
4 additional costs on that institution. They had financed  
5 that through their own tax-exempt mechanism, and they now find  
6 because of federal regulatory changes that the flow of  
7 revenue is inadequate. It seems reasonable that they should  
8 be allowed at that point to refinance.

9 My question to you is, how does that proposal that you  
10 ave suggested allow for that? And do or do you not support  
11 the third refinancing?

12 Senator Durenberger. Thank you for the question. It  
13 gives me an opportunity --

14 Senator Bradley. I have one other point I have to make  
15 after this.

16 Senator Durenberger. Yes. Refer all of this to  
17 Ben Hartley, because he is the expert, and he hasn't had a  
18 chance to comment yet. I would appreciate it if he were  
19 given that opportunity to clarify what we are talking about  
20 here in terms of advanced refunding.

21 Mr. Hartley. The first point I would clarify is the way  
22 the Chairman's package operates with respect to advanced  
23 refundings that occurred before 1986 or before the date of  
24 enactment. Those bonds are counted, and the number of  
25

1 advanced refundings --

2 Senator Chafee. Could you speak a little louder?

3 Mr. Hartley. The advanced refundings before date of  
4 enactment, under the Chairman's package, would be counted, if  
5 they are outstanding on date of enactment, in determining the  
6 number of advanced refundings that could be done.

7 In response to Senator Bradley's question, and this in  
8 part would be a clarification I think of Senator Boren's  
9 Amendment, there are two rules in the Chairman's package. One  
10 allows two advanced refundings; the second restricts the  
11 number of bonds, sets of bonds, that can be outstanding at any  
12 given time to two sets.

13 It is my understanding that Senator Boren's Amendment  
14 would delete the restriction to two sets of bonds outstanding  
15 at any time.

16 Senator Boren. No, it would change it to three. It  
17 would not delete all limits.

18 Mr. Hartley. Okay. So you could still only have two  
19 sets of bonds outstanding at any time.

20 Senator Boren. And that would count the original in the  
21 three.

22 Mr. Hartley. It is the Chairman's proposal, changing  
23 two to three.

24 Senator Boren. The Chairman's proposal, changing two to  
25 three.

1 Senator Bradley. What is the difference between that  
2 proposal and simply changing the effective date, saying that  
3 you are allowed two advanced refundings from the date of the  
4 bill?

5 Mr. Hartley. There are bonds outstanding now that have  
6 already been advanced refunded, in some cases as many as  
7 three, four, five times, and you might have multiple sets  
8 outstanding.

9 Senator Bradley. All right.

10 My one last point, Mr. Chairman, and I know you want to  
11 go to a vote, is the number that you gave us, Mr. Hartley,  
12 on the amount of municipal bond financing. I mean, it is  
13 just amazing. And there is another number that I read  
14 somewhere, and maybe you can confirm this. You said in 1984  
15 that the amount was about \$115 billion?

16 Mr. Hartley. That is correct. Those are Treasury  
17 numbers.

18 Senator Bradley. And in 1985 the estimate is \$230  
19 billion?

20 Mr. Hartley. That is correct.

21 Senator Bradley. In 1984, the number I read somewhere  
22 and you confirmed this, is that the bond fees of that  
23 \$115 billion were about \$6 billion.

24 Mr. Hartley. That would be about right, probably.

25 Senator Bradley. That is \$6 billion that are sprinkled

1 over a very few number of people.

2 Mr. Chairman, I would hope before we leave this area of  
3 bonds that we could look at some way to restrict that amount.  
4 I mean, it is unbelievable to me that you've got \$6 billion  
5 that is spent on a few bond councils that could very well  
6 be spent on hospitals or schools, or whatever.

7 I would suggest that we ask maybe the staff and the  
8 Treasury to try to develop some way that we could limit and  
9 restrict the amount of bond fees.

10 Now, I know that there could be an emergency call to the  
11 medical services to come to the room at this point, but I  
12 hope that we could at least try to develop that so we have it  
13 in standby, depending on what happens here.

14 The Chairman. I would like to put the vote, if I could,  
15 on the Boren Amendment.

16 Do you want a rollcall?

17 Senator Boren. Yes. What it does is, it takes the two  
18 twos in the Chairman's proposal, the original proposal, and  
19 changes it to three. So that if any community, since we had  
20 no cap before, has already had its two, we at least give them  
21 one more chance during the next 30 years to do it. Some of  
22 them are in a situation where I think they need to. That is  
23 all it does. There is nothing else in it at this point except  
24 changing those two twos to the figure three.

25 The Chairman. Clerk, call the roll.

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

1 Senator Matsunaga. No.  
2 The Clerk. Mr. Moynihan?  
3 Senator Moynihan. Aye.  
4 The Clerk. Mr. Baucus?  
5 Senator Baucus. Aye.  
6 The Clerk. Mr. Boren?  
7 Senator Boren. Aye.  
8 The Clerk. Mr. Bradley?  
9 Senator Bradley. Aye.  
10 The Clerk. Mr. Mitchell?  
11 Senator Mitchell. No.  
12 The Clerk. Mr. Pryor?  
13 Senator Pryor. Aye.  
14 The Clerk. Mr. Chairman?  
15 The Chairman. No. Senator Wallop, Aye.  
16 The Clerk. Twelve Yeas, six Nays.  
17 The Chairman. Adopted.  
18 Senator Symms?  
19 Senator Symms. Mr. Chairman, I have a question I just  
20 want to pose to counsel. We don't have to do it today, but  
21 I would just like to reserve the opportunity to look at it,  
22 with some questions that have been asked about the consumer  
23 loan funds, security interest test, on the regional EPA  
24 area. I don't know whether Mr. Colvin would want to comment  
25 on it now, or if we could just reserve it. Has the committee

1 looked at this? I just got this letter yesterday, and I don't  
2 know as I understand the issue well enough to bring it up,  
3 but I think there may be a problem in the Columbia Basin.

4 Ms. Pearson. They've brought up a problem about output  
5 contracts, and we gave Senator Durenberger some language  
6 earlier that Treasury and staff have drawn up, describing  
7 present law.

8 Output contracts will not be considered a consumer loan  
9 unless certain benefits of ownership are transferred. So it  
10 is a fine line that they are worried about, and they are  
11 worried about some of the definitions in the Technical  
12 Corrections Act.

13 I think it is an issue to be picked up in the Technical  
14 Corrections Act when we come to that, and discuss it there.

15 The next issue is, they want to extend an effective date  
16 that was enacted. The sunset is 1989, and they would like  
17 to make it permanent instead of having it into 1989.

18 Senator Grassley. Mr. Chairman?

19 The Chairman. Senator Moynihan, then Senator Grassley,  
20 then Senator Chafee.

21 Senator Moynihan. Could I raise the question that, in a  
22 number of states -- and obviously New York is one -- there are  
23 certain government activities for which the municipality  
24 involved has established a public benefit corporation. And  
25 the question is whether these public benefit corporations can

1 operate such bond issues in the same manner as the  
2 municipality, as it were.

3 Mr. Hardock. Senator Moynihan is referring to a situa-  
4 tion in some states where they have essentially set up  
5 public hospital programs with a conduit entity where the  
6 city or state government controls the 501(c)(3) organization,  
7 but there is an ownership by the 501(c)(3), and then  
8 technically, when that organization issues bonds it would be  
9 subject to certain of the restrictions that are peculiar to  
10 501(c)(3), in the Chairman's package, but not to public  
11 hospitals which are generally owned directly.

12 What Senator Moynihan, I believe, wishes to do is clarify  
13 that, if the 501(c)(3) is run by a government, the board is  
14 totally controlled by the government and only serves essential  
15 governmental functions -- in this case, they are providing a  
16 great deal of indigent care; they are basically inner city  
17 hospitals that are run by the City of New York, in one case,  
18 and there are others. Just to clarify that that is a public  
19 hospital, even though there is this 501(c)(3) conduit.

20 Senator Moynihan. Do you think we could work that out,  
21 Mr. Chairman. There is absolutely no difference between these  
22 hospitals and the public.

23 The Chairman. And that is their sole function.

24 Senator Moynihan. That is their sole function.

25 The Chairman. Mr. Hartley?



1 Mr. Hartley. Mr. Chairman, these hospitals primarily  
2 have trouble satisfying the management contract rules that  
3 you liberalized in your package, because they would want  
4 longer term contracts with the 501(c)(3) organizations.

5 We can take a look at that; if we can tie it so that it  
6 is not all 501(c)(3)s, I think we are okay.

7 The Chairman. Can we look at that and see if we can  
8 draft it very narrowly?

9 Mr. Hartley. Yes, sir.

10 The Chairman. Thank you.

11 Senator Moynihan. For the purposes that I have in mind,  
12 it is a very narrow definition indeed. But if that could be  
13 done, I would appreciate it.

14 The Chairman. Senator Grassley?

15 Senator Grassley. Mr. Chairman, I don't have an amend-  
16 ment on this issue, but I want to do just like Senator Symms  
17 did a minute ago, reserve the right to offer an amendment if  
18 need be.

19 I have a letter I received last night from my state with  
20 some data on tax increment financing bonds and the problem  
21 that they see that they have with the cap, and I am going to  
22 ask your staff and the Tax Committee to look at this letter,  
23 then see if I need to do anything along that line.

24 I assume, then, that we still are going to have an  
25 opportunity even beyond -- even beyond today.

1           The Chairman. Yes. But, Chuck, let me say this in  
2 fairness: Anything can bring something up any time. But once  
3 we have gone through these, and although you have reserved it,  
4 I really do have to have the amendments ahead of time.  
5 Because when we come to a catch-up session on depreciation  
6 and accounting, because we haven't finished them yet --

7           Senator Grassley. Then really, all I have to do, if we  
8 do have a problem in this area, is just give it to you 24  
9 hours ahead of time?

10          The Chairman. Well, it would help if we could even have  
11 it a little more than that, because you will have notice when  
12 we are going to come to our catch-up sessions; but you want  
13 time for the Joint Committee to cost it out, you want time  
14 for any other comments that may be, as to drafting.

15          Twenty-four hours is thin.

16          Senator Grassley. All right.

17          The Chairman. Senator Chafee?

18          Senator Chafee. Mr. Chairman, I would like to follow up  
19 on a proposal I discussed several years ago when we were in  
20 these IDBs, and a matter that Senator Bradley just touched on,  
21 and that is the fees that are being acquired by both the  
22 attorneys and the bond houses, in connection with all these  
23 tax-exempt issues we are talking about.

24          There is no question that a lot of people in this country  
25 are getting very, very, very rich out of this.

1 I proposed several years ago when we were in this that  
2 we require competitive bidding for the attorneys fees and  
3 for the underwriters. That was jumped all over by saying,  
4 "That's impossible to achieve." I am not so sure it was.  
5 Instead, the suggestion was that these matters are negotiated,  
6 which in effect is competitive bidding.

7 Now, I have two specific questions: The first is, as  
8 I recall, and I think we corrected this, the arbitrage that  
9 they were permitted to collect first was after the fees had  
10 been deducted from the arbitrage. The arbitrage limits came  
11 on after that. So therefore, there was no incentive to limit  
12 the fees whatsoever, since the U.S. was paying all of it.

13 Now, we have changed that, have we not?

14 Mr. Hartley. That is correct, Senator Chafee.

15 Senator Chafee. Okay. So, that was a reform -- at  
16 least, I so consider it.

17 Now, the second question is: What, if anything, can we  
18 do further? This is pursuant of what has bothered me for a  
19 long time, and Senator Bradley raised.

20 There is no question that a few people have got a grip  
21 on this, they are getting rich out of it, counsel and certain  
22 underwriters. What can we do to make sure that more people  
23 get a piece of the action, and thus, presumably, more  
24 competitive forces come into play?

25 Mr. Hartley. Senator, you are really talking a cap on

1 permitted bond counsel fees of some sort. There are a number  
2 of ways that could be established. Staff will be willing to  
3 look at it and talk to you about it. I don't have a specific  
4 method that might apply uniformly nationwide at this time.

5 Senator Chafee. How about Treasury?

6 Mr. Mentz. Senator Chafee, the problem here is that our  
7 tax law, section 103 and section 103(a), is very complex, and  
8 it is not getting any easier as a result of decisions that  
9 have been made in the Tax Reform Act of 1986.

10 As long as you are going to have an intricate statute  
11 with literally hundreds of pages of regulations, private  
12 rulings that form a body of law that are essential to the  
13 structuring and understanding of these kinds of transactions,  
14 as long as you have that legal system, you are going to have  
15 large fees.

16 I think that there has been an expansion of counsel who  
17 have been involved in tax-exempt bond practice. It used to  
18 be there were less than a dozen firms in the whole country  
19 that would do it; now, the expertise is much more broadly  
20 spread.

21 But my answer to you is, the only way you are really  
22 going to cut that down is if you simplify the law. And  
23 simplifying the law in this area just doesn't seem to be  
24 something that is very easy to achieve. I don't think you  
25 can do it by a cap or an arbitrary limit, or even requiring

1 public bids. You are still going to get the bids that reflect  
2 the amount of time, the amount of detail and effort it takes  
3 to do these kinds of transactions.

4 I didn't mean to suggest in my discussion with Senator  
5 Boren that I felt there was some kind of a ripoff or something  
6 unconscionable, or anything. I am simply saying that this  
7 is a very intricate area. I have not had direct experience,  
8 but I certainly have had a lot of experience with partners  
9 in my firm who practiced in the area. It takes a lot of  
10 time and a lot of hours and a lot of knowledge and education,  
11 and there is no easy answer to your question; it is a  
12 troublesome question. It is the reason the Treasury started  
13 out with a much more pure proposal that basically would have  
14 gotten rid of all private purpose bonds. But I think that is  
15 just not possible.

16 Senator Chafee. Well, I would venture -- then I will  
17 conclude, Mr. Chairman -- I would venture that the costs came  
18 down precipitously once we no longer allowed the deduction,  
19 before computing the arbitrage.

20 Mr. Mentz. Quite right.

21 Senator Chafee. And of course at that time there was no  
22 incentive on the consumer to complain, since the Federal  
23 Government was paying for it all.

24 Well, now there is a greater incentive, and somehow I  
25 would hope Mr. Hartley or others who are familiar with this

1 area could come up with some suggestions; because, you will  
2 find at least one Senator very receptive to those limitations.

3 The Chairman. Let me ask a question of Mr. Brockway:  
4 How are you doing on our running total? Have you got it?

5 Mr. Brockway. Beginning today we were \$25 billion off  
6 the Chairman's package, and the amendments you have adopted  
7 so far this morning are \$2.1 billion. So, you are essentially  
8 \$27 billion off the package.

9 The Chairman. Senator Danforth?

10 Senator Danforth. Mr. Chairman, I was going to just say  
11 I think Senator Chafee has made a good point. It is the  
12 second time he has made it.

13 Maybe times have changed considerably in the last nine  
14 years, but I remember when I was our State Attorney General  
15 there was something called "a red book," I think, or a "blue  
16 book" or some such thing?

17 Mr. Mentz. Red book.

18 Senator Danforth. The red book. And that red book  
19 contained the names of bond counsel whose opinions would be  
20 accepted by underwriters of bond issues.

21 In the State of Missouri there are only two bond  
22 counsels whose opinions were acceptable. So, it was an  
23 extreme cornering of the market of available bond counsel. It  
24 was said to be a very lucrative practice, very tight.

25 Also, we found at that time -- maybe times have changed

1 -- that the bond counsel were extraordinarily cautious, to  
2 the point of not wanting to issue an opinion on anything,  
3 unless there was litigation.

4 So, they would basically trump up lawsuits in order to  
5 sew up the legal principle on a case-by-case basis on each  
6 bond issue. It wasn't much of a legal opinion.

7 So, I don't know what can be done about it if that  
8 situation continues to exist. But I do think that Senator  
9 Chafee has made a very good point.

10 The Chairman. Senator Moynihan?

11 Senator Moynihan. Mr. Chairman, I would like to note  
12 that Secretary Mentz has been more than forbearing with  
13 respect to these discussions of his previous law firm.

14 Mr. Mentz. I picked a heck of a year to come into the  
15 government, didn't I?

16 (Laughter)

17 Senator Moynihan. Sir, with respect to the annual  
18 recertification of low-income housing, there are a number of  
19 parts of the country, and New York City is one, where the  
20 difference between the level of rents in low-income housing  
21 and the market rents is so wide, that when you go through  
22 this business of when someone reaches above the 120 percent  
23 income level you have to replace someone at the 70 percent,  
24 you can pretty quickly get a situation where you don't have  
25 -- where your tenants just aren't paying enough to carry the

1 development. It is a phenomena of the market, not the  
2 sell them.

