1 EXECUTIVE COMMITTEE MEETING

2 BUDGET RECONCILIATION LEGISLATION

3 WEDNESDAY, OCTOBER 18, 1995

4 U.S. Senate,

5 Committee on Finance,

6 Washington, DC.

7 The meeting was convened, pursuant to notice, at
8 10:30 a.m., in Room SD-215, Dirksen Senate Office
9 Building, Hon. William V. Roth, Jr., Chairman of the
10 Committee, presiding.

11 Also present: Senators Dole, Chafee, Grassley,
12 Hatch, Simpson, Pressler, D'Amato, Murkowski, Nickles,
13 Gramm, Moynihan, Baucus, Bradley, Pryor, Rockefeller,
14 Breaux, Conrad, and Graham.

15 Also present: Lindy Paull, Staff Director and
16 Chief Counsel; Joseph Gale, Minority Staff Director
17 and Chief Counsel; Leslie Samuels, Assistant Secretary
18 for Tax Policy, Department of the Treasury; Ken Kies,
19 Staff Director, Joint Committee on Taxation: Mark
20 Prater, Chief Tax Counsel; Doug Fisher, Tax Counsel;
21 Thomas J. Roesser, Tax Counsel; and Jon Talisman,
22 Chief Tax Counsel, Minority.

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1 The Chairman. The Committee will come to order.
2 First, I would like to welcome our new member, Senator
3 Gramm, to what is his first meeting of the Finance
4 Committee.
5 Phil, I think ----
6 Senator Gramm. Thank you, Bill.
7 I think you all agree with me, it is well worthwhile,
8 the wait to get on the committee, particularly to be here
9 for the purposes of a tax cut, certainly better than
10 being here when we were debating tax increases which I
11 see, Mr. Chairman, that now the President says he made a
12 mistake on it and it is your fault.
13 The Chairman. Well, I was just going to call
14 attention to the article of ---- where Clinton says ----
15 said yesterday, "I might surprise you to know that I
16 think I raised them too much, too."
17 I think we can all agree that the President did
18 indeed raise taxes too much. And we are here today, of
19 course, to give a tax cut to all Americans. That is the
20 purpose of this meeting today.
21 Senator Moynihan. Mr. Chairman, I take the
22 opportunity to welcome Senator Gramm. It could be said
23 that this committee has needed an economist for a long
24 while. And I believe you will be the first professional
25 economist ever to serve on the Finance.

1 And we certainly welcome you, sir.
2 And I would like to say that, having said that, I'd
3 like to take a side issue with what your ---- not your
4 account, but about what the President says.
5 Both of you said, Dr. Gramm and you, Mr. Chairman,
6 that the President said he made a mistake; he raised
7 taxes too much.
8 Mr. Chairman, he did not raise taxes. This committee
9 raised taxes. And this Chairman saw to it that it did.
10 And we did the right thing.
11 What you say at a fund raiser at Texas is not the
12 responsibility of this committee.
13 I will have occasion to say earlier on that $500
14 billion, as the Secretary of Treasury has testified,
15 produced a fiscal dividend of another $100 billion. That
16 is the first time we brought the deficit of this country
17 down.
18 It was at $290 billion when we took that legislation.
19 We brought it down to, this year it will be,
20 approximately $170 billion.
21 We put ourselves on a path of economic recovery that
22 has not been seen. I believe we are now in the fifty-
23 fifth month of a recovery. We have essentially full
24 employment and an inflation rate of approximately 2
25 percent.

1 The President may, in retrospect, think he made a
2 mistake. I am here to say that I think we did the right
3 thing. I am increasingly persuaded we did the right
4 thing when people in election say we did the wrong thing.
5 Thank you, Mr. Chairman.
6 The Chairman. Well, thank you, Pat.
7 [Laughter]
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1 OPENING STATEMENT OF THE HONORABLE WILLIAM V. ROTH, JR.,
2 A U.S. SENATOR FROM DELAWARE
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4 The Chairman. Just let me say this that as far as I
5 am concerned, we are here to reduce taxes for the purpose
6 of creating growth.
7 Sometimes, I think people forget the importance of
8 creating an environment of growth, jobs, and opportunity.
9 And that is what we are seeking to do here, first of all,
10 to take steps that will give a tax break to the American
11 family. And over 60 percent of our tax reductions helps
12 strengthen the family. I think that is critically
13 important as a goal.
14 The second largest item is, of course, to promote
15 investment growth, and as I say, jobs.
16 Seventy percent of our tax cuts for individuals will
17 go to Americans earning less than $75,000 a year. Most
18 families with children under age 18 will get a $500 per
19 child tax cut. And I am talking about a permanent tax
20 cut every single year.
21 Since the average American family has two children,
22 most families will end up with an extra $1,000 in their
23 pocket, instead of sending it to Washington.
24 Now, we have heard a lot about how married couples
25 are penalized by the tax code because they pay more taxes

1 as a couple than if they had never married. And our plan
2 would go a long way to fix this.
3 Over 40 percent of the married couples, now that is
4 23 million couples, will see their marriage penalty
5 eliminated over the next decade.
6 And we have included a tax credit for interest on
7 college loans. I congratulate you, Senator Grassley, on
8 this proposal.
9 And for the first time ---- and this is something I
10 fought for way back when we first approved of IRAs was
11 giving homemakers a full individual retirement account.
12 They deserve it. They are working Americans. As I said,
13 I have supported this for a long time.
14 And I want to thank K. Bailey Hutchinson and Barbara
15 McKulski for their tireless efforts to remedy this
16 inequity.
17 As I have indicated, we also cut taxes on savings and
18 investment. Our national savings, especially personal
19 savings, have tragically continued on a downward path for
20 several decades.
21 Most economists believe saving is the most important
22 factor for promoting economic growth, productivity, and
23 job creation. And let's not forget the impact of higher
24 economic growth on the Federal budget.
25 According to CBO, a one-half of a percent GDP growth

1 will increase Federal revenues by $267 billion over seven
2 years. This would more than offset our tax cut plan.
3 One percent GDP growth will increase Federal revenues by
4 $534 billion over seven years.
5 Our plan enhances saving and investment by first
6 cutting taxes on capital gains for individuals by 50
7 percent by restoring the pre-1986 capital gains rate for
8 corporations, 28 percent; and giving special incentives
9 to encourage venture capital or high-risk investment.
10 And Senator Hatch has indeed worked hard on this.
11 Expanding IRAs by gradually increasing the income
12 limits on deductible IRAs and creating a new IRA-plus
13 account, what is sometimes referred to as back-loaded
14 IRA. IRAs are the most popular savings account we have
15 ever had, aside from our homes.
16 And then, we also provide for a new simple pension
17 plan for small employers with less than 100 workers. I
18 would like to compliment Senator Dole on this proposal
19 which provides small businesses and their workers with a
20 viable way to save for retirement.
21 Health care, our tax cuts are also aimed at fostering
22 personal responsibility in health care. A new medical
23 savings account is created so that Americans who chose
24 this option can exercise more control over their health
25 care dollar and be smarter health care consumers.

1 Long-term carrier insurance is given favorable tax
2 treatment, just like medical insurance now enjoys, to
3 encourage Americans to think ahead and ensure against a
4 prolonged illness.
5 And our tax plan contains much needed estate tax
6 relief for family businesses suffering the loss of an
7 owner.
8 How many times ---- how many times have we heard from
9 a son and daughter who want to continue to run their
10 family's business after a parent dies, but can't because
11 have they to pay the estate taxes?
12 Once again, I applaud Bob Dole for his proposal to
13 protect families from this inequity.
14 I hope my colleagues on the other side of the aisle
15 will take a close look at our tax cut plan. As I said,
16 it is good for middle income families. It is good for
17 jobs and economic growth. It is good for our country.
18 Now, before I turn it over to Senator Moynihan for
19 his opening remarks, I would like to thank a few members
20 off the committee whose advice was extremely helpful, and
21 then go over our schedule for today.
22 I want to thank Larry Craig, Rod Graham, and Spence
23 Abraham for their guidance on structuring the $500 tax
24 credit for junior.
25 And likewise, I want to compliment Senators Lott and

1 Craig on their thoughtful comments on temporary versus
2 permanent tax cuts.
3 I am particular grateful to Senators Smith and Chafee
4 who have been frankly laboring long and hard to reshape
5 the Superfund Program.
6 And although Senator Smith had hoped that we would
7 not extend any Superfund taxes until his reforms are
8 enacted, he was willing to work with us. And we were
9 able to reach a compromise.
10 In response to Senator Smith's concern, the Superfund
11 AMT tax was extended for only two years to ensure that
12 funds that will be available to offset relief from
13 retroactive reliability and comprehensive Superfund
14 legislation. So I once more thank Senators Smith and
15 Chafee for their cooperation.
16 Now, as to today's schedule, it is my understanding
17 that a Democratic Senator has objected to the Finance
18 Committee meeting beyond two hours after the Senate
19 begins today's session.
20 The Senate starts at noon. So we will meet for an
21 initial period from now until 2:00 p.m. As a result, I
22 do ask our members to limit their opening statements to
23 five minutes.
24 Then, following the opening statements, the staff
25 will walk through the proposals.

1 Then, later this afternoon when the Senate recesses,
2 unless, Pat, we can come to some kind of a mutual
3 agreement which I still have hopes that we can, if that
4 does not happen, then I plan to resume the mark-up to
5 consider amendments. The time on amendments will be
6 limited to 10 minutes equally divided, as we did at the
7 last session.
8 I would hope we could work out an orderly procedure
9 for amendments. In my letter to each of you, I did ask
10 that amendments be filed with Lindy by 5:00 p.m. on
11 Tuesday. However, we have received amendments from only
12 six members.
13 I don't know. Pat, do you have any additional
14 amendments to be offered at this time?
15 Senator Moynihan. There are about 40 I would think.
16 The Chairman. Well, what I would like to do ----
17 Senator Moynihan. Not necessarily are going to be
18 offered.
19 The Chairman. I would like to give everyone the
20 opportunity to offer their amendments. Therefore, I will
21 extend the time for filing until 4:00 p.m. today. So
22 that gives everybody that opportunity.
23 Senator Moynihan. That is a fair amount point, Mr.
24 Chairman. 4:00 o'clock today, we will have them.
25 The Chairman. Now, I understand that some members

1 would like to add international trade provisions to the
2 budget reconciliation bill, but I strongly urge you to
3 refrain from doing so.
4 There are, I agree, a number of trade issues that
5 deserve our attention on the near term. And I intend to
6 take them up--I call this to your attention, Pat--as soon
7 as possible on the international area.
8 As I said, I think there are a number of issues that
9 deserve our attention in the near future. And I intend
10 to ----
11 Senator Moynihan. I think that is entirely correct,
12 sir.
13 The Chairman. These issues include, of course,
14 Senator Dole's WTO's Sovereign Commission, extension of a
15 generalized system of preferences, approval of most
16 favored Nation status for Bulgaria and Cambodia.
17 Senator Breaux, I understand that you are interested
18 in a full committee hearing on the OECD ship building
19 subsidy agreement.
20 Senator Graham, I understand that you are anxious to
21 have the committee consider legislation to provide NAFTA
22 equivalent trade benefits to the Caribbean basin
23 initiative for products which are currently excluded from
24 the coverage under the CBI program.
25 So once we get this reconciliation through

1 conference, as I said, I would hope the committee would
2 take a careful look at each of these issues.
3 As I said, the committee will reconvene when the
4 Senate recesses this afternoon. And we will work late in
5 the evening tonight. If at all possible, I do want to
6 complete the mark up today.
7 And finally, I would like to ask consent for Senator
8 Dole to change his vote on an amendment at our last mark-
9 up. The amendment is Senator Chafee's Medicaid memo on
10 pregnant women, children, and disabled. Without
11 objection, it is ----
12 Senator Chafee. That won't change the result?
13 The Chairman. No, that won't.
14 Without objection, it is so agreed.
15 It is now my pleasure to call upon Senator Moynihan.
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1 OPENING STATEMENT OF THE HONORABLE DANIEL PATRICK
2 MOYNIHAN, A U.S. SENATOR FROM NEW YORK
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4 Senator Moynihan. Thank you, Mr. Chairman. Indeed,
5 could I say that we have not previously been strict about
6 the Senator's statements when they open a major
7 enterprise of this kind. I hope we will have plenty of
8 time. And I hope, without agreeing to anything, we will
9 be restrained but not constrained. How is that?
10 [Laughter]
11 Senator Moynihan. Sir ----
12 The Chairman. Just keep it short.
13 [Laughter]
14 Senator Moynihan. Well, and he will likely be
15 heard.
16 Mr. Chairman and fellow Senators, let me say that the
17 first point I would want to make and essentially the one
18 point I want to make is that we are about to add $700
19 billion to the Federal debt. That is the CBO judgment of
20 the cumulative consequences over seven years of this
21 measure.
22 We think it is not necessary. We think that a tax
23 cute is not appropriate. We think that a tax cut is not
24 appropriate. We think that deficit reduction is the
25 first priority or ought to be of this Congress and this

1 Administration. And we will argue our case accordingly.
2 It is now 12 years since the then director of the
3 Office of Management and Budget, Mr. David Stockman, told
4 a cabinet meeting of the Reagan Administration that not
5 only would there be an embarrassing deficit in the coming
6 year, the year in prospect, but that $200 billion
7 deficits were in prospect as far as the eye can see.
8 And indeed, that is exactly what happened. The
9 deficits grew even higher. They reached $290 billion in
10 fiscal year 1992.
11 Then, the consequence was pervasive throughout our
12 government. Joseph White and the late Aaron Rodesky in
13 their book, The Deficit and the Public Interest, put it
14 very succinctly, "Strife over the deficit has affected
15 procedure, as well as policy, monopolizing the
16 congressional agenda, encouraging paralyzing and
17 deceptive legislation frustrating our public officials
18 and scale making the government."
19 And that is what we have. That is we see. That is
20 what we are in the midst of. And that is what we mean to
21 have more of.
22 I confess to my distress at the President's
23 statements at a fund raising event in Texas yesterday
24 that we cut taxes, we raised taxes, and cut spending too
25 much. I guess he said taxes.

1 In 1993, we did indeed put through a budget proposal
2 that cut spending by $500 billion. One result of this
3 was that interest rates dropped to the deficit premium,
4 as Secretary Rubin has testified. And we ended up with a
5 reduction of $600 billion.
6 And we proceeded to find ourselves on a downward path
7 to where we have to get which is a balanced budget and
8 then a budget and surplus to pay off this debt.
9 In fiscal year 1992, the deficit was $290 billion; in
10 1993, $255 billion; 1994, $203 billion. This year, it
11 will be as low as $150 billion. That is where we should
12 be going.
13 Now, sir, just to say, if the deficit under the
14 budget resolution would accumulate $646 billion in debt
15 over seven years. The fiscal dividend, which was not
16 previously scored by CBO, that premium on interest rates
17 dropping, would take off about $170 billion. So you
18 would end up with $476 billion, half a trillion dollars
19 in debt.
20 If, however, we go ahead with this tax bill, we show
21 we will bring that up to $700 billion in increased debt
22 in seven years.
23 And, Mr. Chairman, I will take just another moment to
24 make two points. And I hope no one will agree with this.
25 I hope no one will be disagreeable that I raised the

1 fact. But legislation we are putting together in fact
2 involves a $43 billion tax increase for the working poor.
3 That is the earned tax credit.
4 Overnight, we were able to get the CBO to score, as
5 we say, the distribution ---- the Joint Tax Committee. I
6 am sorry, Mr. Kies. And they worked very hard at this.
7 And we thank you for doing it.
8 And the tables cannot be reached, cannot be quite
9 discerned from here, but they have been passed out. At
10 the year 2000, the change in Federal taxes for persons
11 under $10,000--gentlemen, listen to this--there is a 10
12 percent increase in taxes for persons with incomes under
13 $10,000.
14 People with $200,000 and over get a tax cut. All
15 families with incomes under $30,000 will find their taxes
16 increased by this bill. The increases are 9.6 for under
17 10, 2.2, and then .5.
18 Every family with income under $30,000 will find
19 their tax goes up and in the manner of these things their
20 taxes increase in order that the taxes of persons of
21 family incomes above $30,000, including those above
22 $200.000 may be cut.
23 It doesn't make sense to us either to increase the
24 deficit by $700 billion or to increase taxes for people
25 with family incomes under $30,000.

1 The facts are there, sir. And I leave you to dispute
2 them, if you like. But I think you will find we are
3 dealing with Mr. Kies' numbers. And he has called it as
4 it is.
5 I thank you for your courtesy. And I yield the
6 floor.
7 The Chairman. Thank you, Pat. Just let me make two
8 observations. First of all, EITC is a welfare program,
9 an income redistribution. It does not involve taxes.
10 That is hiding it under ---- cloaking it under false
11 colors.
12 And the fact is, for example, if you reduce the
13 amount of growth, say, an AFDC, nobody would call that a
14 tax increase. So I just can't agree with your basic
15 premise.
16 Let me say that I rarely ---- but I have to say maybe
17 I agree with President Clinton more this time than I do
18 with you, Pat.
19 Senator Moynihan. Let's record this event.
20 [Laughter]
21 The Chairman. That is bothersome, but at least the
22 President made two statements that wouldn't go as far as
23 I would like, but first of all, he admits that the
24 biggest tax increase in the history of this country was
25 too large. He admits it in the paper today, at the

1 meeting in Texas yesterday. And I couldn't agree more.
2 But I would also point out that the President himself
3 has proposed a major tax cut, including a $500 credit for
4 children. So I just make that observation in light of
5 what you said.
6 I would like to now call on our distinguished leader,
7 Bob Dole.
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1 OPENING STATEMENT OF THE HONORABLE BOB DOLE, A U.S.
2 SENATOR FROM KANSAS
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4 Senator Dole. Thank you, Mr. Chairman. There is no
5 doubt about it. Whenever you have a major tax bill, it
6 is exciting and interesting and sometimes controversial.
7 I remember in 1981 when we were cutting taxes,
8 everybody was very happy. Everybody had amendments. I
9 think we added about $90 billion, as I recall, at
10 President Reagan's request. And then, we blamed him
11 later for cutting taxes too much.
12 We did that, a lot of us, in the committee. And we
13 did some good things. We added indexing and things of
14 that kind.
15 But I think certainly first of all, I will commend
16 the Chairman because as I have indicated before, he had
17 to hit the ground running. We are still on target. We
18 hope to finish this bill tonight. We hope the Budget
19 Committee will be ready with a reconciliation on the
20 floor next week.
21 And we are having daily meetings on the Republican
22 side of the House and the Senate leadership to see how
23 quickly we can move the conference on reconciliation.
24 And hopefully, the President will weigh in one of these
25 days and give us his wisdom on what we might do.

1 But we are talking here. And the Chairman has
2 already indicated this. So I won't repeat everything he
3 has said. But if you take a lock at this, the tax cut, I
4 think there is more and more interest now because on the
5 Senate, there are limits; there are gaps. And over 60
6 percent of the tax cut is going to families.
7 I never really understood as well as I did in
8 Jacksonville, Florida about a week ago, maybe 10 days ago
9 when a man approached me. He said, I have 10 children.
10 That is $5,000. I am not rich. I can spend it better
11 than any of you people in Washington. Now, that was his
12 response, a real father with real children who thought
13 this was a pretty good idea.
14 He would get $5,000. And he could do what he wanted
15 with it, clothing, education, whatever for his children -
16 --- his children. And that is what the tax credit is all
17 about.
18 We would have like to have made it retroactive. And
19 there may be still some way to work that out in the
20 conference. But if it would increase the deficit, that
21 was a concern. We decided that that should not happen.
22 So it seems to me that if anybody wants to argue
23 against the $500 credit for families with children, it is
24 a pretty tough argument to make.
25 In my view, we can afford it. We are not cutting

1 taxes for the rich is the daily charge. And if you look
2 at all the other tax cuts that affect families, whether
3 it is adoption or whatever it is, I think what is the
4 final percentage, Bill, even higher than 60 percent,
5 almost ----
6 The Chairman. 70.
7 Senator Dole. Yes, almost 70 percent.
8 So ---- and I know Senator Bradley has been the
9 leader in the marriage penalty effort for years. And we
10 think we have addressed that. And I think that has been
11 a concern of not only of his, but members on both sides
12 of the aisle.
13 And it is something that we don't think about, don't
14 get many questions, but it is real. And it affects
15 millions of families, as the Chairman has pointed out.
16 We also adopt, which the Chairman noted, a little
17 savings incentive for small business employees called
18 SIMPLE.
19 Small business will have the first real opportunity
20 to establish pension plans for their employees free of
21 the burdensome of unnecessary IRS rules and regulation.
22 This is for employers with less than 100 employees.
23 Now, the millions of employees working for small
24 businesses will be able to save up to $12,000 each year
25 tax free. And again, I think this has broad bipartisan

1 support. I don't know of anybody who would be opposed to
2 it.
3 But maybe in the context we come here, we probably
4 won't get many Democratic votes for the package. But I
5 think there are a lot of things in this package that I
6 believe all of us can support.
7 We also have a provision that Senator Pryor is very
8 interested in. I am happy to be a co-sponsor. And that
9 is the estate tax relief.
10 As David may know, we put a cap on it, $5 million. I
11 sought to raise that to $10 million. In fact, we didn't
12 think we ought to have a cap at all.
13 But again, under the constraints, money constraints,
14 it was the Chairman's desire that we not try to increase
15 the cap, but that possible, too, in the conference.
16 But again, we are talking about middle-class
17 Americans: farmers, ranchers, small businessmen, small
18 businesswomen who end up maybe liquidating the estate
19 when the dominant partner dies or a member of the family
20 dies. Or maybe it is two families or three families.
21 Either you liquidate the estate or you slow down the
22 operation. And we believe it is in our interest to have
23 those families continue and to create more jobs and
24 opportunities.
25 Again, it has I thin 13 sponsors on this committee.

1 So it is not something that is partisan. It is
2 bipartisan or nonpartisan. It is another piece of this
3 package that I think everybody would support.
4 We also take an important step to unleash more than
5 $1 trillion in locked up capital, a sure way to stimulate
6 economic growth and job creation.
7 Wayne Angel, a former member of the fed, who happens
8 to be a Kansan, asserts that there are $7 trillion in
9 assets locked up all across America ---- $7 trillion in
10 assets locked up all across America.
11 And many are locked up because of the high capital
12 gains rate. And if we reduce the capital gains rate, we
13 would create a lot of jobs, a lot of activity, stimulate
14 the economy. In my view, I think we have been
15 responsible.
16 And again, this has support on other side of the
17 aisle, maybe not total support, but a lot of support.
18 So, Mr. Chairman, it seems to me that we are off in
19 the right direction.
20 There were some areas that we were ---- foreign tax
21 areas. It is my understanding, we are going to be able
22 to address that later.
23 I have a number of amendments. They are not rifle
24 shot. They are generic. We think they should be
25 addressed. But I am told by the Chairman that we will

1 have that opportunity later on.

2 There are other amendments that were brought to me, I
3 assume brought to other people, that were rifle shot
4 amendments affected one company or one person. And I
5 raised the amendment, as I indicated I would, but they --
6 -- but the Chairman properly advise: if they are rifle
7 shot affecting one company, one person, they would not be
8 entertained.

9 The same rule I think that Senator Bentsen ----
10 Senator Moynihan had. Maybe, it is not fair. Maybe, it
11 is not a good tax policy, but obviously, the press would
12 love something like that if somebody ---- they thought
13 somebody was getting even fair treatment if it was a
14 single company or a single person.

15 So a number of those amendments were raised. And
16 there are others that will be raised.

17 I still think we ought to phase out the luxury tax on
18 automobiles. We did it on everything else. In my view,
19 we did it because it was counter productive. It cost I
20 don't know how many jobs in Rhode Island.

21 The boat tax, I know Senator Breaux and Senator
22 Chafee were responsible for getting that repealed. But
23 there is still a little bit out there. And we have a
24 proposal which I will submit later that I think is in
25 effect revenue neutral, but does help in some cases.

1 So I would ask that my entire statement be made a
2 part of the record. And I hope that we can conclude
3 action.
4 If there is some way that we can accommodate the
5 schedule of those who are objecting to the Senate Finance
6 Committee meeting and the Senate schedule, I would be
7 happy to work with whoever it is that may be objecting.
8 Otherwise, we will I guess have to be here tonight.
9 [The prepared statement of Senator Dole appears in
10 the appendix.]
11 The Chairman. That is correct. It is my plan to
12 proceed as late as necessary tonight to finish.
13 On the international area, I do want to make a
14 clarification with respect to the CBI international trade
15 proposal. I had referenced to Bob Graham's interest in
16 that matter. I was not referring to Phil Gramm. So I
17 just want the record to clearly reflect that.
18 Senator Bradley. Mr. Chairman, maybe we could ----
19 is there a different way you could pronounce these two
20 names so that we would know? I mean, they can each
21 choose.
22 Senator Moynihan. Doctor.
23 Senator Bradley. Dr. Gramm and Governor Graham.
24 Senator Moynihan. I think people love that.
25 Senator Bradley. Okay.

1 The Chairman. Max Baucus, you are next.

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1 OPENING STATEMENT OF THE HONORABLE MAX BAUCUS, A U.S.
2 SENATOR FROM MONTANA
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4 Senator Baucus. Thank you, Mr. Chairman. Mr.
5 Chairman, in reviewing this package, I want to tell you
6 that I find a lot alike. I compliment you. You have
7 come a long way on the House bill which I think is both
8 very significant problems. And I compliment you for
9 that.
10 Generally, the House bill, as many know, focuses on
11 relief and loopholes for corporations and individuals who
12 are already wealthy.
13 It also contains some truly egregious individual
14 proposals, like eliminating the alternative minimum tax
15 completely, instead of doing the hard work that I think
16 is necessary to improve it.
17 That would return us to the situation before tax
18 reform when powerful companies could literally pay a tax
19 of zero.
20 Mr. Chairman, your draft moves away from that badly
21 thought approach and more towards the middle class. It
22 contains some important points that I believe are good
23 policy and I have in fact sponsored or co-sponsored as
24 independent legislation.
25 I think some in my party have been too quick to

1 dismiss any sort of tax relief. There are provisions in
2 this bill which I believe are good for ordinary folks and
3 good for the economy, as a whole.
4 For example, relief from the estate and gift tax for
5 family-owned businesses. I can't tell you how many
6 Montana farmers, ranchers, and small businessmen are
7 suffering from this tax.
8 The tax credit for college and vocational technical
9 education which I frankly think ought to be bigger, but
10 will still help families educate their children and help
11 them achieve the American dream.
12 Continuing the research and development tax credit
13 which promote long-term economic growth, fixing the home
14 office deduction, relief for families, the children.
15 Nonetheless, with regret, I must say the bill needs
16 more work. And in its present form, I will have to vote
17 against it.
18 That is because the bill has a very deep simple flaw.
19 At $245 billion, the package is so big that it forces
20 unwise, huge cuts, unnecessary cuts in Medicare,
21 Medicaid, education, and agriculture. It also raises tax
22 on way too many Americans.
23 A few words on Medicare, if we don't scale the whole
24 thing back, both the tax cut and the Medicare cut, we are
25 threatening seniors and putting rural hospitals in danger

1 of closing or at a minimum impacting health care for
2 seniors and other American citizens.
3 Just listen to this list. Deaconess Hospital in
4 Billings losing $31 million in reimbursements by the year
5 2002. That is a 10 percent cut.
6 Community Memorial in Sydney, Montana also taking a
7 10 percent cut. Community Memorial is the second biggest
8 employer in Richland County next to the sugar plant.
9 St. Johns Luther in Libby loses $2 million. And
10 Powell County Memorial in Deer Lodge loses $500,000.
11 Now, Mr. Chairman, I know you know, since you and I
12 are both graduates from the same high school in Helena,
13 Montana, what that means in Montana. But for other
14 members of the committee who do not know Montana well,
15 that is a extremely significant. It is much too much for
16 us to take.
17 If we move ahead on this Titanic voyage, we are going
18 to lose hospitals, the jobs they support and the health
19 services they provide.
20 But by scaling the whole thing back, we can restore a
21 balance. We can put Medicare on a sound financial base,
22 provide a reasonable amount of tax relief, and balance
23 the budget. And that is what we ought to do.
24 The bill is not a hopeless disaster like the House
25 bill. And if we go back t the drawing board, make some

1 tough choices, and do what is right, we can get something
2 good.
3 Thank you, Mr. Chairman.
4 The Chairman. Thank you.
5 Senator Chafee.
6 Senator Chafee. Mr. Chairman, I don't have an
7 opening statement. I just want to say that I wish we
8 could continue meeting today. I am sorry that we are
9 prevented from doing so.
10 Secondly, Senator Baucus rightfully pointed out some
11 of the changes that will occur in the hospitals in the
12 future, but I would point out, obviously, I am not
13 familiar with the Montana.
14 But in my State, there is all kinds of changes taking
15 place regardless of what we are doing in the legislation
16 or in the reconciliation.
17 The hospitals are being closed. Hospitals are being
18 reduced and the type of services they provide. The
19 number of hospitals beds is diminishing. The length of
20 stays is being cut back dramatically.
21 All of this is regardless of anything that we do on
22 this committee or have done in connection with Medicare.
23 And I think it is important for us to bear that in mind.
24 Everything that will happen in the future in
25 connection with hospitals and closure of hospitals cannot

1 be traced back to efforts that we make in the
2 reconciliation bill.
3 Thank you, Mr. Chairman.
4 The Chairman. Thank you, Senator Chafee.
5 Bill.
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1 OPENING STATEMENT OF THE HONORABLE BILL BRADLEY, A U.S.
2 SENATOR FROM NEW JERSEY
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4 Senator Bradley. Thank you very much, Mr. Chairman.
5 Let me begin by saying that I think the best individual
6 income tax rate is the lowest individual income tax rate.
7 And I think that the way you get the lowest
8 individual income tax rate is not by increasing
9 loopholes, but by decreasing loopholes.
10 The bill before us dramatically increases loopholes.
11 I would hope that we would be able, as we go through this
12 process, to focus on what would be the opportunity if
13 instead of increasing loopholes, we would be simply
14 decreasing rates and paying for them by eliminating
15 loopholes.
16 That, of course, is the idea behind what we did in
17 1986 that has eroded dramatically with bipartisan support
18 in that erosion, I might say, but that at some point, we
19 will offer an amendment that will raise the question of
20 taking some of the money that we use for loopholes and
21 instead reducing tax rates for everybody, not reducing
22 tax rates for only those people who have a lobbyist that
23 gets their provision in the tax code that results in
24 their effective tax rate going down, but eliminating
25 everybody's tax rate.

1 So let me start, as I talk about this, with that
2 premise. That is what I think is good tax policy.
3 The bill before us I think has a number of problems.
4 Senator Moynihan pointed out one of them. And that is
5 the so-called distributional issue.
6 And I will give the Chairman credit that he actually
7 did attempt to counter this by capping the child care
8 credit. And I think that is an improvement because he
9 capped the child care credit.
10 But the bill before us, according to the joint tax
11 analysis, as Senator Moynihan pointed out, still by the
12 tables we were presented in the year 2000 results in a
13 tax increase for everybody earning under $30,000 a year.
14 Senator Moynihan. Forty-nine percent of the
15 taxpayers.
16 Senator Bradley. And I think that there is another
17 way to look at this. If you take people making more
18 $75,000. I don't want to belabor this point because I
19 know this is, you know, not a popular issue, but I just
20 think it is a matter of fact that we should focus on
21 this.
22 Take the people who make more $75,000 a year. They
23 represent about 13 percent of the taxpayers. They get,
24 out of this tax bill, 40 percent of the total benefits.
25 So you take this top 13 percent of the income earners

1 in America in this tax bill, they get 40 percent of the
2 tax benefits.
3 On the other hand, you take those people who are
4 earning under $20,000. They are about 33 percent of all
5 taxpayers. And these people face an increase in taxes,
6 not a decrease, an increase.
7 Now, if we look at it a little further and we take
8 not what is only in this bill, but what is in ---- what
9 we did last week, as well, and I beg to differ with the
10 Chairman that the earned income tax credit is not a
11 welfare program. To the contrary, it offsets taxes that
12 hardworking Americans who are working pay, both the
13 income taxes and Social Security taxes.
14 The Chairman I think misstated when he said, it
15 doesn't have any effect on income. For $10 billion of
16 the $42 billion that we increase taxes, we are increasing
17 taxes in that bill by denying a tax credit against income
18 taxes paid by people who earn under $28,000 a year. So
19 that is factually wrong.
20 I would argue further that the tax relief under
21 earned income tax credit is valuable because those people
22 are working and paying Social Security taxes.
23 So if you simply take on the distributional side, you
24 have about 17 million taxpayers earning about $75,000 a
25 year. They will receive $50 billion in tax cuts over the

1 next five years.

2 You have about 17 million EITC recipients. They will
3 face a $42 billion tax increase in the next seven years.

4 So I don't think you can make much a point on the
5 distributional. I mean, you have improved it a little,
6 but this bill in terms of distribution is a gigantic
7 giveaway to those who earn more than $75,000 a year and a
8 $42 billion tax increase on those who earn under $28,000
9 a year.

10 Then, of course, the next point is the deficit. And
11 this is supposed to be a deficit reduction. We are
12 supposed to be having a tax bill here that spends only
13 the fiscal dividend.

14 Remember, in the budget, you know, we will reduce the
15 deficit. That will cause the economy to grow. Interest
16 rates will be lower. The government will take in more
17 money. We will have a fiscal dividend.

18 What does CBO say over this seven year period will be
19 the fiscal dividend? $170 billion.

20 What is the size of this tax cut? $221 billion.

21 So that the tax cut is $50 billion more added to the
22 deficit than we even said should happen under the budget
23 bill.

24 And then, I would like to simply make one final
25 point. I mean, there are a lot of things in here that

1 when we get to it, I would like to spend some time on and
2 explore, you know, why we need this particular provision.
3 What is the general interest that is being served by it?
4 We will get to that in the course of the debate on the
5 bill.
6 But I must say the estate tax relief that everybody
7 is kind of falling all over themselves to praise here, I
8 think we need a little dose of reality as to who all
9 these small people are.
10 First of all, if you ever want to collect statistics
11 on this subject, good luck. Statistics are very hard to
12 come by when you are trying to assess issues related to
13 wealth at all, but there are some.
14 And the Agriculture and Finance Bulletin tells us
15 that there are about 2 million farms in America. Ninety-
16 two percent of those farms have a net worth below
17 $900,000. And more than 83 percent of all farms have
18 incomes under $100,000.
19 So if we are worried about the farmer here, the vast
20 bulk of the farmers are already covered under existing
21 State tax.
22 You will say, well, no, no. We just want to make
23 sure that they don't lose their farm when they die and
24 they may have to break it up among all the kids. They
25 may have to break it up among all the kids.

1 Well, just another statistics, only 1 percent of the
2 people who die in a given year pay any estate tax. Only
3 1 percent of the people who die in any given year pay any
4 estate tax because most Americans who die don't have that
5 much money.
6 And then, of those who die, only two-tenths of 1
7 percent have an estate that is valued at more than $2
8 million.
9 So we can talk about what we are doing here to
10 protect the family farm and, you know, the small business
11 people, but the data doesn't really back it up.
12 And when we get into this, I hope that we will have a
13 chance to explore it in some greater depth, but those are
14 my concerns.
15 And, Mr. Chairman, I that think again, the direction
16 we should be heading is dropping tax rates on all
17 Americans and paying for it by eliminating loopholes.
18 If anybody is for a flat tax, then this bill is a
19 total contradiction because all the loopholes that are
20 being created in this bill would be gone as soon as the
21 flat tax passes, if it ever does. That is why it is
22 never going to pass.
23 But we could move to a few rates and much less in
24 loopholes and lower rates for all Americans, not lower
25 rates for those few Americans who have a lobbyist to get

1 their provision in the code.

2 The Chairman. I would just make one or two
3 observations. Of course, the bottom ---- and I think it
4 is important to recognize and understand this, who is
5 paying the taxes today.

6 The fact is that the bottom fifth is paying no taxes.
7 So it is hard to cut their taxes. On the other hand, the
8 upper 1 percent is paying 31 percent of the taxes.

9 Senator Bradley. You are not counting Social
10 Security, Mr. Chairman. A person who is working pays the
11 Social Security tax.

12 The Chairman. Just let me point out that if you
13 include all taxes, including Social Security, the highest
14 1 percent pays 18 percent.

15 So don't talk to me about progressive because the
16 taxes are progressive. As I say, the top income group,
17 the highest 10 percent pays 64 percent of the federal
18 income.

19 If you include all the taxes, that highest 10 percent
20 pays 47 percent. That includes Social Security.

21 The highest 5 percent pays 51 percent of the Federal
22 income taxes or 34 percent of all the taxes.

23 So the only point I am making is that we must look at
24 these in the context of what they are happening. And we
25 have an extremely progressive tax package in this

1 country.

2 Senator Grassley.

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1 OPENING STATEMENT OF THE HONORABLE CHARLES E. GRASSLEY, A
2 U.S. SENATOR FROM IOWA
3
4 Senator Grassley. Thank you, Mr. Chairman. The
5 Chairman has already told you that he included a
6 provision that I had proposed for the interest deduction
7 of educational loans.
8 I thank him very much for including that. I thank
9 Senator Moseley-Braun for working with me so that they
10 could be a bipartisan approach.
11 Regardless of the specific interest I have in this
12 bill, I think the Chairman has worked very hard to put
13 together a mark that we can all support.
14 And I know the Chairman gave up much that he had an
15 interest in getting in a tax bill and each of us did so
16 that we could put together a bill that could pass this
17 committee.
18 I support the Chairman with his mark.
19 But I hope that we remember and we should at all
20 times remember that these so-called sacrifices that
21 members have made on this committee are not really our
22 sacrifices.
23 When it comes to taxes, the sacrifices mostly belong
24 to our constituents, the American people, including
25 everyone not in this room today.

1 I have been hearing from many of these Americans, as
2 I am sure each of my colleagues have. We get lots of
3 letters, telephone calls, faxes, electronic mail
4 messages. These all come from taxpayers.
5 So rather than repeating the informed words of the
6 Chairman and my other colleagues, I thought that I would
7 repeat the words of some of these Americans, particularly
8 from my State of Iowa.
9 I have here examples of phone calls that I received
10 in support of the $245 billion in tax cuts in the
11 Chairman's mark. Wanda Edwards, Marion, Iowa, says,
12 "Stick with Republican promises of $245 billion in tax
13 cuts." Now, of course, that is pretty straightforward.
14 Lloyd Lucas of Marion, Iowa said, "Support tax cuts
15 in the Finance Committee vote on that bill."
16 William Zacker of Davenport Iowa said, "Support the
17 $245 billion tax cut. The surest way to get kicked out
18 of Congress is to not vote for this."
19 Chuck Miller of Woodbine, Iowa said, "Support the GOP
20 tax cuts and the $500 tax credit and the $245 billion in
21 tax cuts." Well, of course, Mr. Miller's statement is a
22 little redundant, but he does get his point across.
23 Dwayne Prowell of Monticello, Iowa says, "The
24 Democrats keep ranting and raving, but keep with the
25 conservative agenda, reduce spending, go ahead with the

1 tax cuts. I am tired of Congress acting like it is their
2 money. A commitment was made." That is what Dwayne
3 said.
4 I received the next letter in support of the capital
5 gains tax legislation. "There is an old saying," the
6 writer says, "a farmer lives in poverty and dies rich. I
7 am discovering that I cannot sell the farm to my son
8 without suffering a terrible tax burden. My husband died
9 a year ago. I would like to sell the farm to my son so
10 that I could buy a house in town. I am enclosing an
11 article that explains my predicament." From Theresa
12 Foster of Comwell.
13 I think that it is interesting that Mrs. Foster
14 enclosed the reading material.
15 You see, Mr. Chairman, other Americans know that
16 historic budgetary tax and spend policies have been
17 unfair and unresponsive to their needs.
18 The constituency is both better read and more
19 intelligent than we give them credit for. They are also
20 using technology to gain and communicate information.
21 The following is a facsimile regarding the estate tax
22 legislation that is in this mark. Quote, We need your
23 support on estate tax exemption to help keep family-owned
24 businesses together. It is still my hope that this can
25 be done and still reduce taxes and government spending.

1 This is a tight tough rope to walk. And I wish you well.
2 Unquote. Sam Annis, Annis Petroleum Products, Waterloo,
3 Iowa.
4 This next originally handwritten piece goes slightly
5 longer than I am going to give it to you. It is worth
6 your close attention. Here is a well-informed person who
7 makes his point about IRAs. "I am writing you to
8 encourage support for legislation currently under
9 consideration that would once again make individual
10 retirement accounts universally available. I understand
11 that two proposals, the Roth-Breaux Super IRA and the
12 American Dream Savings Account are being considered. And
13 both would provide expanded usage of IRA funds. As you
14 know, the savings rate in our country is at an all time
15 low and far behind that of many competitive Nations.
16 Savings provide the capital needed to keep our economy
17 growing. A growing economy provides expanded
18 opportunities today and helps build a better America for
19 our children. It is clear that this time has come.
20 Unquote. No. Let me start over again.
21 Quote, It is clear that the time has come for our
22 government to make policies that encourage rather than
23 discourage savings. The Tax Reform Act of '86 curtailed
24 IRA savings. By supporting these legislative proposals,
25 you can reverse that trend and once again make the tax

1 advantage IRA available to everyone. Your assistance in
2 helping Americans help themselves is greatly appreciated.
3 Unquote. And that is from Charles Vandroger, Boden,
4 Iowa.
5 So you see, Mr. Chairman, regular persons are on our
6 side. They are waiting for us to send them their tax
7 dollars back. I mostly read mail from my constituents,
8 but I don't think that good sense is limited to the
9 people in my State.
10 It comes from your town. It comes from any town USA.
11 Their message is very clear. And I would not try to
12 improve upon it.
13 These other Americans can spend their own money
14 better than we can spend their money for them. So the
15 bottom line, let's set ourselves to the matter at hand to
16 do the people's work and reward their sacrifice.
17 The Chairman. Thank you, Senator Grassley.
18 Senator Pryor.
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1 OPENING STATEMENT OF THE HONORABLE DAVID PRYOR, A U.S.
2 SENATOR FROM ARKANSAS
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4 Senator Pryor. Thank you, Mr. Chairman. Mr.
5 Chairman, I think this is the most important piece of
6 legislation of the 104th Congress.
7 And I think because it is of such importance, I am
8 frankly a little bit amazed that we are going to try to
9 do this in one day or two days or even three days.
10 I think it affects every man, woman, and child in
11 this country. And I wish we would take some time to
12 truthfully to develop it and look at it and talk about it
13 and go through it section by section to see what we are
14 doing.
15 I also think that the easiest thing that a legislator
16 can do ---- there are a lot of hard things we have to do,
17 but the easiest thing that the legislator can do is to
18 cut taxes. That is the easiest vote we have to make.
19 And I think the concern that I have, Mr. Chairman, is
20 twofold: one, that we are going to cut taxes, and, two,
21 the distribution of those tax decreases is very
22 concerning to me at this time.
23 I am not going to go into whether the rich are better
24 off than the poor in this tax bill. That is going to be
25 debated later today and tonight and tomorrow I hope.

1 But I do, Mr. Chairman, that in your effort to
2 construct a bill that could achieve bipartisan support, I
3 do believe that the distribution is going to be one of
4 the arguments that you will hear a great deal about.
5 Secondly, I am very concerned that we are repeating
6 what we did 14 years ago. And I know that Senator
7 Moynihan has quoted from David Stockman.
8 I reread some of that earlier this morning, some of
9 David Stockman's book. I am probably not going to quote
10 any of it now because we all know what he said. We all
11 know what was going on at that time in retrospect.
12 I was one of the legislators, Mr. Chairman, at that
13 time who voted for President Reagan's tax cut. I did it.
14 And I am sorry I did it because we had no corresponding
15 spending system of expenditures of tax dollars that would
16 correspond with the tax cuts that we made.
17 And I think we are about to jump off that same cliff
18 again. I wish we would sunset the tax cuts. I wish we
19 would say we are not going to have tax cuts unless we
20 have a balanced budget.
21 I wish there was something we could do to stop the
22 enormous erosion of the economy that I think that we are
23 going to kick off and also the enormous increase in the
24 debt that we are going to create as a result of our
25 actions.

1 I will have some amendments later, Mr. Chairman, I
2 think which I hope will further pinpoint a better and
3 fairer distribution of some of the tax cuts.
4 For example, in pension simplification, even though
5 Senator Dole has attempted to put into the Chairman's
6 mark, I think a proposal that some is accepted I don't
7 think goes far enough.
8 I think the proposals by Senator Hatch and myself and
9 others is a proposal in fact that really goes to the
10 small business person and to the smaller taxpayer.
11 I think the taxpayer's bill of rights in the
12 Chairman's mark is really not worthy of the name. There
13 are only four provisions of the old taxpayer's bill of
14 rights of 27 provisions that have passed this committee
15 in the Senate and the Congress two times, only to be
16 vetoed that are included, only four of the original 27
17 provisions.
18 We don't have the deduction for the self employed. I
19 think that we should address that, Mr. Chairman and my
20 colleagues.
21 And these are concerns that I have. I just hope that
22 we have time to allocate to really looking at what we are
23 about to do and to give the American people a much fairer
24 bill than I think is represented in the Chairman's mark.
25 Mr. Chairman, I yield back the balance of my time.

1 The Chairman. Thank you, Senator Pryor.
2 I would make the comment that the general outlines,
3 of course, of this tax proposal have been in the public
4 eye and before this committee in hearings for an extended
5 period of time.
6 And we do have a deadline that we have to meet under
7 the terms of the budget resolution.
8 Senator Pryor. Mr. Chairman, if I may respond to
9 that, I think we have got just the distribution table
10 this morning immediately prior to our meeting.
11 The Chairman. I suspect that that table might have
12 been available earlier from Treasury. I don't know.
13 Senator Hatch.
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1 OPENING STATEMENT OF THE HONORABLE ORRIN G. HATCH, A U.S.
2 SENATOR FROM UTAH
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4 Senator Hatch. Thank you, Mr. Chairman. I just
5 want to start out by commending you for accomplishing
6 this very difficult job of bringing us to the point with
7 the tax bill that lies before us.
8 I believe you and your staff have done a very good
9 job of balancing a number of difficult issues. You have
10 produced a Chairman's mark that when enacted will result
11 in a stronger America, stronger American families, and a
12 stronger American economy. I don't think there is any
13 question about it.
14 This is a very good combination of family tax relief
15 and tax incentives designed to strengthen the economy,
16 even as we move toward balancing the budget over the next
17 seven years.
18 Now, each of these two elements, family tax relief
19 and strengthening the economy are vitally important to
20 the future of my home State of Utah and I think to the
21 country as a whole.
22 The Chairman's mark in concert with the other changes
23 we are making this year on the spending side represents a
24 significant shift in priorities away from government-
25 based solutions to our problems toward market-based and

1 family-based solutions.

2 Let me stress that point, Mr. Chairman. Tax

3 reduction is not inconsistent with budget balancing.

4 Now, your mark contains a strong dose of tax relief

5 to the American family. I know our folks in Utah are

6 going to be pleased with the emphasis on family. And

7 very importantly, it focuses this relief on middle-income

8 families.

9 In fact, an analysis of two benefits of the tax

10 reduction in this mark shows that 84 percent of the

11 benefits go to families making less than $100,000 per

12 year.

13 It is interesting to note that these same families

14 pay only 64 percent of the total income tax today.

15 So despite what some of our colleagues who oppose

16 this bill may say about its fairness, its benefits are

17 focused on middle and lower-income families.

18 I have a lot more to say, but I think what I will do

19 is conclude. I am very grateful that you included the

20 Hatch-Lieberman capital gains reduction, rate reduction

21 bill in this package.

22 I know that about 79 percent of all tax returns filed

23 claiming capital gains are filed by people who earn less

24 than $75,000 a year. And there are very few tax

25 reductions that would do more to stimulate our economy

1 than reducing capital gains tax rates.
2 And we know that in the last 30 years every time
3 capital gains tax rates have gone up, revenues to the
4 Federal Government from capital gains have gone down.
5 And every time they have gone down, the rates that is,
6 Federal revenues from capital gains transfers have gone
7 up.
8 So we are hopeful that this will stimulate the
9 economy, do an awful lot of good for the middle class in
10 the process and the millions and millions of people in
11 the mutual fund market and their corporate investment
12 markets and so forth that really I think over the long
13 run are going to benefit. These provisions will benefit
14 everybody in America.
15 So I am very grateful to you for putting that and a
16 number of other matters in this mark that we have all
17 worked on. I just want to thank you. And I will end my
18 remarks at that point.
19 The Chairman. Thank you, Senator Hatch.
20 Senator Rockefeller.
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1 OPENING STATEMENT OF THE HONORABLE JOHN D. ROCKEFELLER,
2 IV, A U.S. SENATOR FROM WEST VIRGINIA
3
4 Senator Rockefeller. Today, the Finance Committee
5 on the Senate side takes the final action which in my
6 judgment was preordained and made inevitable by a meeting
7 that was held by Newt Gingrich when he gathered a crowd
8 of new Congressmen on the steps of the House to celebrate
9 and unveil the contract for America.
10 They called this tax cut the crown jewel of their
11 contract. I call it a crowning blow for hard working
12 families, for children, for young people planning a
13 college education, for senior citizens, and for a group
14 of very old Americans who are retired coal miners and
15 their widows and orphans and a lot of other deserving
16 citizens in this country who are getting a raw deal.
17 I personally had to see all of this to believe it.
18 From the moment this began this year, I somehow felt that
19 things could be better, that there would be more
20 bipartisan. Things would work better.
21 There would be an end to the back room and the games
22 and the special deals, special people, the principle of
23 fairness, bipartisanship, you know, that we might start
24 acting that way and give Americans the kind of future
25 that they deserve to look forward to.

1 Instead, in this Senator's judgment, we have before
2 us a document that once again practices a combination of
3 budget witchcraft, sweetheart deals, and I would say
4 highway robbery, all using the name of tax relief in
5 utter vain.
6 For months, many Republican Senators have admitted,
7 publicly and privately, some to me, that throwing $245
8 billion or so at tax breaks and tax cuts when the idea is
9 to balance the Federal budget does not exactly make a lot
10 of sense.
11 In their hearts, one thing; in public, another. But
12 I gather that their reservations about the fiscal
13 irresponsibility of this attempt did not prevail because
14 we have before us what we have before us.
15 And therefore, a budget package rolls forward based
16 on more fiction than fact. We are being asked to pretend
17 that $270 billion in cuts will save Medicare, $187
18 billion in cuts will reform Medicaid, $42 billion of
19 extra taxes can be heaped on the shoulders of hard
20 working families who are staying off of welfare which is
21 the American dream to be able to say off of welfare.
22 And yet, we can tax them $42 billion for their effort
23 to do so without a worry.
24 After that, we are asked to pretend even further that
25 since the budget experts can project a so-called fiscal

1 dividend of $170 billion after seven years, why not spend
2 $224 billion ahead of time just in case.
3 In other words, just borrow between $70 billion to
4 $90 billion over the next few years, splatter some more
5 red ink onto the Federal budget, keep squeezing what you
6 need out of education, out of seniors, out of hospitals,
7 out of nursing home care, out of the pockets of hard
8 working families with incomes below $24,000, whatever it
9 takes to make up the difference.
10 The facts: with money taken from Medicare and
11 Americans with or little or nothing left to sacrifice a
12 feast, a veritable feast has been laid out on the tables
13 before us, the feast that some members of this committee
14 are apparently ready to give away without charge.
15 Since we got on Monday afternoon, and it is 167 pages
16 long, the distribution tables we got at 1:00 a.m., this
17 morning, that is if we had been here to get them, the
18 more tempting selections are obvious. They are the sorts
19 that we read about in newspapers before members on this
20 side of the aisle got the actual document.
21 Child credits, more generous IRAs, marriage penalty
22 relief, estate tax relief, to list some of the main
23 courses in this offering that were previewed with
24 fanfare.
25 It is a much longer list as we can all see from the

1 five pages taken up just by the table of contents.
2 But now, we have a chance to understand just exactly
3 what each item means. Or do we in that the Chairman
4 wants us to conclude by the end of this day the entire
5 mark-up?
6 I have many questions that will help me and West
7 Virginians sort through this spread. I know there are
8 ideas with merit in the package.
9 And I continue to hope that there is an honest, fair
10 way to both balance budget and find ways through tax
11 policy to deal with real priorities, but no one can
12 afford another day of gimmicks and tax binges that enrich
13 Wall Street and K Street and not main street.
14 In a recent year, close to 700,000 tax returns were
15 filed by West Virginians. I represent those folks. Just
16 over 3,000 of the 700,000 were households with incomes
17 over $200,000.
18 In contrast, over 476,000 households had incomes from
19 anywhere under $15,000 up to $30,000, meaning I represent
20 a State of many people playing by the rules, living from
21 paycheck to paycheck, trying to send their kids to
22 college, caring for their grandparents as they get older,
23 and fighting hard.
24 I see in this document a child credit that is not
25 refundable, leaving out, therefore, almost 40 percent of

1 America's children as being ineligible for a full tax
2 credit, leaving out the families about to have their
3 taxes increased in fact, the same ones, through the EITC,
4 the earned income tax credit cut, made in another part of
5 the Republican budget, leaving those folks out in the
6 cold when it comes to the new child credit, as well as
7 having to pay more taxes themselves.
8 This reminds me of a cartoon that I recently saw that
9 asks, quote, Why is it that for Republican incentives for
10 rich means giving them more and incentives for the poor
11 means giving them less? Unquote.
12 I see an idea called IRA-plus, promising tax-free
13 withdrawals for households with no ceiling set on income.
14 I am not sure of the breakdown, but this just might mean
15 that some of the $12.7 billion set aside for the IRA
16 column in this document will produce quite a windfall for
17 very wealthy Americans.
18 I see $28 billion for capital gains breaks for
19 individuals. That is out of a total of $33 billion for
20 individuals. And those will go to individuals who have
21 over $350,000.
22 Capital gains, yes; relief, yes, but for who? People
23 making over $350,000 in the main.
24 I bet the 690,000 households in West Virginia making
25 a lot less than that would like to know the rationale of

1 that high-price item. Why is that so necessary?
2 Today is set aside to learn more about this document,
3 or at least it had. And that is precisely what I hope
4 all of us will do.
5 I will conclude, Mr. Chairman, on a further point. I
6 wanted to cover some of these other points before I
7 expressed my profound ---- profound disappointment over a
8 decision tucked away on pages 165, 66, and 67, given to
9 us on Monday.
10 One more prize had to be thrown into the crackerjack
11 box. I guess that is true. This time it is for
12 companies that want to wriggle out of their commitment
13 over their responsibility to cover the health benefits of
14 their retirees. Promises made. Promises now to be
15 broken.
16 They must have had the password in the back room,
17 some of these lobbyists, that obviously miners did not
18 and do not.
19 The result is nothing less than a special tax break
20 for some companies which will be financed by miners'
21 health benefits.
22 I should say that the Chairman was very kind in
23 saying that one of our Democratic colleagues has
24 objected. That was me objected to the Senate Finance
25 Committee meeting. I have objected. And I will object

1 tomorrow, if there is a tomorrow.

2 I think that every one of my colleagues understands

3 that when it comes to certain subjects in certain areas

4 they act in full and good conscious. I respect my

5 colleagues for their hearts, for their sense of what is

6 most important to them.

7 Everybody has a line. Everybody has a line. And

8 when that line is crossed over, things change. For me,

9 the line is these old miners with pick and shovel, 40s,

10 50s, 60s, built this country.

11 I cannot and I will not go back to West Virginia

12 without knowing I did everything ---- everything to stop

13 this cruelty being perpetuated in this tax cut bill.

14 No amount of procedural pain or legislative suffering

15 that I could impose could possibly offset the pain and

16 the suffering being imposed on so many fragile people who

17 did so much for their country so far under ground with so

18 little reward and so much physical pain that is now being

19 rammed through the United States Senate.

20 I recognize that the powerful interests who will

21 benefit from these harsh measures will probably win in

22 this Congress, but I want to make it as hard as I can. I

23 say that earnestly.

24 Mr. Chairman, I will literally conclude by saying

25 this. And there is an irony I suppose in this. As you

1 can imagine, I have a lot more to say about coal miners.
2 And I will.
3 Three years ago, this very committee responded to the
4 crisis facing these retirees. And it was spelled out
5 interestingly the answer, the solution which we then
6 adopted which will now be repealed. It was spelled out
7 by something called the Dole Commission, Elizabeth Dole.
8 And we ultimately worked on a bipartisan basis to enact
9 that fair solution.
10 Well, evidently, that bipartisan instinct is gone.
11 And some special companies have prevailed. I will have
12 more to say about that. I appreciate the courtesy of the
13 Chairman.
14 The Chairman. Thank you, Senator Rockefeller.
15 And I am, of course, aware the great importance you
16 attach to this particular problem.
17 Senator Simpson.
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1 OPENING STATEMENT OF THE HONORABLE ALAN K. SIMPSON, A
2 U.S. SENATOR FROM WYOMING
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4 Senator Simpson. Mr. Chairman, I commend you on
5 your work. You have been tested by fire. You can remain
6 patient in the face of some of the most recent comments.
7 It has been a pretty short honeymoon.
8 I am deeply disappointed at my friend from West
9 Virginia. It seems to me that in my time on this
10 committee, I see no more harshly partisan person on these
11 issues than my friend from West Virginia.
12 And that is disturbing because it is not that way
13 when we talk face to face. It is when we get here, it is
14 when the lights flip on that suddenly rationale,
15 reasonable behavior is replaced by harshness and a very,
16 very hard edge. Surprising.
17 Senator Rockefeller. When it comes to retired coal
18 miners, Senator, you will find me in their corner.
19 Senator Simpson. Let me say this, if I might in my
20 remarks and maybe, as long as the Senator's from West
21 Virginia.
22 These miners we are talking about entered into a
23 collective bargaining agreement with their employers
24 which turned in to be the cadillac of health care plans
25 which broke everybody.

1 Now, let's get serious about what this was. This was
2 a collective bargaining. And the companies gave away the
3 store. There isn't a single plant in America, and I defy
4 you to find it, that has anything ---- anything connected
5 with what were in those programs.
6 Now, why then should those who did not collectively
7 bargain share in suddenly coming around and paying for
8 it? I will be right here to see that they do not.
9 Now, for a person that speaks so highly with regard
10 to the poor, it will be interesting for me to see how it
11 can be explained that there was not even a vote to means
12 test part B premiums on part B of Medicare.
13 So it would be interesting for me. And I know my
14 friend will share it with me because we will meet out in
15 the hall later and jokingly discuss how ornery we both
16 are.
17 It will be interesting to see to me what the poor of
18 West Virginia think what the working poor of West
19 Virginia think while they are paying 70 percent of the
20 premium for those of us on this panel. I would really
21 want to hear that and how that is explained to the poor.
22 If you do cuts, obviously the rich do better because
23 the rich pay most of the taxes in America. Have we all
24 got that premier number one?
25 The poor in America don't pay taxes. The rich and

1 the middle class do pay taxes. We have taken care of
2 that in our tax structure.
3 Tax relief is most applicable to those who pay the
4 bill. Now, that is a formula that hopefully will be
5 grasped by the general populist at least before election
6 day of 1996. A silly formula I know, but I just thought
7 I would throw it out.
8 I have a lot of trouble with tax cuts per se. We
9 have a $5 trillion debt limit. And we all know that. We
10 have deficits as far as the eye can see under the
11 President's proposal. And we all know that.
12 At least, we don't have that in this program. We
13 have what we think is the reduction to zero of those
14 things in seven years.
15 I will embrace this package with a great lump about
16 the size of a hockey putt in my throat. And I will stick
17 with it.
18 But, colleagues, when are we all going to sober up
19 and heed the fine work of the bipartisan commission on
20 entitlement and tax reform which was Senator Bob Kerry
21 and Senator Jack Danforth and several of us on this
22 panel?
23 There is no such thing in politics as repetition. So
24 just one more time, please, if I may, I will reprise the
25 refrain. A little background music. Hear it. Thirty of

1 the 32 of us ---- no humming, please, no kazoos either.
2 Now, wait, where were we? No.
3 One more time, by the year ---- 30 of the 32 of us
4 agreed on this scenario. By the year 2012, with no
5 increase in revenue, having done a perfect health care
6 bill, there will be only sufficient revenue in the United
7 States Government to operate Medicare, Medicaid, Social
8 Security, and Federal retirement.
9 There will be nothing, nothing at all for education,
10 transportation, defense, WIC, WIN, Head Start, NEA, NEH
11 or any other program of the government. Got it?
12 The trustees of the Social Security program who are
13 three of the cabinet of this President are telling us
14 that Medicare will go broke in the year 2002.
15 So every time I hear about some senior pitching
16 forward into their mush, then I want to ask that senior,
17 how would you feel when it goes broke in the year 2002
18 when you won't even let us mess around with the cost of
19 living allowance?
20 How would you feel when it just goes broke? And how
21 will you feel, you young people when Social Security goes
22 broke in the year 2029 and begins its swan song in the
23 year 2013? How will you feel about that? Those are the
24 facts.
25 And so we are going to leave off the table Social

1 Security. I can't get anybody to even get thrilled about
2 that. We don't even talk about the cost of the living
3 allowance.
4 It just kicked in at 2.6. And it goes to everybody
5 under Social Security, regardless of their net worth or
6 their income. It is billions.
7 So, Mr. Chairman, I am going to sit low on the saddle
8 know, but I intend to pursue these things in coming
9 months.
10 I intend to pursue the Kerry-Simpson package to
11 restore solvency to Social Security and hold those
12 hearings as the chairman of that subcommittee. And I
13 will have. And you have assured me hearings on that.
14 I intend to pursue a correction of the over
15 estimation of the CPI and hope to work with my congenial
16 senior colleague from New York on that.
17 It is over estimated. We all know it is over
18 estimated. And it is not simply a repair tool. It is
19 big bucks, way out, way out front.
20 I intend to affluence test all these variance
21 entitlements. Net worth and income will be considered.
22 There is where we will find out who is for the rich and
23 who is for the poor.
24 We should do 30-year budget projections. I hope that
25 we will do that because all of this is short-term stuff.

1 And I hope that the President will go back to his
2 amazing and wonderfully appropriate statement on
3 generational accounting in his first budget which was
4 completely left off of the second one because the
5 politicians got to the President instead of the practical
6 people.
7 I intend to see up and down votes on all of those
8 crystal clear issues in these next months somehow, some
9 way.
10 Senior groups will object to all we do. They have a
11 solution for you, for you young folks between 18 and 45.
12 Oh, yes, they do.
13 There are two ways to go, either cut benefits or
14 raise the payroll tax. They will never touch income tax
15 nor would any of us here.
16 So guess who that hits? That is the young that it
17 hits. That is the worker that it hits. That is who pays
18 the bill. That is what it is going to be.
19 They will simply raise the payroll tax. It will be
20 minuscule. It will be half a percent. It will be 7. or
21 4. and on out into eternity.
22 We all know what we need to do. We intend to do it.
23 We won't let Medicare go broke in the year 2002. All we
24 are doing amid the partisan shrieking of anguish is
25 casting tough votes. Medicare will now go broke in the

1 year 2008, a rousing cheer for all of us. A rousing
2 cheer, it will now go broke in 2008.
3 We won't let deficits run over $200 to $300 billion
4 as far as the eye can see. And this is only a start,
5 ladies and gentlemen.
6 If the American people can't understand that, they
7 are doomed. It is not Draconian. It is mean spirited.
8 It is not cruel. It is not evil.
9 And each one of us here all know the present course
10 is unsustainable.
11 Mr. Chairman, the party is over. It is time to swamp
12 out the bar. And grab your mops instead of your
13 microphones.
14 The Chairman. Thank you, Senator.
15 Senator Breaux.
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1 OPENING STATEMENT OF THE HONORABLE JOHN BREAUX, A U.S.
2 SENATOR FROM LOUISIANA
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4 Senator Breaux. Thank you, Mr. Chairman. Mr.
5 Chairman, welcome to Christmas in October. The Christmas
6 season is a wonderful time. I remember knowing it as a
7 time for giving and a time for receiving.
8 I remember once when I was young kid, my parents
9 bought me a bicycle for Christmas. And I just loved it.
10 And it was big and it was bright. And it was shining.
11 And I was just so happy to get it.
12 Well, I wonder how I would have felt about that
13 bicycle if I had known that in order to pay for it, my
14 parents had to cut grandma's and grandpa's medical
15 savings.
16 I wonder how I would have felt about getting that
17 bike if I found out that my mom and daddy had to get the
18 money to buy that bike from a disabled aunt who is living
19 in nursing home under long-term care.
20 And I wonder how I would felt about getting that bike
21 if I found out that how hard to pay for it that my
22 parents had to take the money from a single working
23 mother with two children who was earning a minimum wage.
24 Or I wonder how I would have liked to have had that
25 bike if I had found out that my mom and daddy in order to

1 pay for the bike had to take the money from someone on
2 welfare assistance who has a child.
3 Or I wonder how I would have felt if I had found out
4 if they had to take the money to buy my bike from all of
5 them.
6 I think I and every member of this committee would
7 have said, we don't want the bike under those conditions.
8 Mom and dad, we can't afford it. Take the bike back.
9 Take it back.
10 I feel today, we are about to do the same thing
11 because we are about to give a $245 billion present. And
12 it is a wonderful present. I mean, million of things in
13 this present are things that I have individually co-
14 sponsored who would love to have them.
15 But in order to pay for this total package, we are
16 taking $270 billion from seniors who depend on medical
17 health care in the Medicare program.
18 In order to pay for this package, we are taking $182
19 billion from Medicaid for the working poor and disabled
20 people who live in nursing homes.
21 In order to pay for this package, we are cutting the
22 earned income tax credit by $43 billion. In order to pay
23 for this package, we are cutting welfare assistance and
24 food stamps by $76 billion.
25 So, yes, I say let us write a tax cut, but don't pay

1 for it by taking the money from the old, from the sick,
2 and from the poor.
3 In addition to that, don't pay for it by running up
4 the deficit by an additional $93 billion.
5 An article in the Wall Street Journal on Monday by
6 Jackie Combs, "Despite Republican claims to the contrary,
7 their tax cuts will add billions to the Nation's nearly
8 $5 trillion debt, even as the GOP seeks to balance the
9 budget by 2002. An estimated $93 billion in extra debt
10 will pile up as a result of the Republican proposed $245
11 billion and seven-year tax cuts according to calculations
12 from the GOP Congressional Budget Office."
13 So I am saying in this case, Mr. Chairman, that the
14 bike is too big, the bike is too shiny, the bike is too
15 expensive. Take it back and come back with a proposal
16 that is a tax cut that America can afford. This is not
17 it.
18 The Chairman. Well, just let me reiterate one more
19 time what the Washington Post said in a number of
20 editorials that the question of tax cuts is not related
21 to the problem of Medicare.
22 Long before we talked about tax cuts, the trustees,
23 the very trustees appointed by the President indicated
24 that Medicare was in trouble and steps needed to be taken
25 to correct it.

1 That is what we are doing. And as I say, I think it
2 is not a ---- it is a false issue to try to tie the two
3 together. Senators ----
4 Senator Moynihan. Mr. Chairman, may I just say that
5 this morning, the lead editorial in the Washington Post
6 stated a huge mistake on taxes. I will ask that it be
7 put in the record at this point.
8 [The article submitted by Senator Moynihan appears in
9 the appendix.]
10 The Chairman. Well, I realize that the Post has
11 never been pro-tax cut, but at the same time, they have
12 applauded time and again what the Republicans have tried
13 to do in the way of making Medicare viable once more.
14 If we don't do something, the fact we face is that it
15 will be bankrupted in 2002.
16 Senator Moynihan. I think that is a fair statement
17 on the Post in those regards.
18 The Chairman. Senator Pressler.
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1 OPENING STATEMENT OF THE HONORABLE LARRY PRESSLER, A U.S.
2 SENATOR FROM SOUTH DAKOTA
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4 Senator Pressler. Thank you very much, Mr.
5 Chairman. And I also want to join in commending you for
6 pulling this difficult package together.
7 Perhaps, this is the last debate of this nature we
8 will have in the Finance Committee over the years. I
9 think in the coming years, there is going to be so much
10 talk about a flat tax that perhaps the nature of the tax
11 debate will change somewhat. But we will still be
12 struggling with a way to reduce our deficit.
13 And I tend to believe that our deficit is the number
14 one domestic problem. If we do not do something about
15 the debt and the deficit, our interest rates will go up.
16 That will hurt farmers and small businessmen and students
17 who have loans.
18 If we do not do something about the deficit, the
19 stability of the dollar will suffer. And that will hurt
20 us in international trade.
21 So what we are embarking on today is part of a
22 package to bring the deficit into line by the year 2002,
23 but we haven't even begun to pay off the debt.
24 We are assigning every young person in America a
25 permanent tax of about 5 percent a year during their

1 whole lifetime to help pay down the debt, if that ever
2 gets started. So that is the legacy we are leaving.
3 I hope today this is part of an effort to turn that
4 around. And I am glad to be a part of it.
5 Let me also say that I have listened to the
6 grassroots in calls and letters from my State of South
7 Dakota. And I shall put some of them into the record.
8 [The documents submitted by Senator Pressler appears
9 in the appendix.]
10 Senator Pressler. People want this package. People
11 who have children in college or people who have children
12 that they plan to send to vocational education school are
13 very much interested in this package we have pulled
14 together to help people who have children, whether they
15 are in college or not.
16 And families have called seeking this assistance. We
17 are encouraging families in this bill.
18 I would also like to say that this bill is part of an
19 overall reconciliation package which will lead us to a
20 zero deficit, balanced budget in the year 2002.
21 I have said that it is vital to the health of our
22 national economy both in the short and the long run for
23 us to eliminate the deficit.
24 Now, farmers and small businessmen have also
25 contacted me from my State of South Dakota in support of

1 this.

2 I am proud of the estate tax relief that we have
3 proposed in this bill, if we relieve the owner's tax
4 burden that our family-owned businesses currently face
5 and allow those who have worked hard throughout their
6 lives to build a successful business to pass it along to
7 their children without the threat of losing it to taxes
8 or having to sell it in order to pay the taxes.

9 Families, farms, ranches, and businesses are the
10 strength of our communities. In my State of South
11 Dakota, 99 percent of our businesses are small
12 businesses.

13 With our changes, they will not be forced to sell a
14 part of the business to pay estate taxes because we
15 exempt the first $1.5 million in assets and give a 50
16 percent rate cut to further assets up to $5 million.

17 This bill helps families by giving them the power to
18 decide how best their tax dollars should be spent to
19 benefit their children.

20 We provide a $500 per child tax credit for middle and
21 low-income individuals and families. Parents who are
22 struggling to make ends meet will have this money
23 available to help meet essential costs.

24 We have worked to encourage savings and investments
25 through a number of items, including the expansion of the

1 current deductible IRAs and the creation of new back-
2 loaded IRAs.
3 And as I talk to many middle-class people in my
4 State, they seek a restoration of the IRA, an incentive
5 to save.
6 We don't have a lot of incentives for low or middle-
7 income people to save, but somehow a lot of people came
8 up with that $2,000 for an IRA when we had the program.
9 And they will do that.
10 And that is good for our national economy because we
11 do not save at the same rate as many other industrialized
12 societies. And that will make our economy stronger.
13 And I will also say that the back-loaded IRAs will be
14 an incentive for all people to save more.
15 In combination with the cuts in capital gains tax
16 rates, I expect we will see a growth in our economy and a
17 much needed increase in the rate of our national savings.
18 This bill has something for everyone. South Dakota's
19 families with more than 150,000 children will have more
20 money in their family budget.
21 South Dakota businesses, farms, and ranches will
22 benefit from the investment opportunities and tax relief.
23 South Dakota seniors will benefit from the retirement
24 savings incentives and favorable tax treatment for
25 medical savings accounts and long-term care.

1 And our economy will benefit across the board from
2 deficit reduction and economic growth.
3 And I will say in conclusion that this is part of the
4 big economic picture. And someone said to me the other
5 day, well, why don't we spread this out over more years
6 so the pain will be spread out more?
7 Well, I would say that we want to get the benefits
8 sooner. We want to get the job sooner. And the other
9 numbers that have been proposed are really phony numbers
10 if you look at them.
11 So it is not easy to be for something. It is not
12 easy to be part of a team that is putting together a plan
13 that will become law.
14 It is easier to be throwing grenades at it. And it
15 is much easier to throw grenades than to catch them. But
16 in any event, this is a solid plan that has been worked
17 out. I am proud to be a small part of it. And I hope
18 that we do some fine tuning, but that we move forward.
19 The Chairman. Thank you, Senator Pressler.
20 Senator Moynihan. Mr. Chairman, Senator Conrad is
21 necessarily absent for a moment. And if we could move to
22 Senator Graham of Florida, Bob Graham.
23 The Chairman. Please proceed.
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1 OPENING STATEMENT OF THE HONORABLE BOB GRAHAM, A U.S.
2 SENATOR FROM FLORIDA
3
4 Senator Graham. Thank you, Mr. Chairman. Mr.
5 Chairman, as we are basically a function of government,
6 the collection of taxes and the distribution of public
7 resources, I am focused on my own personal, relatively
8 new status as a grandparent. I am the grandparent of
9 eight grandchildren, including triplets of which I will
10 provide photographs at the least instigation.
11 Watching these children grow up, I am reminded of the
12 widespread phenomenon among children. They like to eat
13 dessert before they eat dinner. It is more fun that way.
14 Why mess around with peas and carrots when you can have
15 cake?
16 Kids are naturally drawn to dessert first. I am
17 afraid ---- and I believe in saying this I am echoing the
18 remarks of the Senator from South Dakota and the Senator
19 from Wyoming that that is about what we are commenced to
20 do here.
21 We are going to serve dessert first, the cake with
22 ice cream and all the toppings. And then, we will hope
23 everybody still has plenty of appetite for the spinach.
24 I suggest that we should reverse that sequence and
25 make certain that we have accomplished two objectives

1 before we eat dessert.

2 First, we should enact, not merely propose

3 legislation that would result in a balanced budget. This

4 is not the first time Congress has attempted to balance

5 the budget with significant tax cuts before assuring that

6 it had a balance budget plan in effect.

7 In the early 1980s, Congress reduced taxes

8 dramatically. The theory was that we would balance the

9 budget anyway through economic growth and cutting

10 spending. It did not work. And its failure is one of

11 the principal reasons we are here today.

12 The result, instead of a balanced budget, was

13 hemorrhaging debt. During the decade following those

14 cuts, government piled up over $4 trillion of the

15 national debt.

16 That is more debt than this Nation had accumulated in

17 the entire 190 year history prior to that time.

18 Here we are again considering a monstrous tax cut

19 that the majority claims will encourage savings, spur

20 growth, and economic expansion and will somehow get us to

21 a balanced budget.

22 Every American knows that in order to balance a

23 checkbook, you have to do one of two things: spend less

24 money or take in more money.

25 Reducing income is not one of the options that the

1 average American family has in how to balance its books.
2 In fact, I believe that most Americans of all
3 economic backgrounds prefer deficit reductions to tax
4 cuts.
5 Mr. Chairman, I would like to have inserted into the
6 record immediately after my remarks a series of polls
7 ranging from a poll by Business Week and Lou Harris of
8 last summer in which senior business executives by a
9 margin of 4 to 1 said they would prefer balancing the
10 budget to tax cuts, to the most recent poll conducted by
11 the Wall Street Journal and NBC in which people were
12 asked, if Congress reduces spending on some programs this
13 year, should these savings mainly be used to reduce the
14 deficit to lower taxes or to increase funding for other
15 programs? By a margin of more than 2 to 1, the American
16 people said we should reduce the deficit. That is what
17 the grass roots are telling us.
18 [The polls submitted by Senator Graham appears in the
19 appendix.]
20 Senator Graham. But adopting a balanced budge plan
21 is not only thing we should do. Second, we need to
22 assure ourselves by demonstrated fidelity to that plan
23 that it works before we turn to tax cuts.
24 What happens if these Medicare and Medicaid cuts turn
25 out not to be sustainable? What if after implementation,

1 the people rebel? And we come back two years from now
2 and repeal part of them, as we did after we passed the
3 most recent major modification of Medicare.
4 If that happens, we would have then eaten our dessert
5 and won't be hungry for the vegetables.
6 The tax cuts in the Chairman's mark total
7 approximately $30 to $40 billion a year, $30 to $40
8 billion a year of tax cuts in the Chairman's mark.
9 The spending cuts that this committee has approved,
10 as well as our brother on the Appropriations Committee,
11 total only $60 billion for 1997.
12 Our leadership says that we are cutting nearly $1
13 trillion in Federal spending over the next seven years.
14 But those cuts are heavily back-loaded so that in the
15 early years, the cuts will be relatively modest.
16 In fact, for the first year, we will implement only
17 one-fourteenth of the spending cuts for the seven year
18 period, but we will implement a full one-seventh of the
19 tax cuts. That combination barely makes a dent in the
20 deficit.
21 I would call this eating dessert pretty early in the
22 meal. I urge this committee and the Senate to develop a
23 reconciliation bill that permits tax cuts only after we
24 have enacted spending reduction and gathered some
25 evidence of our commitment to their realization before we

1 eat dessert. Thank you.