3 I wonder if it wouldn't be possible -- I understand,  
4 Mr. Hartley, that the Joint Committee thinks they can  
5 redefine this with respect to situations where there is this  
6 very unusually wide gap between low income and market?

7 Mr. Hartley. Senator Moynihan, we are looking at a rule,  
8 where there is deep rent skewing, which would reflect a high  
9 market rent vis-a-vis what a low-income tenant could pay.

10 Senator Moynihan. Yes.

11 Mr. Hartley. The current rule, and the Chairman's  
12 package, that people are counted as low income only if their  
13 income doesn't rise above 120 percent of the actual limit, it  
14 could increase to 150 percent rather than 120 percent, so that  
15 you would have more people who have gone up who would still  
16 be counted as low income, and therefore they wouldn't have to  
17 rent new apartments to new low-income tenants.

18 Senator Moynihan. That would help a great deal, if you  
19 could do that, and I would appreciate it. Are you saying you  
20 think you can do that?

21 Mr. Hartley. That would be an amendment, I think, that  
22 you would have to make. It would cost just \$100 million off  
23 the package.

24 Senator Moynihan. Could I offer that as an amendment,  
25 Mr. Chairman? I would like to offer that as an amendment,



1 that for purposes of the -- well, I guess it would be routine,  
2 that the 120 percent rule would be changed to --

3 Mr. Hartley. To 150, where there was deep rent skewing,  
4 which reflects a high market rent.

5 The Chairman. Mr. Secretary, any comment?

6 Mr. Mentz. Only that we would try to work at the staff  
7 level to keep it as tight as possible. But I think the  
8 Senator has a reasonable point.

9 Senator Moynihan. Can we then just look to see if this  
10 can be worked out, Mr. Chairman? I think it can be.

11 The Chairman. Absolutely.

12 Senator Moynihan. If it can, we would thank you.

13 The Chairman. We vote at 12:00. Are there any other  
14 amendments?

15 Senator Bradley. Mr. Chairman, I don't have another  
16 amendment, but I would like at some point to maybe revisit  
17 the issue that Senator Chafee raised and Senator Danforth and  
18 I.

19 The Chairman. Count me in.

20 Senator Bradley. I think it would be appropriate,  
21 particularly as we see all the noble public purposes pitted  
22 against each other, and forced to choose among the noble  
23 public purposes. Maybe what we could do is see who are the  
24 moving forces. And I think that we could revisit this at some  
25 point.

1 The Chairman. Senator Grassley?

2 Senator Grassley. My amendment deals with pool  
3 financing. You know, that is used by smaller communities and  
4 rural hospitals that aren't large enough to issue their own  
5 bonds.

6 The amendment would permit the issuer to use the  
7 arbitrage to call the bonds before all the users are in the  
8 pool. And this would be like in the case of what is called  
9 "a calamity call, for those circumstances beyond the issuer's  
10 control.

11 It is my understanding that the staff has a cost on  
12 this amendment of \$100 million. But I would like to ask for  
13 consideration, consider the one-year limit that we have on  
14 this, because I don't see how it could be that expensive.

15 The Chairman. Run this amendment by me again.

16 Senator Grassley. Okay. In other words, where there is  
17 a calamity call, and --

18 The Chairman. A calamity what?

19 Senator Grassley. A calamity call. You know, an  
20 instance where there are things beyond the control, and they  
21 want to bring in bonds and reissue, and then there have been  
22 some cities that have not gotten in to the pool. And to let  
23 them in at that point.

24 In my state, rural hospitals use this a lot; but,  
25 generally throughout the country, small communities would use

1 them. Of course, I hope everybody knows pool financing, so  
2 that communities that want to issue don't have the big  
3 overhead that they would have if they were a small community  
4 small issue, and then pool them together.

5 The Chairman. Let me ask you a question. I understand  
6 what the pooling is; but you are saying you would provide an  
7 exception, as I understand it, where there are circumstances  
8 beyond their control. I think. Have I got it right?

9 Senator Grassley. That is right. And a community or  
10 a rural hospital didn't get into the pool. Then this gives  
11 them an opportunity to get into the pool if there has been --  
12 what are you smiling about?

13 The Chairman. Well, I was under the impression you had  
14 another amendment, and I don't understand this one. I hear  
15 what you are saying; it just isn't registering.

16 Senator Grassley. Well, listen, I promised the Chairman  
17 that he would know about my amendments ahead of time. If  
18 you don't know about this, I want to put it off and bring it  
19 up again.

20 The Chairman. Was staff aware of this particular  
21 amendment?

22 Ms. Pearson. I believe we were. We thought Senator  
23 Moynihan. It is number 7 on your list.

24 The Chairman. And I didn't understand about people  
25 coming into the pool later.

1 Senator Grassley. Well, then, the other thing is, if  
2 Senator Moynihan is going to offer it, then I am not going to.

3 The Chairman. His was a different amendment.

4 Mr. Hartley. Senator Moynihan's dealt with circumstances  
5 beyond the issuer's control.

6 Senator Grassley. Well, let's just put it off until we  
7 have a chance to clear this up.

8 The Chairman. All right.

9 If there are no other amendments, we will stand in  
10 recess until 2:00, and we will go on, instead of the subjects  
11 we were going to discuss, to the foreign tax provisions, and  
12 see if we can do some voting on those.

13 (Whereupon, at 12:04 p.m., the meeting was recessed.)  
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## AFTERNOON SESSION

(2:10 p.m.)

1  
2  
3 The Chairman. The committee will come to order. I  
4 would like to start over the foreign tax provisions this  
5 afternoon.

6 We have six or seven amendments that have been offered,  
7 and I know we can't vote on them until we have seven people  
8 here; but I think we could start with the Chafee amendment  
9 and on the transitional rule.

10 I know that Treasury supports it, and we can discuss it.  
11 And I think when we get seven people here, we can probably  
12 vote on it.

13 This is the cross border loans.

14 Senator Moynihan. I was going to offer current law,  
15 wasn't I?

16 The Chairman. Is this the same amendment?

17 Senator Chafee. No. Mine modifies yours.

18 Senator Moynihan. That is right.

19 Senator Chafee. It does not go to current law.

20 Senator Moynihan. Yes.

21 The Chairman. Yours modifies his to do what?

22 Senator Chafee. Mine modifies the proposed  
23 transitional rule as to when these phase in, including this  
24 Baker initiative countries.

25 And Senator Moynihan goes to present law.

1           Senator Moynihan. And I said yesterday that I guess I  
2 would offer present law; but if there didn't seem to be  
3 a majority in that direction, I would like to join you in  
4 your amendment.

5           Senator Chafee. I would suggest, Mr. Chairman, as  
6 perhaps a way to proceed--and we haven't got enough to  
7 vote here anyway--but maybe if Senator Moynihan and Mr.  
8 Mentz could discuss--or Mr. Mentz rather--discuss the  
9 difficulties of going to present law.

10           Then, I think I would make up my mind as to whether I  
11 would support Senator Moynihan in going to present law  
12 based on that.

13           Senator Moynihan. Mr. Secretary, could we do that?  
14 I think our situation is that obviously we have a problem  
15 here, and the Treasury has been very forthcoming about it.

16           I mean, the transition you are proposing is a very  
17 large offer, and we are very grateful that you have done  
18 that.

19           But if you dispose to make this much of an accommodation  
20 to the existing arrangements, why oughtn't we just keep the  
21 existing arrangements, in the context of the Baker initiative?

22           The transition rules are certainly generous, and the  
23 \$1.2 billion dollar estimate -- But people who are involved  
24 in this will say that they will work well enough in a  
25 situation where interest rates are declining, but won't at all

1 should there be a reversal; and there always is, sooner or  
2 later.

3 And with the Treasury as anxious and concerned as it is  
4 to see that American banks continue to lend money to these  
5 particular 15 countries, the American bankers say that with  
6 these circumstances, it is just going to be much more  
7 difficult to do.

8 And we talked yesterday about the competitiveness, if  
9 nothing else, with British and Japanese banks.

10 We are going to make these changes which are going to  
11 have consequences which we really can't foresee and which  
12 certainly are going to move in the direction other than that,  
13 which Treasury is urging the banking community to move.

14 Mr. Mentz. I think that is a very fair question, and  
15 I would like to try to answer it in a way that hopefully  
16 allays the fears of Senator Chafee and perhaps yourself and  
17 others.

18 This proposal basically--forgetting the transitional  
19 rule--the proposal goes to the question of whether income  
20 from cross-border loans should be treated as totally exempt  
21 from U.S. tax or whether there should be a greater preference,  
22 complete exemption plus spillover credit, or you might look  
23 at it as tax shelter, that could be used against other income  
24 that the bank has from other sources.

25 And I think the answer to that question, as a policy

1 matter--forgetting transition for a moment--right now  
2 the United States policy in this area is too generous.

3 We exempt the income completely plus we provide even  
4 a greater benefit because we allow other income to be exempt  
5 by reason of those cross-border loans.

6 That policy bring us out at about number one in the  
7 world in terms of how generously we treat that income.

8 And what the chairman has suggested is that it brought  
9 back more to the middle of the pack, more to the middle of  
10 the pack of the developed countries, and that means right  
11 around Germany, Switzerland, Canada, I guess.

12 But the question you raise, and I think it is a good  
13 question, is: If the transition rule needs to be so  
14 generous and loses so much money, why even bother? And  
15 there is a very good answer to that.

16 The answer is: We have been talking--not so much this  
17 week, but last week--about voodoo revenue and the out years  
18 and are we going to be in a situation where we get revenue  
19 neutrality for the budget period, but we drop way off in  
20 the out years?

21 This is one of those provisions that, after you get past  
22 the transition and after you have a realignment of lending  
23 and a gradual restructuring, particularly of the LDCs, into  
24 the mode that the tax policy dictates, at that point, Senator,  
25 you will have a significant revenue pickup.



1 It won't be in the budget period, but it will be as  
2 much as \$500 million a year in the out years.

3 So, there is a revenue impact here that is important,  
4 and the principle is important that tax exemption on cross  
5 border loans is really about as far as we should go.

6 Now, I would defend the transitional rule simply by  
7 saying we have the chairman of the Federal Reserve Board  
8 basically subscribing to it, saying it is very fair, it is  
9 a reasonable way to proceed.

10 We have the Secretary of the Treasury who, after all,  
11 is the one ultimately responsible for the Baker initiative,  
12 saying this is fine, this is the way to go.

13 Based on that, I think that the Chafee amendment to  
14 the chairman's proposal really is a very moderate, reasonable  
15 solution and one that I don't think is going to cause any  
16 ripples or major stresses or discombobulations in the  
17 international financial world.

18 The Chairman. It would seem to me, considering the  
19 fact that this is a \$1.2 million loss even if we take the  
20 Chafee amendment and the fact that Treasury is willing to  
21 accept that, then I think in good grace we probably ought  
22 to accept the Chafee amendment and adopt it as presented.

23 Senator Chafee. I am not going to argue with that.

24 Let me just ask Mr. Mentz a question.

25 Mr. Mentz. You have seven people here now.

1 The Chairman. That is exactly what I am thinking.

2 Mr. Mentz. Don't let them get away.

3 The Chairman. Let me ask a quick question, George. I  
4 suggested that we, considering Treasury's willingness, Pat,  
5 to adopt this, that we ought to adopt the Chafee amendment  
6 as long as they are willing to accept it and think it will  
7 work for their purposes.

8 Senator Moynihan. Mr. Chairman, if I could just hear  
9 from Mr. Danforth with his views on the matter.

10 The Chairman. Senator Danforth, do you want to speak  
11 on this?

12 Senator Danforth. No.

13 Senator Moynihan. Mr. Chairman, may I put it this way?  
14 We are moving through this bill with some dispatch, and all  
15 of us reserve the right and you have been very generous in  
16 saying that we can reopen matters at a later date.

17 In the interest of movement the way you have been  
18 going along, I certainly would be happy if I could reserve  
19 the opportunity to try again later. I would like to join  
20 Senator Chafee.

21 The Chairman. Without objection --

22 Senator Chafee. Mr. Chairman, just one question if I  
23 could of Mr. Mentz. As I understand under this, Treasury  
24 is agreeable that as far as the Baker 15 countries go,  
25 during the first three years if there is a rollover, then

1 that would not be considered a new loan. Is that correct?

2 Mr. Mentz. That is right. In fact, you can do any  
3 kind of switching or --

4 Senator Chafee. Restructuring --

5 Mr. Mentz. Restructuring during the first three years,  
6 but not thereafter.

7 Senator Chafee. Right.

8 Senator Moynihan. Mr. Secretary? Sorry.

9 Senator Chafee. That is it. Have we accepted the  
10 amendment?

11 The Chairman. No, not quite.

12 Senator Moynihan. I have one question. In the language  
13 we have, which I think is compared to Treasury, it says that  
14 you grandfather all loans to residents of countries.

15 Does that include governments?

16 Mr. Mentz. Yes, it does, Senator.

17 Senator Moynihan. It does include governments?

18 Mr. Mentz. Absolutely. Incidentally, just to pick up  
19 on just a slight drafting point that Senator Chafee reminded  
20 me of, there may be some--I think Chairman Volcker wanted  
21 some slight limitation on the ability of moving from one  
22 country to another within the Baker 15. It is not a serious  
23 point, but I just wanted to make it on the record.

24 The Chairman. Is there objection to the adoption of  
25 the Chafee amendment?

1 (No response)

2 The Chairman. Adopted. Senator Baucus?

3 Senator Baucus. Mr. Chairman, I have an amendment which  
4 addresses the allocation of expense deductions among parents  
5 and domestic and foreign subsidiaries.

6 Under current law essentially, when a parent borrows  
7 the allocation of the interest expense between the foreign  
8 and domestic is allocated according to the assets, a portion  
9 of the assets of the subsidiaries, that is if 50 percent of  
10 the assets are foreign subs and 50 percent domestic, the  
11 allocation is 50/50.

12 This has been abused because some companies set up  
13 holding companies and because the holding company therefore  
14 is wholly held by the parent and because the parent at some  
15 times uses some of the funds for overseas companies, it  
16 voids the purpose of the asset portion rule.

17 Your proposal in your package, Mr. Chairman, essentially  
18 requires that the borrowing of a domestic sub be combined  
19 with a parent foreign and then allocated according to still  
20 the asset rule--the proportionate asset rule.

21 The problem with that is, as I see it, sometimes there  
22 is a domestic sub which borrows completely against its own  
23 credit and uses its own borrowings only for its own purposes;  
24 and it does not seem fair to attribute some of the interest  
25 expense deduction to a foreign sub in that situation when

1 obviously none of the funds from the loan go to that foreign  
2 sub.

3 I suggest therefore, as a way to try to correct the  
4 abuse under current law and also to help correct an unfairness  
5 that I perceive in your proposal, an amendment whereunder if  
6 a domestic sub borrows a certain amount and the parent also  
7 borrows, that the parent's borrowing then be allocated among  
8 its domestic and foreign subs in a way to equalize the  
9 borrowing among the subs and then back.

10 It is kind of a proportion asset test. That is the long  
11 and the short of it. It is not very precisely said, but I  
12 think I have stated the heart of it.

13 The staff can probably state it with more precision than  
14 have I, but it is a provision which I think is generally  
15 supported all the way around by groups that are affected by  
16 this provision in the Code.

17 The Chairman. Mr. Secretary, what do you think of it?

18 Mr. Mentz. I think it is ingenious. I also believe  
19 that it only loses \$200 million from the chairman's mark.  
20 Is that right?

21 Mr. Brockway. That is correct.

22 The Chairman. That is the smallest loss from the  
23 chairman's mark we have had in our mark-ups.

24 Mr. Mentz. Exactly.

25 (Laughter)

1 The Chairman. That is a major victory.

2 Mr. Mentz. That is right. I guess the only observation  
3 I would make, Mr. Chairman, is that while it seems that when  
4 one company acquires another and the other company has got  
5 all of its assets in the U.S. and it finances itself, it  
6 seems like there shouldn't be any difference in tax whether  
7 the acquiring company itself is solely domestic or whether  
8 the acquiring company has foreign operations.

9 And that is what your amendment, Senator Baucus, is  
10 really designed to achieve--that tax result, as I understand  
11 it.

12 And there is kind of a fairness to that which makes it  
13 hard to rebutt. The only thing I would say about it is that  
14 it does provide an incentive for U.S. companies to finance  
15 their operations in domestic subsidiaries to the extent that  
16 they can without parent borrowing.

17 If you can put as much borrowing down into your lower  
18 tier subs as possible, there will be advantage under the  
19 interest allocation.

20 Of course, the name of the game here is to allocate as  
21 little interest as possible to foreign income so you improve  
22 your foreign tax credit.

23 Senator Baucus. That is right.

24 Mr. Mentz. That is the point. I guess my bottom line,  
25 Senator Baucus, is that I applaud your ingenuity in coming

1 out with this equalization rule, which really brings it very  
2 close to the chairman's mark.

3 The only problem with it is that it is going to be  
4 hellishly difficult to administer, and I would suggest that  
5 we should have a rule that any member who votes for this  
6 should be on the committee to help write the regulations.

7 (Laughter)

8 The Chairman. Is there further comment on the Baucus  
9 amendment?

10 (No response)

11 The Chairman. Without objection, adopted. Other  
12 amendments?

13 Senator Chafee. Mr. Chairman?

14 The Chairman. Senator Chafee?

15 Senator Chafee. I would like to proceed to page 103  
16 to the five percent withholding tax which we have discussed  
17 so many times here. That is item 6 on page 103.

18 The Chairman. Let me make a suggestion. Having counted  
19 noses, I realize that there is relatively little support  
20 for the position I had for the five percent withholding;  
21 and I would be willing to accede to your amendment to  
22 simply strike it.

23 I know Treasury feels extraordinarily strongly about  
24 this. Secretary Mentz has talked with me at least three or  
25 four times on this subject alone.

1 Senator Grassley. Mr. Chairman?

2 The Chairman. Senator Grassley?

3 Senator Grassley. Now, did your proposal apply to the  
4 legislation that I discussed earlier on the taxation of  
5 capital gains on agricultural land that was sold--owned by  
6 foreigners and then sold? We were going to --

7 The Chairman. Are you talking about the --

8 Senator Grassley. Yes.

9 The Chairman. Not right here. That is another section  
10 Ms. Pearson. This is five percent withholding.

11 The Chairman. Right.

12 Ms. Pearson. On interest paid to foreigners.

13 The Chairman. It is the five percent withholding on  
14 interest payments for foreigners.

15 Any objection, Mr. Secretary, to adopting Senator  
16 Chafee's suggestion?

17 Mr. Mentz. You won't hear any from me, Mr. Chairman.

18 (Laughter)

19 The Chairman. Without objection. Further amendments?

20 Senator Danforth. Mr. Chairman, I will have one of  
21 about 30 seconds.

22 The Chairman. About 30 seconds, too?

23 Let's go back to a quick bond provision that Senator  
24 Baucus has already talked to me about. I think it is  
25 acceptable, isn't it, Mary Frances?



1 Ms. Pearson. Yes.

2 Senator Baucus. Mr. Chairman, actually there are two  
3 here. The first one is to actually help make some money.

4 It is addressed at the situation in Georgia where the  
5 Irish companies come in and I think are purchasing \$4.5  
6 million of development bonds for a dairy operation.

7 The problem obviously is that whole-herd dairy buy-out  
8 programs are costing the taxpayers about \$783 million, where  
9 we are buying dairy cows.

10 Now, here we are using taxpayers' funds to build up  
11 herds, and put more dairy cows back in the market through  
12 tax exempt financing.

13 It seems to me that, because a big problem in agriculture  
14 is its surplus, and that is certainly true in dairy, that it  
15 doesn't make sense at all for this vehicle to be used to  
16 finance these kinds of operations.

17 So, I propose a \$250,000 per issuer limit on depreciable  
18 agricultural property. I have talked it over with Senator  
19 Grassley, and he is I think in support of this.

20 In fact, he suggested the amount of \$250,000. The idea  
21 is that we can't let this vehicle be used to increase our  
22 surpluses when we go around spending Federal dollars to  
23 reduce the surplus.

24 The Chairman. Are cows depreciable agricultural  
25 property?

1 Senator Baucus. The breeding stock.

2 The Chairman. They are? Oh, all right. Senator  
3 Grassley?

4 Senator Grassley. Did you agree to the \$250,000?

5 Senator Baucus. Yes, right.

6 Senator Grassley. All right. Mr. Chairman, I discussed  
7 a little wrinkle that I would like to add to this, and this  
8 was originally suggested by Senator Kasten in an amendment  
9 that he has, that we deny the use--

10 So, I am proposing this as an amendment: to deny the  
11 use of revenue bonding for agricultural operations for  
12 people--well, I guess the way we say it is for foreigners--  
13 to prohibit foreigners to take advantage of the tax-exempt  
14 bonding to finance this.

15 Now, Senator Baucus would get at this indirectly by  
16 capping what they could, but one dairy operation in Georgia  
17 that we know about would use revenue bonding--it is based  
18 in Ireland, it is my understanding--it would set up ten  
19 2,000 cow operations.

20 That is two million cows.

21 Mr. Brockway. That is 20,000.

22 Senator Grassley. Yes, 20,000. How did I have that  
23 figured out?

24 (Laughter)

25 Senator Grassley. Anyway, it was getting into millions

1 of dollars--what it was costing the taxpayers, one way or  
2 the other.

3 At 7 percent interest, where the farmer is paying 13  
4 percent interest, where we are at this very time having a  
5 dairy buy-out--whole-herd buy-outs--to cut down on the  
6 surplus, you know we are plugging a hole in the dam at  
7 one point and we are opening it up at another, not for the  
8 benefit of American citizens but inviting foreign capital  
9 into this country to invest.

10 Now, that is a subsidy. If this whole operation in  
11 Georgia goes through, this is a subsidy of \$90.00 per cow.  
12 \$90.00 per cow.

13 So, I am asking to amend the prohibition that foreign  
14 investors can use tax-exempt bonds for agriculture situations  
15 like this and within the definition of what a farmer is,  
16 have it apply across the board.

17 So, I would be going further than Senator Baucus is  
18 for foreign investors, but I still agree with Senator Baucus  
19 that his proposal is getting at it partly by capping the  
20 depreciation.

21 Senator Matsunaga. What about the bulls? Do they get  
22 anything?

23 Senator Grassley. Pardon?

24 Senator Matsunaga. What about the bulls? Do they get  
25 anything?

1 Senator Grassley. They are indirectly producers of  
2 milk, I know.

3 (Laughter)

4 Senator Grassley. And depreciable, but they aren't a  
5 major problem.

6 (Laughter)

7 The Chairman. Discussion on the amendment to the  
8 Baucus amendment? Do you object to the amendment?

9 Senator Baucus. Actually, we are talking about two  
10 separate amendments. One, as I understand it, is only the  
11 \$250,000 cap. Second, as I understand it, Senator Grassley  
12 suggests a prohibition against foreigners or any --

13 Senator Grassley. Foreigners or anybody.

14 Senator Baucus. Exactly, and those are really two  
15 separate amendments. I don't see how the two can be  
16 combined.

17 The Chairman. Why don't we put the vote on his amendment  
18 and you offer yours, Chuck?

19 Senator Grassley. Yes.

20 The Chairman. Do you want to vote on yours?

21 Senator Baucus. Fine.

22 The Chairman. Those in favor of the Baucus amendment  
23 say "Aye."

24 (Chorus of ayes)

25 The Chairman. Opposed, "No."

1 (No response)

2 The Chairman. Adopted.

3 Senator Grassley. Now, then, I would put my amendment  
4 as a separate amendment?

5 The Chairman. And I want to ask Treasury on this one.  
6 Your amendment would be no industrial development bonds may  
7 be used by foreigners?

8 Senator Grassley. For agriculture.

9 The Chairman. For agriculture. All right.

10 Mr. Mentz. Senator Grassley, if a foreign investor set  
11 up a U.S. corporation and the U.S. corporation issued or was  
12 the beneficiary of IDB financing, would that be caught by  
13 your amendment? That is, wholly owned by a foreign person?

14 Senator Grassley. If it is in agriculture, yes.

15 Mr. Mentz. Yes. Well, I think, Mr. Chairman, that  
16 this is an amendment that would run into some treaty  
17 problems, certainly wherever we have treaties. Just about  
18 all our treaties have nondiscrimination provisions in them,  
19 and they would be violated by such a provision because a  
20 U.S. company owned by a U.S. person would not be limited and  
21 yet a U.S. company owned by a British investor, let's say,  
22 would be.

23 The Chairman. I think the point is probably well taken.

24 Senator Grassley. All right. Can I comment? I am  
25 not going to argue the treaty issue except to point out that

1 here we have Treasury speaking for the country as a whole  
2 in international tax treaty relations, saying that it is  
3 all right to have public policy in this country that is  
4 going to have the taxpayers of this country subsidize milk  
5 production \$90.00 per cow for this 20,000 cow operation in  
6 Georgia, financed by tax-exempt bonds, at the very time  
7 when we are trying to cut production--milk production--in  
8 this country by 25 percent through the sale of cows in a  
9 program that is costing hundreds of millions of dollars for  
10 the taxpayers of this country to slaughter dairy cows in  
11 this whole-herd buy-out program.

12 Now, it seems to me that, even though the Secretary may  
13 take a legitimate position as far as the tax treaties are  
14 concerned, we have got to end the inconsistency of the tax  
15 policy.

16 We have just a flood of excess dairy products on the  
17 market at a terrible expense to the taxpayers. We are trying  
18 to do something about it, and it seems to me like we ought  
19 to do it across the board, not just in one place.

20 The Chairman. Are you willing to withdraw the amendment?  
21 Or do you want to vote?

22 Senator Grassley. No. I want a vote on it.

23 The Chairman. You want a vote?

24 Senator Heinz. Senator Grassley, a question? Your point  
25 is that tax-exempt bonds should not be available for items

1 that are in or likely to be in surplus, such as dairy or  
2 feed grains or most agricultural commodities; and therefore,  
3 there shouldn't be any tax-exempt financing for any of  
4 those purposes, having to do with either agriculture or  
5 agribusiness?

6 Senator Grassley. For farming, we would deny through  
7 my amendment, the use of tax-exempt revenue bonds to finance  
8 farming operations by foreigners, whether or not it is in  
9 surplus or not.

10 Senator Heinz. Why just by foreigners? I am sorry;  
11 I misunderstood. I thought your argument was we have a  
12 surplus of a lot of agricultural commodities, and we certainly  
13 do.

14 And I misunderstood. I thought your argument was to  
15 the extent we have a surplus, we shouldn't make it any worse  
16 by having tax-exempt financing for anybody. But you just  
17 want to limit to --

18 Senator Grassley. The point is we are going to be taking  
19 care of, in other provisions of the law, things that should  
20 discourage overcapitalization in agriculture that we have  
21 right now.

22 And all that this tax-exempt financing is doing is  
23 further inviting capital into agriculture when it is not  
24 needed, and not in land, but in personal property and  
25 buildings and facilities and depreciable items.

1 The Chairman. Questions on the Grassley amendment?

2 Senator Matsunaga. Mr. Chairman?

3 The Chairman. Senator Matsunaga?

4 Senator Matsunaga. Will the offer of the amendment  
5 restate his amendment? I don't quite understand.

6 The Chairman. To prohibit industrial development bond  
7 financing for farmers in agriculture.

8 Senator Grassley. Foreigners.

9 The Chairman. Foreigners.

10 Senator Grassley. The use of them by foreigners.

11 The Chairman. By foreigners.

12 Senator Grassley. And I am giving you the example of  
13 ten 2,000 dairy operations in Georgia that will be set up  
14 by foreigners, in this case from Ireland, dairy operations  
15 which will be adding to the surplus that we are trying to  
16 reduce, you know, through another program.

17 So, we would deny the use by foreigners of tax-exempt  
18 bonding in agriculture.

19 Senator Chafee. Mr. Chairman?

20 The Chairman. Senator Chafee?

21 Senator Chafee. Mr. Chairman, it seems to me that this  
22 amendment presents a lot of problems. Not only does it  
23 present the treaty problems that Secretary Mentz pointed  
24 out, I don't think it accomplishes much in that it would  
25 permit Americans to go ahead and cause all the same surpluses



1 that are being discussed here.

2 It doesn't make any difference whether it is somebody  
3 from Ireland or somebody from Rhode Island that goes out  
4 and starts these ten herds of 2,000 each. And we have  
5 attempted to wrestle with this problem through the amendment  
6 that Senator Baucus proposed and was adopted.

7 And I think we are getting into heavy weather if we  
8 should adopt this one.

9 The Chairman. Treasury is opposed. The vote is on the  
10 Grassley amendment.

11 Those in favor say "Aye."

12 Senator Grassley. Call the roll, please.

13 The Chairman. Call the roll. The clerk will call the  
14 roll.

15 The Clerk. Mr. Dole?

16 (No response)

17 The Clerk. Mr. Roth?

18 (No response)

19 The Clerk. Mr. Danforth?

20 (No response)

21 The Clerk. Mr. Chafee?

22 Senator Chafee. No.

23 The Clerk. Mr. Heinz?

24 Senator Heinz. No.

25 The Clerk. Mr. Wallop?

1 (No response)  
2 The Clerk. Mr. Durenberger?  
3 (No response)  
4 The Clerk. Mr. Armstrong?  
5 (No response)  
6 The Clerk. Mr. Symms?  
7 (No response)  
8 The Clerk. Mr. Grassley?  
9 Senator Grassley. Aye.  
10 The Clerk. Mr. Long?  
11 (No response)  
12 The Clerk. Mr. Bentsen?  
13 Senator Bentsen. No.  
14 The Clerk. Mr. Matsunaga?  
15 Senator Matsunaga. No.  
16 The Clerk. Mr. Moynihan?  
17 Senator Moynihan. No.  
18 The Clerk. Mr. Baucus?  
19 Senator Baucus. Aye.  
20 The Clerk. Mr. Boren?  
21 (No response)  
22 The Clerk. Mr. Bradley?  
23 Senator Bradley. No.  
24 The Clerk. Mr. Mitchell?  
25 (No response)

1 The Clerk. Mr. Pryor?

2 Senator Grassley. Aye (by proxy).

3 The Clerk. Mr. Chairman?

4 The Chairman. No.

5 Danforth, "Aye." Mr. Mitchell, "No."

6 The Clerk. Four yeas; eight nays.

7 The Chairman. Four yeas and eight nays. No, six ayes  
8 and eight nays. The motion fails.

9 Let me recognize the Majority Leader out of order. He  
10 has an amendment, and he hopes he has a deal worked out  
11 on the floor that he would like to get back.

12 Any time he can get an arrangement on the floor that  
13 is going to work out, I want to let him get out and go back.

14 Senator Dole?

15 Senator Dole. We are having trouble getting anything  
16 up on the floor, in the event you have any bills you would  
17 like to bring up.

18 (Laughter)

19 Senator Dole. We have room for the tax bill this  
20 afternoon.

21 (Laughter)

22 Senator Dole. This amendment has been discussed, I  
23 think, with John or Dave Brockway. The chairman's package  
24 changes the rules that impose current U.S. tax on foreign  
25 based company income in certain situations.

1 Under the present law, there is a de minimus rule  
2 providing an exception if less than 10 percent of the  
3 foreign corporation's gross income is so-called tax haven  
4 income.

5 The chairman changes this 10 percent gross to 10 percent  
6 of net, and I agree that there is at least the potential  
7 for abuse under the present law; but I believe there may  
8 be a way to address this issue without forcing corporations  
9 to go through the administrative burden of allocating  
10 expenses between U.S. and foreign sources.

11 So, what I would propose, and I think the revenue impact  
12 is negligible, instead of basing the test on net income,  
13 we reduce the percentage of gross income to be eligible  
14 for this de minimus rule from 10 percent to 5 percent.

15 The Chairman. Mr. Brockway?

16 Mr. Brockway. Yes, Mr. Chairman. As the Majority  
17 Leader stated, under the proposal there is a shift in the  
18 rule for determining whether or not a foreign corporation's  
19 passive income will be treated as subpart (f) income  
20 currently subject to tax.

21 There is a de minimus rule right now that says unless  
22 10 percent of the income--the gross income--is passive, then  
23 you will treat it all as active income and none of it would  
24 be currently subject to tax.

25 Your proposal would look at it on a net basis and say

1 when 10 percent of the net income is passive because looking  
2 at gross, there is a certain potential to be able to  
3 manipulate the income somewhat.

4 Taxpayers have argued that looking at net is a more  
5 complex operation to do, and this is an approach to say  
6 rather than switch over to a net rule, say 5 percent of  
7 gross income.

8 Your provision would have picked up \$.2; this would  
9 reduce that pickup to \$.1.

10 The Chairman. It would lose about \$100 million?

11 Mr. Brockway. That is correct.

12 The Chairman. By going to the 5 percent gross rather  
13 than my net. Mr. Secretary?

14 Mr. Mentz. Mr. Chairman, let me just explain a little  
15 bit how this works, or how it can work in practice, or at  
16 least how the present law works.