2 The Chairman. Thank you, Bob.

3 Senator D'Amato.

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1 OPENING STATEMENT OF THE HONORABLE ALFONSE M. D'AMATO, A
2 U.S. SENATOR FROM NEW YORK
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4 Senator D'Amato. Thank you, Mr. Chairman. Mr.
5 Chairman I have to tell you something. I think this
6 committee under your leadership has done an outstanding
7 job.
8 And I have to tell you I don't blame the American
9 people for being confused. There is more demagoguery
10 than I have ever seen.
11 Everyone says cut. When it comes to cutting, they
12 vote against it. You are cutting the poor. You are
13 cutting the elderly. You are cutting X. You are cutting
14 Y. You are cutting my constituents. I am going to stand
15 up. I am going to die for them.
16 We are killing the country because we are spending
17 too much. We are out of control. We don't have the
18 courage to admit it. It is easy to demagogue. We are in
19 a time of fear.
20 I have to tell as one who is a new member of this
21 committee, I am amazed at the incredible balance and
22 proportion that these proposals that we will be voting
23 have.
24 Now, we are not cutting $245 billion in tax relief
25 for the wealthy. That is just nonsense. And that is the

1 way this has been portrayed, giving tax relief to the
2 wealthy. That is nonsense.
3 And if you look at the $245 billion which I really
4 had an opportunity to do, not in great depth, I must
5 admit, $21 billion goes to reducing the deficit. It
6 doesn't go to any individuals. It doesn't go to any
7 corporations. It doesn't go to the wealthy.
8 So we subtract 21 from 245. I think we get $224
9 billion in relief for families, for people, corporations,
10 businesses of tax help.
11 I mean, imagine, considering trying to help the
12 economy grow. So we are dealing with $224 billion.
13 Let's take a look at where the $224 billion goes
14 instead of demagoguery, instead of saying that we are
15 giving it to the rich and to the wealthy because that is
16 a lot of bunk, absolutely bunk.
17 In 1993, members of this panel voted to increase
18 taxes on working middle-class families, voted to increase
19 taxes on the elderly, voted to increase taxes on people
20 on Social Security, irrespective of their income.
21 And the same people, some of those who voted there,
22 are now demagoguing this issue to death. What about your
23 previous votes? What about promises made and promises
24 broken?
25 Now, let's take a look at the $224 billion that is

1 left for distribution. The biggest chunk of that out of
2 $224 billion, $141 billion. That is about 63 percent.
3 Sixty-three percent goes to one area, a $500 credit per
4 child.
5 Most Americans really don't understand what that
6 credit is. And most of that goes to people, if you look
7 at it, who are going to benefit who are in the 15 percent
8 tax bracket. They are not the wealthy. They are working
9 families. They are poor families. They are the middle-
10 class taxpayers that we have abused over the years.
11 So let's stop abusing them again and trying to
12 frighten them. When over 63 percent of that of all of
13 the tax cuts, of all of the tax cuts that are going to
14 people and individuals, again, 63 percent goes on one
15 thing, $500 per child.
16 Now, do you want to help working families? Do you
17 want to help poor people? Now, that is what we have
18 done, $141 billion.
19 You subtract $141 billion from $224 billion, you
20 don't have much left, but let's take a look at where some
21 of that has gone. In addition, $500 per child. We are
22 taking $141 billion. Almost $2 billion goes for credit
23 for adoption expenses. Adoption, adopting children. Do
24 you think that makes sense? Is that going to working
25 people? Is that going to people to encourage them with

1 families? You'd better believe it.

2 $12 million. We have demagogued this. And there
3 hasn't been a person on this panel who hasn't said let's
4 encourage the families. Why penalize people for being
5 married? Why should they pay a disproportionate share?
6 We don't wipe out the inequity. If you are married, you
7 pay more; an individual, you pay less. Two people, we
8 try to do something. We included $12 billion in relief
9 there.

10 Student loans, there is a lot of demagoguing. You
11 are cutting student loans. You are cutting. You are
12 cutting. So we put $1 billion in as a credit for loans
13 to help families. And those are working middle-class
14 families. Those aren't wealthy families. That is a total
15 of $15 billion. And it seems to me if I add the $15
16 billion up and the $141 billion, I get $156 billion.

17 Or to put it another way, in terms of tax cuts that
18 are going to people and individuals, 70 percent ---- 70
19 percent are going to families. And the greatest bulk of
20 that are going to working middle-class families, incomes
21 under $75,000.

22 And we haven't even talked about some of the other
23 things, IRAs. How about spousal IRAs? Do you think the
24 woman who is working at home and she's got every right
25 and has a job that she should not be permitted to put

1 aside? Maybe you want to vote against spousal IRAs. I
2 don't.
3 You want to go out and campaign about how good IRAs
4 are. Well, here is an opportunity. Vote against them.
5 I don't think they are for the rich, the wealthy.
6 Capital gains tax reform, it is going to help this
7 economy. It is going to create jobs. It is not an
8 attempt by anyone on this committee to help the wealthy.
9 It is try to create jobs and hope and opportunity for the
10 future.
11 So sure, you can demagogue it and plenty of that.
12 Talk about fear. Get the AARP to send out more letters.
13 And get the seniors all riled up. You are going to cut
14 my benefits.
15 Only in America can you actually increase spending by
16 $110 billion which we will be doing in Medicare and call
17 that a cut, an increase at the average rate of 6.4
18 percent and keep the system from going broke. Demagoging
19 it got all the seniors scared out of their mind.
20 Why don't we talk about good old fashioned politics,
21 if that is the way you want to play it? And we have a
22 duty and an obligation to defend it, to be able to
23 explain it. And I think we can. And we will. And we
24 will take it to the American people on a balanced program
25 because this is a balanced program. And we do some of

1 the tough things that we are supposed to be doing.

2 And if we don't and if we aren't successful in

3 adopting this, I want to tell you what is going to take

4 place. You will see the financial market places react.

5 It won't be good for working middle-class Americans or

6 for this country.

7 So I want to commend this committee for the work it

8 has done and brought us to this point. And I intend to

9 support this proposal. Would I like to have changes in

10 it? Of course. Can reasonable people disagree on

11 certain elements? Of course, they can. But overall, I

12 think it is a magnificent effort long overdue. Thank

13 you.

14 The Chairman. Thank you, Senator D'Amato.

15 Senator Murkowski.

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1 OPENING STATEMENT OF THE HONORABLE FRANK H. MURKOWSKI, A
2 U.S. SENATOR FROM ALASKA
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4 Senator Murkowski. Thank you, Mr. Chairman. I want
5 to acknowledge the effort that you and the professional
6 have made in putting together your mark.
7 I know you have been pulled individually and
8 collectively by members in our party. Some of us would
9 have preferred a smaller tax cut and a larger part of the
10 savings going towards deficit reduction. I am one of
11 those.
12 Others have argued, of course, for an even larger tax
13 cut package. But I think you really struck a responsible
14 balance in the bill, considering the makeup of the
15 majority. And I commend you specifically for your
16 leadership in putting this together.
17 I would also like to commend my friend from New York.
18 And I don't do this very often. I am talking about the
19 one I just poked, Senator Moynihan.
20 We have had a little dialogue here this morning on
21 the views and interpretations as both sides see it. But
22 I think Senator D'Amato has put it in the earthy terms of
23 reality relative to just where the majority of this
24 actual reduction is and who it affects. And it affects
25 families.

1 And we are all concerned about family values, but
2 let's recognize as he succinctly stated just where the
3 majority of this is going. It is going to families. And
4 those families are going to have greater borrowing power.
5 They are going to have a greater opportunity to educate
6 their children. And if we are concerned about the state
7 of the family, this is a positive contribution.
8 And, Senator D'Amato, I am not going to repeat what
9 you said, but I think you said it as well as I have heard
10 it expressed.
11 I hope the press reflects a little on it. And the
12 writers who are going to editorialize, if you will, on
13 the merits of both the Democrats interpretation and that
14 of the Republicans on the real bottom line as to where
15 the money is going.
16 One of the key elements in this bill is the
17 requirement that nearly one-tenth or $21 billion be set
18 aside for deficit reduction.
19 And over the next 10 years, these tax reforms
20 represent more than a 10 percent set aside for deficit
21 reduction. I think it is roughly $41 billion over 10
22 years.
23 Now, I am not satisfied with that, but it is a
24 significant start. And the Chairman and I think the
25 members on this side can take an awful lot of

1 satisfaction that we can say we started the process of
2 debt reduction by designating a specific amount of this
3 savings.
4 Now, where did this $224 billion come from? We got
5 $224 billion plus another $221, $222 billion which makes
6 up the $245 billion savings. $170 billion came from the
7 economic dividend in the effort to ultimately balance the
8 budget. And $75 billion by reducing the deficit at a
9 slower rate.
10 Now, I am not satisfied with that, but let's be
11 realistic. The American public doesn't trust government.
12 They don't trust government to go out and take a savings
13 and reduce the deficit. But given the choice of that or
14 a tax cut, they are going to say, well, take the tax cut
15 now because it is tangible. It is there.
16 Mr. Chairman, in less than a month, our government is
17 going to run up against a $4.9 trillion debt ceiling
18 limit. We are going to have to extend the debt ceiling.
19 That is a reality. The United States is not going to
20 default on its debt. Until our budget is balanced, our
21 debt is going to continue to grow. And the carrying
22 costs for that debt will continue to rise.
23 I have been a banker all my life. And the thing that
24 bothers me is that we are spending $.14 out of every
25 dollar to carry that accumulated debt of $4.9 trillion.

1 Do you remember what the prime rate was in this
2 country in December of 1980, Mr. Chairman? It was 20 1/2
3 percent?
4 Senator Bradley. I was too young.
5 Senator Murkowski. You remember, Bill. Where would
6 we be today if we got a few bumps on the prime rate? I
7 mean, it is all over, baby. So let's reflect the reality
8 that we've simply got to address this accumulated debt
9 where we are now spending such a significant greater
10 portion of our budget in the carrying charge of the
11 interest.
12 Interest costs will continue to raise over the next
13 four years. By the year 2000, they will begin to level
14 off, we are told. By the time our budget is balanced by
15 the year 2002, hopefully, they will be in decline.
16 The only reason they will be in decline is if indeed
17 the investment community has confidence that we are
18 seriously considering taking the necessary steps for
19 fiscal responsibility.
20 Well, with the tax cuts we are adopting in this bill,
21 I believe the economy will grow at a faster rate over the
22 next several years, resulting in a gain in federal
23 revenue which I think will be beyond what is projected by
24 CBO. And that could mean we could reach our goal of
25 balancing the budget, reducing the debt before the 2002.

1 Mr. Chairman, the vast majority of American families
2 are going to see a major reduction in their taxes as a
3 result of your bill. Seventy percent of this tax cut is
4 targeted, as I said, towards families, a middle-income
5 family. Think about it. A middle-income family with two
6 children is going to see their tax bill cut by $1,000.
7 That is going to make a major difference to millions and
8 millions of families in this country.
9 And, Mr. Chairman, one thing we have not mentioned.
10 It is not temporary. It is permanent. This is
11 permanent, not something we are going to go back on after
12 three to five years.
13 So your proposal to allow a tax cut to offset the
14 cost of student loans is going to be another boost to
15 families.
16 I want to commend you for the changes you have
17 proposed in the rules governing IRAs. For the first
18 time, homemakers will be able to take full advantage of
19 an IRA. Now, whose plan is it? It is our plan.
20 It is responsible. The homemaker works in the home
21 and should be entitled to having an IRA so that they can
22 put some money away for their retirement. And it will
23 encourage the country's low savings rate that has been
24 blamed for much of the sluggishness in economic growth
25 for the last year.

1 We have had a situation where we have rewarded for
2 debt. You used to be able to charge your interest for
3 your credit card or anything else. We reward for debt.
4 We don't reward for savings. Now, we are trying to turn
5 it around.
6 These savings incentives should help boost our pool
7 of national savings and stimulate more long-term
8 investment. And I believe that capital gains cuts that
9 are contained in this mark will unlock hundreds of
10 billions of dollars that have been locked in capital
11 investments for years.
12 You need to have the incentive out there. And the
13 incentive has to be the return on investment.
14 Mr. Chairman, I would have preferred that we could
15 have done more to alleviate the financial penalty on
16 investments that result from the alternative minimum tax,
17 but I know you tried to make additional changes, but ran
18 up against the revenue constraints on this bill. I hope
19 that we will be taking that up further in the Finance
20 Committee at a later time. And I want to thank you for
21 the provisions concerning some of the Alaskans. And I
22 would ask that the balance of my statement be entered in
23 the record as if read.
24 [The prepared statement of Senator Murkowski appears
25 in the appendix.]

1 OPENING STATEMENT OF HON. PHIL GRAMM, A U.S. SENATOR FROM
2 TEXAS
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5 Senator Gramm. Well, Mr. Chairman, thank you.
6 I want to address two issues. I want to address the
7 tax cuts, and I am not going to apologize for them. And
8 I want to address the deficit. And I am proud of what
9 you do on the deficit.
10 I think it is important to remind people that in
11 1950 the average family in America with two little
12 children sent one out of every 50 dollars it earned to
13 Washington, D.C. Today, that same family is sending one
14 out of every 4 dollars it earns to Washington, D.C.
15 And if the current trend continues, if we do not
16 create a single new Federal program in the next decade,
17 the average family with two children is going to be
18 sending one out of every 3 dollars to Washington, D.C.
19 Our colleagues on the Democratic side of the aisle,
20 if you listen to what they are saying, obviously think
21 that is a good trend. We believe it is a bad trend, and
22 we do not apologize for trying to fix it.
23 We want working families to keep more of what they
24 earn. And we have before us a permanent tax cut for
25 working families that will allow a family with two

1 children that work for a living, and pays taxes in
2 America, next year, starting on January 1, to keep $1,000
3 more of what they earn to invest in their own children,
4 their own family and their own future.
5 And we are absolutely confident that they will do a
6 better job investing their money in their children and
7 their future than the Government will do if we do what
8 our Democratic colleagues argue, which is let the
9 Government keep it, and let the Government spend it.
10 When I offered the Contract With America tax cuts on
11 the floor of the Senate, I remember President Clinton
12 saying that my amendment cuts spending for children, to
13 which I responded that it is not a debate about how much
14 money we spend on children, but instead it is a debate
15 about who is going to do the spending.
16 Republicans differ with the President and differ
17 with Democrats. The President and the Democrats want the
18 Federal Government to do the spending; we want the family
19 to do the spending. We know the Government and we know
20 the family, and we know the difference. And we believe
21 the American people know the difference. So I am proud
22 of the fact that we are giving a permanent tax cut to
23 working families.
24 Now I know that some of our colleagues have
25 complained that if people do not pay taxes, they do not

1 OPENING STATEMENT OF HON. PHIL GRAMM, A U.S. SENATOR FROM
2 TEXAS
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4
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13 Washington, D.C. Today, that same family is sending one
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21 that is a good trend. We believe it is a bad trend, and
22 we do not apologize for trying to fix it.
23 We want working families to keep more of what they
24 earn. And we have before us a permanent tax cut for
25 working families that will allow a family with two

1 get a tax cut. I do not understand that complaint. The
2 objective of the tax cut is to cut taxes for people who
3 work for a living, and who pay taxes. And I am not about
4 to start apologizing for it.
5 Now let me say something for the part of the tax
6 package that virtually no one has talked about--tax cuts
7 for rich people. Those tax cuts we are providing, not
8 many of them go to rich people. Well, what is the
9 complaint? Well, the complaint is, if we cut the capital
10 gains tax rate, rich people are going to mobilize their
11 capital, they are going to invest it. If they invest it
12 wisely, they are going to earn profits. Wow. Welcome to
13 America. That is how our system works.
14 I do not know what Bill Clinton's life experience
15 was. But when I was growing up as a boy in Columbus,
16 Georgia, I had lots of jobs. I worked at the Tom Houston
17 Peanut Company, I threw the Columbus Ledger Inquirer, I
18 worked at Kroger's, I worked at a local cabinet shop. No
19 poor person ever hired me in my life. Now maybe that is
20 a unique experience.
21 Maybe if we went around this table, there are all
22 kinds of people here who were hired by poor people. But
23 my experience was that every job I got, I got because
24 somebody beat me to the bottom rung of the economic
25 ladder, climbed up, invested their money wisely, and

1 is the one business where your record has to have nothing
2 to do with your rhetoric. Two years ago, every
3 Democratic Member of this Committee voted for a tax
4 increase larger than the tax cut we are talking about
5 here.
6 The Congressional Budget Office says that their
7 budget, under current services, will produce a steadily
8 rising deficit through the year 2002, and will produce a
9 deficit of $228 billion in the year 2002.
10 Now the budget we have before us, with our tax cut,
11 will produce a surplus, according to the same nonpartisan
12 Congressional Budget Office, of $13 billion surplus,
13 taking in more than we spend by the year 2002.
14 Our budget, even with the tax cut, because we cut
15 spending, because we set priorities, will borrow $761
16 billion less than Bill Clinton's new budget which he
17 submitted--not his first submission, but his second--
18 which never gets to a balanced budget at any moment in
19 future history that we can imagine or project.
20 So it seems to me, if you want working people to
21 keep more of what they earn, which is what we want, you
22 are for these tax cuts. If you want a balanced budget,
23 if you want less borrowing, you are for the spending cuts
24 we put together.
25 We have two problems: We have a deficit; and we

1 have a Government that has taxed so much that working
2 families are not getting to keep enough of what they
3 earn. We try to fix both. And, Mr. Chairman, I am proud
4 of your leadership on these issues.
5 The Chairman. Thank you, Senator Gramm.
6 Senator Nickles?
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1 OPENING STATEMENT OF HON. DON NICKLES, A U.S. SENATOR
2 FROM OKLAHOMA
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5 Senator Nickles. Mr. Chairman, let me also
6 compliment you for the work you have done. And let me
7 make a couple of comments.
8 Senator Gramm said that we are cutting spending. I
9 take issue with that. I do not think we are cutting
10 spending. I see the total outlays in 1995, which are
11 about $1.5 trillion. The total outlays in the year 2002
12 are about $1.9 trillion. So spending goes up.
13 I know my colleagues. I have heard many of them
14 earlier say that we are cutting Medicare $270 billion.
15 Medicare spending goes from $177 billion to about $287
16 billion. That is an increase. Medicaid goes up. Almost
17 everything is going up, total spending increases from
18 $1.5 trillion to $1.9 trillion over this 7-year period of
19 time.
20 Revenues, I might mention, are going up. We are
21 talking about a tax cut, but total revenues right now are
22 $1.35 trillion, and that is estimated to go up to about
23 $1.88 trillion. So even revenues go up.
24 Now we are giving a tax cut for families. I have
25 heard some people say--particularly on the other side--

1 that well, wait a minute, it is unfair to low-income
2 people. The tax cut that we have before us for a family
3 with two children pays no income tax if they have income
4 less than $24,000. I think that is the right dividing
5 line, no income tax.
6 Now some people want to use the Tax Code to
7 redistribute income. They say, wait a minute, you are
8 not giving the benefit for those people who are making
9 $10,000. Well, they want to have a refundable tax credit
10 so Uncle Sam is writing the check. And that is what we
11 do under the earned income tax program. It is a negative
12 income tax. We are writing checks. Well, we are making
13 some changes to reduce the growth in that program.
14 I might tell my colleagues that some people have
15 said that you guys have slashed that program. Not so.
16 The maximum benefit on earned income tax credit right
17 now, if you have a family of four, or a family with two
18 or more children, the maximum benefit is $3,100. Under
19 these radical proposals that we are talking about,
20 Chairman Roth, someone can receive $3,800 by the year
21 2002. So the maximum benefit goes up. It does not go up
22 as much as some people would like, but we cannot afford
23 that.
24 As Senator Gramm mentioned, this is the only plan we
25 have on the table that will balance the budget.

1 President Clinton's budget never balances the budget,
2 disregarding what he does on tax cuts. And he did call
3 for some tax cut. But it never balances the budget.
4 Even in the year 2002, it continues to be over $200
5 billion.
6 I remember having a constituent ask me if we will
7 ever see a balanced budget in our lifetime. The thing
8 that bothered me is that constituent was about 21 years
9 old.
10 Now for the first time, the first time since I have
11 been up here, we are actually going to try to implement.
12 And we have voted on a budget resolution. Now comes the
13 heavier lifting, both on the reconciliation package and
14 this part of the package.
15 Can we afford this tax cut? Somebody talked about
16 the $245 billion tax cut. Actually, this is $224
17 billion, if you net it out. Can we afford it? Well, how
18 much is that over 5 years? Over 5 years, it is $141
19 billion. Two years ago, President Clinton passed a tax
20 increase that was $240 billion over 5 years. So if you
21 compare apples to apples, 2 years ago this Congress, this
22 President, was increasing taxes by $240 billion. What we
23 are doing over 5 years is reducing the growth of taxes
24 $14 billion.
25 Again, as the Chairman mentioned, we are directing

1 that most of this money, about two-thirds of it, towards
2 families. And in some cases, we are totally eliminating
3 the tax liability for families that make less than
4 $24,000.
5 We are making some changes in the inheritance tax.
6 I have heard debate on both sides. I will tell my
7 colleagues that I think that is a very positive
8 provision. It is family-friendly, but also friendly to
9 business, small business.
10 Senator Gramm said he never worked for somebody that
11 was poor. I used to work for Bill and Sons Janitor
12 Service, and they were poor, or maybe they were middle
13 income. They had a little janitor service. Well, I
14 started an even smaller janitor service, so I have worked
15 for people that did not make a lot of money.
16 What we are doing by this inheritance tax change is
17 that we are going to allow people to build a little
18 business without Uncle Sam coming in and saying that he
19 wants 35 to 55 percent of it. So I think it is a
20 positive provision.
21 The provisions that are encouraging savings are also
22 very positive.
23 So, Mr. Chairman, I want to compliment you for your
24 work. I think this is a good program. I think it is
25 very defensible. I think it is good for American

1 families. And it will ultimately lead to a balanced
2 budget, and that is something we have not had in the
3 past.
4 The Chairman. Senator Conrad?
5 Senator Bradley. You might want to get your
6 thoughts together for a minute. Whenever you are ready.
7 While we are recalling our childhoods, Senator Gramm
8 and Senator Nickles talked about their paper routes and
9 so on. I was actually born in a log cabin. [Laughter.]
10 Senator Gramm. How high was the ceiling?
11 Senator Bradley. Are you ready, Senator?
12 The Chairman. Are you running for President?
13 Senator Conrad?
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1 OPENING STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR
2 FROM NORTH DAKOTA
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5 Senator Conrad. Thank you, Mr. Chairman.
6 I welcome the opportunity to comment on the
7 legislation that is before us. I firmly believe that the
8 tax cuts being proposed are the wrong policy at the wrong
9 time.
10 I strongly disagree with my colleagues who assert
11 that this is pro-growth. I think it will actually damage
12 economic growth. And I think the reasons for my views
13 are best explained by a series of charts I have brought
14 along that I would like to share with my colleagues.
15 The first chart shows a copy of the concurrent
16 resolution for fiscal year 1996. We have heard a lot of
17 talk that we are going to balance the budget over the
18 next 7 years. We are not going to balance the budget
19 over the next 7 years. That is a fraud. And the budget
20 document that comes from the Budget Committee shows very
21 clearly that we are not balancing the budget. In fact,
22 it shows that in the year 2002, in the column under
23 deficits, that there is not a zero. We have not balanced
24 the budget. It shows $108 billion deficit in 2002.
25 The only way anyone can claim they are balancing is

1 to use every penny of Social Security surplus between now
2 and 2002, over $600 billion. Throw all of the retirement
3 funds of the people of this country into the pot, and
4 call that a balanced budget. It is not a balanced
5 budget.
6 So I think the first thing the American people have
7 a right to understand is that they are not balancing the
8 budget.
9 Number two, I do not believe that you can justify
10 tax cuts when the Federal debt is increasing. This chart
11 shows that we are going to have, on a total basis, a $1.3
12 trillion increase in the debt under this Republican plan.
13 That is the increase in the debt that will be developed
14 over this 7-year period.
15 I think it is most unwise to be cutting revenue and
16 increasing the debt with the policy that is before us.
17 Let us go to the next chart. We will have to put it
18 on the other axis so that people can see a comparison of
19 the debt increase with or without a tax cut. With a tax
20 cut, the debt is going to increase $1.3 trillion over the
21 next 7 years. Without a tax cut, it would be somewhat
22 smaller.
23 The other chart I would like to bring to my
24 colleagues' attention is the debt increases under the
25 Republican balanced budget plan. You can see year by

1 year what the increase in the debt is as a result of the
2 yearly deficits. The entire block for each year is the
3 amount of deficit. And the orange shading at the bottom
4 of each year shows the amount that is contributed by the
5 tax cut, that is the additional debt that will result
6 from a tax cut.
7 I just say to my colleagues, it makes absolutely no
8 sense to me to be increasing the debt of the United
9 States by having a tax reduction when we are already
10 $5 trillion in debt, and when we are not balancing the
11 budget.
12 Now I noticed the other day that Senator Gramm said
13 in the Wall Street Journal that he would be concerned if
14 we were increasing the debt, but he did not think we were
15 increasing the debt. Well, he is simply mistaken. The
16 debt is increasing--$1.3 trillion over the next 7 years.
17 And $225 billion of that is because of a tax reduction.
18 I find that the people of my State overwhelmingly
19 tell me that we ought not to be cutting taxes before we
20 balance the budget and deal with the debt bomb that is
21 facing this country. I think the people of my State are
22 exactly right. It reminds me a lot of kids eating
23 dessert before they have their dinner. I think our
24 obligation is to first get this country on a track of
25 balancing the budget, doing it honestly, and not adding

1 to the debt.

2 But instead, we see a policy of adding $1.3 trillion

3 to the debt, and $225 billion of it is because of this

4 tax cut.

5 Now some of us assert that it is favorable for

6 economic growth. I just say that I think they are wrong.

7 I go back to what we did in 1993. And the folks on the

8 other side of the aisle said that we were making a

9 tremendous mistake. They said if you have these tax

10 increases to reduce the deficit, and these spending cuts

11 to reduce the deficit, you are going to crater the

12 economy.

13 That is what the people on the other side of the

14 aisle here said in 1993. They said you would crater the

15 economy. They said we would increase unemployment. They

16 said we would undermine economic growth. They were

17 wrong. Economic growth has averaged 3-1/2 percent a

18 year, the best economic growth in 15 years. We have got

19 the highest level of business investment in over 20

20 years. This economy is growing. It has generated nearly

21 8 million jobs. And all of those who asserted that we

22 would crater the economy by reducing the deficit, and

23 curbing the growth of the debt, have been proven wrong.

24 Once again, I think they are selling us an economic

25 policy that is wrong. We should not be increasing the

1 debt. We should not be expanding deficits in order to
2 have a tax cut. We should instead increase the pool of
3 societal savings by reducing the deficit and by curbing
4 the growth of the debt.
5 Finally, Mr. Chairman, if I might--I know I have
6 gone over my time.
7 Senator Moynihan. As others have done.
8 Senator Conrad. I thank the Ranking Member.
9 Senator Moynihan. The Chairman has been very
10 generous.
11 Senator Conrad. And I thank the Chairman.
12 The other question I want to raise today is who
13 benefits, and who loses?
14 I asked the Treasury for the combined effect of the
15 earned income tax credit.
16 The Chairman. I would ask that you keep this very
17 brief.
18 Senator Conrad. I will. I asked for the combined
19 effect of the earned income tax credit cuts and these
20 changes. And they reported to me that for a family of
21 four earning $15,000 a year, that they will pay $357 more
22 as a result of these changes. That is a family of four
23 earning less than $15,000.
24 For a family of four earning $200,000, they will pay
25 $2,471 less. And for a family of four earning $350,000,

1 they will pay $3,582 less. That is not my notion of any
2 kind of targeted tax relief. It is clearly being
3 targeted to the wealthiest among us, at the expense of
4 those who are the least well off among us.
5 We also now see the Joint Tax Committee come back
6 and tell us--I think most seriously--that by 2000 there
7 will be a tax increase for everyone earning up to $30,000
8 a year under this plan. In my State, that is 69 percent
9 of the people of the State of North Dakota are going to
10 have a tax increase so that we can give the wealthiest
11 among us, the best off among us, a tax reduction. That
12 is not fair. That is not equitable. And I do not think
13 it is family-friendly to pursue a policy like that.
14 So I would just say to my colleagues that I do not
15 believe this is good economic policy. I do not think it
16 is wise to increase the debt. I do not think it is wise
17 to allow our country to go on a course that we have
18 pursued that I think has been counterproductive.
19 As a result of the deficit reduction, we saw from
20 measures that we took in 1993 what can happen if you
21 seriously reduce the deficit. The result is much
22 strengthened economic growth, much higher business
23 investment, much higher employment. And that is the
24 policy course we ought to pursue.
25 I thank the Chairman.

1 The Chairman. Well, as I pointed out earlier, even
2 the President himself said yesterday that the tax
3 increase was too much. And I must say that I heartily
4 agree with that.
5 I think it is important for the record to clearly
6 show that we have a letter from the Congressional Budget
7 Office, the nonpartisan Budget Office, to the Chairman of
8 the Committee on the Budget, Pete Domenici, dated
9 October 18, which says, "Based on the estimates of the 11
10 Senate committees, and using the economic and technical
11 assumptions underlying the budget resolution, assuming
12 the level of discretionary spending specified in that
13 resolution. . ." And this is the part that is important.
14 "CBO projects that enactment of the reconciliation
15 legislation submitted to the Budget Committee would
16 produce a small budget surplus in 2002. It is estimated
17 that that surplus would be roughly $10 billion."
18 So the budget is being put in balance by the
19 Congressional Budget Office. The Congressional Budget
20 Office is the office that the President said some time
21 ago is the one that should be accounting for these
22 things. And I am pleased to put that in the record.
23 Senator Conrad. Would the Chairman yield for a
24 question?
25 The Chairman. Yes, I will be happy to.

1 Senator Conrad. If we are balancing the budget,
2 why on the budget transmittal document itself, the
3 official document of the Budget Committee, does it show
4 under deficits for the year 2002, $108,500 of deficit?
5 The Chairman. Again, I cite to you the budget
6 letter dated October 18 that enactment of the
7 reconciliation legislation submitted to the Budget
8 Committee would produce a small budget surplus in the
9 year 2002.
10 Senator Conrad. But, Mr. Chairman, the budget
11 transmittal document itself shows clearly--and I have it
12 before us--$108 billion deficit in 2002.
13 The Chairman. We will have an opportunity to argue
14 the pros and cons later. At this time, however, I would
15 like to move on to the briefing of the ----
16 Senator Moynihan. Mr. Chairman, before you do, can
17 I just make one point?
18 The Chairman. Yes.
19 Senator Moynihan. I do conceded that the President
20 yesterday in Houston, Texas told a fund raising audience
21 that he was sure they were mad, that, "They think I
22 raised their taxes too much." And he said, "It might
23 surprise you to know that I think I raised them too much
24 too."
25 But it ought to be on the record that the Members of

1 this Finance Committee who voted for those measures do
2 not think that. Certainly this one does not.
3 We have in the aftermath the record that the Senator
4 from North Dakota has mentioned. We have had a period of
5 steady growth, increased investment. We are at a stable
6 inflation rate of 2 percent. We have essentially full
7 employment, or very near there. We would not have gotten
8 there without the things we did 2 years ago. And I think
9 that is the record.
10 In the course of the walk-through, I think it would
11 be fair to ask Mr. Kies, is it not the case that whatever
12 the end result in the final year, we do add $700 billion
13 to the debt in this legislation?
14 And I remember in 1980, when all this disastrous
15 sequence began in 1981, I believe the debt was about $840
16 billion. I do not know if this is any use, but it took
17 us from 1789 to 1980 to incur a total debt of $840
18 billion. That is almost two centuries. We will add
19 almost the same amount in the next 7 years.
20 Senator Bradley. Mr. Chairman, if I could too, I
21 do think that it is important since the issue of 1993 was
22 raised so directly here, that we compare what happened in
23 1993 with what is about to happen in this tax bill
24 because I think it is a very strong contrast.
25 It is true that income taxes went up for the

1 wealthiest Americans, What is not reported, of course,
2 is that people who made under $28,000 a year got a big
3 tax cut.
4 I come from a State that has the second highest per-
5 capita income in the country. So the mystery that was
6 explored in this Committee earlier, along the lines of,
7 gee, if you make more money, you will pay more taxes, is
8 well known to my constituents because they have the
9 second highest per-capita income in the country.
10 In New Jersey, 47,000 had an income tax increase
11 because of what happened in 1993. But 370,000 had a tax
12 cut because of what we did with the earned income tax
13 credit.
14 In this bill, it is exactly reversed.
15 The Chairman. Senator, I do not want to interrupt,
16 but everybody has had an opportunity to make an opening
17 statement.
18 Senator Bradley. Mr. Chairman, I do not deny that
19 these are unpleasant facts for the Chair to confront, but
20 these are the facts.
21 The Chairman. We are not here to argue the merits
22 or demerits at this time. The purpose of this meeting
23 this morning was to give everybody an opportunity to make
24 opening statements. We did that. I was fairly loose on
25 the time.

1 Now I want to proceed to the walk-through. So I
2 regretfully move on, and ask our Mark Prater if he would
3 begin the walk-through.
4 Mr. Prater. Thank you, Mr. Chairman.
5 The Chairman's Mark includes a family tax relief
6 package that has four elements: A $500-per-child tax
7 credit; children under 18 are eligible, no indexing,
8 effective January 1, 1996.
9 Senator Breaux. Mr. Chairman, can we get an idea
10 of what he is working from, what document?
11 Mr. Prater. I am sorry, Senator Breaux. I am
12 working from both the description of the Chairman's Mark,
13 which was distributed to the staffs on Monday, and the
14 revenue table, outlined in the same form.
15 Senator Moynihan. Where is the revenue table?
16 Mr. Chairman, might I just take a moment to
17 introduce to the Committee Mr. John Talisman, who is the
18 new Minority Chief Tax Counsel.
19 The Chairman. It is a pleasure to welcome you here
20 today. We look forward to working with you.
21 Mr. Talisman. Thank you, Senator. It is a
22 pleasure to be here. Thank you.
23 Senator Bradley. So far. [Laughter.]
24 Mr. Prater. All right. So the first element,
25 again, contains the $500-per-child tax credit; there is a

1 proposal for a $5,000 credit for adoption expenses, and
2 employer-provided exclusion for adoption expenses.
3 Senator Breaux. Can I ask a question on that, Mr.
4 Chairman?
5 The Chairman. Yes.
6 Senator Breaux. On the $500 tax credit, suppose
7 the family is not paying enough income tax in order to
8 use the $500 tax credit. Can they use it against their
9 payroll tax?
10 Mr. Prater. Senator Breaux, the tax credit is non-
11 refundable, so it goes against income tax.
12 Senator Breaux. Can they use it against their
13 payroll tax?
14 Mr. Prater. No.
15 Senator Breaux. What income level for, say, a
16 family of four would not be able to benefit from the $500
17 tax credit because they in effect, pay no income tax, or
18 that much?
19 Mr. Prater. Roughly $12,000.
20 Mr. Kies. I think it would be slightly higher than
21 that because of earned income up in the $20,000 range.
22 We can give you an exact example of that, Senator Breaux.
23 Senator Breaux. So how many families in this
24 category? You phase it out at what, $110,000?
25 Mr. Prater. That is correct.

1 Senator Breaux. How many families do you think are
2 in that $110,000 category? And how many of them in that
3 category would not be able to benefit from this?
4 Mr. Kies. Senator Breaux, the number of families
5 that would benefit from the credit total for 1996, the
6 first year the credit would be available, 28 million
7 families that would benefit from the credit. They are
8 distributed throughout the income classes.
9 The credit would not be available for tax returns
10 with incomes less than $10,000--not surprisingly--because
11 they do not have any income tax liability. There would
12 be about 3 million returns in that category. About 14
13 million returns would benefit.
14 In the category of $10,000 to $20,000, 3.3 million
15 would not benefit; about 2 million would. Then as you
16 move up, there are very few families that do not benefit.
17 When you get into the middle ranges of $30,000 to
18 $40,000, 4.5 million families would benefit; $40,000 to
19 $50,000, 4 million; $50,000 to $75,000, 7 million.
20 When you get into the upper income levels, basically
21 none of the families benefit because of the phase-out
22 ranges.
23 Senator Breaux. All right. My question, I guess,
24 is a ball park figure of how many families in the
25 category of $110,000 and below would benefit from the

1 full amount of the tax credit, and how many would not be
2 able to?
3 Mr. Kies. The number that would benefit, that are
4 below $110,000, is roughly 28.6 million. That is the
5 total number that would benefit.
6 This is an important clarification. The number of
7 tax returns claiming dependents, including dependents
8 that are not under age 18 children, that would not
9 benefit is 8.2 million.
10 Now I do not have right now the break-out of those
11 8.2 million, how many have children and do not benefit,
12 due to the fact that they are below the income levels.
13 But my rough guess is that it is around 5 million, from
14 the numbers we have.
15 Mr. Talisman. Senator Breaux, we have ----
16 Senator Breaux. Let me ask the final question.
17 Where is Mark?
18 Mr. Talisman. Senator Breaux, we have statistics
19 from the Center on Budget and Policy Priorities that show
20 about 33.5 percent of all children in the economy would
21 not qualify for the credit.
22 Senator Breaux. Let me ask Mr. Kies, under this
23 proposal, is this statement true? "Approximately 23.7
24 million children living in families with low or moderate
25 income, constituting one-third of all U.S. children,

1 would receive no aid from the child credit that is being
2 proposed."
3 Mr. Kies. That is absolutely not true, Senator.
4 The total number of dependents, including over age 18,
5 that would not benefit is only 15.3 million. And that
6 includes people who are not children below the age of 18.
7 So that statistic is just absolutely not correct.
8 Senator Breaux. Does Treasury differ? What I am
9 trying to find out is who benefits from this. I am
10 disturbed that it is not refundable because most of the
11 people that this child credit is trying to help do not
12 pay a lot of income tax. They are getting killed by the
13 payroll tax.
14 And Counsel said that this does not affect the
15 payroll tax, which is really what is eating them alive.
16 So I am trying to figure out who we are helping and who
17 we are not helping by the child tax credit, which is not
18 refundable, and is not off of payroll taxes.
19 Mr. Kies. Senator Breaux, our statistics show that
20 those receiving the credit, there are 49.8 million
21 dependents who would qualify for the credit. So that
22 would be children under the age of 18, with families that
23 have income tax liability. The additional dependents
24 claimed on all other tax returns, including those over
25 the age of 18, is 15.3 million. So it is some portion of

1 that 15.3 million. Let me try to get that statistic for
2 you, that would not qualify for the credit. It is some
3 portion of that, who are actually under age 18, but they
4 are with families that do not have income tax liability.
5 Senator Breaux. I would appreciate those numbers.
6 Mr. Chairman, this is by far the biggest portion of
7 the $245 billion tax credit. It is approximately $160
8 billion of this entire tax bill. And I am just trying to
9 find out who is going to get it, and who is not going to
10 get it.
11 It dwarfs any other provision in this tax bill. I
12 am just trying to find out who gets it, and who sort of
13 really gets it.
14 The Chairman. I appreciate that fact. At the same
15 time, it is important that we do not bog down in
16 arguments at this time.
17 Senator Breaux. Mr. Chairman, I am not arguing the
18 merits at all. I am just asking a question. I am not
19 arguing the merits yet. That will come later. I am
20 merely trying to say give me some numbers here.
21 The Chairman. Why do you not go ahead and ask that
22 question, and then we will try to proceed.
23 Senator Breaux. Does Treasury have some numbers
24 that they can give us?
25 Mr. Samuels. Senator Breaux, I would just mention

1 that, in looking at the numbers, we think you should
2 include children of families who are not necessarily
3 filing tax returns because their income is below the
4 filing threshold, or they are otherwise receiving earned
5 income tax credits.
6 So I think that you should look at the entire pool
7 of children in the country.
8 The Chairman. Mr. Secretary, the purpose of having
9 you here--and we are delighted that you could be here--
10 is, of course, to answer questions. But we are never
11 going to finish the walk-through if we get into these
12 lengthy discussions. And that is the purpose of this
13 part of the meeting, to have a walk-through, so everybody
14 knows what the Chairman's Mark contains.
15 Senator Moynihan. Mr. Chairman, if we never finish
16 the walk-through, is it possible that we will never have
17 this bill?
18 The Chairman. Well, delay is one possible
19 strategy. But we intend to proceed until we finish.
20 Do you want to continue, Mark?
21 Mr. Prater. Thank you, Mr. Chairman.
22 The third element of the family tax relief package
23 is the marriage penalty relief. This proposal would take
24 the disparity that exists between the standard deduction
25 on the individual side and the married couple side, and

1 rid the system of that disparity by the year 2005.
2 The fourth proposal is a credit for student loan
3 interest up to $500 per year, not to exceed $1,000 per
4 return, ratably phased out. The phase-out is indexed.
5 The next set of proposals are proposals to increase
6 savings and investment, including an individual
7 retirement account proposal. The individual retirement
8 account proposal has two elements to it. The first is
9 the tax-deductible IRA proposal. The current law income
10 limits would increase by $5,000 a year until phased up to
11 amounts in the single range from $85,000 to $95,000 in
12 the year 2007, and, for couples, $100,000 to $120,000.
13 These income limits would be indexed when they reach
14 those levels, as well as the contribution being indexed.
15 There would be a new $2,000 IRA for homemakers. And
16 this front-ended IRA would include penalty-free
17 withdrawals for first-time home purchases, limited to
18 $10,000, medical expenses, periods of unemployment, and
19 higher education expenses. That proposal is effective
20 January 1, 1996.
21 Senator Bradley. Mr. Chairman, could I ask a
22 question on this?
23 The Chairman. Yes.
24 Senator Bradley. Oh, I am sorry. Senator
25 Moynihan?

1 Senator Moynihan. You probably want to ask the
2 same question. The table we have here from Joint Tax
3 Committee says that over the next 7 years this measure
4 will cost $12 billion. But then in the 3 years that
5 follow, it adds another $20 billion. How could that be?
6 It is $12 billion for the years 1996 to 2002, and then
7 $33,963,000 in just 3 years.
8 Senator Moynihan. You had a question, Senator
9 Bradley?
10 Senator Bradley. That was really my third
11 question.
12 Senator Moynihan. Your third question. Well, we
13 will start from there.
14 Mr. Kies. Senator Moynihan, the proposal phases in
15 the marriage penalty relief. Under current law, a
16 married couple's standard deduction ----
17 Senator Moynihan. No.
18 Senator Bradley. I am asking about the IRA.
19 Mr. Kies. Oh, I am sorry.
20 Senator Bradley. He asked why the big revenue
21 increase in the eighth, ninth and tenth year. That was
22 the question.
23 Mr. Kies. The answer is actually similar, that the
24 proposal phases up the income limits with respect to the
25 deductible IRA from $40,000, which is the limit for a

1 married couple today, up to $85,000. Is that correct,
2 Mark?
3 Mr. Prater. One hundred thousand.
4 Mr. Kies. Up to $100 ----
5 Mr. Prater. It starts at $100,000.
6 Mr. Kies. Oh, all right. Under current law, if
7 you have over $40,000 of adjusted gross income, you
8 cannot make an IRA deduction unless you are not
9 participating in any qualified plan, and your spouse is
10 not either. That amount is phased up over time, and it
11 is phased up in $5,000 increments, so it gradually phases
12 in.
13 And that is part of the answer. The other part ----
14 Senator Moynihan. How high does it go?
15 Mr. Kies. It goes to $100,000 over roughly an
16 8-year period. No, it would be a 12-year period because
17 it goes up in $5,000 increments.
18 The other part of the answer, Senator Moynihan, is
19 that IRA proposals, by definition, have out-year revenue
20 effects because part of the benefits of IRA's are the
21 deduction up front. But then in addition, it is the
22 inside buildup that is tax-free. So, over time, wherever
23 your income threshold is, you are going to have a profile
24 of out-year revenue costs.
25 Senator Bradley. Mr. Chairman, just on that point.

1 current law allows an IRA deduction for a couple earning
2 up to $40,000, and then it is phased out at $50,000.
3 Right?
4 Mr. Kies. That is correct.
5 Senator Bradley. How many earn under $50,000?
6 From your statistics, 73 to 75 percent of the taxpayers
7 now have an IRA. So that is point number one. Seventy-
8 three to 75 percent of the taxpayers could today put away
9 $2,000 a year, tax-free, and have that invested, and the
10 money that is made on that investment not taxed each
11 year.
12 Now it is also my understanding that current law is,
13 if you earn over $50,000 a year, you can put away $2,000
14 into an IRA, not get a deduction, but your inside buildup
15 is not taxed. Is that correct?
16 Mr. Kies. That is correct.
17 Senator Bradley. So that the really big benefit of
18 the IRA, as Mr. Kies has already described, is the inside
19 buildup, the fact that you can make money, make money,
20 and not pay any taxes. And that exists in current law.
21 This does not change that. It already exists in current
22 law.
23 So as I understand it, the only thing this does is
24 to raise the ability to tax the $2,000 deduction from
25 $50,000 to $120,000. Is that essentially correct?

1 Mr. Kies. Senator Bradley, that is correct.
2 Except that I would point out that we are going to allow
3 a larger group of taxpayers to benefit, to achieve a
4 higher utilization of deductible IRA's.
5 Even though you are correct that people can do non-
6 deductible IRA's, like they can buy a deferred annuity,
7 the incidence of savings does not occur at the same level
8 we think it will if somebody has a deductible IRA. So
9 that is part of our revenue cost analysis.
10 Senator Bradley. Right.
11 Mr. Samuels. Senator Bradley, if I can just ----
12 The Chairman. We must move on. I would just point
13 out to my distinguished friend that the Bentsen-Roth
14 legislation, which was passed by this Committee and
15 enacted by the Senate, did the same thing.
16 There will be opportunity to raise these questions
17 with amendments. But in the meantime ----
18 Senator Bradley. Mr. Chairman, if these questions
19 are not answered now, they are just going to be answered
20 later. This is not a mystery here.
21 The Chairman. But if we could just keep our line
22 of discussion to questioning, rather than arguing the
23 merits and demerits, so that we can get through the walk-
24 through, is what I am trying to say.
25 Senator Bradley. Could I ask the Treasury one

1 question then, Mr. Chairman, in the spirit of comity.
2 The Chairman. Certainly.
3 Senator Bradley. Why is this called a back-loaded
4 IRA, from your standpoint? And why does it increase the
5 budget deficit by $30 billion in years 8, 9 and 10, and
6 only $12 billion in years 1 to 7?
7 Mr. Samuels. Senator Bradley, first, I would like
8 to add to the description of the proposal. There is a
9 so-called back-loaded IRA, which is different from
10 current law in that you do not get a deduction when you
11 put the funds in the IRA. You receive inside buildup
12 tax-free. But then when you take the money out, unlike
13 current law, you do not pay any tax whatsoever on the
14 inside buildup. That is why they are called back-loaded
15 IRA's.
16 And the income limits, as I understand it, do not
17 apply to back-loaded IRA's. Those are available to
18 anyone. So I wanted to just clarify that because when
19 you were describing the proposal before, there was an
20 indication that the income limits applied to both types
21 of IRA's. And, in fact, as I understand it, the income
22 limits do not apply to the back-loaded IRA's.
23 And I also understand from our economist, that the
24 back-loaded IRA's are very attractive economically, so
25 people will contribute to them. I think that is why you

1 see this increase in revenue loss in the out-years.
2 The Chairman. Mark, would you please proceed now?
3 Mr. Prater. Thank you, Mr. Chairman.
4 The third element of the savings package that is in
5 the retirement plan area is a new simple retirement plan
6 for small employers. It would be similar to a 401(k)
7 plan, available to employers with 100 or fewer employees.
8 Employees could contribute up to $6,000 of their wages.
9 Employers must match the employee's contributions up to 3
10 percent of the employee's pay. The contributions could
11 be invested in IRA's for each employee or in a qualified
12 retirement trust. And all contributions would be non-
13 forfeitable. This would be effective January 1, 1996.
14 The next feature in the savings and investment
15 package is the capital gains tax cut. For individuals,
16 there would be a 50 percent deduction for property owned
17 at least 1 year, resulting in a 19.8 percent tax rate.
18 Collectibles would remain at 28 percent, as under current
19 law. One half of the capital gains deduction would be
20 included in the alternative minimum tax as a preference.
21 And the effective date would be for sales and exchanges,
22 including installment payments, after October 13.
23 Mr. Kies. No indexing.
24 Mr. Prater. No indexing.
25 Senator Moynihan. Mr. Chairman, I would like to

1 make the point again that the out-years are horrendously
2 expensive. We have $33 billion in the next 7 years. And
3 in the 3 years that follow, you almost double it. It
4 goes to $59 billion. Why is that?
5 Mr. Kies. Senator, the projections that we have
6 prepared for persons analyzing the capital gains
7 provision does assume that there is a growing pool of
8 capital gain realizations, even under current law. And
9 those would benefit from the exclusion.
10 We also take into account induced realizations, and
11 that is reflected as well.
12 Senator Moynihan. Induced realizations raise
13 revenue in that sense.
14 Mr. Kies. That is correct.
15 Senator Breaux. Mr. Chairman?
16 Senator Breaux. John, yes?
17 Senator Breaux. I would just like to ask the
18 question about how does the proposed 50 percent reduction
19 work with including half of that 50 percent in the AMT?
20 Mr. Prater. That is correct.
21 Senator Breaux. What is the bottom line effect of
22 this change, with the changes that are being proposed in
23 the AMT itself?
24 Mr. Prater. Senator Breaux, the effect is that the
25 persons who are in the AMT would end up paying roughly 21

1 percent rate on their capital gains.

2 Senator Breaux. Instead of 19.8 percent?

3 Mr. Prater. That is correct.

4 The Chairman. Please proceed, Mark.

5 Mr. Prater. Thank you, Mr. Chairman.

6 The next element of the capital gains proposal is a
7 28 percent capital gains rate, no indexing. We have also
8 included in the Chairman's Mark a venture capital piece
9 which would provide a 75 percent deduction for qualified
10 small business stock owned for at least 5 years.

11 There would be adjustments to the current law
12 definition of qualified small businesses.

13 Senator Bradley. Mr. Chairman, could I ask about
14 that definition?

15 The Chairman. Yes.

16 Senator Bradley. What are the changes from current
17 law as to what qualifies as venture capital?

18 Mr. Prater. Senator Bradley, do you mean in terms
19 of the kinds of businesses, the types of business
20 activities? The Chairman's Mark basically retains
21 current section 1201 definitions. The changes are with
22 respect to the size of the corporation. The gross assets
23 test would go from the current law amount of $50 million
24 to $100 million. And the per-issuer limits that are in
25 current law would be eliminated. Those limits are the

1 greater of 10 times the basis of the investment or $10
2 million.
3 Senator Bradley. So, essentially, the effect of
4 those two changes is to dramatically expand the number of
5 businesses that would qualify as venture capital
6 operations. Is that not correct?
7 Mr. Prater. Again, I would stress that the kinds
8 of businesses, the kinds of business activities, are not
9 changed here.
10 Senator Bradley. No, the size. You do the same
11 thing, but you now get the special 75 percent deduction.
12 Right?
13 Mr. Prater. That is correct.
14 Senator Bradley. Now could you tell me, of the
15 revenue loss attributable to capital gains, how much is
16 attributable to this provision, as opposed to the
17 provision on corporations and individuals?
18 Mr. Kies. Senator Bradley, I believe the revenue
19 loss from this change for the 7-year period is less than
20 half a billion. I can get you the exact figures.
21 Senator Bradley. Less than half a billion?
22 Mr. Kies. Yes, sir.
23 Senator Bradley. So the bulk of the revenue loss
24 is basically due to traders. It is not due to people
25 putting money in venture capital and fueling economic

1 growth, based on what you say. I mean the $500 million
2 is all it loses over 7 years, and the total lost over 7
3 years is $33 billion. Then this clearly is not a venture
4 capital provision.
5 Mr. Kies. Well, Senator Bradley, let me point out
6 that there are a number of statistics that the Joint
7 Committee has put together in prior pamphlets on the
8 incidence of capital gain events by individuals that
9 indicate that there are a number of taxpayers who are not
10 traders who have capital gain events over a 5-year basis,
11 3-year basis, or whatever.
12 I might just also point out that ----
13 Senator Bradley. You cannot say that then, that
14 they are traders. The only thing you can say is that
15 only $500 million of $33 billion is venture capital.
16 Mr. Kies. Right. I think that is a fair comment.
17 Let me also point out that this does not kick in until
18 you hold it for 5 years, and that is one of the reasons
19 that in the 5- or 7-year window there is a relatively
20 small amount as well.
21 Senator Hatch. Well, Mr. Chairman, if you could,
22 there could be all kinds of other venture capital, right?
23 And this is just with regard to this one provision.
24 Mr. Kies. That is correct.
25 Senator Hatch. I mean, my goodness, we are talking

1 about all kinds of investments that businesses make,
2 individuals make, where they ride those investments and
3 keep them for years.
4 Senator Bradley. But the question was, how much
5 does this change help venture capital, as a part of the
6 total capital gains?
7 Senator Hatch. Well, then, that is a different
8 question. I think you have to give a different answer
9 than what you have given here.
10 Mr. Kies. No. I was just answering Senator
11 Bradley. I think you are correct, Senator Hatch, that
12 the 50 percent exclusion, independent of this, will have
13 a significant effect on people investing in venture
14 capital.
15 Senator Hatch. We are trying to encourage people
16 to invest in venture capital, especially in the
17 biotechnology companies, where we hope to find some of
18 these breakthroughs that will help us solve some of the
19 health care problems in this society. And, as I see it,
20 this is one of the best ways to get people to do that.
21 Do you differ with that?
22 Mr. Kies. No. I think that is correct.
23 Senator Hatch. Mr. Chairman, could I ask another
24 couple of questions? I will try to be quick.
25 The Chairman. Sure.

1 Senator Hatch. I am very appreciative that the
2 venture capital piece, really the Hatch-Leiberman capital
3 gains bill, S. 959, has been included in the Mark, with
4 several technical changes.
5 But I would just like to ask a couple of questions
6 concerning the details. Does the Chairman's Mark allow
7 corporate taxpayers to invest in qualified small business
8 stock and enjoy the 75 percent exclusion for venture
9 capital investments?
10 Mr. Kies. No, Senator Hatch. It is limited to
11 individual investors.
12 Senator Hatch. I see. Also, does the Mark include
13 an exemption from the alternative minimum tax for those
14 taxpayers who invest in these small businesses?
15 Mr. Kies. No.
16 Senator Hatch. No, it does not. These were
17 provisions of S. 959. I understood that they would be
18 included within the Chairman's Mark, but these questions
19 have arisen because of the lack of specificity in the
20 Mark itself.
21 Personally, I think it is unfair to preclude
22 corporations from investing in these small businesses. I
23 use the biotechnology industry just to make a point.
24 Corporations provide about one-fourth of the venture
25 capital used by small businesses. And I do not think we

1 want to dilute the benefits of this provision by cutting
2 out corporations who have a steady influence on the
3 venture capital market. I think it may be economically
4 foolish to exclude corporations, particularly since they
5 are taxed twice.
6 Now as I understand it, the mark-up document states
7 that only a 75 percent exclusion would be available.
8 Right?
9 Mr. Kies. That is correct.
10 Senator Hatch. But it does not make clear that the
11 75 percent exclusion was to be available only for
12 individuals. It is still ambiguous, is what I am saying.
13 Mr. Kies. I think there is a slight ambiguity.
14 Although what we estimated and what we understood was
15 that the proposal in the Chairman's Mark was limited to
16 individual investors.
17 Senator Hatch. Well, I just point that out.
18 Also, I might add that subjecting investors who are
19 willing to invest in risky small business enterprises for
20 at least 5 years should not be penalized by having the
21 gain subject to the alternative minimum tax.
22 The Chairman. We do want to proceed.
23 Senator Hatch. I wonder if we could do something
24 to clarify this and correct this.
25 The Chairman. I will have our people discuss it

1 with you.

2 Senator Hatch. Will you work on it with us?

3 The Chairman. Yes. We will take a look at it.

4 Senator Hatch. All right.

5 Senator Bradley. Mr. Chairman, be careful. That

6 green line is going to go up over there.

7 The Chairman. We have made no commitment, I assure

8 you.

9 Senator Hatch. Well, it has plenty of room to go

10 up.

11 The Chairman. Mark, do you want to proceed with

12 the next item?

13 Mr. Prater. Thank you, Mr. Chairman.

14 The next item is the alternative minimum tax relief.

15 This proposal contains two parts. The first would

16 conform the method of depreciation for purposes of the

17 alternative minimum tax, and the second part would

18 provide a credit offset mechanism for alternative minimum

19 tax credits that are currently built up against current

20 AMT liability.

21 The fifth provision is a provision clarifying that

22 gas station convenience store depreciations would receive

23 15-year depreciable life.

24 Senator Bradley. Mr. Chairman, this is one of my

25 favorites in the whole bill. And we are going to get to

1 this one when we get to discussing it. But could you
2 just repeat this slowly so everybody can understand what
3 this provision is?
4 Mr. Prater. Senator Bradley, this provision would
5 clarify that gas station convenience store property is
6 eligible for 15-year depreciable life, rather than being
7 eligible for the nonresidential real property life.
8 Senator Bradley. Which is?
9 Mr. Prater. Thirty-nine and a half years.
10 Senator Bradley. Right. So what this says is, if
11 you have got a 7-Eleven, and you put a gas pump in front
12 of it, you depreciate the property in 15 years, as
13 opposed to 39 years.
14 Senator Grassley. What it basically says is what
15 we meant in the statute, which the IRS has come along and
16 interpreted in a different way. So we are just
17 reaffirming here what we thought we said in the last tax
18 bill.
19 Senator Bradley. I see. At least we are now clear
20 on what the author intended.
21 The Chairman. Mark, would you proceed please?
22 Mr. Prater. Thank you, Mr. Chairman.
23 Senator Breaux. Let me ask another question on
24 that. Is there not still a test that more than 50
25 percent of the products have to be gasoline marketing?

1 Is there a 50 percent test?

2 Mr. Prater. That is correct, Senator Breaux. The
3 Service currently applies the 50 percent test
4 conjunctively. In other words, you have to have over 50
5 percent of the revenue from basically petroleum product
6 receipts. And 50 percent of the floor space has to be
7 devoted to petroleum products.

8 Senator Breaux. And is that continued?

9 Mr. Prater. It would be an alternative test.

10 Mr. Roesser. It would be clarified to "not in
11 substantial use." You could not take a 7-Eleven that did
12 not previously have a gas pump in front of it and then
13 put a gas pump in front of it to get the benefit of this.

14 Senator Bradley. Pardon? I did not hear that.

15 Senator Breaux. I guess my question is, do you
16 still have to have this percentage of your business in
17 marketing gasoline, or in marketing food? What kind of a
18 test do we have to determine what this facility really
19 is? Is there a test in this proposal, and what is it?

20 Mr. Roesser. The proposal includes a not in
21 substantial test qualification to get the benefit of this
22 clarification.

23 Senator Breaux. What does that mean in English?

24 Mr. Kies. It is intended to preclude somebody from
25 putting a gas pump out in front an Acme store or a K-Mart

1 store, and qualifying the store for 15-year depreciation.
2 It is intended to limit it to things that are real gas
3 stations, but have convenience stores with them.
4 Senator Bradley. Could I ask Mr. Samuels, what is
5 the public policy issue here that would give a
6 convenience store with a gas pump in front of it 15-year
7 depreciation, but your normal 7-Eleven a 39-year
8 depreciation?
9 Mr. Samuels. Senator Bradley, we have problems
10 with this proposal at two levels. First, it applies to
11 existing property. So, in that sense, it is retroactive.
12 It applies to all convenience stores with gas facilities
13 associated with it.
14 And the second, looking forward, there are very
15 recent press reports explaining how the retail service
16 station industry is changing. And the way it is changing
17 is that companies are getting together with convenience
18 stores and fast food stores, and having one facility.
19 And I think this would allow fast food stores to possibly
20 get 15-year depreciation instead of 39-1/2 depreciation.
21 The Chairman. All right. Shall we move on to the
22 next item, Mark?
23 Mr. Prater. Thank you, Mr. Chairman.
24 The next proposal would allow bank common trust
25 funds to convert to mutual funds. This is a proposal

1 that has been in past tax bills and treats one entity,
2 which is a flow-through entity, to allow it to convert to
3 another flow-through entity on a tax-free basis.
4 The third set of proposals is in the health care
5 area, health care-related proposals.
6 The first one would clarify the tax treatment of
7 long-term care insurance.
8 The second one would provide that the tax treatment
9 of accelerated death benefits would be treated like life
10 insurance benefits.
11 The third one would create a new medical savings
12 account which would be linked with catastrophic
13 insurance, with minimum deductions and contributions
14 limited to $2,000 per year for singles and $4,000 per
15 year for families, indexed. The contributions with
16 respect to self-employed would be treated the same as
17 under current law, regular health insurance of 30 percent
18 contribution. And the earnings would be tax-free. Tax-
19 free and penalty-free withdrawals would be allowed for
20 medical expenses and certain health care insurance
21 premiums.
22 The fourth proposal would adjust the current law
23 tax-free death benefit limit on burial insurance policies
24 from $5,000 and a maximum of $25,000 to $7,000 and
25 $30,000 respectively.

1 The fifth proposal would treat certain health
2 insurers as Blue Cross-Blue Shield organizations.
3 The fourth set of proposals is in the estate tax
4 area.
5 The first is a targeted, family-owned business and
6 farm provision.
7 Senator Breaux. Let us go back to the health
8 stuff. You were finishing up with health and going into
9 estate tax?
10 Mr. Prater. Yes.
11 Senator Breaux. Where is the medical savings
12 account?
13 Mr. Prater. Senator Breaux, that is one page 2 of
14 your document.
15 Senator Breaux. All right. I found it. It is
16 scored as a $1.3 billion loss?
17 Mr. Prater. That is correct.
18 Senator Breaux. Did I not hear the argument that
19 medical savings accounts were going to save us money?
20 How is it that we have a $1.3 billion loss over 7 years
21 and a $2.3 billion loss over 10 years?
22 Mr. Kies. Senator Breaux, we would only score the
23 tax effect of medical savings accounts. The impact on
24 health care spending would not be something we would
25 typically reflect in a revenue estimate. So the debate

1 over the extent to which it affects medical spending
2 would not be reflected as part of our revenue estimate.
3 Senator Breaux. But would it affect what the
4 Government spends on Medicare?
5 Mr. Kies. Well, there is a proposal in the
6 Medicare package which is a Medicare MSA. This MSA is
7 not related to Medicare MSA. This MSA is one that can be
8 used by individuals prior to attaining Medicare
9 eligibility. So this does not really relate to the
10 Medicare effect.
11 Senator Breaux. This $2.3 billion loss over 10
12 years does not take into consideration Medicare patients
13 who may decide to go into an MSA?
14 Mr. Kies. That is correct because this proposal
15 does not affect Medicare recipients at all. It is only
16 available to individuals prior to reaching Medicare
17 eligibility.
18 Senator Breaux. So if we pass a Medicare proposal
19 that allows medical savings accounts, the loss could be
20 even greater?
21 Mr. Kies. No. There is a Medicare MSA provision
22 that was in your Medicare mark-up. The effects of that
23 are already reflected in the overall Medicare numbers
24 that you were given, I think, by CBO.
25 Senator Moynihan. Could I ask, is this Mr.

1 Rooney's proposal?

2 Senator Breaux. It looks like a duck to me.

3 Senator Moynihan. That great benefactor of persons

4 in our calling, Mr. Pat Rooney.

5 Mr. Kies. Senator Moynihan, this is patterned

6 basically after the proposal that was introduced, I

7 think, on the House side by Chairman Archer and by

8 Chairman Roth on this side. There are slight

9 modifications, but I think it basically reflects their

10 proposals.

11 Senator Moynihan. Thank you.

12 The Chairman. Please proceed then, Mark.

13 Mr. Prater. Thank you, Mr. Chairman.

14 Moving on to the estate tax reform area, there are

15 two major reforms here in terms of the targeted approach

16 to family farms and businesses. There is a benefit that

17 results from this exempting the first $1.5 million of a

18 family-owned business or farm, and reducing the estate

19 tax rate by 50 percent on the next $3.5 million of a

20 family-owned farm.

21 The family-owned business and farm must meet a

22 family definition test, and also a liquidity test. In

23 other words, at least 50 percent of the estate must be in

24 the family-owned business or farm.

25 Senator Bradley. Mr. Chairman?

1 The Chairman. Yes, Mr. Bradley.
2 Senator Bradley. Is there anything that would
3 prevent me from transferring my art collection to the
4 family-owned business?
5 Mr. Kies. Senator Bradley, there is nothing that
6 would prevent you from transferring it but you would not
7 qualify for the exclusion if it was a passive asset. The
8 proposal is intended to prevent stuffing of passive-type
9 assets into an entity prior to death, in order to qualify
10 for the exemption.
11 Mr. Samuels. Senator Bradley, if you became a
12 dealer in art after you transferred your collection, I
13 believe you would then qualify.
14 Senator Bradley. Pardon?
15 Mr. Samuels. If you became a dealer in art. It is
16 not that difficult, I do not think, to become an art
17 dealer after you have transferred your collection to the
18 business. Then I believe you are engaged in an act of
19 business, of dealing in art.
20 Senator Bradley. Is there a set criteria you have
21 established to determine whether someone is a dealer or
22 not?
23 Mr. Prater. Senator Bradley, there is a material
24 participation test. It is not as though you could just
25 say you are an art dealer. You would actually have to be

1 operating as an art dealer.

2 Senator Hatch. Having been in that field, it is

3 lot tougher than you think to establish yourself as an

4 art dealer.

5 Senator Bradley. Like what would that mean? Not

6 an artist, an art dealer.

7 Mr. Prater. It means you would have to be in the

8 regular and continuous business activity of dealing art.

9 It would be similar to the passive loss rule test.

10 Mr. Kies. Treasury has been fairly effective.

11 Senator Bradley. So you would require the same

12 notes as the passive loss test? You would have to have

13 the same number of hours a year?

14 Mr. Kies. Well, Treasury's experience in the past,

15 in dealing with the material participation test under

16 2032A, which would adopt these same rules, has been that

17 they have been fairly effective at really requiring

18 actual participation.

19 Senator Bradley. Does Treasury feel that there is

20 an adequate safeguard here that would prevent abuse?

21 Mr. Samuels. Senator Bradley, I think we see that

22 there is this problem of abuse in terms of transferring

23 activities to a closely-held business that would then

24 qualify. And I think the art dealer issue is one that we

25 would have some concern about.

1 This proposal, under our calculation, provides
2 benefits, for example, to estates of $5 million or more.
3 They would get an estate tax cut of $1,750,000.
4 The Chairman. Mark, why do you not say what
5 safeguards are included?
6 Mr. Prater. Mr. Chairman, basically, there are
7 safeguards in terms of the disposition of the business.
8 There would be a recapture of the tax benefit if the
9 family failed to participate in the business within 10
10 years after the decedent's death.
11 The Chairman. After the death of a decedent, what
12 happens during the next 10-year period?
13 Mr. Prater. The decedent's beneficiaries, the
14 estate, who qualify into this standard, have to continue
15 to operate the business and participate in it.
16 Mr. Roesser. If the qualified heir fails to
17 materially participate, in years 1 through 6 there would
18 be a 100 percent recapture of the tax that would have
19 been payable. Year 7 would be an 80 percent recapture;
20 in the eighth year a 60 percent recapture; year 9, 40
21 percent recapture; and the tenth year would be a 20
22 percent recapture.
23 Senator Bradley. Mr. Chairman, could I ask Mr.
24 Samuels, is there any way around this if you had an
25 enterprising tax lawyer?

1 Mr. Samuels. I think the question that has caused
2 us problems in the passive activity rules is when
3 somebody is materially participating. And you will have
4 that same discussion for this proposal.
5 Senator Bradley. Could you confirm in any one year
6 the number of people who have an estate when they die of
7 greater than $2 million a year? The number I have is 1
8 percent who pay any estate taxes at all, and 2 tenths of
9 1 percent who have an estate greater than $2 million.
10 Are those roughly correct?
11 Mr. Samuels. I believe that is correct. As I
12 understand it, about 1 percent of estates are subject to
13 the estate tax. That means they would be over $600,000.
14 So you are correct.
15 Senator Bradley. So 99 percent of the people, when
16 they die, do not pay any estate tax now because they do
17 not have estates greater than the $600,000 exemption?
18 Mr. Samuels. Correct.
19 The Chairman. Shall we proceed, Mark?
20 Senator Hatch. Could I ask one question?
21 The Chairman. I would ask you to keep it short.
22 Senator Hatch. It will be a short question.
23 The Chairman. Sure.
24 Senator Hatch. I would just like to know what how
25 the Clinton administration feels about estate tax relief

1 in general. Are you for it or against it?

2 Mr. Samuels. Senator Hatch, as you know, we
3 testified before the Finance Committee on this issue.
4 And we strongly favor reforms for small, closely-held
5 family farms and family businesses. And we have some
6 ideas of how one might do that. But we think that this
7 proposal, which gives a $1,750,000 tax cut to estates of
8 $5 million or more is excessive. But we think there
9 should be other things we can do without providing that
10 level of estate tax reduction.

11 The Chairman. All right. Will you please proceed.

12 Mr. Prater. Thank you, Mr. Chairman.

13 The next element in the estate tax reform proposal
14 would gradually increase the unified credit up to a
15 credit equivalent amount up to $750,000 a year in 2001.

16 The third element is an exclusion for certain
17 conservation easements to 50 percent of the value of the
18 real property, subject to the conservation easement,
19 capped at $5 million. And the heir, the person receiving
20 the property, would have a carryover basis, not a step-up
21 as under current law.

22 The fourth element is a generation-skipping ----

23 Senator Bradley. Mr. Chairman, on that point,
24 could you expand on what that implies, what that really
25 means when you do not have a step-up, you have a

1 carryover?

2 Mr. Prater. Senator Bradley, it means that the
3 beneficiary of the decedent's estate will take the basis
4 in the property that the decedent had. In other words,
5 the general rule is that when a decedent dies, the basis
6 steps up to the fair market value.

7 Senator Bradley. When it is transferred?

8 Mr. Prater. That is correct.

9 Senator Bradley. But this would essentially allow
10 it to be transferred at the decedent's cost basis?

11 Mr. Prater. Right.

12 Senator Bradley. Well, should that not result in
13 more tax?

14 Mr. Kies. Eventually it will because if and when
15 it is sold, the amount of income tax paid would be higher
16 than if it got a step-up to fair market value.

17 Senator Bradley. All right. Mr. Samuels?

18 Mr. Samuels. Senator Bradley, as I understand this
19 proposal, it gives you a deduction in the following case.
20 You buy a piece of property within 3 years before you die
21 for $5 million. You have to hold it for 3 years. You
22 give a conservation easement. Let us say the value of
23 the conservation easement is $150,000. You are entitled
24 to a deduction under this proposal of $2.5 million, even
25 though the conservation easement is only worth $150,000.

1 So we think it is a poorly targeted incentive to
2 transfer conservation easements. And if you have just
3 bought the property, you do not have to worry about step-
4 up in basis, or maybe no gain.
5 The Chairman. We would ask you to proceed.
6 Mr. Prater. Thank you, Mr. Chairman.
7 The next proposal is a simplification of the
8 generation-skipping transfer tax, with respect to
9 collateral descendants.
10 The fifth proposal would provide that cash leasing
11 coming from special use valuation property under section
12 2032A would not cause recapture.
13 The fifth set of proposals here would extend through
14 February 28 certain expiring tax provisions. There would
15 be a replacement of the current targeted jobs tax credit
16 with a new work opportunity tax credit. The credit would
17 be computed from the first $6,000 of a worker's wages,
18 equal to 35 percent.
19 Senator Baucus. Mr. Chairman, on that, it is clear
20 that the old targeted jobs tax credit needs a little
21 reform. I do not think there is much doubt about that.
22 I must say that my concern here is that this is
23 going to change it way too much. And it makes it almost
24 impossible for certain employers to take advantage of
25 hiring youth, disabled workers, other people who given

1 jobs that they otherwise would not have.

2 This is now very limited. There is a test of 120
3 hours, which is moved up to 500 hours. Second, people
4 can only come from so-called empowerment zones. And,
5 unfortunately, there are no empowerment zones in the
6 State of Montana.

7 Mr. Prater. Senator Baucus, we dropped the 500-
8 hour test in the House bill to 400 hours here.

9 Senator Baucus. Well, that is still a long time.
10 And, second, is the empowerment zone provisions. It just
11 makes it virtually unavailable to way too many people.

12 Let me just mention, there is one major company in
13 the State of Montana, called Four B's. They have
14 restaurants all over. They have received national awards
15 for hiring handicapped people, people who otherwise would
16 not be employed. I wish you knew the management, the
17 head people of this company. It is the Hamlin family.
18 They go out of their way just to help people. This is
19 one way they have been able to do so. And I just wish,
20 Mr. Chairman, that sometime between now and floor, we
21 could work out this provision so it is still available in
22 a good common sense way.

23 Mr. Kies. Senator Baucus, I think maybe there is a
24 misunderstanding. The people who are subject to
25 vocational rehab are still eligible employees. This is

1 not limited to people in empowerment zones. It also is
2 available to people who are receiving cash forms of
3 assistance, the successor to AFDC. This is not limited
4 only to people in empowerment zones. That just happens
5 to be one class of worker that is eligible.
6 We can go over that with your staff.
7 Senator Baucus. What are the other limits then,
8 besides the 120 up to 400 hours, and empowerment zones?
9 Give me an example, if you could, of other limitations
10 then.
11 Mr. Kies. I believe we have got a requirement that
12 there actually be a certification prior to hiring, which
13 is a change from current law.
14 One of the criticisms of current law is that people
15 get hired and then they go and get certified. So there
16 is a requirement that they actually have to be certified
17 prior to a hire date. And there is a work requirement.
18 And those are the two primary requirements.
19 Senator Baucus. You are talking about the 120
20 hours?
21 Mr. Kies. Correct.
22 Senator Bradley. To 400?
23 Mr. Kies. That is correct. The 400-hour
24 requirement.
25 The Chairman. How many weeks is that?

1 Mr. Kies. Roughly 10 weeks, Senator Roth.
2 Senator Baucus. But the work certification is the
3 only other change?
4 Mr. Kies. And then the other change is that the
5 level of credit is reduced to $2,100. It is 35 percent
6 of the first $6,000 of wages, whereas under current law
7 it is 40 percent of the first $6,000. So the level of
8 credit is slightly smaller.
9 Actually, the class of workers is expanded to some
10 extent because families receiving cash welfare benefits
11 is not currently a category of workers that are eligible.
12 Mr. Roesser. Senator Baucus, we also added a
13 category for veterans. It is not only veterans on cash
14 assistance, but it is also veterans on food stamps. So
15 we did expand the veterans category in this program.
16 Senator Baucus. Yes. Well, Mr. Chairman, I would
17 like, if we could, to have our staffs look at this
18 because there are still some questions that are not
19 answered.
20 Senator Bradley. Mr. Chairman, if I could, on what
21 you said, Ken. It may be a narrow category, but you said
22 those people who were on cash assistance, on the new
23 welfare rolls?
24 Mr. Kies. Correct.
25 Senator Bradley. How do we know who they are, as

1 the Federal Government?

2 Mr. Kies. Well, our estimate is based on looking
3 at the proposed changes in welfare and projecting how
4 many people would be in that category. In most cases,
5 those people would be identified because of local welfare
6 offices.

7 Senator Bradley. Yes, but we are not in the
8 welfare business any more. We have just given a block
9 grant back to the States.

10 Mr. Kies. It is the State certification that would
11 determine their status as one of the eligible workers.

12 Senator Bradley. So the State would certify for
13 purposes of Federal taxation?

14 Mr. Kies. That classification is actually similar
15 to the classification under present law, that would
16 control whether they are an eligible worker for purposes
17 of the employer being entitled to the credit.

18 Senator Bradley. So it would be whatever any State
19 decided to say about that? So it could have similarly
20 situated poor people that would be eligible in one State
21 but not in another State. Is that correct?

22 Mr. Kies. State classifications could vary under
23 the changes in the welfare program.

24 Senator Bradley. Right. So you would tend to get
25 a double benefit if you were in one State, as opposed to

1 another State. You would get the benefit of a job and
2 you would get the benefit of the payment. But if you
3 were similarly situated, but the other State said no, you
4 are not eligible, then you could not get a job and you
5 could not get a welfare payment.
6 The Chairman. Senator Moynihan?
7 Senator Moynihan. Can I just add, Mr. Chairman,
8 the present law states that wages used to pay employees
9 who are replacing workers who are on strike, or have been
10 locked out, are not eligible for this credit.
11 In the House version of this work opportunity
12 successor, that prohibition is dropped. What is the case
13 with us? I am sure we would not want to do that.
14 Mr. Kies. It is the same as the House bill,
15 Senator Moynihan.
16 Senator Moynihan. This means that you can get a
17 tax credit for hiring persons to replace strikers?
18 Mr. Kies. Assuming that they fit into the
19 categories of workers that otherwise qualify for the
20 credit, that is correct.
21 Senator Moynihan. Did we know that? Senator
22 Bradley, did you know that?
23 Senator Bradley. No. I did not know that. They
24 did not run it by me before they stuck it in there.
25 [Laughter.]