17 I can recall setting up subsidiaries of a U.S. company.  
18 Let's say you set up a subsidiary in Switzerland, and it  
19 creates an Irish branch; and the Irish branch does  
20 manufacturing and gets a tax holiday in Ireland--a 10-year  
21 or 15-year tax holiday.

22 And the Irish branch has gross income, which is the sales  
23 less the cost of goods sold. In other words, the gross profit  
24 realized on the goods that are sold is gross income; and if  
25 that happens to be \$5 million, that permits a \$500,000 amount

1 of subpart (f) tax shelter income, as the Majority Leader  
2 stated, to basically come into the controlled foreign  
3 corporation without having current U.S. tax.

4 The basis of your proposal, as I understand it, is to  
5 basically avoid that result and take the expenses of that  
6 Irish branch operation and reduce that \$5 million to the  
7 net profit, whatever it is.

8 And if the net profit is only, let's say, \$1.5 million,  
9 then the rule would be that only \$150,000 of tax shelter  
10 income would be available before you start having to pick  
11 it up in the U.S. taxpayer.

12 Senator Dole's amendment would reduce the 10 to 5,  
13 which I think is certainly going in the right direction;  
14 but as a conceptual matter, it is a close one whether you  
15 want to go down to five and leave it on a gross basis, or  
16 whether you want to stick with 10 and go to a net basis.

17 But I think conceptually the ability to use that gross  
18 income as a shelter is a fairly easy opportunity for tax  
19 planning, particularly when it is manufacturing, to take  
20 advantage of.

21 And so, for that reason, I guess Treasury has some  
22 concerns about that amendment.

23 I want to make it clear we like it a lot better than  
24 the current law.

25 The Chairman. Further discussion?

1 (No response)

2 The Chairman. All those in favor of the amendment say  
3 "Aye."

4 (Chorus of ayes)

5 The Chairman. Opposed, "No."

6 (No response)

7 The Chairman. Adopted. All right. Let's take Senator  
8 Danforth and then Senator Bentsen; then Senator Moynihan  
9 and Senator Baucus.

10 Are you ready, Jack?

11 Senator Danforth. I wanted to wait for Senator Wallop  
12 to appear, on this domestic loss recapture provision and at  
13 least discuss it, and then we can offer it.

14 And I understand also that Senator Moynihan, I think,  
15 is going to offer one relating to foreign investment --

16 I will pass for now, if I can, Mr. Chairman, and wait  
17 for Senator Wallop.

18 The Chairman. Senator Bentsen, and then Senator  
19 Moynihan?

20 Senator Bentsen. Mr. Chairman, if I might, I have two  
21 that I think have been worked out with the staff, and I  
22 believe Treasury has no objection. One of them was the  
23 line of business test for the nondiscrimination rules on  
24 benefit plans.

25 And I believe Mr. Hardock has information concerning

1 that.

2 Mr. Hardock. The line of business test is a mechanical  
3 test and, basically, some industry groups have pointed out  
4 some problems that Treasury has conceived. There might be  
5 a way to fix that at this point, rather than make people  
6 go into the service and get an okay on it at that point.

7 So, it really is a slight broadening of the line of  
8 business test to say that a plan which covers 10 percent  
9 of the highly compensated employees will qualify.

10 It is aimed at situations where you have two completely  
11 disparate lines of business--Frito Lay and Taco Belle are  
12 one, and Burger King and Pillsbury are others.

13 And it is consistent with the rule the committee adopted  
14 yesterday.

15 Senator Bentsen. Frito Lay had discussed this, a  
16 constituent of mine. They said they had radically different  
17 types of businesses and therefore they were having a problem  
18 and thought it could be adjusted to the satisfaction of  
19 staff.

20 Mr. Colvin. Yes, Senator Bentsen. Excuse me.

21 The line of business rule is tightly drawn in the  
22 proposal as it stands now, and this provides a little more  
23 flexibility that will make the safe harbor available in  
24 more situations.

25 Mr. Mentz. I have no objection, Mr. Chairman.



1 The Chairman. Is there objection to the amendment?

2 (No response)

3 Senator Bentsen. Mr. Chairman, the other one is one  
4 that we have discussed, and I think we had approval yesterday  
5 but I don't believe we had a vote on it.

6 And that was the question of the 80/20 rule that we  
7 discussed at some length. I don't believe staff had an  
8 objection to that, nor did Treasury, to my understanding.  
9 Is that correct?

10 Ms. Pearson. That is true.

11 Mr. Mentz. That is correct.

12 The Chairman. Treasury? Is there objection?

13 Mr. Mentz. That is right. No objection.

14 The Chairman. Is there objection to the amendment?

15 (No response)

16 The Chairman. Senator Moynihan?

17 Senator Moynihan. Thank you, Mr. Chairman and Senator  
18 Danforth.

19 I would like to propose, and others might like to join  
20 me, just a modification of your proposed new rules for  
21 foreign investment companies. Barbara Groves has the  
22 details. I wonder if she could explain.

23 The Chairman. Go right ahead.

24 Senator Moynihan. Secretary Mentz will probably  
25 understand it; I don't claim to myself.

1 Ms. Groves. We will give it our best shot, Senator.

2 Under the foreign company investment amendment that  
3 Senator Moynihan is talking about, what would happen in  
4 case of a passive foreign investment company that a  
5 shareholder in that company wouldn't be taxed until they  
6 actually got a distribution or disposed of the shares in  
7 the company.

8 However, given the nature, you know, as a passive  
9 foreign investment company and the fact that they deferred  
10 tax on that, they would have to pay an interest charge to  
11 reflect the period over which tax had been deferred on  
12 that money.

13 Now, as a corollary to the rules, since they are  
14 accepting a direct charge for the fact that they deferred  
15 in substance an interest charge for that, they would be  
16 allowed to have some flow-through of capital gain character  
17 if they could show that there had been capital gains at  
18 the FIC level.

19 Senator Moynihan. The point is, Mr. Secretary, that if  
20 you defer paying taxes on the money, you ought to pay  
21 interest on the money deferred.

22 At the same time, if you have capital gains, you  
23 probably should have that treated as capital gains in the  
24 Tax Code.

25 The Chairman. Mr. Secretary?

1 Mr. Mentz. I think this is a good amendment, Mr.  
2 Chairman. It really deals with a U.S. investor who may  
3 invest in a foreign corporation, most of the stockholders  
4 of which are not U.S. and that corporation typically will  
5 be set up by a U.S. investment advisor.

6 It will be investing in U.S. securities. What it  
7 basically does is change current law so that there would  
8 be an interest charge on the taxes that would have been  
9 paid had there been income tax currently.

10 So, we support it.

11 The Chairman. Is there objection to the amendment?

12 (No response)

13 The Chairman. Without objection. Senator Baucus?

14 Senator Baucus. Mr. Chairman, I have an amendment  
15 on the bond section. Actually it is not an amendment. It  
16 is just an R&D subject going to the current language in  
17 the House bill, which I think is overly restrictive insofar  
18 as when it deals with conventional industry versus  
19 cooperative research, the House report language tends to  
20 imply that unless a very strict standard is met, that tax  
21 exempt financing for that facility would not qualify as a  
22 Government essential purpose.

23 I have worked out with staff the language which I  
24 think, if I understand it correctly, appropriately changes  
25 that language so it will more accurately reflect customer

1 usage so that the university coop R&D with private  
2 institutions does qualify in those situations where it  
3 should.

4 The Chairman. Mary Frances?

5 Ms. Pearson. Staff has looked this over, and it  
6 clarifies what we believe to be --

7 Senator Baucus. Pardon me?

8 Ms. Pearson. Staff has looked this over, and it  
9 clarifies what we believe to be the answer in research  
10 and universities.

11 Senator Baucus. I have got some language in front of  
12 me and, as I understand it, that is it. Thank you.

13 Senator Armstrong. What are we amending? The House  
14 committee report?

15 Senator Baucus. The House committee report which  
16 included language which would hopefully at conference  
17 override and supercede what the House has suggested.

18 Senator Armstrong. Mr. Chairman, that is fine with me.  
19 I don't know what we have done, but it is all right.

20 I would just like to say for the record that anybody  
21 at the Treasury or at the IRS or in a Federal court looks  
22 to proceedings like this or to committee reports for a  
23 declaration of Congressional intent is a fool.

24 I made a point one time when the Majority Leader was  
25 chairman and was managing a tax bill of asking him if he

1 had written the committee report; he admitted that he had  
2 not.

3 And I said, well, had he read the committee report; he  
4 admitted he had not. And I asked if any Senator had read  
5 the committee report, and he said he didn't know of anybody.

6 And the fact of the matter is that one of the greatest  
7 abuses, if we are really serious about tax simplification  
8 and reform, would be to make it plain that all of this  
9 mumbo-jumbo in the committee report was never before the  
10 committee or the Senate at the time this stuff was taken  
11 up; and yet, it frequently is, and as Max said, it is  
12 frequently taken as law.

13 And for the poor taxpayer out in the middle of nowhere  
14 who is trying to figure out what to do, that is a terrible  
15 abuse.

16 I don't address that to your proposal, which is  
17 undoubtedly just trying to fix up some problem created by  
18 the House to begin with.

19 Senator Baucus. In this situation, I think we have  
20 something which is far more definite and far more clear  
21 than most insofar as we have actual language. It is written  
22 on paper. Each word is there, and you can have a copy if  
23 you want.

24 And that will be in the report language. Compare that  
25 to most situations, for we all talk about amendments, in vague

1 loose terms about the direction we want to go; and then it  
2 is really up in the air.

3 Senator Armstrong. Fair enough, but you are going to  
4 be the only Senator who ever reads that committee report  
5 language, and nobody is going to vote on it.

6 I am not criticizing you. I am just saying that that  
7 illustrates the problem.

8 Mr. Mentz. Senator Baucus?

9 Senator Baucus. Yes?

10 Mr. Mentz. Is your amendment dealing with only basic  
11 research? Is that right?

12 Senator Baucus. That is correct. It is called basic  
13 and applied, but not product development.

14 Mr. Mentz. Basic and applied?

15 Senator Baucus. Research. General research as opposed  
16 to product development.

17 Mr. Mentz. Well, I wonder if it-- I can't say that I  
18 fully comprehend what your amendment does, but I wonder  
19 whether it should be limited to basic research and not  
20 applied.

21 Senator Baucus. That question has been presented to me,  
22 too.

23 Mr. Mentz. All right. I withdraw the objection.

24 Senator Baucus. All right. Thank you.

25 The Chairman. Senator Boren?

1 Senator Boren. Mr. Chairman, I had mentioned the other  
2 day two items. One is a situation where we have the foreign  
3 interest allocation. This is a problem of a potential  
4 transition rule.

5 It affects several companies that have restructured  
6 their companies recently, and I just wanted to raise a  
7 question as to whether or not we should treat that as a  
8 transition problem later on, or whether we need to bring  
9 that amendment up now.

10 Would you prefer to treat it as a transition --

11 The Chairman. Mary Frances?

12 Ms. Pearson. We would like to take it up as a  
13 transition rule.

14 Senator Boren. A transition rule? I just wanted to  
15 make sure we reserve that.

16 And then, I mentioned earlier in the week that Senator  
17 Zorinsky and Senator Exon had a bill to take care of a  
18 particular problem involving a corporate citizen of their  
19 State that had suffered expropriation of property, and I  
20 believe in Peru.

21 Senator Exon is here, and I think Senator Zorinsky is  
22 coming momentarily. Maybe we might want to call on them  
23 to explain.

24 The Chairman. Why don't we ask Senator Exon for a brief  
25 explanation. Is Treasury familiar with this?

1 Mr. Mentz. Yes, Mr. Chairman, we are.

2 The Chairman. Senator Exon?

3 Senator Exon. Thank you, Mr. Chairman. I am delighted  
4 to be here time in years, to this hectic Finance Committee.

5 I have heard about it. This is the first matter that  
6 I felt was important enough to my State to come over here  
7 and make a personal appeal for consideration favorably of  
8 the committee of the measure that has been offered by my  
9 friend from Oklahoma.

10 Just let me sum it up in this fashion, and my colleague,  
11 Senator Zorinsky, who was the lead Senator on this, first  
12 contacted by the company involved. He is here now. I want  
13 to support him fully.

14 He will fill you in on many of the details. Essentially,  
15 this is a situation that has come to the Internorth Company  
16 of Omaha, Nebraska, because of the seizure of assets--the  
17 illegal seizure of assets--of that company in Peru.

18 And what they are simply asking for is some consideration  
19 since they are not going to be fully compensated by the  
20 Government of Peru by this illegal seizure and since the  
21 Government of the United States has not taken a strong stand,  
22 for reasons best known to them, to recover this property.

23 All that they are asking for is the authority to write  
24 off a portion of the loss that they would otherwise sustain.  
25 And with those brief comments, I would hope that the chairman



1 would recognize my colleague, Senator Zorinsky, for further  
2 explanation.

3 The Chairman. Senator Zorinsky?

4 Senator Zorinsky. Thank you, Mr. Chairman. I think  
5 my colleague has just briefly outlined the problem and the  
6 concern quite well.

7 Even though the company has lost the \$400 million cash  
8 it invested since it acquired the Peruvian operation in  
9 1983, the existing tax rules seems to permit no relief at  
10 all whatsoever to the company.

11 And under the current Internal Revenue Code, the recovery  
12 for a foreign expropriation loss is generally limited to a  
13 taxpayer's basis in the property.

14 Therefore, this transaction was structured when they  
15 acquired the company in Peru in such a way that the buyer  
16 carried over the whole tax basis; and therefore, when the  
17 amount of any potential recovery for insurance or otherwise  
18 is netted out, the United States company would be permitted  
19 no deduction for tax purposes.

20 And moreover, at the time its assets were seized in  
21 the company, the company had already paid \$27 million in  
22 unused foreign tax receipts for taxes paid to Peru.

23 The Internal Revenue Code contains multiple limits on  
24 the use of these credits to offset taxes other than those  
25 generated by foreign oil and gas operations.

1 And since Peru was the company's only major foreign oil  
2 and gas operation, without some legislative relief there  
3 is little likelihood that the company would be able to  
4 utilize these unrecovered credits.

5 The legislative relief we are asking for would permit  
6 the company to claim an expropriation loss using as its  
7 basis for computation purposes the full value of its  
8 unrecovered investment and its Peruvian assets.

9 And this basis, of course, would be reduced by the  
10 amount of any potential recovery from Peru, and the amount  
11 of the loss claimed on this basis would be identical to the  
12 loss reported to the SEC on the company's form 10K.

13 The legislation would waive the limitations on the use  
14 of foreign tax credits to permit the company to utilize its  
15 unrecovered Peruvian tax credits against its domestic tax  
16 liability.

17 The company estimates that this relief would reduce  
18 revenues by around \$100 million over the next 10 years to  
19 the Federal Government.

20 The Chairman. Mr. Secretary?

21 Mr. Mentz. Mr. Chairman, this is an unfortunate  
22 situation. I express my sympathy to the corporation involved  
23 and to the members who have come here to explain it; but  
24 on behalf of Treasury, I would have to oppose both proposals.

25 On the foreign tax credit, let's understand what we

1 have here. We have foreign taxes paid to a foreign  
2 government that, under our general principles, are only  
3 available to the extent that there is foreign source  
4 income.

5 And the likelihood is there won't be any foreign source  
6 income, and what the proposal is is to use those foreign  
7 tax credits against U.S. income.

8 Well, that is exactly what the foreign tax credit  
9 limitation is in the Code to prevent, and the whole purpose  
10 of the foreign tax credit limitation is to prevent foreign  
11 credits to be used against tax, otherwise payable on U.S.  
12 income.

13 And the other side of it is, I am afraid, not much  
14 better. The amount of loss that the U.S. tax law permits  
15 is limited to basis, and it so happens that this corporation  
16 was apparently acquired in a way where they didn't get full  
17 basis in the assets.

18 But again, we don't have any notion in our tax system  
19 of allowing a loss that is equivalent to what is reported  
20 on Form 10K to the SEC.

21 We have a system that limits it to tax basis. I guess  
22 all I would say is that, to the extent that you allow any  
23 relief at all here, you are going directly against well  
24 entrenched principles that are pretty fundamental to the  
25 Internal Revenue Code.

1 Senator Bentsen. Mr. Chairman?

2 The Chairman. Senator Bentsen?

3 Senator Bentsen. I share this constituent in my State,  
4 and they talked to me, too. I think they have one point  
5 that certainly concerns me, that normally you would expect  
6 in this kind of an expropriation, which was a very unfair  
7 one.

8 You would have a very zealous pursuit of the objective  
9 of trying to get serious and adequate compensation and fair  
10 compensation by our own Government; and yet, in this instance,  
11 it has been quite apparent that our Government has not  
12 pushed on the issue.

13 And therefore, I am going to support the amendment by  
14 the Senator from Oklahoma.

15 Senator Boren. Mr. Chairman, if I might ask, I  
16 understand what the Secretary has said in terms of the  
17 principles involved.

18 As I have mentioned, I am offering this amendment as  
19 a courtesy to our colleagues from Nebraska. I think that  
20 Senator Bentsen has made a good point.

21 We have a sensitive political situation obviously--an  
22 international political situation--in which this company  
23 has found itself.

24 There is a recapture provision in the amendment that  
25 would allow that, if compensation were paid, and of course,

1 we would hope--and I know the company is trying to pursue  
2 it, and the Government to some degree is, although it is a  
3 very highly sensitive situation in that country at this  
4 time--that if there were compensation paid, there of course  
5 would be total recapture based upon that compensation of  
6 any benefit that is given to the company in the meantime.

7 If we could even--I am just thinking out loud--have the  
8 possibility to limit the proposal, if it might be in agreement  
9 with the Senators from Nebraska. We might at least try to  
10 do something on the basis situation.

11 I understand the comment that you made about the tax  
12 credit--the foreign tax credit--but since they did acquire it  
13 in a way in which they obviously planned their very  
14 significant gas and oil revenues and other revenues from  
15 their operations in Peru, and that was part of their  
16 agreement of their taking it in a manner which understated  
17 the basis.

18 In other words, they had a lot more cash invested in  
19 this project than the basis would be under tax law in  
20 anticipation of good relationship with that government down  
21 there and a continuation of it. So, we might attempt to do  
22 something constraining the cost as much as possible to the  
23 Treasury that would give them some relief, maybe on the  
24 basis side with the full recapture provision if there were  
25 compensation.

1           The Chairman. What do I understand the revenue loss  
2 on this is?

3           Mr. Brockway. It would be slightly more than \$100  
4 million.

5           The Chairman. For this one company?

6           Mr. Brockway. This one company.

7           Senator Bradley. Mr. Chairman?

8           Senator Bentsen. I recognize the problem that the  
9 Secretary is talking about from the accounting standpoint.

10          Frankly, I have been searching for some way to try to  
11 take care of what has been an unfair expropriation, where I  
12 don't see our Government really pursuing it. And it is  
13 difficult to try to find a way to adequately address it.

14          The Chairman. Senator Chafee and then Senator Bradley?

15          Senator Chafee. Mr. Chairman, this is clearly a  
16 troublesome situation, as we listen to it.

17          It seems to me it breaks down into two parts. One is  
18 the loss, not being able to be taken account of because of  
19 the zero basis; and the other is the tax credit.

20          There are two parts here, aren't there, Mr. Mentz?

21          Mr. Mentz. That is right.

22          Senator Chafee. But first, taking the absence of a  
23 basis on which one can compute--or the company can compute--  
24 its losses. Expropriation is nothing new to Americans. We  
25 have experienced it in Iran to a tremendous degree. I don't

1 know where else lately. I suppose even in Libya.

2 My question is: This isn't unique to this company, to  
3 have worked out something with a zero basis. I mean, they  
4 did it. They probably purchased the corporation rather than  
5 the assets, I presume, and that is how they had a zero basis  
6 in the assets; is that right?

7 Mr. Mentz. I think that is right. I am not familiar  
8 with all the details, but --

9 Senator Chafee. But however they did it, it is not  
10 unique. In other words, they made a plan; they came at it  
11 for certain reasons--tax reasons and other reasons--and thus  
12 ended up with a zero basis, which of course means that they  
13 can't depreciate anything, for example.

14 And it seems to me to treat them in a particular way  
15 because they come out with nothing--there must be a host of  
16 other companies in the past that have suffered this.

17 Now, I am not quite sure of the point that our country  
18 hasn't pursued the Peruvians and that that makes a difference.  
19 I don't know the foreign policy implications there well  
20 enough.

21 Presumably, we pursued in Iran and tried to get something  
22 for a settlement.

23 My principal point is that what has happened here I can  
24 only guess has happened many times before elsewhere; and if  
25 we are going to treat this company--and as I say, they make

1 a sympathetic story--then what about all the others?

2 Mr. Mentz. I guess that is pretty much precisely the  
3 way I feel. It is a sympathetic story, but it is very hard  
4 to completely go in the opposite direction of very  
5 fundamental rules of the Internal Revenue Code for one  
6 company.

7 The Chairman. I would add something further; and then  
8 I will recognize Senator Bradley.

9 We have a difficult enough time, to the public,  
10 explaining what the foreign tax credit is, anyway, and why  
11 companies are allowed to get it when they have overseas  
12 income.

13 If we are going to have any kind of Code at all, the  
14 public has to believe in it. And if we explain to them not  
15 only do they have no income, we are going to let them take  
16 their foreign tax credits against their U.S. income, I just  
17 think we are asking for a tremendous burden of explanation  
18 that is difficult to meet.

19 Senator Bradley?

20 Senator Bradley. Mr. Chairman, if I recall the situation  
21 just from reading about it and talking to people that were  
22 related to the action, there were really two companies that  
23 were involved.

24 One was Occidental and the other was Internorth; and  
25 when the Peruvian government took their action, Occidental



1 reached a settlement; Internorth did not reach a settlement.

2 And I think that there is a discussion at the present  
3 time between Internorth and its insurer.

4 My question is: Doesn't this put us right in the middle  
5 of that kind of discussion, and don't they qualify for  
6 insurance anyway at some point if there is an expropriation,  
7 if it is determined to be an expropriation?

8 And there are enough uncertainties in this matter for  
9 me that would say that we ought to at least delay it and look  
10 at it another time, and perhaps not even jump into the middle  
11 of a battle between a potentially expropriated property in  
12 legal terms and its insurer.

13 Senator Boren. Mr. Chairman, I understand what Senator  
14 Bradley is saying; and I don't honestly know whether  
15 Occidental was involved or other companies were involved.

16 I think there is also a very sensitive situation in  
17 Peru right now in terms of the timing of trying to reach any  
18 settlement.

19 I do think you have made the point about the tax credit  
20 very strongly. The two Senators from Nebraska want their  
21 conclusion, but perhaps we might try to limit the attempt.  
22 Put that aside. Set that aside, and try to limit it, in  
23 an attempt to do something with the problem that the actual  
24 cash out of hand was much greater than the basis. Try to  
25 approach it some way on that side of things.

1           Maybe we should try to work-- I have the same  
2 difficulty that Senator Bentsen has mentioned. I think we  
3 do have a problem; and I have listened to Mr. Mentz and he  
4 has made the point very, very well in terms of the principles,  
5 and yet we have some equities involved here that seem to me  
6 to be due some consideration.

7           Maybe we should defer and see if there is some way that  
8 we can work this out that would not violate the basic  
9 principles that we have tried to follow and set a bad  
10 precedent of some kind, and look into some of the questions  
11 that Senator Bradley has raised and come back to this later  
12 on in the considerations.

13           If there is some way that we can work this out, maybe  
14 it would be a way that would not be so troublesome to us.

15           Mr. Mentz. When did the expropriation take place,  
16 Senator Boren?

17           Ms. Groves. In 1985, sir.

18           Senator Boren. In late 1985, I believe.

19           Senator Symms. Has there been any effort by our State  
20 Department to get the money back?

21           Senator Bradley. I can only say that in visiting with  
22 the Ambassador, they are actively pursuing it. Now, how  
23 effective they are is another question.

24           Mr. Mentz. Typically, it will take a little longer than  
25 six or seven months.

1           The Chairman. I didn't realize that it was late 1985.  
2 I thought we were talking about an expropriation of several  
3 years ago or a decade ago.

4           I think under the circumstances, you have hardly had  
5 time to play out whether or not you are going to have any  
6 success in negotiations.

7           I think it would set a very bad precedent if we were  
8 to adopt this. I think if we were to vote on it, it would  
9 probably fail. I think we would be much wiser just to  
10 lay it aside for the moment.

11          Senator Boren. Mr. Chairman, I would have no objection  
12 to doing that at all, and perhaps we can also get a report  
13 from the State Department to us in terms of how they assess  
14 the situation, the likelihood of some action being taken.

15          And then, perhaps we can work--if they think it is a  
16 negative projection--perhaps we can then work to find some  
17 other method of dealing with this that would be in keeping  
18 with the principles we have followed in the past.

19          Mr. Mentz. I would like to say that I would like to  
20 know more facts. Let's see where the State Department  
21 stands. Hard cases can be made easier when you know more  
22 of the facts.

23          Senator Boren. I appreciate the courtesy and the time  
24 that have been shown to our colleagues from Nebraska, and I  
25 know that they --

1 The Chairman. Senator Zorinsky?

2 Senator Zorinsky. Mr. Chairman, I would just like to  
3 conclude by informing the committee that I have met with  
4 the Ambassador to Peru, and he indicates that not only could  
5 they not pay Internorth if they decided to arrive at a fair  
6 figure, they can't even pay the IMF.

7 In fact, they were up looking to see if I would support  
8 them in rolling over \$600 million or so for the interest  
9 for their IMF loans.

10 So, I think we have got real good chances of getting all  
11 this money right now.

12 (Laughter)

13 Senator Zorinsky. And secondly, I would like the people  
14 in the Treasury Department to look up the records of  
15 Internorth and the company is asking for this help because  
16 they are taxpayers, not tax evaders.

17 Compare what they pay in taxes with General Electric,  
18 and I think you will see that they are paying more than the  
19 fair share of corporate tax in this country historically.

20 And the Marxists down in Peru settled with Arm and Hammer  
21 that had to teach and show the Left in their country that  
22 they are supporting their own independence in penalizing an  
23 American company; and that is why they did settle with one  
24 company, but when they came to this one, they had to show  
25 their strength and their commitment to the Left. Otherwise,

1 they would have had political problems of their own.

2 So, I think there are a lot of things that go into this.

3 The Chairman. The amendment is withdrawn.

4 Senator Symms. But is it withdrawn without prejudice?

5 The Chairman. Oh, yes.

6 Senator Symms. I think they have made a good case  
7 personally.

8 The Chairman. Other amendments? Senator Bradley?

9 Senator Bradley. Mr. Chairman, I have an amendment  
10 that relates to the Virgin Islands mirror tax. It addresses  
11 only the local Virgin Islands tax.

12 Under current law, in effect in the Virgin Islands,  
13 the Virgin Islands is required to tax the worldwide income  
14 of Virgin Islands corporations at United States corporate  
15 rates and withhold tax at a 30 percent rate on Virgin Islands  
16 source income of foreign persons.

17 All this amendment would do would be to allow the Virgin  
18 Islands to reduce its Virgin Islands tax liability on non-U.S.  
19 source income earned by Virgin Islands entities.

20 It essentially puts it on the same playing field as  
21 Guam and Puerto Rico.

22 The Chairman. I am inclined to accept this amendment.  
23 Is there objection?

24 Senator Chafee. What page is this on?

25 The Chairman. The amendment is not in the book. Page 96.

1 Is there objection?

2 (No response)

3 The Chairman. Senator Long on Puerto Rico?

4 Senator Long. I believe that this matter we discussed  
5 about Section 936 funds being deposited in Puerto Rican  
6 banks has been cleared by the Treasury, and I think that--

7 I don't believe there is any problem here, except I  
8 think that we need to see if we can agree on it. Would  
9 Mr. Mentz report on that? Where do we stand on that?

10 Mr. Mentz. Yes, I would be glad to, Senator Long.

11 Senator Long was kind enough to offer an amendment that  
12 would expand the ability of the funds maintained by 936  
13 companies in Puerto Rico for use outside Puerto Rico within  
14 the Caribbean Basin.

15 Under the version of 936 as passed by the House, only  
16 funds of the Government Development Bank would be available  
17 for reloaning outside of Puerto Rico.

18 This amendment would permit commercial banks within  
19 Puerto Rico to effectively finance projects in the Caribbean  
20 Basin and infrastructure, and that would happen without any  
21 disqualification on the investing 936 company that invests  
22 its money with the bank.

23 It is simply a broadening of the means to use the 936  
24 funds for the Caribbean Basin, which is the fundamental point  
25 of the Governor.

1 The Chairman. You like the amendment?

2 Mr. Mentz. Yes, I do like the amendment.

3 When the judge agrees with you, stop talking.

4 The Chairman. That is right.

5 (Laughter)

6 The Chairman. Is there objection to the adoption of  
7 the amendment?

8 (No response)

9 The Chairman. Other amendments?

10 Ms. Pearson. Mr. Chairman?

11 The Chairman. Mary Frances?

12 Ms. Pearson. Yes. I am sorry, excuse me. I would  
13 like to make one clarification since we are on the Possessions  
14 On page 94, in the fourth column, we say same as the  
15 House bill, and there is some language following it.

16 I want to clarify that what we mean is that cost sharing  
17 is to be determined without respect to royalty payments.  
18 So, I would just like to clarify that point.

19 The Chairman. If that is the only clarification you  
20 have to make, Mary Frances, in this whole spreadsheet, that  
21 is excellent.

22 Ms. Pearson. Thank you.

23 (Laughter)

24 The Chairman. Senator Danforth? And then Senator  
25 Moynihan.

1 Senator Danforth. Mr. Chairman, I do want to raise  
2 this point, the question of domestic loss recapture.

3 And the situation where there is unfairness is when  
4 there is a foreign taxable income and a domestic loss.

5 Basically, the problem is that in the opposite of that  
6 situation, the Government wins; but when there is a domestic  
7 loss of foreign taxable income, the taxpayer doesn't win.

8 I wonder if Mr. Mentz could explain the problem.  
9 Yesterday, Mr. Mentz, you indicated that you agreed with  
10 the policy of trying to change this.

11 And I introduced a bill a few years ago that would have  
12 taken care of it. The question now is whether it is  
13 appropriate to do it in the context of this bill.

14 Could you explain in simple terms the situation?

15 Mr. Mentz. In one syllable or less?

16 Mr. Mentz. Right. I mean, with some examples as to  
17 what the situation is now and why it is not equitable?

18 Mr. Mentz. All right. I will try to, Senator Danforth.

19 If you take a case of a U.S. company that has in year  
20 one a domestic loss of \$500 and foreign income of \$1,000  
21 with an associated foreign tax credit of \$500--no, let's  
22 make the income the same: \$500 domestic loss, \$500 foreign  
23 income.

24 The domestic loss will offset the foreign income and  
25 the foreign tax credit will not be available for use in



1 year one.

2 Now, if in year two the only thing that happens is that  
3 there is domestic income of \$500, in year two that foreign  
4 tax credit will also not be creditable--will not be available  
5 --because there is no foreign source income.

6 And that result is anomalous, because if you would  
7 combine years one and two, you would see that you have  
8 neither gain nor loss in U.S. The \$550 loss in the first  
9 year offsets the \$500 gain in the second year; and all you  
10 have is the \$500 of foreign income, and the \$500 of foreign  
11 income would carry with it the foreign tax credit that  
12 would be available because you would have \$500 of foreign  
13 source income.

14 It is the reverse of that situation that was remedied  
15 in the 1976 Act, where recapture of foreign losses was  
16 created, but the other side, which is the pro-taxpayer side--

17 Senator Danforth. In other words, if the business  
18 is losing money abroad and making money at home, then the  
19 foreign tax credit isn't available. Is that correct?

20 Mr. Mentz. If it is losing money abroad and making  
21 money at home, typically in that particular case you probably  
22 won't be paying any foreign tax; but when it turns around,  
23 and the foreign business becomes profitable and there is  
24 foreign tax paid, that foreign tax credit generally won't  
25 be available under the 1976 amendment.

1           That is really sort of the other side of this issue.  
2           And that is a reasonable policy position because if the  
3           foreign country had a loss carryover rule, it shouldn't  
4           be applying any tax.

5           Since they are, the U.S. judgment was that it shouldn't  
6           come out of the U.S. Treasury; it ought to come out of the  
7           company.

8           You are suggesting the other side of it--the domestic  
9           side--which is the pro-taxpayer side.

10          Senator Danforth. Now, as a matter of policy, you  
11          would agree with this proposal, wouldn't you?

12          Mr. Mentz. I think as a matter of policy, the Treasury  
13          Department has been in agreement with it for some time. Is  
14          that right, Mr. Shay?

15          Mr. Shay. Yes.

16          Mr. Mentz. Yes. That is right.

17          Senator Danforth. However, it has a revenue effect of  
18          somewhere between \$1.7--a revenue loss of somewhere between  
19          \$1.7 and \$2 billion. Right? Over the five years?