1 Senator Moynihan. Mr. Chairman, could I ask that
2 you think about this because I do not think this
3 Committee wants to go on record with this kind of
4 position.
5 The Chairman. We will take it up with staff.
6 Senator Moynihan. I appreciate that.
7 Senator Baucus. Just a question if I might, Mr.
8 Chairman.
9 The Chairman. Yes, Max.
10 Senator Baucus. Say you reduced the 400 to 250,
11 roughly double up from the present 120 hours, what would
12 the revenue loss be on 400 down to 250, just your rough
13 guess?
14 Mr. Kies. Senator Baucus, let me try to get back
15 to you on that. It is a little dangerous to make rough
16 guesses on these because it does tend to change things.
17 But let me see if we can get you an estimate of that.
18 Senator Baucus. Thank you.
19 Mr. Prater. Mr. Chairman?
20 The Chairman. Yes, Mark.
21 Mr. Prater. Moving on to employer-provided
22 educational assistance, this program would be extended as
23 it is under current law.
24 The research and development tax credit would be
25 extended with a modification for start-up companies.

1 The Chairman's Mark reinstates tax-free treatment of
2 employer-provided group legal services.
3 The orphan drug credit would be extended, with
4 certain modifications.
5 Contributions of appreciated property and publicly-
6 traded stock to private foundations would be extended.
7 The 4.3-cents-per-gallon exemption for commercial
8 aviation fuel would be extended. And the Chairman's Mark
9 asks Treasury to study the relative burden of fuel taxes
10 on different modes of transportation.
11 The eighth provision would exempt recreational
12 boaters from diesel dyeing requirements from January 1,
13 1996 to February 28, 1997.
14 There is an extension of an expiring expedited
15 refund authority for alcohol fuel blenders that would be
16 extended to coincide with the highway trust fund date.
17 The third provision would be an extension of the
18 diesel dyeing exemption for Alaska to track the EPA
19 exemption that exists.
20 The fourth provision would extend section 29,
21 alternative fuels tax credit for biomass and coal
22 facilities to placed-in-service dates up to December 31,
23 1997.
24 Senator Bradley. Mr. Chairman, this was one that
25 was going to expire. Was that not going to expire?

1 Mr. Prater. That is correct, Senator Bradley. The
2 Chairman's Mark merely extends the binding contract date
3 by 1 year, and the placed-in-service date by 1 year. It
4 does not expand the program or change any of the elements
5 of section 29 that have been cut back.
6 Senator Bradley. And what is the public policy
7 reason for expanding it 1 year as opposed to 5 years or 3
8 years?
9 Mr. Kies. Senator, part of the concern was raised
10 by those who were engaged in trying to put together
11 transactions with respect to coal. At the beginning of
12 this year, the IRS withdrew some private letter rulings
13 that determine what would qualify. And then for a 3- or
14 4-month period, there was a hiatus, and then they
15 reinstated them.
16 At least those entities felt that they had in effect
17 had 6 months taken away from them. So part of this is an
18 effort, I think, to accommodate those who were put into a
19 regulatory state of confusion for the period during which
20 the private letter rulings had been suspended prior to
21 being reinstated.
22 Senator Bradley. So the rationale is if that
23 existed a year from now, you would extend it another
24 year?
25 Mr. Kies. Well, hopefully, Treasury would not do

1 the same thing again.

2 Senator Bradley. Does the administration have a

3 position on this?

4 Mr. Samuels. Senator Bradley, we would oppose the

5 extension. As you may recall, there was a prior

6 extension in 1992 for biomass and coal facilities. And I

7 do not think the problems that a small group of taxpayers

8 had in obtaining private letter rulings warrants an

9 extension, especially, as you know, this program

10 escalated in its cost to the Government. It grew very

11 rapidly.

12 Senator Bradley. You mean it even grew faster than

13 the EITC?

14 Mr. Samuels. I think that is correct.

15 Senator Bradley. I think this was the example I

16 used of a program. If you really want to have growth in

17 a program, you do not focus on the EITC, you focus on

18 section 29. How much did it increase?

19 Mr. Samuels. I can get you the numbers.

20 Senator Bradley. Do you know, Mr. Kies? I am sure

21 you know.

22 Mr. Kies. I actually do not, but I would be happy

23 to get you the numbers.

24 Senator Bradley. All right.

25 The Chairman. All right. We are coming close to

1 the end.

2 Senator Graham. Mr. Chairman, could I ask a

3 question on another matter that we passed over, but which

4 raises some of the same issues that Senator Bradley's

5 question did. And that is item number 7, the 4.3 cents-

6 per-gallon exemption for commercial aviation fuel?

7 As I understand it, the proposal is to extend this

8 exemption for 2 years.

9 Mr. Prater. Senator Graham, the proposal would

10 extend the exemption to February 28, 1997, not for 2

11 years. This is a reduced period because of revenue

12 constraints.

13 Senator Graham. There had been a suggestion that

14 if this were not to expire as it is set to expire, there

15 would be a glide slope, that is reducing the amount of

16 the exemption so that you did not fall off a 4.3-cent

17 cliff, which is a significant economic matter for the

18 aviation industry.

19 Did you consider a gradual phase-out, as opposed to

20 a total phase-out in February of 1997?

21 Mr. Kies. Senator, I think we looked at a number

22 of different options, and the conclusion was that it was

23 probably better to do a temporary extension, which would

24 then allow the Congress the opportunity to take a look

25 and see what they felt the condition of the aviation

1 industry was at that time, rather than do something that
2 slope down. But that was just a policy choice that was
3 made.
4 The Congress would certainly want to look at that
5 when it approached that extension at that time.
6 Senator Graham. But I mean, what about today? By
7 virtue of this action, we are extending it to February of
8 1997. Correct?
9 Mr. Kies. Correct. That is correct.
10 Senator Graham. So would the same analysis that
11 you think should take place in February of 1997 take
12 place today?
13 The Chairman. We are coming up to the end of the
14 time we can continue in session. If we could, I would
15 like to quickly cover E and F, if that is practical.
16 Senator Graham. I assume, Mr. Chairman, we will be
17 able to come back to these items. Is that correct?
18 The Chairman. There will be ample opportunity for
19 amendments and so forth. That is right.
20 Mr. Prater. Mr. Chairman, the item E that you
21 referred to is expiring taxes that are extended. The
22 first one is the Superfund excise tax. That is extended
23 through September 30, 2002. The Superfund alternative
24 minimum tax is extended through December 31, 1997; and
25 the oil spill tax, which expired December 31, 1994, is

1 extended through September 30, 2002.

2 In addition, the extender package includes as an
3 offset a proposal that generally follows Senator
4 Moynihan's proposal that taxes expatriates on accumulated
5 capital gains when they leave the U.S.

6 Senator Moynihan. Mr. Chairman, may I make a point
7 here on behalf of our Committee?

8 The issue of persons who renounce their citizenship
9 and move abroad in order to avoid taxes came before this
10 Committee early in the year, as you well know. And we
11 had at the time a number of letters from persons involved
12 in international law saying that it was not clear that
13 what we were proposing to do at that time would be legal
14 under international law.

15 And so we said, well, let us take a look at this. I
16 found myself on the floor, in the face of a certain
17 amount of hysteria. There is no group with whose rights
18 you have to be more careful than people you despise--you
19 despise. Not many people would think very much of
20 someone who would renounce their American citizenship
21 because they were so rich they did not want to pay taxes.
22 But their rights are things that have to be looked at
23 very carefully because they are very easily abused.

24 So we held off action. We worked with the Treasury.
25 I think Mr. Samuels will attest to that. We now have a

1 proposal which I think is an excellent one. And you do
2 too, sir, or you would not have included it. And I just
3 think, for those who at the time said why is the Finance
4 Committee hesitating, I think because we were being
5 responsible. I think we now have a conclusion that we
6 can be more than pleased with. And I want to thank you
7 for that, Mr. Chairman.
8 The Chairman. Well thank you, Pat.
9 Senator Moynihan. Could I ask Mr. Samuels, is this
10 a measure which the Treasury supports?
11 Mr. Samuels. Senator Moynihan, we will support
12 this in this form. There are some technical issues we
13 are discussing with the staff, but we basically support
14 this.
15 The Chairman. Well, the hour of 2:00 o'clock has
16 come and passed.
17 Senator Chafee. Mr. Chairman, I just want to say
18 on that provision, I think we have really nailed it down
19 now. I think this is the fourth time we have spent this
20 money, is it not? [Laughter.]
21 The Chairman. We plan to reconvene the Committee
22 when the Senate goes out of session. As I mentioned
23 earlier, we will work late into the night. The time for
24 this depends on the outcome of a 2:00 p.m. vote on
25 cloture on the Cuba Democracy Act.

1 Senator Moynihan. How do we vote if we want to
2 prolong this action?
3 The Chairman. I will leave that to your
4 discretion.
5 Please remember that all amendments must be filed
6 with Lindy in Room 209 by 4:00 p.m. today.
7 Senator Moynihan. Mr. Chairman, may I thank you
8 for your courtesy and your patience. We are of necessity
9 asking questions, and you have been very helpful in
10 getting answers.
11 The Chairman. Thank you for your cooperation, Pat.
12 [Whereupon, the Committee recessed at 2:05 p.m., to
13 reconvene subject to the call of the Chair.]
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1 AFTER RECESS

2 (4:48 p.m.)

3 The Chairman. The committee will please be in order.

4 Mark, will you proceed with the walk-through?

5 Mr. Prater. Thank you, Mr. Chairman. Where we left

6 off was at the start of a portion of the Taxpayer Bill of

7 Rights. Number two.

8 Senator Breaux. Where are we?

9 Mr. Prater. Senator Breaux, we are on VI, bottom of

10 page three.

11 Senator Breaux. Are you on capital gains?

12 Mr. Prater. We passed by that. Bottom of page three.

13 Senator Breaux. On page three.

14 Mr. Prater. All right. This is a portion of the

15 Taxpayer Bill of Rights. Number two. There are 10

16 subdivided proposals here, but we have summarized them in

17 the chart here. There are changes to the IRS authority to

18 abate interest and penalties, joint return rules, levy

19 amounts, and offers and compromise, awards for litigation

20 costs, rules relating to summonses, annual reminders for

21 taxpayers with outstanding delinquent taxes, and courts

22 would have the discretion to reduce awards for litigation

23 costs for failure to exhaust administrative remedies.

24 These are, like I said, a portion of the Taxpayer Bill of

25 Rights.

1 Number seven is casualty and involuntary conversion
2 provisions. The first two items on the list, the modified
3 basis rule, for purposes of involuntary conversions. The
4 first one is a technical change that is included in the
5 House bill. The second one would modify the related-party
6 rules for involuntary conversions; again, a House bill
7 technical kind of clarification.
8 The third one would allow farmers who have suffered
9 losses from floods to elect to include in income the
10 insurance proceeds at the time that the flood loss occurred
11 so that they would not have a mismatching of the income and
12 the receipt of the insurance benefits. That is Senators
13 Daschle's and Dole's proposals.
14 The fourth one is a provision that would allow change
15 to the involuntary conversion rules with respect to
16 property replaced for Presidentially-declared disaster area
17 versions.
18 The next title, VII, deals with ----
19 Senator Breaux. Can I go back, Mr. Chairman, and ask
20 a question about something we have covered? I must have
21 sneezed or yawned when we did Superfund and oil spill
22 liability. That was already covered under V?
23 Mr. Prater. That is correct, Senator Breaux.
24 Senator Breaux. What did we do with the Superfund?
25 I know we are extending the taxes. In this draft did we

1 make any substantive changes to the Superfund law?

2 Mr. Prater. No. The only thing that the Chairman's

3 mark does, Senator Breaux, is extend the taxes. The excise

4 taxes are extended through fiscal year ending September 30,

5 2002. The Superfund AMT tax is extended for two years, to

6 December 31, 1997, and the oil spill tax, which expired

7 last year, is extended out to September 30, 2002.

8 Senator Breaux. But in that section we made no

9 changes to how those funds, those taxes, can be used or

10 what they can be used for?

11 Mr. Prater. That is correct. All we did was change

12 the date for the taxes.

13 Senator Breaux. All right.

14 The Chairman. Please proceed.

15 Mr. Prater. Moving on to VII, which is the Tax-Exempt

16 and Charitable Reforms title. The first proposal would

17 provide tax-exempt status to common investment funds. This

18 would permit private foundations and community foundations

19 set up, taxes on pools to invest their endowments.

20 The second one would change the ----

21 Senator Moynihan. Sir, I think you meant VIII.

22 Mr. Prater. Oh, I am sorry. Yes.

23 The second proposal would change the ----

24 Senator Rockefeller. Mr. Chairman?

25 The Chairman. Yes, Jay.

1 Senator Rockefeller. Could I just ask, if I got here
2 at 5:00, which is when I understood we were going to come
3 back, and I take it that the staff has been taking us
4 through this so rapidly that nobody really has any
5 instinct, or cannot keep up with them in trying to flip
6 through their books to ask questions if they have any. Is
7 there a consensus that this process if fair?
8 Senator Moynihan. May I just say to my friend that no
9 one has protested. Everybody who had a question who was
10 here was heard and were not cut off until they were
11 satisfied.
12 The Chairman. Please proceed, Mark.
13 Mr. Prater. Thank you, Mr. Chairman.
14 Going to VIII, Item C. This would be a proposal to
15 exempt non-farmer dues that do not exceed $100 per member
16 from the UBIT tax. This is a measure that was proposed
17 separately.
18 The next item would repeal the tax credit for
19 contributions to non-profit community development
20 corporations. This was in the House bill.
21 The fifth item would provide that personal
22 representatives of estates would have to notify charitable
23 remainder trust beneficiaries.
24 The sixth item would provide a clarification that
25 qualified Football Coaches association plans would be

1 treated as multi-employer pension plans. This fixes a
2 glitch that occurred in 1988.
3 Mr. Kies. 1987.
4 Mr. Prater. 1987. I am sorry.
5 Senator Breaux. We have been trying to fix that since
6 then.
7 Senator Rockefeller. Is it true, Mr. Chairman, that
8 Ken Kies, one of the staff members, lobbied on this
9 proposal?
10 Mr. Kies. Mr. Rockefeller, that is true. I
11 represented the Football Coaches Association on this
12 proposal. I recused myself from this proposal when I took
13 the position of Chief of Staff of the Joint Committee and
14 I have not participated in any discussion that has related
15 to this since that time.
16 The Chairman. Mark, do you want to proceed.
17 Senator Moynihan. May I ask, Mr. Chairman, should
18 this not be a technical correction?
19 Senator Breaux. Yes.
20 Mr. Prater. Senator Moynihan, in the past, this
21 proposal has been scored as a technical correction. The
22 House bill, H.R. 3419, that was proposed in the last
23 Congress included it as a technical correction.
24 Your point about the Byrd Rule and the potential
25 application to technical corrections is one that the staff

1 is aware of. There is a modification to this proposal that
2 would provide a $25,000 excise tax on the submission by the
3 Football Coaches plan for qualification.
4 Senator Moynihan. I am just asking. Could I ask the
5 Treasury?
6 Secretary Samuels. Senator Moynihan, as you know,
7 this has been a technical correction that has been around
8 for a long time. I think our view is that it ought to be
9 treated that way. We do not agree with the proposal. We
10 have kind of dealt with this in previous testimony. But,
11 if it is going to be dealt with, I think it should be dealt
12 with as a technical correction.
13 Senator Moynihan. Mr. Chairman, there is something
14 for you to think about, anyway.
15 The Chairman. All right.
16 Mr. Prater. Going to Title IX. This is the Corporate
17 Other Reforms and Miscellaneous Provisions. The first
18 proposal is a proposal to reform the treatment of corporate
19 stock redemptions where it basically eliminates a device
20 that provides for a dividends received deduction when the
21 transaction is, in fact, a redemption. This proposal is a
22 result of a bipartisan effort on both Senator Moynihan's
23 staff, Senator Roth's staff, and the two House staffs.
24 The next proposal would be a proposal to require
25 corporate tax shelter reporting for certain kinds of tax

1 shelters. Registration and lists would be required. There
2 is a penalty that would be imposed as well.
3 The third proposal is one that has been somewhat
4 controversial but noticed. It is to disallow the interest
5 deduction on corporate-owned life insurance policies.
6 Basically, under the Chairman's mark the policies purchased
7 before June 21, 1986 would continue to be grandfathered at
8 market rate. With respect to non-key employee policies
9 purchased after June 30, 1986, they would be subject to a
10 set of three rules: interest on the policy loans after June
11 31, 1995 would not be deductible; interest on policy
12 loans ----
13 Senator Breaux. What page is this on?
14 Mr. Prater. This is on page 126, Senator Breaux.
15 Senator Breaux. All right.
16 Mr. Prater. Interest on policy loans after 1995 would
17 be limited to 100 percent, 95 percent, 90 percent, 85
18 percent, and 80 percent over the last five years, and the
19 interest rate on those loans could not exceed a market
20 rate. Interest on key person policies purchased after June
21 20th, 1986 would continue to be deductible as long as the
22 market rate of interest is used.
23 Senator Breaux. A question.
24 The Chairman. Senator Breaux.
25 Senator Breaux. Let me try and see if I can

1 understand this. I will start by saying that I clearly do
2 not. But the question I have is that, under the current
3 law, we would allow corporations to buy life insurance
4 policies on their employees and deduct any money that they
5 may have borrowed in order to buy those life insurance
6 contracts if they contributed to the policy for four out of
7 the seven years that the policy would be in effect.
8 It is my understanding that some companies have played
9 by that rule and, in fact, have done that, have put real
10 money into the policies for four out of the seven years,
11 while others have sort of, let me use the word, scammed the
12 system and have worked out a methodology whereby they did
13 not pay anything into the policies and did not comply with
14 the four-out-of-seven-year rule.
15 It is my understanding that under this proposal we, in
16 fact, treat both of those categories the same as far as the
17 changes are concerned. My question is, is it not possible
18 for us to draft legislation that reforms that system and
19 somehow recognizes the companies and organizations that
20 were playing by the four-out-of-seven rule and not penalize
21 them or throw them into the same category of those
22 companies that, in fact, have not played by the clear
23 intent of the four-by-seven rule? It is correct that under
24 this proposal we treat both, in essence, the same way?
25 Mr. Prater. That is correct, Senator Breaux. Maybe

1 I will have Ken explain the rationale. We looked at this
2 issue pretty carefully.
3 Mr. Kies. Senator Breaux, let me just go back a step
4 to explain how the current policies actually function. In
5 1986, Congress passed a rule that said, as a general
6 proposition, corporations may not deduct any interest
7 related to borrowing to purchase policies on their
8 employees. That is the general rule of current law.
9 There was an exception put in at the time that, I
10 think, was viewed as somewhat narrow, that said a
11 corporation may deduct borrowing on up to $50,000 of
12 borrowing of the inside build-up of a life insurance
13 policy.
14 That rule was generally written to accommodate what at
15 the time were referred to as key-man policies, where a
16 company bought insurance on the key executives or key sales
17 people in the company.
18 At the time that rule was written, there was a rule
19 included that said you may not even qualify for deductions
20 with respect to $50,000 of borrowing unless four out of
21 seven of the first years' premiums are paid from non-
22 borrowed funds.
23 Since that time there has been apparently an explosion
24 in the use of these policies whereby companies apparently
25 are insuring many workers, and in some cases as many as

1 hundreds of thousands of workers, by going out and buying
2 a policy on the lives of each one of those individuals. Of
3 those that are engaging in that practice, there are two
4 categories of taxpayer. One category of taxpayer has been
5 somewhat more aggressive. What they have done is they have
6 put in ----
7 Senator Breaux. I like that phrase.
8 Mr. Prater. What they have done is, for the first
9 three years of premium, just assume it is $100 million each
10 year, they put the $100 million in, they borrow it back for
11 the first three years. Then they pay interest on the loan,
12 which, at 10 percent, would be $10 million on the first-
13 year borrowing. Then they borrow that interest back as
14 well. The second year you would be up to $200 million, the
15 third year you would be up to $330 million.
16 For those taxpayers who are more aggressive than
17 others, in the fourth, fifth, sixth, and seventh year, they
18 do not borrow out the premium, but they withdraw it in the
19 form of policyholder dividends or other distributions.
20 Because of the rules taxing withdrawals that apply
21 withdrawals against the basis in the contract first, there
22 is no taxable consequence to withdrawing these amounts.
23 So, for those taxpayers, their net cash is virtually
24 zero. In fact, after tax, it becomes significantly
25 positive. For a taxpayer covering 50,000 lives in the

1 first 10 years, they would have $370 million of net cash
2 flow.
3 There are some taxpayers who have been less aggressive
4 and who have been concerned that a practice of withdrawing
5 those next four years of premiums might run afoul of the
6 four-out-of-seven rule.
7 Those taxpayers have waited until the eighth year and
8 have then withdrawn through borrowing all of the premiums
9 that are paid in those four years. Their net tax benefit
10 is not as generous as those who have been more aggressive,
11 but it is still quite generous.
12 I believe many members who were part of the 1986 Act
13 decision believe that this overall practice, whether it is
14 those who have played by, as you say, the four-out-of-seven
15 rule, or those who have been more aggressive, are both
16 getting substantial tax benefits for basically paying
17 interest to themselves because they own the policy, they
18 own all the rights under the policy.
19 The borrowing is a loan, to some extent, although I
20 think the IRS has some questions about whether those really
21 constitute loans, and that is an issue that is the subject
22 of some audit activity right now, but the bottom line is,
23 those companies are experiencing substantial tax benefits
24 as well.
25 It is not as substantial as those who have taken the

1 more aggressive route, but still quite substantial in terms
2 of the economics of the transaction where there is
3 basically no risk to the corporation because, for financial
4 accounting purposes, they are not required to reflect the
5 debt as a liability for the reason that they are basically
6 borrowing money from themselves.
7 Senator Breaux. I thought I understood the problem
8 before I asked the question. Now I know I did not.
9 Well, let me ask Treasury, if I can, to comment on it.
10 My concern is that you have, I think, sort of like two
11 categories of corporations here that have utilized this
12 purchasing of corporate life insurance on all of their
13 employees.
14 Is there not a way in which, legislatively, we can
15 distinguish between the two categories with some type of a
16 remedy that fits the situation better than lumping them all
17 into one pot and saying we are going to treat them the
18 same?
19 Secretary Samuels. Senator Breaux, we have been
20 looking at this proposal, which basically is denying an
21 interest deduction when the income is not subject to tax,
22 and we agree with the policy objectives of this proposal.
23 We have thought about how one might distinguish between
24 different types of policies and do not think, that from our
25 perspective, we have concluded that, from a policy point of

1 view, we could justify, so we think that this proposal and
2 this form is one that we would not oppose. We have some
3 technical comments on transactions.
4 Senator Breaux. Is it a problem with drafting
5 language that distinguishes between the two categories of
6 corporations, or is it a policy decision here?
7 Secretary Samuels. I think, as Mr. Kies said, it is
8 hard to say that if you just wait till the eighth year and
9 take all the money out, that those policies should receive
10 any special preference under this proposal as compared to
11 transactions where people were being more aggressive. You
12 are still in a situation where you are borrowing against an
13 asset whose income will never be taxed, and that is the
14 problem.
15 Treasury had done a report on this type of financial
16 product back in 1990 and concluded that it raised
17 significant policy objectives and it was not consistent
18 with what we thought at the time the 1986 Act was intended
19 to accomplish.
20 So we can tell from the revenue estimate that this has
21 been a product that has been actively used, and we think in
22 a way that went way beyond anything that was considered in
23 1986, and it is time to close the book on it.
24 Senator Breaux. Mr. Kies, is that your feeling, too?
25 Mr. Kies. Senator Breaux, I would agree with

1 Assistant Secretary Samuels. I would also point out that
2 the transition rule that has been provided in the mark is
3 fairly generous, even to companies who have been more
4 conservative with respect to the four-out-of-seven rule,
5 because they will be permitted borrowing at a somewhat
6 lower rate, probably, but for a full five-year period.
7 Some of these companies, including the ones that have
8 used a more conservative approach to the four-out-of-seven
9 rule, could have easily as much as $1 billion of ostensible
10 borrowing, so that their annual tax benefit for the five-
11 year period could be $30-40 million.
12 I mean, there is a fairly substantial transition that
13 I think was appropriate in light of the fact that there
14 were a lot of reliance issues that were at stake here. But
15 I think, on balance, it is the right choice.
16 Senator Breaux. Thank you, Mr. Chairman.
17 The Chairman. Please proceed, Mark.
18 Mr. Prater. Thank you, Mr. Chairman.
19 Going to the next revenue raising item. It is a change
20 to the large corporate family farm rules. This would take
21 into income the suspense account that was preserved in the
22 1987 Act, and take that suspense account into income over
23 20 years in a ratable fashion.
24 The next proposal is a phase-out of Section 936. The
25 proposal would reduce the credit in three ways.

1 Senator Graham. Excuse me. Could I ask a question on
2 number four? You state that large family farm corporations
3 which were affected by this were permitted to defer the
4 tax, but establish a suspense account. What was the
5 expectation, was that suspense account to be a permanent
6 fixture or was it to be gradually depreciation? What is
7 the current law?
8 Mr. Kies. The current law, Senator Graham, is that
9 the taxpayers who qualify for this are family farms that
10 have exceeded $25 million in gross receipts. They have to
11 switch to the accrual method. They have this suspense
12 account. Under the current law, that suspense account
13 remains suspended until their family farm status
14 terminates.
15 Some of the taxpayers who had previously had that
16 benefit have terminated family farm status, and then the
17 income is recaptured in the year in which that status
18 terminates. So it is a suspense account, but it is only
19 available under current law as long as the status as a
20 family farm continues.
21 Senator Graham. Of those persons who went through
22 this change in accounting method in 1987, what proportion
23 of them have terminated their suspense account due to a
24 change in their circumstances, and what proportion are
25 still operating a suspense account?

1 Mr. Kies. Senator Graham, I think our statistics show
2 there are roughly 50-60 that have enjoyed the benefits of
3 this. The number that have suspended, I do not have a
4 number on that. Let me see if we can get that for you.
5 The number that have terminated their family farm status we
6 do not have a number on, but let me see what we can find
7 out.
8 Mr. Prater. All right. Going to Section 936. The
9 credit would be eliminated in three ways. The economic
10 activity portion of the credit would sunset in six years.
11 That is, for tax years beginning on January 1, 2002. The
12 income portion of the credit would remain at current law
13 levels until 1998. Beginning in 1999, the credit ----
14 Senator Moynihan. Would you say that second point
15 again?
16 Mr. Prater. Senator Moynihan, the income portion of
17 the credit.
18 Senator Moynihan. Right. That is the old ----
19 Mr. Prater. That is right.
20 Senator Moynihan. That was reduced to 40 percent last
21 year.
22 Mr. Prater. That is correct. Well, it is 40 percent
23 for 1998. It goes down to 40 percent in 1998.
24 Senator Moynihan. That is right.
25 Mr. Prater. And then running off that system, it

1 would be rateably phased down beginning in 1999 and be
2 fully phased-out by 2002.
3 The third element of the credit is the Qualified
4 Possession Source Income. They would be ineligible for the
5 credit for investments made after last Friday. Some
6 certain QPSI investments made before October 14th could
7 remain eligible for the credit, but there would be no QPSI
8 at all after December 31, 2000.
9 There is a grandfather rule for existing facilities in
10 America, Samoa, Guam, and the Northern Mariana Islands, but
11 that would run out by the end of 2005.
12 The next change is for the income forecasting method.
13 This is a method that ----
14 Senator Moynihan. Mr. Chairman. I am sorry to
15 interrupt you, sir. I wonder if I could ask Senators to
16 hear me on this point, for the particular and important
17 reason that there is not a single person in Puerto Rico who
18 will vote in the next election, or the one after that, or
19 the one after that, for any members of this committee.
20 This is a possession, an island seized in the Spanish-
21 American War. We have a very solemn responsibility to this
22 Commonwealth. Every President since Harry S. Truman has
23 said that it had the right to remain a Commonwealth, to
24 become a State, or to become an independent Nation. If
25 Senators would just listen, now.

1 We have provided a tax benefit for economic activity in
2 Puerto Rico. I believe it goes back to 1928. It is
3 legislation that goes back to the 1920s. Mr. Prater
4 agrees.
5 In this moment, we are ending it all with no follow-on,
6 with no further provision whatever. Puerto Rico has not
7 just the lowest income of any unit in the United States and
8 its possessions, but it has half the lowest State income.
9 We rejoice that unemployment is down to 14 percent; it is
10 normally 20 percent.
11 We have recognized that the 936 provision could not
12 stay indefinitely. It was not that much of a benefit to
13 Puerto Rico. It was very beneficial to certain firms who
14 moved certain assets, patents, and such-like, and who took
15 tax credits as a consequence.
16 In 1993 we recognized that and we took that original
17 936 credit down to 40 percent, phasing it down. We created
18 a new economic activity credit which had benefits directly
19 tied to wages paid in Puerto Rico. Now we wipe it out.
20 The governor has come to us and said, could there not
21 be an empowerment zone designed to deal with this situation
22 of an island with very low income, very high unemployment?
23 I mean, a very moderate request considering the desperate
24 condition of so many people in the Commonwealth.
25 Mr. Chairman, I can only wish that we had not done

1 this. I do not in any way dispute the fact that the time
2 is coming when the original 936 activity was going to be
3 phased out. We began that in 1993, and took 60 percent
4 away.
5 But can I just put it this way, we are not going to get
6 anywhere trying to change this. But the economic activity
7 credit continues until the year 2002; is that right, Mr.
8 Prater?
9 Mr. Prater. It terminates in 2002.
10 Senator Moynihan. Well, that will give us a chance to
11 return to this subject, will it not, Mr. Chairman?
12 The Chairman. That is correct, Senator Moynihan.
13 Senator Moynihan. Because I think we are honor-bound
14 to do so. I just think it would be extraordinary to just,
15 without any other provision, stop a half century of
16 economic activity which has made a difference.
17 In the 1930s, President Roosevelt's director down there
18 wrote a gripping book called The Stricken Land and it was
19 as bad as the Caribbean could get. It is not now. But to
20 suddenly stop what seems to be a beginning transformation
21 seems to me to be a great mistake.
22 Senator Rockefeller. Mr. Chairman.
23 The Chairman. Yes, Jay.
24 Senator Rockefeller. Could I just ask one technical
25 question of staff? How do these changes affect companies

1 currently doing business in Puerto Rico in the following
2 respects? Specifically, can companies currently operating
3 in Puerto Rico who are expanding their operations before
4 the phase-out is completed expand their credit?
5 Mr. Kies. The credit they would be entitled to would
6 not be limited, as in the House bill, by expansion
7 activities. So for the first three years, if they are
8 under the current law rules, they get 100 percent of what
9 they would get under current law no matter how much they
10 expand. Then they would be into the phase-down.
11 If they are under the economic activity rule they would
12 get 100 percent of what they are entitled to under current
13 law through the year 2001, and then in the year 2002 it
14 would go to zero.
15 The House bill, on the other hand, has a cap that is
16 based upon the prior five years of activity and average and
17 they are limited to that amount. So the House bill would
18 effectively have some limit on a company that is in a
19 growth mode, but the Senate bill does not work in that way.
20 Senator Rockefeller. Thank you.
21 The Chairman. Yes, Dave.
22 Senator Pryor. Governor Graham is before me.
23 The Chairman. Governor.
24 Senator Graham. Thank you, Mr. Chairman.
25 I have two questions. One, is a follow-up on the

1 question of Senator Rockefeller. We seem to be more
2 generous to the income portion of 936 than to the economic
3 activity portion. We allow the income portion to continue
4 at current law through the end of 1998, including
5 expanding, and then we begin to phase out to January 1,
6 2002.
7 My analysis had been that it was the income portion
8 that was relatively less beneficial to the economic growth
9 of Puerto Rico relative to the economic activity portion.
10 It would seem to me that we ought to try to tilt towards
11 the portion of the law which is of maximum benefit to the
12 economic development of Puerto Rico.
13 With that background, could you tell me, what is the
14 relative fiscal note attached to subparagraph A and
15 subparagraph B?
16 Mr. Kies. Senator Graham, let me just clarify, first,
17 the Chairman's mark is actually more generous to the
18 economic activity group because they get six years of
19 current law without any reduction, whereas those that are
20 under the income method, beginning in the fourth year,
21 start to phase down. So this proposal does, indeed, treat
22 the economic activity more favorably than the income group.
23 Is your question, what is the relative relationship between
24 those two pieces?
25 Senator Graham. In terms of, what is the fiscal note

1 attached to subparagraph A and to subparagraph B.

2 Mr. Kies. Senator, let me try and find that out. Let
3 me just identify one little difficulty. Well, let me try
4 and sort out what the difference is between the two. I am
5 not sure exactly what it is right now. We give one
6 favorable treatment more to one than the other, so the net
7 effect, we will have to take that into account. Let me see
8 if we can find that out.

9 Senator Graham. The second question relates to a
10 provision that is not listed here. But, as part of the
11 Caribbean Basin Initiative there was a program in which
12 part of the benefits of 936 were used in a joint venture-
13 type fund to facilitate the economic development of members
14 of the CBI. What treatment will be afforded to that joint
15 development effort?

16 Mr. Kies. Senator Graham, I believe you are referring
17 to one of the qualified uses to which the so-called QPSI
18 amounts can be qualified Puerto Rican investment assets,
19 which some time ago did permit investment outside of Puerto
20 Rico in CBI activities.

21 What the proposal does is it permits those investment
22 activities to continue through the period through to a
23 maximum of five years. The rules under the Puerto Rican
24 withholding rules currently generally provide that when you
25 earn 936 money, if you bring it back to the United States

1 right away, it is subject to, I believe, a 10 percent
2 withholding tax, but if you invest it for up to five years,
3 the withholding tax goes down to five percent.
4 It is those monies that qualify for this tax-free
5 treatment under 936, and one of the qualified activities is
6 investing in these other activities. I believe what we
7 have done is subject them to the same five-year rule that
8 the amounts invested in Puerto Rico would be subject to.
9 Senator Pryor. Mr. Chairman, I have a question.
10 The Chairman. Yes.
11 Senator Pryor. Are you through, Bob?
12 Senator Graham. Well, I am disturbed by this because
13 at the very time that the Caribbean Basin countries are
14 under pressure because of their loss of competitive
15 position vis-a-vis Mexico, we are now about to eliminate
16 one of the provisions that had been of benefit in terms of
17 the economic growth of that region.
18 The Chairman. Dave?
19 Senator Pryor. Yes. Thank you, Mr. Chairman.
20 This is on 936, if I might ask this. It appears that
21 we have grandfathered in, at least for the next, what,
22 five, six, seven years, the companies that are presently
23 doing business in Puerto Rico under 936. Would that be
24 about right?
25 Mr. Kies. Senator, there are two different methods

1 that people enjoy under 936. One, is the economic activity
2 method that Senator Moynihan referred to. Those people get
3 six years of current law. Those that are under the so-
4 called income method get three years of current law and
5 then they phase down over three years.

6 Senator Pryor. All right. In this situation, let us
7 say that you have several pharmaceutical companies doing
8 business there and producing product, and what have you.
9 By the way, that is where about 95 percent of all of our
10 pharmaceuticals are actually manufactured, is in Puerto
11 Rico.

12 But a generic drug company wanting to go to Puerto Rico
13 and hire people, say 1,000 people, and they want to go and
14 manufacture Zantac, or what have you, would they be
15 precluded from benefitting from the tax break? A new
16 company coming in would be precluded, I think. I am not
17 sure.

18 Mr. Kies. Senator, the proposal would currently--
19 although I think there is some ambiguity about this--may
20 permit them to go there, although I am not sure that that
21 was necessarily intended. I think there may be some
22 confusion about that piece.

23 Most of the focus in the drafting of this related to
24 looking at who was there currently, and giving those
25 companies some period of time to basically recover their

1 investments there with a greater sympathy to the economic
2 activity companies who were the companies that are more
3 wage-intensive.
4 Senator D'Amato. Mr. Chairman, if I might, and with
5 the acquiescence of my friend and colleague, Senator Pryor,
6 if I might expand on that, because I had a very real
7 question, without being presumptuous. It was my
8 understanding that all companies would receive the benefits
9 and burdens of the current law, with the exception of the
10 QPSI, through 1998, as Senator Pryor alluded to.
11 That is, that taxpayers calculating their credit under
12 the percentage limitations would continue to have the
13 current law, a one-time opportunity to switch their method
14 of calculating their Section 936 credit to the economic
15 activity limitation, and for the affected taxpayers over
16 the next three taxable years. Is that correct?
17 Mr. Kies. Senator D'Amato, two things. Referring to
18 Senator Pryor's question ----
19 Senator D'Amato. Well, let me finish the rest. It is
20 also my understanding that the House bill eliminates new
21 starts and that our bill was silent on that point. I would
22 like to see it clarified. That is what the Senator was
23 getting at.
24 I would like it clarified that the revenues
25 attributable to the elimination of the new starts would be

1 dedicated specifically to address the election issue and
2 that the staff be given authority in drafting to address
3 that issue. But that was my understanding as we proceeded.
4 Mr. Kies. Senator D'Amato, I think the general
5 understanding was that the transition relief was for
6 companies that are there, and that the revenue estimate
7 that is reflected in the revenue chart, if it was limited
8 to companies that were there, would anticipate that the
9 point in time at which a company would have to choose
10 whether to be on the economic activity or the income
11 method, would have to be done as of the end of, I believe,
12 1996 rather than having to make that election by the end of
13 1995.
14 So, if we clarified it as Senator D'Amato has
15 suggested, then companies would have until the end of 1996
16 to choose which method they want to be on for purposes of
17 then being subject to this transition rule.
18 The Chairman. Why do we not have the staff maintain
19 the current law election for the time period commensurate
20 with the revenue available from the elimination of new
21 starts.
22 Mr. Kies. That would give all taxpayers who are
23 currently there until the end of 1996 to choose which of
24 the two methods, and then they would be subject to the
25 rules as have been presented in the mark-up document.

1 Senator Pryor. What would it do with the companies
2 that wanted to move and take advantage of the next few
3 years of protection?
4 Mr. Kies. Those companies would not be permitted
5 to ----
6 Senator Pryor. I fear we are creating a monopoly
7 here, or kind of adding to a monopolistic ----
8 Senator Breaux. We are perpetuating one.
9 Senator Pryor. Perpetuating a monopoly here, I guess,
10 because these generics cannot compete unless they get the
11 same tax incentive and tax break of existing drug
12 companies.
13 Mr. Kies. Senator Pryor, the only thing I would point
14 out is, with the phase-down and repeal there will be a
15 fairly significant discouragement from any company going to
16 Puerto Rico because of ----
17 Senator Moynihan. That is exactly the case.
18 Senator Breaux. There will be nobody moving there, I
19 will tell you.
20 The Chairman. That is really the purpose, is it not,
21 to phase down.
22 Mr. Kies. The general purpose of the proposal is to
23 phase it down and to do it gradually for those who have
24 made investments there already.
25 Senator Breaux. Mr. Chairman.

1 The Chairman. Yes, John.

2 Senator Breaux. I do not want to belabor the point.
3 I want to associate myself with the remarks of Senator
4 Moynihan from New York, and just point out the old TV
5 commercial of "pay me now or pay me later" is really at
6 work here. I mean, these possessions and commonwealths are
7 partly the responsibility of the United States. We are
8 going to find ourselves either helping them with 936 ----

9 Senator Moynihan. These are American citizens.

10 Senator Breaux. These are American citizens. And
11 probably the best of them have half of the per capita
12 income of the lowest per capita income State in the Nation,
13 which is not Louisiana, but almost.

14 The point I would make is, we are going to have to come
15 up with something. I think that is what the Senator was
16 trying to point out. This gives us some time. I know that
17 Governor Resayo from Puerto Rico has made a suggestion that
18 would apply to depressed areas or economic empowerment
19 zones or development zones that would apply anywhere.

20 I think that this committee really has an obligation to
21 try and come up with something. I think his idea makes a
22 great deal of sense. I do not think we have the time to do
23 it right now, nor the ability to score it, but I think we
24 have a responsibility, not to companies, as individuals,
25 but to these possessions which are ours, to be involved

1 with helping to make their lives better; as Senator
2 Moynihan said, they are American citizens.
3 Now, it is interesting that while we phase it out
4 fairly quickly with Puerto Rico, we have exempted Guam and
5 the Commonwealth of the Northern Mariana Islands. It was
6 good for one, should it not be good for both? I mean, how
7 do we distinguish, I guess, why we are going to keep it
8 longer in one area than in another area? I am glad we are
9 doing it. I mean, I would like to see it stay out there
10 because they are in abject poverty.
11 Mr. Kies. Senator Breaux, I think that was part of
12 the decision. Just to clarify, they do not have a
13 permanent grandfather, they are simply given the treatment
14 through the year 2005.
15 Senator Breaux. Ten years.
16 Mr. Kies. Our statistics indicate that of the total,
17 for example, in 1993, 936 benefits, $1 billion went to
18 Puerto Rico and $1 million went to everywhere else.
19 Senator Breaux. But, you know, if it is bad policy
20 for Puerto Rico, is it good policy for the Northern
21 Marianas?
22 Mr. Kies. I think that was part of the decision to
23 cut it off at the end of 10 years, but provide a little
24 longer transition.
25 Senator Breaux. I think we have an obligation to come

1 back and look at this in the next Congress.

2 The Chairman. All right.

3 Would you proceed, Mark, please?

4 Mr. Prater. Thank you, Mr. Chairman.

5 The next proposal would reform the income forecasting

6 method that corporations that market or sell films,

7 videotapes, or other related products, have the corporation

8 be required to estimate income for the first 10 years of

9 the life of the film, videotape, or related product.

10 The next proposal would provide that interstate

11 trucking rights that are ineffective because of the Federal

12 Aviation Authorization Act of 1994 would be allowed to be

13 amortized over three years.

14 Senator Rockefeller. Excuse me, Mr. Chairman. On

15 number seven. Number six. Was that a Disney problem that

16 got resolved for them?

17 Mr. Kies. The provision would apply to Disney and any

18 other movie production company. I think what you may be

19 referring to, Senator Rockefeller, under an earlier version

20 of the proposal ---- let me go back.

21 Current law, if you make a movie, you are able to

22 recover all of your costs during the period of its first

23 showing, so you look at what is the anticipated period of

24 the first showing.

25 If it is two years and you would earn 70 percent of the

1 money in the first year and 30 percent in the second year,
2 you would be entitled to 70 percent of the depreciation the
3 first year and 30 percent in the second year, even though
4 there might be subsequent revenues that would be generated
5 through subsequent showings outside the United States, et
6 cetera.
7 The provision that was written said, you need to take
8 into account all income. However, any income earned beyond
9 the 10th year is counted in the 10th year. When that rule
10 was written it was in anticipation of the fact that there
11 could be long tails of income that might occur, but they
12 would be in the distant future.
13 Senator Rockefeller. The Lion King being advertised
14 on cups, or whatever.
15 Mr. Kies. Well, I think it more like Cinderella, or
16 things that get remade 20 and 30 years later, where they
17 have kind of a second life to them. It was pointed out,
18 and correctly so, that for a situation like that, the
19 effect of it, because this depreciation or this income is
20 looked at in nominal dollars, not real dollars, that a
21 billion dollars earned 50 years from now, if it was put
22 into the 10th year, would effectively make the depreciation
23 only available in the 10th year, which would really cause
24 somewhat of an economic distortion in terms of how the
25 property has really depreciated.

1 So the rule that I think was selected was to just say,
2 we count all income for 10 years, not just the first
3 showing but for 10 years, and then cut it off at the end of
4 10 years.
5 For properties that have a very long tail of income,
6 that would relieve them of what would otherwise be
7 effectively delaying all or most depreciation until the
8 10th year. Disney might well be one of those companies,
9 but other movie companies that make hits that go on forever
10 would be in a similar situation.
11 Mr. Prater. Mr. Chairman, moving on to the next
12 proposal. I described the interstate trucking rights one.
13 Those are worthless trucking rights because of the federal
14 action last year. These trucking rights would be allowed
15 to be amortized over three years.
16 The next proposal after that would permit
17 corporations ----
18 Senator Graham. Mr. Chairman, could I ask a question
19 on that? I am curious as to why we have to legislate on
20 that. This must be not an uncommon event in which people
21 have an item of intangible worth, such as the right to
22 engage in a particular economic activity, where the rules
23 are changed and that certificate no longer has any
24 commercial value. Do we have to pass legislation every
25 time that occurs and allow people who have purchased those

1 intangible rights to amortize them all?

2 Mr. Kies. Senator Graham, the problem that arose
3 here, which was similar to what arose in 1981 when
4 interstate trucking was deregulated is that the
5 deregulation causes the value of these rights to
6 substantially decline, but not to zero.

7 Some States have actually passed State legislation to
8 say, these rights have no value. But, in the absence of
9 something that extreme, the rights may have some minimal
10 value, although be worth substantially less than what, for
11 example, a taxpayer paid for those rights.

12 When this similar problem arose with respect to
13 interstate trucking rights in the late 1970s, the 1981 Act
14 included a similar provision to this. In the absence of
15 such a provision like this, taxpayers would probably
16 encounter some litigation with the IRS if they attempted to
17 write them off because technically the rule is, unless they
18 are worth nothing, they are not entitled to amortization.

19 This is somewhat of a transitional problem because
20 Section 179, which was enacted in 1993, dealing with
21 intangibles, now would make these types of rights subject
22 to a 15-year depreciation regime. So, going forward you
23 will not encounter this problem, but this exists for those
24 taxpayers who are not subject to Section 197.

25 The Chairman. All right.

1 Mr. Prater. Mr. Chairman, the next proposal would
2 permit corporations to use over-funded pension plan assets
3 to fund ERISA-protected employee benefit plans. The excess
4 pension assets could be used to fund plans that cover a
5 broad group of employees.
6 Plans that would fall under this definition would
7 include active and retiree health, disability, child care,
8 and educational assistance plans. The withdrawals of the
9 excess pension plan assets would be limited to the cost of
10 funding those employee benefit plans for each year, so
11 there would be a year-by-year limitation on the withdrawals
12 for those purposes.
13 Senator Moynihan. Mr. Chairman.
14 The Chairman. Senator Moynihan.
15 Senator Moynihan. Mr. Chairman, I so very much wish
16 we did not have this measure before us right now. We are
17 putting in place a sequence of steps that, in effect, could
18 reproduce the savings & loan disasters of the 1980s. I
19 have a letter, sir, from the trustees of the Pension
20 Benefit Guaranty Corporation.
21 And we all should start by noting that the Federal
22 Government insures pension funds. This was almost the life
23 work of my revered former colleague, Senator Javits. When
24 a pension fund goes bankrupt, the United States Government
25 has got to make the beneficiaries whole. If there is not

1 enough money in the pension fund, we will have to take it
2 out of general funds.
3 The trustees, Secretary Reisch, Secretary of Labor,
4 Secretary Rubin, Secretary of the Treasury, Secretary
5 Brown, Secretary of Commerce, write, "The Board of
6 Directors of the Pension Benefit Guaranty Corporation urges
7 the Senate Committee on Finance to reject the corporate
8 pension transfer provision to be considered later this
9 week.
10 As expressed to you in our letter of September 27th, we
11 oppose any transfer of pension assets that could lead to a
12 reduction in retirement income security. Although the
13 draft Finance Committee bill proposal appears to be more
14 restrictive than the provision reported by the House
15 Committee on Ways and Means, it would still result in the
16 removal of billions of dollars from the pension system,
17 endangering workers' retirement income for the purpose of
18 paying current expenses. This would increase the risk of
19 loss for workers, retirees, and the pension insurance
20 system."
21 I mean, if there is ever a principle of pension funds,
22 it is to put money in and keep it in and not use that money
23 for current expenses, to save that money. I just cannot
24 believe that we are doing this, sir. I would ask that this
25 statement be placed in the record.

1 [The letter appears in the appendix.]

2 The Chairman. Mr. Kies, I understand that you have,
3 at the request of the Chairman of the House Ways and Means
4 Committee, made an analysis of the letter referred to by
5 Senator Moynihan. Would you please advise us as to what
6 you found?

7 Mr. Kies. Mr. Chairman, we reviewed a report that was
8 issued by the Pension Benefit Guaranty Corporation several
9 days after the Ways and Means Committee acted raising
10 concerns about the impact of the reversions. In the
11 process of analyzing that, we met with several well-
12 respected actuarial groups. We met with the PBGC.

13 We also undertook a fair amount of research on our own
14 which supplemented what had been done prior to the Ways and
15 Means Committee action. The conclusions of our analysis
16 are reflected in a letter which was transmitted to Chairman
17 Archer today, and also to Chairman Roth, which we will
18 circulate to all members of both Ways and Mean and Senate
19 Finance.

20 The conclusion of our study is that the PBGC document
21 places undue emphasis on fact patterns of prior reversions
22 that are not similar to any reversion that can be
23 anticipated in the future. The PBGC document understates
24 the asset cushion that would be required under the proposal
25 before the committee.

1 It is the same asset cushion that was adopted in
2 legislation that was adopted as part of the GATT during
3 1993 legislation, although I would emphasize that the uses
4 to which the money can be put are greater under this. But
5 the basic point is, the asset cushion that was reviewed by
6 many as part of the 1993 legislation was viewed as adequate
7 to protect the safety of the beneficiaries of the pension
8 plans.
9 The PBGC document also overstates the potential risk
10 presented by the proposal by focusing on the funding of
11 pension plans on a termination basis. For example, they
12 present scenarios under which interest rates are falling at
13 the same time that asset values are falling. One of the
14 studies done by one of the actuarial firms have never found
15 that actually to occur since 1926, that typically when
16 interest rates fall, asset values rise.
17 I guess the final point that I think is important to
18 emphasize is that it has been the prior position of the
19 Pension Benefit Guaranty Corporation that restrictions on
20 reversions actually act to discourage employers from
21 adequately funding defined benefit pension plans, because
22 if employers cannot touch amounts no matter how over-funded
23 the pension plans are, it acts as an incentive to under-
24 fund the plans. Indeed, that was the position taken by the
25 Pension Benefit Guaranty Corporation when they testified in

1 1987.

2 Senator Roth, I think we prepared a chart that actually
3 illustrates part of the problem of this situation. If you
4 follow the situation in terms of over-funding of pension
5 plans since the 1980s, over-funding has actually declined,
6 while under-funding has increased.

7 We believe that a significant contributor to this
8 phenomenon is the fact that employers, under current law,
9 cannot touch any excess assets in an over-funded plan no
10 matter how over-funded the plan is.

11 What you see on the far left is the amount of assets
12 that would be potentially subject to reversion for purposes
13 of paying these various ERISA-type benefits. It represents
14 a very small portion of the total pension assets.

15 So, on balance, I think we have carefully reviewed the
16 PBGC document. We think that it just overstates the
17 problem substantially and does not focus on the real
18 problem that PBGC has, which is under-funded pension plans.
19 These plans we are talking about are over-funded, not
20 under-funded.

21 Senator Moynihan. Mr. Chairman, I do not want to
22 monopolize this conversation, but I have a letter from the
23 American Academy of Actuaries that says just the opposite.
24 It is a judgment, a professional judgment. I do not deny
25 that, for the moment.

1 But they write, "The provision will be especially
2 welcomed by financially weak companies, and even some
3 financially strong companies will take advantage of the
4 temporary relief from restrictions on asset reversions.
5 The withdrawal of assets from pension funds by both
6 strong and weak companies will reduce the security of the
7 affected pension promises to workers and increase the
8 exposure of the Pension Benefit Guaranty Corporation."
9 Mr. Chairman, I would like to ask that this be placed
10 in the record.
11 The Chairman. So ordered.
12 [The letter appears in the appendix.]
13 Mr. Fisher. Senator Moynihan, that letter was written
14 in response to the House proposal, not the Senate proposal.
15 If you look, I believe in that letter, the American Academy
16 is in favor of the transfer of excess pension assets, they
17 are just quibbling over how you measure it.
18 Senator Moynihan. Well, I will take your word for
19 that, sir.
20 Senator Rockefeller. Mr. Chairman.
21 The Chairman. Yes, Jay.
22 Senator Rockefeller. Thank you very much. Just a
23 couple of points to make in just complete and total support
24 of what Pat Moynihan has said.
25 First of all, I think this is an enormously important

1 problem. I wonder how many members of the Finance
2 Committee, including myself, understand it to the extent
3 that they should, or understand it to the extent that they
4 should put it into tax policy which becomes the law of the
5 land, which is fairly serious business.
6 I would advance these propositions. One, it is very
7 bad insurance policy, pension insurance policy. The mark
8 would let companies use pension assets to pay for other
9 employee benefits and employers would be able to take
10 billions of dollars out of their workers' pension plans.
11 I mean, I think this is going to happen. As we sit here
12 and pass it on an 11 to 9 vote, or whatever it is, we just
13 might as well understand that is what is going to happen.
14 I think it is very bad retirement policy.
15 I think it weakens workers' retirement security, which
16 is meant to be a part of this. It allows companies to take
17 pension assets and use them for non-retirement purposes,
18 unless somebody cares to argue to the contrary. Do you?
19 Mr. Kies. No, Senator Rockefeller. That is correct.
20 Senator Rockefeller. I think this is contrary to the
21 most fundamental principles of ERISA, that pension assets
22 are for the sole benefit of the plan participants. I think
23 it is bad pension policy, all by itself. Money earmarked
24 for retirement rather than general corporate funds will be
25 used to pay for ERISA benefits. This is like robbing Peter

1 to pay Paul, do you want to argue? I would be very
2 interested in Treasury's view on this when I am finished.
3 Mr. Fisher. Senator Rockefeller, it is a well-settled
4 law that any excess pension assets, to the extent that all
5 current liabilities are funded, belongs to the employer.
6 Under this cushion that is built into this proposal, and it
7 is measured by the greater of 125 percent of current
8 liability or the full funding limit--in most cases it is
9 the full funding limit--in which case you can only take
10 assets over that limit. The law says that assets above
11 that limit belong to the employer.
12 Senator Rockefeller. So, indeed, the monies earmarked
13 for retirement could be put elsewhere.
14 Mr. Fisher. That is correct. The money that is
15 earmarked for retirement consists of 100 percent funding of
16 the current liability. An employer that is above the full
17 funding limit is restricted from putting more money into
18 their plan. It is above that point that those monies
19 belong to the employer.
20 Senator Rockefeller. My point continues. I think it
21 is bad benefits policy. It fails to ensure that the
22 quality or availability of the benefits will be maintained.
23 I think it is bad tax policy. It allows companies to game
24 the tax system by putting money into pension plans when
25 their taxes are high and pulling money out when their taxes

1 are low. Would anybody care to argue that at the table?
2 Mr. Prater. Again, the plans that this can be
3 transferred to under this proposal are ERISA-protected
4 benefit plans that cover a broad range of employees. We
5 are not talking about any corporate purpose here, we are
6 talking about keeping the money in employee benefit
7 solution protected for the employees.
8 Senator Rockefeller. Well, the Treasury may want to
9 comment on that in a moment, if they are allowed to do so.
10 I think it is bad economic policy. It is going to
11 further erode the Nation's savings. It is bad budget
12 policy, it is bad legislative policy.
13 I cannot really think of anything more positive to say
14 about it. I think it is a really, really fundamental
15 mistake. I would be interested in what Treasury has to
16 say, at some point, Mr. Chairman, on this matter.
17 The Chairman. Senator Conrad.
18 Senator Conrad. Thank you, Mr. Chairman.
19 When we are talking about being 125 percent of
20 liabilities, that, of course, is measuring assets. Assets
21 typically are company stock, are they not?
22 Mr. Fisher. No, Senator. Usually it consists of, it
23 is not in that particular company stock, it is usually
24 stocks in the market. The usual mix for most pension plans
25 is about 40-50 percent bonds and the rest in stocks.

1 Senator Conrad. Well, I appreciate that. I mean, I
2 have seen companies in my old job as a tax commissioner
3 that had virtually all of their assets in stock holdings,
4 not just of the company, certainly, they would diversify
5 that, but they would be stock holdings and bond holdings,
6 as you correctly point out. The stock market right now is
7 at an all-time high. The bond market has just seen an
8 almost unprecedented rally.
9 Of course, when we are seeing these funds are over-
10 funded, we are taking it from a record high base. Anybody
11 who has followed the stock market knows that the stock
12 market not only goes up, sometimes it goes down, and
13 sometimes it goes way down. In fact, if you look at what
14 happens at this cycle of a stock market rally, typically
15 you will see a correction of as much as 30 percent. Then
16 all of a sudden, if you did an analysis of whether these
17 funds are over-funded or under-funded, you would find quite
18 a different picture, I would suggest.
19 I would just ask Mr. Samuels if there is not a concern
20 that, if we are basing an analysis on values that exist
21 today, that we are not taking a very rosy view of things.
22 And when the stock market, as it always does, goes down, we
23 will be scrambling around here trying to figure out how to
24 protect pension funds that we have just allowed companies
25 to draw on.

1 Secretary Samuels. Senator Conrad, the administration
2 strongly opposes this proposal, which is effectively to
3 create a new corporate loophole. There is a lot of
4 controversy over this. Companies want this and they want
5 it for a reason. They like the idea of having this six-
6 year holiday of taking money out of pension plans at no
7 excise tax. The excise tax is being waived.
8 We think it is bad pension policy, it is bad tax
9 policy. I am reminded, because it is still very vivid in
10 my mind, I believe tomorrow is the anniversary of the stock
11 market fall in 1987. I was on the floor of a large trading
12 house and can remember the panic and confusion.
13 Senator Moynihan. The Dow went from 2700 to 1700 in
14 about six months.
15 Secretary Samuels. Last year, as you will recall,
16 this committee worked very hard to deal with the under-
17 funding problem of pension plans. We are all seriously
18 concerned about our national savings rate. That is why
19 there is an IRA proposal in this mark, to encourage
20 savings. There is a small business pension proposal to
21 encourage savings.
22 We should not be taking savings out of pension plans.
23 It is not a prudent thing to do. When it is suggested that
24 there is a cushion, the problem is, in deciding what the
25 cushion is, the company and their actuaries--this is going

1 to be good business for actuaries--can decide on the
2 assumptions, and there is a wide variation of assumptions
3 that can be used.
4 I think if you look back in time, we have talked to the
5 PBGC and they looked at, for example, the Eastern Airlines
6 pension plans which were terminated in 1991, I recall, with
7 an exposure to the government of, I think, about $450
8 million.
9 If you went back into the early 1980s and looked at the
10 profile of their pension plan, under this proposal it
11 appears that they would have been allowed to take some
12 money out, which would have further been to the detriment
13 of the PBGC and the taxpayers of the United States.
14 So we think that this is not the time to start in any
15 way reducing the security of pensions for workers and
16 current beneficiaries, and this is, as I said at the
17 beginning, from a policy perspective, a bad proposal.
18 Senator Conrad. Could I just follow up and ask the
19 question, could you just remind the committee of the steps
20 that we just took to strengthen pension funds?
21 Secretary Samuels. As part of the GATT legislation
22 last year, this committee passed the Pension Security Act,
23 which was to deal with the under-funding problem. We have
24 had a very serious under-funding problem. That is what we
25 are trying to deal with, and we are trying to deal with it

1 over a period of time.

2 Last year's legislation, we just did not snap our
3 fingers and deal with the under-funding problem, we all
4 understood that it would take some period of time to deal
5 with, and that is what that legislation was designed to do.
6 We are in the process of strengthening our pension plans.

7 Senator Conrad. Does this not directly counter what
8 we just did?

9 Secretary Samuels. Yes, Senator Conrad, we believe
10 so.

11 Mr. Fisher. Senator Conrad, can I follow-up Assistant
12 Secretary Samuels' comments, if I may? With respect to the
13 Eastern Airline example, back in the early 1980s there was
14 no asset cushion required in order to take out transfer
15 excess assets. That is one thing.

16 The other thing is, they did not have this new GATT
17 faster-funding requirement that we diligently worked on
18 last year. So I am not convinced that that situation,
19 under current law, would have happened that way.

20 Secretary Samuels. Senator Conrad, if I can just
21 explain my example of Eastern Airlines, they did not take
22 any money out. What I said was, had this law been in
23 effect in the early 1980s, we believe that they would have
24 been able to take money out of their pension fund, under
25 the standard that this proposal would provide.

1 The Chairman. Senator Hatch. I think we have to move
2 on.
3 Senator Hatch. This is very important stuff. But if
4 I could ask a series of questions of Mr. Fisher, I am
5 hoping that it will clarify it in my mind, and maybe in
6 others' as well. As I understand it, the PBGC uses a
7 cushion of 125 percent of current liability. That would be
8 the plan's obligations if they are terminated today. Am I
9 correct?
10 Mr. Fisher. That is correct.
11 Senator Hatch. Frankly, I think it is incorrect for
12 them to do that because, as I understand it, the proposal
13 defines excess assets as the greater of the "full funding
14 limit." That is the limit beyond which no more funds can
15 be paid into the plan, or 125 percent of current liability.
16 Mr. Fisher. That is correct, Senator.
17 Senator Hatch. All right. The full funding limit
18 then is accrued liability, long-term actuarial obligations
19 of the ongoing plan, right?
20 Mr. Fisher. Yes.
21 Senator Hatch. And that would be up to a cap of 150
22 percent of current liability.
23 Mr. Fisher. Yes.
24 Senator Hatch. So that is the cushion you are talking
25 about.

1 Mr. Fisher. That is correct, Senator.
2 Senator Hatch. All right. Therefore, in most cases
3 the required safety cushion would exceed the 125 percent we
4 have been talking about.
5 Mr. Fisher. Yes. According to the Associate of
6 Private Welfare and Pension Plans, a trade association that
7 represents many of the larger pension plans in the country
8 and these are a lot of the plans that have surplus assets,
9 in many cases the cushion is going to be based on the full
10 funding limit, which, in 70 percent of all over-funded
11 pension plans, is above 125 percent of current liability.
12 Senator Hatch. But these definitions, full funding
13 limit and excess assets, they are PBGC definitions. They
14 have been used always by PBGC in the past.
15 Mr. Fisher. That is true. They are in the Labor
16 statutes as well.
17 Senator Hatch. Now, is it not also true that if a
18 business pulls the money out they cannot just go spend it
19 on whatever they want to.
20 Mr. Fisher. That is true, Senator.
21 Senator Hatch. They can only spend it in what ways?
22 Mr. Fisher. Senator, they can spend the money on
23 ERISA-protected broad-base coverage type plans such as
24 retiree health, which you can do under current law.
25 Senator Hatch. So it has got to be for the benefit of

1 employees one way or the other.

2 Mr. Fisher. That is right. For the most part, we
3 believe that the same employees that participate in the
4 over-funded pension plan will receive a benefit of the
5 excess assets because they are also participating in the
6 health plan, the child care plan, the educational
7 assistance plan.

8 Senator Hatch. So the point I am making is, these, as
9 you have said, are the funds of the business.

10 Mr. Fisher. That is correct.

11 Senator Hatch. These are excess fundings, generally
12 in excess of 125 percent of the current obligations of the
13 program.

14 Mr. Fisher. At a minimum.

15 Senator Hatch. At a minimum, and really at 150
16 percent.

17 Mr. Fisher. In many cases.

18 Senator Hatch. And if they take them out they cannot
19 just spend them for corporate welfare, they have got to
20 spend them on employee-related type benefit programs.

21 Mr. Fisher. Yes, Senator.

22 Senator Hatch. Well, that is a far different thing,
23 Mr. Chairman.

24 Secretary Samuels. Senator Hatch, if I could just
25 follow-up on that.

1 The Chairman. Senator Chafee is next.

2 Senator Chafee. Thank you, Mr. Chairman.

3 Like everyone, I am slightly troubled when you are
4 talking about taking money out of a pension fund, but at
5 the same time, situations, it seems to me, do arise if the
6 thing is over-funded.

7 My question to you, Mr. Samuels, is I notice in the
8 material sent out by the PBGC they talk about these
9 outrages where companies have taken money out. Enron
10 Company took $232 million from a pension plan that is now
11 under-funded. How could they do that? Is that the present
12 law, you can do that anyway?

13 Secretary Samuels. Senator Chafee, the basic problem
14 is that there was a situation in the 1980s where companies
15 were terminating plans, buying annuities, and then taking
16 out the excess. The law was changed to put a penalty on
17 companies that would do that by charging an excise tax to
18 recapture the tax benefit that the companies effectively
19 received because these pension funds gathered deferrals.

20 Senator Chafee. All right.

21 Secretary Samuels. But let me just say, the rule now
22 is, if you terminate a plan you have to buy annuities for
23 your employees and anyone else who was an employee. These
24 are termination amounts that you calculate in order to make
25 sure that the beneficiaries will get their full plan.

1 Senator Chafee. All right. Now suppose you have
2 got ----
3 Secretary Samuels. Let me follow up, because it is
4 very complicated and this is in the world of actuaries.
5 But the bottom line very simply said that the cushions that
6 we are talking about do not provide a basis for saying that
7 the company can purchase annuities for their beneficiaries
8 and then have money left over.
9 That is not what we are talking about. We are not
10 talking about a termination liability. It would be what
11 you would have to spend to actually buy annuities to fund
12 your obligations to your employees and other beneficiaries.
13 What we are talking about is ----
14 Senator Chafee. Give me a chance, Mr. Samuels,
15 because I am on a short string here. Is there any
16 situation you can see where there are excess payments,
17 excess monies in the pension fund, that it would be
18 suitable for the company to take some of that, however you
19 define that excess, out? Is there such a situation that
20 can exist?
21 Secretary Samuels. Senator Chafee, we have been
22 looking at that and we dealt with that issue last year when
23 we extended what was then Section 420, which provided that
24 funds could be used to pay retiree health benefits. There
25 was a crisis with respect to retiree health benefits and we

1 allowed withdrawals last year in a very narrow situation.
2 We built fire walls around it to prevent just this kind of
3 problem that we are talking about today.
4 Senator Chafee. But what were the determinations?
5 Secretary Samuels. The fire walls required that the
6 plan, for example, would maintain--there was a maintenance
7 of effort requirement--its retiree health benefit. That
8 was a condition of being allowed to use the money for
9 retiree health benefits. By the way, this proposal
10 effectively repeals that, so companies no longer would be
11 required to maintain the retiree health benefits, and we
12 think that is also bad policy.
13 The Chairman. I think Dave Pryor is next.
14 Senator Pryor. Thank you.
15 Mr. Samuels, I will make this very quick. You say the
16 company could take this money and buy annuities for its
17 employees; is that correct?
18 Secretary Samuels. No. What I am saying is, if you
19 are talking about making sure that the employees are
20 protected in terms of deciding whether there are excess
21 funds in the pension plan, you ought to look at what it
22 cost to purchase annuities for the retirees, that that is
23 certainly a standard.
24 That is not what this particular definition of excess
25 liabilities is all about. That is not talking about what

1 it would cost to purchase annuities for liabilities. This
2 is a standard that the companies decide in consultation
3 with their actuaries.
4 Senator Pryor. But these companies looking at an
5 over-funding situation, would they not normally say, this
6 program, this particular pension plan, is costing too much.
7 What we are going to do is terminate the plan, buy some
8 annuities for the employees, and the employees are going to
9 be looking at an annuity that is not insured by PBGC. The
10 pension plan is insured by PBGC, is that not correct?
11 Secretary Samuels. Right. That is correct.
12 Senator Pryor. Now, I would like to go to Mr. Fisher
13 here. You talk about the law that states that 125 percent
14 of unfunded liabilities, any other 125 percent belongs to
15 the employer or to the company. Now, I am not questioning
16 you, but could you cite us that law?
17 Mr. Fisher. It is a provision in ERISA.
18 Senator Pryor. If you could, I would like that for
19 the record.
20 Mr. Fisher. Yes. i will find that for you.
21 Senator Pryor. I am not so certain that we look at
22 that the same way. I am not so certain we interpret that
23 the same way, and I think this is of such gravity, as
24 Senator Rockefeller and Senator Moynihan have stated.
25 If I might ask you, Mr. Kies, where did this idea come

1 from; what is driving this?

2 Mr. Kies. Well, Senator Pryor, this idea is merely an

3 extension of what the Congress originally adopted in 1990

4 when they agreed to permit reversions for certain purposes

5 out of pension plans. I think it is important to emphasize

6 that Senator Roth's proposal adheres identically to the

7 cushion that was agreed to in 1993.

8 The judgment was made that a cushion of what

9 effectively is 150 percent of current liabilities--and that

10 includes both vested and unvested benefits--was adequate to

11 protect the rights of existing participants. All this does

12 is say you can use the money for some other purposes. I

13 think the key issue is ----

14 Senator Pryor. There are a lot of other purposes, if

15 I may.

16 Mr. Kies. That is correct.

17 Senator Pryor. Now, Mr. Kies, I am on a short string,

18 as my colleague, Senator Chafee, stated. Where in this

19 Chairman's mark is there a provision that says that the

20 employees who own these funds, basically, are going to be

21 given notice; what notice is required from the employer to

22 the employee?

23 Mr. Kies. Under current law, there is a notice

24 provision in the case of reversion under Section 420. I

25 believe that that notice requirement is carried over,

1 Senator Pryor, but I will be happy to check that.

2 Senator Pryor. I do not think it is carried over, and

3 I do not think any notice is required under the Chairman's

4 mark.

5 Mr. Kies. Senator Pryor, it is carried over. It is

6 part of current law, and all we are doing is piggy-backing

7 on the current law provision.

8 Senator Pryor. Is this issue deficit- or budget-

9 driven?

10 Mr. Kies. Senator Pryor, I think it is driven by

11 pension policy considerations. As I said, the PBGC has

12 long testified that putting undue limits on reversions

13 discourages employers from soundly funding pension plans.

14 The Chairman. Senator Hatch is next.

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1 (6:00 p.m.)

2 Senator Hatch. Well, the thing that bothers me is,
3 frankly, as Senator Pryor indicated, if they take this
4 money and they put it into annuities, that that is not
5 protected by PBGC, but those are surplus funds. The rest
6 of the pension plan that is fully funded up to 150 percent
7 is protected by PBGC, right?

8 Mr. Kies. Senator Hatch, we are not talking about
9 terminating pensions plans. That is correct.

10 Senator Hatch. Second, I understand Mr. Samuels'
11 point, that they decided that annuities to protect
12 retirees' health is important. That is government deciding
13 that. If you are right that it is the business funds, and
14 I believe you are right on that, then maybe they should
15 have the flexibility as business people rather than having
16 government tell them what to do.

17 If I find fault with not just this administration but
18 many administrations, it is that we wonderful oracles here
19 in Washington think we can tell business what to do a lot
20 better than business can tell itself and we will spend
21 their money for them rather than let business do it.
22 Frankly, it is a lot more efficient to let business do it.

23 Now, the fact that there are some people in business
24 that are not honest should not taint everybody in business,
25 but that is what bothers me about this whole argument. The

1 fact is, you are funding this up to 150 percent and if
2 there is a surplus they have to put it into some employee-
3 related funding. They cannot just take the money and use
4 it themselves. Frankly, I cannot see why the hullabaloo.
5 Senator Pryor. Well, that is what happened to the
6 S&Ls. We stopped telling the S&Ls what to do.
7 Senator Hatch. Oh, no. What we did was pass a tax
8 law that threw them into bankruptcy because it just wrecked
9 the real estate industry in this country. That is what
10 happened. It was our fault as much as anybody's.
11 Senator Baucus. Mr. Chairman.
12 The Chairman. Max.
13 Senator Baucus. Mr. Chairman, I would like to follow
14 up a little bit on the question that Senator Pryor asked.
15 That is, what is driving this? The question I was going to
16 ask before he asked that question is, why are we doing
17 this? I asked that because, as I look at this fancy chart
18 that was distributed, nice colors and all that, if you look
19 on the far left--this is all annual averages in 1993
20 constant dollars--you will see that the over-funding was
21 $193 billion in the period 1982-1986, whereas the under-
22 funding in roughly the same period was $21.67 billion.
23 If you look at the trends over this period, essentially
24 the green, which is the over-funding, is declining in the
25 periods, whereas the under-funding, which is the blue, is

1 increasing. It just strikes me that maybe we are doing
2 something, perhaps, backwards here. That is, why are we
3 relaxing the provisions when, over the period of time 1982
4 to current, the fact is, these funds are less over-funded
5 and more funds are more under-funded?
6 Mr. Kies. Senator Baucus, I think you are exactly on
7 the point, except it is the other way around. That the
8 current law says to an employer, no matter how over-funded
9 the pension plan becomes they cannot touch the money,
10 discourages employers from adequately funding pension
11 plans. So what it has done, according to the data, is it
12 has caused the over-funding of plans to decline because
13 employers are holding money back.
14 The PBGC in 1987 specifically testified and said, "we
15 believe the restrictions on reversions discourages
16 employers from adequately funding because if they get too
17 much money in there they cannot touch it." Pension experts
18 across the country have said that giving employers more
19 flexibility will encourage them to fund on a more sound
20 basis, not a less-sound basis.
21 Senator Baucus. If I could follow up. The fact is,
22 still, fewer funds are over-funded.
23 Mr. Kies. And that has happened during the period
24 that these extreme restrictions on reversions have existed.
25 Senator Baucus. If there are fewer that are over-

1 funded, why are we relaxing and allowing more transfers?
2 Mr. Kies. Because we are trying to permit more
3 flexibility. What has happened over time with these
4 incredible restrictions on reversions is, employers are not
5 funding. If you take those off, employers will be more
6 likely to fund on a sound basis because they will know, if
7 the stock market does take a dramatic upturn or they have
8 a downturn in the size of the work force, they can touch
9 the assets.
10 Senator Baucus. Mr. Samuels, if you might comment,
11 please.
12 Secretary Samuels. Senator Baucus, the proposal, in
13 our view, does not create incentives for future funding
14 since it only applies to amounts in excess of 125 percent
15 of accrued liabilities as of January 1, 1995. So it is not
16 like this is going to encourage people in the future, this
17 is as of January 1, 1995.
18 Second, it is only for six years, so it is a window--
19 this is budget-driven--to try to get people to withdraw
20 money and thereby they are going to pay tax on it, that
21 that shows up as a tax increase.
22 Finally, PBGC did an analysis of 10 large pension plans
23 which are insured which showed that, if funded at 125
24 percent level, they would be only able to pay 87 percent of
25 the obligations to workers should the plan terminate. That

1 is because of the differences of assumptions that are used
2 for these various measures, and that is what is so
3 troubling to us.
4 The Chairman. We had an extended discussion of this
5 issue. We still have a ways to go through the walk-
6 through, so I would like to move on.
7 Senator Graham. Mr. Chairman, I have been seeking
8 recognition to ask some questions. I think this is an
9 extremely important issue. It happens to be important to
10 all of us.
11 The Chairman. Bob, please proceed. I would ask you
12 to try to keep it short.
13 Senator Graham. Well, I just want to underscore,
14 there are some special interests here. I represent a state
15 where literally hundreds of thousands of people move, whose
16 ability to come into our State is dependent upon the
17 solidity of their pension plan. So this is an issue that
18 is not only of great importance to the individuals ----
19 The Chairman. I think we are all united in wanting a
20 sound pension program for American workers. Please
21 proceed.
22 Senator Graham. I mean, it would really be my
23 suggestion that this provision should be deleted and dealt
24 with as a discrete matter, given the opportunity for public
25 hearings that an issue of this import would normally have.

1 But, given the conditions under which we are operating, I
2 would like to ask a couple of lines of questions.
3 First, what are the current uses to which excess
4 pension funds can be utilized?
5 Secretary Samuels. Senator Graham, under current law,
6 if one terminates a plan, then you pay the excise tax,
7 which is to reimburse the government for the inside build-
8 up that occurs tax-free. You can only effectively get your
9 money out if you terminate a plan, or, pursuant to this
10 Section 420 which is very limited to retiree benefits,
11 where you agree to maintain the level of health benefits
12 for your retired employees.
13 Senator Graham. It is to that last point that I was
14 directing my question. If I am correct, this committee, by
15 previous action, has just raised the age of eligibility for
16 Medicare from 65-67. Is that not going to increase the
17 obligation of those corporations which provide for retiree
18 benefits by an additional two years?
19 Secretary Samuels. I would expect so, Senator.
20 Senator Graham. So are we not, by action of this
21 committee, facing a situation in which the demands for that
22 excess pension fund, for purposes of adequately funding a
23 new health obligation, are likely to be increased, not
24 decreased?
25 Secretary Samuels. I believe that to be the case. It

1 is obviously going to be up to the employer to decide what
2 they want to do with respect to their retirees' health
3 benefits.
4 Senator Graham. It would seem, in the context of what
5 we have just done with Medicare, this would be a
6 particularly inappropriate time to be discussing the
7 possibility of diminution of the capacity of pension plans
8 to meet this new obligation for their retirees' health
9 benefits. Could you comment as to why that is not poor
10 timing?
11 Mr. Kies. Senator Graham, I would just point out
12 that, again, we believe that the cushion of protection
13 provided to current workers and to retirees, which is fully
14 consistent with what was agreed to by the Congress in 1993,
15 was an adequate cushion and that for plans that are
16 continuing, that that more than adequately protects the
17 interests of workers while giving the employer some
18 flexibility to pay for the costs of other ERISA-protected
19 benefits.
20 Secretary Samuels. Senator Graham, can I mention, in
21 terms of the uses to which the funds will be used, the
22 Chairman's mark provides that the funds should be used for
23 ERISA-protected plans. That is, I think, principally,
24 employer-provided health insurance. This year we expect
25 that employer-provided health insurance will be

1 approximately $273 billion. So if an employer takes
2 advantage of this mark, many of them will be funding
3 expenses that they otherwise would have made.
4 Since its money is fungible, then they will use the
5 money that they would have spent on employer-provided
6 health insurance for something else, for executive bonuses,
7 take-overs, whatever they want. But it is important, I
8 think, for the committee to know the money is fungible.
9 Senator Graham. That was my second question. I would
10 like to ask the gentlemen at the end of the table. I am
11 sorry.
12 The Chairman. I am going to have to move on. One
13 more question.
14 Senator Graham. No, Mr. Chairman. I want to finish
15 this line of questions because I think we have just gotten
16 to a very important point there. If Mr. Samuels is
17 correct, that is, a firm which has an existing obligation
18 such as to fund its annual employee health benefits, let us
19 say that that has a cost of $1 million, and they can reach
20 into their pension plan because it has been determined that
21 it is excess under the standards that are set here, and use
22 that $1 million to pay their employee health benefits, is
23 that what would be allowed? Is that correct? Does that
24 not relieve the company of the $1 million that it would
25 have to pay from its other resources to meet that

1 obligation?