20          Mr. Mentz. That is my understanding; and that is a  
21          little hard to swallow.

22          Senator Danforth. Right. Now, Mr. Chairman, I am not  
23          going to offer the amendment at this point because of the  
24          revenue loss; but it is, as recognized by Treasury, clearly  
25          an inequity.

1 Now, let me ask you this, Mr. Mentz. Can you figure  
2 out any way that we can, if not solve this problem, at  
3 least alleviate it somewhat, perhaps by picking up some  
4 revenue somewhere, making this situation a little bit  
5 better? What can we do creatively?

6 Mr. Mentz. I don't know that there is much that should  
7 be done with your overall domestic loss recapture rule.

8 Sure, you could make it so that five percent of the  
9 domestic income is resource foreign, and then it would have  
10 a tiny revenue impact; but it would also be fairly  
11 insignificant, and I don't think that is the way to do it.

12 I would prefer, and I would suggest, that we move  
13 along and see where we are; and if we get toward the end,  
14 there may be some reshuffling going on. And at that point,  
15 maybe we can find the revenue to do at least some of it.

16 Senator Danforth. I think that is kind of a rosy view  
17 of where we are going with revenue in the bill.

18 (Laughter)

19 Mr. Mentz. Oh, I have got to keep a rosy view, Senator.

20 (Laughter)

21 Senator Danforth. But I do appreciate it, and I did  
22 want to raise it. As I said, I will not offer the amendment  
23 at this time; but if you could figure out some way to solve  
24 the problem and pay for it, you know where to reach me.

25 The Chairman. Further amendments? Senator Moynihan. I

1 am sorry.

2 Senator Moynihan. Mr. Chairman, I don't have an  
3 amendment. I just have a comment. We are trying to work  
4 out with the staff an opportunity which comes but rarely to  
5 this committee to do justice to Franklin D. Roosevelt who,  
6 in 1931, established the New York State Power Authority;  
7 but when he became President, failed to get tax exemption  
8 for its bonds.

9 And it was an oversight on his part, but it is an  
10 opportunity to set history right in a small way at a small  
11 cost. We think we have something that we will be able to  
12 work out.

13 The Chairman. Further amendments? Senator Baucus?

14 Senator Baucus. Mr. Chairman, I have an amendment  
15 designed to help address the unfair situation as applies  
16 to domestic reinsurance companies.

17 Under current law, reinsurance companies in America  
18 insure basically property casualty insurance companies.  
19 About 72 percent of that reinsurance is American companies;  
20 about 27 percent are foreign companies who offer reinsurance  
21 policies in America.

22 The House bill raises the tax consequences to the basic  
23 insurance industry about \$6 billion over five years and  
24 raises the tax consequences to the reinsurance industry in  
25 the U.S. about \$1.2 billion over five years.

1 For not raising the consequences of the foreign  
2 companies, the House went from one percent to four percent,  
3 an equalizer or a sort of excise tax on foreign reinsurance  
4 industry offering reinsurance policies in America.

5 That is to equalize the increase in the tax that the  
6 House bill imposes.

7 The House bill, however, leaves open a loophole, and  
8 that is those companies that offer reinsurance policies in  
9 America that are subject to treaties.

10 It is my thought that because our bill--your bill, Mr.  
11 Chairman--also raises the taxation of insurance companies,  
12 particularly in this case reinsurance companies, about the  
13 same amount as does the House bill, which puts American  
14 reinsurance companies in a very unfair competitive position  
15 with foreigners who are not taxed.

16 The one percent equalized tax, or excise tax, should  
17 be raised to two percent. It doesn't go quite as high as  
18 the House bill. Also, that that two percent should apply  
19 to all foreign companies that offer reinsurance policies  
20 in America.

21 I understand that it is a little bit sensitive because  
22 there are tax treaties with other countries; but nevertheless,  
23 we do have a problem here.

24 And I don't think that, just because we have a treaty,  
25 that we can walk away from this. I think we have to deal

1 with it. And I do know that the U.K., contrary to the tax  
2 treaty that the U.S. has with the U.K., has passed  
3 legislation that is clearly in violation of the treaty.  
4 That, to me, doesn't show good faith on the part of the U.K.

5 To take care of this particular problem, I think, to  
6 be fair about it, we should not exempt Lloyds of London.  
7 We should not exempt the United Kingdom but should try to  
8 equalize the situation.

9 I really appeal to the committee on three levels. One  
10 is just fairness. What I am proposing I think is just fair.

11 Second, it raises money, compared with the present  
12 situation. That helps us a little bit.

13 And third, it helps improve our U.S. company competitive  
14 position. I don't think we should hurt American companies.

15 If we take your package, Mr. Chairman, and do not adopt  
16 my amendment, we in effect are hurting American reinsurance  
17 companies compared with current law, at least compared with  
18 the House bill.

19 So, it seems to me that we should at least address  
20 the situation.

21 The Chairman. It puts the Senate in a bit of an  
22 ambivalent position, though, because we ratified the  
23 treaties.

24 And then we say, oh well, despite the fact that not  
25 only did we negotiate them, but we in the Senate then

1 ratified them. We are now going to undo them by statute.

2 I am a little embarrassed to be in that position;  
3 but I might ask the Treasury's position on this.

4 Mr. Mentz. I think my views, or Treasury's views,  
5 reflect your own, Mr. Chairman. The override of treaties  
6 is a serious matter, and this one is really a direct override  
7 where treaties have been negotiated, one recently with  
8 Barbados and in the more distant past with the U.K. that  
9 actually bargained for exemption from this insurance  
10 excise tax.

11 And they made concessions, and they will actually trade  
12 to get this benefit. And for the U.K., it is very important  
13 because it is sort of the center of the insurance industry,  
14 that is, the offshore insurance industry.

15 And for that reason, I think this would be most  
16 unfortunate even if the Senate Finance Committee were to  
17 pass it. An override that is this flat, I think we could  
18 expect major problems with our trading partners.

19 By the way, on the U.K. legislation that you mentioned,  
20 Senator Baucus, I certainly am troubled with that, as are  
21 you. I would point out that it is not effective until the  
22 Chancellor of the Exchequer lays down a bill, which will  
23 not happen at the very earliest before January 1 of 1987.

24 But I agree with you that that is sort of the other  
25 side--the other treaty partner possibly walking away from

1 a treaty obligation.

2 I think it is very serious on either side.

3 Senator Baucus. Mr. Chairman, I think it is serious,  
4 but there are overrides and there are overrides. I think  
5 it would be more inappropriate for this committee to pass  
6 out legislation which overrides a treaty that puts U.S.  
7 companies at a competitive advantage compared with foreign  
8 companies, in this case the U.K.

9 There is something else to address in a potential  
10 override. We are trying to level the playing field. We  
11 are trying to make our companies be in a competitive  
12 position that is equal to the foreign companies.

13 The situation has changed dramatically since that  
14 treaty was written. What has changed? What has changed is  
15 that we are taxing the U.S. reinsurance industry at a much,  
16 much higher level today by this bill than we were when  
17 that treaty was written.

18 So, we are now putting our U.S. companies at a very  
19 unfair competitive position compared with the foreign  
20 companies. All I am saying is let's make it a level playing  
21 field. Let's make it fair.

22 Mr. Mentz.. I think the way to level it is to  
23 renegotiate the treaty, if that has happened.

24

25

(Continued on next page)



1 Senator Bradley. Mr. Chairman?

2 The Chairman. Senator Bradley?

3 Senator Bradley. Mr. Chairman, I will not go over the  
4 treaty question because I think that has already been aired;  
5 I think it is significant. I think there is another  
6 question. Here we are at a time where we are in a so-called  
7 liability crisis, a lack of coverage and skyrocketing  
8 premiums, and just at the time when we are in this crisis  
9 we are now saying that we want to impair U.S. companies'  
10 ability to increase their capacity by obtaining foreign  
11 reinsurance. The result is pressure on premiums and  
12 exacerbation of the present liability crisis. I have  
13 reservations about this and I would oppose it if it came up.  
14 I don't think we want to increase the problem with liability  
15 insurance.

16 Senator Baucus. Well, I might say the answer is to  
17 lower the taxation on American insurance companies, that is  
18 the answer. You want to propose we reduce the taxation of  
19 the domestic insurance industry, that would address your  
20 problem.

21 Senator Bradley. I wasn't aware that they were paying  
22 any tax.

23 (Laughter)

24 Senator Baucus. Under this bill, they will be paying  
25 tax and a lot more.

1 Senator Matsunaga. Mr. Chairman.

2 The Chairman. Senator Matsunaga.

3 Senator Matsunaga. Is the Senator's amendment limited  
4 to countries which do impose that tax on U.S. --

5 Senator Baucus. My amendment simply is to raise the  
6 excise tax from 1 percent to 2 percent. In fact, it doesn't  
7 even have to be raised.

8 Senator Matsunaga. Generally.

9 Senator Baucus. On foreign reinsurance companies that  
10 sell policies in the U.S.

11 Senator Matsunaga. Not just against UK.

12 Senator Baucus. That is correct. Just general, across  
13 the board. It is all foreign companies, not just the --

14 Senator Matsunaga. So you are punishing the other  
15 countries for what UK is doing.

16 Senator Baucus. No. I am trying to level the playing  
17 field so that American companies compete in the same  
18 situation, same playing field as foreign companies. That is  
19 all I am trying to do.

20 The Chairman. Well, unfortunately, I have to oppose  
21 my good friend Senator Baucus on this, and he and I work  
22 together on 90 percent of the things, but it isn't going to  
23 be just the UK. We have a treaty with what other country,  
24 also?

25 Mr. Mentz. France, Barbados. We have at least half a

1 dozen that have this provision.

2 The Chairman. I am willing to put it to a vote, but I  
3 am very -- I hope the Committee will turn it down.

4 Do you want to vote on it, Max?

5 Senator Baucus. I think we should vote on it, yes.

6 The Chairman. Those in favor of the Baucus amendment  
7 will say aye.

8 (No response)

9 The Chairman. Those opposed, no?

10 (A chorus of "noes.")

11 Senator Baucus. I would like a recorded vote,

12 Mr. Chairman.

13 The Chairman. Those in favor of the Baucus will respond  
14 as the Clerk calls the roll.

15 The Clerk. Mr. Dole.

16 Senator Dole. (No response)

17 The Clerk. Mr. Roth.

18 Mr. Roth. No.

19 The Clerk. Mr. Danforth.

20 Senator Danforth. No.

21 The Clerk. Mr. Chafee.

22 Senator Chafee. No.

23 The Clerk. Mr. Heinz.

24 Senator Heinz. (No response)

25 The Clerk. Mr. Wallop.

1 Senator Wallop. (No response)  
2 The Clerk. Mr. Durenberger.  
3 Senator Durenberger. (No response)  
4 The Clerk. Mr. Armstrong.  
5 Senator Armstrong. (No response)  
6 The Clerk. Mr. Symms.  
7 Senator Symms. (No response)  
8 The Clerk. Mr. Grassley.  
9 Senator Grassley. (No response)  
10 The Clerk. Mr. Long.  
11 Senator Long. Pass.  
12 The Clerk. Mr. Bentsen.  
13 Senator Bentsen. (No response)  
14 The Clerk. Mr. Matsunaga.  
15 Senator Matsunaga. No.  
16 The Clerk. Mr. Moynihan.  
17 Senator Moynihan. (No response)  
18 The Clerk. Mr. Baucus.  
19 Senator Baucus. Aye.  
20 The Clerk. Mr. Boren.  
21 Senator Boren. (No response)  
22 The Clerk. Mr. Bradley.  
23 Senator Bradley. No.  
24 The Clerk. Mr. Mitchell.  
25 Senator Mitchell. (No response)

1 The Clerk. Mr. Pryor.

2 Senator Pryor. (No response)

3 The Clerk. Mr. Chairman.

4 The Chairman. No, and Senator Durenberger, no. Oh,  
5 there he is.

6 Senator Heinz, no. Any other Senators wish to be  
7 recorded?

8 The Clerk. Three ayes, eight nays.

9 The Chairman. The amendment is defeated.

10 Senator Baucus. Mr. Chairman?

11 The Chairman. Senator Baucus.

12 Senator Baucus. Mr. Chairman, I wonder if I could ask  
13 what the Treasury's response would be if I were to offer the  
14 same amendment but with the following change; that is, that  
15 the increase in excise tax, let's leave it at 1 percent,  
16 but that it only goes into effect if a country passes  
17 legislation, like that which has passed the Parliament in  
18 the UK, which overrides the Treaty?

19 Mr. Mentz. Well, I would prefer not to support you on  
20 that, Senator Baucus. I would rather not escalate the  
21 disagreement that is at this point I think just a mild  
22 disagreement between the U.S. and the UK. I think we are  
23 well advised to not act and see if we cannot get our  
24 differences resolved. If they cannot be resolved, at that  
25 point I would be much more sympathetic to your amendment.

1 But at this point I think I would have to oppose it.

2 Senator Baucus. Okay. Mr. Chairman, I will not offer  
3 the amendment.

4 The Chairman. Are there further amendments?

5 (No response)

6 The Chairman. I have indicated that there will be a  
7 FIFRA amendment tomorrow. The sponsors are not ready today  
8 and we will take it up first thing tomorrow and then move  
9 on to the remainder -- not the remainder, the individual  
10 income tax sections, other than those that we have laid aside  
11 that we are not going to consider tomorrow. I will have for  
12 the Committee tomorrow the order of consideration next week.  
13 We will have excise taxes all day Monday. That is a long  
14 hearing. There are 29 or 30 witnesses, including a number  
15 of Senators, so we will start at 9:30 and my hunch is we will  
16 go to 9:30 or thereabouts. I have asked the witnesses very  
17 vehemently to hold themselves down to five minutes, including  
18 the Senators, but I know there is a lot of interest in this  
19 and I have a feeling there may be a lot of questions.

20 Tuesday we will start, the first item, Canadian-American  
21 free trade, and we will have whatever discussion we need and  
22 we will vote on it that day, and then I will have for you in  
23 the morning what we will consider Tuesday afternoon and for  
24 the remainder of the week.

25 Mr. Mentz. Mr. Chairman?

1 The Chairman. Mr. Secretary.

2 Mr. Mentz. Could I just preserve the opportunity to  
3 see if we can't improve with the staff the branch profits  
4 tax as it applies to interest? I think we have some  
5 technical problems with it. I think we may be able to work  
6 them out.

7 The Chairman. I understand you have and, as  
8 Senator Moynihan indicated, you hoped you could work that  
9 out.

10 Mr. Mentz. Oh, fine.

11 Senator Baucus. Mr. Chairman?

12 The Chairman. Senator Armstrong, then Senator Baucus.

13 Senator Armstrong. Mr. Chairman, I would just like to  
14 note that at some point I want to come back to the IDC  
15 issue; not tomorrow or any particular time, but some time  
16 before we finish up.

17 The Chairman. Senator Baucus, then Senator Heinz.

18 Senator Baucus. Mr. Chairman, I have an amendment that  
19 deals with the Section 911 exclusion. I mentioned it the  
20 other day. Essentially I think that American citizens  
21 living abroad contrary to an Executive order should not be  
22 entitled to a benefit of Section 911, \$80,000 exclusion. I  
23 am particularly talking about Libya. It seems to me that  
24 our tax policy should work in harmony with, not in opposition  
25 to, foreign policy. And if the President of the United States

1 issues an Executive order, as he has, that American citizens  
2 should not be conducting economic activity in certain  
3 countries, and if Americans are doing that contrary to the  
4 Executive order, I do not think they should be entitled to  
5 the Section 911 exclusion, and I offer an amendment which  
6 would deny such treatment to American citizens living abroad  
7 under those situations.

8 The Chairman. Any views, Mr. Secretary?

9 Mr. Mentz. It sounds like a reasonable position to  
10 me, Mr. Chairman.

11 Senator Durenberger. Mr. Chairman?

12 The Chairman. Senator Durenberger and then Senator  
13 Chafee.

14 Senator Durenberger. The thought occurs to me -- or just  
15 ask Max, maybe. This relates to the penalties on individuals.  
16 What are we going to do about American companies that are  
17 doing business in Libya or Angola, or some of these other  
18 countries we are making war on? Are we going to permit them  
19 access to the tax code for the profits of their operations?

20 Senator Baucus. Well, that is probably a situation  
21 that should also be addressed. I am only addressing the  
22 income tax, individual income tax treatment. It is not a  
23 penalty; just denying the \$80,000 exclusion which is presently  
24 in the law.

25 The Chairman. Discussion on the amendment?



1 Senator Chafee?

2 Senator Chafee. Mr. Chairman, as you recall, this is  
3 an amendment that I was deeply involved in several years ago  
4 and it seems to me that under the existing laws, the President  
5 definitely sets forth some countries that are specific in  
6 this area; for example, North Korea, Albania, certain  
7 countries out there that American's do not receive any tax  
8 treatment or favorable tax treatment in. Is that correct?  
9 In other words, I think we are talking two different lists,  
10 or maybe I am wrong. But I think there are certain countries  
11 that indeed you have to receive special permission to go to.  
12 Is that correct?

13 In other words, I am not opposed to what Senator Baucus  
14 is proposing here, but I think that, as I recall, there are  
15 certain countries that an American has to go through very  
16 special permissions to even go to and I am not sure that --

17 Senator Baucus. I think, if I understand the Senator, --

18 Senator Chafee. Is this the same group?

19 Senator Baucus. There is a group of countries listed  
20 by -- or subject to various residential Executive Orders, but  
21 I think on that list those are only countries where the  
22 President has prohibited Americans from conducting economic  
23 activity. I don't think that that list in any way addresses  
24 the tax consequences. My amendment is addressing the tax  
25 consequences; that is, that the Section 911 exclusion would

1 not apply to Americans living in those countries.

2 The Chairman. Senator Long.

3 Senator Long. Mr. Chairman, there is merit to the  
4 amendment, but I am not sure that the amendment considers  
5 all the different problems that we probably ought to think  
6 about. For example, let's just take the network. I would  
7 assume that the situation being the way it is between the  
8 United States and Libya right now, for example, that if those  
9 networks can, they are going to try to get some person that  
10 understands the United States' position and can report to  
11 the United States on what is going on in Libya. And we have  
12 heard it. We have just heard -- you know, you turn on the TV  
13 and there's this fellow speaking from a hotel room. He is  
14 there at considerable risk, but they have to do it; the  
15 network will pay the tax to have him there. They want  
16 someone to report what the situation is. And although what  
17 they did to us and what we did to them can be regarded as an  
18 act of war, we still have not declared war, and I suspect  
19 that you are going to find that there are varying  
20 circumstances.

21 I really would like to hope that between the time we  
22 finalize this that we would have taken into account a lot  
23 of things that don't quite meet the eye. So that I would  
24 hope that we, for example, would invite the State Department  
25 to comment on it and offer their suggestions.

1 Has this been passed by the State Department, by the  
2 way, Senator?

3 Senator Baucus. I'm sorry?

4 Senator Long. Has the State Department passed judgment  
5 on this matter?

6 Senator Baucus. Not that I am aware of. But I might  
7 say to the Senator that I have in front of me a copy of the  
8 Executive Order that applies to Libya that does exempt media.

9 Senator Long. It exempts the media.

10 Senator Baucus. That is correct.

11 Senator Long. Do you exempt the media from your  
12 amendment?

13 Senator Baucus. Yes. My amendment only applies insofar  
14 as the Executive Order applies to American citizens.

15 Senator Long. Well, I would just like to ask, and I am  
16 willing to go along with this with the understanding that  
17 we would ask the State Department to please give us their  
18 reaction to it. I just don't know what --

19 Senator Chafee. Well, I would like to do the same,  
20 Mr. Chairman, because -- is it necessary to vote on this now?  
21 I mean, it seems to me we can take it up again and it is a  
22 very brief matter, rather than trying to reverse gears, if  
23 we should like to later. Is there any chance, Max, of just  
24 postponing this and looking at it? I realize you brought it  
25 up --

1 Senator Baucus. Why don't we just accept it now with  
2 the understanding that we can come back and address it later?

3 (Laughter)

4 Senator Bradley. Mr. Chairman?

5 The Chairman. Senator Bradley.

6 Senator Bradley. As we are thinking about whether we  
7 want to delay this amendment for further consideration, let  
8 me suggest that I am thinking about offering an amendment to  
9 expand. If you deny 911 for, in this case, Libya, maybe  
10 what we should do is expand it and deny it for all those  
11 countries that participate in international boycott. That  
12 list of countries is right there under the provisions of  
13 the foreign tax credit, and I think that that might be the  
14 next amendment that we would consider after this one.

15 Maybe we want to delay both of them.

16 Senator Chafee. I am more enthusiastic about the delay  
17 as we go along here.

18 (Laughter)

19 The Chairman. What do you want to do, Max?

20 Senator Baucus. Well, Mr. Chairman, I suggest that we  
21 vote on it. Here we are. We might as well act on it.

22 The Chairman. Those in favor --

23 Senator Baucus. And I also think that because it is a  
24 little bit unclear in the minds of some Senators, that this  
25 certainly is an amendment, a provision, that if it is

1 included, we can revisit again at a later date.

2 Senator Long. Mr. Chairman, I would really like to note  
3 that in view of the fact that theoretically at least the  
4 State Department speaks for the President. Theoretically;  
5 it might not be true, but we are supposed to believe that,  
6 and I would really like to know if --

7 Senator Chafee. They certainly do on trade matters.

8 (Laughter)

9 Senator Long. So I would like to know whether the  
10 State Department finds any problem with the amendment. If  
11 they don't find any problem with it, I am glad to vote for  
12 the amendment. But I do think that this is something where  
13 State ought to know better than Treasury, so I would like to  
14 suggest that we at least ask for their reaction, what their  
15 thoughts are about the matter before we vote on it, just  
16 because they are entitled to know. But that shows my good  
17 judgment. So I would like --

18 Senator Baucus. Mr. Chairman, I will show my good  
19 judgment and I will offer it later, at a later date.

20 The Chairman. The Senator from Montana will withhold  
21 on his amendment for the moment.

22 Senator Heinz.

23 Senator Heinz. Mr. Chairman, I have three small items  
24 that I think require clarification by staff. The first is,  
25 it is my understanding that we have at least staff agreement

1 on an amendment to treat previously-taxed Subpart F income to  
2 be passed through a foreign trust to retain its character  
3 as previously-taxed income. Is that agreed to? I see the  
4 staff signifying yes.

5 Ms. Pearson. That is correct.

6 Mr. Mentz. No, it is not.

7 Mr. Brockway. I think at the staff level, the committee  
8 staff level, joint committee staff level, I think there is  
9 some agreement, but I think in Treasury there is a problem  
10 with that.

11 The Chairman. Mr. Secretary.

12 Mr. Mentz. I think in order to do that you are  
13 basically changing the trust rules. This is a complicated  
14 problem, but fundamentally we have a set of rules as to how  
15 income flows through a trust. And, if I understand the  
16 amendment correctly, it would basically treat the trust the  
17 same as a corporation and flow through previously-taxed  
18 income -- that is income that is taxed from a foreign  
19 subsidiary -- first, even though that is not the way our  
20 trust rules would ordinarily -- ordinarily do work. I guess  
21 I just have a reservation about -- I have not seen the  
22 amendment, I have not seen the text of it. I just have some  
23 concern about making what could be a change in our rules of  
24 trust taxation.

25 Senator Heinz. Mr. Mentz, would you please take a look

1 Mr. Mentz. Sure.

2 Senator Heinz. -- at the amendment, and if you have  
3 some problems with it, let us know if you think there is a  
4 better way of handling the problem.

5 Mr. Mentz. Okay.

6 (Pause)

7 Mr. Mentz. Let me see if we can't work it out,  
8 Senator Heinz, I think we can.

9 The Chairman. I would hope --

10 Senator Heinz. It is my understanding that somebody  
11 on your staff has looked at it and had signed off on it.

12 The Chairman. John, let me ask you this, if I might.

13 Senator Heinz. All right. Let's pass that one over --

14 The Chairman. I have no objection to overriding  
15 Treasury if they have had a chance to see it and they have  
16 made their case and we say, "No, we're going to override you,  
17 anyway." But if he thinks he hasn't had a chance to see it,  
18 I think it would be wise to wait.

19 Senator Heinz. Yes, I agree with you, Mr. Chairman.

20 I have a second question. This has to do with the  
21 interest to allocation rules. It is my understanding that  
22 for the interest allocations rules, that additions to  
23 insurance reserves will not be treated as interest. Is that  
24 correct?

25 Ms. Pearson. That is correct.

1 Senator Heinz. I thank you, Mr. Chairman.

2 Lastly, this has to do with the problem that I brought  
3 up, oh, several days ago regarding income from satellite  
4 or other income, the AT&T problem. We have, as I understand  
5 it, a 50/50 allocation rule for --

6 The Chairman. I think that would be a fair solution to  
7 that problem, if you would be willing to accept 50/50.

8 Senator Heinz. We do use the 50/50 rule in a similar  
9 instance, and I forget what it is. It is in the spreadsheet.

10 Ms. Pearson. Transportation, Senator.

11 Senator Heinz. Yes, for shipping. Would there be any  
12 objection, Mr. Chairman, to treating a non-U.S. source to  
13 income, as I have just described it, to the 50/50 rule?

14 The Chairman. I think in this particular situation it  
15 is probably a wise conclusion, because when you are talking  
16 about satellite transmission and the thing is fixed in the  
17 sky and who knows over whose land it is, a 50/50 allocation  
18 would be fair.

19 Senator Heinz. Very well.

20 The Chairman. Anything else to be -- Senator Baucus.

21 Senator Baucus. Mr. Chairman, my amendment deals  
22 with the Montana company that is trying to be a good citizen  
23 both in the United States and still follow Subpart F. And  
24 Barbara Groves can explain --

25 The Chairman. I think it is a fair amendment. I hope



1 Treasury is aware of it and is willing to accede to it.

2 Senator Baucus. I don't know that they are.

3 Ms. Groves. It has been given to Treasury, I think.

4 Senator Baucus. Excuse me?

5 Mr. Chairman. It is a \$4 million amendment --

6 Senator Baucus. Yes, it is \$4 million.

7 Mr. Chairman. -- in a very equitable case.

8 Senator Long. Would you explain the amendment so that  
9 I could --

10 Senator Baucus. Barbara can.

11 The Chairman. Barbara?

12 Ms. Groves. Yes. The situation is that a subsidiary  
13 of a Montana company was going into a mining venture in  
14 Brazil with some other interests and is doing an active  
15 participation, but because of some Brazilian restrictions,  
16 primarily banking and financial restrictions, instead of  
17 doing it as a partnership, they had to do it through a  
18 corporation. Because of the way Subpart F works in the Code  
19 and since they are getting their money back from working the  
20 mine in the form of dividends, because they don't own 50  
21 percent or more of the corporation, because there are more  
22 than two partners in it, those are not related party dividends.  
23 If they were related party dividends, they would be excepted  
24 under what is called a same country exception. Because they  
25 are unrelated, they don't. It basically boils down to if

1 they had done it in a partnership, they wouldn't have a  
2 problem, but they were forced to do it through a corporation.

3 The Chairman. That makes sense to me.

4 Mr. Mentz. So how does it work?

5 Ms. Groves. The amendment would work that to the  
6 extent the dividends from the corporation were attributable  
7 to the mining venture, then they would get the same  
8 Subpart F exception as has been, you know, related parties,  
9 same country dividends.

10 Mr. Mentz. Okay, Christmas only comes once a year.

11 The Chairman. Well, you offset it against the  
12 hobgoblin factor and it works out evenly.

13 Is there objection? Senator Symms?

14 Senator Symms. No objection. I wanted to bring up  
15 another issue.

16 The Chairman. Is there objection?

17 (No response)

18 The Chairman. Adopted.

19 Senator Symms?

20 Senator Symms. Mr. Chairman, I have two issues that I  
21 want to bring up, and I think one of them Senator Long and  
22 Wallop and Senator Baucus talked about it the other day, and  
23 I just asked the question was there ever an amendment that  
24 took care of the problem of companies that have in-country --  
25 domestic companies -- well, Mobile, Montgomery Ward,

1 specifically. Did that get taken care of?

2 The Chairman. That got taken care of earlier today.

3 Senator Symms. Earlier today.

4 The Chairman. Yes. There is a Baucus amendment.

5 Senator Symms. Okay, thank. I hope I got recorded as  
6 yes on that.

7 The Chairman. It was, as I recall, accepted by voice  
8 vote, wasn't it?

9 Senator Baucus. It was voice vote.

10 The Chairman. Yes.

11 Senator Symms. The other question that I raised the  
12 other day, and I want the staff to explain this to me, and  
13 that is the question has been brought to my attention about  
14 the changing the way foreign shipping companies are taxed  
15 with respect to whether the resident -- where the resident  
16 lives or where the flag is flown. Would someone please  
17 explain that to me, how it impacts? I have been told that  
18 it is going to be very difficult to administer the way the  
19 Chairman's draft is and the way the House Bill is.

20 Mr. Brockway. Under present law there is a reciprocal  
21 exemption from tax if the country where the ship is registered  
22 exempts U.S. shipping from tax. So that you could have a  
23 ship registered in a country that exempts U.S. shipping from  
24 tax but is owned by residents of a third country where there  
25 is not an exemption from tax.

1 Under the Chairman's proposal, in the case of shipping  
2 income, you look at the resident of -- the residence of the  
3 owners of the ship, not where the ship is registered. So  
4 using a flag of convenience, so called, would not be  
5 sufficient. The country where the owners of the ship, or,  
6 if it was a holding company, the owners of that holding  
7 company, resided would have to exempt U.S. shipping from tax  
8 in order to qualify for the exemption from U.S. tax.

9 Senator Symms. What happens if you have a consortium  
10 that own the ship and they come from three different countries  
11 and it is by the flag in a fourth country?

12 Mr. Brockway. You aggregate all the shareholders. You  
13 look and see whether more than 75 percent of them are from  
14 good countries, countries that exempt U.S. shipping, as it  
15 were. And if they are from treaty countries where they  
16 exempt U.S. shipping, then they would be -- they would  
17 qualify for the exemption; if they were not, they would not.

18 Senator Symms. Well, is Treasury going to comment on  
19 that? Is that something that -- that sounds very complicated  
20 to me. Is there some big abuse taking place and, if so,  
21 where is the abuse?

22 Mr. Mentz. Yes, we do agree with that, Senator Symms,  
23 and --

24 Senator Symms. You agree with what they are trying to  
25 do?

1 Mr. Mentz. Yes.

2 Mr. Brockway. Well, this is the administration proposal.

3 Mr. Mentz. Indeed, it was the President's proposal.

4 There is sort of a flag of convenience practice in the  
5 shipping industry where it basically works to the  
6 disadvantage of the U.S. Treasury because there is a  
7 reciprocal -- there may be a reciprocal agreement with the  
8 country where the ship is registered and technically under  
9 our law that provides the exemption, and yet the true owner  
10 is not -- doesn't have anything to do with that jurisdiction.  
11 And so we are not getting any reciprocal advantage. I mean,  
12 the idea of a reciprocal agreement is we get something and  
13 they get something. In other words, it is like a treaty,  
14 really, it is like a small treaty, and this simply puts it  
15 on the level of the two real parties in interest, the person  
16 who owns the ship, not just the flag of convenience.

17 Senator Symms. Well, now about if a -- how would this  
18 impact on U.S. residents that would own ships and fly them  
19 in the flag of another country?

20 Mr. Brockway. Under the House Bill, a U.S. owner of,  
21 let's say, a Liberian corporation or Panamanian corporation,  
22 typical flag of convenience, would be counted as from a  
23 country where the flag of convenience. But one of the things  
24 in the House Bill is that the income of that foreign  
25 subsidiary, in effect, would be currently taxed in the

1 United States, in any event. So that is why it was treated  
2 as from a good country.

3 Now, that other provision is not in the Senate Bill,  
4 but I think the same rule would apply. So, therefore, if  
5 you had a U.S. shareholder of a flag of convenience  
6 corporation, that would still qualify for the reciprocal  
7 exemption.

8 Senator Symms. Well, I guess the other question that  
9 I want to finally get to is what countries are abusing this?  
10 Where is the abuse coming from that brought this on? I was  
11 told Pakistan and India, is that correct?

12 Mr. Shay. Senator, those are two countries that impose  
13 gross taxes on U.S. shippers.

14 Senator Symms. They impose them on U.S. shippers.

15 Mr. Shay. On U.S. shippers, and that is really --

16 Senator Symms. So that is a one-way street. Most of  
17 our shipping goes there and then they tax our people, is that  
18 it?

19 Mr. Shay. That is correct. But in terms of the flag  
20 of convenience issue, my understanding is that the most  
21 heavily used flag is Liberia and most of the owners of ships  
22 registered in Liberia we do not understand are Liberian.  
23 They are from other countries, and some of them are from  
24 countries that would not exempt tax on American shipping.  
25 It is really illustrative of the point the Secretary is making.

1 Senator Symms. I guess what I am trying to get at is  
2 if there is an abuse, is there any abuse, say, with the  
3 shipping between some of the Northern European-owned ships,  
4 like Sweden, Norway and so forth?