2 Mr. Fisher. Senator, that is partially correct in

3 that ----

4 Senator Graham. In what area is it not correct?

5 Mr. Fisher. This money is being held in non-

6 productive uses, these excess assets, and they can be

7 channeled into the very employee benefit programs that

8 these people may select.

9 Senator Graham. But is it not disingenuous to say

10 that the only benefit of this process is going to be the

11 employees themselves because essentially what you are

12 allowing is an employer who has an obligation to his

13 employees--for instance, to pay their health benefits--is

14 now, instead of having to come out of general corporate

15 assets, is able to reach into the pension fund, withdraw

16 the amount of money required to pay for those health

17 benefits, pay them out of the pension funds, and,

18 therefore, be relieved of my hypothetical $1 million of

19 expense and use that million dollars for whatever purpose

20 the corporation chooses to use it for.

21 Mr. Kies. Senator Graham, exactly the same point

22 could be made about the provision which was supported by

23 the administration last year that permits the use of these

24 monies for retiree health benefits. Those are obligations

25 of the employer, just like the health benefit obligations

1 to the current workers.

2 So I think you really have to come back to the basic
3 issue, that they are protecting the participants in the
4 pension plan with the same level of protection that was
5 approved by the Congress as part of the GATT legislation.

6 The Chairman. I am going to call, next ----

7 Senator Graham. Mr. Samuels, is that correct?

8 Secretary Samuels. I think that using a very narrow
9 exception where we built fire walls around it, and
10 extrapolating that to something of this magnitude, is not
11 a ----

12 The Chairman. I want to now call on Senator Moynihan
13 for a final comment on this area. Then we will move on to
14 the next section.

15 Senator Moynihan?

16 Senator Moynihan. Two things, sir, just for the
17 record. I was distressed that Mr. Fisher suggested that
18 the letter I was reading from the American Academy of
19 Actuaries replied only to the House, that the American
20 Academy of Actuaries has expressed great concern about this
21 measure as well.

22 May I also say, I think it helps if persons at our
23 table be very careful in their language. Mr. Fisher, to
24 describe stocks and bonds in a savings account set aside
25 for pensions as being non-productive is a usage with which

1 I am unfamiliar, and which I hope I would not have to hear
2 again.
3 The Chairman. Mark, will you proceed to the next
4 matter?
5 Mr. Prater. Thank you, Mr. Chairman.
6 The next series of proposals deal with treatment of
7 damages. The first one would treat all punitive damages as
8 taxable. I would clarify that punitive damages, whether or
9 not received on account of personal injury or sickness,
10 would be taxable.
11 Senator Rockefeller. Mr. Chairman.
12 The Chairman. Can we have order in the committee
13 room, please.
14 Jay?
15 Senator Rockefeller. Thank you, Mr. Chairman. I
16 appreciate your determined good will. I am grateful for
17 it.
18 On this matter of taxation of punitive damages, some
19 here may know that I have been very active in product
20 liability reform with Senator Slade Gordon from Washington.
21 I am, frankly, very curious to know how this particular
22 provision arose.
23 Mr. Kies. This is a provision that comes from the
24 House bill, Senator Rockefeller.
25 Senator Rockefeller. That does not answer my

1 question. It does not have to be included in the Senate
2 bill by virtue of its being in the House bill.
3 Mr. Kies. I was not commenting on whether it had to
4 be included or not. You asked where it came from, and what
5 I told you was ----
6 Senator Rockefeller. Why is it in the Senate bill?
7 Mr. Kies. That was a decision made by the Chairman.
8 Senator Rockefeller. I would ask the Chairman, but
9 ordinarily it is more courteous, that the staff has
10 something more appropriate than just saying ----
11 Mr. Kies. If you are asking the policy behind it ----
12 Senator Rockefeller. Yes.
13 Senator Moynihan. It is perfectly obvious, sir, that
14 that is what he is asking.
15 Mr. Kies. Well, he was asking where it came from,
16 Senator. I was not exactly sure.
17 Senator Moynihan. I think it came from the other
18 side, the dark side of the moon. He wanted to know, why
19 are you doing this?
20 Mr. Kies. The answer to that is, there are two
21 provisions here; one deals with punitive damages, the other
22 deals with recoveries for non-physical injuries. In the
23 case of the non-physical injuries provision, there is
24 substantial confusion under current law as to how these
25 recoveries are treated.

1 There have been Supreme Court decisions, for example,
2 dealing with age discrimination that have found that age
3 discrimination recoveries are taxable. There are splits in
4 the Circuits on other non-physical injury recoveries.
5 I think from the standpoint of analyzing policy, these
6 amounts represent income like other forms of income, and
7 that the general rules of the tax system are to treat
8 amounts that come to taxpayers from whatever sources as
9 income, unless there are specific exceptions provided.
10 So, in the case of punitive damages, I think the view
11 from a policy perspective was that punitive damages are not
12 necessarily the type of income that should be given
13 preferred status over wage income or other forms of income
14 that are generally taxable, and that there was not any
15 particular policy that supported treating these amounts as
16 tax-exempt.
17 Senator Rockefeller. So if somebody is injured by a
18 lawnmower, or car wreck, or something of that sort that was
19 not the fault of the individual but of the machine and was
20 awarded punitive damages, they would pay taxes on those
21 punitive damages?
22 Mr. Kies. The punitive damages. The regular damages
23 would not be taxed. Punitive damages are viewed as
24 something to punish the tortfeaser rather than to reward
25 the injured party. The damages for physical injury which

1 are treated as non-taxable are intended to compensate the
2 injured party for the damage which he or she has received.
3 Punitive damages are intended as a penalty on the
4 tortfeaser, not as a reward to the individual that has been
5 injured. So, the policy recommendation was that those
6 amounts be treated as taxable.
7 Senator Rockefeller. This would be the same for
8 malpractice?
9 Mr. Kies. Punitive damages. Yes, sir.
10 Senator Rockefeller. Thank you.
11 Senator Moynihan. Mr. Chairman.
12 The Chairman. Senator Moynihan.
13 Senator Moynihan. Senator Moseley-Braun has an
14 amendment in this area which will be offered at the
15 appropriate time.
16 The Chairman. We take due notice.
17 Senator Conrad. Mr. Chairman, might I just inquire
18 procedurally on a matter, just very quickly?
19 The Chairman. Sure.
20 Senator Conrad. When we are done would it be
21 possible, for those of us that did not get a couple of
22 questions answered on the pension matter that I would very
23 much like to have answered, could we revisit that when we
24 are done with all of the rest?
25 The Chairman. It may be very late, or very early in

1 the morning, but we will try to accommodate you.

2 Please proceed, Mark.

3 Mr. Prater. Mr. Chairman, the next proposal would
4 require tax reporting for payments from insurance companies
5 to attorneys' trust accounts. The gross income reporting
6 to the IRS by the business on all these payments to
7 attorneys would be part of this proposal.

8 Senator Rockefeller. I am sorry, Mr. Chairman. I do
9 not understand. I mean, I have the words written here in
10 front of me, "require tax reporting for payments to
11 attorneys," page 141. It does not really give me much of
12 a lead, an insight, if we are to vote upon tax policy in
13 the United States Code.

14 Mr. Kies. Senator Rockefeller, this provision is
15 intended to try and address a problem that has been
16 identified as a compliance issue. A lawyer that might
17 represent a Plaintiff may receive a payment from an
18 insurance company that includes both the amount which
19 actually represents the settlement to the victim, but also
20 the attorneys' fees.

21 Because there is no separate reporting mechanism today,
22 there appears that there is some under-reporting by lawyers
23 of their income because the amounts simply get deposited
24 into their escrow account, the recovery gets paid out to
25 the victim, and then somehow it doesn't seem to find its

1 way into the reportable income of the lawyer. There has
2 been some high visibility failure to file by lawyers.
3 What this is intended to do is give the IRS some paper
4 trail that does indicate that there has been a payment of
5 gross proceeds so that there would be at least some
6 indication of the fact that the lawyer might have received
7 attorneys' fees--typically a one-third settlement is not
8 uncommon--that came out of those gross proceeds reporting.
9 Senator Rockefeller. That is very helpful. Thank
10 you.
11 The Chairman. Mark.
12 Mr. Prater. Mr. Chairman, the next provision would
13 make a kind of conforming change for principal residents
14 rollovers, where the house has a home office component to
15 it, where in a regular situation depreciation recapture
16 would occur on disposition of the property, this would
17 conform the treatment for residences.
18 The next proposal would limit the rollover treatment
19 for resident aliens. When a resident alien leaves the
20 U.S., within two years after selling his principal
21 residence, he has to buy a new residence in the U.S. in
22 order to get the benefits of the rollover rule.
23 The next proposal would repeal the exemption for
24 withholding on gaming winnings from Bingo and Keno where
25 the proceeds exceed $5,000.

1 The next proposal after that would repeal an advance
2 refunding procedure for diesel fuel tax for light trucks
3 and cars.
4 The proposal after that would apply to a failure to pay
5 penalty to substitute returns that the service files for a
6 taxpayer.
7 The next proposal would reform foreign trust rules.
8 This follows a proposal introduced by Senator Moynihan for
9 the administration that would contain a package of
10 information reporting rules and anti-abuse rules directed
11 at sophisticated tax planning techniques involving foreign
12 trust.
13 The provision after that would repeal the interest
14 income exclusion for employee stock ownership plans on a
15 prospective basis.
16 The proposal after that would repeal the wine content
17 credit for distilled spirits which are made from fruit
18 products.
19 The next proposal after that would create financial
20 asset securization and investment trusts. These would be
21 pass-through entities that lenders could use for purposes
22 of credit card receivables, auto loans, and home equity
23 loans. The facet regime be under the partnership rubric so
24 that anti-abuse rules and other partnership rules would
25 work for purposes of facet transactions.

1 The next proposal would allow the tax-free treatment of
2 contributions in aid of construction for water or sewage
3 disposal utility companies, and that would be paid for by
4 stretching out the utility property depreciable life from
5 20 to 25 years.
6 The next proposal after that reduced the ozone-
7 depleting chemicals tax on imported recycled halons that
8 would conform it to the treatment of domestically recycled
9 ozone-depleting halons.
10 Senator Rockefeller. That sounds important. Could
11 you explain that more fully, please?
12 Mr. Prater. Senator Rockefeller, under current law
13 the ozone-depleting chemicals tax does not apply to
14 domestically recycled halons. The policy there is to
15 encourage the recycling rather than the production of these
16 chemicals because they are harmful to the environment, to
17 reduce the risk to the environment. That exemption does
18 not apply to imported recycled halons. This would conform
19 that.
20 Senator Rockefeller. So they would be included.
21 Mr. Prater. Yes.
22 Senator Rockefeller. That would be a change of
23 policy.
24 Mr. Prater. That is correct.
25 Senator Rockefeller. Thank you very much.

1 Senator Graham. And what is the rationale of that?
2 Mr. Prater. Again, Senator Graham, the rationale here
3 is to discourage the production of halons because they are
4 harmful to the environment.
5 Senator Graham. I assume that domestic industries
6 that recycle halons have some economic advantage over
7 imported recycled halons because of the fact that currently
8 the special tax provision only applies to domestic
9 production. Is that correct?
10 Mr. Kies. Senator Graham, actually, we are told that
11 there is excess demand right now, that there is not enough
12 of the recycled halons available, so I am not sure that it
13 would have a significant effect upon domestic recyclers.
14 There is more demand than there is supply right now to
15 service. These halons are used, for example, in fire
16 extinguisher systems on aircraft carriers and in
17 sophisticated fire suppression systems.
18 Senator Graham. Is there some economic analysis of
19 why we are leveling the playing field, so to speak,
20 relative to domestic versus imported?
21 Mr. Kies. Well, because there is excess demand right
22 now ----
23 Senator Graham. Has excess demand been a permanent
24 condition, or is that a temporary phenomenon? How long has
25 there been excess demand?

1 Mr. Kies. Apparently we have stopped producing halons
2 entirely at the end of 1994, so it would appear probably
3 the excess demand situation will just continue since there
4 is no production of new halons ongoing as a result of
5 environmental concerns.
6 Senator Graham. Does Treasury have a comment on this
7 provision?
8 Secretary Samuels. This is a proposal we would
9 support. We have some technical suggestions to make sure
10 that these imported halons will be taxed in the same way as
11 the domestic recycled halons, but we think that this is a
12 good proposal.
13 Mr. Prater. Mr. Chairman, the next proposal would
14 create an exception to the two-county tax-exempt bond rule
15 for local furnishers of gas or electricity what would allow
16 them to elect to forego the benefits of tax-exempt bond
17 financing and call all the outstanding bonds. This
18 proposal raises revenue.
19 The next proposal after that would provide for tax-
20 exempt bond financing for the sale of the Alaska Power
21 Administration's Snettisham hydroelectric facility. This
22 conforms this tax proposal to what the Energy Committee has
23 authorized, which is an overall spending reduction proposal
24 that came out of the Energy Committee for purposes of this
25 bill.

1 Senator Baucus. Mr. Chairman.
2 The Chairman. Yes.
3 Senator Baucus. On that one, if I might ask, this is
4 the PMA sales. Am I correct, this is Alaska PMA?
5 Mr. Prater. This is Alaska Power.
6 Senator Baucus. Right. Now, what is the status of
7 the Public Marketing Administration provisions and where
8 are we now, in the conference? Because there is a proposal
9 to sell the PMAs and I am just curious, do you know what
10 the current legislative status is of all PMAs other than
11 Alaska?
12 Mr. Prater. As far as I know, Senator Baucus, this
13 just applies to the Alaska Power sale.
14 Senator Baucus. But my point is, others are in play,
15 if you will. I just want to make sure there is equal
16 treatment here.
17 Mr. Kies. Well, Senator Baucus, this proposal only
18 applies to them so it does not have any effect ----
19 Senator Baucus. Only applies to?
20 Mr. Kies. Only applies to the Alaska Power
21 Administration, not to others.
22 Senator Baucus. I understand that. That is because
23 the Energy Committee bill provided for the sale of Alaska
24 Power Administration. But what if it turns out that other
25 public marketing administrations are also sold, will they

1 be accorded the same treatment or not?

2 Mr. Kies. Not under the terms of this provision.

3 They would require ----

4 Senator Baucus. That is the question, because that is

5 very much in the air right now as to what we are going to

6 finally do in this Congress with respect to those other

7 PMAs.

8 Mr. Prater. Senator Baucus, from what I understand,

9 and I have a letter here from the Department of Energy that

10 says that the Alaska Power sale was authorized under the

11 Energy Committee's action ----

12 Senator Baucus. I know that. That is not the point.

13 Mr. Prater. [continued]. Was that the price was

14 premised in that sale on tax-exempt bond financing. That

15 may be -- I do not know the terms of these other sales,

16 whether that is a factor, but I would just point that out.

17 Senator Baucus. Thank you.

18 The Chairman. Please proceed.

19 Mr. Prater. Mr. Chairman, the next proposal would

20 require life insurance companies to treat 85 percent of

21 their capital losses from foreclosed real estate as

22 ordinary losses and spread that loss over a period of time.

23 The life insurance companies would be entitled to this

24 ordinary loss treatment. It raises revenue over the life

25 of the seven-year period.

1 Senator Moynihan. But loses over the 10-year period.
2 Mr. Prater. That is correct, Senator Moynihan. That
3 is correct.
4 Senator Moynihan. Just keeping a record.
5 Mr. Prater. The next proposal is a proposal that
6 would provide relief to certain reach-back companies with
7 respect to the United Mine Workers Health Care Benefit
8 Plans. This is a two-year provision. I know Senator
9 Rockefeller is very opposed to this, and I expect we will
10 hear about that.
11 [Laughter]
12 Senator Rockefeller. Mr. Chairman.
13 The Chairman. Senator Roth.
14 Senator Rockefeller. Mr. Chairman, I just want to
15 sort of ask the Chairman's advice on this. Obviously, I
16 feel very, very strongly about this because I have never
17 done the sort of thing which I have done as a result of
18 this being included in the mark. It affects 35,000 people
19 in my State in a very dangerous way, in my judgment.
20 I have, in fact, a series of questions which are not
21 confrontational, and I really mean that, but are designed
22 to try to, in a sense, show my colleagues on both sides of
23 the aisle where I think this is coming from, why I think
24 this is happening, and what the problems are.
25 I think the questions I ask are all sequentially done.

1 There are quite a few of them, but it is not for the
2 purpose of delaying, it is for the purpose of getting
3 through my logical approach. I would just ask the
4 Chairman's advice on that. I would like to be able to ask
5 those questions, but it will take me beyond the so-called
6 short string.
7 On the other hand, we have had no hearing on this. We
8 had hearings on this for the 1992 Act. We have not had
9 hearings on this. There are 92,000 people in the country.
10 They are dying at the rate of 6,000 a year. I would think
11 that my colleagues on both sides of the aisle would want to
12 know about this. Obviously I feel strongly about it, but
13 I just ask the Chairman's advice.
14 The Chairman. I would say to my good friend that I
15 would proceed with the questions, and hope they will be
16 expeditious as possible.
17 Senator Rockefeller. As possible. Yes.
18 The Chairman. Why do we not just play it by ear as we
19 go along.
20 Senator Rockefeller. All right. I thank the Chairman
21 very, very much.
22 To whom am I addressing these questions?
23 Senator Chafee. To whom it may concern.
24 Senator Rockefeller. To whom it may concern.
25 [Laughter]

1 Senator Rockefeller. As I understand it, the purpose
2 of this section in the Chairman's mark is to provide
3 certain companies known as reach-back companies with
4 temporary relief from responsibility to pay the health care
5 costs of their retired coal miners.
6 Under the 1992 Coal Industry Retiree Health Benefits
7 Act, the Coal Act, a combined fund was established to pay
8 the health benefits of some 110,000 at that time--since
9 then, many have died--and their dependents'.
10 Now, this fund was paid for by premium contributions
11 from coal companies which previously employed the retired
12 miners, from a transfer of $210 million in excess funds
13 from the 1950 Miner's Pension Fund--the miners kicked in
14 pension money for this--and a transfer of up to $70 million
15 annually from interest on the Abandoned Mine Lands
16 Reclamation, the Federal Abandoned Mine Lands Fund. Is
17 this your understanding of the funding sources for the
18 program as it exists today? And $85 million in Medicare
19 reimbursements.
20 Mr. Kies. Senator Rockefeller, I think basically
21 everything you said is correct. The only, I guess,
22 clarification that might be appropriate, because it does
23 flush out why this issue is in the mark, is that there is
24 great controversy over whether that particular legislation
25 did fairly apportion economic burden in relationship to

1 connection in which some of these reach-back companies had
2 to these liabilities. Indeed, there are ----
3 Senator Rockefeller. We could get to that.
4 Mr. Kies. All right. That is fine.
5 Senator Rockefeller. All is fair, and we will get to
6 that.
7 The proposed language is based upon the assumption that
8 the combined fund contains a surplus of cash. Is there a
9 cash surplus in the fund at this time?
10 Mr. Kies. Senator Rockefeller, again, I understand
11 that there is some disagreement over that issue. We have
12 had difficulty gathering data from the trustees of the
13 fund, so there appears to be a difference of view on that
14 issue. Some believe there is, some believe there is not.
15 I do not that we know the answer, but there are people on
16 both sides in that particular matter.
17 I might say, the revenue estimate, which is not done by
18 Joint Committee but is done by CBO, does reflect what
19 apparently is an anticipated increase in premiums which may
20 kick in if this two-year period in which the reach-back
21 companies are not subject to the tax.
22 Under the legislative scheme, if the fund drops below
23 a certain level, there is increased funding and it does
24 appear from the CBO numbers, which we did not get until
25 late today, that it is anticipated at some point in the

1 future there might be an uptick in premiums which
2 presumably is a consequence of their assumption that there
3 might be a shortfall in the fund. But I would just tell
4 you, we have heard from all sides and there seems to be a
5 lot of disagreement.
6 Senator Rockefeller. We have to work together well on
7 this because we are both subtracting from the same short
8 string.
9 Would there be a surplus in the combined fund if there
10 had been no contribution from the 1950 UMW pension fund,
11 the transfer from the Abandoned Mine Lands fund, or the
12 transfer of $85 million from Medicare?
13 Mr. Kies. Senator Rockefeller, I do not ----
14 Senator Rockefeller. The answer is, no. It is
15 quicker.
16 Would there be a surplus in the combined fund today is
17 the only funding source for it had been the premium
18 payments made by coal companies?
19 Mr. Kies. I suspect the answer might be no.
20 Senator Rockefeller. You got it.
21 Now, earlier this year, Guy King, who is a very strong
22 Republican, of Ernst & Young, and who was former Chief
23 Actuary of HCFA under Gail Wilensky, issued a report
24 commissioned by the trustees of the combined fund. Is it
25 not true that the General Accounting Office reviewed this

1 report and found that Mr. King's report was based on sound
2 assumptions which are routinely used when considering
3 similar issues such as health care reform?
4 Mr. Kies. I believe he did issue such a report and
5 the GAO did conclude accordingly.
6 Senator Rockefeller. You see, Mr. Chairman, these are
7 honestly sequential.
8 According to Mr. King's report, even if the current
9 surplus in the fund is left intact, the fund will
10 experience a modest deficit by the year 2003. What would
11 the size of this deficit in the year 2003 be if under the
12 proposed language in the mark the surplus is given away in
13 credits to reach-back companies?
14 Mr. Kies. Senator Rockefeller, I think under the way
15 the proposal functions it would not actually have an effect
16 because premiums would go back up and, in fact, the CBO
17 estimate of the overall effect of this proposal is a
18 positive $8 million over the period. So I think, under the
19 mechanics of this statute, the premiums would go up and
20 apparently, CBO believes, more than make up for the effect
21 of the first-year impact.
22 Senator Rockefeller. If you have that CBO report,
23 this Senator ought to have it.
24 Mr. Kies. You will. It is in our estimating table.
25 We only got the information at about 4:00 this afternoon.

1 Senator Rockefeller. All right. All right.

2 Senator Conrad. Could I ask a question? When you say

3 the premiums are going to go up, Ken, whose premiums are

4 going to go up?

5 Mr. Kies. Under the way in which the legislation is

6 drafted there are multiple parties who can be subject to

7 the premiums: the signatories to the BCOA ----

8 Senator Conrad. The BCOA. Is it not their premiums

9 that would go up?

10 Mr. Kies. Theirs would go up, but under the proposal

11 before you the tax on reach-back is only suspended for two

12 years and the legislation that is in current law then kicks

13 back in, so the reach-back companies would be in the

14 position also of having their premiums go up.

15 Senator Conrad. After the two years.

16 Mr. Kies. That is correct.

17 Senator Conrad. Thank you.

18 Senator Rockefeller. And I believe all the money

19 would go in the first year. I think this is also according

20 to Guy King.

21 Were the accounting standards which were employed in

22 that study on an accrual or cash basis?

23 Mr. Kies. Senator Rockefeller, I would be amazed if

24 they were not an accrual basis.

25 Senator Rockefeller. They were.

1 Mr. Kies. Yes.
2 Senator Rockefeller. The section of this bill which
3 contemplates a distribution of surplus is based upon cash
4 accounting principles, is it not?
5 Mr. Kies. That is the way all revenue estimates are
6 done because that is how you score against the budget
7 deficit. You are absolutely correct.
8 Senator Rockefeller. Mr. Chairman, I am more than a
9 third of the way through. You see, I am progressing
10 rapidly here.
11 Is it consistent to set up a fund's liabilities on one
12 accounting basis but distribute its assets on another?
13 Mr. Kies. I do not think it would be. Distribute the
14 assets, do you mean pay out benefits? No, a more
15 consistent and accurate approach would be to use accrual
16 for both payment and liabilities and incoming receipts.
17 Senator Rockefeller. Right. Because one of the
18 problems with the cash accounting is that, at the end of
19 the years, that does not count for any of the medical bills
20 which may be pending to be paid.
21 Mr. Kies. Witness the Social Security Trust Fund.
22 Senator Rockefeller. Exactly.
23 Is it not true that the benefits under the 1992 Act are
24 defined by reference to the level of benefits which were
25 provided under the 1988 National Bituminous Coal Wage

1 Agreement?

2 Mr. Kies. That is correct; substantially similar,

3 Senator.

4 Senator Rockefeller. Under the 1992 Coal Act, is

5 there one set premium which all companies pay for their own

6 retirees?

7 Mr. Kies. That is correct, Senator.

8 Senator Rockefeller. Did any of the companies which

9 would receive a benefit under the proposed language pay a

10 higher premium per retired miner than the premiums paid by

11 those companies which would not benefit?

12 Mr. Kies. No, they all paid the same premium.

13 Senator Rockefeller. In other words, did the reach-

14 back companies pay higher premiums than other coal

15 companies?

16 Mr. Kies. No, sir.

17 Senator Rockefeller. In some years it is conceivable

18 that expenses of the combined fund, meaning the cost of

19 providing the defined level of benefits, may exceed the

20 revenues generated by the defined level of contributions.

21 Mr. Kies. That is certainly possible.

22 Senator Rockefeller. Let us assume this happens. If

23 the remaining surplus is too small to cover the shortfall,

24 what happens to the fund?

25 Mr. Kies. The premiums are increased to make up for

1 the shortfall. That is what we see reflected, I think, in
2 the revenue chart that we now have.
3 Senator Rockefeller. According to the Ernst & Young
4 study, it was anticipated that at the end of fiscal year
5 1995 there would be a $111 million balance in the combined
6 fund. You should know that. With administrative and
7 medical expenses this year anticipated to be approximately
8 $360 million, this means that the combined fund is spending
9 at about $30 million a month.
10 The proposal before us would authorize the distribution
11 of $75 million as surplus. Now, that is $111 million as
12 surplus less $36 million, representing the 10 percent of
13 the annual benefit and administrative costs the mark would
14 allow to be retained, which is part of the Cochran plan.
15 Is this consistent with your understanding of the proposal?
16 Mr. Kies. Yes, sir, Senator.
17 Senator Rockefeller. Is one month's cash reserve
18 adequate to administer the combined fund?
19 Mr. Kies. Senator, I would guess not.
20 Senator Rockefeller. Gail Wilensky testified before
21 the Senate Finance Committee earlier this year. She said
22 the following about the administration of the fund and
23 about the solution embodied in the Coal Act. I want to ask
24 when I am finished, was she correct in her assessment?
25 I have been given permission directly by Dr. Wilensky

1 to use this. She said, "When the fund was concerned as to
2 whether or not the long-term actuarial balance seemed to be
3 about right for the fund because there appeared to be an
4 initial surplus of funds showing up in its accounts, I had
5 encouraged the Chair of the trustees to ask Guy King, who,
6 because he was Ernst & Young as opposed to Ernst & Young,
7 per se," whatever that means, "to look at the issue, or at
8 least to be on the list.

9 The reason I made that suggestion is because I have the
10 highest regard for Guy King from my knowledge of him as a
11 former HCFA actuary and because of his knowledge about the
12 Medicare population." Remember, now, she is talking as a
13 trustee of this combined fund.

14 I asked her, do you think the fund has been managed
15 properly? Dr. Wilensky replied, "I think there has been
16 some feeling that more benefits could be provided under a
17 different arrangement, that the combined funds went through
18 a long press of looking for a way to increase managed care
19 and competition," which reminds me of something Senator
20 Simpson said this afternoon.

21 "I think it has been proceeding in a prudent way. Yes,
22 I think at this point it is well managed and it seeking
23 ways to improve its management."

24 Then I said, finally, to Dr. Wilensky, I think I had a
25 pretty clear reading from what you are saying that any sort

1 of arbitrary reduction in the reserve as a health care
2 program, you have to have reserve for exigencies, a broad-
3 scale assault on the reserves in the fund might be
4 something that you might question.

5 Then she said--and this is my main point--"I would be
6 stronger. I think it would be a mistake. This was a very
7 painfully-wrought solution. I think there are now adequate
8 funds in the future to take care of the miners and the
9 retirees.

10 It has been put together in a way that did not raise
11 issues with regard to employer mandates or bringing in
12 employers who never had anything to do with unionized mine
13 workers. There are always some tinkerings that we could
14 do, but essentially we should not change it."

15 Now, I am sorry to take so much time in presenting
16 that. In any event, do you think she was correct in her
17 assessment?

18 Mr. Kies. Senator Rockefeller, as I pointed out
19 before, there appears to be a split in view as to the
20 adequacy of the current amounts in the fund. I understand
21 that there has been a study done by Towers, Perrin that
22 takes an opposite conclusion.

23 We are not in a position to make that judgment. There
24 are people that apparently have different views of the
25 situation. Apparently the reach-back companies have had

1 some difficulty getting data out of the trustees as to the
2 exact situation in the fund, but we are not in a position
3 to judge who is right or wrong.
4 Senator Rockefeller. I would just, again, point out
5 that Guy King was her particular person, and that GAO has
6 confirmed what she has said and what I have just reported.
7 Mr. Chairman, I am more than 60 percent of the way
8 through.
9 Are there any other federal programs which mandate that
10 only a surplus of 10 percent needs to be retained before
11 contributors are relieved of their responsibilities to make
12 contributions?
13 Mr. Kies. Senator Rockefeller, this is sort of a
14 hybrid federal or private entity. It has characteristics
15 of both.
16 Senator Rockefeller. I understand that. But if you
17 could just answer the question.
18 Mr. Kies. Are there any other federal ----
19 Senator Rockefeller. Federal. Social Security,
20 Medicare.
21 Mr. Kies. I am not aware of any.
22 Senator Rockefeller. There are not. They are both
23 required at 100 percent of solvency as a reserve.
24 Mr. Kies. Actually, no. I mean, the Social Security
25 fund, if you have looked at it on an actuarial basis, at

1 various times it has been, I think, under funded if you
2 used your accrual methodology.
3 Senator Rockefeller. That may be. But it requires
4 100 percent to guarantee solvency.
5 Mr. Kies. To be solvent, if you were going to use an
6 accrual method, you would need 100 percent of your
7 liabilities, yes.
8 Senator Rockefeller. All right.
9 The Court of Appeals for the 2nd and 6th Circuits have
10 held that the 1992 Act is constitutional. In fact, the
11 Supreme Court just denied Sershiari.
12 Senator Moynihan. Yes, that is how you pronounce it.
13 Did they do it?
14 Senator Rockefeller. Yes, they did do it. They
15 denied Sershiari in the 2nd Circuit decision involving LTV.
16 They have upheld this Coal Act.
17 Has any court found it unconstitutional for the reach-
18 back companies to be required to pay for the health benefit
19 costs of their own retirees?
20 Mr. Kies. Senator Rockefeller, no court has held it
21 unconstitutional for their own retirees. A District court
22 in Pennsylvania has held it unconstitutional to the extent
23 that they were assigned so-called orphan beneficiaries in
24 a decision that was rendered, I believe, in 1995, and they
25 held that it was unconstitutional on the basis of violation

1 of the 5th amendment.

2 In an injunction proceeding, which is a fairly rare

3 thing to happen--it was a preliminary injunction--the court

4 concluded that the argument of the Plaintiff in favor of

5 holding that the statute was unconstitutional was so strong

6 that they granted injunctive relief. That case was

7 reported in the Western District of Pennsylvania.

8 Senator Rockefeller. All right.

9 It is my understanding that the following six companies

10 will be the primary beneficiaries under this proposal, at

11 least from a dollar standpoint: A.T. Massey, Allied Signal,

12 Pittston, Berwyn, North American, and LTV.

13 According to the combined fund, these six companies

14 alone are responsible for $36 million in premium payments

15 annually. Has the committee been made aware of any

16 information which would indicate that those companies were

17 incorrectly assigned retirees under the 1992 Coal Act?

18 Mr. Kies. Senator, we are not familiar with who are

19 the primary beneficiaries. The only thing that we know is,

20 there are 600 reach-back companies. The top six we do not

21 know about, so we do not have any information that would

22 respond to that.

23 Senator Rockefeller. All right. I am closing now.

24 Getting close to it.

25 Although I do not have actual legislative language in

1 front of me--and you are doing a good job, Ken--I
2 understand that a reach-back company will be defined as a
3 company that did not sign the 1988 collective bargaining
4 agreement or a more recent agreement with United Mine
5 Workers. Is that correct?
6 Mr. Kies. That is correct.
7 Senator Rockefeller. It is my understanding that the
8 contractual obligations to provide health care for one's
9 retirees in the 1988 agreement is the same as the
10 obligation in, for example, the 1978 Labor agreement.
11 consequently, what is the legal basis for distinguishing
12 between reach-back companies which signed the 1988 or later
13 contract?
14 Mr. Kies. Senator Rockefeller, I think it is a policy
15 basis, not a legal basis, because it is a policy decision
16 that is being made. I think the policy basis is, they were
17 not signatories to the 1988 agreement. The policy judgment
18 is, those who were not signatories to the 1988 agreement
19 did not commit to the same type of obligation that
20 companies who were not signatories did. So, it is a policy
21 judgment.
22 Had the 1992 legislation never been enacted, I am sure
23 there would have been litigation over who was obligation to
24 provide these benefits to the extent they were or were not
25 signatories to the 1988 agreement. That was the subject,

1 I understand, of a lot of litigation at the time.

2 Senator Rockefeller. Just for clarification on this,
3 the 1974 and later National Bituminous Coal Wage Agreement
4 said the following about retiree health care. I am quoting
5 from the contract. "Such pensioner will be entitled to
6 retain his health services card for life. Upon his death,
7 his widow will retain a health services card until her
8 death or remarriage."

9 The Court of Appeals for the District of Columbia has
10 held that the obligation to contribute to the former health
11 funds for retirees did not stop if a company refused to
12 sign a subsequent agreement. In other words, the nature of
13 the promise in 1988 was no different than the nature of the
14 promise in 1978. Consequently, how do we justify
15 distinguishing between the two?

16 Mr. Kies. Well, Senator Rockefeller, I believe under
17 that agreement, as under a number of collectively bargained
18 pension agreements, there were always two pieces to an
19 agreement. One, was a promise of benefits, and the other,
20 was promise of funding.

21 Typically, I think what you find is that the providing
22 of the benefits was dependent on the commitment of funding
23 level, so to only focus upon the benefits promised without
24 recognizing that the signatories were only committing to
25 fund at a certain level and whatever amounts were necessary

1 at that level were used to provide those benefits kind of
2 separates two issues that are integrally entwined.
3 But I would readily concede, as in the pension area and
4 in the retiree health area, there has been extensive
5 litigation over, what was the contractual promise?
6 Sometimes employers have won, sometimes workers have won.
7 It is an area that is very contentious and that the law is
8 not clear in.
9 Senator Rockefeller. There is one court case that you
10 can point to, many that I can point to, and there is no
11 disagreement in the coal industry as to what the promise
12 was.
13 This is my third to last question. I have been told
14 that as far as the six companies that I mentioned earlier
15 are concerned, the 1992 Coal Act has placed them under
16 extreme financial stress.
17 One way to judge the impact of this law to a
18 corporation's finances is to compare stock prices over
19 time. For example, in September 1992, two months before
20 the enactment of the Coal Act, Fleur Corporation, the
21 parent company of A.T. Massey Coal, was selling at $40.25
22 per share. Two years later after the passage of the Coal
23 Act in September of 1994, the same stock was selling for
24 $53.00 a share.
25 NACCO industries was selling at $40 per share; in

1 September of 1994, the stock had jumped to $62 per share.
2 Pittston was selling at $13.25 per share in September of
3 1992; September 1994 the stock had grown to $23 a share.
4 Does growth of 30 percent, 50 percent, and 75 percent
5 sound like extreme financial stress to you? I apologize
6 for that question.
7 Mr. Kies. Thank you.
8 Senator Rockefeller. Surely the answer is, no, it
9 does not sound like extreme financial duress.
10 Mr. Kies. Based on those stock prices.
11 Senator Rockefeller. Yes.
12 Since the proposed language would allow a surplus in a
13 federal program to be drawn down, what is the budgetary
14 impact of the proposed language, is it neutral, does it
15 raise revenues, or does it lose revenues?
16 Mr. Kies. Senator, under the CBO scoring it actually
17 raises a net plus $8 million over the seven-year period
18 because of the fact that, in the first two years, there is
19 a decline in premiums because the reach-back companies
20 would be exempt, and then apparently CBO projects a rise in
21 premiums against the current law baseline so that the net
22 effect is a plus $8 million over the seven, five, and 10-
23 year period.
24 Senator Rockefeller. It has been pointed out to me
25 that in the years 2000, 2001, 2002 there is a loss of 20,

1 and then all of a sudden it goes up to eight in 1996-2000,
2 1996-2002, 1996-2005. That is somewhat ----
3 Mr. Kies. No, no. I believe that is not what the CBO
4 has projected.
5 Senator Rockefeller. Rather than argue that ----
6 Mr. Kies. Oh, no. Excuse me. The 20 is a footnote.
7 It is in brackets. That refers to a footnote. We always
8 run into a problem with that. If you look, the footnote
9 will say negligible revenue effect, on the final page. I
10 think we have got to come up with a different system.
11 Senator Rockefeller. Nevertheless, this is an area
12 that I wish to explore further.
13 My final question is, is there anything in the proposed
14 language which could be interpreted as indicating directly
15 or indirectly that the reach-back companies should not be
16 liable for the cost of providing heath benefits to their
17 retirees?
18 Mr. Kies. Is there anything in the legislation that
19 says that?
20 Senator Rockefeller. In the proposed language.
21 Mr. Kies. The proposed language does not address the
22 issue one way or the other, it simply provides that, for
23 the two-year period, the reach-back companies are not
24 subject to the tax, again, only if there is a surplus. But
25 it does not address one way or the other whether it is the

1 Congress' view that there is a legal liability or not.
2 Senator Rockefeller. Mr. Kies, I thank you very much,
3 sir, and I thank you, Mr. Chairman.
4 The Chairman. Thank you, Jay.
5 I believe we have one more matter.
6 Mr. Prater. That is correct, Mr. Chairman.
7 Senator Conrad. Mr. Chairman, just before we leave
8 this matter might I ask one question?
9 The Chairman. Yes.
10 Senator Conrad. Are the miners in any way at risk for
11 getting their health care benefits under this proposal?
12 Mr. Kies. Senator Conrad, it would appear not,
13 because the provisions of the proposal provide, again, only
14 for a two-year period that the reach-back companies are not
15 subject to the premium tax.
16 Then if the amounts in the fund drop below a certain
17 level there are increased premiums, and CBO's projection
18 shows that the net effect would not only not be neutral,
19 but it would be actually positive. So, at least according
20 to CBO's projections, it would appear not.
21 Senator Conrad. What if their projections were wrong,
22 though. Would BCOA companies have to pay increased
23 premiums in this two-year period in order to provide the
24 obligations to the miners?
25 Mr. Kies. The premium levels on the BCOA companies

1 would go up, and then in the third year the premium levels
2 on both BCOA and those that were not signatories of the
3 BCOA agreement would go up as well.
4 Senator Conrad. And the BCOA companies have
5 experienced a sharp reduction as a result of what occurred
6 several years ago with this Act; is that not correct?
7 Mr. Kies. Senator Conrad, I am not familiar with
8 that. Do you mean a reduction in their premium levels?
9 Senator Conrad. Yes.
10 Mr. Kies. I understand that is the case, yes.
11 Mr. Prater. Mr. Chairman.
12 The Chairman. Yes. Go ahead.
13 Mr. Prater. The last item is ----
14 Senator Moynihan. Oh, the newspaper boys. Let us
15 hear it for the news boys.
16 Mr. Prater. That is what this provision goes to.
17 Newspaper distributors and other workers would be deemed
18 independent contractors for employment and income tax
19 purposes, provided they qualified under this provision.
20 With that, we are done.
21 Senator Conrad. Mr. Chairman.
22 The Chairman. Kent.
23 Senator Conrad. Might I briefly return to the pension
24 matter? I have two questions that I would like to very
25 briefly get answered.

1 The Chairman. Please proceed.
2 Senator Conrad. I do not know, Ken, if you are the
3 one to respond to these, or whom I should address my
4 question to. I would also ask Mr. Samuels.
5 I have this fact sheet from the Pension Benefit
6 Guaranty Corporation and they indicate that an analysis of
7 10 large pension plans insured by the PBGC showed that it
8 funded at the 125 percent level. The funding level would
9 fall to an average 87 percent on a termination basis. The
10 point that they make is, assumptions are different for an
11 ongoing basis and a termination basis.
12 Are you aware of the different assumptions on an
13 ongoing basis and a termination basis, and to your
14 knowledge is this statement correct?
15 Mr. Kies. Senator Conrad, the PBGC did present some
16 examples using certain interest rate assumptions and
17 certain differences in actuarial assumptions that could
18 produce, theoretically, those type of situations.
19 The only thing that I would point out is, what they
20 projected was dropping interest rates while holding asset
21 values constant. The studies done by Towers, Perrin &
22 Wyatt indicate that they are not aware of that situation
23 ever occurring, going all the way back to 1926. Typically
24 when interest values fall, the stock market goes up.
25 So our conclusion, as is the conclusion of several

1 independent actuaries, is that the assumptions used by the
2 PBGC are unrealistically pessimistic, but, moreover, they
3 are based upon the assumption of a termination which is not
4 what is occurred here.
5 This plan is continuing as an ongoing plan subject to
6 the 1993 Act minimum funding requirements, which I think
7 the Congress wisely enacted, so that any plan that does
8 drop into an under-funded situation is subject to more
9 rigorous funding requirements.
10 So it is our conclusion and the conclusion of several
11 outside actuaries that the fact patterns presented in the
12 PBGC report are unrealistic. Indeed, I think one of the
13 actuaries said the likelihood of them occurring was less
14 than one percent.
15 Senator Conrad. Mr. Samuels.
16 Secretary Samuels. Senator Conrad, first, an
17 observation. When we heard the discussion of the coal
18 miners retiree health situation there was reference to
19 dueling actuaries, and that is the exactly the problem that
20 we face. There are different assumptions that can be used
21 in calculating these matters and you can use aggressive
22 assumptions.
23 That was the point of this quote that you referred to,
24 that is, when you look at the definition of current
25 liabilities, if you then also say, what will it take to buy

1 an annuity in the private insurance market, this did not
2 have anything to do with fluctuations and assets.
3 If you just go out into the market and say, I am going
4 to buy annuities for my retirees and current workers to
5 give them what they are entitled to, would I be over-funded
6 and under-funded? The PBGC concluded, based on looking at
7 the values and costs of acquiring annuities in the private
8 market, that you would be under-funded.
9 Senator Conrad. Let me ask one final question. That
10 is, the PBGC also asserted that a plan that is over-funded
11 today can quickly become under-funded with a relatively
12 insignificant change in interest rates and asset values.
13 For example, they say "a reduction in the interest rate of
14 one percentage point, together with an asset reduction of
15 10 percent, reduces the funding level from 125 percent to
16 96 percent."
17 Would you agree with that calculation, Mr. Kies?
18 Mr. Kies. Senator Conrad, that actually refers to the
19 point I made earlier as to the assumptions.
20 Senator Conrad. I thought it did.
21 Mr. Kies. But I would also point out, Senator Conrad,
22 that they keep working off the 125 percent cushion.
23 Indeed, the cushion in this proposal, which is the cushion
24 in current law, actually, effectively for most companies,
25 is 150 percent because it is the higher of.

1 I would just say that for many, if not most, of the
2 companies, the real threshold for being able to take any
3 dollar out in a reversion, including under current law 420
4 for retiree health, is closer to 150 percent than 125
5 percent.
6 Senator Conrad. Mr. Samuels?
7 Secretary Samuels. Senator Conrad, the problem we
8 have with that analysis is that the calculation of the 150
9 percent is also subject to assumptions that are being made
10 as to how you arrive at that number, and there is a great
11 variability in assumptions of interest rates, mortality
12 rates, and we saw, when we were dealing with our under-
13 funding problems last year, that the aggressive assumptions
14 about those two items, interest rates and mortality rates,
15 were the things that caused plans to be under-funded. We
16 learned a lesson last year, and I do not think we should
17 forget that lesson.
18 Senator Conrad. Well, if PBGC said--and I conclude on
19 this note, Mr. Chairman, "the 20 companies that took money
20 from over-funded plans subsequently appeared on the PBGC's
21 list of 50 companies with the largest under-funded plans."
22 I will tell you, my own conclusion is, when you have
23 got the stock market at a record level, lots of indications
24 that we may have a break in interest rates, and lots of
25 indications that the stock market is probably due for a

1 correction, I am very concerned about this provision. I
2 think it is unwise. We have just gone through a period of
3 strengthening pensions. To provide for an ability to drain
4 them, I think, is a mistake.
5 The Chairman. Thank you, Kent.
6 Senator Moynihan. Mr. Chairman, could I request that
7 we have a five-minute recess that we might talk about the
8 next session?
9 The Chairman. So directed.
10 Senator Moynihan. Would the Democratic Senators
11 kindly join us across the hall?
12 [Whereupon, at 7:16 p.m., the meeting was recessed.]
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1 AFTER RECESS

2 (7:35 p.m.)

3 The Chairman. The committee will please be in order.

4 Senator Moynihan?

5 Senator Moynihan. Thank you, sir.

6 We would like to propose, since the hour is getting

7 late and we would like to be in good form to offer

8 amendments and ask for their consideration, that we come in

9 at 9:00 tomorrow morning--you are an early bird, anyway--

10 and that the committee will be in session for seven hours,

11 and at the end of seven hours, there be a vote and final

12 passage. There will be a quorum at all times in the sense

13 that at all times a Democratic Senator will be present.

14 Senator Grassley. And if it is 4:00 ----

15 Senator Moynihan. Well, it could be.

16 The Chairman. So the understanding is that we would

17 meet at 9:00 tomorrow morning.

18 Senator Moynihan. Yes, sir.

19 The Chairman. And the vote would come no later than

20 after seven hours of meeting and that there would be a

21 quorum, with both Republican and Democrats present.

22 Senator Moynihan. Yes, sir. I believe this was

23 agreed to on our side.

24 The Chairman. Now, if we have votes I would suggest

25 that we might just go right on through during those votes.

1 Senator Moynihan. You mean votes on the floor?

2 The Chairman. Votes on the floor.

3 Senator Moynihan. Sure. That will be building up our
4 running the clock.

5 The Chairman. Running the clock.

6 With no objection?

7 Senator Chafee. Well, Mr. Chairman, personally, we
8 have a hearing in the Environment and Public Works
9 Committee, which I will be Chairing tomorrow starting at
10 9:00. I thought I was the only committee chairman that
11 started at 9:00. I hope it is not contagious. I hope it
12 is not too contagious.

13 So, in any event, I will not be here, but I will get
14 somebody to take that over later on and I will be along.

15 The Chairman. Very good. Without objection, it is so
16 agreed upon.

17 Senator Moynihan. Mr. Chairman, finally, may I
18 express, I am sure for all of us, appreciation to Mr. Kies
19 and to Mr. Prater for their very careful representations.
20 Thank you, Secretary Samuels. And I deeply regret that on
21 his maiden voyage no one asked John Talisman anything.
22 Tomorrow, we will do.

23 [Laughter]

24 The Chairman. Thank you. Senator Moynihan raised an
25 issue concerning the New Work Opportunity Tax Credit and

1 strike breakers. I believe the staff has looked at this
2 issue. Mr. Kies, would you comment?
3 Mr. Kies. Mr. Chairman, we did look at that issue.
4 Senator Moynihan, I misspoke. The provision that was
5 raised is not included in the mark-up document and, indeed,
6 was not discussed by the staffs. The mark-up document
7 indicates that generally, other than where there are
8 changes, current law continues. So the provision which
9 would not allow the Targeted Jobs Tax Credit to be allowed
10 to workers that replace strikers would continue under the
11 proposal.
12 Senator Moynihan. Would continue.
13 Mr. Kies. Yes.
14 Senator Moynihan. That is good. That is good news
15 for all of us.
16 Senator Chafee. Can I ask a quick question? Suppose
17 somebody is working for a plant and there is a strike, and
18 he chooses not to go out. That is not a replacement. He
19 is not a replacement under those conditions.
20 Mr. Kies. Senator Chafee, I believe that under the
21 provision that expired, that person would not be impacted.
22 It is intended that the provision that existed under the
23 old law continues.
24 Senator Moynihan. Mr. Chairman, could I also say that
25 Senator Moseley-Braun very much regrets that she has not

1 been here today, not so much because she wanted to be here,
2 but because she did not want to have the flu. I may have
3 to offer two amendments for her tomorrow.
4 The Chairman. Very good.
5 Mr. Kies, much has been said here today about the
6 distributional charts the committee staff circulated on
7 Monday regarding the effect of the legislation before the
8 committee. Could you please review what those charts
9 indicate?
10 Mr. Kies. Yes, Mr. Chairman. The charts that I
11 believe were circulated by the Senate Finance Committee,
12 which were prepared by the Joint Committee, reflect a
13 complete analysis of the distributional effects of the
14 provisions that are before the committee today. So, it
15 completely reflects the provisions that the committee has
16 within the Chairman's mark that is under consideration
17 right now.
18 The Chairman. Do these charts include any effects of
19 the EITC?
20 Mr. Kies. Mr. Chairman, they do not include any of
21 the changes in the EITC because those provisions were
22 adopted as part of the Medicare mark-up and are not the
23 subject of today's mark-up. This was an attempt to reflect
24 what are the subject of today's mark-up.
25 The Chairman. Do the charts which you prepared for

1 Senator Moynihan include EITC effects, and if so, why are
2 these effects included?
3 Mr. Kies. Senator Moynihan's staff asked us to
4 prepare a distributional analysis that did include the
5 effects of the prior actions of the committee and,
6 therefore, we did prepare those at their request.
7 Senator Moynihan. For which we are very appreciative.
8 The Chairman. Is the inclusion of EITC appropriate
9 for purposes of demonstrating the effect of income tax
10 changes?
11 Mr. Kies. Well, Mr. Chairman, I think that is really
12 a subject of philosophical debate. The facts are, a
13 substantial portion of the Earned Income Tax Credit does
14 represent an outlay and not actually a tax payment.
15 So some have taken the view that all EITC amounts
16 should be reflected in an income tax distribution, while
17 others I think would strongly disagree with that view
18 because as much as 85 percent of payments under the EITC
19 actually represent an outlay by the Federal Government.
20 So, I think there is a strong philosophical disagreement.
21 Senator Moynihan. May I say, Mr. Chairman, that in
22 1993 the Joint Tax Committee did include EITC in its
23 judgment.
24 The Chairman. Without more, the committee is in
25 recess until 9:00 tomorrow morning.

1 [Whereupon, at 7:40 p.m., the meeting was recessed, to
2 reconvene at 9:00 a.m. on Thursday, October 19, 1995.]
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UNITED STATES SENATE
COMMITTEE ON FINANCE

EXECUTIVE SESSION

Wednesday, October 18, 1995; 10:00 a.m.
215 Dirksen Senate Office Building

AGENDA

1. Chairman's mark of tax portion of the budget reconciliation legislation.

Pursuant to Committee Rule 2(a), the official notification and this agenda are being delivered at least 48 hours in advance. The Chairman will rule out of order nongermane items (offered as a single amendment or as part of a larger amendment).

DESCRIPTION OF CHAIRMAN'S MARK FOR REVENUE RECONCILIATION PROPOSALS

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on October 18 , 1995

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 16, 1995

JCX-44-95

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup beginning on October 18, 1995, on revenue reconciliation proposals for the fiscal year 1996 budget resolution. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's proposed mark for the revenue reconciliation provisions.

Part I describes provisions relating to family tax relief; Part II describes provisions relating to savings and investment; Part III describes provisions relating to health care; Part IV describes provisions relating to estate and gift taxes; Part V describes expiring tax provisions; Part VI describes provisions relating to the Taxpayer Bill of Rights 2, Part VII describes casualty and involuntary conversion provisions; Part VIII describes exempt organization and charitable reforms; and Part IX describes corporate and other reforms and miscellaneous provisions.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Chairman's Mark for Revenue Reconciliation Proposals (JCX-44-95), October 16, 1995.

DESCRIPTION OF REVENUE RECONCILIATION PROPOSALS

I. FAMILY TAX RELIEF

A. Child Tax Credit for Children Under Age 18

Present Law

Present law does not provide tax credits based solely on the taxpayer's number of dependent children. Taxpayers with dependent children, however, generally are able to claim a personal exemption for each of these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is $2,500 for 1995, and is adjusted annually for inflation. In 1995, the amount of the personal exemption is phased out for taxpayers with AGI in excess of $114,700 for single taxpayers, $143,350 for heads of household, and $172,050 for married couples filing joint returns. These phaseout thresholds are adjusted annually for inflation.

In general, in order for a taxpayer to claim an individual as a dependent, the individual must (1) be a member of the taxpayer's household for the entire taxable year or be related to the taxpayer, (2) receive more than half of his total support from the taxpayer, (3) be a citizen, national, or resident of the United States or a resident of Canada or Mexico, (4) not file a joint return with his spouse, and (5) have gross income that is less than the exemption amount. This gross income test does not apply to a child of the taxpayer who is (1) under the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins or (2) a student under the age of 24 at the close of such calendar year.

Description of Proposal

In general

The proposal would provide taxpayers with a maximum nonrefundable tax credit of $500 for each qualifying child under the age of 18 (as of the close of the calendar year in which the taxpayer's taxable year begins). The amount of the credit would not be indexed for inflation.

To be a qualifying child, an individual would have to satisfy a relationship test and a dependency test. An individual would satisfy the relationship test if the individual is a son or daughter of the taxpayer, a descendant of a son or daughter of the taxpayer, a stepson or stepdaughter of the taxpayer, or an adopted child of the taxpayer. An adopted child would include a child who is legally adopted or who is placed with the taxpayer by an authorized placement agency for adoption by the taxpayer. A foster child would also satisfy the relationship test if, for the taxpayer's entire taxable year, the foster child (1) is a member of the taxpayer's household and (2) has as his principal place of abode the home of the taxpayer. An individual generally would satisfy the dependency test if the taxpayer is entitled to claim the individual is a dependent.

Except in the case of a taxable year closed by reason of the taxpayer's death, the credit would not be allowable in the case of a taxable year covering a period of less than 12 months.

Income phaseout

For taxpayers with AGI in excess of certain thresholds, the allowable child credit would be reduced by $25 for each $1,000 of AGI (or fraction thereof) in excess of the threshold. Thus, the size of the phaseout range would be proportional to the number of qualifying children. For married taxpayers filing joint returns, the threshold would be $110,000. For taxpayers filing single or head of household returns, the threshold would be $75,000. For married taxpayers filing separate returns, the threshold would be $55,000. These thresholds would not be indexed for inflation.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1995.

B. Tax Credit for Adoption Expenses; Exclusion for Certain Adoption Expenses

Present Law

Present law does not provide a tax credit for adoption expenses. Also, present law does not provide an exclusion from gross income for employer-provided adoption assistance. The Federal Adoption Assistance program (a Federal outlay program) provides financial assistance for the adoption of certain special needs children. In general, a special needs child is defined as a child who (1) according to a State determination, could not or should not be returned to the home of the natural parents and (2) on account of a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical condition, or physical, mental or emotional handicap), could not reasonably be expected to be adopted unless adoption assistance is provided. Specifically, the program provides assistance for adoption expenses for those special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State-funded programs. The maximum Federal reimbursement is $1,000 per special needs child. Reimbursable expenses include those nonrecurring costs directly associated with the adoption process such as legal costs, social service review, and transportation costs.

Description of Proposal

Tax credit

The proposal would provide taxpayers with a maximum credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. Any unused adoption credit could be carried forward by the taxpayer for up to five years. Qualified adoption expenses would be reasonable and necessary adoption fees, court costs, attorneys' fees and other expenses that are directly related to the legal and final adoption of an eligible child. An eligible child would be an individual (1) who has not attained age 18 as of the time of the adoption, or (2) who is physically or mentally incapable of caring for himself or herself. No credit would be allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, or (3) in connection with the adoption of a child of the taxpayer's spouse. The credit would be phased out ratably for taxpayers with taxable income above $60,000, and would be fully phased out at $100,000 of taxable income.

The $5,000 limit would be a per child limit, not an annual limitation. For example, if a taxpayer incurs $3,000 of qualified adoption expenses in year one and $3,000 of qualified adoption expenses in year two, then the taxpayer would receive a $3,000 credit in year one and a $2,000 credit in year two.

To avoid a double benefit, the proposal would deny the credit to taxpayers to the extent the taxpayer may use otherwise qualified adoption expenses as the basis of another credit or

deduction. Also the credit would not allowed for any expenses for which a grant is received under any Federal, State, or local program.

The proposal would provide that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from each other for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Further, the proposal would provide that an individual legally separated from his spouse under a decree of divorce or separate maintenance would not considered married for purposes of this provision.

Exclusion from income

The proposal would provide a maximum $5,000 exclusion from the gross income of an employee for amounts paid by the employer. The $5,000 limit would be a per child limit, not an annual limitation. These amounts must be in connection with an adoption of an eligible child (as described above) by an employee if such amounts are furnished pursuant to an adoption assistance program. An adoption reimbursement program operated under section 1052 of title 10 of the U.S. Code (relating to the armed forces) or section 514 of title 14 of the U.S. Code (relating to members of the Coast Guard) would be treated as an adoption assistance program for these purposes. An adoption assistance program would be a nondiscriminatory plan of an employer under which the employer provides employees with adoption assistance. Also, not more than 5 percent of the benefits under the program for any year could benefit more than 5 percent owners of the employee or their spouses or dependents. An adoption assistance program would not have to be funded. Adoption assistance would be a qualified benefit under a cafeteria plan. The exclusion would be phased out ratably for taxpayers with taxable income (determined without regard to the exclusion) above $60,000 and would be fully phased out at $100,000 of taxable income (determined without regard to the exclusion). No credit would be allowed for adoption expenses paid as reimbursed under an adoption assistance program.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1995.

C. Marriage Penalty Relief: Increase in Standard Deduction for Joint Returns

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the unit's total taxable income. Although married couples may elect to file separate returns, the rate schedules and provisions are structured so that filing separate returns usually results in a higher tax than filing joint returns. Other rate schedules apply to single persons and to single heads of household.

A "marriage penalty" exists when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry). A "marriage bonus" exists when the sum of the tax liabilities of the individuals is greater than their combined tax liability under a joint return.

While the size of any marriage penalty or bonus under present law depends upon the individuals' incomes, number of dependents, and itemized deductions, as a general rule married couples whose earnings are split more evenly than 70-30 suffer a marriage penalty. Married couples whose earnings are largely attributable to one spouse generally receive a marriage bonus.

Under present law, the size of the standard deduction and the tax bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and tax bracket breakpoints for single filers are roughly 60 percent of those for joint filers. The standard deduction and tax bracket breakpoints for head of household filers are about 83 percent of those for joint filers. With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals. Furthermore, because of the way the tax bracket breakpoints are structured, as joint filers they may have some of their taxable income pushed into a higher marginal tax bracket than when they were not married.

The rate changes in the Revenue Reconciliation Act of 1993 exacerbated the existing marriage penalty because the new tax bracket breakpoints did not provide the customary ratios across filing statuses. For the new 36-percent tax bracket, the breakpoint for single filers and for head of household filers are 82 percent and 91 percent, respectively, of the breakpoint for joint filers. For the 39.6-percent tax bracket, the tax bracket breakpoint is $250,000 regardless of filing status.

Standard deduction

Taxpayers who do not itemize deductions may choose the standard deduction. The size of the standard deduction varies according to filing status and is indexed for inflation. For 1995, the size of the standard deduction is as follows:

Filing status	Standard deduction
Married, joint return	$6,550
Head of household return	5,750
Single return	3,900
Married, separate return	3,275

For 1996, the size of the standard deduction is projected to be as follows:

Filing status	Standard deduction
Married, joint return	$6,700
Head of household return	5,900
Single return	4,000
Married, separate return	3,350

Taxpayers may claim an additional standard deduction if they are blind or aged 65 or older. For 1995, the amount of the additional standard deduction is $750 ($900 if the taxpayer is unmarried and not a surviving spouse). These amounts are indexed for inflation.

The total amount of standard deductions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income.

Description of Proposal

The proposal would increase the standard deduction for married taxpayers filing a joint return according to the following schedule:

For taxable years beginning in calendar year--	The standard deduction would be--
1996	$6,800
1997	7,150
1998	7,500
1999	7,950
2000	8,200
2001	8,600
2002	9,100
2003	9,500
2004	9,950
2005	10,800

For calendar years after 2005, the amount would be indexed for inflation.

Providing the marriage penalty relief through an increase in the standard deduction would target the relief to moderate-income taxpayers, who are less likely to itemize deductions.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1995.

D. Credit for Interest on Student Loans

Present Law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest is generally treated as personal interest and thus is not allowable as an itemized deduction from income. There is no tax credit allowed for student loan interest paid by a taxpayer.

Description of Proposal

In general

The proposal would allow individuals who have paid interest on qualified education loans a nonrefundable credit against regular tax liability generally equal to 20 percent of such interest. The maximum credit allowed would be $500 ($1,000 in the case of a taxpayer paying interest on loans for two or more students). Unused amounts of credit could not be carried forward or backward to other taxable years.

A qualified education loan generally would be any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer or the taxpayer's spouse or dependents in attending higher education institutions and certain area vocational education schools (i.e., eligible educational institutions defined in Code section 135(c)(3)). Indebtedness incurred by a student from borrowing from a related party would not be treated as a qualified education loan. The qualified higher education expenses would have to be paid while the individual was at least a half-time student. Indebtedness that is used to refinance any indebtedness described in the previous sentence would also be treated as a qualified education loan. Qualified higher education expenses would be defined as the student's cost of attendance (generally, tuition, fees, room and board, and related expenses). At the time the expenses are incurred, the student would have to be the taxpayer or the taxpayer's spouse or dependent.

Income phaseout range for credit

The credit would be phased out ratably over the following modified adjusted gross income (AGI) ranges: joint filers ($60,000-$75,000) and unmarried individuals ($40,000-$55,000). The beginning of the phaseout ranges (but not the size of the phaseout range) would be indexed for inflation for taxable years beginning after 1996. Modified AGI would be defined as the taxpayer's AGI (1) increased by the amount otherwise excluded from gross income under Code sections 135, 911, 931, or 933 (relating to educational savings bonds and to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively) and (2) calculated after the inclusion of Social Security benefits in income, the deduction for individual retirement losses, and the limitation on passive losses.

Credit claimed for interest on borrowing for expenses of taxpayer or spouse

In the case of qualified education loans used to pay the qualified higher education expenses of the taxpayer or the taxpayer's spouse, the credit would be allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. For purposes of counting the 60 months, any qualified education loan and all refinancing (that is treated a qualified education loan) of such loan would be treated as a single loan.

Credit claimed for interest on borrowing for expenses of taxpayer's dependent

In the case of qualified education loans used to pay the qualified higher education expenses of an individual other than the taxpayer or the taxpayer's spouse, no credit would be allowed unless the individual is claimed as a dependent of the taxpayer for that taxable year and the individual is at least a half-time student during that taxable year.

Limitations on claiming credit

No credit would be allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year beginning in the calendar year in which such individual's taxable year begins. No credit would be allowed for interest on any amount of education loan indebtedness for which a deduction is claimed under any other provision.

Couples who are married at the end of the taxable year would have to file a joint return to claim the credit unless they lived apart for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for a dependent child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. An individual legally separated from his spouse under a decree of divorce or separate maintenance would not considered married for purposes of this provision.

Information reporting on student loan interest

Any person in a trade or business or any governmental agency who receives $600 or more in qualified education loan interest from an individual during a calendar year would be required to file an information report on such interest to the IRS and to the payor. In the case of interest received by any person on behalf of another person, generally only the first person receiving the interest would be required to file the information reports.

Effective Date

The proposal would be effective for payments of interest due after December 31, 1995, but, in the case of qualified education loans used to pay the qualified higher education expenses of the taxpayer or the taxpayer's spouse, only if the 60-month period has not expired.

II. INCREASE SAVINGS AND INVESTMENT

A. Provisions Relating to Individual Retirement Arrangements

Present Law

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an "IRA"). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA. No deduction is permitted with respect to IRA contributions made after an individual attains age 70-1/2.

Deductible IRA contributions

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). The maximum IRA deduction limit is increased to $2,250 if the individual is married, files a joint return, and has a spouse that has no compensation (or elects to be treated as having no compensation). The $2,250 contribution may be allocated in any manner between IRAs for each spouse, as long as no more than $2,000 is contributed for either spouse. A contribution to an IRA is treated as made for a taxable year if made by April 15 of the following year.

A single individual is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income ("AGI") of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent they are not permitted to make deductible contributions. An individual may also elect to make nondeductible

contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent nondeductible contributions) are taxable.

To discourage IRA withdrawals for nonretirement purposes, IRA withdrawals before age 59-1/2, death, or disability are generally subject to an additional 10-percent tax. The 10-percent additional tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the individual or the joint lives (or joint life expectancies) of the individual and the individual's designated beneficiary.

Description of Proposal

In general

The proposal would phase up the income limits on the deductibility of traditional IRA contributions and modify the definition of active participant. The proposal would index the $2,000 limit on deductible IRA contributions for inflation. In addition, the proposal would permit nondeductible contributions to a new IRA Plus account. The limits on contributions to traditional IRAs and IRA Plus accounts would be coordinated, so that no more than $2,000 could be contributed per year to an individual's IRAs.

In general, an IRA Plus would be subject to the same rules as IRAs. However, withdrawals from an IRA Plus would not be includible in income (or subject to the 10-percent early withdrawal tax) if attributable to contributions that had been held in the IRA Plus account for at least 5 years and are either (1) made after the individual attains age 59-1/2, or (2) made for a special purpose or on account of death or disability or in the form of an annuity. Other withdrawals would be taxable (to the extent of earnings on contributions).

The proposal would allow penalty-free withdrawals from deductible IRAs to the extent used for certain special purposes. Special purposes would be the purchase of a first home (up to $10,000), certain education expenses, catastrophic medical expenses, and withdrawals by individuals who have received unemployment compensation for at least 12 weeks.

Expansion of deductible IRAs

The proposal would provide that a person is not considered an active participant for purposes of the IRA rules merely because his or her spouse is an active participant in an employer-sponsored retirement plan.

Beginning in 1996, for single individuals, the proposal would phase up the income limits on deductible IRA contributions in $5,000 increments until the phaseout range is $85,000 to $95,000 (in 2007). Also beginning in 1996, for married couples, the deduction would be phased out over a $20,000 income range (rather than $10,000) and the phaseout range would be increased in $5,000 increments until the phaseout range is $100,000 to $120,000 (in 2007) After these new ranges are reached, the income limits would be indexed for inflation in $5,000 increments.

Thus, under the proposal, the phaseout ranges would be as follows:

Year	Singles	Married Couples
1996	$30,000 - $40,000	$ 45,000 - $ 65,000
1997	$35,000 - $45,000	$ 50,000 - $ 70,000
1998	$40,000 - $50,000	$ 55,000 - $ 75,000
1999	$45,000 - $55,000	$ 60,000 - $ 80,000
2000	$50,000 - $60,000	$ 65,000 - $ 85,000
2001	$55,000 - $65,000	$ 70,000 - $ 90,000
2002	$60,000 - $70,000	$ 75,000 - $ 95,000
2003	$65,000 - $75,000	$ 80,000 - $100,000
2004	$70,000 - $80,000	$ 85,000 - $105,000
2005	$75,000 - $85,000	$ 90,000 - $110,000
2006	$80,000 - $90,000	$ 95,000 - $115,000
2007	$85,000 - $95,000	$100,000 - $120,000
2008 and later	---income thresholds indexed for inflation in $5,000 increments---	

Spousal IRAs

The proposal would permit annual contributions of up to $2,000 for each spouse in a married couple.

Inflation adjustment for IRA deduction limit

Under the proposal, the $2,000 limit on contributions that could be made to an IRA would be indexed for inflation in $500 increments.

IRA investments in coins and metals

The proposal would permit IRAs to acquire certain coins or bullion, as long as they are in the physical possession of the IRA trustee.

IRA Plus accounts

In general

The proposal would replace present-law nondeductible IRAs with new IRA Plus accounts to which individuals could make nondeductible contributions. Generally, IRA Plus accounts would be subject to the same rules applicable to deductible IRAs. However, a number of special rules would apply.

Contributions

Contributions to an IRA Plus would be nondeductible. The amount of nondeductible contributions to an IRA Plus that could be made for any taxable year would be coordinated with the limits for deductible IRAs, so that the maximum permitted contribution to an IRA Plus would be reduced by any deductible IRA contribution for the year.

Taxation of distributions

The taxation of withdrawals from an IRA Plus would depend on how long the contributions had been in the IRA Plus, the age of the individual, and the purpose of the withdrawal.[1] Withdrawals of amounts attributable to contributions that have been in the IRA Plus for less than 5 years would be includible in income (to the extent of earnings). The 10-percent early withdrawal tax would also apply to the amount includible unless the distribution is on account of death or disability or is in the form of an annuity. Withdrawals made after 5 years and before the individual is age 59-1/2 would be excludable from income (and not subject to the 10-percent tax) if the withdrawal is made for a special purpose, on account of death or disability, or in the form of an annuity; otherwise, such withdrawals would be includible in income (to the extent of earnings) and subject to the 10-percent tax (on earnings). Withdrawals after 5 years and after age 59-1/2 would not be includible in income (or subject to the 10-percent tax), regardless of the purpose of the withdrawal.

In determining whether amounts are includible in income under the 5-year rule, distributions would be treated as having been made first from the earliest contributions (and earnings attributable to such contributions) remaining in the account at the time of distribution

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[1] In some cases, the minimum required distribution rules may require distributions from an IRA Plus to begin before the expiration of the 5-year holding period. The 10-percent tax would not apply to such minimum required distributions.

and then from other contributions (and earnings) in the order made. For purposes of this rule, all contributions for a taxable year would be treated as made on January 1 of that year. Earnings would be allocated to contributions under rules to be prescribed by the Secretary.

Rollovers

Tax-free rollovers from an IRA Plus to another IRA Plus would be permitted. For purposes of the 5-year rule, the IRA Plus to which amounts are rolled over would be treated as having held the amounts during any period during which such contributions were held in the IRA Plus to which the contributions were first made.

The proposal would permit amounts withdrawn from present-law IRAs to be rolled over into an IRA Plus. The amount rolled over would be includible in gross income in the year the withdrawal was made, except that amounts rolled over to an IRA Plus before January 1, 1998, would be includible in income ratably over a 4-year period. The 10-percent early withdrawal tax would not apply to amounts rolled over from an IRA to an IRA Plus.

Special purpose withdrawals

In general

As described above, withdrawals from an IRA Plus after 5 years and before age 59-1/2 would be excludable from income (and not subject to the 10-percent early withdrawal tax) if the distribution is for a special purpose. In addition, the proposal would provide exceptions to the early withdrawal tax in the case of special purpose distributions from deductible IRAs. In general, special purposes would be (1) qualified first-time homebuyer distributions that do not exceed $10,000, (2) qualified higher education distributions, (3) distributions used for extraordinary medical expenses, or (4) distributions made to certain unemployed individuals.

Withdrawals by first-time homebuyers

Under the proposal, qualified first-time homebuyer distributions would be withdrawals of up to $10,000 during the individual's lifetime that are used within 60 days to pay costs (including reasonable settlement, financing, or other closing costs) of acquiring, constructing, or reconstructing the principal residence of a first-time homebuyer who is the taxpayer, taxpayer's spouse, or a child, grandchild, or ancestor of the individual or individual's spouse. A first-time homebuyer would be an individual who has not had an ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which the withdrawal relates. The proposal would require that the spouse of the individual also meet this requirement as of the date the contract is entered into or construction commences. The date of acquisition would be the date the individual enters into a binding contract to purchase a principal residence or begins construction or reconstruction of such a residence. Principal residence would

be defined as under the provisions relating to the rollover of gain on the sale of a principal residence.

Under the proposal, any amount withdrawn for the purchase of a principal residence would be required to be used within 60 days of the date of withdrawal. The 10-percent additional income tax on early withdrawals would be imposed with respect to any amount not so used. If the 60-day rule could not be satisfied due to a delay in the acquisition of the residence, the taxpayer would be able to recontribute all or part of the amount withdrawn to the IRA prior to the end of the 60-day period without adverse tax consequences. Any amount recontributed would be treated as a rollover contribution without regard to the limitations on the frequency of IRA-to-IRA rollovers.

Withdrawals for education expenses

Qualified higher education expenses would be defined as tuition, fees, books, supplies, and equipment required for courses at an eligible educational institution. Amounts withdrawn would be available for use for the education of the individual or the individual's spouse, or a child, grandchild, or ancestor of the individual or the individual's spouse.

The amount that could be considered qualified higher education expenses would be reduced by any amount that is excludable from the taxable income of the taxpayer under the provisions relating to education savings bonds.

Financially devastating medical expenses

Withdrawals for the medical expenses of the individual, his or her spouse or dependents, and any child, grandchild, or ancestor of the individual or the individual's spouse, whether or not a dependent of the individual for income tax purposes, would be a special purpose withdrawal to the extent such medical expenses exceed 7.5 percent of adjusted gross income.

Distributions to unemployed individuals

Withdrawals by an individual who has received unemployment compensation for at least 12 consecutive weeks under any Federal or State unemployment compensation law would be a special purpose distribution.

Effective Date

The proposal would generally be effective for taxable years beginning after December 31, 1995.

B. Establish SIMPLE Retirement Plans

Present Law

Present law does not contain rules relating to SIMPLE retirement plans. However, present law does provide a number of ways in which individuals can save for retirement on a tax-favored basis. These include employer-sponsored retirement plans that meet the requirements of the Internal Revenue Code (a "qualified plan") and individual retirement arrangements ("IRAs"). Employees can earn significant retirement benefits under employer-sponsored retirement plans. However, in order to receive tax-favored treatment, such plans must comply with a variety of rules, including complex nondiscrimination and administrative rules (including top-heavy rules). Such plans are also subject to requirements under the labor law provisions of the Employee Retirement Income Security Act of 1974 ("ERISA").

IRAs are not subject to the same rules as qualified plans, but the amount that can be contributed in any year is significantly less. The maximum deductible IRA contribution for a year is limited to $2,000.

Distributions from IRAs and employer-sponsored retirement plans are generally taxable when made. In addition, distributions prior to age 59-1/2 generally are subject to an additional 10-percent early withdrawal tax.

Under one type of qualified plan, employees can elect to reduce their taxable compensation and have nontaxable contributions made to the plan. Such contributions are called elective deferrals, and the plans which allow such contributions are called qualified cash or deferred arrangements (or "401(k) plans"). The maximum annual amount of elective deferrals that can be made by an individual is $9,240 for 1995. This dollar limit is indexed for inflation in $500 increments. A special nondiscrimination test applies to elective deferrals.

The special nondiscrimination test applicable to elective deferrals under qualified cash or deferred arrangements is satisfied if the actual deferral percentage ("ADP") for eligible highly compensated employees for a plan year is equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement, or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage pints. The ADP for a group of employees is the average of the ratios (calculated separately for each employee in the group) of the contributions paid to the plan on behalf of the employee to the employee's compensation.

An employer may make contributions based on an employee's elective contributions. Such contributions are called matching contributions, and are subject to a special nondiscrimination test similar to the special nondiscrimination test applicable to elective deferrals.

Description of Proposal

In general

The proposal would create a simplified retirement plan for small business called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans could be adopted by employers with 100 or fewer employees who do not maintain another employer-sponsored retirement plan. A SIMPLE plan could either be an IRA for each employee or part of a qualified cash or deferred arrangement ("401(k) plan"). If established in IRA form, a SIMPLE plan would not be subject to the nondiscrimination rules generally applicable to qualified plans (including the top-heavy rules) and would not be subject to the labor law provisions of ERISA. In addition, simplified reporting requirements would apply. Within limits, contributions to a SIMPLE plan would not be taxable until withdrawn.

A SIMPLE plan could also be adopted as part of a 401(k) plan. In that case, the plan would not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and would not be subject to the top-heavy rules. The other qualified plan rules would continue to apply.

SIMPLE retirement plans in IRA form

In general

A SIMPLE retirement plan would allow employees to make elective contributions to an IRA. Employee contributions would have to be expressed as a percentage of the employee's compensation, and could not exceed $6,000 per year. The $6,000 dollar limit would be indexed for inflation in $500 increments.

The employer generally would be required to match employee elective contributions on a dollar-for-dollar basis up to 3 percent of the employee's compensation. Under a special rule, the employer could elect a lower percentage matching contribution for all employees (but not less than 1 percent of the employee's compensation). In order for the employer to lower the matching percentage, the employer would be required to notify employees of the applicable match. In addition, a lower percentage could not be elected for more than 2 out of any 5 years. No contributions other than employee elective contributions and employer matching contributions could be made to a SIMPLE account.

Only employers who normally employ 100 or fewer employees on any day during the year and who do not currently maintain a qualified plan could establish SIMPLE retirement accounts for their employees.

Each employee of the employer who received at least $5,000 in compensation from the employer during each of the 2 preceding years and who is reasonably expected to receive at least $5,000 in compensation during the year would be required to be eligible to participate in the

SIMPLE plan. Nonresident aliens and employees covered under a collective bargaining agreement would not have to be eligible to participate in the SIMPLE plan. Self-employed individuals could participate in a SIMPLE plan.

All contributions to an employee's SIMPLE account would be fully vested.