5 Mr. Shay. I don't have facts as to the number of ships  
6 that are registered in those countries, but certainly the  
7 residents of those countries are exempted by virtue of the  
8 tax treaties which we do have with most of the Northern  
9 European countries. And U.S. taxpayers are also exempted  
10 from their taxes under the same treaties. This would -- so  
11 they are served duplication of coverage in that case.

12 Senator Symms. How long has the current law been  
13 operating that we now use?

14 Mr. Shay. How long --

15 Senator Symms. I mean, the way we do it now, by using  
16 the flag of convenience. What I want to know is how long  
17 has that been a law?

18 Mr. Brockway. For I think as long as any of us have  
19 memories.

20 Senator Symms. Well, okay, that is what I understood.  
21 But what I want to know is what is the revenue difference  
22 going to be? That is, I guess, what the question is I should  
23 have asked sooner. What is the revenue change that you are  
24 seeking for this change of the methodology of the --

25 Mr. Brockway. Well, unfortunately, Senator, since we

1 don't have that item broken out, there is a whole set of items  
2 dealing with shipping in the proposal, and the aggregate we  
3 were saying 600 million. As to what this particular piece  
4 would be, I am not -- well, I am not sure.

5 Senator Symms. Well, Mr. Chairman, I am not prepared  
6 to offer an amendment or anything on this. I guess what I  
7 would like to do is to have a meeting with some of you that  
8 understand this a little better. I have been told there is  
9 a real problem with this to some of our countries that are  
10 not abusive and are not -- and do have reciprocal agreements  
11 with us, and that it is going to cause a complication for  
12 Treasury that they have not anticipated yet on trying to  
13 establish the residence and so forth needlessly. And when  
14 there are two or three places in the world where we have a  
15 problem, and this is kind of a broad-brush approach, and I  
16 would just like to have you all examine it and maybe we could  
17 talk about it another day.

18 The Chairman. That's fine.

19 Senator Symms. Okay. And then, Mr. Chairman, we were  
20 going to revisit this foreign tax credit before we get  
21 through?

22 The Chairman. Which foreign tax credit?

23 Senator Symms. I mean the foreign tax and the allocation  
24 of interest, some of these issues? Are you considering that  
25 we are done with this forever?



1           The Chairman. Well, nothing is forever, but we did it  
2 off the Baucus amendment, if you mean the allocation.

3           Senator Symms. That is one. There are a couple of  
4 other issues that I am not prepared to offer an amendment on  
5 now, but I still want to examine it, just keep the thing open.

6           The Chairman. I do not plan to come back to it tomorrow.  
7 The only one we are going to come back to tomorrow is the  
8 FIFRA if those who want to change it want to bring it up.  
9 Short of that, I want to go on to the individual issues  
10 tomorrow and this will be one of those. If you have one to  
11 bring up, we will get into a catchall session.

12           Senator Symms. Well, this would be a catchall type.

13           The Chairman. All right.

14           Senator Symms. Okay, thank you.

15           The Chairman. Anything else?

16           (No response)

17           The Chairman. We are in adjournment until 9:30  
18 tomorrow.

19           (Recess at 4:09 p.m. to reconvene at 9:30 a.m. on  
20 Friday, April 18, 1986.)

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## 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 Committee Meeting of the United States Senate  
4 Finance Committee, held on April 17, 1986, were transcribed  
5 as herein appears and that this is the original transcript  
6 thereof.

7  
8   
9 WILLIAM J. MOFFITT  
10 Official Court Reporter

11 My Commission expires April 14, 1989.  
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April 16, 1986

Foreign Investment Company Proposal

- Require that any U.S. shareholder of a foreign passive investment vehicle (without regard to U.S. control or the degree of his ownership) pay a tax whenever he receives a dividend from the PFIC or disposes of shares in the PFIC, the tax being computed as follows:
  - Any gain on the disposition of shares in a PFIC would be treated in its entirety as a distribution of the PFIC's earnings and profits. The distribution would be deemed to consist of earnings and profits allocated on a pro rata basis to each of the taxable years of the PFIC during which the shareholder held the stock. There would be imposed on that part of the distribution which is allocated to prior years' earnings and profits a tax and an interest charge which reflect the value of deferral of the tax liability (e.g., possibly using, to some extent, the model for accumulation distributions from trusts).
  - Actual distributions from the PFIC would be similarly taxed.

IF can show CGs at Corporal line

Shareholders taxed under these rules would ~~not~~ be entitled to any flow-through of the capital gain character of any of the PFIC's earnings and profits which consisted of capital gains. ~~on disposition~~

~~As an alternative to the above rules, U.S. shareholders of PFICs could elect to be taxed on the actual earnings and profits of the PFIC under principles similar to those which apply to U.S. shareholders of controlled foreign corporations under Subpart F. In that event:~~

SH could elect

Such shareholders would be currently taxed on their share of the actual earnings and profits of the PFIC.

~~Alternatively, such shareholders could elect to defer payment of their tax liability until such time as they receive a dividend carrying out such earnings and profits or dispose of their shares, triggering a deemed distribution of any remaining earnings and profits. There would be no gain limitation on such deemed distribution. Shareholders who elect to defer payment of their tax liability under this approach would be liable for an interest charge which reflects the value of the deferral to them.~~

Shareholders who elect to come under either of these

Subpart F-type rules (i.e., who compute their share of actual earnings and profits and pay a tax either currently or on a deferred basis with an interest charge) would be entitled to flow-through capital gain treatment with respect to that portion of the actual earnings and profits which such shareholders could demonstrate consisted of capital gains.



# Tax-free bonds: Friend or foe for farmers?

■ As a source of low-cost money, industrial development bonds have been like a godsend to many young farmers. But in south Georgia this winter, dairymen see them more as a scourge.

The difference is, this time the Macon County, Ga., Industrial Development Authority is lending tax-exempt money to Masstock International, an Irish firm. They intend to build 10 or more 2,000-cow dairies that will compete directly with established dairymen.

"When I first heard about it, I didn't mind too much because I thought I could compete with them," Jack Smith of Houston County, Ga., told FARM JOURNAL. "Now that I've heard they're doing it with tax-free financing, I do object. The only way a new producer can get into an established market like ours is by lowering the price, and they'll be doing it with tax-exempt money!"

Smith isn't the only one who objects. "I've never seen Georgia farmers rally around anything like this," says Harold Gay, vice president of Dairymen, Inc., the Louisville-based co-op.

"Here we are with 30% overcapacity and facing a whole-herd buyout to get our supplies in line, and they're going to flood us with new milk."

**Why encourage many farmers to expand when our elevators and warehouses are already bulging?**

Listen to Ron Bailey, who heads up the Illinois Industrial Development Authority, which has 1,800 loans out to young farmers through an aggie bond program: "We're just trying to help good, young farmers get a start. Look, the farm operators in this country are aging; we need to be helping their replacements.

"We couldn't make a loan like that in Georgia," Bailey continues. "One of our requirements is that the borrower must be a citizen of Illinois."

John Gamble, coordinator of Alabama's development program, credits their aggie bonds with rescuing part of their poultry industry after a heavy storm collapsed a number of houses.

"Many of them would not have rebuilt without this money," says Gamble. "The demand is heavy. We have a number of new catfish units nearing completion, too."

Although the law authorizing aggie bonds does not target them for young farmers, most state development authorities are using the funds that way. Morris Reynolds of Nebraska's Investment Finance Authority says the average age of their borrowers is 29 and their average net worth is \$100,000.

**Some Georgians see big benefits from their Masstock project using industrial development bonds.** They claim it will bring 800 jobs to Macon and surrounding counties. The owners intend to contract with local farmers to grow the hay and silage they need and supply the replacement heifers.

"We see this as a response to a changing market," says Helen Garr of the Macon County Development Authority. "We realize that dairying is in a state of flux and feel that this project can't

hurt or save a sluggish ag economy. We've approached this cautiously. We went to the dairymen and asked for their ideas."

Rural areas are as entitled to tax-free funds for development as are urban areas where so many billions have been spent. The differences are:

(1) The new dairies simply aren't needed—if they were, we wouldn't be supporting milk prices or trying to cut back on surpluses;

(2) The lost taxes are an unnecessary drain on the Treasury. If the Southeast represents such a promising market for new milk, the Masstock people ought to be willing to build it with their own money—not the government's; and

(3) Tax-free bonds give an unfair advantage to a big corporation, enabling them to crowd out more of the very farms we are trying to save.

The Georgia developers claim that everything they are doing is legal. We didn't even bother to find out, because if it is legal, then it's the duty of Congress to make it illegal—SOON. ◀

## Farm program's fiasco

■ The nation's farmers are used to late farm program announcements. But this year's mass confusion and chaos were a cynic's worst nightmare. Take the whole-herd dairy buyout: USDA pressured the nation's dairy producers to submit bids to terminate their lifetime businesses—before the agency published the program's final rules.

Last October, John Block promised to announce 1986 farm program details within days of the farm bill's passage. But the former Agriculture Secretary left office Feb. 14 without revealing details, and so did two of his successors.

USDA's lack of leadership is only partly responsible. The Administration deliberately postponed signup until March 1 to bring 1986 farm programs under the Gramm-Rudman ax. An ear-

lier date would have exempted 1986 crops as Congress intended when writing the deficit reduction act.

Naturally Congress shares a large part of the blame, too, for this year's fiasco. Legislators took nearly two years to craft the 1985 farm bill that became law in late December. Then farm-state congressmen broke out in partisan bickering when rewriting major portions of the bill in February and March.

Farmers were ill-served by Senate Republicans' attempt to fashion a bill single-handedly. It only provoked weeks of delay tactics by Iowa Sen. Tom Harkin and other Democrats who hope to use farm policy as a campaign crusade. If this experience teaches us anything, it is that gamesmanship in farm politics serves no one. ◀

BAUCUS AMENDMENT-INTEREST ALLOCATION

SEN. BAUCUS

4/17

\* As a general rule, a U.S. corporation would be required to take into account only its assets (including the assets of any of its subsidiaries) in allocating its interest deductions between U.S. sources and foreign sources.

\* Once it is determined which assets are to be taken into account, the allocation would be made according to the rules set forth in the Chairman's proposal.

\* If an upper-tier corporation (e.g., the U.S. parent) also had borrowings, its interest deductions would be allocated first to equalize borrowing among the group, with the remainder being allocated to all assets (including the U.S. borrowing subsidiary) on a pro rata basis.

\* If an upper-tier corporation (e.g., the U.S. parent corporation) participated in the U.S. corporation's borrowing (e.g., by guaranteeing the loan or otherwise lending its credit), then the borrowing would be treated as being made by the other corporation.

\* Rules would be provided to prevent a U.S. subsidiary from retaining its interest deductions (without group allocation) to the extent it made the borrowed funds available to other members of the group. For example--(1) if the U.S. corporation paid dividends in excess of its historic level (measured on a 5-year moving average), the excess dividends would carry out borrowed amounts and (2) if the U.S. corporation dealt with group members at less than arms' length, borrowed amounts would be carried out. In addition, Treasury would be given broad regulatory authority to address other instances in which the U.S. corporation, through non-arms' length transactions, might afford use of borrowed amounts to other group members.

4/15/86

Amended Treasury Transition Rule Proposal for Withholding  
Taxes on Cross-Border Loans

Modify the Chairman's proposed transitional rule as follows:

1. Grandfather all loans to residents of countries not subject to the Baker Initiative outstanding on November 16, 1985 for a period of 10 years beginning with the effective date of the new rule (January 1, 1986 in the House bill; January 1, 1987 in the Senate spreadsheet).
2. With respect to loans to residents of the 15 countries subject to the Baker Initiative only, permit loans to be rolled over, rescheduled, restructured, or otherwise rearranged among borrowers resident in the 15 countries on a lender-by-lender basis so long as the total amount of foreign taxes creditable on an annual basis with respect to such loans held by a given lender does not exceed the dollar amount creditable with respect to loans held by such lender on November 16, 1985. (N.B. this limit is based on credits available with respect to existing loans, not the principal amounts of such loans.)
3. Increase the dollar amount of the overall lender-by-lender limitation in Paragraph 2 above by 3 percent per annum for a period of three years beginning with the effective date of the new rule. Adjust this limitation to take into account movements in market interest rates (i.e. if rates increase, the limitation will increase and vice versa).
4. Thereafter, subject loans to the Baker Initiative countries to the same rule applicable to other loans from day one (i.e. grandfather interest paid on continuing loans but treat any rollover, restructuring, or rescheduling after the three year period as a new loan subject to the new separate basket limitation to the extent such a change would be treated as a new loan under current law). Provide permanent grandfather treatment for existing Baker Initiative loans and for new or restructured loans to residents of the Baker Initiative countries entered into during the three year transition period.

5. Provide a special per country "floor" to limit the benefits derived from any excess grandfathered credit generated by sale or transfer (but not repayment) of existing loans to residents of the Baker Initiative countries (i.e., a lender will not be able to derive benefits from credits relating to loans outstanding on November 16, 1985 to residents of one Baker Initiative country if such loans are sold and replaced by loans to a second Baker Initiative country).

Under the proposed transitional rule a lender to the 15 countries can do whatever it likes with respect to existing loans, including increasing the principal amounts of such loans and switching loans among residents of the 15 countries (subject to paragraph 5 above) so long as the lender does not exceed the credit limitations described in paragraphs 2, 3, and 4 above. In effect, lenders to the 15 countries will be given 3 years from the effective date to rearrange their affairs in that group of countries before the separate basket rule will apply to new loans. Note that this rule should give the 15 countries an incentive to reduce their withholding rates during the transition period in order to attract new loans (e.g. everything else being equal, if a country with high withholding taxes cuts its withholding rate by one half, existing lenders will be able to double the principal balances of their outstanding loans without running afoul of the limitations described above).



Baker Initiative Countries

Argentina  
Brazil  
Chile  
Mexico  
Nigeria  
Philippines  
Venezuela  
Bolivia  
Colombia  
Ecuador  
Ivory Coast  
Peru  
Uruguay  
Yugoslavia  
Morocco

POSSIBLE MODIFICATION TO THE TAX-EXEMPT BOND PROVISIONS

Adopt the Chairman's proposal with the following modifications:

1. Increase the 10% use and security interest test to 25%.
2. Place multifamily housing bonds outside the IDB volume cap.
3. Student loan bonds are expanded to include supplemental loans.
4. Rebate penalties will be modified to provide as follows: A 100% penalty will be imposed on the issuer of bonds if it fails to rebate as required. The penalty may be waived in whole or in part by the Secretary of the Treasury if the Secretary finds that the issuer did not willfully disregard the rebate rules. The issuer has six months in which to cure any defect. If the issuer fails to cure defects and pay the penalty within six months after notification from the Department of the Treasury of such defect, then the bonds will become

taxable. (This is a clarification of the proposed modification offered on April 15.)

5. The following are added to the category of tax-exempt IDB's subject to a volume cap:
  - a. District heating and cooling facilities
  - b. Hazardous waste facilities.
6. Clarify that the "safe harbor rules" for purposes of airports, docks and wharves electing outside the volume cap is as follows: "leases not more than 80% of the facility's useful life with no option in the lease to buy the facility at less than fair market value."
7. Require that the Treasury SLGS program, as modified by the Chairman's proposal, be in place as of January 1, 1987.
8. As under current law, each state's volume limitation is allocated one-half to State issuers and one-half to local governments within the state on the basis of relative populations unless the state adopts a statute providing a different allocation. Clarify that the Governor

of each State is permitted to issue a proclamation overriding the Federal rules prior to State legislation allocating the volume limitation.

9. Minimum size requirement for designated blighted area would be reduced from 15 to 10 contiguous acres.
10. Hazardous waste facilities and solid waste facilities issued under the IDB volume cap would be eligible to claim depreciation over a recovery period of 8 years.\*
11. There will be an exception from the rule restricting the term of the bonds to no more than 120 percent of the economic life of the property financed for bonds issued in equipment "pooled" financing arrangements, but it will be limited to loans made to individual organizations by the pool to 120 percent of the economic life of the property financed.
12. The Chairman's proposal continues the present-law rule allowing costs of bond insurance to be recovered from arbitrage profits if the costs do

not exceed interest rate savings resulting from the insurance. The proposed modification would expand this exception to letters of credit, provided the letters of credit were purchased pursuant to competitive bidding.

All other provisions in the Chairman's proposal are adopted without change. Those provisions include:

1. the present law volume caps, and
2. the Chairman's arbitrage and advance refunding rules.

\* Depreciation for IDB financed multifamily housing will be deferred until the Committee considers the proposed credit for low income rental housing.

(TED-0233)