Rules similar to the spousal consent rules applicable to qualified defined contribution plans would apply to SIMPLE plans.

Distributions generally would be taxed as under the rules relating to IRAs, except that an increased early withdrawal tax would apply to distributions within the first 2 years the SIMPLE is established.

Tax treatment of SIMPLE accounts, contributions, and distributions

Contributions to a SIMPLE account generally would be deductible by the employer for the year in which they are made, and would be excludable from the employee's income. SIMPLE accounts, like IRAs would not be subject to tax. Distributions from a SIMPLE retirement account generally would be taxed under the rules applicable to IRAs. Thus, they would be includible in income when withdrawn. Tax-free rollovers could be made from one SIMPLE account to another.

Early withdrawals from a SIMPLE account generally would be subject to the 10-percent early withdrawal tax applicable to IRAs. However, withdrawals of contributions during the 2-year period beginning on the date the employee first participated in the SIMPLE account would be subject to a 25-percent early withdrawal tax (rather than 10 percent). This increased excise tax is intended to encourage employees to keep money in the SIMPLE account for retirement.

Administrative requirements

Each eligible employee would be able to elect, within the 60-day period before the beginning of the year, to participate in the SIMPLE plan (i.e., to make elective deferrals), and to modify any previous elections regarding the amount of contributions. An employer would be required to contribute employees' contributions to the employee's SIMPLE account within 30 days after the end of the month to which the contributions relate. Employees would be able to terminate participation in the SIMPLE plan at any time during the year (i.e., to stop making contributions). The plan could provide that an employee that does so could not resume participation until the following year. A plan could permit (but is not required to permit) an individual to make other changes to his or her salary reduction contribution election during the year (e.g., reduce contributions).

No fee could be imposed on the employee with respect to the employee's initial investment decision with respect to any contributions. This rule would not be intended to preclude the imposition of a reasonable fee based on the rate of return on assets held in a SIMPLE account.

Reporting requirements

Trustee requirements.--The trustee of a SIMPLE account would be required each year to prepare, and provide to the employer maintaining the SIMPLE plan, a summary description containing the following basic information about the plan: the name and address of the employer and the trustee; the requirements for eligibility; the benefits provided under the plan; the time and method of making salary reduction elections; and the procedures for and effects of, withdrawals from the SIMPLE account. At least once a year, the trustee also would be required to furnish an account statement to each individual maintaining a SIMPLE account. In addition, the trustee would be required to an annual file report with the Secretary similar to those required with respect to IRAS. A trustee who fails to provide any of such reports or descriptions would be subject to a penalty of $50 per day until such failure is corrected, unless the failure is due to reasonable cause.

Employer reports.--The employer maintaining a SIMPLE plan would be required to notify each employee of the employee's opportunity to make salary reduction contributions under the plan immediately before the employee becomes eligible to make such election. This notice would have to include a copy of the summary description prepared by the trustee. An employer who fails to provide such notice would be subject to a penalty of $50 per day on which such failure continues, unless the failure is due to reasonable cause.

Definitions

For purposes of the rules relating to SIMPLE plans, compensation would be compensation required to be reported by the employer on Form W-2, plus any elective deferrals of the employee. In the case of a self-employed individual, compensation would mean net earnings from self-employment. "Employer" would include the employer and related employers. Related employers would include trades or businesses under common control (whether incorporated or not), controlled groups of corporations, and affiliated service groups. In addition, the leased employee rules would apply.

For purpose of the rule prohibiting an employer from establishing a SIMPLE plan if they have another qualified plan, an employer would be treated as maintaining a qualified plan if the employer (or a predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, with respect to service in the period beginning with the year the SIMPLE plan became effective and ending with the year for which the determination is being made. In addition, a qualified plan of the employer would not be permitted to give credit for any service (other than vesting or eligibility purposes) during a year for which the employee was eligible to participate in a SIMPLE plan. A qualified plan would include a

qualified retirement plan, a qualified annuity plan, a governmental plan, a tax-sheltered annuity, and a simplified employee pension.

SIMPLE 401(k) plans

Under the proposal, a cash or deferred arrangement (i.e., 401(k) plan), would be deemed to satisfy the special nondiscrimination tests applicable to employee elective deferrals and employer matching contributions if the plan satisfies the contribution requirements applicable to SIMPLE plans. In addition, the plan would not be subject to the top-heavy rules for any year for which the safe harbor is satisfied. The plan would be subject to the other qualified plan rules.

The safe harbor would be satisfied if, for the year the employer does not maintain another qualified plan and (1) employee's elective deferrals are limited to no more than $6,000, (2) the employer matches employees' elective deferrals up to 3 percent of compensation, and (3) no other contributions are made to the arrangement. Contributions under the safe harbor would have to be 100 percent vested. The employer could not reduce the matching percentage below 3 percent of compensation.

In order for the safe harbor to be satisfied, the following SIMPLE administrative requirements would also have to be satisfied: (1) no fee with respect to the employee's initial investment, (2) the employee's right to terminate participation during the year, and (3) the 60-day election period.

Effective Date

The proposal relating to SIMPLE plans would be effective for years beginning after December 31, 1995.

C. Capital Gains Provisions

1. 50-percent capital gains deduction for individuals

Present Law

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, the net capital gain is taxed at the same rate as ordinary income, except that individuals are subject to a maximum marginal rate of 28 percent of the net capital gain. Net capital gain is the excess of the net long-term capital gain over the net short-term capital loss for the taxable year. Gain or loss is treated as long-term if the asset is held for more than one year.

Prior to the enactment of the Tax Reform Act of 1986, individuals were allowed a deduction equal to 60 percent of net capital gain. The deduction resulted in a maximum effective tax rate of 20 percent on such gains.

Capital losses are generally deductible in full against capital gains. In addition, individuals may deduct capital losses against up to $3,000 of ordinary income in each year. Capital losses in excess of the amount deductible are carried forward indefinitely. Prior to the Tax Reform Act of 1986, individuals were required to use two dollars of long-term capital loss to offset each dollar of ordinary income.

Description of Proposal

The proposal would allow individuals a deduction equal to 50 percent of net capital gain for the taxable year. The proposal would repeal the present-law maximum 28-percent rate. Thus, under the proposal, the effective rate under the regular tax on the net capital gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket would be 19.8 percent. One-half of the capital gains deduction would be a minimum tax preference.

Collectibles would be excluded from net capital gain. A maximum rate of 28 percent would apply to the net gain from the sale or exchange of collectibles held for more than one year.

The proposal would reinstate the rule in effect prior to the 1986 Tax Reform Act that required two dollars of the long-term capital loss of an individual to offset one dollar of ordinary income. The $3,000 limitation on the deduction of capital losses against ordinary income would continue to apply.

Effective Date

The proposal generally would apply to sales and exchanges (and installment payments received) after October 13, 1995.

The capital loss rule would not apply to losses arising in taxable years beginning before January 1, 1996.

2. Small business stock

Present Law

The Revenue Reconciliation Act of 1993 provided individuals a 50-percent exclusion for the sale of certain small business stock acquired at original issue and held for at least five years. One-half of the excluded gain is a minimum tax preference.

The amount of gain eligible for the 50-percent exclusion by an individual with respect to any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million.

In order to qualify as a small business, when the stock is issued, the gross assets of the corporation may not exceed $50 million. The corporation also must meet an active trade or business requirement.

Description of Proposal

The taxable portion of the gain from the sale of small business stock would be eligible for the capital gains deduction added by the proposal . Thus, only 25 percent of the gain from a qualified sale of small business stock would be subject to tax. The effective rate under the regular tax on the gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket would be 9.9 percent.

The proposal would increase the size of an eligible corporation from gross assets of $50 million to gross assets of $100 million. The proposal would also repeal the limitation on the amount of gain an individual could exclude with respect to the stock of any corporation.

The proposal would provide that certain working capital must be expended within five years (rather than two years) in order to be treated as used in the active conduct of a trade or business. No limit on the percent of the corporation's assets that are working capital would be imposed.

The proposal would provide that if the corporation establishes a business purpose for a redemption of its stock, that redemption would be disregarded in determining whether other newly issued stock could qualify as eligible stock.

The proposal would allow an individual to roll over gain from the sale or exchange of small business stock otherwise qualifying for the exclusion where the individual uses the proceeds to purchase other qualifying small business stock within 60 days of the sale of the original stock. If the individual sells the replacement stock, the gain attributable to the original stock would be eligible for the small business stock exclusion and the capital gain deduction, and any remaining gain would be eligible for the capital gain deduction if held more than one year and the small business exclusion if held for at least five years. In addition, any gain that otherwise would be recognized from the sale of the replacement stock could be rolled over to other small business stock purchased within 60 days.

Effective Date

The increase in the size of corporations whose stock is eligible for the exclusion would apply to stock issued after the date of the enactment of the proposal. The remaining provisions would apply to stock issued after August 10, 1993 (the original effective date of the small business stock provision).

3. 28-percent corporate alternative tax for capital gains

Present Law

Under present law, the net capital gain of a corporation is taxed at the same rate as ordinary income, and subject to tax at graduated rates up to 35 percent. Prior to the Tax Reform Act of 1986, the net capital gain of a corporation was subject to a maximum effective tax rate of 28 percent.

Description of Proposal

The proposal would provide an alternative tax of 28 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate.

Effective Date

The proposal generally would apply to sales and exchanges (and installment payments received) after October 13, 1995.

D. Alternative Minimum Tax (AMT) Reform

1. Provide relief for depreciation deductions

Present Law

Alternative minimum tax, in general

Present law imposes an alternative minimum tax ("AMT") on an individual or a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability. The individual minimum tax is imposed at graduated rates of 26 and 28 percent on alternative minimum taxable income in excess of a phased-out exemption amount; the corporate minimum tax is imposed at a rate of 20 percent on alternative minimum taxable income in excess of a phased-out $40,000 exemption amount. Alternative minimum taxable income ("AMTI") is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Depreciation under the AMT

Individuals and corporations must adjust their regular tax depreciation deductions in computing their AMTI. Under the AMT, depreciation on property placed in service after 1986 must be computed by using the class lives prescribed by the alternative depreciation system of section 168(g) and either (1) the straight-line method in the case of property subject to the straight-line method under the regular tax or (2) the 150-percent declining balance method in the case of other property. Under the regular tax, depreciation on such property generally is determined using shorter recovery periods and more accelerated recovery methods. The depreciable lives for some property is the same under both the regular tax and the AMT. For example, automobiles, light general purpose trucks, computers and other qualified technological equipment, and semi-conductor manufacturing equipment have 5-year lives under both the regular tax and the AMT; however, such property has a slower recovery method under the AMT (the 150-percent declining balance method) than it does under the regular tax (the 200-percent declining balance method). Similarly, other property (generally, longer-lived personal property and real property) have the same recovery methods under the regular tax and the AMT, but have longer depreciable lives under the AMT.

In the case of a corporation, in addition to the regular set of adjustments and preferences used in calculating AMTI, there is a second set of adjustments known as the "adjusted current earnings" adjustment. The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings ("ACE") of a corporation exceeds its AMTI

(determined without the ACE adjustment and the alternative tax net operating loss deduction).[2] The determination of ACE generally follows the rules for the determination of corporate earnings and profits. For property placed in service before 1994, depreciation under ACE generally is determined using the straight-line method and the class life determined under the alternative depreciation system.[3] Pursuant to a provision contained in the Omnibus Budget Reconciliation Act of 1993, an ACE depreciation adjustment is not required with respect to property placed in service after 1993.

Description of Proposal

For purposes of the individual and corporate AMTs, the proposal would conform the AMT depreciation method to the regular tax method. Thus, property that is recovered using the 200-percent declining balance method for regular tax purposes (generally, shorter-lived tangible personal property) would use that method under the AMT. The proposal would not change the class lives applicable to property for AMT purposes.

Effective Date

The proposal would be effective for property placed in service after December 31, 1995.

2. Allow corporations to take certain minimum tax credits against the minimum tax

Present Law

As described above, present law imposes an alternative minimum tax ("AMT") on an individual or a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability.

If a taxpayer is subject to the AMT in one year, such amount of tax is allowed as a credit ("AMT credit") in a subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in such subsequent year. If the taxpayer is an individual, the AMT credit is allowed to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature (e.g., the adjustment for depreciation). The AMT credit has an unlimited carryforward but cannot be carried back.

The various credits allowed under the regular tax generally are not allowed against the AMT. To the extent the orphan drug credit of section 28 or the nonconventional fuels credit of

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[2] If ACE is less than AMTI, the ACE adjustment may reduce AMTI to the extent of prior-year ACE inclusions.

[3] Similar rules apply for purposes of computing corporate earnings and profits under sec. 312(k).

section 29 are not allowed in a taxable year because of this limitation, the amount of credit so disallowed becomes part of the taxpayer's AMT credit. Unlike other credits, unused sections 28 and 29 credits cannot be carried over to other taxable years.

Description of Proposal

The proposal would allow a corporation with certain AMT credits to offset a portion of its tentative minimum tax in excess of its regular tax. The portion so allowed would be the least of: (1) the amount of the taxpayer's AMT credits that are at least five years old; (2) 50 percent of the taxpayer's tentative minimum tax; or (3) the amount by which the taxpayer's tentative minimum tax exceeds it regular tax for the year. A taxpayer would be deemed to use its oldest AMT credits first under both the present-law provision that allows the use of AMT credits and under the proposal. The use of AMT credits under the proposal would not affect the present-law ability of a corporation to generate AMT credits in the year the proposal is used. Likewise, the proposal would not affect the determination of a corporation's alternative minimum tax or its tentative minimum tax (e.g., the 90-percent limitations on the use of net operating losses and foreign tax credits would continue to apply as under present law).

The following examples illustrate the proposal:

Example 1.--Assume that calendar year corporation X is liable for a minimum tax of $1,000 in each of the years 1990 through 1994. Corporation X was not subject to the minimum tax before 1990. In 1995, X's regular tax exceeds its tentative minimum tax ("TMT") by $200. Under present law, X is allowed to offset its regular tax with an AMT credit of $200 in 1995. Further assume that in 1996, the TMT of X is $1,000 and its regular tax is $400.

Under the proposal, for 1996, X would be allowed to offset its TMT of $1,000 with an AMT credit of $500, computed as the least of:

(1) $800, i.e., its unused AMT credits from 1990, that are at least five years old;
(2) $500, i.e., one-half of its $1,000 TMT; or
(3) $600, i.e., the excess of its $1,000 TMT over its $400 regular tax.

Example 2.--Assume the same facts as in Example 1, except that X has a regular tax of $600 in 1996 (rather than $400). Under the proposal, for 1996, X would be allowed to offset its TMT of $1,000 with an AMT credit of $400, computed as the least of:

(1) $800, i.e., its unused AMT credits from 1990;
(2) $500, i.e., one-half of its $1,000 TMT; or
(3) $400, i.e., the excess of its $1000 TMT over its $600 regular tax.

Example 3.--Assume the same facts as in Example 1, except that X's minimum tax liability in each of the years 1990 through 1994 was $500 (rather than $1,000 in each year). Under the proposal, for 1996, X would be allowed to offset its TMT of $1,000 with an AMT credit of $300, computed as the least of:

(1) $300, i.e., the unused AMT credit from 1990;
(2) $500, i.e., one-half of its $1,000 TMT; or
(3) $600, i.e., the excess of its $1,000 TMT over its $400 regular tax.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1995.

E. Establish 15-Year Recovery Period for Retail Motor Fuel Outlet Stores

Present Law

Under present law, property used in the retail gasoline trade is depreciated under section 168 using a 15-year recovery period and the 150-percent declining balance method. Nonresidential real property (such as a convenience store) is depreciated using a 39-year recovery period and the straight-line method. It is understood that taxpayers generally have taken the position that convenience stores and other structures installed at motor fuel retail outlets have a 15-year recovery period. The IRS, in a position described in a recent Coordinated Issues Paper, generally limits the application of the 15-year recovery period to instances where the structure (1) is 1,400 square feet or less or (2) meets a 50-percent test. The 50-percent test is met if : (1) 50 percent or more of the gross revenues that are generated from the building are derived from petroleum sales and (2) 50 percent or more of the floor space in the building is devoted to petroleum marketing sales.

Description of Proposal

The proposal would provide that 15-year property includes any building and depreciable land improvements that is section 1250 property (generally, depreciable real property) used in the marketing of petroleum products, such as a retail motor fuel outlet building where gasoline and food are sold, but not including any of these facilities related to petroleum and natural gas truck pipelines. The 15-year designation would not apply to any section 1250 property used only to an insubstantial extent in the retail marketing of petroleum or petroleum products.

Effective Date

The proposal would be effective for property placed in service before, on, or after the date of enactment.

F. Allow Bank Common Trust Funds to Transfer Assets to Regulated Investment Companies Without Taxation

Present Law

Common trust funds

A common trust fund is a fund maintained by a bank exclusively for the investment and reinvestment of monies contributed by the bank in its role as a trustee, executor, and other fiduciary capacity.

The common trust fund of a bank is not subject to tax and is not treated as a corporation. Each participant in a common trust fund includes his proportional share of common trust fund income, whether or not the income is distributed.

No gain or loss is realized by the fund upon admission or withdrawal of a participant. Participants generally treat their admission to the fund as the purchase of an interest. Withdrawals from the fund generally are treated as the sale of an interest by the participant.

Regulated investment companies (RICs)

A RIC also is treated as a conduit for Federal income tax purposes. A RIC gets a deduction for dividend distributions to its shareholders. Present law is unclear as to whether a common trust can transfer its assets to one or more RICs tax-free.

Description of Proposal

In general, the proposal would permit a common trust fund to transfer substantially all of its assets to one or more RICs without gain or loss being recognized. The fund must transfer its assets to the RICs solely in exchange for shares of the RICs, and the fund must then distribute the RIC shares to the fund's participants in exchange for the participant's interests in the fund. In addition, each participant's pro-rata interest in each of the RICs must be substantially the same as was the participant's pro-rata interest in the fund.

The basis of any asset that is received by a RIC will be the basis of the asset in the hands of the fund prior to transfer (increased by the amount of gain recognized by reason of the rule regarding the assumption of liabilities). In addition, the basis of any RIC shares ("converted shares") that are received by a fund participant will be an allocable portion of the participant's basis in the interests exchanged. However, special basis rules will apply to determine gain or loss from RIC shares that are redeemed after the conversion.

The tax-free transfer is not available to a common trust fund with assets that are not diversified except that the diversification test is modified so that Government securities are not to be included as securities of an issuer and are to be included in determining total assets for purposes of the 25- and 50-percent tests.

No inference is intended as to the tax consequences under present law when a common trust fund transfers its assets to one or more RICs.

Effective Date

The proposal would be effective for transfers on or after January 1, 1996.

III. HEALTH CARE-RELATED PROVISIONS

A. Treatment of Long-Term Care Insurance

Present Law

In general

Present law generally does not provide explicit rules relating to the tax treatment of long-term care insurance contracts or long-term care services. Thus, the treatment of long-term care contracts and services is unclear. Present law does provide rules relating to the tax treatment of medical expenses and accident or health insurance.

Deduction for medical expenses

In determining taxable income for Federal income tax purposes, a taxpayer is allowed an itemized deduction for unreimbursed expenses that are paid by the taxpayer during the taxable year for medical care of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer, to the extent that such expenses exceed 7.5 percent of the adjusted gross income of the taxpayer for such year.

Exclusion for amounts received under accident or health insurance

Amounts received by a taxpayer under accident or health insurance for personal injuries or sickness generally are excluded from gross income to the extent that the amounts received are not attributable to medical expenses that were allowed as a deduction for a prior taxable year.

Treatment of accident or health plans maintained by employers

Employer contributions to an accident or health plan that provides compensation (through insurance or otherwise) to an employee for personal injuries or sickness of the employee, the employee's spouse, or a dependent of the employee, are excluded from the gross income of the employee. In addition, amounts received by an employee under such a plan generally are excluded from gross income to the extent that the amounts received are paid, directly or indirectly, to reimburse the employee for expenses incurred by the employer for the medical care of the employee, the employee's spouse, or a dependent of the employee. For this purpose, expenses incurred for medical care are defined in the same manner as under the rules regarding the deduction for medical expenses.

A cafeteria plan is an employer-sponsored arrangement under which employees can elect among cash and certain employer-provided qualified benefits. No amount is included in the gross income of a participant in a cafeteria plan merely because the participant has the opportunity to make such an election. Employer-provided accident or health coverage is one of the benefits that may be offered under a cafeteria plan.

A flexible spending arrangement (FSA) is an arrangement under which an employee is reimbursed for medical expenses or other nontaxable employer-provided benefits, such as dependent care. An FSA may be part of a cafeteria plan or provided by an employer outside a cafeteria plan. FSAs are commonly used reimburse employees for medical expenses not covered by insurance. If certain requirements are satisfied, amounts reimbursed for nontaxable benefits from an FSA are excludable from income.

<u>Health care continuation rules</u>

The health care continuation rules require that an employer must provide qualified beneficiaries the opportunity to continue to participate for a specified period in the employer's health plan after the occurrence of certain events (such as termination of employment) that would have terminated such participation. Individuals electing continuation coverage can be required to pay for such coverage.

<u>Life insurance company reserve rules</u>

In general, life insurance companies are allowed a deduction for a net increase in reserves and must take into income any net decreases in reserves. Present law prescribes a tax reserve method based on the nature of the contract. For noncancellable accident and health insurance contracts, the prescribed method is a two-year full preliminary term method. Long-term care insurance reserves are treated like noncancellable accident and health insurance for this purpose and, therefore, are subject to the two-year full preliminary term method of reserves. In no event is the tax reserve for any contract as of any time permitted to exceed the amount which would be taken into account in determining statutory reserves (i.e., set forth on the annual statement for State law reporting purposes). Under the National Association of Insurance Commissioners (NAIC) Long-Term Care Insurance Model Act and Regulations, which have been adopted by some States, by contrast, long-term care insurance reserves are calculated under a one-year full preliminary term method. Thus, because of this inconsistency, in some cases life insurance companies establish reserves for long-term care insurance contracts earlier for State regulatory purposes than they do for Federal tax purposes. In addition, some life insurance companies have voluntary complied with the NAIC model act and regulations, even though not required to do so in all cases.

Changes in reserve amounts due to changes in the basis on which reserves are calculated are generally spread over a 10-year period.

<u>Description of Proposal</u>

<u>Tax treatment and definition of long-term care insurance contracts and qualified long-term care services</u>

<u>In general</u>

A long-term care insurance contract would be treated as an accident and health insurance contract. A plan of an employer providing coverage under a long-term care insurance contract generally would be treated as an accident and health plan; however, coverage under a long-term care insurance contract would not be excludable by an employee if provided through a cafeteria plan, and expenses for long-term care services could not be reimbursed under an FSA. Amounts (other than policyholder dividends or premium refunds) received under a long-term care insurance contract would be excludable as amounts received for personal injuries or sickness. A contract would not fail to be treated as a long-term care insurance contract solely because it provides for payments on a per diem or other periodic basis without regard to expenses during the period. If the aggregate payments under all per diem contracts issued by the same insurer with respect to any one insured exceed $150 per day, then the excess would not be excludable. A payor of long-term care benefits in excess of $150 per day would be required to report the amount of such benefits. The $150 limit would be indexed.

Premiums for long-term care insurance would be treated as medical expenses for purposes of the itemized deduction for medical expenses. Similarly, expenses for qualified long-term care services would be treated as medical expenses for purposes of the itemized deduction. The $150 limitation would not apply with respect to the deduction of long-term care premiums or expenses as medical expenses.

Definition of long-term care insurance contract

A long-term care insurance contract would be defined as any insurance contract that provides only coverage of qualified long-term care services and that meets other requirements. The other requirements would be that (1) premiums are level annual payments over the life of the contract (or 20 years, if shorter), (2) refunds (other than refunds on death of the insured or complete surrender or cancellation of the contract) and dividends under the contract may be used only to reduce future premiums or increase future benefits, (3) the contract prohibits borrowing, assignment, or pledging, (4) the contract generally does not pay or reimburse expenses reimbursable under Medicare (except where Medicare is a secondary payor).

The proposal would provide that a long-term care insurance contract that coordinates its benefits with those provided under Medicare, and health insurance policies (other than Medigap policies) that pay in addition to other coverage, may be sold without violating other laws.

Definition of qualified long-term care services

Qualified long-term care services would mean necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative and maintenance (including personal care) services, that are required by a functionally impaired individual. Such services would be provided pursuant to a plan of care prescribed by a licensed health care practitioner, and would have as their primary purpose the provision of needed assistance with one or more activities of daily living, or substantial supervision to protect from threats to health and safety due to substantial cognitive impairment.

A functionally impaired individual would be one who has been certified within the previous 12 months by a licensed health care practitioner as (1) being unable to perform (without substantial assistance) at least 2 activities of daily living, or (2) requiring substantial supervision to protect such individual from threats to health and safety due to substantial cognitive impairment. Activities of daily living would be eating, toileting, transferring, bathing, dressing and continence.

A licensed health care practitioner would be defined as a physician, registered professional nurse, qualified community care case manager, or other qualified individual who meets such requirements as may be prescribed by the Secretary of the Treasury, provided such person is not a relative of the individual receiving care. A qualified community care case manager would mean an individual or entity with experience in assessing individuals to determine functional and cognitive impairment, and with experience in providing case management services and preparing individual care plans, and that meets requirements prescribed by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services.

Itemized deduction for medical expenses

Unreimbursed expenses for qualified long-term care services provided to the taxpayer or the taxpayer's spouse or dependent would be treated as medical expenses for purposes of the itemized deduction for medical expenses (subject to the present-law floor of 7.5 percent of adjusted gross income). Amounts received under a long-term care insurance contract (regardless of whether the contract reimburses expenses or pays benefits on a per diem or other basis) would be treated as reimbursement for expenses for this purpose. For purposes of this deduction, qualified long-term care services would not include services provided to an individual by a relative or a related corporation. A deduction would also be provided for premiums for insurance covering otherwise deductible expenses for medical care that is provided under a long-term care insurance contract.

Long-term care riders on life insurance contracts

In the case of long-term care insurance coverage provided by a rider on a life insurance contract, the requirements applicable to long-term care insurance contracts would apply as if the portion of the contract providing such coverage were a separate contract. The term "portion" would mean only the terms and benefits that are in addition to the terms and benefits under the life insurance contract without regard to long-term care coverage. The guideline premium limitation and adjustment rules applicable under present law to the life insurance contract would be modified appropriately to take account of charges with respect to the long-term care rider.

Life insurance company reserves

In determining reserves for insurance company tax purposes, the Federal income tax reserve method would be the method prescribed by the National Association of Insurance Commissioners, but no earlier and not in excess of the reserve under the method actually used by the company with respect to the long-term care insurance contract for determining statutory reserves.

Health care continuation rules

The health care continuation rules would not apply to coverage under a long-term care insurance contract.

Consumer protection provisions

Under the proposal, long-term care insurance contracts, and issuers of contracts, would be required to satisfy certain provisions of the long-term care insurance model Act and model regulations promulgated by the National Association of Insurance Commissioners (as adopted as of January 1993). The policy requirements relate to disclosure, nonforfeitability, guaranteed renewal or noncancellability, prohibitions on limitations and exclusions, extension of benefits, continuation or conversion of coverage, discontinuance and replacement of policies, unintentional lapse, post-claims underwriting, minimum standards, inflation protection, preexisting conditions, and prior hospitalization. The proposal also would provide disclosure and nonforfeiture requirements. The nonforfeiture provision would give consumers the option of selecting reduced paid-up insurance, extended term insurance, or a shortened benefit period in the event the policyholder is unable to continue to pay premiums. The requirements for issuers of long-term care insurance contracts relate to application forms, reporting requirements, marketing, appropriateness of purchase, format, delivering a shopper's guide, right to return, outline of coverage, group plans, policy summary, monthly reports on accelerated death benefits, and incontestability period. A tax would be imposed equal to $100 per policy per day for failure to satisfy these requirements.

Nothing in the proposal would prevent a State from establishing, implementing or continuing standards related to the protection of policyholders of long-term care insurance policies, if such standards are not inconsistent with standards established under the proposal.

Effective Date

The proposals relating to treatment of long-term care insurance or plans would apply to contracts issued after December 31, 1995. The proposals relating to treatment of qualified long-term care services as medical care would apply to taxable years beginning after December 31, 1995. The proposal would provide that no inference is intended as to the tax treatment of long-term care insurance and services prior to the effective date.

A contract providing for payment or reimbursement of services similar to qualified long-term care services, that is issued on or before December 31, 1995, could be exchanged for a long-term care insurance contract tax-free until June 30, 1997. Taxable gain would be recognized to the extent money or other property is received in the exchange.

The issuance or conformance of a rider to a life insurance contract providing long-term care insurance coverage would not be treated as a modification or a material change for purposes of

applying present-law rules relating to flexible premium contracts and the definition of life insurance contracts and modified endowment contracts.

The change in treatment of reserves for long-term care insurance contracts would be effective for contracts issued after December 31, 1995.

The provision relating to treatment of contracts that coordinate benefits with those provided under Medicare is effective November 5, 1990.

The proposal relating to consumer protections would be apply to contracts issued after December 31, 1995 with respect to policy requirements, and to actions taken after December 31, 1995 with respect to actions by insurers.

B. Treatment of Accelerated Death Benefits Under Life Insurance Contracts

Present Law

Treatment of amounts received under a life insurance contract

If a contract meets the definition of a life insurance contract, gross income does not include insurance proceeds that are paid pursuant to the contract by reason of the death of the insured (sec. 101(a)). In addition, the undistributed investment income ("inside buildup") earned on premiums credited under the contract is not subject to current taxation to the owner of the contract. The exclusion of death benefits from taxation applies regardless of whether the death benefits are paid as a lump sum or otherwise.

Amounts received under a life insurance contract (other than a modified endowment contract) prior to the death of the insured are includible in the gross income of the recipient to the extent that the amount received constitutes cash value in excess of the taxpayer's investment in the contract (generally, the investment in the contract is the aggregate amount of premiums paid less amounts previously received that were excluded from gross income).

If a contract fails to be treated as a life insurance contract under a statutory definition, inside buildup on the contract is generally subject to tax.

Proposed regulations on accelerated death benefits

The Treasury Department has issued proposed regulations[1] under which certain "qualified accelerated death benefits" paid by reason of the terminal illness of an insured would be treated as paid by reason of the death of the insured and therefore qualify for exclusion under section 101. In addition, the proposed regulations would permit an insurance contract that includes a qualified accelerated death benefit rider to qualify as a life insurance contract under section 7702. Thus, the proposed regulations provide that including this benefit would not cause an insurance contract to fail to meet the definition of a life insurance contract.

Under the proposed regulations, a benefit would qualify as a qualified accelerated death benefit only if it meets three requirements. First, the accelerated death benefit can be payable only if the insured becomes terminally ill. Second, the amount of the benefit must equal or exceed the present value of the reduction in the death benefit otherwise payable.[2] Third, the cash surrender value

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[1] Prop. Treas. Reg. Secs. 1.101-8, 1.7702-0, 1.7702-2, and 1.7702A-1 (December 15, 1992).

[2] For purposes of determining the present value under the proposed regulations, the maximum permissible discount rate would be the greater of (1) the applicable Federal rate that applies under the discounting rules for property and casualty insurance loss reserves, and (2) the interest rate applicable to policy loans under the contract. Also, the present value would be determined

and the death benefit payable under the policy must be reduced proportionately as a result of the accelerated death benefit.

For purposes of the proposed regulations, an insured would be treated as terminally ill if he or she has an illness that, despite appropriate medical care, the insurer reasonably expects to result in death within 12 months from the payment of the accelerated death benefit. The proposed regulations do not apply to viatical settlements.

Description of Proposal

In general

The proposal would provide an exclusion from gross income as an amount paid by reason of the death of an insured for (1) amounts received under a life insurance contract and (2) amounts received for the sale or assignment of a life insurance contract to a viatical settlement provider, provided the insured under the life insurance contract is terminally ill. For this purpose, an individual would be considered terminally ill if the insurer determines, after receipt of an acceptable certification by a licensed physician, that the individual has an illness or physical condition that is reasonably expected to result in death within 12 months of the certification.

The proposal would not apply in the case of an amount paid to any taxpayer other than the insured, if such taxpayer has an insurable interest by reason of the insured being a director, officer or employee of the taxpayer, or by reason of the insured being financially interested in any trade or business carried on by the taxpayer.

Amounts received under a life insurance contract

The exclusion for amounts received under a life insurance contract would be applicable only if two requirements are met. First, under a present value test, the amount received must equal or exceed the present value of the reduction in the death benefit otherwise payable under the life insurance contract. Second, under a ratio test, the payment of the amount must not reduce the cash surrender value of the contract proportionately more than the death benefit payable under the contract. In other words, the percentage derived by dividing the cash surrender value of the contract immediately after the distribution by the cash surrender value of the contract immediately before the distribution must equal or exceed the percentage derived by dividing the death benefit payable immediately after the distribution by the death benefit payable immediately before the distribution. The amount received would include a series of payments.

For purposes of the present value test, the present value of the reduction in the death benefit would be determined by reference to a maximum permissible discount rate, and by assuming that the

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assuming that the death benefit would have been paid twelve months after payment of the accelerated death benefit.

death benefit would have been paid on the date that is 12 months from the date of the physician's certification. The maximum permissible discount rate would be the highest of the following three interest rates: (1) the 90-day Treasury bill yield (as most recently published); (2) Moody's Corporate Bond Yield Average-Monthly Average Corporates (or any successor rate) for the month ending two months before the date the rate is determined; or (3) the rate used to determine cash surrender values under the contract during the applicable period plus 1 percent per annum. The rate would be determined as of the date (or dates) that the payment is made.

If the accelerated death benefit under the contract is paid in connection with a lien against the death benefit rather than an actual reduction in the death benefit on a discounted basis, then the amount of the lien, and interest charges with respect to any amount in connection with the lien, would be taken into account so as to achieve parity between use of the lien method and use of a discounted payment.

For life insurance company tax purposes, the proposal would treat a qualified accelerated death benefit rider to a life insurance contract as life insurance. A qualified accelerated death benefit rider would be any rider on a life insurance contract that provides for a distribution to an individual upon the insured becoming a terminally ill individual (as defined above), but only if such payments under the rider are payments that are excludible under this proposal.

<u>Viatical settlements</u>

The proposal would provide an exclusion for the amount paid for the sale or assignment to a viatical settlement provider of a life insurance contract on the life of an insured individual who is terminally ill. A viatical settlement provider would be any person that regularly engaged on the trade or business of purchasing or taking assignments of life insurance contracts on the lives of terminally ill individuals and either (1) is licensed for such purposes in the State in which the insured resides, or (2) if the person is not required to be licensed by that State, meets the requirements of sections 8 and 9 of the Viatical Settlements Model Act issued by the National Association of Insurance Commissioners (NAIC) (relating to disclosure requirements and general rules for a viatical settlement contract). In addition, any such sale or assignment of a life insurance contract would have to satisfy the requirements of the section of the Viatical Settlements Model Regulation issued by the NAIC relating to standards for evaluation of reasonable payments, including discount rates.

<u>Effective Date</u>

The proposal would apply to amounts received after December 31, 1995. The discount rules applicable to payments under life insurance contracts would not apply to any amount received before July 1, 1996. The proposal treating a qualified accelerated death benefit rider as life insurance for life insurance company tax purposes would take effect on January 1, 1996. The issuance of a qualified accelerated death benefit rider to a life insurance contract, or the addition of any provision required to conform an accelerated death benefit rider to these proposals, would not be treated as a modification or material change of the contract for purposes of the definition of a life insurance

contract and a modified endowment contract (and would not affect the issue date of any contract under present-law rules relating to flexible premium contracts).

C. Medical Savings Accounts

Present Law

Under present law, the tax treatment of health insurance expenses depends on whether the individual is an employee or self employed, and whether the individual is covered under an employer-sponsored health plan. Employer contributions to a health plan for coverage for the employee and the employee's spouse and dependents is excludable from the employee's income. In addition, employers generally can deduct, as an employee compensation expense, the full cost of any health insurance coverage provided for their employees. The exclusion and deduction are generally also available in the case of owners of subchapter C corporations who are also employees.

Self-employed individuals are entitled to a deduction for 30 percent of the amount paid for health insurance for a self-employed individual and the individual's spouse and dependents. The 30-percent deduction is also available to more than 2-percent shareholders of subchapter S corporations.

Individuals who itemize their tax deductions may deduct unreimbursed medical expenses (including expenses for medical insurance) paid during the year to the extent that the total of such expenses exceeds 7.5 percent of the individual's adjusted gross income ("AGI"). Medical expenses include the expenses of the individual and his or her spouse or dependents.

Description of Proposal

In general

In general, the proposal would permit individuals who are covered by a high-deductible health plan to maintain a medical savings account ("MSA"). Only one MSA could be maintained per family. Within limits, contributions to an MSA would be deductible if made by the individual, or alternatively, would be excludable from an employee's income if made by the employer. An individual could not make contributions if the individual is eligible for employer-subsidized health care (or to receive employer contributions to an MSA). Income earned on amounts held in an MSA would not be currently includible in income. Withdrawals from an MSA would be excludable from income if used for medical expenses for the individual and his or her spouse or dependents.

Contributions to MSAs

The proposal would extend the present-law tax treatment for medical expenses to MSA contributions (within certain limits). Thus, an individual could deduct MSA contributions to the extent the contributions, together with other medical expenses for the year exceed 7-1/2 percent of AGI. Self-employed individuals would be able to deduct 30 percent of MSA contributions.

Employer contributions to an MSA would be excludable from income for income and employment tax purposes. An individual would not be eligible to make contributions to an MSA if the individual is eligible to receive employer-subsidized health care (or to receive employer contributions to an MSA).

The maximum annual amount of contributions that could be taken into account for purposes of the deductions for individual contributions or the exclusion for employer contributions would be limited to the lesser of (1) the deductible under the high deductible health plan, and (2) $2,000 ($4,000 in the case of family coverage). The dollar limits would be indexed for medical inflation after 1996.

This maximum contribution limit would be determined separately for each month based on the individual's status in that month, including: (1) whether the individual is covered under a high deductible plan, (2) whether the high-deductible health plan covers only the individual or also a spouse and dependents, and (3) the amount of the deductible under the plan. The maximum annual contribution would be the sum of the monthly contribution limits.

A high deductible plan would be a plan with an annual deductible of at least $1,500 in the case of individual coverage and $3,000 in the case of coverage of more than one person. These dollar amounts would be indexed for medical inflation after 1996.

Contributions to an MSA for a taxable year could be made until the due date for filing the individual's tax return for the year (determined without regard to extensions).

The proposal would not expressly limit the timing of employer contributions. Thus, for example, an employer could make monthly contributions or a single annual contribution to an MSA. Employer contributions made through a cafeteria plan would not be excludable from income.

<u>Definition and tax treatment of MSAs</u>

In general, an MSA would be a trust (or a custodial account) created exclusively for the benefit of the beneficiaries of the trust that meets requirements similar to those applicable to individual retirement arrangements ("IRAs").[3] The trustee of an MSA could be a bank, insurance

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[3] For example, MSA contributions (other than amounts rolled over from another MSA) would have to be in cash, no MSA assets could be invested in life insurance contracts, MSA assets could not be commingled with other property except in a common trust fund or common investment fund, and an account holder's interest in an MSA would be required to be nonforfeitable. In addition, if an account holder engages in a prohibited transaction with respect to an MSA or pledges assets in an MSA, rules similar to those for IRAs would apply, and any amounts treated as distributed to the account holder under these rules would be treated as not used for qualified medical expenses.

company,[4] or other person that demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with applicable requirements.

Earnings in amounts in an MSA would not be currently taxed.

Distributions from an MSA

Distributions from an MSA that are used to pay the unreimbursed qualified medical expenses of the individual or the individual's spouse or dependents would not be taxable. Qualified medical expenses would generally be defined as under the rules relating to the itemized deduction for medical expenses (as modified by the proposal), and thus would include amounts expended for qualified long-term care services. Qualified medical expenses would not include any insurance premiums (including premiums for the high-deductible health plan), except for premiums for long-term care insurance, health care continuation coverage for certain individuals who have lost employer-provided health coverage, and coverage while the individual is receiving unemployment compensation. Qualified medical expenses paid with distributions from an MSA that are excludable from gross income could not be taken into account for purposes of the itemized deduction for medical expenses.

Distributions for purposes other than qualified medical expenses would be taxable. An additional tax of 10 percent of the taxable amount also would apply unless the distribution is made after the individual attains the age of 59-1/2 , dies, or becomes disabled.

If certain events occur, an MSA would cease to be an MSA. This could happen if an individual engages in a prohibited transaction during a taxable year. In addition, an MSA would cease to be treated as an MSA unless the individual remains in a high-deductible health plan for at least two years after the MSA is established. This two-year rule would not apply to individual who does not remain in a high-deductible health plan because of the termination of employment. If an MSA ceases to be treated as an MSA, the individual would be treated as taking the account balance as a distribution for purposes other than qualified medical expenses.

Rollovers from one MSA to another MSA would be permitted without income inclusion if made within 60 days of distribution.

The proposal would include a correction mechanism so that if contributions for a year (whether made by the individual or the employer) exceed the deduction limit for the year, the excess contribution can be withdrawn tax free. In order for tax-free treatment to apply, the excess contributions would have to be withdrawn before the due date (including extensions) for

[4] The acquisition expenses of an insurance company relating to the establishment of an MSA would not be subject to the rules relating to the capitalization of policy acquisition expenses.

filing the individual's tax return for the year and be accompanied by the amount of income attributable to such contribution.

Upon the death of the individual, an MSA would not be subject to estate tax, and income tax treatment of an MSA would depend on who is the individual's beneficiary. If the beneficiary is the surviving spouse, then the spouse may continue the MSA as his or her own. Thus, new contributions could be made by the spouse (or the spouse's employer) if the spouse is in a high deductible plan. Tax-free distributions could be made from the account for the benefit of the spouse and his or her dependents (and any subsequent spouse).

If the beneficiary is not the surviving spouse, then the MSA balance would be included in the income of the beneficiary in the year of death. If the individual does not designate a beneficiary, then the MSA account balance would be includible in the individual's income for the year of death.

Effective Date

The proposal would be effective with respect to taxable years beginning after December 31, 1995.

D. Increase Dollar Limits for Burial Insurance

Present Law

To qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement.[5] Under these rules, the death benefit is generally deemed not to increase.

Special rules apply with respect to a contract that is purchased to cover payment of burial expenses or in connection with prearranged funeral expenses. For such a contract, death benefit increases may be taken into account in applying the cash value accumulation test if the contract (1) has an initial death benefit of $5,000 or less and a maximum death benefit of $25,000 or less, and (2) provides for a fixed predetermined annual increase not to exceed 10 percent of the initial death benefit or 8 percent of the death benefit at the end of the preceding year.

Description of Proposal

The proposal would increase the dollar limits applicable in the case of an insurance contract to cover payment of burial expenses or in connection with prearranged funeral expenses. For such a contract, death benefit increases could be taken into account in applying the cash value accumulation test if the contract has an initial death benefit of $7,000 or less and a maximum death benefit of $30,000 or less (and other requirements of present law are met). In addition, these dollar limits would be adjusted annually, after the first year, for inflation in accordance with the consumer price index.

Effective Date

The proposal would be effective for contracts entered into after December 31, 1995.

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[5] A contract satisfies the cash value accumulation test if the cash surrender value of the contact may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium and cash value corridor tests if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and if the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract.

E. Health Insurance Organizations Eligible for Benefits of Section 833

Present Law

An organization described in section 501(c)(3) or (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance. Special rules apply to certain eligible health insurance organizations. Eligible health insurance organizations are (1) Blue Cross or Blue Shield organizations existing on August 16, 1986, which have not experienced a material change in structure or operations since that date, and (2) other organizations that meet certain community-service-related requirements and substantially all of whose activities involve the providing of health insurance. Section 833 provides that eligible organizations are generally treated as stock property and casualty insurance companies.

Section 833 provides a special deduction for eligible organizations, equal to 25 percent of the claims and expenses incurred during the year, less the adjusted surplus at the beginning of the year. This deduction is calculated by computing surplus, taxable income, claims incurred, expenses incurred, tax-exempt income, net operating loss carryovers, and other items attributable to health business. The deduction may not exceed taxable income attributable to health business for the year (calculated without regard to this deduction).

In addition, section 833 eliminates, for eligible organizations, the 20-percent reduction in unearned premium reserves that applies generally to all property and casualty insurance companies.

Description of Proposal

The proposal would apply the special rules under section 833 to the same extent they are provided to certain existing Blue Cross or Blue Shield organizations, in the case of any organization that (1) is not a Blue Cross or Blue Shield organization existing on August 16, 1986, and (2) otherwise meets the requirements of section 833 (including the requirement of no material change in operations or structure since August 16, 1986). Under the proposal, an organization qualifies for this treatment only if (1) it is not a health maintenance organization and (2) it is organized under and governed by State laws which are specifically and exclusively applicable to not-for-profit health insurance or health service type organizations.

Effective Date

The proposal would be effective for taxable years ending after October 13, 1995.

IV. ESTATE AND GIFT TAX REFORM

A. Reduction in Estate Tax for Qualified Family-Owned Businesses

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[1] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million (Code sec. 2001(c)).

The amount of gift tax payable for any calendar year generally is determined by applying the tax rates (from the unified rate schedule) to the cumulative lifetime taxable transfers made by the taxpayer, and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period.

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable transfers made by the taxpayer during his lifetime or at death and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

A taxpayer may exclude $10,000 of gifts made to any one donee during a calendar year (sec. 2503).

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800 (sec. 2010), which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased-out by a 5-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000 (sec. 2001(c)(2)).[2]

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[1] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

[2] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her average transfer tax rate will be 55 percent under present law.

The unified credit originally was enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

Special use valuation of farms and other closely-held businesses

Generally, for Federal transfer tax purposes, the value of property is its fair market value. Under section 2032A, an executor may elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value. The maximum reduction in the value of such real property resulting from an election under section 2032A is $750,000.

If, after the special use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death (15 years for decedents dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special use valuation.

Installment payment of estate tax attributable to closely-held businesses

Under section 6166, an executor generally may elect to pay the Federal estate tax attributable to an interest in a closely-held business in installments over, at most, a 14-year period. To qualify for the election, the business must be an active trade or business and the value of the decedent's interest in the closely-held business must exceed 35 percent of the decedent's adjusted gross estate.

If an election is made, the estate pays only interest for the first four years, followed by up to 10 annual installments of principal and interest. Interest is generally imposed at the rate applicable to underpayments of tax under section 6621 (i.e., the Federal short-term rate plus 3 percentage points). Under section 6601(j), however, a special 4-percent interest rate applies to the amount of deferred estate tax attributable to the first $1,000,000 in value of the closely-held business. The maximum amount that may be subject to the four-percent rate is the lower of (1) $345,800 (i.e., the amount of estate tax on the first $1,000,000), less the amount of allowable unified credit, or (2) the amount of estate tax attributable to the closely-held business that is being paid in installments pursuant to section 6166.

Description of Proposal

Overview

The proposal would provide special estate tax treatment for qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate. Subject

to the requirements set forth below, the proposal would exclude the first $1.5 million of value in qualified family-owned business interests from the decedent's estate, and also would exclude from the estate 50 percent of the value of qualified family-owned business interests between $1.5 million and $5 million. Thus, the total amount of exclusion available per decedent for qualified family-owned business interests would be equal to $3.25 million (i.e., $1.5 million plus 50 percent of $3.5 million).

This new exclusion for qualified family-owned business interests would be provided in addition to the present-law unified credit (which effectively exempts $600,000 of taxable transfers from the estate and gift tax) and the special-use provisions of section 2032A (which permit the exclusion of up to $750,000 in value of a qualifying farm or other closely-held business from a decedent's estate).

<u>Qualified family-owned business interests</u>

For purposes of the proposal, a qualified family-owned business interest would be defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if ownership of the trade or business is held at least 50 percent by one family, 70 percent by two families, or 90 percent by three families, as long as the decedent's family owns at least 30 percent of the trade or business. Under the proposal, members of an individual's family would be defined using the same definition as is used for the special-use valuation rules of section 2032A, and thus would include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants. In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special rules would apply.

An interest in a trade or business would not qualify if the business's (or a related entity's) stock or securities were publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also would not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income (as defined in section 543). The value of qualified family-owned business interests would not include any cash or marketable securities in excess of the reasonably expected day-to-day working capital needs of the trade or business. The value of the qualified family-owned business interests also would not include certain other passive assets.

<u>Qualifying estates</u>

A decedent's estate would qualify for the special treatment only if the decedent was a U.S. citizen or resident at the time of death, and the aggregate value of the decedent's qualified family-owned business interests that are passed to qualified heirs exceeds 50 percent of the decedent's adjusted gross estate (the "50-percent liquidity test"). For this purpose, qualified heirs include any individual who has been actively employed by the trade or business for at least 10 years prior to

the date of the decedent's death, and members of the decedent's family. If a qualified heir is not a citizen of the United States, any qualified family-owned business interest acquired by that heir must be held in a trust meeting requirements similar to those imposed on qualified domestic trusts (under present-law section 2056A(a)), or through any other security arrangement that meets the satisfaction of the Secretary. The 50-percent liquidity test generally would be applied by adding all transfers of qualified family-owned business interests made by the decedent to qualified heirs at the time of the decedent's death, plus certain lifetime gifts of qualified family-owned business interests made to members of the decedent's family, and comparing this total to the decedent's adjusted gross estate. To the extent that a decedent held qualified family-owned business interests in more than one trade or business, all such interests would be aggregated for purposes of applying the 50-percent liquidity test.

The 50-percent liquidity test would be calculated using a ratio, the numerator and denominator of which are described below.

The numerator would be equal to the aggregate qualified family-owned business interests that are includible in the decedent's gross estate and are passed from the decedent to a qualified heir, plus any lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family and were not otherwise includible in the decedent's gross estate, and reduced by certain indebtedness of the estate.

The denominator would be equal to the decedent's gross estate, reduced by any indebtedness of the estate, and increased by the amount of the following transfers, to the extent not already included in the decedent's gross estate: (a) any lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family, plus (b) any other transfers from the decedent to the decedent's spouse that were made within 10 years of the date of the decedent's death, plus (c) any other transfers made by the decedent within three years of the decedent's death, except non-taxable transfers made to members of the decedent's family. The Secretary of Treasury would be granted authority to disregard de minimis gifts. In determining the amount of gifts made by the decedent, any gift that the donor and the donor's spouse elected to have treated as a split gift (pursuant to sec. 2513) would be treated as made one-half by each spouse for purposes of this proposal.

Participation requirements

To qualify for the beneficial treatment provided under the proposal, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, each qualified heir (or a member of the qualified heir's family) would be required to materially participate in the trade or business for at least five years of any 8-year period within ten years following the decedent's death. For this purpose, "material participation" would be defined as

under present-law section 2032A (special use valuation) and the regulations promulgated thereunder. Under such regulations, no one factor is determinative of the presence of material participation and the uniqueness of the particular industry (e.g., timber, farming, manufacturing, etc.) must be considered. Physical work and participation in management decisions are the principal factors to be considered. For example, an individual who personally manages the business fully generally would be considered to be materially participating in the business regardless of the number of hours worked, as long as any necessary functions are performed.

If a qualified heir rents qualifying property to a member of the qualified heir's family on a net cash basis, and that family member materially participates in the business, the material participation requirement would be considered to have been met with respect to the qualified heir for purposes of this proposal.

Recapture provisions

The benefit of the exclusions for qualified family-owned business interests would be subject to recapture if, within 10 years of the decedent's death and before the qualified heir's death, one of the following "recapture events" occurs: (1) the qualified heir ceases to meet the material participation requirements (i.e., if neither the qualified heir nor any member of his or her family has materially participated in the trade or business for at least five years of any 8-year period); (2) the qualified heir disposes of any portion of his or her interest in the family-owned business, other than by a disposition to a member of the qualified heir's family or through a conservation contribution under section 170(h); (3) the principal place of business of the trade or business ceases to be located in the United States; or (4) the qualified heir loses U.S. citizenship. A qualified heir who loses U.S. citizenship may avoid such recapture by placing the qualified family-owned business assets into a trust meeting requirements similar to a qualified domestic trust (as described in present law section 2056A(a)), or through any other security arrangement that meets the satisfaction of the Secretary of Treasury.

If one of the above recapture events occurs, an additional tax would be imposed on the date of such event. The portion of the reduction in estate taxes that would be recaptured would be dependent upon the number of years that the qualified heir (or members of the qualified heir's family) materially participated in the trade or business after the decedent's death. If the qualified heir (or his or her family members) materially participated in the trade or business after the decedent's death for less than six years, 100 percent of the reduction in estate taxes attributable to that heir's interest would be recaptured; if the participation was for at least six years but less than seven years, 80 percent of the reduction in estate taxes would be recaptured; if the participation was for at least seven years but less than eight years, 60 percent would be recaptured; if the participation was for at least eight years but less than nine years, 40 percent would be recaptured; and if the participation was for at least nine years but less than ten years, 20 percent of the reduction in estates taxes would be recaptured. In general, there would be no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. As under present-law section 2032A,

however, the 10-year recapture period could be extended for a period of up to two years if the qualified heir did not begin to use the property for a period of up to two years after the decedent's death.

If a recapture event occurs with respect to any qualified family-owned business interest (or portion thereof), the amount of reduction in estate taxes attributable to that interest would be determined on a proportionate basis. For example, if the decedent's estate included $15 million in qualified family-owned business interests and $5 million of such interests received beneficial treatment under this proposal, one-third of the value of the interest disposed of would be deemed to have received the benefits provided under this proposal.

Effective Date

The proposal would be effective with respect to the estates of decedents dying after December 31, 1995.

B. Increase Estate and Gift Tax Unified Credit

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers by gift and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[3] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million.

The amount of gift tax payable for any calendar year generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative lifetime taxable transfers made by the taxpayer and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period.

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable lifetime and deathtime transfers made by the taxpayer and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800, which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased out by a five-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000.[4]

The unified credit was originally enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an

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[3] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

[4] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her effective transfer tax rate will be 55 percent under present law.

effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

Description of Proposal

The proposal would increase the present-law unified credit over a six-year period beginning in 1996, from an effective exemption of $600,000 to an effective exemption of $750,000. The increase would be phased in as follows:

Decedents dying and gifts made in	Effective exemption
1996	$625,000
1997	$650,000
1998	$675,000
1999	$700,000
2000	$725,000
2001 and thereafter	$750,000

Conforming amendments to reflect the increased unified credit would be made (1) to the 5-percent surtax in order to permit the proper phase out of the increased unified credit, (2) to the general filing requirements for an estate tax return under section 6018(a), and (3) to the amount of the unified credit allowed under section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

Effective Date

The proposal would apply to the estates of decedents dying, and gifts made, after December 31, 1995.

C. Reduction in Estate Tax for Certain Land Subject to Permanent Conservation Easement

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[5] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million (Code sec. 2001(c)).

The amount of gift tax payable for any calendar year generally is determined by applying the tax rates (from the unified rate schedule) to the cumulative lifetime taxable transfers made by the taxpayer, and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period.

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable transfers made by the taxpayer during his lifetime or at death and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

A taxpayer may exclude $10,000 of gifts made to any one donee during a calendar year (sec. 2503).

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800 (sec. 2010), which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased-out by a 5-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000 (sec. 2001(c)(2)).[6]

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[5] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

[6] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her average transfer tax rate will be 55 percent under present law.

The unified credit originally was enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

Special use valuation of farms and other closely-held businesses

Generally, for Federal transfer tax purposes, the value of property is its fair market value. Under section 2032A, an executor may elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value. The maximum reduction in the value of such real property resulting from an election under section 2032A is $750,000.

If, after the special use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special use valuation.

Conservation easements

A deduction is allowed for estate and gift tax purposes for a contribution of a qualified real property interest to a charity (or other qualified organization) exclusively for conservation purposes (secs. 2055(f), 2522(d)). For this purpose, a qualified real property interest means the entire interest of the transferor in real property (other than certain mineral interests), a remainder interest in real property, or a perpetual restriction on the use of real property (sec. 170(h)). A "conservation purpose" is (1) preservation of land for outdoor recreation by, or the education of, the general public, (2) preservation of natural habitat, (3) preservation of open space for scenic enjoyment of the general public or pursuant to a governmental conservation policy, and (4) preservation of historically important land or certified historic structures. Also, a contribution will be treated as "exclusively for conservation purposes" only if the conservation purpose is protected in perpetuity.[7]

Description of Proposal

Reduction in estate taxes for certain land subject to permanent conservation easement

The proposal would provide that an executor may elect to exclude from the estate tax 50 percent of the value of any land subject to a qualified conservation easement that meets the following

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[7] A member of the transferor's family would include: (1) his or her ancestors; (2) his or her spouse; (3) a lineal descendant of the decedent, the decedent's spouse or the decedent's parents; and (4) the spouse of any of the foregoing lineal descendants.

requirements: (1) the land must be located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area; (2) the land must have been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of section 170(h)) of a qualified real property interest (as generally defined in section 170(h)(2)(C)) had been granted by the transferor or a member of his or her family. The basis of such land acquired at death would be a carryover basis (i.e., the basis would not be stepped-up to its fair market value at death). For purposes of the proposal, preservation of a historically important land area or a certified historic structure would not qualify as a conservation purpose. Debt-financed property would not be eligible for the exclusion.

The exclusion from estate taxes would not extend to the value of any development rights retained by the decedent or donor, although payment for estate taxes on retained development rights may be deferred for up to two years. For this purpose, retained development rights would be any rights retained to establish or use any structure (and the land immediately surrounding it) for sale, rent or any other commercial purpose, which is not subordinate to and directly supportive of (1) the conservation purpose identified in the easement, or (2) the activity of farming, forestry, ranching, horticulture, viticulture, or recreation, whether or not for profit, conducted on the land subject to the easement.

<u>Maximum benefit allowed</u>

The 50-percent exclusion from estate taxes for land subject to a qualified conservation easement (described above) could only be taken to the extent that the value of such land, plus the value of qualified family-owned business interests that qualify for the reduction in estate taxes (described in Part A., above), does not exceed $5 million. The executor of an estate holding land subject to a qualified conservation easement and/or qualified family-owned business interests would be required to designate which of the two benefits was being claimed with respect to each property on which a benefit is claimed. To the extent that the aggregate value of such property exceeds $5 million, such excess would be taxed at the regular estate tax rates.

<u>Treatment of land subject to a conservation easement for purposes of special-use valuation</u>

The proposal would amend the special-use valuation rules of present-law section 2032A in two respects. First, the granting of a qualified conservation easement (as defined above) would not be treated as a disposition triggering the recapture provisions of section 2032A. In addition, the proposal would provide that the existence of a qualified conservation easement would not prevent such property from subsequently qualifying for special-use valuation treatment under section 2032A.

<u>Effective Date</u>

The proposal would apply to decedents dying after December 31, 1995.

D. Modification of Generation-Skipping Transfer Tax for Transfers to Individuals with Deceased Parents

Present Law

A generation-skipping transfer tax ("GST" tax) generally is imposed on transfers, either directly or through a trust or similar arrangement, to a skip person (i.e., a beneficiary in more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations and taxable distributions. For this purpose, a direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person (sec. 2612(c)(1)). A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person (sec. 2612(a)). A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or a direct skip)(sec. 2612(b)).

Direct skips are subject to less GST tax than taxable terminations and distributions since the GST tax on direct skips is paid by the transferor (sec. 2603(a)(3)) and, therefore, the tax base for a direct skip is tax exclusive (like the Federal gift tax), while the GST tax on taxable terminations and distributions is paid by the trust or beneficiary (secs. 2603(a)(1) & (2)) and, therefore, the tax base on taxable terminations and distributions is tax inclusive (like the Federal estate tax).

Under the "predeceased parent exception", a direct skip transfer to a transferor's grandchild is not subject to the GST tax if the child of the transferor who was the grandchild's parent is deceased at the time of the transfer (sec. 2612(c)(2)). This "predeceased parent exception" to the GST tax is not applicable to (1) transfers to collateral heirs (e.g., grandnieces or grandnephews), or (2) taxable terminations or taxable distributions.

Description of Proposal

The proposal would extend the predeceased parent exception to transfers to collateral heirs, provided that the decedent has no living lineal descendants at the time of the transfer. For example, the exception would apply to a transfer made by an individual (with no living lineal heirs) to a grandniece where the transferor's nephew or niece who is the parent of the grandniece is deceased at the time of the transfer.

In addition, the proposal would extend the predeceased parent exception (as modified by the change in the preceding paragraph) to taxable terminations and taxable distributions, provided that the parent of the relevant beneficiary was dead at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax. For example, where a trust was established to pay an annuity to a charity for a term for years with a remainder interest granted to a grandson, the termination of the term for years would not be a taxable

termination subject to the GST tax if the grandson's parent (who is the son or daughter of the transferor) was deceased at the time the trust was created and the transfer creating the trust was subject to estate or gift tax.

Effective Date

The proposal would be effective for generation skipping transfers occurring after December 31, 1994.

E. Estate Tax Recapture From Cash Leases of Specially-Valued Property

Present Law

A Federal estate tax is imposed on the value of property passing at death. Generally, such property is included in the decedent's estate at its fair market value. Under section 2032A, the executor may elect to value certain "qualified real property" used in farming or other qualifying trade or business at its current use value rather than its highest and best use. If, after the special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special-use valuation (sec. 2032A(c)).

Some courts have held that cash rental of specially-valued property after the death of the decedent is not a qualified use and, therefore, results in the imposition of the additional estate tax under section 2032A(c). See Martin v. Commissioner, 783 F.2d 81 (7th Cir. 1986) (cash lease to unrelated party); Williamson v. Commissioner, 93 T.C. 242 (1989), aff'd, 974 F.2d 1525 (9th Cir. 1992) (cash lease to family member); Fisher v. Commissioner, 65 T.C.M. 2284 (1993) (cash lease to family member).

With respect to a decedent's surviving spouse, a special rule provides that the surviving spouse will not be treated as failing to use the property in a qualified use solely because the spouse rents the property to a member of the spouse's family on a net cash basis. (sec. 2032A(b)(5)). Under section 2032A, members of an individual's family include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants.

Description of Proposal

The proposal would provide that the cash lease of specially-valued real property by a lineal descendant of the decedent to a member of the lineal descendant's family, who continues to operate the farm or closely held business, would not cause the qualified use of such property to cease for purposes of imposing the additional estate tax under section 2032A(c). No inference would be intended as to whether the cash lease of specially-valued real property is a qualified use of such property under present law.

Effective Date

The proposal would be effective for cash rentals with respect to decedents dying after December 31, 1994.

V. EXPIRING TAX PROVISIONS

A. Provisions Extended Through February 28, 1997

1. Work opportunity tax credit

<u>Present and Prior Law</u>

<u>General rules</u>

Prior to January 1, 1995, the targeted jobs tax credit was available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The credit generally was equal to 40 percent of qualified first-year wages. Qualified first-year wages consisted of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. For a vocational rehabilitation referral, however, the period began the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

No more than $6,000 of wages during the first year of employment were permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual was $2,400.

With respect to economically disadvantaged summer youth employees, the credit was equal to 40 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,200.

The deduction for wages was reduced by the amount of the credit.

<u>Certification of members of targeted groups</u>

In general, an individual was not treated as a member of a targeted group unless certification that the individual was a member of such a group was received or requested in writing by the employer from the designated local agency on or before the day on which the individual began work for the employer. In the case of a certification of an economically disadvantaged youth participating in a cooperative education program, this requirement was satisfied if the certification was requested or received from the participating school on or before the day on which the individual began work for the employer. The "designated local agency" was the State employment security agency.

If a certification was incorrect because it was based on false information provided as to the employee's membership in a targeted group, the certification was revoked. Wages paid after the revocation notice was received by the employer were not treated as qualified wages.

The U.S. Employment Service, in consultation with the Internal Revenue Service, was directed to take whatever steps necessary to keep employers informed of the availability of the credit.

Targeted groups eligible for the credit

The nine groups eligible for the credit were either recipients of payments under means-tested transfer programs, economically disadvantaged (as measured by family income), or disabled individuals.

(1) Vocational rehabilitation referrals

Vocational rehabilitation referrals were those individuals who had a physical or mental disability that constituted a substantial handicap to employment and who had been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification was provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee had met the above conditions.

(2) Economically disadvantaged youths

Economically disadvantaged youths were individuals certified by the designated local employment agency as (1) members of economically disadvantaged families and (2) at least age 18 but not age 23 on the date they were hired by the employer. An individual was determined to be a member of an economically disadvantaged family if, during the six months immediately preceding the earlier of the month in which the determination occurred or the month in which the hiring date occurred, the individual's family income was, on an annual basis, not more than 70 percent of the Bureau of Labor Statistics' lower living standard. A determination that an individual was a member of an economically disadvantaged family was valid for 45 days from the date on which the determination was made.

Except as otherwise noted below, a determination of whether an individual was a member of an economically disadvantaged family was made on the same basis and was subject to the same 45-day limitation, where required in connection with the four other targeted groups that excluded individuals who were not economically disadvantaged.

(3) Economically disadvantaged Vietnam-era veterans

The third targeted group was Vietnam-era veterans certified by the designated local employment agency as members of economically disadvantaged families. For these purposes, a Vietnam-era veteran was an individual who had served on active duty (other than for training) in

the Armed Forces for more than 180 days, or who had been discharged or released from active duty in the Armed Forces for a service-connected disability, but in either case, the active duty must have taken place after August 4, 1964, and before May 8, 1975. However, any individual who had served for a period of more than 90 days during which the individual was on active duty (other than for training) was not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule was intended to prevent employers who hired current members of the armed services (or those departed from service within the last 60-days) from receiving the credit.

(4) SSI recipients

The fourth targeted group was individuals receiving either Supplemental Security Income ("SSI") under Title XVI of the Social Security Act or State supplements described in section 1616 of that Act or section 212 of P.L. 93-66. To be an eligible employee, the individual must have received SSI payments during at least a one-month period ending during the 60-day period that ended on the date the individual was hired by the employer. The designated local agency was to issue the certification after a determination by the agency making the payments that these conditions had been fulfilled.

(5) General assistance recipients

General assistance recipients were individuals who received general assistance for a period of not less than 30 days if that period ended within the 60-day period ending on the date the individual was hired by the employer. General assistance programs were State and local programs that provided individuals with money payments, vouchers, or scrip based on need. These programs were referred to by a wide variety of names, including home relief, poor relief, temporary relief, and direct relief. Because of the wide variety of such programs, Congress provided that a recipient was an eligible employee only after the program had been designated by the Secretary of the Treasury as a program that provided money payments, vouchers, or scrip to needy individuals. Certification was performed by the designated local agency.

(6) Economically disadvantaged former convicts

The sixth targeted group included any individual who was certified by the designated local employment agency as (1) having at some time been convicted of a felony under State or Federal law, (2) being a member of an economically disadvantaged family, and (3) having been hired within five years of the later of release from prison or date of conviction.

(7) Economically disadvantaged cooperative education students

The seventh targeted group was youths who (1) actively participated in qualified cooperative education programs, (2) had attained age 16 but had not attained age 20, (3) had not graduated from high school or vocational school, and (4) were members of economically

disadvantaged families. The definitions of a qualified cooperative education program and a qualified school were similar to those used in the Vocational Education Act of 1963. Thus, a qualified cooperative education program meant a program of vocational education for individuals who, through written cooperative arrangements between a qualified school and one or more employers, received instruction, including required academic instruction, by alternation of study in school with a job in any occupational field, but only if these two experiences were planned and supervised by the school and the employer so that each experience contributed to the student's education and employability.

For this purpose, a qualified school was (1) a specialized high school used exclusively or principally for the provision of vocational education to individuals who were available for study in preparation for entering the labor market, (2) the department of a high school used exclusively or principally for providing vocational education to individuals who were available for study in preparation for entering the labor market, or (3) a technical or vocational school used exclusively or principally for the provision of vocational education to individuals who had completed or left high school and who were available for study in preparation for entering the labor market. In order for a nonpublic school to be a qualified school, it must have been exempt from income tax under section 501(a) of the Code.

The certification was performed by the school participating in the cooperative education program. After initial certification, an individual remained a member of the targeted group only while meeting the program participation, age, and degree status requirements of (a), (b), and (c), above.

(8) AFDC recipients

The eighth targeted group included any individual who was certified by the designated local employment agency as being eligible for Aid to Families with Dependent Children ("AFDC") and as having continually received such aid during the 90 days before being hired by the employer.

(9) Economically disadvantaged summer youth employees

The ninth targeted group included youths who performed services during any 90-day period between May 1 and September 15 of a given year and who were certified by the designated local agency as (1) being 16 or 17 years of age on the hiring date and (2) a member of an economically disadvantaged family. A youth must not have been an employee of the employer prior to that 90-day period. With respect to any particular employer, an employee could qualify only one time for this summer youth credit. If, after the end of the 90-day period, the employer continued to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages took into account wages paid to the youth while a qualified summer youth employee.

Definition of wages

In general, wages eligible for the credit were defined by reference to the definition of wages under the Federal Unemployment Tax Act (FUTA). Because wages paid to economically disadvantaged cooperative education students and to certain agricultural and railroad employees were not FUTA wages, special rules were provided for these wages.

Wages were taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee were for services in the employer's business. The test as to whether more than one-half of an employee's wages were for services in a business was applied to each separate employer in a controlled group.

Other rules

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit could not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit was allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year was less than the targeted jobs tax credit, the excess credit could be carried back three years and carried forward 15 years.

All employees of all corporations in a controlled group of corporations were treated as if they were employed by one corporation for purposes of determining the years of employment and the $6,000 wage limit. Generally, under the controlled group rules, the credit allowed the group was the same as if the group were a single company. A comparable rule was provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that were under common control.

No credit was available for the hiring of related individuals (primarily dependents or owners of the taxpayer).

No credit was allowed for wages paid unless the eligible individual was either (1) employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees) or (2) had completed at least 120 hours (20 hours for summer youth) of services performed for the employer.

Description of Proposal

General rules

The proposal would replace the targeted jobs tax credit with the "work opportunity tax credit." The work opportunity tax credit would be available on an elective basis for employers hiring individuals from one or more of six targeted groups. The credit generally would be

available equal to 35 percent of qualified wages. Qualified wages would consist of wages earned by a member of a targeted group during the one-year period beginning with the day the individual begins work. For a vocational rehabilitation referral the period would begin on the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

No more than $6,000 of wages during the first year of employment would be allowed for the credit. Thus, the maximum credit per worker would be $2,100.

With respect to qualified summer youth employees, the maximum credit would be $1050.

Employers would have to reduce the deduction for wages paid by the amount of the credit.

Certification of members of targeted groups

An individual would not be treated as a member of a targeted group unless: (1) on or before the day the individual begins work, the employer received a written certification from the designated local agency that the individual is a member of a specific targeted group, or (2) on or before the day the individual is offered work, a pre-screening notice is completed by the employer. The notice must be filed with the State agency within 14 days after the individual begins work. The pre-screening notice would contain the information necessary to determine whether the individual is a member of a targeted group.

If a certification is based on false information, the certification would be revoked. No credit would be allowed on wages paid after receipt by the employer of the revocation notice.

A designated local agency that rejects a certification request would have to provide a written explanation of that rejection.

Targeted groups eligible for the credit

(1) Families receiving cash welfare benefits

An eligible recipient would be an individual certified as receiving cash welfare benefits under a Federally funded program (AFDC or successor programs) for a period of at least nine months part of which is during the 9-month period ending on the hiring date. For these purposes, each member of the family receiving such assistance would be treated as receiving such assistance.

(2) Qualified ex-felon

A qualified ex-felon would be an individual certified as: (1) having been convicted of a felony under any State or Federal law; (2) being a member of a family which had an income during the six months before the earlier of the date of determination or the hiring date which on an annual basis is 70 percent or less of the Bureau of Labor Statistics lower living standard; and (3) having a hiring date within one year of release from prison or date of conviction.

(3) High-risk-youth

A high-risk youth would be an individual certified as being at least 18 but not 25 on the hiring date and as having a principal place of abode within an empowerment zone or enterprise community. Qualified wages would not include wages paid or incurred for services performed after the individual moves outside an empowerment zone or enterprise community.

(4) Vocational rehabilitation referral

Vocational rehabilitation referrals would be those individuals who have physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a Federally approved State plan. Certification would be provided by the designated State employment agency after assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(5) Qualified summer youth employee

Qualified summer youth employees would be individuals: (1) who perform services during any 90-day period between May 1 and September 15; (2) who are certified by the designated State agency as being 16 or 17 years of age on the hiring date; (3) who have not been an employee of that employer before; and (4) who are certified by the designated local agency as having a principal place of abode within an empowerment zone or enterprise community. No credit would be available on wages earned for service performed after the qualified summer youth moves outside of an empowerment zone or enterprise community. If, after the end of the 90-day period, the employer continued to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages would take into account wages paid to the youth while a qualified summer youth employee.

(6) Qualified Veterans

A qualified veteran would be a veteran who has been certified as receiving assistance under: (1) a Federally funded program of cash welfare benefits (AFDC or successor program) for a period of at least nine months part of which is during the 12-month period ending on the

hiring date, or (2) the Food Stamp Program under the Food Stamp Act of 1977, for a period of at least three months part of which is during the 12-month period ending on the hiring date.

Further, a qualified veteran would be an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days, or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

Definition of wages and other rules

In general, wages eligible for the credit would be defined by reference to the definition of wages under the Federal Unemployment Tax Act ("FUTA"). Also, the other prior-law rules are generally still applicable.

Minimum employment period

No credit would be allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee).

Business awareness program

The Secretary of Labor would establish a program to encourage small businesses to work with the designated local agencies to identify eligible individuals for inclusion in the credit program. The Secretary and heads of other Federal agencies also would be directed to simplify credit procedures to encourage participation.

Effective Date

The credit would be effective for wages paid or incurred to qualified individuals who begin work on or after January 1, 1996, and before March 1, 1997.

2. Employer-provided educational assistance

Present and Prior Law

For taxable years beginning after December 31, 1994, an employee must include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to an employee, unless the cost of such assistance qualifies as a deductible job-

related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment in the employee's current job (Treas. Reg. sec. 1.162-5(a)). Such expenses (if not reimbursed by the employer) are deductible only to the extent that, when aggregated with other miscellaneous itemized deductions, they exceed 2 percent of the taxpayer's adjusted gross income. No deduction (or exclusion) is allowed for expenses incurred to qualify for a new trade or business.

For taxable years beginning before January 1, 1995, an employee's gross income and wages did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. This exclusion, which expired for taxable years beginning after December 31, 1994, was limited to $5,250 of educational assistance with respect to an individual during a calendar year. The exclusion applied whether or not the education was job related.

Description of Proposal

The proposal would extend the exclusion for educational assistance for taxable years beginning after December 31, 1994, and before January 1, 1998. In the case of a taxable year beginning in 1997, the maximum amount that could be excluded would be one-sixth of $5,250 or $875, and only amounts paid by the employer before March 1, 1997, would be taken into account.

Effective Date

The proposal would be effective with respect to taxable years beginning after December 31, 1994, and before January 1, 1998.

3. Research and experimentation tax credit

Present and Prior Law

General rule

Prior to July 1, 1995, section 41 of the Internal Revenue Code provided for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceeded its base amount for that year. The research tax credit expired and does not apply to amounts paid or incurred after June 30, 1995.

A 20-percent research tax credit also applied to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over
(2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

Computation of allowable credit

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of 3 percent.[1]

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, research expenditures and gross receipts of the taxpayer are aggregated with research expenditures and gross receipts of certain related persons for purposes of computing any allowable credit (sec. 41(f)(1)). Special rules apply for computing the credit when a major portion of a business changes hands, under which qualified research expenditures and gross receipts for periods prior to the change or ownership of a trade or

[1] The Omnibus Budget Reconciliation Act of 1993 included a special rule designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm (i.e., any taxpayer that did not have gross receipts in at least three years during the 1984-1988 period) will be assigned a fixed-base percentage of 3 percent for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled June 30, 1995 expiration date, a start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec. 41(c)(3)(B)).

business are treated as transferred with the trade or business that gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage (sec. 41(f)(3)).

Eligible expenditures

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 (described below) but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must pertain to functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors (sec. 41(d)(3)). In addition, research does not qualify for the credit if conducted after the beginning of commercial production of the business component, if related to the adaptation of an existing business component to a particular customer's requirements, if related to the duplication of an existing business component from a physical examination of the component itself or certain other information, or if related to certain efficiency surveys, market research or development, or routine quality control (sec. 41(d)(4)).

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized. However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year. Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

Description of Proposal

The research tax credit (including the university basic research credit) would be extended for the period July 1, 1995, through February 28, 1997.

In addition, the proposal would expand the definition of "start-up firms" under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983.

Effective Date

The proposal would be effective for expenditures paid or incurred during the period July 1, 1995, through February 28, 1997.

4. Exclusion for employer-provided group legal services; tax exemption for qualified group legal services organizations

Prior Law

Under prior law, employees were not subject to income or employment tax on amounts contributed by an employer to a qualified group legal services plan. The exclusion did not apply to the extent that the value of insurance against legal costs incurred by the individual (or spouse or dependents) provided under the plan exceeded $70. The exclusion for group legal services benefits expired after June 30, 1992.

In addition, prior law provided tax-exempt status for an organization the exclusive function of which was to provide legal services or indemnification against the cost of legal services provided through a qualified group legal services plan. The tax exemption for such an organization expired for taxable years beginning after June 30, 1992.

Description of Proposal

The proposal would extend the exclusion from income for contributions to employer-provided group legal services plans and the exemption from tax for certain group legal services organizations from January 1, 1996, through February 28, 1997. The exclusion would be available with respect to contributions to employer-provided group legal services plans through February 28, 1997, but the limit on the value of insurance provided under the plan for taxable years beginning in 1997 would be one-sixth of $70 or $12.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1995, and before February 28, 1997.

5. Orphan drug tax credit

Present and Prior Law

Prior to January 1, 1995, a 50-percent nonrefundable tax credit was allowed for qualified clinical testing expenses incurred in testing of certain drugs for rare diseases or conditions, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. A rare disease or condition is defined as one that (1) affects less than 200,000 persons in the United States or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for it from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

Under prior law, the orphan drug tax credit could be claimed by a taxpayer only to the extent that its regular tax liability for the year the credit was earned exceeded its tentative minimum tax for that year, after regular tax was reduced by nonrefundable personal credits and the foreign tax credit.[2] Unused credits could not be carried back or carried forward to reduce taxes in other years.

The orphan drug tax credit expired after December 31, 1994.

Description of Proposal

The orphan drug tax credit would be extended for the period January 1, 1995, through February 28, 1997.

In addition, taxpayers would be allowed to carry back unused credits to three years preceding the year the credit was earned and to carry forward unused credits to 15 years following the year the credit was earned.

Effective Date

The proposal would be effective for qualified clinical testing expenses incurred during the period January 1, 1995, through February 28, 1997. Credits could not be carried back to a taxable year beginning before January 1, 1995.

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[2] To the extent that the orphan drug tax credit could not be used by reason of the minimum tax limitation, the taxpayer's minimum tax credit was increased (sec. 53(d)(1)(B)(iii)).

6. Contributions of appreciated stock to private foundations

Present and Prior Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization.[3] However, in the case of a charitable contribution of short-term gain, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.[4]

In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property. However, under a special rule contained in section 170(e)(5), taxpayers were allowed a deduction equal to the fair market value of "qualified appreciated stock" contributed to a private foundation prior to January 1, 1995. Qualified appreciated stock was defined as publicly traded stock which is capital gain property. The fair-market-value deduction for qualified appreciated stock donations applied only to the extent that total donations made by the donor to private foundations of stock in a particular corporation did not exceed 10 percent of the outstanding stock of that corporation. For this purpose, an individual was treated as making all contributions that were made by any member of the individual's family. This special rule contained in section 170(e)(5) expired after December 31, 1994.

Description of Proposal

The special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations would be extended for contributions made during the period January 1, 1995, through February 28, 1997.

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[3] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

[4] As part of the Omnibus Budget Reconciliation Act of 1993, Congress eliminated the treatment of contributions of appreciated property (real, personal, and intangible) as a tax preference for alternative minimum tax (AMT) purposes. Thus, if a taxpayer makes a gift to charity of property (other than short-term gain, inventory, or other ordinary income property, or gifts to private foundations) that is real property, intangible property, or tangible personal property the use of which is related to the donee's tax-exempt purpose, the taxpayer is allowed to claim the same fair-market-value deduction for both regular tax and AMT purposes (subject to present-law percentage limitations).

Effective Date

The proposal would be effective for contributions of qualified appreciated stock to private foundations made during the period January 1, 1995, through February 28, 1997.

7. Transportation fuels tax exemption for fuel used in commercial aviation

Present law

A 4.3-cents-per-gallon deficit reduction excise tax is imposed on fuel used in most transportation modes. Fuels subject to the tax include gasoline (including gasoline blended with alcohol, "gasohol"), diesel fuel, special motor fuels, propane, compressed natural gas, aviation fuels (jet fuel and gasoline), and any other motor fuel used in shipping in the inland waterway system. Fuel consumed before October 1, 1995, in commercial aviation, defined as the air transportation of persons or property for hire, was exempt from this tax. Revenues from this transportation fuels tax are deposited in the General Fund of the Treasury.

Description of Proposal

The present exemption for commercial aviation fuels would be extended for through February 28, 1997. Thereafter, the full 4.3-cents-per-gallon tax would be imposed.

Effective Date

The proposal generally would be effective after September 30, 1995.

Under present law, this excise tax is imposed on transactions occurring after September 30, 1995, and the floor stocks tax imposed by the Omnibus Budget Reconciliation Act of 1993 was imposed on October 1, 1995. Therefore, the proposal would provide refunds to commercial aviation users for any such taxes paid before its enactment upon adequate documentation that tax-paid fuel was purchased. A further expression of the Committee's desire that the Internal Revenue Service consider waiving the semimonthly deposit requirements for this tax during the period beginning on October 1, 1995, and ending on the date on which 1995 budget reconciliation process is completed would be included in the legislative history accompanying the proposal.

Appropriate floor stocks taxes would be imposed on March 1, 1997.

8. Suspend imposition of diesel fuel tax on motorboats

Present Law

An excise tax totaling 24.4 cents per gallon is imposed on diesel fuel. The Omnibus Budget Reconciliation Act of 1993 extended this tax to diesel fuel used in recreational motorboats,

effective through December 31, 1999. The tax on diesel fuel used in motorboats was enacted as a revenue offset for repeal of the luxury excise tax on certain boats.

The diesel fuel tax is imposed on removal of the fuel from a registered terminal facility (i.e., at the "terminal rack"). Present law provides that tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use and is indelibly dyed pursuant to Treasury Department regulations. If fuel on which tax is paid at the terminal rack (i.e., undyed diesel fuel) ultimately is used in a nontaxable use, a refund is allowed. Depending on the aggregate amount of tax to be refunded, this refund may be claimed either by a direct filing with the Internal Revenue Service or as a credit against income tax.

Dyed diesel fuel (fuel on which no tax is paid) may not be used in a taxable use. Present law imposes a penalty equal to the greater of $10 per gallon of $1,000 on persons found to be violating this prohibition.

Description of Proposal

No tax would be imposed on diesel fuel used in recreational motorboats during the period January 1, 1996, through February 28, 1997.

This exemption would temporarily address current supply problems. In an attempt to find a permanent solution that protects tax collection and avoids supply disruptions, the legislative history accompanying in the proposal would request the Treasury Department to study possible alternatives to the current collection regime for motorboat diesel fuel that would provide comparable compliance with the law, and to report to the Committee on Ways and Means and the Committee on Finance no later than June 30, 1996.

Effective Date

The proposal would be effective after December 31, 1995.

B. Extend Expired Ethanol Blender Refund Provision

Present Law

A 54-cents-per-gallon blender income tax credit is provided for ethanol used as a motor fuel. This credit applies to ethanol which is blended with gasoline ("gasohol").

Gasoline is subject to an 18.4-cents-per-gallon excise tax. As an alternative to claiming the income tax credit gasohol blenders may claim the benefit of the ethanol income tax credit against their gasoline excise tax liability. The benefit may be claimed against excise tax liability in either of two ways: (1) by purchasing gasoline destined for blending with ethanol at a reduced excise tax rate, or (2) before October 1, 1995, by claiming expedited refunds of excise tax paid on gasoline purchased at the full 18.4-cents-per-gallon rate after that gasoline is blended with ethanol. In general, the gasoline (including gasohol) excise tax provisions associated with the Highway Trust Fund expire after September 30, 1999.

Description of Proposal

The proposal would conform the expiration date for the excise tax expedited refund provision for gasohol blenders that expired after September 30, 1995, to that for gasoline tax provisions generally. Thus, these refunds would be permitted through September 30, 1999.

For refund claims that could have been filed during the period beginning on October 8, 1995 and ending on the date of enactment, but for expiration of the refund provision after September 30, 1995, interest would accrue from the date which is the later of (1) November 1, 1995, or (2) 20 days after the claim could have been filed under the law as in effect on September 30, 1995.

Effective Date

The proposal would be effective on enactment.

C. Exempt Alaska from Diesel Dyeing Requirement While Alaska is Exempt From Similar Clean Air Act Dyeing

Present Law

An excise tax totaling 24.4 cents per gallon is imposed on diesel fuel. In the case of fuel used in highway transportation, 20 cents per gallon is dedicated to the Highway Trust Fund. Revenues equal to 0.1 cent per gallon of the diesel fuel tax are dedicated to the Leaking Underground Storage Trust Fund. The remaining portion of this tax is imposed on transportation generally and is retained in the General Fund.

The diesel fuel tax is imposed on removal of the fuel from a pipeline or barge terminal facility (i.e., at the "terminal rack"). Present law provides that tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use and is indelibly dyed pursuant to Treasury Department regulations.

In general, the diesel fuel tax does not apply to non-transportation uses of the fuel. Off-highway business uses are included within this non-transportation use exemption. This exemption includes use on a farm for farming purposes and as fuel powering off-highway equipment (e.g., oil drilling equipment). Use as heating oil also is exempt. (Most fuel commonly referred to as heating oil is diesel fuel.) The tax also does not apply to fuel used by State and local governments, to exported fuels, and to fuel used in commercial shipping. Fuel used by intercity buses and trains is partially exempt from the diesel fuel tax.

A similar dyeing regime exists for diesel fuel under the Clean Air Act. That Act prohibits the use on highways of diesel fuel with a sulphur content exceeding prescribed levels. This "high sulphur" diesel fuel is required to be dyed by the EPA. The State of Alaska generally was exempted from the Clean Air Act, but not the excise tax, dyeing regime for three years.

Description of Proposal

Diesel fuel sold in the State of Alaska would be exempt from the diesel dyeing requirement during the period when that State is exempt from the Clean Air Act dyeing requirements. Thus, dyed diesel fuel could be used in taxable uses without penalties being imposed (subject to a certification procedure to be established by the Treasury Department).

Effective Date

The proposal would be effective as if included in the Omnibus Budget Reconciliation Act of 1993.

D. Tax Credit for Producing Fuel From a Nonconventional Source

Present Law

Certain fuels produced from "nonconventional sources" and sold to unrelated parties are eligible for an income tax credit equal to $3 (generally adjusted for inflation) per barrel or BTU oil barrel equivalent (sec. 29) (referred to as the "section 29 credit"). Qualified fuels must be produced within the United States. Qualified fuels include:

(1) oil produced from shale and tar sands;
(2) gas produced from geopressured brine, Devonian shale, coal seams, tight formations ("tight sands"), or biomass; and
(3) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

In general, the credit is available only with respect to fuels produced from wells drilled or facilities placed in service after December 31, 1979, and before January 1, 1993. An exception extends the January 1, 1993, expiration date for facilities producing gas from biomass and synthetic fuel from coal if the facility producing the fuel is place in service before January 1, 1997, pursuant to a binding written contract in effect before January 1, 1996.

The credit may be claimed for qualified fuels produced and sold before January 1, 2003 (in the case of nonconventional sources subject to the January 1, 1993 expiration date) or January 1, 2008 (in the case of biomass gas and synthetic fuel facilities eligible for the extension period).

Description of Proposal

The placed-in-service (and binding contract) dates for facilities producing synthetic fuels from coal and gas from biomass would be extended for one year. The present sunset on production qualifying for the credit would not be changed. Under the proposal, fuel produced from a facility placed in service before January 1, 1998, pursuant to a binding contract entered into before January 1, 1997, would be eligible for the tax credit if produced before January 1, 2008.

Effective Date

The proposal would be effective upon enactment.

E. Superfund and Oil Spill Liability Taxes

1. Extend Superfund excise taxes and corporate environmental income tax

Present Law

Four different Superfund taxes are imposed under present law. These are:

(1) An excise tax on petroleum, imposed at a rate of 9.7 cents per barrel, on domestic or imported crude oil or refined products;

(2) An excise tax on listed hazardous chemicals, imposed at a rate that varies from $0.22 to $4.87 per ton;

(3) An excise tax on imported substances that use as materials in their manufacture or production one or more of the hazardous chemicals subject to the excise tax described in (2), above;

(4) A corporate environmental income tax equal to 0.12 percent of the amount of modified alternative minimum taxable income of a corporation that exceeds $2 million.

Modified alternative minimum taxable income is defined as a corporation's alternative minimum taxable income, but determined without regard to the alternative tax net operating loss deduction and the deduction for the corporate environmental income tax (sec. 59A).

Amounts equivalent to the revenues from these taxes are dedicated to the Hazardous Substance Superfund Trust Fund ("Superfund Trust Fund"), established in the Trust Fund Code of the Internal Revenue Code. Amounts in the Superfund Trust Fund generally are available for expenditures incurred in connection with releases or threats of releases of hazardous substances into the environment under specified provisions of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (as amended).

The Superfund taxes are scheduled to expire after December 31, 1995. However, the taxes would have terminated earlier if either (1) the obligated balance in the Superfund Trust Fund exceeded $3.5 billion on December 31, 1994, and the Treasury Department estimated that the unobligated balance would exceed $3.5 billion at the end of 1995 (assuming no Superfund taxes had been imposed during 1995), or (2) the Treasury Department had estimated that more than $11.97 billion of revenues from these taxes would have been credited into the Superfund Trust Fund before January 1, 1996.

Description of Proposal

The present-law Superfund excise taxes on petroleum, chemicals, and imported substances would be extended through September 30, 2002. The corporate environmental income tax would be extended through December 31, 1997.

The provisions terminating the Superfund taxes if either the unobligated balance in the Superfund exceeds $3.5 billion before a specified date or if aggregate tax collections exceed $11.97 billion would be repealed.

Effective Date

The proposal would be effective on enactment.

2. Extend Oil Spill Liability Trust Fund excise tax

Present Law

A 5-cents-per-barrel excise tax was imposed on crude oil received at United States refineries and refined petroleum products imported into the United States before January 1, 1995. Revenues from this tax were dedicated to the Oil Spill Liability Trust Fund ("Oil Spill Trust Fund"). In addition to the January 1, 1995, expiration date, imposition of this tax was suspended during any calendar quarter (before 1995) when the unobligated balance of the Oil Spill Trust Fund, as of the close of the preceding quarter, exceeded $1 billion.

Description of Proposal

The 5-cents-per-barrel excise tax would be reimposed during the period January 1, 1996, through September 30, 2002. The $1 billion unobligated balance limit on the Oil Spill Trust Fund would be retained.

Effective Date

The proposal would be effective after December 31, 1995.

F. Expatriation Tax Provisions

Present Law

a. Taxation of United States citizens, residents, and nonresidents

Individual income taxation

Income taxation of U.S. citizens and residents

In general.--A United States citizen generally is subject to the U.S. individual income tax on his or her worldwide taxable income. All income earned by a U.S. citizen, from sources inside and outside the United States, is taxable, whether or not the individual lives within the United States. A non-U.S. citizen who resides in the United States generally is taxed in the same manner as a U.S. citizen if the individual meets the definition of a "resident alien," described below.

The taxable income of a U.S. citizen or resident is equal to the taxpayer's total income less certain exclusions, exemptions, and deductions. The appropriate tax rates are then applied to a taxpayer's taxable income to determine his or her individual income tax liability. A taxpayer may reduce his or her income tax liability by any applicable tax credits. When an individual disposes of property, any gain or loss on the disposition is determined by reference to the taxpayer's cost basis in the property, regardless of whether the property was acquired during the period in which the taxpayer was a citizen or resident of the United States.

If a U.S. citizen or resident earns income from sources outside the United States, and that income is subject to foreign income taxes, the individual generally is permitted a foreign tax credit against his or her U.S. income tax liability to the extent of foreign income taxes paid on that income.[5] In addition, a United States citizen who lives and works in a foreign country generally is permitted to exclude up to $70,000 of annual compensation from being subject to U.S. income taxes, and is permitted an exclusion or deduction for certain housing expenses.[6]

Resident aliens.--In general, a non-U.S. citizen is considered a resident of the United States if the individual (1) has entered the United States as a lawful permanent U.S. resident (the "green card test"); or (2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for a substantial period of time--183 or

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[5] See sections 901-907.

[6] Section 911.

more days during a 3-year period weighted toward the present year (the "substantial presence test").[7]

If an individual is present in the United States for fewer than 183 days during the calendar year, and if the individual establishes that he or she has a closer connection with a foreign country than with the United States and has a tax home in that country for the year, the individual generally is not subject to U.S. tax as a resident on account of the substantial presence test. If an individual is present for as many as 183 days during a calendar year, this closer connections/tax home exception is not available. An alien who has an application pending to change his or her status to permanent resident or who has taken other steps to apply for status as a lawful permanent U.S. resident is not eligible for the closer connections/tax home exception.

For purposes of applying the substantial presence test, any days that an individual is present as an "exempt individual" are not counted. Exempt individuals include certain foreign government-related individuals, teachers, trainees, students, and professional athletes temporarily in the United States to compete in charitable sports events. In addition, the substantial presence test does not count days of presence of an individual who is physically unable to leave the United States because of a medical condition that arose while he or she was present in the United States, if the individual can establish to the satisfaction of the Secretary of the Treasury that he or she qualifies for this special medical exception.

In some circumstances, an individual who meets the definition of a U.S. resident (as described above) could also be defined as a resident of another country under the internal laws of that country. In order to avoid the double taxation of such individuals, most income tax treaties include a set of "tie-breaker" rules to determine the individual's country of residence for income tax purposes. In general, a dual resident is deemed to be a resident of the country in which such person has a permanent home. If the individual has a permanent home available in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer (i.e., the "center of vital interests.") If the country in which such individual has his or her center of vital interests cannot be determined, or if such individual does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a citizen. If each country considers the person to be its citizen or if he or she is a citizen of neither country, the competent authorities of the countries are to settle the question of residence by mutual agreement.

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[7] The definitions of resident and nonresident aliens are set forth in section 7701(b). The substantial presence test will compare 183 days to the sum of (1) the days present during the current calendar year, (2) one-third of the days present during the preceding calendar year, and (3) one-sixth of the days present during the second preceding calendar year. Presence for 122 days (or more) per year over the 3-year period would constitute substantial presence under the test.

Income taxation of nonresident aliens

Non-U.S. citizens who do not meet the definition of "resident aliens" are considered to be nonresident aliens for tax purposes. Nonresident aliens are subject to U.S. tax only to the extent their income is from U.S. sources or is effectively connected with the conduct of a trade or business within the United States. Bilateral income tax treaties may modify the U.S. taxation of a nonresident alien.

A nonresident alien is taxed at regular graduated rates on net profits derived from a U.S. business.[8] Nonresident aliens also are taxed at a flat rate of 30 percent on certain types of passive income derived from U.S. sources, although a lower rate may be provided by treaty (e.g., dividends are frequently taxed at a reduced rate of 15 percent). Such passive income includes interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits and income. There is no U.S. tax imposed, however, on interest earned by nonresident aliens with respect to deposits with U.S. banks and certain types of portfolio debt investments.[9] Gains on the sale of stocks or securities issued by U.S. persons generally are not taxable to a nonresident alien because they are considered to be foreign source income.[10]

Nonresident aliens are subject to U.S. income taxation on any gain recognized on the disposition of an interest in U.S. real property.[11] Such gains generally are subject to tax at the same rates that apply to similar income received by U.S. persons. If a U.S. real property interest is acquired from a foreign person, the purchaser generally is required to withhold 10 percent of the amount realized (gross sales price). Alternatively, either party may request that the Internal

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[8] Section 871.

[9] See sections 871(h) and 871(i)(3).

[10] Section 865(a).

[11] Sections 897, 1445, 6039C, and 6652(f), known as the Foreign Investment in Real Property Tax Act ("FIRPTA"). Under the FIRPTA provisions, tax is imposed on gains from the disposition of an interest (other than an interest solely as a creditor) in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the U.S. Virgin Islands. Also included in the definition of a U.S. real property interest is any interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation ("USRPHC") at any time during the five-year period ending on the date of the disposition of the interest (sec. 897(c)(1)(A)(ii)). A USRPHC is any corporation, the fair market value of whose U.S. real property interests equals or exceeds 50 percent of the sum of the fair market values of (1) its U.S. real property interests, (2) its interests in foreign real property, plus (3) any other of its assets which are used or held for use in a trade or business (sec. 897(c)(2)).

Revenue Service ("IRS") determine the transferor's maximum tax liability and issue a certificate prescribing a reduced amount of withholding (not to exceed the transferor's maximum tax liability).[12]

Estate and gift taxation

The United States imposes a gift tax on any transfer of property by gift made by a U.S. citizen or resident,[13] whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. No gift tax is imposed, however, on gifts made by nonresident aliens of intangible property having a situs within the United States (e.g., stocks and bonds).[14]

The United States also imposes an estate tax on the worldwide "gross estate" of any person who was a citizen or resident of the United States at the time of death, and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death.[15]

Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a U.S. citizen or resident during his or her lifetime and at death. Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million.[16] A unified credit of $192,800 is available with respect to taxable transfers by gift and at death. The unified credit effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax.

Residency for purposes of estate and gift taxation is determined under different rules than those applicable for income tax purposes. In general, an individual is considered to be a resident of the United States for estate and gift tax purposes if the individual is "domiciled" in the United States. An individual is domiciled in the United States if the individual (a) is living in the United States and has the intention to remain in the United States indefinitely; or (b) has lived in the United States with such an intention and has not formed the intention to remain indefinitely in another country. In the case of a U.S. citizen who resided in a U.S. possession at the time of

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[12] Section 1445.

[13] Section 2501.

[14] Section 2501(a)(2).

[15] Sections 2001, 2031, 2101, and 2103.

[16] Section 2001(c).

death, if the individual acquired U.S. citizenship solely on account of his or her birth or residence in a U.S. possession, that individual is not treated as a U.S. citizen or resident for estate tax purposes.[17]

In addition to the estate and gift taxes, a separate transfer tax is imposed on certain "generation-skipping" transfers.

Special tax rules with respect to the movement of persons into or out of the United States

Individuals who relinquish U.S. citizenship with a principal purpose of avoiding U.S. tax

An individual who relinquishes his or her U.S. citizenship with a principal purpose of avoiding U.S. taxes is subject to an alternative method of income taxation for 10 years after expatriation under section 877.[18] Under this provision, if the Treasury Department establishes that it is reasonable to believe that the expatriate's loss of U.S. citizenship would, but for the application of this provision, result in a substantial reduction in U.S. tax based on the expatriate's probable income for the taxable year, then the expatriate has the burden of proving that the loss of citizenship did not have as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. Section 877 does not apply to resident aliens who terminate their U.S. residency.

The alternative method modifies the rules generally applicable to the taxation of nonresident aliens in two ways. First, the expatriate is subject to tax on his or her U.S. source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident aliens. (Unlike U.S. citizens, however, individuals subject to section 877 are not taxed on any foreign source income.) Second, the scope of items treated as U.S. source income for section 877 purposes is broader than those items generally considered to be U.S. source income under the Code. For example, gains on the sale of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S. source income under the Code. However, if an individual is subject to the alternative taxing method of section 877, such gains are treated as U.S. source income with respect to that individual. The alternative method applies only if it results in a higher U.S. tax liability than would otherwise be determined if the individual were taxed as a nonresident alien.

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[17] Section 2209.

[18] Treasury regulations provide that an individual's citizenship status is governed by the provisions of the Immigration and Nationality Act, specifically referring to the "rules governing loss of citizenship [set forth in] sections 349 to 357, inclusive, of such Act (8 U.S.C. 1481-1489)." Treas. Reg. section 1.1-1(c). Under the Immigration and Nationality Act, an individual is generally considered to lose U.S. citizenship on the date that an expatriating act is committed. The present-law rules governing the loss of citizenship, and a description of the types of expatriating acts that lead to a loss of citizenship, are discussed more fully below.

Because section 877 alters the sourcing rules generally used to determine the country having primary taxing jurisdiction over certain items of income, there is an increased potential for such items to be subject to double taxation. For example, a former U.S. citizen subject to the section 877 rules may have capital gains derived from stock in a U.S. corporation. Under section 877, such gains are treated as U.S. source income, and are, therefore, subject to U.S. tax. Under the internal laws of the individual's new country of residence, however, that country may provide that all capital gains realized by a resident of that country are subject to taxation in that country, and thus the individual's gain from the sale of U.S. stock also would be taxable in his or her country of residence. If the individual's new country of residence has an income tax treaty with the United States, the treaty may provide for the amelioration of this potential double tax.

Similar rules apply in the context of estate and gift taxation if the transferor relinquished U.S. citizenship with a principal purpose of avoiding U.S. taxes within the 10-year period ending on the date of the transfer. A special rule is applied to the estate tax treatment of any decedent who relinquished his or her U.S. citizenship within 10 years of death, if the decedent's loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.[19] Once the Secretary of the Treasury establishes a reasonable belief that the expatriate's loss of U.S. citizenship would result in a substantial reduction in estate, inheritance, legacy and succession taxes, the burden of proving that one of the principal purposes of the loss of U.S. citizenship was <u>not</u> avoidance of U.S. income or estate tax is on the executor of the decedent's estate.

In general, the estates of individuals who have relinquished U.S. citizenship are taxed in accordance with the rules generally applicable to the estates of nonresident aliens (i.e., the gross estate includes all U.S.-situs property held by the decedent at death, is subject to U.S. estate tax at the rates generally applicable to the estates of U.S. citizens, and is allowed a unified credit of $13,000, as well as credits for State death taxes, gift taxes, and prior transfers). However, a special rule provides that the individual's gross estate also includes his or her pro-rata share of any U.S.-situs property held through a foreign corporation in which the decedent had a 10-percent or greater voting interest, provided that the decedent and related parties together owned more than 50 percent of the voting power of the corporation. Similarly, gifts of intangible property having a situs within the United States (e.g., stocks and bonds) made by a nonresident alien who relinquished his or her U.S. citizenship within the 10-year period ending on the date of transfer are subject to U.S. gift tax, if the loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.[20]

<u>Aliens having a break in residency status</u>

A special rule applies in the case of an individual who has been treated as a resident of the United States for at least three consecutive years, if the individual becomes a nonresident but

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[19] Section 2107.

[20] Section 2501(a)(3).

regains residency status within a three-year period.[21] In such cases, the individual is subject to U.S. tax for all intermediate years under the section 877 rules described above (i.e., the individual is taxed in the same manner as a U.S. citizen who renounced U.S. citizenship with a principal purpose of avoiding U.S. taxes). The special rule for a break in residency status applies regardless of the subjective intent of the individual.

b. Requirements for United States citizenship, immigration, and visas

United States citizenship

An individual may acquire U.S. citizenship in one of three ways: (1) being born within the geographical boundaries of the United States; (2) being born outside the United States to at least one U.S. citizen parent (as long as that parent had previously been resident in the United States for a requisite period of time); or (3) through the naturalization process. All U.S. citizens are required to pay U.S. income taxes on their worldwide income. The State Department estimates that there are approximately 3 million U.S. citizens living abroad, although thousands of these individuals may not even know that they are U.S. citizens.

A U.S. citizen may voluntarily give up his or her U.S. citizenship at any time by performing one of the following acts ("expatriating acts") with the intention of relinquishing U.S. nationality: (1) becoming naturalized in another country; (2) formally declaring allegiance to another country; (3) serving in a foreign army; (4) serving in certain types of foreign government employment; (5) making a formal renunciation of nationality before a U.S. diplomatic or consular officer in a foreign country; (6) making a formal renunciation of nationality in the United States during a time of war; or (7) committing an act of treason.[22] An individual who wishes formally to renounce citizenship (item (5), above) must execute an Oath of Renunciation before a consular officer, and the individual's loss of citizenship is effective on the date the oath is executed. In all other cases, the loss of citizenship is effective on the date that the expatriating act is committed, even though the loss may not be documented until a later date. The State Department generally documents loss in such cases when the individual acknowledges to a consular officer that the act was taken with the requisite intent. In all cases, the consular officer abroad submits a certificate of loss of nationality ("CLN") to the State Department in Washington, D.C. for approval.[23] Upon approval, a copy of the CLN is issued to the affected individual.

Before a CLN is issued, the State Department reviews the individual's files to confirm that: (1) the individual was a U.S. citizen; (2) an expatriating act was committed; (3) the act was undertaken voluntarily; and (4) the individual had the intent of relinquishing citizenship when the

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[21] Section 7701(b)(10).

[22] 8 U.S.C. section 1481.

[23] 8 U.S.C. section 1501.

expatriating act was committed. If the expatriating act involved an action of a foreign government (for example, if the individual was naturalized in a foreign country or joined a foreign army), the State Department will not issue a CLN until it has obtained an official statement from the foreign government confirming the expatriating act. If a CLN is not issued because the State Department does not believe that an expatriating act has occurred (for example, if the requisite intent appears to be lacking), the issue is likely to be resolved through litigation. Whenever the loss of U.S. nationality is put in issue, the burden of proof is on the person or party claiming that a loss of citizenship has occurred to establish, by a preponderance of the evidence, that the loss occurred.[24] Similarly, if a CLN has been issued, but the State Department later discovers that such issuance was improper (for example, because fraudulent documentation was submitted, or the requisite intent appears to be lacking), the State Department could initiate proceedings to revoke the CLN. If the recipient is unable to establish beyond a preponderance of the evidence that citizenship was lost on the date claimed, the CLN would be revoked. To the extent that the IRS believes a CLN was improperly issued, the IRS could present such evidence to the State Department and request that revocation proceedings be commenced. If it is determined that the individual has indeed committed an expatriating act, the date for loss of citizenship will be the date of the expatriating act.

A child under the age of 18 cannot lose U.S. citizenship by naturalizing in a foreign state or by taking an oath of allegiance to a foreign state. A child under 18 can, however, lose U.S. citizenship by serving in a foreign military or by formally renouncing citizenship, but such individuals may regain their citizenship by asserting a claim of citizenship before reaching the age of eighteen years and six months.

A naturalized U.S. citizen can have his or her citizenship involuntarily revoked if a U.S. court determines that the certificate of naturalization was illegally procured, or was procured by concealment of a material fact or by willful misrepresentation. In such cases, the individual's certificate of naturalization is cancelled, effective as of the original date of the certificate; in other words, it is as if the individual were never a U.S. citizen at all.

United States immigration and visas

In general, a non-U.S. citizen who enters the United States is required to obtain a visa.[25] An immigrant visa (also known as a "green card") is issued to an individual who intends to relocate to the United States permanently. Various types of nonimmigrant visas are issued to

[24] 8 U.S.C. section 1481(b).

[25] Under the Visa Waiver Pilot Program, nationals of most European countries are not required to obtain a visa to enter the United States if they are coming as tourists and staying a maximum of 90 days. Also, citizens of Canada, Mexico, and certain islands in close proximity to the United States do not need visas to enter the United States, although other types of travel documents may be required.

individuals who come to the United States on a temporary basis and intend to return home after a certain period of time. The type of nonimmigrant visa issued to such individuals is dependent upon the purpose of the visit and its duration. An individual holding a nonimmigrant visa is prohibited from engaging in activities that are inconsistent with the purpose of the visa (for example, an individual holding a tourist visa is not permitted to obtain employment in the United States).

Foreign business people and investors often obtain "E" visas to come into the United States. Generally, an "E" visa is initially granted for a one-year period, but it can be routinely extended for additional two-year periods. There is no overall limit on the amount of time an individual may retain an "E" visa. There are two types of "E" visas: an "E-1" visa, for "treaty traders" and an "E-2" visa, for "treaty investors."

Relinquishment of green cards

There are several ways in which a green card can be relinquished. First, an individual who wishes to terminate his or her permanent residency may simply return his or her green card to the INS. Second, an individual may be involuntarily deported from the United States (through a judicial or administrative proceeding), and the green card must be relinquished at that time. Third, a green card holder who leaves the United States and attempts to re-enter more than a year later may have his or her green card taken away by the INS border examiner, although the individual may appeal to an immigration judge to have the green card reinstated. A green-card holder may permanently leave the United States without relinquishing his or her green card, although such individuals would continue to be taxed as U.S. residents.[26]

Description of Proposal

In general

The proposal would replace the present-law expatriation income tax rules with rules that would generally subject certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who relinquish their U.S. residency to tax on the net unrealized gain in their property as if such property were sold for fair market value on the expatriation date. The proposal also would impose information reporting obligations on U.S. citizens who relinquish their citizenship and long-term residents whose U.S. residency is terminated.

[26] Section 7701(b)(6)(B) provides that an individual who has obtained the status of residing permanently in the United States as an immigrant (i.e., an individual who has obtained a green card) will continue to be taxed as a lawful permanent resident of the United States until such status is revoked, or is administratively or judicially determined to have been abandoned.

Individuals covered

The proposal would apply the expatriation tax to certain U.S. citizens and long-term residents who terminate their U.S. citizenship or residency. For this purpose, a long-term resident would be any individual who was a lawful permanent resident of the United States for at least 8 out of the 15 taxable years ending with the year in which the termination of residency occurs. In applying this 8-year test, an individual would not be considered to be a lawful permanent resident of the United States for any year in which the individual is taxed as a resident of another country under a treaty tie-breaker rule. An individual's U.S. residency would be considered to be terminated when either the individual ceases to be a lawful permanent resident pursuant to section 7701(b)(6) (i.e., the individual loses his or her green-card status) or the individual is treated as a resident of another country under a tie-breaker provision of a tax treaty (and the individual does not elect to waive the benefits of such treaty).

The expatriation tax under the proposal would apply only to individuals whose average income tax liability or net worth exceeds specified levels. U.S. citizens who lose their citizenship and long-term residents who terminate U.S. residency would be subject to the expatriation tax if they meet either of the following tests: (1) the individual's average annual U.S. Federal income tax liability for the 5 taxable years ending before the date of such loss or termination is greater than $100,000, or (2) the individual's net worth as of the date of such loss or termination is $500,000 or more. The dollar amount thresholds contained in these tests would be indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996.

Exceptions from the expatriation tax under the proposal would be provided for individuals in two situations. The first exception would apply to an individual who was born with citizenship both in the United States and in another country, provided that (1) as of the date of relinquishment of U.S. citizenship the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual was a resident of the United States for no more than 8 out of the 15 taxable years ending with the year in which the relinquishment of U.S. citizenship occurred. The second exception would apply to a U.S. citizen who relinquishes citizenship before reaching age 18-1/2, provided that the individual was a resident of the United States for no more than 5 taxable years before such relinquishment.

Deemed sale of property upon expatriation

Under the proposal, individuals who are subject to the expatriation tax generally would be treated as having sold all of their property at fair market value immediately prior to the relinquishment of citizenship or termination of residency. Gain or loss from the deemed sale of property would be recognized at that time, generally without regard to provisions of the Code that would otherwise provide nonrecognition treatment. The net gain, if any, on the deemed sale of all such property would be subject to U.S. tax at such time to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate).

The deemed sale rule of the proposal would generally apply to all property interests held by the individual on the date of relinquishment of citizenship or termination of residency, provided that the gain on such property interest would be includible in the individual's gross income if such property interest were sold for its fair market value on such date. Special rules would apply in the case of trust interests (see "Interests in trusts", below). U.S. real property interests, which remain subject to U.S. taxing jurisdiction in the hands of nonresident aliens, generally would be excepted from the proposal. An exception would also apply to interests in qualified retirement plans and, subject to a limit of $500,000, interests in certain foreign pension plans as prescribed by regulations. The Secretary of the Treasury would have authority to issue regulations exempting other property interests as appropriate.

Under the proposal, an individual subject to the expatriation tax would be required to pay a tentative tax equal to the amount of tax that would have been due for a hypothetical short tax year ending on the date the individual relinquished citizenship or terminated residency. Thus, the tentative tax would be based on all the income, gain, deductions, loss and credits of the individual for the year through such date, including amounts realized from the deemed sale of property. The tentative tax would be due on the 90th day after the date of relinquishment of citizenship or termination of residency.

Deferral of payment of tax

Under the proposal, an individual would be permitted to elect to defer payment of the expatriation tax with respect to the deemed sale of any property. Under this election, the expatriation tax with respect to a particular property, plus interest thereon, would be due when the property is subsequently disposed of. For this purpose, except as provided in regulations, the disposition of property in a nonrecognition transaction would constitute a disposition. In addition, if an individual holds property until his or her death, the individual would be treated as having disposed of the property immediately before death. In order to elect deferral of the expatriation tax, the individual would be required to provide adequate security to ensure that the deferred expatriation tax and interest would ultimately be paid. A bond in the amount of the deferred tax and interest would constitute adequate security. Other security mechanisms would also be permitted provided that the individual establishes to the satisfaction of the Secretary of the Treasury that the security is adequate. In the event that the security provided with respect to a particular property subsequently becomes inadequate and the individual fails to correct such situation, the deferred expatriation tax and interest with respect to such property would become due. As a further condition to making this election, the individual would be required to consent to the waiver of any treaty rights that would preclude the collection of the expatriation tax.

Interests in trusts

In general

Special rules would apply to trust interests held by the individual at the time of relinquishment of citizenship or the termination of residency. The treatment of trust interests would depend upon whether the trust is a qualified trust. For this purpose, a "qualified trust" would be a trust which is organized under and governed by U.S. law and which is required by its instruments to have at least one U.S. trustee.

Constructive ownership rules would apply to a trust beneficiary that is a corporation, partnership, trust or estate. In such cases, the shareholders, partners or beneficiaries of the entity would be deemed to be the direct beneficiaries of the trust for purposes of applying these provisions. In addition, individuals who hold (or who are treated as holding) trust interests at the time of relinquishment of citizenship or termination of residency would be required to disclose on their respective tax returns the methodology used to determine that beneficiary's interest in the trust, and whether that beneficiary knows (or has reason to know) that any other beneficiary of the trust uses a different method.

Nonqualified trusts

If an individual holds an interest in a trust that is not a qualified trust, a special rule would apply for purposes of determining the amount of the expatriation tax due with respect to such trust interest. The individual's interest in the trust would be treated as a separate trust consisting of the trust assets allocable to such interest. Such separate trust would be treated as having sold its assets as of the date of relinquishment of citizenship or termination of residency and having distributed all proceeds to the individual, and the individual would be treated as having recontributed such proceeds to the trust. The individual would be subject to the expatriation tax with respect to any net income or gain arising from the deemed distribution from the trust. The election to defer payment would be available for the expatriation tax attributable to a nonqualified trust interest.

A beneficiary's interest in a nonqualified trust would be determined on the basis of all facts and circumstances. These include the terms of the trust instrument itself, any letter of wishes or similar document, historical patterns of trust distributions, and the role of any trust protector or similar advisor.

Qualified trusts

If the individual has an interest in a qualified trust, special rules would apply. The amount of unrealized gain allocable to the individual's trust interest would be calculated at the time of expatriation. In determining this amount, all contingencies and discretionary interests would be assumed to be resolved in the individual's favor (i.e., the individual would be allocated the maximum amount that he or she potentially could receive under the terms of the trust instrument). The expatriation tax imposed on such gains generally would be collected when the individual

receives distributions from the trust, or, if earlier, upon the individual's death. Interest would be charged for the period between the date of expatriation and the date on which the tax is paid.

If an individual has an interest in a qualified trust, the individual would be subject to expatriation tax upon the receipt of any distribution from the trust. Such distributions may also be subject to U.S. income tax. For any distribution from a qualified trust made to an individual after he or she has expatriated, expatriation tax would be imposed in an amount equal to the amount of the distribution multiplied by the highest tax rate generally applicable to trusts and estates, but in no event would the tax imposed exceed the deferred tax amount with respect to such trust interest. The "deferred tax amount" would be equal to (1) the tax calculated with respect to the unrealized gain allocable to the trust interest at the time of expatriation, (2) increased by interest thereon, and (3) reduced by the tax imposed under this provision with respect to prior trust distributions to the individual.

If an individual's interest in a trust is vested as of the expatriation date (e.g., if the individual's interest in the trust is non-contingent and non-discretionary), the gain allocable to the individual's trust interest would be determined based on the trust assets allocable to his or her trust interest. If the individual's interest in the trust is not vested as of the expatriation date (e.g., if the individual's trust interest is a contingent or discretionary interest), the gain allocable to his or her trust interest would be determined based on all of the trust assets that could be allocable to his or her trust interest, determined by resolving all contingencies and discretionary powers in the individual's favor. In the case where more than one trust beneficiary is subject to the expatriation tax with respect to trust interests that are not vested, the rules would apply so that the same unrealized gain with respect to assets in the trust is not taxed to both individuals.

If the individual disposes of his or her trust interest, the trust ceases to be a qualified trust, or the individual dies, expatriation tax with respect to the trust interest would be imposed on the trust as of such date (with a right of contribution for any other beneficiaries of the trust). The amount of such tax would be equal to the lesser of (1) the tax calculated under the rules for nonqualified trust interests applied as of such date or (2) the deferred tax amount with respect to the trust interest as of such date.

If the individual agrees to waive any treaty rights that would preclude collection of the tax, the tax imposed under this provision would be deducted and withheld from distributions from the qualified trust to the individual. If the individual does not agree to such a waiver of treaty rights, the tax would be imposed on the trust, the trustee would be personally liable therefor, and any other beneficiary of the trust would have a right of contribution against such individual with respect to such tax.

Election to be treated as a U.S. citizen

Under the proposal, an individual would be permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that would otherwise be

covered by the expatriation tax. This election would be an "all-or-nothing" election; an individual would not be permitted to elect this treatment for some property but not other property. The election would apply to all property that would be subject to the expatriation tax and to any property the basis of which is determined by reference to such property. Under this election, the individual would continue to pay U.S. income taxes at the rates applicable to U.S. citizens following expatriation on any income generated by the property and on any gain realized on the disposition of the property, as well as any excise tax imposed with respect to the property (see, e.g., sec. 1491). In addition, the property would continue to be subject to U.S. gift, estate, and generation-skipping transfer taxes. However, the amount of any transfer tax so imposed would be limited to the amount of income tax that would have been due if the property had been sold for its fair market value immediately before the transfer or death. The $600,000 exclusion provided under the expatriation tax would be available to reduce the tax imposed by reason of this election. In order to make this election, the taxpayer would be required to waive any treaty rights that would preclude the collection of the tax. The individual would also be required to provide security to ensure payment of the tax under this election in such form, manner, and amount as the Secretary requires.

Date of relinquishment of citizenship

Under the proposal, an individual would be treated as having relinquished U.S. citizenship on the date that the individual first makes known to a U.S. government or consular officer his or her intention to relinquish U.S. citizenship. Thus, a U.S. citizen who relinquishes citizenship by formally renouncing his or her U.S. nationality before a diplomatic or consular officer of the United States would be treated as having relinquished citizenship on that date, provided that the renunciation is later confirmed by the issuance of a CLN. A U.S. citizen who furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act would be treated as having relinquished his or her citizenship on the date the statement is so furnished (regardless of when the expatriating act was performed), provided that the voluntary relinquishment is later confirmed by the issuance of a CLN. If neither of these circumstances exist, the individual would be treated as having relinquished citizenship on the date a CLN is issued or a certificate of naturalization is cancelled. The date of relinquishment of citizenship determined under the proposal would apply for all tax purposes.

Effect on present-law expatriation provisions

Under the proposal, the present-law provisions with respect to U.S. citizens who expatriate with a principal purpose of avoiding tax (sec. 877) and certain aliens who have a break in residency status (sec. 7701(b)(10)) would not apply to U.S. citizens who are treated as relinquishing their citizenship on or after February 6, 1995 or to long-term U.S. residents who terminate their residency on or after such date. The special estate and gift tax provisions with respect to individuals who expatriate with a principal purpose of avoiding tax (secs. 2107 and 2501(a)(3)), however, would continue to apply; a credit against the tax imposed solely by reason

of such special provisions would be allowed for the expatriation tax imposed with respect to the same property.

Treatment of gifts and inheritances from an expatriate

Under the proposal, the exclusion from income provided in section 102 would not apply to the value of any property received by gift or inheritance from an individual who was subject to the expatriation tax (i.e., an individual who relinquished citizenship or terminated residency and to whom the expatriation tax was applicable). Accordingly, a U.S. taxpayer who receives a gift or inheritance from such an individual would be required to include the value of such gift or inheritance in gross income and would be subject to U.S. income tax on such amount.

Required information reporting and sharing

Under the proposal, an individual who relinquishes citizenship or terminates residency would be required to provide a statement which includes the individual's social security number, forwarding foreign address, new country of residence and citizenship and, in the case of individuals with a net worth of at least $500,000, a balance sheet. The entity to which such statement is to be provided would be required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements. An individual's failure to provide the required statement would result in the imposition of a penalty for each year the failure continues equal to the greater of (1) 5 percent of the individual's expatriation tax liability for such year or (2) $1,000.

The proposal would require the State Department to provide the Secretary of the Treasury with a copy of each CLN approved by the State Department. Similarly, the proposal would require the agency administering the immigration laws to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned.

Further, the proposal would require the Secretary of the Treasury to publish in the Federal Register the names of all former U.S. citizens from whom it receives the required statements or whose names it receives under the foregoing information-sharing provisions.

Effective Date

The proposal would be effective for U.S. citizens whose date of relinquishment of citizenship (as determined under the proposal, see "Date of relinquishment of citizenship" above) occurs on or after February 6, 1995. Similarly, the proposal would be effective for long-term residents who terminate their U.S. residency on or after February 6, 1995.

U.S. citizens who committed an expatriating act prior to February 6, 1995, but whose date of relinquishment of citizenship does not occur until after such date, would be subject to the

expatriation tax under the proposal as of date of relinquishment of citizenship. However, the individual would not be subject retroactively to worldwide tax as a U.S. citizen for the period after he or she committed the expatriating act (and therefore ceased being a U.S. citizen for tax purposes under present law). Such an individual would continue to be subject to the expatriation tax imposed by present-law section 877 until the individual's date of relinquishment of citizenship (at which time the individual would be subject to the expatriation tax of the proposal).

The tentative tax would not be required to be paid, and the reporting requirements would not be required to be met, until 90 days after the date of enactment. Such provisions would apply to all individuals whose date of relinquishment of U.S. citizenship or termination of U.S. residency occurs on or after February 6, 1995.

VI. TAXPAYER BILL OF RIGHTS 2 PROVISIONS

1. Abatement of interest and penalties

a. Expansion of authority to abate interest

Present Law

Any assessment of interest on any deficiency attributable in whole or in part to any error or delay by an officer or employee of the IRS (acting in his official capacity) in performing a ministerial act may be abated.

Description of Proposal

The proposal would permit the IRS to abate interest with respect to any unreasonable error or delay resulting from managerial acts as well as ministerial acts. This would include extensive delays resulting from managerial acts such as: the loss of records by the IRS, IRS personnel transfers, extended illnesses, extended personnel training, or extended leave. On the other hand, interest would not be abated for delays resulting from general administrative decisions. For example, the taxpayer could not claim that the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system resulted in an unreasonable delay in the IRS's action on the taxpayer's tax return, and so the interest on any subsequent deficiency should be waived.

Effective Date

The proposal would apply to interest accruing with respect to deficiencies or payments for taxable years beginning after the date of enactment.

b. Review of IRS failure to abate interest

Present Law

Federal courts generally do not have the jurisdiction to review the IRS's failure to abate interest.

Description of Proposal

The proposal would grant the Tax Court jurisdiction to determine whether the IRS's failure to abate interest for an eligible taxpayer was an abuse of discretion. The action must be brought within six months after the date of the Secretary's final determination not to abate interest. An eligible taxpayer must meet the net worth and size requirements imposed with

respect to awards of attorney's fees. No inference is intended as to whether under present law any court has jurisdiction to review IRS's failure to abate interest.

Effective Date

The proposal would apply to requests for abatement after the date of enactment.

2. Joint return may be made after separate returns without full payment of tax

Present Law

Taxpayers who file separate returns and subsequently determine that their tax liability would have been less if they had filed a joint return are precluded by statute from reducing their tax liability by filing jointly if they are unable to pay the entire amount of the joint return liability before the expiration of the three-year period for making the election to file jointly.

Description of Proposal

The proposal would repeal the requirement of full payment of tax liability as a precondition to switching from married filing separately status to married filing jointly status.

Effective Date

The proposal would apply to taxable years beginning after the date of the enactment.

3. Collection activities

a. Modifications in certain levy exemption amounts

Present Law

Property exempt from levy includes personal property with a value of up to $1,650 as well as books and tools with a value of up to $1,100.

Description of Proposal

The proposal would increase the exemption amount to $2,500 for personal property and to $1,250 for books and tools. These amounts would be indexed for inflation commencing January 1, 1996.

Effective Date

The proposal would be effective with respect to levies issued after December 31, 1995.

b. Offers-in-compromise

Present Law

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. IRS regulations provide that such offers can be accepted if: the taxpayer is unable to pay the full amount of the tax liability and it is doubtful that the tax, interest, and penalties can be collected or there is doubt as to the validity of the actual tax liability. Amounts over $500 can only be accepted if the reasons for the acceptance are documented in detail and supported by an opinion of the IRS Chief Counsel.

Description of Proposal

The proposal would increase from $500 to $50,000 the amount requiring a written opinion from the Office of Chief Counsel. Compromises below the $50,000 threshold would be subject to continuing quality review by the IRS.

Effective Date

The proposal would be effective on the date of enactment.

4. Award of litigation costs permitted in declaratory judgment proceedings

Present Law

Section 7430(b)(3) denies any reimbursement for attorney's fees in all declaratory judgment actions, except those actions related to the revocation of an organization's qualification under section 501(c)(3) (relating to tax-exempt status).

Description of Proposal

The proposal would eliminate the present-law restrictions on awarding attorney's fees in all declaratory judgment proceedings.

Effective Date

The proposal would apply to proceedings commenced after the date of enactment.

5. **Modifications of rules relating to summonses**

a. Enrolled agents included as third-party recordkeepers

Present Law

Section 7609 contains special procedures that the IRS must follow before it issues a third-party summons. A third-party summons is a summons issued to a third-party recordkeeper compelling him to provide information with respect to the taxpayer. An example of this would be a summons served on a stock brokerage house to provide data on the securities trading of the taxpayer-client.

If a third-party summons is served on a third-party recordkeeper listed in section 7609(a)(3), then the taxpayer must receive notice of the summons and have an opportunity to challenge the summons in court. Otherwise the taxpayer has no statutory right to receive notice of the summons and accordingly he will not have the opportunity to challenge it in court.

Section 7609(a)(3) lists attorneys and accountants as third-party recordkeepers, but it does not list "enrolled agents", who are authorized to practice before the IRS.

Description of Proposal

The proposal would include enrolled agents as third-party recordkeepers.

Effective Date

The proposal would apply to summonses issued after the date of enactment.

b. Safeguards relating to designated summonses

Present Law

The period for assessment of additional tax with respect to most tax returns, corporate or otherwise, is three years. The IRS and the taxpayer can together agree to extend the period, either for a specified period of time or indefinitely. The taxpayer may terminate an indefinite agreement to extend the period by providing notice to the IRS.

During an audit, the IRS may informally request that the taxpayer provide additional information necessary to arrive at a fair and accurate audit adjustment, if any adjustment is warranted. Not all taxpayers cooperate by providing the requested information on a timely basis. In some cases the IRS seeks information by issuing an administrative summons. Such a summons will not be judicially enforced unless the Government (as a practical matter, the Department of

Justice) seeks and obtains an order for enforcement in Federal court. In addition, a taxpayer may petition the court to quash an administrative summons where this is permitted by statute.[1]

In certain cases, the running of the assessment period is suspended during the period when the parties are in court to obtain or avoid judicial enforcement of an administrative summons. Such a suspension is provided in the case of litigation over a third-party summons (sec. 7609(e)) or litigation over a summons regarding the examination of a related party transaction. Such a suspension can also occur with respect to a corporate tax return if a summons is issued at least 60 days before the day on which the assessment period (as extended) is scheduled to expire. In this case, suspension is only permitted if the summons clearly states that it is a "designated summons" for this purpose. Only one summons may be treated as a designated summons for purposes of any one tax return. The limitations period is suspended during the judicial enforcement period of the designated summons and of any other summons relating to the same tax return that is issued within 30 days after the designated summons is issued.

<u>Description of Proposal</u>

The proposal would limit the use of a designated summons to corporations (or to any other person to whom the corporation has transferred records) that are being examined as part of the Coordinated Examination Program (CEP) or its successor. CEP audits cover about 1,600 of the largest corporate taxpayers. If a corporation moves between CEP and non-CEP audit categories, only the tax years covered by the CEP may be the subject of a designated summons. The proposal would not affect Code section 6038A(e)(1), which relates to a U.S. reporting corporation that acts merely as the agent of the foreign related party by receiving summonses on behalf of the foreign party.

<u>Effective Date</u>

The proposal would apply to summonses issued after date of enactment.

6. Annual reminders to taxpayers with outstanding delinquent accounts

<u>Present Law</u>

There is no statutory requirement in the Code that the IRS send annual reminders to persons who have outstanding tax liabilities.

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[1] Petitions to quash are permitted, for example, in connection with the examination of certain related party transactions under section 6038A(e)(4), and in the case of certain third-party summonses under section 7609(b)(2).

Numerous taxpayers become delinquent in paying their tax liability. The delinquencies may occur because the person did not make enough payments through payroll withholding or quarterly estimated payments or because of an adjustment following an audit.

The IRS generally pursues larger tax deficiencies first, and then it pursues small deficiencies. Because of the limited amount of IRS resources to work collection cases, cases with smaller deficiencies may not be addressed for years. In the meantime, the taxpayer may come to believe that the apparent lack of IRS collection activity means that it has abandoned its claim against the taxpayer. The taxpayer may be surprised when the IRS resumes collection action years later, when the 10-year statute of limitations on collections is close to expiring.

Description of Proposal

The proposal would require the IRS to send taxpayers an annual reminder of their outstanding tax liabilities. The fact that a taxpayer did not receive a timely, annual reminder notice would not affect the tax liability.

Effective Date

The proposal would require the IRS to send annual reminder notices beginning in 1996.

7. Court discretion to reduce award for litigation costs for failure to exhaust administrative remedies

Present Law

A taxpayer suing the United States for civil damages for unauthorized collection activities must exhaust administrative remedies to be eligible for an award.

Description of Proposal

The proposal would permit (but not require) a court to reduce an award if the taxpayer has not exhausted administrative remedies.

Effective Date

The proposal would be effective for proceedings commenced after the date of enactment.

VII. CASUALTY AND INVOLUNTARY CONVERSION PROVISIONS

A. Modify Basis Adjustment Rules Under Section 1033

Present Law

Gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases similar property within a specified period of time. The replacement property may be acquired directly or by acquiring control of a corporation (generally, 80 percent of the stock of the corporation) that owns similar replacement property. The taxpayer's basis in the replacement property generally is the same as the taxpayer's basis in the converted property. In cases in which a taxpayer purchases stock as replacement property, the taxpayer reduces the basis of the stock, but does not reduce the basis of the underlying assets. Thus, the reduction in the basis of the stock generally does not result in reduced depreciation deductions where the corporation holds depreciable property, and may result in the taxpayer having more aggregate depreciable basis after the acquisition of replacement property than before the involuntary conversion.

Description of Proposal

The proposal would provide that where the taxpayer satisfies the replacement property requirement by acquiring stock in a corporation, the corporation generally would reduce its adjusted bases in its assets by the amount by which the taxpayer reduces its basis in the stock. The corporation's adjusted bases in its assets would not be reduced, in the aggregate, below the taxpayer's basis in its stock (determined after the appropriate basis adjustment for the stock). In addition, the basis of any individual asset would not be reduced below zero.

The application of these rules can be demonstrated by the following examples:

Example 1.--Assume that a taxpayer owned a commercial building with an adjusted basis of $100,000 that was involuntarily converted, causing the taxpayer to receive $1 million in insurance proceeds. Further assume that the taxpayer acquires, as replacement property, all of the stock of a corporation, the sole asset of the corporation is a building with a value and an adjusted basis of $1 million. Under the proposal, the taxpayer would reduce its basis in the stock to $100,000 (as under present law) and the corporation would reduce its adjusted basis in the building to $100,000.

Example 2.--Assume the same facts as in Example 1, except that on the date of acquisition, the corporation has an adjusted basis of $100,000 (rather than $1 million) in the building. Under the proposal, the taxpayer would reduce its basis in the stock to $100,000 (as under present law) and the corporation would not be required to reduce its adjusted basis in the building.

Effective Date

The proposal would apply to involuntary conversions occurring after September 13, 1995.

B. Modify the Exception to the Related Party Rule of Section 1033 for Individuals to Only Provide an Exception for De Minimis Amounts

Present Law

Gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period of time. Pursuant to a provision of H.R. 831, as passed by the Congress and signed by the President on April 11, 1995 (P.L.104-7), subchapter C corporations (and certain partnerships with corporate partners) are not entitled to defer gain if the replacement property or stock is purchased from a related person. An exception to this related party rule provides that a taxpayer may purchase replacement property or stock from a related person and defer gain to the extent the related person acquired the replacement property or stock from an unrelated person within the period prescribed under section 1033.

Description of Proposal

The proposal would expand the present-law denial of the application of section 1033 to any other taxpayer (including an individual) that acquires replacement property from a related party, unless the taxpayer has aggregate realized gain of $100,000 or less for the taxable year with respect to converted property with aggregate realized gains.

Effective Date

The proposal would apply to involuntary conversions occurring after September 13, 1995.

C. Treatment of Certain Crop Insurance Proceeds and Disaster Assistance Payments

Present Law

A taxpayer engaged in a farming business generally may use the cash receipts and disbursements method of accounting ("cash method") to report taxable income. A cash method taxpayer generally recognizes income in the taxable year in which cash is received, regardless of when the economic events that give rise to such income occur. Under a special rule (sec. 451(d) of the Internal Revenue Code), in the case of insurance proceeds received as a result of destruction or damage to crops, a cash method taxpayer may elect to defer the income recognition of the proceeds until the taxable year following the year of the destruction or damage, if the taxpayer establishes that under his practice, income from such crops would have been reported in a following taxable year. For this purpose, certain payments received under the Agricultural Act of 1949, as amended, or title II of the Disaster Assistance Act of 1988, are treated as insurance proceeds received as a result of destruction or damage to crops.

Description of Proposal

The proposal would amend the special rule of section 451(d) to allow a cash method taxpayer to elect to accelerate (or defer) the recognition of certain disaster-related payments if the taxpayer establishes that, under the taxpayer's practice, income from the crops lost in the disaster would have been accelerated (or deferred). The proposal also would expand the payments for which these elections are available to include disaster assistance received as a result of destruction or damage to crops caused by drought, flood, or other natural disaster, or the inability to plant crops because of such a disaster, under any Federal law (rather than only payments received under the Agricultural Act of 1949, as amended, or title II of the Disaster Assistance Act of 1988).

Thus, for example, the proposal would allow a calendar-year, cash method taxpayer who has received disaster assistance payments in 1997 relating to the destruction of crops by a flood in 1996 to elect to treat such payments as received in 1996, so long as the taxpayer establishes that, under the taxpayer's practice, income from such crops would have been reported in 1996. Without the benefit of the proposal, the income of such a taxpayer would be "bunched" in 1997, possibly resulting in the loss of itemized deductions in 1996, a higher marginal income tax rate in 1997, and the loss of AGI-based deductions and exemptions in 1997.

Effective Date

The proposal would be effective for payments received after December 31, 1992, as a result of destruction or damage occurring after such date.

D. Application of Involuntary Conversion Rules to Property Damaged as a Result of Presidentially Declared Disasters

Present Law

Under present law, a taxpayer may elect not to recognize gain with respect to property that is involuntarily converted if the taxpayer acquires similar property within an applicable period. The applicable period generally begins with the date of the disposition of the converted property and generally ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. If the taxpayer does not replace the converted property with similar property, then gain generally is recognized.

Description of Proposal

For purposes of the involuntary conversion rules, any tangible property acquired and held for productive use in a business would be treated as similar to Presidential disaster area property. "Presidential disaster area property" would be property that (1) was held for investment or for productive use in a business, (2) was involuntarily converted as a result of a disaster, and (3) was located in a Presidentially declared disaster area.

Effective Date

The proposal would be effective for disasters declared after December 31, 1994.

VIII. EXEMPT ORGANIZATIONS AND CHARITABLE REFORMS

A. Common Investment Fund for Private Foundations

Present Law

Code section 501(c)(3) requires that an organization be organized and operated exclusively for a charitable or other exempt purpose in order to qualify for tax-exempt status under that section.

Section 501(f) provides that an organization is treated as organized and operated exclusively for charitable purposes if it is comprised solely of members that are educational institutions and is organized and operated solely to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) funds contributed by the members in stocks and securities, and to collect income from such investments and turn over such income, less expenses, to the members.

Description of Proposal

A cooperative service organization comprised solely of members that are tax-exempt private foundations and community foundations would be treated as organized and operated exclusively for charitable purposes if: (1) it has at least 20 members; (2) no one member holds (after the organization's second taxable year) more than 10 percent (by value) of the interests in the organization; (3) it is organized and controlled by its members, but no one member by itself controls the organization or any other member; (4) the members are permitted to dismiss any of the organization's investment advisors, if (following reasonable notice) members holding a majority of interest in the account managed by such advisor vote to remove such advisor; and (5) the organization is organized and operated solely to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) funds contributed by the members in stocks and securities, and to collect income from such investments and turn over such income, less expenses, to the members.[1]

A cooperative service organization meeting the criteria of the proposal would be subject to the present-law excise tax provisions applicable to private foundations (e.g., sec. 4941 rules governing self-dealing arrangements), other than sections 4940 and 4942.[2] In addition, each

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[1] Legislative history would indicate that an organization would be deemed to be organized and operated solely to collectively invest in stocks and securities if its investment portfolio consists solely of stocks and securities, and ordinary and routine investments held in connection with a stock and securities portfolio.

[2] In addition, the proposal would provide that the present-law expenditure responsibility requirements of section 4945(d)(4)(B) would not apply to grants made by private foundations to

member's allocable share (whether or not distributed) of the capital gain net income and gross investment income of the organization for any taxable year of the organization would be treated, for purposes of the excise tax imposed under present-law section 4940, as capital gain net income and gross investment income of the member for the taxable year of such member in which the taxable year of the organization ends.

Effective Date

The proposal would be effective for taxable years ending after December 31, 1995.

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the cooperative service organization and that such grants would be deemed to be qualifying distributions for purposes of 4942.

B. Exclusion From UBIT for Corporate Sponsorship Payments Received by Tax-Exempt Organizations in Connection With Public Events

Present Law

Although generally exempt from Federal income tax, tax-exempt organizations are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511-514). Contributions or gifts received by tax-exempt organizations generally are not subject to the UBIT. However, present-law section 513(c) provides that an activity (such as advertising) does not lose its identity as a separate trade or business merely because it is carried on within a larger complex of other endeavors.[3] If a tax-exempt organization receives sponsorship payments in connection with conducting a public event, the solicitation and receipt of such sponsorship payments may be treated as a separate activity. The Internal Revenue Service (IRS) has taken the position that, under some circumstances, such sponsorship payments may be subject to the UBIT.[4]

Description of Proposal

Under the proposal, qualified sponsorship payments received by certain tax-exempt organizations in connection with qualified public events would be excluded from the UBIT.

The term "qualified public event" would be defined as any event conducted by a tax-exempt organization described in paragraph (3), (4), (5), or (6) of section 501(c),[5] that is either:

(1) a public event that is substantially related to the exempt purposes of the organization conducting such event, or

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[3] See United States v. American College of Physicians, 475 U.S. 834 (1986)(holding that activity of selling advertising in medical journal was not substantially related to the organization's exempt purposes and, as a separate business under section 513(c), was subject to tax).

[4] See Prop.Treas. Reg. sec. 1.513-4 (issued January 19, 1993, EE-74-92, IRB 1993-7, 71). These proposed regulations generally exclude from the UBIT financial arrangements under which the tax-exempt organization provides so-called "institutional" or "good will" advertising to a sponsor (i.e., arrangements under which a sponsor's name, logo, or product line is acknowledged by the tax-exempt organization). However, specific product advertising (e.g., "comparative or qualitative descriptions of the sponsor's products") provided by a tax-exempt organization on behalf of a sponsor is not shielded from the UBIT under the proposed regulations.

[5] In addition, events conducted by State colleges and universities described in section 511(d)(2)(B) would be eligible for the UBIT exception provided for by the proposal.

(2) any other public event provided that such event is the only event of that type conducted (i.e., patronized by, or broadcast to, members of the public) by such organization during a calendar year and such event does not exceed 30 consecutive days.[6]

Public events that are substantially related to the exempt purposes of the organization conducting the event (e.g., symphony concerts, museum exhibits, intercollegiate athletic events, and county and agricultural fairs) would be governed by the proposal, even if held for more than a 30-day period. A public event conducted once a year for a period that does not exceed 30 days also would be governed by the proposal, even if the event is not substantially related to the exempt purposes of the organization (e.g., an annual vaudeville show conducted by a hospital or an annual auction or other fundraising event).

For purposes of the proposal, "qualified sponsorship payments" received by a tax-exempt organization that are excluded from UBIT would be defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than:

(1) the use of the name or logo of the person's trade or business in connection with a qualified public event under arrangements (including advertising) in connection with such event which acknowledge such person's sponsorship or promote such person's products or services, or

(2) the furnishing of facilities, services, or other privileges in connection with such event to individuals designated by such person (e.g., tickets furnished to employees).[7]

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[6] The proposal would provide that an event is treated as a qualified public event with respect to all qualified tax-exempt organizations that receive sponsorship payments with respect to the event if such event is a qualified public event with respect to one of such organizations, but only to the extent that such payment is used to meet expenses of such event or for the benefit of the organization with respect to which the event is a qualified public event. Thus, if a national charitable organization receives sponsorship payments with respect to several local fundraising events conducted in conjunction with local affiliates (e.g., walk-a-thons at different sites around the country), the national organization would not be subject to the UBIT with respect to sponsorship payments used to meet event expenses or distributed to local affiliates (assuming the events are qualified public events with respect to the local affiliates).

[7] The "in connection with" requirement would be satisfied only if benefits provided to the sponsor (or individuals designated by the sponsor) are provided within a reasonable time period compared to when the qualified public event itself is patronized by (or broadcast to) the public and only if the benefits are provided in a manner reasonably related to the conduct of the public event activities (e.g., providing advertising in a program or brochure distributed to event patrons, or providing special seating at the event, or related pre- or post-event functions, to employees of the sponsor).

To prevent avoidance of the 30-day rule governing unrelated events, the Secretary of the Treasury would be granted authority to prescribe regulations to prevent avoidance of the purposes of the provision through the use of entities under common control.[8]

The exception provided for by the proposal would be in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on). No inference would be intended as to the tax treatment under present-law rules of sponsorship payments received in connection with events not governed by the provision (e.g., unrelated events held more than once per year or for more than 30 days) or events held by organizations that are not covered by the provision (e.g., 501(c)(10) fraternal organizations).

Effective Date

The proposal would apply to events conducted after 1995.

[8] For this purpose, it is intended that organizations that conduct public events would not be treated as under common control solely as a result of their common affiliation with a national sanctioning body.

C. Treatment of Dues Paid to Agricultural or Horticultural Organizations

Present Law

Tax-exempt organizations generally are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511-514). Dues payments made to a membership organization generally are not subject to the UBIT. However, several courts have held that, with respect to postal labor organizations, dues payments were subject to the UBIT when received from individuals who were not postal workers but who became "associate" members for the purpose of obtaining health insurance available to members of the organization. See National League of Postmasters of the United States v. Commissioner, No. 8032-93, T.C. Memo (May 11, 1995); American Postal Workers Union, AFL-CIO v. United States, 925 F.2d 480 (D.C. Cir. 1991); National Association of Postal Supervisors v. United States, 944 F.2d 859 (Fed. Cir. 1991).

In Rev. Proc. 95-21 (issued March 23, 1995), the IRS set forth its position regarding when associate member dues payments received by an organization described in section 501(c)(5) will be treated as subject to the UBIT. The IRS stated that dues payments from associate members will not be treated as subject to UBIT unless, for the relevant period, "the associate member category has been formed or availed of for the principal purpose of producing unrelated business income." Thus, under Rev. Proc. 95-21, the focus of the inquiry is upon the organization's purposes in forming the associate member category (and whether the purposes of that category of membership are substantially related to the organization's exempt purposes other than through the production of income), rather than upon the motive of the individuals who join as associate members.

Description of Proposal

Under the proposal, if an agricultural or horticultural organization described in section 501(c)(5) requires annual dues not exceeding $100 to be paid in order to be a member of such organization, then in no event would any portion of such dues be subject to the UBIT by reason of any benefits or privileges to which members of such organization are entitled. For taxable years beginning after 1995, the $100 amount would be indexed for inflation. The term "dues" would be defined as "any payment required to be made in order to be recognized by the organization as a member of the organization."[9]

Effective Date

The proposal would apply to taxable years beginning after December 31, 1994.

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[9] Legislative history would indicate that no inference would be intended regarding the UBIT treatment of any dues payment not governed by the proposal.

D. Repeal Tax Credit for Contributions to Special Community Development Corporations

Present Law

Taxpayers are entitled to claim a tax credit for qualified contributions made to one of 20 non-profit community development corporations (CDCs) selected by the Secretary of HUD to provide assistance in economically distressed areas. A qualified contribution means a transfer of cash to a selected CDC (made in the form of an equity investment or loan) which is made available for use by the CDC for at least 10 years to provide employment and business opportunities to low-income residents who live in an area where (1) the unemployment rate is not less than the national unemployment rate and (2) the median family income does not exceed 80 percent of the median gross income of residents of the jurisdiction of the local government which includes such area.[10]

If a taxpayer makes a qualified contribution, the credit may be claimed by the taxpayer for each taxable year during the 10-year period beginning with the taxable year during which the contribution was made. The credit that may be claimed for each year is equal to 5 percent of the amount of the contribution to the CDC. Thus, during the 10-year credit period, the taxpayer may claim aggregate credit amounts totalling 50 percent of his or her contribution. The aggregate amount of contributions that may be designated by any one CDC as eligible for the credit may not exceed $2 million. (Consequently, a total amount of $40 million in contributions will be eligible for the credit with respect to all 20 selected CDCs--and the maximum credit amounts will total $20 million over the 10-year credit period.)

On June 30, 1994, the Secretary of HUD announced the 20 CDCs selected to receive contributions that qualify the for the credit. The eligible CDCs are located in the following areas: (1) Atlanta, (2) Baltimore, (3) Boston, (4) Chicago, (5) Cleveland, (6) Dallas, (7) Washington D.C., (8) Los Angeles, (9) Memphis, (10) Miami, (11) Brooklyn, (12) Newark, (13) Watsonville, Ca., (14) London, Ky., (15) Wiscasset, Maine, (16) Greenville, Miss., (17) Mayville, N.Y., (18) Barnesboro, Pa., (19) San Antonio, Texas, and (20) Christiansburg, Va.

Description of Proposal

The special tax credit for qualified contributions to selected community development corporations would be repealed.

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[10] The contribution to the CDC must be available for use by the CDC for at least ten years, but need not meet the requirements of a "contribution or gift" for purposes of section 170. In other words, a contribution eligible for the credit may be made in the form of a 10-year loan (or other long-term investment), the principal of which is to be returned to the taxpayer after the 10-year period. However, in the case of a donation of cash made by a taxpayer to an eligible CDC, the taxpayer is allowed to claim a charitable contribution deduction (subject to present-law rules under section 170), in addition to the special credit for qualified contributions to a selected CDC.

Effective Date

The proposal would be effective for contributions made after the date of enactment (other than a contribution made pursuant to a legally enforceable agreement to make such contribution, if such agreement is in effect on the date of enactment).

E. Required Notices to Charitable Beneficiaries of Charitable Remainder Trusts

Present Law

Subject to certain limitations, an estate generally is allowed a deduction for transfers of property to charitable organizations, the United States, or a State or local government (sec. 2055(a)). Where a remainder interest is transferred to the charity in trust, however, a deduction is only permitted if the interest passing to the charitable remainderman is in the form of a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund (sec. 2055(e)).

In order for the estate to take the deduction authorized by section 2055, the Treasury regulations require that the executor submit a copy of the transfer instrument with the estate tax return and stipulate that no actions have been filed or are (according to the executor's information and belief) contemplated to contest the decedent's will in a manner affecting the charitable deduction claimed.

A qualifying charitable remainder trust is generally exempt from tax unless it has unrelated business taxable income. The fiduciary of a qualifying charitable remainder trust must presently file an annual information return and a tax return unless all net income is required to be distributed currently to the beneficiaries. A charitable remainderman generally may inspect any such returns upon written request to the Internal Revenue Service (sec. 6103). Presently, the executor and trust fiduciaries generally are not required under the Code to provide any information directly to the charitable remainderman.

Description of Proposal

The proposal would require an executor claiming a charitable deduction on the estate tax return for certain qualified remainder interests to provide to the beneficiary of such a remainder interest notification that such a remainder interest has been created. Such notice would be provided to the beneficiary within three months of the due date (or any extension thereof) for filing the estate tax return. This notification requirement would not apply in the case of a contingent remainder interest.

The proposal would further require the fiduciary of certain trusts with a charitable remainder interest to notify annually the beneficiary of such a remainder interest that such a remainder interest exists. The proposal would provide exceptions to this annual notification requirement if the Secretary determines it is not necessary for the efficient administration of tax law; if the fiduciary has previously provided notification; if the beneficiary relieves the fiduciary of the requirement; or if, as provided under State law, the fiduciary provides periodic accounting to the beneficiary of the remainder interest. The annual notification requirement would not apply in the case of a contingent remainder interest.

Effective Date

The proposal with respect to notification relating to charitable interest claimed on estate tax returns would be effective after December 31, 1995. The annual notification requirement would be effective for taxable years beginning after December 31, 1995.

F. Treat Qualified Football Coaches Plan as Multiemployer Pension Plan for Purposes of the Internal Revenue Code

Present Law

Under present law, a tax-qualified pension plan (including a qualified cash or deferred arrangement) must be maintained for the exclusive benefit of the employees and their beneficiaries covered under the plan.

The American Football Coaches Association ("AFCA") is a tax-exempt organization described in section 501(c)(6) of the Code. The members of the AFCA include college coaches, athletic directors, and high school coaches; the participating members of the AFCA are not employees of the organization. The AFCA maintains a cash or deferred arrangement (i.e., a "401(k) plan") on behalf of participating members.

The Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by the Continuing Appropriations for Fiscal Year 1988, provides that, for purposes of the labor law provisions of ERISA, a qualified football coaches plan generally is treated as a multiemployer plan and may include a qualified cash or deferred arrangement. Under ERISA, a qualified football coaches plan is defined as any defined contribution plan established and maintained by an organization described in Code section 501(c)(6), the membership of which consists entirely of individuals who primarily coach football as full-time employees of 4-year colleges or universities, if the organization was in existence on September 18, 1986. This definition is generally intended to apply to the AFCA.

However, the Omnibus Budget Reconciliation Act of 1987 provided that certain provisions of ERISA are not applicable in interpreting the Internal Revenue Code, except to the extent specifically provided in the Code or as determined by the Secretary of the Treasury.

The Internal Revenue Service determined that the cash or deferred arrangement maintained by the AFCA is not a qualified cash or deferred arrangement under the Internal Revenue Code. In making this determination, the IRS also observed that the AFCA plan may also violate a number of provisions of the Code. For example, the Code requires that a qualified plan be maintained for the benefit of employees, but the coaches are not employees of the AFCA.

Description of Proposal

A technical correction to the Continuing Appropriations for Fiscal Year 1988 would provide that a qualified football coaches plan (as defined in ERISA) is eligible to maintain a qualified cash or deferred arrangement under the Internal Revenue Code on behalf of the football coaches belonging to the AFCA. In order for the plan to be reinstated as a qualified football coaches plan, a $25,000 excise tax would be imposed on the plan.

Effective Date

The proposal would generally be effective as if included in the Continuing Appropriations for Fiscal Year 1988 (i.e., years beginning after December 22, 1987). The excise tax would have to be paid in the first plan year beginning after the date of enactment.

IX. CORPORATE AND OTHER TAX REFORMS AND MISCELLANEOUS PROVISIONS

1. Reform the tax treatment of certain corporate stock redemptions

Present Law

A corporate shareholder generally can deduct at least 70 percent of a dividend received from another corporation. This dividends received deduction is 80 percent if the corporate shareholder owns at least 20 percent of the distributing corporation and generally 100 percent if the shareholder owns at least 80 percent of the distributing corporation.

Section 1059 of the Code requires a corporate shareholder that receives an "extraordinary dividend" to reduce the basis of the stock with respect to which the dividend was paid by the nontaxed portion of the dividend. Whether a dividend is "extraordinary" is determined, among other things, by reference to the size of the dividend in relation to the adjusted basis of the shareholder's stock. Also, a dividend resulting from a non pro rata redemption or a partial liquidation is an extraordinary dividend. If the reduction in basis of stock exceeds the basis in the stock with respect to which an extraordinary dividend is paid, the excess is taxed as gain on the sale or disposition of such stock, but not until that time (sec. 1059(a)(2)).

In general, a distribution in redemption of stock is treated as a dividend, rather than as a sale of the stock, if it is essentially equivalent to a dividend (sec. 302). A redemption of the stock of a shareholder generally is essentially equivalent to a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation. Section 302(b) also contains several specific tests (e.g., a substantial reduction computation and a termination test) to identify redemptions that are not essentially equivalent to dividends. The determination whether a redemption is essentially equivalent to a dividend includes reference to the constructive ownership rules of section 318, including the option attribution rules of section 318(a)(4).

Description of Proposal

Under the proposal, except as provided in regulations, a corporate shareholder would recognize gain immediately with respect to any redemption treated as a dividend (in whole or in part) when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership.[1]

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[1] Thus, for example, where a portion of such a distribution would not have been treated as a dividend due to insufficient earnings and profits, the rule would apply to the portion treated as a dividend.

In addition, the proposal would require immediate gain recognition whenever the basis of stock with respect to which any extraordinary dividend was received is reduced below zero.

Reorganizations or other exchanges involving amounts that are treated as dividends under section 356(a)(2) of the Code are treated as redemptions for purposes of applying the rules relating to redemptions under section 1059(e). For example, if a recapitalization or other transaction that involves a dividend under section 356 has the effect of a non-pro rata redemption or is treated as a dividend due to options being counted as stock, the rules of section 1059 apply. Redemptions of shares (or other extraordinary dividends on shares) held by a partnership will be subject to section 1059 to the extent there are corporate partners (e.g., appropriate adjustments to the basis of the shares held by the partnership and to the basis of the corporate partner's partnership interest will be required).

Finally, under continuing section 1059(g) of present law, the Treasury Department would be authorized to issue regulations where necessary to carry out the purposes and prevent the avoidance of the provision.

Effective Date

The proposal would generally be effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on that date. However, in applying the new gain recognition rules to any distribution that is not a partial liquidation, a non-pro rata redemption, or a redemption that is treated as a dividend by reason of options, September 13, 1995 would be substituted for May 3, 1995 in applying the transition rules.

No inference is intended regarding the tax treatment under present law of any transaction within the scope of the proposal, including transactions utilizing options.

2. Require corporate tax shelter reporting

Present Law

An organizer of a tax shelter is required to register the shelter with the Internal Revenue Service (IRS) (sec. 6111). If the principal organizer does not do so, the duty may fall upon any other participant in the organization of the shelter or any person participating in its sale or management. The shelter's identification number must be furnished to each investor who purchases or acquires an interest in the shelter. Failure to furnish this number to the tax shelter investors will subject the organizer to a $100 penalty for each such failure (sec. 6707(b)).

A penalty may be imposed against an organizer who fails without reasonable cause to timely register the shelter or who provides false or incomplete information with respect to it. The penalty is the greater of one percent of the aggregate amount invested in the shelter or $500. Any person claiming any tax benefit with respect to a shelter must report its registration number on her

return. Failure to do so without reasonable cause will subject that person to a $250 penalty (sec. 6707(b)(2)).

A person who organizes or sells an interest in a tax shelter subject to the registration rule or in any other potentially abusive plan or arrangement must maintain a list of the investors (Code sec. 6112). A $50 penalty may be assessed for each name omitted from the list. The maximum penalty per year is $100,000 (sec. 6708).

For this purpose, a tax shelter is defined as any investment that meets two requirements. First, the investment must be (1) required to be registered under a Federal or state law regulating securities, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or state agency regulating the offering or sale of securities, or (3) a substantial investment. Second, it must be reasonable to infer that the ratio of deductions and 350% of credits to investment for any investor (i.e., the tax shelter ratio) may be greater than two to one as of the close of any of the first five years ending after the date on which the investment is offered for sale. An investment that meets these requirements will be considered a tax shelter regardless of whether it is marketed or customarily designated as a tax shelter (sec. 6111(c)(1)).

Description of Proposal

The proposal would require a promoter of a corporate tax shelter to register the shelter with the Secretary. Registration would be required not later than the next business day after the day when the tax shelter is first offered to potential users. If the promoter is not a U.S. person, or if a required registration is not otherwise made, then any U.S. participant is required to register the shelter. An exception to this special rule provides that registration is not required if the U.S. participant notifies the promoter in writing not later than the seventh day after discussions began that the U.S. participant will not participate in the shelter and the U.S. person does not in fact participate in the shelter.

A corporate tax shelter is any investment, plan, arrangement or transaction (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoters may receive total fees in excess of $100,000. A transaction is offered under conditions of confidentiality if: (a) an offeree (or any person acting on its behalf) has an understanding or agreement with or for the benefit of any promoter to restrict or limit its disclosure of the transaction or any significant tax features of the transaction; or (b) the promoter claims, knows or has reason to know (or the promoter causes another person to claim or otherwise knows or has reason to know that a party other than the potential offeree claims) that the transaction (or one or more aspects of its structure) is proprietary to the promoter or any party other than the offeree, or is otherwise protected from disclosure or use. The promoter would include related parties.

Registration will require the submission of information identifying and describing the tax shelter and the tax benefits of the tax shelter, as well as such other information as the Treasury Department may require.

Tax shelter promoters would be required to maintain lists of those who have signed confidentiality agreements, or otherwise been subjected to nondisclosure requirements, with respect to particular tax shelters. In addition, promoters would have to retain lists of those paying fees with respect to plans or arrangements which have previously been registered (even though the particular party may not have been subject to confidentiality restrictions).

All registrations will be treated as taxpayer information under the provisions of section 6103 and will therefore not be subject to any public disclosure.

The penalty for failing to timely register a corporate tax shelter would be the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration (i.e., this part of the penalty would not apply to fee payments with respect to offerings after late registration). A similar penalty would apply to actual participants in any corporate tax shelter who were required to register the tax shelter but did not. With respect to participants, however, the 50-percent penalty would only be based on fees paid by that participant. Intentional disregard of the requirement to register by either a promoter or a participant would result in the 50-percent penalty being increased to 75 percent of the applicable fees.

Effective Date

The proposal would apply to any tax shelter offered to potential participants after the date of enactment. No filings would be due, however, until the Treasury Department issues guidance with respect to the filing requirements.

3. Disallow interest deduction for corporate-owned life insurance policy loans

Present Law

No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract ("inside buildup").[2] Further, an exclusion from Federal income tax

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[2] This favorable tax treatment is available only if a life insurance contract meets certain requirements designed to limit the investment character of the contract. Distributions from a life insurance contract (other than a modified endowment contract) that are made prior to the death of the insured generally are includible in income, to the extent that the amounts distributed exceed the taxpayer's basis in the contract; such distributions generally are treated first as a tax-free recovery of basis, and then as income. In the case of a modified endowment contract, however, distributions are treated as income first, loans are treated as distributions (i.e., income rather than

is provided for amounts received under a life insurance contract paid by reason of the death of the insured. The policyholder may borrow with respect to the life insurance contract without affecting these exclusions, subject to certain limitations.

Considerable publicity has been focused on the magnitude of business borrowings with respect to life insurance and the scale of the tax benefits. In a recent article describing corporate-owned life insurance ("COLI"), it was stated, "COLIs can net big bucks. After 40 years, a COLI program that pays a $10,000 annual premium on each of 5,000 employees will produce about $450 million in death benefits and $300 million in tax benefits -- netting the company $230 million."[3]

A company that sets up a COLI program typically purchases life insurance on the lives of its employees, in many cases thousands or tens of thousands of employees.[4] The company, not the employee or his family, receives all or most of the proceeds on the employee's death. The company borrows against the value of the life insurance policies at an interest rate just above the rate at which inside buildup is credited under the policy. The interest that the company pays on policy loans from the insurer is credited under the policy and increases the tax-free inside buildup. At the same time, the company deducts the interest it pays. The company shows a positive return on the COLI program, because the after-tax interest it pays on the policy loan is less than the interest income being credited under the policy. In addition, tax-free death benefits that the company receives on the death of insured employees subsidize future years' premiums. The company is able to increase the value of its life insurance contract while using funds borrowed under the insurance contract for other purposes.[5] Large COLI programs could be viewed as the economic equivalent of a tax-free savings account owned by the company into which it pays itself tax-deductible interest.

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basis recovery first), and an additional ten percent tax is imposed on the income portion of distributions made before age 59-1/2 and in certain other circumstances. A modified endowment contract is a life insurance contract that is funded more rapidly than seven annual level premiums.

[3] Solov, Diane, "Companies Profit By Insurance," St. Paul Pioneer Press, p. 2E, March 20, 1995. See also Sheppard, Lee, "'Janitor' Insurance as a Tax Shelter," Tax Notes, p. 1526, September 25, 1995.

[4] In some cases, state law provides that an employer continues to have an insurable interest in former employees even after the termination of their employment. Thus, this life insurance coverage may be continued after an employee terminates employment with an employer, creating an ever-increasing pool of lives.

[5] Companies sometimes use the funds borrowed under the life insurance contracts for tax-advantaged funding of expenses such as retiree health benefits and nuclear decommissioning expenses, even though Congress has already provided special tax benefits specifically for funding these expenses.

The limitations on borrowing with respect to a life insurance contract under present law provide that no deduction is allowed for any interest paid or accrued on any indebtedness with respect to one or more life insurance policies owned by the taxpayer covering the life of any individual who (1) is an officer or employee of, or (2) is financially interested in, any trade or business carried on by the taxpayer to the extent that the aggregate amount of such debt with respect to policies covering the individual exceeds $50,000.

Further, no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a life insurance, endowment or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract.[6] An exception to the latter rule is provided, permitting deductibility of interest on bona fide debt that is part of such a plan, if no part of 4 of the annual premiums due during the first 7 years is paid by means of debt (the "4-out-of-7 rule"). Provided the transaction gives rise to debt for Federal income tax purposes, and provided the 4-out-of-7 rule is met, a company may under present law borrow up to $50,000 per employee, officer, or financially interested person to purchase or carry a life insurance contract covering such a person, and is not precluded by the statutory disallowance rules from deducting the interest on the debt, even though the earnings inside the life insurance contract (inside buildup) are tax-free, and in fact the taxpayer has full use of the borrowed funds.

Description of Proposal

Subject to an exception described below, the proposal would eliminate any deduction for any amount paid or accrued on any indebtedness with respect to life insurance, endowment or annuity policies owned by the taxpayer covering any individual who is either an officer or employee of, or financially interested in, any trade or business carried on by the taxpayer, regardless of the aggregate amount of debt with respect to policies covering the individual.

An exception would be provided retaining present law for interest on indebtedness with respect to life insurance policies covering up to 25 key persons. A key person would be an individual who is either an officer or a 20-percent owner of the taxpayer. The taxpayer could designate a number of key persons equal to the greater of 5 people or 5 percent of the number of officers and employees, but not more than 25. All members of a controlled group would be treated as one taxpayer for this purpose. Interest paid or accrued on debt with respect to a life insurance contract covering a key person would be deductible only if the rate of interest does not

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[6] The statute provides a that the $50,000 limitation does not apply with respect to contracts purchased on or before June 20, 1986. However, additional limitations are imposed by statute on the deductibility of interest with respect to single premium contracts, and on the deductibility of premiums paid on a life insurance contract covering the life of any officer or employee or person financially interested in a trade or business of the taxpayer when the taxpayer is directly or indirectly a beneficiary under the contract. In addition to statutory disallowance rules, generally applicable principles of tax law apply.

exceed Moody's Corporate Bond Yield Average - Monthly Average Corporates for each month interest is paid or accrued.

Effective Date

With respect to debt incurred after December 31, 1995, no deduction would be allowed except with respect to policies that satisfy the key man exception. In addition, as described below, a grandfather rule would be provided with respect to certain interests on indebtedness with respect to contracts issued on or before June 20, 1986.

With respect to debt incurred on or before December 31, 1995, any interest paid or accrued after October 13, 1995, and before January 1, 2001, would be allowed to the extent the rate of interest does not exceed the lesser of (1) the borrowing rate specified in the contract as of October 13, 1995, or (2) a percentage of Moody's Corporate Bond Yield Average - Monthly Average Corporates for each month the interest is paid or accrued. For interest paid or accrued after October 13, 1995, and before January 1, 1997, the percentage of the Moody's rate would be 100 percent; for interest paid or accrued in 1997, the percentage would be 95 percent; for 1998, the percentage would be 90 percent; for 1999, the percentage would be 85 percent; for 2000, the percentage would be 80 percent; and for 2001 and thereafter, the percentage would be 0 percent.

Any amount included in income during 1996, 1997, 1998, 1999, 2000 or 2001, that is received under a contract described in the proposal on the complete surrender, redemption or maturity of the contract or in full discharge of the obligation under the contract that is in the nature of a refund of the consideration paid for the contract, would be includable ratably over the first four taxable years beginning with the taxable year the amount would otherwise have been includable. Utilization of this 4-year income-spreading rule would not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of failure to meet the 4-out-of-7 rule.

In the case of an insurance company, the unamortized balance of policy expenses attributable to a contract with respect to which the 4-year income-spreading treatment is allowed to the policyholder would be deductible in the year in which the transaction giving rise to income-spreading occurs.

The proposal generally would not apply to interest on debt with respect to contracts purchased on or before June 20, 1986 (thus continuing the effective date provision of the $50,000 limitation enacted in the 1986 Act), except that interest on such contracts paid or accrued after October 13, 1995 would be allowable only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average - Monthly Average Corporates for each month the interest is paid or accrued.

Under the proposal, there would be no inference as to the tax treatment of interest paid or accrued under present law.

4. Phase-out preferential tax deferral for certain large farm corporations required to use accrual accounting

Present Law

A corporation engaged in the trade or business of farming must use an accrual method of accounting for such activities unless such corporation, for each prior taxable year beginning after December 31, 1975, did not have gross receipts exceeding $1 million. If a farm corporation is required to change its method of accounting, the section 481 adjustment resulting from such change is included in gross income ratably over a 10-year period, beginning with the year of change. This rule does not apply to a family farm corporation.

A provision of the Revenue Act of 1987 ("1987 Act") requires a family corporation to use an accrual method of accounting for its farming business unless, for each prior taxable year beginning after December 31, 1985, such corporation (and any predecessor corporation) did not have gross receipts exceeding $25 million. A family corporation is one where 50 percent or more of the stock of the corporation is held by one (or in some limited cases, two or three) families.

A family farm corporation that must change to an accrual method of accounting as a result of the 1987 Act provision is to establish a suspense account in lieu of including the entire amount of the section 481 adjustment in gross income. The initial balance of the suspense account equals the lesser of (1) the section 481 adjustment otherwise required for the year of change, or (2) the section 481 adjustment computed as if the change in method of accounting had occurred as of the beginning of the taxable year preceding the year of change.

The amount of the suspense account is required to be included in gross income if the corporation ceases to be a family corporation. In addition, if the gross receipts of the corporation attributable to farming for any taxable year decline to an amount below the lesser of (1) the gross receipts attributable to farming for the last taxable year for which an accrual method of accounting was not required, or (2) the gross receipts attributable to farming for the most recent taxable year for which a portion of the suspense account was required to be included in income, a portion of the suspense account is required to be included in gross income.

Description of Proposal

The proposal would repeal the ability of a family farm corporation to establish a suspense account when it is required to change to an accrual method of accounting. Thus, under the proposal, any family farm corporation required to change to an accrual method of accounting would include in gross income the section 481 adjustment applicable to the change ratably over a 10-year period beginning with the year of change. In addition, any taxpayer with an existing suspense account would be required to include the account in income ratably over a 20-year period beginning in the first taxable year beginning after September 13, 1995, subject to the

present-law requirements to include all or a portion of the account in income more rapidly in certain instances.

Effective Date

The proposal would be effective for taxable years ending after September 13, 1995.

5. Phaseout of section 936 credit

Present Law

Certain domestic corporations with business operations in the U.S. possessions (including, for this purpose, Puerto Rico and the U.S. Virgin Islands) may elect the section 936 credit which generally eliminates the U.S. tax on certain income related to their operations in the possessions. In contrast to the foreign tax credit, the possessions tax credit is a "tax sparing" credit. That is, the credit is granted whether or not the electing corporation pays income tax to the possession. Income exempt from U.S. tax under this provision falls into two broad categories: (1) possession business income, which is derived from the active conduct of a trade or business within a U.S. possession or from the sale or exchange of substantially all of the assets that were used in such a trade or business; and (2) qualified possession source investment income ("QPSII"), which is attributable to the investment in the possession or in certain Caribbean Basin countries of funds derived from the active conduct of a possession business.

In order to qualify for the section 936 credit for a taxable year, a domestic corporation must satisfy two conditions (sec.936(a)(2)). First, the corporation must derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation must derive at least 75 percent of its gross income for that same period from the active conduct of a possession business.

A domestic corporation that has elected the section 936 credit and that satisfies these two conditions for a taxable year generally is entitled to a credit equal to the U.S. tax attributable to the sum of the taxpayer's possession business income and its QPSII. However, the amount of the credit attributable to possession business income is subject to the limitations enacted by the Omnibus Budget Reconciliation Act of 1993 ("1993 Act") (sec. 936(a)(4)). Under the economic activity limit, the amount of the credit with respect to such income cannot exceed the sum of a portion of the taxpayer's wage and fringe benefit expenses and depreciation allowances (plus, in certain cases, possession income taxes). In the alternative, the taxpayer may elect to apply a limit equal to the applicable percentage of the credit that would otherwise be allowable with respect to possession business income; the applicable percentage is phased down, beginning at 60 percent for 1994 and reaching 40 percent for 1998 and thereafter. The amount of the section 936 credit attributable to QPSII is not subject to these limitations.

Description of Proposal

The proposal would limit the section 936 credit attributable to both possession business income and QPSII as described below. Except as described below with respect to existing facilities in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands, the section 936 credit would be eliminated for taxable years beginning after December 31, 2001.

For taxpayers using the economic activity limit enacted by the 1993 Act, the section 936 credit attributable to possession business income (determined under the economic activity limit) would continue to be determined as under present law through the taxpayer's taxable year beginning in 2001. For taxable years beginning in 2002 and thereafter, the section 936 credit attributable to possession business income (determined under the economic activity limit) would be eliminated.

For taxpayers that elected to use the applicable percentage limit and not to use the economic activity limit, the section 936 credit attributable to possession business income would continue to be determined as under present law through the taxpayer's taxable year beginning in 1998. For taxable years beginning during 1999, the section 936 credit attributable to possession business income (determined under the applicable percentage limitation) that would be allowed under the proposal would be limited to 75 percent of the amount that would otherwise be allowed. For taxable years beginning during 2000, the section 936 credit attributable to possession business income (determined under the applicable percentage limit) that would be allowed under the proposal would be limited to 50 percent of the amount that would otherwise be allowed. For taxable years beginning during 2001, the section 936 credit attributable to possession business income (determined under the applicable percentage limit) that would be allowed under the proposal would be limited to 25 percent of the amount that would otherwise be allowed. For taxable years beginning in 2002 and thereafter, the section 936 credit attributable to possession business income (determined under the applicable percentage limit) would be eliminated.

A taxpayer that elected to use the applicable percentage limit would be permitted to revoke that election for its taxable year beginning in 1996 and thereafter. A revocation must be made not later than for the taxable year beginning after December 31, 1995; such revocation, if made, would apply to such taxable year and to all subsequent taxable years.

For taxable years beginning in 1996 and thereafter, the section 936 credit attributable to QPSII would apply only to income attributable to investments made on or before October 13, 1995 (provided such income would otherwise qualify as QPSII under present law). For taxable years beginning after December 31, 1995, income attributable to investments made after October 13, 1995 would not be eligible for the section 936 credit. Income attributable to an investment made on or before October 13, 1995 (or to the reinvestment of the proceeds of such an investment) would be eligible for the section 936 credit attributable to QPSII through the date that such investment, if distributed, would be eligible for the maximum reduction in local taxes

(as determined under local law in effect as of October 13, 1995). However, the section 936 credit attributable to QPSII would be eliminated for taxable years beginning after December 31, 2000.

With respect to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands, the section 936 credit would be eliminated for taxable years beginning after December 31, 1995. However, special rules would apply with respect to the section 936 credit derived from existing operations in Guam, American Samoa, and the Northern Mariana Islands. For taxable years beginning before 2006, present law would continue to apply in determining the section 936 credit derived from operations conducted through existing facilities in such possessions. A facility would cease to qualify as an existing facility if a substantial new line of business is conducted through such facility after October 13, 1995; such a facility would cease to qualify as an existing facility as of the beginning of the taxable year during which the substantial new line of business is added. An existing facility would continue to qualify as an existing facility following a change of ownership of such facility (provided that a substantial new line of business is not conducted through such facility). For taxable years beginning in 2006 and thereafter, the section 936 credit with respect to such existing facilities would be eliminated.

Effective Date

The proposal would be effective on the date of enactment.

6. Corporate accounting--reform of income forecast method

Present Law

Depreciation and amortization, in general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through allowances for depreciation or amortization. Depreciation deductions are allowed under section 167 and the amounts of such deductions are determined under the modified Accelerated Cost Recovery System ("MACRS") of section 168 for most tangible property. MACRS determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Intangible property generally is amortized under section 197, which applies a 15-year recovery period and the straight-line method to the cost of applicable property.

Treatment of film, video tape, and similar property

MACRS does not apply to certain property, including (1) any motion picture film, video tape, or sound recording or (2) any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer applies a unit-of-production method or other method of depreciation not expressed in a term of years. Likewise, section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property unless acquired as part of a trade or business.

Thus, the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be recovered under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost of such property may be depreciated under the general depreciation provision of section 167, which allows deductions for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property.

The "income forecast" method is an allowable method for calculating depreciation under section 167 for certain property. The income forecast method attempts to match allocable portions of the cost of property with the income expected to be generated by the property. Specifically, under the income forecast method, the depreciation deduction for a taxable year for a property is determined by multiplying the cost of the property[7] (less estimated salvage value) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income to be derived from the property during its useful life. The income forecast method has been held to be applicable for computing depreciation deductions for motion picture films, television films and taped shows, books, patents, master sound recordings and video games.[8] The total forecasted or estimated income to be derived from a property is to be based on the conditions known to exist at the end of the period for which depreciation is claimed. This estimate can be revised upward or downward at the end of a subsequent taxable period based on additional information that becomes available after the last prior estimate. These revisions, however, do not affect the amount of depreciation claimed in a prior taxable year. Thus, unforeseen income that is generated after the property is fully depreciated is never taken into account under the income forecast method.

In the case of a film, income to be taken into account under the income forecast method means income from the film less the expense of distributing the film, including estimated income

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[7] In Transamerica Corp. v. U.S., 999 F.2d 1362, (9th Cir. 1993), the Ninth Circuit overturned the District Court and held that for purposes of applying the income forecast method to a film, the "cost of a film" includes "participation" and "residual" payments (i.e., payments to producers, writers, directors, actors, guilds, and others based on a percentage of the profits from the film) even though these payments were contingent on the occurrence of future events. It is unclear to what extent, if any, the Transamerica decision applies to amounts incurred after the enactment of the economic performance rules of Code section 461(h), as contained in the Deficit Reduction Act of 1984.

[8] See, e.g., Rev. Rul. 60-358, 1960-2 C.B. 68; Rev. Rul. 64-273, 1964-2 C.B. 62; Rev. Rul 79-285, 1979-2 C.B. 91; and Rev. Rul. 89-62, 1989-1 C.B. 78. Conversely, the courts have held that certain tangible personal property was not of a character to which the income forecast method was applicable. See, e.g., ABC Rentals of San Antonio v. Comm., 68 TCM 1362 (1994) (consumer durable property subject to short-term, "rent-to-own" leases not eligible) and Carland, Inc. v. Comm., 90 T.C. 505 (1988), aff'd on this issue, 909 F.2d 1101 (8th Cir 1990) (railroad rolling stock subject to a lease not eligible).

from foreign distribution or other exploitation of the film.[9] In the case of a motion picture released for theatrical exhibition, income does not include estimated income from future television exhibition of the film (unless an arrangement for domestic television exhibition has been entered into before the film has been depreciated to its reasonable salvage value). In the case of a series or a motion picture produced for television exhibition, income does not include estimated income from domestic syndication of the series or the film (unless an arrangement for syndication has been entered into before the series or film has been depreciated to its reasonable salvage value).[10] The Internal Revenue Service also has ruled that income does not include net merchandising revenue received from the exploitation of film characters.[11]

Description of Proposal

The proposal would make several amendments to the income forecast method of determining depreciation deductions.

First, the proposal would provide that income to be taken into account under the income forecast method includes all estimated income generated by the property. In applying this rule (and the look-back method described below), a taxpayer generally need not take into account income expected to be generated more than ten years after the year the property was placed in service. In addition, pursuant to a special rule, if a taxpayer produces a television series and initially does not anticipate syndicating the episodes from the series, the forecasted income for the episodes of the first three years of the series need not take into account any future syndication fees (unless the taxpayer enters into an arrangement to syndicate such episodes during such period). The 10-year rule and the syndication rule would apply for purposes of the look-back method described below.

In the case of a film, television show, or similar property, estimated income to be taken into account with respect to the property would include, but would not necessarily be limited to, income from foreign and domestic theatrical, television, and other releases and syndications; video tape releases, sales, rentals, and syndications; and the exploitation of film or program characters, prints, scripts, and scores. It is anticipated that income from the exploitation of film or program characters would, except as provided in regulations, generally be limited to income realized from licensing, rental, royalty and other similar arrangements with third parties with respect to such property and income from the sales of merchandise or other items that embody such characters.

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[9] Rev. Rul. 60-358, 1960-2 C.B. 68.

[10] Rev. Proc. 71-29, 1971-2 C.B. 568.

[11] Private letter ruling 7918012, January 24, 1979. Private letter rulings do no have precedential authority and may not be relied upon by any taxpayer other than the taxpayer receiving the ruling but are some indication of IRS administrative practice.

In addition, the cost of property subject to depreciation would only include amounts that satisfy the economic performance standard of section 461(h).[12] Any costs that are taken into account after the property is placed in service would be treated as a separate piece of property to the extent (1) such amounts are expected to give rise to significant future income not reasonably anticipated with respect to the property originally placed in service or (2) such costs are incurred more than 10 years after the property was placed in service.
Except as provided in regulations, any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year.

Finally, taxpayers that claim depreciation deductions under the income forecast method would be required to pay (or would receive) interest based on the recalculation of depreciation under a "look-back" method.[13] The "look-back" method would be applied in any "recomputation year" by: (1) comparing depreciation deductions that had been claimed in prior periods to depreciation deductions that would have been claimed had the taxpayer used actual, rather than estimated, total income from the property; (2) determining the hypothetical overpayment or underpayment of tax based on this recalculated depreciation; and (3) applying the overpayment rate of section 6621 of the Code. Except as provided in regulations, a "recomputation year" would be the third and tenth taxable year after the taxable year the property was placed in service unless the actual income from the property for each period before the close of such years was within 10 percent of the estimated income from the property for such periods. The Secretary of the Treasury would have the authority to allow a taxpayer to delay the initial application of the look-back method where the taxpayer may be expected to have significant income from the property after the third taxable year after the taxable year the property was placed in service (e.g., the Secretary may exercise such authority where the depreciable life of the property is expected to be longer than three years).[14] Property with an adjusted basis of $100,000 or less when the property was placed in service would not be subject to the look-back method. The proposal would provide a simplified look-back method for pass-through entities.

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[12] No inference would be intended as to the proper application of section 461(h) to the income forecast method under present law.

[13] The "look-back" method of the proposal would resemble the look-back method applicable to long-term contracts accounted for under the percentage-of-completion method of present-law sec. 460. Interest paid or received under the look-back method of the proposal would be treated similarly to interest paid or received under sec. 460.

[14] In applying the look-back method, any cost that is taken into account after the property was placed in service may be taken into account by discounting (using the Federal mid-term rate determined under sec. 1274(d) as of the time the costs were taken into account) such cost to its value as of the date the property was placed in service.

Effective Date

The proposal would be effective for property placed in service after September 13, 1995, unless placed in service pursuant to a binding written contract in effect before such date and all times thereafter.

7. Allow amortization for intrastate operating rights of motor carriers

Present Law and Background

A taxpayer is allowed to write-off and deduct the adjusted basis of property used in trade or business when such property becomes worthless (sec. 165). A write-off is not allowed if the property merely loses value but does not become worthless. For example, in CRST, Inc., 909 F2d. 1146, (8th Cir. 1990), a motor carrier was denied a worthlessness deduction for the basis of operating authorities that had become less valuable, but not worthless, due to deregulation.

Effective January 1, 1995, section 601 of the Federal Aviation Administration Authorization Act of 1994 preempts and prohibits States regulation of the price, route, or service of intrastate operations of motor carriers.

Description of Proposal

The proposal would allow a taxpayer who held, on January 1, 1995, an operating authority that was preempted by section 601 of the Federal Aviation Administration Authorization Act of 1994 to amortize the adjust basis of such authority ratably over a 36-month period. No other deduction would be allowed with respect to such property.

Effective Date

The proposal would be effective for taxable years ending on or after January 1, 1995.

8. Permit corporate pension transfers to fund employee benefits

Present Law

Pension plan funding

Present law imposes minimum funding requirements on employers sponsoring a defined benefit pension plan which are designed to provide at least a certain level of benefit security by requiring the employer to make certain minimum contributions to the plan.

Within limits, an employer is permitted to make contributions in excess of the minimum funding requirements. Making contributions in excess of those required by the minimum funding

requirements, as well as other factors, such as greater investment returns than assumed for funding purposes, can contribute to overfunding of pension plans.

Contributions to a plan are no longer deductible by the employer when plan assets reach a certain level, called the full-funding limit. Contributions in excess of the full-funding limit are also subject to a 10-percent excise tax. A plan has reached the full-funding limit if the level of plan assets exceeds the lesser of (1) 150 percent of current liability, or (2) the accrued liability under the plan. In general terms, "current liability" is the amount of plan assets needed to fund all current accrued benefits under the plan to date (vested and nonvested). Current liability is determined using a statutorily prescribed interest rate assumption--the interest rate used must be between 90 and 110 percent of the four-year weighted average 30-year Treasury rate. As under the general minimum funding rules, other actuarial assumptions used to calculate current liability are required to be reasonable. Accrued liability is generally the amount of assets required to fund the plan under the actuarial funding method used by the plan.

Transfers of excess pension assets

Under present law, defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Any assets that revert to the employer upon such termination are includible in the gross income of the employer and subject to an excise tax. The rate of the excise tax generally is 20 percent, and is increased to 50 percent unless the employer maintains a replacement plan or makes certain benefit increases in connection with the plan termination. Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested.

The Omnibus Budget Reconciliation Act of 1990 included a provision under which employers could transfer excess assets in an overfunded pension plan to pay certain retiree health liabilities. Provided certain requirements are satisfied, such a transfer does not affect a plan's tax-qualified status and is not a prohibited transaction. Further, the assets transferred are not includible in the gross income of the employer and are not subject to the excise tax on reversions. The employer is not entitled to deduct retiree health benefits paid with transferred assets.

A transfer must satisfy certain requirements designed to protect the benefit security of plan participants. Under one of these requirements, the accrued retirement benefits of participants under the pension plan (including participants who separated from service during the 1-year period ending on the date of the transfer) must be nonforfeitable as if the plan terminated immediately before the transfer. In addition, only excess pension assets may be transferred. Excess pension assets are defined to be the excess of the value of plan assets over the greater of (1) the plan's full funding limit, or (2) 125 percent of current liability. As described above, the first part of this standard is the same as the maximum limit for making contributions to the plan for deduction purposes. As under that limit, the interest rate used in calculating current liability for the 125 percent asset cushion must be between 90 and 110 percent of the four-year weighted average 30-year Treasury rate. The second part only applies if current liability is greater than the full funding limit. Thus, a transfer can only be made from a plan that is at the full funding limit

and is no longer permitted to receive deductible contributions.

If any amount transferred is not used to pay retiree health expenses, such amount must be transferred back to the pension plan. Such amounts transferred back are not includible in the employer's income, but are subject to the 20-percent excise tax on reversions.

The provision permitting certain transfers of excess pension assets was originally adopted for a 5-year period, through 1995. The excess pension assets transfer provision was extended through the year 2000 by the Retirement Protection Act of 1994, which was enacted as part of the Uruguay Round Agreements Act (commonly referred to as the implementing legislation for the General Agreement on Tariffs and Trade ("GATT")). The GATT legislation did not change the way in which excess pension assets are calculated.

Description of Proposal

The proposal would modify the circumstances under which employers may transfer excess assets from a defined benefit pension plan. The proposal would permit a qualified transfer of excess assets from a defined benefit pension plan (other than a multiemployer plan) to the employer, provided such assets are used to pay for qualified employee benefits provided by the employer. Qualified employee benefits would be defined as qualified retirement plan benefits, accident and health benefits, disability benefits, educational assistance, and dependent care assistance. Such benefits are provided under plans which cover a broad group of employees, and are subject to regulation under the Internal Revenue Code and the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). For example, excess pension assets could be transferred from an overfunded pension plan maintained by an employer to an underfunded pension plan maintained by the same employer.

The total amount of excess pension assets which could be transferred in qualified transfers during any year could not exceed the amount the employer pays during the year of transfer for qualified employee benefits. In addition, in order for the transfer to be qualified, the accrued retirement benefits of participants (including participants who separated from service during the 1-year period ending on the date of the transfer) under the pension plan must be nonforfeitable as if the plan terminated immediately before the transfer.

Amounts transferred would be includible in the gross income of the employer. Except as described below, no excise tax would apply to the amount transferred in a qualified transfer. There would be no limit on the number of qualified transfers that could be made during any taxable year. As under present law, a qualified transfer under the proposal would not affect the plan's qualified status and would not be a prohibited transaction.

Excess pension assets would be defined as under present law, and would be determined as of whichever of the following dates excess pension assets are lower: (1) January 1, 1995 (or, if January 1, 1995, is not a plan valuation date, as of the last plan valuation date preceding January 1, 1995), or (2) the most recent plan valuation date preceding the transfer.

The present-law rules would apply with respect to transferred amounts that are not used to pay for qualified employee benefits for the year of transfer. Thus, any such amount income would have to be returned to the pension plan. Amounts returned would not be includible in the gross income of the employer, but would be subject to the 20-percent excise tax on reversions. No deduction would be allowed with respect to returned amounts.

As under present law, the proposal would not apply to transfers in taxable years beginning after December 31, 2000.

Effective Date

The proposal would be effective with respect to transfers on or after the date of enactment.

9. Modify exclusion of damages received on account of personal injury or sickness

Present Law

Under present law, gross income does not include any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injury or sickness (sec. 104(a)(2)).

The exclusion from gross income of damages received on account of personal injury or sickness specifically does not apply to punitive damages received in connection with a case not involving physical injury or sickness. Courts presently differ as to whether the exclusion applies to damages received in connection with a case involving a physical injury or physical sickness.

Courts have interpreted the exclusion from gross income of damages received on account of personal injury or sickness broadly in some cases to cover awards for personal injury that do not relate to a physical injury or sickness. For example, some courts have held that the exclusion applies to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness. The damages received in these cases generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits. The Supreme Court recently held that damages received based on a claim under the Age Discrimination in Employment Act could not be excluded from income. In light of the Supreme Court decision, the Internal Revenue Service has suspended existing guidance on the tax treatment of damages received on account of other forms of employment discrimination.

Description of Proposals

Include in income all punitive damages

The proposal would provide that the exclusion from gross income does not apply to any punitive damages received on account of personal injury or sickness whether or not related to a

physical injury or sickness. No inference would be intended as to the application of the exclusion to punitive damages received prior to the effective date of this proposal in connection with a case involving a physical injury or sickness.

Include in income damage recoveries for nonphysical injuries

The proposal would provide that the exclusion from gross income only applies to damages received on account of a personal physical injury or physical sickness. If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom would be treated as payments involving physical injury or physical sickness whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of such individual's spouse would be excludable from gross income. In addition, damages (other than punitive damages) received on account of a claim of wrongful death would continue to be excludable from income as under present law.

The proposal also would provide that emotional distress is not considered a physical injury or physical sickness. Thus, the exclusion from gross income would not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. Because all damages received on account of physical injury or physical sickness are excludable from gross income, the exclusion from gross income would apply to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness. In addition, the exclusion from gross income would apply to the amount of damages received that is not in excess of the amount paid for medical care attributable to emotional distress.

Effective Date

The proposals generally would be effective with respect to amounts received after December 31, 1995. The proposals would not apply to amounts received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

10. Require tax reporting for payments to attorneys

Present Law

Information reporting is required by persons engaged in a trade or business and making payments in the course of that trade or business of "rent, salaries, wages, ... or other fixed or determinable gains, profits, and income" (Code sec. 6041(a)). Treas. Reg. sec. 1.6041-1(d)(2) provides that attorney's fees are required to be reported if they are paid by a person in a trade or business in the course of a trade or business. Reporting is required to be done on Form 1099-Misc. If, on the other hand, the payment is a gross amount and it is not known what portion is the attorney's fee, no reporting is required on any portion of the payment.

Description of Proposal

The proposal would require gross proceeds reporting on all payments to attorneys made by a trade or business in the course of that trade or business. It is anticipated that gross proceeds reporting would be required on Form 1099-B (currently used by brokers to report gross proceeds). The only exception to this new reporting requirement would be for any payments reported on either Form 1099-Misc under section 6041 (reports of payment of income) or on Form W-2 under section 6051 (payments of wages).

In addition, the present exception in the regulations exempting from reporting any payments made to corporations would not apply to payments made to attorneys. Treas. Reg. sec. 1.6041-3(c) exempts payments to corporations generally (although payments to most corporations providing medical services must be reported). Reporting would be required under both 6041 and 6045 (as proposed) for payments to corporations that provide legal services. The exception of Treas. Reg. sec. 1.6041-3(g) exempting from reporting payments of salaries or profits paid or distributed by a partnership to the individual partners would continue to apply to both sections (since these amounts are required to reported on Form K-1).

Effective Date

The proposal would be effective for payments made after December 31, 1995. Consequently, the first information reports would be filed with the IRS (and copies would be provided to recipients of the payments) in 1997, with respect to payments made in 1996.

11. Disallow rollover under section 1034 to extent of previously claimed depreciation for home office or other depreciable use of residence

Present Law

Rollover

Generally, no gain is recognized on the sale of a principal residence to the extent that the amount of the sales price of the old residence is reinvested in a new residence within a specified period. The specified period generally is a period beginning two years before the sale of the old residence and ending two years after the sale of the old residence.

One-time exclusion

In general, a taxpayer may exclude from gross income up to $125,000 of gain from the sale or exchange of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has used the residence as a principal residence for at least three of the five years preceding the sale. This election is allowed only once in a lifetime unless all previous elections are revoked.

In the case of a mixed use of a residence, the exclusion is limited only to that portion of

the residence that is owned and used by the individual as his principal residence for at least three of the previous five years before the date of sale. Gain on the portion not qualifying as a principal residence is not eligible for this exclusion.

Description of Proposal

Rollover

The proposal would provide that gain shall be recognized on the sale of a principal residence to the extent of any depreciation allowable with respect to such principal residence for periods after December 31, 1995.

One-time exclusion

The proposal would impose an additional restriction on the availability of the one-time exclusion. Specifically, the amount of the otherwise allowable one-time exclusion would be reduced (and therefore the amount of recognized gain would be increased) to the extent of depreciation allowable with respect to such principal residence for periods after December 31, 1995.

Effective Date

The proposal would be effective for taxable years ending after December 31, 1995.

12. Provide that rollover of gain on sale of a principal residence cannot be elected by a resident alien unless the replacement property purchased is located within the United States

Present Law

Generally, no gain is recognized on the sale or exchange of a principal residence to the extent that the amount of the sales price of the old residence is reinvested in a new residence within a specified period ("the rollover"). The specified period generally is a period beginning two years before the sale of the old residence, and ending two years after the sale of the old residence. There is no requirement that either the old residence or new residence be located within the United States or its possessions.

Description of Proposal

Generally, the proposal would require the recognition of gain on the sale of a principal residence by a resident alien unless the resident alien (1) retains resident alien status for at least two years after the date of sale, (2) becomes a U.S. citizen within two years of the date of sale, or (3) acquires a new residence located in the U.S. or its possessions within the specified time period.

The proposal would not apply where (1) the old residence is held jointly by the resident alien and the resident alien's spouse, (2) they file a joint tax return, and (3) the spouse is a U.S. citizen on the date of sale of the old residence.

Effective Date

The proposal would apply to the sale of old residences after December 31, 1995, unless a new residence was purchased before September 13, 1995, or purchased on or after such date pursuant to a binding contract in effect on such date and at all times thereafter before such purchase.

13. Repeal exemption for withholding on gambling winnings from bingo and keno where proceeds exceed $5,000

Present Law

In general, proceeds from a wagering transaction are subject to withholding at a rate of 28 percent if the proceeds exceed $5,000 and are at least 300 times as large as the amount wagered. The proceeds from a wagering transaction are determined by subtracting the amount wagered from the amount received. Any non-monetary proceeds that are received are taken into account at fair market value.

In the case of sweepstakes, wagering pools, or lotteries, proceeds from a wager are subject to withholding at a rate of 28 percent if the proceeds exceed $5,000, regardless of the odds of the wager.

No withholding tax is imposed on winnings from bingo or keno.

Description of Proposal

The proposal would impose withholding on proceeds from bingo or keno wagering transactions at a rate of 28 percent if such proceeds exceed $5,000, regardless of the odds of the wager.

Effective Date

The proposal would be effective on January 1, 1996.

14. Repeal advance refunds of diesel fuel tax for diesel cars and light trucks

Present Law

Excise taxes are imposed on gasoline (14 cents per gallon) and diesel fuel (20 cents per gallon) to fund the Federal Highway Trust Fund. Before 1985, the gasoline and diesel fuel tax

rates were the same. The predominate highway use of diesel fuel is by trucks. In 1984, the diesel fuel excise tax rate was increased above the gasoline tax as the revenue offset for a reduction in the annual heavy truck use tax. Because automobiles, vans, and light trucks, did not benefit from the use tax reductions, a provision was enacted allowing first purchasers of model year 1979 and later diesel-powered automobiles and light trucks a tax credit to offset this increased diesel fuel tax. The credit is $102 for automobiles, and $198 for vans and light trucks.

Description of Proposal

The tax credit for purchasers of diesel-powered automobiles and light trucks would be repealed.

Effective Date

The proposal would be effective for vehicles purchased after December 31, 1995.

15. Apply failure to pay penalty to substitute returns

Present Law

Section 6651(a)(2) provides that the IRS may assess a penalty for failure to pay tax from the due date of the return until the tax is paid. If no return is filed by the taxpayer and the IRS files a substitute return under section 6020, the tax on which the penalty is measured is considered a deficiency assessable under section 6212 or 6213, and the failure to pay penalty begins to accumulate ten days after the IRS sends the taxpayer a notice and demand for payment of the tax.

Description of Proposal

The proposal would apply the failure to pay penalty to substitute returns in the same manner as the penalty applies to delinquent filers.

Effective Date

The proposal would apply in the case of any return the due date for which (determined without regard to extensions) is after the date of enactment.

16. Modify treatment of foreign trusts

Present Law

Income taxation of trusts and their beneficiaries

Taxation of trusts

A trust is treated as a separate taxable entity, except in cases where the grantor (or a person with a power to revoke the trust) has certain powers with respect to the trust (discussed below). A trust generally is taxed like an individual with certain modifications. These modifications include: (1) a separate tax rate schedule applicable to estates and trusts; (2) an unlimited charitable deduction for amounts paid to charity; (3) a personal exemption of $300 for a trust that is required to distribute all of its income currently, or $100 for any other trust; (4) no standard deduction for trusts; and (5) a deduction for distributions to beneficiaries. A trust is required to use the calendar year as its taxable year. Trusts generally are required to pay estimated income tax.

Taxation of distributions to beneficiaries

Distributions from a trust to a beneficiary generally are includible in the beneficiary's gross income to the extent of the distributable net income ("DNI") of the trust for the taxable year ending with, or within, the taxable year of the beneficiary. DNI is taxable income (1) increased by any tax-exempt income (net of disallowed deductions attributable to such income), and (2) computed without regard to personal exemptions, the distribution deduction, capital gains that are allocated to corpus and are neither distributed to any beneficiary during the taxable year nor set aside for charitable purposes, capital losses other than capital losses taken into account in determining the amount of capital gains which are paid to beneficiaries, and (with respect to simple trusts) extraordinary dividends which are not distributed to beneficiaries (sec. 643). The exclusion for small business capital gains under section 1202 is not taken into account in determining DNI.

Distributions to trust beneficiaries out of previously accumulated income are taxed to the beneficiaries under a throwback rule (sec. 667). The effect of the throwback rule is to impose an additional tax on the distribution of previously accumulated income in the year of distribution at the beneficiary's average marginal rate for the 5 years prior to the distribution. The amount of the distribution is grossed-up by the amount of the taxes paid by the trust on the accumulated income and a nonrefundable credit is allowed to the beneficiary for such taxes. In order to prevent trusts from accumulating income for a year, the fiduciary of a trust may elect to treat distributions within the first 65 days after the close of its taxable year as having occurred at the end of the preceding taxable year.

If a trust makes a loan to one of its beneficiaries, the principal of such a loan is generally not taxable as income to the beneficiary.

Grantor trust rules

Under the grantor trust rules (secs. 671-679), the grantor of a trust will continue to be taxed as the owner of the trust (or a portion thereof) if it retains certain rights or powers. A grantor of a trust generally is treated as the owner of any portion of a trust when the following circumstances exist:

(1) The grantor has a reversionary interest that has more than a 5-percent probability of returning to the grantor.

(2) The grantor has power to control beneficial enjoyment of the income or corpus. Certain powers are disregarded for this purpose--(a) a power to apply income to support a dependent; (b) a power affecting beneficial enjoyment that can be exercised only after an event that has a 5 percent or less probability of occurring; (c) a power exercisable only by will; (d) a power to allocate among charities; (e) a power to distribute corpus under an ascertainable standard or as an advancement; (f) a power to withhold income temporarily; (g) a power to withhold income during disability; (h) a power to allocate between corpus and income; (i) a power to distribute, apportion, or accumulate income or corpus among a class of beneficiaries that is held by an independent trustee or trustees; and, (j) a power to distribute, apportion, or accumulate income among beneficiaries that is limited by an ascertainable standard.

(3) The grantor retains any of the following administrative powers--(a) a power to deal at non-arms' length; (b) a power to borrow trust funds without adequate interest or security; (c) a borrowing that extends over one taxable year; (d) a power to vote stock of a controlled corporation held in the trust; (e) a power to control investment of trust funds in a controlled corporation; and (f) a power to reacquire trust corpus by substituting property with equivalent value.

(4) The grantor has a power to revoke, unless such power may not be exercised any time before an event that has a 5-percent or less probability of occurring.

(5) The income is or may be distributed to, held for the future benefit of, or used to pay for life insurance on the lives of, the grantor or the grantor's spouse, unless such power may not be exercised any time before an event that has a 5-percent or less probability of occurring. (An exception is provided for income that may be used to discharge an obligation of support, unless the income is so used.)

If the grantor is not treated as the owner of any portion of a trust, another person generally will be treated as the owner of that portion of the trust if he or she has the power to revoke that portion of the trust or gave up a power to revoke and retained any of the powers set forth above, unless the retained power is disclaimed within a reasonable time.

Under the grantor trust rules, a U.S. person who transfers property to a foreign trust generally is treated as the owner of the portion of the trust comprising that property for any

taxable year in which there is a U.S. beneficiary of any portion of the trust. This treatment generally does not apply, however, to transfers by reason of death, to sales or exchanges of property at fair market value where gain is recognized to the transferor, or to transfers made before the transferor became a U.S. person (sec. 679).

Payments from foreign trusts through nominees

Under a special rule, intermediaries or nominees interposed between certain foreign trusts and their beneficiaries are disregarded. This special rule treats any amount paid from a foreign person to a U.S. person, where the amount was derived (directly or indirectly) from a foreign trust that was created by a U.S. person, as if paid to the recipient directly by the foreign trust (sec. 665(c)).

Grantor trusts established by non-U.S. persons

Under the grantor trust rules, a grantor generally is treated as the owner of the trust's assets without regard to whether the grantor is a domestic or foreign person. Under these rules, U.S. trust beneficiaries can avoid U.S. tax on distributions from a trust where a foreign grantor is treated as owner of the trust, even though no tax may be imposed on the trust income by any jurisdiction.[15]

A special rule applies in the case of a grantor trust with a U.S. beneficiary, where the grantor trust rules otherwise would treat a foreign person as the owner of a portion of the trust, and the U.S. beneficiary had made gifts at any time, directly or indirectly, to the foreign person. In such a case, the U.S. beneficiary generally is treated as the grantor and owner of that portion to the extent of the gifts to the foreign person (sec. 672(f)).

Foreign trusts that are not grantor trusts

In cases where the grantor trust rules do not apply to a foreign trust, its U.S. beneficiaries generally are taxable on their respective shares of the income of the trust that is required to be distributed, as well as any other income of the trust that is paid, credited, or distributed to them (secs. 652, 662). Distributions from a trust in excess of the trust's distributable net income[16] for the taxable year generally are treated as accumulation distributions (sec. 665(b)), subject to the throwback rules. Under these rules, a distribution by a foreign trust of previously accumulated income generally is taxed at the beneficiary's average marginal rate for the prior 5 years, plus interest (secs. 666, 667). Interest is computed at a fixed annual rate of 6 percent, with no compounding (sec. 668).

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[15] See Rev. Rul. 69-70, 1969-1 C.B. 182.

[16] In the case of a foreign trust, DNI also includes foreign-source income net of related deductions, income that is exempt under treaties, and capital gains reduced (but not below zero) by capital losses.

If adequate records of the trust are not available to determine the proper application of the rules relating to accumulation distributions to any distribution from a trust, the distribution is treated as an accumulation distribution out of income earned during the first year of the trust (sec. 666(d)).

Residence of estates and trusts

An estate or trust is treated as foreign if it is not subject to U.S. income taxation on its income that is neither derived from U.S. sources nor effectively connected with the conduct of a trade or business within the United States (sec. 7701(a)(31)). Thus, if a trust is taxed in a manner similar to a nonresident alien individual, it is considered to be a foreign trust. Any other estate or trust is treated as domestic (sec. 7701(a)(30)).

The Code does not specify what characteristics must exist before a trust is treated as being comparable to a nonresident alien individual. Internal Revenue Service ("IRS") rulings and court cases, however, indicate that this status depends on various factors, such as the residence of the trustee, the location of the trust assets, the country under whose laws the trust is created, the nationality of the grantor, and the nationality of the beneficiaries.[17] If an examination of these factors indicates that a trust has sufficient foreign contacts, it is deemed comparable to a nonresident alien individual and, thus, is a foreign trust.

Section 1491 generally imposes a 35-percent excise tax on a U.S. person that transfers appreciated property to certain foreign entities, including a foreign trust.[18] In the case of a domestic trust that changes its situs and becomes a foreign trust, it is unclear whether property has been transferred from a U.S. person to a foreign entity, and, thus, whether the transfer is subject to section 1491.

Information reporting requirements and associated penalties

Any U.S. person who creates a foreign trust or transfers money or property to a foreign trust is required to report that event to the IRS (sec. 6048(a)). Current regulations require reporting of, inter alia, the name, address and identification number (if any) of the transferor, the trust, the fiduciary and trust beneficiaries; the interest of each beneficiary; the location of the trust records; and the value of each item transferred (Treas. Reg. sec. 16.3-1(c)). Similarly, any U.S. person who transfers property to a foreign trust that has one or more U.S. beneficiaries is required to report annually to the IRS (sec. 6048(c)). In addition, if the transfer of any

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[17] For example, see Rev. Rul. 87-61, 1987-2 C.B. 219, Rev. Rul. 81-112, 1981-1 C.B. 598, Rev. Rul. 60-181, 1960-1 C.B. 257, and B.W. Jones Trust v. Commissioner, 46 B.T.A. 531 (1942), aff'd, 132 F.2d 914 (4th Cir. 1943).

[18] In Rev. Rul. 87-61 the IRS held that a U.S. citizen who transferred appreciated property to a foreign grantor trust is not subject to the section 1491 excise tax because the grantor continues to own the property for income tax purposes.

appreciated property by a U.S. person is subject to section 1491, the transferor is required to report the transfer to the IRS (Treas. Reg. sec. 1.1494-1(a)).

Any person who fails to file a required report with respect to the creation of, or a transfer to, a foreign trust may be subjected to a penalty of 5 percent of the amount transferred to the foreign trust (sec. 6677). Similarly, any person who fails to file a required annual report with respect to a foreign trust with U.S. beneficiaries may be subjected to a penalty of 5 percent of the value of the corpus of the trust at the close of the taxable year. The maximum amount of the penalty imposed under either case may not exceed $1,000. A reasonable cause exception is available. These civil penalties are determined separately from any applicable criminal penalties.

Description of Proposals

a. Inbound foreign grantor trust rules

Foreign grantors not treated as owners

Under the proposal, the grantor trust rules generally would apply only to the extent that they result, directly or indirectly, in amounts being currently taken into account in computing the income of a U.S. citizen or resident or a domestic corporation. Thus, the grantor trust rules generally would not apply to any portion of a trust where their effect would be to treat a foreign person as owner of that portion. The proposal would provide certain exceptions to this general rule. The proposal generally would not apply in the case of revocable trusts and trusts where the only amounts distributable during the lifetime of the grantor are to the grantor or the grantor's spouse. These exceptions would not apply to the extent of gifts made by a U.S. beneficiary of the trust to the foreign grantor. The proposal also would not apply to trusts established to pay compensation, and certain trusts in existence as of September 19, 1995.[19] In addition, the proposal generally would not apply where the grantor is a controlled foreign corporation, foreign personal holding company or passive foreign investment company.

In a case where the foreign grantor, who would be treated as the owner of the trust but for the above rule, actually pays tax on the income of the trust to a foreign country, it is anticipated that Treasury regulations would provide that U.S. beneficiaries who are subject to U.S. income tax on that income would be treated for foreign tax credit purposes as having paid the foreign taxes that were paid by the foreign grantor. Any resulting foreign tax credits would be subject to applicable foreign tax credit limitations.

The proposal would provide a transition rule for any domestic trust that has a foreign grantor who is treated as the owner of the trust under present law. If such a trust becomes a foreign trust before January 1, 1997, or if the assets of such a trust are transferred to a foreign trust before that date, such trust would be exempt from the excise tax on transfers to a foreign

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[19] The exception would not apply to the portion of any such trust attributable to any transfers made after September 19, 1995.

trust otherwise imposed by section 1491. However, the proposal's new reporting requirements and penalties would be applicable.

Distributions by foreign trusts through nominees

The proposal would treat any amount paid to a U.S. person, where the amount was derived (directly or indirectly) from a foreign trust of which the payor is not the grantor, as if paid by the foreign trust directly to the U.S. person. This rule would disregard the role of an intermediary or nominee that may be interposed between a foreign trust and a U.S. beneficiary. Unlike present law, however, the rule would apply whether or not the trust was created by a U.S. person. The rule would not apply to a withdrawal from a foreign trust by its grantor, with a subsequent gift or other payment to a U.S. person.

Effective date

The proposal would be effective on the date of enactment.

b. Foreign trusts that are not grantor trusts

Interest charge on accumulation distributions

The proposal would change the interest rate applicable to accumulation distributions from foreign trusts from simple interest at a fixed rate of 6 percent to compound interest determined in the manner of the interest imposed on underpayments of tax under section 6621(a)(2). Simple interest would continue to accrue at the rate of 6 percent through 1995. Beginning on January 1, 1996, however, compound interest based on the underpayment rate would be imposed not only on tax amounts determined under the accumulation distribution rules but also on the total simple interest for pre-1996 periods, if any. For purposes of computing the interest charge, the accumulation distribution would be allocated proportionately to prior trust years in which the trust has undistributed net income (and the beneficiary receiving the distribution was a U.S. citizen or resident), rather than to the earliest of such years. An accumulation distribution would be treated as reducing proportionately the undistributed income net income for such years.

The proposal would include an anti-abuse rule which authorizes the Secretary of the Treasury to issue regulations that may be necessary or appropriate to carry out the purposes of the rules applicable to accumulation distributions, including regulations to prevent the avoidance of those purposes.

Loans to grantors or beneficiaries

In the case of a loan of cash or marketable securities by the foreign trust to a U.S. grantor or a U.S. beneficiary (or a U.S. person related to such grantor or beneficiary[20]), the proposal would treat the full amount of the loan as distributed to the grantor or beneficiary, even if the loan bears interest at an adequate rate and is subsequently repaid. In addition, any subsequent transaction between the trust and the original borrower regarding the principal of the loan (e.g., repayment) would be disregarded for all purposes of the Code.

Effective date

The proposal to modify the interest charge on accumulation distributions would apply to distributions after the date of enactment. The Secretary of the Treasury would be authorized to issue regulations in the case of anti-abuse transactions; such regulations would be effective on the date of enactment. The proposal with respect to loans to U.S. grantors or U.S. beneficiaries would apply to loans made after September 19, 1995.

c. Outbound foreign grantor trust rules

The proposal would make several modifications to the rules of section 679 under which foreign trusts with U.S. grantors and U.S. beneficiaries are treated as grantor trusts.

Sale or exchange at market value

Present law contains an exception from grantor trust treatment for property transferred by a U.S. person to a foreign trust in the form of a sale or exchange at fair market value where gain is recognized to the transferor. In determining whether the trust paid fair market value to the transferor, the proposal would provide that obligations issued (or, to the extent provided by regulations, guaranteed) by the trust, by any grantor or beneficiary of the trust, or by any person related to a grantor or beneficiary[21] generally would not be taken into account except as provided in regulations.

Other transfers

Under the proposal, a transfer of property to certain charitable trusts would be exempt from the application of the rules treating foreign trusts with U.S. grantors and U.S. beneficiaries

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[20] For this purpose, a person generally would be treated as related to the grantor or beneficiary if the relationship between such person and the grantor or beneficiary would result in a disallowance of losses under section 267 or 707(b).

[21] For this purpose, a person generally would be treated as related to the grantor or beneficiary if the relationship between such person and the grantor or beneficiary would result in a disallowance of losses under section 267 or 707(b).

as grantor trusts.

Transferors or beneficiaries who become U.S. persons

The proposal would apply the rules of section 679 to certain foreign persons who transfer property to a foreign trust and subsequently become U.S. persons. A nonresident alien individual who transfers property, directly or indirectly, to a foreign trust and then becomes a resident of the United States within 5 years after the transfer generally would be treated as making a transfer to the foreign trust at the time the individual becomes a U.S. resident. The amount of the deemed transfer would be the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally would be treated under the rules of section 679 as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The proposal's new reporting requirements and penalties (discussed below) also would be applicable.

Under the proposal, a beneficiary would not be treated as a U.S. person for purposes of determining whether the transferor of property to a foreign trust would be taxed as a grantor with respect to any portion of a foreign trust if such beneficiary first became a U.S. resident more than 5 years after the transfer.

Outbound trust migrations

The proposal would apply the rules of section 679 to a U.S. person that transferred property to a domestic trust if the trust subsequently became a foreign trust while the transferor was still alive. Such a person would be deemed to make a transfer to the foreign trust on the date of the migration. The amount of the deemed transfer would be the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally would be treated under the rules of section 679 as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The proposal's reporting requirements and penalties (discussed below) also would be applicable.

Effective date

The proposals would apply to transfers of property after February 6, 1995.

d. Residence of estates and trusts

Treatment as U.S. person

The proposal would establish a two-part objective test for determining for tax purposes whether a trust is foreign or domestic. If both parts of the test are satisfied, the trust would be treated as domestic. Only the first part of the test would apply to estates.

Under the first part of the proposed test, in order for an estate or trust to be treated as domestic, a U.S. court (i.e., Federal, State, or local) must be able to exercise primary supervision over the administration of the estate or trust. It is expected that this test would be satisfied by any trust instrument that specifies that it is to be governed by the laws of any State. In addition, an estate or trust may be able to subject itself voluntarily to the jurisdiction of a U.S. court through registration of the estate or trust under a State law similar to Article VII of the American Law Institute's Uniform Probate Code.

Under the second part of the proposed test, in order for a trust to be treated as domestic, one or more U.S. fiduciaries must have the authority to control all substantial decisions of the trust. It is expected that this test would be satisfied in any case where fiduciaries who are U.S. persons hold a majority of the fiduciary power (whether by vote or otherwise), and where no foreign fiduciary, such as a "trust protector" or other trust advisor, has the power to veto important decisions of the U.S. fiduciaries. It is further expected that, in applying this test, a reasonable period of time would be allowed for a trust to replace a U.S. fiduciary who resigns or dies before the trust would be treated as foreign.

Under the proposal, a foreign estate would be defined as an estate other than an estate that is determined to be domestic under the court-supervision test. A foreign trust would be defined as a trust other than a trust that is determined to be domestic under both the court-supervision test and the U.S. fiduciary test.

Outbound migration of domestic trusts

Under the proposal, if a domestic trust changes its situs and becomes a foreign trust, the trust would be treated as having made a transfer of its assets to the foreign trust and would be subject to the 35-percent excise tax imposed by present-law section 1491 unless one of the exceptions to this excise tax were applicable. In addition, the U.S. grantor would be required to report the transfer under the reporting requirements described below. Failure to report such a transfer would result in penalties (discussed below).

Effective date

The proposal to modify the treatment of a trust or estate as a U.S. person would apply to taxable years beginning after December 31, 1996. In addition, if the trustee of a trust so elects, the proposal would apply to taxable years ending after the date of enactment. The proposed amendment to section 1491 would be effective on the date of enactment.

e. Information reporting relating to foreign trusts

The proposal would expand the reporting requirements with respect to foreign trusts if there is a U.S. grantor of the foreign trust or a distribution from the foreign trust to a U.S. person. The proposal would require the responsible parties to file the designated information reports with

the IRS upon the occurrence of certain events. A failure to comply with the reporting requirements would result in increased monetary penalties under the proposal.

Information reporting requirements

First, the proposal would require the grantor, transferor or executor (i.e., the "responsible party") to notify the IRS upon the occurrence of certain reportable events. The reportable events include direct and indirect transfers of property to a foreign trust and the death of a U.S. citizen or resident if any portion of a foreign trust was included in the gross estate of the decedent. The required notice would identify the money or other property transferred and report information regarding the trustee and beneficiaries of the foreign trust.

Second, a U.S. person that is treated as the owner of any portion of a foreign trust would be required to ensure that the trust files an annual report to provide full accounting of all the trust activities for the taxable year, the name of the U.S. agent for the trust, and other information as prescribed by the Secretary of the Treasury.[22] In addition, unless a U.S. person is authorized to accept service of process as the trust's limited agent with respect to with any request by the IRS to examine records or to take testimony and any summons for such records or testimony in connection with the tax treatment of any items related to the trust, the IRS would be entitled to determine, in its sole discretion, the amount to be taken into account under the grantor trust rules (secs. 671 through 679). This limited agency relationship would not constitute an agency relationship for any other purpose under Federal or State law.

Third, any U.S. person who receives (directly or indirectly) any distribution from a foreign trust would be required to file a notice to report the name of the trust, the aggregate amount of the distributions received, and other information that the Secretary of the Treasury may prescribe.

Monetary penalties for failure to report

Under the proposal, a person who fails to provide the required notice in cases involving the transfer of property to a new or existing foreign trust, or a distribution by a foreign trust to a U.S. person, would be subject to an initial penalty equal to 35 percent of the gross reportable amount. A failure to provide an annual reporting of trust activities would result in an initial penalty equal to 5 percent of the gross reportable amount. In cases involving a transfer of property to a foreign trust, the gross reportable amount would be the gross value of the property transferred. In cases involving the death of a U.S. citizen or resident whose estate includes any portion of a foreign trust, the gross amount would be the value of the property includible in the gross estate of the decedent. In cases where annual reporting of trust activities is required, the gross reportable amount would be the gross value of the portion of the foreign trust's assets

[22] It is intended that the regulations would require the trust to furnish information to U.S. grantors and beneficiaries concerning income reportable by such persons that is similar to the items on schedule K-1 of Form 1041.

treated as owned by the U.S. grantor at the close of the year, and in cases involving a distribution to a U.S. beneficiary of a foreign trust, the gross reportable amount would be the amount of the distribution to the beneficiary. An additional $10,000 penalty would be imposed for continued failure for each 30-day period (or fraction thereof) beginning 90 days after the IRS notifies the responsible party of such failure. Such penalties would be subject to a reasonable cause exception. In no event would the total amount of penalties exceed the gross reportable amount.

Effective date

The reporting requirements and applicable penalties generally would apply to reportable events occurring or distributions received after the date of enactment. The annual reporting requirement and penalties applicable to U.S. grantors would apply to taxable years of such persons beginning after the date of enactment.

f. Reporting of certain foreign gifts

The proposal generally would require any U.S. person (other than certain tax-exempt organizations) that receives purported gifts or bequests from foreign sources totaling more than $10,000 during the taxable year to report them to the IRS. The definition of a gift to a U.S. person for this purpose would exclude qualified tuition or medical payments made on behalf of the U.S. person, as defined for gift tax purposes (sec. 2503(e)(2)). If the U.S. person fails, without reasonable cause, to report foreign gifts as required, the IRS would be authorized to determine, in its sole discretion, the tax treatment of the unreported gifts, based on information in its possession or as it may obtain. In addition, the U.S. person would be subject to a penalty equal to 5 percent of the amount of the gift for each month that the failure continues, with the total penalty not to exceed 25 percent of such amount.

Effective date

The proposal would apply to amounts received after the date of enactment.

17. Repeal 50-percent interest income exclusion for financial institution loans to ESOPs

Present Law

An employee stock ownership plan ("ESOP") is a qualified pension plan that meets certain requirements and under which employer securities are held for the benefit of employees. Present law generally prohibits loans between a qualified plan and a disqualified person. An exception to this rule is provided in the case of an ESOP.

If employer securities are acquired by an ESOP with loan proceeds, the ESOP is referred to as a leveraged ESOP. The ESOP may borrow directly from a financial institution (typically with a guarantee from the employer), or the employer may borrow from a financial institution and in turn lend the funds to the ESOP which then uses them to acquire employer securities. Such

loans are referred to as securities acquisition loans. The employer securities are typically pledged as security for the loan. The employer makes contributions to the ESOP which are then used to repay the securities acquisition loan. Shares that are purchased with a securities acquisition loan are allocated to the accounts of ESOP participants as the loan is repaid.

A bank, insurance company, regulated investment company, or a corporation actively engaged in the business of lending money may generally exclude from gross income 50 percent of interest received on an ESOP loan. The partial exclusion applies if the loan is made directly to the ESOP or if the loan is made to the employer who in turn lends the proceeds to the ESOP and certain requirements are satisfied. Generally effective for ESOP loans made after June 10, 1989, the 50-percent interest exclusion only applies if: (1) immediately after the acquisition of securities with the loan proceeds, the ESOP owns more 50 percent of the outstanding stock or more than 50 percent of the total value of all outstanding stock of the corporation; (2) the ESOP loan term will not exceed 15 years; and (3) the ESOP provides for full pass-through voting to participants on all allocated shares.

Description of Proposal

The proposal would repeal the 50-percent interest exclusion with respect to ESOP loans.

Effective Date

The proposal generally would be effective with respect to loans made after October 13, 1995. The repeal of the 50-percent interest exclusion would not apply to the refinancing of an ESOP loan originally made on or before October 13, 1995, provided (1) such refinancing loan otherwise meets the requirements of section 133 in effect before October 14, 1995; (2) the outstanding principal amount of the loan is not increased; and (3) the term of the refinancing loan does not extend beyond the term of the original ESOP loan.

18. Repeal the wine and flavors credit

Present Law

Distilled spirits are subject to excise tax at $13.50 per proof gallon. (A proof gallon is a liquid gallon containing 50 percent alcohol). Wine is subject to a graduated excise tax based on alcohol content. All wine tax rates (other than on champagne) are lower on an alcohol content basis than the distilled spirits tax rate.

Present law allows an excise tax credit equal to the difference between the distilled spirits tax rate and the applicable wine tax rate when wine alcohol is blended into distilled spirits. Wine is defined as any alcohol derived from fruit. Wine alcohol is not required to be alcohol that could be marketed to the public for consumption as "wine".

Present law also allows an excise tax credit equal to $13.50 per proof gallon (less an administrative processing fee) for each gallon of flavors contained in distilled spirits. Examples of "flavors" for which the credit is allowed are vanilla extract and mint. This credit is limited to tax on alcohol not exceeding 2.5 percent of the alcohol content of the finished product.

Description of Proposal

The excise tax credits for wine alcohol and flavors content would be repealed.

Effective Date

The proposal would be effective for distilled spirits removed from bonded premises after December 31, 1995.

19. Treatment of financial asset securitization investment trusts ("FASITs")

Background and Present Law

An individual can own income-producing assets directly, or indirectly through an entity (i.e., corporation, partnership, or trust). Where an individual owns assets through an entity (e.g., a corporation), the nature of the interest in the entity (e.g., stock of a corporation) is different than the nature of the assets held by the entity (e.g., assets of the corporation).

Securitization is the process of converting one type of asset into another and generally involves use of an entity separate from the underlying assets. In the case of securitization of debt instruments, the instruments created in the securitization typically have different maturities and characteristics than the debt obligations that are securitized.

Entities used in securitization include entities that are subject to tax (e.g., corporation), conduit entities that generally are not subject to tax (e.g., a partnership, grantor trust, or real estate mortgage investment conduit ("REMIC")), or partial-conduit entities that generally are subject to tax only to the extent its income is not distributed to its owners (e.g., a trust, real estate investment trust ("REIT"), or regulated investment company ("RIC")).

There is no statutory entity that facilitates the securitization of revolving, non-mortgage debt obligations.

Description of Proposal

In general

The proposal would create a new type of statutory entity called a financial asset securitization investment trust ("FASIT") that would facilitate the securitization of debt obligations such as credit card receivables, home equity loans, and auto loans. A FASIT generally

would not be taxable; the FASIT's taxable income or net loss would flow through to the owner of the FASIT.

The ownership of a FASIT generally would be required to be entirely by a single domestic C corporation. In addition, a FASIT generally could hold only cash, qualified debt obligations, certain other specified assets and would be subject to certain restrictions on its activities. An entity that qualifies as a FASIT could issue debt instruments that meet certain specified requirements and treat those instruments as debt for Federal income tax purposes. Debt instruments bearing yields to maturity over 5 percentage points above the yield to maturity on specified United States government obligations (i.e., a "high-yield debt obligation") could be held only by domestic C corporations and certain other specified entities.

To qualify as a FASIT, an entity would be subject to certain requirements, including: (1) an election must be made to be treated as a FASIT; (2) substantially all of its assets must be limited to certain specified assets; (3) the interests in the entity must be limited to an ownership interest or qualified debt instruments (including high-yield debt instruments); and (4) ownership of the ownership interest must be held by a domestic C corporation.

Debt instruments issued by FASITs

The proposal would allow FASITs to issue "regular" debt instruments, including "high-yield interest" instruments, that would be treated as debt for Federal tax purposes. Ownership of high-yield interest instruments would be limited to certain qualified holders (generallly domestic C corporations).

Transfers to non-permitted holders of certain FASIT interests

A transfer of an ownership interest or a high-yield interest instrument to a disqualified holder, or a transfer of less than 100 percent of the interest interest to a transferee, would be ignored. Thus, such a transferor would continue to be liable for any taxes due on the transferred interest. Subject to certain exceptions, a disqualified holder generally is any holder other than a domestic C corporation.

Taxation of a FASIT and interests in the FASIT

A FASIT generally would not be subject to tax. However, a FASIT would be subject to tax at the highest corporate rate on income from any foreclosure property. In addition, a FASIT would be required to pay a tax equal to 100 percent of net income from certain types of income from entities not related to the FASIT's purposes. Income from dispositions that are exempt from the 100-percent tax include dispositions occurring in a qualified liquidation or any disposition incident to the foreclosure, default, or imminent default of the asset, or to the bankruptcy or insolvency of the FASIT.

The taxable income of a FASIT generally would be calculated as if it were a partnership using the accrual method of accounting. A holder of regular or high-yield debt instruments generally would be taxed in the same manner as a holder of any other debt instrument. However, qualified holders of high-yield debt would not be allowed to use net operating losses to offset any income derived from the high-yield debt. The holder of FASIT ownership interest would take into account the FASIT's taxable income or net loss for the taxable year. The character, source, and other attributes of the income to the holder of an ownership interest would be determined as if the income had been earned by a partnership.

A portion of any net loss of a FASIT could be taken into account by its owner to the extent of its adjusted basis in the ownership interest. Disallowed losses would be carried forward by the owner. A special rule provides that a FASIT owner cannot offset income from the FASIT by any other losses.

<u>Transfers to and distributions from FASITs</u>

Gain or loss generally would be recognized immediately by the owner of the FASIT on the transfer of assets to a FASIT. However, to the extent provided by Treasury regulations, gain recognition on the contributed assets could be deferred until the FASIT securitizes its assets. For these purposes, the value of contributed assets generally would be the present value of the reasonably expected cash flows from such assets discounted over the weighted average life of such assets. The discount rate would be 130 percent of the applicable Federal rate for obilgations with a maturity comparable to the average expected maturity of the pool of contributed debt insturments of the similar type.

A distribution of assets by a FASIT with respect to a debt instrument generally would be treated as a sale of the assets and a distribution of the sale proceeds. A distribution by a FASIT with respect to an ownership interest generally would not be included in gross income by the holder to the extent that the distribution does not exceed the adjusted basis of the holder's interest.

<u>Effective Date</u>

The proposal would be effective on the date of enactment.

20. Treatment of contributions in aid of construction for water utilities

<u>Present and Prior Law</u>

The gross income of a corporation does not include contributions to its capital. A tax-free contribution to the capital of a corporation does not include any contribution in aid of construction or any other contribution as a customer or potential customer.

Prior to the enactment of the Tax Reform Act of 1986 ("1986 Act"), a regulated public utility that provided electric energy, gas, water, or sewage disposal services was allowed to treat any amount of money or property received from any person as a tax-free contribution to its capital so long as such amount: (1) was a contribution in aid of construction and (2) was not included in the taxpayer's rate base for rate-making purposes. A contribution in aid of construction did not include a connection fee. The basis of any property acquired with a contribution in aid of construction was zero.

If the contribution was in property other than electric energy, gas, steam, water, or sewerage disposal facilities, such contribution was not includible in the utility's gross income so long as: (1) an amount at least equal to the amount of the contribution was expended for the acquisition or construction of tangible property that was used predominantly in the trade or business of furnishing utility services; (2) the expenditure occurred before the end of the second taxable year after the year that the contribution was received; and (3) certain records were kept with respect to the contribution and the expenditure. In addition, the statute of limitations for the assessment of deficiencies was extended in the case of these contributions.

These rules were repealed by the 1986 Act. Thus, after the 1986 Act, the receipt by a utility of a contribution in aid of construction is includible in the gross income of the utility, and the basis of property received or constructed pursuant to the contribution is not reduced.

Description of Proposal

The proposal would restore the contributions in aid of construction provisions that were repealed by the 1986 Act for regulated public utilities that provide water or sewerage disposal services.

Effective Date

The proposal would be effective for amounts received after the date of enactment.

21. Require water utility property to be depreciated over 25 years

Present Law

Property used by a water utility in the gathering, treatment, and commercial distribution of water and municipal sewers are depreciated over a 20-year period for regular tax purposes. The depreciation method generally applicable to property with a recovery period of 20 years is the 150-percent declining balance method (switching to the straight-line method in the year that maximizes the depreciation deduction). The straight-line method applies to property with a recovery period over 20 years.

Description of Proposal

The proposal would provide that water utility property would have a recovery period of 25 years and would be depreciated under the straight-line method. For this purpose, "water utility property" would mean (1) property that is an integral part of the gathering, treatment, or commercial distribution of water, and that, without regard to the proposal, would have had a recovery period of 20 years and (2) any municipal sewer.

Effective Date

The proposal would be effective for property placed in service after the date of enactment, other than property placed in service pursuant to a binding contract in effect on such date and at all times thereafter before the property is placed in service.

22. Modifications to the excise tax on ozone-depleting chemicals

Present Law

An excise tax is imposed on the sale or use by the manufacturer or importer of certain ozone-depleting chemicals (Code sec. 4681). The amount of tax generally is determined by multiplying the base tax amount applicable for the calendar year by an ozone-depleting factor assigned to each taxable chemical. The base tax amount is $5.35 per pound in 1995 and will increase by 45 cents per pound per year thereafter.

Taxable chemicals that are recovered and recycled within the United States are exempt from tax.

Description of Proposal

The proposal would extend the exemption from tax for domestically recovered recycled ozone-depleting chemicals to imported recycled halons.

Effective Date

The proposal would be effective on the date of enactment.

23. Allow certain utilities to elect not to be eligible for future tax-exempt bond financing

Present Law

Interest on State and local government bonds generally is excluded from income unless the bonds are issued to provide financing for private parties. Present law includes several exceptions, however, that allow tax-exempt bonds to be used to provide for financing of certain specifically identified private parties. One such exception allows tax-exempt bonds to be issued for the

benefit of electric and gas utilities whose service area does not exceed (1) two contiguous counties or (2) a city and a contiguous county (i.e., "local furnishers').

Tax-exempt bonds issued for local furnishers of electricity and gas are subject to the general State private activity bond volume limits of the greater of $50 per resident of the State or $150 million per year. Like most other private beneficiaries of tax-exempt bonds, these local furnishers are denied interest deductions on debt underlying the bonds if they cease to qualify as a local furnisher. Additionally, as with all tax-exempt bonds, if the use of the proceeds (or the beneficiary of the bonds) changes its character to a use not qualified for tax-exempt financing within certain periods after the debt is incurred, interest on the bonds becomes taxable unless certain safe harbor standards are satisfied.

Description of Proposal

The proposal would allow utilities that currently qualify as local furnishers of electricity or gas to elect to terminate that status and expand their service areas without incurring the present-law loss of interest deductions and loss of tax-exemption penalties if :

(1) no additional bonds were issued for the benefit of the electing utility after the date of the proposal's enactment;

(2) the expansion of the utility's service area was not financed with any tax-exempt bond proceeds; and

(3) all outstanding tax-exempt bonds of the utility were redeemed not later than 6 months after the earliest date on which redemption is not prohibited (or 6 months after the election, if earlier).

The proposal further would limit the exception allowing tax-exempt bonds to be issued for local furnishers of electricity or gas to utilities that were qualified as such before the date of its enactment.

Effective Date

The proposal would be effective on the date of enactment.

24. Tax-exempt bonds for the sale of Alaska Power Administration facility

Present Law

Interest on State and local government bonds generally is excluded from income unless the bonds are issued to provide financing for private parties. Present law includes several exceptions, however, that allow tax-exempt bonds to be used to provide financing for certain specifically identified private parties ("private activity bonds"). State and local government bonds issued to

acquire existing output property (other than water facilities) are treated as private activity bonds even if a State or local government owns or operates the property. Similarly, bonds issued to acquire existing property, the output from which will be sold to a private party under a take or pay contract are private activity bonds.

Most private activity bonds are subject to annual State volume limits of the greater of $50 per resident of the State or $150 million. Additionally, persons acquiring property financed with most private activity bonds must satisfy a rehabilitation requirement as a condition of the financing.

Description of Proposal

The proposal would provide an exception from the general rehabilitation requirement for private activity bonds used to acquire existing property for certain bonds to finance the acquisition of the Snettisham hydroelectric project from the Alaska Power Administration. Bonds for this acquisition would remain subject to the State of Alaska's private activity bond volume limit.

Effective Date

The proposal would be effective for bonds issued after the date of enactment.

25. Treatment of certain gains and losses of life insurance companies under section 818(b)

Present Law

In the case of a taxpayer that is a corporation, losses from the sale or exchange of a capital asset generally are allowed only to the extent of gains from such sales or exchanges. A loss on the sale or exchange of property used in the trade or business of the taxpayer, however, may be treated as an ordinary loss, rather than as a loss from the sale or exchange of a capital asset.

A special limitation on ordinary loss treatment applies in the case of a life insurance company, under section 818(b). Section 818(b) provides that property used in the trade or business includes only property used in carrying on an insurance business. Thus, for example, a loss on the sale or exchange of real estate that is held by a life insurance company and that is not used in the insurance business is treated as a capital loss, and is allowed only to the extent of the taxpayer's capital gain.

Description of Proposal

Under the proposal, capital loss treatment under present-law section 818(b) would not apply to 85 percent of a life insurance company's losses from dispositions of foreclosed real estate, and such losses would be allowed as ordinary losses in equal amounts over each of the first 10 taxable years following the year of disposition. Present-law section 818(b) treatment would be retained for the percentage of such losses that are not eligible for the treatment provided by the proposal.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1994.

26. Coal industry retiree health equity

Present Law

The financing of retiree health benefits previously provided by the United Mine Workers of America ("UMWA") 1950 and 1974 Benefit Funds was substantially revised by the Energy Policy Act of 1992 (H.R. 776, P.L. 104-486), enacted October 2, 1992. The relevant provisions, contained in the Coal Industry Retiree Health Benefit Act of 1992 (the "Coal Act"), created two new UMWA retiree health benefit funds and completely changed the financing mechanism. The two funds, known as the UMWA Combined Benefit Fund and the UMWA 1992 Benefit Plan, service beneficiaries who retired on or before September 30, 1994. No provision was made for employees who retired or will retire after September 30, 1994. Future retirees will remain dependent on the provisions of future collective bargaining agreements.

Under the Coal Act, which supersedes the retiree health benefits financing provisions of the 1988 National Bituminous Coal Wage Agreement ("NBCWA"), a company is charged an insurance premium based on the number of beneficiaries assigned to the company in its role as the retiree's "last signatory employer." Under what are referred to as the "super-reachback" provisions of the Coal Act, companies responsible for paying premiums include any company that had signed any NBCWA since 1946 or any related company as defined under the Act. To cover the costs associated with beneficiaries who cannot be assigned, up to $70 million per year is transferred into the Combined Fund. The first three transfers came from the surplus in the UMWA 1950 Pension Fund. Subsequent transfers will be made from the interest earnings of the Federal Abandoned Mine Reclamation Fund. If costs for unassigned beneficiaries exceed the annual transfer, they can be allocated to the signatory and reachback companies in proportion to their share of assigned beneficiaries.

The per beneficiary insurance premium is calculated each year by the Secretary of Health and Human Services. The dollar amount is based on the actual per capita net expenses of the 1950 and 1974 Benefit Funds in fiscal year 1992, indexed by the net increase in the medical component of the consumer price index. The insurance premium can be increased to offset any cuts in Medicare benefits.

Description of Proposal

The proposal would provide relief to reachback companies by reducing their insurance premiums required to be paid to the Combined Fund for the period beginning October 1, 1995 through September 30, 1997, to the extent of any surplus in the Combined Fund. Under the proposal, the determination of whether the Combined Fund has any surplus would be made by the trustees at the end of each fund year on a cash basis. The amount of any surplus would be

reduced by an amount equal to 10 percent of the benefits and administrative costs paid by the Combined Fund for the plan year and would be determined without regard to amounts transferred to the Combined Fund from the UMWA 1950 Pension Fund and Federal Abandoned Mine Reclamation Fund. Any remaining surplus would be used to provide insurance premium relief to the reachback companies.

The proposal would also fix the actual per capita net expenses of the 1950 and 1974 Benefit Funds in fiscal year 1992 at $2,116.67 per beneficiary.

Effective Date

The proposal would apply to Combined Fund years beginning after September 30, 1995.

27. Treatment of newspaper distributors and carriers as direct sellers

Present Law

For Federal tax purposes, there are two classifications of workers: a worker is either an employee of the service recipient or an independent contractor. Significant tax consequences result from the classification of a worker as an employee or independent contractor. These differences relate to withholding and employment tax requirements, as well as the ability to exclude certain types of compensation from income or take tax deductions for certain expenses. Some of these consequences favor employee status, while others favor independent contractor status. For example, an employee may exclude from gross income employer-provided benefits such as pension, health, and group-term life insurance benefits. On the other hand, an independent contractor can establish his or her own pension plan and deduct contributions to the plan. An independent contractor also has greater ability to deduct work-related expenses.

Under present law, the determination of whether a worker is an employee or an independent contractor is generally made under a 20-factor common-law facts and circumstances test that seeks to determine whether the service provider is subject to the control of the service recipient, not only as to the nature of the work performed, but the circumstances under which it is performed. Under a special safe harbor rule (sec. 530 of the Revenue Act of 1978), a service recipient may treat a worker as an independent contractor for employment tax purposes even though the worker is an employee under the common-law test if the service recipient has a reasonable basis for treating the worker as an independent contractor and certain other requirements are met.

In addition to the 20-factor common-law test, there are also some persons who are treated by statute as either employees or independent contractors. For example, "direct sellers" are deemed to be independent contractors. A direct seller is a person engaged in the trade or business of selling consumer products in the home or otherwise than in a permanent retail establishment, if substantially all the remuneration for the performance of the services is directly related to sales or other output rather than to the number of hours worked, and the services performed by the person

are performed pursuant to a written contract between such person and the service recipient and such contract provides that the person will not be treated as an employee for Federal tax purposes.

The newspaper industry has generally taken the position that newspaper distributors and carriers should be treated as direct sellers for income and employment tax purposes. The Internal Revenue Service has generally taken the position that the direct seller rules do not apply to newspaper distributors and carriers operating under an agency distribution system (i.e., where the publisher retains title to the newspapers).

Description of Proposal

The proposal would treat qualifying newspaper distributors and carriers as direct sellers. Under the proposal, a person engaged in the trade or business of the delivery or distribution of newspapers or shopping news (including any services that are directly related to such trade or business such as solicitation of customers or collection of receipts) would qualify as a direct seller, provided substantially all the remuneration for the performance of the services is directly related to sales or other output rather than to the number of hours worked, and the services performed by the person are performed pursuant to a written contract between such person and the service recipient and such contract provides that the person will not be treated as an employee for Federal tax purposes. For example, newspaper distributors and carriers operating under an agency distribution system who are paid based on the number of papers delivered and have an appropriate written agreement would be treated as direct sellers. The status of newspaper distributors and carriers who do not qualify as direct sellers under the proposal would continue to be determined under present-law rules. No inference is intended with respect to the employment status of the affected workers under present law.

Effective Date

The proposal would be effective with respect to services performed after December 31, 1995.

Joint Committee on Taxation
October 18, 1995

ERRATA FOR JCX-44-95

1. **On page 20-22 the description of SIMPLE retirement plans should be modified as follows:** on page 20, the second full paragraph should be deleted; on page 21, in the last paragraph beginning on the page, the sentence beginning "In addition," should be deleted; and on page 22, the last paragraph before the heading "Effective Date" should be deleted.

2. **On page 31, delete the last sentence and insert the following:** "If stock in more than one RIC is received in a conversion, the basis of each RIC shall be determined by allocating the basis of common fund interests used in the exchange among each RIC received in the conversion on the basis of respective fair market values."

3. **On page 62, the effective date should read as follows:** "The proposal would be effective for cash rentals after December 31, 1995."

4. **On pages 113-115, the description of the proposed exemption from the UBIT for corporate sponsorship payments received by tax-exempt organizations should read as follows:**

"Description of Proposal

Under the proposal, qualified sponsorship payments received by a tax-exempt organization (or State college or university described in section 511(d)(2)(B)) would be exempt from the UBIT.

For purposes of the proposal, "qualified sponsorship payments" received by a tax-exempt organization would be defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities. Such a use or acknowledgment would not include advertising of such person's products or services -- meaning qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services. Thus, for example, if, in return for receiving a sponsorship payment, an organization promises to use the sponsor's name or logo in acknowledging the sponsor's support for an educational or fundraising event conducted by the organization, such payment would not be subject to the UBIT. In contrast, if the organization

provides advertising of a sponsor's products, the payment made to the organization by the sponsor in order to receive such advertising would be subject to the UBIT (provided that the other, present-law requirements for UBIT liability are found to exist).

The proposal would specifically provide that a qualified sponsorship payment does not include any payment where the amount of such payment is contingent, by contract or otherwise, upon the level of attendance at an event, broadcast ratings, or other factors indicating the degree of public exposure to an activity. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast, in and of itself, would not cause the payment to fail to be a qualified sponsorship payment. Moreover, distribution of a sponsor's products by the sponsor or the tax-exempt organization to the general public at a sponsored event, whether for free or for remuneration, would be considered to be "use or acknowledgment" of the sponsor's product lines (as opposed to advertising), and thus would not affect the determination of whether a payment made by the sponsor is a qualified sponsorship payment.

The proposal would not apply to the sale of advertising or acknowledgements in tax-exempt organization periodicals. For this purpose, the term "periodical" includes regularly scheduled and printed material that is not related to and primarily distributed in connection with a specific sponsored event.

The proposal would specifically provide that, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of the payment will be treated as a separate payment. Thus, if a sponsorship payment made to a tax-exempt organization entitles the sponsor to both product advertising and use or acknowledgment of the sponsor's name or logo by the organization, then the UBIT would not apply to the amount of such payment that exceeds the fair market value of the product advertising provided to the sponsor.

The exemption provided by the proposal would be in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on). No inference would be intended as to the tax treatment under present-law rules of sponsorship payments received by tax-exempt organizations prior to 1996.

Effective Date

The proposal would apply to qualified sponsorship payments received after 1995."

5. **On page 129, add at the end of the third full paragraph the following language:** "Similarly, utilization of this 4-year income-spreading rule would not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of causing the contract to be treated as a single premium contract (i.e., a contract in which substantially all of the premiums are paid within 4 years after the date of purchase). In addition, the lapse of a contract into

extended term insurance as a result of the changes made by the proposal, during the period that the 4-year income spreading rule applies, would not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of causing the contract to be treated as a single premium contract or by reason of failure to meet the 4-out-of-7 rule."

6. **On page 140, the second full paragraph should read as follows:** "The proposal would not apply to transfers in taxable years beginning after December 31, 2001."

16-Oct-95 10:40am

#95-2 195 R
PRELIMINARY
16-Oct-95

- Senate Finance Committee -

ESTIMATED BUDGET EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE SENATE FINANCE COMMITTEE ON OCTOBER 18, 1995

Fiscal Years 1996 - 2005

[Millions of Dollars]

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
I. Family Tax Relief											
A. $500 Tax Credit for Children Under Age 18	tybo/a 1/1/96	-4,449	-22,290	-22,515	-22,731	-22,942	-23,140	-23,340	-94,927	-141,407	-212,645
B. Credit for Adoption Expenses; Exclusion for Adoption Expenses	tybo/a 1/1/96	-27	-283	-303	-325	-346	-347	-348	-1,284	-1,978	-3,026
C. Marriage Penalty Relief: Increase standard deduction for joint returns to 200% of single by 2005	tybo/a 1/1/96	-137	-612	-1,079	-1,787	-2,196	-2,746	-3,720	-5,811	-12,277	-28,567
D. Student Loan Interest Credit ($500 per person not to exceed $1,000 per return)	1/1/96	-51	-146	-151	-157	-162	-168	-174	-668	-1,009	-1,568
Total for Family Tax Relief		-4,664	-23,331	-24,048	-25,000	-25,646	-26,401	-27,582	-102,690	-156,671	-245,806
II. Increase Savings and Investment											
A. Individual Retirement Arrangements (increase deductible IRA income limits; adopt back-end IRAs; and increase spousal IRAs)	tybo/a 1/1/96	-282	-638	-337	-1,190	-1,922	-3,445	-4,931	-4,349	-12,725	-33,963
B. Adopt SIMPLE pension plan	yba 12/31/95	-46	-71	-73	-75	-78	-80	-84	-343	-507	-775
C. Capital Gains Reforms: (a) 50% deduction for individuals; (b) maximum rate of 28% for corporations; (c) collectibles - 28% maximum rate; (d) 50% deduction in minimum tax; and (e) 75% deduction for venture capital investments:											
1. Corporate	sa 10/13/95	-1,009	-893	-912	-945	-971	-1,011	-1,071	-4,730	-6,812	-10,248
2. Individual	sa 10/13/95	3,950	-2,265	-5,674	-6,882	-7,296	-7,455	-7,835	-18,187	-33,477	-59,498

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
D. Alternative Minimum Tax (AMT) Reform: Conform AMT depreciation methods to regular tax recovery methods (effective ppisa 12/31/95); allow taxpayers to take certain minimum tax credits against minimum tax (effective tyba 12/31/95).......	—	-856	-1,875	-2,017	-1,748	-1,125	-821	-794	-7,621	-9,236	-11,241
E. Modify Depreciation for Small Motor Fuel/Convenience Store Outlets................	ppisa/a/b DOE	-1	-4	-23	-26	-29	-16	-19	-83	-118	-191
F. Allow for Tax-Free Conversion of Common Trust Funds to Mutual Funds.....	1/1/96	-4	-9	-8	-8	-8	-8	-8	-37	-52	-78
Total for Increase Savings and Investment......................		**1,772**	**-5,775**	**-9,044**	**-10,874**	**-11,429**	**-12,836**	**-14,742**	**-35,350**	**-62,927**	**-115,994**
III. Health Care-Related Provisions											
A. Treatment of Long-Term Care Insurance..	1/1/96	-886	-990	-1,209	-1,386	-1,575	-1,796	-2,040	-6,047	-9,885	-17,552
B. Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts..	1/1/96	-5	-50	-82	-128	-166	-207	-249	-431	-887	-1,971
C. Permit Medical Savings Accounts.............	1/1/96	-58	-122	-156	-194	-236	-259	-283	-765	-1,308	-2,306
D. Increase Tax-free Death Benefit Limit on Burial Insurance Policies......................	1/1/96	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
E. Treat Certain Health Insurers Similar to Blue Cross/Blue Shield Organizations.......	tyea 10/13/95	-1	-1	-1	-1	-1	-1	-1	-6	-8	-12
Total for Health Care Related Provisions...........................		**-950**	**-1,163**	**-1,448**	**-1,709**	**-1,978**	**-2,265**	**-2,573**	**-7,249**	**-12,088**	**-21,841**
IV. Estate Tax Reform											
A. Reduction in Estate Taxes for Qualified Businesses After Unified Credit Increase..	dda 12/31/95	—	-589	-698	-821	-965	-1,132	-1,313	-3,073	-5,517	-11,105
B. Phaseup Unified Credit to $750,000 by 2001..	dda/gma 12/31/95	—	-333	-663	-1,020	-1,401	-1,805	-2,144	-3,417	-7,366	-14,790
C. Provide a 50% Exclusion From Estate Taxes for Property Donated Subject to a Conservation Easement..........................	dda 12/31/95	—	-45	-50	-55	-64	-71	-79	-214	-364	-653
D. Technical Modification to the Generation Skipping Transfer Tax............................	gsta 12/31/95	-3	-4	-4	-4	-4	-4	-4	-19	-27	-41
E. Clarify Cash Leases Under Section 2032A..	dda 12/31/94	[1]	-1	-1	-1	-1	-1	-1	-4	-6	-9
Total for Estate Tax Reform...		**-3**	**-972**	**-1,416**	**-1,901**	**-2,435**	**-3,013**	**-3,541**	**-6,727**	**-13,280**	**-26,598**
TOTAL FOR SECTIONS I, II, III, AND IV..............................		**-3,845**	**-31,241**	**-35,956**	**-39,484**	**-41,488**	**-44,515**	**-48,438**	**-152,016**	**-244,966**	**-410,239**

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-06
V. Expiring Tax Provisions											
A. Provisions Extended Through 2/28/97:											
1. Work opportunity tax credit [2]	1/1/96	-67	-122	-86	-38	-15	-4	---	-327	-332	-332
2. Employer-provided educational assistance	1/1/95	-731	-404	-65	---	---	---	---	-1,201	-1,201	-1,201
3. R&E credit, with modifications	7/1/95	-1,149	-842	-449	-285	-177	-60	-7	-2,902	-2,969	-2,969
4. Reinstate tax-free treatment of employer-provided group legal services	1/1/96	-73	-45	---	---	---	---	---	-118	-118	-118
5. Orphan drug tax credit	1/1/95	-37	-12	-4	-2	-1	[1]	[1]	-56	-57	-57
6. Contributions of appreciated stock to private foundations	1/1/95	-47	-76	-14	-5	---	---	---	-142	-142	-142
7. Commercial Aviation Fuel: extend 4.3 cents/gallon exemption	10/1/95	-417	-187	---	---	---	---	---	-604	-604	-604
8. Suspend tax on diesel fuel for recreational boats	1/1/96	-24	-16	-4	-3	-1	---	---	-48	-48	-48
B. Extend Excise Tax Refund Authority for Alcohol Fuels Blenders Through 9/30/99	10/1/95	Negligible Revenue Effect									
C. Diesel Dyeing Exemption for Alaska During Period of Clean Air Act Exemption	[3]	-1	[1]	---	---	---	---	---	-1	-1	-1
D. Extend Section 29 Binding Contract Date to 12/31/96 and Placed-in-Service Date to 12/31/97 for Biomass and Coal	DOE	---	-17	-94	-137	-135	-139	-146	-383	-668	-1,152
E. Superfund and Oil Spill Liability Taxes:											
1. Extend Superfund excise taxes through 9/30/02	DOE	198	641	651	663	676	691	683	2,830	4,204	4,226
2. Extend Superfund AMT (through 12/31/97) [4]	DOE	300	503	202	---	---	---	---	1,005	1,005	1,005
3. Extend oil spill tax through 9/30/02 (leave billion dollar cap)	1/1/96	Pending Data from CBO									
F. Expatriation Tax Provisions	2/6/95	21	37	63	97	139	181	216	357	754	1,574
Total for Expiring Tax Provisions		**-2,027**	**-540**	**200**	**290**	**486**	**669**	**746**	**-1,590**	**-177**	**181**
VI. TAXPAYER BILL OF RIGHTS 2											
1. Expand IRS authority to abate interest	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
2. Tax Court review of IRS failure to abate interest	raa DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
3. Substitute joint returns for separate returns without full payment of separate return tax liability................	tyba DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
4. Increase in amount of property exempt from levy................................	lia 12/31/95	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
5. Modify offers-in-compromise rule......	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
6. Allow litigation cost recoveries in declaratory judgment proceedings....	pca DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
7. Enrolled agents included as third-party recordkeepers for purposes of receiving designated summonses.....	sia DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
8. New safeguards relating to designated summonses.....................	sia DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
9. Annual reminders to taxpayers with delinquent accounts....................	1/1/96	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[9]	[9]	[9]
10. Expand court discretion to reduce award for litigation costs for failure to exhaust administrative remedies.......	pca DOE	-1	-1	-1	-1	-1	-1	-1	-5	-7	-10
Total for Taxpayer Bill of Rights 2.......................................		**-3**	**-3**	**-3**	**-3**	**-3**	**-3**	**-3**	**-18**	**-20**	**-31**
VII. CASUALTY AND INVOLUNTARY CONVERSION PROVISIONS											
1. Modify basis adjustment rules under section 1033..........................	ica 9/13/95	2	4	6	9	14	20	29	35	84	225
2. Modify the exception to the related-party rule of section 1033 for individuals to only provide an exception for de minimis amounts ($100,000).............	ica 9/13/95	1	2	4	6	8	11	13	21	45	96
3. Provide that a taxpayer may elect to include in income crop insurance proceeds and disaster payments in the year of the disaster or in the following year..............................	pra 12/31/92	2	-1	-1	-1	-1	-1	-1	-2	-4	-6
4. Change involuntary conversion rules for Presidentially declared disaster areas..	DDA 12/31/94	-6	-14	-10	-10	-10	-10	-10	-50	-70	-100
Total for Casualty and Involuntary Conversion Provisions..		**-1**	**-9**	**-1**	**4**	**11**	**20**	**31**	**4**	**55**	**215**
VIII. TAX EXEMPT AND CHARITABLE REFORMS											
1. Provide tax-exempt status to common investment funds...............................	tyea 12/31/95	-4	-6	-6	-7	-7	-7	-8	-29	-45	-70

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
2. Change charitable corporate sponsorship rules.............................	1/1/96					Negligible Revenue Effect					
3. Treatment of dues paid to agricultural or horticultural organizations.............	tyba 12/31/94					Negligible Revenue Effect					
4. Repeal tax credit for contributions to special Community Development Corporations.....................................	DOE	1	1	2	2	2	2	2	8	12	18
5. Notice to charitable beneficiaries for certain gifts..	toa 12/31/95					Negligible Revenue Effect					
6. Football coaches' pension plan clarification...	[10]					Negligible Revenue Effect					
***Total for Tax Exempt and Charitable Reforms*..**		-3	-5	-4	-5	-5	-5	-6	-21	-33	-52
IX. CORPORATE, OTHER REFORMS AND MISCELLANEOUS PROVISIONS											
1. Reform the tax treatment of certain corporate stock redemptions.............	da 5/3/95	-83	-100	-17	84	209	343	437	93	873	2,444
2. Require corporate tax shelter reporting..	atsotppa DOE	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[12]	[12]	[13]
3. Disallow interest deduction for corporate-owned life insurance policy loans; modification of treatment of deferred acquisition costs for surrendered policies.........................	lpoaa 10/13/95	134	372	594	802	966	1,539	2,005	2,868	6,412	12,314
4. Phaseout preferential tax deferral for certain large farm corporations required to use accrual accounting...	[14]	26	37	38	39	40	41	42	179	261	392
5. Section 936: (a) Phaseout income-based credit from 1999 through 2001; (b) eliminate economic activity credit in 2002; (c) eliminate credit for new QPSII, permit credit for maximum of five years on old QPSII; (d) no credit method change after 1995; and (e) elimination of credit for certain U.S. possessions in 2005......	[15]	220	250	315	432	551	662	2,131	1,768	4,561	14,533
6. Corporate accounting -- reform of income forecast method	pplsa 9/13/95	32	69	29	13	14	16	19	157	192	273
7. Provide 3-year amortization of intrastate operating rights of truckers...	tybo/a 1/1/95	-11	-14	-8	-4	---	---	---	-37	-37	-37

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-06
8. Permit corporate pension reversions to fund employee benefits (generally includes ERISA covered benefits).....	DOE	1,591	1,490	916	471	295	135	46	4,772	4,953	4,846
9. Modify exclusion of damages received on account of personal injury or sickness:											
a. Treat all punitive damages as taxable.....	ama 12/31/95	3	4	6	7	7	7	8	27	42	66
b. Include in income damage recoveries for non-physical injuries.....	ama 12/31/95	31	47	49	52	54	57	60	233	350	548
10. Require tax reporting for payments to attorneys.....	pma 12/31/95	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[12]	[12]	[13]
11. Disallow rollover under section 1034 to extent of previously claimed depreciation for home office or other depreciable use of residence.....	tyea 12/31/95	1	3	4	5	6	8	9	19	35	69
12. Provide that rollover of gain on sale of a principal residence cannot be elected unless the replacement property purchased is located within the United States (limited to non-citizens who terminate residence within 2 years).....	sea 12/31/95	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]
13. Repeal exemption for withholding on gambling winnings from bingo and keno, where proceeds exceed $5,000.....	1/1/96	20	6	6	6	6	7	7	45	58	80
14. Repeal advance refunds of diesel fuel tax for diesel cars and light trucks.....	12/31/95	8	19	19	19	19	19	19	84	122	179
15. Apply failure to pay penalty to substitute returns.....	DOE	1	3	29	30	32	33	35	95	163	278
16. Modify treatment of foreign trusts.....	[16]	93	162	171	180	188	197	206	794	1,197	1,879
17. Repeal 50% interest income exclusion for financial institution loans to ESOPs.....	lma 10/13/95	27	69	109	149	187	224	261	541	1,026	2,019
18. Repeal the wine and flavors excise tax credit.....	1/1/96	58	87	92	97	102	107	113	436	655	1,024
19. Provide for flow through treatment for Financial Asset Securitization Investment Trusts (FASITs).....	DOE	34	18	10	5	2	---	-2	69	67	49
20. Tax-free treatment of contributions in aid of construction for water utilities; change depreciation for water utilities.....	[17]	-16	-26	-12	4	19	32	[illegible]	[illegible]	[illegible]	[illegible]

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
21. Modify the ozone depleting chemicals tax for imported recycled halons	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[7]	[7]	[18]
22. Modify two county tax-exempt bond rule for local furnishers of electricity or gas	DOE	[11]	1	2	3	4	5	6	11	22	49
23. Provide tax-exempt bonds status for Alaska Power Administration sale	bia DOE	[1]	-1	-1	-1	-1	-1	-1	-5	-8	-12
24. Require that life insurance companies treat 85% of their capital losses from foreclosed real estate as ordinary losses spread over 10 years	tyba 12/31/94	6	[11]	-1	-2	-2	[11]	1	1	2	-7
25. Modify treatment of reachback companies under coal industry retiree tax [19]	10/1/95	Estimate Will Be Supplied By CBO									
26. Clarify that newspaper carriers and other workers are independent contractors	spa 12/31/95	Negligible Revenue Effect									
Total for Corporate, Other Reforms and Miscellaneous Provisions		2,181	2,511	2,356	2,397	2,704	3,437	5,451	12,145	21,028	41,266
NET TOTALS		-3,696	-29,287	-33,408	-36,801	-38,296	-40,397	-42,219	-141,496	-224,113	-368,660

Joint Committee on Taxation

NOTES: Details may not add to totals due to rounding.

Legend for "Effective" column:
- ppisa = property placed in service after
- sea = sales and exchanges after
- sa = sales after
- DOE = date of enactment
- tyba = taxable years beginning after
- tyea = taxable years ending after
- ama = awards made after
- ipoaa = interest paid or accrued after
- ica = involuntary conversion after
- tybo/a = taxable years beginning on or after
- yba = years beginning after
- gsta = generation skipping transfers after
- raa = requests for abatement after
- ppiso/a/b DOE = property placed in service on, after, or before date of enactment
- atsoippa DOE = any tax shelter offered to potential participants after date of enactment
- lma = loans made after
- dda = decedents dying after
- dda/gma = decedents dying after and gifts made after
- pra = payments received after
- bia DOE = bonds issued after date of enactment
- pca DOE = proceeding commenced after date of enactment
- pra = payments received after
- DDA = disasters declared after
- da = distributions after
- lia = levies issued after
- sia = summonses issued after
- tca = trusts created after
- spa = services performed after
- pma = payments made after

[Footnotes for Table #95-2 195 R appear on the following page]

Footnotes for Table #95-2 195 R:

[1] Loss of less than $500,000.
[2] Credit rate at 35% on first $6,000 of income; eligible workers expanded to include welfare cash recipients and veteran foodstamp recipients; 400 hour work requirement.
[3] Effective as if included in the Omnibus Budget Reconciliation Act of 1993.
[4] Estimates presented after interaction with Alternative Minimum Tax provisions and are shown net of offset with the corporate income tax.
[5] Loss of less than $1 million.
[6] Loss of less than $2 million.
[7] Loss of less than $5 million.
[8] Gain of less than $1 million.
[9] Gain of less than $5 million.
[10] Generally effective as if included in Public Law 100-202 (i.e., years beginning after 12/22/87). Excise tax is payable in the first year beginning after the date of enactment.
[11] Gain of less than $500,000.
[12] Gain of less than $25 million.
[13] Gain of less than $30 million.
[14] No new suspense accounts could be established in taxable years ending after 9/13/95. The income in existing suspense accounts would be recognized in equal installments over a 20-year period beginning with the first taxable year beginning after 9/13/95.
[15] QPSII investments after 10/13/95 and date of enactment for other provisions generally.
[16] Various effective dates depending on provisions.
[17] Effective for amounts received after date of enactment and property placed in service after date of enactment.
[18] Loss of less than $10 million.
[19] Estimates provided by the Congressional Budget Office.

October 17, 1995 (9:51pm)

PROPOSED AMENDMENTS TO THE CHAIRMAN'S MARK

The following is a list of amendments that will be offered during mark-up.

Senator Pryor

1. The Pension Simplification Act.

2. The Subchapter S Reform Act.

3. The Taxpayer Bill of Rights 2.

4. An amendment to the corporate capital gains provision in the Chairman's Mark.

5. An amendment to the tax treatment of long-term care insurance.

6. The Church Pension Simplification Act.

7. An amendment to permit the application of the GATT transition provisions to the prescription drug industry in the same manner as they are applied to all other industries.

Senator Baucus

1. An amendment to grandfather §403(b) pension plans which have been established by certain Indian Tribal Governments.

2. Phase in the child tax credit from $400 to $500. In 1996, the credit would be $400, in 1997 the credit would be $450, and in 1998 all subsequent years the credit would be $500.

3. Reduce the AGI levels at which the child tax credit would be phased out. For married taxpayers filing jointly it would be $90,000; married taxpayers filing separately would be $45,000; and single or head of household would be $55,000.

4. Reduce the exemption increases for marriage penalty relief.

5. Strike corporate capital gains.

6. Reduce the capital gains relief for individuals by limiting the 50% deduction to the first $100,000 of net capital gain.

7. Strike the AMT provision regarding the use of AMT credits to offset 50% of the current year AMT liability.

8. Redirect the revenues resulting from the 1/2 cent of the excise tax rate directed to the mass transit account in the Highway Trust Fund by OBRA '93 to a new account for grants to AMTRAK for operating expenses and capital improvements.

Senator Breaux

1. Three amendments to implement the Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry:

   a. Repeal the 50% ad valorem duty on non-emergency foreign repairs to U.S. flag ships.

   b. Repeal "U.S. built" requirements in the Capital Construction Fund and Capital Reserve Fund.

   c. Create anti-dumping provisions that would allow cases to be brought against commercial ships sold at less than fair value.

2. Bar Customs from collecting the 2 years that it suspended enforcement of duties against LASH barge repairs and vessel spare parts and equipment.

3. Exempt certain coffee products from country of origin labeling requirements.

Senator Graham

1. Accelerate the start date for the 3-year phase out of section 936 applicable percentage limitation by such time as is necessary to raise sufficient revenue to pay for S. 529, The Caribbean Basin Trade Security Act.

2. Amend the common paymaster rule currently applicable to a state medical school and a tax-exempt facility plan.

3. Modify the unrelated person sale rule in §29 to apply to electricity produced from eligible fuel, instead of the fuel itself. The amendment would apply in the case of synthetic gas produced from coal.

4. Modify the unrelated person sale rule in §29 to apply to electricity produced from eligible fuel,

instead of the fuel itself. The amendment would apply in the case of synthetic gas produced from coal and gas produced from landfills.

This provision would be paid for by shortening the extension period for the binding contract and placed-in-service deadlines under the Chairman's mark with respect to biomass facilities only.

5. Exempt certain short-term OID obligations held by a non-resident alien from U.S. estate tax.

6. Strike the provision of the Chairman's mark that would repeal the tax credit for contributions to certain community development corporations.

7. Strike the provision of the Chairman's mark that would repeal the wine and flavors credit.

8. Income earned by a nonresident alien individual from the performance of services in connection with the international operation of ships or aircrafts would be treated as earned from sources outside the U.S.

9. Raise the maximum annual amount that can be deferred under a §457 deferred compensation plan of a tax-exempt or governmental employer from $7,500 to $25,000 if the individual is a member or employee of a group medical practice.

   This provision would be paid for by requiring mandatory inclusion into income of excess pension assets, regardless of whether the corporation is in an NOL position.

<u>Senator Dole</u>

1. The 10% luxury tax on automobiles is scheduled to expire at the end of 1999. The amendment would extend the tax through March 31, 2002, but begin phasing down the tax rate in 1996.

DAVID PRYOR
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United States Senate

WASHINGTON, DC 20510-0402

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
FINANCE
GOVERNMENTAL AFFAIRS
SPECIAL COMMITTEE ON AGING

October 17, 1995

Senator William V. Roth
Chairman, Senate Finance Committee
209 Dirksen Senate Office Building
Washington, D.C. 20510

Attention: Lindy Paull

Dear Mr. Chairman:

In order to help you ensure an orderly amendment process during to upcoming Finance Committee Mark-up, at this time, I plan to offer the following amendments regarding:

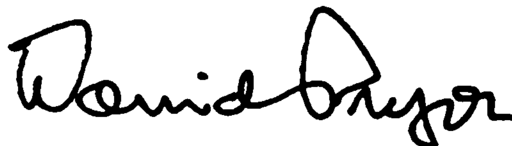
1. The Pension Simplification Act.
2. The Subchapter S Reform Act.
3. The Taxpayer Bill of Rights 2.
4. The Corporate Capital Gains provision in the Mark.
5. Tax Treatment of Long-Term Care Insurance in the Mark.
6. The Church Pension Simplification Act.

At this time, I have no written description of the above amendments, and no revenue estimate prepared by the Joint Committee on Taxation are available.

Also, I reserve the right to offer additional amendments as I see fit once the amendment process begins.

If you or your staff has any questions, please do not hesitate to call me or Steve Glaze at 224-7827.

Sincerely,



David Pryor

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COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
FINANCE
GOVERNMENTAL AFFAIRS
SPECIAL COMMITTEE ON AGING

October 17, 1995

The Honorable William Roth
Chairman
Committee on Finance

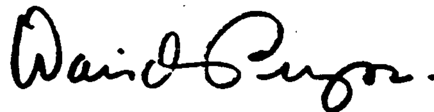
Dear Mr. Chairman:

In addition to the amendments I filed previously for the purposes of the Committee's markup tomorrow, I plan to offer an additional amendment which corrects an inadvertent technical omission in the Uruguay Round Agreements Act (URAA). As you know, the URAA was the subject of lengthy Committee deliberations.

In spite of the Congress' best efforts, a conforming amendment was not adopted which would allow the equitable application of the GATT transition provisions to the prescription drug industry in the same manner as all other industries.

Again, I reserve the right to offer additional amendments during the markup.

Sincerely,



David Pryor

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LAWRENCE O'DONNELL, JR., MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

October 17, 1995

The Honorable William V. Roth, Jr.
Chairman
Senate Finance Committee
Washington, D.C. 20510

Dear Mr. Chairman,

My staff has been advised that my initial amendments to your current Tax Mark for Revenue Reconciliation (dated October 16, 1995) should be submitted by 5:00 p.m. this evening.

I have not had a chance to thoroughly review the Mark, but can advise you at this time that I intend to submit the amendments described below. In addition, I may introduce additional amendments as the Mark progresses.

1. An amendment to grandfather 403(b) pension plans which have been established by certain Indian Tribal Governments. Senator Nickels and I advised you of our position on this matter in a letter dated October 4, 1995.

2. An amendment which would:

-phase in the child tax credit from $400 to $500,

-reduce the AGI levels at which the child tax credit would phase out,

-reduce the exemption increases for marriage penalty relief,

-strike corporate capital gains relief,

-reduce the capital gains relief for individuals, and

-strike the AMT relief provision related to the use of AMT credits.

Savings from the above would be applied to reduce the Medicare cuts.

3. An amendment which would redirect revenues resulting from the 1/2 cent of the excise tax rate directed by the amendments made by OBRA '93 in FY 1996-1999 to the mass transit account in the Highway

Trust Fund to a new account for grants to AMTRAK for operating expenses and capital improvements.

I deliver the texts of the above-described amendments and will advise you of any other amendments as expeditiously as possible.

Max Baucus

AMENDMENT BY SENATOR BREAUX
TO IMPLEMENT THE O.E.C.D. SHIPBUILDING AGREEMENT

Purpose
To implement the "Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry", otherwise known as the OECD Shipbuilding Agreement.

Explanation
The global shipbuilding industry has long been characterized by a destructive pattern of heavy government subsidies and chronic predatory pricing practices, distorting the global market -- and harming the U.S. shipbuilding industry.

U.S. shipbuilders lacked the incentive and resources to enter the heavily subsidized international commercial shipbuilding market. Instead, they focused their efforts on meeting the demands of the U.S. military shipbuilding market. With the end of the Cold War, however, U.S. shipyards are facing the challenge of competing in the international commercial market.

The OECD Shipbuilding Agreement, concluded on December 21, 1994, after 5 years of negotiations, will eliminate distortive government subsidies and provide a remedy against injurious pricing practices in the shipbuilding sector. The Agreement will enter into force on January 1, 1996, assuming completion of formal ratification procedures by all signatories (South Korea, Japan, Norway, the U.S. and the E.U.), including passage of implementing legislation by the United States.

Significant growth is projected for the highly competitive international shipbuilding market, while domestic military and commercial markets are expected to be small. The commercial shipbuilding market is projected to be $265 billion for the period 1992 to 2001. At present, U.S. participation in this market is minimal.

Required changes to U.S. law within Finance Committee jurisdiction
- o repeal of 50% ad valorem duty on non-emergency foreign repairs to U.S. flag ships;
- o repeal U.S. build requirements in the Capital Construction Fund (CCF) and Capital Reserve Fund (CRF);
- o create injurious pricing (antidumping) provisions that would allow cases to be brought against commercial ships sold at less than fair value.

AMENDMENT BY SENATOR JOHN BREAUX

PURPOSE: Technical amendment to end discriminatory application of duty assessments on vessel spare parts for LASH barge vessels.

PROPOSAL: The GATT implementation legislation passed by Congress specified that permanent LASH barge and spare parts exemptions would be effective upon the entry into force of the WTO Agreement. Prior to that, Customs had agreed to suspend the assessment of duties against LASH barge repairs and vessel spare parts and equipment until Congress could implement new rules. Customs is now seeking to retroactively enforce duties for the two years it had suspended enforcement. This amendment would bar this collection.

AMENDMENT BY SENATOR JOHN BREAUX

PURPOSE: Technical amendment to clarify labeling requirement designating country of origin for instant coffee products.

PROPOSAL: Recently implemented Customs rules will cause retail instant coffee products made from imported soluble coffee powder to carry country of origin labeling. Prior to this proposal, the industry operated on the basis that instant coffee manufactured from imported soluble powder was a product of the United Stated because of the substantial transformation which occurs prior to retail sale.

The amendment would exempt coffee products described in subheading 0901.21, 0901.22, 0902.10, 0902.20, 0902.30, 0902.40, 2101.10, or 2101.20 of the HTS from country of origin labeling requirements.

Graham Amendment #3

Caribbean Basin Economic Security Act

Amendment: S. 529, as amended (see legislative language)

Revenue offset: Accelerate the start date for the three-year phase-out of the Section 936 applicable percentage limitation by such time as is necessary to raise sufficient revenue to pay for S. 529. The phase-out would remain a three-year phase out. The amendment would not affect the sunset of the wage-based credit or the QPSII.

Graham Amendment #4

Application of Common Paymaster Rules To Agency Accounts of State University Medical Schools

Amendment: Amend the common paymaster rule currently applicable to a state medical school and a tax-exempt faculty practice plan employing the same faculty member to apply to a state medical school where the faculty member is paid through an agency account rather than directly from a tax-exempt faculty practice plan. Such treatment would be applicable only if:

1. the agency account is authorized by state law and receives funds from a tax-exempt faculty practice plan;

2. the agency account distributes the payments to faculty members who render patient care at the medical school; and

3. the faculty members receiving payment from the agency account comprise at least 30 percent of the membership of the faculty practice plan.

Offset: Revenue estimate pending and expected to be negligible.

Graham Amendment #5

Section 29 Unrelated Person Sale Rule

Amendment: Modify the unrelated person sale rule in section 29 to apply to electricity produced from eligible fuel, instead of to the fuel itself. The amendment would apply in the case of synthetic gas produced from coal. The amendment would be effective for coal gasification facilities placed in service after 1995.

Offset: Revenue estimate not available, but expected to be negligible.

Graham Amendment #5a

Section 29 Unrelated Person Sale Rule

Amendment: Modify the unrelated person sale rule in section 29 to apply to electricity produced from eligible fuel, instead of to the fuel itself. The amendment would apply in the case of synthetic gas produced from coal and gas produced from landfills. The amendmend would be effective for coal gasification and landfill gas facilities placed in service after 1995.

Offset: Shorten the extension period for the binding contract and placed-in-service deadlines under the Chairman's mark with respect to biomass facilities only. The Joint Tax Committee staff would establish the necessary reduction in length of the extension period (probably a month or two).

Graham Amendment #6

Exempt Certain Short-Term OID Obligations Held by a Non-Resident Alien From U.S. Estate Tax

Amendment: Treat any debt obligation the income from which would be eligible for short-term OID exclusion under section 871(g)(2) as property located outside of the United States for determining the U.S. estate tax liability of a non-resident not a citizen. The rule would be effective for all returns filed after December 31, 1995.

Offset: Negligible per Ways & Means mark-up.

Graham Amendment #7

Strike Repeal of the Tax Credit for Contributions to Certain Commmunity Development Corporations

Amendment: Strike the provision of the mark that repeals the tax credit for contributions to certain Community Development Corporations.

Graham Amendment #8

Strike Repeal of the Wine and Flavors Credit (Section 5010)

Amendment: Strike the provision of the mark that repeals the wine and flavors credit, keeping current law in effect.

Graham Amendment #9

Taxation of Nonresident Aliens Temporarily in the United States To Engage in International Transportation Services

Amendment: In the case of a nonresident alien individual, gross income from the performance of services in connection with the international operation of ships or aircraft shall be considered as earned from sources outside the U.S. and exempt from U.S. taxation. Income of a non-resident alien exempt from U.S. taxation under this amendment will be exempt from withholding under sections 1441 and 3402.

In addition, for purposes of applying the residency rules under section 7701, an alien individual will not be considered present in the United States on any day during which (1) the individual is physically present in the United States for less than 24 hours during the day and (2) the individual renders services on such day aboard an aircraft or vessel engaged in international transportation operations.

Offset: Revenue estimate not available but expected to be negligible.

Graham Amendment #10

Exemption for Certain Medical Group Practices

Amendment: For a section 457 eligible deferred compensation plan of a tax-exempt or governmental employer, raise the maximum annual amount that can be deferred from $7,500 to $25,000 if the individual is a member or employee of a group medical practice. The $25,000 amount would be indexed for inflation.

* A group medical practice would be defined as a group medical practice or integrated health care delivery system which employs groups of physicians to provide clinical services and which is exempt from taxation under section 501(a).

* The proposal would only apply to excess benefit plans, which would be defined as a plan maintained solely to provide benefits in excess of the limitations on contributions and benefits under section 415.

The rule coordinating deferrals under a section 457 plan with elective deferrals would not apply to amounts deferred under a plan maintained by a group medical practice.

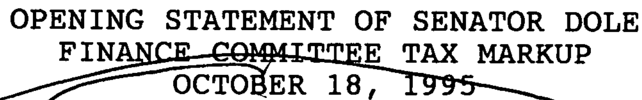
Offset: Require mandatory inclusion into income of excess pension assets, regardless of whether the corporation is in an NOL position.

Amendment to Phase Out Automobile Luxury Tax
Senator Dole

The 10% luxury tax on automobiles is scheduled to expire at the end of 1999. The amendment would extend the tax through March 31, 2002, but begin phasing down the tax rate in 1996 as follows:

1996	9%
1997	8%
1998	7%
1999	6%
2000	5%
2001	4%
2002	3%

The Joint Tax Committee staff estimated that terminating the tax on December 31, 2001 would reduce federal budget receipts by $4 million over 7 years. To completely offset this revenue loss, the tax would be extended into the first quarter of 2002, slightly raising revenue in that year.



OPENING STATEMENT OF SENATOR DOLE
FINANCE COMMITTEE TAX MARKUP
OCTOBER 18, 1995

THIS IS AN HISTORIC TIME FOR AMERICA. AND THIS IS AN HISTORIC PIECE OF LEGISLATION FOR AMERICANS. FOR THE FIRST TIME IN DECADES THE CONGRESS WILL ENACT LEGISLATION TO ELIMINATE THE FEDERAL BUDGET DEFICIT AND PROVIDE DRAMATIC AND FAR-REACHING TAX RELIEF TO FAMILIES AND TO STIMULATE SAVINGS AND INVESTMENT, ECONOMIC GROWTH AND JOB CREATION. OUR CHILDREN AND GRANDCHILDREN, AND GENERATIONS TO COME WILL BENEFIT GREATLY FROM THIS LEGISLATION.

I AM VERY PLEASED THAT MORE THAN 60% OF THE TAX CUTS WILL GO DIRECTLY TO FAMILIES, GIVING THEM DESPERATELY-NEEDED TAX RELIEF. WE PROVIDE A $500 TAX CREDIT FOR FAMILIES WITH CHILDREN UP TO AGE 18. AND FOR FAMILIES WITH CHILDREN IN COLLEGE OR TECHNICAL SCHOOL THE BILL PROVIDES A TAX CREDIT FOR A PORTION OF THEIR STUDENT LOAN INTEREST EXPENSES.

THE TAX CUTS FOR FAMILIES IN THE BILL ARE SIGNIFICANT, AND I AM HOPEFUL THAT IN CONFERENCE THEY CAN BE INCREASED EVEN MORE. I WOULD LIKE TO SEE THE FAMILY TAX CREDIT APPLY THIS YEAR, SO THAT FAMILIES WILL RECEIVE THE CREDIT AT THE EARLIEST POSSIBLE TIME -- WHEN THEY FILE THEIR TAX RETURN NEXT APRIL.

THE BILL ELIMINATES THE MARRIAGE PENALTY FOR TAXPAYERS WHO DO NOT ITEMIZE THEIR DEDUCTIONS. THIS IS AN IMPORTANT FIRST STEP

IN WHAT SHOULD BE A TOTAL ELIMINATION OF THE MARRIAGE PENALTY AND ONE THAT WILL HELP OVER 20 MILLION FAMILIES ACROSS THE COUNTRY.

I AM ALSO PLEASED THAT THE BILL ADOPTS MY PROPOSAL TO CREATE A NEW SAVINGS INCENTIVE FOR SMALL BUSINESS EMPLOYEES. SMALL BUSINESSES WILL HAVE THE FIRST REAL OPPORTUNITY TO ESTABLISH PENSION PLANS FOR THEIR EMPLOYEES, FREE OF BURDENSOME AND UNNECESSARY IRS RULES AND REGULATIONS. NOW THE MILLIONS OF EMPLOYEES WORKING FOR SMALL BUSINESSES WILL BE ABLE TO SAVE UP TO $12,000 EACH YEAR TAX-FREE. I WILL SOON INTRODUCE THE TEXT OF THIS PLAN, CALLED THE SIMPLE -- THE SAVINGS INCENTIVE MATCH PLAN FOR EMPLOYEES -- AND I ENCOURAGE MY COLLEAGUES ON THE COMMITTEE TO SUPPORT THIS IMPORTANT INITIATIVE.

THE BILL ALSO CONTAINS VITAL PROVISIONS TO PROTECT AND CREATE AMERICAN JOBS. SMALL FAMILY-OWNED BUSINESSES WILL BE INSULATED FROM THE ONEROUS ESTATE TAX SO THAT THEY CAN CONTINUE TO OPERATE THEIR BUSINESSES, PROVIDING JOBS AND INCOME IN COMMUNITIES AROUND THE COUNTRY. UNDER CURRENT LAW COMPANIES ARE TOO OFTEN FORCED TO LIQUIDATE SIMPLY TO PAY THE ESTATE TAX, WITH EMPLOYEES LOSING THEIR JOBS IN THE PROCESS. TO ADDRESS THIS PROBLEM THE MARK CONTAINS THE BASIC STRUCTURE OF THE AMERICAN FAMILY-OWNED BUSINESS ACT WHICH I INTRODUCED THIS YEAR ON A BIPARTISAN BASIS ALONG WITH 12 OTHER MEMBERS OF THIS COMMITTEE.

WE HAVE ALSO TAKEN AN IMPORTANT STEP TO UNLEASH MORE THAN A

TRILLION DOLLARS IN LOCKED-UP CAPITAL -- A SURE WAY TO STIMULATE ECONOMIC GROWTH AND JOB CREATION. I HAVE LONG CALLED FOR A CAPITAL GAINS RATE CUT SO THAT AMERICANS CAN HAVE THE FREEDOM TO SELL THEIR LONG-HELD ASSETS WITHOUT TURNING OVER MOST OF THEIR PROFITS TO THE FEDERAL GOVERNMENT. WHILE THE RATE CUT APPLIES TO GAINS EARNED AFTER OCTOBER OF THIS YEAR, I HOPE THAT IN CONFERENCE WE AGREE TO APPLY THE CAPITAL GAINS CUT AT THE BEGINNING OF 1995 AS IN THE HOUSE BILL.

WHILE SOME MAY QUIBBLE OVER THE DETAILS OF CERTAIN ITEMS IN THE BILL, WHEN YOU STEP BACK AND LOOK TO THE TAX RELIEF PROVIDED TO HELP MIDDLE- AND LOWER-INCOME FAMILIES AND ENCOURAGE ECONOMIC GROWTH, WE SHOULD ALL BE PLEASED. FOR THAT I THANK THE CHAIRMAN AND OTHER MEMBERS OF THE COMMITTEE.

COAL REACHBACK ISSUE

- THE COAL REACHBACK PROVISION IN THE CHAIRMAN'S MARK IN NO WAY JEOPARDIZES THE HEALTH BENEFITS OF RETIRED MINERS. MINERS WILL CONTINUE TO RECEIVE THEIR BENEFITS AT THE SAME LEVELS PROVIDED IN CURRENT LAW.

- THE FACT IS THAT THE CURRENT LAW COAL INDUSTRY RETIREE HEALTH ACT HAS BEEN DECLARED UNCONSTITUTIONAL AS RECENTLY AS THIS PAST SUMMER. AND THE MARK PROVIDES A TWO-YEAR PERIOD FOR THE COURTS TO ADDRESS THE ISSUE.

- FOR REACHBACK COMPANIES THE MARK MERELY PROVIDES THAT TO THE EXTENT THERE IS A SURPLUS IN THE FUND OF AT LEAST 10%, THE PREMIUM PAYMENTS OF REACHBACK COMPANIES CAN BE REDUCED. IF THERE IS NO SURPLUS, THEN REACHBACK COMPANIES CONTINUE TO PAY. IN ALL CASES, THERE WILL STILL BE MORE THAN ENOUGH MONEY IN THE TRUST FUND TO PAY FOR MINERS' BENEFITS.

- THIS ISSUE HAS BEEN CONTROVERSIAL FROM THE VERY BEGINNING, HAVING BEEN ENACTED WITHOUT EVER BEING CONSIDERED BY THIS COMMITTEE. THE COCHRAN LEGISLATION THAT IS ADOPTED IN THE MARK IS A PERFECTLY APPROPRIATE TEMPORARY SOLUTION TO THE PROBLEM.

Moynihan

OPENING STATEMENT

It is now 12 years since the then Director of the Office of Management and Budget, David Stockman, told a Cabinet meeting of the Reagan administration that not only would there be an embarrassing deficit for the fiscal year then in prospect, but $200 billion in deficits "as far as the eye can see." As matters turned out, the deficits grew even higher, reaching $290.4 billion in Fiscal Year 1992. The number would have been even larger without the Social Security surplus. Thanks to the 1993 combination of outlay reductions and tax increases which came out of this committee, -- without a single vote from the Republican side I might add -- the deficit for the fiscal year that just ended dropped below $200 billion for the first time since 1989.

However, the Federal deficit remains the central fact of the American political economy. In their book, The Deficit and the Public Interest, Joseph White and the late Aaron Wildavsky wrote:

> Strife over the deficit has affected procedure as well as policy, monopolizing the congressional agenda, encouraging paralyzing and deceptive legislation...frustrating our public officials, and stalemating the government.

Today the Finance Committee begins a second round of the budget reconciliation process. Three weeks ago we took action on the expenditure side of the budget. And now we will consider the revenue side. It is understandable if these proceedings confuse the public.

But why the separation? A budget, according to The Columbia Encyclopedia -- third edition -- , is an "inclusive list of proposed expenditures and expected receipts of any person, enterprise or government...."

The FY 1996 Budget Resolution anticipates that as a result of actions, primarily on the outlay side, by this and other committees the budget deficit will be eliminated by the year 2002. Starting with a deficit of $174.6 billion in FY 1995, the budget, at the end of 7 years, ends up with a small surplus of $6.4 billion. This is shown on line 1 of the chart. These figures are derived from the budget resolution -- page 44 of the Conference Report on the Budget. CBO's final tally of the budgetary impact of committee actions may differ slightly, but as of late last (Tuesday) night we did not have those numbers, and they won't that much matter.

Line 2 of the chart shows the fiscal dividend -- from Table B-4 of CBO's April 1995 Budget Report. It is said we will earn, over 7 years, a $170 billion bonus. As the deficit declines, interest rates decline. CBO estimates that eliminating the deficit on this path leads to a gradual reduction of almost 2

percentage points in the interest rate on 10 year Treasury bonds -- from 6.8 to 5.1 percent resulting in the fiscal dividend of $170 billion.

Line 3 shows what would happen if we stopped -- adjourned this mark-up hearing. In the year 2000, the fiscal dividend reduces the deficit by $32 billion from $80.8 billion to $48.8 billion. And in 2002 the surplus is increased by $50 billion from $6.4 billion to $56.4 billion.

But alas we will not stop. Unfortunately, we will enact a tax cut with a seven year cost of $245 billion. Line 4A of the chart shows the annual cost of the tax cut.

We will be told that the fiscal dividend is paying for the tax cut.

Simple arithmetic and logic contradict this argument. The fiscal dividend is $170 billion; the tax cut $245 billion -- a $75 billion difference, not counting interest.

And now look at line 5 of the chart which shows the deficit after accounting for the tax cut and the other revenue measures in today's Mark. If we had stopped at line 3, i.e. adjourned this hearing, the deficit would be smaller -- for example, $48.8 billion in 2000 with no net tax cut compared to $87.1 billion with the net tax cut. And in 2002 the surplus would be larger -- $56.4 billion with no net tax cut compared to only $14.2 billion with the net tax cut.

The end result is clear; the 7 year cumulative deficit in line 3 --$476 billion -- is $224 billion lower than the cumulative deficit in line 5 -- $700 billion. Excluding interest costs, the revenue provisions of this mark-up increase the accumulated national debt by $224 billion.

One last point should be noted from the chart. Look at line 5. We are not making any progress. For FY 1995 CBO projects a deficit of $174.6. In

FY 1997 the deficit, after all the painful cuts, -- eliminating the Social Security provision for poor children, reducing EITC and so on -- and including the effects of the fiscal dividend and the revenue provisions considered in today's mark-up, the deficit is <u>$174.5</u> billion.

NO CHANGE!

As I indicated, the final numbers may be slightly different. It should also be noted that the budget resolution and my analysis are based on the April 1995 CBO baseline. CBO's August update lowered the baseline by about $15 billion. But the basic comparisons remain valid.

If we had stopped at line 3 -- with no net tax cut and a more gradual and different mix of expenditure reductions -- we would continue the downward trend in the deficit started with the Omnibus Budget Reconciliation Act of 1993.

Primarily as a result of actions taken in this Finance Committee a deficit reduction program --roughly one-half from receipts and one-half from outlays -- was enacted in 1993. Both CBO and OMB estimated the direct budget impact -- no fiscal dividend in these estimates -- of OBRA 93 as a five year, FY 94-98, $500 billion reduction in the deficit.

We are heading for the third consecutive decline in the deficit.

FISCAL YEAR	DEFICIT
1992	$290.4 BILLION
1993	$255.1 BILLION
1994	$203.2 BILLION
1995 (EST.)	$160 - $170 BILLION

In the last five years the deficit, as a percentage of GDP, has been cut in half, from about 5.0 to 2.5 percent.

Much more is needed. We need more than balance. We need a surplus to promote economic growth and to ensure the long-run solvency of the Social Security Trust Funds.

In 1989, as a member of the National Economic Commission, I joined with my Democratic colleagues on the Commission, including Vice-Chairman Robert S. Strauss, in arguing:

> First, that deficits do matter. Coming to grips with our policy of spending more money than we take in must be this nation's first priority. Rationalizations of the policy debacle that has led to the immense deficits are an irresponsible answer to a serious problem. Republicans and Democrats must work together to address the problem in a realistic way.

Unfortunately, we couldn't reach a bi-partisan agreement because the Republicans' approach to balancing the budget, then as now, was unbalanced. They argued for continued sharp reductions in domestic spending with no discussion of revenues. Now they compound the imbalance by advocating a

reduction in revenues. Let's also not forget the economic benefits of a balanced program. Last week Robert Lucas, the most recent Nobel Laureate in Economics and a Professor of Economics at the University of Chicago, pronounced the economy in good health, noting in the Wall Street Journal last Wednesday October 11th that:

> ...The U.S. is a low-inflation country without major unemployment. We're doing great, and have been for a long time.

Lucas' comments about low inflation and low unemployment should remind us of the Presidential debates of 1980 and 1984 when attention focused on the so-called discomfort or "misery" index - which is the sum of the annual inflation rate and the monthly unemployment rate.

Let me quote a statement from President Ronald Reagan as reprinted in the October 5, 1984 Scholastic Update:

> Back in 1976, the Democrats came up with a gimmick to rate the economy. They added the inflation and unemployment rates and got what they called a "misery index." In 1976 it came to 12.6 percent. But in the 1980 election they didn't mention the misery index. That's because they drove the misery index up over 20 percent. In 1984, you probably won't hear our opposition mention the misery index either. That's because it's down to 11.6 percent ....

Well, we have done better still. Back in December 1992 the misery index was at 10.2 percent. And largely as a result of balanced budget proposals enacted in 1993, the misery index for last month was 8.1 percent.

During 10 post-war business cycles the average length of the recovery phase was 50 months. We are now into the 55th month of the recovery from the bottom of the 1990-91 recession.

Let's not spoil it with a tax cut that will add to the deficit, increase interest rates, stimulate demand -- when no fiscal stimulus is needed --, perhaps end an era of relatively stable prices, and increase the accumulated national debt by $224 billion.

In the end there is a balanced alternative way to eliminate the deficit. Throw out the tax cut and consider ways to implement the Moynihan/Simpson Sense of the Senate Resolution unanimously adopted three weeks ago by this committee.

As noted in the resolution, "all cost of living adjustments required by statute should be corrected as soon as possible to accurately reflect future changes in the cost of living."

Getting it right could save the Federal government one trillion dollars over the next 12 years.

BUDGET OUTLOOK

(In Billions of Dollars)

(Surplus + / Deficit -)

	1995	1996	1997	1998	1999	2000	2001	2002	Cumulative (1996-2002)
Line 1:									
DEFICIT UNDER FY 1996 BUDGET RESOLUTION	-174.6	-170.3	-152.2	-115.8	-100.4	-80.8	-33.1	6.4	-646.2
Line 2:									
FISCAL DIVIDEND	N/A	3.0	7.0	14.0	23.0	32.0	41.0	50.0	170.0
Line 3 [Line 1 + Line 2]:									
DEFICIT WITH FISCAL DIVIDEND	**-174.6**	**-167.3**	**-145.2**	**-101.8**	**-77.4**	**-48.8**	**7.9**	**56.4**	**-476.2**
Line 4 A:									
TAX CUTS	N/A	-3.8	-31.2	-36.0	-39.5	-41.5	-44.5	-48.4	-244.9
Line 4 B:									
NET TAX INCREASES	N/A	0.1	1.9	2.6	2.7	3.2	4.1	6.2	20.8
Line 5 [Line 3 + Line 4 A & B]:									
DEFICIT WITH FISCAL DIVIDEND AND REVENUE RECONCILIATION PROVISIONS	**-174.6**	**-171.0**	**-174.5**	**-135.2**	**-114.2**	**-87.1**	**-32.5**	**14.2**	**-700.3**

Source: Compiled October 17, 1995 by Minority Finance Staff from Conference Report on FY 1996 Budget Resolution and from published data supplied by CBO and JCT.

Mr. Chairman, I would also add that there are specific features of the Republican Majority bill that, standing alone, ought to cause it to be rejected.

The bill, by cutting the Earned Income Tax Credit (EITC), will impose a tax increase on working Americans. The bill contains a $43 billion tax increase on the working poor. The distributional charts released by the Republican Majority attempt to disguise this fact by omitting the impact of the EITC reductions agreed to in the Committee's previous markup three weeks ago. But we asked the Joint Committee on Taxation to include the impact of the EITC on the distribution of the tax benefits and burdens in the Republican bill, and they provided us with the results last night. They are disheartening. The Joint Tax charts show a tax increase starting in 1998 and continuing through 2000 on workers making $30,000 or less. In 2000, it is a $1 billion dollar increase on workers in the $20,000 to $30,000 range, a $1 billion increase on workers in the $10,000 to $20,000 range, and a $1 billion increase on workers making $10,000 or less. Increasing taxes on the working poor while providing a tax cut for others is a piece of social policy that mystifies me.

Second, the Republican bill completely eliminates any tax incentives for economic development in Puerto Rico after 2001. Starting in 2002, there is absolutely nothing. And investors looking at these cut-offs will of course begin to pull out earlier. We see this abandonment of any effort to address Puerto Rico's economic problems, even though the Island's unemployment

rate is just under 14 percent -- which while happily is the lowest in 20 years, we are still talking about an economy where unemployment has routinely approached, and exceeded, 20 percent in the last two decades. It is also an economy where the median income of the American citizens who live there is about $6,200 -- half that of Mississippi, our poorest state. To simply abandon any effort to address these problems is, it seems to me, irresponsible.

Finally, Mr. Chairman, I want to call attention to a provision in the bill that would allow companies to withdraw assets from workers' pension plans. This provision would allow the removal of $40 billion in assets from existing pension plans, putting the retirement security of workers at great risk, along with the financial security of the Pension Benefit Guaranty Corporation, and ultimately the U.S. taxpayer.

Attachment (JCT Distributional Charts)

#D-95-59a
17-Oct-95

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 AND PREVIOUSLY ADOPTED CHANGES IN THE EITC (1)
Calendar Year 1996

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	$802	10.0%	$8	0.7%	$9	0.8%	7.9%	8.7%
10,000 to 20,000.......	561	1.5%	37	3.2%	37	3.3%	9.3%	9.4%
20,000 to 30,000.......	-371	-0.5%	75	6.5%	75	6.6%	13.9%	13.8%
30,000 to 40,000.......	-3,217	-3.1%	104	9.1%	101	9.0%	17.1%	16.5%
40,000 to 50,000.......	-4,007	-3.6%	110	9.6%	106	9.4%	19.1%	18.3%
50,000 to 75,000.......	-8,705	-3.7%	238	20.7%	229	20.3%	21.0%	20.1%
75,000 to 100,000.......	-3,433	-2.1%	163	14.2%	160	14.2%	23.1%	22.4%
100,000 to 200,000......	-2,234	-1.1%	197	17.1%	195	17.2%	24.2%	23.4%
200,000 and over.........	-256	-0.1%	217	18.9%	217	19.2%	29.4%	28.4%
Total, All Taxpayers...	**-$20,860**	**-1.8%**	**$1,150**	**100.0%**	**$1,129**	**100.0%**	**20.5%**	**19.9%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit as well as EITC changes previously adopted by the Senate Finance Committee.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 AND PREVIOUSLY ADOPTED CHANGES IN THE EITC (1)
Calendar Year 1997

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	$806	9.7%	$8	0.7%	$9	0.8%	8.1%	8.9%
10,000 to 20,000.......	613	1.6%	38	3.2%	39	3.3%	9.2%	9.3%
20,000 to 30,000.......	-182	-0.2%	78	6.4%	78	6.6%	13.9%	13.8%
30,000 to 40,000.......	-3,410	-3.1%	109	9.0%	106	8.9%	17.0%	16.5%
40,000 to 50,000.......	-4,259	-3.7%	116	9.6%	112	9.4%	18.9%	18.1%
50,000 to 75,000.......	-9,239	-3.7%	248	20.6%	239	20.2%	20.9%	20.0%
75,000 to 100,000.......	-4,149	-2.4%	174	14.4%	169	14.3%	23.1%	22.3%
100,000 to 200,000......	-3,382	-1.6%	208	17.2%	205	17.3%	24.2%	23.4%
200,000 and over.........	-1,843	-0.8%	229	19.0%	227	19.2%	29.5%	28.5%
Total, All Taxpayers...	**-$25,045**	**-2.1%**	**$1,209**	**100.0%**	**$1,184**	**100.0%**	**20.4%**	**19.8%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit as well as EITC changes previously adopted by the Senate Finance Committee.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees). and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 AND PREVIOUSLY ADOPTED CHANGES IN THE EITC (1)
Calendar Year 1998

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	$855	9.8%	$9	0.7%	$10	0.8%	8.3%	9.1%
10,000 to 20,000.......	747	1.9%	40	3.1%	40	3.2%	9.1%	9.3%
20,000 to 30,000.......	64	0.1%	81	6.4%	81	6.5%	13.8%	13.8%
30,000 to 40,000.......	-3,536	-3.1%	114	9.0%	111	8.9%	16.9%	16.4%
40,000 to 50,000.......	-4,456	-3.7%	121	9.5%	116	9.3%	18.7%	18.0%
50,000 to 75,000.......	-9,842	-3.8%	259	20.4%	249	20.0%	20.7%	19.9%
75,000 to 100,000.......	-4,576	-2.5%	185	14.5%	180	14.5%	23.0%	22.3%
100,000 to 200,000......	-3,717	-1.7%	220	17.3%	216	17.4%	24.2%	23.4%
200,000 and over.........	-2,351	-1.0%	244	19.2%	241	19.4%	29.6%	28.6%
Total, All Taxpayers...	**-$26,813**	**-2.1%**	**$1,271**	**100.0%**	**$1,245**	**100.0%**	**20.4%**	**19.8%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit as well as EITC changes previously adopted by the Senate Finance Committee.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

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17-Oct-95

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 AND PREVIOUSLY ADOPTED CHANGES IN THE EITC (1)

Calendar Year 1999

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	$888	10.0%	$9	0.7%	$10	0.7%	8.4%	9.3%
10,000 to 20,000.......	836	2.0%	41	3.1%	42	3.2%	9.1%	9.3%
20,000 to 30,000.......	305	0.4%	83	6.2%	84	6.4%	13.6%	13.7%
30,000 to 40,000.......	-3,794	-3.2%	120	9.0%	116	8.9%	16.8%	16.3%
40,000 to 50,000.......	-4,822	-3.8%	126	9.4%	121	9.3%	18.6%	17.8%
50,000 to 75,000.......	-10,764	-4.0%	270	20.2%	259	19.8%	20.6%	19.7%
75,000 to 100,000.......	-5,023	-2.6%	196	14.7%	191	14.6%	22.9%	22.2%
100,000 to 200,000......	-3,767	-1.6%	233	17.4%	229	17.5%	24.1%	23.4%
200,000 and over.........	-2,468	-1.0%	259	19.4%	256	19.6%	29.7%	28.7%
Total, All Taxpayers...	**-$28,609**	**-2.1%**	**$1,337**	**100.0%**	**$1,309**	**100.0%**	**20.4%**	**19.8%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit as well as EITC changes previously adopted by the Senate Finance Committee.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation. [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees). and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 AND PREVIOUSLY ADOPTED CHANGES IN THE EITC (1)
Calendar Year 2000

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	$879	9.6%	$9	0.7%	$10	0.7%	8.6%	9.4%
10,000 to 20,000.......	922	2.2%	42	3.0%	43	3.1%	9.0%	9.2%
20,000 to 30,000.......	417	0.5%	86	6.1%	87	6.3%	13.6%	13.6%
30,000 to 40,000.......	-4,221	-3.4%	125	8.9%	121	8.8%	16.7%	16.2%
40,000 to 50,000.......	-5,347	-4.0%	132	9.4%	127	9.2%	18.4%	17.6%
50,000 to 75,000.......	-11,740	-4.2%	280	19.9%	269	19.5%	20.5%	19.5%
75,000 to 100,000.......	-5,814	-2.8%	209	14.8%	203	14.8%	22.9%	22.1%
100,000 to 200,000.......	-3,850	-1.6%	246	17.5%	242	17.6%	24.1%	23.4%
200,000 and over.........	-2,792	-1.0%	277	19.7%	274	19.9%	29.8%	28.8%
Total, All Taxpayers...	**-$31,546**	**-2.2%**	**$1,407**	**100.0%**	**$1,375**	**100.0%**	**20.4%**	**19.7%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit as well as EITC changes previously adopted by the Senate Finance Committee.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

#D-95-59
16-Oct-95

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 (1)

Calendar Year 1996

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	-$6	(5)	$8	0.7%	$8	0.7%	7.9%	7.9%
10,000 to 20,000.......	-979	-2.7%	37	3.2%	36	3.2%	9.3%	9.0%
20,000 to 30,000.......	-2,517	-3.4%	75	6.5%	72	6.4%	13.9%	13.4%
30,000 to 40,000.......	-3,902	-3.7%	104	9.1%	101	8.9%	17.1%	16.4%
40,000 to 50,000.......	-4,060	-3.7%	110	9.6%	106	9.5%	19.1%	18.3%
50,000 to 75,000.......	-8,734	-3.7%	238	20.7%	229	20.4%	21.0%	20.1%
75,000 to 100,000.......	-3,433	-2.1%	163	14.2%	160	14.2%	23.1%	22.4%
100,000 to 200,000......	-2,234	-1.1%	197	17.1%	195	17.3%	24.2%	23.4%
200,000 and over.........	-256	-0.1%	217	18.9%	217	19.3%	29.4%	28.4%
Total, All Taxpayers...	**-$26,120**	**-2.3%**	**$1,150**	**100.0%**	**$1,124**	**100.0%**	**20.5%**	**19.8%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

(5) Less than 0.05%

#D-95-59
16-Oct-95

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 (1)
Calendar Year 1997

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000	-$34	-0.4%	$8	0.7%	$8	0.7%	8.1%	8.1%
10,000 to 20,000	-1,088	-2.8%	38	3.2%	37	3.2%	9.2%	8.9%
20,000 to 30,000	-2,687	-3.5%	78	6.4%	75	6.4%	13.9%	13.4%
30,000 to 40,000	-4,174	-3.8%	109	9.0%	105	8.9%	17.0%	16.3%
40,000 to 50,000	-4,321	-3.7%	116	9.6%	112	9.5%	18.9%	18.1%
50,000 to 75,000	-9,270	-3.7%	248	20.6%	239	20.3%	20.9%	20.0%
75,000 to 100,000	-4,149	-2.4%	174	14.4%	169	14.4%	23.1%	22.3%
100,000 to 200,000	-3,382	-1.6%	208	17.2%	205	17.4%	24.2%	23.4%
200,000 and over	-1,843	-0.8%	229	19.0%	227	19.3%	29.5%	28.5%
Total, All Taxpayers	**-$30,948**	**-2.6%**	**$1,209**	**100.0%**	**$1,178**	**100.0%**	**20.4%**	**19.7%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 (1)
Calendar Year 1998

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	-$20	-0.2%	$9	0.7%	$9	0.7%	8.3%	8.3%
10,000 to 20,000.......	-1,136	-2.9%	40	3.1%	38	3.1%	9.1%	8.8%
20,000 to 30,000.......	-2,780	-3.4%	81	6.4%	78	6.3%	13.8%	13.3%
30,000 to 40,000.......	-4,385	-3.8%	114	9.0%	110	8.9%	16.9%	16.3%
40,000 to 50,000.......	-4,527	-3.8%	121	9.5%	116	9.4%	18.7%	18.0%
50,000 to 75,000.......	-9,876	-3.8%	259	20.4%	249	20.1%	20.7%	19.9%
75,000 to 100,000.......	-4,577	-2.5%	185	14.5%	180	14.5%	23.0%	22.3%
100,000 to 200,000......	-3,717	-1.7%	220	17.3%	216	17.5%	24.2%	23.4%
200,000 and over.........	-2,351	-1.0%	244	19.2%	241	19.5%	29.6%	28.6%
Total, All Taxpayers...	**-$33,368**	**-2.6%**	**$1,271**	**100.0%**	**$1,238**	**100.0%**	**20.4%**	**19.7%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 (1)

Calendar Year 1999

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	-$23	-0.3%	$9	0.7%	$9	0.7%	8.4%	8.4%
10,000 to 20,000........	-1,221	-3.0%	41	3.1%	40	3.1%	9.1%	8.8%
20,000 to 30,000........	-2,946	-3.5%	83	6.2%	80	6.2%	13.6%	13.1%
30,000 to 40,000........	-4,733	-3.9%	120	9.0%	115	8.8%	16.8%	16.2%
40,000 to 50,000........	-4,899	-3.9%	126	9.4%	121	9.3%	18.6%	17.8%
50,000 to 75,000........	-10,799	-4.0%	270	20.2%	259	19.9%	20.6%	19.7%
75,000 to 100,000........	-5,023	-2.6%	196	14.7%	191	14.7%	22.9%	22.2%
100,000 to 200,000......	-3,767	-1.6%	233	17.4%	229	17.6%	24.1%	23.4%
200,000 and over.........	-2,468	-1.0%	259	19.4%	256	19.7%	29.7%	28.7%
Total, All Taxpayers...	**-$35,879**	**-2.7%**	**$1,337**	**100.0%**	**$1,301**	**100.0%**	**20.4%**	**19.7%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRA changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

DISTRIBUTIONAL EFFECTS OF REVENUE RECONCILIATION PROVISIONS OF THE CHAIRMAN'S MARK SCHEDULED FOR MARKUP IN THE FINANCE COMMITTEE ON OCTOBER 18,1995 (1)
Calendar Year 2000

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000........	-$59	-0.6%	$9	0.7%	$9	0.7%	8.6%	8.5%
10,000 to 20,000.......	-1,345	-3.2%	42	3.0%	41	3.0%	9.0%	8.7%
20,000 to 30,000.......	-3,169	-3.7%	86	6.1%	83	6.1%	13.6%	13.1%
30,000 to 40,000.......	-5,284	-4.2%	125	8.9%	120	8.8%	16.7%	16.0%
40,000 to 50,000.......	-5,442	-4.1%	132	9.4%	127	9.3%	18.4%	17.6%
50,000 to 75,000.......	-11,766	-4.2%	280	19.9%	269	19.7%	20.5%	19.5%
75,000 to 100,000.......	-5,814	-2.8%	209	14.8%	203	14.9%	22.9%	22.1%
100,000 to 200,000......	-3,850	-1.6%	246	17.5%	242	17.7%	24.1%	23.4%
200,000 and over.........	-2,792	-1.0%	277	19.7%	274	20.0%	29.8%	28.8%
Total, All Taxpayers...	**-$39,522**	**-2.8%**	**$1,407**	**100.0%**	**$1,367**	**100.0%**	**20.4%**	**19.6%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

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(1) Includes the tax credit for children under age 18, student loan interest credit, marriage penalty relief, IRÂ changes, long term care, capital gains deduction, treatment of adoption expense, aviation fuel exemption, and repeal of the wine and flavors credit.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EITC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.

Senator John Breaux

Democrat-Louisiana

Contact: Bette Phelan, Laine Glisson, 202-224-4623; Bob Mann, 504-382-2050

OPENING STATEMENT
SENATE FINANCE COMMITTEE
OCTOBER 18, 1995

WELCOME TO CHRISTMAS IN OCTOBER

Welcome to Christmas in October. When I was a kid, my parents gave me a new bike for Christmas. I thought it was just great and I was happy to get it.

But I wonder how I would have felt if I had found out that:

* My parents had taken the money from my grandma and grandpa's lifetime medical savings, or

* My parents had taken the money from a disabled aunt who lives in a nursing home, or

* My parents had taken the money from a single working mother with two children earning the minimum wage, or

* My parents had taken the money from a mother of one who gets welfare assistance.

I think I would have felt pretty lousy about the bike. I would have said, as most of us would, we can't afford the bike. I would have said, Take it back, Take it back.

These example may seem far-fetched, but I believe they represent the type of severe budget cuts the Republican majority is proposing here today.

We're giving out $245 billion in Christmas presents that nearly everyone would say are great and wonderful.

But these tax presents aren't free. We are being asked to pay for the tax breaks by:

* Cutting Medicare health benefits for seniors by $270 billion.

* Cutting Medicaid for the disabled, poor kids and seniors in nursing homes by $182 billion.

* Cutting the Earned Income Tax Credit for working poor families by $43 billion.

* Cutting welfare assistance and food stamps by $76 billion.

So, yes, let's give a new bike for Christmas, but don't pay for it by taking money from the old, the sick and the poor. And, let's not pay for it by adding $93 billion to the federal debt that's already close to $5 trillion. <u>I say Take it Back, Take it Back.</u>

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